Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

New Capital Rule

Community Bank Guide

July 2013

Note: The agencies revised this guide on July 18, 2013, to correct an error on page 8, Table 4, Comparison of Risk Weights of the Current Rule with the New Rule. The risk weight under the New Capital Rule column was corrected to 0% from Unchanged for the “Claims on certain supranational entities and multilateral development banks” category.

Introduction

This guide is intended to help small, non-complex community banking organizations understand the sections of the capital rule recently adopted by the federal banking agencies (the new rule)[1] most relevant to their operations. This guide summarizes significant changes from the current general risk-based capital rule for exposures commonly held by community banking organizations, and it provides relevant information regarding the treatment of more complex exposures such as securitization exposures, equity exposures, and exposures to a foreign government or bank. Community banking organizations become subject to the new rule on January 1, 2015.

The new rule takes important steps toward improving the quality and increasing the quantity of capital for all banking organizations as well as setting higher standards for large, internationally active banking organizations. The agencies believe that the new rule will result in capital requirements that better reflect banking organizations' risk profiles, thereby improving the overall resilience of the banking system. The agencies have carefully considered the potential impacts on all banking organizations, including community banking organizations, and sought to minimize the potential burden of these changes where consistent with applicable law and the agencies' goals of establishing a robust and comprehensive capital framework.

This guide does not provide complete coverage of the new rule and does not carry the force and effect of law or regulation. In addition to using this guide, community banking organizations should review the portions of the new rule that are relevant to them. The summary tables in this document provide citations to sections in the new rule to allow community banking organizations to efficiently identify the most relevant sections.

The new rule can be found on your primary Federal supervisor's Web site.

Key Changes From the June 2012 Proposals

There are three key changes from the June 2012 proposals in the new rule:

Residential Mortgage Exposures: The proposals included several changes to the treatment for residential mortgage exposures. None of these proposed changes are included in the new rule. The new rule's treatment of one- to four-family residential mortgage exposures remains the same as under the current general risk-based capital rule. This includes a 50 percent risk weight for prudently underwritten first lien mortgage loans that are not past due, reported as nonaccrual, or restructured, and a 100 percent risk weight for all other residential mortgages. Similarly, the new rule does not change the current exclusions from the definition of credit-enhancing representations and warranties.

Accumulated Other Comprehensive Income (AOCI) Filter: The proposals would have required all banking organizations to reflect most AOCI components in regulatory capital. In the new rule, non-advanced approaches banking organizations are given a one-time option to filter certain AOCI components, comparable to the treatment under the current general risk-based

[1] The new rule will be adopted as a final rule and codified at Title 12 of the Code of Federal Regulations (CFR) for the OCC in Part 3 and for the FRB in Part 217. The new rule will be adopted as an interim final rule and codified at Title 12 of the CFR for the FDIC in Part 324.

capital rule. The AOCI opt-out election must be made on the institution's first Call Report, FR Y-9C, or FR Y-9SP, as applicable, filed after January 1, 2015.

Non-Qualifying Capital Instruments and Tier 1 Capital: The proposal would have required trust preferred securities (TruPS) and cumulative perpetual preferred stock to be phased out of tier 1 capital. The new rule exempts depository institution holding companies with less than $15 billion in total consolidated assets as of December 31, 2009, or organized in mutual form as of May 19, 2010, from this requirement. Capital instruments that were issued prior to May 19, 2010, by these institutions and that are currently in tier 1 capital, including TruPS and cumulative perpetual preferred stock, are grandfathered in tier 1 capital, subject to limits. More specifically, consistent with the current requirements, these instruments are limited to 25 percent of tier 1 capital elements, excluding any non-qualifying capital instruments and after all regulatory capital deductions and adjustments have been applied to tier 1 capital.

Major Changes From the Current General Risk-Based Capital Rule

Revisions to the Minimum Capital Requirements and Adjustments to Prompt Corrective Action (PCA) Thresholds: The new rule implements higher minimum capital requirements, includes a new common equity tier 1 capital requirement, and establishes criteria that instruments must meet in order to be considered common equity tier 1 capital, additional tier 1 capital, or tier 2 capital. These enhancements will both improve the quality and increase the quantity of capital required to be held by banking organizations, better equipping the U.S. banking system to deal with adverse economic conditions. The new minimum capital to risk-weighted assets (RWA) requirements are a common equity tier 1 capital ratio of 4.5 percent and a tier 1 capital ratio of 6.0 percent, which is an increase from 4.0 percent, and a total capital ratio that remains at 8.0 percent. The minimum leverage ratio (tier 1 capital to total assets) is 4.0 percent. The new rule maintains the general structure of the current PCA framework while incorporating these increased minimum requirements.

Additional Improvements to the Quality of Regulatory Capital: The new rule improves the quality of capital by implementing changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of instruments such as TruPS in tier 1 capital going forward, and new constraints on the inclusion of minority interests, mortgage-servicing assets (MSAs), deferred tax assets (DTAs), and certain investments in the capital of unconsolidated financial institutions. In addition, the new rule requires that most regulatory capital deductions be made from common equity tier 1 capital.

Capital Conservation Buffer: Under the new rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity tier 1 capital above its minimum risk-based capital requirements (see Table 1). This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to RWA. Phase-in of the capital conservation buffer requirements will begin on January 1, 2016 (see Table 2).

Table 1 summarizes how much a banking organization can pay out in the form of distributions or discretionary bonus payments in a quarter based on its capital conservation buffer. A banking organization with a buffer greater than 2.5 percent would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5 percent would be subject to increasingly stringent limitations as the buffer approaches zero.

Table 1: Payout Restrictions and Capital Conservation Buffer

Capital Conservation Buffer (as a percentage of risk-weighted assets)	**Maximum Payout** (as a percentage of eligible retained income)
Greater than 2.5 percent	No payout limitation applies
Less than or equal to 2.5 percent and greater than 1.875 percent	60 percent
Less than or equal to 1.875 percent and greater than 1.25 percent	40 percent
Less than or equal to 1.25 percent and greater than 0.625 percent	20 percent
Less than or equal to 0.625 percent	0 percent

The new rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5 percent at the beginning of the quarter. The eligible retained income of a banking organization is defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization's quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the PCA well-capitalized thresholds.

Credit Ratings: Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibits using references to, and reliance on, external credit ratings in the regulations of federal agencies and directs agencies to use alternative standards of creditworthiness. As a result, the new rule replaces the ratings-based approach, which is based on credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for securitization exposures. Alternatively, banking organizations may use the existing gross-up approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250 percent risk weight.

MSAs and DTAs: Under the new rule, MSAs and DTAs are subject to stricter limitations than those applicable under the current general risk-based capital rule. More specifically, certain DTAs arising from temporary differences, MSAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock are each subject to an individual limit of 10 percent of common equity tier 1 capital elements and are subject to an aggregate limit of 15 percent of common equity tier 1 capital elements. The amount of these items in excess of the 10 and 15 percent thresholds are to be deducted from common equity tier 1 capital. Amounts of MSAs, DTAs, and significant investments in unconsolidated financial institutions that are not deducted due to the aforementioned 10 and 15 percent thresholds must be assigned to the 250 percent risk weight.

Revised Risk Weights: The new rule increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors. See Table 4 for details.

Timeline and Transition Period

Community banks will begin transitioning to the new rule on January 1, 2015. The new minimum capital requirements are effective on January 1, 2015, whereas the capital conservation buffer and the deductions from common equity tier 1 capital phase in over time. Similarly, non-qualifying capital instruments phase out over time, except as described above. The timeline is summarized in Table 2.

Table 2: Transition Schedule for New Ratios and Capital Definitions

Year (as of January 1)	**2015**	**2016**	**2017**	**2018**	**2019**
Minimum common equity tier 1 capital ratio	4.5%	4.5%	4.5%	4.5%	4.5%
Common equity tier 1 capital conservation buffer	N/A	0.625%	1.25%	1.875%	2.5%
Minimum common equity tier 1 capital ratio plus capital conservation buffer	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of most deductions from common equity tier 1 (including 10 percent & 15 percent common equity tier 1 threshold deduction items that are over the limits)[2]	40%	60%	80%	100%	100%
Minimum tier 1 capital ratio	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum tier 1 capital ratio plus capital conservation buffer	N/A	6.625%	7.25%	7.875%	8.5%
Minimum total capital ratio	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum total capital ratio plus conservation buffer	N/A	8.625%	9.25%	9.875%	10.5%

N/A means not applicable.

Most existing capital instruments issued by community banks will continue to count as regulatory capital. Community banks that have concerns about whether existing capital instruments meet the new eligibility criteria should consult with their primary Federal supervisor.

[2] Deductions from common equity tier 1 capital include goodwill and other intangibles, DTAs that arise from net operating loss and tax credit carryforwards (above certain levels), gains-on-sale in connection with a securitization, any defined benefit pension fund net asset (for banking organizations that are not insured depository institutions), investments in a banking organization's own capital instruments, MSAs (above certain levels) and investments in the capital of unconsolidated financial institutions (above certain levels).

Summary Tables Comparing the Current Rule With the New Rule

The remaining aspects of the new capital rule are summarized in the following tables. Table 3 covers minimum capital ratios, capital buffers, PCA, and a regulatory capital components comparison. Table 4 provides comparison of the risk weights by asset category.

Table 3: Comparison of the Components of the Current Rule With the New Rule

	Current General Risk-Based Capital Rule	New Capital Rule	Section
Minimum regulatory capital ratios			
Common equity tier 1 capital / RWA	N/A	4.5%	Subpart B, §.10
Tier 1 capital / RWA	4%	6%	
Total capital / RWA	8%	8%	
Leverage ratio	4% (or 3%)	4%	
Capital buffers			
Capital conservation buffer	N/A	Capital conservation buffer equivalent to 2.5% of risk-weighted assets; composed of common equity tier 1 capital	Subpart B, §.11
Prompt corrective action levels: Common equity tier 1 capital ratio			
Well capitalized	N/A	≥ 6.5%	See footnote[3]
Adequately capitalized	N/A	≥ 4.5%	
Undercapitalized	N/A	< 4.5%	
Significantly undercapitalized	N/A	< 3%	
Prompt corrective action levels: Tier 1 capital ratio			
Well capitalized	≥ 6%	≥ 8%	See footnote[3]
Adequately capitalized	≥ 4%	≥ 6%	
Undercapitalized	< 4%	< 6%	
Significantly undercapitalized	< 3%	< 4%	
Prompt corrective action levels: Total capital ratio			
Well capitalized	≥ 10%	≥ 10%	See footnote[3]
Adequately capitalized	≥ 8%	≥ 8%	
Undercapitalized	< 8%	< 8%	
Significantly undercapitalized	< 6%	< 6%	

[3] PCA regulations are found in the following locations: 12 CFR Part 6 for banking organizations supervised by the OCC; Subpart D of Regulation H (12 CFR Part 208), §.208.41 for banking organizations supervised by the Federal Reserve; and 12 CFR Part 324, subpart H for banking organizations supervised by the FDIC.

	Current General Risk-Based Capital Rule	New Capital Rule	Section
Prompt corrective action levels: Leverage ratio			
Well capitalized	≥ 5%	≥ 5%	See footnote[3]
Adequately capitalized	≥ 4% (or ≥ 3%)	≥ 4%	
Undercapitalized	< 4% (or < 3%)	< 4%	
Significantly undercapitalized	< 3%	< 3%	
Prompt corrective action levels: Critically undercapitalized category			
Critically undercapitalized	Tangible equity to total assets ≤ 2%	Tangible equity to total assets ≤ 2%	See footnote[3]
Regulatory capital components (definition/instruments)			
Common equity tier 1 capital	No specific definition.	Common stock (plus related surplus) and retained earnings plus limited amounts of minority interest in the form of common stock, less the majority of the regulatory deductions.	Subpart C, §.20(b) and §.22
Tier 1 capital	Common stock (plus related surplus) and retained earnings plus; Non-cumulative preferred stock and related surplus; Cumulative preferred stock and related surplus, trust-preferred securities (for BHCs); Limited amounts of minority interests; Less the majority of regulatory deductions.	Unchanged; Unchanged, however, instruments must meet new eligibility criteria; Not permitted going forward, but grandfathered securities are permitted; Limited amounts of minority interest in the form of additional tier 1 capital instruments; Less certain deductions.	Subpart C, §.20(c) and §.22
Tier 2 capital	Certain capital instruments (e.g., subordinated debt) and limited amounts of the allowance for loan and lease losses (ALLL). Less applicable deductions.	Generally unchanged for most banking organizations with respect to subordinated debt and the ALLL. However, there are new eligibility criteria that tier 2 capital instruments, including subordinated debt, must meet. Less applicable deductions.	Subpart C, §.20(d) and §.22

	Current General Risk-Based Capital Rule	New Capital Rule	Section
Regulatory deductions and adjustments treatment			
Regulatory deductions	Current deductions from regulatory capital include goodwill and other intangibles, DTAs (above certain levels), and MSAs (above certain levels).	Deductions from common equity tier 1 capital include goodwill and other intangibles, DTAs that arise from net operating loss and tax credit carryforwards (above certain levels), gains-on-sale in connection with a securitization, any defined benefit pension fund net asset (for banking organizations that are not insured depository institutions), investments in a banking organization's own capital instruments, MSAs (above certain levels) and investments in the capital of unconsolidated financial institutions (above certain levels). MSAs, DTAs arising from temporary differences that the banking organization could not realize through net operating loss carrybacks, and certain investments in financial institutions, are each limited to 10 percent of common equity tier 1 and in combination are limited to 15 percent of common equity tier 1.	Subpart C, §.22
Regulatory adjustments	Current adjustments include the neutralization of unrealized gains and losses on available-for-sale (AFS) debt securities for regulatory capital purposes.	For banking organizations that make a one-time, irrevocable AOCI opt-out election, adjustments include the neutralization of unrealized gains and losses on AFS debt securities for regulatory capital purposes.[4]	Subpart C, §.22

[4] Institutions will not be able to reverse their choice in order to benefit from recognizing gains, or to protect against recognizing losses, in AOCI due to changes in the interest rate environment. For example, an institution that has elected to take the AOCI opt-out and neutralize the unrealized gains and losses on AFS debt securities from flowing through to regulatory capital cannot reverse the election in a declining interest rate environment in order to recognize unrealized gains.

Table 4: Comparison of Risk Weights of the Current Rule With the New Rule

Category	Current Risk Weight	New Capital Rule	Section
Cash	0%	Unchanged.	Subpart D, §.32(l)(1)
Direct and unconditional claims on the U.S. government, its agencies, and the Federal Reserve	0%	Unchanged.	Subpart D, §.32(a)(1)(i)
Claims on certain supranational entities and multilateral development banks	20%	0%	Subpart D, §.32(b)
Cash items in the process of collection	20%	Unchanged.	Subpart D, §.32
Conditional claims on the U.S. government	20%	Unchanged.	Subpart D, §.32(a)(1)(ii)
Claims on government-sponsored enterprises (GSEs)	20% 100% on GSE preferred stock (20% for national banks).	20% on exposures other than equity exposures and preferred stock. 100% on GSE preferred stock.	Subpart D, §.32(c)
Claims on U.S. depository institutions and National Credit Union Administration-insured credit unions	20% 100% risk weight for an investment in an instrument included in another banking organization's regulatory capital.	20% Unchanged unless the instrument is an equity exposure or required to be deducted.	Subpart D, §.32(d)(1)
Claims on U.S. public sector entities (PSEs)	20% for general obligations. 50% for revenue obligations.	Unchanged.	Subpart D, §.32(e)(1)
Industrial development bonds	100%	Unchanged.	Subpart D, §.32
Claims on qualifying securities firms	20% in general.	100% See corporate exposures below.	Subpart D, §.32(f)
One- to four-family loans	50% if first lien, prudently underwritten, owner occupied or rented, not 90 days or more past due or carried in nonaccrual status, is not restructured or modified. 100% otherwise.	Unchanged.	Subpart D, §.32(g)
One- to four-family loans modified under Home Affordable Modification Program	50% and 100% The banking organization must use the same risk weight assigned to the loan prior to the modification so long as the loan continues to meet other applicable prudential criteria.	Unchanged.	Subpart D, §.32(g)(3)

Category	Current Risk Weight	New Capital Rule	Section
Loans to builders secured by one- to four-family properties presold under firm contracts	50% if the loan meets all criteria in the regulation. 100% if the contract is cancelled. 100% for loans not meeting the criteria.	Unchanged.	Subpart D, §.32(h)
Loans on multifamily properties	50% if the loan meets all the criteria in the regulation; 100% otherwise.	Substantively unchanged. Clarified and updated the manner in which the rule defines these exposures.	Subpart D, §.32(i)
Corporate exposures and consumer loans	100%	Unchanged unless the exposure is an investment in an instrument included in the regulatory capital of another financial institution.	Subpart D, §.32(f)
Commercial real estate (CRE)	100%	Unchanged. 150% for high volatility commercial real estate (HVCRE), which is a subset of CRE, and defined as a credit facility that, prior to conversion to permanent financing, finances or has financed the acquisition, development, or construction of real property, ***unless*** the facility finances (1) one- to four-family residential properties; (2) certain community development projects; (3) the purchase or development of agricultural land; or (4) commercial real estate projects that meet the criteria in the rule, including criteria regarding the loan-to-value ratio and capital contributions to the project.	Subpart D, §.32(j)
Past-due exposures	Generally, the risk weight does not change when the loan is past due. However, one- to four-family loans that are past due 90 days or more are assigned a 100% risk weight.	150% for the portion that is not guaranteed or secured (does not apply to sovereign exposures). Unchanged.	Subpart D, §.32(k)
Assets not assigned to a risk weight category, including fixed assets, premises, and other real estate owned	100%	Unchanged.	Subpart D, §.32(l)(5)

Category	Current Risk Weight	New Capital Rule	Section
Mortgage-backed securities (MBS), asset-backed securities (ABS), and structured securities[5]	Two general approaches—ratings-based approach and gross-up approach.	Two general approaches—gross-up approach and simple supervisory formula approach. May also choose to risk weight a securitization exposure at 1,250%.	Subpart D, §.42, §.43, and §.44
Equity exposures	100% or incremental deduction approach for nonfinancial equity investments.	Range of risk weights between 0 and 600% depending on the entity and whether the equity is publicly traded.	Subpart D, §.51 and §.52
Equity exposures to investment funds	There is a 20% risk weight floor on investment fund holdings. Two approaches available: i. Risk weight is the same as the highest risk weight investment the fund is permitted to hold. ii. A banking organization may assign risk weight on a pro rata basis based on the investment limits in the fund's prospectus.	Unchanged. Unchanged. (now called the Simple Modified Look-Through Approach) Unchanged. (now called the Alternative Modified Look-Through Approach) A third treatment (called the Full Look-Through Approach) has been introduced and it risk weights each asset of the fund (as if owned directly) and multiplies by the banking organization's proportional ownership in the fund.	Subpart D, §.53
Claims on foreign governments and their central banks, foreign banking organizations, and foreign public sector entities	Risk weight depends on the sovereign's membership in the Organization for Economic Cooperation and Development (OECD).	Risk weight depends on Country Risk Classification (CRC) applicable to the sovereign and whether the sovereign has defaulted within the previous five years.	Subpart D, §.32(a)(2) to (6), (d)(2) and (e)(2) to (6)

[5] See earlier discussion on page 3 regarding the removal of references to, and reliance on credit ratings, from the agencies' capital rules.

Category	Current Risk Weight	New Capital Rule	Section
Conversion factors for off-balance sheet items	0% for the unused portion of a commitment with an original maturity of one year or less, or which is unconditionally cancellable at any time;	0% for the unused portion of a commitment that is unconditionally cancellable by the banking organization; 20% for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable;	Subpart D, §.33
	20% for self-liquidating, trade-related contingent items;	Unchanged;	
	50% for the unused portion of a commitment with an original maturity of more than one year that is not unconditionally cancellable;	Unchanged;	
	50% for transaction-related contingent items (performance bonds, bid bonds, warranties, and standby letters of credit);	Unchanged;	
	100% for guarantees, repurchase agreements, securities lending and borrowing transactions, financial standby letters of credit, and forward agreements and certain credit-enhancing representations and warranties that are not securitization exposures.	Unchanged.	
Derivative contracts	Conversion to an on-balance sheet amount based on current exposure plus potential future exposure and a set of conversion factors.	Unchanged.	Subpart D, §.34
	50% risk weight cap.	No risk weight cap.	

Category	Current Risk Weight	New Capital Rule	Section
Guarantees	Generally recognizes guarantees provided by central governments, GSEs, PSEs in OECD countries, multilateral lending institutions, regional development banking organizations, U.S. depository institutions, foreign banking organizations, and qualifying securities firms in OECD countries. Substitution approach that allows the banking organization to substitute the risk weight of the protection provider for the risk weight ordinarily assigned to the exposure.	Recognizes guarantees from eligible guarantors: sovereign entities, certain international organizations, such as the Bank for International Settlements, Federal Home Loan Banks, Farmer Mac, a multilateral development bank, a depository institution, a bank holding company, a savings and loan holding company, a foreign banking organization, a qualifying central counterparty banking organization, or certain entities that have investment grade debt. Unchanged.	Subpart D, §.36
Collateralized transactions	Recognize only cash on deposit, securities issued or guaranteed by OECD countries, securities issued or guaranteed by the U.S. government or a U.S. government agency, and securities issued by certain multilateral development banks. Substitute risk weight of collateral for risk weight of exposure, sometimes with a 20 percent risk weight floor.	The new rule provides two approaches for recognizing a broader range of financial collateral: Unchanged. (now called the Simple Approach) Includes a new treatment (called the Collateral Haircut Approach) that is available only for eligible margin loans, repo-style transactions, and collateralized derivative contracts.	Subpart D, §.37
MSAs, certain DTAs arising from temporary differences, and certain significant investments in the common stock of unconsolidated financial institutions	MSAs and DTAs that are not deducted and investments in common stock are subject to a 100 percent risk weight.	Items that are not deducted are subject to a 250 percent risk weight.	Subpart D, §.32(l) and §.52