air service operations during its Chapter 11 reorganization case, on or before February 16, 2001.

Dorothy Y. Beard,

Federal Register Liaison.

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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket Number 01–02]

Report to the Congress Regarding the Differences in Capital and Accounting Standards Among the Federal Banking and Thrift Agencies

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Report to the Committee on Banking, Housing, and Urban Affairs of the United States Senate and to the Committee on Banking and Financial Services of the United States House of Representatives regarding differences in capital and accounting standards among the federal banking and thrift agencies.

SUMMARY: The Office of the Comptroller of the Currency (OCC) has prepared this report as required by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). FDICIA requires the OCC to provide a report to Congress on any differences in capital standards among the federal financial regulatory agencies. This notice is intended to satisfy the FDICIA requirement that the report be published in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Roger Tufts, Senior Economic Advisor, Office of the Chief National Bank Examiner (202) 874–5070; Louise A. Francis, National Bank Examiner, Office of the Chief Accountant (202) 874–1306; Laura Goldman, Senior Attorney, Legislative and Regulatory Activities Division (202) 874–5090; or Ron Shimabukuro, Senior Attorney, Legislative and Regulatory Activities Division, (202) 874–5090, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

SUPPLEMENTARY INFORMATION:

Differences in Capital and Accounting Standards Among the Federal Banking and Thrift Agencies

Report to the Committee on Banking, Housing, and Urban Affairs of the United States Senate and to the Committee on Banking and Financial Services of the United States House of Representatives, Submitted by the Office of the Comptroller of the Currency

December 2000.

This report [1] describes the differences among the capital requirements of the Office of the Comptroller of the Currency (OCC) and those of the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS).[2] The report is divided into five sections. The first section provides a short overview of the current capital requirements; the second section discusses the differences in the capital standards; the third section briefly discusses recent amendments made by the Agencies to their respective capital standards to promote more consistent capital standards; the fourth section discusses recent interagency proposals; and the fifth section discusses the differences in accounting standards related to capital.

A. Overview of the Risk-Based Capital Standards

1. Credit Risk Component

Since the adoption of the risk-based capital guidelines in 1989, all of the Agencies have applied similar capital standards to the institutions they supervise. The risk-based capital guidelines implement the Accord on International Convergence of Capital Measurement and Capital Standards adopted by the Basel Committee on Banking Supervision (Basel Accord) [3] in July, 1988.

The risk-based capital guidelines establish a framework for imposing capital requirements generally based on credit risk. Under the risk-based capital guidelines, balance sheet assets and off-balance sheet items are categorized, or "risk weighted," according to the relative degree of credit risk inherent in the asset or off-balance sheet item. The risk-based capital guidelines specify four risk-weight categories—zero percent, 20 percent, 50 percent, and 100 percent. Assets or off-balance sheet items with the lowest levels of credit risk are placed in the lowest risk-weight category; those presenting greater levels of credit risk receive a higher risk weight. Thus, for example, securities issued by the U.S. government are risk weighted at zero percent; one- to four-family residential mortgages are risk weighted at 50 percent; and unsecured commercial loans are risk weighted at 100 percent.

Off-balance sheet items must first be translated into an on-balance sheet credit equivalent amount by applying the conversion factors, or multipliers, that are specified in the risk-based capital guidelines of the Agencies. This credit equivalent amount is then assigned to one of the four risk-weight categories. For example, a bank may extend to its customer an unsecured line of credit that the customer may borrow against for up to two years. The unused portion of this two year line of credit—that is, the amount of available credit that the customer has not drawn—is reported as an off-balance sheet item. Under the Agencies' risk-based capital guidelines, this unused portion is translated into an on-balance sheet credit equivalent amount and then assigned a risk weight according to the credit risk of the counterparty.

Once the assets and off-balance sheet items have been risk weighted, the total amount of all risk-weighted assets and off-balance sheet items is used to determine the minimum total amount of capital required for that institution. Specifically, the risk-based capital guidelines of the Agencies require each institution to maintain a ratio of total capital to risk-weighted assets of at least 8 percent. Total capital is comprised of two components—Tier 1 capital (core capital) and Tier 2 capital (supplementary capital). Tier 1 capital includes common stockholders' equity, noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries.

[1] This report is made pursuant to section 37(c) of the Federal Deposit Insurance Act (FDIA). 12 U.S.C. 1831n(c). Section 37(c) was added to the FDIA by section 121 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Pub. L. No. 102–242, 105 Stat. 2236 (December 19, 1991). Section 121 of FDICIA supersedes section 1215 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101–73, 103 Stat. 183 (August 9, 1989), which imposed similar reporting requirements.

[2] The OCC is the primary supervisor of national banks. Bank holding companies and state-chartered banks that are members of the Federal Reserve System are supervised by the FRB. State-chartered nonmember banks are supervised by the FDIC. The OTS supervises savings associations and savings and loan holding companies. In this report, the term "Banking Agencies refers to the OCC, FRB, and the FDIC; the term "Agencies" refers to all four of the agencies, including the OTS.

[3] The Basel Committee on Banking Supervision has issued a consultative paper that describes and solicits views on substantial revisions to the Basel Accord. The paper, entitled "A New Capital Adequacy Framework," was published in June, 1999. Comments were due by March 31, 2000.

Tier 2 capital includes the allowance for loan and lease losses, certain types of preferred stock, some hybrid capital instruments, and certain subordinated debt. Some of the Tier 2 capital instruments, as well as the total amount of Tier 2 capital, are subject to limitations and conditions provided by the risk-based capital guidelines of the Agencies. In addition, the risk-based capital guidelines require the deduction of certain assets from either Tier 1 capital or total capital. Such assets include, for example, goodwill and certain other intangible assets and the amount of some servicing assets in excess of prescribed limits.

In addition to Tier 1 and Tier 2 capital, the risk-based capital guidelines of the Banking Agencies also permit certain banks with significant trading activities to hold limited amounts of Tier 3 capital to satisfy market risk requirements. *See* Section A.2. for a summary of the market risk component.

Institutions generally are expected to hold capital above the required minimum level. In 1999, most national banks, for example, on average had risk-based capital ratios in excess of 11.72. percent. In addition to the risk-based capital requirement, the Agencies also impose a minimum leverage capital requirement, expressed as a percentage of Tier 1 capital to adjusted total assets. Unlike the risk-based capital ratio, the leverage capital ratio is based on total balance sheets assets, not total risk-weighted assets. This means that the leverage capital ratio is computed without regard to risk-weight categories and without including off-balance sheet items.[4]

2. Market Risk Component

In 1996, the Banking Agencies amended their respective risk-based capital standards to take account of market risk. *See* 61 FR 47358 (September 6, 1996).[5] Generally, under the Banking Agencies' market risk rules, banks and bank holding companies with significant trading activities must measure and hold capital for exposure to general market risk and specific market risk. General market risk represents the change in market value of on- and off-balance sheet positions resulting from broad market movements arising from fluctuations in interest rates, equity prices, foreign exchange rates, and commodity prices. Specific market risk refers to changes in the market value of individual positions due to factors other than broad market movements and includes such risk as credit risk of an instrument's issuer.

Under the 1996 market risk rule, an institution measured specific risk through a standardized approach or a valid internal model. The standardized approach uses a risk weighting process that relies on a category-based fixed capital charge. An institution using an internal model, however, faced a burdensome dual calculation of specific risk because it still had to use the standardized approach to determine the minimum specific risk charge. The rules required an institution to hold capital for specific risk at least equal to 50 percent of the specific risk charge calculated using the standardized approach.

In light of advances in the modeling of specific risk, the Banking Agencies concluded that it was not necessary to impose a minimum specific risk charge. As a result, in December 1997, the Banking Agencies issued interim rule that eliminated the minimum specific risk capital charge for certain institutions using a qualifying internal model to measure specific risk. 62 FR 68064 (December 30, 1997) (interim rule with request for comments). The interim rule was adopted in final form, without substantive change, in April, 1999. 64 FR 19034 (April 19, 1999).

3. Interest Rate Risk Component

In 1995, the Banking Agencies amended their respective risk-based capital standards to include an evaluation of interest rate risk, as measured by a change in a bank's exposure to declines in the economic value of its capital as a result of changes in interest rates. 60 FR 39490 (August 2, 1995). The Banking Agencies subsequently issued a joint policy statement that provides guidance on sound practices for managing interest rate risk and sets out standards for evaluating the effectiveness of a bank's interest rate risk management. 61 FR 33166 (June 26, 1996).

The OTS has adopted a regulation that adds an interest rate risk component to its risk-based capital standards. The OTS's regulation differs from the Banking Agencies' rules in that it establishes a standardized measure of interest rate risk and, when fully implemented, will require an explicit capital charge against that risk. The OTS's regulation would require a deduction from capital for thrifts with greater than normal interest rate risk exposure; the amount of the deduction would be one-half the difference between the thrift's actual level of exposure and the normal level of exposure. The OTS has partially implemented this rule by formally reviewing institutions' interest rate risk, but does not currently require thrifts to take deductions from capital.

B. Remaining Differences in Capital Standards of the Agencies

Although the Agencies have adopted common leverage capital requirements and risk-based capital guidelines, a few differences in their respective capital standards remain. These differences are described in this section.

1. Assets Subject To Guarantee Arrangements by the Federal Savings and Loan Insurance Corporation (FSLIC)/Federal Deposit Insurance Corporation

The OCC risk-based capital guidelines assign assets with FDIC guarantees (or guarantees issued by the former FSLIC) to the 20 percent risk-weight category, the same category to which claims on depository institutions and government-sponsored agencies are assigned. The other Banking Agencies also assign these assets to the 20 percent weight category. The OTS assigns these assets to the zero percent risk-weight category.

2. Limitation on Subordinated Debt and Limited-Life Preferred Stock

The OCC limits the amount of Tier 2 capital that may be included in total capital to no more than 100 percent of Tier 1 capital. Consistent with the Basel Accord, under the OCC guidelines, the amount of subordinated debt and limited-life preferred stock included in Tier 2 capital may not constitute more than 50 percent of Tier 1 capital. In addition, the OCC risk-based capital guidelines require that subordinated debt and limited-life preferred stock be discounted 20 percent in each of the five years prior to maturity. The other Banking Agencies have similar rules.

[4] In addition to the risk-based capital guidelines, the Agencies have issued regulations implementing the prompt corrective action (PCA) provisions of the FDICIA. FDICIA requires that the Agencies take certain supervisory actions if an institution's capital declines to unacceptable levels. *See* 12 U.S.C. 1831o. The PCA regulations establish four capital categories that are defined in terms of three separate capital measures (the risk-based capital ratio, the leverage ratio, and the ratio of Tier 1 capital to risk-weighted assets). These four categories are: Well capitalized, adequately capitalized, undercapitalized, and significantly undercapitalized. By way of illustration, an institution is well capitalized if its risk-based capital ratio is 10 percent or greater; its leverage ratio is 5 percent or greater; and its ratio of Tier 1 capital to risk-weighted assets is 6 percent or greater. A fifth PCA category—critically undercapitalized—is defined, as the statute requires, as a 2 percent ratio of tangible equity to total assets. *See* 12 CFR part 6 (1997) (OCC PCA regulations).

[5] Because of differences in portfolio characteristics and permissible activities between banks and thrifts, the OTS did not add a market risk component to its risk-based capital standards.

The OTS risk-based capital rules also limit the amount of Tier 2 capital that may be included in total capital to 100 percent of Tier 1 capital, but do not contain any sublimits on the total amount of limited-life instruments that may be included in Tier 2 capital. In addition, the OTS allows savings associations the option of either (1) discounting maturing capital instruments (issued on or after November 7, 1989) by 20 percent a year over the last five years prior to maturity, or (2) including the full amount of such instruments, provided that the amount maturing in any of the next seven years does not exceed 20 percent of the total capital of the savings association.

3. Subsidiaries Other Than Financial Subsidiaries

Consistent with the Basel Accord, the Banking Agencies generally require that ''significant majority-owned subsidiaries'' [6] be consolidated with the parent institution for both regulatory reporting and capital purposes. If a subsidiary is not consolidated, the bank's investment in the subsidiary constitutes a capital investment in the subsidiary. The OCC risk-based capital guidelines specifically provide that capital investments in an unconsolidated subsidiary must be deducted from the total capital of the bank. The OCC risk-based capital guidelines also permit the OCC to require the deduction of investments in other subsidiaries and associated companies on a case-by-case basis. *See* 12 CFR Part 3, Appendix A, section 2(c)(4)(i).

The FRB risk-based capital guidelines for state member banks generally require the deduction of investments in unconsolidated subsidiaries. The FRB may require an investment in unconsolidated subsidiaries, other than banking and finance subsidiaries or joint ventures and associated companies to be: (1) Deducted, (2) appropriately risk weighted against the proportionate share of the assets of the entity, or (3) consolidated with the entity. In addition, the FRB may require the parent organization to maintain capital above the minimum standard sufficient to compensate for any risks associated with the investment. The FRB risk-based capital guidelines also explicitly permit the FRB to require the deduction of investments in certain subsidiaries that, while consolidated for accounting purposes, are not consolidated for certain specified supervisory or regulatory purposes.

The FDIC similarly requires the deduction of investments in certain types of securities subsidiaries of state-chartered nonmember banks that, while consolidated for accounting purposes, are not consolidated for regulatory capital purposes. Moreover, under the FDIC rules, investments in, and extensions of credit to, certain mortgage banking subsidiaries [7] are also deducted in computing the capital of the parent bank. Neither the OCC nor the FRB has a similar requirement with regard to mortgage banking subsidiaries.

The OTS risk-based capital guidelines make a distinction, mandated by FIRREA, between saving associations subsidiaries engaged in activities permissible for national banks and savings association subsidiaries engaged in activities impermissible for national banks. Similar to the treatment of subsidiaries by the Banking Agencies, subsidiaries of savings associations that engage only in activities permissible for national banks are either consolidated on a line-for-line basis, if majority-owned,[8] or on a *pro rata* basis using the equity method of accounting, if not. The OTS has retained the right to review a savings association's investment in a subsidiary on a case-by-case basis, regardless of the percentage of ownership held by the savings association.

Savings associations' investments in subsidiaries (which include loans to subsidiaries) that engage in national bank-impermissible activities, however, are deducted as a general rule in computing tangible and core capital of the parent association. The remaining assets (the percent of assets corresponding to the nondeducted portion of the investment in the subsidiary) are consolidated with the assets of the parent association.[9]

4. Financial Subsidiaries

The Gramm-Leach-Bliley Act (GLBA) authorizes national banks to conduct certain expanded financial activities through financial subsidiaries. Section 121(a) of the GLBA [10] imposes a number of conditions and requirements upon national banks that have financial subsidiaries, including specifying the treatment that applies for regulatory capital purposes. The statute requires that a national bank deduct from assets and tangible equity the aggregate amount of its equity investments (including retained earnings) in financial subsidiaries. The statute further requires that the financial subsidiary's assets and liabilities not be consolidated with those of the parent national bank. The OCC has issued regulations implementing these requirements, as well as the other requirements that GLBA imposes on national banks that have financial subsidiaries.[11]

State banks that establish financial subsidiaries are also subject to certain requirements. GLBA amends the Federal Deposit Insurance Act to provide that an insured state bank is, among other limitations, subject to the capital deduction and deconsolidation requirements that apply to a national bank if the state bank holds an interest in a subsidiary that is engaging as principal in activities that would only be permissible for a national bank to conduct through a financial subsidiary.[12] Under GLBA a state member bank that holds an interest in any financial subsidiary—whether conducting activities as principal or agent—must comply with all of the

[6] A ''significant majority-owned subsidiary'' is a subsidiary in which the investment by the parent bank represents a significant financial interest of the parent bank as evidenced by one or more of the following: (1) The bank's investment in or advances to the subsidiary equals 5 percent or more of the total equity capital of the bank; (2) the bank's proportional share of the gross income or revenue of the subsidiary equals 5 percent or more of the gross in come or revenue of the bank; (3) the income or loss (before taxes) of the subsidiary amount to 5 percent or more of the income or loss (before taxes) of the bank; or (4) the subsidiary is the parent of a subsidiary that is considered a significant subsidiary. *See* FFIEC, Instructions to the Consolidated Reports of Condition and Income, Glossary A–76a (3–99).

[7] The FDIC capital guidelines define finance subsidiaries as ''any company that is primarily engaged in banking or finance and in which the bank, either directly or indirectly, owns more than 50 percent of the outstanding voting stock but does not consolidate the company for regulatory capital purposes.'' 12 CFR part 325, Appendix A § I(B)(2) note 9.

[8] Instead of referring to an ownership interest of 50 percent or greater, the OTS regulation refers to ownership interests that would not be consolidated under generally accewpted accounting principles (GAAP). Because such ownership interests are generally majority investments, the reference to GAAP would not present a difference in treatment of subsidiaries of Federal savings associations as compared to subsidiaries of other federal banking agencies.

[9] There is one statutory exception to this rule on consolidation for subsidiaries engaging in national bank-impermissible activities. Investments in subsidiary insured depository institutions acquired before May 1, 1989, need not be deducted from the savings association's capital. Investments in such subsidiaries are permanently grandfathered by statute. *See* 12 U.S.C. 1464(t)(5)(C)(ii). A subsidiary insured depository institution is ''itself an insured depository institution or a company the sole investment of which is an insured depository institution.'' 12 U.S.C.. 1464(t)(5)(C)(ii)(I).

[10] GLBA, Pub. L. No. 106–102, § 121, 113 Stat. 1338–1373–81 (November 12, 1999) (codified at 12 U.S.C. 24a).

[11] *See* 65 FR 12905, 12906, 12915 (March 10, 2000) (OCC final rule) (capital deduction and deconsolidation requirements codified at 12 CFR 5.39(h)).

[12] *See* GLBA, § 121(d)(1) (capital deduction and deconsolidation requirement codified at 12 U.S.C. 1831w(a)(2)).

same conditions and limitations that apply to a national bank, including the capital deduction and deconsolidation requirement.[13] The FRB and the FDIC have each issued interim final rules that incorporate these requirements.[14] The GLBA did not provide new authority to savings associations to have financial subsidiaries, so it has not been necessary for the OTS to make similar changes to its regulations.

5. Merchant Banking Activities

The GLBA authorizes financial holding companies to acquire or control shares, assets, or ownership interests of any nonfinancial company as part of a *bona fide* underwriting, or merchant or investment banking activity.[15] The FRB has recently issued a proposed regulation that would apply a 50 percent capital charge at the holding company level, not only to investments made by bank holding companies pursuant to the new merchant banking investment authority, but also to investments made by holding companies—including bank subsidiaries—in small business investment companies (SBICs) pursuant to longstanding authority in the Small Business Investment Act.[16] The Banking Agencies currently apply an 8 percent capital charge to investments in SBICs. Adoption of the FRB regulation as proposed would therefore create a significant difference in the capital requirement that the FRB applies—through its supervision of financial holding company capital—to bank-level investments in SBICs and the capital requirement that the Banking Agencies apply to those same investments. The Agencies currently are discussing this issue in an effort to resolve the potential differences in capital requirements for SBIC investments.

6. Mortgage-Backed Securities (MBS)

The OCC risk-based capital guidelines generally assign a risk weight to privately issued MBSs according to the underlying assets, but in no case is a privately issued MBS assigned to the zero percent risk-weight category. Privately issued MBSs, where the direct underlying assets are mortgages, are generally assigned a risk weight of 50 percent or 100 percent. Privately issued MBSs that have government agency or government-sponsored agency securities as their direct underlying assets are generally assigned to the 20 percent risk-weight category. The other Banking Agencies have similar rules.

Similarly, the OTS assigns privately issued MBSs backed by securities issued or guaranteed by government agencies or government-sponsored enterprises to the 20 percent risk-weight category. Unlike the Banking Agencies, however, the OTS also assigns certain privately-issued high quality mortgage-related securities with AA or better investment ratings to the 20 percent risk-weight category. Like the Banking Agencies, the OTS does not assign any privately issued MBS to the zero percent category.

7. Nonresidential Construction and Land Loans

Under the OCC risk-based capital guidelines, loans for real estate development and construction are assigned to the 100 percent risk-weight category. Reserves or charge-offs are required for such loans when weaknesses or losses develop. The OCC has no requirement for an automatic charge-off when the amount of a loan exceeds the fair value of the property pledged as collateral for the loan. The other Banking Agencies have similar rules.

OTS generally also assigns these loans to the 100 percent risk-weight category. If the amount of the loan exceeds 80 percent of the fair value of the property, however, savings associations must deduct the full amount of the excess portion from total capital.

8. Pledged Deposits and Nonwithdrawable Accounts

Pledged deposits and nonwithdrawable accounts that satisfy specified OTS criteria may be included in core capital by mutual savings associations. Pledged deposits and nonwithdrawable accounts generally represent capital investments in mutual saving associations under the same terms as perpetual noncumulative preferred stock. These mutual saving associations accept capital investments in the form of pledged deposits and nonwithdrawable accounts because mutual associations are not legally authorized to issue common or preferred stock. Income capital certificates and mutual capital certificates that were issued by savings associations under applicable statutory authority and regulations and held by the FDIC may be included in Tier 2 capital by savings associations.

These instruments are unique to savings associations organized in mutual form and are not held by commercial banks. Consequently, these instruments are not addressed in the OCC risk-based capital guidelines.

C. Recent Interagency Amendments to Capital Rules

The following describes the Agencies' most significant recent rulemaking projects.

1. Unrealized Gains and Losses on Securities Available for Sale

Under the Agencies' risk-based capital standards Tier 1 capital is defined to include common stockholders' equity, noncumulative preferred stock, and minority interests in the equity accounts of consolidated subsidiaries. Common stockholders' equity is further defined to include common stock, related surplus, and retained earnings (including capital reserves and adjustments for the cumulative effect of foreign currency translation), less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values.[17] Tier 2 capital is defined, subject to certain limitations and conditions, to include the allowance for loan and lease losses, cumulative perpetual preferred stock and related surplus, convertible preferred stock, and certain other subordinated debt and hybrid capital instruments.

The Basel Accord, however, also permits up to 45 percent of the gross (i.e., pretax) unrealized gains on equity securities to be included in Tier 2 capital. The 55 percent discount applies to the unrealized gains to reflect potential volatility of this form of unrealized capital, as well as the tax liability charges that might be incurred if the unrealized gain were realized or otherwise taxed currently.

On September 1, 1998, the Agencies issued a final rule authorizing this treatment for banks and thrifts. See 63 FR 46518 (September 1, 1998). Specifically, this rule permits institutions to include in Tier 2 capital up to 45 percent of the pretax net unrealized holding gains[18] on certain

[13] *Id.* at § 121(d)(2), amending 12 U.S.C. 335.

[14] *See* 65 FR 14810 (March 20, 2000) (FRB); 65 FR 15526 (March 23, 2000) (FDIC).

[15] GLBA § 103(a), 113 Stat. at 1344 (merchant banking authority codified at 12 U.S.C. 1843(k)(4)(H)).

[16] 65 FR 16480, 16481 (March 28, 2000).

[17] For regulatory capital purposes, institutions record net unrealized gains or losses on available-for-sale securities (debt and equity) in accordance with the Financial Accounting Standard (FAS) 115, which generally requires net unrealized gains and losses on securities available for sale to be included in capital. See Financial Accounting Standards Board, Statement of Financial Accounting Standards Number 115 (Accounting for Certain Investments in Debt and Equity Securities), No. 126–D (May 1993). The FFIEC adopted FAS 115 for regulatory reporting purposes beginning December 14, 1993.

[18] This is the excess amount of the fair value over historical cost as reported in the institution's most recent quarterly regulatory report (e.g., the Consolidated Report of Condition and Income (Call Report) for banks supervised by the OCC, the FRB,

available-for-sale equity securities. The equity securities must be valued in accordance with GAAP and have readily determinable fair values,[19] which the institutions should be able to substantiate. In the event an Agency determines that an institution's available-for-sale equity securities are not prudently valued, the institution may be precluded from including all or a portion of the eligible pretax net unrealized gains on those securities in Tier 2 capital.

2. Servicing Assets

On August 4, 1997, the Agencies issued a joint notice of proposed rulemaking with request for comment on the capital treatment of mortgage and non-mortgage servicing assets. See 62 FR 42006 (August 4, 1997). The Agencies issued the proposed rule in response to FAS 125, which became effective January 1, 1997. FAS 125 required the recording of servicing on all financial assets serviced for others, including loans other than mortgages. See Financial Accounting Standards Board, Statement of Financial Accounting Standards Number 125 (Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities). FAS 125 superseded FAS 122, which had eliminated the accounting distinction between originated mortgage servicing rights (OMSR) and purchased mortgage servicing rights (PMSR). See Financial Accounting Standards Board, Statement of Financial Accounting Standards Number 122 (Accounting for Mortgage Servicing Rights).

The Agencies proposed to increase the amount of mortgage servicing assets (MSAs) (consisting of both OMSRs and PMSRs) included in Tier 1 capital from 50 to 100 percent. The Agencies' proposal also included a requirement that MSAs continue to be subject to a 10 percent valuation discount which permits only the lesser of book value or 90 percent of fair market value to be included in Tier 1 capital. On August 10, 1998, the Agencies published a final rule adopting these and other changes to the risk-based capital treatment of servicing assets. *See* 63 FR 42668 (August 10, 1998).

3. CDRI Act Section 303(a)(2) Capital Amendments

As part of the interagency review of regulations undertaken pursuant to section 303(a)(2) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act),[20] the Agencies adopted joint final rules to eliminate differences in their rules in five areas: leverage capital requirements, construction loans on presold residential properties, junior liens on 1- to 4-family residential properties, and mutual funds. *See* 64 FR 10194 (March 2, 1999). A review of the capital treatment of collateralized transactions was also proposed as part of the section 303(a)(2) CDRI Act review; however, this proposed rule was issued separately and is discussed in section D.2 of this report. *See* 1996 Report at I–6 to I–9.

a. Leverage Capital Requirements

The OCC, together with the Banking Agencies, adopted revisions to their leverage capital requirements to clarify that highly-rated institutions with a CAMELS[21] rating of 1 need only maintain a 3 percent minimum leverage ratio and that all other institutions must maintain a 4 percent minimum leverage ratio. In addition, the OTS amended its leverage capital standard to be consistent with the Banking Agencies by stating that higher-than-minimum capital levels may be required if warranted, and that institutions should maintain capital levels consistent with their risk exposures. *See* 64 FR 10194 (March 2, 1997).

b. Construction Loans on Presold Residential Properties

Under former OCC and OTS rules, loans to a builder to finance the construction of a presold 1- to 4-family residential property could not receive a 50 percent risk weight unless, prior to the extension of credit to the builder, the property was sold to an individual who would occupy the residence upon completion of the construction. In contrast, the Board and FDIC considered this type of construction loan to be eligible for a 50 percent risk weight once the property is sold, regardless of whether the institution made the loan to the builder before or after the individual purchased the residence from the builder.

To permit a uniform treatment of qualifying residential construction loans, the OCC and OTS revised its risk-based capital standards to adopt the Board and FDIC's treatment of these loans. The Agencies now uniformly permit qualifying residential construction loans to be eligible for the 50 percent risk weight category at the time the property is sold, regardless of when the institution made the loan to the builder. *See* 64 FR 10194 (March 2, 1997).

c. Junior Liens on 1- to 4-Family Properties

The Agencies have adopted a uniform risk-based capital treatment of real estate loans secured by junior liens on 1- to 4-family residential properties. The Agencies' former rules were not uniform in their treatment of these junior liens in instances where the lending institution held the first lien and no other party held an intervening lien. The OCC and OTS rules treated all first and junior liens separately, even if the lending institution held both liens and no party held an intervening lien, and risk weighted qualifying first liens which conform to prudent underwriting standards at 50 percent and non-qualifying first liens and all junior liens at 100 percent. In contrast, the FRB and FDIC rules treated the first and junior liens as a single loan secured by a first lien held by the lending institution, provided there were no intervening liens and assigned the combined loan amount to either the 50 percent or 100 percent risk-weight category depending on whether certain criteria are met.

Under the joint final rule, the Agencies adopted the Board's capital treatment of junior liens as the uniform interagency approach. This approach combines first and junior liens as a single exposure and risk weights the combined exposure at either 50 or 100

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or the FDIC; the Thrift Financial Report (TFR) for thrift institutions supervised by the OTS; and the Y–9C Report for bank holding companies supervised by the FRB).

[19] The Agencies intend to rely on the guidance set forth in FAS 115 for purposes of determining whether equity securities have fair values that are "readily determinable."

[20] Pub. L. No. 103–325, § 303, 108 Stat. 2160, 2215 (1994) (codified at 12 U.S.C. 4803). Section 303(a)(2) required that the Agencies "work jointly * * * to make uniform all regulations and guidelines implementing common statutory or supervisory policies." *See also* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the Office of Thrift Supervision, Joint Report: Streamlining of Regulatory Requirements (September 23, 1996) (report submitted by the Agencies to the Congress pursuant to section 303(a)(3) of the CDRI Act; referred to hereafter as the 1996 Report), updated by Joint Report: Update on Review of Regulations and Paperwork Reductions (Section 402 of the Credit Union Membership Access Act) (August 5, 1999).

[21] On December 9, 1996, the Federal Financial Institutions Examination Council (FFIEC) adopted revisions to the Uniform Financial Institutions Rating System (UFIRS). The UFIRS is used by federal and state banking regulators for assessing the soundness of financial institutions on a uniform basis and for identifying those insured institutions requiring special supervisory attention. The condition of each institution is reflected in the "CAMELS" rating, which provides a measure of a bank's Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to market risk. *See* 61 FR 67021 (December 19, 1996).

percent, as appropriate, taking into account the loan-to-value ratio of the combined exposure. To qualify for the 50 percent risk category, the combined loan must be made in accordance with prudent underwriting standards, including an appropriate LTV ratio.[22] In addition, none of the combined loans may be 90 days or more past due, or be in nonaccrual status. Loans that do not meet all of these criteria must be assigned in their entirety to the 100 percent risk category. *See* 64 FR 10194 (March 2, 1997).

d. Mutual Funds

The Agencies have adopted a uniform treatment of an institution's investment in a mutual fund. Under this uniform approach, the Agencies generally assign an institution's total investment in a mutual fund to the risk category appropriate to the highest risk-weighted asset the fund may hold in accordance with its stated investment limits set forth in its prospectus. Alternatively, institutions also have the option of assigning the investment on a pro rata basis to different risk categories according to the investment limits in the fund's prospectus.

Regardless of the risk-weighting method used, the minimum risk weight that may be assigned to such a pool is 20 percent. If an institution assigns the asset on a pro rata basis, and the sum of the investment limits in the fund's prospectus exceeds 100 percent, the institution must assign the highest pro rata amounts of its total investment to the highest risk category. In addition, if a mutual fund is permitted to hold an immaterial amount of highly liquid, high quality securities that do not qualify for a preferential risk weight, then those securities may be disregarded in determining the fund's risk weight. However, if a fund engages in any activities that are deemed to be speculative in nature or has any other characteristics that are inconsistent with the preferential risk-weighting assigned to the fund's assets, the institution's investment in the fund will be assigned to the 100 percent risk-weight category. *See* 64 FR 10194 (March 2, 1997).

[22] Prudent underwriting standards include an appropriate ratio of the loan balance to the value of the property. A loan secured by a one- to four-family residential property is considered prudently underwritten if the loan complies with the Interagency Guidelines for Real Estate Lending. *See, e.g.*, 12 CFR part 34, subpart D (OCC).

D. Recent Interagency Proposals

1. Recourse [23] and Direct Credit Substitutes

As a result of the adoption of GAAP as the reporting basis for Uniform Reports of Condition and Income (Call Reports) in 1997, banks now may remove assets transferred with recourse from their balance sheets if the transfers qualify for sale treatment under GAAP.[24] Prior to the adoption of GAAP, the Banking Agencies' regulatory accounting principles (RAP) precluded banks from removing assets sold with recourse from the bank's balance sheet, thereby requiring them to maintain leverage capital against assets sold with recourse.

The OTS capital rules, however, had previously enabled thrifts to remove assets sold with recourse from their balance sheets when such transactions qualify as sales under GAAP. Consequently, thrifts have not had to hold leverage capital against assets sold with recourse. The Banking Agencies' adoption of GAAP has resolved this difference in the capital treatment of sales with recourse. The Agencies' current risk-based capital guidelines prescribe a single treatment for most assets transferred with recourse, regardless of whether the transaction is reported under GAAP as a financing or a sale of assets.

Direct credit substitutes are arrangements in which an institution assumes the risk of credit loss from assets that it did not originate. The Banking Agencies' current capital rules treat direct credit substitutes and recourse differently.[25] The OTS, however, treats some direct credit substitutes, such as purchased-subordinated interests, under its general recourse provisions and others, such as financial guarantee-type letters of credits, differently than recourse.

On November 5, 1997 and again on March 8, 2000, the Agencies issued proposed rules on the regulatory capital treatment of recourse obligations and direct credit substitutes. The proposed rules would treat direct credit substitutes and recourse obligations consistently and would use credit ratings to match the risk-based capital assessment more closely to a banking organization's relative retention or assumption of credit risk in asset securitizations. *See* 62 FR 59944 (November 5, 1997) and 65 FR 12320 (March 8, 2000). The March 2000 proposed rule also would assess a capital surcharge against banks that sponsor revolving securitizations (*i.e.* credit card securitizations) that contain early amortization features.[26]

2. Collateralized Transactions

The Agencies currently have different rules on the risk weighting of collateralized transactions. Both the OCC and FRB permit certain loans and transactions collateralized by cash and government securities of the Organization for Economic Cooperation and Development (OECD) to qualify for a zero percent risk weight. The FDIC and OTS risk weight loans and transactions collateralized by cash and OECD government securities at 20 percent.

To ensure uniform treatment of collateralized transactions, the Agencies are considering revisions to their capital rules. The FDIC and OTS have proposed to adopt a collateralized transactions rule lowering the risk weight from 20 percent to zero percent on certain loans and transactions collateralized by cash or government securities, while the OCC and FRB propose to revise their current collateralized transactions rule to use more uniform language. *See* 61 FR 42565 (August 16, 1996).

3. Residual Interests

On September 27, 2000, the Agencies issued a proposed rule to amend the regulatory capital treatment of certain residual interests created in asset securitizations or other transfers of financial assets. The proposed rule is

[23] Section 208 of the CDRI Act (12 U.S.C. 1835) prescribes modified risk-based capital requirements for transfers of small business loans or leases of personal property with recourse that are sales under GAAP. This modified risk-based capital treatment generally reduces the amount of capital required to be held by certain qualified institutions for recourse retained in certain transfers of small business loans and leases of personal property. Specifically, section 208 permits such qualified institutions to include in its risk-weighted assets only the amount of the retained recourse, not the full value of assets transferred with recourse, multiplied by the appropriate risk-weight percentage. The Agencies have issued final rules implementing section 208. *See* 60 FR 45612 (August 31, 1995) (FRB final rule); *see also* 62 FR 55490 (October 24, 1997) (OCC, FDIC, and OTS joint final rule).

[24] In their Call Report instructions, the Agencies define recourse as the risk of credit loss an institution retains when it sells an asset.

[25] When an asset is transferred with recourse, risk-based capital must be held against the full amount of the transferred asset (not just the amount of the recourse), subject to the low-level recourse rule. 12 U.S.C. 4808(b)(1). The low-level recourse rule limits the maximum risk-based capital requirement to the bank's maximum contractual obligation. A bank that provides an equivalent direct credit substitute, in contrast, must hold capital only against the face amount of the direct credit substitute.

[26] An early amortization feature requires the sponsor of a securitization to accelerate the paydown of senior securities in a securitization upon the occurrence of triggering events, such as a certain number of defaults or prepayments.

intended to better align regulatory capital requirements with the risk exposure of residual interests, to encourage conservative valuation methods, and to restrict excessive concentrations in these assets. Residual interest are defined to include retained on-balance sheet residual interests, created through the sale of assets, that absorb more than a pro rata share of credit loss through subordination provisions or other credit enhancement techniques. Residual interests, as defined, would include subordinated security interests, cash collateral accounts, interest-only strips, and any other on-balance sheet assets that serve as credit enhancements. The definition of residual interests would exclude those residual interests that do not serve as credit enhancements as well as residual interests purchased by a third party.

The proposed rule would (1) require dollar-for-dollar capital charge against the value of residual interests, even if the amount of capital exceeded the capital charge for the underlying assets supported by the residuals (in effect removing the cap imposed by the low level recourse rule) and (2) include residual interests within the 25 percent of Tier 1 capital sublimit already established for non-mortgage servicing assets and purchased credit card relationships. Any amounts above the sublimit would be deducted from Tier 1 capital. Any residual interests excluded in determining the Tier 1 capital numerator for the leverage and risk-based capital ratios would also be excluded from the denominators of these ratios to avoid double counting. *See* 65 FR 57993 (September 27, 2000).

4. Simplified Capital Framework for Non-Complex Institutions

The Agencies have published an advance notice of proposed rulemaking (ANPR) on a simplified regulatory capital framework for non-complex banking institutions. *See* 65 FR 66193 (November 3, 2000). Currently, banks and thrifts are required to maintain minimum levels of risk-based capital under a framework established by the Basel Accord. However, the Agencies believe that the size, complexity, and risk profile of many banking institutions may warrant the application of a simplified capital framework that could reduce the regulatory burden associated with existing capital standards (or any future modification of those standards). Under such a framework, banks deemed non-complex would be subject to simplified capital requirements.

The ANPR describes non-complex banks as being relatively small in terms of asset size and operations, possessing a relatively simple balance sheet, being principally engaged in traditional banking activities, and not having significant off-balance-sheet exposures. It is also noted that such banks generally have regulatory capital far in excess of the required minimums. The ANPR suggests that in order to be eligible for the non-complex framework a bank should maintain a level of capital sufficiently high such that more precise risk-based measures are not necessary.

The ANPR considers the potential for using the nature of a bank's activities, its asset size, and its risk profile as determinants of eligibility for the simplified regulatory capital framework. Three options for setting minimum regulatory capital requirements for non-complex banks are presented: (1) A risk-based ratio, (2) a simple leverage ratio, and (3) a modified leverage ratio that incorporates certain off-balance-sheet exposures.

5. Securities Borrowing Transactions

The banking agencies have issued an interim rule that revises the market risk capital treatment for certain securities borrowing transactions. See 65 FR 75856 (December 5, 2000). Specifically, the interim rule generally would lower the capital requirements for certain qualifying securities borrowing transactions by permitting the collateralized portion of the securities borrowing transaction to be subject to the market risk capital requirements instead of the risk-based capital requirements. In order to qualify for the lower market risk capital requirement under this joint interim rule, a bank must be subject to the market risk capital requirements and the securities borrowing transaction must result in a receivable that arises from the posting of the cash collateral. Only the portion of the receivable collateralized by the market value of the securities borrowed qualifies for the lower market risk capital requirement; uncollateralized portions must continue to be risk weighted under the risk-based capital guidelines. Moreover, the interim rule only applies to securities borrowing transactions collateralized by cash—securities borrowing transactions collateralized by securities must continue to be risk-weighted according to the securities posted as collateral. In addition, the securities borrowing transaction must satisfy other prudential requirements, including the conditions that the borrowed securities must be marked-to-market daily and the cash collateral must be subject to a daily margin maintenance requirement.

In a typical securities borrowing transaction, a bank will borrow securities from a securities lender and will post collateral in the form of cash or highly marketable securities with the securities lender in an amount that fully covers the value of the securities borrowed plus an additional margin. If cash is posted as collateral, generally accepted accounting principles require the cash to be treated as a loan from the bank to the securities lender. Under the current capital guidelines, the securities borrower must hold capital against the full amount of the loan which would be the standard 100 percent risk weight for nonbank securities lenders. If the collateral is in the form of securities, the risk-based capital charge is based on the capital charge that would be imposed on the securities posted as collateral. The borrowed securities are generally treated as an off-balance sheet item that does not require capital. The banking agencies believe that current capital requirement is inordinately high given the actual risks associated with securities borrowing transactions that are collateralized by cash. The current capital treatment fails to recognize that the bank holding the borrowed securities is at risk only for the amount of the cash collateral posted that exceeds the value of the securities it holds. Moreover, the current capital requirement is inconsistent with the capital requirements imposed by other U.S. and foreign regulators for the same transactions.

E. Interagency Differences in Accounting Principles

The Banking Agencies, under the auspices of the FFIEC, developed Call Reports setting forth the regulatory reporting standards for all commercial banks and FDIC supervised savings banks. In the past, the Call Reports were mostly consistent with GAAP. The instructions to the Call Report required banks to follow GAAP for reports of condition and income filed with the Banking Agencies, except as permitted under section 121 of FDICIA. Section 121 of FDICIA requires financial institutions to use accounting principles ''no less stringent than [GAAP].'' 12 U.S.C. 1831n(a)(2)(B). Although the accounting and reporting requirements imposed by the Banking Agencies were already mostly consistent with GAAP, effective March 1997, the Banking Agencies fully adopted GAAP as the reporting basis for the Call Report.

The OTS requires each savings association to file the Thrift Financial Report. That report requires savings associations to prepare all financial statements included in the report on a basis fully consistent with GAAP. Accordingly, the Banking Agencies' adoption of GAAP for Call Report purposes in 1997 has eliminated the significant differences in regulatory reporting standards between the Agencies.[27]

Dated: December 6, 2000.

John D. Hawke, Jr.,

Comptroller of the Currency.

[FR Doc. 01–2958 Filed 2–2–01; 8:45 am]

BILLING CODE 4810–33–P

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

Submission for OMB Review; Comment Request

January 30, 2001.

The Office of Thrift Supervision (OTS) has submitted the following public information collection requirement(s) to OMB for review and clearance under the Paperwork Reduction Act of 1995, Public Law 104–13. Interested persons may obtain copies of the submission(s) by calling the OTS Clearance Officer listed. Send comments regarding this information collection to the OMB reviewer listed and to the OTS Clearance Officer, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

DATES: Submit written comments on or before March 7, 2001.

OMB Number: 1550–0019.

Form Number: SEC Schedules 13D, 13G, 14A, 14C, 14D–1, and TO; SEC Forms 10, 10–SB, 10–K, 10–KSB, 8, 8–K, 8–A, 12b–25, 10–Q, 10–QSB, 15, 3, 4, 5, and Annual Report.

Type of Review: Regular.

Title: '34 Act Disclosures.

Description: OTS collects periodic disclosure documents required to be filed by savings associations pursuant to the Securities Exchange Act of 1934 on forms promulgated by the U.S. Securities and Exchange Commission for its registrants.

Respondents: Savings and Loan Associations and Savings Banks.

Estimated Number of Responses: 28.

Estimated Burden Hours Per Response: 3,410 hours.

Frequency of Response: Quarterly, Annually, and as required.

Estimated Total Reporting Burden: 95,467 hours.

Clearance Officer: Ralph E. Maxwell, (202) 906–7740, Office of Thrift Supervision, 1700 Street, NW., Washington, DC 20552.

OMB Reviewer: Alexander Hunt, (202) 395–7860, Office of Management and Budget, Room 10202, New Executive Office Building, Washington, DC 20503.

John E. Werner,

Director, Information & Management Services.

[FR Doc. 01–2917 Filed 2–2–01; 8:45 am]

BILLING CODE 6720–01–P

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

Submission for OMB Review; Comment Request

January 30, 2001.

The Office of Thrift Supervision (OTS) has submitted the following public information collection requirement(s) to OMB for review and clearance under the Paperwork Reduction Act of 1995, Public Law 104–13. Interested persons may obtain copies of the submission(s) by calling the OTS Clearance Officer listed. Send comments regarding this information collection to the OMB reviewer listed and to the OTS Clearance Officer, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

DATES: Submit written comments on or before March 7, 2001.

OMB Number: 1550–0035.

Form Number: SEC Forms S–4, S–8, SB–1, SB–2 and OTS Forms PS, OC and G–12.

Type of Review: Regular.

Title: Securities Offerings Disclosure.

Description: OTS collects information for disclosure in securities offerings by savings associations related directly to U.S. Securities and Exchange Commission requirements for offering of information to potential securities purchasers.

Respondents: Savings and Loan Associations and Savings Banks.

Estimated Number of Responses: 38.

Estimated Burden Hours Per Response: 379 hours.

Frequency of Response: Once per filing.

Estimated Total Reporting Burden: 14,402 hours.

Clearance Officer: Ralph E. Maxwell, (202) 906–7740, Office of Thrift Supervision, 1700 Street, NW., Washington, DC 20552.

OMB Reviewer: Alexander Hunt, (202) 395–7860, Office of Management and Budget, Room 10202, New Executive Office Building, Washington, DC 20503.

John E. Werner,

Director, Information & Management Services.

[FR Doc. 01–2918 Filed 2–2–01; 8:45 am]

BILLING CODE 6720–01–P

[27] Differences in reporting standards between the banking agencies and the OTS were eliminated in 1997 in the following areas: sales of assets with recourse, futures and forward contracts, excess servicing fees, offsetting of assets and liabilities, and in-substance defeasance of debt.