



Community Bank Leverage Ratio

April 10, 2019

On February 8, 2019, the three federal banking agencies recently asked for comments on a proposed rule that would simplify the regulatory capital requirements for community banks. The proposal is designed to simplify the calculation of regulatory capital and allow community banks to calculate a leverage ratio based on total assets. Qualifying banks would thus no longer have to calculate risk-weighted assets.

Specifically, a qualifying community banking organization would be eligible to elect the community bank leverage ratio framework (“CBLR”) and not be required to calculate the existing risk-based and leverage capital requirements. To elect the CBLR framework, a community banking organization would have to have a CBLR of greater than 9 percent.

Qualifying Community Banking Organization

A qualifying community banking organization would be defined as a depository institution or depository institution holding company that is not an advanced approaches banking organization and that meets the following criteria:

- Total consolidated assets of less than \$10 billion;
- Total off-balance sheet exposures (excluding derivatives other than credit derivatives and unconditionally cancelable commitments) of 25 percent or less of total consolidated assets;
- Total trading assets and trading liabilities of 5 percent or less of total consolidated assets;
- Mortgage servicing rights assets (“MSAs”) of 25 percent or less of CBLR tangible equity; and
- Temporary difference deferred tax assets (“DTAs”) of 25 percent or less of CBLR tangible equity.

Calculation of the CBLR

The CBLR would be calculated as the ratio of tangible equity capital (CBLR tangible equity) divided by average total consolidated assets.

CBLR tangible equity would be defined as total bank equity capital or total holding company equity capital, as applicable prior to including minority interests, excluding:

- Accumulated other comprehensive income (AOCI);
- DTAs arising from net operating loss and tax credit carryforwards;

- Goodwill; and
- Other intangible assets (other than MSAs).

Average total consolidated assets would be calculated so that amounts deducted from the CBLR numerator would also be excluded from the CBLR denominator.

Off-Balance Sheet Exposures

While most of the qualifying criteria are relatively straightforward, off-balance sheet exposures require further explanation. Under the proposal, total off-balance sheet exposures would be calculated as the sum of the **notional** amounts of certain off-balance sheet items as of the end of the most recent calendar quarter. Total off-balance sheet exposures would include:

- 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;
- Letters of credit;
- Forward agreements that are not derivative contracts; and
- Securities lending and borrowing transactions (total off-balance sheet exposures).

Total off-balance sheet exposures would not include derivatives (such as foreign exchange swaps and interest rate swaps) but would include credit derivatives.

CBLR less than 9%

What happens if a community bank elects the CBLR and then falls below it, because of growth in total assets and/or declines in tangible equity. If a community bank falls below the 9% threshold, it could revert to use of the existing rules. On the other hand, if the community bank elects to continue using the CBLR framework, the banking agencies are proposing the following proxies to satisfy statutory capital requirements:

- Adequately capitalized – CBLR of 7.5 percent or greater;
- Undercapitalized – CBLR of less than 7.5 percent; and
- Significantly undercapitalized – CBLR of less than 6 percent.

The agencies are not proposing a proxy critically undercapitalized which would continue to be calculated under the existing rules.

Implications for Our Clients

The proposed rule has implications for our servicing clients in general and especially for our MPF clients.

Our servicing clients will have to consider the value of their MSAs relative the 25% capital limitation and the potential ramifications of being unable to use the CBLR.

For our FHLB MPF® clients, the potential ramifications of the CE obligation amount are less clear. If the banking regulators continue to treat the sales of loans to the FHLBanks with a CE obligation as a synthetic securitization, then the off-balance sheet 25% of total asset limitation would likely be based on the dollar amount of loans sold and outstanding as of the reporting date. If the regulators do not continue this treatment for MPF loans, the credit enhancement limitation could have adverse results. The rule notes that the off-balance sheet limitation is based on the notional amounts outstanding. The question is whether the notional amount of the CE obligation amount is the dollar amount itself, given that it is a separate contract from the sale of the loan, or whether the measurement will be based on the amount of loans sold and outstanding subject to the CE obligation.

The comment period closed yesterday. The ABA and ICBA also filed comment letters yesterday. Wilary Winn will continue to follow the proposed rule. Please contact us if you would like more information or if we can be of service to you.

About Wilary Winn

Founded in 2003, our mission is to provide advice to strengthen institutions. We provide independent, fee-based advice to more than 500 financial institutions located across the country. We offer the following services:

CECL & ALM

We provide holistic solutions to measure, monitor and mitigate interest rate, liquidity, and credit risk on an integrated basis.

OUR CECL & ALM SERVICES INCLUDE:

Credit Risk:

Current Expected Credit Loss (CECL)
Capital Stress Testing
Concentration Risk Management
Real Return Analyses

Outsourced ALM Advisory:

Interest Rate Risk Management
Budgeting and Balance Sheet Optimization
Liquidity Stress Testing

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We provide independent, fee-based determinations of fair value for mergers and acquisitions.

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Accretion True-up

Goodwill Impairment Testing
ASC 310-30

VALUATION OF LOAN SERVICING

We provide comprehensive and cost-effective valuations of servicing arising from the sale of residential mortgage, SBA 7(a), auto, home equity and commercial loans.

OUR LOAN SERVICING OFFERINGS INCLUDE:

Residential MSRs
SBA 7(a) Loan Servicing
Commercial Servicing

ADDITIONAL SERVICES

We provide services to support our CECL, ALM, Fair Value and Loan Servicing product offerings.

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Fair Value Footnote	SBA 7(a) Gain on Sale
ALM Model Validation	Troubled Debt Restructurings (TDRs)
Non-Maturity Sensitivity Analyses	Non-Agency MBS
Mortgage Banking Derivatives (IRLCs)	TruPS

For additional details on Wilary Winn's services, please visit our website at www.wilwinn.com

Contact Information

For more information about our services, please contact us.

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