

CAPITAL REQUIREMENTS

(as of July 7, 2011)

Generally, the Dodd-Frank Act imposes more stringent regulatory capital requirements on financial institutions. The Act requires that the Financial Stability Oversight Council (“Council”) make recommendations to the Federal Reserve regarding the establishment of heightened prudential standards for risk-based capital, leverage, liquidity and contingent capital.

Supervised Nonbanks and Bank Holding Companies with Total Consolidated Assets Equal to or Greater than \$50 Billion

- The Federal Reserve must establish prudential standards for these institutions, which include:
 - Risk-based capital requirements;
 - Leverage limits;
 - Liquidity requirements;
 - Requirements for a resolution plan; and
 - Concentration limits
- These standards also include a risk committee requirement, a stress test requirement, and may include a contingent capital requirement, requirements for enhanced public disclosures, and short-term debt limits
- These institutions will be subject to a maximum debt-to-equity ratio of 15-to-1

Collins Amendment Provisions (Section 171)

- Require the establishment of minimum leverage and risk-based capital requirements
 - Set the risk-based capital requirements and the Tier 1 to total assets standard applicable to insured depository institutions under the prompt corrective action provisions of the Federal Deposit Insurance Act
 - Set these current rates as a floor
 - Limit regulatory discretion in establishing Basel III requirements
- Raise the specter of additional capital requirements for activities that are determined to be risky, including, but not limited to, derivatives, securitized products, financial guarantees, securities borrowing and lending and repos
- All of these requirements become effective upon the adoption of implementing regulations, which are required to be passed within 18 months of the Act’s enactment

Final Rules to date:

Risk-Based Capital Floor. On June 14, 2011, the banking agencies adopted a final rule (<http://www.fdic.gov/news/board/14june2011no4.pdf>) that implements Section 171 and establishes a permanent risk-based capital floor equal to the capital requirements calculated under a banking agency’s general capital rules.

Effect on Hybrids

- The application of the prompt corrective action provisions for insured depository institutions to bank holding companies no longer permits the inclusion of trust preferred securities or other hybrid securities in the numerator of Tier 1, subject to certain exceptions and phase-in periods as discussed below
 - Mutual holding companies and thrift and bank holding companies with less than \$15 billion in total consolidated assets are not subject to this prohibition for hybrids issued before May 16, 2010
 - Intermediate U.S. holding companies of foreign banks have a five-year phase-in period
 - For newly issued securities (those issued after May 19, 2010), the requirement is retroactively effective
 - For bank holding companies and systemically important nonbank financial companies, hybrids issued prior to May 19, 2010 will be subject to a phase in from January 2013 to January 2016

Required Studies

- There are a number of studies required that impact regulatory capital requirements
 - Hybrids: Within 18 months of enactment, the GAO must conduct a study on the use of hybrid capital instruments and make recommendations for legislative or regulatory actions regarding hybrids

- Contingent capital: within two years of enactment, the Council must present the results of a study on contingent capital that evaluates, among other things, the effect on safety and soundness of a contingent capital requirement, the characteristics and amounts of contingent capital that should be required and the standards for triggering such requirements; following this study, the Council may recommend to the Federal Reserve certain minimum contingent capital requirements.