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M E M O R A N D U M

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To Our Clients and Friends

Re: Risk-Based Treatment of Convertible Trust Preferred Securities

The Federal Reserve Board (the “Board”) has issued an interpretive letter stating that mandatory convertible preferred securities that convert into noncumulative perpetual preferred securities will be permitted to be included in tier 1 capital on the same terms and subject to the same quantitative limit as trust preferred securities that convert into common stock. Accordingly, such securities will be subject to a limit of 25 percent of tier 1 capital under the Board’s risk-based capital adequacy guidelines (the “Capital Guidelines”).

The Capital Guidelines generally limit an internationally active bank holding company’s (“BHC’s”) restricted core capital elements to 15 percent of the sum of all core capital.¹ Restricted core capital elements may be included in tier 1 capital, however, up to 25 percent of the BHC’s tier 1 capital, if the elements exceeding the 15 percent limit are in the form of mandatory convertible preferred securities.

The Board’s letter provides that the exception to the 15 percent limit also applies to preferred securities mandatorily convertible into noncumulative perpetual preferred securities as well as into common stock. The Board stated that, although common stock is the highest form of tier 1 capital, noncumulative perpetual preferred stock is a high form of tier 1 capital and is not a restricted core capital element. The Board found it determinative that, like common stock, noncumulative perpetual preferred stock is available to absorb losses incurred by the issuer, constitutes equity under generally accepted accounting principles and enables the issuer to waive dividends on a noncumulative basis, which possibly avoids potential restrictions on the issuer’s ability to raise equity.

¹ The Board has amended the Capital Guidelines to revise the criteria for inclusion of capital instruments in tier 1 capital effective March 31, 2009. 70 *Fed. Reg.* 11827 (Mar. 10, 2005).

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A copy of the Board's interpretive letter can be found on our web site at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.