Tackling the Revised Call Report Schedule RC-R:

What Community Banks Need to Know to Implement Basel III

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Agenda

- Overview of the new regulatory capital requirements
- Details on calculating Common Equity Tier 1 Capital and the revised capital ratios
- Guidance on common deductions and adjustments to capital
- Discussion of the major changes to risk weighted assets

Resources

- Call Report Instructions for March 31, 2015
- FDIC Regulatory Capital Page

  https://www.fdic.gov/regulations/capital/index.html

- Regulatory Guides for Community Banks:
  - Interagency Community Bank Guide to the New Capital Rule
  - Expanded Community Bank Guide to the New Capital Rule for FDIC-Supervised Banks

Overview of the New Reg Cap Rules

- New rules revise reg. capital definitions and minimum ratios
- Redefines Tier 1 Capital as two components
  - Common Equity Tier 1 Capital
  - Additional Tier 1 Capital
- Creates a new capital ratio:
  - Common Equity Tier 1 Risk-based Capital Ratio
- Creates a Capital Conservation Buffer that can limit dividend payouts and bonuses
- Changes risk weightings for certain assets
- Changes the calculation of disallowed deferred taxes

Calculating Common Equity Tier 1 Capital

Common Equity Tier 1 Capital =
Common Stock and Related Surplus (Net of Treasury Stock and Unearned ESOP Shares)
+ Retained Earnings
+/- Accumulated Other Comprehensive Income*
+ Qualifying Minority Interest
+/- Deductions and Adjustment

* Election to opt out available on March 31, 2015 call report

Opt Out Election

- Banks that are not advanced approaches institutions may make a one-time election to opt-out of the requirement to include most accumulated other comprehensive income (AOCI) components in CET1
  - Anticipated that most community banks will opt out
  - Prevents volatility in capital associated with gains/losses in investment portfolio
- Opt out by entering “Yes” in line 3.a. on March 31st
- One time irrevocable election

RC-R: CET1 Calculation

Part I. Regulatory Capital Components and Ratios

Part I is to be completed on a consolidated basis.

Dollar Amounts in Thousands		RCOA	Bil	Mil	Thou	
Common Equity Tier 1 Capital						
1. Common stock plus related surplus, net of treasury stock and unearned employee stock ownership plan (ESOP) shares		P742				1.
		RCON				
2. Retained earnings		3632				2.
		RCOA				
3. Accumulated other comprehensive income (AOCI)		B530				3.
a. AOCI opt-out election (enter "1" for Yes; enter "0" for No.) (Advanced approaches institutions must enter "0" for No.)	0=No 1=Yes	RCOA P838				3.a.
		RCOA	Bil	Mil	Thou	
4. Common equity tier 1 minority interest includable in common equity tier 1 capital		P839				4.
5. Common equity tier 1 capital before adjustments and deductions (sum of items 1 through 4)		P840				5.

Deductions to Common Equity Tier 1

- Direct Dollar for Dollar Reduction in Capital
- Components
  - Goodwill- net of related deferred tax liabilities
  - Other Intangible Assets (Except MSRs)- net of related deferred tax liabilities
  - Deferred Tax Assets associated with net operating loss carryforwards and tax credit carryforwards
    - ◊ Federal NOLs
    - ◊ State NOLs
    - ◊ AMT Credit carryforwards
    - ◊ Business Credit carryforwards
    - ◊ Net of any valuation allowance recorded

RC-R- CET1 Calculation (cont.)

Common Equity Tier 1 Capital: Adjustments and Deductions

6. LESS: Goodwill net of associated deferred tax liabilities (DTLs)	P841	6.
7. LESS: Intangible assets (other than goodwill and mortgage servicing assets (MSAs)), net of associated DTLs	P842	7.
8. LESS: Deferred tax assets (DTAs) that arise from net operating loss and tax credit carryforwards, net of any related valuation allowances and net of DTLs	P843	8.

9. AOCI related adjustments (if entered "1" for Yes in item 3.a, complete only items 9.a through

Adjustments to Common Equity Tier 1

- Assuming “Opt Out” Election was made
- Direct Dollar for Dollar Adjustment in Capital
  - To eliminate the impact of these items to regulatory capital
- Components
  - AOCI for Net Unrealized Gains/Losses on Available for Sale Securities
  - AOCI for Net Unrealized Losses on Preferred Stock
  - AOCI for Pension and Post-Retirement Benefits

RC-R- CET1 Calculation (cont.)

carryforwards, net of any related valuation allowances and net of DTLs	P843	8.
9. AOCI-related adjustments (if entered "1" for Yes in item 3.a, complete only items 9.a through 9.e; if entered "0" for No in item 3.a, complete only item 9.f):		
a. LESS: Net unrealized gains (losses) on available-for-sale securities (if a gain, report as a positive value; if a loss, report as a negative value)	P844	9.a.
b. LESS: Net unrealized loss on available-for-sale preferred stock classified as an equity security under GAAP and available-for-sale equity exposures (report loss as a positive value)	P845	9.b.
c. LESS: Accumulated net gains (losses) on cash flow hedges (if a gain, report as a positive value; if a loss, report as a negative value)	P846	9.c.
d. LESS: Amounts recorded in AOCI attributed to defined benefit postretirement plans resulting from the initial and subsequent application of the relevant GAAP standards that pertain to such plans (if a gain, report as a positive value; if a loss, report as a negative value)	P847	9.d.
e. LESS: Net unrealized gains (losses) on held-to-maturity securities that are included in AOCI (if a gain, report as a positive value; if a loss, report as a negative value)	P848	9.e.
f. To be completed only by institutions that entered "0" for No in item 3.a: LESS: Accumulated net gain (loss) on cash flow hedges included in AOCI, net of applicable income taxes, that relates to the hedging of items that are not recognized at fair value on the balance sheet (if a gain, report as a positive value; if a loss, report as a negative value)	P849	9.f.

Threshold Deductions to CET1

- Deduct amounts > 10% individually or >15% in aggregate of CET1 Capital
- Components
  - Mortgage Servicing Rights- net of related deferred tax liabilities
  - Deferred Tax Assets associated with timing differences that can not be realized through net operating loss carryback
    - ◊ Bad debts deduction
    - ◊ Depreciation on fixed assets
    - ◊ Deferred compensation
    - ◊ Net of any valuation allowance recorded

RC-R- CET1 Calculation (cont.)

Dollar Amounts in Thousands	RCOA	Bil	Mil	Thou	
13. LESS: Significant investments in the capital of unconsolidated financial institutions in the form of common stock, net of associated DTLs, that exceed the 10 percent common equity tier 1 capital deduction threshold	P853				13.
14. LESS: MSAs, net of associated DTLs, that exceed the 10 percent common equity tier 1 capital deduction threshold	P854				14.
15. LESS: DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, net of related valuation allowances and net of DTLs, that exceed the 10 percent common equity tier 1 capital deduction threshold	P855				15.
16. LESS: Amount of significant investments in the capital of unconsolidated financial institutions in the form of common stock, net of associated DTLs; MSAs, net of associated DTLs; and DTAs arising from temporary differences that could not be realized through net operating loss carrybacks, net of related valuation allowances and net of DTLs; that exceeds the 15 percent common equity tier 1 capital deduction threshold	P856				16.

Deferred Taxes on Schedule RC-R

- Line 8- Deferred Tax Assets Arising from Net Operating Losses and Tax Credits
  - Dollar for dollar reduction in capital
  - These items are considered less likely to be utilized by the bank within a reasonable period
- Line 15- Deferred Tax Assets Arising from Temporary Differences
  - Sum of the remaining deferred tax items that haven’t been considered on the previous lines
  - If these items result in a net deferred tax asset, compare to the 10% and 15% thresholds to determine if a deduction is necessary
  - Net deferred tax asset can be reduced by any amount that could be realized from a net operating loss carryback

Netting of Deferred Tax Assets and Liabilities

- In general for the call report, all deferred tax assets and liabilities are grouped and netted (Schedule RC-F and RC-G)
- Under the new Schedule RC-R rules, deferred tax liabilities arising from temporary differences are allocated against deferred tax assets
  - Allocate to Line 8- DTAs Arising from Carryforwards and Line 15- DTAs Arising from Temporary Differences on a proportionate basis
  - Do not allocate DTLs associated with goodwill, intangibles, mortgage servicing rights as they are allocated elsewhere.
  - Consider any deferred tax assets or liabilities associated with available-for-sale securities
- Need a detailed breakout of deferred taxes from your tax accountant

Carryback Potential and Risk Weighting

- Bank is allowed to look back and see if any of the deductions/losses associated with a hypothetical reversal of the timing differences would result in a tax refund for the bank
  - Generally federal tax losses can be carried back two tax years. Often state losses can not be carried back
- If the bank would receive a tax refund on the carryback, then the carryback amount can be used to reduce net deferred tax assets in Line 15.
  - The refund portion is also risk weighted 100% for RWA
  - All remaining timing differences not deducted on line 15 are risk weighted 250% <u>starting in 2018</u>

Tier 2 Capital

- Line 30a: Limited Allowance for Loan & Lease Losses
  - Limited to 1.25% of risk weighted assets
  - Same as current limits

Calculation of Capital Ratios

Common Equity Tier 1 RBC Ratio =
Common Equity Tier 1
/ Total Risk Weighted Asset

Tier 1 Capital Ratio =
Total Tier 1 Capital
/ Total Risk Weighted Asset

Total Capital Ratio =
Total Capital
/ Total Risk Weighted Asset

Tier 1 Leverage Ratio=
Total Tier 1 Capital
/ Total Assets for Leverage Ratio (=Avg Total Assets – Adjustments)

RC-R- Capital Ratios

Risk-Based Capital Ratios

	(Column A)		(Column B)		
	RCOA	Percentage	RCOW	Percentage	
41. Common equity tier 1 capital ratio (Column A: item 19 divided by item 40.a) (Advanced approaches institutions that exit parallel run only: Column B: item 19 divided by item 40.b)	P793		P793		41.
42. Tier 1 capital ratio (Column A: item 26 divided by item 40.a) (Advanced approaches institutions that exit parallel run only: Column B: item 26 divided by item 40.b)	7206		7206		42.
43. Total capital ratio (Column A: item 35.a divided by item 40.a) (Advanced approaches institutions that exit parallel run only: Column B: item 35.b divided by item 40.b)	7205		7205		43.

Leverage Capital Ratios

	RCOA	Percentage	
44. Tier 1 leverage ratio (item 26 divided by item 39)	7204		44.

Transition Period of Some CET1 Deductions

- Deductions and Adjustments including items related to deferred taxes and mortgage servicing rights phase in through 2018

Calendar Year	% of the Deductions from CET1 Capital
2015	40%
2016	60%
2017	80%
2018 and thereafter	100%

Prompt Corrective Action (PCA)

	Adequately Capitalized		Well Capitalized	
	2013 and 2014	Starting in 2015	2013 and 2014	Starting in 2015
Total risk-based capital	8.0%	8.0%	10.0%	10.0%
Tier 1 risk-based capital	4.0%	6.0%	6.0%	8.0%
Common equity tier 1 risk-based capital	N/A	4.5%	N/A	6.5%
Tier 1 leverage capital	4.0%	4.0%	5.0%	5.0%

Note: Must be met on March 31, 2015 call report. No phase in

Capital Conservation Buffer

- Dividends and discretionary bonuses are limited if banks fails to maintain a buffer above the minimum required capital ratios (adequately capitalized level under PCA)
- Buffer limits the payout ratio for dividends and bonuses based on a percentage of eligible retained income
  - Regulators have released statement indicating that S Corporation banks that don’t meet the required capital conservation buffer will be reviewed on a case-by-case basis and will likely be able to continue to pay tax dividend distributions
- Buffer phases in over the next 5 years

Capital Conservation Buffer

	2015	2016	2017	2018	2019
Phase-in Requirement	**N/A**	**0.625%**	**1.25%**	**1.875%**	**2.5%**
Total risk-based capital with buffer	N/A	8.625%	9.25%	9.875%	10.5%
Tier 1 risk-based capital with buffer	N/A	6.625%	7.25%	7.875%	8.5%
Common equity tier 1 risk-based with buffer	4.5%	5.125%	5.75%	6.375%	7.0%

Maximum Payout Ratio

Maximum Payout Ratio as of % of Eligible Retained Income*	
Payout Allowed as % of Eligible Retained Inc.	Size of Buffer (% of RWA)
No Limit	Greater than 2.50%
60%	1.875% to 2.50%
40%	1.25% to 1.875%
20%	.0625% to 1.25%
0%	< .625%

* Eligible Retained Income: The most recent 4 quarters of net income preceding the current quarter, net of any capital distributions, and certain discretionary bonus payments

Risk Weighted Assets

- For community banks, the majority of the risk weighting rules did not change as a result of the new regulatory capital requirements
  - The new Schedule RC-R will contain additional risk weighting columns: 150%, 250%, 300%, 400%, 600%, 625%, 937.5%, 1250%
  - Other than the 150% and perhaps 250% categories the others will generally not be used by community banks
- Additional information may be needed to prepare certain sections of risk weighted assets for March 31st

Risk Weighting- Cash and Securities

- Cash and due from banks- Line 1
  - 0%- Currency, balances at Fed, FDIC insured deposits
  - 20%- Amounts in excess of FDIC insured deposits, balances at the FHLB, cash items
- Securities- HTM and AFS- Line 2
  - Investments that are not considered securitizations
  - 0%- US Treasury, US agencies, GNMA MBS
  - 20%- General obligation muni bonds, US government-sponsored agencies, FNMA and FHLMC MBS
  - 50%- Revenue obligation municipal bonds and other CMOs and MBSs
  - 300%- Publically traded equity securities (including certain mutual funds using simple risk weight and look thru approach)
  - 600%- Equity securities to investment firms
  - Note: Certain investments may be Line 9 rather than here

Risk Weighting- Fed Funds and Loans

- Fed Funds and Reverse Repos- Line 3
  - 0%- Any amount unconditionally guaranteed by US agency
  - 20%- Exposures to US depository counterparties
- Loans Held for Sale and Loans and Leases- Lines 4 and 5
  - New breakout in 2014
  - Residential Mortgage Exposures- Line 4a and 5a
  - High Volatility Commercial Real Estate- Line 4b and 5b
  - Exposures past due 90 days or more or on NA- Line 4c, 5c
  - All other exposures- Line 4d and 5d

Loan Risk Weighting Breakout

Dollar Amounts in Thousands	(Column A) Totals From Schedule RC	(Column B) Adjustments to Totals Reported in Column A	(Column C)	(Column D)	(Column E)	(Column F)	(Column G)	(Column H)	(Column I)	(Column J)	
			Allocation by Risk-Weight Category								
			0%	2%	4%	10%	20%	50%	100%	150%	
	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	
4. Loans and leases held for sale (continued):											
d. All other exposures................	RCON S431	RCON S432	RCON S433				RCON S434	RCON S435	RCON S436	RCON S437	4.d.
5. Loans and leases, net of unearned income:											
a. Residential mortgage exposures................	RCON S439	RCON S440	RCON H178				RCON S441	RCON S442	RCON S443		5.a.
b. High volatility commercial real estate exposures................	RCON S445	RCON S446	RCON H179				RCON H180	RCON H181	RCON H182	RCON S447	5.b.
c. Exposures past due 90 days or more or on nonaccrual[1]..............	RCON S449	RCON S450	RCON S451				RCON S452	RCON S453	RCON S454	RCON S455	5.c.
d. All other exposures....	RCON S457	RCON S458	RCON S459				RCON S460	RCON S461	RCON S462	RCON S463	5.d.

Residential Mortgage Exposures

- What are Residential Mortgage Exposures?
  - First or Junior Liens on 1-to-4 family residential real estate
  - First or Junior Lien Multi-family residential real estate where the original and outstanding amount is $1 million or less
  - Other homogenous pool multi-family residential loans
- 50% Risk Weighting Category
  - First liens that are prudently underwritten and not more than 90 days past due or on non-accrual
- 100% Risk Weighting Category
  - Other residential mortgage exposures including past due loans

High Volatility Commercial Real Estate

- HVCRE is an acquisition, development, or construction loan prior to permanent financing
  - NOT: 1-to-4 Family Residential Construction Project
  - NOT: Community Development Loan
  - NOT: For the Purchase of Agricultural Land
  - NOT: Meeting Certain Exemption Criteria
- Exemptions- must meet all to not be a HVCRE
  - LTV is at or below the maximum supervisory Loan-To-Value
  - Borrower has contributed at least 15% of "as completed" appraised value in cash, marketable assets, or paying development costs out of pocket
  - Borrower contributed capital is contractually required to remain throughout the life of the project
- Remains HVCRE until converted to permanent financing

Risk Weighting for HVCREs

- All HVCREs will be risk weighted at 150% regardless of payment status
- Properly identifying HVCREs will be critical:
  - Start with the pool of non-residential construction loans
  - Review loan files to determine original LTVs
  - Assess the initial capital contributions by borrowers
- Regulators will likely assume all non-residential construction loans are HVCRE unless proven/documented otherwise
  - Document in the loan file the determination whether or not a loan in a HVCRE
- Begin by reviewing the population of development loans in Schedule RC-C, line 1.a.2 (assuming loans are properly classified)

Risk Weighting Past Due Loans

- Loans past due more than 90 days or on nonaccrual will generally have higher risk weightings under the new rules
- Past due residential mortgages
  - 100% risk weighting
- Past due HVCREs
  - Stay at 150% risk weighting like the loans that aren't past due
- All other past due loans
  - 150% risk weighting

Risk Weighting All of the Loans

- For other performing loans risk weighting has not changed
- 20% Risk Weighting- Certain Guaranteed Loans
- 50% Risk Weighting- Loans meeting the requirements to be classified as Presold Construction Loans
- 100% Risk Weighting- Other Performing Loans

Risk Weighting- Other Assets

- All Other Assets- Line 8
  - 0%- Federal Reserve Stock, accrued interest on 0% assets
  - 20%- FHLB Stock, accrued interest on 20% assets
  - 50%- Accrued interest on 50% assets
  - 100%- Mortgage servicing assets*, DTAs from temporary items*, accrued interest on 100% items
    - ◊ *These items will be 250% starting in 2018
  - 150%- Accrued interest on 150% items
  - 400%- Equity securities that do not have a readily determinable fair value

Line 9a and 9b: On-Balance Sheet Securitization Exposures

- Can arise from purchasing MBSs and CMOs if there is a tranching of underlying credit risk
- Not all MBSs and CMOs are securitization exposures
  – MBS Pass Through Securities involve no tranching of credit risk
- Securitization exposures guaranteed by the US Government or GSEs are not securitizations (stay on line 2a and 2b)
  – Ginnie Mae MBS are still 0% risk weighted
  – Fannie Mae and Freddie Mac are still 20% risk weighted
- Private label MBSs and CMOs and certain other products can no longer be risk weighted based on ratings
  – Must use SSFA or Gross Up Method or default to 1250%
  – Report on Line 9a or 9b

Risk Weighting Securitization Exposures

	(Column A) Totals	(Column B) Adjustments to Totals Reported in Column A	(Column Q) Allocation by Risk-Weight Category (Exposure Amount)	(Column T) Total Risk-Weighted Asset Amount by Calculation Methodology	(Column U)	
			1250%	SSFA[13]	Gross-Up	
Dollar Amounts in Thousands	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	Bil Mil Thou	
Securitization Exposures: On- and Off-Balance Sheet						
9. On-balance sheet securitization exposures:						
a. Held-to-maturity securities	RCON S475	RCON S476	RCON S477	RCON S478	RCON S479	9.a.
b. Available-for-sale securities	RCON S480	RCON S481	RCON S482	RCON S483	RCON S484	9.b.
c. Trading assets	RCON S485	RCON S486	RCON S487	RCON S488	RCON S489	9.c.
d. All other on-balance sheet securitization exposures	RCON S490	RCON S491	RCON S492	RCON S493	RCON S494	9.d.
10. Off-balance sheet securitization exposures	RCON S495	RCON S496	RCON S497	RCON S498	RCON S499	10.

Risk Weighting- Off Balance Sheet Items

- Risk weighting for off balance sheet exposures is complex
  - Consult the detailed guidance in instructions.
- Line 10- Off Balance Sheet Securitization Exposures
  - Certain types of credit enhancement/recourse may be considered a securitization exposure
  - Example- Credit Enhancement through FHLB MPF program
  - Use the SSFA Method, Gross Up Method, or 1250% risk weighting
- Line 12- Financial Standby Letters of Credit
  - From Schedule RC-L, Line 2
  - Credit Equivalent Amount = 100% of Letters
  - Usually 100% risk weighted

Risk Weighting- Off Balance Sheet Amounts

- Line 13- Performance Standby Letters of Credit
  - From Schedule RC-L, Line 3
  - Credit Equivalent Amount = 50%
  - Usually 100% risk weighted
- Line 14- Commercial Letters of Credit
  - From Schedule RC-L, Line 4
  - Credit Equivalent Amount = 20%
  - Could be risk weighted 20% or 100%
- Line 15- Retained Recourse on Small Business Oblig.
  - Report in this line amounts that are not securitization exposures
  - Report the retained recourse amount of SBA loans sold
  - Credit Equivalent Amount = 100%
  - Risk weighted 100%

Risk Weighting- Unused Commitments

- Line 18a- Original maturity of one year or less
  - Amounts from Schedule RC-L, Line 1.a to 1.e.3
  - Do not include unconditionally cancellable commitments
  - Credit Conversion factor= 20%
  - Risk weighting follows the risk weighting for loans
    - ◊ 20%- Certain guaranteed loans
    - ◊ 50%- Residential mortgage exposures
    - ◊ 100%- Most other loans
    - ◊ 150%- HVCREs
- Line 18c- Original maturity exceeding one year
  - Same general rules and risk weighting as above
  - Credit Conversion factor = 50%

Risk Weighting- Unused Commitments

- Line 19- Unconditionally Cancelable Commitments
  - Commitments which are cancelable without cause at any time by the bank to the extent permissible by law
  - Home equity lines are deemed unconditionally cancelable if the bank can prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent allowed by law
  - Retail credit cards and overdraft plans are considered short term and should be considered unconditionally cancellable as long as the bank has the unconditional right to cancel the line of credit
  - Credit conversion factor= 0%
  - Not subject to risk weighting, but must be reported in Column A and B

Next Steps

- Become familiar with the revised Call Report schedules and instructions
- Visit regulatory websites for further information
- Identify any High Volatility Commercial Real Estate loans
- Obtain your deferred tax components with your tax preparer
- Review your balance sheet and unused commitments for possible risk weighting changes
- Consider the impact of higher required capital ratios and the capital conservation buffer on your institution
- Reach out for assistance, if needed

Questions?

Thank You!

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