

Proposed Rules

Federal Register

Vol. 60, No. 232

Monday, December 4, 1995

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Part 250

[Docket No. R-0902]

Transactions With Affiliates

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is proposing to conform the definition of capital stock and surplus for purposes of section 23A of the Federal Reserve Act to the definition of unimpaired capital and unimpaired surplus used in Regulation O and to the definition of capital and surplus used by Office of the Comptroller of the Currency (OCC) in calculating the limit on loans by a national bank to a single borrower. The proposed rule seeks to reduce the burden for member banks and other insured depository institutions monitoring lending to their affiliates.

DATES: Comments must be submitted on or before January 8, 1996.

ADDRESSES: Comments should refer to Docket No. R-0902, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments also may be delivered to the Board's mail room in the Eccles Building between 8:45 am and 5:15 pm weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP 500 of the Martin Building between 9 am and 5 pm weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

FOR FURTHER INFORMATION CONTACT: Pamela G. Nardolilli, Senior Attorney (202/452-3289) Legal Division, or Barbara Bouchard, Supervisory Financial Analyst (202/452-3072), Division of Banking Supervision and Regulation, Board of Governors of the

Federal Reserve System. For users of the Telecommunications Device for the Deaf (TDD) only, please contact Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, regulates certain transactions between insured depository institutions and their affiliates, including transactions between affiliated depository institutions. Section 23A is designed to protect insured depository institutions from abuses that may result from lending and asset purchase transactions with their affiliates. In general, section 23A prohibits an insured depository institution from engaging in covered transactions (which include extensions of credit and purchases of assets) with any single affiliate in excess of 10 percent of the institution's capital stock and surplus. A 20 percent aggregate limit is imposed on the total amount of covered transactions by an insured depository institution with all affiliates. Under section 23A, all extensions of credit between an insured depository institution and its affiliate must meet certain collateral requirements. Section 23A also prohibits an insured depository institution from purchasing any low-quality assets from an affiliate, and requires that all transactions with an affiliate must be conducted on terms that are consistent with safe and sound banking practices. Although section 23A, by its terms, applies only to member banks, the Federal Deposit Insurance Act applies section 23A to all nonmember insured banks (12 U.S.C. 1828 (j)) and the Home Owners' Loan Act applies section 23A to savings associations (12 U.S.C. 1468).

Section 23A does not include an explicit definition of "capital stock and surplus." A 1964 Board interpretation refers to the definition of capital as "the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired" but explicitly excluded debt-like instruments from the definition of capital and surplus. 12 CFR 250.161. In the interpretation, the Board recognized that certain notes and debentures could be considered as capital or capital stock for purposes of membership in the Federal Reserve System, but concluded that for purposes of certain Federal Reserve Act limitations and requirements, such instruments could

not be regarded as part of either capital or capital stock. A subsequent Board interpretation issued in 1971 states that capital stock and surplus, as used in provisions of the Federal Reserve Act, includes reserves for loan losses and valuation reserves for securities. 12 CFR 250.162. As a practical matter, this definition of capital and surplus has been implemented as total equity capital and the allowance for loan and lease losses (ALLL) as set forth in the bank's Report of Condition and Income (Call Report).

Revisions to the Definition of Capital and Surplus

In February 1995, the OCC amended its regulation, 60 FR 8526 (February 15, 1995) (to be codified at 12 CFR 32.2(b)), setting forth lending limits on the amount a national bank may lend to a single counterparty and revised the definition of capital and surplus upon which lending limits are based. In June 1995, the Board amended its Regulation O, 60 FR 31053 (June 13, 1995) (to be codified at 12 CFR 215.2), to revise the definition of unimpaired capital and unimpaired surplus used to limit loans to insiders, to a definition that is consistent with that used for purposes of the OCC's single borrower lending limits to eliminate discrepancies in the definitions of capital used for different lending limit purposes and to reduce regulatory burden for banks monitoring lending to their insiders. Under the revised OCC regulation, capital and surplus is defined as Tier 1 and Tier 2 capital as calculated under the risk-based capital guidelines plus the balance of the allowance for loan and lease losses (ALLL) excluded from Tier 2 capital.¹

The Board is recommending the adoption of a definition of "capital stock and surplus" for purposes of section 23A that is the same as the general capital definitions that are used for Regulation O and the national bank lending limits. Based on June 1995 Call Report data, the revised definition would decrease the limits for

¹ Under the banking agencies' risk-based capital guidelines, Tier 1 capital includes common stock, some noncumulative perpetual preferred stock and related surplus, and minority interest in equity accounts of consolidated subsidiaries. Tier 2 capital includes the ALLL up to 1.25 percent of the bank's weighted risk assets, perpetual preferred stock and related surplus, hybrid capital instruments, and certain subordinated debt.