

November 22, 2017

Bank Capital Requirements

Federal Banking Agencies Extend Certain Transition Provisions for Non-Advanced Approaches Banking Organizations

Yesterday, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation published a final rule¹ to extend the current transitional regulatory capital treatment for certain capital deductions, risk weightings, and minority interest requirements for banking organizations that are not subject to the agencies' advanced approaches capital rules.² The agencies did not change their August 2017 proposal,³ which is described in our prior [Memorandum to Clients](#). The affected transition provisions are those for mortgage servicing assets ("MSAs"), certain deferred tax assets ("DTAs"), investments in the capital instruments of unconsolidated financial institutions, and minority interests. Non-advanced approaches banking organizations will continue to apply the transition provisions applicable for calendar year 2017 for these items. The final rule does not modify the transition provisions applicable to advanced approaches banking organizations, which will be required to apply the fully phased-in regulatory capital treatment for the items noted above beginning on January 1, 2018.

The final rule is effective January 1, 2018.

Background

- ***The Transitions Proposal and the Simplifications Proposal.*** In preparation for a proposal to simplify certain aspects of the capital rules (the "*simplifications proposal*"),⁴ in August 2017, the agencies issued a proposal to extend the current transition provisions for the regulatory capital treatment of MSAs, temporary difference DTAs, investments in the capital of unconsolidated financial institutions, and minority interest for non-advanced approaches banking organizations (the "*transitions proposal*"). In September 2017, the agencies published the simplifications proposal "with the goal of meaningfully reducing regulatory burden on community banking organizations while at the same time maintaining safety and soundness and the quality and quantity of regulatory capital in the banking system."⁵ With respect to comments received in response to the transitions proposal related to simplification or other changes to the capital rules, the agencies note in several places in the

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supplementary information accompanying the final rule that “the transitions NPR was intended solely to stay the phase-in of certain elements of the capital rules in light of goals stated in the EGRPRA report and in contemplation of the simplifications NPR” and that the agencies will “consider comments applicable to the proposed changes in the simplifications NPR as part of that rulemaking process.”⁶

Final Rule Provisions

- ***Extension of transition provisions adopted as proposed for non-advanced approaches banking organizations.*** The agencies adopted the transitions proposal as a final rule without change. Accordingly, pursuant to the transition provisions applicable for calendar year 2017, non-advanced approaches banking organizations will continue after 2017 to:
 - deduct from regulatory capital 80 percent of the amount of MSAs, temporary difference DTAs, and investments in the capital of unconsolidated financial institutions that are not includable in regulatory capital;
 - apply a 100 percent risk weight to any amounts of MSAs, temporary difference DTAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from capital; and
 - include 20 percent of any minority interest exceeding the capital rules’ minority interest limitations.
- ***Duration of extension.*** The extended transition periods will remain in effect until the simplifications proposal is finalized or the agencies “determine otherwise.”⁷
- ***Advanced approaches banking organizations must continue to apply the transition provisions set forth in the capital rules.*** Under the final rule, advanced approaches banking organizations continue to be subject to the transition provisions established by the capital rules for the items noted above. Accordingly, the transition schedule for these banking organizations is unchanged, and they are required to apply the capital rules’ fully phased-in treatment for these items beginning January 1, 2018.

Responses to Certain Comments

- ***Dichotomy between non-advanced and advanced approaches banking organizations.*** In response to comments on the proposal’s exclusion of advanced approaches banking organizations, the agencies noted that they believe “that it is appropriate to tailor regulatory capital requirements to different banking organizations based, in certain cases, on the organization’s size and level of complexity,” that advanced approaches banking organizations “have the sophistication and infrastructure to implement and apply the fully phased-in treatment of the capital rules,” and that the fully phased-in treatment of the affected items remains appropriate for those firms given their business models and risk profiles.⁸
- ***Implementation of the current expected credit loss (“CECL”) accounting standard.*** In response to comments raising concerns about the impact on regulatory capital as a result of the implementation of CECL,⁹ the agencies noted that they “are considering separately whether or not it will be appropriate to make adjustments to the capital rules in response to CECL and its potential impact on regulatory capital.”¹⁰ The Basel Committee recently revised its capital framework to permit jurisdictions to adopt transitional arrangements addressing the impact on regulatory capital upon implementation of accounting standards requiring the use expected credit loss models, such as CECL and International Financial Reporting Standard (“IFRS”) 9.¹¹ It remains to be seen whether the agencies will propose a transitional arrangement regarding CECL.

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ENDNOTES

- ¹ Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation, *Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations that are not Subject to the Advanced Approaches Capital Rules*, 82 Fed. Reg. 55309 (Nov. 21, 2017) (hereafter, the “Final rule”).
- ² Advanced approaches banking organizations are generally those with \$250 billion or more in total consolidated assets or \$10 billion or more in foreign exposures (including subsidiary depository institutions of bank holding companies that meet one of these thresholds). In the supplementary information, the agencies confirmed that intermediate holding companies (“IHCs”) of foreign banking organizations that meet the advanced approaches definition are treated as advanced approaches banking organizations even though IHCs are not required to determine their risk-based capital ratios under the agencies’ advanced approaches rules. See Final rule at 55310, n. 10.
- ³ Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation, *Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations that are not Subject to the Advanced Approaches Capital Rules*, 82 Fed. Reg. 40495 (Aug. 25, 2017) (hereafter, the “Proposal”). For additional information on the Proposal, please refer to our Client Memorandum, *Banking Organization Capital Requirements: Federal Banking Agencies Propose Extension of Certain Transitional Provisions for Non-Advanced Approaches Banking Organizations* dated August 25, 2017, available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Banking_Organization_Capital_Requirements_August_25_2017.pdf.
- ⁴ Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation, *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 82 Fed. Reg. 49984 (Oct. 27, 2017). For additional information on the simplification proposal, refer to our Client Memorandum, *Bank Capital Requirements: Federal Banking Agencies Propose Capital Rule Simplifications to the Standardized Approach Calculations Applicable Primarily to Non-Advanced Approaches Banking Organizations* dated October 4, 2017, available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Bank_Capital_Requirements_October_04_2017.pdf.
- ⁵ Final rule, at 55310.
- ⁶ Final rule, at 55312.
- ⁷ Final rule, at 55313.
- ⁸ Final rule, at 55311. In the proposal, the agencies limited their explanation as to the dichotomy between non-advanced and advanced approaches banking organizations to the statement that “[t]he agencies believe that ... given the business models and risk profiles of [the advanced approaches banking organizations] ... the current treatment for these items strikes an appropriate balance between complexity and risk sensitivity for the largest and most complex banking organizations.” Proposal, at 40497.
- ⁹ CECL will require banking organizations to establish accounting provisions for credit losses on financial assets based on past events, current conditions and reasonable and supportable forecasts. Upon initial implementation, banking organizations will be required to make a one-time adjustment to retained earnings and, therefore, common equity Tier 1 capital. CECL will become effective beginning with the first quarter of 2020 for banking organizations that are SEC reporting companies and have December 31 fiscal year ends. For additional information on CECL, refer to our Client Memorandum, *FASB Expected Credit Loss Methodology* dated June 23, 2016, available at https://www.sullcrom.com/siteFiles/Publications/S_Publication_Client_AlertFASB_Expected_Credit_Loss_Methodology.pdf.
- ¹⁰ Final rule, at 55312.

ENDNOTES (CONTINUED)

- ¹¹ See Basel Committee on Banking Supervision, *Standards: Regulatory Treatment of Accounting Provisions – Interim Approach and Transitional Arrangements* (March 2017), available at <https://www.bis.org/bcbs/publ/d401.pdf>.

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CONTACTS

New York

Thomas C. Baxter Jr.	+1-212-558-4324	baxtert@sullcrom.com
Jason J. Cabral	+1-212-558-7370	cabralj@sullcrom.com
Whitney A. Chatterjee	+1-212-558-4883	chatterjee@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Elizabeth T. Davy	+1-212-558-7257	davye@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
Michael T. Escue	+1-212-558-3721	escuem@sullcrom.com
Jared M. Fishman	+1-212-558-1689	fishmanj@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Wendy M. Goldberg	+1-212-558-7915	goldbergw@sullcrom.com
Charles C. Gray	+1-212-558-4410	grayc@sullcrom.com
Joseph A. Hearn	+1-212-558-4457	hearnj@sullcrom.com
Shari D. Leventhal	+1-212-558-4354	leventhals@sullcrom.com
Erik D. Lindauer	+1-212-558-3548	lindauere@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Camille L. Orme	+1-212-558-3373	ormec@sullcrom.com
Stephen M. Salley	+1-212-558-4998	salleys@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
Donald J. Toumey	+1-212-558-4077	toumeyd@sullcrom.com
Marc Treviño	+1-212-558-4239	trevinom@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com

SULLIVAN & CROMWELL LLP

Mark J. Welshimer	+1-212-558-3669	welshimerm@sullcrom.com
Michael M. Wiseman	+1-212-558-3846	wisemanm@sullcrom.com
Washington, D.C.		
Sarah C. Flowers	+1-202-956-7630	flowerss@sullcrom.com
Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
William F. Kroener III	+1-202-956-7095	kroenerw@sullcrom.com
Stephen H. Meyer	+1-202-956-7605	meyerst@sullcrom.com
Jennifer L. Sutton	+1-202-956-7060	suttonj@sullcrom.com
Andrea R. Tokheim	+1-202-956-7015	tokheima@sullcrom.com
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
William F. Kroener III	+1-310-712-6696	kroenerw@sullcrom.com
Tokyo		
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com