Federal Deposit Insurance Corporation
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Division of Insurance and Research

September 10, 2019

MEMORANDUM TO: The Board of Directors

FROM: Diane Ellis
Director, Division of Insurance and Research

SUBJECT: Final Rule to Apply CBLR Framework to Deposit Insurance Assessment System

RECOMMENDATION

Staff recommends that the FDIC Board of Directors (the Board) approve the attached final rule (CBLR Assessments final rule) for publication in the *Federal Register*. The CBLR Assessments final rule would amend the FDIC's deposit insurance assessment regulations to apply the community bank leverage ratio (CBLR) framework to the deposit insurance assessment system.[1]

The primary objective of the CBLR Assessments final rule is to incorporate the CBLR framework into the current risk-based deposit insurance assessment system in a manner that maximizes regulatory relief for small institutions and maintains fair and appropriate pricing of deposit insurance.

Specifically, the CBLR Assessments final rule amends the FDIC's assessment regulations to price all banks that elect to use the CBLR framework under the small bank assessment methodology. In addition, this final rule makes technical changes to the assessment regulations to ensure that the assessment system continues to incorporate the prompt corrective action (PCA) regulations for the definitions of capital categories used in the deposit insurance assessment system. This final rule also clarifies that a bank that elects to use the CBLR framework and also meets the definition of a custodial bank will have no change to its custodial bank deduction or reporting items required to calculate the deduction.

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[1] In this rule, the term "CBLR framework" refers to the simplified reporting of capital adequacy that is being considered, and is expected to be adopted, by the FDIC, the Board of Governors of the Federal Reserve System (Federal Reserve) and the Office of the Comptroller of the Currency (OCC) (collectively, the Federal banking agencies). The CBLR Assessments final rule will be effective on the same date as the expected effective date of the CBLR final rule, January 1, 2020, with all definitions and references aligned accordingly.

Concur:

Nicholas J. Podsiadly
General Counsel

The final rule does not make any changes to the FDIC's assessment methodology for small or large banks. If adopted, the rule will only result in a change to assessments for a very limited subset of banks—those that elect to use the CBLR framework and would have otherwise been assessed as a large institution under current assessment regulations. Upon the effective date of this rule, such institutions will be assessed under the small bank methodology. Based on Call Report data as of March 31, 2019, only one bank that was assessed as a large institution also met the qualifying criteria to be eligible to opt into the CBLR framework.

BACKGROUND

CBLR Framework

On February 8, 2019, the Federal banking agencies published in the *Federal Register* a notice of proposed rulemaking (CBLR NPR) that would have provided a simple alternative methodology to measure capital adequacy for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA or the Act).[2, 3]

In the CBLR NPR, the Federal banking agencies proposed, among other things, to define tangible equity capital (tangible equity).[4] In addition, under the CBLR NPR, a bank that elected to use the CBLR framework would have been required to have a CBLR greater than 9 percent to be considered well capitalized.[5] For banks with a CBLR equal to or less than 9 percent, the Federal banking agencies proposed proxy CBLR thresholds for the adequately capitalized, undercapitalized, and significantly undercapitalized PCA categories.[6]

In response to comments received on the CBLR NPR, the Federal banking agencies are considering, and are expected to adopt, the CBLR framework, as described in the CBLR final rule. Under the CBLR final rule, a "qualified community banking organization" must not be an advanced approaches banking organization[7] and must have less than $10 billion in total

[2] *See* 84 FR 3062 (February 8, 2019).

[3] Public Law 115-174 (May 24, 2018). The Act defines a qualifying community banking organization as a depository institution or depository institution holding company with total consolidated assets of less than $10 billion. *See* section 201(a)(3)(A) of the Act. In addition, the Act states that the Federal banking agencies may determine that a banking organization is not a qualifying community bank based on its risk profile. *See* section 201(a)(3)(B) of the Act. A qualifying community banking organization that reports a CBLR (defined in the Act as the ratio of tangible equity capital to average total consolidated assets, both as reported on an institution's applicable regulatory filing) exceeding the level established by the Federal banking agencies of not less than 8 percent and not more than 10 percent would be considered well capitalized. *See generally* section 201(b) of the Act.

[4] *See* 84 FR at 3068-69 (defining tangible equity capital as total bank equity capital, prior to including minority interests, and excluding accumulated other comprehensive income, deferred tax assets arising from net operating loss and tax credit carryforwards, goodwill, and certain other intangible assets, calculated in accordance with a qualifying community bank organization's regulatory reports).

[5] *See* 84 FR at 3065-67.

[6] *See* 84 FR at 3064 and 3071.

[7] An advanced approaches banking organization is generally defined as a firm with at least $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposure, and depository institution

consolidated assets, meet certain risk-based qualifying criteria, and have a leverage ratio of greater than 9 percent.[8] Staff expects that, under the CBLR final rule, the numerator of the CBLR will be the existing measure of tier 1 capital used by non-advanced approaches banking organizations. Due to the adoption of tier 1 capital, the CBLR generally is calculated in the same manner as the leverage ratio under the Federal banking agencies' generally applicable risk-based and leverage capital requirements in the agencies' capital rule (generally applicable capital rule)—tier 1 capital divided by average total consolidated assets minus amounts deducted from tier 1 capital. Thus, the CBLR final rule incorporates and refers to the generally applicable capital rule's leverage ratio.

Staff expects that the CBLR final rule also will provide for a two-quarter grace period for a bank that has opted to use the CBLR framework and subsequently fails to satisfy one or more of the qualifying criteria, but continues to report a leverage ratio of greater than 8 percent. During this grace period the bank could continue to use the framework and will be deemed "well capitalized." A qualifying community banking organization will be required to comply with the generally applicable capital rule and file the relevant regulatory reports if the banking organization: (1) is unable to restore compliance with all qualifying criteria during the two-quarter grace period (including coming into compliance with the greater than 9 percent leverage ratio requirement); (2) reports a leverage ratio of 8 percent or less; or (3) ceases to satisfy the qualifying criteria due to consummation of a merger transaction.

CBLR Assessments NPR

Under the CBLR Assessments NPR, the FDIC proposed amending the deposit insurance assessment regulations to apply the proposed CBLR framework to the deposit insurance assessment system. In the NPR, the FDIC would have assessed all banks that elected to use the CBLR framework as small banks.[9] Further, because the use of the proposed CBLR framework under the CBLR NPR could have resulted in a higher assessment rate or a larger assessment base for a minority of small banks, the CBLR Assessments NPR would have allowed banks that elected to use the framework the option to use either tangible equity or tier 1 capital for their assessment base calculation, and to have the option to report the tier 1 leverage ratio in addition to the CBLR, with the FDIC applying the value that would result in the lower assessment rate.[10]

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subsidiaries of those firms. Proposed rulemakings to tailor capital and liquidity requirements applicable to large banking organizations may result in changing the definition of advanced approaches banking organization. See 83 FR 66024 (December 21, 2018) and 84 FR 24296 (May 24, 2019).

[8] The risk-based qualifying criteria under the CBLR final rule include total off-balance sheet exposures (excluding derivatives other than sold credit derivatives and unconditionally cancelable commitments) of 25 percent or less of total consolidated assets and total trading assets and trading liabilities of 5 percent or less of total consolidated assets.

[9] *See* 84 FR at 5384.

[10] A bank that elected to use the CBLR framework under the CBLR NPR would have reported only its tangible equity and CBLR, which would have been calculated differently than tier 1 capital and the tier 1 leverage ratio, respectively, as proposed. Tier 1 capital is used in the calculation of a bank's assessment base, as well as in the depository institution debt adjustment (DIDA) applicable to a bank's assessment rate. The tier 1 leverage ratio is one of seven financial measures, in addition to a weighted average of supervisory ratings (CAMELS), used to calculate an established small bank's assessment rate. *See* 12 CFR 327.16(a). Generally, an "established small

The CBLR Assessments NPR also clarified that: (1) a bank that elects to use the CBLR framework and also meets the definition of a custodial bank under the FDIC's assessment regulations would have no change to its custodial bank deduction or reporting items required to calculate the deduction; and (2) the assessment regulations would continue to reference the PCA regulations for the definition of capital categories used in the deposit insurance assessment system, with technical amendments to align with the CBLR NPR.

The FDIC sought comment on every aspect of the CBLR Assessments NPR, including alternatives. The FDIC received one comment from a trade group that generally supported the FDIC's objective of maintaining fair and appropriate pricing of deposit insurance for institutions that elect to use the CBLR framework.

DISCUSSION OF CBLR ASSESSMENTS FINAL RULE

Use of Capital Measures in the Current Deposit Insurance Assessment System

The leverage ratio under the CBLR final rule is the same leverage ratio that is currently used for assessments for established small banks. As a result, no changes are necessary to the FDIC's assessment methodology.

Pricing Banks That Elect to Use The CBLR Framework as Small Institutions

Consistent with the CBLR Assessments NPR, the CBLR Assessments final rule amends the definition of "small institution" in the FDIC's deposit insurance assessment regulations so that all banks that elect to use the CBLR framework are priced under the small bank assessment methodology, even if that institution would otherwise be priced as a large bank. Otherwise, the different eligibility thresholds used to define a small bank in the assessment regulations and a qualifying community banking organization under the CBLR framework could result in a qualifying community banking organization that is classified and priced as a large bank.[11]

Staff believes these changes are warranted because the CBLR framework was intended to provide regulatory relief to small, community banks; whereas, the pricing methodology for large banks is meant to measure the risk of banks with more complex operations and organizational structures.

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institution" is an institution with less than $10 billion in total assets that has been federally insured for at least five years. *See* 12 CFR 327.8(v).

[11] Under the current assessment regulations, a large institution is reclassified as small once it has reported less than $10 billion in total assets for four consecutive quarters, and a small institution is reclassified as large once it has reported $10 billion or more in total assets for four consecutive quarters. *See* 12 CFR 327.8(e) and (f). A small institution with assets between $5 billion and $10 billion also may request treatment as a large institution for deposit insurance assessment purposes. *See* 12 CFR 327.16(f). Under the CBLR final rule, a qualifying community banking organization is generally defined as a depository institution or depository institution holding company with less than $10 billion in total consolidated assets as of the end of the most recent calendar quarter and that meet certain qualifying criteria. Therefore, it is possible that a bank could be eligible to report under the CBLR framework in a given quarter, but under existing assessment regulations would not be reclassified as small until it reported total assets below $10 billion for four consecutive quarters.

Technical Changes in Regulations

The CBLR Assessments final rule makes technical changes to the FDIC's assessment regulations to ensure that the assessment system will continue to reference the PCA regulations for the definitions of capital categories used in the deposit insurance assessment system. Capital categories for deposit insurance assessment purposes are defined by reference to the agencies' generally applicable capital rules that are being amended by the CBLR final rule.[12] As such, changes made by the CBLR final rule to the generally applicable capital rules will be automatically incorporated into the assessment regulations.

Clarifications Regarding Custodial Bank Definition

This final rule also clarifies that there is no change being made to the custodial bank deduction or the reporting items required to calculate the deduction.[13] Also, the FDIC will require custodial banks to continue to maintain the proper documentation of their calculation for the custodial bank adjustment, and to make that documentation available upon request.

Proposed Changes Not Adopted in the CBLR Assessments Final Rule

The CBLR Assessments final rule does not adopt several changes to the deposit insurance assessment regulations that were proposed in the CBLR Assessments NPR because the CBLR framework, as adopted by the Federal banking agencies in the CBLR final rule, have made them unnecessary. For example, proposed amendments to the FDIC's assessment regulations that were related to the Federal banking agencies' proposed definitions of "tangible equity" and "community bank leverage ratio" in the CBLR NPR were not adopted, rendering proposed conforming changes in the assessment regulations unnecessary.

Expected Effects

Staff does not expect that changes to its assessment regulations under this rule would have a material impact on aggregate assessment revenue or on rates paid by individual institutions. Based on Call Report data as of March 31, 2019, 5,221 out of 5,371 IDIs had less than $10 billion in total consolidated assets. The FDIC estimates that approximately 85 percent of IDIs with less than $10 billion in total assets would meet the qualifying criteria and thus be eligible to opt into the CBLR framework under the CBLR final rule. Included in this total are four custodial banks that would meet the definition of a "qualifying community banking organization" under the CBLR final rule.

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[12] *See* 12 CFR 327.8(z).

[13] In calculating the assessment base for custodial banks, the FDIC excludes a certain amount of low-risk assets, which are reported in Schedule RC-R of the Call Report, subject to the deduction limit. *See* 12 CFR 327.5(c)(1). The FDIC will exclude from a custodial bank's assessment base the daily or weekly average (depending on how the bank reports its average consolidated total assets) of all asset types described in the instructions to lines 1, 2, and 3 of Schedule RC of the Call Report with a standardized approach risk weight of 0 percent, regardless of maturity, plus 50 percent of those asset types described in the instructions to lines 1, 2, and 3 of Schedule RC of the Call Report, with a standardized approach risk-weight greater than 0 and up to and including 20 percent, regardless of maturity. *See* 12 CFR 327.5(c)(2).

As mentioned above, because the Federal banking agencies incorporate and refer to the generally applicable capital rule's leverage ratio, the CBLR final rule results in no change to the ratio that is utilized in the FDIC's pricing methodology, and thus no changes to the FDIC's assessment methodology are necessary. Additionally, a custodial bank that elects to use the CBLR framework will be able to continue to report the custodial bank deduction for its assessment base, even though it will not separately report risk-weighted assets used in the calculation of the deduction, and will see no change to its assessment amount.

While many institutions could elect to use the CBLR framework, the change to the definition of "small institution" in this rule will only affect the deposit insurance assessments for banks that elect to use the CBLR framework and would have otherwise been assessed as large institutions under current assessment regulations. Based on Call Report data as of March 31, 2019, only one bank that was assessed as a large institution also met the qualifying criteria to be eligible to opt into the CBLR framework under the CBLR final rule.

EFFECTIVE DATES

Staff recommends that the final rule become effective on January 1, 2020. This date coincides with the effective date of the CBLR framework being considered by the Federal banking agencies in the CBLR final rule.

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