

At- Cir. No. 10106

December 9, 1986

To the Addressee:

As indicated in Circular No. 10106, dated November 18, 1986, the Board of Governors of the Federal Reserve System has amended Appendix A, "Capital Adequacy Guidelines for Bank Holding Companies and State Member Banks," of its Regulation Y, regarding the treatment of perpetual debt as primary capital. Enclosed -- for those that maintain sets of the Board's regulations -- is a copy of the text of that amendment, which has been reprinted from the Federal Register of November 12, 1986.

Circulars Division
Federal Reserve Bank of New York

Amendment to Regulation Y Bank Holding Companies and Change in Bank Control November 1986

Effective November 4, 1986, appendix A is amended as follows:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority for Part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1843(c)(8), 1844(b), 3106, 3108, 3907, 3909.

2. The portion of Appendix A entitled "Definition of Capital to be used in Determining Capital Adequacy of Bank Holding Companies and State Member Banks" is amended by adding "perpetual debt" to the list of primary capital components, by removing footnote 3, and by adding a new subsection entitled "Limits on Non-common-Equity Forms of Primary Capital" to follow the list of primary capital components. The added and revised portions of Appendix A read as follows:

Appendix A—Capital Adequacy Guidelines for Bank Holding Companies and State Member Banks

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Definition of Capital to be Used in Determining Capital Adequacy of Bank Holding Companies and State Member Banks

Primary capital components :

The components of primary capital are:

- Common stock,
- Perpetual preferred stock (preferred stock that does not have a stated maturity date and that may not be redeemed at the option of the holder),
- Surplus (excluding surplus relating to limited-life preferred stock),
- Undivided profits,
- Contingency and other capital reserves,

* The complete regulation, as amended effective November 4, 1986, consists of —

- the pamphlet dated February 3, 1984
- slip sheet dated May 1985
- Amendments effective November 7, 1986 and December 15, 1986
- this slip sheet

- Mandatory convertible instruments,²
- Allowance for possible loan and lease losses (exclusive of allocated transfer risk reserves),
- Minority interest in equity accounts of consolidated subsidiaries,
- Perpetual debt instruments (for bank holding companies but not for state member banks).

Limits on Certain Forms of Primary Capital

Bank Holding Companies. The maximum composite amount of mandatory convertible securities, perpetual debt, and perpetual preferred stock that may be counted as primary capital for bank holding companies is limited to 33.3 percent of all primary capital, including these instruments. Perpetual preferred stock issued prior to November 20, 1985 (or determined by the Federal Reserve to be in the process of being issued prior to that date), shall continue to be included as primary capital.

The maximum composite amount of mandatory convertible securities and perpetual debt that may be counted as primary capital for bank holding companies is limited to 20 percent of all primary capital, including these instruments. The maximum amount of equity commitment notes (a form of mandatory convertible securities) that may be counted as primary capital for a bank holding company is limited to 10 percent of all primary capital, including mandatory convertible securities. Amounts outstanding in excess of these limitations may be counted as secondary capital provided they meet the requirements of secondary capital instruments.

State Member Banks. The composite limitations on the amount of mandatory convertible securities and perpetual preferred stock (perpetual debt is not primary capital for state member banks) that may serve as primary capital for bank holding companies shall not be applied formally to state member banks, although the Board shall determine appropriate limits for these forms of primary capital on a case-by-case basis.

The maximum amount of mandatory convertible securities that may be counted as

² See the definitional section below that lists the criteria for mandatory convertible instruments to qualify as primary capital.

primary capital for state member banks is limited to 16% percent of all primary capital, including mandatory convertible securities. Equity commitment notes, one form of mandatory convertible securities, shall not be included as primary capital for state member banks, except that notes issued by state member banks prior to May 15, 1985, will continue to be included in primary capital. Amounts of mandatory convertible securities in excess of these limitations may be counted as secondary capital if they meet the requirements of secondary capital instruments.

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3. That portion of Appendix A entitled "Criteria Applicable to Both Types of Mandatory Convertible Securities" is amended by removing paragraph (b) and footnote 4 and redesignating paragraphs (c) through (f) as paragraphs (b) through (e). Footnotes 5 and 6 are redesignated as footnotes 3 and 4.

4. That portion of Appendix A entitled "Additional Criteria Applicable to Equity Commitment Notes" is amended by deleting paragraph (d) and by redesignating footnotes 7 and 8 as footnotes 5 and 6.

5. Appendix A is amended by adding the following paragraphs at the end of the Appendix.

Criteria for Determining the Primary Capital Status of Perpetual Debt Instruments of Bank Holding Companies

1. The instrument must be unsecured and, if issued by a bank, must be subordinated to the claims of depositors.

2. The instrument may not provide the noteholder with the right to demand repayment of principal except in the event of bankruptcy, insolvency, or reorganization. The instrument must provide that nonpayment of interest shall not trigger repayment of the principal of the perpetual debt note or any other obligation of the issuer, nor shall it constitute prima facie evidence of insolvency or bankruptcy.

3. The issuer shall not voluntarily redeem the debt issue without prior approval of the Federal Reserve, except when the debt is converted to, exchanged for, or simultaneously replaced in like amount by an issue of common or perpetual preferred stock of the issuer or the issuer's parent company.

4. If issued by a bank holding company, a bank subsidiary, or a subsidiary with substantial operations, the instrument must contain a provision that allows the issuer to defer interest payments on the perpetual debt in the event of, and at the same time as the elimination of dividends on all outstanding common or preferred stock of the issuer (or in the case of a guarantee by a parent company at the same time as the elimination of the dividends of the parent company's common and preferred stock). In the case of a nonoperating subsidiary (a funding subsidiary or one formed to issue securities), the deferral of interest payments must be triggered by elimination of dividends by the parent company.

5. If issued by a bank holding company or a subsidiary with substantial operations, the instrument must convert automatically to common or perpetual preferred stock of the issuer when the issuer's retained earnings and surplus accounts become negative. If an operating subsidiary's perpetual debt is guaranteed by its parent, the debt may convert to the shares of the issuer or guarantor and such conversion may be triggered when the issuer's or parent's retained earnings and surplus accounts become negative. If issued by a nonoperating subsidiary of a bank holding company or bank, the instrument must convert automatically to common or preferred stock of the issuer's parent when the retained earnings and surplus accounts of the issuer's parent become negative.

By order of the Board of Governors of the Federal Reserve System, November 3, 1986.

William W. Wiles,

Secretary of the Board.

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