the FAS 115 unrealized holding gains and losses on available-for-sale securities in financial reports, it also must include any deferred tax effects of these unrealized gains and losses in its determination of the deferred tax asset.

For example, if a bank has an unrealized gain in the available-for-sale portfolio, it must record a deferred tax liability for the taxes that would be due if they sold the assets and realized the gain. On the other hand, if a bank has an unrealized loss in the available-for-sale portfolio, the bank should include the tax benefits from realizing that loss when it records its deferred tax asset.

The OCC and the other banking agencies recently agreed that banks should exclude the net unrealized holding gains and losses on available-for-sale debt securities from regulatory capital calculations. Therefore, it would be consistent to exclude the deferred tax assets and liabilities relating to the FAS 115 gains and losses on available-for-sale debt securities in the calculation of the allowable amount of deferred tax assets for regulatory capital.

It has been argued that failure to eliminate these FAS 115 deferred tax effects would cause a bank to overstate or understate the amount of deferred tax assets disallowed for regulatory capital purposes. For example, a bank with a net unrealized loss in its available-for-sale account would report a related deferred tax asset in its Call Report. If the bank does not remove the deferred tax asset relating to the net unrealized loss, and has net deferred tax assets that exceed the allowable amount stipulated in this final rule, the bank will overstate the amount of deferred tax assets that it must deduct from regulatory capital. Conversely, if the bank has a net unrealized gain on available-for-sale securities, and does not remove its deferred tax effect, the calculation of the limit on deferred tax assets will understate the amount of deferred tax assets the bank must deduct from regulatory capital.

The OCC believes that identifying and removing the deferred tax components that specifically relate to FAS 115 may be very complicated, and in some situations may place significant burden on banks. Therefore, the OCC has decided to allow, but not require, banks to eliminate the FAS 115 deferred tax items before calculating the limit on deferred tax assets. Consequently, a bank that does not want to deal with the complexity of the adjustment can reduce its implementation burden. On the other hand, a bank that wants to achieve greater precision may make such adjustments. Whether or not a bank chooses to adjust for the FAS 115 deferred tax effects, it must apply that approach consistently in future calculations of the limit on deferred tax assets.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. When considered with the change in the reporting of deferred tax assets in the Call Report, this final rule permits banks to include more deferred tax assets in regulatory capital than under previous policy. However, this change will not significantly impact banks of any size.

Executive Order 12866

The OCC has determined that this final rule is not a significant regulatory action under Executive Order 12866.

List of Subjects in 12 CFR Part 3

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set out in the preamble, part 3 of title 12, chapter I, of the Code of Federal Regulations is amended as set forth below.

PART 3—MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1818, 1828(n), 1828 note, 1831n note, 3907, and 3909.

2. Paragraph (a) of § 3.2 is revised to read as follows:

§ 3.2 Definitions.

* * * * *

(a) *Adjusted total assets* means the average total assets figure required to be computed for and stated in a bank's most recent quarterly *Consolidated Report of Condition and Income* (Call Report) minus end-of-quarter intangible assets and deferred tax assets that are deducted from Tier 1 capital. The OCC reserves the right to require a bank to compute and maintain its capital ratios on the basis of actual, rather than average, total assets when necessary to carry out the purposes of this part.

* * * * *

3. In appendix A to part 3, section 1, paragraphs (c)(9) through (c)(29) are redesignated as paragraphs (c)(10) through (c)(30) and a new paragraph (c)(9) is added to read as follows:

Appendix A to Part 3—Risk-Based Capital Guidelines

Section 1. Purpose, Applicability of Guidelines, and Definitions.

* * * * *

(c) * * *

(9) *Deferred tax assets* means the tax consequences attributable to tax carryforwards and deductible temporary differences. Tax carryforwards are deductions or credits that cannot be used for tax purposes during the current period, but can be carried forward to reduce taxable income or taxes payable in a future period or periods. Temporary differences are financial events or transactions that are recognized in one period for financial statement purposes, but are recognized in another period or periods for income tax purposes. Deductible temporary differences are temporary differences that result in a reduction of taxable income in a future period or periods.

* * * * *

4. In appendix A to part 3, section 2, paragraph (c)(1) is revised, a new paragraph heading is added to paragraph (c)(2), paragraph (c)(3) is redesignated as paragraph (c)(4) and a heading is added to newly designated paragraph (c)(4) and the introductory text is revised, and a new paragraph (c)(3) is added, to read as follows:

* * * * *

Section 2. Components of Capital.

* * * * *

(c) * * *

(1) *Deductions from Tier 1 capital.* The following items are deducted from Tier 1 capital before the Tier 2 portion of the calculation is made:

(i) All goodwill subject to the transition rules contained in section 4(a)(1)(ii) of this appendix A;

(ii) Other intangible assets, except as provided in section 2(c)(2) of this appendix A; and

(iii) Deferred tax assets, except as provided in section 2(c)(3) of this appendix A, that are dependent upon future taxable income, which exceed thelesser of either:

(A) The amount of deferred tax assets that the bank could reasonably expect to realize within one year of the quarter-end call report, based on its estimate of future taxable income for that year; or

(B) 10% of Tier 1 capital, net of goodwill and all intangible assets other than purchased mortgage servicing rights and purchased credit card relationships, and before any disallowed deferred tax assets are deducted.

(2) *Qualifying intangible assets.* * * *

(3) *Deferred tax assets*—(i) Net unrealized gains and losses on available-for-sale securities. Before calculating the amount of deferred tax assets subject to the limit in section 2(c)(1)(iii) of this appendix A, a bank may eliminate the deferred tax effects of any net unrealized holding gains and losses on available-for-sale debt securities. Banks report these net unrealized holding gains and losses in their Call Reports as a separate component of equity capital, but exclude them from the definition of common stockholders' equity for regulatory capital