With passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (S. 2155), community banks gained exemption from several key facets of the post-crisis financial regulatory framework. Included among the provisions of S. 2155 was the Community Bank Leverage Ratio (CBLR), a special alternative capital framework available only to banks holding less than $10 billion in assets.

Under the requirements of the CBLR, qualifying institutions are provided the option to meet a simple leverage ratio of 9% tier 1 capital to average total consolidated assets, instead of the risk-weighted requirements currently in place. Proponents of the measure argue that by reducing burdensome risk-weighting requirements, the CBLR standard provides community banks a more level playing field on which to compete with large institutions.

**Capital Regulation Fundamentals**

In order to understand the potential impact of the CBLR, it is important to have some background on the basics of capital regulation.

In a basic sense, **capital** represents the amount of funding a financial institution has secured from equity, and thus the amount of losses it can sustain without defaulting on its obligations to creditors. Regulators use several measures to assess a bank’s capital adequacy, established under an international regulatory accord known as Basel III.

The simplest measure of capital adequacy is a **leverage ratio**, which measures a bank’s
proportion of core capital – consisting mostly of common stock and retained earnings – to average total assets over a quarterly period. Regulators often use several complementary leverage ratios which distinguish between the quality of capital held in order to capture a full picture of a bank’s overall solvency.

![Leverage Ratio](image)

\[
\text{Leverage Ratio} = \frac{\text{Capital}}{\text{Average Assets}}
\]

In addition, regulators use risk-weighted ratios, which assign each asset on a bank’s balance sheet a weight based on likelihood of default, to provide a more complete picture of an institution’s exposure to risk. Under current Basel III rules, banks must maintain a total risk-based capital ratio of 8%, with an additional buffer of 2.5%.

![Total Risk-Based Capital Ratio](image)

\[
\text{Total Risk-Based Capital Ratio} = \frac{\text{Capital}}{\text{Risk-Weighted Assets}}
\]

For example, US Treasury Securities are assigned a risk weight of 0% under current capital rules. Consequently, banks are not required to hold capital against US Treasuries on their balance sheet. However, if the same bank holds $5 million in senior debt securities issued by ABC Widgets Inc. – which are risk weighted at 100% – it must recognize $5 million of risk-weighted assets for that particular exposure. In order to meet its 10% total risk-based capital requirement under Basel III, the bank must hold at least $500,000 in capital against the exposure.

To learn more about eligibility requirements for the CBLR and its potential impact on community banks, visit the FDIC Community Banking Initiative [website](#).
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