

April 2, 2020

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director

SUBJECT: Regulatory Capital Rule: Temporary Changes to the Community Bank Leverage Ratio Framework and Transition

SUMMARY: To implement section 4012 of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), staff is presenting for approval of the Federal Deposit Insurance Corporation (“FDIC”) Board of Directors (“FDIC Board”) a request to adopt and publish the attached interagency interim final rule (“statutory interim final rule”) to make temporary changes to the community bank leverage ratio framework in the regulatory capital rule of the FDIC, Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (together, the “agencies”). Specifically, the statutory interim final rule would temporarily establish a community bank leverage ratio requirement equal to or greater than 8 percent and a two-quarter grace period for a qualifying community banking organization that falls below the 8 percent community bank leverage ratio requirement, so long as the banking organization maintains a leverage ratio equal to or greater than 7 percent. The statutory interim final rule will cease to be effective as of the earlier of the termination date of the national emergency concerning the coronavirus disease (“COVID-19”) emergency declared by the President on March 13, 2020, under the National Emergencies Act; or December 31, 2020.

In addition, staff is presenting for approval of the FDIC Board the attached separate and concurrent interagency interim final rule (“transition interim final rule”) that would provide

Concur:

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certainty that the community bank leverage ratio requirement would remain at 8 percent through December 31, 2020 and would provide a graduated transition to a community bank leverage ratio of 9 percent from the temporary 8 percent community bank leverage ratio requirement (“transition interim final rule”). The transition interim final rule would provide community banking organizations with sufficient time and clarity to meet the 9 percent leverage ratio requirement under the community bank leverage ratio framework while they also focus on supporting lending to creditworthy households and businesses given the recent strains on the U.S. economy caused by the COVID-19 emergency.

Recommendation: Staff requests that the FDIC Board approve these separate and concurrent interagency interim final rules and authorize their publication in the *Federal Register* with an effective date as the date of publication and a comment period that closes 45 days after publication.

Discussion:

I. Background on the Community Bank Leverage Ratio Framework

The community bank leverage ratio framework provides a simple measure of capital adequacy for community banking organizations that meet certain qualifying criteria. The community bank leverage ratio framework implements section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (“section 201 of EGRRCPA”), which requires the agencies to establish a community bank leverage ratio requirement of not less than 8 percent and not more than 10 percent for qualifying community banking organizations.¹ Under section

¹ Pub. L. 115-174, 132 Stat. 1296, 1306–07 (2018) (codified at 12 U.S.C. 5371 note). The authorizing statutes use the term “qualifying community bank,” whereas the regulation implementing the statutes uses the term “qualifying community banking organization.” The terms

201(c) of EGRRCPA, a qualifying community banking organization that exceeds the community bank leverage ratio requirement, as established by the agencies, shall be considered to have met the generally applicable risk-based and leverage capital requirements in the capital rule (“generally applicable rule”), any other applicable capital and or leverage requirements, and, if applicable, the “well capitalized” ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Section 201(b) of EGRRCPA also requires the agencies to establish procedures for the treatment of a qualifying community banking organization that falls below the community bank leverage ratio requirement as established by the agencies.

In 2019, the agencies issued a final rule establishing the community bank leverage ratio framework, which established a community bank leverage ratio of 9 percent using the existing leverage ratio (“2019 final rule”).² A qualifying community banking organization that maintains a leverage ratio of greater than 9 percent and elects to use the community bank leverage ratio framework will be considered to have satisfied the generally applicable rule and any other applicable capital and or leverage requirements, and, if applicable, will be considered to be well capitalized.³

generally have the same meaning. Section 201(a)(3) of EGRRCPA provides that a qualifying community banking organization is a depository institution or depository institution holding company with total consolidated assets of less than \$10 billion that satisfies such other factors, based on the banking organization’s risk profile, that the agencies determine are appropriate. This determination shall be based on consideration of off-balance sheet exposures, trading assets and liabilities, total notional derivatives exposures, and any other such factors that the agencies determine appropriate.

² 84 FR 61776 (November 13, 2019).

³ Under existing PCA requirements applicable to insured depository institutions, to be considered “well capitalized” a banking organization must demonstrate that it is not subject to any written agreement, order, capital directive, or as applicable, prompt corrective action directive, to meet

Under the 2019 final rule, a qualifying community banking organization is any depository institution or depository institution holding company that has less than \$10 billion in total consolidated assets, 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 trading assets and liabilities of 5 percent or less of total consolidated assets. The banking organization also cannot be an advanced approaches banking organization.⁴

In addition, the 2019 final rule established 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-9-percent leverage ratio requirement, generally would still be considered well capitalized so long as the banking organization maintains a leverage ratio greater than 8 percent. A banking organization that either fails to meet all the qualifying criteria within the grace period or fails to maintain a leverage ratio of greater than 8 percent is required to comply with the generally applicable rule and file the appropriate regulatory reports.

II. Section 4012 of the Coronavirus Aid, Relief, and Economic Security Act

On March 27, 2020, the CARES Act was signed into law.⁵ The CARES Act directs the agencies to issue an interim final rule that provides that, for purposes of section 201 of

and maintain a specific capital level for any capital measure. See 12 CFR 324.403(b)(1)(v). The same legal requirements would continue to apply under the community bank leverage ratio framework.

⁴ A banking organization is an advanced approaches banking organization if it (1) is a global systemically important bank holding company, (2) is a Category II banking organization, (3) has elected to be an advanced approached banking organization, (4) is a subsidiary of a company that is an advanced approaches banking organization, or (5) has a subsidiary depository institution that is an advanced approaches banking organization. See 12 CFR 324.100.

⁵ Coronavirus Aid, Relief, and Economic Security Act, Pub. L. 116-136, § 4012, 134 Stat. 281.

EGRRCPA, the community bank leverage ratio shall be 8 percent and that a qualifying community banking organization that falls below the community bank leverage ratio requirement established under the CARES Act shall have a reasonable grace period to satisfy that requirement. A qualifying community banking organization to which the grace period applies may continue to be treated as a qualifying community banking organization and shall be presumed to satisfy the capital and leverage requirements described in section 201(c) of EGRRCPA.

Under section 4012 of the CARES Act, this interim final rule is effective during the period beginning on the date on which the agencies issue the interim final rule and ending on the sooner of the termination date of the national emergency concerning the coronavirus disease emergency declared by the President on March 13, 2020, under the National Emergencies Act; or December 31, 2020 (termination date).

III. Statutory Interim Final Rule

In accordance with section 4012 of the CARES Act, the statutory interim final rule makes certain temporary changes to the community bank leverage ratio framework. Effective as of the issuance of this interim final rule, the community bank leverage ratio will be 8 percent until the termination date of the statutory interim final rule. A banking organization with a leverage ratio equal to or greater than 8 percent (and that meets the other qualifying criteria) may elect to use the community bank leverage ratio framework during the time the interim final rule is in effect.

In addition, under the statutory interim final rule, a community banking organization that temporarily fails to meet any of the qualifying criteria, including the 8 percent community bank leverage ratio requirement, generally would still be considered well-capitalized so long as the

banking organization maintains a leverage ratio equal to or greater than 7 percent. A banking organization that fails to meet the qualifying criteria after the end of the grace period or reports a leverage ratio of less than 7 percent will be required to comply with the generally applicable rule and file the appropriate regulatory reports.⁶ Consistent with the CARES Act, the interim final rule would not make any changes to the other qualifying criteria in the community bank leverage ratio framework.

The agencies adopted in the 2019 final rule a two-quarter grace period with a leverage ratio requirement that is 100 basis points below the community bank leverage ratio requirement on the basis that these requirements appropriately mitigate potential volatility in capital and associated regulatory reporting requirements based on temporary changes in a banking organization's risk profile from quarter to quarter, while capturing more permanent changes in a banking organization's risk profile. Staff of the agencies continue to believe that this approach is appropriate and provides a qualifying community banking organization that falls below the 8 percent community bank leverage ratio requirement a reasonable amount of time to satisfy that requirement, consistent with section 4012 of the CARES Act.

IV. Transition Interim Final Rule

Under section 4012 of the CARES Act, the statutory interim final rule could cease to be effective at any time before December 31, 2020. To provide clarity to community banking organizations that are planning to elect to use the community bank leverage ratio framework and sufficient time to meet a 9 percent community bank leverage ratio requirement while they also

⁶ Consistent with the 2019 final rule, a banking organization that ceases to satisfy the qualifying criteria as a result of a business combination also will receive no grace period and will be required to comply with the generally applicable rule.

focus on supporting lending to creditworthy households and businesses, the transition interim final rule would provide a graduated transition to a community bank leverage ratio of 9 percent from the temporary 8 percent community bank leverage ratio requirement, mandated under the CARES Act. The transition interim final rule would be consistent with the agencies' authority under section 201 of EGRRCPA (which mandates a community bank leverage ratio of not less than 8 percent and not more than 10 percent). Specifically, the transition interim final rule would provide that community bank leverage ratio requirement will be 8 percent in the second through fourth quarters of calendar year 2020,⁷ 8.5 percent in calendar year 2021, and 9 percent in calendar year 2022. The transition interim final rule also would modify the two-quarter grace period for a qualifying community banking organization to take into account the graduated increase in the community bank leverage ratio requirement. The transition interim final rule would not modify the other qualifying criteria in the community bank leverage ratio framework.

Based on reported data as of December 31, 2019, there are 5,258 banking organizations with less than \$10 billion in total consolidated assets. The agencies estimate that approximately 95 percent of these banking organizations would qualify to use the community bank leverage ratio framework under the 8 percent calibration and other qualifying criteria. The agencies estimate that approximately 91 percent of such banking organizations would qualify to use the

⁷ The transition interim final rule would extend the 8 percent community bank leverage ratio through December 31, 2020, in the event the statutory interim final rule terminates before December 31, 2020. Section 201 of EGRRCPA requires a qualifying community banking organization to exceed the community bank leverage ratio established by the agencies in order to be considered to have met the generally applicable rule, any other applicable capital and or leverage requirements, and, if applicable, the "well capitalized" capital ratio requirements, whereas section 4012 of the CARES Act requires a qualifying community banking organization to meet the community bank leverage ratio with a leverage equal to or greater than 8 percent. Thus, under the transition interim final rule, to the extent the statutory interim final rule terminates prior to December 31, 2020, a qualifying community banking organization must have a leverage ratio greater than 8 percent to use the community bank leverage ratio framework.

community bank leverage ratio framework under the 8.5 percent calibration and other qualifying criteria.

Consistent with section 201(c) of EGRRCPA, under the transition interim final rule, a qualifying community banking organization that temporarily fails to meet any of the qualifying criteria, including the applicable community bank leverage ratio requirement, generally would still be deemed well-capitalized so long as the banking organization maintains a leverage ratio of the following: greater than 7 percent in the second through fourth quarters of calendar year 2020, greater than 7.5 percent in calendar year 2021, and greater than 8 percent in calendar year 2022 and thereafter.⁸ A banking organization that fails to meet the qualifying criteria after the end of the grace period or reports a leverage ratio equal to or less than 7 percent in the second through fourth quarters of calendar year 2020, equal to or less than 7.5 percent in calendar year 2021, or equal to or less than 8 percent in calendar year 2022 and thereafter, would be required to comply immediately with the generally applicable rule and file the appropriate regulatory reports.⁹

As with the 2019 final rule and the statutory interim final rule, staff of the agencies believe that a two-quarter grace period with a leverage ratio requirement that is 100 basis points

⁸ While the statutory interim final rule is in effect, a qualifying community banking organization that temporarily fails to meet any of the qualifying criteria, including the applicable community bank leverage ratio requirement, generally would still be deemed well-capitalized so long as the banking organization maintains a leverage ratio equal to or greater than 7 percent. Similarly, while the statutory interim final rule is in effect, a banking organization that fails to meet the qualifying criteria after the end of the grace period or reports a leverage ratio less than 7 percent must comply immediately with the generally applicable rule and file the appropriate regulatory reports.

⁹ In addition, consistent with the 2019 final rule, a banking organization that ceases to satisfy the qualifying criteria as a result of a business combination also will receive no grace period and will be required to comply with the generally applicable rule.

below the community bank leverage ratio requirement is appropriate and provides a qualifying community banking organization that falls below the applicable community bank leverage ratio requirement a reasonable amount of time to satisfy that requirement. This approach would be consistent with section 201(b)(2) of EGRRCPA, which directs the agencies to establish procedures for the treatment of a qualifying community bank that has a community bank leverage ratio that falls below the required community bank leverage ratio.

Conclusion:

Staff requests that the FDIC Board approve these separate and concurrent interim final rules and authorize their publication in the *Federal Register* with an effective date as the date of publication and a comment period that closes 45 days after publication.

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