

# Rules and Regulations

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This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

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## FEDERAL RESERVE SYSTEM

### 12 CFR Part 225

[Regulation Y; Docket No. R-1356]

#### Capital Adequacy Guidelines; Small Bank Holding Company Policy Statement: Treatment of Subordinated Securities Issued to the United States Treasury Under the Emergency Economic Stabilization Act of 2008

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Interim final rule with request for public comment.

**SUMMARY:** The Board has adopted, and is seeking public comment on an interim final rule (interim final rule or rule) to support in a timely manner, the full implementation and acceptance of the capital purchase program of the U.S. Department of Treasury (Treasury) and promote the stability of banking organizations and the financial system. This rule permits bank holding companies that have made a valid election to be taxed under Subchapter S of Chapter 1 of the U.S. Internal Revenue Code (S-Corp BHCs) and bank holding companies organized in mutual form (Mutual BHCs) to include the full amount of any new subordinated debt securities issued to the Treasury under the capital purchase program announced by the Secretary of the Treasury on October 14, 2008 (Subordinated Securities) in tier 1 capital for purposes of the Board's risk-based and leverage capital guidelines for bank holding companies, provided that the Subordinated Securities will count toward the limit on the amount of other restricted core capital elements includable in tier 1 capital; and allows bank holding companies that are subject to the Board's Small Bank Holding Company Policy Statement and that are S-Corps or Mutual BHCs to exclude the Subordinated Securities from treatment

as debt for purposes of the debt-to-equity standard under the Small Bank Holding Company Policy Statement.

**DATES:** The interim final rule will become effective on June 1, 2009. Comments must be received by July 1, 2009.

**ADDRESSES:** You may submit comments, identified by Docket No. R-1356, by any of the following methods:

- *Agency Web Site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *E-mail:* [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include docket number in the subject line of the message.

- *FAX:* (202) 452-3819 or (202) 452-3102.

- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Street, NW.) between 9 a.m. and 5 p.m. on weekdays.

**FOR FURTHER INFORMATION CONTACT:** Norah M. Barger, Deputy Director, (202) 452-2402, John F. Connolly, Manager, (202) 452-3621, or Michael J. Sexton, Manager, (202) 452-3009, Division of Banking Supervision and Regulation; or Kieran J. Fallon, Assistant General Counsel, (202) 452-5270, April C. Snyder, Counsel, (202) 452-3099, or Benjamin W. McDonough, Senior Attorney, (202) 452-2036, Legal Division; Board of Governors of the Federal Reserve System, 20th Street and Constitution Ave., NW., Washington, DC 20551. For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

**SUPPLEMENTARY INFORMATION:**

## Capital Guidelines

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (EESA), Division A of Public Law No. 110-343, 122 Stat. 3765 (2008). Pursuant to the authorities granted by the EESA, and in order to restore liquidity and stability to the financial system, on October 14, 2008, the Secretary of the Treasury announced a program within the Troubled Asset Relief Program (TARP) established by section 101 of the EESA to provide capital to eligible banks, bank holding companies and savings associations (collectively, banking organizations), as well as certain other financial institutions (the Capital Purchase Program or CPP).

As of April 20, 2009, Treasury had invested approximately \$198 billion under the CPP in newly issued senior perpetual preferred stock of banking organizations (Senior Perpetual Preferred Stock) that are not S-Corps or organized in mutual form. In order to support the CPP and promote the stability of banking organizations and the financial system through Treasury's investments in Senior Perpetual Preferred Stock, the Board published an interim final rule on October 22, 2008 (October interim final rule) permitting bank holding companies that issued Senior Perpetual Preferred Stock to the Treasury under the CPP to include all of the Senior Perpetual Preferred Stock in their tier 1 capital without limit. The Board today published a final rule on the capital treatment of the Senior Perpetual Preferred Stock substantially identical to the October interim final rule.<sup>1</sup>

Since the time that Treasury announced the terms of the Senior Perpetual Preferred Stock, Treasury has worked towards developing terms under which banking organizations organized as S-Corps or in mutual form could participate in the Capital Purchase Program. This is consistent with the goal of the CPP, which is to promote financial stability by offering capital support to all viable banking organizations regardless of their form of organization.

S-Corp BHCs generally may not participate in the CPP through the issuance of Senior Perpetual Preferred

<sup>1</sup> Published elsewhere in today's issue.

Stock because, under the Internal Revenue Code, S-Corps may not issue more than one class of equity security. Bank holding companies organized in mutual form also cannot issue Senior Perpetual Preferred Stock because of their mutual ownership structure.

On January 14, 2009, Treasury announced the terms under which it will purchase newly-issued subordinated debt securities from S-Corps under the Capital Purchase Program. These terms are designed to facilitate S-Corp participation in the CPP in a manner that is as economically comparable as possible, consistent with the legal structure of S-Corp BHCs, the Board's capital adequacy guidelines, and the Internal Revenue Code, to institutions that have issued Senior Perpetual Preferred Stock. In particular, Treasury will purchase from S-Corps that are eligible to participate in the CPP subordinated debt securities that rank senior to common stock but that are subordinated to the claims of depositors and other creditors (Subordinated Securities), unless such other claims are explicitly made *pari passu* or subordinated to the Subordinated Securities.<sup>2</sup>

As with other CPP participants, the aggregate amount of Subordinated Securities that may be issued by an S-Corp to Treasury must be (i) not less than one percent of the S-Corp's risk-weighted assets, and (ii) not more than the lesser of (A) \$25 billion and (B) three percent of its risk-weighted assets.<sup>3</sup> In connection with its purchase of the Subordinated Securities, the Treasury also will receive warrants to purchase, upon net settlement, a number of additional Subordinated Securities in an amount equal to 5 percent of the amount of Subordinated Securities purchased on the date of investment.

Similar to the Senior Perpetual Preferred Stock, Subordinated Securities issued pursuant to the CPP must include certain features designed to make them attractive to a wide array of generally sound S-Corp banking

organizations and to encourage such companies to replace such securities with private capital once the financial markets return to more normal conditions. In particular, the Subordinated Securities will bear an initial interest rate of 7.7 percent per annum, which will increase to 13.8 percent per annum five years after issuance.<sup>4</sup> An S-Corp issuer may redeem the Subordinated Securities at 100 percent of their issuance price, plus accrued and unpaid interest. In all cases, Treasury must consult with the appropriate Federal banking agency before a banking organization may redeem the Subordinated Securities.<sup>5</sup> In addition, following the redemption of all outstanding Subordinated Securities, an S-Corp issuer shall have the right to repurchase any warrants for additional Subordinated Securities held by Treasury.

Under the Board's current risk-based and leverage capital adequacy guidelines for bank holding companies (Capital Guidelines),<sup>6</sup> the Subordinated Securities would be ineligible for tier 1 capital treatment because they are subordinated debt, but would be eligible for inclusion in tier 2 capital.<sup>7</sup> However, the Subordinated Securities were purposefully structured to have features that are very close to those of the subordinated notes underlying trust preferred securities that qualify for tier 1 capital as a restricted core capital element for bank holding companies (qualifying trust preferred securities). Like such junior subordinated notes, the Subordinated Securities would be deeply subordinated and junior to the claims of depositors and other creditors of the issuing bank holding company. Furthermore, as required of the junior subordinated notes underlying qualifying trust preferred securities, interest payable on the Subordinated Securities may be deferred by the issuing S-Corp BHC for up to 20 quarters without creating an event of default. Principal and accrued interest on such securities would only become due and payable if interest is deferred more than 20 quarters or if the issuing S-Corp BHC enters bankruptcy, is liquidated, or if one or more of its major

bank subsidiaries is put into receivership. Additionally, under the terms of the Capital Purchase Program, the Subordinated Securities have a maturity of 30 years, which is the same minimum term required for such junior subordinated notes.<sup>8</sup>

In addition, like the Senior Perpetual Preferred Stock, the Subordinated Securities will be issued to Treasury as part of a nationwide program, established by Treasury under the EESA, to provide capital to eligible banking organizations that are in generally sound financial condition in order to increase the capital available to banking organizations and thereby promote stability in the financial markets and the banking industry as a whole.<sup>9</sup> Treasury will purchase these Subordinated Securities under special powers granted by Congress to the Secretary of the Treasury in the EESA to achieve these important public policy objectives. In addition, the terms of the Subordinated Securities issued under the CPP provide that redemption is subject to the approval of the Federal Reserve.<sup>10</sup> In light of this provision, the Board recently specified in Federal Reserve SR letter 09-4<sup>11</sup> that any bank holding company that intends to redeem Subordinated Securities issued to Treasury under the CPP should first consult with Federal Reserve supervisory staff. After reviewing a request by a bank holding company to redeem Subordinated Securities, the Board may take such actions as are necessary or appropriate to restrict the bank holding company from redeeming such securities if the redemption would be inconsistent with the safety and soundness of the bank holding company.<sup>12</sup> Each of these factors, and the features of the Subordinated Securities that are comparable to those of qualifying trust preferred securities, is important to the determinations made by the Board with respect to the appropriate regulatory capital treatment of the Subordinated Securities.

For these reasons and in order to support the participation of S-Corp

<sup>2</sup> On April 7, 2009, the Treasury announced a term sheet for top-tier Mutual BHCs under which these banking organizations issue subordinated debt to Treasury under the CPP on substantially the same terms as S-Corp BHCs. This interim final rule also accords the same capital treatment to Subordinated Securities issued by Mutual BHCs as those issued by S-Corp BHCs, and accordingly, any reference to a S-Corp BHC in the notice shall also be deemed to include a Mutual BHC unless the context otherwise requires.

<sup>3</sup> Treasury has announced that it is considering re-opening the Capital Purchase Program for institutions with total assets under \$500 million and raising—from 3 percent to 5 percent of risk-weighted assets—the amount of capital instruments for which qualifying institutions can apply.

<sup>4</sup> The interest payments on the Subordinated Securities will be tax deductible for shareholders of the issuing S-Corp and therefore this interest rate is economically comparable (assuming a 35 percent marginal tax rate) to the dividend payments on the Senior Preferred Stock, which are not tax deductible.

<sup>5</sup> See section 7001 of the American Recovery and Reinvestment Act of 2009, Public Law No. 111-5, 123 Stat. 115.

<sup>6</sup> 12 CFR part 225, Appendices A and D.

<sup>7</sup> See 12 CFR part 225, Appendix A, sections II.A.2. and II.A.2.d.

<sup>8</sup> 12 CFR part 225, Appendix A, section II.A.1.c.iv.

<sup>9</sup> This interim final rule addresses only the regulatory capital treatment of Subordinated Securities. Details about the CPP, including eligibility requirements and the general terms and conditions of the Subordinated Securities and warrants associated with such securities, are available at <http://www.financialstability.gov>.

<sup>10</sup> See 12 CFR part 225, Appendix A, section II.A.1.c.ii.(2).

<sup>11</sup> SR 09-4, "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies," March 27, 2009.

<sup>12</sup> See 12 CFR part 225, Appendix A, sections II.(iii) and II.A.1.c.ii.(2).

BHCs in the Capital Purchase Program, promote the stability of banking organizations and the financial system, and help banking organizations meet the credit needs of creditworthy customers, the Board has adopted this interim final rule to permit S-Corp BHCs that issue new Subordinated Securities to the Treasury under the TARP to include the full amount of such securities in tier 1 capital for purposes of the Board's Capital Guidelines.<sup>13</sup>

The Board is allowing the full amount of the Subordinated Securities to count in tier 1 capital to provide similar regulatory capital treatment to the instruments issued by S-Corp BHCs and other bank holding companies under the Capital Purchase Program and in light of the special and unique public policy objectives of the CPP. However, the interim final rule requires an S-Corp BHC to take into account the amount of Subordinated Securities in determining the amount of *other* restricted core capital elements the company may include in its tier 1 capital.<sup>14</sup> Thus, for example, if the amount of Subordinated Securities issued by an S-Corp BHC equals or exceeds 25 percent of the company's tier 1 capital elements, the company may not include any other currently outstanding or future restricted core capital elements in tier 1 capital, and any such restricted core capital elements in the company's tier 1 capital elements could only be included in tier 2 capital. This approach is designed to give the Subordinated Securities tier 1 treatment that is equivalent to that provided Senior Perpetual Preferred Stock, while preventing a S-Corp BHC's tier 1 capital from becoming dominated by instruments that are, or have features similar to, restricted core capital elements. The following examples provide an explanation of how this computation will operate; each example assumes that the bank holding company's limit on inclusion of restricted core capital elements in tier 1 capital is \$25 million.

- *Example 1.* The bank holding company has no existing restricted core capital elements and issues \$30 million of Subordinated Securities to the Treasury. The bank holding company may include the full \$30 million in tier 1 capital, but may not include any additional restricted core capital elements that it issues in tier 1 capital unless its limit expands.

- *Example 2.* The bank holding company has \$10 million of previously issued trust preferred securities

included in tier 1 capital and issues \$30 million of Subordinated Securities. The \$30 million of Subordinated Securities is includable in tier 1 capital, and the \$10 million of trust preferred securities is includable in tier 2 capital. The bank holding company may not include the trust preferred securities in tier 1 capital, because the \$30 million of Subordinated Securities exceeds the bank holding company's \$25 million limit on inclusion of restricted core capital elements in tier 1 capital.

- *Example 3.* The bank holding company has no restricted core capital elements and issues \$20 million of Subordinated Securities to Treasury. The \$20 million of Subordinated Securities is includable in tier 1 capital, and the bank holding company may issue an additional \$5 million of other restricted core capital elements (e.g., trust preferred securities or cumulative perpetual preferred securities) and include them in its tier 1 capital. The Board expects S-Corp BHCs that issue Subordinated Securities, like all other bank holding companies, to hold capital commensurate with the level and nature of the risks to which they are exposed. In addition, the Board expects banking organizations that issue Subordinated Securities to appropriately incorporate the obligations of the Subordinated Securities into the organization's liquidity and capital funding plans.

The Board notes that, as a matter of prudential policy and practice, it generally has not allowed subordinated debt to be included in tier 1 capital. Furthermore, the Board has restricted the amount of qualifying trust preferred securities that may be included in core capital, along with other restricted core capital elements, to an aggregate total that may not exceed 25 percent of the sum of all core capital elements, including restricted core capital elements (which will be computed net of goodwill less any associated deferred tax liability as of March 31, 2011).<sup>15</sup> The Board has long expressed concern about banking organizations including debt instruments of any kind in tier 1 capital given the contractual obligations they place on the issuing banking organization and consequent limited ability to absorb losses. The Board also expressed concerns with the inclusion in tier 1 capital of instruments that provide for a step-up in dividend or coupon rates.<sup>16</sup> In light of these

concerns, the Board previously has declined to allow subordinated debt to be included in tier 1 capital and has restricted the amount of qualifying trust preferred securities that may be included in tier 1 capital. The Board remains concerned that instruments with debt or debt-like features have limited ability to absorb losses.

However, as discussed above, issuance of the Subordinated Securities is consistent with a strong public policy objective, which is to increase the capital available to banking organizations generally in the current environment and thereby promote stability in the financial markets and the banking industry as a whole and facilitate the ability of banking organizations to meet the needs of creditworthy households, businesses, and other customers. In addition, the Board notes that other terms and public policy considerations related to the Subordinated Securities mitigate supervisory concerns. As with qualifying trust preferred securities, the Subordinated Securities allow the issuing bank holding company to defer interest payments for five years. Furthermore, under the terms of the CPP, issuers of this instrument generally will not be allowed to repurchase equity securities or trust preferred securities for ten years after the issuance of the Subordinated Securities or increase common dividends for three years after issuance without the consent of the Treasury. These restrictions promote in an important way the overall safety and soundness of the issuer. Moreover, as previously discussed, Treasury must consult with the Board before an S-Corp BHC may redeem the Subordinated Securities. These features, viewed in light of the unique, temporary, and extraordinary nature of the CPP, countervail in many respects the Board's concerns with regard to the subordinated debt nature of the securities. As previously noted, the Board also would retain general

to the financial condition of the issuing organization, such debt (sometimes referred to as expanding or exploding rate debt) has a strong potential to be credit sensitive in substance. Organizations whose financial condition has strengthened are more likely to be able to refinance the debt at a rate lower than that mandated by the preset increase, whereas institutions whose condition has deteriorated are less likely to be able to do so. Moreover, just when these latter institutions would be in the most need of conserving capital, they would be under strong pressure to redeem the debt as an alternative to paying higher rates and, thus, would accelerate depletion of their resources." See 12 CFR § 250.166(b)(4) at n. 4. Furthermore, the Board has not permitted bank holding companies to include capital instruments in tier 1 capital if they include dividend rate step-ups.

<sup>15</sup> See 74 FR 12076 (March 23, 2009).

<sup>16</sup> For example, in a 1992 policy statement on subordinated debt, the Board noted: "Although payments on debt whose rates increase over time on the surface may not appear to be directly linked

<sup>13</sup> See 12 CFR part 225, Appendices A and D.

<sup>14</sup> 12 CFR part 225, Appendix A, section II.A.1.b.

supervisory authority with respect to any S-Corp BHC.

In light of the instrument- and circumstances-specific nature of the Board's determination, the Board strongly cautions bank holding companies against construing the inclusion of the Subordinated Securities in tier 1 capital as in any way detracting from the Board's longstanding stance regarding the unacceptability of including other forms of subordinated debt in tier 1 capital.

#### **Small Bank Holding Company Policy Statement**

In order to maintain competitive equality between large and small bank holding companies, the Board also is amending its Small Bank Holding Policy Statement (Policy Statement) to allow bank holding companies that are subject to the Policy Statement and that are S-Corp BHCs to exclude the Subordinated Securities from debt for purposes of the Policy Statement.<sup>17</sup> Generally, bank holding companies with less than \$500 million in consolidated assets (small bank holding companies) are not subject to the Capital Guidelines and instead are subject to the Policy Statement. The Policy Statement limits the ability of a small bank holding company to pay dividends if its debt-to-equity ratio exceeds certain limits. However, the Policy Statement currently provides that small bank holding companies may exclude from debt an amount of subordinated debt associated with qualifying trust preferred securities up to 25 percent of the bank holding company's equity (as defined in the Policy Statement), less goodwill on the parent company's balance sheet, in determining compliance with the requirements of certain provisions of the Policy Statement.<sup>18</sup> The practical effect of excluding the Subordinated Securities from debt for purposes of the Policy Statement is to allow issuance of Subordinated Securities by small bank holding companies without exceeding the debt-to-equity ratio standard that would disallow the payment of dividends by such small bank holding companies. In turn, this allows small bank holding companies that issue Subordinated Securities to downstream Treasury's investment in the form of the Subordinated Securities as additional common stock to subsidiary depository institutions (that counts as tier 1 capital of the depository institutions) and to pay dividends to the small bank holding company's shareholders to the extent

appropriate and permitted by the Federal Reserve.

Because, as previously discussed, the Subordinated Securities and the junior subordinated notes underlying qualifying trust preferred securities have very similar features, and to facilitate the participation of small bank holding companies in the Capital Purchase Program, the Board has adopted this interim final rule to allow small bank holding companies that are S-Corp BHCs to exclude the Subordinated Securities from the definition of debt for purposes of the debt-to-equity ratio standard under the Policy Statement. The factors and considerations discussed above apply equally to the Board's decision to modify the Policy Statement in this manner.

The Board solicits comments on all aspects of the rule.

#### **Administrative Procedure Act**

Pursuant to sections 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. 553(b) and (d)), the Board finds that there is good cause for issuing this interim final rule and making the rule effective on June 1, 2009, and that it is impracticable, unnecessary, or contrary to the public interest to issue a notice of proposed rulemaking and provide an opportunity to comment before the effective date. The Board has adopted the rule in light of, and to help address, the continuing unusual and exigent circumstances in the financial markets. The rule will allow S-Corp BHCs to immediately include the full amount of Subordinated Securities they issue to Treasury under the CPP in tier 1 capital. This will help promote stability in the banking system and financial markets. The rule also will allow small bank holding companies that are S-Corp BHCs to exclude the Subordinated Securities from the definition of debt for purposes of the debt-to-equity ratio standard of the Policy Statement.

The Board believes it is important to provide S-Corp BHCs immediately with guidance concerning the capital treatment of the Subordinated Securities so that they may make appropriate judgments concerning the extent of their participation in the CPP and to provide S-Corp BHCs with immediate certainty concerning the regulatory capital treatment of the Subordinated Securities for capital planning purposes. (Treasury recently completed the documentation for issuances of the Subordinated Securities by S-Corp BHCs.) The Board is soliciting comment on all aspects of the rule and will make such changes that it considers appropriate or necessary after review of any comments received.

#### **Regulatory Flexibility Act**

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), generally requires that an agency prepare and make available for public comment an initial regulatory flexibility analysis in connection with a notice of proposed rulemaking.<sup>19</sup> Under regulations issued by the Small Business Administration,<sup>20</sup> a small entity includes a bank holding company with assets of \$175 million or less (a small bank holding company). As of December 31, 2008, there were approximately 2,586 small bank holding companies.

As a general matter, the Capital Guidelines apply only to a bank holding company that has consolidated assets of \$500 million or more. Therefore, the changes to the Capital Guidelines will not affect small bank holding companies. In addition, the rule would reduce burden and benefit small bank holding companies by allowing them to exclude the Subordinated Securities from treatment as debt for purposes of the debt-to-equity standard under the Policy Statement. This treatment is similar to the current treatment of junior subordinated notes underlying trust preferred securities under the Policy Statement. Furthermore, the Board estimates that the changes to the Policy Statement will affect less than one percent of small bank holding companies. Accordingly, the Board certifies that this interim final rule does not have a significant impact on a substantial number of small bank holding companies.

#### **Paperwork Reduction Act**

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3506), the Board has reviewed the interim final rule to assess any information collections. There are no collections of information as defined by the Paperwork Reduction Act in the interim final rule.

#### **Solicitation of Comments on Use of Plain Language**

Section 722 of the Gramm-Leach-Bliley Act, Public Law No. 106-102, requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board invites comment on how to make the interim final rule easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could the rule be more clearly stated?

<sup>17</sup> 12 CFR part 225, Appendix C.

<sup>18</sup> 12 CFR part 225, Appendix C, section 2, n. 3.

<sup>19</sup> See 5 U.S.C. 603(a).

<sup>20</sup> See 13 CFR 121.201.

• Are the requirements in the rule clearly stated? If not, how could the rule be more clearly stated?

• Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?

• Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes would make the regulation easier to understand?

• Would more, but shorter, sections be better? If so, which sections should be changed?

• What else could we do to make the regulation easier to understand?

#### List of Subjects in 12 CFR Part 225

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

#### Board of Governors of the Federal Reserve System

#### 12 CFR Chapter II

#### Authority and Issuance

■ For the reasons stated in the preamble, the Board of Governors of the Federal Reserve System amends part 225 of chapter II of title 12 of the Code of Federal Regulations as follows:

#### 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(1), 3106, 3108, 3310, 3331–3351, 3906, 3907, and 3909; 15 U.S.C. 1681s, 1681w, 6801 and 6805.

■ 2. Appendix A to part 225 is amended as set forth below:

■ a. In section II.A.1.a.iv., remove “and” from the end of paragraph (3), remove the period from the end of paragraph (4), add a semicolon and “and” to the end of subparagraph (4), and add a new paragraph (5) to read as follows; and

■ b. In section II.A.1.b.i., amend paragraph (1) by adding the following sentence to the end of paragraph (1) to read as follows:

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

II. \* \* \*  
A. \* \* \*  
1. \* \* \*  
a. \* \* \*  
iv. \* \* \*

(5) Subordinated debentures issued to the Treasury under the TARP (TARP Subordinated Securities) established by the EESA by a bank holding company that has made a valid election to be taxed under Subchapter S of Chapter 1 of the U.S. Internal Revenue Code (S–Corp BHC) or by a bank holding company organized in mutual form (Mutual BHC).

b. \* \* \*

i. \* \* \*

(1) \* \* \* Notwithstanding the foregoing, the full amount of TARP Subordinated Securities issued by an S–Corp BHC or Mutual BHC may be included in its tier 1 capital, provided that the banking organization must include the TARP Subordinated Securities in restricted core capital elements for the purposes of determining the aggregate amount of other restricted core capital elements that may be included in tier 1 capital in accordance with this section.

\* \* \* \* \*

■ 3. In appendix C to part 225, revise footnote 3 in section 2 to read as follows:

#### Appendix C to Part 225—Small Bank Holding Company Policy Statement

\* \* \* \* \*

2. \* \* \*

<sup>3</sup> The term *debt*, as used in the ratio of debt to equity, means any borrowed funds (exclusive of short-term borrowings that arise out of current transactions, the proceeds of which are used for current transactions), and any securities issued by, or obligations of, the holding company that are the functional equivalent of borrowed funds.

Subordinated debt associated with trust preferred securities generally would be treated as debt for purposes of paragraphs 2.C., 3.A., 4.A.i., and 4.B.i. of this policy statement. A bank holding company, however, may exclude from debt an amount of subordinated debt associated with trust preferred securities up to 25 percent of the holding company's equity (as defined below) less goodwill on the parent company's balance sheet in determining compliance with the requirements of such paragraphs of the policy statement. In addition, a bank holding company subject to this policy statement that has not issued subordinated debt associated with a new issuance of trust preferred securities after December 31, 2005, may exclude from debt any subordinated debt associated with trust preferred securities until December 31, 2010. Bank holding companies subject to this policy statement also may exclude from debt until December 31, 2010, any subordinated debt associated with refinanced issuances of trust preferred securities originally issued on or prior to December 31, 2005, provided that the refinancing does not increase the bank holding company's outstanding amount of subordinated debt. Subordinated debt associated with trust preferred securities will not be included as debt in determining compliance with any other requirements of this policy statement.

In addition, notwithstanding any other provision of this policy statement and for

purposes of compliance with paragraphs 2.C., 3.A., 4.A.i., and 4.B.i. of this policy statement, both a bank holding company that is organized in mutual form and a bank holding company that has made a valid election to be taxed under Subchapter S of Chapter 1 of the U.S. Internal Revenue Code may exclude from debt subordinated debentures issued to the United States Department of the Treasury under the Troubled Asset Relief Program established by the Emergency Economic Stabilization Act of 2008, Division A of Pub. L. No. 110–343, 122 Stat. 3765 (2008).

The term *equity*, as used in the ratio of debt to equity, means the total stockholders' equity of the bank holding company as defined in accordance with generally accepted accounting principles. In determining the total amount of stockholders' equity, the bank holding company should account for its investments in the common stock of subsidiaries by the equity method of accounting.

Ordinarily the Board does not view redeemable preferred stock as a substitute for common stock in a small bank holding company. Nevertheless, to a limited degree and under certain circumstances, the Board will consider redeemable preferred stock as equity in the capital accounts of the holding company if the following conditions are met: (1) The preferred stock is redeemable only at the option of the issuer; and (2) the debt to equity ratio of the holding company would be at or remain below .30:1 following the redemption or retirement of any preferred stock. Preferred stock that is convertible into common stock of the holding company may be treated as equity.

\* \* \* \* \*

By order of the Board of Governors of the Federal Reserve System, May 21, 2009.

**Robert deV. Frierson,**

*Deputy Secretary of the Board.*

[FR Doc. E9–12626 Filed 5–29–09; 8:45 am]

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#### FEDERAL RESERVE SYSTEM

#### 12 CFR Part 225

[Regulation Y; Docket No. R–1336]

#### Capital Adequacy Guidelines: Treatment of Perpetual Preferred Stock Issued to the United States Treasury Under the Emergency Economic Stabilization Act of 2008

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Final rule.

**SUMMARY:** The Board is adopting a final rule to allow bank holding companies that have issued senior perpetual preferred stock to the U.S. Department of the Treasury under the capital purchase and other programs established by the Secretary of the Treasury under the Emergency