



FEDERAL RESERVE BANK  
OF DALLAS

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

DALLAS, TEXAS  
75265-5906

November 24, 1998

**Notice 98-108**

**TO:** The Chief Executive Officer of each  
financial institution and others concerned  
in the Eleventh Federal Reserve District

**SUBJECT**

**Basle Framework for Capital Adequacy**

**DETAILS**

The Basle Committee on Banking Supervision has issued an interpretation of the Basle framework for capital adequacy (Basle Accord) regarding instruments eligible for inclusion in Tier 1 capital. The interpretation will be subject to review as part of a broader effort already under way to reassess the present framework for evaluating banks' capital adequacy. The governors of the central banks of the G-10 countries in 1988 endorsed the Basle Accord, which applies to internationally active banks.

After consulting with other federal financial institutions regulatory agencies, the Federal Reserve will determine how to implement the Basle interpretation with regard to U.S. banks.

The Basle Committee's press release and its report (referred to in the Board's press release) entitled *Enhancing Bank Transparency* can be obtained from the Internet at <<http://www.bis.org>>. You may also obtain the press release and the report from the Basle Committee Secretariat, Bank of International Settlements, Centralbahnplatz 2, CH-4002, Basle, Switzerland.

**ATTACHMENT**

A copy of the Board's press release regarding the interpretation is attached.

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

Sincerely yours,

*Robert D. McTeer, Jr.*

# FEDERAL RESERVE press release



For immediate release

October 27, 1998

The Basle Committee on Banking Supervision (Basle Committee) today issued an interpretation of the Basle framework for capital adequacy (Basle Accord) regarding instruments eligible for inclusion in Tier 1 capital.

The Committee noted that the interpretation will be subject to review as part of a broader effort already underway to reassess the present framework for evaluating banks' capital adequacy.

The governors of the central banks of the G-10 countries endorsed the Basle Accord, which applies to internationally active banks, in 1988.

The interpretation reaffirms that the common shareholders' equity is the key element of capital and should be the predominant form of a bank's Tier 1 capital under the Basle Accord. The interpretation emphasizes the important role public disclosure plays in ensuring that the integrity of capital is maintained.

In this regard, the Committee notes the need for banks to publicly disclose each component of Tier 1 capital and its main features. Such disclosure is consistent with a report entitled

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"*Enhancing Bank Transparency*," which the Basle Committee released in September 1998.

The interpretation states that the Committee has determined that minority interest in equity accounts of consolidated subsidiaries that take the form of special purpose vehicles may be included in Tier 1 provided they meet certain minimum criteria. These criteria include permanence, deferrability of distributions on a noncumulative basis, and ability to absorb losses within the bank on a going concern basis.

Further, the Committee has determined that moderate step-ups after a minimum of ten years are an acceptable feature in a Tier 1 instrument. Issuances of instruments with such a feature, however, are limited to 15 percent of Tier 1 capital in order to avoid undue reliance on innovative noncommon instruments in Tier 1.

The Federal Reserve will make a determination as to how to implement the Basle interpretation with regard to U.S. banks after consulting with other federal financial institutions regulatory agencies.

With regard to bank holding companies, the Federal Reserve notes that by its terms, the Basle Accord applies to internationally-active banks but states that ownership structures should not be allowed to weaken capital positions of banks.

Since the inception of the Basle Accord, U.S. bank holding

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companies, entities which are legally separate from banks, have been subject to a risk-based capital regime that is identical to the Basle Accord, with the exception that holding companies are allowed to include cumulative preferred stock in Tier 1 on a limited basis.

Consistent with the principles that common equity should be the predominant component of Tier 1 capital and that ownership structures should not weaken bank capital positions, state member banks and bank holding companies generally have been expected to maintain risk-based capital ratios above Basle minimums, without reliance on preferred stock.

State member banks and bank holding companies disclose the components of their capital positions in sufficient detail to allow analysts and supervisors to calculate capital ratios on many different bases, including the Basle capital standard.

The Federal Reserve has no plans to change these policies and practices.

The Basle Committee's press release and its report on "*Enhancing Bank Transparency*", can be obtained from the Internet (<http://www.bis.org>) or from the Basle Committee Secretariat at the Bank for International Settlements.