A. The Character of the FAS 114 Allowance

The FFIEC has concluded that FAS 114 sets forth a method for estimating a portion of an institution's allowance for loan and lease losses. Therefore, the regulatory capital treatment of the ALLL for institutions will not be affected by the adoption of FAS 114 for regulatory reporting purposes. Consistent with this determination, the ALLL of institutions will continue to be reported net of any identified losses and will be includible in Tier 2 capital, subject to current limits.

In concluding that the portion of the allowance established pursuant to FAS 114 is general in nature, the FFIEC notes that FAS 114 in no way affects regulatory charge-off policies and is reiterating that these policies require banks to promptly charge-off all identified losses and require thrifts to either promptly charge-off identified losses or provide for them using separate, specific allowances that may not be included in regulatory capital. With respect to impaired collateral-dependent loans, any portion of the loan balance that exceeds the amount that is adequately secured by the fair value of the collateral is generally classified as loss by examiners. Consequently, the FFIEC notes that such losses on collateral-dependent loans are excluded from the general allowance and Tier 2 capital. Because of the conclusions on the treatment of FAS 114 allowances, no changes are required in the agencies' regulatory capital rules. The FFIEC further notes that the portion of the allowance established pursuant to FAS 114 is available to meet losses in any part of the loan and lease portfolio and that institutions currently use a number of techniques in estimating the overall adequacy of their ALLL.

B. Nonaccrual Policies

The FFIEC has also decided to retain its existing nonaccrual policies governing the recognition of interest income. As noted above, FASB has amended FAS 114 by issuing FAS 118 to remove the provisions describing how income on an impaired loan should be reported. Thus, the agencies' nonaccrual standards are not inconsistent with GAAP. Furthermore, as noted in the request for comment included in the **Federal Register** of May 17, 1994, the agencies' nonaccrual policies also provide many supervisory benefits, and retention of nonaccrual policies reduces regulatory burden by permitting institutions to continue their current reporting systems.

Consistent with its determinations with respect to the Call Report, the FFIEC is not recommending any changes to regulatory nonaccrual standards in the 002 Report as a result of FAS 114. Accordingly, current regulatory nonaccrual standards will continue to apply to U.S. branches and agencies of foreign banks.

Dated: February 7, 1995.

Keith J. Todd,

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FEDERAL RESERVE SYSTEM

Federal Open Market Committee; Domestic Policy Directive of December 20, 1994

In accordance with § 271.5 of its rules regarding availability of information (12 CFR part 271), there is set forth below the domestic policy directive issued by the Federal Open Market Committee at its meeting held on December 20, 1994.[1] The directive was issued to the Federal Reserve Bank of New York as follows:

The information reviewed at this meeting suggests a further pickup in economic growth in recent months. Nonfarm payroll employment rose sharply in November, and the civilian unemployment rate declined to 5.6 percent. Industrial production registered another large increase in November and capacity utilization moved up further from already high levels. Retail sales have continued to rise rapidly. Housing starts increased appreciably in November. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been trending higher. The nominal deficit on U.S. trade in goods and services widened somewhat in October from its average rate in the third quarter. Prices of many materials have continued to move up rapidly, but broad indexes of prices for consumer goods and services have increased moderately on average over recent months.

On November 15, 1994, the Board of Governors approved an increase from 4 to 4-3/4 percent in the discount rate, and in line with the Committee's decision the increase was allowed to show through fully to interest rates in reserve markets. In the period since the November meeting, short-term interest rates have risen considerably while long-term rates have declined slightly. The trade-weighted value of the dollar in terms of the other G-10 currencies recovered further over the intermeeting period.

Growth of M2 resumed in November after several months of decline, while M3 expanded moderately further. For the year through November, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months and for the year-to-date it has grown at a rate in the lower half of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated

[1] Copies of the Minutes of the Federal Open Market Committee meeting of December 20, 1994, which include the domestic policy directive issued at that meeting, are available upon request to the Board of Governors of the Federal Reserve System, Washington, D.C. 20551. The minutes are published in the Federal Reserve Bulletin and in the Board's annual report.