4 REALITIES TO CONSIDER ABOUT RISK-BASED CAPITAL PROPOSALS

Don't discount them, but don't have an ulcer, either

* * *

There is a lot of discussion going on about the newly proposed capital requirements since the Federal Reserve issued its notice of proposed rulemaking on June 7, 2012. As expected, no one appears to be entirely satisfied with the updated rules. In light of all of the commotion, I thought I would provide my overall impressions of the proposed capital requirements, adding on to my initial thoughts recorded in my previous blog.

-

Four key points to keep in mind

It's important to not look at the new proposal in a vacuum, but in light of the overall environment:

-

1. The new capital levels should not be a game-changer for most community banks.

Please do not misunderstand me on this. Increased requirements are always a burden on some level.

Still, the reality is that most community banks already operate in excess of the current capital requirements. Increasing the tier 1 capital ratio to 6% and total capital ratio to 8% does not change this reality. Obviously, banks operating right at the edge of current levels will be impacted, but the new requirements do not change how community banks operate and bulk up capital on the whole.

Troubled banks under the current levels will still be troubled under the proposed levels, and healthy banks under the current levels can be just as healthy under the proposed levels.

2. The new capital conservation buffer is a formalization of what the regulators already practice.

Basically, under the proposed rules a bank must have 2.5% more capital than the minimum risk-weighted capital ratios require in order to pay dividends and discretionary compensation without restriction. As with the capital level increases, most community banks operate in excess of this buffer. For those banks that are teetering on the edge or that are already below the capital requirements, the regulators limiting dividends and executive compensation is nothing new. In our experience, once a bank begins to approach the regulatory "danger zone," the regulators look very closely at bank payouts of any kind. Putting this policy into a formal regulation ups the ante slightly, but the overall impact should not expose community banks to new significant risks.

3. The new risk weighting scheme is overkill for community banks.

The most significant change to the proposed asset risk weight requirements is that the risk-weight for single-family mortgages ranges from 35% to 200%, depending on certain factors such as the loan-to-value ratio.

This is an example where tiered regulation would be highly preferred for community banks.

When combined with the already increasing compliance costs and regulatory scrutiny in the mortgage arena, these increased risk-weights could limit the ability of some small-player banks from successfully competing in mortgage products and services.

4. Don't forget about the phase-in periods.

The minimum equity, tier 1 capital, and total capital ratios are fully phased in by 2015, but the capital conservation buffer does not begin to phase in until 2016 and is not fully phased in until 2019. This gives community banks a few years to bulk up their capital, if necessary.

Looking forward

The capital proposals that were put out by the federal regulatory agencies, as outlined above, will likely be changed somewhat before final implementation.

Although there are some points in the proposed capital rules that community bankers would like changed (maybe a lot of things), I still would not lose a lot of sleep over the proposals.

Community banks have historically operated under a much higher and stricter capital requirement than is being set forth. This, however, is another example of the community bank segment in the industry paying for the sins of the mega banks.

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.

Gerrish formerly served as Regional Counsel for the Memphis Regional Office of the FDIC, with responsibility for all legal matters, including cease-and-desist and other enforcement actions. Before coming to Memphis, Gerrish was with the FDIC Liquidation Division in Washington, D.C. where he had nationwide responsibility for litigation against directors of failed banks.

-

Gerrish can be reached at jgerrish@gerrish.com, and the firm’s website, www.gerrish.com.

You can get word about these columns the week they are posted by subscribing to ABA Banking Journal Editors Report e-letter. It's free and takes only a minute to sign up for. Click here.