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shall have the right to introduce relevant written materials and to present oral argument. A Respondent may introduce oral testimony and present witnesses only if expressly authorized by the OTS or the presiding officer(s). Neither the provisions of the Administrative Procedure Act governing adjudications required by statute to be determined on the record nor part 509 of this chapter apply to an informal hearing under this section unless the OTS orders that such procedures shall apply.

(2) The informal hearing shall be recorded and a transcript furnished to the Respondent upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer(s). The presiding officer(s) may ask questions of any witness.

(3) The presiding officer(s) may order that the hearing be continued for a reasonable period (normally five business days) following completion of oral testimony or argument to allow additional written submissions to the hearing record.

(e) *Standard for review.* A Respondent shall bear the burden of demonstrating that his or her continued employment by or service with the savings association would materially strengthen the savings association's ability:

(1) To become adequately capitalized, to the extent that the directive was issued as a result of the savings association's capital level or failure to submit or implement a capital restoration plan; and

(2) To correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the directive was issued as a result of classification of the savings association based on supervisory criteria other than capital, pursuant to section 38(g) of the FDI Act.

(f) *Recommendation of presiding officers.* Within 20 calendar days following the date the hearing and the record on the proceeding are closed, the presiding officer(s) shall make a recommendation to the OTS concerning the Respondent's request for reinstatement with the savings association.

(g) *Time for decision.* Not later than 60 calendar days after the date the record

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is closed or the date of the response in a case where no hearing has been requested, the OTS shall grant or deny the request for reinstatement and notify the Respondent of the OTS's decision. If the OTS denies the request for reinstatement, the OTS shall set forth in the notification the reasons for the OTS's action.

[57 FR 44903, Sept. 29, 1992, as amended at 60 FR 66719, Dec. 26, 1995]

§ 565.10 Enforcement of directives.

(a) *Judicial remedies.* Whenever a savings association or company that controls a savings association fails to comply with a directive issued under section 38, the OTS may seek enforcement of the directive in the appropriate United States district court pursuant to section 8(i)(1) of the FDI Act.

(b) *Administrative remedies—(1) Failure to comply with directive.* Pursuant to section 8(i)(2)(A) of the FDI Act, the OTS may assess a civil money penalty against any savings association or company that controls a savings association that violates or otherwise fails to comply with any final directive issued under section 38 and against any institution-affiliated party who participates in such violation or non-compliance.

(2) *Failure to implement capital restoration plan.* The failure of a savings association to implement a capital restoration plan required under section 38, or this part, or the failure of a company having control of a savings association to fulfill a guarantee of a capital restoration plan made pursuant to section 38(e)(2) of the FDI Act shall subject the savings association or company to the assessment of civil money penalties pursuant to section 8(i)(2)(A) of the FDI Act.

(c) *Other enforcement action.* In addition to the actions described in paragraphs (a) and (b) of this section, the OTS may seek enforcement of the provisions of section 38 or this part through any other judicial or administrative proceeding authorized by law.

PART 567—CAPITAL

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567.1 Definitions.

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- 567.2 Minimum regulatory capital requirement.
- 567.3 Individual minimum capital requirements.
- 567.4 Capital directives.
- 567.5 Components of capital.
- 567.6 Risk-based capital credit risk-weight categories.
- 567.8 Leverage ratio.
- 567.9 Tangible capital requirement.
- 567.10 Consequences of failure to meet capital requirements.
- 567.11 Reservation of authority.
- 567.12 Intangible assets, servicing assets, and credit-enhancing interest-only strips.
- 567.14–567.19 [Reserved]

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

SOURCE: 54 FR 49649, Nov. 30, 1989, unless otherwise noted.

§ 567.1 Definitions.

For purposes of this part:

Adjusted total assets. The term *adjusted total assets* means:

- (1) A savings association's total assets as that term is defined in this section;
- (2) Plus
 - (i) The prorated assets of any includable subsidiary in which the savings association has a minority ownership interest that is not consolidated under generally accepted accounting principles; and
 - (ii) The remaining goodwill (FSLIC Capital Contributions) resulting from prior regulatory accounting practices as provided in the definition of *qualifying supervisory goodwill* in this section;
- (3) Minus
 - (i) Assets not included in the applicable capital standard except for those subject to paragraphs (3)(i) and (3)(iii) of this definition;
 - (ii) Investments in any includable subsidiary in which a savings association has a minority interest;
 - (iii) Investments in any subsidiary subject to consolidation under paragraph (2)(ii) of this definition; and
 - (iv) For purposes of determining core capital, qualifying supervisory goodwill.

Asset-backed commercial paper program. The term *asset-backed commercial paper program* (ABCP program) means a program that primarily issues commercial paper that has received a credit

rating from an NRSRO and that is backed by assets or other exposures held in a bankruptcy-remote special purpose entity. The term *sponsor* of an ABCP program means a savings association that:

- (1) Establishes an ABCP program;
- (2) Approves the sellers permitted to participate in an ABCP program;
- (3) Approves the asset pools to be purchased by an ABCP program; or
- (4) Administers the ABCP program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Cash items in the process of collection. The term *cash items in the process of collection* means checks or drafts in the process of collection that are drawn on another depository institution, including a central bank, and that are payable immediately upon presentation; U.S. Government checks that are drawn on the United States Treasury or any other U.S. Government or Government-sponsored agency and that are payable immediately upon presentation; broker's security drafts and commodity or bill-of-lading drafts payable immediately upon presentation; and unposted debits.

Commitment. The term *commitment* means any arrangement that obligates a savings association to:

- (1) Purchase loans or securities;
- (2) Extend credit in the form of loans or leases, participations in loans or leases, overdraft facilities, revolving credit facilities, home equity lines of credit, eligible ABCP liquidity facilities, or similar transactions.

Common stockholders' equity. The term *common stockholders' equity* means common stock, common stock surplus, retained earnings, and adjustments for the cumulative effect of foreign currency translation, less net unrealized losses on available-for-sale equity securities with readily determinable fair values.

Conditional guarantee. The term *conditional guarantee* means a contingent obligation of the United States Government or its agencies, the validity of which to the beneficiary is dependent upon some affirmative action—e.g., servicing requirements—on the part of

the beneficiary of the guarantee or a third party.

Credit derivative. The term *credit derivative* means a contract that allows one party (the protection purchaser) to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the protection provider). The value of a credit derivative is dependent, at least in part, on the credit performance of a “referenced asset.”

Credit-enhancing interest-only strip. (1) The term *credit-enhancing interest-only strip* means an on-balance sheet asset that, in form or in substance:

(i) Represents the contractual right to receive some or all of the interest due on transferred assets; and

(ii) Exposes the savings association to credit risk directly or indirectly associated with the transferred assets that exceeds its *pro rata* share of the savings association’s claim on the assets whether through subordination provisions or other credit enhancement techniques.

(2) OTS reserves the right to identify other cash flows or related interests as a credit-enhancing interest-only strip. In determining whether a particular interest cash flow functions as a credit-enhancing interest-only strip, OTS will consider the economic substance of the transaction.

Credit-enhancing representations and warranties. (1) The term *credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate a savings association to protect investors from losses arising from credit risk in the assets transferred or loans serviced.

(2) Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral.

(3) Credit-enhancing representations and warranties do not include:

(i) Early-default clauses and similar warranties that permit the return of, or premium refund clauses covering, qualifying mortgage loans for a period not to exceed 120 days from the date of transfer. These warranties may cover

only those loans that were originated within one year of the date of the transfer;

(ii) Premium refund clauses covering assets guaranteed, in whole or in part, by the United States government, a United States government agency, or a United States government-sponsored enterprise, provided the premium refund clause is for a period not to exceed 120 days from the date of transfer; or

(iii) Warranties that permit the return of assets in instances of fraud, misrepresentation or incomplete documentation.

Depository institution. The term *domestic depository institution* means a financial institution that engages in the business of banking; that is recognized as a bank by the bank supervisory or monetary authorities of the country of its incorporation and the country of its principal banking operations; that receives deposits to a substantial extent in the regular course of business; and that has the power to accept demand deposits. In the United States, this definition encompasses all federally insured offices of commercial banks, mutual and stock savings banks, savings or building and loan associations (stock and mutual), cooperative banks, credit unions, and international banking facilities of domestic depository institutions. Bank holding companies and savings and loan holding companies are excluded from this definition. For the purposes of assigning risk weights, the differentiation between OECD depository institutions and non-OECD depository institutions is based on the country of incorporation. Claims on branches and agencies of foreign banks located in the United States are to be categorized on the basis of the parent bank’s country of incorporation.

Direct credit substitute. The term *direct credit substitute* means an arrangement in which a savings association assumes, in form or in substance, credit risk associated with an on-or off-balance sheet asset or exposure that was not previously owned by the savings association (third-party asset) and the risk assumed by the savings association exceeds the *pro rata* share of the savings association’s interest in the

third-party asset. If a savings association has no claim on the third-party asset, then the savings association's assumption of any credit risk is a direct credit substitute. Direct credit substitutes include:

(1) Financial standby letters of credit that support financial claims on a third party that exceed a savings association's *pro rata* share in the financial claim;

(2) Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a savings association's *pro rata* share in the financial claim;

(3) Purchased subordinated interests that absorb more than their *pro rata* share of losses from the underlying assets;

(4) Credit derivative contracts under which the savings association assumes more than its *pro rata* share of credit risk on a third-party asset or exposure;

(5) Loans or lines of credit that provide credit enhancement for the financial obligations of a third party;

(6) Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Servicer cash advances as defined in this section are not direct credit substitutes;

(7) Clean-up calls on third party assets. However, clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the savings association are not direct credit substitutes; and

(8) Liquidity facilities that provide support to asset-backed commercial paper (other than eligible ABCP liquidity facilities).

Eligible ABCP liquidity facility. The term *eligible ABCP liquidity facility* means a liquidity facility that supports asset-backed commercial paper, in form or in substance, and that meets the following criteria:

(1)(i) At the time of the draw, the liquidity facility must be subject to an asset quality test that precludes funding against assets that are 90 days or more past due or in default; and

(ii) If the assets that the liquidity facility is required to fund against are assets or exposures that have received

a credit rating by a NRSRO at the time the inception of the facility, the facility can be used to fund only those assets or exposures that are rated investment grade by an NRSRO at the time of funding; or

(2) If the assets that are funded under the liquidity facility do not meet the criteria described in paragraph (1) of this definition, the assets must be guaranteed, conditionally or unconditionally, by the United States Government, its agencies, or the central government of an OECD country.

Eligible savings association. (1) The term *eligible savings association* means a savings association with respect to which the Director of the Office of Thrift Supervision has determined, on the basis of information available at the time, that:

(i) The savings association's management appears to be competent;

(ii) The savings association, as certified by its Board of Directors, is in substantial compliance with all applicable statutes, regulations, orders and written agreements and directives; and

(iii) The savings association's management, as certified by its Board of Directors, has not engaged in insider dealing, speculative practices, or any other activities that have or may jeopardize the association's safety and soundness or contributed to impairing the association's capital.

(2) Savings associations, for purposes of this paragraph, will be deemed to be eligible unless the Director makes a determination otherwise or notifies the savings association of its intent to conduct either an informal or formal examination to determine eligibility and provides written notification thereof to the savings association.

Equity investments. (1) The term *equity investments* includes investments in equity securities and real property that would be considered an equity investment under generally accepted accounting principles.

(2)(i) The term *equity securities* means any:

(A) Stock, certificate of interest of participation in any profit-sharing agreement, collateral trust certificate or subscription, preorganization certificate or subscription, transferable

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share, investment contract, or voting trust certificate; or

(B) In general, any interest or instrument commonly known as an equity security; or

(C) Loans having profit sharing features which generally accepted accounting principles would reclassify as equity securities; or

(D) Any security immediately convertible at the option of the holder without payment of substantial additional consideration into such a security; or

(E) Any security carrying any warrant or right to subscribe to or purchase such a security; or

(F) Any certificate of interest or participation in, temporary or Interim certificate for, or receipt for any of the foregoing or any partnership interest; or

(G) Investments in equity securities and loans or advances to and guarantees issued on behalf of partnerships or joint ventures in which a savings association holds an interest in real property under generally accepted accounting principles.

(ii) The term *equity securities* does not include investments in a subsidiary as that term is defined in this section, equity investments that are permissible for national banks, ownership interests in pools of assets that are risk-weighted in accordance with § 567.6(a)(1)(vi) of this part, or the stock of Federal Home Loan Banks or Federal Reserve Banks.

(3) For purposes of this part, the term *equity investments in real property* does not include interests in real property that are primarily used or intended to be used by the savings association, its subsidiaries, or its affiliates as offices or related facilities for the conduct of its business.

(4) In addition, for purposes of this part, the term *equity investments in real property* does not include interests in real property that are acquired in satisfaction of a debt previously contracted in good faith or acquired in sales under judgments, decrees, or mortgages held by the savings association, provided that the property is not intended to be held for real estate investment purposes but is expected to be disposed of within five years or a longer period approved by the Office.

Exchange rate contracts. The term *exchange rate contracts* includes cross-currency interest rate swaps; forward foreign exchange rate contracts; currency options purchased; and any similar instrument that, in the opinion of the Office, may give rise to similar risks.

Face amount. The term *face amount* means the notational principal, or face value, amount of an off-balance sheet item or the amortized cost of an on-balance sheet asset.

Financial asset. The term *financial asset* means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

Financial standby letter of credit. The term *financial standby letter of credit* means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

(1) To repay money borrowed by, or advanced to, or for the account of, a second party (the account party); or

(2) To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

Includable subsidiary. The term *includable subsidiary* means a subsidiary of a savings association that is:

(1) Engaged solely in activities not impermissible for a national bank;

(2) Engaged in activities not permissible for a national bank, but only if acting solely as agent for its customers and such agency position is clearly documented in the savings association's files;

(3) Engaged solely in mortgage-banking activities;

(4)(i) Itself an insured depository institution or a company the sole investment of which is an insured depository institution, and

(ii) Was acquired by the parent savings association prior to May 1, 1989; or

(5) A subsidiary of any Federal savings association existing as a Federal savings association on August 9, 1989 that

(i) Was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under State law, or

(ii) Acquired its principal assets from an association that was chartered prior to October 15, 1982, as a savings bank or a cooperative bank under State law.

Intangible assets. The term *intangible assets* means assets considered to be intangible assets under generally accepted accounting principles. These assets include, but are not limited to, goodwill, core deposit premiums, purchased credit card relationships, and favorable leaseholds. Servicing assets are not intangible assets, and interest-only strips receivable and other nonsecurity financial instruments are not intangible assets under this definition.

Interest-rate contracts. The term *interest-rate contracts* includes single currency interest-rate swaps; basis swaps; forward rate agreements; interest-rate options purchased; forward forward deposits accepted; and any other instrument that, in the opinion of the Office, may give rise to similar risks, including when-issued securities.

Liquidity facility. The term *liquidity facility* means a legally binding commitment to provide liquidity support to asset-backed commercial paper by lending to, or purchasing assets from any structure, program or conduit in the event that funds are required to repay maturing asset-backed commercial paper.

Mortgage-related securities. The term *mortgage-related securities* means any mortgage-related qualifying securities under section 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(41), *Provided*, That the rating requirements of that section shall not be considered for purposes of this definition.

Nationally recognized statistical rating organization (NRSRO). The term *nationally recognized statistical rating organization* means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

OECD-based country. The term *OECD-based country* means a member of that grouping of countries that are full members of the Organization for Economic Cooperation and Development

(OECD) plus countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General Arrangements to Borrow. This term excludes any country that has rescheduled its external sovereign debt within the previous five years. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other change in market conditions.

Original maturity. The term *original maturity* means, with respect to a commitment, the earliest date after a commitment is made on which the commitment is scheduled to expire (*i.e.*, it will reach its stated maturity and cease to be binding on either party), *Provided*, That either:

(i) The commitment is not subject to extension or renewal and will actually expire on its stated expiration date; or

(ii) If the commitment is subject to extension or renewal beyond its stated expiration date, the stated expiration date will be deemed the original maturity only if the extension or renewal must be based upon terms and conditions independently negotiated in good faith with the customer at the time of the extension or renewal and upon a new, *bona fide* credit analysis utilizing current information on financial condition and trends.

Performance-based standby letter of credit. The term *performance-based standby letter of credit* means any letter of credit, or similar arrangement, however named or described, which represents an irrevocable obligation to the beneficiary on the part of the issuer to make payment on account of any default by a third party in the performance of a nonfinancial or commercial obligation. Such letters of credit include arrangements backing subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

Perpetual preferred stock. The term *perpetual preferred stock* means preferred stock without a fixed maturity date that cannot be redeemed at the option of the holder, and that has no other provisions that will require future redemption of the issue. For purposes of these instruments, preferred stock that can be redeemed at the option of the holder is deemed to have an “original maturity” of the earliest possible date on which it may be so redeemed. Cumulative perpetual preferred stock is preferred stock where the dividends accumulate from one period to the next. Noncumulative perpetual preferred stock is preferred stock where the unpaid dividends are not carried over to subsequent dividend periods.

Problem institution. The term *problem institution* means a savings association that, at the time of its acquisition, merger, purchase of assets or other business combination with or by another savings association:

- (1) Was subject to special regulatory controls by its primary Federal or state regulatory authority;
- (2) Posed particular supervisory concerns to its primary Federal or state regulatory authority; or
- (3) Failed to meet its regulatory capital requirement immediately before the transaction.

Prorated assets. The term *prorated assets* means the total assets (as determined in the most recently available GAAP report but in no event more than one year old) of a subsidiary (including those subsidiaries where the savings association has a minority interest) multiplied by the savings association’s percentage of ownership of that subsidiary.

Qualifying mortgage loan. (1) The term *qualifying mortgage loan* means a loan that:

- (i) Is fully secured by a first lien on a one-to-four-family residential property;
- (ii) Is underwritten in accordance with prudent underwriting standards, including standards relating the ratio of the loan amount to the value of the property (LTV ratio). See Appendix to 12 CFR 560.101. A nonqualifying mortgage loan that is paid down to an appropriate LTV ratio (calculated using

value at origination) may become a qualifying loan if it meets all other requirements of this definition;

(iii) Maintains an appropriate LTV ratio based on the amortized principal balance of the loan; and

(iv) Is performing and is not more than 90 days past due.

(2) If a savings association holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purposes of determining the LTV ratio and the appropriate risk weight under § 567.6(a).

(3) A loan to an individual borrower for the construction of the borrower’s home may be included as a qualifying mortgage loan.

Qualifying multifamily mortgage loan.

(1) The term *qualifying multifamily mortgage loan* means a loan secured by a first lien on multifamily residential properties consisting of 5 or more dwelling units, provided that:

(i) The amortization of principal and interest occurs over a period of not more than 30 years;

(ii) The original minimum maturity for repayment of principal on the loan is not less than seven years;

(iii) When considering the loan for placement in a lower risk-weight category, all principal and interest payments have been made on a timely basis in accordance with its terms for the preceding year;

(iv) The loan is performing and not 90 days or more past due;

(v) The loan is made by the savings association in accordance with prudent underwriting standards; and

(vi) If the interest rate on the loan does not change over the term of the loan:

(A) The current loan balance amount does not exceed 80 percent of the value of the property securing the loan; and

(B) For the property’s most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 120 percent, or in the case of cooperative or other not-for-profit housing projects, the property generates sufficient cash

flows to provide comparable protection to the institution; or

(vii) If the interest rate on the loan changes over the term of the loan:

(A) The current loan balance amount does not exceed 75 percent of the value of the property securing the loan; and

(B) For the property's most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 115 percent, or in the case of cooperative or other not-for-profit housing projects, the property generates sufficient cash flows to provide comparable protection to the institution.

(2) The term *qualifying multifamily mortgage loan* also includes a multifamily mortgage loan that on March 18, 1994 was a first mortgage loan on an existing property consisting of 5-36 dwelling units with an initial loan-to-value ratio of not more than 80% where an average annual occupancy rate of 80% or more of total units had existed for at least one year, and continues to meet these criteria.

(3) For purposes of paragraphs (1) (vi) and (vii) of this definition, the term *value of the property* means, at origination of a loan to purchase a multifamily property: the lower of the purchase price or the amount of the initial appraisal, or if appropriate, the initial evaluation. In cases not involving the purchase of a multifamily loan, the *value of the property* is determined by the most current appraisal, or if appropriate, the most current evaluation.

(4) In cases where a borrower refinances a loan on an existing property, as an alternative to paragraphs (1) (iii), (vi), and (vii) of this definition:

(i) All principal and interest payments on the loan being refinanced have been made on a timely basis in accordance with the terms of that loan for the preceding year; and

(ii) The net income on the property for the preceding year would support timely principal and interest payments on the new loan in accordance with the applicable debt service requirement.

Qualifying residential construction loan. (1) The term *qualifying residential construction loan*, also referred to as a residential bridge loan, means a loan

made in accordance with sound lending principles satisfying the following criteria:

(i) The builder must have substantial project equity in the home construction project;

(ii) The residence being constructed must be a 1-4 family residence sold to a home purchaser;

(iii) The lending savings association must obtain sufficient documentation from a permanent lender (which may be the construction lender) demonstrating that:

(A) The home buyer intends to purchase the residence; and

(B) Has the ability to obtain a permanent qualifying mortgage loan sufficient to purchase the residence;

(iv) The home purchaser must have made a substantial earnest money deposit;

(v) The construction loan must not exceed 80 percent of the sales price of the residence;

(vi) The construction loan must be secured by a first lien on the lot, residence under construction, and other improvements;

(vii) The lending thrift must retain sufficient undisbursed loan funds throughout the construction period to ensure project completion;

(viii) The builder must incur a significant percentage of direct costs (*i.e.*, the actual costs of land, labor, and material) before any drawdown on the loan;

(ix) If at any time during the life of the construction loan any of the criteria of this rule are no longer satisfied, the association must immediately recategorize the loan at a 100 percent risk-weight and must accurately report the loan in the association's next quarterly Thrift Financial Report;

(x) The home purchaser must intend that the home will be owner-occupied;

(xi) The home purchaser(s) must be an individual(s), not a partnership, joint venture, trust corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing the home(s) for speculative purposes; and

(xii) The loan must be performing and not more than 90 days past due.

(2) The documentation for each loan and home sale must be sufficient to

demonstrate compliance with the criteria in paragraph (1) of this definition. The OTS retains the discretion to determine that any loans not meeting sound lending principles must be placed in a higher risk-weight category. The OTS also reserves the discretion to modify these criteria on a case-by-case basis provided that any such modifications are not inconsistent with the safety and soundness objectives of this definition.

Qualifying securities firm. The term *qualifying securities firm* means:

(1) A securities firm incorporated in the United States that is a broker-dealer that is registered with the Securities and Exchange Commission (SEC) and that complies with the SEC's net capital regulations (17 CFR 240.15c3(1)); and

(2) A securities firm incorporated in any other OECD-based country, if the savings association is able to demonstrate that the securities firm is subject to consolidated supervision and regulation (covering its subsidiaries, but not necessarily its parent organizations) comparable to that imposed on depository institutions in OECD countries. Such regulation must include risk-based capital requirements comparable to those imposed on depository institutions under the Accord on International Convergence of Capital Measurement and Capital Standards (1988, as amended in 1998).

Qualifying supervisory goodwill. The term *qualifying supervisory goodwill* means, for eligible savings associations:

(1) Any unamortized goodwill (FSLIC Capital Contributions, as reported in the September 30, 1989 Thrift Financial Report) that existed on April 12, 1989 resulting from prior regulatory accounting practices less any amortization that would have occurred subsequent to April 12, 1989 through the current reporting period where the amortization is calculated on a straight line basis over the shorter of 20 years, or the remaining period for amortization in effect on April 12, 1989 for regulatory accounting practices; plus

(2) The lesser of:

(i) Supervisory goodwill as defined in this section that is included in goodwill that is reflected in the current re-

porting period under generally accepted accounting principles ("GAAP"); or

(ii)(A) Supervisory goodwill as defined in this section that is included in goodwill that is reflected in the current reporting period under GAAP;

(B) Plus any amortization of the goodwill in paragraph (2)(ii)(A) of this definition that occurred subsequent to April 12, 1989 for GAAP reporting purposes;

(C) Minus the amortization of the goodwill in paragraph (2)(ii)(A) of this definition through the current reporting period that results when the goodwill is amortized subsequent to April 12, 1989 on a straightline basis over the shorter of—

(1) 20 years; or

(2) The remaining period for amortization in effect on April 12, 1989 under regulatory accounting practices.

Reciprocal holdings of depository institution instruments. The term *reciprocal holdings of depository institution instruments* means cross-holdings or other formal or informal arrangements in which two or more depository institutions swap, exchange, or otherwise agree to hold each other's capital instruments. This definition does not include holdings of capital instruments issued by other depository institutions that were taken in satisfaction of debts previously contracted, provided that the reporting savings association has not held such instruments for more than five years or a longer period approved by the Office.

Recourse. The term *recourse* means a savings association's retention, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold (in accordance with generally accepted accounting principles) that exceeds a *pro rata* share of that savings association's claim on the asset. If a savings association has no claim on a asset it has sold, then the retention of any credit risk is recourse. A recourse obligation typically arises when a savings association transfers assets in a sale and retains an explicit obligation to repurchase assets or to absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other

party. Recourse may also exist implicitly if a savings association provides credit enhancement beyond any contractual obligation to support assets it has sold. Recourse obligations include:

(1) Credit-enhancing representations and warranties made on transferred assets;

(2) Loan servicing assets retained pursuant to an agreement under which the savings association will be responsible for losses associated with the loans serviced. Servicer cash advances as defined in this section are not recourse obligations;

(3) Retained subordinated interests that absorb more than their *pro rata* share of losses from the underlying assets;

(4) Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

(5) Loan strips sold without contractual recourse where the maturity of the transferred portion of the loan is shorter than the maturity of the commitment under which the loan is drawn;

(6) Credit derivatives that absorb more than the savings association's *pro rata* share of losses from the transferred assets;

(7) Clean-up calls on assets the savings association has sold. However, clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the savings association are not recourse arrangements; and

(8) Liquidity facilities that provide support to asset-backed commercial paper (other than eligible ABCP liquidity facilities).

Replacement cost. The term *replacement cost* means, with respect to interest rate and exchange-rate contracts, the loss that would be incurred in the event of a counterparty default, as measured by the net cost of replacing the contract at the current market value. If default would result in a theoretical profit, the replacement value is considered to be zero. This mark-to-market process must incorporate changes in both interest rates and counterparty credit quality.

Residential properties. The term *residential properties* means houses, condominiums, cooperative units, and

manufactured homes. This definition does not include boats or motor homes, even if used as a primary residence, or timeshare properties.

Residual characteristics. The term *residual characteristics* means interests similar to a multi-class pay-through obligation representing the excess cash flow generated from mortgage collateral over the amount required for the issuer's debt service and ongoing administrative expenses or interests presenting similar degrees of interest-rate/prepayment risk and principal loss risks.

Residual interest. (1) The term *residual interest* means any on-balance sheet asset that:

(i) Represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise; and

(ii) Exposes a savings association to credit risk directly or indirectly associated with the transferred asset that exceeds a *pro rata* share of that savings association's claim on the asset, whether through subordination provisions or other credit enhancement techniques.

(2) Residual interests generally include credit-enhancing interest-only strips, spread accounts, cash collateral accounts, retained subordinated interests (and other forms of overcollateralization), and similar assets that function as a credit enhancement.

(3) Residual interests further include those exposures that, in substance, cause the savings association to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold.

(4) Residual interests generally do not include assets purchased from a third party. However, a credit-enhancing interest-only strip that is acquired in any asset transfer is a residual interest.

Risk participation. The term *risk participation* means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute), notwithstanding

that another party has acquired a participation in that obligation.

Risk-weighted assets. The term *risk-weighted assets* means the sum total of risk-weighted on-balance sheet assets and the total of risk-weighted off-balance sheet credit equivalent amounts. These assets are calculated in accordance with §567.6 of this part.

Securitization. The term *securitization* means the pooling and repackaging by a special purpose entity of assets or other credit exposures that can be sold to investors. *Securitization* includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

Servicer cash advance. The term *servicer cash advance* means funds that a residential mortgage servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A servicer cash advance is not a recourse obligation or a direct credit substitute if:

(1) The servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

(2) For any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal amount on that loan.

State. The term *State* means any one of the several states of the United States of America, the District of Columbia, Puerto Rico, and the territories and possessions of the United States.

Structured financing program. The term *structured financing program* means a program where receivable interests and asset-or mortgage-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured financing programs allocate credit risk, generally, between the participants and credit enhancement provided to the program.

Subsidiary. The term *subsidiary* means any corporation, partnership, business trust, joint venture, association or similar organization in which a savings association directly or indirectly holds an ownership interest and the assets of which are consolidated with those of the savings association for purposes of reporting under Generally Accepted Accounting Principles (GAAP). Generally, these are majority-owned subsidiaries.¹ This definition does not include ownership interests that were taken in satisfaction of debts previously contracted, provided that the reporting association has not held the interest for more than five years or a longer period approved by the OTS.

Supervisory goodwill. The term *supervisory goodwill* means goodwill² resulting from the acquisition, merger, consolidation, purchase of assets, or other business combination (if such transaction occurred on or before April 12, 1989) of

(1) A savings association where the fair market value of assets was less than the fair market value of liabilities at the acquisition date; or

(2) A problem institution.

Tier 1 capital. The term *Tier 1 capital* means core capital as computed in accordance with §567.5(a) of this part.

Tier 2 capital. The term *Tier 2 capital* means supplementary capital as computed in accordance with §567.5 of this part.

Total assets. The term *total assets* means total assets as would be required to be reported for consolidated entities on period-end reports filed with the Office in accordance with generally accepted accounting principles.

Traded position. The term *traded position* means a position retained, assumed, or issued in connection with a

¹The OTS reserves the right to review a savings association's investment in a subsidiary on a case-by-case basis. If the OTS determines that such investment is more appropriately treated as an equity security or an ownership interest in a subsidiary, it will make such determination regardless of the percentage of ownership held by the savings association.

²Goodwill that has been written off of an association's balance sheet for its GAAP financial statements or Thrift Financial Report cannot be counted as supervisory goodwill.

securitization that is rated by a NRSRO, where there is a reasonable expectation that, in the near future, the rating will be relied upon by:

(1) Unaffiliated investors to purchase the security; or

(2) An unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

Unconditionally cancelable. The term *unconditionally cancelable* means, with respect to a commitment-type lending arrangement, that the savings association may, at any time, with or without cause, refuse to advance funds or extend credit under the facility. In the case of home equity lines of credit, the savings association is deemed able to unconditionally cancel the commitment if it can, at its option, prohibit additional extensions of credit, reduce the line, and terminate the commitment to the full extent permitted by relevant Federal law.

United States Government or its agencies. The term *United States Government or its agencies* means an instrumentality of the U.S. Government whose debt obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States Government.

United States Government-sponsored agency or corporation. The term *United States Government-sponsored agency or corporation* means an agency or corporation originally established or chartered to serve public purposes specified by the United States Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 12709, Apr. 13, 1992; 57 FR 33439, July 29, 1992; 58 FR 15086, Mar. 19, 1993; 59 FR 12810, Mar. 18, 1994; 60 FR 39232, Aug. 1, 1995; 60 FR 42028, Aug. 15, 1995; 61 FR 66579, Dec. 18, 1996; 62 FR 66263, Dec. 18, 1997; 63 FR 42678, Aug. 10, 1998; 64 FR 10200, Mar. 2, 1999; 66 FR 59661, Nov. 29, 2001; 67 FR 16979, Apr. 9, 2002; 67 FR 31726, May 10, 2002; 68 FR 56536, Oct. 1, 2003; 69 FR 44924, July 28, 2004]

§ 567.2 Minimum regulatory capital requirement.

(a) To meet its regulatory capital requirement a savings association must

satisfy each of the following capital standards:

(1) *Risk-based capital requirement.* (i) A savings association's minimum risk-based capital requirement shall be an amount equal to 8% of its risk-weighted assets as measured under § 567.6 of this part.

(ii) A savings association may not use supplementary capital to satisfy this requirement in an amount greater than 100% of its core capital as defined in § 567.5 of this part.

(2) *Leverage ratio requirement.* (i) A savings association's minimum leverage ratio requirement shall be the amount set forth in § 567.8 of this part.

(ii) A savings association must satisfy this requirement with core capital as defined in § 567.5(a) of this part.

(3) *Tangible capital requirement.* (i) A savings association's minimum tangible capital requirement shall be the amount set forth in § 567.9 of this part.

(ii) A savings association must satisfy this requirement with tangible capital as defined in § 567.9 of this part in an amount not less than 1.5% of its adjusted total assets.

(b) [Reserved]

(c) Savings associations are expected to maintain compliance with all of these standards at all times.

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 33440, July 29, 1992; 58 FR 45813, Aug. 31, 1993; 62 FR 66263, Dec. 18, 1997; 64 FR 10201, Mar 2, 1999; 66 FR 59663, Nov. 29, 2001]

§ 567.3 Individual minimum capital requirements.

(a) *Purpose and scope.* The rules and procedures specified in this section apply to the establishment of an individual minimum capital requirement for a savings association that varies from the requirement that would otherwise apply to the savings association under § 567.2 of this part. Pursuant to 12 U.S.C. 1464(s), the OTS may establish such individual minimum capital requirements for savings associations as it deems necessary or appropriate on a case-by-case basis in light of the particular circumstances of each savings association.

(b) *Appropriate considerations for establishing individual minimum capital requirements.* Minimum capital levels higher than those required under § 567.2

may be appropriate for individual savings associations. Increased individual minimum capital requirements may be established upon a determination that the savings association's capital is or may become inadequate in view of its circumstances. For example, higher capital levels may be appropriate for:

- (1) A savings association receiving special supervisory attention;
- (2) A savings association that has or is expected to have losses resulting in capital inadequacy;
- (3) A savings association that has a high degree of exposure to interest rate risk, prepayment risk, credit risk, concentration of credit risk, certain risks arising from nontraditional activities, or similar risks; or a high proportion of off-balance sheet risk, especially stand-by letters of credit;
- (4) A savings association that has poor liquidity or cash flow;
- (5) A savings association growing, either internally or through acquisitions, at such a rate that supervisory problems are presented that are not dealt with adequately by other Office regulations or other guidance;
- (6) A savings association that may be adversely affected by the activities or condition of its holding company, affiliate(s), subsidiaries, or other persons or savings associations with which it has significant business relationships, including concentrations of credit;
- (7) A savings association with a portfolio reflecting weak credit quality or a significant likelihood of financial loss, or that has loans in nonperforming status or on which borrowers fail to comply with repayment terms;
- (8) A savings association that has inadequate underwriting policies, standards, or procedures for its loans and investments; or
- (9) A savings association that has a record of operational losses that exceeds the average of other, similarly situated savings associations; has management deficiencies, including failure to adequately monitor and control financial and operating risks, particularly the risks presented by concentrations of credit and nontraditional activities; or has a poor record of supervisory compliance.

(c) *Standards for determination of appropriate individual minimum capital re-*

quirements. The appropriate minimum capital level for an individual savings association cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. The decision is necessarily based, in part, on subjective judgment grounded in agency expertise. The factors to be considered in the determination will vary in each case and may include, for example:

- (1) The conditions or circumstances leading to the determination that a higher minimum capital requirement is appropriate or necessary for the savings association;
- (2) The exigency of those circumstances or potential problems;
- (3) The overall condition, management strength, and future prospects of the savings association and, if applicable, its holding company, subsidiaries, and affiliates;
- (4) The savings association's liquidity, capital and other indicators of financial stability, particularly as compared with those of similarly situated savings associations; and
- (5) The policies and practices of the savings association's directors, officers, and senior management as well as the internal control and internal audit systems for implementation of such adopted policies and practices.

(d) *Procedures—(1) Notification.* When the OTS determines that a minimum capital requirement different from that set forth in § 567.2 of this part is necessary or appropriate for a particular savings association, it shall notify the savings association in writing of its proposed individual minimum capital requirement; the schedule for compliance with the new requirement; and the specific causes for determining that the higher individual minimum capital requirement is necessary or appropriate for the savings association. The OTS shall forward the notifying letter to the appropriate state supervisor if a state-chartered savings association would be subject to an individual minimum capital requirement.

(2) *Response.* (i) The response shall include any information that the savings association wants the OTS to consider in deciding whether to establish or to amend an individual minimum capital

requirement for the savings association, what the individual capital requirement should be, and, if applicable, what compliance schedule is appropriate for achieving the required capital level. The responses of the savings association and appropriate state supervisor must be in writing and must be delivered to the OTS within 30 days after the date on which the notification was received. Such response must be filed in accordance with §§ 516.30 and 516.40 of this chapter. The OTS may extend the time period for good cause. The time period for response by the insured savings association may be shortened for good cause:

(A) When, in the opinion of the OTS, the condition of the savings association so requires, and the OTS informs the savings association of the shortened response period in the notice;

(B) With the consent of the savings association; or

(C) When the savings association already has advised the OTS that it cannot or will not achieve its applicable minimum capital requirement.

(ii) Failure to respond within 30 days, or such other time period as may be specified by the OTS, may constitute a waiver of any objections to the proposed individual minimum capital requirement or to the schedule for complying with it, unless the OTS has provided an extension of the response period for good cause.

(3) *Decision.* After expiration of the response period, the OTS shall decide whether or not he believes the proposed individual minimum capital requirement should be established for the savings association, or whether that proposed requirement should be adopted in modified form, based on a review of the savings association's response and other relevant information. The OTS's decision shall address comments received within the response period from the savings association and the appropriate state supervisor (if a state-chartered savings association is involved) and shall state the level of capital required, the schedule for compliance with this requirement, and any specific remedial action the savings association could take to eliminate the need for continued applicability of the individual minimum capital requirement.

The OTS shall provide the savings association and the appropriate state supervisor (if a state-chartered savings association is involved) with a written decision on the individual minimum capital requirement, addressing the substantive comments made by the savings association and setting forth the decision and the basis for that decision. Upon receipt of this decision by the savings association, the individual minimum capital requirement becomes effective and binding upon the savings association. This decision represents final agency action.

(4) *Failure to comply.* Failure to satisfy an individual minimum capital requirement, or to meet any required incremental additions to capital under a schedule for compliance with such an individual minimum capital requirement, shall constitute a legal basis for issuing a capital directive pursuant to § 567.4 of this part.

(5) *Change in circumstances.* If, after a decision is made under paragraph (d)(3) of this section, there is a change in the circumstances affecting the savings association's capital adequacy or its ability to reach its required minimum capital level by the specified date, OTS may amend the individual minimum capital requirement or the savings association's schedule for such compliance. The OTS may decline to consider a savings association's request for such changes that are not based on a significant change in circumstances or that are repetitive or frivolous. Pending the OTS's reexamination of the original decision, that original decision and any compliance schedule established thereunder shall continue in full force and effect.

[54 FR 49649, Nov. 30, 1989, as amended at 55 FR 13516, Apr. 11, 1990; 57 FR 14335, 14348, Apr. 20, 1992; 59 FR 64564, Dec. 15, 1994; 60 FR 66719, Dec. 26, 1995; 66 FR 13009, Mar. 2, 2001]

§ 567.4 Capital directives.

(a) *Issuance of a Capital Directive—(1) Purpose.* In addition to any other action authorized by law, the Office may issue a capital directive to a savings association that does not have an amount of capital satisfying its minimum capital requirement. Issuance of such a capital directive may be based

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on a savings association's noncompliance with a capital requirement established under § 567.2, § 567.3, by a written agreement under 12 U.S.C. 1464(s), or as a condition for approval of an application. A capital directive may order a savings association to:

- (i) Achieve its minimum capital requirement by a specified date;
- (ii) Adhere to the compliance schedule for achieving its individual minimum capital requirement;
- (iii) Submit and adhere to a capital plan acceptable to the Office describing the means and a time schedule by which the savings association shall reach its required capital level;
- (iv) Take other action, including but not limited to, reducing the savings association's assets or its rate of liability growth, or imposing restrictions on the savings association's payment of dividends, in order to cause the savings association to reach its required capital level;
- (v) Take any action authorized under § 567.10(e); or
- (vi) Take a combination of any of these actions.

A capital directive issued under this section, including a plan submitted pursuant to a capital directive, is enforceable under 12 U.S.C. 1818 in the same manner and to the same extent as an effective and outstanding cease and desist order which has become final under 12 U.S.C. 1818.

(2) *Notice of intent to issue capital directive.* The OTS will determine whether to initiate the process of issuing a capital directive. The OTS will notify a savings association in writing by registered mail of its intention to issue a capital directive. If a state-chartered savings association is involved, the OTS will also notify and solicit comment from the appropriate state supervisor. The notice will state:

- (i) The reasons for issuance of the capital directive and
- (ii) The proposed contents of the capital directive.

(3) *Response to notice of intent.* (i) A savings association may respond to the notice of intent by submitting its own compliance plan, or may propose an alternative plan. The response should also include any information that the savings association wishes the OTS to

consider in deciding whether to issue a capital directive. The appropriate state supervisor may also submit a response. These responses must be in writing and be delivered within 30 days after the receipt of the notices. Such responses must be filed in accordance with §§ 516.30 and 516.40 of this chapter. In its discretion, the Office may extend the time period for the response for good cause. The Office may, for good cause, shorten the 30-day time period for response by the insured savings association:

(A) When, in the opinion of the Office, the condition of the savings association so requires, and the Office informs the savings association of the shortened response period in the notice;

(B) With the consent of the savings association; or

(C) When the savings association already has advised the Office that it cannot or will not achieve its applicable minimum capital requirement.

(ii) Failure to respond within 30 days of receipt, or such other time period as may be specified by the Office, may constitute a waiver of any objections to the capital directive unless the Office grants an extension of the time period for good cause.

(4) *Decision.* After the closing date of the savings association's response period, or upon receipt of the savings association's response, if earlier, the Office shall consider the savings association's response and may seek additional information or clarification of the response. Thereafter, the Office will determine whether or not to issue a capital directive and, if one is to be issued, whether it should be as originally proposed or in modified form.

(5) *Service and effectiveness.* (i) Upon issuance, a capital directive will be served upon the savings association. It will include or be accompanied by a statement of reasons for its issuance and shall address the responses received during the response period.

(ii) A capital directive shall become effective upon the expiration of 30 days after service upon the savings association, unless the Office determines that a shorter effective period is necessary either on account of the public interest

or in order to achieve the capital directive's purpose. If the savings association has consented to issuance of the capital directive, it may become effective immediately. A capital directive shall remain in effect and enforceable unless, and then only to the extent that, it is stayed, modified, or terminated by the Office.

(6) *Change in circumstances.* Upon a change in circumstances, a savings association may submit a request to the OTS to reconsider the terms of the capital directive or consider changes in the savings association's capital plan issued under a directive for the savings association to achieve its minimum capital requirement. If the OTS believes such a change is warranted, the OTS may modify the savings association's capital requirement or may refuse to make such modification if it determines that there are not significant changes in circumstances. Pending a decision on reconsideration, the capital directive and capital plan shall continue in full force and effect.

(b) *Relation to other administrative actions.* The Office—

(1) May consider a savings association's progress in adhering to any capital plan required under this section whenever such savings association or any affiliate of such savings association (including any company which controls such savings association) seeks approval for any proposal that would have the effect of diverting earnings, diminishing capital, or otherwise impeding such savings association's progress in meeting its minimum capital requirement; and

(2) May disapprove any proposal referred to in paragraph (b)(1) of this section if the Office determines that the proposal would adversely affect the ability of the savings association on a current or pro forma basis to satisfy its capital requirement.

[54 FR 49649, Nov. 30, 1989, as amended at 55 FR 13517, Apr. 11, 1990; 57 FR 14335, Apr. 20, 1992; 57 FR 33440, July 29, 1992; 60 FR 66719, Dec. 26, 1995; 66 FR 13009, Mar. 2, 2001]

§ 567.5 Components of capital.

(a) *Core Capital.* (1) The following elements,³ less the amount of any deductions pursuant to paragraph (a)(2) of this section, comprise a savings association's core capital:

(i) Common stockholders' equity (including retained earnings);

(ii) Noncumulative perpetual preferred stock and related surplus;⁴

(iii) Minority interests in the equity accounts of subsidiaries that are fully consolidated. However, minority interests in consolidated ABCP programs sponsored by a savings association are excluded from the association's core capital or total capital base if the savings association excludes the consolidated assets of such programs from risk-weighted assets pursuant to § 567.6(a)(3);

(iv) Nonwithdrawable accounts and pledged deposits of mutual savings associations (excluding any treasury shares held by the savings association) meeting the criteria of regulations and memoranda of the Office to the extent that such accounts or deposits have no fixed maturity date, cannot be withdrawn at the option of the accountholder, and do not earn interest that carries over to subsequent periods;

(v) The remaining goodwill (FSLIC Capital Contributions) resulting from prior regulatory accounting practices as provided in paragraph (1) of the definition for *qualifying supervisory goodwill* in § 567.1 of this part.

(2) *Deductions from core capital.* (i) Intangible assets, as defined in § 567.1 of this part, are deducted from assets and

³Stock issues where the dividend is reset periodically based on current market conditions and the savings associations's current credit rating, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to supplementary capital, regardless of cumulative or noncumulative characteristics.

⁴Stock issued by subsidiaries that may not be counted by the parent savings association on the Thrift Financial Report, likewise shall not be considered in calculating capital. For example, preferred stock issued by a savings association or a subsidiary that is, in effect, collateralized by assets of the savings association or one of its subsidiaries shall not be included in capital. Similarly, common stock with mandatorily redeemable provisions is not includable in core capital.

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capital in computing core capital, except as otherwise provided by §567.12 of this part.

(ii) Servicing assets that are not includable in core capital pursuant to §567.12 of this part are deducted from assets and capital in computing core capital.

(iii) Credit-enhancing interest-only strips that are not includable in core capital under §567.12 of this part are deducted from assets and capital in computing core capital.

(iv) Investments, both equity and debt, in subsidiaries that are not includable subsidiaries (including those subsidiaries where the savings association has a minority ownership interest) are deducted from assets and, thus, core capital except as provided in paragraphs (a)(2)(v) and (a)(2)(vi) of this section.

(v) If a savings association has any investments (both debt and equity) in one or more subsidiaries engaged as of April 12, 1989 and continuing to be engaged in any activity that would not fall within the scope of activities in which includable subsidiaries may engage, it must deduct such investments from assets and, thus, core capital in accordance with this paragraph (a)(2)(v). The savings association must first deduct from assets and, thus, core capital the amount by which any investments in such subsidiary(ies) exceed the amount of such investments held by the savings association as of April 12, 1989. Next the savings association must deduct from assets and, thus, core capital the lesser of:

(A) The savings association's investments in and extensions of credit to the subsidiary as of April 12, 1989; or

(B) The savings association's investments in and extensions of credit to the subsidiary on the date as of which the savings association's capital is being determined.

(vi) If a savings association holds a subsidiary (either directly or through a subsidiary) that is itself a domestic depository institution, the Office may, in its sole discretion upon determining that the amount of core capital that would be required would be higher if the assets and liabilities of such subsidiary were consolidated with those of the parent savings association than the

amount that would be required if the parent savings association's investment were deducted pursuant to paragraphs (a)(2)(iv) and (a)(2)(v) of this section, consolidate the assets and liabilities of that subsidiary with those of the parent savings association in calculating the capital adequacy of the parent savings association, regardless of whether the subsidiary would otherwise be an includable subsidiary as defined in §567.1 of this part.

(b) *Supplementary Capital.* Supplementary capital counts towards a savings association's total capital up to a maximum of 100% of the savings association's core capital. The following elements comprise a savings association's supplementary capital:

(1) *Permanent Capital Instruments.* (i) Cumulative perpetual preferred stock and other perpetual preferred stock⁵ issued pursuant to regulations and memoranda of the Office;

(ii) Mutual capital certificates issued pursuant to regulations and memoranda of the Office;

(iii) Nonwithdrawable accounts and pledged deposits (excluding any treasury shares held by the savings association) meeting the criteria of 12 CFR 561.42 to the extent that such instruments are not included in core capital under paragraph (a) of this section;

(iv) Net worth certificates either issued pursuant to regulations and memoranda of the Office, or that the FDIC is committed to purchase;

(v) Income capital certificates;

(vi) Perpetual subordinated debt issued pursuant to regulations and memoranda of the Office; and

(vii) Mandatory convertible subordinated debt (capital notes) issued pursuant to regulations and memoranda of the Office.

(2) *Maturing Capital Instruments.* (i) Subordinated debt issued pursuant to regulations and memoranda of the Office;

⁵Preferred stock issued by subsidiaries that may not be counted by the parent savings association on the Thrift Financial Report likewise may not be considered in calculating capital. Preferred stock issued by a savings association or a subsidiary that is, in effect, collateralized by assets of the savings association or one of its subsidiaries may not be included in capital.

(ii) Intermediate-term preferred stock issued pursuant to regulations and memoranda of the Office and any related surplus;

(iii) Mandatory convertible subordinated debt (commitment notes) issued pursuant to regulations and memoranda of the Office; and

(iv) Mandatorily redeemable preferred stock that was issued before July 23, 1985 or issued pursuant to regulations and memoranda of the Office and approved in writing by the FSLIC for inclusion as regulatory capital before or after issuance.

(3) *Transition rules for maturing capital instruments*—(i) *Maturing capital instruments issued on or before November 7, 1989.* All maturing capital instruments issued on or before November 7, 1989, are includable in supplementary capital to the extent such instruments were includable in capital pursuant to the regulations of the OTS in effect as of that date, including any applicable amortization schedules. With the prior approval of the OTS, a savings association may include maturing capital instruments issued on or before November 7, 1989, in supplementary capital in accordance with the treatment set forth in paragraph (b)(3)(ii) of this section.

Years to maturity of outstanding subordinated debt	Percent included in supplementary capital
Greater than or equal to 7	100
Less than 7 but greater than or equal to 6	86
Less than 6 but greater than or equal to 5	71
Less than 5 but greater than or equal to 4	57
Less than 4 but greater than or equal to 3	43
Less than 3 but greater than or equal to 2	29
Less than 2 but greater than or equal to 1	14
Less than 1	0

(ii) *Maturing capital instruments issued after November 7, 1989.* A savings association issuing maturing capital instruments after November 7, 1989, may choose, subject to paragraph (b)(3)(ii)(C) of this section, to include such instruments pursuant to either paragraph (b)(3)(ii)(A) or (b)(3)(ii)(B) of this section.

(A) At the beginning of each of the last five years of the life of the maturing capital instrument, the amount that is eligible to be included as supplementary capital is reduced by 20%

of the original amount of that instrument (net of redemptions).⁶

(B) Only the aggregate amount of maturing capital instruments that mature in any one year during the seven years immediately prior to an instrument's maturity that does not exceed 20% of an institution's capital will qualify as supplementary capital.

(C) Once a savings association selects either paragraph (b)(3)(ii)(A) or (b)(3)(ii)(B) of this section for the issuance of a maturing capital instrument, it must continue to elect that option for all subsequent issuances of maturing capital instruments for as long as there is a balance outstanding of such post-November 7, 1989 issuances. Only when such issuances have all been repaid and the savings association has no balance of such issuances outstanding may the savings association elect the other option.

(4) *Allowance for loan and lease losses.* Allowance for loan and lease losses established under OTS regulations and memoranda to a maximum of 1.25 percent of risk-weighted assets.⁷

(5) *Unrealized gains on equity securities.* Up to 45 percent of unrealized gains on available-for-sale equity securities with readily determinable fair

⁶ Capital instruments may be redeemed prior to maturity and without the prior approval of the Office, as long as the instruments are redeemed with the proceeds of, or replaced by, a like amount of a similar or higher quality capital instrument. However, the Office must be notified in writing at least 30 days in advance of such redemption.

⁷ The amount of the allowance for loan and lease losses that may be included in capital is based on a percentage of risk-weighted assets. The gross sum of risk-weighted assets used in this calculation includes all risk-weighted assets, with the exception of assets required to be deducted under § 567.6 in establishing risk-weighted assets. "Excess reserves for loan and lease losses" is defined as assets required to be deducted from capital under § 567.5(a)(2). A savings association may deduct excess reserves for loan and lease losses from the gross sum of risk-weighted assets (i.e., risk-weighted assets including allowance for loan and lease losses) in computing the denominator of the risk-based capital standard. Thus, a savings association will exclude the same amount of excess allowance for loan and lease losses from both the numerator and the denominator of the risk-based capital ratio.

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values may be included in supplementary capital. Unrealized gains are unrealized holding gains, net of unrealized holding losses, before income taxes, calculated as the amount, if any, by which fair value exceeds historical cost. The OTS may disallow such inclusion in the calculation of supplementary capital if the Office determines that the equity securities are not prudently valued.

(c) *Total capital.* (1) A savings association's total capital equals the sum of its core capital and supplementary capital (to the extent that such supplementary capital does not exceed 100% of its core capital).

(2) The following assets, in addition to assets required to be deducted elsewhere in calculating core capital, are deducted from assets for purposes of determining total capital:

- (i) Reciprocal holdings of depository institution capital instruments; and
- (ii) All equity investments.

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 33439, July 29, 1992; 57 FR 33440, July 29, 1992; 58 FR 45813, Aug. 31, 1993; 59 FR 4788, Feb. 2, 1994; 60 FR 39232, Aug. 1, 1995; 62 FR 66263, Dec. 18, 1997; 63 FR 42678, Aug. 10, 1998; 63 FR 46524, Sept. 1, 1998; 66 FR 59663, Nov. 29, 2001; 67 FR 31726, May 10, 2002; 68 FR 56536, Oct. 1, 2003; 69 FR 22385, Apr. 26, 2004; 69 FR 44925, July 28, 2004]

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

(a) *Risk-weighted assets.* Risk-weighted assets equal risk-weighted on-balance sheet assets (computed under paragraph (a)(1) of this section), plus risk-weighted off-balance sheet activities (computed under paragraph (a)(2) of this section), plus risk-weighted recourse obligations, direct credit substitutes, and certain other positions (computed under paragraph (b) of this section). Assets not included (*i.e.*, deducted from capital) for purposes of calculating capital under § 567.5 are not included in calculating risk-weighted assets.

(1) *On-balance sheet assets.* Except as provided in paragraph (b) of this section, risk-weighted on-balance sheet assets are computed by multiplying the on-balance sheet asset amounts times the appropriate risk-weight categories. The risk-weight categories are:

(i) *Zero percent Risk Weight (Category 1).* (A) Cash, including domestic and foreign currency owned and held in all offices of a savings association or in transit. Any foreign currency held by a savings association must be converted into U.S. dollar equivalents;

(B) Securities issued by and other direct claims on the U.S. Government or its agencies (to the extent such securities or claims are unconditionally backed by the full faith and credit of the United States Government) or the central government of an OECD country;

(C) Notes and obligations issued by either the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation and backed by the full faith and credit of the United States Government;

(D) Deposit reserves at, claims on, and balances due from Federal Reserve Banks;

(E) The book value of paid-in Federal Reserve Bank stock;

(F) That portion of assets that is fully covered against capital loss and/or yield maintenance agreements by the Federal Savings and Loan Insurance Corporation or any successor agency.

(G) That portion of assets directly and unconditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country.

(H) Claims on, and claims guaranteed by, a qualifying securities firm that are collateralized by cash on deposit in the savings association or by securities issued or guaranteed by the United States Government or its agencies, or the central government of an OECD country. To be eligible for this risk weight, the savings association must maintain a positive margin of collateral on the claim on a daily basis, taking into account any change in a savings association's exposure to the obligor or counterparty under the claim in relation to the market value of the collateral held in support of the claim.

(ii) *20 percent Risk Weight (Category 2).* (A) Cash items in the process of collection;

(B) That portion of assets collateralized by the current market value of securities issued or guaranteed

by the United States government or its agencies, or the central government of an OECD country;

(C) That portion of assets conditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country;

(D) Securities (not including equity securities) issued by and other claims on the U.S. Government or its agencies which are not backed by the full faith and credit of the United States Government;

(E) Securities (not including equity securities) issued by, or other direct claims on, United States Government-sponsored agencies;

(F) That portion of assets guaranteed by United States Government-sponsored agencies;

(G) That portion of assets collateralized by the current market value of securities issued or guaranteed by United States Government-sponsored agencies;

(H) Claims on, and claims guaranteed by, a qualifying securities firm, subject to the following conditions:

(1) A qualifying securities firm must have a long-term issuer credit rating, or a rating on at least one issue of long-term unsecured debt, from a NRSRO. The rating must be in one of the three highest investment grade categories used by the NRSRO. If two or more NRSROs assign ratings to the qualifying securities firm, the savings association must use the lowest rating to determine whether the rating requirement of this paragraph is met. A qualifying securities firm may rely on the rating of its parent consolidated company, if the parent consolidated company guarantees the claim.

(2) A collateralized claim on a qualifying securities firm does not have to comply with the rating requirements under paragraph (a)(1)(ii)(H)(1) of this section if the claim arises under a contract that:

(i) Is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed using standard industry documentation;

(ii) Is collateralized by debt or equity securities that are liquid and readily marketable;

(iii) Is marked-to-market daily;

(iv) Is subject to a daily margin maintenance requirement under the standard industry documentation; and

(v) Can be liquidated, terminated or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided under applicable law of the relevant jurisdiction. For example, a claim is exempt from the automatic stay in bankruptcy in the United States if it arises under a securities contract or a repurchase agreement subject to section 555 or 559 of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or Regulation EE (12 CFR part 231).

(3) If the securities firm uses the claim to satisfy its applicable capital requirements, the claim is not eligible for a risk weight under this paragraph (a)(1)(ii)(H);

(I) Claims representing general obligations of any public-sector entity in an OECD country, and that portion of any claims guaranteed by any such public-sector entity;

(J) Bonds issued by the Financing Corporation or the Resolution Funding Corporation;

(K) Balances due from and all claims on domestic depository institutions. This includes demand deposits and other transaction accounts, savings deposits and time certificates of deposit, federal funds sold, loans to other depository institutions, including overdrafts and term federal funds, holdings of the savings association's own discounted acceptances for which the account party is a depository institution, holdings of bankers acceptances of other institutions and securities issued by depository institutions, except those that qualify as capital;

(L) The book value of paid-in Federal Home Loan Bank stock;

(M) Deposit reserves at, claims on and balances due from the Federal Home Loan Banks;

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(N) Assets collateralized by cash held in a segregated deposit account by the reporting savings association;

(O) Claims on, or guaranteed by, official multilateral lending institutions or regional development institutions in which the United States Government is a shareholder or contributing member;⁸

(P) That portion of assets collateralized by the current market value of securities issued by official multilateral lending institutions or regional development institutions in which the United States Government is a shareholder or contributing member.

(Q) All claims on depository institutions incorporated in an OECD country, and all assets backed by the full faith and credit of depository institutions incorporated in an OECD country. This includes the credit equivalent amount of participations in commitments and standby letters of credit sold to other depository institutions incorporated in an OECD country, but only if the originating bank remains liable to the customer or beneficiary for the full amount of the commitment or standby letter of credit. Also included in this category are the credit equivalent amounts of risk participations in bankers' acceptances conveyed to other depository institutions incorporated in an OECD country. However, bank-issued securities that qualify as capital of the issuing bank are not included in this risk category;

(R) Claims on, or guaranteed by depository institutions other than the central bank, incorporated in a non-OECD country, with a remaining maturity of one year or less;

(S) That portion of local currency claims conditionally guaranteed by central governments of non-OECD countries, to the extent the savings association has local currency liabilities in that country.

(iii) *50 percent Risk Weight (Category 3)*. (A) Revenue bonds issued by any public-sector entity in an OECD coun-

try for which the underlying obligor is a public-sector entity, but which are repayable solely from the revenues generated from the project financed through the issuance of the obligations;

(B) Qualifying mortgage loans and qualifying multifamily mortgage loans;

(C) Privately-issued mortgage-backed securities (*i.e.*, those that do not carry the guarantee of a government or government sponsored entity) representing an interest in qualifying mortgage loans or qualifying multifamily mortgage loans. If the security is backed by qualifying multifamily mortgage loans, the savings association must receive timely payments of principal and interest in accordance with the terms of the security. Payments will generally be considered timely if they are not 30 days past due;

(D) Qualifying residential construction loans as defined in § 567.1 of this part.

(iv) *100 percent Risk Weight (Category 4)*. All assets not specified above or deducted from calculations of capital pursuant to § 567.5 of this part, including, but not limited to:

- (A) Consumer loans;
- (B) Commercial loans;
- (C) Home equity loans;
- (D) Non-qualifying mortgage loans;
- (E) Non-qualifying multifamily mortgage loans;
- (F) Residential construction loans;
- (G) Land loans;
- (H) Nonresidential construction loans;

(I) Obligations issued by any state or any political subdivision thereof for the benefit of a private party or enterprise where that party or enterprise, rather than the issuing state or political subdivision, is responsible for the timely payment of principal and interest on the obligations, *e.g.*, industrial development bonds;

(J) Debt securities not otherwise described in this section;

(K) Investments in fixed assets and premises;

(L) Certain nonsecurity financial instruments including servicing assets and intangible assets includable in core capital under § 567.12 of this part;

⁸These institutions include, but are not limited to, the International Bank for Reconstruction and Development (World Bank), the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the International Monetary Fund and the Bank for International Settlements.

(M) Interest-only strips receivable, other than credit-enhancing interest-only strips;

(N)-(O) [Reserved]

(P) That portion of equity investments not deducted pursuant to § 567.5 of this part;

(Q) The prorated assets of subsidiaries (except for the assets of includable, fully consolidated subsidiaries) to the extent such assets are included in adjusted total assets;

(R) All repossessed assets or assets that are more than 90 days past due; and

(S) Equity investments that the Office determines have the same risk characteristics as foreclosed real estate by the savings association;

(T) Equity investments permissible for a national bank.

(v) [Reserved]

(vi) *Indirect ownership interests in pools of assets.* Assets representing an indirect holding of a pool of assets, e.g., mutual funds, are assigned to risk-weight categories under this section based upon the risk weight that would be assigned to the assets in the portfolio of the pool. An investment in shares of a mutual fund whose portfolio consists primarily of various securities or money market instruments that, if held separately, would be assigned to different risk-weight categories, generally is assigned to the risk-weight category appropriate to the highest risk-weighted asset that the fund is permitted to hold in accordance with the investment objectives set forth in its prospectus. The savings association may, at its option, assign the investment on a pro rata basis to different risk-weight categories according to the investment limits in its prospectus. In no case will an investment in shares in any such fund be assigned to a total risk weight less than 20 percent. If the savings association chooses to assign investments on a pro rata basis, and the sum of the investment limits of assets in the fund's prospectus exceeds 100 percent, the savings association must assign the highest pro rata amounts of its total investment to the higher risk categories. If, in order to maintain a necessary degree of short-term liquidity, a fund is permitted to hold an insignificant amount of its as-

sets in short-term, highly liquid securities of superior credit quality that do not qualify for a preferential risk weight, such securities will generally be disregarded in determining the risk-weight category into which the savings association's holding in the overall fund should be assigned. The prudent use of hedging instruments by a mutual fund to reduce the risk of its assets will not increase the risk weighting of the mutual fund investment. For example, the use of hedging instruments by a mutual fund to reduce the interest rate risk of its government bond portfolio will not increase the risk weight of that fund above the 20 percent category. Nonetheless, if the fund engages in any activities that appear speculative in nature or has any other characteristics that are inconsistent with the preferential risk-weighting assigned to the fund's assets, holdings in the fund will be assigned to the 100 percent risk-weight category.

(2) *Off-balance sheet items.* Except as provided in paragraph (b) of this section, risk-weighted off-balance sheet items are determined by the following two-step process. First, the face amount of the off-balance sheet item must be multiplied by the appropriate credit conversion factor listed in this paragraph (a)(2). This calculation translates the face amount of an off-balance sheet exposure into an on-balance sheet credit-equivalent amount. Second, the credit-equivalent amount must be assigned to the appropriate risk-weight category using the criteria regarding obligors, guarantors, and collateral listed in paragraph (a)(1) of this section, *provided* that the maximum risk weight assigned to the credit-equivalent amount of an interest-rate or exchange-rate contract is 50 percent. The following are the credit conversion factors and the off-balance sheet items to which they apply.

(i) *100 percent credit conversion factor (Group A).*

(A) [Reserved]

(B) Risk participations purchased in bankers' acceptances;

(C) [Reserved]

(D) Forward agreements and other contingent obligations with a certain

draw down, *e.g.*, legally binding agreements to purchase assets at a specified future date. On the date an institution enters into a forward agreement or similar obligation, it should convert the principal amount of the assets to be purchased at 100 percent as of that date and then assign this amount to the risk-weight category appropriate to the obligor or guarantor of the item, or the nature of the collateral;

(E) Indemnification of customers whose securities the savings association has lent as agent. If the customer is not indemnified against loss by the savings association, the transaction is excluded from the risk-based capital calculation. When a savings association lends its own securities, the transaction is treated as a loan. When a savings association lends its own securities or is acting as agent, agrees to indemnify a customer, the transaction is assigned to the risk weight appropriate to the obligor or collateral that is delivered to the lending or indemnifying institution or to an independent custodian acting on their behalf.

(ii) *50 percent credit conversion factor (Group B)*. (A) Transaction-related contingencies, including, among other things, performance bonds and performance-based standby letters of credit related to a particular transaction;

(B) Unused portions of commitments (including home equity lines of credit and eligible ABCP liquidity facilities) with an original maturity exceeding one year except those listed in paragraph (a)(2)(v) of this section. For eligible ABCP liquidity facilities, the resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph (b)(3) of this section, if applicable; and

(C) Revolving underwriting facilities, note issuance facilities, and similar arrangements pursuant to which the savings association's customer can issue short-term debt obligations in its own name, but for which the savings association has a legally binding commitment to either:

(1) Purchase the obligations the customer is unable to sell by a stated date; or

(2) Advance funds to its customer, if the obligations cannot be sold.

(iii) *20 percent credit conversion factor (Group C)*. Trade-related contingencies, *i.e.*, short-term, self-liquidating instruments used to finance the movement of goods and collateralized by the underlying shipment. A commercial letter of credit is an example of such an instrument.

(iv) *10 percent credit conversion factor (Group D)*. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less. The resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph (b)(3) of this section, if applicable;

(v) *Zero percent credit conversion factor (Group E)*. (A) Unused portions of commitments with an original maturity of one year or less, except for eligible ABCP liquidity facilities;

(B) Unused commitments with an original maturity greater than one year, if they are unconditionally cancelable at any time at the option of the savings association and the savings association has the contractual right to make, and in fact does make, either:

(1) A separate credit decision based upon the borrower's current financial condition before each drawing under the lending facility; or

(2) An annual (or more frequent) credit review based upon the borrower's current financial condition to determine whether or not the lending facility should be continued; and

(C) The unused portion of retail credit card lines or other related plans that are unconditionally cancelable by the savings association in accordance with applicable law.

(vi) *Off-balance sheet contracts; interest-rate and foreign exchange rate contracts (Group F)*—(A) *Calculation of credit equivalent amounts*. The credit equivalent amount of an off-balance sheet interest rate or foreign exchange rate

contract that is not subject to a qualifying bilateral netting contract in accordance with paragraph (a)(2)(vi)(B) of this section is equal to the sum of the current credit exposure, *i.e.*, the replacement cost of the contract, and the potential future credit exposure of the off-balance sheet rate contract. The calculation of credit equivalent amounts is measured in U.S. dollars, regardless of the currency or currencies specified in the off-balance sheet rate contract.

(1) *Current credit exposure.* The current credit exposure of an off-balance sheet rate contract is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current credit exposure equals that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. In determining its current credit exposure for multiple off-balance sheet rate contracts executed with a single counterparty, a savings association may net positive and negative mark-to-market values of off-balance sheet rate contracts if subject to a bilateral netting contract as provided in paragraph (a)(2)(vi)(B) of this section.

(2) *Potential future credit exposure.* The potential future credit exposure of an off-balance sheet rate contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal⁹ by a credit conversion factor. Savings associations, subject to examiner review, should use the effective rather than the apparent or stated notional amount in this calculation. The conversion factors are:¹⁰

Remaining maturity	Interest rate contracts (percents)	Foreign exchange rate contracts (percents)
One year or less	0.0	1.0
Over one year	0.5	5.0

(B) *Off-balance sheet rate contracts subject to bilateral netting contracts.* In determining its current credit exposure for multiple off-balance sheet rate contracts executed with a single counterparty, a savings association may net off-balance sheet rate contracts subject to a bilateral netting contract by offsetting positive and negative mark-to-market values, provided that:

(1) The bilateral netting contract is in writing;

(2) The bilateral netting contract creates a single legal obligation for all individual off-balance sheet rate contracts covered by the bilateral netting contract. In effect, the bilateral netting contract provides that the savings association has a single claim or obligation either to receive or pay only the net amount of the sum of the positive and negative mark-to-market values on the individual off-balance sheet rate contracts covered by the bilateral netting contract. The single legal obligation for the net amount is operative in the event that a counterparty, or a counterparty to whom the bilateral netting contract has been validly assigned, fails to perform due to any of the following events: default, insolvency, bankruptcy, or other similar circumstances;

(3) The savings association obtains a written and reasoned legal opinion(s) representing, with a high degree of certainty, that in the event of a legal challenge, including one resulting from default, insolvency, bankruptcy or similar circumstances, the relevant court and administrative authorities would find the savings association's exposure to be the net amount under:

(i) The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

(ii) The law that governs the individual off-balance sheet rate contracts

⁹For purposes of calculating potential future credit exposure for foreign exchange contracts and other similar contracts, in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts to each party falling due on each value date in each currency.

¹⁰No potential future credit exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating rate indices, so-called floating/floating or basis swaps; the credit equivalent amount is measured solely on the basis of the current credit exposure.

covered by the bilateral netting contract; and

(iii) The law that governs the bilateral netting contract;

(4) The savings association establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the bilateral netting contract continues to satisfy the requirements of this section; and

(5) The savings association maintains in its files documentation adequate to support the netting of an off-balance sheet rate contract.¹¹

(C) *Walkaway clause.* A bilateral netting contract that contains a walkaway clause is not eligible for netting for purposes of calculating the current credit exposure amount. The term “walkaway clause” means a provision in a bilateral netting contract that permits a nondefaulting counterparty to make a lower payment than it would make otherwise under the bilateral netting contract, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the bilateral netting contract.

(D) *Risk weighting.* Once the savings association determines the credit equivalent amount for an off-balance sheet rate contract, that amount is assigned to the risk-weight category appropriate to the counterparty, or, if relevant, to the nature of any collateral or guarantee. Collateral held against a netting contract is not recognized for capital purposes unless it is legally available for all contracts included in the netting contract. However, the maximum risk weight for the credit equivalent amount of such off-

balance sheet rate contracts is 50 percent.

(E) *Exceptions.* The following off-balance sheet rate contracts are not subject to the above calculation, and therefore, are not part of the denominator of a savings association’s risk-based capital ratio:

(1) A foreign exchange rate contract with an original maturity of 14 calendar days or less; and

(2) Any interest rate or foreign exchange rate contract that is traded on an exchange requiring the daily payment of any variations in the market value of the contract.

(3) *Asset-backed commercial paper programs.* (i) A savings association that qualifies as a primary beneficiary and must consolidate an ABCP program that is a variable interest entity under generally accepted accounting principles may exclude the consolidated ABCP program assets from risk-weighted assets if the savings association is the sponsor of the ABCP program.

(ii) If a savings association excludes such consolidated ABCP program assets from risk-weighted assets, the savings association must assess the appropriate risk-based capital requirement against any exposures of the savings association arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with paragraphs (a)(1) and (2) and (b) of this section.

(iii) If a savings association bank has multiple overlapping exposures (such as a program-wide credit enhancement and a liquidity facility) to an ABCP program that is not consolidated for risk-based capital purposes, the savings association is not required to hold duplicative risk-based capital under this part against the overlapping position. Instead, the savings association should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

(b) *Recourse obligations, direct credit substitutes, and certain other positions—*

(1) *In general.* Except as otherwise permitted in this paragraph (b), to determine the risk-weighted asset amount

¹¹By netting individual off-balance sheet rate contracts for the purpose of calculating its credit equivalent amount, a savings association represents that documentation adequate to support the netting of an off-balance sheet rate contract is in the savings association’s files and available for inspection by the OTS. Upon determination by the OTS that a savings association’s files are inadequate or that a bilateral netting contract may not be legally enforceable under any one of the bodies of law described in paragraphs (a)(2)(vi)(B)(3) (i) through (iii) of this section, the underlying individual off-balance sheet rate contracts may not be netted for the purposes of this section.

for a recourse obligation or a direct credit substitute (but not a residual interest):

(i) Multiply the full amount of the credit-enhanced assets for which the savings association directly or indirectly retains or assumes credit risk by a 100 percent conversion factor. (For a direct credit substitute that is an on-balance sheet asset (e.g., a purchased subordinated security), a savings association must use the amount of the direct credit substitute and the full amount of the asset its supports, *i.e.*, all the more senior positions in the structure); and

(ii) Assign this credit equivalent amount to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral. Paragraph (a)(1) of this section lists the risk-weight categories.

(2) *Residual interests.* Except as otherwise permitted under this paragraph (b), a savings association must maintain risk-based capital for residual interests as follows:

(i) *Credit-enhancing interest-only strips.* After applying the concentration limit under § 567.12(e)(2) of this part, a saving association must maintain risk-based capital for a credit-enhancing interest-only strip equal to the remaining amount of the strip (net of any existing associated deferred tax liability), even if the amount of risk-based capital that must be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred credit-enhancing interest-only strip are treated as if the strip was retained by the savings association and was not transferred.

(ii) *Other residual interests.* A saving association must maintain risk-based capital for a residual interest (excluding a credit-enhancing interest-only strip) equal to the face amount of the residual interest (net of any existing associated deferred tax liability), even if the amount of risk-based capital that must be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a trans-

ferred residual interest are treated as if the residual interest was retained by the savings association and was not transferred.

(iii) *Residual interests and other recourse obligations.* Where a savings association holds a residual interest (including a credit-enhancing interest-only strip) and another recourse obligation in connection with the same transfer of assets, the savings association must maintain risk-based capital equal to the greater of:

(A) The risk-based capital requirement for the residual interest as calculated under paragraph (b)(2)(i) through (ii) of this section; or

(B) The full risk-based capital requirement for the assets transferred, subject to the low-level recourse rules under paragraph (b)(7) of this section.

(3) *Ratings-based approach—(i) Calculation.* A savings association may calculate the risk-weighted asset amount for an eligible position described in paragraph (b)(3)(ii) of this section by multiplying the face amount of the position by the appropriate risk weight determined in accordance with Table A or B of this section.

NOTE: Stripped mortgage-backed securities or other similar instruments, such as interest-only and principal-only strips, that are not credit enhancing must be assigned to the 100% risk-weight category.

TABLE A

Long term rating category	Risk weight (In percent)
Highest or second highest investment grade	20
Third highest investment grade	50
Lowest investment grade	100
One category below investment grade	200

TABLE B

Short term rating category	Risk weight (In percent)
Highest investment grade	20
Second highest investment grade	50
Lowest investment grade	100

(ii) *Eligibility—(A) Traded positions.* A position is eligible for the treatment described in paragraph (b)(3)(i) of this section, if:

(1) The position is a recourse obligation, direct credit substitute, residual

interest, or asset- or mortgage-backed security and is not a credit-enhancing interest-only strip;

(2) The position is a traded position; and

(3) The NRSRO has rated a long term position as one grade below investment grade or better or a short term position as investment grade. If two or more NRSROs assign ratings to a traded position, the savings association must use the lowest rating to determine the appropriate risk-weight category under paragraph (b)(3)(i) of this section.

(B) *Non-traded positions.* A position that is not traded is eligible for the treatment described in paragraph (b)(3)(i) of this section if:

(1) The position is a recourse obligation, direct credit substitute, residual interest, or asset- or mortgage-backed security extended in connection with a securitization and is not a credit-enhancing interest-only strip;

(2) More than one NRSRO rate the position;

(3) All of the NRSROs that provide a rating rate a long term position as one grade below investment grade or better or a short term position as investment grade. If the NRSROs assign different ratings to the position, the savings association must use the lowest rating to determine the appropriate risk-weight category under paragraph (b)(3)(i) of this section;

(4) The NRSROs base their ratings on the same criteria that they use to rate securities that are traded positions; and

(5) The ratings are publicly available.

(C) *Unrated senior positions.* If a recourse obligation, direct credit substitute, residual interest, or asset- or mortgage-backed security is not rated by an NRSRO, but is senior or preferred in all features to a traded position (including collateralization and maturity), the savings association may risk-weight the face amount of the senior position under paragraph (b)(3)(i) of this section, based on the rating of the traded position, subject to supervisory guidance. The savings association must satisfy OTS that this treatment is appropriate. This paragraph (b)(3)(i)(C) applies only if the traded position provides substantive credit support to the

unrated position until the unrated position matures.

(4) *Certain positions that are not rated by NRSROs—(i) Calculation.* A savings association may calculate the risk-weighted asset amount for eligible position described in paragraph (b)(4)(ii) of this section based on the savings association’s determination of the credit rating of the position. To risk-weight the asset, the savings association must multiply the face amount of the position by the appropriate risk weight determined in accordance with Table C of this section.

TABLE C

Rating category	Risk weight (In percent)
Investment grade	100
One category below investment grade	200

(ii) *Eligibility.* A position extended in connection with a securitization is eligible for the treatment described in paragraph (b)(4)(i) of this section if it is not rated by an NRSRO, is not a residual interest, and meets the one of the three alternative standards described in paragraph (b)(4)(ii)(A), (B), or (C) below of this section:

(A) *Position rated internally.* A direct credit substitute, but not a purchased credit-enhancing interest-only strip, is eligible for the treatment described under paragraph (b)(4)(i) of this section, if the position is assumed in connection with an asset-backed commercial paper program sponsored by the savings association. Before it may rely on an internal credit risk rating system, the saving association must demonstrate to OTS’s satisfaction that the system is adequate. Adequate internal credit risk rating systems typically:

(1) Are an integral part of the savings association’s risk management system that explicitly incorporates the full range of risks arising from the savings association’s participation in securitization activities;

(2) Link internal credit ratings to measurable outcomes, such as the probability that the position will experience any loss, the expected loss on the position in the event of default, and the degree of variance in losses in the event of default on that position;

(3) Separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of the particular securitization transaction;

(4) Identify gradations of risk among “pass” assets and other risk positions;

(5) Use clear, explicit criteria to classify assets into each internal rating grade, including subjective factors;

(6) Employ independent credit risk management or loan review personnel to assign or review the credit risk ratings;

(7) Include an internal audit procedure to periodically verify that internal risk ratings are assigned in accordance with the savings association’s established criteria;

(8) Monitor the performance of the assigned internal credit risk ratings over time to determine the appropriateness of the initial credit risk rating assignment, and adjust individual credit risk ratings or the overall internal credit risk rating system, as needed; and

(9) Make credit risk rating assumptions that are consistent with, or more conservative than, the credit risk rating assumptions and methodologies of NRSROs.

(B) *Program ratings.* (1) A recourse obligation or direct credit substitute, but not a residual interest, is eligible for the treatment described in paragraph (b)(4)(i) of this section, if the position is retained or assumed in connection with a structured finance program and an NRSRO has reviewed the terms of the program and stated a rating for positions associated with the program. If the program has options for different combinations of assets, standards, internal or external credit enhancements and other relevant factors, and the NRSRO specifies ranges of rating categories to them, the savings association may apply the rating category applicable to the option that corresponds to the savings association’s position.

(2) To rely on a program rating, the savings association must demonstrate to OTS’s satisfaction that that the credit risk rating assigned to the program meets the same standards generally used by NRSROs for rating traded positions. The savings association must also demonstrate to OTS’s satis-

faction that the criteria underlying the assignments for the program are satisfied by the particular position.

(3) If a savings association participates in a securitization sponsored by another party, OTS may authorize the savings association to use this approach based on a program rating obtained by the sponsor of the program.

(C) *Computer program.* A recourse obligation or direct credit substitute, but not a residual interest, is eligible for the treatment described in paragraph (b)(4)(i) of this section, if the position is extended in connection with a structured financing program and the savings association uses an acceptable credit assessment computer program to determine the rating of the position. An NRSRO must have developed the computer program and the savings association must demonstrate to OTS’s satisfaction that the ratings under the program correspond credibly and reliably with the rating of traded positions.

(5) *Alternative capital computation for small business obligations—(i) Definitions.* For the purposes of this paragraph (b)(5):

(A) *Qualified savings association* means a savings association that:

(1) Is well capitalized as defined in § 565.4 of this chapter without applying the capital treatment described in this paragraph (b)(5); or

(2) Is adequately capitalized as defined in § 565.4 of this chapter without applying the capital treatment described in this paragraph (b)(5) and has received written permission from the OTS to apply that capital treatment.

(B) *Small business* means a business that meets the criteria for a small business concern established by the Small Business Administration in 13 CFR 121 pursuant to 15 U.S.C. 632.

(ii) *Capital requirement.* Notwithstanding any other provision of this paragraph (b), with respect to a transfer of a small business loan or lease of personal property with recourse that is a sale under generally accepted accounting principles, a qualified savings association may elect to include only the amount of its recourse in its risk-weighted assets. To qualify for this election, the savings association must establish and maintain a reserve under

generally accepted accounting principles sufficient to meet the reasonable estimated liability of the savings association under the recourse obligation.

(iii) *Aggregate amount of recourse.* The total outstanding amount of recourse retained by a qualified savings association with respect to transfers of small business loans and leases of personal property and included in the risk-weighted assets of the savings association as described in paragraph (b)(5)(ii) of this section, may not exceed 15 percent of the association's total capital computed under § 567.5(c).

(iv) *Savings association that ceases to be a qualified savings association or that exceeds aggregate limits.* If a savings association ceases to be a qualified savings association or exceeds the aggregate limit described in paragraph (b)(5)(iii) of this section, the savings association may continue to apply the capital treatment described in paragraph (b)(5)(ii) of this section to transfers of small business loans and leases of personal property that occurred when the association was a qualified savings association and did not exceed the limit.

(v) *Prompt corrective action not affected.* (A) A savings association shall compute its capital without regard to this paragraph (b)(5) of this section for purposes of prompt corrective action (12 U.S.C. 1831o), unless the savings association is adequately or well capitalized without applying the capital treatment described in this paragraph (b)(5) and would be well capitalized after applying that capital treatment.

(B) A savings association shall compute its capital requirement without regard to this paragraph (b)(5) for the purposes of applying 12 U.S.C. 1381o(g), regardless of the association's capital level.

(6) *Risk participations and syndications of direct credit substitutes.* A savings association must calculate the risk-weighted asset amount for a risk participation in, or syndication of, a direct credit substitute as follows:

(i) If a savings association conveys a risk participation in a direct credit substitute, the savings association must convert the full amount of the assets that are supported by the direct credit substitute to a credit equivalent

amount using a 100 percent conversion factor. The savings association must assign the *pro rata* share of the credit equivalent amount that was conveyed through the risk participation to the lower of: The risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral; or the risk-weight category appropriate to the party acquiring the participation. The savings association must assign the *pro rata* share of the credit equivalent amount that was not participated out to the risk-weight category appropriate to the obligor, after considering any associated guarantees or collateral.

(ii) If a savings association acquires a risk participation in a direct credit substitute, the savings association must multiply its *pro rata* share of the direct credit substitute by the full amount of the assets that are supported by the direct credit substitute, and convert this amount to a credit equivalent amount using a 100 percent conversion factor. The savings association must assign the resulting credit equivalent amount to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral.

(iii) If the savings association holds a direct credit substitute in the form of a syndication where each savings association or other participant is obligated only for its *pro rata* share of the risk and there is no recourse to the originating party, the savings association must calculate the credit equivalent amount by multiplying only its *pro rata* share of the assets supported by the direct credit substitute by a 100 percent conversion factor. The savings association must assign the resulting credit equivalent amount to the risk-weight category appropriate to the obligor in the underlying transaction after considering any associated guarantees or collateral.

(7) *Limitations on risk-based capital requirements—(i) Low-level exposure rule.* If the maximum contractual exposure to loss retained or assumed by a savings association is less than the effective risk-based capital requirement, as determined in accordance with this

paragraph (b), for the assets supported by the savings association's position, the risk-based capital requirement is limited to the savings association's contractual exposure less any recourse liability account established in accordance with generally accepted accounting principles. This limitation does not apply when a savings association provides credit enhancement beyond any contractual obligation to support assets it has sold.

(ii) *Mortgage-related securities or participation certificates retained in a mortgage loan swap.* If a savings association holds a mortgage-related security or a participation certificate as a result of a mortgage loan swap with recourse, it must hold risk-based capital to support the recourse obligation and that percentage of the mortgage-related security or participation certificate that is not covered by the recourse obligation. The total amount of risk-based capital required for the security (or certificate) and the recourse obligation is limited to the risk-based capital requirement for the underlying loans, calculated as if the savings association continued to hold these loans as an on-balance sheet asset.

(iii) *Related on-balance sheet assets.* If an asset is included in the calculation of the risk-based capital requirement under this paragraph (b) and also appears as an asset on the savings association's balance sheet, the savings association must risk-weight the asset only under this paragraph (b), except in the case of loan servicing assets and similar arrangements with embedded recourse obligations or direct credit substitutes. In that case, the savings association must separately risk-weight the on-balance sheet servicing asset and the related recourse obligations and direct credit substitutes under this section, and incorporate these amounts into the risk-based capital calculation.

(8) *Obligations of subsidiaries.* If a savings association retains a recourse obligation or assumes a direct credit substitute on the obligation of a subsidiary that is not an includable subsidiary, and the recourse obligation or direct credit substitute is an equity or debt investment in that subsidiary under generally accepted accounting

principles, the face amount of the recourse obligation or direct credit substitute is deducted for capital under §§ 567.5(a)(2) and 567.9(c). All other recourse obligations and direct credit substitutes retained or assumed by a savings association on the obligations of an entity in which the savings association has an equity investment are risk-weighted in accordance with this paragraph (b).

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 33439, July 29, 1992; 57 FR 12709, Apr. 13, 1992; 57 FR 33440, July 29, 1992; 58 FR 476, Jan. 6, 1993; 58 FR 15086, Mar. 19, 1993; 58 FR 45813, Aug. 31, 1993; 59 FR 12810, Mar. 18, 1994; 59 FR 4788, Feb. 2, 1994; 59 FR 66652, Dec. 28, 1994; 60 FR 39232, Aug. 1, 1995; 60 FR 45621, Aug. 31, 1995; 62 FR 66264, Dec. 18, 1997; 63 FR 42678, Aug. 10, 1998; 64 FR 10201, Mar. 2, 1999; 66 FR 59663, Nov. 29, 2001; 67 FR 16980, Apr. 9, 2002; 67 FR 31726, May 10, 2002; 68 FR 56536, Oct. 1, 2003; 69 FR 22385, Apr. 26, 2004; 69 FR 44925, July 28, 2004; 69 FR 76602, Dec. 22, 2004]

§ 567.8 Leverage ratio.

(a) The minimum leverage capital requirement for a savings association assigned a composite rating of 1, as defined in § 516.3 of this chapter, shall consist of a ratio of core capital to adjusted total assets of 3 percent. These generally are strong associations that are not anticipating or experiencing significant growth and have well-diversified risks, including no undue interest rate risk exposure, excellent asset quality, high liquidity, and good earnings.

(b) For all savings associations not meeting the conditions set forth in paragraph (a) of this section, the minimum leverage capital requirement shall consist of a ratio of core capital to adjusted total assets of 4 percent. Higher capital ratios may be required if warranted by the particular circumstances or risk profiles of an individual savings association. In all cases, savings associations should hold capital commensurate with the level and nature of all risks, including the volume and severity of problem loans, to which they are exposed.

[64 FR 10201, Mar. 2, 1999]

§ 567.9 Tangible capital requirement.

(a) Savings associations shall have and maintain tangible capital in an

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amount equal to at least 1.5% of adjusted total assets.

(b) The following elements, less the amount of any deductions pursuant to paragraph (c) of this section, comprise a savings association's tangible capital:

- (1) Common stockholders' equity (including retained earnings);
- (2) Noncumulative perpetual preferred stock and related earnings;
- (3) Nonwithdrawable accounts and pledged deposits that would qualify as core capital under §567.5 of this part; and
- (4) Minority interests in the equity accounts of fully consolidated subsidiaries.

(c) *Deductions from tangible capital.* In calculating tangible capital, a savings association must deduct from assets, and, thus, from capital:

(1) Intangible assets (as defined in §567.1), servicing assets, and credit-enhancing interest-only strips not includable in tangible capital under §567.12.

(2) Investments, both equity and debt, in subsidiaries that are not includable subsidiaries (including those subsidiaries where the savings association has a minority ownership interest), except as provided in paragraphs (c)(3) and (c)(4) of this section.

(3) If a savings association has any investments (both debt and equity) in one or more subsidiary(ies) engaged as of April 12, 1989 and continuing to be engaged in any activity that would not fall within the scope of activities in which includable subsidiaries may engage, it must deduct such investments from assets and, thus, tangible capital in accordance with this paragraph (c)(3). The savings association must first deduct from assets and, thus, capital the amount by which any investments in such a subsidiary(ies) exceed the amount of such investments held by the savings association as of April 12, 1989. Next, the savings association must deduct from assets and, thus, tangible capital the lesser of:

- (i) The savings association's investments in and extensions of credit to the subsidiary as of April 12, 1989; or
- (ii) The savings association's investments in and extensions of credit to the subsidiary on the date as of which

the savings association's capital is being determined.

(4) If a savings association holds a subsidiary (either directly or through a subsidiary) that is itself a domestic depository institution the Office may, in its sole discretion upon determining that the amount of tangible capital that would be required would be higher if the assets and liabilities of such subsidiary were consolidated with those of the parent savings association than the amount that would be required if the parent savings association's investment were deducted pursuant to paragraphs (c)(2) and (c)(3) of this section, consolidate the assets and liabilities of that subsidiary with those of the parent savings association in calculating the capital adequacy of the parent savings association, regardless of whether the subsidiary would otherwise be an includable subsidiary as defined in §567.1 of this part.

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 33441, July 29, 1992; 59 FR 4788, Feb. 2, 1994; 60 FR 39232, Aug. 1, 1995; 62 FR 66264, Dec. 18, 1997; 63 FR 42678, Aug. 10, 1998; 66 FR 59666, Nov. 29, 2001]

§567.10 Consequences of failure to meet capital requirements.

(a) *Capital plans.* (1) [Reserved]

(2) The Director shall require any savings association not in compliance with capital standards to submit a capital plan that:

- (i) Addresses the savings association's need for increased capital;
- (ii) Describes the manner in which the savings association will increase capital so as to achieve compliance with capital standards;
- (iii) Specifies types and levels of activities in which the savings association will engage;
- (iv) Requires any increase in assets to be accompanied by increase in tangible capital not less in percentage amount than the leverage limit then applicable;
- (v) Requires any increase in assets to be accompanied by an increase in capital not less in percentage amount than required under the risk-based capital standard then applicable; and
- (vi) Is acceptable to the Director.

(3) To be acceptable to the Director under this section, a plan must, in addition to satisfying all of the requirements set forth in paragraphs (a)(2)(i) through (a)(2)(v) of this section, contain a certification that while the plan is under review by the Office, the savings association will not, without the prior written approval of the Regional Director:

- (i) Grow beyond net interest credited;
 - (ii) Make any capital distributions;
- or
- (iii) Act inconsistently with any other limitations on activities established by statute, regulation or by the Office in supervisory guidance for savings associations not meeting capital standards.

(4) If the plan submitted to the Director under paragraph (a)(2) of this section is not approved by the Office, the savings association shall immediately and without any further action, be subject to the following restrictions:

(i) It may not increase its assets beyond the amount held on the day it receives written notice of the Director's disapproval of the plan; and

(ii) It must comply with any other restrictions or limitations set forth in the written notice of the Director's disapproval of the plan.

(b) On or after January 1, 1991, the Director shall:

(1) Prohibit any asset growth by any savings association not in compliance with capital standards, *except* as provided in paragraph (d) of this section; and

(2) Require any savings association not in compliance with capital standards to comply with a capital directive issued by the Director which may include the restrictions contained in paragraph (e) of this section and any other restrictions the Director determines appropriate.

(c) A savings association that wishes to obtain an exemption from the sanctions provided in paragraph (b)(2) of this section must file a request for exemption with the Regional Director. Such request must include a capital plan that satisfies the requirements of paragraph (a)(2) of this section.

(d) The Director may permit any savings association that is subject to paragraph (b) of this section to increase its

assets in an amount not exceeding the amount of net interest credited to the savings association's deposit liabilities, if:

(1) The savings association obtains the Director's prior approval;

(2) Any increase in assets is accompanied by an increase in tangible capital in an amount not less than 3% of the increase in assets;

(3) Any increase in assets is accompanied by an increase in capital not less in percentage amount than required under the risk-based capital standards then applicable;

(4) Any increase in assets is invested in low-risk assets; and

(5) The savings association's ratio of core capital to total assets is not less than the ratio existing on January 1, 1991.

(e) If a savings association fails to meet any of the regulatory capital requirements set forth in §567.2 of this part, the Director may, through enforcement proceedings or otherwise, require such savings association to take one or more of the following corrective actions:

(1) Increase the amount of its regulatory capital to a specified level or levels;

(2) Convene a meeting or meetings with the Office's supervision staff for the purpose of accomplishing the objectives of this section;

(3) Reduce the rate of earnings that may be paid on savings accounts;

(4) Limit the receipt of deposits to those made to existing accounts;

(5) Cease or limit the issuance of new accounts of any or all classes or categories, except in exchange for existing accounts;

(6) Cease or limit lending or the making of a particular type or category of loan;

(7) Cease or limit the purchase of loans or the making of specified other investments;

(8) Limit operational expenditures to specified levels;

(9) Increase liquid assets and maintain such increased liquidity at specified levels; or

(10) Take such other action or actions as the Director may deem necessary or appropriate for the safety and soundness of the savings association,

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or depositors or investors in the savings association.

(f) The Director shall treat as an unsafe and unsound practice any material failure by a savings association to comply with any plan, regulation, written agreement undertaken under this section or order or directive issued to comply with the requirements of this part.

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 33441, July 29, 1992; 60 FR 66720, Dec. 26, 1995]

§ 567.11 Reservation of authority.

(a) *Transactions for purposes of evasion.* The Director or the Regional Director for the region in which a savings association is located may disregard any transaction entered into primarily for the purpose of reducing the minimum required amount of regulatory capital or otherwise evading the requirements of this part.

(b) *Average versus period-end figures.* The Office reserves the right to require a savings association to compute its capital ratios on the basis of average, rather than period-end, assets when the Office determines appropriate to carry out the purposes of this part.

(c)(1) *Reservation of authority.* Notwithstanding the definitions of core and supplementary capital in § 567.5 of this part, OTS may find that a particular type of purchased intangible asset or capital instrument constitutes or may constitute core or supplementary capital, and may permit one or more savings associations to include all or a portion of such intangible asset or funds obtained through such capital instrument as core or supplementary capital, permanently or on a temporary basis, for the purposes of compliance with this part or for any other purposes. Similarly, the Office may find that a particular asset or core or supplementary capital component has characteristics or terms that diminish its contribution to a savings association's ability to absorb losses, and the Office may require the discounting or deduction of such asset or component from the computation of core, supplementary, or total capital.

(2) Notwithstanding § 567.6 of this part, OTS will look to the substance of a transaction and may find that the as-

signed risk weight for any asset, or credit equivalent amount or credit conversion factor for any off-balance sheet item does not appropriately reflect the risks imposed on the savings association. OTS may require the savings association to apply another risk-weight, credit equivalent amount, or credit conversion factor that OTS deems appropriate.

(3) If this part does not specifically assign a risk weight, credit equivalent amount, or credit conversion factor, OTS may assign any risk weight, credit equivalent amount, or credit conversion factor that it deems appropriate. In making this determination, OTS will consider the risks associated with the asset or off-balance sheet item as well as other relevant factors.

[54 FR 49649, Nov. 30, 1989, as amended at 57 FR 33441, July 29, 1992; 66 FR 59666, Nov. 29, 2001]

§ 567.12 Intangible assets, servicing assets, and credit-enhancing interest-only strips.

(a) *Scope.* This section prescribes the maximum amount of intangible assets, servicing assets, and credit-enhancing interest-only strips that savings associations may include in calculating tangible and core capital.

(b) *Computation of core and tangible capital.* (1) Purchased credit card relationships may be included (that is, not deducted) in computing core capital in accordance with the restrictions in this section, but must be deducted in computing tangible capital.

(2) In accordance with the restrictions in this section, mortgage servicing assets may be included in computing core and tangible capital and nonmortgage servicing assets may be included in core capital.

(3) Intangible assets, as defined in § 567.1 of this part, other than purchased credit card relationships described in paragraph (b)(1) of this section and core deposit intangibles described in paragraph (g)(3) of this section, are deducted in computing tangible and core capital.

(4) Credit-enhancing interest-only strips may be included (that is not deducted) in computing core capital subject to the restrictions of this section,

and may be included in tangible capital in the same amount.

(c) *Market valuations.* The OTS reserves the authority to require any savings association to perform an independent market valuation of assets subject to this section 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 value of assets subject to this section. 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 value for assets subject to this section 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), purchased credit card relationships and servicing assets must be valued at the lesser of:

(1) 90 percent of their fair 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 limitations—(1) Servicing assets and purchased credit card relationships.* (i) The maximum aggregate amount of servicing assets and purchased credit card relationships that may be included in core capital is limited to the lesser of:

(A) 100 percent of the amount of core capital; or

(B) The amount of servicing assets and purchased credit card relationships determined in accordance with paragraph (d) of this section.

(ii) In addition to the aggregate limitation in paragraph (e)(1)(i) of this sec-

tion, a sublimit applies to purchased credit card relationships and non mortgage-related servicing assets. The maximum allowable amount of these two types of assets combined is limited to the lesser of:

(A) 25 percent the amount of core capital; and

(B) The amount of purchased credit card relationships and non mortgage-related servicing assets determined in accordance with paragraph (d) of this section.

(2) *Credit-enhancing interest-only strips.* The maximum aggregate amount of credit-enhancing interest-only strips that may be included in core capital is limited to 25 percent of the amount of core capital. Purchased and retained credit-enhancing interest-only strips, on a non-tax adjusted basis, are included in the total amount that is used for purposes of determining whether a savings association exceeds the core capital limit.

(3) *Computation.* (i) For purposes of computing the limits and sublimit in this paragraph (e), core capital is computed before the deduction of disallowed servicing assets, disallowed credit card relationships, and disallowed credit-enhancing interest-only strips.

(ii) A savings association may elect to deduct disallowed servicing assets and credit-enhancing interest-only strips on a basis that is net of any associated deferred tax liability.

(f) *Tangible capital limitation.* The maximum amount of mortgage servicing assets 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) of this section. All non-mortgage servicing assets are deducted in computing tangible capital.

(g) *Grandfathering.* (1) Notwithstanding the core capital and tangible capital limitations set forth in paragraphs (e) and (f) of this section, any otherwise disallowed purchased mortgage servicing rights that were acquired on or before February 9, 1990, and any otherwise disallowed purchased mortgage servicing rights for which a contract to purchase the servicing rights had been executed on or

before February 9, 1990, may be grandfathered and recognized for regulatory capital purposes under this part to the extent permitted by the OTS. Grandfathered purchased mortgage servicing rights must be treated in accordance with generally accepted accounting principles and the requirements of paragraphs (c) and (d) of this section. Grandfathered purchased mortgage servicing rights will count toward the core capital and tangible capital limitations described in paragraphs (e) and (f) of this section.

(2)(i) On a case-by-case basis, the OTS may extend grandfathered treatment prospectively to all or part of the purchased mortgage servicing rights acquired by an association to replace its grandfathered purchased mortgage servicing rights if OTS determines that:

(A) The association is reducing, at an acceptable rate, its level of purchased mortgage servicing rights to the levels permitted by this section; and

(B) The granting of such grandfathered treatment is consistent with the safe and sound operation of the association.

(ii) The OTS may terminate or limit such grandfathered treatment at any time if it determines that either of the conditions in paragraph (g)(2)(i) of this section is not being satisfied.

(3) Core deposit intangibles resulting from transactions consummated or under firm contract on the effective date of this rule may be grandfathered and recognized for capital purposes under this part, to the extent permitted by OTS, provided that such core deposit intangibles are valued in accordance with generally accepted accounting principles, supported by credible assumptions, and have their amortization adjusted at least annually to reflect decay rates (past and projected) in the acquired customer base.

(h) *Exemption for certain subsidiaries.*—
(1) *Exemption standard.* An association holding purchased mortgage servicing rights in separately capitalized, non-includable subsidiaries may submit an application for approval by the OTS for an exemption from the deductions and limitations set forth in this section. The deductions and limitations will apply to such purchased mortgage serv-

icing rights, however, if the OTS determines that:

(i) The thrift and subsidiary are not conducting activities on an arm's length basis; or

(ii) The exemption is not consistent with the association's safe and sound operation.

(2) *Applicable requirements.* If the OTS determines to grant or to permit the continuation of an exemption under paragraph (h)(1) of this section, the association receiving the exemption must ensure the following:

(i) The association's investments in, and extensions of credit to, the subsidiary are deducted from capital when calculating capital under this part;

(ii) Extensions of credit and other transactions with the subsidiary are conducted in compliance with the rules for covered transactions with affiliates set forth in sections 23A and 23B of the Federal Reserve Act, as applied to thrifts; and

(iii) Any contracts entered into by the subsidiary include a written disclosure indicating that the subsidiary is not a bank or savings association; the subsidiary is an organization separate and apart from any bank or savings association; and the obligations of the subsidiary are not backed or guaranteed by any bank or savings association and are not insured by the FDIC.

[59 FR 4788, Feb. 2, 1994, as amended at 60 FR 39232, Aug. 1, 1995; 62 FR 66264, Dec. 18, 1997; 63 FR 42678, Aug. 10, 1998; 66 FR 59666, Nov. 29, 2001]

§§ 567.14–567.19 [Reserved]

PART 568—SECURITY PROCEDURES UNDER THE BANK PROTECTION ACT

Sec.

568.1 Authority, purpose, and scope.

568.2 Designation of security officer.

568.3 Security program.

568.4 Report.

568.5 Protection of customer information.

AUTHORITY: Secs. 2–5, 82 Stat. 294–295 (12 U.S.C. 1881–1884).

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