should emphasize training of licensee management as to its obligations under the employee protection regulations and provide information as to the recommended content of such training. Although the NRC believes the current employee protection regulations are adequate, clear, and sufficiently flexible to accommodate the concerns in PRM–30–62, the Commission believes that such guidance would further the NRC policy statement related to an SCWE.

The DTG concluded that the petition would not correct the problem that was the basis for the petition. The fact that a licensee manager may have received training on the discrimination regulations does not constitute enough evidence to conclude that an adverse action taken was deliberate. Consistent with the Commission's direction in the SRM of March 26, 2003, regulatory guidance will be developed and made available for licensees' use that will consider those attributes that constitute an effective SCWE program. Developing such guidance is consistent with NRC's performance-based approach, which allows licensees flexibility to develop programs that are best suited for them.

Reasons for Denial

The NRC is denying the petition for the following reasons:

1. As discussed above, on March 26, 2003, the Commission issued a Staff Requirements Memorandum (SRM) on SECY–02–0166 approving the recommendations of the DTG, as revised by the SMRT and subject to the specific comments provided in the SRM. The SRM also stated that proposed guidance to licensees should be developed and should emphasize training of licensee management as to its obligations under the employee protection regulations and provide information as to the recommended content of such training. Although the NRC believes the current employee protection regulations are adequate, clear, and sufficiently flexible to accommodate the concerns in PRM–30–62, the Commission believes that such guidance would further the NRC policy statement related to an SCWE.

2. The NRC has concluded that the petition would not correct the problem that was the basis for the petition. The fact that a licensee manager may have received training on the discrimination regulations does not constitute enough evidence to conclude that an adverse action taken was deliberate. Consistent with the Commission's direction in the SRM of March 26, 2003, regulatory guidance will be developed and made available for licensees' use that will consider those attributes that constitute an effective SCWE program. Developing such guidance is consistent with NRC's performance-based approach, which also allows licensees flexibility to develop programs that are best suited for them.

In sum, no new information has been provided by the petitioner that supports the need to undertake rulemaking action to amend the requirements of the employee protection regulations. The goals of the petition can be achieved through the development of regulatory guidance in conjunction with licensees and stakeholders and communicating this guidance to their managers and employees. Additional rulemaking would impose unnecessary regulatory burden on licensees and does not appear to be warranted for the adequate protection of the public health and safety and the common defense and security.

For the reasons cited in this document, the NRC denies this petition.

Dated at Rockville, Maryland, this 29th day of April, 2004.

For the Nuclear Regulatory Commission.

William D. Travers,

Executive Director for Operations.

[FR Doc. 04–11296 Filed 5–18–04; 8:45 am]

BILLING CODE 7590–01–P

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Regulations H and Y; Docket No. R–1193]

Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board of Governors of the Federal Reserve System (Board) proposes to allow the continued inclusion of outstanding and prospective issuances of trust preferred securities in the tier 1 capital of bank holding companies, subject to stricter quantitative limits and qualitative standards. The Board also proposes to revise the quantitative limits applied to the aggregate amount of cumulative perpetual preferred stock, trust preferred securities, and minority interests in the equity accounts of certain consolidated subsidiaries (collectively, restricted core capital elements) included in the tier 1 capital of bank holding companies. The quantitative limits would become effective after a three-year transition period. In addition, the Board is proposing to revise the qualitative standards for capital instruments included in regulatory capital consistent with longstanding Board policies. These revisions are being proposed to address supervisory concerns, competitive equity considerations, and changes in generally accepted accounting principles. The proposal would have the effect of strengthening the definition of regulatory capital for bank holding companies.

DATES: Comments must be received by no later than July 11, 2004.

ADDRESSES: You may submit comments, identified by Docket No. R–1193, by any of the following methods:

- Agency Web Site: *http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.*
- Federal eRulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments.
- E-mail: *regs.comments@federalreserve.gov.* Include docket number in the subject line of the message.
- FAX: 202/452–3819 or 202/452–3102.
- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

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

FOR FURTHER INFORMATION CONTACT: Norah Barger, Associate Director (202/452–2402 or *norah.barger@frb.gov*), Mary Frances Monroe, Manager (202/452–5231 or *mary.f.monroe@frb.gov*), John F. Connolly, Senior Supervisory Financial Analyst (202/452–3621 or *john.f.connolly@frb.gov*), Division of Banking Supervision and Regulation, or Mark E. Van Der Weide, Senior Counsel (202/452–2263 or *mark.vanderweide@frb.gov*), Legal Division. For users of Telecommunications Device for the Deaf (''TDD'') only, contact 202/263–4869.

SUPPLEMENTARY INFORMATION:

Background

The Board's current risk-based capital guidelines, which are based on the 1988

Basel Accord, as well as the Board's leverage capital guidelines for bank holding companies (BHCs), allow BHCs to include in their tier 1 capital the following items that are defined as core (or tier 1) capital elements: common stockholders' equity; qualifying noncumulative perpetual preferred stock (including related surplus); qualifying cumulative perpetual preferred stock (including related surplus); and minority interest in the equity accounts of consolidated subsidiaries. Qualifying cumulative preferred stock is limited to 25 percent of the sum of core capital elements. Tier 1 capital generally is defined as the sum of core capital elements less any amounts of goodwill, other intangible assets, interest-only strips receivable, deferred tax assets, non-financial equity investments, and other items that are required to be deducted from a BHC's tier 1 capital for purposes of calculating regulatory capital ratios.

The Federal Reserve's capital guidelines allow minority interest in the equity accounts of consolidated subsidiaries to be included in a BHC's tier 1 capital because it represents capital support from third-party investors in a subsidiary owned by a BHC and consolidated on its balance sheet. Nonetheless, minority interest does not constitute equity on the BHC's consolidated balance sheet because typically minority interest is available to absorb losses only within the subsidiary that issues it and is not generally available to absorb losses in the broader consolidated banking organization. Although the Board's capital rules state that voting common stock generally should be the dominant form of tier 1 capital, minority interest is not subject to a specific numeric limit. Minority interest in the form of cumulative preferred stock, however, generally has been subject to the same limits as cumulative preferred stock issued directly by a BHC.

In 1996, the Board explicitly approved the inclusion in BHCs' tier 1 capital of minority interest in the form of trust preferred securities. Trust preferred securities are undated cumulative preferred securities issued out of a special purpose entity (SPE), usually in the form of a trust, in which a BHC owns all of the common securities. The trust preferred securities allow for at least twenty consecutive quarters of dividend deferral, after which the investors have the right to take hold of the sole asset in the trust, a deeply subordinated note issued by the BHC. The note, which is subordinated to all obligations of the BHC other than its common and preferred stock, has terms that generally mirror those of the trust preferred securities, except that the subordinated debt has a fixed maturity of at least 30 years. Trust preferred securities are considered tax-efficient because, for tax purposes, payments on the instrument are deductible from the issuer's income, unlike dividends on directly issued preferred stock, which must be paid from after-tax earnings. Because trust preferred securities are cumulative, they currently are limited, together with directly issued cumulative perpetual preferred stock and other minority interest in the form of cumulative preferred stock, to no more than 25 percent of a BHC's core capital elements.

The Board's decision to include trust preferred securities in tier 1 capital was based on a number of factors in addition to its qualification as minority interest under generally accepted accounting principles (GAAP). In terms of features, trust preferred securities have long lives that approach economic perpetuity and deferral rights that, at twenty consecutive quarters, approach economically indefinite deferral. With regard to loss absorbency, trust preferred securities, like other minority interest included in tier 1 capital, cannot deter technical insolvency because they are not represented as equity on the BHC's consolidated balance sheet. Unlike minority interest in the form of equity in a typical operating subsidiary, however, trust preferred securities are available to absorb losses more broadly in the consolidated banking organization. Its availability for this purpose stems from the fact that the sole asset of the issuing subsidiary is a note from the parent BHC, which constitutes a deeply subordinated claim on the consolidated BHC. Thus, if a BHC defers payments on trust preferred securities, the cash flow preserved can be used anywhere within the consolidated organization. Dividend deferrals on equity in the typical operating subsidiary, on the other hand, absorb losses and preserve cash flow only within the subsidiary; the cash that is freed up cannot be used elsewhere in the consolidated organization.

The Board also considered competitive equity factors in making its decision to include trust preferred securities in tier 1 capital. A number of non-BHC companies, including domestic and non-domestic financial institutions, had issued trust preferred securities or similar tax-efficient instruments. Thus, these companies were able to enjoy a lower after-tax cost of capital than BHCs that compete in some of the same markets. Since 1996, approximately 820 BHCs have issued over $77 billion of trust preferred securities, the popularity of which stems in large part from its tax-efficiency.

Trust preferred securities are not the only tax-efficient source of tier 1 capital, although BHCs tend to favor them because they are relatively simple, standard, and well-understood instruments that are also issued by non-banking corporations. One alternative tax-efficient instrument that is included in the tier 1 capital of banks and BHCs as minority interest in the form of perpetual preferred securities is referred to as real estate investment trust (REIT) preferred securities. These securities, which usually are noncumulative, are issued by an SPE that qualifies as a REIT for tax purposes. Proceeds from the issuance of the REIT's common securities, which are wholly owned by the sponsoring banking organization, and preferred securities, which are owned by third-party investors, are used to buy real estate-related assets. Because the source of the assets typically is a subsidiary bank of the sponsoring banking organization, REIT preferred securities are usually issued by an SPE that is a subsidiary of the bank, rather than of the BHC. Statutorily, dividends on REIT preferred securities may be deducted from the taxable income of the banking organization if the assets are related to real estate and certain other criteria are met, including the distribution of 95 percent of the REIT's income in dividends to investors. A key prudential condition for REIT preferred securities to be included in tier 1 capital is that they must have an exchange feature providing for an exchange of the securities for an equal amount of directly-issued perpetual preferred securities of the sponsoring bank with identical terms upon the occurrence of certain events, including the event that the sponsoring bank becomes undercapitalized or insolvent. This feature is necessary for regulatory capital inclusion of the REIT preferred securities because they are effectively secured by the assets of the SPE, which often are high quality and very liquid. The Federal Reserve, together with the other Federal banking agencies, limits the inclusion of REIT preferred securities to 25 percent of the sum of a banking organization's core capital elements.

A few banking organizations have used other asset-driven structures that are similar to REIT preferred securities to issue tier 1 preferred securities that are included in minority interest and are subject to the same exchange provision as REIT preferred securities. Asset-

driven structures can be highly tailored to suit investors' needs and the preferred securities issued out of them are often privately placed. However, the amount of preferred securities issued out of REITs and similar asset-driven structures is relatively small. BHCs generally favor issuing trust preferred securities instead of preferred securities issued out of asset-driven structures because trust preferred securities do not tie up liquid assets, are easier and more cost-efficient to issue and manage, and are more transparent and better understood by the market. Also, banking organizations generally prefer to issue non-asset-backed preferred securities at the holding company level to give them maximum flexibility in the use of the proceeds of such issuances, a flexibility that is not available for asset-backed instruments issued at the bank level. From a supervisory perspective, asset-driven structures raise concerns because they trap high quality, liquid assets in a subsidiary that the banking organization would have difficulty accessing to meet immediate liquidity needs.

Factors in the Reconsideration of the Treatment of Trust Preferred Securities

Overall, the supervisory experience with trust preferred securities has been positive. The instrument has performed much as expected in troubled banking organizations; in numerous instances, BHCs in deteriorating financial condition have deferred dividends on trust preferred securities to preserve cash flow. In addition, trust preferred securities have proven to be a useful source of capital funding for BHCs, which often downstream the proceeds in the form of common stock to subsidiary banks, thereby strengthening the banks' capital bases. For example, in the months following the events of September 11, 2001, a period when issuance of most other capital instruments was extremely difficult, BHCs were able to execute large issuances of trust preferred securities to retail investors, demonstrating the financial flexibility offered by this instrument.

Around 2000, the first securities backed by a pool of trust preferred securities from multiple issuers came to the market. Pooling arrangements, which have become increasingly popular and typically involve thirty or so separate issuers, have made the issuance of trust preferred securities possible for even very small BHCs, most of which had not previously enjoyed capital market access for tier 1 instruments. Although this development has helped level the competitive playing field between small and large banking organizations with regard to capital funding sources, it also has given rise to concerns. Evidence supports the view that, in some instances, BHCs that participate in poolings have over-relied on trust preferred securities within their capital structures. As a result, for some time the Federal Reserve has been considering ways to limit undue reliance on these instruments.

Excessive reliance generally has not been a concern at large banking organizations because they are subject to much more rigorous market discipline, which works to limit the amount of trust preferred securities a BHC may issue. Moreover, a 1998 agreement among the G–10 banking supervisors that participate in deliberations of the Basel Committee on Banking Supervision called for the Federal Reserve's best efforts to limit the issuance by internationally active banking organizations of innovative instruments'a category that would include trust preferred securities'to 15 percent of their tier 1 capital. Although the Federal Reserve has informally encouraged BHCs to comply with this standard, the Federal Reserve's commitment to the standard has not been formalized.

As the Federal Reserve was working through various issues related to trust preferred securities and alternative tax-efficient instruments, the accounting treatment of trust preferred securities was revised, adding yet another factor to be taken into account in the reconsideration of the regulatory capital treatment of these instruments. In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). Since then the accounting industry and BHCs have wrestled with the application of FIN 46 to the consolidation by BHC sponsors of trusts issuing trust preferred securities. In late December 2003, when FASB issued a revised version of FIN 46 (FIN 46R), the accounting authorities generally concluded that such trusts must be deconsolidated in financial statements under GAAP. The result is that, under GAAP, trust preferred securities generally continue to be accounted for as equity at the level of the trust that issues them, but the instruments may no longer be treated as minority interest in the equity accounts of a consolidated subsidiary on a BHC's consolidated balance sheet. Instead, upon adopting FIN 46 and FIN 46R, a BHC no longer may reflect on its balance sheet the trust preferred securities issued out of the SPE, but rather must reflect the deeply subordinated note the BHC issued to the deconsolidated SPE.

Consistent with longstanding Board direction, BHCs are required to follow GAAP for regulatory reporting purposes. Thus, BHCs should, for both accounting and regulatory reporting purposes, determine the appropriate application of GAAP (including FIN 46 and FIN 46R) to their trusts issuing trust preferred securities. Accordingly, there should be no substantive difference in the treatment of such trusts for purposes of regulatory reporting and GAAP accounting.

The change in the GAAP accounting of a capital instrument does not necessarily change the regulatory capital treatment of that instrument. Although GAAP informs the definition of regulatory capital, the Federal Reserve is not bound by GAAP accounting in its definition of tier 1 or tier 2 capital because these are regulatory constructs designed to ensure the safety and soundness of banking organizations, not accounting designations designed to ensure the transparency of financial statements. The current definition of tier 1 capital differs from GAAP equity in a number of ways that the Federal Reserve has determined are consistent with its responsibility for ensuring the soundness of the capital bases of banking organizations under its supervision. These differences do not constitute differences between regulatory reporting and GAAP accounting requirements, but rather are differences only between GAAP equity and the concept of tier 1 capital as used in the Board's regulatory capital requirements for banking organizations.

Proposed Regulatory Capital Treatment of Trust Preferred Securities

In proposing a revised capital treatment of trust preferred securities, the Board has taken into account a number of factors. In addition to its supervisory experience and the revised accounting treatment, the Board has considered domestic and international competitive equity issues and supervisory concerns with alternative tax-efficient instruments. In balancing all these considerations, the Board has decided to propose permitting BHCs to continue to include outstanding and prospective issuances of trust preferred securities in their tier 1 capital, subject to stricter quantitative limits, which would apply to a broader range of capital instruments issued by BHCs.

In the Board's view, experience with trust preferred securities has demonstrated that they can play a useful role in providing financial support to banking organizations in deteriorating

financial condition. Although the consolidated accounting treatment for trust preferred securities, which continue to be accounted for as equity at the issuing entity level, has been revised, neither the instrument nor any of its features have changed since 1996 when the Board decided that the securities could be included in tier 1 capital. From a competitive equity point of view, poolings of trust preferred securities have permitted small BHCs for the first time to access the capital markets for tier 1 capital, which larger BHCs have long enjoyed. No alternative tier 1 structure to trust preferred securities has emerged that can be similarly pooled and issued to the capital markets by small banking organizations. With regard to large BHCs, the Board is aware that their foreign competitors have issued as much as $125 billion of similar tax-efficient tier 1 capital instruments and that preventing the use of a standard tax-efficient capital instrument by U.S. BHCs could place them at a competitive disadvantage.

In reviewing existing alternative tax-efficient tier 1 capital instruments available to BHCs, the Board has concluded that in several ways trust preferred securities are a superior instrument to these alternatives. In this regard, trust preferred securities are available to absorb losses throughout the BHC and do not affect the BHC's liquidity position. Trust preferred securities are relatively simple, standardized, and well-understood instruments that are widely issued by both corporate and banking organizations. Moreover, issuance of trust preferred securities tends to be broad and transparent and, thus, easy for the market to track. In the Board's view, these reasons support maintaining trust preferred securities as a component of tier 1 capital within limits that should likewise be applied to other capital instruments that do not provide the same level of capital support as common equity and noncumulative perpetual preferred stock.

Accordingly, in formulating quantitative limits for trust preferred securities, the Board has decided to apply them to a range of other instruments. Since 1989, cumulative perpetual preferred stock has been limited to 25 percent of the sum of core capital elements. In 1996, trust preferred was grouped together with other cumulative preferred stock for the purpose of the 25 percent limit. The Board is proposing to continue subjecting cumulative perpetual preferred stock and trust preferred securities to a common limit, while requiring other capital elements in the form of minority interest in the equity accounts of consolidated subsidiaries to be subject to that same limit. In this regard, the Board is proposing to distinguish among three types of qualifying minority interest. The aim of making this distinction is to allow common and preferred equity instruments issued directly by a consolidated U.S. depository institution or foreign bank subsidiary of a BHC to receive a treatment parallel to similar instruments issued directly by a BHC, while placing additional restrictions on minority interest in the equity accounts of other subsidiaries, whether the subsidiary is at the bank or the BHC level.

Thus, the Board is proposing that minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (Class A minority interest) would not be subject to formal limitation within tier 1 capital. Under the proposal, minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (Class B minority interest) would be a restricted core capital element subject to limitation within tier 1 capital, but not subject to a tier 2 capital sublimit. Finally, minority interest in the form of qualifying common stockholders' equity or qualifying perpetual preferred stock (and related surplus) in a consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank (Class C minority interest) would be eligible for inclusion in tier 1 capital as a restricted core capital element. In addition, as discussed below, Class C minority interest, which would include REIT preferred securities and other asset-driven capital instruments whether issued directly by a nonbank subsidiary of the BHC or of a U.S. depository institution or foreign bank subsidiary of the BHC, is subject to a tier 2 sublimit.

As discussed above, minority interest in a typical operating subsidiary does not stave off technical insolvency or provide capital support for the broader consolidated organization. Minority interest in the equity accounts of a consolidated U.S. depository institution or foreign bank subsidiary, however, does absorb losses throughout the issuing U.S. depository institution or foreign bank and provides protection to depositors, whose deposit accounts are often government-insured. Further, a BHC generally is expected to support a subsidiary depository institution. Because of the special role that such minority interest plays in protecting subsidiary depository institutions, the Board is proposing a more favorable treatment for Class A and Class B minority interest within tier 1 capital than it is proposing for minority interest in the equity accounts of other consolidated subsidiaries, including subsidiaries of a consolidated U.S. depository institution or foreign bank subsidiary or a subsidiary of the parent BHC (Class C minority interest). The Board seeks views on the appropriateness of the distinction among types of minority interest and specifically seeks comment on the treatment of minority interest in a foreign bank subsidiary of a BHC.

The limit the Board is proposing for the aggregate amount of a BHC's cumulative perpetual preferred stock, trust preferred securities, Class B minority interest, and Class C minority interest (collectively referred to as restricted core capital elements) is 25 percent of core capital elements, net of goodwill. By netting goodwill from the calculation of the 25 percent limit, the Board is tightening the current 25 percent limit, which currently is determined on a basis that does not deduct goodwill. Deducting goodwill from core capital elements will help ensure that a BHC is not unduly leveraging its tangible equity to issue restricted core capital elements. The deduction of goodwill for the purpose of this limit is also consistent with the direction taken by the Basel Committee on Banking Supervision in its consultative paper on a new capital accord. The paper proposes that limits set for so-called innovative capital instruments within tier 1 capital be determined on a basis that deducts goodwill from the sum of core capital elements.

Qualifying cumulative perpetual preferred stock and Class B minority interest in excess of the 25 percent limit would be includable in tier 2 capital with no sublimit. To further guard against potential over-reliance on trust preferred securities and other non-equity elements within a BHC's capital structure, the Board is proposing that amounts of qualifying trust preferred securities and Class C minority interest in excess of the 25 percent limit be included in tier 2 capital but be limited, together with subordinated debt and limited-life preferred stock, to 50 percent of tier 1 capital. A BHC would be free to attribute its excess amounts of restricted core capital elements first to any qualifying cumulative perpetual preferred stock or to Class B minority interest, and second to qualifying trust

preferred securities or Class C minority interest, which are subject to the tier 2 sublimit.

To help ensure comparability in capital structures among internationally active banking organizations, the Board is proposing to amend its capital guidelines to make explicit the Board's general expectation that internationally active BHCs limit the amount of restricted core capital elements to 15 percent of the sum of core capital elements, including restricted core capital elements, net of goodwill. The 15 percent limit for internationally active banking organizations is in line with the above-mentioned 1998 Basel agreement concerning innovative capital instruments. As indicated above, most internationally active banking organizations have long used the 15 percent limit as a guideline for their issuance of innovative instruments. For this purpose, an internationally active BHC is one that has significant activity in non-U.S. markets or that is considered a candidate for the Advanced Internal Ratings Based Approach under the proposals for a new Basel Accord. The Board seeks comment on whether the capital guidelines for BHCs should contain such an explicit expression of the Board's expectation for internationally active BHCs with respect to use of restricted core capital elements, should impose an explicit 15 percent limit on the use by internationally active BHCs of restricted core capital elements, or should include a more explicit definition of internationally active BHCs.

The proposal would provide a three-year transition period for BHCs to meet the new, stricter limitations within regulatory capital by proposing that the limits on restricted core capital elements become fully effective as of March 31, 2007. During the interim, BHCs with restricted core capital elements in excess of these limits must consult with the Federal Reserve on a plan for ensuring that the banking organization is not unduly relying upon these elements in its capital base and, where appropriate, for reducing such reliance. Until March 31, 2007, BHCs generally must comply with the current tier 1 capital limits. That is, BHCs generally should calculate their tier 1 capital on a basis that limits the aggregate amount of qualifying cumulative perpetual preferred stock and qualifying trust preferred securities to 25 percent of the sum of qualifying common stockholders' equity, qualifying noncumulative and cumulative perpetual preferred stock (including related surplus), qualifying minority interest in the equity accounts of consolidated subsidiaries, and qualifying trust preferred securities. Amounts of qualifying cumulative perpetual preferred stock and qualifying trust preferred securities in excess of this limit may be included in tier 2 capital.

The Board is also proposing to revise the capital guidelines to specify the criteria trust preferred securities must meet to be eligible for inclusion in tier 1 capital. Under these criteria, which the Board has broadly used since 1996, a BHC must consult with the Federal Reserve before issuing trust preferred securities. Such consultation would normally be undertaken with the BHC's District Reserve Bank. Qualifying trust preferred securities must be undated and provide for a minimum of twenty consecutive quarters of dividend deferral, as well as a call at the BHC's option commencing no later than ten years from issuance. The Board seeks comment on the continued requirement for a call option on trust preferred securities qualifying for inclusion in tier 1 capital. The criteria also specify that the sole asset of the trust must be a subordinated note issued by the BHC, which must have a minimum maturity of thirty years and must be subordinated to all other subordinated debt of the BHC. The terms of the subordinated note must conform to the requirements of the Board's subordinated debt policy statement, 12 CFR 250.166, although, consistent with the approved structure of these securities, the note may become due and payable upon default following the deferral of dividends for more than 20 consecutive quarters. Trust preferred securities issued before May 31, 2004 for which the underlying subordinated debt does not comply with 12 CFR 250.166 may continue to be included in tier 1 capital provided the noncomplying terms (i) have been commonly used by banking organizations, (ii) do not provide an unreasonably high degree of protection to the holder in circumstances other than bankruptcy, and (iii) do not effectively allow the holder in due course of the note to stand ahead of senior or subordinated debt holders in the event of bankruptcy. With regard to trust preferred securities issued by a BHC to a pool, the proposal sets forth the longstanding Board policy that the BHC may not purchase a security issued by that same pool. Where it does hold such a security (for example, through an acquisition of another banking organization), the notional amount of that security must be deducted from the amount of trust preferred securities qualifying for inclusion in regulatory capital.

The proposal also provides that in the last five years before the underlying subordinated note matures, the associated trust preferred securities must be treated as limited-life preferred stock. Thus, in the last five years of the life of the note, the outstanding amount of trust preferred securities will be excluded from tier 1 capital and included in tier 2 capital, subject, together with subordinated debt and other limited-life preferred stock, to a limit of 50 percent of tier 1 capital. During this period, the trust preferred securities will be amortized out of tier 2 capital by one-fifth of the original amount (less redemptions) each year and excluded totally from tier 2 capital during the last year of life of the underlying note.

Other Proposed Revisions

To ensure that the overall framework for the definition of regulatory capital remains effective, the Board is proposing a number of revisions to set forth in the capital guidelines for BHCs longstanding policies with regard to the terms and features of qualifying capital instruments. The Board seeks comment on whether parallel revisions to the definition of regulatory capital for state member banks should be made in Regulation H.

The proposal notes that where a BHC has directly or indirectly funded the purchase of an instrument, the instrument generally is excluded from regulatory capital. This provision is not intended to capture unintentional, indirect funding of capital instruments but rather intentional arrangements that undermine the concept that instruments included in regulatory capital must be fully paid up. The proposal also clarifies that common stockholders' equity may not have terms or features that create investor preferences, and strengthens language on the need for voting common equity to be the dominant form of tier 1 capital. In addition, the proposal emphasizes the need for a BHC to have the unrestricted ability to waive preferred dividends and the general expectation of the Board that such dividends will be waived when a BHC is in weakened condition and clarifies the distinction between cumulative and noncumulative preferred stock. The proposal also sets forth the general exclusion from tier 1 capital of preferred instruments with dividend rate step-ups or so-called market value conversion features whereby the holder must or can convert the preferred instrument into common stock at the market price prevailing at the time of the conversion.

Such features tend to either increase an organization's cost of capital or provide powerful incentives for an organization to redeem capital at a time when its condition is deteriorating, lessening the extent to which the instrument can help a BHC weather a period of distress. Further, the proposal incorporates into the guidelines for subordinated debt a reference to the Federal Reserve's subordinated debt policy statement set forth in 12 CFR 250.166, which outlines a number of technical requirements that subordinated debt included in regulatory capital must meet. The proposal also incorporates some clarifications of that policy with regard to subordination and acceleration. The Board seeks comment on whether similar clarifying amendments, or any other amendments, should be made to the subordinated debt policy statement.

The Board also is considering clarifying either by rulemaking or through supervisory guidance the treatment of qualifying trust preferred securities issued by small BHCs (that is, BHCs with consolidated assets of $150 million or less) under the Small Bank Holding Company Policy Statement, 12 CFR Part 225 Appendix C (Small BHC Policy Statement), which generally exempts small BHCs from the Board's risk-based capital and leverage capital guidelines. One approach being considered by the Board is to generally treat the subordinated debt associated with trust preferred securities issued by small BHCs as debt for most purposes under the Small BHC Policy Statement (other than the 12-year debt reduction and 25-year debt retirement standards), except that an amount of subordinated debt up to 25 percent of a small BHC's GAAP total stockholders' equity, net of goodwill, would be considered as neither debt nor equity under the Small BHC Policy Statement. This approach would result in a treatment for trust preferred securities issued by BHCs subject to the Small BHC Policy Statement that would be more in line with the treatment of these securities that the Board is proposing for larger BHCs subject to the Federal Reserve's risk-based capital guidelines. The Board seeks comment on this approach and other approaches to revision of the Small BHC Policy Statement to ensure a fair and sound approach for small BHCs' issuances of trust preferred securities.

The Board is also proposing to delete tables and attachments in the risk-based capital standards for state member banks and BHCs that summarize the definition of capital, the risk categories, credit conversion factors, credit equivalent amount calculations, and transitional arrangements to remove unnecessary regulatory text. These tables and attachments have become outdated and unnecessary because the substance of these summaries is included in the main text of the risk-based capital standards. Furthermore, these summary tables and attachments were originally provided to assist banking organizations unfamiliar with the new framework during the transition period when the Board's risk-based capital requirements were initially implemented.

The Board welcomes comments on all aspects of this notice of proposed rulemaking.

Regulatory Flexibility Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the Board has determined that this proposed rule would not have a significant impact on a substantial number of small entities in accordance with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). The Board believes that this proposed rule should not impact a substantial number of small banking organizations because most small banking organizations are already substantially in compliance, or will readily come into compliance within the proposed three-year transition period, with the regulatory standards of this proposed rule.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1.), the Board reviewed the proposed rulemaking under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the proposed rulemaking.

Plain Language

Section 722 of the Gramm-Leach-Bliley (GLB) Act requires the Board to use "plain language" in all proposed and final rules published after January 1, 2000. In light of this requirement, the Board has sought to present its proposed rule in a simple and straightforward manner. The Board invites comment on whether there are additional steps the Board could take to make its rule easier to understand.

List of Subjects

12 CFR Part 208

Accounting, Agriculture, Banks, Banking, Confidential business information, Crime, Currency, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

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

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation of part 208 continues to read as follows:

Authority: 12 U.S.C. 24, 36, 92a, 93a, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1816, 1818, 1820(d)(9), 1823(j), 1828(o), 1831, 1831o, 1831p–1, 1831r–1, 1831w, 1831x, 1835a, 1882, 2901–2907, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 78l(b), 781(g), 781(i), 78o–4(c)(5), 78q, 78q–1, and 78w; 31 U.S.C. 5318, 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

Appendix A to Part 208—[Amended]

2. In Appendix A to part 208, remove Attachments II, III, IV, V, and VI.

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

3. The authority citation for part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p–1, 1843(c)(8), 1844(b). 1972(l), 3106, 3108, 3310, 3331–3351, 3907, and 3909; 15 U.S.C. 6801 and 6805.

4. In Appendix A to part 225, the following amendments are proposed:

a. In section II, designate the first three undesignated paragraphs as paragraphs (i), (ii), and (iii); and revise redesignated paragraphs (i), (ii) and (iii).

b. In section II.A.,

i. Revise the heading.

ii. Remove footnote 5.

c. Revise section II.A.1.

d. In section II.A.2.,

i. Revise the heading.

ii. Remove footnote 8.

iii. Redesignate footnotes 9 and 10 as footnotes 11 and 12.

iv. Revise paragraph b.

v. Revise paragraph d.

vi. Redesignate footnotes 14 through 61 as footnotes 15 through 62 respectively, and add new footnote 14.

e. Add a sentence at the end of newly redesignated footnote 17.

f. Revise newly redesignated footnotes 38 and 39.

g. Remove Attachments II, III, IV, V, and VI.

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

* * * * *

II. Definition of Qualifying Capital for the Risk-Based Capital Ratio

(i) A banking organization's qualifying total capital consists of two types of capital components: ''core capital elements'' (tier 1 capital elements) and ''supplementary capital elements'' (tier 2 capital elements). These capital elements and the various limits, restrictions, and deductions to which they are subject, are discussed below. To qualify as an element of tier 1 or tier 2 capital, an instrument must be fully paid up and effectively unsecured. Accordingly, if a banking organization has purchased, or has directly or indirectly funded the purchase of, its own capital instrument, that instrument generally is disqualified from inclusion in regulatory capital. A qualifying tier 1 or tier 2 capital instrument also must be subordinated to all senior indebtedness of the organization. If issued by a bank, it also must be subordinated to claims of depositors. In addition, the instrument must not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

(ii) On a case-by-case basis, the Federal Reserve may determine whether, and to what extent, any instrument that does not fit wholly within the terms of a capital element set forth below, or that does not have an ability to absorb losses commensurate with the capital treatment specified below, will qualify as an element of tier 1 or tier 2 capital. In making such a determination, the Federal Reserve will consider the similarity of the instrument to instruments explicitly treated in the guidelines; the ability of the instrument to absorb losses, particularly while the organization operates as a going concern; the maturity and redemption features of the instrument; and other relevant terms and factors.

(iii) Redemptions of capital instruments before stated maturity could have a significant impact on an organization's overall capital structure. Consequently, an organization considering such a step should consult with the Federal Reserve before redeeming any equity or debt capital instrument prior to stated maturity if such redemption could have a material effect on the level or composition of the organization's capital base. Such consultation generally would not be necessary when the instrument is to be redeemed with the proceeds of, or replaced by, a like amount of a capital instrument that is of equal or higher quality with regard to terms and maturity and the Federal Reserve considers the organization's capital position to be fully sufficient.

A. The Definition and Components of Qualifying Capital

1. *Tier 1 capital.* Tier 1 capital generally is defined as the sum of core capital elements less any amounts of goodwill, other intangible assets, interest-only strips receivables, deferred tax assets, nonfinancial equity investments, and other items that are required to be deducted in accordance with section II.B. of this appendix. Tier 1 capital must represent at least 50 percent of total qualifying capital.

a. *Core capital elements (tier 1 capital elements).* The elements qualifying for inclusion in the tier 1 component of an institution's total qualifying capital are:

i. Qualifying common stockholders' equity;

ii. Qualifying noncumulative perpetual preferred stock (including related surplus);

iii. Minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (Class A minority interest); and

iv. Restricted core capital elements. The aggregate of these items is limited within tier 1 capital as set forth in section II.A.1.b. of this appendix. These elements are defined to include:

(1) Qualifying cumulative perpetual preferred stock (including related surplus);

(2) Minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (Class B minority interest);

(3) Minority interest in the form of qualifying common stockholders' equity or qualifying perpetual preferred stock (and related surplus) in a consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank (Class C minority interest); and

(4) Qualifying trust preferred securities.

b. *Limits on restricted core capital elements*—i. *Limits.* (1) The aggregate amount of restricted core capital elements that may be included in a banking organization's tier 1 capital must not exceed 25 percent of the sum of all core capital elements, including restricted core capital elements, net of goodwill. Stated differently, the aggregate amount of restricted core capital elements is limited to one-third of the sum of core capital elements, excluding restricted core capital elements, net of goodwill. Amounts of restricted core capital elements in excess of this limit generally may be included in tier 2 capital.

(2) The excess amounts of restricted core capital elements that are in the form of Class C minority interest and qualifying trust preferred securities are subject to further limitation within tier 2 capital in accordance with section II.A.2.d.iv. of this appendix. A banking organization may attribute excess amounts of restricted core capital elements first to any qualifying cumulative perpetual preferred stock or to Class B minority interest, and second to qualifying trust preferred securities or to Class C minority interest, which are subject to a tier 2 sublimit.

(3) The Federal Reserve generally expects internationally active banking organizations to limit the aggregate amount of restricted core capital elements included in tier 1 capital to 15 percent of the sum of all core capital elements, including restricted core capital elements, net of goodwill.

ii. *Transition.*

(1) The quantitative limits for restricted core capital elements set forth in sections II.A.1.b.i. and II.A.2.d.iv. of this appendix do not become effective until March 31, 2007. Prior to that time, a banking organization with restricted core capital elements in amounts that cause them to exceed these limits must consult with the Federal Reserve on a plan for ensuring that the banking organization is not unduly relying on these elements in its capital base and, where appropriate, for reducing such reliance.

(2) Until March 31, 2007, the aggregate amount of qualifying cumulative perpetual preferred stock (including related surplus) and qualifying trust preferred securities that a banking organization may include in tier 1 capital is limited to 25 percent of the sum of the following core capital elements: qualifying common stockholders' equity, qualifying noncumulative and cumulative perpetual preferred stock (including related surplus), qualifying minority interest in the equity accounts of consolidated subsidiaries, and qualifying trust preferred securities. Until March 31, 2007, amounts of qualifying cumulative perpetual preferred stock and qualifying trust preferred securities in excess of this limit may be included in tier 2 capital.

(3) Until March 31, 2007, internationally active banking organizations generally are expected to limit the amount of qualifying cumulative perpetual preferred stock and qualifying trust preferred securities included in tier 1 capital to 15 percent of the sum of core capital elements set forth in section II.A.1.b.ii.(2) of this appendix.

c. *Definitions and requirements for core capital elements.*

i. *Qualifying common stockholders' equity.*

(1) *Definition.* Qualifying common stockholders' equity is limited to common stock; related surplus; and retained earnings, including capital reserves and adjustments for the cumulative effect of foreign currency translation, net of any treasury stock, less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values. For this purpose, net unrealized holding gains on such equity securities and net unrealized holding gains (losses) on available-for-sale debt securities are not included in qualifying common stockholders' equity.

(2) *Restrictions on terms and features.* A capital instrument that has a stated maturity date or that has a preference with regard to liquidation or the payment of dividends is not deemed to be a component of qualifying common stockholders' equity, regardless of whether or not it is called common equity. Terms or features that grant other preferences also may call into question whether the capital instrument would be deemed to be qualifying common stockholders' equity. Features that require, or provide significant incentives for, the issuer to redeem the instrument for cash or cash equivalents will render the instrument ineligible as a component of qualifying common stockholders' equity.

(3) *Reliance on voting common stockholders' equity.* Although section II.A.1. of this appendix allows for the inclusion of elements other than common stockholders' equity within tier 1 capital, voting common stockholders' equity, which is the most desirable capital element from a supervisory standpoint, generally should be the dominant element within tier 1 capital. Thus, bank holding companies should avoid over-reliance on preferred stock or other nonvoting elements within tier 1 capital. Such nonvoting elements can include

portions of common stockholders' equity where, for example, a banking organization has a class of nonvoting common equity, or a class of voting common equity that has substantially fewer voting rights per share than another class of voting equity. Where a banking organization relies excessively on nonvoting elements within tier 1 capital, the Federal Reserve generally will require the banking organization to allocate a portion of the nonvoting elements to tier 2 capital.

ii. *Qualifying perpetual preferred stock.*

(1) *Qualifying requirements.* Perpetual preferred stock qualifying for inclusion in tier 1 capital has no maturity date, cannot be redeemed at the option of the holder, and has no other provisions or features that will require, or create significant incentives for, future redemption of the issue. Perpetual preferred stock will qualify for inclusion in tier 1 capital only if it can absorb losses while the issuer operates as a going concern and only if the issuer has the ability and legal right to defer or eliminate dividends on the preferred stock.

(2) *Restrictions on terms and features.* Perpetual preferred stock included in tier 1 capital may not have any provisions restricting the banking organization's ability to defer or eliminate dividends, other than provisions requiring prior or concurrent deferral of payments on more junior instruments, which the Federal Reserve generally expects in such instruments consistent with the notion that the most junior capital elements should absorb losses first. Dividend deferrals on preferred stock, which the Federal Reserve expects will occur either voluntarily or at its direction when an organization is in a weakened condition, must not be subject to arrangements that would diminish the ability of the deferral to shore up the organization's resources. Any perpetual preferred stock with a feature permitting redemption at the option of the issuer may qualify as tier 1 capital only if the redemption is subject to prior approval of the Federal Reserve. Features that require, or create significant incentives for, the issuer to redeem the instrument for cash or cash equivalents generally will render the instrument ineligible for inclusion in tier 1 capital. For example, perpetual preferred stock that has a credit-sensitive dividend feature—that is, a dividend rate that is reset periodically based, in whole or in part, on the banking organization's current credit standing—generally does not qualify for inclusion in tier 1 capital.[5] Similarly, perpetual preferred stock that has a dividend rate step-up or a market value conversion feature—that is, a feature whereby the holder must or can convert the preferred stock into common stock at the market price prevailing at the time of conversion—generally does not qualify for inclusion in tier 1 capital.[6] Perpetual preferred stock that does not qualify for inclusion in tier 1 capital generally will qualify for inclusion in tier 2 capital.

(3) *Noncumulative and cumulative features.* Perpetual preferred stock that is noncumulative generally may not permit the accrual or payment of unpaid dividends in any form, including in the form of common stock. Perpetual preferred stock that provides for the accumulation or future payment of unpaid dividends is deemed to be cumulative, regardless of whether or not it is called noncumulative.

iii. *Qualifying minority interest.* Minority interest in the common and preferred stockholders' equity accounts of a consolidated subsidiary (minority interest) represents stockholders' equity associated with common or preferred equity instruments issued by a banking organization's consolidated subsidiary that are held by investors other than the banking organization. Minority interest is included in tier 1 capital because, as a general rule, it represents equity that is freely available to absorb losses in the issuing subsidiary. Nonetheless, minority interest typically is not available to absorb losses in the banking organization as a whole, a feature that is a particular concern when the minority interest is issued by a subsidiary that is neither a U.S. depository institution nor a foreign bank. For this reason, these guidelines distinguish among three types of qualifying minority interest. Class A minority interest is limited to minority interest related to qualifying common and noncumulative perpetual preferred equity instruments issued directly (that is, not through a subsidiary) by a consolidated U.S. depository institution[7] or foreign bank[8] subsidiary of a banking organization. Class A minority interest is not subject to a formal limitation within tier 1 capital. Class B minority interest is limited to minority interest related to qualifying cumulative perpetual preferred equity instruments issued directly by a consolidated U.S. depository institution or foreign bank subsidiary of a banking organization. Class B minority interest is a restricted core capital element subject to the limitation set forth in section II.A.1.b.i. of this appendix, but is not subject to a tier 2 sublimit. Class C minority interest includes any minority interest related to qualifying common or perpetual preferred equity instruments that are issued by a banking organization's consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank. Class C minority interest is eligible for inclusion in tier 1 capital as a restricted core capital element and is subject to the limitations set forth in section II.A.1.b.i. and II.A.2.d.iv. of this appendix. Minority interest in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix), and subsidiaries engaged in nonfinancial activities are not included in the banking organization's tier 1 or total capital base if the banking organization's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. of this appendix. In addition, minority interest in consolidated asset-backed commercial paper programs (as defined in section III.B.6. of this appendix) that are sponsored by a banking organization are not included in the organization's tier 1 or total capital base if the organization excludes the consolidated assets of the program from risk-weighted assets pursuant to section III.B.6. of this appendix. This capital treatment for minority interest in consolidated asset-backed commercial paper programs will be effective from July 1, 2003 and will expire on July 1, 2004.

iv. *Qualifying trust preferred securities.* A banking organization that wishes to issue trust preferred securities and include them in tier 1 capital must first consult with the Federal Reserve. Trust preferred securities are defined as undated preferred securities issued by a trust or similar entity sponsored by a banking organization that is the sole common equity holder of the trust. Qualifying trust preferred securities must allow for dividends to be deferred for at least twenty consecutive quarters without an event of default and any notification period for deferral must be reasonably short, generally no more than one business week. The securities are otherwise subject to the same restrictions on terms and features as qualifying perpetual preferred stock as set forth in section II.A.c.ii.(2) of this appendix and must provide for a call at the banking organization's option commencing no later than ten years from the date of issuance. Further, the sole asset of the trust generally must be a subordinated note, issued by the sponsoring banking organization, that has a minimum maturity of thirty years, is subordinated to all senior and all other subordinated debt of the banking organization, and otherwise has terms that mirror those of the preferred securities issued by the trust.[9] The note may have terms

[5] Traditional floating-rate or adjustable-rate perpetual preferred stock (that is, perpetual preferred stock in which the dividend rate is not affected by the issuer's credit standing or financial condition but is adjusted periodically in relation to an independent index based solely on general market interest rates), however, generally qualifies for inclusion in tier 1 capital (provided all other requirements are met).

[6] Traditional convertible perpetual preferred stock, which the holder must or can convert into a fixed number of common shares at a preset price, generally qualifies for inclusion in tier 1 capital (provided all other requirements are met).

[7] U.S. depository institutions are defined to include branches (foreign and domestic) of federally insured banks and depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, and international banking facilities of domestic banks.

[8] For this purpose, a foreign bank is defined as an institution that engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authorities of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of business; and has the power to accept demand deposits.

[9] Under generally accepted accounting principles, the trust issuing the preferred securities generally is not consolidated on the banking organization's balance sheet; rather the underlying subordinated note is recorded as a liability on the organization's balance sheet. Only the amount of the trust preferred securities issued, which is equal to the amount of the underlying subordinated note less the amount of the sponsoring banking organization's common equity investment in the trust (which is recorded as an asset on the banking organization's consolidated balance sheet), may be included in tier 1 capital. The common equity

providing for an event of default and acceleration of principal and accrued interest upon deferral of payments for twenty or more consecutive quarters but otherwise must comply with the Federal Reserve's subordinated debt policy statement set forth in 12 CFR 250.166.[10] In the last five years before the maturity of the note, the outstanding amount of the associated trust preferred securities are excluded from tier 1 capital and included in tier 2 capital, where they are subject to the amortization provisions and quantitative restrictions set forth in sections II.A.2.d.iii. and iv. of this appendix as if the trust preferred securities were limited-life preferred stock.

2. *Supplementary capital elements (tier 2 capital elements)* * * *

* * * * *

b. *Perpetual preferred stock.* Perpetual preferred stock (and related surplus) that meets the requirements set forth in section II.A.1.c.ii.(1) of this appendix is eligible for inclusion in tier 2 capital without limit.[13]

* * * * *

d. *Subordinated debt and intermediate-term preferred stock*—i. *Five-year minimum maturity.* Subordinated debt and intermediate-term preferred stock must have an original weighted average maturity of at least five years to qualify as tier 2 capital. If the holder has the option to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing banking organization.

ii. *Other restrictions on subordinated debt.* Subordinated debt included in tier 2 capital must comply with the Federal Reserve's subordinated debt policy statement set forth in 12 CFR 250.166.[14] Accordingly, such subordinated debt must meet the following requirements:

(1) The subordinated debt must be unsecured.

(2) The subordinated debt must clearly state on its face that it is not a deposit and is not insured by a Federal agency.

(3) The subordinated debt must not have credit-sensitive features or other provisions that are inconsistent with safe and sound banking practice.

(4) Subordinated debt issued by a subsidiary depository institution of a bank holding company must be subordinated in right of payment to the claims of all the institution's general creditors and depositors, and must not contain provisions permitting debt holders to accelerate payment of principal or interest upon the occurrence of any event other than receivership of the institution. Subordinated debt issued by a bank holding company or its non-depository institution subsidiaries must be subordinated to all senior indebtedness of the issuer; that is, the debt must be subordinated at a minimum to all borrowed and purchased money, similar obligations arising from off-balance sheet guarantees and direct credit substitutes, and obligations associated with derivative products such as interest rate and foreign exchange contracts, commodity contracts, and similar arrangements. Subordinated debt issued by a bank holding company or its non-depository institution subsidiaries must not contain provisions permitting debt holders to accelerate payment of principal or interest upon the occurrence of any event other than bankruptcy of the bank holding company or the receivership of a major subsidiary depository institution. Thus, a provision permitting acceleration in the event that any other affiliate of the bank holding company issuer enters into bankruptcy or receivership makes the instrument ineligible for inclusion in tier 2 capital.

iii. *Discounting in last five years.* As a limited-life capital instrument approaches maturity, it begins to take on characteristics of a short-term obligation. For this reason, the outstanding amount of term subordinated debt and limited-life preferred stock eligible for inclusion in tier 2 capital is reduced, or discounted, as these instruments approach maturity: one-fifth of the outstanding amount is excluded each year during the instrument's last five years before maturity. When remaining maturity is less than one year, the instrument is excluded from tier 2 capital.

iv. *Limits.* The aggregate amount of term subordinated debt (excluding mandatory convertible debt) and limited-life preferred stock—as well as, beginning March 31, 2007, qualifying trust preferred securities and Class C minority interest in excess of the limits set forth in section II.A.1.b.i. of this appendix—that may be included in tier 2 capital is limited to 50 percent of tier 1 capital (net of goodwill and other intangible assets required to be deducted in accordance with section II.B.1.b. of this appendix). Amounts of these instruments in excess of this limit, although not included in tier 2 capital, will be taken into account in the overall assessment of an organization's funding and financial condition.

B. * * *

2. * * *

a. * * * The aggregate amount of investments in banking or finance subsidiaries[17] * * *

* * * * *

III. * * *

C. * * *

2. * * *

a. * * * U.S. depository institutions[38] and foreign banks[39]; * * *

* * * * *

5. In Appendix D to Part 225, the following amendments are proposed:

a. Amend the second sentence of section I.b. by changing the word "that" to "than."

b. In section II.b., revise footnote 3.

c. In section II.c., revise the second sentence.

Appendix D to Part 225—Capital Adequacy Guidelines for Bank Holding Companies: Tier 1 Leverage Measure

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investment in the trust should be excluded from the calculation of risk-weighted assets in accordance with footnote 15 of this appendix. Where a banking organization has issued trust preferred securities pursuant to a pooling arrangement, the organization generally must not buy back a security issued from the pool. Where a banking organization does hold such a security (for example, as a result of an acquisition of another banking organization), the amount of the trust preferred securities included in regulatory capital must, consistent with section II.(i) of this appendix, be reduced by the notional amount of the banking organization's investment in the security issued by the pool.

[10] Trust preferred securities issued before May 31, 2004, generally would not be ineligible for inclusion in tier 1 capital because of noncompliance with 12 CFR 250.166 provided the non-complying terms of the subordinated note (i) have been commonly used by banking organizations, (ii) do not provide an unreasonably high degree of protection to the holder in circumstances other than bankruptcy of the banking organization, and (iii) do not effectively allow a holder in due course of the note to stand ahead of senior or subordinated debt holders in the event of bankruptcy of the banking organization.

[13] Long-term preferred stock with an original maturity of 20 years or more (including related surplus) will also qualify in this category as an element of tier 2 capital. If the holder of such an instrument has a right to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined for risk-based capital purposes as the earliest possible date on which the holder can put the instrument back to the issuing banking organization. In the last five years before the maturity of the stock, it must be treated as limited-life preferred stock, subject to the amortization provisions and quantitative restriction set forth in section II.A.2.d.iii. and iv. of this appendix. Minority interest in the form of preferred stock (and related surplus) directly issued by a consolidated U.S. depository institution or foreign bank subsidiary that does not qualify for inclusion in tier 1 capital also generally is eligible for inclusion in this category as an element of tier 2 capital.

[14] The subordinated debt policy statement set forth in 12 CFR 250.166 notes that certain terms found in subordinated debt may provide protection to investors without adversely affecting the overall benefits of the instrument to the issuing banking organization and, thus, would be acceptable for subordinated debt included in capital. Among such acceptable terms would be a provision that prohibits a bank holding company from merging, consolidating, or selling substantially all of its assets unless the new entity assumes the subordinated debt. Another acceptable provision would be the inclusion as an event of default the failure to pay principal or interest on a timely basis, so long as such event of default does not allow the debtholders to accelerate the repayment of principal or interest.

[17] * * * For the purpose of this section, the definition of banking and finance subsidiary does not include a trust or other special purpose entity used to issue trust preferred securities.

[38] See footnote 7 of this appendix for the definition of a U.S. depository institution. For this purpose, the definition also includes U.S.-chartered depository institutions owned by foreigners. However, branches and agencies of foreign banks located in the U.S., as well as all bank holding companies, are excluded.

[39] See footnote 8 of this appendix for the definition of a foreign bank. Foreign banks are distinguished as either OECD banks or non-OECD banks. OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries (other than the U.S.) that belong to the OECD-based group of countries. Non-OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries that do not belong to the OECD–based group of countries.

II. * * *

b. * * * For the purpose of this leverage ratio, the definition of tier 1 capital as set forth in the risk-based capital guidelines contained in appendix A of this part will be used.[3] * * *

c. * * * This is consistent with the Federal Reserve's risk-based capital guidelines and long-standing Board policy and practice with regard to leverage guidelines. * * *

* * * * *

By order of the Board of Governors of the Federal Reserve System, May 6, 2004.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 04–10728 Filed 5–18–04; 8:45 am]

BILLING CODE 6210–01–P

[3] Tier 1 capital for banking organizations includes the following core capital elements: qualifying common stockholders' equity, qualifying noncumulative and cumulative perpetual preferred stock, qualifying minority interest in the equity accounts of consolidated subsidiaries, and qualifying trust preferred securities. Qualifying cumulative perpetual preferred stock and trust preferred securities, as well as, beginning March 31, 2007, certain types of minority interest, are limited to 25 percent of the sum of core capital elements, net, beginning March 31, 2007, of goodwill. Internationally active banking organizations generally are expected to limit these elements to 15 percent of the sum of tier 1 capital elements, net, beginning March 31, 2007, of goodwill. In addition, as a general matter, tier 1 capital excludes goodwill; amounts of mortgage-servicing assets, non-mortgage-servicing assets, and purchased credit-card relationships that, in the aggregate, exceed 100 percent of tier 1 capital; amounts of non-mortgage-servicing assets and purchased credit-card relationships that, in the aggregate, exceed 25 percent of tier 1 capital; amounts of credit-enhancing interest-only strips that are in excess of 25 percent of tier 1 capital; all other identifiable intangible assets; deferred tax assets that are dependent upon future taxable income, net of their valuation allowance in excess of certain limitations; and a percentage of the organization's nonfinancial equity investments. The Federal Reserve may exclude certain investments in subsidiaries or associated companies as appropriate.

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 2002–NM–347–AD]

RIN 2120–AA64

Airworthiness Directives; Saab Model SAAB 2000 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This document proposes the adoption of a new airworthiness directive (AD) that is applicable to certain Saab Model SAAB 2000 series airplanes. This proposal would require various repetitive inspections for cracking of the drag and shear angles that attach the nacelle to the front spar of the wing, and related corrective action. The proposal also would require eventual modification of the drag and shear angles, which would end the repetitive inspections. This action is necessary to prevent fatigue cracking of the drag and shear angles, which could result in reduced structural integrity of the nacelle and wing. This action is intended to address the identified unsafe condition.

DATES: Comments must be received by June 18, 2004.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM–114, Attention: Rules Docket No. 2002–NM–347–AD, 1601 Lind Avenue, SW., Renton, Washington 98055–4056. Comments may be inspected at this location between 9 a.m. and 3 p.m., Monday through Friday, except Federal holidays. Comments may be submitted via fax to (425) 227–1232. Comments may also be sent via the Internet using the following address: *9-anm-nprmcomment@faa.gov.* Comments sent via fax or the Internet must contain "Docket No. 2002–NM–347–AD" in the subject line and need not be submitted in triplicate. Comments sent via the Internet as attached electronic files must be formatted in Microsoft Word 97 or 2000 or ASCII text.

The service information referenced in the proposed rule may be obtained from Saab Aircraft AB, SAAB Aircraft Product Support, S–581.88, Linköping, Sweden. This information may be examined at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington.

FOR FURTHER INFORMATION CONTACT: Dan Rodina, Aerospace Engineer, International Branch, ANM–116, FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington 98055–4057; telephone (425) 227–2125; fax (425) 227–1149.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested persons are invited to participate in the making of the proposed rule by submitting such written data, views, or arguments as they may desire. Communications shall identify the Rules Docket number and be submitted in triplicate to the address specified above. All communications received on or before the closing date for comments, specified above, will be considered before taking action on the proposed rule. The proposals contained in this action may be changed in light of the comments received.

Submit comments using the following format:

- Organize comments issue-by-issue. For example, discuss a request to change the compliance time and a request to change the service bulletin reference as two separate issues.
- For each issue, state what specific change to the proposed AD is being requested.
- Include justification (*e.g.*, reasons or data) for each request.

Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the proposed rule. All comments submitted will be available, both before and after the closing date for comments, in the Rules Docket for examination by interested persons. A report summarizing each FAA-public contact concerned with the substance of this proposal will be filed in the Rules Docket.

Commenters wishing the FAA to acknowledge receipt of their comments submitted in response to this action must submit a self-addressed, stamped postcard on which the following statement is made: "Comments to Docket Number 2002–NM–347–AD." The postcard will be date stamped and returned to the commenter.

Availability of NPRMs

Any person may obtain a copy of this NPRM by submitting a request to the FAA, Transport Airplane Directorate, ANM–114, Attention: Rules Docket No. 2002–NM–347–AD, 1601 Lind Avenue, SW., Renton, Washington 98055–4056.

Discussion

The Luftfartsverket (LFV), which is the airworthiness authority for Sweden, notified the FAA that an unsafe condition may exist on certain Saab Model SAAB 2000 series airplanes. The LFV advises that inspections done by a full-scale fatigue unit have revealed cracks in the drag angles that attach the nacelle to the wing box via the upper and lower wing skin; and in the shear angles that attach the nacelle to the front spar of the wing. Fatigue cracking of the drag and shear angles of the front spar of the wing could result in reduced structural integrity of the nacelle and wing.

Explanation of Relevant Service Information

The manufacturer has issued Saab Service Bulletins 2000–54–026, Revision 01, and 2000–54–028, Revision 01, both dated June 20, 2002. The service bulletins describe procedures for