federal register

Thursday
August 31, 1995

Part V

Federal Deposit Insurance Corporation

12 CFR Part 325
Capital Maintenance; Interim Rule

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 325

RIN 3064–AB57

Capital Maintenance

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Interim rule with request for comment.

SUMMARY: The FDIC is amending its capital adequacy standards for FDIC-supervised banks with regard to the regulatory capital treatment of certain transfers with recourse. This amendment is being adopted to implement section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act). Section 208 provides that a qualifying insured depository institution that transfers small business loans and leases on personal property with recourse need include only the amount of retained recourse in its risk-weighted assets when calculating its capital ratios, provided that certain conditions are met. This rule will have the effect of lowering the capital requirements for small business loans and leases on personal property that have been transferred with recourse by qualifying insured depository institutions that are supervised by the FDIC.

DATES: The interim rule is effective August 31, 1995. Comments on this interim rule must be received by October 30, 1995.

ADDRESSES: All comments should be submitted to Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. Comments may be hand delivered to Room F–402, 1776 F Street, N.W., Washington, D.C. 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, N.W., Washington, D.C. between 9:00 a.m. and 4:30 p.m. on business days.

FOR FURTHER INFORMATION CONTACT: For supervisory issues, Stephen G. Pfeifer, Examination Specialist, Accounting Section, Division of Supervision (202/898–8904); for legal issues, Dirck A. Hargraves, Attorney, Legal Division (202/898–7049).

SUPPLEMENTARY INFORMATION:

I. Background

The FDIC's current regulatory capital standards are intended to ensure that insured depository institutions that transfer assets and retain the credit risk inherent in those assets maintain adequate capital to support that risk. This is generally accomplished by requiring that assets transferred with recourse continue to be reported on the institution's balance sheet when the institution files its quarterly Reports of Condition and Income (Call Report) with the FDIC. Thus, these amounts are included in the calculation of the risk-based and leverage capital ratios for FDIC-supervised institutions.

This regulatory reporting and capital treatment differs from how sales of assets with recourse are reported under generally accepted accounting principles (GAAP), which generally permit most such transactions to be reported as sales, thereby allowing the assets to be removed from the balance sheet.[1]

Section 208 of the Riegle Act, which Congress enacted last year, directs the federal banking agencies to revise the current regulatory capital treatment applied to depository institutions engaging in recourse transactions involving small business obligations. Specifically, the Riegle Act indicates that a qualifying insured depository institution that transfers small business loans and leases on personal property with recourse need include only the amount of retained recourse in its risk-weighted assets when calculating its capital ratios, provided two conditions are met. First, the transaction must be treated as a sale under GAAP and, second, the depository institution must establish a non-capital reserve sufficient to meet the institution's reasonably estimated liability under the recourse arrangement. The aggregate amount of recourse retained in accordance with the provisions of the Riegle Act may not exceed 15 percent of an institution's total risk-based capital or a greater amount established by the appropriate federal banking agency. The Act also states that the preferential capital treatment set forth in section 208 is not to be applied for purposes of determining an institution's status under the prompt corrective action statute (section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o) (FDI Act)).

The Riegle Act defines a small business as one that meets the criteria for a small business concern established by the Small Business Administration under section 3(a) of the Small Business Act.[2] This Act also defines a qualifying institution as one that is well capitalized or, with the approval of the appropriate federal banking agency, adequately capitalized, as these terms are set forth in the prompt corrective action statute. For purposes of determining whether an institution is qualifying, its capital ratios must be calculated *without regard* to the preferential capital treatment that section 208 sets forth for small business obligations.

II. Interim Rule

To implement the requirements of section 208 of the Riegle Act, the FDIC is amending its risk-based and leverage capital standards. In general, the FDIC's interim rule reduces the amount of capital that some depository institutions are required to hold against recourse transactions involving small business obligations.

Under the FDIC's interim rule, qualifying institutions that transfer small business obligations with recourse are required to maintain capital only against the amount of recourse retained (rather than against the full amount of assets transferred with recourse), provided two conditions are met. First, the transactions must be treated as sales under GAAP and, second, the transferring institutions must establish, pursuant to GAAP, a non-capital reserve sufficient to meet the reasonably estimated liability under their recourse arrangements. Consistent with section 208 of the Riegle Act, the interim rule applies only to transfers of obligations of small businesses that meet the criteria for a small business as established by the Small Business Administration. The FDIC also notes that the capital treatment specified in section 208 and in this interim rule for transfers of small business obligations with recourse takes

[1] The GAAP treatment focuses on the transfer of benefits rather than the retention of risk and, thus, allows a transfer of receivables with recourse to be accounted for as a sale if the transferor: (1) Surrenders control of the future economic benefits of the assets, (2) is able to reasonably estimate its obligations under the recourse provision, and (3) is not obligated to repurchase the assets except pursuant to the recourse provision. In addition, the transferor must establish a separate liability account equal to the estimated probable losses under the recourse provision (GAAP recourse liability account).

[2] See 15 U.S.C. 631. The Small Business Administration has implemented regulations setting forth the criteria for a small business concern at 13 C.F.R. 121.101 through 121.2106. For most industry categories, the regulation defines a small business concern as one with 500 or fewer employees. For some industry categories, a small business concern is defined in terms of a greater or lesser number of employees or in terms of a specified threshold of annual receipts.

precedence over the capital requirements recently implemented for transactions involving low level recourse (60 FR 15858, March 28, 1995) to the extent that they also involve small business obligations. In this regard, the capital requirements under Section 208 for qualifying institutions that transfer small business obligations with recourse are more preferential than those specified in the low level recourse rule.

The FDIC's interim rule extends the preferential capital treatment for transfers of small business obligations with recourse only to qualifying institutions. An institution will be considered qualifying if, pursuant to the FDIC's prompt corrective action regulation (12 CFR part 325—subpart B),[3] it is well capitalized. By order of the FDIC, a bank that is adequately capitalized also may be deemed a qualifying institution. In determining whether a bank meets the qualifying institution criteria, the well capitalized and adequately capitalized definitions set forth in the FDIC's prompt corrective action regulation will be used, except that the bank's capital ratios must be calculated without taking into consideration the preferential capital treatment the interim rule provides for transfers of small business obligations with recourse.

Under the interim rule, the total outstanding amount of recourse retained by a qualifying institution on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the institution's total risk-based capital.[4] By order, the FDIC may approve a higher limit. If an institution is no longer a qualifying institution (e.g., it becomes less than well capitalized) or exceeds the established limit, the institution will not be able to apply the preferential capital treatment to any new transfers of small business loans and leases of personal property with recourse. However, those transfers of small business obligations with recourse that were completed while the institution was qualified and before it exceeded the established limit of 15 percent of total risk-based capital will continue to receive the preferential capital treatment even if the institution is no longer qualified or the amount of retained recourse on such transfers subsequently exceeds the capital limitation.

Section 208(f) of the Riegle Act provides that the capital of an insured depository institution shall be computed without regard to section 208 when determining whether an institution is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under section 38 of the FDI Act.

The caption to section 208(f), ''Prompt Corrective Action Not Affected'', and the legislative history indicate section 208 was not intended to affect the operation of the prompt corrective action system. See S. Rep No. 103–169, 103d Cong., 1st Sess. 38, 69 (1993). However, the statute does not include ''well capitalized'' in the list of capital categories not affected. The prompt corrective action system under section 38 of the FDI Act deals primarily with imposing corrective sanctions on institutions that are less than adequately capitalized. Therefore, allowing an institution that is adequately capitalized without regard to the section 208 preferential capital treatment to use section 208 for purposes of determining whether the bank is well capitalized generally would not affect the application of the prompt corrective action sanctions to the institution.[5] Other statutes and regulations treat an institution more favorably if it is well capitalized as defined under the prompt corrective action statute, but these provisions are not part of the prompt corrective action system of sanctions. Permitting an institution to be treated as well capitalized for purposes of these other provisions also will not affect the imposition of prompt corrective action sanctions.

There is one provision of the prompt corrective action system that could be affected by treating an institution as well capitalized rather than as adequately capitalized. In this regard, if the institution is in an unsafe and unsound condition or is engaging in an unsafe or unsound practice, § 325.103(d) of the FDIC's regulations (12 CFR 325.103(d)) authorizes the FDIC to: (1) Reclassify a well capitalized institution as adequately capitalized; and (2) require an adequately capitalized institution to comply with certain prompt corrective action provisions as if that institution were undercapitalized. Because the text and legislative history of section 208 of the Riegle Act indicate that it was not intended to affect prompt corrective action sanctions, the FDIC believes that the provisions of section 208 do not affect the capital calculation for purposes of reclassifying an institution from one capital category to a lower capital category, regardless of the bank's capital level.

Thus, in general, an institution may use the capital treatment described in section 208 of the Riegle Act when determining whether it is well capitalized for purposes of prompt corrective action as well as for other regulations that reference the well capitalized capital category.[6] An institution may not use the capital treatment described in section 208 when determining whether it is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized for purposes of prompt corrective action or other regulations that directly or indirectly reference the prompt corrective action capital categories.[7] Furthermore, the

[3] Under 12 CFR Part 325—Subpart B, an institution is deemed to be well capitalized if it: (1) Has a total risk-based capital ratio of 10.0 percent or greater; (2) has a Tier 1 risk-based capital ratio of 6.0 percent or greater; (3) has a leverage ratio of 5.0 percent or greater; and (4) is not subject to any written agreement, order, capital directive or prompt corrective action directive issued by the FDIC pursuant to section 8 of the FDI Act (12 U.S.C. 1818), the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or section 38 of the FDI Act (12 U.S.C. 1831o) or any regulation thereunder, to meet and maintain a specific capital level for any capital measure. An institution is deemed to be adequately capitalized if it: (1) has a total risk-based capital ratio of 8.0 percent or greater; (2) has a Tier 1 risk-based capital ratio of 4.0 percent or greater; (3) has a leverage ratio of 4.0 percent or greater or a leverage ratio of 3.0 percent or greater if the institution is rated composite 1 under the CAMEL rating system in its most recent examination and is not experiencing or anticipating significant growth; and (4) does not meet the definition of a well capitalized institution.

[4] Thus, a transfer of small business loans with recourse that results in a qualifying institution retaining recourse in an amount greater than 15 percent of its total risk-based capital would not be eligible for the preferential capital treatment, even though the institution's amount of retained recourse before the transfer was less than 15 percent of capital.

[5] It is very unlikely but theoretically possible for a bank that is undercapitalized without using the preferential capital treatment in section 208 to become well capitalized if the section 208 capital treatment is applied. Section 208 was not intended to affect prompt corrective action, and allowing an undercapitalized institution (without regard to section 208) to be treated as well capitalized (with regard to section 208) would affect prompt corrective action. The FDIC therefore believes it is inappropriate to allow an undercapitalized institution to use the section 208 preferential capital treatment to become well capitalized for prompt corrective action purposes. Accordingly, such an institution would continue to be treated as undercapitalized for purposes of applying the prompt corrective action sanctions.

[6] An institution that is subject to a written agreement or capital directive as discussed in the FDIC's prompt corrective action regulation would not be considered well capitalized. Also, an institution that is undercapitalized without regard to the preferential Section 208 capital treatment would continue to be treated as undercapitalized for purposes of prompt corrective action (see footnote 5).

[7] Under the provisions of section 208, the capital calculation used to determine whether an institution is well capitalized differs from the calculation used to determine whether an institution is adequately capitalized. As a result, it is possible that an institution could be well capitalized using one calculation (i.e., one that considers the preferential capital treatment under

Continued

capital ratios of an institution are to be determined without regard to the preferential capital treatment described in section 208 of the Riegle Act for purposes of applying the reclassification provisions set forth in § 325.103(d).

Section 208(g) of the Riegle Act directed the federal banking agencies to promulgate final regulations implementing section 208 not later than 180 days after the date of the statute's enactment—that is, not later than March 22, 1995. It can be fairly implied from the statutory directive that Congress intended for qualifying institutions to reap the benefits of the Section 208 capital treatment no later than March 22, 1995. In order to meet the spirit of the statute, the FDIC will raise no objection if an FDIC-supervised bank that is a qualifying institution under the interim rule hereafter chooses to apply the provisions of this interim rule to small business obligations that were transferred with recourse between March 22, 1995, and the effective date of this interim rule.

The FDIC also notes that section 208(a) of the Riegle Act provides that accounting principles applicable to the transfer of small business obligations with recourse contained in reports or statements required to be filed with the Federal banking agencies by a qualified insured depository institution shall be consistent with GAAP.[8] The FDIC, in consultation with the other agencies and under the auspices of the Federal Financial Institutions Examination Council, intends to ensure that appropriate revisions are made to the Call Report and the Call Report instructions to implement Section 208(a) of the Riegle Act.

The FDIC is seeking comments on all aspects of this interim rule.

section 208) and adequately capitalized using the other (i.e., one that is calculated ''without regard'' to section 208). In this situation, the institution would be considered well capitalized. This preferential capital treatment will be applied in a similar fashion for purposes of determining whether an institution is well capitalized under the FDIC's brokered deposit (12 CFR 337.6) and insurance assessment (12 CFR part 327) regulations. These rules have definitions for well capitalized and adequately capitalized institutions that employ the same capital ratios that are used in the FDIC's prompt corrective action regulation.

[8] Transfers of small business obligations with recourse that are consummated at a time when the transferring institution does not qualify for the preferential capital treatment will continue to be reported in accordance with the instructions of the Consolidated Reports of Condition and Income (Call Reports) for sales of assets with recourse. These instructions generally require banks transferring assets with recourse to continue to report the assets on their balance sheets.

III. Regulatory Flexibility Act

This interim rule reduces the regulatory capital requirement on transfers with recourse of small business loans and leases on personal property and there will be no adverse economic effect on small business entities from the adoption of this interim rule.

The Board of Directors of the FDIC hereby certifies that adoption of this amendment to part 325 will not have a significant economic impact on a substantial number of small business entities within the meaning of the Regulatory Flexibility Act requirements (5 U.S.C. 601 et seq.).

This amendment will not necessitate the development of sophisticated recordkeeping or reporting systems by small institutions nor will small institutions need to seek out the expertise of specialized accountants, lawyers, or managers to comply with this regulation. In light of this certification, the Regulatory Flexibility Act requirements (at 5 U.S.C. 603, 604) to prepare initial and final regulatory flexibility analyses do not apply.

IV. Administrative Procedure Act

Section 208(g) of the Riegle Act requires that the federal bank regulatory agencies promulgate final rules implementing Section 208 no later than March 22, 1995. The FDIC Board of Directors (Board) has determined that the notice and public participation that are ordinarily required by the Administrative Procedure Act (5 U.S.C. 553) before a regulation may take effect would, in this case, be impracticable due to the time constraints imposed by Section 208(g). In addition, in the Board's view, advanced public notice and comment is unnecessary, as the interim rule merely restates the statute. Further, the interim rule would permit qualifying institutions to reduce their capital levels, thereby providing these institutions with greater lending flexibility. Consequently, the added delay that would result from seeking advanced notice and public participation could potentially adversely impact credit availability.

The interim rule will be immediately effective upon publication in the **Federal Register**. This action is being taken pursuant to section 553(d) of the Administrative Procedure Act which permits the waiver of the 30-day delayed effective date requirement for good cause and/or where a rule relieves a restriction. The Board views the limitations of time and the potential loss of benefit to affected parties during the pendency of this rulemaking as good cause to waive the customary 30-day delayed effective date. In addition, as the rule relieves a restriction, the 30-day delayed effective date may be waived. Nevertheless, the Board desires to have the benefit of public comment before adoption of a permanent final rule on this subject. Accordingly, the Board invites interested persons to submit comments during a 60-day comment period. In adopting a final regulation, the Board will make such revisions to the interim rule as may be appropriate based on the comments received on the interim rule.

V. Paperwork Reduction Act and Regulatory Burden

The FDIC has determined that this interim rule will not increase the regulatory paperwork burden of state nonmember banks pursuant to the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 et seq.). Consequently, no information has been submitted to the Office of Management and Budget for review.

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103–325, 108 Stat. 2160) requires that new regulations and amendments to regulations which impose additional reporting, disclosures, or other new requirements take effect on the first day of the calendar quarter following publication of the rule unless, among other things, the agency determines, for good cause, that the regulation should become effective on a day other than the first day of the next quarter. The FDIC believes that an immediate effective date is appropriate since the interim rule relieves a regulatory burden on qualifying FDIC-supervised institutions that transfer small business obligations with recourse by significantly reducing the capital requirements on such obligations. This immediate effective date will permit qualifying institutions to reduce the amount of capital they must maintain to support the risk retained in these sales. Moreover, the FDIC does not anticipate that immediate application of the rule will present a hardship to qualifying institutions in terms of compliance. Also, there is a statutory requirement for the banking agencies to promulgate final regulations implementing the provisions of section 208 by March 22, 1995. For these reasons, the FDIC has determined that an immediate effective date is appropriate.

List of Subjects in 12 CFR Part 325

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

For the reasons set forth in the preamble, the Board of Directors of the Federal Deposit Insurance Corporation amends part 325 of title 12 of the Code of Federal Regulations as follows:

PART 325—CAPITAL MAINTENANCE

1. The authority citation for Part 325 is revised 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, 1835, 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 part 325, § 325.3 is amended by adding a new paragraph (e) to read as follows:

§ 325.3 Minimum leverage capital requirement.

* * * * *

(e) *Small business loans and leases on personal property transferred with recourse.* (1) Notwithstanding other provisions of this part, for purposes of calculating its leverage ratio, a qualifying institution that has transferred small business loans and leases on personal property (small business obligations) with recourse shall exclude from its total assets the outstanding principal amount of the loans and leases transferred with recourse, provided two conditions are met. First, the transaction must be treated as a sale under generally accepted accounting principles (GAAP) and, second, the qualifying institution must establish pursuant to GAAP a non-capital reserve sufficient to meet the institution's reasonably estimated liability under the recourse arrangement. Only loans and leases to businesses that meet the criteria for a small business concern established by the Small Business Administration under section 3(a) of the Small Business Act (12 U.S.C. 631) are eligible for this capital treatment.

(2) For purposes of this part, a qualifying institution is a bank that is well capitalized. In addition, by order of the FDIC, a bank that is adequately capitalized may be deemed a qualifying institution. In determining whether a bank meets the qualifying institution criteria, the prompt corrective action well capitalized and adequately capitalized definitions set forth in § 325.103 shall be used, except that the bank's capital ratios must be calculated *without regard* to the preferential capital treatment for transfers of small business obligations with recourse specified in paragraph (e)(1) of this section. The total outstanding amount of recourse retained by a qualifying institution on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the institution's total risk-based capital. By order, the FDIC may approve a higher limit.

(3) If a bank ceases to be a qualifying institution or exceeds the 15 percent of capital limit under paragraph (e)(2) of this section, the preferential capital treatment will continue to apply to any transfers of small business obligations with recourse that were consummated during the time the bank was a qualifying institution and did not exceed such limit.

(4) The leverage capital ratio of a bank shall be calculated *without regard* to the preferential capital treatment for transfers of small business obligations with recourse specified in paragraph (e)(1) of this section for purposes of:

(i) Determining whether a bank is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under the prompt corrective action capital category definitions specified in § 325.103; and

(ii) Applying the prompt corrective action reclassification provisions specified in § 325.103(d), regardless of the bank's capital level.

* * * * *

3. Appendix A to part 325 is amended by adding a new paragraph 6 to section II.B. to read as follows:

Appendix A to Part 325—Statement of Policy on Risk-Based Capital

* * * * *

II. * * *

B. * * *

6. *Small Business Loans and Leases on Personal Property Transferred with Recourse.*—(a) Notwithstanding other provisions of this appendix A, a qualifying institution that has transferred small business loans and leases on personal property (small business obligations) with recourse shall include in risk-weighted assets only the amount of retained recourse, provided two conditions are met. First, the transaction must be treated as a sale under generally accepted accounting principles (GAAP) and, second, the qualifying institution must establish pursuant to GAAP a non-capital reserve sufficient to meet the institution's reasonably estimated liability under the recourse arrangement. Only loans and leases to businesses that meet the criteria for a small business concern established by the Small Business Administration under section 3(a) of the Small Business Act are eligible for this capital treatment.

(b) For purposes of this appendix A, a qualifying institution is a bank that is well capitalized. In addition, by order of the FDIC, a bank that is adequately capitalized may be deemed a qualifying institution. In determining whether a bank meets the qualifying institution criteria, the prompt corrective action well capitalized and adequately capitalized definitions set forth in § 325.103 shall be used, except that the bank's capital ratios must be calculated *without regard* to the preferential capital treatment for transfers of small business obligations with recourse specified in section II.B.6.(a) of this appendix A. The total outstanding amount of recourse retained by a qualifying institution on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the institution's total risk-based capital. By order, the FDIC may approve a higher limit.

(c) If a bank ceases to be a qualifying institution or exceeds the 15 percent of capital limit under section II.B.6.(b) of this appendix A, the preferential capital treatment will continue to apply to any transfers of small business obligations with recourse that were consummated during the time the bank was a qualifying institution and did not exceed such limit.

(d) The risk-based capital ratios of a bank shall be calculated *without regard* to the preferential capital treatment for transfers of small business obligations with recourse specified in paragraph (a) of this section for purposes of:

(i) Determining whether a bank is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under the prompt corrective action capital category definitions specified in § 325.103; and

(ii) Applying the prompt corrective action reclassification provisions specified in § 325.103(d), regardless of the bank's capital level.

* * * * *

By the order of the Board of Directors.

Dated at Washington, D.C. this 25th day of August, 1995.

Federal Deposit Insurance Corporation.

Jerry L. Langley,

Executive Secretary.

[FR Doc. 95–21567 Filed 8–30–95; 8:45 am]

BILLING CODE 6714–01–P