



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

October 29, 1991

DALLAS, TEXAS 75222

Notice 91-85

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Final Guidelines for Risk-Based Capital

DETAILS

The Federal Reserve Board has issued in final form modifications clarifying the risk-based capital guidelines. The changes are consistent with recent international interpretations of the Basle Accord and with current treatment of certain items by other federal banking agencies. The new guidelines relate to

- treatment of residential mortgages sold with recourse;
- redemption of perpetual preferred stock;
- treatment of supervisory goodwill in the definition of capital; and
- treatment of claims on non-Organisation for Economic Cooperation and Development central banks.

The Board's guidelines are effective November 8, 1991.

ATTACHMENT

A copy of the Board's notice as it appears on pages 51151-56, Vol. 56, No. 197, of the Federal Register dated October 10, 1991, is attached.

MORE INFORMATION

For more information, please contact Dorsey Davis at (214) 744-7420. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Regulation H, Regulation Y; Docket No. R-0709]

Capital; Capital Adequacy Guidelines

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final guidelines.

SUMMARY: On October 12, 1990, the Board proposed for public comment certain modifications, clarifications, and technical changes to its risk-based capital guidelines. The comment period for the Federal Reserve's proposal ended December 17, 1990. The Board received comments addressing various aspects of the proposed modifications and clarifications from 26 commenters.

Based upon the comments received, and further consideration of the issues involved, the Board is now issuing in

final form the modifications, clarifications, and technical changes to the Board's risk-based capital guidelines. The modifications and technical changes relate to the: (1) Treatment of certain assets sold with recourse; (2) redemption of perpetual preferred stock; (3) treatment of supervisory goodwill in the definition of capital; and (4) treatment of claims on non-OECD central banks.

The purpose of these modifications, clarifications, and technical changes is to make the Board's risk-based capital framework consistent with recent international interpretations of the risk-based capital accord (Basle Accord) and with the current or proposed treatment of certain items by the other federal banking agencies. In addition, some of the proposed modifications to the language of the Board's risk-based capital guidelines are intended to bring the guidelines into closer conformity with the risks associated with certain transactions and with current Federal Reserve supervisory practices.

EFFECTIVE DATE: The modifications, clarifications, and technical changes to the Federal Reserve Board's risk-based capital guidelines will be effective November 8, 1991.

FOR FURTHER INFORMATION CONTACT: Roger T. Cole, Assistant Director (202/452-2618), Rhoger H. Pugh, Manager (202/728-5883), Thomas R. Boemio, Supervisory Financial Analyst (202/452-2982), Division of Banking Supervision and Regulation; and Michael J. O'Rourke, Senior Attorney (202/452-3288), Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

I. Background

Since the Board initially published its risk-based capital guidelines, some questions have arisen concerning how certain recourse transactions involving credit risk are to be captured by the framework. In addition, certain interpretations and clarifications have emerged from international and domestic discussions among supervisory authorities. Finally, the enactment of the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 (FIRREA) affects the treatment of goodwill for capital purposes.

On October 12, 1990, the Board accordingly proposed for public comment certain modifications, clarifications, and technical changes to its risk-based capital guidelines. The comment period for the Federal Reserve's proposal ended December 17,

1990. The Board received comments addressing various aspects of the proposed modifications and clarifications from 26 commenters.

After reviewing the comments received and further consideration of the issues involved, the Board is now issuing in final form the modifications, clarifications, and technical changes to the Board's risk-based capital guidelines. The modifications and clarifications outlined in this notice are identical to those originally proposed and will: (1) Ensure, consistent with the general treatment of recourse and the objectives of the risk-based capital framework, that certain off-balance sheet credit exposures, particularly sales of mortgages with recourse, are adequately captured in the risk-based capital framework; (2) implement interpretations agreed to by supervisory authorities represented on the Basle Committee on Supervision; and (3) foster consistency between the Federal Reserve's treatment of certain transactions for risk-based capital purposes and the current or proposed treatment of such transactions by the other federal banking agencies.

II. Modifications, Clarifications, and Technical Changes

1. Treatment of Sales of Assets (Including Residential Mortgages) With Recourse

It is a basic tenet of the Basle Accord, and of the risk-based capital guidelines of the three federal banking agencies, that all forms of credit risk, whether on- or off-balance sheet, are to be taken into account in calculating an institution's risk-based capital ratio.¹ In view of this principle, past practice with respect to recourse transactions, and questions that have arisen regarding the application of the risk-based guidelines to the sale of certain assets with recourse, the Federal Reserve Board is modifying and clarifying the language of its risk-based capital guidelines. The purpose of this step is to ensure, consistent with the overall objectives of the risk-based capital framework and the general treatment of recourse, that credit risks stemming from certain mortgage recourse sales are subject to an appropriate capital charge.

In general, so-called recourse "sales" allow the buyer of a loan or pools of

loans to put back to the seller, that is, require the seller to repurchase, loans that are not performing as agreed. This, in effect, means that the credit risk associated with the loans remains with the "seller." The modifications and clarifications to the language of the risk-based capital guidelines pertain to the treatment for risk-based capital purposes of the sale of assets with recourse, primarily the sale of residential mortgages with recourse.

In defining assets sold with recourse for risk-based capital purposes, the U.S. banking agencies incorporated the longstanding "general rule" definition contained in the commercial bank Call Report instructions. This general rule states that a transfer of assets is to be reported as a true sale, and, therefore, taken off the balance sheet, only if the transferring (that is, selling) institution (i) retains no risk of loss from the assets transferred resulting from any cause, including a recourse provision, and (ii) has no obligation to any party for the payment of principal or interest on the assets transferred.

Under the longstanding general rule, a transfer involving any retention by the seller of recourse or risk of loss, even if limited under the terms of the transfer agreement, is considered a borrowing transaction, as opposed to a sale, and the entire amount of the assets "transferred" must remain on the books of the "selling" institution. The general rule was intentionally adopted by the banking agencies for supervisory policy reasons and has been in effect for reporting and primary capital (leverage) ratio purposes for many years. The principal reason for adopting the rule was to ensure that, as a general matter, institutions retaining credit risk through recourse provisions would be required under capital-to-total assets (leverage) ratios to maintain capital against these transactions.

In 1985, the banking agencies considered adopting FASB 77 for regulatory reporting purposes in lieu of the general Call Report rule.² However, given capital adequacy considerations and other supervisory concerns, the banking agencies expressly decided not to adopt FASB 77. Rather, the agencies, under the auspices of the Federal

² GAAP, as set forth in Financial Accounting Standards Board Statement No. 77 (FASB 77), permits a transfer of assets with recourse to be treated as a sale if: (a) Control of the future economic benefits is surrendered; (b) the amount of the seller's obligation under the recourse provisions can be reasonably estimated; and (c) the assets cannot be returned to the seller except pursuant to the recourse provisions. When sales treatment is accorded, the seller's estimated liability for any loss under the recourse provisions must be provided for.

¹ In order to conform to the principles established in the Basle Accord, the Board's risk-based capital guidelines cover credit risks retained when an institution sells an asset, obtained in the issuance of a financial guarantee, or acquired in any other manner. This could be done directly through the issuance of any form of direct credit enhancement or indirectly through the acquisition of an asset or obligation.

Financial Institutions Examination Council (FFIEC), chose to reaffirm the general Call Report rule for bank reporting and leverage ratio purposes.

The regulatory (Call Report) definition of sales of assets with recourse in the special case of pools of residential mortgages differs from the general rule just described. In particular, the Call Report instructions state that for regulatory reporting purposes, any transfers of mortgage loan pools under government programs (e.g., the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC)) will be treated as sales. It should be noted that such treatment is related to the reporting of these items and was not intended to preclude consideration of the risks associated with the transactions in assessing a banking organization's overall capital adequacy. In addition, the Call Report instructions state that transfers of pools of residential mortgages to private obligors (not under the government programs) are to be reported as sales when the selling bank does not retain any significant risk of loss.³

These regulatory reporting definitions were developed at a time when the disposition or transfer of residential mortgages under the government programs involved little or no recourse and the amount of possible loss under the private transactions was considered to be insignificant. Thus, no major policy concerns existed regarding the possibility that the "selling" party in these transactions could retain a significant measure of credit risk that was not adequately backed by capital. As discussed below, however, this situation has changed over time.

The Board's risk-based capital guidelines incorporated the general Call Report definition of sales of assets with recourse and also made specific reference to the Call Report treatment of the sale of 1-to-4 family residential mortgages with recourse. The broad intent of the guidelines was to incorporate into the risk-based capital framework the supervisory principle implicit in the general Call Report rule, that is, if the seller retains any risk of loss, the transaction would require capital support. However, questions have arisen regarding whether the original language in the guidelines

achieved this objective with regard to the specific case of residential mortgage sales, and some banking organizations appear to have interpreted the reference to the Call Report treatment of residential mortgage recourse sales as excluding these transactions from risk-based capital calculations.

The exclusion from capital requirements of a broad class of transactions with a significant amount of credit risk would be inconsistent with the principles of the risk-based capital framework and, as a matter of general policy, was not intended when the Board issued its risk-based capital guidelines. In this regard, it should be noted that the Federal Reserve's risk-based capital guidelines contain the statement that " * * * asset sales with recourse (to the extent not included on the balance sheet) * * * are converted at 100 percent." In general, this would have the effect of applying a capital charge to recourse transactions.

The treatment of asset sales with recourse, including the transfer of residential mortgages with recourse, is of particular importance since it has become apparent that the "sales" of residential mortgages under the government programs can involve either no recourse, or recourse of up to 100 percent to the "seller"—a distinct departure from the situation that existed when the regulatory reporting definition of "residential mortgages sold with recourse" was initially adopted. Thus, the incorporation in the risk-based capital guidelines of the Call Report definition of residential mortgages sold with recourse has been interpreted by some as allowing sales of residential mortgages under the government programs with significant recourse to escape an explicit capital charge. Such an interpretation appears to have been based, in part, on bank regulatory reporting treatment of residential mortgage recourse sales and on past supervisory practice under the capital-to-total assets leverage ratio.

If such treatment were permitted, however, banking organizations would not necessarily maintain sufficient capital to support the credit risks associated with recourse arrangements, even though these risks could be the same as if the organizations continued to hold the assets directly on their books. For this reason, the Federal Reserve has modified and clarified the language in the risk-based capital guidelines to ensure that 1-to-4 family residential mortgage sales with recourse are not exempt from an appropriate explicit capital charge.

To achieve this objective, the modified language provides that, for risk-based capital purposes, assets sold with recourse (that are not already on the balance sheet), including residential mortgages, are to be treated by the selling institution like any other direct credit substitute or financial guarantee. This would mean that the general Call Report definition of recourse would be applied to residential mortgages for risk-based capital purposes. Under this approach, such off-balance sheet obligations would be converted at 100 percent to an on-balance sheet credit equivalent amount and assigned to the appropriate risk category, typically 50 percent in the case of residential mortgages. Thus, with the exception of the limited recourse exemption discussed below, applying the general rule to residential mortgages would require a 4 percent capital charge on the entire amount of residential mortgage loans sold with recourse, regardless of the amount of the recourse obligation.

The vast majority of the commenters, i.e., 92 percent or 23 of the 25 commenters that addressed this issue, opposed the incorporation of language into the risk-based capital guidelines that applies the general recourse rule to residential mortgages sold with recourse. Eight commenters stated that the Board should not clarify the treatment of residential mortgage recourse sales until an interagency review of recourse transactions currently being conducted by the FFIEC is completed. In addition, eight respondents expressed their view that the clarification constituted a change to existing practice. In this regard, it should be noted that most of the bank holding companies and banks engaged in selling residential mortgages with recourse appear to be treating such sales in a manner consistent with the treatment set forth in the modified language of the guidelines.

Seventeen of the 23 respondents that opposed the clarification voiced their belief that generally accepted accounting principles (GAAP) should be adopted as the appropriate capital treatment for assets sold with recourse. Thus, if the transaction is reported as a sale for reporting purposes in accordance with GAAP, then a reserve would be established at the time of sale for any probable losses. The establishment of the reserve would directly reduce earnings and Tier 1 capital. Six commenters added that contractual recourse in excess of probable losses should be treated as any other off-balance sheet guarantee or

³ The Call Report instructions state that in a private transaction, recourse is considered significant if at the time of the transfer the maximum contractual exposure under the recourse provision (or through retention of a subordinated interest in the mortgages) is greater than the amount of probable loss that the bank has reasonably estimated it will incur on the transferred mortgages.

standby letter of credit under the risk-based capital guidelines.

The approach adopted in these final guidelines would not mean that banking organizations would be unable to sell or securitize residential mortgages, or that they would be unable to provide limited recourse or certain other credit enhancements to support sales of mortgage pools. For example, banking organizations always have the option to sell assets without recourse, thereby avoiding a capital charge altogether. Moreover, there are several ways banking organizations can provide credit enhancements and still sell assets without recourse, or with limited recourse, and either incur no capital charge or a reduced capital charge.

First, banking organizations can establish a spread account that provides a cushion of protection to the purchasers of securitized assets while at the same time insulating the selling banking organization from losses arising from the transaction. Funds can be placed in the account directly by the selling institution through a charge against earnings or capital, or can accumulate in the account based upon the difference between the rate paid to the purchasers of the securities and the higher yield earned on the underlying assets. Under these arrangements, any losses on the underlying assets would be charged against the spread account. So long as such losses can only be charged against the spread account and cannot adversely affect the originating bank's capital or future earnings, no additional capital would be charged for transactions employing this technique. These spread accounts have been used successfully to securitize credit cards and automobile receivables. Moreover, these arrangements can be supplemented or enhanced by the originating or selling bank's purchase of a standby letter of credit from a third party guarantor in order to protect the purchasers from losses on the securitized assets.

Second, transactions can be structured in such a way that the seller and the buyer proportionately share in any losses, that is, on a pro rata basis. For example, if a bank sells assets of \$1,000,000 and the buyer agrees to absorb 90 percent of any losses while the seller will absorb the other 10 percent, the selling bank would only have to maintain capital against \$100,000, as opposed to the entire amount of the asset transferred.

Third, with respect to the sale of mortgages, a limited recourse exception has been approved by the Board for those transactions where the maximum possible recourse obligation, at the time

of the transfer, is less than the expected loss on the transferred assets and the banking organization establishes and maintains a liability or specifically identified (non-capital) reserve for an amount equal to the maximum loss possible under the recourse provision. The maximum possible loss under this recourse arrangement would in effect be deducted from capital "up front," and the originating or selling institution would not be subject to further loss. Under such conditions, no additional capital will be required and the amount of the liability created to cover the maximum possible loss under the recourse agreement will not be included in capital.

Eleven respondents opposed the limited recourse exception because they were of the opinion that GAAP would be a more appropriate method to measure the necessary amount of capital required against a limited recourse transaction. One additional commenter addressed the limited recourse issue and supported the Board's proposal since any losses under the recourse provisions would be provided for at the time that the mortgages are sold.

Consistent with the spirit of the Basle Accord and the fact that bank holding companies are engaged in bank-related activities, the Federal Reserve has applied risk-based capital requirements similar to those of the Basle framework to holding companies on a consolidated basis. In view of (i) the greater flexibility that the Board has in applying the framework to bank holding companies, (ii) the original language of the guidelines and the fact that this language, in conjunction with bank regulatory reporting requirements and prior supervisory practice, created ambiguity regarding the treatment of certain recourse sales, and (iii) the fact that the proposed modifications and clarifications could have a significant impact on some holding companies, the Board invited comments on the appropriateness of a brief transition or phase-in arrangement. Such an arrangement would provide for the phasing in of the capital requirements pertaining to residential mortgage recourse sales by bank holding companies completed prior to the October 12, 1990 publication of the Federal Register Notice. Since that date, banking organizations have been on notice that the Board intended to modify and clarify the language of the risk-based capital guidelines to ensure that capital is held against mortgage recourse sales.

The issue of a phase-in for bank holding companies with respect to the

treatment of residential mortgages sold with recourse was discussed by eight respondents. Only one commenter agreed that a phase-in was appropriate. The other seven respondents argued that existing transactions should be grandfathered and that the clarification be applied prospectively to future residential mortgage recourse sales. Five of the commenters implied or expressly stated that any grandfathering provision that may be granted to bank holding companies should also be extended to banks.

In adopting the final guidelines, the Board has determined that state member banks should be immediately required to back their mortgage recourse transactions with capital. The Board believes that recourse transactions require capital backing and that such treatment for commercial banks is consistent with the intent of the Basle Accord, with the current or proposed policies of the other U.S. federal banking agencies, and with the policies of supervisors in foreign countries whose banks participate in similar transactions.

These final guidelines do not incorporate a grandfather arrangement, which would, in effect, permanently exempt the credit risk associated with mortgage recourse sales by some organizations from an appropriate capital charge. As noted above, this would be contrary to the intent of the Basle Accord and the Federal Reserve's risk-based capital guidelines.

While the Basle Accord applies to commercial banks, it explicitly recognizes that bank ownership structures should not be allowed to weaken the capital positions of the banks they own or expose those banks to undue risks. Consistent with this principle, the fact that bank holding companies are engaged in activities closely related to banking, and the longstanding application of capital ratios to holding companies on a consolidated basis, the Federal Reserve has also applied risk-based capital requirements to bank holding companies. In view of the greater flexibility that the Board has in applying the risk-based capital framework to bank holding companies, the potential ambiguity of the language in the original capital guidelines, the confusion stemming from prior practice regarding certain recourse transactions, and the fact that the modifications and clarifications could have a significant impact on some holding companies, the Board approved an optional temporary phase-in arrangement for the inclusion of mortgages sold with recourse in the

calculation of the supervisory risk-based capital ratios for bank holding companies that in good faith interpreted or understood the risk-based capital guidelines to exclude these transactions from a capital charge.⁴

This phase-in alternative would apply only to those mortgages sold with recourse prior to October 12, 1990, the date upon which banking organizations regulated by the Board were put on notice that the Board intended to modify and clarify the language regarding this issue.⁵ All residential mortgage recourse sales completed after the October 12th date are to be fully and immediately included in the calculation of the risk-based capital ratio when the modifications and clarifications become effective.

2. Redemption of Perpetual Preferred Stock

The Board's risk-based capital guidelines indicate that banking organizations should consult with the Federal Reserve before redeeming permanent equity instruments or debt capital instruments prior to their stated maturity. A limited exception to this guideline is provided for instruments redeemed with the proceeds of a higher form of capital, if the capital position of the banking organization is deemed fully adequate by the Federal Reserve. As a practical matter, it has long been expected that banking organizations would consult with the Federal Reserve when contemplating redemptions of core capital in order to give the Federal Reserve an opportunity to determine the

impact of the redemption on the organization's financial condition.

The Basle Committee on Supervision has arrived at a consensus that the redemption of perpetual preferred stock should only be permitted at the issuer's option and only with the prior approval of the supervisory authority. This approach is not inconsistent with the intent of the Federal Reserve's current practice of calling for consultation, and is consistent with requirements established by the Board in connection with the review of some capital plans submitted by bank holding companies. In this connection, the Federal Reserve has stipulated that any redemption of perpetual preferred stock could be only at the bank holding companies' option and only with prior approval from the Federal Reserve.

Nine respondents addressed the proposed amendment to the language of the risk-based capital guidelines that would require prior Board approval when redeeming perpetual preferred stock. Five of the commenters opposed the requirement stating that it would restrict management's ability to manage the institution. Also, four of these commenters thought that requiring prior Board approval before redeeming perpetual preferred stock is particularly inappropriate for organizations that meet the current capital standards. Of the other four respondents, three were in agreement with the Board's proposal while one had no objection.

As a result of the Basle interpretation, the Federal Reserve Board has amended the language of its risk-based capital guidelines to clarify that the approval of the Board is necessary prior to the redemption of any perpetual preferred stock in order to qualify as capital.

3. Treatment of Supervisory Goodwill

Currently, the Board's risk-based capital guidelines, consistent with the Basle Accord, require that goodwill be deducted from Tier 1 capital. However, the guidelines contain a footnote that was intended to give the Federal Reserve the option to make an exception in those very limited situations in which banking organizations acquired goodwill in the past in connection with mergers with troubled or failed depository institutions. The wording of the footnote could also be interpreted as accommodating the possible future inclusion in capital of goodwill stemming from the merger of troubled or failed institutions. As a matter of policy, the Federal Reserve does not give credit for goodwill in assessing the capital of institutions involved in supervisory mergers. Indeed, institutions making

acquisitions are normally required to exceed minimum capital levels without undue reliance on intangible assets, particularly goodwill. In addition, FIRREA prohibits the regulatory agencies from allowing goodwill to be included in the calculation of capital if the goodwill was acquired after April 12, 1989.

Five of the six commenters addressing the deletion of a footnote giving the Board the option to make an exception to allow supervisory goodwill in capital either supported or did not object to the removal of the footnote. One respondent agreed that the footnote should be clarified, although they indicated that the value of core deposit intangibles or supervisory goodwill should not be deducted from Tier 1 capital.

The Board has deleted the footnote that appears to suggest the possibility that supervisory goodwill acquired in the future could be included in the definition of capital for risk-based capital purposes.

4. Claims on Central Banks

The Basle Accord assigns all long- and short-term claims on OECD commercial banks and short-term claims on non-OECD commercial banks to the 20 percent risk category. On the other hand, long-term claims on non-OECD commercial banks, and claims on non-OECD central governments that involve an element of transfer risk are assigned to the 100 percent risk category. Claims on OECD central governments and central banks are assigned to the zero percent risk category.

In promulgating their risk-based capital guidelines, the U.S. banking agencies' allowed claims on non-OECD central banks to be in the same 20 percent risk category as short-term claims on non-OECD commercial banks on the assumption that claims on central banks should not be in a higher category than claims on commercial banks. However, further discussions among international supervisors have led to a consensus that claims on central banks should be in the same risk category as claims on the corresponding central governments. This clarification will have little impact on OECD central banks since claims on OECD central banks and governments are already assigned to the zero percent risk category. On the other hand, the Basle Committee on Supervision has held that claims on non-OECD central banks that could involve an element of transfer risk should be assigned to the same 100 percent risk category as claims on their central governments that involve transfer risk.

⁴ The phase-in should commence as soon as possible after the effective date of this final rule, but in no event later than December 31, 1991, and ending no later than June 30, 1993. Under this phase-in, 1/3 of the outstanding principal balance of all recourse mortgage sales completed before October 12, 1990 would be included in the calculation of the risk-based capital ratio at the beginning of the phase-in. As of June 30, 1992, 2/3 of the remaining outstanding principal balance of sales consummated prior to the date of October 12, 1990 would be included in the risk-based capital ratio calculation. Finally, as of June 30, 1993, the entire amount of the outstanding principal balance of recourse mortgage sales would be included in the calculation. Such arrangements should be discussed between a bank holding company and the appropriate Federal Reserve Bank prior to the holding company availing itself of the phase-in option. Any bank holding company that qualifies to utilize this option may phase-in its mortgage recourse sales into the risk-based capital calculation at a faster rate if it so desires.

⁵ In providing for this optional phase-in arrangement, the Board notes that GAAP requires banking organizations that have sold assets with recourse to provide amounts for the estimated loss in these transactions. Under current practice, amounts set aside to cover the estimated losses in mortgage recourse sales are generally included in a liability account or a specific reserve—neither of which is included in the definition of capital.

This change, which is necessary to ensure consistency with the Basle framework, has the practical effect of moving claims on non-OECD central banks that involve an element of transfer risk from the 20 percent to the 100 percent risk category. As already noted, this has no effect on the treatment of claims on central banks in OECD countries since all claims on these institutions are already assigned to the same risk category as OECD central governments, that is, to the zero percent risk category.

Four of the five respondents discussing this issue agreed with the proposed realignment. The sole dissenter expressed its belief that the change would disrupt to the international interbank market.

As a result of the Basle interpretation, the Federal Reserve Board has amended the language of its risk-based capital guidelines to provide that claims on central banks are to be assigned to the same risk category as claims on their respective central governments.

III. Regulatory Flexibility Act Analysis

The Federal Reserve Board does not believe that adoption of this proposal would have a significant economic impact on a substantial number of small business entities (in this case, small banking organizations), in accord with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). In addition, consistent with current policy, these guidelines generally will not apply to bank holding companies with consolidated assets of less than \$150 million.

List of Subjects

12 CFR Part 208

Accounting, Agricultural loan losses, Applications, Appraisals, Banks, Banking, Capital adequacy, Confidential business information, Currency, Dividend payments, Federal Reserve System, Publication of reports of condition, Reporting and recordkeeping requirements, Securities, State member banks.

12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this notice, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(b)), and section 910 of the International Lending Supervision Act of 1983 (12

U.S.C. 3909), the Board is amending 12 CFR parts 208 and 225 to read as follows:

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. The authority citation for part 208 continues to read as follows:

Authority: Sections 9, 11(a), 11(c), 19, 21, 25, and 25(a) of the Federal Reserve Act, as amended (12 U.S.C. 321-338, 248(a), 248(c), 461, 481-486, 601, and 611, respectively); sections 4 and 13(j) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1814 and 1823(j), respectively); section 7(a) of the International Banking Act of 1978 (12 U.S.C. 3105); sections 907-910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3906-3909); sections 2, 12(b), 12(g), 12(i), 15B(c)(5), 17, 17A, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w, respectively); section 5155 of the Revised Statutes (12 U.S.C. 36) as amended by the McFadden Act of 1927; and sections 1101-1122 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 3310 and 3331-3351).

Appendix A [Amended]

2. A new sentence is added immediately following the first sentence of the first paragraph under "II. A. 1. b. Perpetual preferred stock" of appendix A to read as follows:

* * * Consistent with these provisions, any perpetual preferred stock with a feature permitting redemption at the option of the issuer may qualify as capital only if the redemption is subject to prior approval of the Federal Reserve. * * *

3. In appendix A, the footnote designator in the text is removed and footnote 14 is removed and reserved.

4. The last two sentences of footnote 30 under "III. C. 2. Category 2: 20 percent" of appendix A are removed.

5. Two new sentences are added immediately following the second sentence of the seventh paragraph under "III. D. 1. Items with a 100 percent conversion factor" of appendix A to read as follows:

* * * Accordingly, the entire amount of any assets transferred with recourse that are not already included on the balance sheet, including pools of one-to-four family residential mortgages, are to be converted at 100 percent and assigned to the risk weight appropriate to the obligor, or if relevant, the nature of any collateral or guarantees. The only exception involves transfers of pools of residential mortgages that have been made with insignificant recourse for which a liability or specific non-capital reserve has been established and is maintained for the maximum amount of possible loss under the recourse provision. * * *

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1843(c)(8), 1844(b), 3106, 3108, 3907, 3909, 3310, and 3331-3351.

Appendix A [Amended]

2. A new sentence is added immediately following the first sentence of the first paragraph under "II. A. 1. b. Perpetual preferred stock" of appendix A to read as follows:

* * * Consistent with these provisions, any perpetual preferred stock with a feature permitting redemption at the option of the issuer may qualify as capital only if the redemption is subject to prior approval of the Federal Reserve. * * *

3. In appendix A, the footnote designator in the text is removed and footnote 15 is removed and reserved.

4. The last two sentences of footnote 33 under "III. C. 2. Category 2: 20 percent" of appendix A are removed.

5. Two new sentences are added to the end of footnote 48 under "III. D. 1. Items with a 100 percent conversion factor" of appendix A to read as follows:

* * * Accordingly, the entire amount of any assets transferred with recourse that are not already included on the balance sheet, including pools of one-to-four family residential mortgages, are to be converted at 100 percent and assigned to the risk weight appropriate to the obligor, or if relevant, the nature of any collateral or guarantees. The only exception involves transfers of pools of residential mortgages that have been made with insignificant recourse for which a liability or specific non-capital reserve has been established and is maintained for the maximum amount of possible loss under the recourse provision.

Board of Governors of the Federal Reserve System, October 3, 1991.

William W. Wiles,
Secretary of the Board.

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