ii. For purposes of calculating these limitations on mortgage servicing rights and purchased credit card relationships, tier 1 capital is defined as the sum of core capital elements, net of goodwill and all identifiable intangible assets other than mortgage servicing rights and purchased credit card relationships, regardless of the date acquired. This method of calculation could result in mortgage servicing rights and purchased credit card relationships being included in capital in an amount greater than 50 percent—or in purchased credit card relationships being included in an amount greater than 25 percent—of the amount of tier 1 capital used to calculate an institution's capital ratios. In such instances, the Federal Reserve may determine that an organization is operating in an unsafe and unsound manner because of overreliance on intangible assets in tier 1 capital.

iii. Bank holding companies must review the book value of all intangible assets at least quarterly and make adjustments to these values as necessary. The fair market value of mortgage servicing rights and purchased credit card relationships also must be determined at least quarterly. The fair market value generally shall be determined by applying an appropriate market discount rate to the expected future net cash flows. This determination shall include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates or account attrition rates.

iv. Examiners will review both the book value and the fair market value assigned to these assets, together with supporting documentation, during the inspection process. In addition, the Federal Reserve may require, on a case-by-case basis, an independent valuation of an organization's intangible assets.

v. The amount of mortgage servicing rights and purchased credit card relationships that a bank holding company may include in capital shall be the lesser of 90 percent of their fair market value, as determined in accordance with this section, or 100 percent of their book value, as adjusted for capital purposes in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (FR Y–9C Report). If both the application of the limits on mortgage servicing rights and purchased credit card relationships and the adjustment of the balance sheet amount for these intangibles would result in an amount being deducted from capital, the bank holding company would deduct only the greater of the two amounts from its core capital elements in determining tier 1 capital.

vi. The treatment of identifiable intangible assets set forth in this section generally will be used in the calculation of a bank holding company's capital ratios for supervisory and applications purposes. However, in making an overall assessment of an organization's capital adequacy for applications purposes, the Board may, if it deems appropriate, take into account the quality and composition of an organization's capital, together with the quality and value of its tangible and intangible assets.

vii. Consistent with long-standing Board policy, banking organizations experiencing substantial growth, whether internally or by acquisition, are expected to maintain strong capital positions substantially above minimum supervisory levels, without significant reliance on intangible assets.

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3. Appendix A to Part 225 is amended by revising section II.B.4. to read as follows:

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II. * * *

B. * * *

4. *Deferred tax assets.* The amount of deferred tax assets that are dependent upon future taxable income, net of the valuation allowance for deferred tax assets, that may be included in, that is, not deducted from, a banking organization's capital may not exceed the lesser of: (i) the amount of these deferred tax assets that the banking organization is expected to realize within one year of the calendar quarter-end date, based on its projections of future taxable income for that year,[23] or (ii) 10 percent of tier 1 capital. The reported amount of deferred tax assets, net of any valuation allowance for deferred tax assets, in excess of the lesser of these two amounts is to be deducted from a banking organization's core capital elements in determining tier 1 capital. For purposes of calculating the 10 percent limitation, tier 1 capital is defined as the sum of core capital elements, net of goodwill and all identifiable intangible assets other than mortgage servicing rights and purchased credit card relationships, before any disallowed deferred tax assets are deducted. There generally is no limit in tier 1 capital on the amount of deferred tax assets that can be realized from taxes paid in prior carryback years or from future reversals of existing taxable temporary differences.

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4. Appendix D to part 225 is amended by revising section II.b. to read as follows:

Appendix D to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Tier 1 Leverage Measure

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II. * * *

b. A banking organization's tier 1 leverage ratio is calculated by dividing its tier 1 capital (the numerator of the ratio) by its average total consolidated assets (the denominator of the ratio). The ratio will also be calculated using period-end assets whenever necessary, on a case-by-case basis. For the purpose of this leverage ratio, the definition of tier 1 capital for year-end 1992 as set forth in the risk-based capital guidelines contained in Appendix A of this part will be used.[3] As a general matter, average total consolidated assets are defined as the quarterly average total assets (defined net of the allowance for loan and lease losses) reported on the organization's Consolidated Financial Statements (FR Y–9C Report), less goodwill; amounts of mortgage servicing rights and purchased credit card relationships that, in the aggregate, are in excess of 50 percent of tier 1 capital; amounts of purchased credit card relationships in excess of 25 percent of tier 1 capital; all other intangible assets; any investments in subsidiaries or associated companies that the Federal Reserve determines should be deducted from tier 1 capital; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of the limitation set forth in section II.B.4 of this Appendix A.[4]

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By order of the Board of Governors of the Federal Reserve System, July 26, 1995

William W. Wiles,

Secretary of the Board.

Federal Deposit Insurance Corporation

12 CFR Chapter III

For the reasons outlined in the joint preamble, the Board of Directors of the Federal Deposit Insurance Corporation amends 12 CFR chapter III as set forth below.

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these limitations, as well as all other identifiable intangible assets, including core deposit intangibles and favorable leaseholds, are to be deducted from an organization's core capital elements in determining tier 1 capital. However, identifiable intangible assets (other than mortgage servicing rights and purchased credit card relationships) acquired on or before February 19, 1992, generally will not be deducted from capital for supervisory purposes, although they will continue to be deducted for applications purposes.

[23] To determine the amount of expected deferred tax assets realizable in the next 12 months, an institution should assume that all existing temporary differences fully reverse as of the report date. Projected future taxable income should not include net operating loss carryforwards to be used during that year or the amount of existing temporary differences a bank holding company expects to reverse within the year. Such projections should include the estimated effect of tax planning strategies that the organization expects to implement to realize net operating losses or tax credit carryforwards that would otherwise expire during the year. Institutions do not have to prepare a new 12 month projection each quarter. Rather, on interim report dates, institutions may use the future taxable income projections for their current fiscal year, adjusted for any significant changes that have occurred or are expected to occur.

[3] At the end of 1992, tier 1 capital for banking organizations includes common equity, minority interest in the equity accounts of consolidated subsidiaries, qualifying noncumulative perpetual preferred stock, and qualifying cumulative perpetual preferred stock. (Cumulative perpetual preferred stock is limited to 25 percent of tier 1 capital.) In addition, as a general matter, tier 1 capital excludes goodwill; amounts of mortgage servicing rights and purchased credit card relationships that, in the aggregate, exceed 50 percent of tier 1 capital; amounts of purchased credit card relationships that exceed 25 percent of tier 1 capital; all other intangible assets; and deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of certain limitations. The Federal Reserve may exclude certain investments in subsidiaries or associated companies as appropriate.

[4] Deductions from tier 1 capital and other adjustments are discussed more fully in section II.B. in Appendix A of this part.