Federal Banking Agencies Issue Final Capital Rules

Thursday, July 11, 2019

On July 9, 2019, the federal banking agencies approved revisions to their respective regulations to simplify the calculation of regulatory capital. These changes were first proposed by the agencies on October 27, 2017 (the NPR), with the goal of reducing regulatory burden on community banking organizations.[1] Specifically, the final rule will simplify the capital treatment for mortgage servicing rights, certain deferred tax assets, and other complex aspects of regulatory capital compliance. The NPR pre-dates the passage of the Economic Growth, Regulatory Relief and Consumer Protection Act (EGRRCPA) in May 2018 and does not affect the still-pending banking agencies’ proposal to establish a “community bank leverage ratio.” The NPR had included proposed revisions to the treatment of high volatility commercial real estate (HVCRE) loans as well. However, Section 214 of EGRRCPA amended the capital treatment of HVCRE loans and directed the agencies to implement the changes through regulations. The federal banking agencies issued proposed regulations mandating the implementation of Section 214 on September 28, 2018, which remain pending.

What Institutions May be Affected?

The final rule applies only to institutions that use the “standardized approach” methodology for calculating risk-based capital rather than the “advanced approaches” capital framework established by Basel III: generally, institutions with under $250 billion in total assets and foreign exposure of less than $10 billion. Technical amendments to the capital rules will be applicable to all institutions.

Treatment of Mortgage Servicing Assets, Temporary Difference Deferred Tax Assets, and Investments in Unconsolidated Subsidiaries

Under current rules, institutions must deduct from common equity tier 1 capital certain intangible assets to the extent the value of such assets exceeds a threshold amount. For mortgage servicing rights, deferred tax assets (DTAs) that could not be realized through the use of operating loss carrybacks (temporary difference DTAs), and investments in the capital of unconsolidated financial institutions, the current threshold is 10%. In addition, amounts not otherwise deducted under the individual threshold that exceed 15% in the aggregate must also be deducted. Any amounts that are not deductible are to be risk-weighted at 100% under transition rules, with the final risk weighting to be 250%. Under the revised regulations, the individual threshold will be increased to 25% of common equity tier 1 capital, and the aggregate limit will be eliminated. Amounts in excess of the threshold will be subject to the 250% risk weighting. Currently, applicable regulations also made a distinction between non-significant and significant investments in the capital of unconsolidated financial institutions. Significant investments not in the form of common stock are required to be deducted in their entirety. The revised regulations eliminate the distinction between significant and non-significant investments and permit the institution to determine which investments — regardless of investment type — will be deducted for capital purposes.

Treatment of Minority Interests

The capital treatment of minority interests — tier 1 capital of a consolidated subsidiary held by a third person — under current rules is complicated, as it focuses on the capital compliance of the subsidiary. The revised
regulations will simplify the calculations by allowing the parent banking organization to include common equity tier 1 minority interest, tier 1 minority interest, and total capital minority interest of up to 10% of the parent banking organization’s common equity tier 1, tier 1, and total capital elements (before the inclusion of any minority interest and after certain deductions and adjustments), respectively.

**Redemptions of Capital Instruments**

The NPR proposed the addition of a requirement that Federal Reserve Board-regulated institutions obtain prior approval before redeeming or repurchasing any common equity tier 1 or tier 2 capital instruments or any additional capital instrument. In response to comments, the Federal Reserve Board modified its proposal to require prior approval only if a Federal Reserve Board-regulated institution is subject to a separate legal requirement to do so, such as under a capital plan or Regulation Y.

**Effective Date**

The provisions of the amended rules are generally effective on April 1, 2020, although certain technical corrections will be effective on October 1, 2019.


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