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Transmittal – See OCC 2020-11

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Simplifications to the Capital Rule: Notice of Proposed Rulemaking

Summary

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the agencies) are seeking comment on a proposed rule that would simplify certain aspects of the capital rule. The majority of the proposed simplifications would apply solely to banking organizations that are not subject to the advanced approaches capital rule (the advanced approaches capital rule generally applies to banks that are part of banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total consolidated foreign financial exposure).

Specifically, this proposed rule would (1) replace the complex treatment of high-volatility commercial real estate (HVCRE) exposures with a more straightforward treatment for most acquisition, development, or construction loans; (2) simplify the current regulatory capital treatment for mortgage servicing assets (MSA), temporary difference deferred tax assets (DTA), and holdings of regulatory capital instruments issued by other financial institutions; and (3) simplify the current limitations on minority interest includable in regulatory capital. In addition, the proposed rule would make certain technical amendments that would apply to all banks.

To

Chief Executive Officers of All National Banks and Federal Savings Associations, Department and Division Heads, All Examining Personnel, and Other Interested Parties

Note for Community Banks

The proposed rule applies to all national banks and federal savings associations (collectively, banks), including community banks.

Highlights

- With regard to treatment of real estate acquisition, development, and construction lending:
  - The agencies are proposing to replace the HVCRE exposure definition in the standardized approach with a new term, high volatility acquisition, development, or construction (HVADC) exposure. The definition of HVADC exposure should be simpler to apply than the current HVCRE exposure definition.
  - The definition of HVADC exposure generally is expected to cover a broader range of exposures than the current definition of HVCRE exposure. Accordingly, the agencies are proposing to apply a lower risk weight to the proposed HVADC exposure category. The proposed risk weight for HVADC exposures would be 130 percent, a reduction from the 150 percent risk weight

that currently applies to HVCRE exposures under the capital rule's standardized approach.

  - The proposed HVADC exposure definition is simpler to implement than the HVCRE exposure definition because it removes the contributed capital exemption and eliminates the requirement that internally generated capital must stay in the project for the life of the project.
  - To mitigate the potential burden of requiring banks to re-evaluate all of their ADC exposures using the new HVADC exposure definition, the proposal contains a grandfathering provision for exposures originated prior to the effective date of the revisions.
  - The agencies are not proposing to replace the definition of HVCRE exposure in the advanced approaches. Under the proposal, advanced approaches banks would continue to apply the definition of HVCRE exposure when calculating their advanced approaches risk-weighted assets.
  - Additionally, for purposes of both HVADC and HVCRE exposures, the proposal clarifies that the exemptions for credit facilities that finance one- to four-family residential properties include loans to construct one- to four-family residential structures and loans that combine the land, acquisition, development or construction of one- to four-family structures. For example, credit facilities that finance the construction of one- to four-family residential properties for which no buyer has been identified, as well as lot development loans, would be eligible for the exemptions for credit facilities that finance one- to four-family residential properties.

- With regard to the treatment of MSAs, DTAs, and holdings of regulatory capital instruments issued by other financial institutions:
  - For non-advanced approaches banks, the proposed rule would replace the existing individual 10 percent and cumulative 15 percent common equity tier 1 capital deduction thresholds for MSAs and temporary difference DTAs that cannot be realized through net operating loss carrybacks with individual thresholds of 25 percent of common equity tier 1. Non-advanced approaches banks would be required to deduct from common equity tier 1 capital any amount of these assets that individually exceeds the 25 percent threshold.
  - To reduce complexity for non-advanced approaches banks, the proposal also would replace the current capital rule's different deduction treatments for (i) significant investments in the regulatory capital of other financial institutions in the form of common stock, (ii) significant investments in the regulatory capital of other financial institutions that are not in the form of common stock, and (iii) non-significant investments in the regulatory capital of other financial institutions with one treatment for all investments in the regulatory capital of other financial institutions. Non-advanced approaches banks would be required to deduct from common equity tier 1 capital any amount of its total investments in the regulatory capital of other financial institutions that exceeds 25 percent of common equity tier 1.

- With regard to the inclusion of minority interest in regulatory capital:

- For non-advanced approaches banks, the agencies propose to simplify the calculation for limiting minority interest in regulatory capital. Specifically, the proposal would limit the inclusion of minority interest in regulatory capital as follows: of common equity tier 1 minority interest up to 10 percent of the bank's common equity tier 1 capital; tier 1 minority interest up to 10 percent of the bank's tier 1 capital; and total capital minority interest up to 10 percent of the bank's total capital.

- The proposal would also make several technical amendments to correct and clarify other areas of the capital rule that would apply to all banks.

Background

In 2013, the agencies adopted a rule that strengthened the capital requirements applicable to banking organizations (capital rule). The capital rule increased the quantity and improved the quality of regulatory capital, thereby strengthening the ability of banking organizations to absorb losses in times of market and economic stress.

Since issuance of the capital rule in 2013, banking organizations and other members of the public have raised concerns regarding regulatory burden, complexity, and costs associated with certain aspects of the rule. In response to these concerns, the agencies stated in the March 2017 Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) Joint Report to Congress that they would develop a notice of proposed rulemaking to simplify certain aspects of the capital rule for smaller and less complex banking organizations. Consistent with that commitment, the agencies are inviting public comment on a notice of proposed rulemaking that would simplify compliance with several aspects of the capital rule for community banks.

Further Information

Please contact Mark Ginsberg, Senior Risk Expert, or Benjamin Pegg, Risk Expert, Capital Policy Division, at (202) 649-6370; or Rima Kundnani, Attorney, Legislative and Regulatory Activities Division, at (202) 649-5490.

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Related Link

- "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996" (PDF)