

April 12, 1993

*To All Depository Institutions in the Second  
Federal Reserve District, and Others  
Maintaining Sets of Board Regulations:*

Enclosed is a copy of the newly printed Regulation F pamphlet, "Limitations on Interbank Liabilities," effective December 19, 1992, of the Board of Governors of the Federal Reserve System.

This pamphlet will replace the previous printing of this regulation from the *Federal Register* that was issued with our Circular No. 10609, dated January 7, 1993.

Circulars Division  
FEDERAL RESERVE BANK OF NEW YORK

# **NOTICE**

## **BOARD OF GOVERNORS' SEMIANNUAL REGULATORY FLEXIBILITY AGENDA**

**April 1, 1993 - October 1, 1993**

The Semiannual Regulatory Flexibility Agenda provides information on those regulatory matters that the Board now has under consideration or anticipates considering over the next six months. It is divided into three parts: (1) regulatory matters that the Board may consider for public comment during the next six months; (2) matters that have been proposed and are under consideration; and (3) regulatory matters that the Board has completed or is not expected to consider further.

A copy of the Agenda was mailed to those on our mailing list who have previously requested it. Copies will be mailed to others upon request (Tel. No. 212-720-5215 or 5216); single copies of any regulation or regulatory amendment can also be obtained at this Bank (33 Liberty Street), in the Issues Division area on the first floor.

Circulars Division  
FEDERAL RESERVE BANK OF NEW YORK  
April 1992

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# Regulation F

## Limitations on Interbank Liabilities

12 CFR 206; effective December 19, 1992



**Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the District in which the inquiry arises.**

**February 1993**

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# Regulation F

## Limitations on Interbank Liabilities

12 CFR 206; effective December 19, 1992

### SECTION 206.1—Authority, Purpose, and Scope

(a) *Authority and purpose.* This part (Regulation F, 12 CFR 206) is issued by the Board of Governors of the Federal Reserve System (Board) to implement section 308 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (act), Pub. L. 102-242. The purpose of the regulation is to limit the risks that the failure of a depository institution would pose to insured depository institutions.

(b) *Scope.* This regulation applies to all depository institutions insured by the Federal Deposit Insurance Corporation.

### SECTION 206.2—Definitions

As used in this part, unless the context requires otherwise:

(a) *Bank* means an insured depository institution, as defined in section 3 of the Federal Deposit Insurance Act (12 USC 1813), and includes an insured national bank, state bank, District bank, or savings association, and an insured branch of a foreign bank.

(b) *Commonly controlled correspondent* means a correspondent that is commonly controlled with the bank and for which the bank is subject to liability under section 5(e) of the Federal Deposit Insurance Act. A correspondent is considered to be commonly controlled with the bank if—

(1) 25 percent or more of any class of voting securities of the bank and the correspondent are owned, directly or indirectly, by the same depository institution or company; or

(2) either the bank or the correspondent owns 25 percent or more of any class of voting securities of the other.

(c) *Correspondent* means a U.S. depository institution or a foreign bank, as defined in this part, to which a bank has exposure, but does not include a commonly controlled correspondent.

(d) *Exposure* means the potential that an obligation will not be paid in a timely manner or in full. “Exposure” includes credit and liquidity risks, including operational risks, related to intraday and interday transactions.

(e) *Foreign bank* means an institution that—

- (1) is organized under the laws of a country other than the United States;
- (2) engages in the business of banking;
- (3) is recognized as a bank by the bank supervisory or monetary authorities of the country of the bank’s organization;
- (4) receives deposits to a substantial extent in the regular course of business; and
- (5) has the power to accept demand deposits.

(f) *Primary federal supervisor* has the same meaning as the term “appropriate federal banking agency” in section 3(q) of the Federal Deposit Insurance Act (12 USC 1813(q)).

(g) *Total capital* means the total of a bank’s tier 1 and tier 2 capital under the risk-based capital guidelines provided by the bank’s primary federal supervisor. For an insured branch of a foreign bank organized under the laws of a country that subscribes to the principles of the Basle Capital Accord, “total capital” means total tier 1 and tier 2 capital as calculated under the standards of that country. For an insured branch of a foreign bank organized under the laws of a country that does not subscribe to the principles of the Basle Capital Accord, “total capital” means total tier 1 and tier 2 capital as calculated under the provisions of the accord.

(h) *U.S. depository institution* means a bank, as defined in section 206.2(a) of this part, other than an insured branch of a foreign bank.

### SECTION 206.3—Prudential Standards

(a) *General.* A bank shall establish and maintain written policies and procedures to prevent excessive exposure to any individual

correspondent in relation to the condition of the correspondent.

(b) *Standards for selecting correspondents.*

(1) A bank shall establish policies and procedures that take into account credit and liquidity risks, including operational risks, in selecting correspondents and terminating those relationships.

(2) Where exposure to a correspondent is significant, the policies and procedures shall require periodic reviews of the financial condition of the correspondent and shall take into account any deterioration in the correspondent's financial condition. Factors bearing on the financial condition of the correspondent include the capital level of the correspondent, level of nonaccrual and past-due loans and leases, level of earnings, and other factors affecting the financial condition of the correspondent. Where public information on the financial condition of the correspondent is available, a bank may base its review of the financial condition of a correspondent on such information, and is not required to obtain nonpublic information for its review.<sup>1</sup>

(3) A bank may rely on another party, such as a bank rating agency or the bank's holding company, to assess the financial condition of or select a correspondent, provided that the bank's board of directors has reviewed and approved the general assessment or selection criteria used by that party.

(c) *Internal limits on exposure.*

(1) Where the financial condition of the correspondent and the form or maturity of the exposure create a significant risk that payments will not be made in full or in a timely manner, a bank's policies and procedures shall limit the bank's exposure to the correspondent, either by the establishment of internal limits or by other means. Limits shall be consistent with the risk undertaken, considering the financial condition and the form and maturity of exposure to the correspondent. Limits may be fixed as to amount or flexible, based on such factors as the

<sup>1</sup> A bank will be required to obtain nonpublic information for its review for those foreign banks for which there is no public source of financial information.

monitoring of exposure and the financial condition of the correspondent. Different limits may be set for different forms of exposure, different products, and different maturities.

(2) A bank shall structure transactions with a correspondent or monitor exposure to a correspondent, directly or through another party, to ensure that its exposure ordinarily does not exceed the bank's internal limits, including limits established for credit exposure, except for occasional excesses resulting from unusual market disturbances, market movements favorable to the bank, increases in activity, operational problems, or other unusual circumstances. Generally, monitoring may be done on a retrospective basis. The level of monitoring required depends on—

- (i) the extent to which exposure approaches the bank's internal limits;
- (ii) the volatility of the exposure; and
- (iii) the financial condition of the correspondent.

(3) A bank shall establish appropriate procedures to address excesses over its internal limits.

(d) *Review by board of directors.* The policies and procedures established under this section shall be reviewed and approved by the bank's board of directors at least annually.

## SECTION 206.4—Credit Exposure

(a) *Limits on credit exposure.*

(1) The policies and procedures on exposure established by a bank under section 206.3(c) of this part shall limit a bank's interday credit exposure to an individual correspondent to not more than 25 percent of the bank's total capital, unless the bank can demonstrate that its correspondent is at least adequately capitalized, as defined in section 206.5(a) of this part.<sup>2</sup>

(2) Where a bank is no longer able to demonstrate that a correspondent is at least adequately capitalized for the purposes of sec-

<sup>2</sup> As used in this final rule, the term "adequately capitalized" is similar but not identical to the definition of that term as used for the purposes of the prompt-corrective-action standards.

tion 206.4(a) of this part, including where the bank cannot obtain adequate information concerning the capital ratios of the correspondent, the bank shall reduce its credit exposure to comply with the requirements of section 206.4(a)(1) of this part within 120 days after the date when the current Report of Condition and Income or other relevant report normally would be available.

(b) *Calculation of credit exposure.* Except as provided in sections 206.4(c) and (d) of this part, the credit exposure of a bank to a correspondent shall consist of the bank's assets and off-balance-sheet items that are subject to capital requirements under the capital adequacy guidelines of the bank's primary federal supervisor, and that involve claims on the correspondent or capital instruments issued by the correspondent. For this purpose, off-balance-sheet items shall be valued on the basis of current exposure. The term "credit exposure" does not include exposure related to the settlement of transactions, intraday exposure, transactions in an agency or similar capacity where losses will be passed back to the principal or other party, or other sources of exposure that are not covered by the capital adequacy guidelines.

(c) *Netting.* Transactions covered by netting agreements that are valid and enforceable under all applicable laws may be netted in calculating credit exposure.

(d) *Exclusions.* A bank may exclude the following from the calculation of credit exposure to a correspondent:

- (1) transactions, including reverse repurchase agreements, to the extent that the transactions are secured by government securities or readily marketable collateral, as defined in paragraph (f) of this section, based on the current market value of the collateral;
- (2) the proceeds of checks and other cash items deposited in an account at a correspondent that are not yet available for withdrawal;
- (3) quality assets, as defined in paragraph (f) of this section, on which the correspon-

dent is secondarily liable, or obligations of the correspondent on which a creditworthy obligor in addition to the correspondent is available, including but not limited to—

- (i) loans to third parties secured by stock or debt obligations of the correspondent;
  - (ii) loans to third parties purchased from the correspondent with recourse;
  - (iii) loans or obligations of third parties backed by standby letters of credit issued by the correspondent; or
  - (iv) obligations of the correspondent backed by standby letters of credit issued by a creditworthy third party;
- (4) exposure that results from the merger with or acquisition of another bank for one year after that merger or acquisition is consummated; and
- (5) the portion of the bank's exposure to the correspondent that is covered by federal deposit insurance.

(e) *Credit exposure of subsidiaries.* In calculating credit exposure to a correspondent under this part, a bank shall include credit exposure to the correspondent of any entity that the bank is required to consolidate on its Report of Condition and Income or Thrift Financial Report.

(f) *Definitions.* As used in this section:

- (1) *Government securities* means obligations of, or obligations fully guaranteed as to principal and interest by, the United States government or any department, agency, bureau, board, commission, or establishment of the United States, or any corporation wholly owned, directly or indirectly, by the United States.
- (2) *Readily marketable collateral* means financial instruments or bullion that may be sold in ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions on an auction or a similarly available daily bid- and ask-price market.
- (3) *Quality asset* means an asset—
  - (i) that is not in a nonaccrual status;
  - (ii) on which principal or interest is not more than 30 days past due; and
  - (iii) whose terms have not been renegotiated or compromised due to the deterior-



rating financial condition of the additional obligor; except that

(iv) an asset is not considered a "quality asset" if any other loans to the primary obligor on the asset have been classified as "substandard," "doubtful," or "loss," or treated as "other loans specially mentioned" in the most recent report of examination or inspection of the bank or an affiliate prepared by either a federal or a state supervisory agency.

### SECTION 206.5—Capital Levels of Correspondents

(a) *Adequately capitalized correspondents.* For the purpose of this part, a correspondent is considered adequately capitalized if the correspondent has—

- (1) a total risk-based capital ratio, as defined in paragraph (e) (1) of this section, of 8.0 percent or greater;
- (2) a Tier 1 risk-based capital ratio, as defined in paragraph (e) (2) of this section, of 4.0 percent or greater; and
- (3) a leverage ratio, as defined in paragraph (e) (3) of this section, of 4.0 percent or greater.

(b) *Frequency of monitoring capital levels.* A bank shall obtain information to demonstrate that a correspondent is at least adequately capitalized on a quarterly basis, either from the most recently available Report of Condition and Income, Thrift Financial Report, financial statement, or bank rating report for the correspondent. For a foreign bank correspondent for which quarterly financial statements or reports are not available, a bank shall obtain such information on as frequent a basis as such information is available. Information obtained directly from a correspondent for the purpose of this section should be based on the most recently available Report of Condition and Income, Thrift Financial Report, or financial statement of the correspondent.

(c) *Foreign banks.* A correspondent that is a foreign bank may be considered adequately capitalized under this section without regard

to the minimum leverage ratio required under paragraph (a) (3) of this section.

(d) *Reliance on information.* A bank may rely on information as to the capital levels of a correspondent obtained from the correspondent, a bank rating agency, or other party that it reasonably believes to be accurate.

(e) *Definitions.* For the purposes of this section:

(1) *Total risk-based capital ratio* means the ratio of qualifying total capital to weighted risk assets.

(2) *Tier 1 risk-based capital ratio* means the ratio of tier 1 capital to weighted-risk assets.

(3) *Leverage ratio* means the ratio of tier 1 capital to average total consolidated assets, as calculated in accordance with the capital adequacy guidelines of the correspondent's primary federal supervisor.

(f) *Calculation of capital ratios.*

(i) For a correspondent that is a U.S. depository institution, the ratios shall be calculated in accordance with the capital adequacy guidelines of the correspondent's primary federal supervisor.

(ii) For a correspondent that is a foreign bank organized in a country that has adopted the risk-based framework of the Basle Capital Accord, the ratios shall be calculated in accordance with the capital adequacy guidelines of the appropriate supervisory authority of the country in which the correspondent is chartered.

(iii) For a correspondent that is a foreign bank organized in a country that has not adopted the risk-based framework of the Basle Capital Accord, the ratios shall be calculated in accordance with the provisions of the Basle Capital Accord.

### SECTION 206.6—Waiver

The Board may waive the application of Section 206.4(a) of this part to a bank if the primary federal supervisor of the bank advises the Board that the bank is not reasonably able to obtain necessary services, including payment-related services and placement of funds, without incurring exposure to a correspon-

dent in excess of the otherwise applicable limit.

**SECTION 206.7—Transition Provisions**

(a) Beginning on June 19, 1993, a bank shall comply with the prudential standards prescribed under Section 206.3 of this part.

(b) Beginning on June 19, 1994, a bank shall comply with the limit on credit exposure to an individual correspondent required under Section 206.4(a) of this part, but for a period of one year after this date the limit shall be 50 percent of the bank's total capital.



# Statutory Provisions

*Section 308 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (105 Stat. 2362) added a new section 23 to the Federal Reserve Act, effective December 19, 1992, and authorized the Board to "prescribe reasonable transition rules to facilitate compliance with section 23 of the Federal Reserve Act."*

## FEDERAL RESERVE ACT

### SECTION 23—Interbank Liabilities

(a) The purpose of this section is to limit the risks that the failure of a large depository institution (whether or not that institution is an insured depository institution) would pose to insured depository institutions.

(b) *Aggregate limits on insured depository institutions' exposure to other depository institutions.* The Board shall, by regulation or order, prescribe standards that have the effect of limiting the risks posed by an insured depository institution's exposure to any other depository institution.

(c) *"Exposure" defined.* (1) For purposes of subsection (b), an insured depository institution's "exposure" to another depository institution means—

(A) all extensions of credit to the other depository institution, regardless of name or description, including—

(i) all deposits at the other depository institution;

(ii) all purchases of securities or other assets from the other depository institution subject to an agreement to repurchase; and

(iii) all guarantees, acceptances, or letters of credit (including endorsements or standby letters of credit) on

behalf of the other depository institution;

(B) all purchases of or investments in securities issued by the other depository institution;

(C) all securities issued by the other depository institution accepted as collateral for an extension of credit to any person; and

(D) all similar transactions that the Board by regulation determines to be exposure for purposes of this section.

(2) The Board may, at its discretion, by regulation or order, exempt transactions from the definition of "exposure" if it finds the exemptions to be in the public interest and consistent with the purpose of this section.

(3) For purposes of this section, any transaction by an insured depository institution with any person is a transaction with another depository institution to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that other depository institution.

(d) *"Insured depository institution" defined.* For purposes of this section, the term "insured depository institution" has the same meaning as in section 3 of the Federal Deposit Insurance Act.

(e) *Rulemaking authority; enforcement.* The Board may issue such regulations and orders, including definitions consistent with this section, as may be necessary to administer and carry out the purpose of this section. The appropriate Federal banking agency shall enforce compliance with those regulations under section 8 of the Federal Deposit Insurance Act.

[12 USC 371b-2. As added by act of Dec. 19, 1991 (105 Stat. 2362).]