Community Bank Leverage Ratio Framework
FDIC Staff Discussion - Questions and Answers
February 25, 2020

Suzanne Clair: We have a number of questions that we received earlier and a couple that we had received on the industry or the interagency [Community Bank Leverage Ratio (CBLR)] call in November where we weren't able to address them on the line. So with that, I'll turn it back over to Ben.

Benedetto Bosco: Thanks Suzie, so one of the questions is, **"If capital, surplus and retained earnings are less than 9 percent, but with 100 percent of the allowance for loan and lease losses would be 9 percent, does the bank meet the 9 percent CBLR ratio?"** The answer to that is no. The CBLR ratio is calculated the same way as the current Tier 1 leverage ratio and the existing calculation of Tier 1 does not include the allowance for loan and lease losses. Therefore, also under the CBLR you would not be able to include any portion of the allowance of allowance for loan and lease losses.

Benedetto Bosco: We've also received another question, **"Are Federal Home Loan Bank or FHLB letters of credit counted in the off-balance sheet exposures calculation?"** So the answer to that is "no." Letters of credit extended by the FHLB and provide to the bank are not included in the off-balance sheet criteria in the CBLR.

In general, the off-balance sheet criterion captures off-balance sheet exposures that are multiplied by a positive credit conversion factor under the general applicable rule including risk-weighted assets. Letters of credit from the FHLB are not included in the risk-based capital calculation because when a bank draws on a FHLB letter of credit but provides to the bank and liability is created, which in this case does not require risk weighting.

Benedetto Bosco: Another question that we've received is **"How is a liability for a credit enhancement obligation under the FHLB Mortgage Partnership Finance Program or the MPF Program reflected under the CBLR framework?"** The answer is that if the credit enhancement meets the definition of a credit-enhancing representation and warranty, it would otherwise be considered an off-balance sheet securitization under the generally applicable rule. The exposure amount would be included in the off-balance sheet criteria.

For example, some FHLB programs limit the amount of the banks' credit enhancement obligation. If this is the case, only the exposure amount of the remaining credit-enhancing obligation would be included in the off-balance sheet criteria. If the warranty is not limited, then the entire exposure amount would be included in the off-balance sheet criteria.

Suzanne Clair: We've also received a number of questions about **"How CRE and other loan concentrations will be calculated under the CBLR framework?"** The agencies recognize that for institutions that choose the CBLR option there will be an impact on certain asset concentration calculations in the absence of total capital.

And we are discussing with the other agencies how to address to ensure consistency across all institutions. Included in those discussions is a desire to minimize any potential regulatory burden that could arise if electing banking organizations subsequently decide to switch between the CBLR framework and the generally applicable capital rule. These conversations are ongoing and we are striving to get more clarity to the industry in the very near term.

Suzanne Clair: We've also received this question – **“What if a bank is a subsidiary of a holding company that has less than 10 billion in total assets? The bank also has less than 10 billion in assets.**” This situation assumes that the holding company is not an Advanced Approaches banking organization and that neither is the bank. As long as the other qualifying criteria are met along with the CBLR requirements, both would qualify for an opt-in election into the CBLR framework.

Suzanne Clair: In a related question to that previous one is - **“What if there are two banks that are subsidiaries of a holding company that has more than 10 billion in total assets but is not an Advanced Approaches holding company?”** If each of the subsidiary banks has less than 10 billion in total assets, each could qualify for the CBLR framework. The holding company though can't elect the framework and has to do risk-based capital under the generally applicable capital rules because it has more than 10 billion in total assets.

Benedetto Bosco: One other previously received question before we go into the questions that are being submitted and as we are speaking actually. The question is **– “How did the Simplifications capital final rule affect CBLR banks?”**

Banking organizations electing to use the CBLR framework would incorporate the changes made by the capital Simplification's final rule when calculating fuel and capital would include an increase in individual regulatory limit threshold deduction limit from mortgage servicing assets and certain deferred tax assets from 10 percent to 25 percent of a non-Advanced Approaches banking organization's common equity Tier 1 capital.

In addition to capital Simplifications final rule removed, the aggregate 15 percent common equity Tier 1 capital threshold reduction can streamlined the treatment for investments in the capital of the unconsolidated financial institutions and it simplified the calculation for minority interest limitations for non-Advanced Approaches banking organizations.

These rules apply whether you're on the CBLR framework or you're on the risk-based framework and I've said in the as part of the presentation, the Tier 1 calculations are similar apart from the potential effect of Tier 2 deductions which for CBLR bank you're not required to calculate Tier 2 or identify any Tier 2 deductions.

Benedetto Bosco: One of the questions is – **"If a bank opts out, are there any changes to the way a bank calculates their capital ratios?"** What we were trying to say as part of the presentation is in the CBLR [framework] what we use for the community bank leverage ratio itself is the Tier 1 leverage ratio.

You're going to be calculating your Common Equity Tier 1 capital and then the Additional Tier 1 capital. Those two elements combined give you your Tier 1 which is going to be similar to the same Tier 1 capital that you have under your risk-based rule. But if you're a CBLR bank, you can stop at Tier 1 rather than [continuing the calculations] if you are a non-CBLR bank.

So a bank that wants to continue to use a risk-based framework, you would then have to calculate Tier 2. You have to calculate your Total Capital ratio and you'd then have to calculate all your risk-weighted assets to calculate all of your risk-weighted capital ratios.

There's not really a difference between the two Tier 1[ratio]s. But if you're a CBLR bank you can stop at Tier 1. Whereas if you elect to, if you want to continue to use the risk-based capital framework, you have to then calculate all the requirements that the risk-based requirement imposes on banking organizations.

Benedetto Bosco: So we received another question. “**What effect does following the CBLR framework have on a banking institution which meets all the eligibility criteria? The loans that are designated as HVCRE or HVADC loans. Would HVCRE or HVADC loans still need to be disclosed on the Call Report assuming the bank is designated as a well-capitalized bank?”**

If you're on the CBLR framework, you do not have to calculate risk-weighted assets. And therefore you would not, for your regulatory capital purposes, have to identify which loans are HVCRE because the only reason under the capital rule is you identify each HVCRE loan is to identify which loans get a high-end 150 percent risk rate and which HVADC or HVCRE loans can get a 100 percent risk weight.

There is no risk weighting under the CBLR framework. That is one of the simplifications that a banking organization can enjoy as part of the CBLR framework. Therefore, for capital purposes, you're not going to have to identify which loans in your ADC portfolio is HVCRE or HVADC.

Although to the extent that you have to report a portion of your portfolio as a construction loan or ADC loan they will show on schedule RC-C in the Call Report and the requirements to identify and to report your construction loans - those reporting requirements [still] exist. But from a capital perspective, a bank on the CBLR - that meets all the eligibility criteria and they elect to use a CBLR- are not going to have to identify any HVCRE loans.

Benedetto Bosco: **We've gotten some questions about [accessing] the slides.** The slides should be posted today. The recording of this webinar will take a little additional time, but the slides should be posted today and can be found on www.FDIC.gov. If you go to the FDIC website and you search for Regulatory Capital, the Regulatory Capital webpage, you'll be able to identify or find the Regulatory Capital webpage. You go to that link and then you should immediately see the slides for this presentation. Again, we hope to have it up later today.

Suzanne Clair: Another question: **"Does the opt-in or opt-out decision need to be in our policy?"** There's no requirement for that – that the bank's policy or strategic plan include it. You can reference it [at management's discretion], but there's no requirement that you have it in the policy.

Benedetto Bosco: Another question that we received today deals with **"How are financial assets sold with recourse treated with respect to the 25 percent off-balance sheet exposure?"** The answer is that a bank should look to the capital rule definition of credit-enhancing representations and warranties.

So if you sold a financial asset with recourse and that transaction meets the definition of a credit-enhancing representation and warranty in the capital rule, then you would have to include the total amount of that exposure amount in the off-balance sheet qualifying criteria exposure amount. But I'd like to note, if you look at the definition there are exclusions from what is considered a credit-enhancing representation and warranty. What I'm going to read now comes from capital rule addressing exposures that are not considered credit-enhancing representations and warranties. [See FDIC Rules and Regulations Part 324.2 - Definitions]

If there are early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1-4 family residential first mortgage loans that qualify for a 50 percent risk rate for a period not to exceed 120 days from date of transfer. These warranties may cover only those loans that originated within one year of the date of transfer;
The premium refund clauses that cover assets guaranteed, in whole or in part,

by the US government, a US government agency, or a GSE, provided the premium refund clauses are for a period not to exceed 120 days from date of transfer; or warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

What I just read are these are things that are not considered credit-enhancing reps and warranties and therefore they should not be included in the 25 percent off-balance sheet exposure qualifying criteria. But again, you should read the definition of credit-enhancing rep and warranty contained in the capital rule and if it meets that definition but not one of these exclusions, then it would have to be included in the off-balance sheet criteria.

Benedetto Bosco: A question that we get sometimes, which is difficult for us to answer, asks **"What are the pros and cons or the advantages or the disadvantages of opting into the CBLR?"** The best response would be that the agency has implemented the CBLR following Section 201 - or consistent with Section 201 of the Economic Growth Relief and Consumer Protection Act.

Congress passed a law and then that directed us to write a rule to implement the CBLR into our capital regulations. And that is what the agency did. CBLR is an optional framework for banks to opt into if they meet all the qualifying criteria. And if you do that we try to set up a framework that is a simpler way to calculate your regulatory capital ratio requirements.

Under the CBLR, you don't calculate risk-weighted assets, so RC-R Part 2 [of the Call Report] where you report all your HVCRE loans and retail exposures and corporate exposures - you're not going to have to fill it out. You don't have to risk weight. You just have your Tier 1 capital calculation, which you have all calculated for a while, over average assets - and you have a single ratio as opposed to having multiple ratios.

It is set up to be a simpler framework, and it's really up to the bank, based upon their own facts and circumstances. It's up to your board, your management [to do] what you think is the most appropriate way forward for your bank.

We're not really in the position to say [whether a bank should decide to elect the framework or pros and cons of electing]. We didn't set one framework out to be better or worse than the other, or as disadvantaging or advantaging you. It's really an optional framework that allows the bank to calculate the capital requirement in a much simpler fashion.

That was the intention. That's what we tried to set out to do and we encourage every institution to read the rule, understand it, ask us questions, and if you think it's appropriate then you should use it. But of course, it's optional and if you don't want to use it you can also continue to do the risk-based capital requirements.

Suzanne Clair: **We've got a question if it's possible to get the responses in written form.** What we'll do is we'll post the script, but it takes time to have the recording transcribed. And then we clean that and we have to have the webinar recording and the script all acceptable. So once we get that and I believe we will be able to have the script included with the other links and materials on our web page.

With that, I think we'll just close out today's webinar. And I want to thank everybody for their time this afternoon and the operator for facilitating for us.