Banker Teleconference

Proposed Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996

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Introduction

On September 27, 2017, the Federal banking agencies issued a proposed rule for purposes of simplifying certain requirements in the agencies' regulatory capital rule (simplifications NPR).

The comment period will close 60 days after publication in the Federal Register.

During today's teleconference and webinar, staff from the Federal banking agencies will provide an overview of the proposed rule and answer questions.

This teleconference is intended to help interested parties better understand the outstanding proposed rulemaking. Thus, the Federal banking agencies welcome any questions today to help clarify the contents of the proposal. Comments relating to the substance of the proposal that are received by the Federal banking agencies during the call will be incorporated into the rulemaking record so that they can be properly considered and addressed as part of the rulemaking process. The Federal banking agencies encourage interested parties to also submit any comments on the proposal to the agencies' respective public dockets.

Submit questions during the call to RAC@fdic.gov

Key Aspects of the Proposed Rulemaking

The proposed rule would:

- Replace the definition of high volatility commercial real estate (HVCRE) exposures in the agencies' standardized approach of the agencies' capital framework with a revised definition for acquisition, development, or construction (ADC) loans called high volatility acquisition, development, or construction (HVADC) exposures.

- Simplify, for non-advanced approaches banking organizations, the capital rule's treatment of:
  - Mortgage servicing assets (MSAs);
  - Temporary difference deferred tax assets not realizable through carryback (temporary difference DTAs);
  - Investments in the capital of unconsolidated financial institutions; and
  - Minority interest.

Proposed HVADC Exposure Definition

HVADC exposure 130% Risk Weight = **Credit facilities that *primarily finance or refinance* ADC activities**

Except

- **1-4 Family Residential Properties**
- **Community Development Loans**
- **Permanent Loans***
- **Purchase or Development of Agricultural Land**

- Proposal grandfathers current HVCRE exposure definition and treatment for loans originated on or before the effective date of any final rule.
- Maintains exemptions for loans that finance agricultural land, simplifies the exemption for facilities financing Community Development projects, and clarifies exemptions for facilities financing 1-4 family residential properties and permanent loans.
- Removes the exemption for loans that finance projects with substantial borrower contributed capital.

* Please see page 5 for new HVADC definition

Proposed HVADC Exposure definition

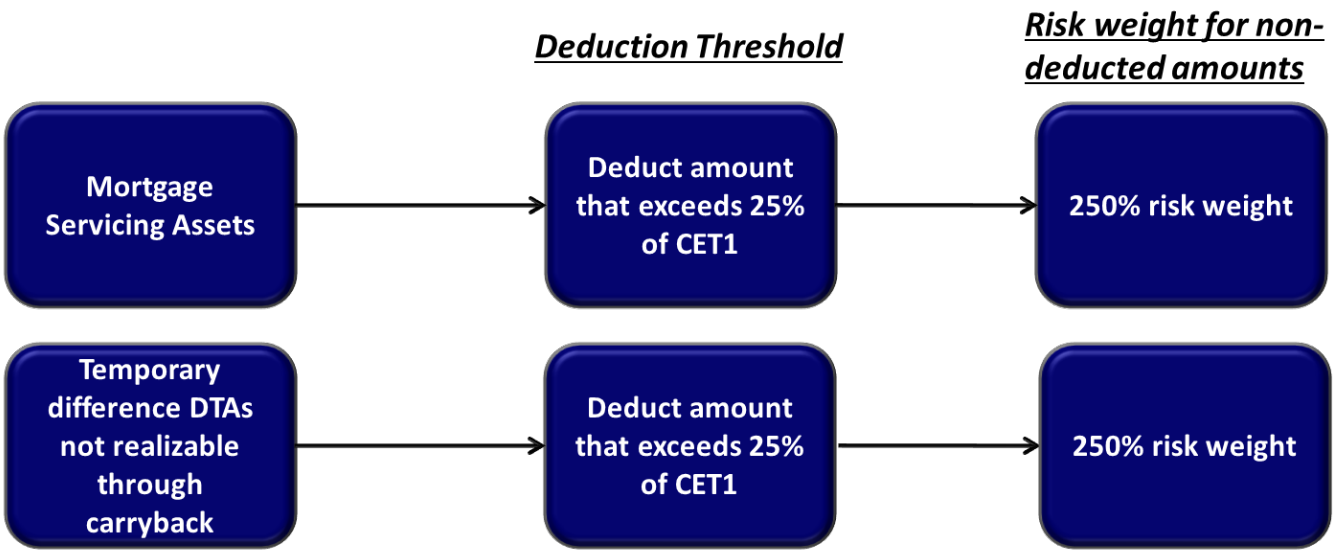
- HVCRE exposure category in the standardized approach would be replaced with HVADC exposure category.
- HVADC exposure is a purpose-based definition that applies to credit facilities that *primarily* (>50%) finance or refinance ADC activities.
- HVADC exposures would receive a 130% risk weight vs. 150% risk weight for HVCRE exposures.
- Maintains several exemptions that currently apply to certain ADC exposures – meaning that certain ADC exposures would continue to receive a 100% risk weight.
- HVCRE grandfathering:
  - Treatment for loans originated before the effective date of any final rule that meet the current HVCRE definition would be grandfathered.
  - ADC exposures currently exempt from the treatment for HVCRE exposures would continue to receive a 100% risk weight. HVCRE exposures would continue to receive a 150% risk weight.

New HVADC Definition

	Key Clarifications	Impact	HVADC	Not HVADC
Scope	**Primarily finance**	Multipurpose facilities where more than 50% of loan proceeds finance non-ADC activities		✓
Exemptions	***One- to four-family residential properties***	• Lot development loans and loans to finance the ADC of townhomes or row homes		✓
	Community development loans	• Real property projects that have the primary purpose of "community development" • Loans to finance activities that promote economic development by financing businesses or farms that meet the size eligibility standards of certain SBA programs or have gross annual revenues of $1 million or less		✓
	Permanent loan means a prudently underwritten loan that has a clearly identified ongoing source of repayment sufficient to service amortizing principal and interest payments aside from the sale of the property	Bridge loans generally are not considered to be "permanent loans"	✓	
		Owner-occupied ADC projects may have sufficient capacity at origination to repay the loan from ongoing operations, in which case the loan would be considered a "permanent loan"		✓
		Interest-only loans where the bank has identified a source of repayment that is sufficient to service an amortizing payment		✓

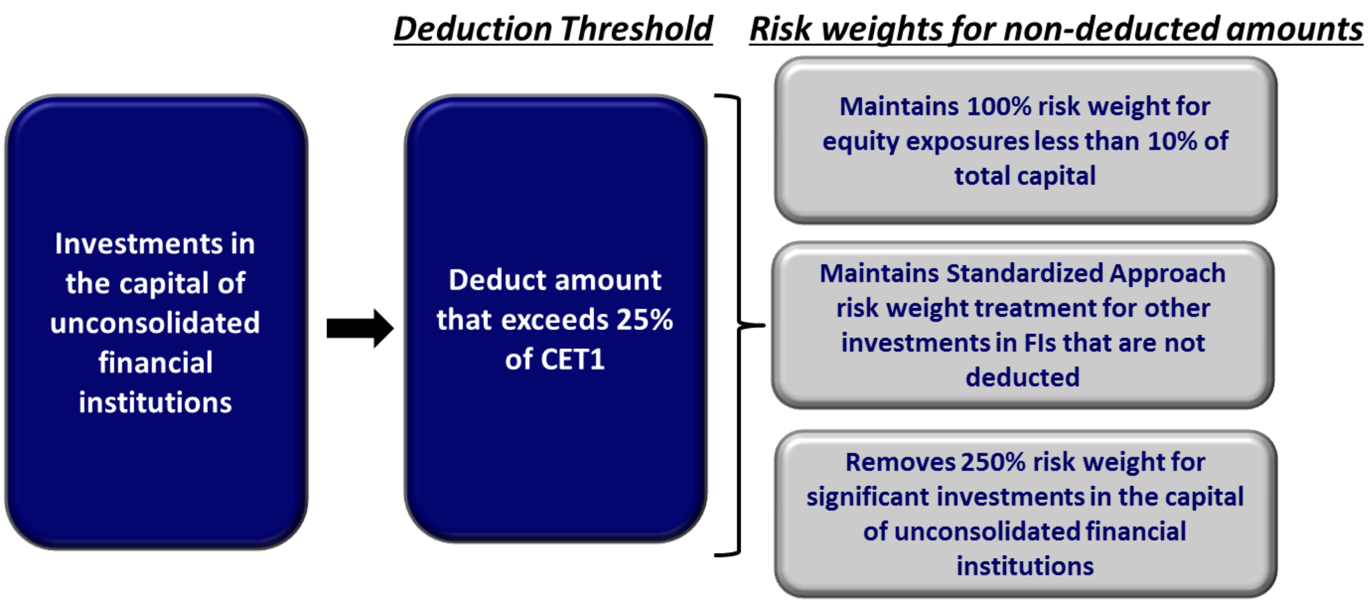
Treatment of exposures subject to CET1 Deduction Thresholds under the proposal

- **For banking organizations that are not subject to the capital rule's advanced approaches, the proposal increases the individual limit on MSAs and temporary difference DTAs from 10% to 25% of common equity tier 1 capital (CET1).**
  - Any amount exceeding this limit would be deducted from CET1 and any amount not deducted would be assigned a 250% risk weight.
  - No change in definitions for MSAs or temporary difference DTAs.
  - The capital rule's aggregate 15% common equity tier 1 capital deduction threshold would be eliminated.



Treatment of investments in the capital of unconsolidated financial institutions

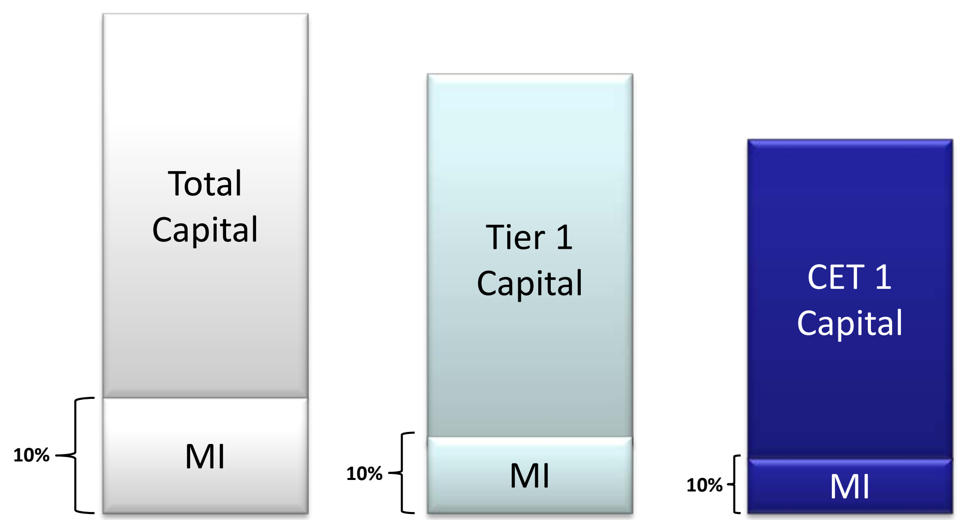
- **For banking organizations that are not subject to the capital rule's advanced approaches, the proposal removes the distinction between significant and non-significant investments in the capital of unconsolidated financial institutions — It implements an individual limit of 25% of common equity tier 1 capital on all investments in the capital of unconsolidated financial institutions.**
  - Any amount exceeding the 25% limit would be deducted from regulatory capital and any amount not deducted would be risk weighted according to the relevant treatment for the exposure category of the investment.



Limitations on minority interest includable in regulatory capital

- For banking organizations that are not subject to the capital rule's advanced approaches, the proposal eliminates the existing complex calculation of minority interest limitations.
- Banking organizations would be allowed to include CET1 minority interest, tier 1 minority interest, and total capital minority interest up to 10% of the parent banking organization's CET1, tier 1, and total capital elements, before the inclusion of minority interest.

Regulatory Capital Stack with Includable Minority Interest (MI)



Transitions NPR

- In August 2017, in anticipation of this proposal, the banking agencies invited public comment on a proposed rule to extend for non-advanced approaches banking organizations the capital rule's transitional provisions for MSAs, temporary difference DTAs, and investments in the capital of consolidated financial institutions and certain minority interest limitations (transitions NPR).

- The transitions NPR would avoid a situation whereby non-advanced approaches banking organizations would fully phase-in certain requirements in the current capital rule that may be changed due to the simplifications NPR.

- Comment period closed on September 25, 2017 and the agencies are currently reviewing comments received.

Comments on Capital Simplifications

- The agencies seek comment on the modifications to the capital rule proposed in the NPR as well as broad comment on other potential simplifications to the capital rule.

Thank You

Additional Resources

- Summary of the proposed EGRPRA Simplifications to the Capital Rule for Community Banks

- Questions directed to the FDIC can be emailed to **regulatorycapital@fdic.gov**

- Questions directed to the OCC can be emailed to **CapitalPolicy@occ.treas.gov**

- Questions directed to the Federal Reserve Board can be emailed to **questions@askthefed.org**

Questions?

Submit questions during the call to RAC@fdic.gov