FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **9227**
January 6, 1982]

Capital Adequacy Guidelines

To All Member Banks and Bank Holding Companies in the Second Federal Reserve District:

As set forth in our Circular No. 9201, dated December 17, 1981, the Board of Governors of the Federal Reserve System has adopted a broadened definition of bank capital for use in determining the adequacy of capital in State member banks. That new definition was recommended to the Federal Reserve and to the other Federal bank regulators by the Federal Financial Institutions Examination Council in the interest of promoting uniformity among Federal bank regulators in determining capital adequacy.

The Board of Governors and the Office of the Comptroller of the Currency have now developed capital adequacy guidelines which are designed to provide the framework for assessing the capital of well-managed national banks, State member banks, and bank holding companies. These guidelines will be used by the two agencies in conducting their examination and supervisory activities.

The following is quoted from the text of a joint statement issued by the Board and the Comptroller in announcing their capital adequacy guidelines:

> The agencies developed the guidelines in the interest of achieving greater consistency in their supervisory activities. The guidelines should also be helpful to banking organizations in their financial planning. The regulators stressed that the guidelines will be used in a manner that allows for consideration of differences in the situations of individual financial institutions.
>
> One of the objectives of the agencies was to address the sizable existing disparity in capital ratios among banking organizations of different size. To this end, the agencies considered both qualitative characteristics and practical economic and market constraints which often account for differences in capital ratios. The program adopted will permit somewhat lower capital ratios for smaller banks than most of these institutions currently maintain. At the same time, the agencies indicated that their policies with respect to the multinational banking organizations — at present, 17 institutions with assets in excess of $15 billion — would be amended to insure that appropriate steps are taken to improve over time the capital positions of banking organizations in this group.
>
> The guidelines will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices. As conditions permit, further consideration will be given to the differences in the capital ratios by size of institution.

The Capital Adequacy Guidelines are printed on the following pages. Questions thereon may be directed to our Bank Analysis Department (Tel. No. 212-791-6710).

ANTHONY M. SOLOMON,
President.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
OFFICE OF THE COMPTROLLER OF THE CURRENCY

CAPITAL ADEQUACY GUIDELINES

The Federal Reserve and the Office of the Comptroller of the Currency have developed capital adequacy guidelines to provide a framework for assessing the capital of well-managed national banks, state member banks and bank holding companies. 1/ The guidelines will be used in the examination and supervisory process and will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices.

Objectives of the capital adequacy guidelines program are to:

- address the long-term decline in capital ratios, particularly those of the multinational group;
- introduce greater uniformity, objectivity and consistency into the supervisory approach for assessing capital adequacy;
- provide direction for capital and strategic planning to banks and bank holding companies and for the appraisal of this planning by the agencies; and,
- permit some reduction of existing disparities in capital ratios between banking organizations of different size.

Two principal ratio measurements of capital will be used: (1) primary capital to total assets; and (2) total capital to total assets. Primary capital consists of common stock, perpetual preferred stock, capital surplus, undivided profits, reserves for contingencies and other capital reserves, mandatory convertible instruments and the allowance for possible loan losses. Total capital includes the primary capital components plus limited life preferred stock and qualifying subordinated notes and debentures.

1/ Institutions that are under special supervision and those that have been in operation for less than two years are not included in the program.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The capital guidelines generally will be applied on a consolidated basis. However, for those bank holding companies with consolidated assets under $150 million, the capital guidelines will apply to the bank only, if: (1) the company does not engage directly or indirectly in any nonbanking activity involving significant leverage; and (2) no significant debt of the parent company is held by the general public.

Some bank holding companies are engaged in significant nonbanking activities that require capital ratios higher than those for the bank alone. In these cases, appropriate adjustments will be made in the application of the consolidated capital guidelines.

Institutions affected by the guidelines are categorized as either multinational organizations (as designated by their respective supervisory agency); regional organizations (all other institutions with assets in excess of $1 billion)[1/]; or community organizations (less than $1 billion in total assets).

Capital guidelines for the relatively small number of multinational organizations will continue to be formulated and monitored on an individual basis, taking into account their present and prospective financial condition. The supervisory agencies are increasingly concerned about the secular declines in the capital ratios of the nation's largest banking organizations, particularly in view of increased risks both domestically and internationally. In general, supervisory policies of the Federal Reserve and the Office of the Comptroller of the Currency, designed to arrest the secular decline in the capital ratios of this group of institutions, will be modified to insure that appropriate steps are taken to improve over time the capital positions of this group.

1/ May include some institutions located in money centers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

A minimum level of primary capital to total assets is established at 5 percent for regional organizations and 6 percent for community organizations. Generally, regional and community banking organizations are expected to operate above the minimum primary capital levels.

The agencies also have established capital guidelines for regional and community organizations for the total capital to total assets ratio. These guidelines consist of three broad zones:

	Regional	Community
Zone 1	Above 6.5%	Above 7.0%
Zone 2	5.5% to 6.5%	6.0% to 7.0%
Zone 3	Below 5.5%	Below 6.0%

Generally, the nature and intensity of supervisory action will be determined by the zone in which an institution falls.

For banking institutions operating in zone 1, the agencies will:

- o presume adequate capital if the primary capital ratio is acceptable to the regulator and is above the minimum level;
- o intensify analysis and action when unwarranted declines in capital ratios occur.

For banking institutions operating in zone 2, agencies will:

- o presume that the institution may be undercapitalized, particularly if the primary and total capital ratios are at or near the minimum guidelines;
- o engage in extensive contact and discussion with the management and require the submission of comprehensive capital plans acceptable to the regulator;
- o closely monitor the capital position over time.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The agencies' approach to institutions operating in zone 3 will include:

- o a very strong presumption that the bank is undercapitalized;
- o frequent contact with management and a requirement that the bank submit a comprehensive capital plan, including a capital augmentation program that is acceptable to the regulator;
- o continuous analysis, monitoring and supervision.

The guidelines will be applied in a flexible manner with exceptions as appropriate. The assessment of capital adequacy will continue to be made on a case-by-case basis considering various qualitative factors that affect an institution's overall financial condition. Thus, the agencies retain the flexibility to recognize the unique characteristics of sound and well-managed banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis