ended on July 25, 1994. The agencies are reviewing the comments received.

Bilateral Netting Arrangements

In response to industry recommendations, and pursuant to the consultative paper the Basle Supervisors' Committee issued in April, 1993, the staffs of the four agencies in 1994 made uniform proposals to amend their risk-based capital standards to recognize bilateral netting arrangements associated with interest and exchange rate contracts. To qualify for netting treatment, netting arrangements would have to genuinely reduce credit risk and be legally enforceable in all relevant jurisdictions as evidenced by well-founded and reasoned legal opinions. A final rule on this matter was adopted by the Board on December 2, 1994, and the other agencies are expected to issue final rules in the near future.

Derivative Contracts and Recognizing the Effects of Netting on Potential Future Exposure

The agencies worked together on proposing amendments to their respective risk-based capital guidelines that are based on proposed revisions to the Basle Accord that the Basle Supervisors' Committee initiated in July 1994. The Board issued for public comment, on August 22, 1994, a proposed rulemaking that would: (1) increase the capital charge for the potential future counterparty exposure of interest and exchange rate contracts that are over five years in remaining maturity, as well as of equity, precious metals, and other commodity-related contracts; and (2) recognize the effects of bilateral netting arrangements in calculating the potential future exposure for contracts subject to qualifying netting arrangements. The agencies have been coordinating their efforts to review the public comments and to draft final rules on these proposals. The final amendments to the agencies' risk-based capital standards are contingent upon an endorsement by the G–10 Governors of a final revision to the Basle Accord.

Country Transfer Risk

In July 1994, the G–10 Governors announced their intention to modify the Basle Accord in 1995 with regard to country transfer risk. Specifically, it was agreed to revise the definition of the OECD-based group of countries [4] that are accorded a preferential risk weight. The revision would retain the OECD-based group of countries as the principle criterion for preferential risk weight status, but exclude for five years any country that reschedules its external sovereign debt. The Board and the OCC issued a joint notice of proposed rulemaking on October 14, 1994, that seeks public comment on an amendment to their respective risk-based capital guidelines. The FDIC and OTS expect to issue similar proposals in 1995.

Capital Impact of Recent Changes to Accounting Standards

Recently, FASB issued pronouncements concerning new and modified financial accounting standards. The adoption of some of these standards for regulatory reporting purposes had the potential of affecting the definition and calculation of regulatory capital. Accordingly, the staffs of the agencies worked together to propose uniform regulatory capital responses to such accounting changes. Over this past year, the agencies dealt with the accounting issues, described below.

FAS 115, ''Accounting for Certain Investments in Debt and Equity Securities.''

The staffs of the four agencies met this year to discuss the public comments received in response to proposed amendments, issued in 1993 and early 1994, to their respective risk-based capital standards that would include in Tier 1 capital the net unrealized changes in value of securities available for sale for purposes of calculating the risk-based and leverage capital ratios of banking organizations. The proposals, which were in response to the recently adopted FAS 115, also requested comment on several alternative approaches, one of which was to not adopt FAS 115 for capital purposes. On November 10, 1994, the FFIEC recommended to the agencies that they not adopt FAS 115 for capital purposes. Acting on this recommendation, the Board, on November 30, 1994, adopted a final rule effective December 31, 1994. Under the final rule, institutions are generally directed not to include in Tier 1 capital the component of common stockholders' equity, net unrealized holding gains and losses on securities available for sale that was created by FAS 115. The other agencies are expected to issue similar rules in the near future.

FAS 109, ''Accounting for Income Taxes.''

The agencies issued in 1993 proposals to limit the amount of deferred tax assets includable in calculating Tier 1 capital. Under the proposals, certain deferred tax assets are limited to the lesser of 10 percent of Tier 1 capital or the amount of such assets the institution expects to realize in the subsequent year. On November 18, 1994, the FFIEC recommended that the agencies finalize these proposals. The agencies are preparing to issue final rules that will be made effective early in 1995.

FAS 114, ''Accounting by Creditors for Impairment of a Loan.''

On May 17, 1994, the agencies issued a joint request for comment regarding certain implementation issues arising from the agencies' recent adoption for regulatory reporting purposes of FAS 114. FAS 114 presents a methodology for calculating the loan loss reserve for certain loans that is based on present value considerations. Through the FFIEC, the agencies, on November 18, 1994, announced a decision that the current reporting of nonaccrual loans would be maintained and the allowances calculated under FAS 114 are to be reported as part of the general allowance.

Specific Capital Differences

Differences among the risk-based capital standards of the OTS and the three banking agencies are discussed below.

Certain collateralized transactions

On December 23, 1992, the Federal Reserve Board issued an amendment to its risk-based and leverage capital guidelines that lowers from 20 to 0 percent the risk category for collateralized transactions meeting certain criteria. This preferential treatment is only available for claims collateralized by cash on deposit in the bank or by securities issued or guaranteed by OECD central governments or U.S. government agencies. In addition, a positive margin of collateral must be maintained on a daily basis fully taking into account any change in the banking organization's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

As reported in last year's report, the OCC, on August 18, 1993, issued a proposal for public comment that would also lower the risk weight for certain collateralized transactions. At the time of this report, a final rule has not been approved. The FDIC and OTS are considering similar proposals.

Equity Investments

In general, commercial banks that are members of the Federal Reserve System

[4] The OECD-based group of countries currently includes members of the Organization of Economic Cooperation and Development and countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow. Saudi Arabia is the only non-OECD country that has concluded such arrangements.