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participation. This result is based upon the language of the statute which includes within a covered bank's limits on eligible BAs outstanding the amount of participations received by the covered bank. This provision reflects Congressional intent that a covered bank not be obligated on eligible bankers' acceptances, and participations therein, for an amount in excess of 150 or 200 percent of the institution's capital.

(c) The statute also provides that eligible acceptances growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for covered banks. The Board has clarified that this 50 percent limitation is applicable to the maximum permissible amount of eligible BAs (150 or 200 percent of capital), regardless of the bank's amount of eligible acceptances outstanding. The statutory language prior to the BESA amendment made clear that covered banks could issue eligible acceptances growing out of domestic transactions up to 50 percent of the amount of the total permissible eligible acceptances the bank could issue. The legislative history of the BESA indicates no intent to change this domestic acceptance limitation.

(d) The statute also provides that for the purpose of the limitations applicable to U.S. branches and agencies of foreign banks, a branch's or agency's capital is to be calculated as the dollar equivalent of the capital stock and surplus of the parent foreign bank as determined by the Board. The Board has clarified that for purposes of calculating the BA limits applicable to U.S. branches and agencies of foreign banks, the identity of the parent foreign bank is generally the same as for reserve requirement purposes; that is, the bank entity that owns the branch or agency most directly. The Board has also clarified that the procedures currently used for purposes of reporting to the Board on the Annual Report of Foreign Banking Organizations, Form FR Y–7, are also to be used in the calculation of the acceptance limits applicable to U.S. branches and agencies of foreign banks. (The FR Y–7 generally requires financial statements prepared in accordance with local accounting practices and an explanation of the accounting terminology and the major features of the accounting standards used in the preparation of the financial statements.) Conversions to the dollar equivalent of the worldwide capital of the foreign bank should be made periodically, but in no event less frequently than quarterly. In this regard, the Board recognizes the need to be flexible in dealing with the effect of foreign exchange rate fluctuations on the calculation of the worldwide capital of the parent foreign bank. Each foreign bank is to be responsible for coordinating the BA activity of its U.S. branches and agencies (including the aggregation of such activity) and establishing procedures that ensure that examiners will be able readily to determine compliance with the BESA limits.

(Sec. 13, Federal Reserve Act (12 U.S.C. 372))

[48 FR 28975, June 24, 1983]

§ 250.165 Bankers' acceptances: definition of participations.

(a)(1) Section 207 of the Bank Export Services Act (Title II of Pub. L. 97–290) (''BESA'') raised the limits on the aggregate amount of eligible bankers' acceptances (''BAs'') that may be created by a member bank from 50 percent (or 100 percent with the permission of the Board) of its paid up and unimpaired capital stock and surplus (''capital'') to 150 percent (or 200 percent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 percent of the institution's capital. Eligible BAs growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for a member bank. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105). [1]

(2) This section of the BESA also provides that any portion of an eligible BA

[1] The institutions subject to the BA limitations of BESA will hereinafter be referred to as ''covered banks.''

created by a covered bank (''senior bank'') that is conveyed through a ''participation agreement'' to another covered bank (''junior bank'') shall *not* be included in the calculation of the senior bank's bankers' acceptance limits established by section 207 of BESA.[2] However, the amount of the participation *is* to be included in the BA limits applicable to the junior bank. The language of the statute does not define what constitutes a participation agreement for purposes of the applicability of the BESA limitations. However, the statute does authorize the Board to further define any of the terms used in section 207 of the BESA (12 U.S.C. 372(g)). The Board is clarifying the term participation for purposes of the BA limitations of the BESA.

(b) The legislative history of section 207 of the BESA indicates that Congress intended that the junior bank be obligated to the senior bank in the event that the account party defaults on its obligation to pay, but that the junior bank need not also be obligated to pay the holder of the acceptance at the time the BA is presented for payment. H. Rep. No. 97–629, 97th Cong., 2nd Sess. 15 (1982); 128 *Cong. Rec.* H 4647 (daily ed. July 27, 1982) (remarks by Rep. Barnard): and 128 *Cong. Rec.* H 8462 (daily ed. October 1, 1982) (remarks by Rep. Barnard). The legislative history also indicates that Congress intended that eligible BAs in which participations had been conveyed not be required to indicate the name(s) (or interest(s)) of the junior bank(s) on the acceptance in order for the BA to be excluded from the BESA limitations applicable to the senior bank. 128 *Cong.* Rec. S 12237 (daily ed. September 24, 1982) (remarks of Senators Heinz and Garn): and 128 *Cong. Rec.* H 4647 (daily ed. July 27, 1982) (remarks of Rep. Barnard).

(c)(1) In view of Congressional intent with regard to what constitutes a participation in an eligible BA, the Board has determined that, for purposes of the BESA limits, a participation must satisfy the following two *minimum* requirements:

(i) A written agreement entered into between the junior and senior bank under which the junior bank acquires the senior bank's claim against the account party to the extent of the amount of the participation that is enforceable in the event that the account party fails to perform in accordance with the terms of the acceptance; and

(ii) The agreement between the junior and senior bank provides that the senior bank obtains a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(2) Consistent with Congressional intent, the minimum requirements do not require the junior bank to be obligated to pay the holder of the acceptance at the time the BA is presented for payment. Similarly, the minimum requirements do not require the name(s) or interest(s) of the junior bank(s) to appear on the face of the acceptance.

(3) An eligible BA that is conveyed through a participation that does not satisfy these minimum requirements would continue to be included in the BA limits applicable to the senior bank. Further, an eligible BA conveyed to a covered bank through a participation that provided for additional rights and obligations among the parties would be excluded from the BESA limitations of the senior bank provided the minimum requirements were satisfied.

(4) A participation structured pursuant to these minimum requirements would be as follows: Upon the conveyance of the participation, the senior bank retains its entire obligation to pay the holder of the BA at maturity. The senior bank has a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance. Similarly, the junior bank has a corresponding claim against the account party to the extent of the amount of

[2] The use of the terms *senior bank* and *junior bank* has no implications regarding priority of claims. These terms merely represent a shorthand method of identifying the depository institution that has created the acceptance and conveyed the participation (senior bank) and the depository institution that has received the participation (junior bank).

the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(d)(1) The Board is not requiring the senior bank and the account party specifically to agree that the senior bank's rights are assignable because the Board believes such rights to be assignable even in the absence of an explicit agreement.

(2) The junior and senior banks may contract among themselves as to which party(ies) have the responsibility for administering the arrangement, enforcing claims, or exercising remedies.

(e) The Board recognizes that both the junior bank's claim on the account party and the senior bank's claim on the junior bank involve risk. Therefore, it is essential that these risks be assessed by the banks involved in accordance with prudent and sound banking practices. The examiners will in the normal course of the examination process review the risk assessment procedures instituted by the banks. The junior bank should review the creditworthiness of each account party when the junior bank acquires a participation and the senior bank should review on an ongoing basis the creditworthiness of the junior bank. Junior bank agreement to rely exclusively upon the credit judgment of the senior bank and purchase on an ongoing basis from the senior bank all participations in BAs regardless of the identity of the account party is not appropriate in view of the risks involved. However, in those cases involving a participation between a parent bank and its Edge affiliate where the credit review for both entities is performed by the parent bank, the Edge Corporation should maintain documentation indicating that it concurs with the parent bank's analysis and that the acceptance participation is appropriate for inclusion in the Edge Corporation's portfolio.

(f) Similarly, the Board has determined that it is appropriate to include the risks incurred by the senior bank in assessing the senior bank's capital and the risks incurred by the junior bank in assessing the junior bank's capital.

(g) In view of this clarification of the issues relating to participations in BAs, the Board encourages the private sector to develop standardized forms for BAs and participations therein that clearly delineate the rights and responsibilities of the relevant parties.

(Sec. 13, Federal Reserve Act (12 U.S.C. 372))

[48 FR 57109, Dec. 28, 1983]

§ 250.166 Treatment of mandatory convertible debt and subordinated notes of state member banks and bank holding companies as "capital".

(a) *General.* Under the Board's risk-based capital guidelines, state member banks and bank holding companies may include in Tier 2 capital subordinated debt and mandatory convertible debt that meets certain criteria. The purpose of this interpretation is to clarify these criteria. This interpretation should be read with those guidelines, particularly with paragraphs II.c. through II.e. of appendix A of 12 CFR part 208 if the issuer is a state member bank and with paragraphs II.A.2.c. and II.A.2.d. of appendix A of 12 CFR part 225 if the issuer is a bank holding company.

(b) *Criteria for subordinated debt included in capital*—(1) *Characteristics.* To be included in Tier 2 capital under the Board's risk-based capital guidelines for state member banks and bank holding companies, subordinated debt must be subordinated in right of payment to the claims of the issuer's general creditors[1] and, for banks, to the claims of depositors as well; must be unsecured; must state clearly on its face that it is not a deposit and is not insured by a federal agency; must have a minimum average maturity of five years;[2] must not contain provisions that permit debtholders to accelerate payment of principal prior to maturity except in the event of bankruptcy of or the appointment of a receiver for the issuing organization; must not contain or be

[1] The risk-based capital guidelines for bank holding companies state that bank holding company debt must be subordinated to all senior indebtedness of the company. To meet this requirement, the debt should be subordinated to all general creditors.

[2] The ''average maturity'' of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled payments.