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S&P Global
Market Intelligence

Most community banks would qualify for Congress' proposed capital standard

By Zach Fox and Chris Vanderpool **December 22, 2017**

Bipartisan legislation in the Senate would introduce a simple leverage ratio that could reduce reporting requirements on thousands of banks, although the change would move just a handful of companies off the list of inadequately capitalized banks.

On Dec. 5, the Senate Banking Committee passed legislation that would introduce a "community bank leverage ratio" that would measure tangible equity capital against average total consolidated assets. Banks that meet a regulatory minimum for this ratio — which should be at least 8% but not larger than 10% — would be deemed well-capitalized per regulators' risk-based capital requirements. Banks could use this ratio in lieu of the current four-ratio standard to be deemed well-capitalized.

The change would apply only to "qualifying community banks," defined as institutions with less than $10 billion of assets and limited off-balance sheet exposures, trading assets or notional derivatives exposure. Regulators would have some discretion in adding other factors to the definition, making the final determination via the rulemaking process. Also, banks could elect to continue to abide by the current regime.

Of the 5,410 community banks in the analysis, just 40 banks, or roughly 1%, were less than well-capitalized. Of those 40 banks, only five lenders would be well-capitalized under the Senate's proposed legislation.There are very few banks that are not well-capitalized under the current risk-based regime, and most of the ones that fail to meet current requirements would not qualify for the new leverage ratio, according to an analysis by S&P Global Market Intelligence. A bank is considered "well-capitalized" if it stays above minimums for four different ratios: common equity Tier 1, Tier 1, total capital and Tier 1 leverage.

First Banks Inc. would be the largest community bank to benefit, with $6.2 billion of assets. Bank of Highland Park Financial Corp. would be the next-largest bank, with $1.6 billion of assets. Although Bank of Highland Park Financial's total capital ratio falls just short of 10%, its single depository unit, First Bank of Highland Park, is currently well-capitalized for purposes of prompt corrective action. The other three banks that are currently not well-capitalized but would be under the new leverage ratio each have less than $1 billion of assets.

While very few banks would be reclassified as well-capitalized, industry groups argue that banks that are well-capitalized would derive significant value from the leverage ratio. And most of the currently well-capitalized banks would qualify under the new leverage ratio. Overall, 5,094 currently well-capitalized community banks would meet a minimum leverage ratio of 8%. If the ratio were instead set at 10%, the upper limit of the legislation, 3,356 currently well-capitalized banks would qualify.

Christopher Cole, senior regulatory counsel for the Independent Community Bankers of America, said most community banks would opt for the leverage ratio instead of the risk-based capital rules. He said the decision would not be a matter of holding less capital.

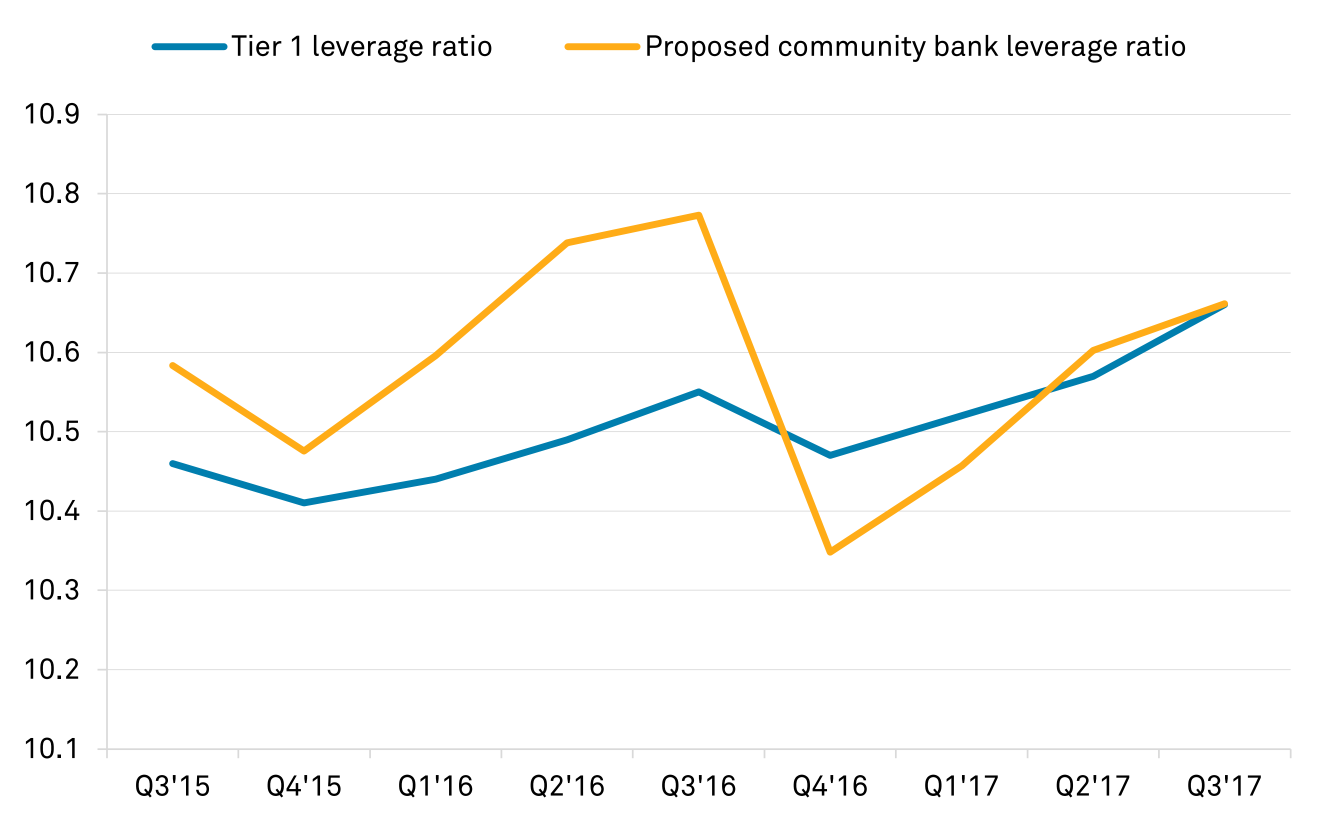
The median community bank leverage ratio in the third quarter almost matched the median Tier 1 leverage ratio and has been generally similar over the last several years. Rather, community banks would largely benefit from the new leverage ratio because it carries less complexity than the risk-based capital ratios.

"For banks that have commercial real estate loans, there is a real regulatory burden in figuring out which loans are considered [high volatility commercial real estate], which carries a 150% risk weight," Cole said. "There are some banks that put a lot of time in figuring that out."

Thomas Hoenig, vice chairman of the Federal Deposit Insurance Corp. and a longtime advocate for leverage ratios and higher capital levels at banks, applauded the provision in a Dec. 5 statement. While Hoenig was critical of other elements of the legislation, citing some potential risks to the economy, he was supportive of the community bank leverage ratio, calling it an improvement "in the regulatory cost and landscape for these commercial banks."

Capital levels at community banks remain elevated (%)

Median values for banks and thrifts under $10B in total assets



Data compiled Dec. 11, 2017.
Based on regulatory filings.
Analysis includes U.S. commercial banks, savings banks, and savings and loan associations.
Community bank leverage ratio = tangible equity as a percentage of average assets
Tier 1 leverage ratio = Tier 1 capital as a percentage of average adjusted assets
Source: S&P Global Market Intelligence

Less than 'well capitalized' community banks with a tangible equity-to-average assets ratio above 8%

Company (top-level ticker)	Total assets ($M)	Current PCA categories: CET1 ratio (%)	Tier 1 ratio (%)	Total capital ratio (%)	Tier 1 leverage ratio (%)	Proposed community bank leverage ratio (%)
"Well capitalized" minimum		**6.50**	**8.00**	**10.00**	**5.00**	**8.00-10.00**
First Banks Inc.	6,176.4	-0.08	8.97	13.66	6.23	8.14
Bank of Highland Park Financial Corp.	1,556.5	8.37	8.37	9.96	8.11	8.03
CIB Marine Bancshares Inc.	640.3	4.71	14.80	16.05	11.41	11.18
First National Bank	261.0	8.83	8.83	9.87	8.18	8.21
Golden State Bank	192.2	8.66	8.66	9.54	8.59	8.59

Data compiled Dec. 11, 2017.
Based on regulatory filings.
Analysis limited to current top-tier banks and thrifts under $10 billion in total assets as of Sept. 30, 2017.
Values in orange represent regulatory capital ratios below each respective "well capitalized" minimum.
Community bank leverage ratio = tangible equity as a percentage of average assets
CET1 = common equity Tier 1; PCA = prompt corrective action
Source: S&P Global Market Intelligence

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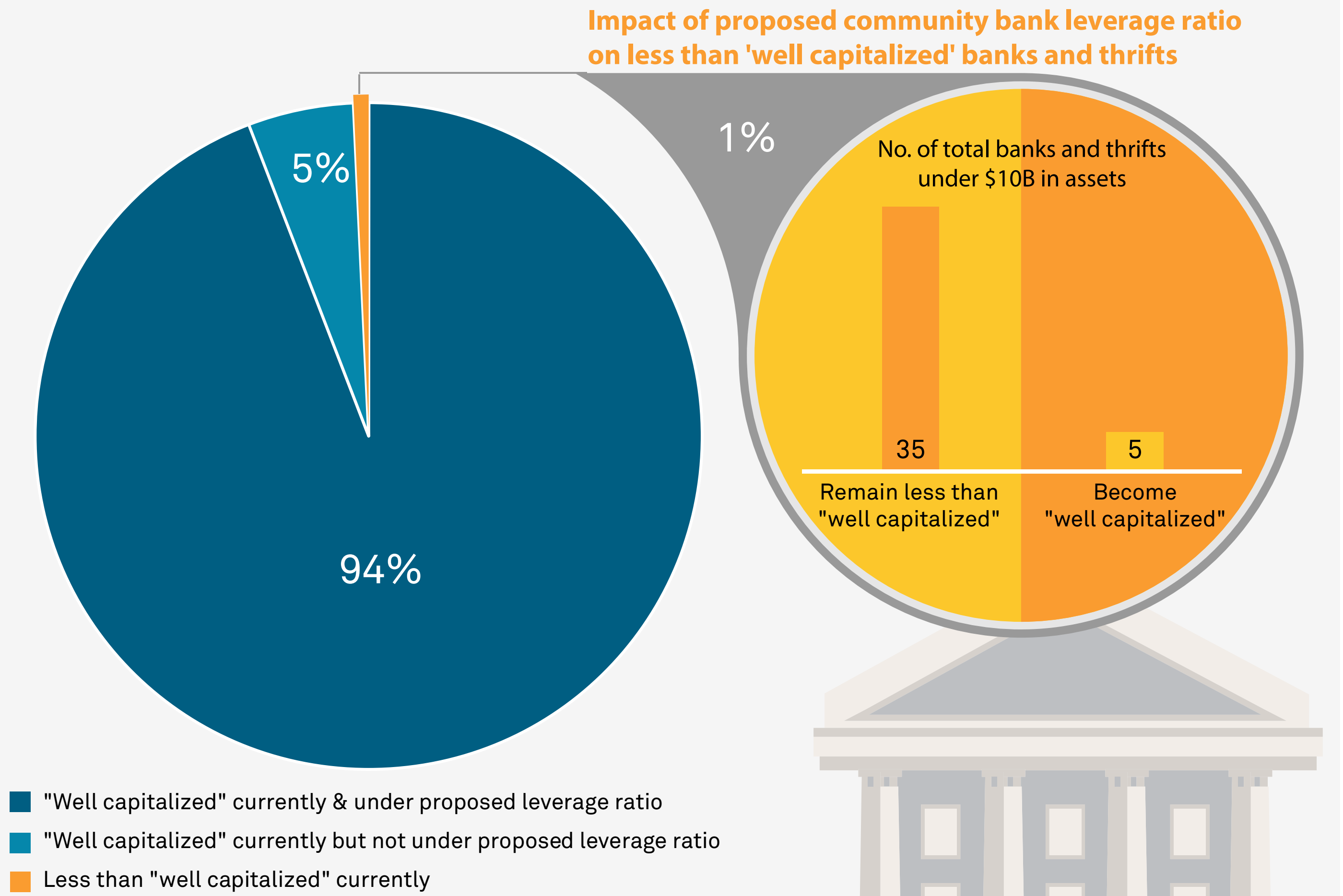
Breaking down the proposed community bank leverage ratio's impact



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Community bank leverage ratio = tangible equity as a percentage of average assets
Source: S&P Global Market Intelligence
Credit: Saddat Sarfraz

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