Overview of the New Regulatory Capital Rules

September 2019

Capital Policy
### Simplifications
- Simplification of the regulatory capital rules for non-advanced approaches banks.
  - Effective date: 1/1/2020, option to delay to 4/1/2020
- The changes to the capital requirements for HVCRE exposures will be addressed in a separate rulemaking.

### Community Bank Leverage Ratio Framework (CBLR)
- Simple alternative methodology to measure capital adequacy for qualifying community banking organizations.
  - Effective date: 1/1/2020

### CECL Implementation and Transition
- Allows for an optional transition to phase in the day-one effects that decrease regulatory capital due to new accounting standard for credit loss allowances (ASU 2016-13).
  - Effective date: slide 11
CBLR Framework

Scope of CBLR Framework

- Applies to qualifying community banks
- Approximately 85% of all banks with assets under $10 billion qualify
- Approximately 83% of OCC supervised banks qualify

Qualifying community banks - Size, Ratio, Filters

- Average total consolidated assets of less than $10 billion
- Leverage ratio greater than 9.0%
- Must meet the qualifying (i.e., filters) criteria: limited amounts of (1) certain off-balance sheet exposures and (2) trading assets plus trading liabilities (slide 5 and appendix)

Proposed CBLR Framework Benefits

- Simple and non-complex calculation and reporting requirement
- Intended to not reduce the amount of capital currently held

Optional

- Banks elect the CBLR framework
Qualifying community banking organizations that opt into the framework are considered to have satisfied the generally applicable risk-based and leverage capital requirements.

Maintaining a leverage ratio of greater than 9.0%

- If a CBLR banking organization fails to satisfy one or more of the qualifying criteria but has a leverage ratio of >8.0%, the banking organization can continue in the CBLR framework and be considered “well capitalized” for a grace period of up to two quarters.
- As long as the banking organization is able to return to compliance with all the qualifying criteria within two quarters, it continues to be “well capitalized” under PCA.
- A banking organization with a leverage ratio \( \leq 8.0\% \) must comply with the generally applicable capital rule.

CBLR Calculation:

\[
\text{Tier 1 Capital} \div \text{Average Total Assets}
\]
Total off-balance-sheet exposures

- Less than 25% of total consolidated assets
- Off-balance sheet exposures currently required to be captured and reported in the Call Report or Form FR Y-9C
- Measure excludes derivatives other than sold credit derivatives and unconditionally cancellable commitments

Total trading assets plus trading liabilities

- Less than 5% of total consolidated assets
**Increases the individual threshold deduction**
- Increases the individual deduction thresholds from 10% to 25% of common equity tier 1.

**Eliminates the aggregate threshold deduction**
- Eliminates the aggregate 15% common equity tier 1 deduction threshold.

**Changes to investment in unconsolidated financial institutions**
- Replaces the current distinction between significant and non-significant investments with one treatment.
Simplifications – Minority Interest limitation

Current limitation on Minority Interest

- Based on the calculation of the capital ratios of the subsidiary

New limitation on Minority Interest

- Removes allocation based on the subsidiary's capital ratios.
- Limited to 10% of the bank’s relevant tier of capital.
- For example, Tier 1 minority interest included in Tier 1 capital would be limited to 10% of the bank’s Tier 1 capital.
CECL Transition Rule

CECL Implementation and Transition final rule

• Provides an optional three-year phase in period to address industry concerns about capital planning challenges associated with uncertainty about the economic environment at the time of CECL adoption.

• Specifies regulatory capital treatment of credit loss allowances under ASU 2016-13 to provide clarity to banking organizations.

New Terminology

• Adjusted allowances for credit losses (AACL) for the standardized approach for banking organizations to replace ALLL.

• AACL definition includes only those allowances that have been charged against earnings or retained earnings.

• AACL amount up to 1.25% of standardized RWA can be included in Tier 2 capital.

Optional

• Bank elects to use the optional transition period in its first regulatory report reflecting CECL adoption.
• An “electing bank” calculates the day-one effects of adopting CECL on retained earnings, temporary difference deferred tax assets (DTAs), and AAACL.

• In the first year after adopting CECL, for regulatory capital purposes, the electing bank:
  • Adds back to retained earnings and average total consolidated assets 75% of any decrease in retained earnings due to CECL adoption;
  • Excludes 75% of additional DTAs created by adopting CECL from risk-weighted assets; and
  • Excludes 75% of the increase in AAACL when calculating its allowance includable in tier 2 capital.

• These percentages decrease to 50% in the second year after adopting CECL, 25% in the third year, and 0% in the fourth and later years.

• Notwithstanding the CECL transition provision, all other aspects of the capital rule will continue to apply. Thus, all regulatory capital adjustments and deductions will continue to apply.
The agencies have finalized changes to regulatory reporting forms, including the Call Report and FFIEC 101, to be consistent with the final rule and ASU 2016-13.

Disclosures for larger institutions (top-tier consolidated assets of greater than $50 billion) use the new terminology consistent with ASU 2016-13 following an institution’s adoption of CECL.

Advanced approaches banking organizations that use the transition and publicly report advanced approaches risk-weighted assets are required to disclose capital ratios both with and without transition effects.
<table>
<thead>
<tr>
<th>Entity Type</th>
<th>U.S. GAAP Effective Date</th>
<th>Call Report Effective Date*</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEC Filers that are not Smaller Reporting Companies (SRC)**</td>
<td>Fiscal years beginning after December 15, 2019, including interim periods within those fiscal years</td>
<td>Q1 2020 (March 31, 2020)</td>
</tr>
<tr>
<td>SEC Filers that are SRCs and all other entities</td>
<td>Fiscal years beginning after December 15, 2022, including interim periods within those fiscal years</td>
<td>Q1 2023 (March 31, 2023)</td>
</tr>
<tr>
<td>Early Application</td>
<td>Early application permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years</td>
<td>Permissible no earlier than March 31, 2019</td>
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</tbody>
</table>

* For all entities, CECL is effective at the beginning of the reporting period (i.e., January 1st for a March 31st call report). Effective dates shown are for institutions with calendar year ends.
** SRC is an SEC-defined term. Refer to the SEC’s website for SRC qualifications: [https://www.sec.gov/smallbusiness/goingpublic/SRC](https://www.sec.gov/smallbusiness/goingpublic/SRC)
Anticipated Rulemakings for Large Banks

- Tailoring
- Standardized Approach to Counterparty Credit Risk (derivatives)
- Fundamental Review of the Trading Book (market risk)
- Section 402 – Supplementary Leverage Ratio for Custody Banks
- Investments in Total Loss-absorbing Capacity Instruments
- Basel III Reform Package
Additional Resources and Tools

Capital Policy topic page @ OCC.gov

- Rulemakings, FAQs, and other reference materials
- OCC.gov → Topics → Supervision & Examination → Capital

Interagency Webinars

- Stay tuned....
Questions?
Off-balance-sheet exposures included in the calculation

- The unused portions of commitments (except for unconditionally cancellable commitments);
- Self-liquidating, trade-related contingent items that arise from the movement of goods;
- Transaction-related contingent items (i.e., performance bonds, bid bonds, and warranties);
- Sold credit protection in the form of guarantees and credit derivatives;
- Credit-enhancing representations and warranties;
- Off-balance-sheet securitization exposures (to the extent that they are not captured in other off balance-sheet exposures);
- Letters of credit;
- Forward agreements that are not derivative contracts; and
- Securities lending and borrowing transactions.