FEDERAL DEPOSIT INSURANCE CORPORATION

Regulatory Capital Interim Final Rule

Legal Disclaimer

- ***This presentation has been prepared by FDIC staff to provide an overview of the interim final capital rule as it generally applies to community banking organizations. This presentation does not address all aspects of the interim final rule that could apply to such an institution. Therefore, each bank should carefully review the rule as it may relate to your specific institution.***

- ***The information provided in this presentation is not an official interpretation of the Federal banking agencies with respect to the interim final capital rule.***

Scope of Presentation

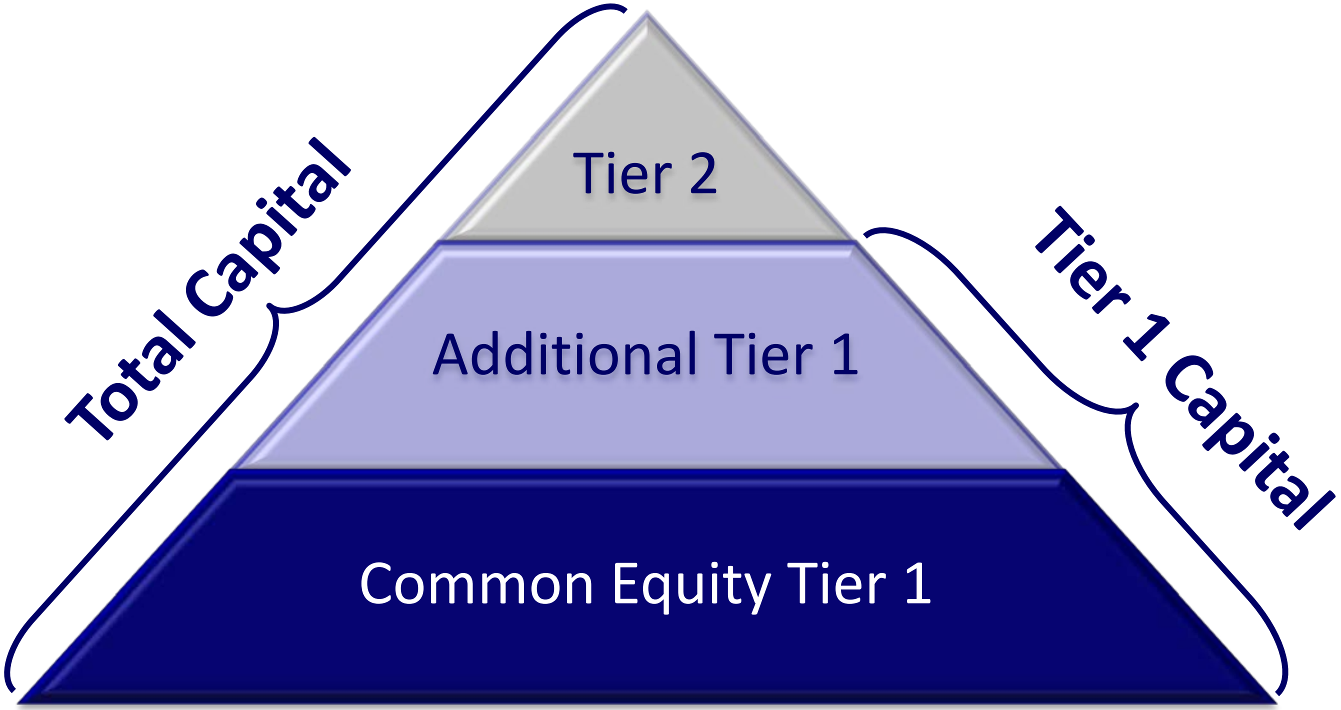
- **Capital Definitions & Requirements**
- **Risk-weighted Assets**
- **Changes from Proposed Rule to Interim Final Rule**
- **Conclusion & Additional Resources**

Interim Final Rule Changes

- **Revises regulatory capital definitions and minimum ratios**
- **Redefines Tier 1 Capital as two components**
  - Common Equity Tier 1 Capital
  - Additional Tier 1 Capital
- **Creates a new capital ratio: Common Equity Tier 1 Risk-based Capital Ratio**
- **Implements a Capital Conservation Buffer**
- **Revises Prompt Corrective Action (PCA) thresholds and adds the new ratio to PCA framework**
- **Changes risk weights for certain assets and off-balance sheet exposures**

Capital Definitions & Requirements

Regulatory Capital Components



All capital ratio calculations will use the new capital definitions

Definition of Common Equity Tier 1 Capital

<u>Banks that Do Not Elect AOCI Opt-out and Advanced Approaches Banks*</u>

Common Stock & Retained Earnings ± **Accumulated Other Comprehensive Income (AOCI)** ± **Deductions & Adjustments** + **Qualifying CET1 Minority Interest** = **Common Equity Tier 1 Capital**

* Institutions with $250B or more in assets or $10B or more in foreign exposures

Definition of Common Equity Tier 1 Capital

<u>Banks with AOCI Permanent Opt-out Election</u>

Common Stock & Retained Earnings ± **Limited AOCI Items** ± **Deductions & Adjustments** + **Qualifying CET1 Minority Interest** = **Common Equity Tier 1 Capital**

- Opt-out: same AOCI treatment as today
- Election: the March 31, 2015 Call Report and FR Y-9C (if applicable)

Deductions & Adjustments
Common Equity Tier 1 Capital

Deductions

- Goodwill
- Deferred Tax Assets (NOL & Tax Credit Carryforwards)
- Other Intangibles (except for MSAs)
- Gain on Sale of Securitization Exposures
- Certain investments in other unconsolidated financial institutions' capital instruments

Adjustments

- Deduct unrealized gains and add unrealized losses on cash flow hedges

Threshold Deductions

- Deduct amounts > 10% individually or > 15% aggregate of Common Equity Tier 1 Capital:
  - Mortgage Servicing Assets (MSAs)
  - Deferred Tax Assets related to temporary timing differences
  - Significant investments in other unconsolidated financial institutions' common stock

Amounts not deducted are generally subject to a 250% Risk Weight

Investments in Unconsolidated Financial Institutions' Capital Instruments

Is your investment in an unconsolidated financial institution's capital instruments *non-significant* or *significant*?

If the bank owns 10% or less of the other financial institution's common shares

↓

All investments in the financial institution are considered *non-significant*

If the bank owns over 10% of the other financial institution's common shares

↓

All investments in the financial institution are considered *significant*

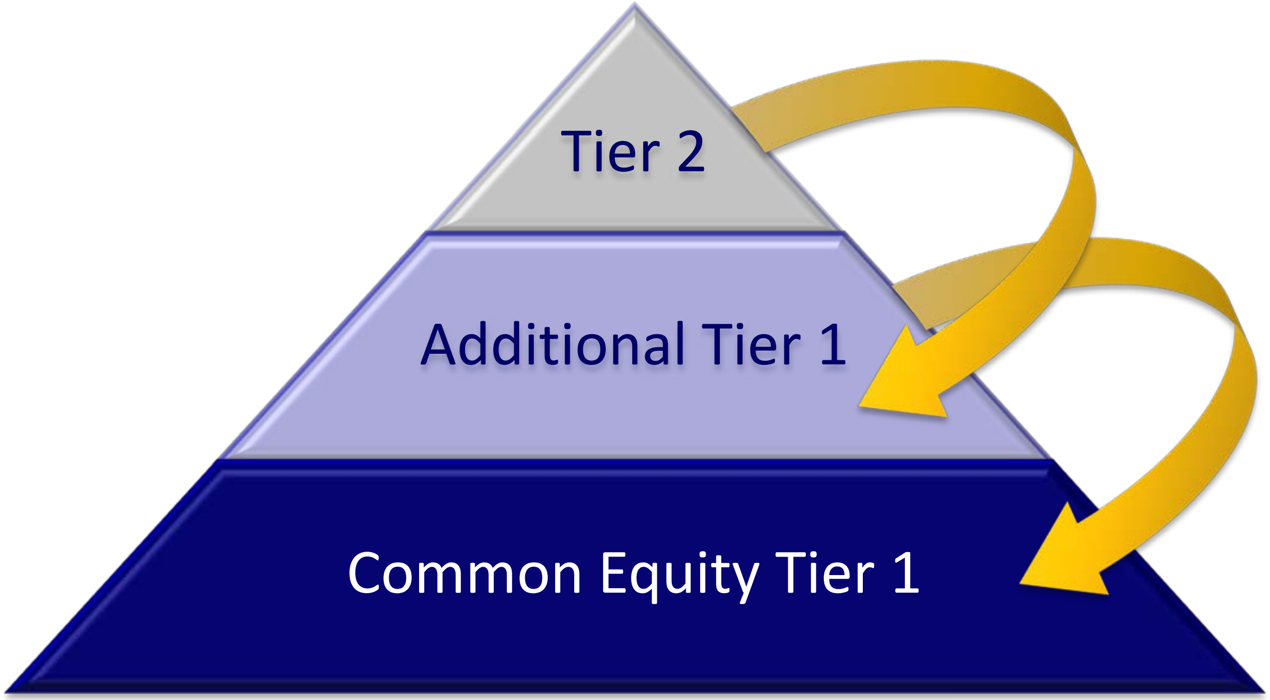
Please refer to the interim final rule for additional information on this topic.

Significant / Non-significant Investment Deductions

Deduct from the tier of capital the instrument would qualify for:

If your bank's investment is in an instrument that qualifies as:	Any required deductions would be:
Tier 2 Capital	Deducted from your Tier 2 Capital
Additional Tier 1 Capital	Deducted from your Additional Tier 1 Capital
Common Equity Tier 1 Capital	Deducted from your Common Equity Tier 1 Capital

If a Tier is Not Sufficient to Absorb the Deduction, Deduct Shortfall from Next Tier



Treatment of Minority Interest

- **A limited amount of minority interest may qualify for each tier of capital**
  - Refer to the rule for the specific calculation method for the limit that will apply for your bank
- **Common Equity Tier 1 Minority Interest**
  - Subsidiary <u>must be</u> a depository institution
- **Additional Tier 1 and Total Capital Minority Interest**
  - Subsidiary <u>is not required to be</u> a depository institution
- **The capital instruments issued by the subsidiary must meet all criteria for the respective tier of capital**

Definition of Additional Tier 1 Capital

Noncumulative Perpetual Preferred Stock, including surplus

+

SBLF & TARP *
(Bank Issued)

+

Qualifying Tier 1 Minority Interest

Less

Certain Investments in Financial Institutions

=

Additional Tier 1 Capital

* Only if original bank issuance qualified as Tier 1 Capital

Definition of Tier 2 Capital

Limited Allowance for Loan & Lease Losses

+

Preferred Stock & Subordinated Debt *

+

Qualifying Tier 2 Minority Interest

Less

Tier 2 Investments in Financial Institutions

=

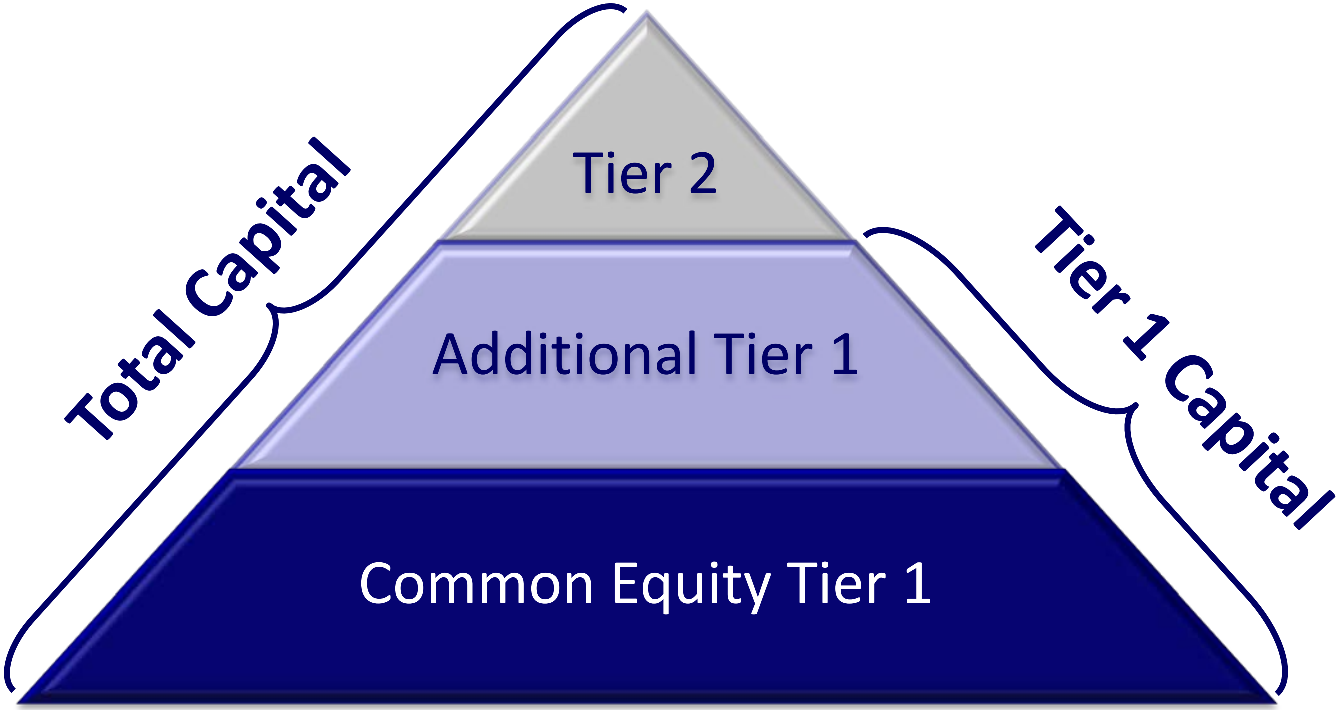
Tier 2 Capital

Eliminated Limits on:

- Subordinated debt
- Limited-life preferred stock
- Amount of Tier 2 Capital included in Total Capital

* Includes bank-issued SBLF and TARP instruments that currently qualify as Tier 2 Capital.

Components of Total Capital



All capital ratio calculations will use the new capital definitions

Calculation of Common Equity Tier 1 Risk-based Capital Ratio

$$\frac{\text{Common Equity Tier 1}}{\text{Total Risk-weighted Assets}} = \text{Common Equity Tier 1 RBC Ratio}$$

Revised Regulatory Capital Minimum Ratios

Regulatory Capital Minimum Ratios (%)		
	Current Rule	Interim Final Rule
Tier 1 Leverage Capital	3.0 / 4.0	4.0
Common Equity Tier 1 Risk-based Capital	n/a	4.5
Tier 1 Risk-based Capital	4.0	6.0
Total Risk-based Capital	8.0	8.0

Effective on January 1, 2015, for all banks

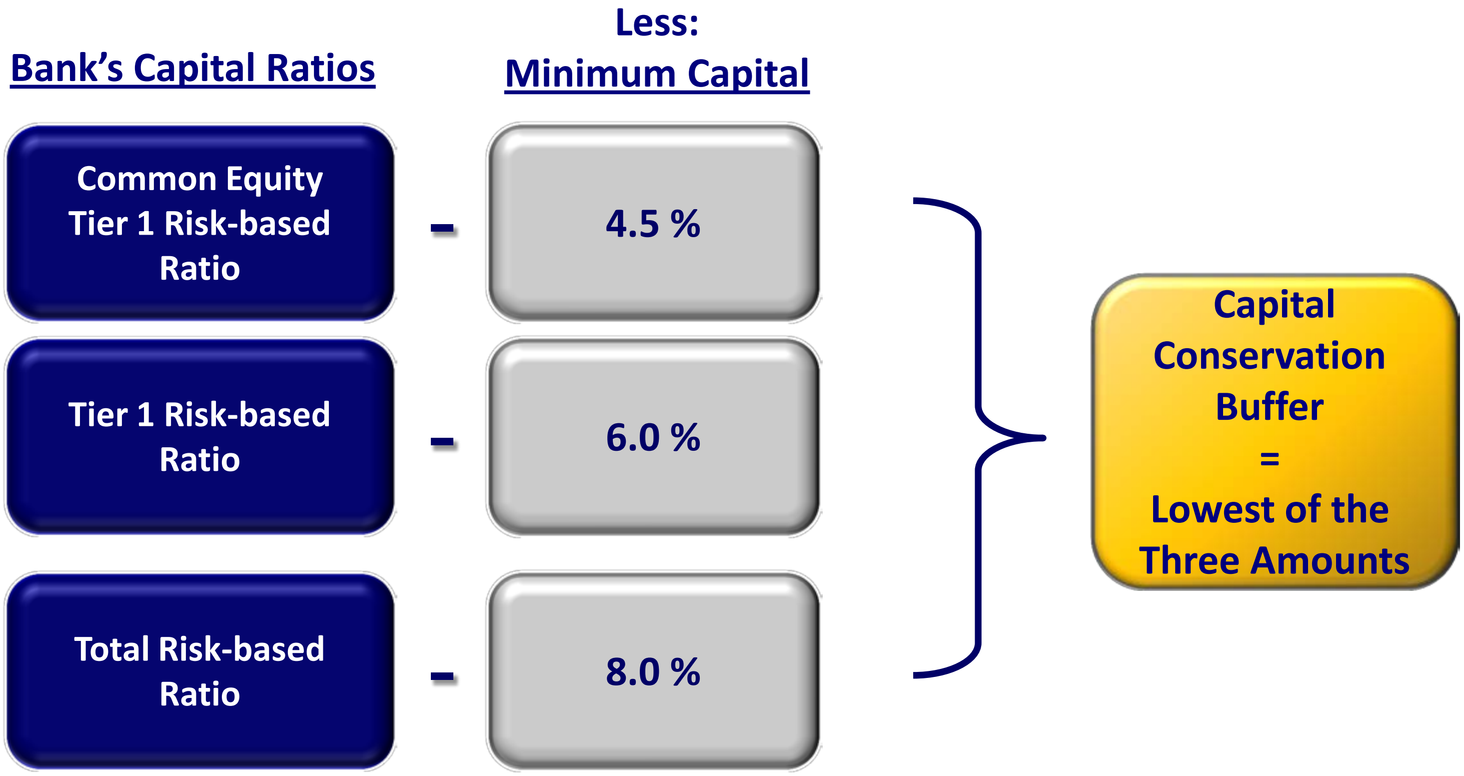
Capital Conservation Buffer

Maximum Payout Ratio
as % of Eligible Retained Income

Maximum Payout Ratio	**Size of Buffer (% of RWA)**
No Limit	Greater than 2.5
60	> 1.875 to 2.500
40	> 1.250 to 1.875
20	> 0.625 to 1.250
0	≤ 0.625

- Types of payments that are restricted if a bank does not satisfy the Capital Conservation Buffer requirement:
  - Dividends
  - Share buybacks
  - Discretionary payments on Tier 1 instruments
  - Discretionary bonus payments
- Eligible Retained Income: The most recent four quarters of net income preceding the current calendar quarter, net of any capital distributions, and certain discretionary bonus payments
- Agencies maintain the supervisory authority to impose further restrictions and / or require capital commensurate with the bank's risk profile

Capital Conservation Buffer Calculation



Capital Conservation Buffer Example

Conservation Buffer Example	Determination of Buffer and Limit		
	Example Bank Ratios (%)	(less) Minimum Regulatory Capital Ratios (%)	Result (%)
Common Equity Tier 1 Risk-based Capital Ratio	7.50	4.50	3.00
Tier 1 Risk-based Capital Ratio	8.50	6.00	2.50
Total Risk-based Capital Ratio	9.00	8.00	1.00

Maximum Payout Ratio

20%

1. Determine bank's risk-based capital ratios
2. Subtract minimum regulatory capital ratios
3. The capital buffer is the lowest of the three results
4. Apply the maximum payout ratio that is consistent with the lowest calculated buffer measure

Timeline and Transition Period

Phase-in Schedule					
Item	2015 (%)	2016 (%)	2017 (%)	2018(%)	2019(%)
Minimum Tier 1 Leverage Capital Ratio	**4.0**				
Minimum Common Equity Tier 1 Risk-based Capital Ratio	**4.5**				
Minimum Tier 1 Risk-based Capital Ratio	**6.0**				
Minimum Total Risk-based Capital Ratio	8.0				
Buffer					
Capital Conservation Buffer		0.625	1.25	1.875	**2.50**
Minimum Common Equity Tier 1 Plus Capital Conservation Buffer	4.5	5.125	5.75	6.375	**7.00**
Minimum Tier 1 Capital Plus Capital Conservation Buffer	6.0	6.625	7.25	7.875	**8.50**
Minimum Total Capital Plus Conservation Buffer	8.0	8.625	9.25	9.875	**10.50**
Deductions / Adjustments					
Phase-in of certain deductions and adjustments	40	60	80	**100**	

Prompt Corrective Action (PCA)

PCA Categories	Tier 1 Leverage (%)	Common Equity Tier 1 RBC (%)	Tier 1 RBC		Total RBC (%)
			Current (%)	Interim Final Rule (%)	
Well Capitalized	≥ 5.0	≥ 6.5	≥ 6.0	≥ 8.0	≥ 10.0
Adequately Capitalized	≥ 4.0	≥ 4.5	≥ 4.0	≥ 6.0	≥ 8.0
Undercapitalized	< 4.0	< 4.5	< 4.0	< 6.0	< 8.0
Significantly Undercapitalized	< 3.0	< 3.0	< 3.0	< 4.0	< 6.0
Critically Undercapitalized	Tangible Equity / Total Assets ≤ 2%				

- Revised PCA ratios are effective on January 1, 2015, for all banks
- Tangible Equity equals the revised Tier 1 Capital plus outstanding non-Tier 1 perpetual preferred stock

Risk-Weighted Assets

Interim Final Rule: Risk-weighted Assets

What Has Not Changed From Current Rules	
Cash / Items in Process / Gold	**1-4 Family Residential Mortgages**
U.S. Government Securities	Consumer Loans and Credit Cards
U.S. Government Sponsored Entities Securities	Commercial & Industrial Loans
U.S. Depository Institutions Exposures	Owner-occupied CRE Loans
U.S. Public Sector Entities Securities	1-4 Family Acquisition, Development and Construction (ADC) Loans
Non-structured Corporate Investment Securities	Income Property Real Estate Loans *
Fixed Assets	Statutory Multi-family Loans
	Pre-sold Construction Loans

* Refers to permanent mortgage loans, not ADC loans

1-4 Family Risk Weights: No Changes

No Changes From Current Rules

Banks Should Continue To:
▪ Use 50% & 100% risk weights
▪ Recognize Private Mortgage Insurance (PMI)
▪ Combine first & junior liens and treat as a single exposure (with no intervening lien)

No change for “balloon” and “interest only” mortgages

No change for loans sold

- 120 day safe harbor rule remains

Interim Final Rule: Risk-weighted Assets

What Has Changed From Current Rules	
On-balance Sheet	
High Volatility Commercial Real Estate	Claims on Securities Brokerage Firms
Past-due Asset Exposures	Cleared Transactions
Securitizations (Structured Investments)	Unsettled Transactions
Equity Exposures	Foreign Government Exposures
Equity Exposures to Investment Funds	Foreign Bank Exposures
Off-balance Sheet	
Certain Credit Conversion Factors	Certain Repo-style Transactions
Risk-weighting Substitution	
Collateralized Exposures	Guaranteed Exposures

High Volatility CRE (HVCRE)

HVCRE
150%
Risk Weight

=

Total ADC Loans

Less

- **1-4 Family Residential Projects**
- **Secured by Properties for Agricultural Purposes**
- **ADC Loans Meeting Certain Criteria ***
- **Community Development Loans**

* ADC loans meeting certain criteria are not HVCRE:

- LTV is at or below maximum supervisory LTV; **and**
- Borrower has contributed at least 15% of “as completed” appraised value in cash or unencumbered readily marketable assets; **and**
- Borrower contributed capital is contractually required to remain throughout the project life

Is it HVCRE?

Not HVCRE	HVCRE
1-4 Family ADC project	ADC loan on shopping center with LTV above supervisory maximum
Loan to finance Farmland and valued as such	ADC loan to construct office building where borrower has not contributed qualifying capital
Community Development ADC project	ADC loan to construct hotel where borrower-contributed capital is not held for life of project

CRE Risk Weights: Examples

Other Commercial Real Estate	Risk Weights	
	100%	150%
Owner / Non Owner-occupied Office Building		
Manufacturing / Industrial Building		
Acquisition, Development, & Construction		
1-4 Family Residential Property		
High Volatility CRE		

Past-due Asset Risk Weights

Assets 90 Days or More Past-due or on Nonaccrual	Risk Weights		
	50%	100%	150%
Revenue Bonds			
Multi-family Loans			
Consumer Loans			
Commercial and Industrial Loans			
Non-farm Non-residential Loan			
Agricultural Loans			

- **Does not apply to:**
  - 1-4 family residential exposures (no change to current treatment)
  - HVCRE (already risk weighted at 150% under interim final rule)
  - Portion of loan balances with eligible guarantees or collateral (risk weight varies)

Structured Securities & Securitizations

Examples Include:

Private Label Collateralized Mortgage Obligations (CMOs)

Trust Preferred Collateralized Debt Obligations (TruPS CDOs)

Asset-Backed Securities

Three Approaches

- Risk weight based on one of the following:
  - Gross Up Approach
  - Simplified Supervisory Formula Approach
  - 1,250% Risk Weight
- Eliminates Ratings-based Approach

Other Requirements / Options

- Must apply approach selected consistently
- 1,250% option may be used regardless of approach selected
- Requires due diligence

Generally does not apply to GSEs

Approaches for Risk-weighting Structured Securities & Securitizations

Must Choose One…

…or Bank May Use 1,250% Risk Weighting

Gross Up Method	Simplified Supervisory Formula Approach – the New Option *	1,250% Risk Weight

• Similar to current rules
• Capital required for subordinated tranches is based on the amount of the tranche held by the bank plus the pro-rata support provided to senior tranches
• Key clarification: use weighted average risk weight of underlying collateral
	• Assigns a risk weight based on several criteria:
	  • Weighted average risk weight of underlying collateral
	  • Relative size & seniority of a particular security in a structure
	  • Delinquency level of underlying collateral
		• A bank may apply a 1,250% risk weight to any of its securitization exposures

* A securitization can not be assigned a risk weight of less than 20%.

Structured Securities & Securitizations: Due Diligence Requirement

- **Management must:**
  - Understand complexity & materiality
  - Understand performance features
  - Conduct initial and ongoing written analysis

- **If management is unable to demonstrate this understanding, regulators may require a bank to assign the exposure a risk weight of 1,250%**

Equity Risk Weights

Equity Exposures	Risk Weights						
	0%	20%	100%	250%	300%	400%	600%
Federal Reserve Bank stock							
Federal Home Loan Bank stock							
CDFI and community development equity exposures							
A significant investment in common stock of an unconsolidated financial institution (unless already deducted)							
A publicly traded equity exposure *							
An equity exposure that is not publicly traded *							
An equity exposure to a hedge fund or any investment firm that has greater than immaterial leverage *							

* To the extent that the aggregate adjusted carrying value of certain equity exposures does not exceed 10% of the bank's total capital, a 100% risk weight may be applied

Off-balance Sheet Exposures & Credit Conversion Factors

Credit Conversion Factor	Description
0%	• Unused portion of commitments that are unconditionally cancelable by the bank
20%	• Commitments with original maturity of one year or less not unconditionally cancelable by the bank • Self-liquidating, trade-related contingent items that arise from the movement of goods, with an original maturity of one year or less
50%	• Commitments with original maturity of more than one year, not unconditionally cancelable by the bank • Transaction-related contingent items, including performance bonds, bid bonds, warranties, and performance standby letters of credit
100%	• Guarantees • Repurchase agreements (but no change for most community banks) • Off-balance sheet securities lending transactions (but no change for most community banks) • Off-balance sheet securities borrowing • Financial standby letters of credit • Forward agreements • Credit enhancing representations and warranties

Collateralized Transactions

- **Collateralized transactions include loans and repurchase agreements**
- **May substitute the risk weight of an exposure that is secured by <u>financial collateral</u>, consisting of:**
  - Cash on deposit
  - Gold bullion
  - U.S. Government securities
  - Certain other investment grade securities
  - Publicly traded equities & convertible bonds
  - Money market fund shares (if quoted daily)
- **Available methods for recognizing collateral**
  - Simple approach (similar to current capital rules)
  - Collateral haircut approach

Examples of Collateralized Transactions (Simple Approach)

Financial Collateral	Risk Weights			
	0%	20%	50%	100%
Cash on deposit at the bank or third party custodian				
U.S. Government securities (must discount market value by 20%)				
Government Sponsored Entity securities				
Money market funds		Risk Weight Varies		
"Investment Grade" Securities (examples):				
General Obligation municipal bond				
Municipal Revenue bond				
Corporate bond				

Treatment of Guarantees

A bank may substitute the risk weight of an eligible guarantor for the risk weight of the exposure

Eligible Guarantors Include

- **Depository institution or holding company**
- **Federal Home Loan Banks**
- **Farmer Mac**
- **Entities with investment grade debt**

Eligible Guarantees Must

- **Be written and either:**
  - Unconditional
  - A contingent obligation of the U.S. Government or its agencies
- **Also meet other requirements of the rule**

Changes from NPR to Interim Final Rule

Comment Process / Findings

- **Received over 2,500 comments from financial institutions, trade groups, and other interested parties**

- **All were considered in the development of the interim final rule**

Definition of Capital: Comparison to NPR

NPR	Interim Final Rule
Accumulated Other Comprehensive Income Recognized in Common Equity Tier 1 Capital	Provides banks (Other than Advanced Approaches Banks) a One-time AOCI Opt-out to Retain Current AOCI Treatment
Holding Company-issued TruPS Phased Out of Tier 1 Capital	Permits certain TruPS in Tier 1 Capital per the Dodd-Frank Act
Retained Mortgage Servicing Rights Fair Value Haircut	Removes Mortgage Servicing Rights Fair Value Haircut
Certain ESOP Shares Did Not Qualify as Capital	Waives Certain Qualifying Criteria for Limited ESOP Shares
Effective Date: January 1, 2013	Effective Date: January 1, 2015 (for non-Advanced Approaches Banks)

Risk-Weighted Assets: Comparison to NPR

NPR	Interim Final Rule
1-4 Family Risk Weights Varied from 35% to 200%	No Changes to Existing 50% and 100% Risk Weightings for 1-4 Family Residential Loans (including Interest Only and Balloons)
No Recognition of PMI	Recognition of PMI
Eliminate 120 day Safe Harbor Provision for Mortgage Loan Sales	Retains Safe Harbor Provision
HVCRE Definition Potentially Included Farmland and Community Development Projects	HVCRE Excludes Farmland and Community Development Projects
Foreign Gov't, Bank, & Public Sector Entity Risk Weight Depends on Country Risk Classification (CRC) Assessment	If No CRC Assessment, Weighting Depends on Organization for Economic Co-operation & Development (OECD) Membership
No Provision for Bank Owned Life Insurance	Look-through to Risk Weight of Underlying Assets or Guarantor

Summary & Additional Resources

Interim Final Rule Changes

- Revises regulatory capital definitions and minimum ratios
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- Revises Prompt Corrective Action (PCA) thresholds and adds the new ratio to PCA framework
- Changes risk weighting for certain asset categories and off-balance sheet exposures

Resources

- **Community Bank Guide**
- **www.fdic.gov/regulations/capital**
- **Mailbox: regulatorycapital@fdic.gov**
- **Capital Markets Headquarters: (202) 898-6888**
- **Capital Markets Branch staff and Regional Capital Markets Specialists**

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