BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 19-7

March 21, 2019

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK AND TO FINANCIAL INSTITUTIONS SUPERVISED BY THE FEDERAL RESERVE

SUBJECT: Statement on the Implications of the New Lease Accounting Standard on Regulation H

Applicability: This guidance applies to state member banks, including those with $10 billion or less in consolidated assets, that file regulatory reports prepared in accordance with generally accepted accounting principles (GAAP).

The purpose of this letter is to provide state member banks with guidance on the treatment of operating leases as an investment in bank premises under Regulation H upon the implementation of the new lease accounting standard.[1]

In February 2016, the Financial Accounting Standards Board (FASB) issued a new accounting standard on leases, Accounting Standards Update No. 2016-02, Leases (Topic 842), which revises the accounting for lease transactions.[2] The most significant change in the new accounting standard is to lessee accounting for operating leases. Under existing accounting standards, lessees recognize lease assets and lease liabilities on the balance sheet for finance leases, but do not recognize lease assets and lease liabilities on the balance sheet for operating leases. The new standard requires lessees to record a right-of-use asset and a lease liability on the balance sheet for virtually all leases. Therefore once a state member bank adopts the standard, operating leases (other than leases that meet the accounting definition of a short-term lease as well as certain types that are accounted for outside the scope of Topic 842), including those entered into prior to the standard's effective date, will be recorded on lessees' balance sheets. In general, the new standard's effect on lessor accounting for lease transactions is not significant.

[1] The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, for public business entities. For all other entities, the standard is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application of the new standard is permitted. An institution that early adopts the new standard must apply it in its entirety to all lease-related transactions.

[2] Refer to https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176167901010.

Upon adoption of the new lease accounting standard, the carrying value of bank premises will include leases recorded on the balance sheet, and may exceed the amount of the bank's capital stock. This excess may raise questions with respect to Section 24A of the Federal Reserve Act (Section 24A),[3] under which a state member bank may not, without the approval of the Board of Governors of the Federal Reserve System (Board), make investments in bank premises if such investments, in the aggregate, exceed the capital stock of the bank.[4]

The Board maintains the opinion that approval by the Board is not required under Section 24A where a change in U.S. GAAP requires a state member bank to capitalize premises leased prior to the effective date of the new standard.[5] Thus, if prior to adoption of the new accounting standard, a state member bank's investment in bank premises is less than capital stock, but that investment increases to an amount in excess of capital stock by virtue of adopting the new standard, the bank need not seek the Board's approval under Section 24A. However, approval will be required under Section 24A for any bank premises investment in excess of capital stock made following adoption of the new standard.[6]

Reserve Banks should distribute this letter to the state member banks in their districts and to appropriate supervisory staff. Questions regarding this letter should be directed to the following individuals in the Accounting Policy Section in the Division of Supervision and Regulation: Lara Lylozian, Manager, at (202) 475-6656; and Meg Buckley, Accounting Policy Analyst, at (202) 452-3981; or to David Alexander, Counsel, in the Legal Division, at (202) 452-2877.

In addition, institutions may send questions via the Board's public website.[7]

Michael S. Gibson
Director

[3] See https://www.federalreserve.gov/aboutthefed/section24a.htm.

[4] Section 24A is implemented by the Board's Regulation H, which generally requires a state member bank to provide fifteen days notice prior to an investment in bank premises unless the bank's aggregate amount of investment in bank premises is less than or equal to the bank's perpetual preferred stock and related surplus plus common stock and related surplus, as those terms are defined in the instructions to the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income. See 12 CFR 208.21(a).

[5] The Board has previously expressed the view that a change in GAAP that results in the capitalization of leased property by a lessee does not necessitate approval under Section 24A for leases entered prior to the effective date of the change. See the Board's December 19, 1977, policy statement (S-2362), which is available here.

[6] For more information on the appropriate treatment of capital leases for the purposes of the Federal Reserve's Regulation H and Section 24A, see S-2362.

[7] See http://www.federalreserve.gov/apps/contactus/feedback.aspx.

BOARD OF GOVERNORS

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WASHINGTON, D.C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

S - 2362

December 19, 1977

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS AND THE OFFICERS IN CHARGE OF BRANCHES

SUBJECT: Financial Accounting Standards Board's Statement of Financial Accounting Standard No. 13

Effective January 1, 1977, the Financial Accounting Standards Board's Statement of Financial Accounting Standard (SFAS) No. 13 "Accounting for Leases" revised significantly the accounting for lease transactions. The Statement requires "capitalization" of leased property by the lessee whenever the lease agreement meets the criteria of a capital lease. Further, existing capital leases entered into prior to January 1, 1977 will be required to be retroactively restated no later than fiscal year ending December 31, 1981. The effect on lessor accounting for lease transactions is relatively minor. The Board adopts this SFAS as generally accepted accounting applicable to State member banks that are on an accrual accounting basis.[1]

State member banks may be lessees pursuant to capital lease agreements which require capitalization of leased property. In cases where State member banks have entered into bank premises capital lease agreements in 1977 or retroactively restate premises accounts related to pre-1977 capital leases as required by SFAS No. 13, increases in the carrying value of the bank premises may exceed the amount of the bank's capital stock.

This may raise questions with respect to section 24A of the Federal Reserve Act, under which a State member bank may not, without the Board's approval, make an investment in bank premises, or in stock, bonds, debentures, or other such obligations of any corporation, holding the bank premises, if such investments, in the aggregate exceed the capital stock of the bank. The Board is of the opinion that its approval is not required under section 24A where a change in generally accepted accounting principles requires a State member bank to capitalize premises leased in the year 1977 or restate retroactively leased premises pursuant to capital lease agreements entered into prior to the year 1977. Thus, if an investment in bank premises is increased to an amount in excess of a State member bank's capital stock by virtue of

[1] Beginning with the supervisory call report for the year ended December 31, 1977, specific reporting instructions for capital lease transactions will be issued. In general, all capital lease property will be included in the fixed asset caption and capital lease liability will be included in the expanded caption, "mortgage indebtedness and capital lease obligations." Accounting for capital lease expenses will continue to be reported in the captions related to the nature of the leased property (i.e., occupancy or equipment expense).

capitalization of a lease entered into by the bank prior to January 1, 1978, the bank need not seek the Board's approval under section 24A. However, the Board's approval would be required under section 24A where such excess investment in bank premises derives from the capitalization of a lease entered into January 1, 1978 or subsequent thereto.

Very truly yours,

//signed//

Theodore E. Allison
Secretary