FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10395**
October 26, 1990]

CAPITAL ADEQUACY GUIDELINES

Proposed Amendments to Regulations H and Y
Regarding the Risk-Based Capital Guidelines

Comment Invited by December 17, 1990

To All State Member Banks and Bank Holding Companies
in the Second Federal Reserve District, and Others Concerned:

The following statement has been issued by the Board of Governors of the Federal Reserve System:

> The Federal Reserve Board has issued for public comment certain clarifications, modifications, and technical changes to the Board's risk-based capital guidelines.
>
> Comment is requested by December 17, 1990.
>
> The proposed changes include the modification and clarification of:
>
> - The language of the guidelines to ensure that residential mortgages sold with recourse receive an adequate capital charge under this framework; and
> - Certain provisions of the guidelines that call for prior supervisory approval before any redemption of perpetual preferred stock.

Printed on the following pages is the text of the proposed amendments to Appendix A of Regulations H and Y, which has been reprinted from the *Federal Register* of October 17; Appendix A deals with risk-based capital guidelines. Comments thereon should be submitted by December 17, and may be sent to the Board of Governors, as set forth in the notice, or to our Bank Analysis Department.

E. GERALD CORRIGAN,
President.

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FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Regulation H, Regulation Y; Docket No. R-0709]

Capital; Capital Adequacy Guidelines

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Federal Reserve Board is proposing several modifications, clarifications, and technical changes to the risk-based capital guidelines. The modifications and technical changes relate to the: (1) Treatment of certain assets sold with recourse; (2) redemption of perpetual preferred stock; (3) treatment of supervisory goodwill in the definition of capital; and (4) treatment of claims on non-OECD central banks.

The purpose of these modifications, clarifications, and technical changes is to make the Board's risk-based capital framework consistent with recent international interpretations of the risk-based capital accord (Basel Accord) and with the current or proposed treatment of certain items by the other federal banking agencies. In addition, certain of the proposed modifications to the language of the Board's risk-based capital guidelines are intended to bring the guidelines into closer conformity with current Federal Reserve supervisory practices. In light of the importance of the modifications and clarifications described in this Notice, their overall consistency with the spirit and intent of the risk-based capital framework and the Basel Accord, and the need to ensure that risks are backed by an appropriate level of capital, it is intended that the modifications and clarifications be incorporated into the guidelines by the end of 1990, or as soon as possible thereafter. Year-end 1990 is the date upon which the interim risk-based capital ratios first take effect; the final guidelines take effect at the end of 1992. Because the modifications and clarifications require adjustments in the language of the risk-based capital guidelines, the Board will accept and consider comments from the public for a 60-day comment period.

DATES: Comments on the modifications, clarifications, and technical changes should be submitted on or before December 17, 1990.

ADDRESSES: Comments, which should refer to docket No. R-0709, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551; or delivered to room B-2223, Eccles Building, between 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in Room B-1122 between 9 a.m. and 5 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: Roger T. Cole, Assistant Director (202/452-2618), Rhoger H. Pugh, Manager (202/728-5883), Norah Barger, Senior Financial Analyst (202/452-2402), Thomas R. Boemio, Senior Financial Analyst (202/452-2982), Division of Banking Supervision and Regulation; Michael J. O'Rourke, Senior Attorney (202/452-3288) or Mark J. Tenhundfeld, Attorney (202/452-3612), Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

I. Background

Since the Board initially published its risk-based capital guidelines, some questions have arisen concerning how certain recourse transactions involving credit risk are to be captured by the framework. In addition, certain interpretations and clarifications have emerged from international and domestic discussions among supervisory authorities. Finally, the enactment of the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 (FIRREA) affects the treatment of goodwill for capital purposes. Accordingly, the Board has proposed the following modifications and clarifications in order to address these developments.

The modifications and clarifications outlined in this notice will: (1) Ensure that certain off-balance sheet credit exposures, particularly sales of residential mortgages with recourse, are adequately captured in the risk-based capital framework; (2) implement interpretations agreed to by supervisory authorities represented on the Basle Committee on Supervision; and (3) foster consistency between the Federal Reserve's treatment of certain transactions for risk-based capital purposes and the current or proposed treatment of such transactions by the other federal banking agencies.

II. Modifications, Clarifications, and Technical Changes

1. Treatment of Sales of Assets (Including Residential Mortgages) With Recourse

It is a basic tenet of the Basle Accord, and of the risk-based capital guidelines of the three federal banking agencies, that all forms of credit risk, whether on- or off-balance sheet, are to be taken into account in calculating an institution's risk-based capital ratio.[1] In view of this principle and in light of questions that have arisen regarding the application of the risk-based guidelines to the sale of certain assets with recourse, the Federal Reserve Board believes that it is necessary to modify the language of the guidelines in order to clarify that credit risks stemming from residential mortgage recourse sales are subject to an appropriate capital charge.

In general, so-called recourse "sales" allow the buyer of a loan or pools of loans to put back to the seller, that is, require the seller to repurchase, loans that are not performing as agreed. This, in effect, means that the credit risk associated with the loans remains with the "seller." The modifications and clarifications to the language of the risk-based capital guidelines could clarify the treatment for risk-based capital purposes of the sale of certain assets with recourse, primarily the sale of residential mortgages with recourse.

In defining assets sold with recourse for risk-based capital purposes, the U.S. banking agencies incorporated the longstanding "general rule" definition contained in the commercial bank Call Report instructions. This general rule states that a transfer of assets is to be reported as a true sale, and, therefore, taken off the balance sheet, only if the transferring (that is, selling) institution (i) Retains no risk of loss from the assets transferred resulting from any cause, including a recourse provision, and (ii) has no obligation to any party for the

[18] See paragraph (c)(26) of section 1 of appendix A to this part.

[1] In order to conform to the principles established in the Basle Accord, the Board's risk-based capital guidelines cover credit risks retained when an institution sells an asset, obtained in the issuance of a financial guarantee, or acquired in any other manner. This could be done directly through the issuance of any form of direct credit enhancement or indirectly through the acquisition of an asset or obligation.

PRINTED IN NEW YORK, FROM *FEDERAL REGISTER*, VOL. 55, NO. 201, pp. 42022-42026

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payment of principal or interest on the assets transferred.

Under the longstanding general rule, a transfer involving any retention by the seller of recourse or risk of loss, even if limited under the terms of the transfer agreement, is considered a borrowing transaction, as opposed to a sale, and the entire amount of the assets "transferred" must remain on the books of the "selling" institution. The general rule was intentionally adopted by the banking agencies for supervisory policy reasons and has been in effect for reporting and primary capital (leverage) ratio purposes for many years. The principal reason for adopting the rule was to ensure that institutions retaining any credit risk through recourse provisions would be required under capital-to-total assets (leverage) ratios to maintain capital against these transactions.

In 1985, the banking agencies considered adopting FASB 77 for regulatory reporting purposes in lieu of the general Call Report rule.[2] However, given capital adequacy considerations and other supervisory concerns, the banking agencies expressly decided not to adopt FASB 77. Rather, the agencies, under the auspices of the Examination Council, chose to reaffirm the general Call Report rule for bank reporting and leverage ratio purposes.

The regulatory (Call Report) definition of sales of assets with recourse in the special case of pools of residential mortgages differs from the general rule just described. In particular, the Call Report instructions state that for regulatory reporting purposes, any transfers of residential mortgage loan pools under government programs, such as the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), will be treated as sales. It should be noted that such treatment is related to the reporting of these items and was never intended to preclude taking account of the risks associated with the transactions in assessing a banking organization's overall capital adequacy. In addition, the Call Report instructions state that transfers of pools of residential mortgages to private obligors (not under the government programs) are to be reported as sales when the selling bank does not retain any significant risk of loss.[3]

These regulatory reporting definitions were developed at a time when the disposition or transfer of residential mortgages under the government programs involved little or no recourse and the amount of possible loss under the private transactions was considered to be insignificant. Thus, no major policy concerns existed regarding the possibility that the "selling" party in these transactions could retain a significant measure of credit risk that was not adequately backed by capital. As discussed below, however, this situation has changed over time.

The Board's risk-based capital guidelines incorporated the general Call Report definition of sales of assets with recourse and also made specific reference to the Call Report treatment of the sale of 1-to-4 family residential mortgages with recourse. The intent of the guidelines was to incorporate into the risk-based capital framework the supervisory principle implicit in the general Call Report rule, that is, if the seller retains any risk of loss, the transaction would require capital support. Despite this, the reference to the Call Report treatment of the sale of 1-to-4 family residential mortgages has apparently led some to believe that such transactions could be excluded entirely from the risk-based capital framework, regardless of the amount of credit risk involved in these transactions.

The exclusion from capital requirements of transactions with a significant amount of credit risk would be inconsistent with the principles of risk-based capital and was not intended when the Board issued its risk-based capital guidelines. In this regard, it should be noted that the Federal Reserve's risk-based capital guidelines contain the statement that "* * * asset sales with recourse (to the extent not included on the balance sheet) * * * are converted at 100 percent." This would have the effect of applying a capital charge to such transactions.

The treatment of asset sales with recourse, including the transfer of residential mortgages with recourse, is of particular importance since it has become apparent that the "sales" of residential mortgages under the government programs can involve either no recourse, or recourse of up to 100 percent to the "seller"—a distinct departure from the situation that existed when the regulatory reporting definition of "residential mortgages sold with recourse" was initially adopted. Thus, the incorporation in the risk-based capital guidelines of the Call Report definition of residential mortgages sold with recourse has been interpreted by some as allowing sales of residential mortgages under the government programs with up to 100 percent recourse to escape a capital charge.

If such treatment were permitted, banking organizations would not have to maintain any capital to support the credit risks associated with recourse arrangements, even though these risks associated with recourse arrangements, even though these risks would be the same as if they continued to hold the assets directly on their books. For this reason, the Federal Reserve is clarifying the language in the risk-based capital guidelines to ensure that 1-to-4 family residential mortgage sales with recourse are not exempt from an appropriate capital charge.

To achieve this objective, the modified language would provide for risk-based capital purposes that assets sold with recourse (that are not already on the balance sheet), including residential mortgages, are to be treated by the selling institution like any other direct credit substitute or financial guarantee. Thus, such off-balance sheet obligations would be converted at 100 percent to an on-balance sheet credit equivalent amount and assigned to the appropriate risk category, typically 50 percent in the case of residential mortgages. In general, this would have the effect of putting a 4 percent capital charge on the entire amount of residential mortgage loans sold with recourse.

An exception under this proposal would be allowed where the maximum possible recourse obligation, at the time of the transfer, is less than the expected loss on the transferred assets and the banking organization establishes and maintains a liability or specifically identified (non-capital) reserve for an amount equal to the maximum loss possible under the recourse provision. Such a liability or reserve would mean that the maximum possible loss under the recourse arrangement would in effect be deducted from capital "up front," and the originating or selling institution would not suffer any further loss under the recourse obligation. Under such conditions, no additional

[2] GAAP, as set forth in Financial Accounting Standards Board Statement No. 77 (FASB 77), permits a transfer of assets with recourse to be treated as a sale if: (a) Control of the future economic benefits is surrendered; (b) the amount of the seller's obligation under the recourse provisions can be reasonably estimated; and (c) the assets cannot be returned to the seller except pursuant to the recourse provisions. When sales treatment is accorded, the seller's estimated liability for any loss under the recourse provisions must be provided for.

[3] The Call Report instructions state that in a private transaction, recourse is considered significant if at the time of the transfer the maximum contractual exposure under the recourse provision (or through retention of a subordinated interest in the mortgages) is greater than the amount of probable loss that the bank has reasonably estimated it will incur on the transferred mortgages.

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capital would be required and the amount of the liability created to cover the maximum possible loss under the recourse agreement would not be included in capital.

Clarifying in the proposed manner that residential mortgage sales with recourse incur a capital charge is desirable for several reasons.

First, it would ensure that the Federal Reserve's treatment for risk-based capital purposes of residential mortgage sale with recourse is consistent with (i) The general regulatory rule on asset sales with recourse long employed by the Federal banking agencies and (ii) the existing or proposed treatment of the other Federal banking agencies.

Second, addressing the residential mortgage issue will ensure consistency with the intent of the Basle Accord, which requires capital backing for all on- and off-balance sheet credit risks.

Third, addressing the mortgage exception will enable the depository institution regulatory agencies to deal with a number of broad issues pertaining to recourse in a consistent fashion going forward.[4]

With reference to the second point above regarding the consistency with the Accord, it should be noted that the terms and provisions of the Basle Accord apply to commercial banks on a consolidated basis. In this regard, under the approach described above, commercial banks will be required to back their recourse transactions with capital when the interim risk-based capital ratios become effective at year-end 1990, or upon the effective date of the clarification, whichever is later. While the Basle Accord does not apply to companies that own banks, the Accord does caution that bank ownership structures or affiliations with other firms not be allowed to weaken the capital position of the bank or expose the bank to undue risks. The Board has chosen to apply risk-based capital requirements similar to those in the Basle Accord to bank holding companies. In this regard, there are certain limited differences between the risk-based capital guidelines for banks and bank holding companies. In view of this, the Board invites comments on whether it might be appropriate in the case of bank holding companies, as distinct from commercial banks, to consider a brief transition or phase-in arrangement for the full risk-based capital requirements with respect to the sale of residential mortgages with recourse completed prior to the publication of this Notice. Such treatment would only be contemplated in the case of assets sold with recourse by bank holding companies or their nonbank subsidiaries. In considering this point, commenters are asked to address whether the credit risks of the recourse arrangements to the bank holding company selling the assets are any different from the risks to the holding company if the assets were held directly on the holding company's books.

In general, under the Board's recommended approach, 4 percent capital would normally be required against the entire amount of residential mortgages sold with recourse. However, this approach would not mean that banking organizations would be unable to sell or securitize residential mortgages, or that they would be unable to provide limited recourse or certain other credit enhancements to support sales of mortgage pools. For example, banking organizations always have the clear option to sell assets outright, without any recourse, thereby avoiding a capital charge altogther. Moreover, there are several ways banking organizations can provide credit enhancements and still sell assets without recourse, or with limited recourse, and either incur no capital charge or a reduced capital charge.

First, banking organizations can establish a spread account that provides a cushion of protection to the purchasers of securitized assets, while at the same time insulating the selling banking organization from losses arising from the transaction. Funds can be placed in the account directly by the selling institution through a charge against earnings or capital, or can accumulate in the account based upon the difference between the rate paid to the purchasers of the securities and the higher yield earned on the underlying assets. Under these arrangements, any losses on the underlying assets would be charged against the spread account. So long as such losses can only be charged against the spread account and cannot adversely affect the originating bank's capital or future earnings, no additional capital would be charged for transactions employing this technique. Indeed, the banking agencies do not view such arrangements as recourse transactions and these spread accounts have been used successfully to securitize credit card and automobile receivables. Moreover, these arrangements can be supplemented or enhanced by the originating or selling bank's purchase of a standby letter of credit from a third party guarantor in order to protect the purchasers from losses on the securitized assets.

Second, transactions can be structured in such a way that the seller and the buyer proportionately share in any losses, that is, on a *pro rata* basis. For example, if a bank sells assets of $1,000,000 and the buyer agrees to absorb 90 percent of any losses while the seller will absorb the other 10 percent, the selling bank would only have to maintain capital against $100,000, as opposed to the entire amount of the asset transferred.

Third, as noted above, with respect to the sale of mortgages either under the government programs or in private transactions, banking organizations can avoid a capital charge by (1) limiting their maximum recourse obligation to an amount that is less than the expected loss on the transferred pool of mortgages at the time of the transfer and (2) establishing and maintaining a liability or a specifically identified non-capital reserve for the maximum amount of possible loss under the recourse provision. This provision would give banking organizations engaged in recourse transactions an incentive to limit recourse and take a charge against capital for their maximum possible loss under the recourse arrangement. Given the uncertainties that can surround recourse obligations, such incentives would appear to have a sound prudential and supervisory justification.

As a general rule, this treatment should not result in extraordinary or unwarranted new capital requirements for most banking organizations. This is because prudently run institutions have always had the responsibility to monitor off-balance sheet risk-taking and back such activities with adequate capital, regardless of how the transactions have been treated for regulatory reporting or regulatory capital purposes.

FFIEC Study on Recourse

In light of the matters discussed in this notice, as well as other emerging concerns relating to recourse transactions, the staffs of the banking agencies recognize the need to address in a comprehensive fashion the reporting, supervisory, and capital adequacy issues stemming from the sale of assets with recourse. In this regard, the federal depository institution regulatory agencies, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), have

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[4] As explained more fully below, a project under the auspices of the Federal Financial Institutions Examination Council (FFIEC) is focusing on the types of recourse arrangements employed by banking organizations, the incorporation of recourse transactions into lending limitations, the supervisory and capital treatment of limited recourse, and regulatory reporting implications.

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requested public comment on how to define recourse and how to treat various types of recourse for purposes of regulatory reporting, capital adequacy, and lending limits. This interagency effort is also focusing on a number of related issues, including cases where assets are sold with limited recourse.

2. Redemption of Perpetual Preferred Stock

The Board's risk-based capital guidelines currently indicate that banking organizations should consult with the Federal Reserve before redeeming permanent equity instruments or debt capital instruments prior to their stated maturity. A limited exception to this rule is provided for instruments redeemed with the proceeds of a higher form of capital, if the capital position of the banking organization is deemed fully adequate by the Federal Reserve. As a practical matter, it has long been expected that banking organizations would consult with the Federal Reserve when contemplating redemptions of core capital in order to give the Federal Reserve an opportunity to determine the impact of the redemption on the organization's financial condition.

The Basle Committee on Supervision has arrived at a consensus that the redemption of perpetual preferred stock should only be permitted at the issuer's option and only with the prior approval of the supervisory authority. This approach is not inconsistent with the Federal Reserve's current practice as set forth above, and is consistent with requirements contained in letters sent by the Board in connection with the review of capital plans submitted by bank holding companies seeking to engage in Section 20 securities underwriting activities. These letters stipulated that any redemption of perpetual preferred stock could be only at the bank holding companies' option and only with prior approval from the Federal Reserve.

As a result of the Basle interpretation, the Federal Reserve Board is proposing to amend the language of its risk-based capital guidelines to clarify that the approval of the Board is necessary prior to the redemption of any perpetual preferred stock.

3. Treatment of Supervisory Goodwill

Currently, the Board's risk-based capital guidelines, consistent with the Basle Accord, require that goodwill be deducted from Teir 1 capital. However, the guidelines contain a footnote that was intended to give the Federal Reserve the option to make an exception in those very limited situtations in which banking organizations acquired goodwill in the past in connection with supervisory mergers with troubled or failed depository institutions. The wording of the footnote could also be interpreted as accommodating the possible future inclusion in capital of goodwill stemming from the merger of troubled or failed institutions. As a matter of policy, the Federal Reserve does not give credit for goodwill in assessing the capital of institutions involved in supervisory mergers. Indeed, institutions making acquisitions are normally required to exceed minimum capital levels without undue reliance on intangible assets, particularly goodwill. In addition, FIRREA prohibits the regulatory agencies from allowing goodwill to be included in the calculation of capital if the goodwill was acquired after April 12, 1989. Thus, the Board is proposing to delete the footnote that appears to suggest the possibility that supervisory goodwill acquired in the future could be included in the definition of capital for risk-based capital purposes.

4. Claims on Central Banks

The Basle Accord assigns all claims on OECD commercial banks and short-term claims on non-OECD commercial banks to the 20 percent risk category. On the other hand, long-term claims on non-OECD commercial banks, and all claims on non-OECD central governments are assigned to the 100 percent risk category. Claims on OECD governments and central banks are assigned to the zero percent risk category.

In promulgating their risk-based capital guidelines, the U.S. banking agencies' allowed claims on non-OECD central banks to be in the same risk category as short-term claims on non-OECD commercial banks on the assumption that claims on central banks should not be in a higher category than claims on commercial banks. However, further discussions among international supervisors have led to a consensus that claims on central banks should be in the same risk category as claims on the corresponding central governments. This will have little impact on OECD central banks since claims on OECD central banks and governments are already assigned to the zero percent risk category. On the other hand, the Basle Committee on Supervision has held that claims on non-OECD central banks, which could involve an element of transfer risk, should be assigned to the same 100 percent risk category as claims on their central governments.

Incorporation of this change into the U.S. banking agencies' capital guidelines, which is necessary to ensure consistency with the Basle framework, will have the practical effect of moving claims on non-OECD central banks that involve an element of transfer risk from the 20 percent to the 100 percent risk category. As already noted, this will have no effect on the treatment of claims on central banks in OECD countries since all claims on these institutions are already assigned to the same risk category as OECD central governments, that is, to the zero percent risk category.

As a result of the Basle interpretation, the Federal Reserve Board is proposing to amend the language of its risk-based capital guidelines to provide that claims on central banks are to be assigned to the same risk category as claims on the respective central governments.

III. Regulatory Flexibility Act Analysis

The Federal Reserve Board does not believe that adoption of this proposal would have a significant economic impact on a substantial number of small business entities (in this case, small banking organizations), in accord with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). In addition, consistent with current policy, these guidelines generally will not apply to bank holding companies with consolidated assets of less than $150 million.

List of Subjects

12 CFR Part 208

Accounting, Agricultural loan losses, Applications, Appraisals, Banks, Banking, Capital adequacy, Confidential business information, Currency, Dividend payments, Federal Reserve System, Publication of reports of condition, Reporting and recordkeeping requirements, Securities, State member banks.

12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this notice, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(b)), and section 910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3909), the Board proposes to amend 12 CFR parts 208 and 225 as follows:

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PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. The authority citation for part 208 continues to read as follows:

Authority: Sections 9, 11(a), 11(c), 19, 21, 25, and 25(a) of the Federal Reserve Act, as amended (12 U.S.C. 321–338, 248(a), 248(c), 461, 481–486, 601, and 611, respectively); sections 4 and 13(j) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1814 and 1823(j), respectively); section 7(a) of the International Banking Act of 1978 (12 U.S.C. 3105); sections 907–910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3906–3909); sections 2, 12(b), 12(g), 12(i), 15B(c)(5), 17, 17A, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 78*l*(b), 78*l*(g), 78*l*(1), 78o–4(c)(5), 78q, 78q–1, and 78w, respectively); section 5155 of the Revised Statutes (12 U.S.C. 36) as amended by the McFadden Act of 1927; and sections 1101–1122 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 3310 and 3331–3351).

Appendix A [Amended]

2. A new sentence is added immediately following the first sentence of the first paragraph under "II. A. 1. b. Perpetual preferred stock" of appendix A to Part 208 to read as follows:

II. Definition of Qualifying Capital for the Risk-Based Capital Ratio

* * * * *

A. * * *

1. * * *

b. * * * Consistent with these provisions, any perpetual preferred stock with a redemption feature may qualify as capital *only if* the redemption is subject to prior approval of the Federal Reserve. * * *

* * * * *

Appendix A [Amended]

3. In appendix A to part 208, in II. B. 1., the footnote designator 14 in the text is removed and footnote 14 is removed and reserved.

Appendix A [Amended]

4. The last two sentences of footnote 30 under "III. C. 2. Category 2: 20 percent" of appendix A to part 208 are removed.

Appendix A [Amended]

5. Two new sentences are added immediately following the second sentence of the seventh paragraph under "II. D. 1. Items with a 100 percent conversion factor" of appendix A to part 208 to read as follows:

III. Procedures for Computing Weighted Risk Assets and Off-Balance Sheet Items

* * * * *

D. * * *

1. * * *

* * * Accordingly, the entire amount of any assets transferred with recourse that are not already included on the balance sheet, including pools of one-to-four family residential mortgages, are to be converted at 100 percent and assigned to the risk weight appropriate to the obligor, or if relevant, the nature of any collateral or guarantees. The only exception involves transfers of pools of residential mortgages that have been made with insignificant recourse for which a liability or specific non-capital reserve has been established and is maintained for the maximum amount of possible loss under the recourse provision. * * *

* * * * *

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

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

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1843(c)(8), 1844(b), 3106, 3108, 3907, 3909, 3310, and 3331–3351.

Appendix A [Amended]

2. A new sentence is added immediately following the first sentence of the first paragraph under "II. A. 1. b. Perpetual preferred stock of appendix A to part 225 to read as follows:

II. Definition of Qualifying Capital for the Risk Based Capital Ratio

* * * * *

A. * * *

1. * * *

b. * * * Consistent with these provisions, any perpetual preferred stock with a redemption feature may qualify as capital *only if* the redemption is subject to prior approval of the Federal Reserve. * * *

* * * * *

Appendix A [Amended]

3. In appendix A to part 225, in II. B., the footnote designator 15 in the text is removed and footnote 15 is removed and reserved.

Appendix A [Amended]

4. The last two sentences of footnote 33 under "III. C. 2. Category 2: 20 percent" of appendix A to part 225 are removed.

Appendix A [Amended]

5. Two new sentences are added to the end of footnote 48 under "III. D. 1. Items with a 100 percent conversion factor" of appendix A to part 225 to read as follows:

[48] * * * Accordingly, the entire amount of any assets transferred with recourse that are not already included on the balance sheet, including pools of one-to-four family residential mortgages, are to be converted at 100 percent and assigned to the risk weight appropriate to the obligor, or if relevant, the nature of any collateral or guarantees. The only exception involves transfers of pools of residential mortgages that have been made with insignificant recourse for which a liability or specific non-capital reserve has been established and is maintained for the maximum amount of possible loss under the recourse provision.

Board of Governors of the Federal Reserve System, October 11, 1990.

William W. Wiles,

Secretary of the Board.

[FR Doc. 90–24425 Filed 10–16–90; 8:45 am]

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