FHLBank Boston

Community Bank Leverage Ratio: Implications for Community Banks

Richard Moran, *Financial Strategist & Account Manager*
Andrew Paolillo, CFA, *Director of Member Strategies & Solutions*

The S. 2155 community bank regulatory reform bill passed last year proposed the creation of a simpler way to measure leverage for community banks. Under the terms of S. 2155, regulatory agencies have the discretion to set a Community Bank Leverage Ratio (CBLR) between eight percent and 10 percent to classify a bank as well capitalized.

The proposal was met with skepticism, as it was not initially clear that adopting the ratio would make strategic sense for all community banks. Many of the comment letters asked regulators to drop the ratio to eight percent from the proposed nine percent level. The tradeoffs between a reduction in the complex risk-based capital rules currently in place and the proposed nine percent required capital level have been a point of discussion.

FHLBank Boston has been following this topic and has gathered the following key points analysis.

What is CBLR?

CBLR allows qualifying bank and thrift institutions with less than $10 billion in assets to measure capital adequacy through a simplified calculation. It was proposed jointly by the Office of the Comptroller of the Currency, Federal Reserve and Federal Deposit Insurance Corporation to ***reduce regulatory burden, complexity, and costs***. The agencies issued a notice of proposed rulemaking in November 2018, and the 60-day comment period closed in early April 2019.

Preliminary research done by FHLBank Boston shows that **more than 75 percent of our member banks meet the nine percent ratio and satisfy the off-balance sheet requirements.** At an eight percent ratio, that figure jumps to 90 percent.

How is CBLR calculated?

$$\frac{\text{Capital} - \begin{matrix}\text{AOCI}\\ \text{Intangible Assets}\\ \text{DTAs}\end{matrix}}{\text{Assets} - \begin{matrix}\text{Intangible Assets}\\ \text{DTAs}\end{matrix}}$$

The CBLR calculation numerator is composed of equity (minority interests excluded) less accumulated other comprehensive income (AOCI), intangible assets, and deferred tax assets (DTAs). The denominator is average total consolidated assets less the same items deducted from the numerator, other than AOCI.

What are the qualifying criteria to use CBLR?

- ***An institution must have assets under $10 billion and meet a minimum CBLR threshold of nine percent.***
- Total off-balance sheet exposures must be 25 percent or less of total consolidated assets. These include unfunded loan commitments, securitization exposures, credit-enhancing representations, and warranties. These do not include non-credit derivatives, such as interest-rate derivatives, and unconditionally cancelable commitments.
- Trading assets and liabilities must be five percent or less of total consolidated assets.
- Mortgage Servicing Assets must be 25 percent or less of CBLR tangible equity.
- DTAs arising from temporary differences that could not be realized through net operating loss carryback, net of any related valuation allowances as a percent of CBLR tangible equity, must be less than or equal to 25 percent.

What if a bank doesn't maintain the criteria?

If a qualifying community bank's CBLR falls below nine percent, it can continue using the CBLR framework. However, classification will shift from well capitalized to adequately capitalized. If the bank fails to satisfy the other requirements, it could use the generally applicable capital rule or use the CBLR framework during a two-quarter grace period. The below chart shows the four current capital standards for a bank to be deemed well capitalized compared to the proposed, simplified CBLR approach. As currently constructed, the CBLR ratio requirement would be higher than the current Tier 1 leverage ratio.

	RBC[1] Generally Applicable Capital Rules				
	Total RBC ratio	Tier 1 RBC ratio	CET1 RBC ratio	Tier 1 Leverage ratio	**CBLR ratio**
Well Capitalized	10%	8%	6.5%	5%	**9.0%**
Adequately Capitalized	8%	6%	4.5%	4%	**7.5%**

[1] Risk-Based Capital

Prompt Corrective Action will occur if a bank falls below a CBLR of six percent. U.S. Senators Mike Crapo, R-Idaho, and Jerry Moran, R-Kansas, have recently asked for more clarity on how the new Prompt Corrective Action framework will work.

A bank that has opted into the CBLR framework can also opt out of it. Once opted out, the institution would need to meet the qualifying criteria and have a CBLR greater than nine percent to opt back into the framework.

What are the benefits to FHLBank Boston members?

Simplicity

CBLR offers qualifying banks a sharp ***reduction in the regulatory burden, complexity, and costs*** involved with Basel III calculations, in addition to greater focus on balance sheet strategies with fewer iterations of capital to consider.

Flexibility with Asset Mix

Members may be able to generate higher returns by investing in loans and securities that carry higher risk weightings under risk-based capital (RBC) standards. For example, consider a bank that has above average Tier 1 capital but below average risk-based capital due to a strong loan-to-asset ratio. Under CBLR, they might have greater flexibility on allocation decisions within the investment portfolio (ex. corporate bonds, or municipal revenue bonds) that would have been more challenging to implement in a risk-based capital framework.

Improvement of MPF Risk-Sharing Program Profile

For certain credit-enhancement obligations resulting from FHLBank Boston's Mortgage Partnership Finance®* (MPF) program which currently carry a risk-based capital cost, removing risk-based capital as a consideration improves the earnings profile of the program. Contact your MPF Relationship Manager to see if your institution could benefit.

More Options for Growth and Profitability

The new ratio could result in a greater excess capital, which allows for leverage capacity using FHLBank Boston advances, potentially spurring additional growth and earnings.

For more information about CBLR, refer to the notice of proposed rulemaking from the Office of the Comptroller of the Currency.

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