AN EARLY LOOK AT BASEL III AND COMMUNITY BANKS

Devil may be in the details, not the ratios

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For community banks, capital is king, and always will be.

It is always interesting to figure out what you need, how you are going to get it, and what you are going to allocate it toward. How important is capital? Well, if you had any doubts or questions, note that the "CAMELS" rating starts with "C."

New wrinkles from Basel

As many of you might have noticed, the regulators have just come out with a new Notice of Proposed Rulemaking on capital. Its frightening title is "Regulatory Capital Rules: Regulatory Capital, Implementation of BASEL III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action."

The most frightening part, off the bat, of all this is the press release statement that indicates:

"This Financial Institution Letter (25-2012) is applicable to all banks" (emphasis added).

Nope, no carve-out for community banks, no carve-out for anybody under $10 billion, no application only to those over $50 billion. This hits us all.

"OK, so what?" you may say. You know, "so what" may not be a bad response.

The Notice of Proposed Rulemaking sets elevated capital levels to apply to all institutions. So they are going to change the old capital rules of 4%, 5%, and 10% to something higher.

Truth is, when is the last time a community bank operated at 4% Tier 1 capital without drawing the serious attention of our regulatory friends at the federal and state level?

Capital rules, as such, for community banks, even as they stand, are fairly meaningless because the regulators impose significantly higher de facto capital requirements in the field. (Does 8% Tier 1 and 11% total risk-base or often 9% Tier 1 and 12% total risked base sound familiar?)

I do not think this rule will be a whole lot different, but it does adjust some definitions as it relates to the capital. It changes up the ratios a little bit; adjusts risk weightings (which may have the most impact on community banks); and the like.

The burden of sheer volume

Frankly, the biggest concern I have with the Proposed Rule is its length and complexity. Even if it does not increase the capital requirements, as a practical matter, for community bankers, one impact is that "somebody" must read through this multi-page proposal. "Somebody" should also comment on the proposal (in addition to the trade associations), and then, "somebody" has to implement it and report according to its terms.

All of this spells more cost for community banks. Actually, not "more capital," but more expense. As a practical matter, most community banks are well in excess of the capital requirements, even as these proposed capital requirements will be phased in over the next multiple year period.

What this really is going to result in is more compliance costs.

I have always been in favor of leaving a bad rule in place if I understand it, rather than receiving a new 50-page rule that I not only do not understand, but have to spend the time and money to figure out.

Game worth the candle?

Is the implementation of this new rule worth it?

The reality is that community banks have maintained significant amounts of capital in excess of the regulatory minimums for a long, long time. Not the large banks though. They never played by the same rules as the community banks. The intent of this document, even though it applies to all banks, is really to bring the large banks' capital ratios up.

We might argue that community bank's capital ratios ought to come down.

What do you think?

Jeff continues his discussion of the Basell III proposals in his next blog, "4 Realities To Consider About Risk-Based Capital Proposals."

Disclaimer: Jeff Gerrish's views are not necessarily those of the American Bankers Association.

About Jeff Gerrish

Jeff Gerrish is chairman of the board of Gerrish McCreary Smith Consultants, LLC, and a member of the Memphis-based law firm of Gerrish McCreary Smith, PC, Attorneys. He is a frequent contributor to ABA Banking Journal and ABA Bank Directors Briefing, and frequently speaks at ABA events and telephone briefings.

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