FEDERAL RESERVE BANK
OF DALLAS

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

April 21, 1992

DALLAS, TEXAS 75222

Notice 92-34

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

SUBJECT

Risk-based Capital Guidelines

DETAILS

The Federal Reserve Board has requested public comment on proposed modifications to its risk-based capital guidelines affecting the treatment of multifamily housing loans and certain collateralized transactions.

The proposed modifications would

- Lower the risk weight from 100 percent to 50 percent for multifamily family housing loans meeting criteria that are specified in the proposal. This change was directed by a provision of the Resolution Trust Corporation Refunding Act of 1991.

- Lower the risk weight from 20 percent to zero for certain transactions that are collateralized by cash and Organisation for Economic Cooperation and Development central government securities, including U.S. government agency securities, provided the transactions meet criteria specified in the proposal. This change is designed to put U.S. banking organizations on a more equal footing with foreign banks with regard to the capital treatment of such transactions.

The Board must receive comments by May 15, 1992. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0756.

ATTACHMENT

A copy of the Board's notice (Federal Reserve System Docket No. R-0756) is attached.

For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

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-0756]

Capital; Capital Adequacy Guidelines

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed Revisions to Capital Adequacy Guidelines.

SUMMARY: The Board is proposing to modify its capital adequacy guidelines for state member banks and bank holding companies to lower the risk weight assigned to certain multifamily housing loans and to certain collateralized transactions. The proposed modification with regard to multifamily housing is intended to implement provisions of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Pub. L. 102-233, 105 Stat. 1761) ("RTC Refunding Act"), while the second proposed modification is aimed at placing U.S. banking organizations on a more equal footing with foreign banks subject to the Basle Accord with regard to capital requirements for certain low-risk collateralized transactions.

DATES: Comments on the proposed revisions to the Federal Reserve Board's risk-based capital guidelines should be submitted on or before May 15, 1992.

ADDRESSES: Comments, which should refer to Docket No. R-0756, may be mailed to the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551, to the attention of Mr. William Wiles, Secretary. Comments addressed to the attention of Mr. Wiles may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments may be inspected in Room B-1122 between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in section 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Rhoger H Pugh, Manager (202/728-5883), Norah M. Barger, Supervisory Financial Analyst (202/452-2402), Kelly S. Shaw, Supervisory Financial Analyst (202/452-3054), Robert E. Motyka, Senior Financial Analyst (202/452-3621), 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:

The RTC Refunding Act, recently enacted by Congress, contains provisions affecting the capital treatment of certain housing-related assets. In addition, since the Board initially published its risk-based capital guidelines implementing the international bank capital standards ("Basle Accord")[1], questions have arisen with regard to differences between the domestic and nondomestic treatment of certain low-risk collateralized transactions. To address these developments, the Board is proposing to modify the risk-based capital guidelines for state member banks and bank holding companies to: 1) lower the risk weight for multifamily housing loans meeting certain criteria from 100 percent to 50 percent, and 2) lower the risk weight for collateralized transactions that meet certain criteria from 20 percent to zero percent. Adoption of the first proposed modification would implement provisions of the RTC Refunding Act with regard to multifamily housing. Adoption of the second proposed modification would place U.S. banking organizations on a more equal footing with foreign banks subject to the Basle Accord with regard to capital requirements for certain low-risk collateralized transactions.

I. PROPOSAL ON MULTIFAMILY HOUSING LOANS:

The Basle Accord allows loans fully secured by mortgages on residential property to receive a preferential risk weight of 50 percent. The Accord directs signatory countries to apply this concessionary risk weight restrictively and in accordance with strict prudential criteria. In adopting the risk-based capital guidelines, the Federal Reserve Board and the other federal banking agencies specified that only loans secured by first liens on 1- to 4-family residential properties that meet

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[1]The Basle Accord is a risk-based framework that was proposed by the Basle Committee on Banking Supervision and endorsed by the central bank governors of the Group of Ten (G-10) countries in July 1988. The Committee is comprised of representatives of the central banks and supervisory authorities from the G-10 countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the United Kingdom and the United States) and Luxembourg.

certain prudential criteria may be assigned to the 50 percent risk category. The guidelines also state that privately-issued mortgage-backed securities backed by mortgage loans qualifying for the 50 percent risk category and meeting other criteria, may receive a 50 percent risk weight. Loans secured by mortgages on multifamily housing were assigned to the 100 percent risk category because, historically, the loss experience on such loans have exceeded significantly the loss experience on single family mortgages. The Office of Thrift Supervision ("OTS"), however, in its risk-based capital rule for savings associations permits certain multifamily loans to be included in the 50 percent risk category.

Section 618(b) of the RTC Refunding Act (105 Stat. 1790-91), which Congress enacted last year, directs the federal banking agencies to amend their risk-based capital guidelines to lower the risk weight of certain multifamily housing loans, and securities backed by such loans, from 100 percent to 50 percent. The section specifies several criteria that a multifamily housing loan must satisfy in order to qualify for a 50 percent risk weight. These criteria are: 1) the loan is secured by a first lien, 2) the ratio of the principal obligation to the appraised value of the property, that is, the loan-to-value ("LTV") ratio, does not exceed 80 percent (75 percent if the loan is based on a floating interest rate), 3) the annual net operating income generated by the property (before debt service) is not less than 120 percent of the annual debt service on the loan (115 percent if the loan is based on a floating interest rate), 4) the term of the loan is not more than 30 years and not less than 7 years, and, 5) all principal and interest payments have been made on time for a period of not less than one year. (This last criterion implies that no original financing of multifamily housing loans may be assigned to the 50 percent risk category.) The proposed modification to the risk-based capital guidelines with regard to the treatment of multifamily housing incorporates all of the criteria set forth in Section 618(b).

Section 618(b) also provides that multifamily housing loans accorded a 50 percent risk weight must meet any other underwriting characteristics that the appropriate federal banking agency may establish, consistent with the purposes of the minimum acceptable capital requirements to maintain the safety and soundness of financial institutions. In this regard, the federal banking agencies have agreed upon certain additional criteria. These additional criteria would ensure that only those multifamily housing loans for which future repayment prospects are certain and, as such, expose an institution to relatively low levels of credit risk, would receive the favorable 50 percent risk weight. The Board believes that these additional criteria are needed in order to conform the banking agencies' risk-based capital guidelines to the Basle Accord's directive that the 50 percent risk weight be applied restrictively to residential loans

and in accordance with strict prudential criteria.

Accordingly, the Board is proposing that multifamily loans included in the 50 percent risk category meet not only the criteria specified in the legislation, but also the additional criteria that the banking agencies have agreed upon. The additional criteria are:

1) the LTV ratio used for the purposes of the statutory criterion cited above is the LTV ratio based on the most current appraised value of the property, which normally would be the appraised value at the time the loan was originated, unless a more recent appraisal has been performed;
2) the loan is performing in accordance with its original terms and is not more than 90 days past due nor carried in nonaccrual status;
3) the average annual occupancy for the property securing the loan has been at least 80 percent for the preceding year; and
4) the loan has been made in accordance with prudent underwriting standards.

The first additional criterion would permit banking organizations to use appraisals obtained at the time a multifamily housing loan was originated to establish that it meets the LTV ratio required for inclusion in the 50 percent risk category. Subsequent appraisals of a multifamily loan conducted for the purpose of assigning it to, or continuing to include it in, the 50 percent risk category will not be required. However, if for any reason a later appraisal were obtained and it reflected a decline in the value of a multifamily property that resulted in a LTV ratio exceeding the statutory standards, the associated loan would have to be reassigned to the 100 percent risk category. This requirement is consistent with requirements of the agencies' risk-based capital guidelines with regard to LTV ratios on loans secured by mortgages on 1- to 4-family residential properties that are included in the 50 percent risk category.

The second additional criterion essentially would require a multifamily real estate loan to remain current in order to continue to be included in the 50 percent risk category. This provision parallels requirements that loans secured by mortgages on 1- to 4-family residential properties must meet in order to be included in the 50 percent risk category.

The third additional criterion would impose a minimum occupancy rate on the property. This criterion is consistent with the OTS' current requirement that a property securing a multifamily housing loan must have had an annual average occupancy rate of at least 80 percent for at least one year in order for the loan to be placed in the 50 percent risk category.

This occupancy provision is also intended to complement the statutorily mandated requirement on the minimum ratio of annual net income generated by the property to required debt service. While a high occupancy rate by itself does not necessarily ensure that a multifamily property will generate sufficient cash flow to service a loan secured by the property, the combination of cash flow and occupancy rate criteria in the proposed rule should increase the likelihood that the loan will be repaid. The occupancy rate criterion will further ensure that only those multifamily housing loans that are of high quality will receive a 50 percent risk weight.

The last criterion conforms to the Basle Accord specification that residential housing loans must be made in accordance with prudential criteria in order to qualify for a preferential risk weight. Compliance with prudent underwriting standards is designed to manage and control the credit risk inherent in the lending process. The imposition of this requirement is also necessary in order to achieve consistent treatment between multifamily and single family housing loans under the Board's risk-based capital guidelines. To be considered prudently underwritten, a bank's files for a multifamily housing loan would need to contain, for example, a title policy or opinion, adequate fire/hazard/liability insurance, and other appropriate documentation.

The proposed revision to the risk-based capital guidelines to include certain loans secured by liens on multifamily residential property in the 50 percent risk category will have the effect of also placing privately-issued securities backed by such loans in the 50 percent risk category. The risk-based capital guidelines already state that privately-issued securities backed by mortgages that qualify for the 50 percent risk category may be assigned a 50 percent risk weight, provided that the securities meet certain structural requirements.

II. PROPOSAL ON CERTAIN COLLATERALIZED TRANSACTIONS

The Basle Accord assigns claims collateralized by cash and OECD central government securities to the zero percent risk weight. In proposing risk-based capital guidelines implementing the Accord, the federal banking agencies proposed assigning such claims to the 10 percent risk category in order to limit the amount of claims qualifying for the zero percent risk category and to address concerns arising from the operational risks associated with maintaining and liquidating collateral. When the agencies adopted the risk-based capital guidelines, they decided to eliminate the 10 percent risk category in the interest of

simplicity and to assign claims collateralized by cash[2] and OECD central government securities (which include U.S. Government agency securities) to the lowest nonzero risk weight, 20 percent.[3]

Since the guidelines were issued, the Board has further reviewed the treatment of collateralized transactions, particularly, instances where the U.S. treatment of very low-risk collateralized transactions, such as certain indemnified securities lending transactions, may place U.S. banking organizations at a competitive disadvantage to foreign banks subject to the Basle Accord.

In this regard, consideration has been given to whether the operational risks associated with certain collateralized transactions are minimal enough to justify placement in the zero percent risk category. In particular, a review was made of the possibility of assigning to the zero percent risk category claims collateralized by cash on deposit in the banking organization or by OECD central government or U.S. Government agency securities for which a positive collateral margin is maintained on a daily basis, fully taking into account any change in the banking organization's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim. After careful consideration of the issues involved, the Board has concluded that such transactions prudently could be assigned to the zero percent risk category in a manner that is consistent with the Basle Accord. In such transactions, if the market value of the collateral received from the obligor or counterparty falls below 100 percent of the amount of the banking organization's exposure under the claim, the borrower is required to immediately post enough additional collateral to cover any shortfall and maintain a positive margin. The potential risk of loss is extremely limited since the market value of the collateral would have to decline substantially in relation to the banking organization's exposure under the claim on the very day the borrower defaults in order for the banking organization to incur a loss.

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[2]Cash collateral is not recognized under the risk-based capital framework unless it is on deposit in the lending bank or, in the case of a bank holding company, on deposit in a subsidiary lending institution.

[3]A claim secured by cash or OECD government securities may be assigned to the 20 percent risk category only to the extent that the face amount of the claim is covered by the market value of the collateral. The portion of the claim that is not covered by recognized collateral is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor.

Consistent with the Basle Accord, the Board will continue to require that where a claim is collateralized by cash, the cash must be on deposit in the banking organization in order for the claim to receive a reduced risk weight. In this connection, the Board is proposing to clarify that where a banking organization is acting as agent for a customer in a securities lending transaction collateralized by cash delivered to the banking organization, the transaction is deemed to be collateralized by cash on deposit for purposes of determining the appropriate risk weight, provided that any indemnification is limited to the difference between the market value of the lent securities and the amount of cash received and any reinvestment risk associated with the cash collateral is borne by the customer.

While the Board is seeking comments on all aspects of its proposed modifications to its risk-based capital guidelines, it seeks specific comment on the following questions with regard to the proposed treatment for low-risk collateralized transactions:

1) Should the Board set forth additional criteria in order to better ensure that only truly low-risk collateralized transactions are assigned to the zero percent risk category? For example, the Board could require a specific minimum positive margin percentage, or it could make this risk weight available only to institutions that have in place appropriate management and operating systems.

2) Should the Board consider assigning a higher risk weight than zero percent to such transactions, for example, 10 percent?

III. Regulatory Flexibility Act Analysis

The Federal Reserve Board does not believe 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 this regard, the proposed revisions would reduce certain regulatory burdens on bank holding companies as it would reduce the capital charge on certain transactions. In addition, because the risk-based capital guidelines generally do not apply to bank holding companies with consolidated assets of less than $150 million, this proposal will not affect such companies.

List of Subjects

12 CFR Part 208

Accounting, Agricultural loan losses, Applications, Appraisals, Banks, banking, Branches, Capital adequacy, Confidential business information, Currency, Dividend payments, Federal Reserve System, Flood insurance, 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. Appendix A is amended by replacing the second sentence in the first paragraph, adding a sentence at the end of the first paragraph, and replacing the first and second sentences of the second paragraph of section III.B.1.; adding a paragraph to the end of section III.C.1.; replacing the third paragraph of section III.C.2.; replacing the first sentence and inserting a new second sentence in the first paragraph of section III.C.3.; by adding a new sentence to the end of the ninth paragraph of section III.D.1.; and by adding a new item 5. under "Category 1: Zero Percent" and revising item 8. under "Category 2: 20 Percent" of Attachment III, to read as follows:

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III. ***

A. ***

B. ***Claims fully secured by such collateral generally are assigned to the 20 percent risk-weight category. Collateralized transactions meeting all the conditions described in section III.C.1. may be assigned a zero percent risk weight.

With regard to collateralized claims that may be assigned to the 20 percent risk-weight category, the extent to which qualifying securities are recognized as collateral is determined by their current market value. If such a claim is only partially secured, that is, the market value of the pledged securities is less than the face amount of a balance-sheet asset or an off-balance-sheet item, the portion that is covered by the market value of the qualifying collateral is assigned to the 20 percent risk category, and the portion of the claim that is not covered by collateral in the form of cash or a qualifying security is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor.***

C. ***

1. ***This category also includes claims collateralized by cash on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the bank's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.***

2. ***This category also includes the portions of claims (including repurchase transactions) collateralized by cash

on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies that do not qualify for the zero percent risk-weight category; collateralized by securities issued or guaranteed by U.S. government-sponsored agencies; or collateralized by securities issued by multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member.

3. *** This category includes loans fully secured by first liens[34] on one- to four-family residential properties, either owner-occupied or rented, or on multifamily housing properties,[35] provided that such loans have been made in accordance with prudent underwriting standards, including a conservative loan-to-value ratio;[36] are performing in accordance with their original terms; and are not 90 days or more past due or carried in nonaccrual status. The following additional criteria also apply to loans secured by multifamily housing properties that are included in this category: in the year preceding placement in this category, all principal and interest payments must have been made on time and the average annual occupancy for the properties securing such loans must have been at least 80 percent; the original term of the loans must be not less than seven years and not more than 30 years; and the annual net operating income (before debt service) generated by the properties must not be less than 120 percent of the loans' annual debt service (115 percent if the loans are based on a

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[34]If a bank holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purpose of determining the loan-to-value ratio.

[35]The types of properties that qualify as one- to four-family residences or multifamily housing are listed in the instructions to the commercial bank call report.

[36]For a loan secured by a multifamily residential property, the loan-to-value ratio would not be deemed conservative if it exceeds 80 percent (75 percent if the loan is based on a floating interest rate). For both multifamily and one- to four-family residential properties, the loan-to-value ratio is based upon the value of the property determined by the most current appraisal or, if appropriate for a one- to four-family residential property, the most current evaluation. Normally this would be the appraisal or evaluation performed at the time the loan was originated.

floating interest rate).[37] ***

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D.***

1.*** Where a bank is acting as agent for a customer in a securities lending transaction collateralized by cash delivered to the bank, the transaction is deemed to be collateralized by cash on deposit in the bank for purposes of determining the appropriate risk-weight category, provided that any indemnification is limited to the difference between the market value of the securities lent and the cash received and any reinvestment risk associated with the cash collateral is borne by the customer.***

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Attachment III***

Category 1: Zero Percent***
5. Claims collateralized by cash on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the bank's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.***

Category 2: 20 Percent***
8. The portions of claims that are collateralized[3] by cash on deposit in the bank or by securities issued or guaranteed by the U.S. Treasury, the central governments of other OECD countries, and U.S government agencies that do not qualify for the zero percent risk-weight category, or that are collateralized by securities issued or guaranteed by U.S. government-sponsored agencies.***

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[37]Residential property loans that do not meet all the specified criteria or that are made for the purpose of speculative property development are placed in the 100 percent risk category.

[3]The extent of collateralization is determined by current market value.

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. Appendix A is amended by replacing the second sentence in the first paragraph, adding a sentence at the end of the first paragraph, and replacing the first and second sentences of the second paragraph of section III.B.1.; adding a paragraph to the end of section III.C.1.; replacing the third paragraph of section III.C.2.; replacing the first sentence and inserting a new second sentence in the first paragraph of section III.C.3.; by adding a new sentence to the end of the ninth paragraph of section III.D.1.; and by adding a new item 5. under "Category 1: Zero Percent" and revising item 8. under "Category 2: 20 Percent" of Attachment III, to read as follows:

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III. ***

A. ***

B. ***Claims fully secured by such collateral generally are assigned to the 20 percent risk-weight category. Collateralized transactions meeting all the conditions described in section III.C.1. may be assigned a zero percent risk weight.

With regard to collateralized claims that may be assigned to the 20 percent risk-weight category, the extent to which qualifying securities are recognized as collateral is determined by their current market value. If such a claim is only partially secured, that is, the market value of the pledged securities is less than the face amount of a balance-sheet asset or an off-balance-sheet item, the portion that is covered by the market value of the qualifying collateral is assigned to the 20 percent risk category, and the portion of the claim that is not covered by collateral in the form of cash or a qualifying security is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor.***

C. ***

1. ***This category also includes claims collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the banking organization's exposure to

the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.***

2. ***This category also includes the portions of claims (including repurchase transactions) collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies that do not qualify for the zero percent risk-weight category; collateralized by securities issued or guaranteed by U.S. government-sponsored agencies; or collateralized by securities issued by multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member.***

3. *** This category includes loans fully secured by first liens[37] on one- to four-family residential properties, either owner-occupied or rented, or on multifamily housing properties,[38] provided that such loans have been made in accordance with prudent underwriting standards, including a conservative loan-to-value ratio;[39] are performing in accordance with their original terms; and are not 90 days or more past due or carried in nonaccrual status. The following additional criteria also apply to loans secured by multifamily housing properties that are included in this category: in the year preceding placement in this category, all principal and interest payments must have been made on time and the average annual occupancy for the properties securing such loans must have been at least 80 percent; the original term of the loans must be not less than seven years and not more than 30 years; and the annual net operating income (before debt service) generated by the

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[37]If a banking organization holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purpose of determining the loan-to-value ratio.

[38]The types of properties that qualify as one- to four-family residences or multifamily housing are listed in the instructions to the FR Y-9C Report.

[39]For a loan secured by a multifamily residential property, the loan-to-value ratio would not be deemed conservative if it exceeds 80 percent (75 percent if the loan is based on a floating interest rate). For both multifamily and one- to four-family residential properties, the loan-to-value ratio is based upon the value of the property determined by the most current appraisal or, if appropriate for a one- to four-family residential property, the most current evaluation. Normally, this would be the appraisal or evaluation performed at the time the loan was originated.

properties must not be less than 120 percent of the loans' annual debt service (115 percent if the loans are based on a floating interest rate).[40] ***

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D.***

1.*** Where a banking organization is acting as agent for a customer in a securities lending transaction collateralized by cash delivered to the banking organization, the transaction is deemed to be collateralized by cash on deposit in a subsidiary lending institution for purposes of determining the appropriate risk-weight category, provided that any indemnification is limited to the difference between the market value of the securities lent and the cash received and any reinvestment risk associated with the cash collateral is borne by the customer.***

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Attachment III***

Category 1: Zero Percent***
5. Claims collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the bank's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.***

Category 2: 20 Percent***
8. The portions of claims that are collateralized[3] by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by the U.S. Treasury, the central governments of other OECD countries, and U.S government agencies that do not qualify for the zero percent risk-weight category, or that are collateralized by securities issued or guaranteed by U.S. government-sponsored agencies.***

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[40]Residential property loans that do not meet all the specified criteria or that are made for the purpose of speculative property development are placed in the 100 percent risk category.

[3]The extent of collateralization is determined by current market value.

Board of Governors of the Federal Reserve System, April 10, 1992.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

FEDERAL RESERVE BANK OF DALLAS
STATION K
DALLAS, TEXAS 75222