

Risk-Based Capital Final Rule Applicable to Community Banks

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New Capital Requirements

Key Changes from Original Proposal

- Financial institutions with consolidated assets below \$250 billion will be permitted a one-time irrevocable option to permanently exclude accumulated other comprehensive income (AOCI) from inclusion in regulatory capital, instead of including AOCI in regulatory capital calculations as proposed.
- Community banks will continue to use current risk weights for residential mortgages when calculating risk-based capital, instead of eight separate risk buckets as proposed.
- Trust preferred securities (TruPS) will continue to be permanently included in Tier 1 capital (TruPS issued prior to May 19, 2010 for banking organizations that had less than \$15 billion in assets as of Dec. 31, 2009, or that were in mutual form as of May 19, 2010), instead of phased out over time as proposed.

Applicability

- All banks and savings associations.
- All bank holding companies with more than \$500 million in assets.
- All savings and loan holding companies.
- For financial institutions with total consolidated assets of less than \$250 billion, the final rule doesn't apply until Jan. 1, 2015.

New Common Equity Ratio

- Minimum ratio of 4.5 percent common equity to risk-weighted assets to be “adequately” capitalized.
- Financial institutions with consolidated assets under \$250 billion have a one-time option to permanently exclude AOCI (changes in fair market value of certain investment securities). The AOCI opt-out election is irrevocable and must be taken when the first call report is filed after the bank becomes first subject to the rule—(i.e., for community banks, the first call report following Jan. 1, 2015).
- Goodwill and certain deferred tax assets excluded from measurement.

New Tier 1 Capital Ratio

- Minimum ratio of 6 percent Tier 1 capital to risk-weighted assets (increases current minimum of 4 percent) to be “adequately” capitalized.
- Non-cumulative perpetual preferred stock would generally be included.
- TruPS and cumulative perpetual preferred stock would be included pursuant to the Collins Amendment in Dodd-Frank (i.e., TruPS issued prior to May 19, 2010 for banking organizations that had less than \$15 billion in assets as of December 31, 2009, or that were in mutual form as of May 19, 2010).
- TARP equity would be grandfathered permanently.

New Total Capital Ratio

- Minimum ratio of 8 percent total capital to risk-weighted assets to be “adequately” capitalized.
- Includes allowance for loan and lease losses up to 1.25 percent of risk-weighted assets.

New Capital Conservation Buffer

- Additional 2.5 percent capital buffer to be applied to the common equity Tier 1 capital, the Tier 1 capital ratio, and the total capital ratio.
- Must be met with common equity capital.
- Failure to meet additional capital buffer would result in limits on capital payouts (dividends) and discretionary bonuses to executives.

Leverage Ratio

- All banking organizations subject to 4 percent Tier 1 leverage ratio.
- Defined as Tier 1 capital divided by average total consolidated assets less Tier 1 capital deductions.
- Advanced approaches banking organizations subject to 3 percent supplementary leverage ratio that adds certain off-balance-sheet exposures (institutions greater than \$250 billion in consolidated assets).
- Agencies have proposed that the eight largest banking organizations be subject to an additional 2 percent (holding company) leverage buffer above the 3 percent supplementary leverage ratio (total of 5 percent) to avoid limitations on distributions and certain executive bonuses and 6 percent (bank) supplementary leverage ratio including certain off-balance-sheet exposures to be deemed “well capitalized” under prompt corrective action requirements.

New Prompt Corrective Action Requirements (effective Jan. 1, 2015)

Requirement	Total Risk-Based Capital Measure %	Tier 1 Risk-Based Capital Measure %	Common Equity Risk-Based Capital Measure %	Leverage Measure %
Well Capitalized	≥10	≥8	≥6.5	≥5
Adequately Capitalized	≥8	≥6	≥4.5	≥4
Undercapitalized	<8	<6	<4.5	<4
Significantly Undercapitalized	<6	<4	<3	<3
Critically Undercapitalized	Tangible equity to total assets ≤2			

Capital Ratios Phase-in Schedule

Jan. 1	2015	2016	2017	2018	2019
Minimum Common Equity %	4.5	4.5	4.5	4.5	4.5
Capital Conservation Buffer %		0.625	1.25	1.875	2.5
Common Equity with Capital Conservation Buffer %	4.5	5.125	5.75	6.375	7.0
Minimum Tier 1 Capital %	6.0	6.0	6.0	6.0	6.0
Minimum Tier 1 Capital with Capital Conservation Buffer %		6.625	7.25	7.875	8.5
Minimum Total Capital %	8.0	8.0	8.0	8.0	8.0
Minimum Total Capital with Capital Conservation Buffer %	8.0	8.625	9.25	9.875	10.5

New Asset Risk Weight Requirements

- Cash and U.S. government guaranteed securities remain unchanged from current rules at 0 percent risk weight.
- GSE securities and general obligation claims on state and local governments remain unchanged from current rules at 20 percent risk weight.
- State and local government exposures that rely on payment from specific projects (e.g. revenue bonds) carry a 50 percent risk weight.
- Residential mortgages remain unchanged from current rules at 50 percent or 100 percent risk weight depending on the type of exposure.
- Home affordable modification program loans would follow criteria for non-modified mortgages.

- Certain “high volatility” commercial real estate (CRE) loans carry 150 percent risk weight (excludes CRE for 1-4 family residences).
- Non-residential loans 90 days or more delinquent carry 150 percent risk weight for the portion not guaranteed or secured.
- Securitized structures other than government-backed securities and GSE securities (e.g. jumbo securitization of residential mortgages or an asset-backed security) may be risk weighted based on a gross-up approach considering underlying assets and senior securities; otherwise they default to 1,250 percent risk weight.
- Delayed settlement securities and commodities would range from 100-1,250 percent risk weight depending on number of days after contractual settlement.
- Equity exposures would range from 300-400 percent risk weight based on liquidity.
- Equity exposures can carry a 100 percent risk weight if deemed “non-significant”.
- 100 percent risk weight on GSE preferred stock, up from 20 percent for national banks.
- Mortgage servicing assets, significant investments in the common stock of other financial institutions, and certain deferred tax assets are subject to threshold deductions when they exceed common equity Tier 1 capital 10 percent individually or 15 percent collectively.

Capital Requirements for the Largest Banks

- Supplementary Tier 1 leverage ratio of 3 percent (incorporates off-balance-sheet exposures) for advanced approaches banks (defined as \$250 billion or more in total consolidated assets or total consolidated on-balance sheet foreign exposure of \$10 billion or more).
- Countercyclical capital buffer (on top of capital conservation buffer) up to 2.5 percent (initially set at 0) for advanced approaches banks.
- Advanced approach risk weighting of assets for the largest banks as defined above.
- Market risk final rule to enhance market risk capital standards (for banks with trading assets or liabilities of \$1 billion or more or 10 percent or more of total assets).
- Agencies have proposed that the eight largest banking organizations be subject to an additional proposed 2 percent (holding company) leverage buffer above the 3 percent supplementary leverage ratio (total of 5 percent) to avoid limitations on distributions and certain executive bonuses and 6 percent (bank) supplementary leverage ratio including certain off-balance-sheet exposures to be deemed “well capitalized” under prompt corrective action requirements.