

# Regulatory Capital Guide for Minority Depository Institutions and Community Development Financial Institution Banking Organizations

Office of the Comptroller of the Currency  
Board of Governors of the Federal Reserve System  
Federal Deposit Insurance Corporation

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## Section 1: Introduction

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) have developed this guide to provide minority depository institutions (MDI) and community development financial institutions (CDFI) banking organizations with an overview of key considerations regarding the effect of capital investments on their regulatory capital requirements under the agencies' regulatory capital rule (capital rule).

For purposes of the capital rule, and this guide, banking organizations include bank holding companies and savings and loan holding companies (collectively, holding companies), and national banks, state member banks, insured state nonmember banks, and savings associations (collectively, depository institutions).

This guide is an overview of those aspects of the capital rule to which MDI and CDFI banking organizations may wish to consider when raising capital. As such, this guide does not address all aspects of the capital rule and does not set forth any new requirements or expectations. In addition to using this guide, the agencies encourage the management teams of MDI and CDFI banking organizations to review the portions of the capital rule that are relevant to their organization and to consult with their primary federal regulator as warranted. The agencies' capital rules are located at:

Primary Federal Regulator	Applicable Code of Federal Regulations
OCC	<a href="#">12 CFR part 3</a>
Federal Reserve	<a href="#">12 CFR part 217</a>
FDIC	<a href="#">12 CFR part 324</a>

## Section 2: Overview of Capital Rule

The capital rule provides minimum risk-based and leverage capital requirements for banking organizations. While the regulatory capital requirements of each agency are generally the same, there are differences between requirements for holding companies and depository institutions. This guide points out many of those differences.

Banking organizations report their regulatory capital on a quarterly basis. Holding companies report their regulatory capital on [Schedule HC-R of the FR Y-9C](#) and depository institutions report their regulatory capital on [Schedule RC-R of the Consolidated Report of Condition and Income \(Call Report\)](#).

## ***2.1 Minimum Regulatory Capital Ratios***

In general, a banking organization must maintain the following minimum risk-based capital ratios:

- Common equity tier 1 (CET1) capital to total risk-weighted assets ratio of 4.5 percent;
- Tier 1 capital (sum of CET1 and additional tier 1 capital) to total risk-weighted assets ratio of 6 percent; and
- Total capital (sum of tier 1 and tier 2 capital) to total risk-weighted assets ratio of 8 percent.

A banking organization also must maintain the following minimum leverage capital ratio, called the leverage ratio:

- Tier 1 capital to average total consolidated assets ratio of 4 percent.

However, the aforementioned requirements do not apply to banking organizations that have elected to use the Community Bank Leverage Ratio framework (see Section 2.6) or are subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement (see Section 2.7).

Total risk-weighted assets include a banking organization's on- and off-balance sheet exposures, calculated in accordance with Subpart D of the agencies' capital rule. The general instructions for [Form FR-Y9C, Schedule HC-R, Part II](#) and [Call Report Schedule RC-R, Part II](#) provide guidance to banking organizations for risk-weighting their on- and off-balance sheet exposures.

Average total consolidated assets are the banking organization's quarterly average assets, as reported in the Form FR-Y9C, Schedule HC-K – Quarterly Averages or Call Report Schedule RC-K – Quarterly Averages, as applicable, adjusted for any regulatory deductions and adjustments.

## ***2.2 Components of Regulatory Capital***

The following are the three components of regulatory capital: CET1 capital, additional tier 1 capital, and tier 2 capital. To qualify as regulatory capital, an instrument must meet the respective qualifying criteria for either CET1 capital, additional tier 1 capital, or tier 2 capital under the agencies' capital rule.

- CET1 capital is the form of capital with the greatest loss-absorbing capacity and includes:
  - Common stock and related surplus, net of treasury stock and unearned employee stock ownership plan shares (see **Box 1** for a note about stockholders' voting rights);
  - Retained earnings;
  - Accumulated other comprehensive income (AOCI) if the banking organization does not make a permanent one-time election to opt out of excluding certain components of AOCI in CET1 capital;
  - Certain minority interest (subject to limitations); and

- Any applicable regulatory adjustments and deductions, including any deductions for investments in another financial institution’s capital instrument (see section 2.3).
- Additional tier 1 capital includes:
  - Qualifying non-cumulative perpetual preferred stock (and related surplus);
  - Perpetual preferred stock issued under the Emergency Capital Investment Program;
  - Small Business Lending Fund and Troubled Asset Relief Program instruments that previously qualified for tier 1 capital;
  - Certain minority interest that is not included in CET1 capital (subject to the limitations); and
  - Any applicable regulatory adjustments and deductions, including any deductions for investments in another financial institution’s capital instrument (see section 2.3).
- Tier 2 capital includes:
  - Qualifying subordinated debt;
  - Qualifying preferred stock (including related surplus);
  - Subordinated debt issued under the Emergency Capital Investment Program;
  - Small Business Lending Fund and Troubled Asset Relief Program instruments that previously qualified for tier 2 capital;
  - Certain minority interest that is not included in tier 1 capital (subject to limitations);
  - Allowance for loan and lease losses (or adjusted allowances for credit losses for banking organizations that have adopted the current expected credit losses (CECL) methodology) up to 1.25 percent of risk-weighted assets (see **Box 2** for a note about CECL’s effective date and the available transition adjustment); and
  - Any applicable regulatory adjustments and deductions, including any deductions for investments in another financial institution’s capital instrument (see section 2.3).

**Box 1 - *Stockholders’ Voting Rights***

The agencies’ capital rule does not place a restriction on the percentage of a banking organization’s regulatory capital that consists of qualifying perpetual preferred stock, nor does it require voting common equity to be the dominant form of a banking organization’s regulatory capital. The agencies believe, however, that voting common stockholders’ equity can serve as a valuable corporate governance tool that permits parties with an economic interest to participate in the decision-making process through votes on establishing corporate objectives and policy, and in electing the institution’s board of directors. On a case-by-case basis, the agencies may provide feedback if a banking organization’s capital base is composed predominantly of non-voting common equity. Banking organizations are encouraged to discuss potential supervisory concerns with their primary federal regulator.

### **Box 2 – CECL Effective Date and Transition Adjustment**

All banking organizations are required to apply the CECL methodology beginning January 1, 2023, with reporting in the March 31, 2023 regulatory reports for a banking organization with a calendar year fiscal year. Many larger banking organizations (i.e., public business entities that are U.S. Securities and Exchange Commission (SEC) filers, excluding smaller reporting companies, as defined by the SEC) began applying CECL as of January 1, 2020.

In recognition of the potential decrease in regulatory capital as of the date of a banking organization's adoption of CECL and the difficulty in capital planning due to uncertainty about the economic environment at the time of CECL adoption, the capital rule permits banking organizations to elect to phase in, over a three-year period, the day-one effects of CECL adoption on their regulatory capital. *See* 84 FR 4222 (Feb. 14, 2019)

The agencies separately permit a five-year transition for banking organizations that adopted CECL in 2020 as part of efforts to address the disruption of economic activity in the United States caused by the spread of coronavirus disease 2019. *See* 85 FR 17723 (March 31, 2020)

### **2.3 Regulatory Capital Deductions and Adjustments**

The agencies' capital rule includes a number of adjustments and deductions to exclude exposures from regulatory capital because of the high level of uncertainty regarding the ability of banking institutions to realize value from these assets, especially under adverse financial conditions (e.g., intangible assets). Some of the deductions also exclude from regulatory capital certain investments in the capital of another financial institution in order to reduce the likelihood that financial stress at a banking organization is transmitted to other financial institutions.

Deductions from regulatory capital generally include goodwill and other intangibles, net of certain deferred tax assets that arise from net operating loss and tax credit carryforwards, gains-on-sale in connection with a securitization, any defined benefit pension fund net asset (for banking organizations that are not insured depository institutions), and any investments in a banking organization's own capital instruments. Banking organizations also are required to deduct mortgage servicing assets, deferred tax assets arising from temporary differences, and investments in the capital of unconsolidated financial institutions that individually exceed 25 percent of the banking organization's CET1 capital. In addition, banking organizations that opt out of including AOCI in CET1 capital must neutralize the effects of unrealized gains and losses on available-for-sale debt securities in CET1 capital.

When a deduction is required, the banking organization must decrease its regulatory capital by the deducted amount and should not include the asset in the banking organization's total risk-weighted assets or total assets for the leverage ratio. In addition, banking organizations that issue capital instruments such as subordinated debt should be mindful of any reciprocal holdings with other similar issuers. Reciprocal cross holdings result from a formal or informal arrangement to swap, exchange, or otherwise intend to hold each other's capital instruments.

Reciprocal capital holdings typically result in a deduction of those holdings from regulatory capital.

For investments in the capital of another financial institution, a banking organization must deduct from the tier of capital for which the investment would otherwise be eligible if the investing banking organization were to issue the instruments. For example, a banking organization's investment that qualifies as additional tier 1 capital must deduct the amount of the investment from additional tier 1 capital. Furthermore, a banking organization that does not have enough capital to absorb a deduction must deduct the shortfall from the next, more subordinated (higher quality) tier of capital. For example, if the banking organization does not have sufficient tier 2 capital to absorb a deduction, then the shortfall would be deducted from additional tier 1 capital or, if there is insufficient additional tier 1 capital, from CET1 capital.

## ***2.4 Capital Conservation Buffer***

The agencies established the capital conservation buffer to encourage better capital conservation by banking organizations and to enhance the resilience of the banking system during stress periods. The capital conservation buffer gradually limits the ability of banking organizations to distribute capital or to make certain discretionary bonus payments if their capital ratios fall below certain levels, thereby strengthening the ability of banking organizations to continue lending and conducting other financial intermediation activities during stress periods.

The capital conservation buffer is not applicable to banking organizations that have elected to use the Community Bank Leverage Ratio (CBLR) framework (see Section 2.6) or are subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement (see Section 2.7Ca). See **Box 3** for a note about S-corporations.

The capital conservation buffer requirement equals 2.5 percent of risk-weighted assets above the minimum risk-based capital ratio requirements. A banking organization determines its capital conservation buffer as the smallest difference between each of its three risk-based capital ratios and the minimum requirement for each ratio. Thus, to avoid restrictions under the capital conservation buffer, a banking organization must maintain a CET1 risk-based capital ratio of greater than 7 percent, a tier 1 risk-based capital ratio of greater than 8.5 percent and a total risk-based capital ratio of greater than 10.5 percent. The 7 percent CET1 risk-based capital ratio threshold (4.5 percent minimum plus 2.5 percent buffer) ensures that the capital conservation buffer requirement is composed solely of CET1 capital.

In the event that a banking organization's capital conservation buffer drops below the required 2.5 percent, the maximum amount of capital distributions that the banking organization can make becomes a function of its eligible retained income. Eligible retained income is defined as the greater of (1) a banking organization's net income for the four preceding calendar quarters, net of any distributions and associated tax effects not already reflected in net income, and (2) the average of a banking organization's net income over the preceding four quarters. The capital rule permits the primary federal regulator to approve capital distributions and discretionary bonuses that exceed the limits imposed by the capital conservation buffer. See the table below for further details.

<b>Capital Conservation Buffer (% of RWA)</b>	<b>Maximum Payout Ratio (% of Eligible Retained Income)</b>
Greater than 2.5%	No payout limitation
Less than or equal to 2.5% and greater than 1.875%	60%
Less than or equal to 1.875% and greater than 1.25%	40%
Less than or equal to 1.25% and greater than 0.625%	20%
Less than or equal to 0.625%	0%

**Box 3 - Requests from S-Corporation Institution for Dividend Exceptions to the Capital Conservation Buffer**

The capital conservation buffer may impose dividend restrictions based on the regulatory capital ratios of the S-corporation institution. The FDIC issued a [Financial Institution Letter \(FIL-40-2014\)](#) to describe how the FDIC will consider requests from S-corporation institutions to pay dividends to shareholders to cover taxes on their pass-through share of the banking organization’s earnings, when these dividends would otherwise not be permitted under the capital conservation buffer requirements. As described in more detail in FIL-40-2014, absent significant safety-and-soundness concerns about the requesting banking organization, the FDIC generally would expect to approve exception requests by well-rated S-corporation institutions that are limited to the payment of dividends to cover shareholders’ taxes on their portion of an S-corporation’s earnings.

**2.5 Prompt Corrective Action Framework**

The purpose of the prompt corrective action (PCA) framework is to resolve the problems of insured depository institutions at the least possible long-term loss to the FDIC’s Deposit Insurance Fund.<sup>1</sup> The PCA framework classifies insured depository institutions into the following five categories based on their regulatory capital ratios as illustrated in the following table. Holding companies are not subject to the PCA framework. See **Box 4** for a note regarding the relationship between the capital conservation buffer and PCA thresholds.

<sup>1</sup> See section 38 of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. 1831o.

PCA Category	CET1 Capital Ratio	Tier 1 Capital Ratio	Total Capital Ratio	Tier 1 Leverage Ratio
Well capitalized	≥ 6.5%	≥ 8%	≥ 10%	≥ 5%
Adequately capitalized	≥ 4.5%	≥ 6%	≥ 8%	≥ 4%
Undercapitalized	< 4.5%	< 6%	< 8%	< 4%
Significantly undercapitalized	< 3%	< 4%	< 6%	< 3%
Critically undercapitalized	Ratio of tangible equity to total assets that is equal to or less than 2%			

Insured depository institutions that fail to meet these capital measures are subject to increasingly strict limits on their activities, including their ability to make capital distributions, pay management fees, grow their balance sheet, and take other actions, including limitations on accepting, renewing or rolling over brokered deposits.

To be considered “well capitalized,” each of the insured depository institution’s capital ratios must meet or exceed all applicable levels. Regardless of an insured depository institution’s capital level, no insured depository institution is considered “well capitalized” if it is subject to any written agreement, order, capital directive, or PCA directive that requires the insured depository institution to meet and maintain a specific capital level for any capital measure. Insured depository institutions in compliance with such agreements, orders, or directives will not be considered “well capitalized” unless and until the agreement, order, or directive is terminated or modified to eliminate the capital requirement.

**Box 4 - Relationship between the Capital Conservation Buffer and PCA**

The capital conservation buffer is calibrated to be 50 basis points higher than the thresholds to be considered “well capitalized” under PCA. As a result, insured depository institutions may be considered “well capitalized” but still be below the 2.5 percent capital conservation buffer and subject to dividend restrictions. Further, the capital conservation buffer is applicable to both holding companies and depository institutions, whereas the PCA framework is only applicable to insured depository institutions.

**2.6 Community Bank Leverage Ratio Framework**

The CBLR framework is an optional capital framework designed to reduce burden for certain banking organizations with less \$10 billion in total consolidated assets (collectively, qualifying community banking organizations).<sup>2</sup> The CBLR framework does this by applying a simpler,

<sup>2</sup> See 84 FR 61776 (January 1, 2020).



alternative regulatory capital framework, while simultaneously maintaining the safety and soundness of individual qualifying community banking organizations and the banking system as a whole.

Qualifying community banking organizations that elect to use the CBLR framework (electing community banking organizations) and that maintain the minimum CBLR ratio of greater than 9 percent (8.5 percent during calendar year 2021<sup>3</sup>) will be deemed to have satisfied the applicable non-CBLR risk-based and leverage capital requirements under the capital rule and, if applicable, will be deemed to be “well-capitalized” for purposes of the PCA framework.

Community banking organizations that meet all of the following eligibility criteria are able to elect to use the CBLR framework:

- Total consolidated assets of less than \$10 billion<sup>4</sup>;
- A leverage ratio of greater than 9 percent (greater than 8.5 percent during calendar year 2021);
- Average total off-balance sheet exposures of 25 percent or less of average total consolidated assets;
- The sum of total trading assets and trading liabilities of 5 percent or less of average total consolidated assets; and
- The institution cannot be an advanced approaches banking organization.<sup>5</sup>

An electing community banking organization can opt out of the CBLR framework at any time. If an electing community banking organization fails to meet any of the eligibility criteria, it

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<sup>3</sup> In April 2020, the agencies made temporary revisions to the CBLR framework due to the strain on the U.S. economy caused by the coronavirus disease 2019. Under these temporary revisions, an electing community banking organization with a CBLR greater than 8.5 percent for calendar year 2021 and 9 percent thereafter will be deemed to have satisfied the generally applicable rule and, if applicable, will be deemed to have met the “well-capitalized” ratio requirements for purposes of the PCA framework. In addition, the CBLR of the organization must not fall more than 1 percentage point below the applicable CBLR requirement (7.5 percent for calendar year 2021 and 8 percent thereafter) during the grace period. An electing community banking organization that fails to meet the qualifying criteria after the end of the grace period or reports a leverage ratio of less than 1 percent below the CBLR threshold must comply with the generally applicable rule and file the appropriate regulatory reports. *See* 85 FR 22924 (April 23, 2020).

<sup>4</sup> In November 2020, the agencies revised their capital rule to allow community banking organizations with total assets of \$10 billion or less as of December 31, 2019 to elect to use the CBLR framework from December 31, 2020, to December 31, 2021, provided that they meet the other qualifying criteria for the framework. *See* 85 FR 64003 (November 9, 2020).

<sup>5</sup> Advanced approaches banking organizations are composed of banking organizations subject to category I and II capital standards. Under the tailoring rule, Category IV banking organizations are those with consolidated total assets of at least \$100 billion that do not meet the thresholds for a higher category. Category III banking organizations are those with total consolidated assets of at least \$250 billion or at least \$75 billion in weighted short-term wholesale funding, nonbank assets, or off-balance sheet exposure. Category II banking organizations are those with at least \$700 billion in total consolidated assets or at least \$75 billion in cross-jurisdictional activity. Category I is comprised of U.S. Global Systemically Important Bank Holding Companies and their depository institution subsidiaries, as determined under the Board’s GSIB surcharge rule.

would have a two-quarter “grace” period to return to CBLR compliance or revert to the non-CBLR minimum risk-based and leverage capital requirements under the capital rule (generally applicable rule). In addition, if the CBLR of an electing community banking organization fails to meet the greater than 9 percent requirement (greater than 8.5 percent requirement during calendar year 2021), the organization would be deemed to be “well-capitalized” for purposes of the PCA framework during the grace period as long as the banking organization’s leverage ratio remains greater than 8 percent (greater than 7.5 percent during calendar year 2021). If the CBLR ratio of an electing community banking organization falls to 8 percent or less (7.5 percent or less during 2021), the organization would be required to revert immediately to the generally applicable rule.

## ***2.7 Small Bank Holding Company and Savings and Loan Holding Company Policy Statement***

The Small Bank Holding Company and Savings and Loan Holding Company Policy Statement applies to holding companies that (1) have less than \$3 billion in consolidated assets; (2) are not engaged in significant nonbanking activities; (3) do not conduct significant off-balance sheet activities; and (4) do not have a material amount of registered securities outstanding (excluding trust preferred securities).<sup>6</sup> These holding companies are exempt from the Board’s capital rule and are instead subject to debt-to-equity ratio requirements.

The Small Bank Holding Company and Savings and Loan Holding Company Policy Statement facilitates the transfer of ownership of small community-based banks by allowing their holding companies to operate with higher levels of debt than would normally be permitted. While holding companies that meet the conditions of the policy statement are excluded from consolidated capital requirements, their depository institution subsidiaries continue to be subject to minimum risk-based and leverage capital requirements or the CBLR framework, as applicable.

Holding companies that meet the qualitative requirements may use debt to finance up to 75 percent of the purchase price of an acquisition (i.e., the holding company may have a debt-to-equity ratio of up to 3:1). However, such a holding company must satisfy additional ongoing requirements, including that the holding company (1) reduce its debt such that all debt is retired within 25 years of the debt being incurred; (2) reduce its debt-to equity ratio to 0.30:1 or less within 12 years of the debt being incurred; (3) ensure that each of its subsidiary insured depository institutions is “well capitalized”; and (4) refrain from paying dividends until such time as it reduces its debt-to-equity ratio to 1:1 or less.

## **Section 3: Capital Adequacy and Other Considerations Related to Raising New Capital**

MDI and CDFI banking organizations can increase their regulatory capital in several ways. One way to increase regulatory capital is by retaining a portion of earnings. MDI and CDFI banking organizations also can increase regulatory capital by issuing financial instruments that meet the applicable criteria for regulatory capital. An MDI or CDFI banking organization that includes both a holding company and a depository institution subsidiary can issue capital instruments from either legal entity. An MDI or CDFI banking organization with a holding company has the

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<sup>6</sup> 12 CFR part 225, appendix C. *See* 83 FR 44195 (August 30, 2018).

ability to issue capital instruments at the holding company level and then contribute the proceeds of the issuance to a depository institution subsidiary. This portion of the guide describes capital adequacy and other considerations related to issuing capital instruments.

### ***3.1 Managing Regulatory Capital Requirements at the Holding Company and Depository Institution Levels***

When considering whether to issue a new capital instrument, an MDI or CDFI banking organization should be mindful of how the new capital issuance would affect its ability to comply with the minimum CET1, tier 1, and total risk-based capital requirements and the tier 1 leverage ratio at both the holding company and depository institution levels.

The capital rule does not limit the amount of capital a banking organization can issue in a given tier, but the calibration of the ratios together with the capital conservation buffer set out the minimum amounts that each tier should comprise of an MDI or CDFI banking organization's regulatory capital base (section 2.4 discusses minimum capital requirements plus buffers; section 2.7 discusses the risk-based and leverage capital requirements at the holding company level for MDI and CDFI banking organizations with holding companies subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement; and section 2.6 discusses capital requirements for qualifying community banking organizations that elect to use the CBLR framework).

An MDI or CDFI banking organization that raises capital at the holding company level through the issuance of tier 2 capital and then contributes the proceeds to a depository institution subsidiary in the form of additional tier 1 capital should understand that this potentially could decrease the CET1 capital ratios at the holding company. See **Box 5** for a note about issuing non-qualifying capital with respect to a particular capital requirement.

#### ***Box 5- Nonqualifying Capital***

The capital rule does not prohibit a banking organization from issuing capital instruments that do not qualify as capital under the capital rule. However, a banking organization should be aware that issuing non-qualifying capital can decrease the banking organization's regulatory capital ratios. Regulatory capital ratios are generally the ratio of regulatory capital (numerator) to a measure of assets (denominator). An infusion of non-qualifying capital will not increase the banking organization's regulatory capital but will increase the banking organization's assets (initially as cash, which could be converted into other assets such as loans). This in turn could result in an increase in the denominator of the regulatory capital ratios without a corresponding increase to the numerator.

### ***3.2 Injecting Capital from a Holding Company to a Depository Institution Subsidiary***

Capital raised at the holding company level in the form of CET1 capital, additional tier 1 capital, or tier 2 capital can be subsequently contributed to a depository institution subsidiary so that the subsidiary can utilize the capital for lending activities. A holding company can effect such a

contribution by structuring a transaction so that the holding company purchases a capital instrument of the subsidiary. In order for such capital to be included as regulatory capital at the subsidiary level, the instrument purchased by the holding company must meet the regulatory capital criteria for CET1, additional tier 1, or tier 2 capital. For example, a holding company may issue subordinated debt that counts as tier 2 capital at the holding company level and use the proceeds of the debt issuance to buy common shares of the depository institution subsidiary. Those common shares may count as CET1 capital at the depository institution subsidiary level, provided the common shares meet the qualifying requirements under the capital rule. Note that the tier of capital for which the instrument is included at the holding company does not dictate the tier of capital at the subsidiary.

In the case where 100 percent ownership of the depository institution subsidiary is with one holding company, the holding company may contribute cash to the subsidiary, which would qualify for CET1 capital.

### ***3.3 Potential Issues with Contributing Subordinated Debt Proceeds from a Holding Company to a Subsidiary Depository Institution***

As discussed in section 3.2, a holding company may contribute the proceeds from a subordinated debt offering to a depository institution subsidiary as tier 1 capital. While this type of transaction can be used to increase the regulatory capital base of the subsidiary, a holding company should consider the potential financial strain that debt service requirements may place on itself and their depository institution subsidiaries. In particular, high debt service obligations at the holding company could result in significant dividend demands on the depository institution subsidiaries so that the holding company may meet its debt service requirements.

Holding companies are expected to serve as a source of strength for their depository institution subsidiaries and should factor the debt usage and appropriate limits in their capital management plans to avoid excessive double leverage. Holding companies considering the issuance of subordinated debt with the intention of contributing the proceeds to a depository institution subsidiary should be mindful of the following:

- **Parent liquidity and the level of debt** – Examiners assess parent liquidity by looking at the contractual maturity of the holding company’s assets and liabilities to determine whether any funding gaps exist. Examiners also may review the debt-to-equity ratio and the double-leverage ratio of the holding company, especially when the proceeds are contributed to the subsidiary. The double-leverage ratio is calculated by dividing the parent’s equity investment in the subsidiary by the parent’s total equity. A holding company generally is considered to have double leverage when this ratio exceeds 100 percent, and high levels of double leverage may raise supervisory concerns.
- **Ability to service debt** – Examiners will evaluate parent holding company cash flow to ascertain whether there is adequate cash flow for the holding company to make interest payments. To the extent the holding company plans to rely on dividends from the subsidiary, examiners will analyze the subsidiary’s existing and projected earnings and capital positions. A holding company’s overreliance on such dividends may become a

concern when the subsidiary's capital position is weakened or when its earnings decline to the point when dividends from the subsidiary are restricted by the bank's regulator.

- **Tier 2 treatment** – For holding companies not subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement, examiners will review capital on a consolidated basis. For these holding companies, subordinated debt may count as tier 2 capital if it satisfies the qualification requirements under the Board's capital rule. For holding companies subject to the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement, consolidated capital requirements are not applicable and thus an examiner will not review whether the subordinated debt qualifies as tier 2 capital. Nonetheless, examiners may still analyze the impact of the debt on the holding company. In addition, holding companies may want to confirm that newly incurred debt qualifies as tier 2 capital under the Board's capital rule in the event that growth of the holding company crosses the asset threshold for that rule.
- **Enforcement actions** – A holding company under a regulatory enforcement action likely will need to obtain prior written approval before incurring debt, as well as to pay interest and redeem subordinated debt.

### ***3.4 Regulatory Capital in Excess of Regulatory Minimums and Buffers***

A requirement of the capital rule is that a banking organization must maintain capital commensurate with the level and nature of all risks to which the banking organization is exposed. A banking organization typically operates with capital levels above the minimum requirements to align the organization's capital with its risk profile. A banking organization must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital. The amount of regulatory capital held in excess of regulatory capital minimums should reflect the risk tolerance and risk appetite of the management of MDI and CDFI banking organizations.

Therefore, when raising new capital to fund investment in new assets, an MDI or CDFI banking organization should take into account how these actions affect the assessment of its overall capital adequacy.