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APPENDIX B TO PART 208—CAPITAL ADEQUACY GUIDELINES FOR STATE MEMBER BANKS: TIER 1 LEVERAGE MEASURE

I. OVERVIEW

a. The Board of Governors of the Federal Reserve System has adopted a minimum ratio of tier 1 capital to total assets to assist in the assessment of the capital adequacy of state member banks.[1] The principal objective of this measure is to place a constraint on the maximum degree to which a state member bank can leverage its equity capital base. It is intended to be used as a supplement to the risk-based capital measure.

b. The guidelines apply to all state member banks on a consolidated basis and are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. The Board will review the guidelines from time to time and will consider the need for possible adjustments in light of any significant changes in the economy, financial markets, and banking practices.

II. THE TIER 1 LEVERAGE RATIO

a. The minimum ratio of Tier 1 capital to total assets for strong banking institutions (rated composite ''1'' under the UFIRS rating system of banks) is 3.0 percent. For all other institutions, the minimum ratio of Tier 1 capital to total assets is 4.0 percent. Banking institutions with supervisory, financial, operational, or managerial weaknesses, as well as institutions that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels. Moreover, higher capital ratios may be required for any banking institution if warranted by its particular circumstances or risk profile. In all cases, institutions should hold capital commensurate with the level and nature of the risks, including the volume and severity of problem loans, to which they are exposed.

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 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 assets, nonmortgage servicing assets, and purchased credit card relationships that, in the aggregate, are in excess of 100 percent of Tier 1 capital; amounts of nonmortgage servicing assets and purchased credit card relationships that, in the aggregate, are in excess of 25 percent of Tier 1 capital; amounts of credit-enhancing interest-only strips that are in excess of 25 percent of Tier 1 capital; all other identifiable intangible assets; any investments in subsidiaries or associated companies that the Federal Reserve determines should be deducted Tier 1 capital; deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of the limitations set forth in section II.B.4 of appendix A of this part; and the amount of the total adjusted carrying value of nonfinancial equity investments that is subject to a deduction from Tier 1 capital.[3]

c. Notwithstanding other provisions of this appendix B, a qualifying bank that has transferred small business loans and leases on personal property (small business obligations) with recourse shall, for purposes of calculating its tier 1 leverage ratio, exclude from its average total consolidated assets the outstanding principal amount of the small business 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 bank

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[1] Supervisory risk-based capital ratios that related capital to weighted-risk assets for state member banks are outlined in Appendix A to this part.

[2] 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 assets, nonmortgage servicing assets, and purchased credit card relationships that, in the aggregate, exceed 100 percent of Tier 1 capital; nonmortgage servicing assets and purchased credit card relationships that, in the aggregate, exceed 25 percent of Tier 1 capital; amounts of credit enhancing interest-only strips in excess of 25 percent of Tier 1 capital; other identifiable intangible assets; deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of certain limitations; and a percentage of the bank's nonfinancial equity investments. The Federal Reserve may exclude certain other 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.

must establish pursuant to GAAP a non-capital reserve sufficient to meet the bank'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.

d. For purposes of this appendix B, a bank is qualifying if it meets the criteria set forth in the Board's prompt corrective action regulation (12 CFR 208.40) for well capitalized or, by order of the Board, adequately capitalized. For purposes of determining whether a bank meets these criteria, its capital ratios must be calculated without regard to the preferential capital treatment for transfers of small business obligations with recourse specified in section II.c. of this appendix B. The total outstanding amount of recourse retained by a qualifying bank on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the bank's total risk-based capital. By order, the Board may approve a higher limit.

e. If a bank ceases to be qualifying or exceeds the 15 percent capital limitation, the preferential capital treatment will continue to apply to any transfers of small business obligations with recourse that were consummated during the time that the bank was qualifying and did not exceed the capital limit.

f. The leverage capital ratio of the bank shall be calculated without regard to the preferential capital treatment for transfers of small business obligations with recourse specified in section II of this appendix B for purposes of:

(i) Determining whether a bank is adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized under prompt corrective action (12 CFR 208.43(b)(1)); and

(ii) Reclassifying a well capitalized bank to adequately capitalized and requiring an adequately capitalized bank to comply with certain mandatory or discretionary supervisory actions as if the bank were in the next lower prompt corrective action capital category (12 CFR 208.43(c)).

g. Whenever appropriate, including when a bank is undertaking expansion, seeking to engage in new activities or otherwise facing unusual or abnormal risks, the Board will continue to consider the level of an individual bank's tangible tier 1 leverage ratio (after deducting all intangibles) in making an overall assessment of capital adequacy. This is consistent with the Federal Reserve's risk-based capital guidelines an long-standing Board policy and practice with regard to leverage guidelines. Banks experiencing growth, whether internally or by acquisition, are expected to maintain strong capital position substantially above minimum supervisory levels, without significant reliance on intangible assets.

[Reg. H, 59 FR 65925, Dec. 22, 1994, as amended at 60 FR 39230, Aug. 1, 1995; 60 FR 45615, Aug. 31, 1995; 63 FR 42675, Aug. 10, 1998; 63 FR 58621, Nov. 2, 1998; 64 FR 10200, Mar. 2, 1999; 66 FR 59643, Nov. 29, 2001; 67 FR 3800, Jan. 25, 2002]

APPENDIX C TO PART 208—INTERAGENCY GUIDELINES FOR REAL ESTATE LENDING POLICIES

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements.[1] These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and scope of its individual operations, as well as satisfies the requirements of the regulation.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

LOAN PORTFOLIO MANAGEMENT CONSIDERATIONS

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should:

- Identify the geographic areas in which the institution will consider lending.
- Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher risk loans).
- Identify appropriate terms and conditions by type of real estate loan.

[1] The agencies have adopted a uniform rule on real estate lending. See 12 CFR part 365 (FDIC); 12 CFR part 208, subpart E (FRB); 12 CFR part 34, subpart D (OCC); and 12 CFR 563.100–101 (OTS).