AN ALERT FROM THE BDO FINANCIAL INSTITUTIONS & SPECIALTY FINANCE PRACTICE

BDO KNOWS: FINANCIAL INSTITUTIONS & SPECIALTY FINANCE

SUBJECT

FINAL BANK CAPITAL RULES IMPLEMENTED – BASEL III

By Paul Mattaini and Kim Decker, Barley Snyder LLP: Reprinted with authors' permission

BDO Comment: The release of the Basel III final bank capital rules give us a clearer picture of what to expect. Among other things, the new regulations specify minimum capital levels and buffers, and spell out what qualifies as capital. Under the new rules, you are expected to carry capital well above the minimums to cover risk unique to your balance sheet. Now comes the challenging part – assessing your risk, setting capital goals and preparing for the changes. As you schedule your annual planning session, plan on using this time to gauge the impact of the new regulations on your organization and make any necessary adjustments.

After several years in the making, on July 9, 2013, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board (FRB) approved a final rule amending the risk-based regulatory capital framework for U.S. banking organizations. For the most part, the final rule implements the rule as proposed, but with some important changes that lessen the impact of the rule on community banks.

The Basel III framework revises many regulatory capital components and generally raises required ratios. Briefly, the required ratios are as follows:

	Base	CCR	Total
Common Equity Tier 1 Capital (CET1) Ratio	4.5%	2.5%	7.0%
Tier 1 Capital Ratio	6.0%	2.5%	8.5%
Total Capital Ratio	8.0%	2.5%	10.5%
Leverage Ratio	4.0%	–	4.0%

Read more

CONTACT:

JIM CARTER
Partner - Richmond
804-330-3092 / jcarter@bdo.com

DAVE WEISKITTEL
Partner - Grand Rapids
616-776-3766 / dweiskittel@bdo.com

JOEL ROBINSON
Partner - New York
212-885-8415 / jorobinson@bdo.com

ERNIE SAUMELL
Partner - Miami
305-420-8068 / esaumell@bdo.com

PAUL BRIDGE
Partner - Spokane
509-747-8095 / pbridge@bdo.com

ANTHONY FERGUSON
Partner - Los Angeles
310-557-8258 / aferguson@bdo.com

BARRY PELAGATTI
Partner - Philadelphia
215-564-1900 / bpelagatti@bdo.com

TERRY LEHMAN
Director - Harrisburg
717-233-8800t / tlehman@bdo.com

Each of the required ratios, other than the Leverage Ratio, is 2.5 percent higher than indicated above as the Base due to a "capital conservation ratio" of 2.5 percent, consisting entirely of CET1. Failure to meet the capital conservation buffer limits an institution from making discretionary distributions, such as dividends, stock buybacks (with some exceptions) and executive compensation incentive payments. Most banking institutions become subject to the rule on Jan. 1, 2015; larger, international banking institutions become subject to the new rule on Jan. 1, 2014.

The most significant differences between the final rule and the proposed rule are in the following three areas:

- All but the largest banks are permitted to make a one-time, permanent election to opt out of the provisions of the final rule eliminating the "AOCI Filter," which is a provision in existing rules that permits banks to reverse fair value adjustments to shareholders' equity. In other words, upon making the election, banks are permitted to continue to use the AOCI Filter.

- The proposed rule had assigned a higher risk weighting to residential mortgages ranging from 35 percent to 100 percent, depending upon the loan-to-value ratio and the terms of the loan. The final rule retained the current risk weightings for residential loans of 50 percent for high-quality seasoned residential mortgage loans and 100 percent for all other mortgage loans.

- For institutions with total consolidated assets of less than $15 billion at Dec. 31, 2009, trust preferred securities and other non-qualifying Tier 1 capital instruments are permanently grandfathered as components of additional Tier 1 Capital; institutions above this asset level (other than the largest banks) are subject to a phase out of such capital instruments for Tier 1 Capital purposes.

BDO Comment: This rule will affect banks of all sizes. The FDIC has recently released a guide for community banks which highlights the areas of the final rule that will most impact community banks. We at BDO are tracking any further changes or commentary set forth by the OCC, FDIC or FRB on this rule and are helping clients prepare for the new capital requirements. Please contact BDO if you would like to discuss or have questions.