

The Banking Law Journal

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Banking Agencies Adopt Community Bank Leverage Ratio Rules

Lee A. Meyerson, Keith A. Noreika, Spencer A. Sloan, and Adam J. Cohen*

Several banking agencies finalized a rule that simplifies capital requirements for certain community banking organizations by allowing qualifying organizations to adopt a simple leverage ratio to measure capital adequacy. This article provides a high-level summary of key features of the final rule.

The Federal Reserve, Office of the Comptroller of the Currency (“OCC”) and Federal Deposit Insurance Corporation (“FDIC”) have finalized a rule that simplifies capital requirements for certain community banking organizations, consistent with Section 201 of the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act, by allowing qualifying community banking organizations to adopt a simple leverage ratio to measure capital adequacy. To qualify for the simplified framework, a depository institution or depository institution holding company must have less than \$10 billion in total consolidated assets, limited amounts of off-balance-sheet exposures and trading assets and liabilities, and a leverage ratio (equal to tier 1 capital divided by average total consolidated assets) greater than nine percent.

Qualifying community banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than nine percent will be considered to have satisfied the risk-based and leverage capital requirements in the agencies’ generally applicable capital rules. Additionally, qualifying community banks that are insured depository institutions will be deemed to have met the well-capitalized ratio requirements for purposes of the Federal Deposit Insurance Act’s “prompt corrective action” framework.

The agencies estimate approximately 85 percent of community banks will qualify for the community bank leverage ratio framework, which first became available for banking organizations to use in their March 31, 2020 Call Report or Form FR Y-9C, as applicable. Banking organizations will be permitted to opt

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into or out of the community bank leverage ratio framework in a subsequent Call Report or Form FR Y-9C, as applicable.

Following is a high-level summary of key features of the final rule.

QUALIFYING COMMUNITY BANKING ORGANIZATION

The community bank leverage ratio framework is optional for a banking organization that is not an advanced approaches banking organization, and that meets all of the following qualifying criteria:

- *Leverage Ratio Greater Than Nine Percent:* The leverage ratio is generally calculated as tier 1 capital divided by average total consolidated assets. Additional detail is provided below;
- *Total Consolidated Assets Less Than \$10 Billion:* Total consolidated assets are calculated in accordance with the reporting instructions to Schedule RC of the Call Report or Schedule HC of Form FR Y-9C, as applicable;
- *Limited Off-Balance Sheet Exposures:* Total off-balance-sheet exposures (excluding derivatives other than sold credit derivatives and unconditionally cancellable commitments) must equal 25 percent or less of total consolidated assets. The off-balance sheet qualifying criterion incorporates off-balance sheet exposures currently required to be captured and reported by banking organizations in the Call Report or Form FR Y-9C, and includes the following:
 - 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.
- *Limited Trading Assets and Liabilities:* Total trading assets plus trading

liabilities must equal five percent or less of total consolidated assets, calculated as the sum of those exposures, in accordance with the reporting instructions for total trading assets and liabilities in the Call Report or Form FR Y-9C, as applicable.

CALCULATION OF COMMUNITY BANK LEVERAGE RATIO

The community bank leverage ratio is generally calculated as the community banking organization's tier 1 capital divided by average total consolidated assets. While the agencies had initially proposed using a community banking organization's tangible equity as the leverage ratio numerator, the final rule replaces the proposed tangible equity measure with tier 1 capital as the numerator of the community bank leverage ratio to align the final rule's calculation of the leverage ratio with the generally applicable leverage ratio and thereby streamline adoption of the community bank leverage ratio framework.

Notably, generally applicable capital rules require deductions from tier 2 capital related to investments in capital instruments of unconsolidated financial institutions when such investments exceed certain limits, and such deductions can affect the calculation of tier 1 capital under the "corresponding deduction" approach, which generally requires a banking organization to make deductions from the same component of capital for which the underlying instrument would qualify if it was issued by the banking organization itself.

Under the final rule, however, since the community bank leverage ratio framework does not have a total capital requirement, an electing banking organization will not be required to calculate tier 2 capital nor make any deductions that would have been taken from tier 2 capital under the generally applicable capital rules.

Instead, an electing banking organization will only be required to make a deduction from its common equity tier 1 capital or tier 1 capital if the sum of its investments in the capital of an unconsolidated financial institution is in a form that would qualify as common equity tier 1 capital or tier 1 capital instruments of the electing banking organization and exceeds the threshold for deduction.

COMMUNITY BANK LEVERAGE RATIO OPT-IN

A qualifying community banking organization may opt into the community bank leverage ratio framework by completing the associated reporting line items that are required for such firms on its Call Report and/or Form FR Y-9C, as applicable. A qualifying community banking organization becomes subject to the community bank leverage ratio framework when it makes an election.

Under the final rule, a qualifying community banking organization may opt into or out of the community bank leverage ratio framework at any time and for any reason.

ONGOING COMPLIANCE

The final rule includes a two-quarter grace period during which a qualifying community banking organization that temporarily fails to meet any of the qualifying criteria, including the greater than nine percent leverage ratio requirement, generally would still be deemed well-capitalized so long as the banking organization maintains a leverage ratio greater than eight percent.

At the end of the grace period, the banking organization must meet all qualifying criteria to remain in the community bank leverage ratio framework or otherwise must comply with and report under the generally applicable capital rules.

Similarly, a banking organization that fails to maintain a leverage ratio greater than eight percent would not be permitted to use the grace period and must comply with the capital rules' generally applicable requirements and file the appropriate regulatory reports.

