BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 20-8

March 30, 2020

Revised April 2, 2020

On April 2, 2020 the SR letter was revised to modify the descriptions of the denominators that examiners will use to calculate credit concentrations. The descriptions of the denominators in the SR letter now fully align with the descriptions in the interagency statement. The interagency statement was not modified.

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach

Applicability: This guidance is relevant to the supervision of state member banks, bank holding companies, and savings and loan holding companies.

The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the agencies) have issued an interagency statement to clarify the approach on calculating credit concentrations for supervisory purposes. Historically, total capital, which includes tier 2 capital, has been the denominator in calculating credit concentration ratios used for supervisory processes, such as describing concentrations in supervisory letters or reports of examination. However, qualifying community banking organizations that elect the community bank leverage ratio (CBLR) framework are not required to report tier 2 capital on the appropriate reports of condition and income (Call report).[1]

Accordingly, as of March 31, 2020, the agencies will use the following denominators to calculate credit concentration ratios:[2]

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[1] Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), Pub. L. No. 115-174, 132 Stat. 1296, 1306–07 (2018), directed the agencies to establish a community bank leverage ratio for qualifying community banking organizations as a simple alternative methodology to measure capital adequacy. For the agencies' final CBLR rule, see 84 *Fed. Reg*. 61776 (November 19, 2019).

[2] This is based on applicable Call report filing for state member banks and the applicable Y-9 reports for holding companies.

- For banking organizations that have adopted the Financial Accounting Standards Board's Accounting Standards Codification Topic 326, Financial Instruments—Credit Losses (CECL): Tier 1 capital plus the portion of the allowance for credit losses attributed to loans and leases.
- For banking organizations that have not adopted CECL: Tier 1 capital plus the entire allowance for loan and lease losses.

These denominators apply to supervisory calculations of credit concentration ratios and do not affect the calculation of total capital in other areas, including agency requirements. Federal Reserve Board staff plan to identify and update historical guidance on the calculation of credit concentrations found in SR letters and in supervision manuals, including the *Bank Holding Company Supervision Manual* and the *Commercial Bank Examination Manual*.

Federal Reserve Banks are asked to distribute this letter to the supervised institutions in their districts and to appropriate supervisory staff. Questions regarding this letter may be directed to the following staff in the Division of Supervision and Regulation: Juan Climent, Manager, at (202) 872-7526; Andrew Willis, Lead Financial Institution Policy Analyst, at (202) 912-4323; and Mason Wesenberg, Senior Financial Institution Policy Analyst I, at (202) 452-3697. In addition, supervised organizations may send questions via the Board's public website.[3]

Michael S. Gibson
Director

Attachment:

- *Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach*

[3] https://www.federalreserve.gov/apps/contactus/feedback.aspx

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach

March 30, 2020

For supervision purposes, the agencies are adjusting their calculation for credit concentration ratios to maintain a consistent approach for all banking organizations. A concentration of credit generally exists when the extensions of credit or other obligations possess similar risk characteristics. Typically, loans to related groups of borrowers, loans collateralized by a single security or securities with common characteristics, and loans to borrowers with common characteristics within an industry have been included in homogenous risk groupings when assessing credit concentrations. For supervisory processes, credit concentration ratios assist in capturing the size and potential risks of material credit concentrations posed to an institution's capital. The adjustment in the ratios is in response to changes in the regulatory capital requirements for some banking organizations after the implementation of the Community Bank Leverage Ratio (CBLR) Rule.[1] As of March 31, 2020, qualifying community banking organizations[2] that elect the CBLR framework are no longer required to report tier 2 capital. Tier 2 capital is a component of total capital, which has generally been the denominator in credit concentration ratios used for supervisory processes.

As of March 31, 2020, for banking organizations that have adopted the Financial Accounting Standards Board's Accounting Standards Codification Topic 326, *Financial Instruments—Credit Losses* that implements the current expected credit losses (CECL) methodology, the agencies' examiners will calculate credit concentration ratios using tier 1 capital plus the allowance for credit losses attributed to loans and leases as the denominator. For banking organizations that have not adopted CECL, the agencies' examiners will calculate credit concentration ratios using tier 1 capital plus the entire allowance for loan and lease losses as the denominator.

This adjustment is expected to approximate the agencies' historical methodology for calculating credit concentration ratios. This adjustment also provides a consistent supervisory approach for all banking organizations. This adjustment applies only to supervisory calculations for credit concentration ratios and does not affect the calculation of total capital for other purposes.

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[1] Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), Pub. L. No. 115-174, 132 Stat. 1296, 1306–07 (2018), directed the agencies to establish a community bank leverage ratio for qualifying community banking organizations as a simple alternative methodology to measure capital adequacy. For the agencies' final CBLR Rule, see 84 *Fed. Reg*. 61776 (November 19, 2019).

[2] The CBLR Rule defines qualifying community banking organizations as depository institutions and depository institution holding companies with less than $10 billion in total consolidated assets and meet other qualifying criteria, including a leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than 9 percent.