FEDERAL RESERVE BANK
OF DALLAS

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

DALLAS, TEXAS 75222

February 23, 1993

Notice 93-28

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

SUBJECT

Request for Comment on Proposed Amendments to Capital Adequacy Guidelines

DETAILS

The Federal Reserve Board has requested public comment on proposed amendments to its capital adequacy guidelines for state member banks and bank holding companies to establish a limitation on the amount of certain deferred tax assets that may be included in the Tier 1 capital calculation for risk-based and leverage capital purposes.

The proposed amendments would provide that

1) deferred tax assets that are dependent on an institution's future taxable income would be limited for regulatory capital purposes to the amount that can be realized within one year of a quarter-end report date or ten percent of Tier 1 capital, whichever is less; and,

2) no limit for regulatory capital purposes would be placed on deferred tax assets that can be realized from taxes paid in prior carry-back years.

The proposed amendments were developed by the Board consistent with recommendations made by the Federal Financial Institutions Examination Council for federally supervised banks and thrift institutions in response to the Financial Accounting Standard Board Statement No. 109, "Accounting for Income Taxes" (FASB 109), which must be adopted no later than the first quarter of 1993, or the beginning of the institution's first fiscal year thereafter, if later.

The Board must receive comments by March 5, 1993. 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-0795.

ATTACHMENT

A copy of the Board's notice (Federal Reserve System Docket No. R-0795) is attached.

MORE INFORMATION

For more information, please contact Dorsey Davis at (214) 922-6051. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Regulation H, Regulation Y; Docket No. R-0795]

Capital; Capital Adequacy Guidelines

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed revisions to capital adequacy guidelines.

SUMMARY: The Board of Governors of the Federal Reserve System (Board, Federal Reserve or FRB) is proposing to amend its capital adequacy guidelines for state member banks and bank holding companies to establish a limitation on the amount of certain deferred tax assets that may be included in (that is, not deducted from) the Tier 1 capital calculation for risk-based and leverage capital purposes. Under the proposal, deferred tax assets that can be realized through carrybacks to taxes paid on income earned in prior periods generally would not be subject to limitation for regulatory capital purposes. On the other hand, deferred tax assets that can only be realized if an institution earns taxable income in the future would be limited for regulatory capital purposes to the amount that the institution is projected to realize within one year of the quarter-end report date -- based on the institution's projection of taxable income for that year -- or 10 percent of Tier 1 capital, whichever is less. Deferred tax

assets in excess of these limitations would be deducted from Tier 1 capital and from assets for purposes of calculating both the risk-based and leverage capital ratios. The capital proposal was developed on a consistent basis by the Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) (hereafter, the "federal banking agencies" or the "agencies") in response to the Financial Accounting Standards Board's (FASB) issuance of Statement No. 109, "Accounting for Income Taxes" (FASB 109) in February 1992. This FASB accounting standard must be adopted by state member banks and bank holding companies for regulatory reporting and financial reporting purposes no later than the first quarter of 1993, or the beginning of their first fiscal year thereafter, if later.

DATES: Comments on the proposed revisions to the Federal Reserve Board's risk-based and leverage capital guidelines should be submitted on or before March 6, 1993.

ADDRESSES: Comments on the Federal Reserve Board's proposal, which should refer to Docket No. R-0795 may be mailed to Mr. William W. Wiles, Secretary, Board ofGovernors of the Federal Reserve System, 20th Street and Constitution Avenues, N.W., Washington, D.C. 20551; or delivered to Room B-2223, Eccles Building, between 8:45 a.m. and 5:15 p.m. weekdays. 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: Charles H. Holm, Project

Manager, (202) 452-3502; John M. Frech, Supervisory Financial Analyst, (202) 452-2275; Nancy J. Rawlings, Senior Financial Analyst, (202) 452-3059, Regulatory Reporting and Accounting Issues Section; Barbara J. Bouchard, Senior Financial Analyst, (202) 452-3072, Policy Development Section, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

1. Background

Characteristics of Deferred Tax Assets

Deferred tax assets are assets that reflect, for financial reporting purposes, benefits of certain aspects of the tax laws. Deferred tax assets may arise because of specific limitations under tax laws of different tax jurisdictions that require that certain net operating losses (i.e., when, for tax purposes, expenses exceed revenues) or tax credits be carried forward if they cannot be used to recover taxes previously paid. These "tax carryforwards" are realized only if the institution generates sufficient future taxable income during the carryforward period.

Deferred tax assets may also arise from the tax effects of certain events that have been recognized in one period for financial statement purposes but will result in deductible amounts in a future period for tax purposes, i.e., the tax effects of "deductible temporary differences". For example, many depository institutions and bank holding companies may report higher income to taxing authorities than they reflect in their regulatory reports[1] because their loan loss provisions are expensed for reporting purposes but are not deducted for tax purposes until the loans are charged off.

Deferred tax assets arising from an organization's deductible temporary differences may or may not exceed the amount of taxes previously paid that the organization could recover if the differences fully reversed at the report date. Some of these deferred tax assets may theoretically be "carried back" and recovered from taxes previously paid. On the other hand, when such deferred tax assets exceed such previously paid tax amounts, they will be realized only if there is sufficient future taxable income during the carryforward period.[2]

FASB 109

In February 1992, the FASB issued Statement No. 109, which supersedes Accounting Principles Board Opinion No. 11 (APB 11) and FASB Statement No. 96. FASB 109 provides guidance on many aspects of accounting for income taxes, including the accounting for deferred tax assets. FASB 109 potentially allows some state

---

[1] State member banks are required to file quarterly Consolidated Reports of Condition and Income (Call Reports) with the Federal Reserve. Bank holding companies with total consolidated assets of $150 million or more file Consolidated Financial Statements for Bank Holding Companies (FR Y-9C reports) on a quarterly basis with the Federal Reserve.

[2] Hereafter, such deferred tax assets and deferred tax assets arising from tax carryforwards are referred to as "deferred tax assets that are dependent upon future taxable income."

member banks and bank holding companies to record significantly higher deferred tax assets than previously permitted under generally accepted accounting principles (GAAP) and the federal banking agencies' prior reporting policies. Unlike the general practice under previous standards, FASB 109 permits the reporting of deferred tax assets that are dependent upon future taxable income.[3] However, FASB 109 requires the establishment of a valuation allowance to reduce the net deferred tax asset to an amount that is more likely than not (i.e., a greater than 50 percent likelihood) to be realized.

FASB 109 is effective for fiscal years beginning on or after December 15, 1992, but early adoption of this standard was encouraged by the FASB. The adoption of this standard could result in the reporting of additional deferred tax assets in Call Reports and FR Y-9C reports that would directly increase an institution's undivided profits (retained earnings) and thus its Tier 1 capital.

---

[3] Prior supervisory policies of the OCC and FDIC, as set forth in Banking Circular 202 and Bank letter BL-36-85, respectively, limited the reporting of deferred tax assets in the regulatory reports filed by national banks and insured state nonmember banks to the amount of taxes previously paid which are potentially available through carryback of net operating losses. As such, the OCC and FDIC did not permit the reporting of deferred tax assets that are dependent upon future taxable income in the Call Reports filed by national and insured state nonmember banks. The FRB and OTS did not issue policies explicitly addressing the recognition of deferred tax assets. Consequently, state member banks and savings institutions were able to report deferred tax assets in accordance with GAAP. Prior to FASB 109, GAAP, as set forth in APB 11 and FASB 96, also for the most part did not permit the reporting of deferred tax assets that are dependent upon future taxable income.

Concerns Regarding Deferred Tax Assets That Are Dependent Upon Future Taxable Income

Certain regulatory concerns exist with respect to including in capital deferred tax assets that are dependent upon future taxable income. Realization of such assets depends on whether a banking organization has sufficient future taxable income during the carryforward period. Since a banking organization that is in a net operating loss carryforward position is often experiencing financial difficulties, its prospects for generating sufficient taxable income in the future are uncertain. In addition, the condition of and future prospects for an organization often can and do change very rapidly in the banking environment. This raises concerns about the realizability of deferred tax assets that are dependent upon future taxable income, even when an organization appears on the surface to be sound and well-managed. Thus, for many organizations, such deferred tax assets may not be realized and, for other organizations, there will be a high degree of subjectivity in determining the realizability of this asset.

In addition, as an organization's condition deteriorates, it is less likely that deferred tax assets that are dependent upon future taxable income will be realized. Therefore, the organization would be expected under FASB 109 to reduce its deferred tax assets through increases to the asset's valuation allowance. Additions to this allowance would reduce the organization's regulatory capital at precisely the time it needs capital support the most. Thus, the reporting of deferred tax assets that are dependent upon future taxable income raises, for safety and soundness reasons, a supervisory concern.

Moreover, net operating loss carryforwards of an acquired banking organization can be severely limited to the acquirer when an acquisition or change in control occurs. If an acquisition is structured as a taxable asset purchase, the net operating loss carryforwards are generally extinguished. In addition, if an acquisition or change in control qualifies as a tax-free reorganization, a strict limitation (Section 382 of the Internal Revenue Code) on the use of the acquired institution's net operating loss carryforwards generally applies. This limitation is based on the value of the acquired institution at the time of its acquisition, and thus the potential value of a net operating loss carryforward to a prospective purchaser tends to decline as the institution's financial condition weakens.

Because of these concerns, in March 1992, the Federal Reserve and the other federal banking agencies issued separate letters to the banking organizations under their supervision expressing concerns about FASB 109 and stated that banking organizations should not adopt FASB 109 for regulatory reporting purposes until the agencies had determined the appropriate regulatory reporting and capital treatment.[4]

FFIEC Request For Comment

---

[4] OTS's letter indicated that savings associations could adopt the provisions of FASB 109, except that any deferred tax asset could not exceed what was allowed to be reported under APB 11 or FASB 96.

On August 3, 1992, the agencies, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), requested public comment on various regulatory reporting and capital treatments for deferred tax assets of depository institutions (57 FR 34135). In the comment request, the agency staffs indicated that, while no final decision would be made until all comments were received, their preference would be to limit the amount of deferred tax assets that could be reported to the amount that could be recovered through the carryback of losses against taxes previously paid (hereafter referred to as the "carryback approach"). Under the carryback approach, depository institutions' deferred tax assets that are dependent upon future taxable income could not be reported as assets for regulatory reporting purposes and, thus, would be excluded from regulatory capital.

The FFIEC received 198 comment letters in response to its request for comment, primarily from banks, thrifts, and holding companies. The vast majority of the commenters indicated that they believe that strong reasons exist for adopting FASB 109 for both regulatory reporting and capital purposes. These commenters generally asserted that deferred tax assets that are dependent upon future taxable income are valuable assets for many institutions and that FASB 109 provides sufficient criteria for measuring these assets and for distinguishing those institutions that will be able to realize these assets from those that will not. Furthermore, the commenters indicated that, under the carryback approach, the agencies were effectively proposing a liquidation value approach to deferred tax assets and that such an approach is inconsistent with the going concern concept used for measuring other assets and liabilities.

Commenters also noted that tax laws have changed significantly in the last several years, and many banking organizations will have a longer carryforward period (i.e., 15 years) than they now have to absorb all losses beginning in 1994. (For these organizations, the carryforward period for losses attributable to bad debts is now five years.) Thus, these commenters indicated there is a greater likelihood that in the future carryforwards will ultimately be realized. Moreover, commenters indicated that, as a result of changes in tax laws that require some banking organizations to deduct charge-offs, rather than provisions for loan losses, for tax purposes, even strong banking organizations may have large amounts of deferred tax assets that are dependent upon future taxable income.

Commenters also expressed concern that the carryback approach could create a difference between the deferred tax assets reported in GAAP financial statements and regulatory reports, thereby creating an additional reporting burden for institutions. Commenters also questioned whether banking organizations could compete equally with other financial services companies if the carryback approach were imposed.

Some commenters indicated that, if the agencies did limit deferred tax assets, they should permit the recognition of some deferred tax assets that are dependent upon future taxable income and should set the limitation for capital purposes rather than for reporting purposes.

II. Proposal

The Federal Reserve and the other agencies remain concerned about the realizability and characteristics of deferred tax assets that are dependent upon future taxable income. On the other hand, the agencies believe that many of the comments received in response to the FFIEC request for comment have merit. In this regard, some relatively strong organizations have large amounts of deferred tax assets that are dependent upon future taxable income. Such deferred tax assets could not be reported under the carryback approach. Yet there is a high likelihood in some cases that such assets will be realized. Thus, the agencies believe that the recognition of some amounts of deferred tax assets that are dependent upon future taxable income is appropriate. Furthermore, the agencies believe that their supervisory concerns regarding deferred tax assets can be adequately addressed by setting forth a limitation through the capital standards rather than through reporting instructions. Such an approach would not result in a difference between GAAP and regulatory reporting requirements.

Therefore, after careful consideration of the comments received, the FFIEC decided that banks and savings associations should adopt FASB 109 for reporting purposes in Call Reports and Thrift Financial Reports (TFRs) beginning in the first quarter of 1993 (or the beginning of their first fiscal year thereafter, if later). Furthermore, the Board decided that bank holding companies should adopt FASB 109 in FR Y-9C Reports at the same time.

The FFIEC, in reaching its decision on regulatory reporting, also recommended that each of the federal banking and thrift regulatory agencies should amend its regulatory capital standards to limit the amount of deferred tax assets that are dependent upon future taxable income that can be included in regulatory capital to the lesser of:

(1) the amount of deferred tax assets that is expected to be realized within one year of the quarter-end date,[5] based on an organization's projections of future taxable income (exclusive of tax carryforwards and reversals of existing temporary differences) for that year. Such projections should include the estimated effect of tax planning strategies that the organization expects to implement to realize tax carryforwards that will otherwise expire during the year, or

(2) 10 percent of Tier 1 capital.

When the recorded amount of deferred tax assets that are dependent upon future taxable income, net of the valuation allowance for deferred tax assets, exceeds this limitation, the excess amount is to be deducted from Tier 1 capital and from assets in regulatory capital calculations.[6] Deferred tax assets which can be realized

---

[5] For purposes of determining the limit in (1) above, the Board proposes that state member banks and bank holding companies should assume that all temporary differences fully reverse at the report date. Other than this provision, the one-year cutoff for projections of future taxable income, and the inclusion of an organization's tax planning strategies as part of those projections, state member banks and bank holding companies should adhere to FASB 109 when determining this limit. Consistent with FASB 109 and the separate entity method discussed later in this proposal, the Board proposes to permit the netting of deferred tax liabilities and assets for a particular tax-paying component of a state member bank or bank holding company and within a particular tax jurisdiction. Netting of deferred tax assets and liabilities attributable to different tax-paying components of a state member bank or bank holding company or to different tax jurisdictions would not be permitted.

[6] With respect to the regulatory capital limitation, a transition provision applies to deferred tax assets reported as of September 30, 1992, under APB 11 or FASB 96. For some state member banks and bank holding companies, such reported deferred tax assets may be in excess of the amount otherwise includable in

from taxes paid in prior carryback years and from future reversals of existing taxable temporary differences would generally not be limited.

The Board is proposing to adopt the recommendation of the FFIEC in full, as summarized immediately above.[7] Furthermore, consistent with the recommendations of the FFIEC, FASB 109, and longstanding policy of the Board and the other agencies, the Board is proposing that the capital limit should be determined on a separate entity basis for each state member bank.[8] However, in some cases, a state member bank's holding company may not have the financial capability to reimburse the institution for tax benefits derived from the institution's carryback of net operating losses or tax credits. In these cases, the amount of carryback potential the bank may consider in calculating the capital limit on deferred tax assets should be limited to the lesser amount which it could reasonably expect to have refunded by its parent. Bank holding companies generally would determine the limit on a consolidated

---

regulatory capital under this proposal. The amount of this excess deferred tax asset would be includable in capital subject to the following phase-out provisions. For these purposes, the amount of this excess deferred tax asset must be amortized each period on a straight-line basis and must be fully amortized within two years. Furthermore, such excess deferred tax assets are subject to previously-existing rules and supervisory policy, including periodic evaluation as to realization and as to their contribution to the banking organization's ability to absorb losses.

[7] Under the Board's risk-based capital guidelines, all deferred tax assets included in capital would continue to be assigned a risk weight of 100 percent.

[8] Under the separate entity method, a bank (together with its consolidated subsidiaries) that is a subsidiary of a holding company is treated as a separate taxpayer rather than as part of the consolidated group of which it is a member.

basis.

Consistent with FASB 109, the limit would also be determined on a tax jurisdiction-by-jurisdiction basis. A limit for one jurisdiction (e.g., the United States) in excess of the reported amount of deferred tax assets for that jurisdiction should not be used to effectively increase the limit for other jurisdictions (e.g., the state in which the organization is chartered).

The agencies plan to issue additional regulatory reporting guidance on FASB 109 in the first quarter of 1993. The amount of deferred tax assets that organizations report in their regulatory reports and use to meet capital requirements will be subject to review by examiners.

The proposed capital limitation is intended to balance the Board's concerns about deferred tax assets that are dependent upon future taxable income against the fact that such assets will, in many cases, be realized. The proposed approach generally permits full inclusion of deferred tax assets potentially recoverable from carrybacks, since there is a high likelihood that such amounts will be realized. In addition, the proposed approach also includes those deferred tax assets that are dependent upon future taxable income, if any, that can be recovered from projected taxable income during the next year. The Board is proposing to limit projections of future taxable income to one year because, in general, the Board believes that many organizations are able to make reasonable projections of taxable income for the following twelve month period and then achieve their projected results. However, the reliability of these projections and the ability to actually achieve them tends to decrease significantly beyond that time period. Deferred tax assets that are dependent upon future taxable income are further limited to 10 percent of Tier 1 capital, since the Board believes such assets should not comprise a large portion of an organization's capital base given the uncertainty of realization associated with these assets and the difficulty in selling these assets apart from the organization.

Questions for Comment

While the Board is seeking public comment on all aspects of its proposal on the capital treatment of deferred tax assets, it seeks specific comment on the following questions.

1) Under previous GAAP as set forth in Accounting Principles Board Opinion No. 16, "Business Combinations," (APB 16) the reported value of an asset (other than goodwill) acquired in a purchase business combination is adjusted for the tax effect of the difference between the market or appraised value of the asset and its tax basis. FASB 109 changes this treatment by requiring that this tax effect be recorded separately in a deferred tax account. This change in treatment could cause a large increase in the reported amount of certain identifiable intangible assets, such as core deposit intangibles, which are deducted for purposes of computing regulatory capital. Should these increases in such identifiable intangible assets be deducted for purposes of computing regulatory capital ratios? Are there any other provisions of FASB 109 which

the agencies should consider for purposes of applying a different regulatory capital treatment than has been proposed above?

2) The Board is interested in receiving comments on ways of reducing the potential burden associated with this proposal and requests comments on this matter. For example, is a limitation based on projections of future taxable income difficult to implement? Would it be simpler to base a capital limitation on deferred tax assets without consideration of future projections of taxable income, such as permitting only healthy organizations to include in capital deferred tax assets that are dependent upon future taxable income up to a specified percentage of Tier 1 capital (e.g., 5 or 10 percent)? Would there be any other method that would be simpler to administer while recognizing the Board's concerns about deferred tax assets? Also, for example, the limitation, as proposed, would be based on the separate entity method. Would another method be more appropriate for determining the limitation on deferred tax assets and for tax-sharing agreements in general?

3) The proposal would require tax planning strategies to be included as part of an institution's projections of taxable income for the next year. Furthermore, the proposal would require organizations to assume that all temporary differences fully reverse at the report date. In addition, the proposal would permit grandfathering of

amounts previously reported if they were in excess of the proposed limitation, provided the excess amounts are amortized on a straight line basis over two years. Comment is specifically requested on the appropriateness of these provisions.

III. Regulatory Flexibility Act Analysis

The Board does not believe that the 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 accordance with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). In this regard, the vast majority of small banking organizations currently have very limited amounts of net deferred tax assets, which are the subject of this proposal, as a component of their capital structures. Furthermore, adoption of this proposal, in combination with the recent adoption of FASB 109 for regulatory reporting purposes, will allow many organizations to increase the amount of deferred tax assets they include in regulatory capital. In addition, because the risk-based and leverage 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.

IV. Paperwork Reduction Act

The following information about paperwork relates only to Federal Reserve ("FR") reports, which are approved by the Federal

Reserve Board under delegated authority from the Office of Management and Budget.

The proposed amendments to the Capital Adequacy Guidelines would require one additional line item to Schedule HC-I, Part I, of the Consolidated Financial Statements for Bank Holding Companies With Total Consolidated Assets of $150 Million or More or With More Than One Subsidiary Bank (FR Y-9C; OMB No. 7100-0128). The new item, Memorandum item 8, would be titled "Deferred tax assets disallowed for regulatory capital purposes." The proposed additional item will be reviewed by the Federal Reserve Board under delegated authority from the Office of Management and Budget after consideration of comments received during the public comment period. Comments on the proposed additional item should be submitted to the Federal Reserve under procedures described earlier in this notice.

Description of Affected Report

Report Title: Consolidated Financial Statements for Bank Holding Companies With Total Consolidated Assets of $150 Million or More, or With More Than One Subsidiary Bank.

This report is filed by all bank holding companies that have total consolidated assets of $150 million or more and by all multibank holding companies regardless of size. The following bank holding companies are exempt from filing the FR Y-9C, unless the Board specifically requires an exempt company to file the report: bank holding companies that are subsidiaries of another bank holding company and have total consolidated assets of less than $1 billion; bank holding companies that have been granted a hardship exemption

by the Board under section 4(d) of the Bank Holding Company Act; and foreign banking organizations as defined by 211.23(b) of Regulation K.

Agency Form Number: FR Y 9-C
OMB Docket Number: 7100-0128
Frequency: Quarterly
Reporters: Bank Holding Companies
Annual Reporting Hours: 148,054
Estimated Average Hours per Response: Range from 5 to 1,250
Number of Respondents: 1,598
Small businesses are affected.

Federal Reserve Board

List of Subjects

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Currency, Federal Reserve System, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, the Board is proposing to amend 12 CFR Parts 208 and 225 as follows:

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

1. The authority citation for Part 208 is revised to read as follows:

AUTHORITY: 12 U.S.C. 321-338, 248(a), 248(c), 461, 481-486, 601, and 611; 12 U.S.C. 1814 and 1823(j); 12 U.S.C. 3105; 12 U.S.C. 3906-3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w; 12 U.S.C. 36; 12 U.S.C. 3310 and 3331-3351.

Appendix A - [Amended]

2. Appendix A to Part 208 is amended by adding paragraph II.B.(iv) to read as follows:

II. DEFINITION OF QUALIFYING CAPITAL FOR THE RISK BASED CAPITAL RATIO.

*****

A. ***

B. ***

(i) ***

(ii) ***

(iii) ***

(iv) Deferred tax assets - portions are deducted from the sum of core capital elements in accordance with section II.B.4. of this appendix.

3. Appendix A to Part 208 is amended by revising footnote 19 in paragraph II.B.3.; by moving footnote designator 20; by adding paragraph II.B.4.; and by adding footnote 20 in paragraph II.B.4. to read as follows:

II. DEFINITION OF QUALIFYING CAPITAL FOR THE RISK BASED CAPITAL

RATIO.

*****

A. ***

B. ***

1. ***

2. ***

3. ***[19] Deductions of holdings of capital securities also would not be made in the case of interstate "stake out" investments that comply with the Board's Policy Statement on Nonvoting Equity Investments, 12 CFR 225.143 (Federal Reserve Regulatory Service 4-172.1; 68 Federal Reserve Bulletin 413 (1982)). In addition, holdings of capital instruments issued by other banking organizations but taken in satisfaction of debts previously contracted would be exempt from any deduction from capital. The Board intends to monitor nonreciprocal holdings of other banking organizations' capital instruments and to provide information on such holdings to the Basle Supervisors' Committee as called for under the Basle capital framework.

4. <u>Deferred tax assets</u>. The amount of deferred tax assets that are dependent upon future taxable income, net of the valuation allowance for deferred tax assets, that may be included in, that is, not deducted from, a bank's capital may not exceed the lesser of: (a) the amount of these deferred tax assets that the bank is expected to realize within one year of the quarter-end date, based on

its projections of future taxable income for that year,[20] or (b) 10 percent of Tier 1 capital. For purposes of calculating this limitation, Tier 1 capital is defined as the sum of core capital elements, net of goodwill and all identifiable intangible assets other than purchased mortgage servicing rights and purchased credit card relationships. The recorded amount of such deferred tax assets, net of any valuation allowance for deferred tax assets, in excess of this limitation is to be deducted from a bank's core capital elements in determining Tier 1 capital. The amount of deferred tax assets that can be realized from taxes paid in prior carryback years and from future reversals of existing taxable temporary differences generally would not be deducted from capital. However, regardless of the above limitations, the amount of carryback potential a bank may consider in calculating the capital limit on deferred tax assets may not exceed the amount which it could reasonably expect to have refunded by its parent.

Appendix B - [Amended]

---

[20] Projected future taxable income should not include net operating loss carryforwards to be used during that year or the amount of existing temporary differences a bank expects to reverse within the year. Such projections should include the estimated effect of tax planning strategies that the organization expects to implement to realize tax carryforwards that will otherwise expire during the year.

4. Appendix B to Part 208 is amended by revising the last two sentences in footnote 2 and by revising the last sentence of the second paragraph in section II., to read as follows:

II. THE TIER 1 LEVERAGE RATIO

*****

[2] At the end of 1992, Tier 1 capital for state member banks includes common equity, minority interest in the equity accounts of consolidated subsidiaries, and qualifying noncumulative perpetual preferred stock. In addition, as a general matter, Tier 1 capital excludes goodwill; amounts of purchased mortgage servicing rights and purchased credit card relationships that, in the aggregate, exceed 50 percent of Tier 1 capital; amounts of purchased credit card relationships that exceed 25 percent of Tier 1 capital; all other intangible assets; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of certain limitations. The Federal Reserve may exclude certain investments in subsidiaries or associated companies as appropriate.

***As a general matter, average total consolidated assets are defined as the quarterly average total assets (defined net of the allowance for loan and lease losses) reported on the bank's Reports of Condition and Income ("Call Report"), less goodwill; amounts of purchased mortgage servicing rights and purchased credit card relationships that, in the aggregate, are in excess of 50 percent of Tier 1 capital; amounts of purchased credit card relationships in excess of 25 percent of Tier 1 capital; all other intangible assets; any investments in subsidiaries or associated companies that the Federal Reserve determines should be deducted from Tier 1 capital; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of the limitation set forth in section II.B.4.[3]

*****

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 to Part 225 is amended by adding paragraph II.B.(iv) to
read as follows:

*****

[3] Deductions from Tier 1 capital and other adjustments are discussed more fully in section II.B. of Appendix A of this Part.

II. DEFINITION OF QUALIFYING CAPITAL FOR THE RISK BASED CAPITAL RATIO

*****

A. ***

B. ***

(i) ***

(ii) ***

(iii) ***

(iv) Deferred tax assets - portions are deducted from the sum of core capital elements in accordance with section II.B.4. of this appendix.

3. Appendix A to Part 225 is amended by revising footnote 22 in paragraph II.B.3.; by moving footnote designator 23; by adding paragraph II.B.4.; and by adding footnote 23 in paragraph II.B.4. to read as follows:

*****

II. DEFINITION OF QUALIFYING CAPITAL FOR THE RISK-BASED CAPITAL RATIO

*****

A. ***

B. ***

1. ***

2. ***

3. ***[22] Deductions of holdings of capital securities also would not be made in the case of interstate "stake out" investments that comply with the Board's Policy

Statement on Nonvoting Equity Investments, 12 CFR 225.143 (Federal Reserve Regulatory Service 4-172.1; 68 Federal Reserve Bulletin 413 (1982)). In addition, holdings of capital instruments issued by other banking organizations but taken in satisfaction of debts previously contracted would be exempt from any deduction from capital. The Board intends to monitor nonreciprocal holdings of other banking organizations' capital instruments and to provide information on such holdings to the Basle Supervisors' Committee as called for under the Basle capital framework.

4. Deferred tax assets. The amount of deferred tax assets that are dependent upon future taxable income, net of the valuation allowance for deferred tax assets, that may be included in, that is, not deducted from, a bank holding company's capital may not exceed the lesser of: (a) the amount of these deferred tax assets that the bank holding company is expected to realize within one year of the quarter-end date, based on its projections of future taxable income for that year,[23] or (b) 10 percent of Tier 1 capital. For purposes of calculating this limitation, Tier 1 capital is defined as the sum of core capital elements, net of goodwill and all identifiable

[23] Projected future taxable income should not include net operating loss carryforwards to be used during that year or the amount of existing temporary differences a bank holding company expects to reverse within the year. Such projections should include the estimated effect of tax planning strategies that the organization expects to implement to realize tax carryforwards that will otherwise expire during the year.

intangible assets other than purchased mortgage servicing rights and purchased credit card relationships. The recorded amount of such deferred tax assets, net of any valuation allowance for deferred tax assets, in excess of this limitation is to be deducted from a bank holding company's core capital elements in determining Tier 1 capital. The amount of deferred tax assets that can be realized from taxes paid in prior carryback years and from future reversals of existing taxable temporary differences generally would not be deducted from capital.

Appendix D - [Amended]

4. Appendix D to Part 225 is amended by revising the last two sentences in footnote 3 and by revising the last sentence of the second paragraph in section II., to read as follows:

*****

II. THE TIER 1 LEVERAGE RATIO

*****

[3] At the end of 1992, Tier 1 capital for bank holding companies includes common equity, minority interest in the equity accounts of consolidated subsidiaries, and qualifying noncumulative perpetual preferred stock. In addition, as a general matter, Tier 1 capital excludes goodwill; amounts of purchased mortgage servicing rights and purchased credit card relationships that, in the aggregate, exceed 50 percent of Tier 1 capital; amounts of purchased credit card relationships that exceed 25 percent of Tier 1 capital; all other intangible assets; and deferred tax assets that are dependent upon future

taxable income, net of their valuation allowance, in excess of certain limitations. The Federal Reserve may exclude certain investments in subsidiaries or associated companies as appropriate.

***As a general matter, average total consolidated assets are defined as the quarterly average total assets (defined net of the allowance for loan and lease losses) reported on the banking organization's Consolidated Financial Statement ("FR Y-9C Report"), less goodwill; amounts of purchased mortgage servicing rights and purchased credit card relationships that, in the aggregate, are in excess of 50 percent of Tier 1 capital; amounts of purchased credit card relationships in excess of 25 percent of Tier 1 capital; all other intangible assets; any investments in subsidiaries or associated companies that the Federal Reserve determines should be deducted from Tier 1 capital; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of the limitation set forth in section II.B.4.[4]

*****

Board of Governors of the Federal Reserve System, February 1, 1993.

(signed William W. Wiles

William W. Wiles
Secretary of the Board

W.W.W.

[4] Deductions from Tier 1 capital and other adjustments are discussed more fully in section II.B. of Appendix A to this Part.

FEDERAL RESERVE BANK OF DALLAS
P.O. BOX 655906
DALLAS, TX 75265-5906