FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 9513
June 16, 1983]

Amended Capital Adequacy Guidelines

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

The following is quoted from the text of a joint statement issued by the Board of Governors of the Federal Reserve System and the Comptroller of the Currency in announcing amendments to their capital adequacy guidelines:

The Comptroller of the Currency and the Federal Reserve Board have announced amendments to their minimum capital guidelines. The guidelines, which were originally made public in December 1981, are used by the two agencies in examining and supervising national banks, state chartered banks that are members of the Federal Reserve System, and bank holding companies. The two agencies will be guided by the amendments effective immediately; however, they will continue to accept comments on the changes until August 12, 1983.

The revisions would:

— Establish a 5 percent minimum ratio of primary capital to total assets for the 17 banking organizations designated by the agencies as multinationals.

— Expand the definition of secondary capital in considering the capital adequacy of consolidated bank holding companies.

Definitions of primary and secondary capital are included in the attached revised guidelines.

The agencies noted in connection with the amendments that they had previously amended their policies to ensure that the capital positions of the 17 multinationals[1] would be strengthened. Over the past 18 months, the average primary capital ratio for these banking organizations increased from 4.63 percent to 5.35 percent through the issue of $450 million of common stock, $2.9 billion of preferred stock, and $1.3 billion of mandatory convertible securities. This substantial improvement means that most of these institutions are already in compliance or will not have far to go to come into compliance with the amended guidelines. In light of the progress made toward greater uniformity in the treatment of capital among banks and within the context of fostering continued improvement in bank capital ratios, the agencies are particularly interested in receiving comment on the question whether a further step would now be advisable, moving toward a closer alignment of capital ratios for all banking organizations, regardless of size.

The guidelines for the multinationals are the same as those already used for regional banking organizations — companies with total assets exceeding $1 billion that are not designated as multinationals. The agencies recognized that the primary capital ratios of several multinationals currently were below desired levels. They emphasized that these organizations would be given a reasonable period of time to bring their ratios up to acceptable levels. The agencies noted that they will continue to administer the capital guidelines with appropriate flexibility, and will take into consideration the unique characteristics of individual banks.

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[1] BankAmerica Corporation (Bank of America, NT&SA); Bank of Boston Corporation (The First National Bank of Boston); Bankers Trust New York Corporation (Bankers Trust Company); The Chase Manhattan Corporation (The Chase Manhattan Bank, N.A.); Chemical New York Corporation (Chemical Bank); Citicorp (Citibank, N.A.); Continental Illinois Corporation (Continental Illinois National Bank and Trust Company of Chicago); Crocker National Corporation (Crocker National Bank); First Chicago Corporation (The First National Bank of Chicago); First Interstate Bancorp (First Interstate Bank of California); Irving Bank Corporation (Irving Trust Company); Manufacturers Hanover Corporation (Manufacturers Hanover Trust Company); Marine Midland Banks, Inc. (Marine Midland Bank, N.A.); Mellon National Corporation (Mellon Bank, N.A.); J.P. Morgan & Co., Inc. (Morgan Guaranty Trust Company of New York); Security Pacific Corporation (Security Pacific National Bank); and Wells Fargo & Company (Wells Fargo Bank, N.A.).

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In the second major change, the agencies said that the unsecured long-term debt of the parent company and its nonbank affiliates could now be counted as secondary capital for purposes of evaluating the capital adequacy of the consolidated holding company. However, unlike bank-issued debt, the long-term debt of the parent company and its nonbank subsidiaries would not be required to be subordinated. In addition, such long-term debt would not be limited to 50 percent of holding company primary capital, whereas bank subordinated debt is limited to 50 percent of bank primary capital. The agencies will retain the 50 percent limit for bank subordinated debt, because lending limits of many banks are tied to capital, which includes subordinated debt.

In amending the capital guidelines program, the agencies reemphasized that banking organizations generally are expected to operate above the minimum primary capital ratios. The agencies also said that some banking organizations will be expected to hold additional primary capital to compensate for additional risk. Such banks would include those that have a higher than average percentage of their assets exposed to risk or a greater than average amount of off-balance sheet risk. As techniques of financial analysis evolve, the agencies plan to review these guidelines and in particular will continue to review such issues as the level of intangibles, the role of debt as capital and the possible need for a single capital standard for all banks.

The definition of capital for use in determining capital adequacy and the minimum capital 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.

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

DEFINITION OF CAPITAL TO BE USED IN DETERMINING CAPITAL ADEQUACY OF NATIONAL AND STATE MEMBER BANKS AND BANK HOLDING COMPANIES

Primary Components of Capital

The primary components of capital are:

-- common stock

-- perpetual preferred stock

-- surplus

-- undivided profits

-- contingency and other capital reserves

-- mandatory convertible instruments (capital instruments with covenants mandating conversion into common or perpetual preferred stock)

-- allowance for possible loan and lease losses

-- minority interest in equity accounts of consolidated subsidiaries

Secondary Components of Capital

It is recognized that other financial instruments can, with certain restrictions, be considered as part of capital because they possess some, though not all, of the features of capital. These instruments are:

-- Limited-life preferred stock

-- Bank subordinated notes and debentures and unsecured long-term debt of the parent company and its nonbank subsidiaries.

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Restrictions Relating to Secondary Components

The secondary components will be considered as capital under the conditions listed below:

- -- The issue must have an original weighted average maturity of at least seven years.
- -- If the issue has a serial or installment repayment program, all scheduled repayments shall be made at at least annually, once contractual repayment of principal begins, and the amount repaid in a given year shall be no less than the amount repaid in the previous year.
- -- For banks only, the aggregate amount of limited-life preferred stock and subordinated debt qualifying as capital may not exceed 50 percent of the amount of the bank's primary capital.
- -- As the secondary components approach maturity, redemption or payment, the outstanding balance of all such instruments--including those with serial note payments, sinking fund provisions, or an amortization schedule--will be amortized in accordance with the following schedule:

Years to Maturity	Percent of Issue Considered Capital
Greater than or equal to 5	100
Less than 5 but greater than or equal to 4	80
Less than 4 but greater than or equal to 3	60
Less than 3 but greater than or equal to 2	40
Less than 2 but greater than or equal to 1	20
Less than 1	0

(No adjustment in the book amount of the issue is required or expected by tnis schedule. Adjustment will be made by a memorandum account).

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MINIMUM CAPITAL GUIDELINES

The Federal Reserve and the Office of the Comptroller of the Currency have developed minimum capital guidelines to provide a framework for assessing the capital of well-managed national banks, state member banks and bank holding companies.[1] The guidelines are 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 minimum capital guidelines are to:

- 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 are 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, the allowance for possible loan and lease losses, and any minority interest in the equity accounts of consolidated subsidiaries. Total capital includes the primary capital components plus limited life preferred stock and qualifying 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.

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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 only to the bank 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).

A minimum level of primary capital to total assets is established at 5 percent for multinational and regional organizations and 6 percent for community organizations. Generally, banking organizations are expected to operate above the minimum primary capital levels. Also, those banking organizations that have a higher than average percentage of their assets exposed to risk, or have a higher than average amount of off-balance sheet risk, may be expected to hold additional primary capital to compensate for this risk.

1/ May include some other institutions located in money centers.

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

	Multinational and 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. While an institution's position in the quantitative capital zones will normally trigger the below specified supervisory responses, qualitative analysis will continue to be used in determining minimum levels of capital for banking institutions.

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

° presume that capital is adequate if the primary capital ratio is acceptable to the regulator and is above the minimum level;

° intensify analysis and action when unwarranted declines in capital ratios occur.

For banking institutions operating in Zone 2, the agencies will:

° presume that the insititution may be under-capitalized, particularly if the primary and total capital ratios are at or near the minimum guidelines;

° engage in extensive contact and discussion with the management and require the submission of comprehensive capital plans acceptable to the regulator;

° closely monitor the capital position over time.

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

° a very strong presumption that the institution is under-capitalized;

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° frequent contact with management and a requirement that the institution submit a comprehensive capital plan, including a capital augmentation program that is acceptable to the regulator;

° 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 make appropriate adjustments in the application of the guidelines to individual institutions.

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