



FEDERAL RESERVE BANK
OF DALLAS

DALLAS, TEXAS
75265-5906

November 2, 2001

Notice 01-82

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

SUBJECT

**Request for Comment on a Proposal to Amend Regulation K
(International Banking Operations)**

DETAILS

The Board of Governors of the Federal Reserve System has requested public comment on a proposal to amend its regulation relating to international lending. The proposal would simplify the discussion concerning the accounting for fees on international loans by making the regulation consistent with generally accepted accounting principles.

The Board must receive comments by December 1, 2001. Please address comments to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Street, N.W., Washington, DC 20551. Also, you may mail comments electronically to **regs.comments@federalreserve.gov**. All comments should refer to Docket No. R-1114.

ATTACHMENT

A copy of the Board's notice as it appears on pages 54399-402, Vol. 66, No. 208 of the *Federal Register* dated October 26, 2001, is attached.

MORE INFORMATION

For more information, please contact Dick Burda, Banking Supervision Department, (713) 652-1503. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254 or access District Notices on our web site at <http://www.dallasfed.org/banking/notices/index.html>.

FEDERAL RESERVE SYSTEM**12 CFR Part 211****[Regulation K; Docket No. R-1114]****International Banking Operations;
International Lending Supervision****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Notice of proposed rulemaking.**SUMMARY:** The Board of Governors of the Federal Reserve System (Board) is seeking public comment on a proposal to amend its regulations relating to international lending by simplifying the discussion concerning the accounting for fees on international loans to make the regulation consistent with generally accepted accounting principles (GAAP).**DATES:** Comments should be submitted on or before December 1, 2001.**ADDRESSES:** Comments, which should refer to Docket No. R-1114, may be mailed to the Board of Governors of the Federal Reserve System, 20th & C Street, NW., Washington, DC 20551, to the attention of Jennifer J. Johnson, Secretary. Comments addressed to the attention of Ms. Johnson 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 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, NW. Comments may be inspected in Room MP-500 between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.**FOR FURTHER INFORMATION CONTACT:** Michael G. Martinson, Associate Director (202/452-3640), Division of Banking Supervision and Regulation; or Ann Misback, Assistant General Counsel (202/452-3788), Legal Division, Board of Governors of the Federal Reserve System, 20th & C Street, NW., Washington, DC 20551. For users of Telecommunications Device for the Deaf ("TDD") only, contact 202/263-4869.**SUPPLEMENTARY INFORMATION:** The International Lending Supervision Act of 1983 (ILSA), 12 U.S.C. 3901, *et seq.*, requires each federal banking agency to evaluate the foreign country exposure and transfer risk of banking institutions within its jurisdiction for use in examination and supervision of such institutions. To implement ILSA, the federal banking agencies, through the Interagency Country Exposure Review Committee (ICERC), assess and categorize countries on the basis of

conditions that may lead to increased transfer risk. Transfer risk may arise due to the possibility that an asset of a banking institution cannot be serviced in the currency of payment because of a lack of, or restraints on, the availability of foreign exchange in the country of the obligor. Section 905(a) of ILSA directs each federal banking agency to require banking institutions within its jurisdiction to establish and maintain a special reserve whenever the agency determines that the quality of an institution's assets has been impaired by a protracted inability of public or private borrowers in a foreign country to make payments on their external indebtedness, or no definite prospects exist for the orderly restoration of debt service. 12 U.S.C. 3904(a). In keeping with the requirements of ILSA, on February 13, 1984, the Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the federal banking agencies) issued a joint notice of final rulemaking requiring banking institutions to establish special reserves, the allocated transfer risk reserve (ATRR), against the risks presented in certain international assets. (49 FR 5594).

ILSA also requires the federal banking agencies to promulgate regulations for accounting for fees charged by banking institutions in connection with international loans. Section 906(a) of ILSA (12 U.S.C. 3905(a)) deals specifically with the restructuring of international loans to avoid excessive debt service burden on debtor countries. This section requires banking institutions, in connection with the restructuring of an international loan, to amortize any fee exceeding the administrative cost of the restructuring over the effective life of the loan. Section 906(b) of ILSA (12 U.S.C. 3905(b)) deals with all international loans and requires the federal banking agencies to promulgate regulations for accounting for agency, commitment, management and other fees in connection with such loans to assure that the appropriate portion of such fees is accrued in income over the effective life of each such loan.

The Board's current regulation provides a separate accounting treatment for each type of fee charged by banking institutions in connection with their international lending. When ILSA was enacted in 1983 and the current regulation on accounting for international loan fees was promulgated on March 29, 1984, Congress and the federal banking agencies considered that the application of the broad fee accounting principles for banks

contained in GAAP were insufficient to accomplish adequate uniformity in accounting principles in this area. Since that time, the Financial Accounting Standards Board (FASB) has revised the GAAP rules for fee accounting for international loans in a manner that accommodates the specific requirements of section 906 of ILSA. In order to reduce the regulatory burden on banking institutions, and simplify its regulations, the Board proposes to eliminate from the revised version of Subpart D the requirements as to the particular accounting method to be followed in accounting for fees on international loans and to require instead that institutions follow GAAP in accounting for such fees. The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency have revised their regulations to eliminate the requirements as to the particular accounting method to be followed in accounting for fees on international loans and to require instead that banking institutions follow GAAP in accounting for such fees. In the event that the FASB changes the GAAP rules on fee accounting for international loans, the Board will reexamine its regulation in light of ILSA to assess the need for a revision to the regulation.

Initial Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires an initial regulatory flexibility analysis with any notice of proposed rulemaking. No analysis is required, however, if the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small business entities. 5 U.S.C. 605(b). A description of the reasons why the action by the agency is being considered and a statement of the objectives of, and the legal basis for, the proposed rule are contained in the supplementary information above. As described more fully above, the proposed rule revises accounting mechanisms for fees associated with international loans and harmonizes their treatment with accounting principles set forth in other regulations. Both the underlying regulation and the rule proposed herein primarily affect financial institutions engaged in significant international loan transactions, and the overall impact of the proposed rule will be to reduce regulatory burden. Accordingly, pursuant to 5 U.S.C. 605(b), the Board hereby certifies that the rule will not have a significant economic impact on a substantial number of small business entities.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget.

The collections of information associated with this proposed rulemaking are found in 12 CFR 211.43 and 211.44. This information is required to evidence compliance with the requirements of Regulation K and the International Lending Supervision Act. The respondents/recordkeepers are for-profit financial institutions, including small businesses.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The information on the allocated transfer risk reserve requested in 211.43 is collected in the Consolidated Reports of Condition and Income (FFIEC 031 and 041; OMB No. 7100-0036), the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C; OMB No. 7100-0128), and the Report of Condition for Edge and Agreement Corporations (FR 2886B; OMB No. 7100-0086). The proposed rule would not change the burden associated with these reports. The information requested in 211.44 on international assets is collected in the Country Exposure Reports (FFIEC 009/009a; OMB No. 7100-0035) and the burden for this report also remains unchanged.

Comments are invited on: a. whether the collections of information are necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; b. the accuracy of the Federal Reserve's estimate of the burden of the information collections, including the cost of compliance; c. ways to enhance the quality, utility, and clarity of the information to be collected; and d. ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the collections of information should be sent to Mary M. West, Chief, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 41, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments to be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0036, 7100-0128, 7100-0086, or 7100-0035), Washington, DC 20503.

Solicitation of Comments Regarding Use of "Plain Language"

Section 722 of the GLB Act requires the Board to use "plain language" in all proposed and final rules published after January 1, 2000. The Board invites comments about how to make the proposed rule easier to understand, including answers to the following questions:

(1) Has the Board organized the material in an effective manner? If not, how could the material be better organized?

(2) Are the terms of the rule clearly stated? If not, how could the terms be more clearly stated?

(3) Does the rule contain technical language or jargon that is unclear? If so, which language requires clarification?

(4) Would a different format (with respect to grouping and order of sections and use of headings) make the rule easier to understand? If so, what changes to the format would make the rule easier to understand?

(5) Would increasing the number of sections (and making each section shorter) clarify the rule? If so, which portions of the rule should be changed in this respect?

(6) What additional changes would make the rule easier to understand?

List of Subjects in 12 CFR Part 211

Exports, Federal Reserve System, Foreign banking, Holding companies, Investments, Reporting and recordkeeping requirements.

For the reasons set out in the preamble, the Board proposes to amend 12 CFR part 211 as follows:

PART 211—INTERNATIONAL BANKING OPERATIONS (REGULATION K)

1. The authority citation for part 211 continues to read as follows:

Authority: 12 U.S.C. 221 *et seq.*, 1818, 1835a, 1841 *et seq.*, 3101 *et seq.*, 3109 *et seq.*

2. Sections 211.41 through 211.45 are revised to read as follows:

§ 211.41 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (Board) under the authority of the International Lending Supervision Act of 1983 (Pub. L. 98-181, title IX, 97 Stat. 1153) (International Lending Supervision Act); the Federal Reserve Act (12 U.S.C. 221 *et seq.*) (FRA), and the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*) (BHC Act).

(b) *Purpose and scope.* This subpart is issued in furtherance of the purposes of the International Lending Supervision

Act. It applies to State banks that are members of the Federal Reserve System (State member banks); corporations organized under section 25(A) of the FRA (12 U.S.C. 611 through 631) (Edge Corporations); corporations operating subject to an agreement with the Board under section 25 of the FRA (12 U.S.C. 601 through 604a) (Agreement Corporations); and bank holding companies (as defined in section 2 of the BHC Act (12 U.S.C. 1841(a)) but not including a bank holding company that is a foreign banking organization as defined in § 211.21(n).

§ 211.42 Definitions.

For the purposes of this subpart:

(a) *Administrative cost* means those costs which are specifically identified with negotiating, processing and consummating the loan. These costs include, but are not necessarily limited to: legal fees; costs of preparing and processing loan documents; and an allocable portion of salaries and related benefits of employees engaged in the international lending function. No portion of supervisory and administrative expenses or other indirect expenses such as occupancy and other similar overhead costs shall be included.

(b) *Banking institution* means a State member bank; bank holding company; Edge Corporation and Agreement Corporation engaged in banking. Banking institution does not include a foreign banking organization as defined in § 211.21(n).

(c) *Federal banking agencies* means the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

(d) *International assets* means those assets required to be included in banking institutions' *Country Exposure Report* forms (FFIEC No. 009).

(e) *International loan* means a loan as defined in the instructions to the *Report of Condition and Income* for the respective banking institution (FFIEC Nos. 031 and 041) and made to a foreign government, or to an individual, a corporation, or other entity not a citizen of, resident in, or organized or incorporated in the United States.

(f) *Restructured international loan* means a loan that meets the following criteria:

(1) The borrower is unable to service the existing loan according to its terms and is a resident of a foreign country in which there is a generalized inability of public and private sector obligors to meet their external debt obligations on a timely basis because of a lack of, or

restraints on the availability of, needed foreign exchange in the country; and

(2) The terms of the existing loan are amended to reduce stated interest or extend the schedule of payments; or

(3) A new loan is made to, or for the benefit of, the borrower, enabling the borrower to service or refinance the existing debt.

(g) *Transfer risk* means the possibility that an asset cannot be serviced in the currency of payment because of a lack of, or restraints on the availability of, needed foreign exchange in the country of the obligor.

§ 211.43 Allocated transfer risk reserve.

(a) *Establishment of allocated transfer risk reserve.* A banking institution shall establish an allocated transfer risk reserve (ATRR) for specified international assets when required by the Board in accordance with this section.

(b) *Procedures and standards—(1) Joint agency determination.* At least annually, the Federal banking agencies shall determine jointly, based on the standards set forth in paragraph (b)(2) of this section, the following:

(i) Which international assets subject to transfer risk warrant establishment of an ATRR;

(ii) The amount of the ATRR for the specified assets; and

(iii) Whether an ATRR established for specified assets may be reduced.

(2) *Standards for requiring ATRR—(i) Evaluation of assets.* The Federal banking agencies shall apply the following criteria in determining whether an ATRR is required for particular international assets:

(A) Whether the quality of a banking institution's assets has been impaired by a protracted inability of public or private obligors in a foreign country to make payments on their external indebtedness as indicated by such factors, among others, as whether:

(1) Such obligors have failed to make full interest payments on external indebtedness; or

(2) Such obligors have failed to comply with the terms of any restructured indebtedness; or

(3) A foreign country has failed to comply with any International Monetary Fund or other suitable adjustment program; or

(B) Whether no definite prospects exist for the orderly restoration of debt service.

(ii) *Determination of amount of ATRR.* (A) In determining the amount of the ATRR, the Federal banking agencies shall consider:

(1) The length of time the quality of the asset has been impaired;

(2) Recent actions taken to restore debt service capability;

(3) Prospects for restored asset quality; and

(4) Such other factors as the Federal banking agencies may consider relevant to the quality of the asset.

(B) The initial year's provision for the ATRR shall be ten percent of the principal amount of each specified international asset, or such greater or lesser percentage determined by the Federal banking agencies. Additional provision, if any, for the ATRR in subsequent years shall be fifteen percent of the principal amount of each specified international asset, or such greater or lesser percentage determined by the Federal banking agencies.

(3) *Board notification.* Based on the joint agency determinations under paragraph (b)(1) of this section, the Board shall notify each banking institution holding assets subject to an ATRR:

(i) Of the amount of the ATRR to be established by the institution for specified international assets; and

(ii) That an ATRR established for specified assets may be reduced.

(c) *Accounting treatment of ATRR—(1) Charge to current income.* A banking institution shall establish an ATRR by a charge to current income and the amounts so charged shall not be included in the banking institution's capital or surplus.

(2) *Separate accounting.* A banking institution shall account for an ATRR separately from the Allowance for Loan and Lease Losses, and shall deduct the ATRR from "gross loans and leases" to arrive at "net loans and leases." The ATRR must be established for each asset subject to the ATRR in the percentage amount specified.

(3) *Consolidation.* A banking institution shall establish an ATRR, as required, on a consolidated basis. For banks, consolidation should be in accordance with the procedures and tests of significance set forth in the instructions for preparation of *Consolidated Reports of Condition and Income* (FFIEC Nos. 031 and 041). For bank holding companies, the consolidation shall be in accordance with the principles set forth in the "Instructions to Consolidated Financial Statements for Bank Holding Companies" (Form F.R. Y-9). Edge and Agreement corporations engaged in banking shall report in accordance with instructions for preparation of the Report of Condition for Edge and Agreement Corporations (Form F.R. 2886b).

(4) *Alternative accounting treatment.* A banking institution need not establish

an ATRR if it writes down in the period in which the ATRR is required, or has written down in prior periods, the value of the specified international assets in the requisite amount for each such asset. For purposes of this paragraph, international assets may be written down by a charge to the Allowance for Loan and Lease Losses or a reduction in the principal amount of the asset by application of interest payments or other collections on the asset; provided, that only those international assets that may be charged to the Allowance for Loan and Lease Losses pursuant to generally accepted accounting principles may be written down by a charge to the Allowance for Loan and Lease Losses. However, the Allowance for Loan and Lease Losses must be replenished in such amount necessary to restore it to a level which adequately provides for the estimated losses inherent in the banking institution's loan portfolio.

(5) *Reduction of ATRR.* A banking institution may reduce an ATRR when notified by the Board or, at any time, by writing down such amount of the international asset for which the ATRR was established.

§ 211.44 Reporting and disclosure of international assets.

(a) *Requirements.* (1) Pursuant to section 907(a) of the International Lending Supervision Act of 1983 (Title IX, Pub. L. 98-181, 97 Stat. 1153) (ILSA), a banking institution shall submit to the Board, at least quarterly, information regarding the amounts and composition of its holdings of international assets.

(2) Pursuant to section 907(b) of ILSA, a banking institution shall submit to the Board information regarding concentrations in its holdings of international assets that are material in relation to total assets and to capital of the institution, such information to be made publicly available by the Board on request.

(b) *Procedures.* The format, content and reporting and filing dates of the reports required under paragraph (a) of this section shall be determined jointly by the Federal banking agencies. The requirements to be prescribed by the Federal banking agencies may include changes to existing reporting forms (such as the Country Exposure Report, form FFIEC No. 009) or such other requirements as the Federal banking agencies deem appropriate. The Federal banking agencies also may determine to exempt from the requirements of paragraph (a) of this section banking institutions that, in the Federal banking

agencies' judgment, have *de minimis* holdings of international assets.

(c) *Reservation of authority.* Nothing contained in this rule shall preclude the Board from requiring from a banking institution such additional or more frequent information on the institution's holding of international assets as the Board may consider necessary.

§ 211.45 Accounting for fees on international loans.

(a) *Restrictions on fees for restructured international loans.* No banking institution shall charge, in connection with the restructuring of an international loan, any fee exceeding the administrative cost of the restructuring unless it amortizes the amount of the fee exceeding the administrative cost over the effective life of the loan.

(b) *Accounting treatment.* Subject to paragraph (a) of this section, banking institutions shall account for fees on international loans in accordance with generally accepted accounting principles.

By order of the Board of Governors of the Federal Reserve System, October 18, 2001.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 01-26731 Filed 10-25-01; 8:45 am]

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