DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 3 and 6

[Docket No. 95–18]

RIN 1557–AB14

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Docket No. R–0887]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 325

RIN 3064–AB61

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 565 and 567

[Docket No. 95–140]

RIN 1550–AA84

Capital; Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance

AGENCIES: Office of the Comptroller of the Currency (OCC), Department of the Treasury; Board of Governors of the Federal Reserve System (FRB); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision (OTS), Department of the Treasury.

ACTION: Joint interim rule with request for comments.

SUMMARY: The OCC, FRB, FDIC, and OTS (the Agencies) are amending their capital adequacy standards for banks, bank holding companies, and savings associations (banking organizations) to treat originated mortgage servicing rights (OMSRs) the same as purchased mortgage servicing rights (PMSRs) for regulatory capital purposes. The interim capital rule was developed in response to the Financial Accounting Standards Board's issuance of Statement No. 122, ''Accounting for Mortgage Servicing Rights,'' which eliminates the accounting distinction between OMSRs and PMSRs by requiring OMSRs to be capitalized as balance sheet assets, a treatment previously required only for PMSRs. Under the interim rule, both OMSRs and PMSRs are ''included in'' (i.e., not deducted from) regulatory capital when determining Tier 1 (core) capital for purposes of the Agencies' risk-based and leverage capital standards, and when calculating tangible equity for purposes of prompt corrective action, subject to the regulatory capital limitations that previously applied only to PMSRs. Thus, the effect of the interim rule is to permit OMSRs in regulatory capital, subject to certain limitations.

DATES: The interim rule is effective August 1, 1995. Comments must be received by October 2, 1995.

ADDRESSES: Commenters should respond to their primary federal regulator. All comments will be shared among all of the Agencies.

OCC: Written comments should be submitted to Docket No. 95–18, Communications Division, Ninth Floor, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219, Attention: Karen Carter. Comments will be available for inspection and photocopying at that address.

FRB: Comments should refer to Docket No. R–0887, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. Comments also may be delivered to Room B–2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street NW. (between Constitution Avenue and C Street) at any time. Comments received will be available for inspection in Room MP–500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

FDIC: Written comments shall be addressed to Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429. Comments may be hand delivered to Room F–402, 1776 F Street NW., Washington, DC 20429, on business days between 8:30 a.m. and 5:00 p.m. (Fax number: (202) 898–3838; Internet address: comments@fdic.gov) Comments will be available for inspection at the FDIC's Reading Room, Room 7118, 550 17th Street NW., Washington, DC, between 9:00 a.m. and 4:30 p.m. on business days.

OTS: Send comments to Chief, Dissemination Branch, Records Management and Information Policy, Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552, Attention Docket No. 95–140. These submissions may be hand-delivered to 1700 G Street, N.W. between 9 a.m. and 5 p.m. on business days; they may be sent by facsimile transmission to FAX Number (202) 906–7755. Comments will be available for inspection at 1700 G Street, N.W., from 1:00 p.m. until 4:00 p.m. on business days.

FOR FURTHER INFORMATION CONTACT:
OCC: Christine A. Smith, Esq., Professional Accounting Fellow, (202/874–5180), Roger Tufts, Senior Economic Advisor, (202/874–5070), Office of the Chief National Bank Examiner; Mitchell Stengel, Financial Economist, (202/874–5431), Risk Analysis Division; Ronald Shimabukuro, Senior Attorney, or P. Moni SenGupta, Attorney, (202/874–5090), Legislative and Regulatory Activities Division, Washington, D.C. 20219.

FRB: Arthur W. Lindo, Supervisory Financial Analyst, (202/452–2695) or Thomas R. Boemio, Supervisory Financial Analyst, (202/452–2982), Division of Banking Supervision and Regulation. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202) 452–3544, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551.

FDIC: For supervisory issues, Stephen G. Pfeifer, Examination Specialist, (202/898–8904), Accounting Section, Division of Supervision; for legal issues, Jules E. Bernard, Counsel, (202/898–3731), Legal Division.

OTS: John F. Connolly, Senior Program Manager for Capital Policy, (202/906–6465), or Timothy J. Stier, Assistant Chief Accountant, (202/906–5699), Supervision; Deborah Dakin, Assistant Chief Counsel, (202/906–6445), Regulations and Legislation Division, Office of the Chief Counsel, Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION:

Background

Mortgage servicing rights are the contractual obligations undertaken by an institution to provide servicing for mortgage loans owned by others, typically for a fee. Originated mortgage servicing rights (OMSRs) generally represent the servicing rights acquired when an institution originates mortgage loans and subsequently sells the loans but retains the servicing rights. Purchased mortgage servicing rights (PMSRs) are mortgage servicing rights that have been purchased from other parties.

In May 1995, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 122 (FAS 122), ''Accounting for Mortgage Servicing Rights.'' FAS 122 eliminates the accounting distinction between

OMSRs and PMSRs and the need for companies engaged in mortgage banking to sell OMSRs in order to realize their value for financial statement purposes. FAS 122 specifies that capitalized mortgage servicing rights are to be treated as a single type of asset, regardless of how these rights were acquired. As a result, upon an institution's adoption of FAS 122, both OMSRs and PMSRs must be capitalized as balance sheet assets, a treatment previously permitted only for PMSRs. Both types of mortgage servicing rights may be reported in the same balance sheet asset category. Thus, on a prospective basis, under generally accepted accounting principles (GAAP), there generally will no longer be any significant accounting distinction between OMSRs and PMSRs for reporting, valuation, or disclosure purposes.

Prior to the issuance of FAS 122, GAAP referred to PMSRs as intangible assets. FAS 122 eliminates the reference to PMSRs as intangible assets but does not characterize mortgage servicing rights as either intangible or tangible assets. FAS 122 indicates that no characterization of mortgage servicing rights as either intangible or tangible assets is necessary because similar characterizations are not made for most other assets. However, FAS 122 also indicates that the elimination of the intangible asset reference does not imply that mortgage servicing rights are tangible assets.

FAS 122 requires that mortgage servicing rights be considered impaired whenever their fair value is less than their amortized cost. A valuation allowance is required for the amount of any impairment, which must be measured by stratifying mortgage servicing rights based on one or more of the predominant risk characteristics of the underlying loans. These characteristics may include loan type, size, note rate, date of origination, term and geographic location.

FAS 122 is effective for financial statements prepared in accordance with GAAP for fiscal years beginning after December 15, 1995, although FASB encourages earlier application. On June 21, 1995, the Federal Financial Institutions Examination Council (FFIEC) announced that banks must adopt FAS 122 for purposes of the Reports of Condition and Income (Call Report) as of the same effective date and with earlier application permitted to the extent allowable in this accounting standard. The OTS requires savings associations to follow GAAP for regulatory reporting and, thus, FAS 122's effective date provisions are also applicable for Thrift Financial Report purposes.[1]

Interim Amendments to the Capital Adequacy Guidelines

Banking organizations adopting FAS 122 early could reflect OMSRs on their regulatory reports as soon as June 30, 1995.[2] In view of this implementation schedule, the Agencies are now adopting an interim rule that is effective immediately in order to give banking organizations that adopt FAS 122 early direction on the regulatory capital treatment of OMSRs.

Under the interim rule, for risk-based and leverage capital purposes, mortgage servicing rights, including both PMSRs and OMSRs[3], and purchased credit card relationships (PCCRs) may be included in capital only to the extent that, in the aggregate, they do not exceed 50 percent of Tier 1 (core) capital.[4] For purposes of calculating Tier 1 (core) capital, all mortgage servicing rights are valued—as PMSRs previously were—at the lesser of 90 percent of fair market value or 100 percent of their book value (net of any valuation allowance). In addition, under the interim rule, the amount of mortgage servicing rights that may be included in tangible equity for purposes of prompt corrective action is the same as that permitted in Tier 1 (core) capital.

The Agencies are adopting this interim rule because they believe that the risk characteristics of OMSRs are similar to those of PMSRs. In view of the subjectivity and uncertainty surrounding the valuation of PMSRs and the consequent risks resulting from a high concentration of these assets, the Agencies previously decided to limit the amount of PMSRs that an institution could include in regulatory capital. Therefore, the Agencies believe that it is consistent to limit OMSRs in the same manner as PMSRs, pending a review of the comments received on this interim rule and the Agencies' resulting determination of the appropriate capital treatment of mortgage servicing rights. This interim capital rule is consistent with the recommendations provided on June 21, 1995, to the Agencies by the FFIEC's Task Force on Supervision.

The Agencies are seeking comment on all aspects of this interim rule. The Agencies also request specific comment on the following:

(1) For regulatory capital purposes, the Agencies have considered PMSRs as intangible assets. This determination was based, in part, on the prior GAAP characterization of this asset. FAS 122 indicates indifference toward any characterization of mortgage servicing rights (both PMSRs and OMSRs) as intangible or tangible assets.

(a) Should mortgage servicing rights be viewed as intangible assets for regulatory capital purposes?

(b) If mortgage servicing rights are considered to be intangible assets for regulatory capital purposes, should they continue to be subject to the regulatory capital limitations previously applied only to PMSRs?

(c) If mortgage servicing rights are considered to be tangible assets for regulatory capital purposes, what regulatory capital limitations, if any, should apply?

(2) How should any deferred tax liability associated with PMSRs and OMSRs be treated when calculating a regulatory capital limit?

(3) When an institution originates mortgage loans and swaps them for mortgage-backed securities, including agency guaranteed mortgage-backed securities, FAS 122 requires the institution to attribute a separate cost basis to the loan and servicing right components of such mortgage-backed securities. What is the appropriate regulatory capital treatment of mortgage servicing rights that are associated with mortgage-backed securities that are

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[1] Commercial banks are required to file quarterly Consolidated Reports of Condition and Income (Call Reports) and should report OMSRs and PMSRs in Schedule RC-M (Memoranda), item 6.a., ''Mortgage servicing rights'' and in Schedule RC (Balance Sheet), item 10, ''Intangible assets.'' Bank holding companies with total consolidated assets of $150 million or more file quarterly Consolidated Financial Statements for Bank Holding Companies (FR Y–9C reports) with the Federal Reserve, and should report OMSRs and PMSRs in Schedule HC—Consolidated Balance Sheet, item 10.a., ''Mortgage servicing rights.'' Savings Associations are required to file quarterly Thrift Financial Reports and should report capitalized OMSRs and PMSRs on Thrift Financial Report Schedule SC, line 640, which is currently labeled ''purchased loan servicing rights.''

[2] Banking organizations that do not adopt FAS 122 early may not capitalize OMSRs in 1995 and would not reflect the asset on their regulatory reports. In the interim, such institutions should continue to report PMSRs in accordance with the existing Call Report and Thrift Financial Report instructions until they adopt FAS 122 in 1996.

[3] Due to the 50 percent of Tier 1 (core) capital limitation, it is possible that at least some of the OMSRs an institution reports as balance sheet assets for Call Report and Thrift Financial Report purposes may be required to be deducted in computing regulatory capital under this interim rule. For purposes of determining the amount of any OMSRs that would be deducted (or disallowed) under this 50 percent of Tier 1 (core) capital limitation, institutions may choose to reduce their otherwise disallowed OMSRs by the amount of any associated deferred tax liability. Any such deferred tax liability used in this manner would not be available for the institution to use in determining the amount of any net deferred tax assets that may be included in Tier 1 (core) capital for risk-based and leverage capital purposes.

[4] The 25 percent of Tier 1 (core) capital sublimit on PCCRs is not affected by this rulemaking. In addition, all other intangible assets continue to be fully deducted from capital.

acquired in swap transactions and included in an institution's assets?

Regulatory Flexibility Act Analysis

The Agencies do not believe that the adoption of their interim rule will have a significant economic impact on a substantial number of small business entities (in this case, small banking organizations), in accordance with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). Because of the pre-FAS 122 accounting treatment of OMSRs, no banking organizations—large or small—currently carry any OMSRs, which are the subject of the interim rule, as assets on their balance sheets or include them in capital. The Agencies' interim rule, in combination with the requirement that institutions adopt FAS 122 for regulatory reporting purposes, allows banking organizations to increase their regulatory capital by including OMSRs in assets and Tier 1 (core) capital. This interim rule would only affect those banking organizations that originate and subsequently sell or securitize mortgage loans but retain the servicing rights. In addition, FAS 122 is to be applied prospectively. As a result, OMSRs will only need to be capitalized for those transactions that occur after the date as of which an institution adopts FAS 122. Moreover, because the risk-based and leverage capital guidelines generally do not apply to bank holding companies with consolidated assets of less than $150 million, this proposal will not affect such companies.

OCC and OTS Executive Order 12866 Statement

The Comptroller of the Currency and the Director of the OTS have determined that the interim rule described in this notice is not a significant regulatory action under Executive Order 12866. Accordingly, a regulatory impact analysis is not required.

Paperwork Reduction Act and Regulatory Burden

The Agencies have determined that this interim rule will not increase the regulatory paperwork burden of banking organizations pursuant to the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103–325, 108 Stat. 2160) provides that the federal banking agencies must consider the administrative burdens and benefits of any new regulation that imposes additional requirements on insured depository institutions. The Agencies have found that their interim rule does not impose any additional reporting or recordkeeping burdens. Section 302 also requires such a rule to take effect on the first day of the calendar quarter following final publication of the rule, unless the agency, for good cause, determines an earlier effective date is appropriate. The Agencies have decided that their interim rule should be effective immediately because it provides institutions with information on the regulatory capital treatment for OMSRs that may begin to be reported on the June 30, 1995 Call Report and Thrift Financial Report.

Administrative Procedure Act

Pursuant to section 553 of the Administrative Procedure Act, 5 U.S.C. 553, the Agencies find good cause for issuing this interim rule in advance of the receipt of comments from interested parties and for waiving the 30-day delay of effectiveness provisions of the Administrative Procedures Act. This ''good cause'' determination is based upon institutions' immediate need to know how to treat OMSRs in computing regulatory capital. This guidance is necessary because the Financial Accounting Standards Board, on May 12, 1995, revised the treatment of OMSRs under generally accepted accounting principles by adopting Statement of Financial Accounting Standard No. 122 (FAS 122), ''Accounting for Mortgage Servicing Rights,'' which institutions may adopt beginning in reports prepared as of June 30, 1995. Under FAS 122, OMSRs will be capitalized and included in assets with corresponding increases to an institution's capital base. Prior to the issuance of FAS 122, OMSRs were not capitalized and not recorded on the balance sheet. This interim rule allows institutions that early adopt FAS 122 in their June 30, 1995, regulatory reports to include OMSRs in assets and regulatory capital, subject to certain limitations.

OCC and OTS Unfunded Mandates Act Statement

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104–4 (Unfunded Mandates Act) (signed into law on March 22, 1995) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. As discussed in the preamble, this interim rule, in conjunction with FAS 122, permits OMSRs to be capitalized as balance sheet items, a treatment that was previously only permitted for PMSRs. Under the interim rule, OMSRs will be included in calculating Tier 1 (core) capital for risk-based capital and leverage capital standards subject to the same constraints that are imposed on PMSRs. Thus, no additional cost of $100 million or more, to State, local, or tribal governments or to the private sector will result from this rule. Accordingly, the OCC and the OTS have not prepared a budgetary impact statement nor specifically addressed any regulatory alternatives.

List of Subjects

12 CFR Part 3

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

12 CFR Part 6

Capital, National banks.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Flood insurance, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Bank deposit insurance, Banks, banking, Capital adequacy, Reporting and recordkeeping requirements, Savings associations, State nonmember banks.

12 CFR Part 565

Administrative practice and procedure, Capital, Savings associations.

12 CFR Part 567

Capital, Reporting and recordkeeping requirements, Savings associations.

Authority and Issuance

Office of the Comptroller of the Currency

12 CFR Chapter I

For the reasons set out in the joint preamble, the Office of the Comptroller of the Currency amends 12 CFR chapter I 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, 1835, 3907, and 3909.

2. In part 3, paragraph (c)(2) of § 3.100 is revised to read as follows:

§ 3.100 Capital and surplus.

* * * * *

(c) * * *

(2) Mortgage servicing rights;

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3. In appendix A to part 3, paragraph (c)(13) of section 1 is revised to read as follows:

Appendix A to Part 3—Risk-Based Capital Guidelines

Section 1. Purpose, Applicability of Guidelines, and Definitions

* * * * *

(c) * * *

(13) *Intangible assets* include mortgage servicing rights, purchased credit card relationships (servicing rights), goodwill, favorable leaseholds, and core deposit value.

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4. In appendix A to part 3, paragraphs (c) introductory text, (c)(1), and (c)(3) of section 2 are revised to read as follows:

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Section 2. Components of Capital

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(c) *Deductions From Capital.* The following items are deducted from the appropriate portion of a national bank's capital base when calculating its risk-based capital ratio:

(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 the lesser 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 mortgage servicing rights and purchased credit card relationships, and before any disallowed deferred tax assets are deducted.

(2) *Qualifying intangible assets.* Subject to the following conditions, mortgage servicing rights (originated and purchased) and purchased credit card relationships need not be deducted from Tier 1 capital:

(i) The total of all intangible assets which are included in Tier 1 capital is limited to 50 percent of Tier 1 capital, of which no more than 25 percent of Tier 1 capital can consist of purchased credit card relationships. Calculation of these limitations must be based on Tier 1 capital net of goodwill and other disallowed intangible assets.

(ii) Each intangible asset which is included in Tier 1 capital must be valued at the lesser of:

(A) 90 percent of the fair market value of the intangible asset, determined in accordance with section 2(c)(2)(iii) of this appendix A; or

(B) 100 percent of the remaining unamortized book value of the intangible asset, determined at least quarterly in accordance with the instructions of the Call Report.

(iii) Banks shall determine the current fair market value of each intangible asset included in Tier 1 capital at least quarterly. The quarterly determination of the current fair market value of the intangible asset must include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates. In determining the current fair market value of the intangible asset, the bank shall apply an appropriate market discount rate to the expected net cash flows of the intangible asset.

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6 [Reserved].

PART 6—PROMPT CORRECTIVE ACTION

1. The authority citation for part 6 continues to read as follows:

Authority: 12 U.S.C. 93a, 1831o.

2. In subpart A to part 6, paragraph (g) of § 6.2 is revised to read as follows:

§ 6.2 Definitions.

* * * * *

(g) *Tangible equity* means the amount of Tier 1 capital elements in the OCC's Risk-Based Capital Guidelines (appendix A to part 3 of this chapter) plus the amount of outstanding cumulative perpetual preferred stock (including related surplus) minus all intangible assets except mortgage servicing rights to the extent permitted in Tier 1 capital under section 2(c) in appendix A to part 3 of this chapter.

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Dated: July 21, 1995.

Eugene A. Ludwig,

Comptroller of the Currency.

Federal Reserve System

12 CFR Chapter II

For the reasons outlined in the joint preamble, the Board of Governors of the Federal Reserve System amends 12 CFR Chapter II as set forth below.

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for part 208 is revised to read as follows:

Authority: 12 U.S.C. 36, 248(a), 248(c), 321–338, 371d, 461, 481–486, 601, 611, 1814, 1823(j), 1828(o), 1831o, 1831p–1, 3105, 3310, 3331–3351 and 3906–3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o–4(c) (5), 78q, 78q–l, and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. In § 208.31, paragraph (f) is revised to read as follows:

§ 208.31 Definitions.

* * * * *

(f) *Tangible equity* means the amount of core capital elements in the Board's Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure (Appendix A to this part), plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets except mortgage servicing rights to the extent that the Board determines that mortgage servicing rights may be included in calculating the bank's tier 1 capital.

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3. Appendix A to part 208 is amended by revising section II.B.1.b. to read as follows:

Appendix A to Part 208—Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure

* * * * *

II. * * *

B. * * *

1. * * *

b. *Other intangible assets.* i. The only types of identifiable intangible assets that may be included in, that is, not deducted from, a bank's capital are readily marketable mortgage servicing rights and purchased credit card relationships, provided that, in the aggregate, the total amount of these assets included in capital does not exceed 50 percent of tier 1 capital. Purchased credit card relationships are subject to a separate sublimit of 25 percent of tier 1 capital.[14]

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

[14] Amounts of mortgage servicing rights and purchased credit card relationships in excess of these limitations, as well as all other identifiable intangible assets, including core deposit intangibles and favorable leaseholds, are to be deducted from a bank'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.

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 a bank is operating in an unsafe and unsound manner because of over-reliance on intangible assets in tier 1 capital.

iii. Banks 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 examination process. In addition, the Federal Reserve may require, on a case-by-case basis, an independent valuation of a bank's intangible assets.

v. The amount of mortgage servicing rights and purchased credit card relationships that a bank 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 in the commercial bank Consolidated Reports of Condition and Income (Call Reports). 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 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's capital ratios for supervisory and applications purposes. However, in making an overall assessment of a bank's capital adequacy for applications purposes, the Board may, if it deems appropriate, take into account the quality and composition of a bank's capital, together with the quality and value of its tangible and intangible assets.

vii. Consistent with long-standing Board policy, banks 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.

2. * * *

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4. Appendix A to part 208 is amended by revising section II.B.4. to read as follows:

* * * * *

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 bank's capital may not exceed the lesser of: (i) the amount of these deferred tax assets that the bank is expected to realize within one year of the calendar quarter-end date, based on its projections of future taxable income for that year,[20] 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 bank'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, but, for banks that have a parent, this may not exceed the amount the bank could reasonably expect its parent to refund.

* * * * *

5. Appendix B to part 208 is amended by revising section II.b. to read as follows:

Appendix B to Part 208—Capital Adequacy Guidelines for State Member Banks: Tier 1 Leverage Measure

* * * * *

II. * * *

b. A bank'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.[2] 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 bank's Reports of Condition and Income (Call Reports), 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.[3]

* * * * *

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

1. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p–1, 1843(c)(8), 1844(b), 1972(l), 3106, 3108, 3310, 3331–3351, 3907, and 3909.

2. Appendix A to part 225 is amended by revising section II.B.1.b. to read as follows:

Appendix A to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure

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II. * * *

B. * * *

1.* * *

b. *Other intangible assets.* i. The only types of identifiable intangible assets that may be included in, that is, not deducted from, a organization's capital are readily marketable mortgage servicing rights and purchased credit card relationships, provided that, in the aggregate, the total amount of these assets included in capital does not exceed 50 percent of tier 1 capital. Purchased credit card relationships are subject to a separate sublimit of 25 percent of tier 1 capital.[15]

[20] 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 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.

[2] At the end of 1992, tier 1 capital for state member banks includes common equity, minority interest in the equity accounts of consolidated subsidiaries, and qualifying noncumulative perpetual preferred stock. 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.

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

[15] Amounts of mortgage servicing rights and purchased credit card relationships in excess of

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.

2.* * *

* * * * *

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

* * * * *

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.

* * * * *

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

* * * * *

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]

* * * * *

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.

PART 325—CAPITAL MAINTENANCE

1. The authority citation for part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 3907, 3909, 4808; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, 2386 (12 U.S.C. 1828 note).

2. In § 325.2, paragraph (n) is amended by removing the word ''purchased'' each place it appears and paragraph (s) is revised to read as follows:

§ 325.2 Definitions.

* * * * *

(s) *Tangible equity* means the amount of core capital elements as defined in Section I.A.1. of the FDIC's Statement of Policy on Risk-Based Capital (appendix A to this Part 325), plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets except mortgage servicing rights to the extent that the FDIC determines pursuant to § 325.5(f) of this part that mortgage servicing rights may be included in calculating the bank's Tier 1 capital.

* * * * *

§ 325.5 [Amended]

3. Section 325.5 is amended by removing the words ''purchased mortgage servicing rights'' and adding, in their place, the words ''mortgage servicing rights'' in paragraphs (f), (g)(2)(i)(B), and (g)(5).

Appendix A to Part 325 [Amended]

4. In Appendix A to part 325, remove the words ''purchased mortgage servicing rights'' in footnote 2 to ''Table I—Definition of Qualifying Capital'' and add, in their place, the words ''mortgage servicing rights''.

Appendix B to Part 325 [Amended]

5. In Appendix B to part 325, section IV.A.:

a. Remove the words ''purchased mortgage servicing rights'' and add, in their place, the words ''mortgage servicing rights'' each place they appear in footnote 1 and in the last sentence of the last paragraph; and

b. Remove the words ''purchased servicing intangibles'' and add, in their place, the words ''servicing intangibles'' in the last sentence of the last paragraph.

By order of the Board of Directors.

Dated at Washington, DC, this 21st day of July, 1995.

Federal Deposit Insurance Corporation.

Jerry L. Langley,

Executive Secretary.

Office of Thrift Supervision

12 CFR Chapter V

For the reasons outlined in the joint preamble, the Office of Thrift Supervision hereby amends 12 CFR chapter V as set forth below.

SUBCHAPTER D—REGULATIONS APPLICABLE TO ALL SAVINGS ASSOCIATIONS

PART 565—PROMPT CORRECTIVE ACTION

1. The authority citation for part 565 continues to read as follows:

Authority: 12 U.S.C. 1831o.

2. Section 565.2 is amended by revising paragraph (f) to read as follows:

§ 565.2 Definitions

* * * * *

(f) *Tangible equity* means the amount of a savings association's core capital as defined in part 567 of this subchapter plus the amount of its outstanding cumulative perpetual preferred stock (including related surplus), minus intangible assets as defined in § 567.1(m) of this subchapter and mortgage servicing rights not includable in core capital pursuant to § 567.12 of this subchapter.

* * * * *

PART 567—CAPITAL

1. The authority citation for part 567 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828 (note).

2. Section 567.1 is amended by revising paragraph (m) to read as follows:

§ 567.1 Definitions.

* * * * *

(m) *Intangible assets.* The term *intangible assets* means assets referred to as intangible assets in authoritative literature on generally accepted accounting principles. These intangible assets include, but are not limited to, goodwill, favorable leaseholds, core deposit premiums and purchased credit card relationships. Mortgage servicing rights (either originated or purchased) are not intangible assets under this definition.

* * * * *

3. Section 567.5 is amended by revising paragraphs (a)(2) heading, (a)(2)(i) and (a)(2)(ii) to read as follows:

§ 567.5 Components of capital.

(a) * * *

(2) *Deductions from core capital.* (i) Intangible assets, as defined in § 567.1(m) of this part, are deducted from assets and capital in computing core capital, except as otherwise provided by § 567.12 of this part.

(ii) Mortgage servicing rights (both originated and purchased) that are not includable in tangible and core capital pursuant to § 567.12 of this part are deducted from assets and capital in computing core capital.

* * * * *

4. Section 567.6 is amended by revising paragraphs (a)(1)(iv)(L) and (a)(1)(iv)(M) to read as follows:

§ 567.6 Risk-based capital credit risk-weight categories.

(a) * * *

(1) * * *

(iv) * * *

(L) Mortgage servicing rights and intangible assets includable in core capital pursuant to § 567.12 of this part;

(M) Excess servicing receivables;

* * * * *

5. Section 567.9 is amended by revising paragraph (c)(1) to read as follows:

§ 567.9 Tangible capital requirement.

* * * * *

(c) * * *

(1) Intangible assets, as defined in § 567.1(m) of this part, and mortgage servicing rights (purchased or originated) not includable in core and tangible capital pursuant to § 567.12 of this part.

* * * * *

6. Section 567.12 is amended by revising the section heading and paragraphs (a) through (f) to read as follows:

§ 567.12 Qualifying intangible assets and mortgage servicing rights.

(a) *Scope.* This section prescribes the maximum amount of qualifying intangible assets, as defined in § 567.1(m) of this part, and mortgage servicing rights that savings associations may include in calculating tangible and core capital.

(b) *Definition. Qualifying intangible assets and mortgage servicing rights* means purchased credit card relationships and mortgage servicing rights (both originated and purchased). Mortgage servicing rights (both originated and purchased) may be included (that is, not deducted) in computing core and tangible capital. Purchased credit card relationships may be included in computing core capital, but must be deducted in computing tangible capital. These qualifying intangible assets and mortgage servicing rights may be included in capital only in accordance with the limitations and restrictions set forth in this section. Intangible assets, as defined in § 567.1(m) of this part, other than purchased credit card relationships and core deposit intangibles grandfathered by paragraph (g)(3) of this section, must be deducted in computing tangible and core capital.

(c) *Market valuations.* The OTS reserves the authority to require any savings association to perform an independent market valuation of qualifying intangible assets and mortgage servicing rights on a case-by-case basis or through the issuance of policy guidance. An independent market valuation, if required, shall be conducted in accordance with any policy guidance issued by the OTS. A required valuation shall include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates or attrition rates. The valuation shall determine the current fair market value of the qualifying intangible assets and mortgage servicing rights by applying an appropriate market discount rate to the net cash flows expected to be generated from the qualifying intangible assets and mortgage servicing rights. This independent market valuation may be conducted by an independent valuation expert evaluating the reasonableness of the internal calculations and assumptions used by the association in conducting its internal analysis. The association shall calculate an estimated fair market value for the qualifying intangible assets and mortgage servicing rights at least quarterly regardless of whether an independent valuation expert is required to perform an independent market valuation.

(d) *Value limitation.* For purposes of calculating core capital under this part (but not for financial statement purposes), qualifying intangible assets and mortgage servicing rights must be valued at the lesser of:

(1) 90 percent of their fair market value determined in accordance with paragraph (c) of this section; or

(2) 100 percent of their remaining unamortized book value determined in accordance with the instructions for the Thrift Financial Report.

(e) *Core capital limitation.*—(1) *Aggregate limit.* The maximum aggregate amount of qualifying intangible assets and mortgage servicing rights that may be included in core capital shall be limited to the *lesser* of:

(i) 50 percent of the amount of core capital computed before the deduction of any disallowed qualifying intangible assets or mortgage servicing rights; or

(ii) The amount of qualifying intangible assets and mortgage servicing rights determined in accordance with paragraph (d) of this section.

(2) *Reduction by deferred tax liability.* Associations may elect to reduce the amount of their disallowed (i.e., not includable in capital) originated mortgage servicing rights exceeding the 50 percent aggregate limit by the amount of any associated deferred tax liability.

(3) *Sublimit for purchased credit card relationships.* In addition to the aggregate limitation on qualifying intangible assets and mortgage servicing rights set forth in paragraph (e)(1) of this section, a sublimit shall apply to purchased credit card relationships. The maximum allowable amount of purchased credit card relationships shall be limited to the lesser of:

(i) 25 percent of the amount of core capital computed before the deduction of any disallowed qualifying intangible assets or mortgage servicing rights; or

(ii) the amount of purchased credit card relationships determined in accordance with paragraph (d) of this section.

(f) *Tangible capital limitation.* The maximum amount of mortgage servicing rights that may be included in tangible capital shall be the same amount includable in core capital in accordance with the limitations set by paragraph (e)(1) of this section.

* * * * *

Dated: July 25, 1995.

By the Office of Thrift Supervision.

Jonathan L. Fiechter,

Acting Director.

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