

By order of the Board of Governors of the Federal Reserve System, September 12, 2003.

Jennifer J. Johnson,
Secretary of the Board.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the joint preamble, the Board of Directors of the Federal Deposit Insurance Corporation proposes to amend part 325 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 325—CAPITAL MAINTENANCE

1. The authority citation for part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, as amended by Pub. L. 103–325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102–242, 105 Stat. 2236, 2386, as amended by Pub. L. 102–550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note).

2. In Appendix A to part 325, the following amendments are proposed:

a. Section I.A.1. is revised.

b. In section II.B.5 —

i. Paragraph (a), *Definitions*, is revised.

ii. Paragraph (h), *Limitations on risk-based capital requirements*, and paragraph (i), *Alternative Capital Calculation for Small Business Obligations*, are redesignated as paragraphs (i) and (j) respectively.

iii. A new paragraph (h), *Early amortization triggers*, is added.

iv. A new paragraph (4), is added to the redesignated paragraph (i).

c. Section II.B.6. is revised.

d. In section II.D—

i. The last sentence of the introductory paragraph is removed;

ii. In paragraph 2., *Items With a 50 Percent Conversion Factor*, the four undesignated paragraphs are designated 2.a. through 2.d. and newly designated 2.c. is revised;

iii. In paragraph 3, *Items With a 20 Percent Conversion Factor*, the first undesignated paragraph is designated as 3.a. and a new paragraph 3.b. is added;

iv. The first sentence in paragraph 4., *Items With a Zero Percent Conversion Factor*, is revised.

e. Tables III and IV are removed.

APPENDIX A TO PART 325— STATEMENT OF POLICY ON RISK-BASED CAPITAL

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I. * * *

A. * * *

1. *Core capital elements (Tier 1) consists of:*

i. Common stockholders' equity capital (includes common stock and related surplus, undivided profits, disclosed capital reserves that represent a segregation of undivided profits, and foreign currency translation adjustments, less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values);

ii. Noncumulative perpetual preferred stock,² including any related surplus; and

iii. Minority interests in the equity capital accounts of consolidated subsidiaries.

(a) At least 50 percent of the qualifying total capital base should consist of Tier 1 capital. Core (Tier 1) capital is defined as the sum of core capital elements minus all intangible assets (other than mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships eligible for inclusion in core capital pursuant to § 325.5(f),³ minus credit-enhancing interest-only strips that are not eligible for inclusion in core capital pursuant to § 325.5(f), minus any disallowed deferred tax assets, and minus any amount of nonfinancial equity investments required to be deducted pursuant to section II.B.(6) of this Appendix.

(b) Although nonvoting common stock, noncumulative perpetual preferred stock, and minority interests in the equity capital accounts of consolidated subsidiaries are normally included in Tier 1 capital, voting common stockholders' equity generally will be expected to be the dominant form of Tier 1 capital. Thus, banks should avoid undue reliance on nonvoting equity, preferred stock and minority interests.

(c) Although minority interests in consolidated subsidiaries are generally included in regulatory capital, exceptions to this general rule will be made if the minority interests fail to provide meaningful capital support to the consolidated bank. Such a situation could arise if the minority interests are entitled to a preferred claim on essentially low risk assets of the subsidiary. Similarly, although credit-enhancing interest-only strips and intangible assets in the form of mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships are generally recognized for risk-based capital purposes, the deduction of part or all of the credit-enhancing interest-only strips, mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships may be required if the carrying amounts of these assets are

² Preferred stock issues where the dividend is reset periodically based, in whole or in part, upon the bank's current credit standing, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to Tier 2 capital, regardless of whether the dividends are cumulative or noncumulative.

³ An exception is allowed for intangible assets that are explicitly approved by the FDIC as part of the bank's regulatory capital on a specific case basis. These intangibles will be included in capital for risk-based capital purposes under the terms and conditions that are specifically approved by the FDIC.

excessive in relation to their market value or the level of the bank's capital accounts. Credit-enhancing interest-only strips, mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships and deferred tax assets that do not meet the conditions, limitations and restrictions described in § 325.5(f) and (g) of this part will not be recognized for risk-based capital purposes.

(d) Minority interests in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.(6)(ii) of this appendix A), and subsidiaries that are engaged in nonfinancial activities are not included in the bank's Tier 1 or total capital base if the bank's interest in the company or fund is held under one of the legal authorities listed in section II.B.(6)(ii) of this appendix A. In addition, minority interests in consolidated asset-backed commercial paper programs that are sponsored by a bank are not to be included in the bank's Tier 1 or total capital base if the bank excludes the consolidated assets of such programs from risk-weighted assets pursuant to section II.B.6. of this appendix.

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II. * * *

B. * * *

5. * * *

a. *Definitions*—(1) *Credit derivative* means a contract that allows one party (the "protection purchaser") to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the "protection provider"). The value of a credit derivative is dependent, at least in part, on the credit performance of the "reference asset."

(2) *Credit-enhancing interest only strip* is defined in § 325.2(g).

(3) *Credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

(i) Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1–4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

(ii) Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

(iii) Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.