BANKING & FINANCE

Banking Conditions, Regulatory Updates Discussed in New "ViewPoint"

September 28, 2018

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It doesn't seem possible that the fourth quarter begins in just a few days—hopefully we will finally have some fall weather! The third quarter has been busy—the Board and other banking agencies are hard at work on policies implementing the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), and we are taking stock of what the changes mean for the Sixth District. As always, we remain focused on providing effective and efficient supervision to maintain a healthy banking system.

This edition of "ViewPoint" includes our regular feature, State of the District. We are also preparing articles on residential real estate and an update on implementation of EGRRCPA. First, we review the State of the District.

State of the District

In the second quarter, community banks in the District continued to move beyond the crisis. The median return on average assets (ROAA) reached 1.20 percent, a postcrisis high. Stronger net interest margins and earnings helped maintain capital levels. On a median basis, the tier 1 capital ratio exceeded 15 percent, on par with the prior year and a slight improvement over the first quarter.

Although higher interest rates have resulted in improved earnings, the potential impact of rising rates on liquidity is cause for concern. Loan growth has been outpacing deposit growth for many community banks, and institutions are borrowing to cover the difference. So far, net noncore funding remains historically low, but the increased use of borrowed money requires close monitoring.

On a broad basis, asset quality metrics at community banks remained healthy in the second quarter. The coverage ratio has returned to precrisis levels, with the allowance for loan losses at 1.7 times nonaccrual loans. Despite the strength of current metrics, increased delinquencies and defaults on consumer loans are troubling. Small business delinquencies are also starting to climb across multiple industries in the Southeast. These trends warrant continued scrutiny.

Regulatory Update

EGRRCPA Interim Approach: On July 6, the Banking Agencies issued a joint statement describing their supervisory approach during EGRRCPA implementation. The Fed also released a separate statement on the implications for holding company supervision. The Act included certain provisions that were immediately effective, leading to conflict with existing regulatory requirements. Several of these provisions require a rulemaking process, which takes time. In the interim period, the Agencies will not enforce regulations and reporting requirements that are inconsistent with EGRRCPA. Information on other provisions, including reporting requirements for smaller depository institutions, as well as requirements for firms with $100 billion to less than $250 billion in assets, will be provided at a later date.

Three interim EGRRCPA rules, which are effective immediately, were announced in August, including:

- An increase in the threshold for application of the Board's Small Bank Holding Company Policy Statement from $1 billion to $3 billion in total consolidated assets;
- An expansion of the threshold for an 18-month onsite examination cycle from under $1 billion to under $3 billion in total assets for qualified institutions. The rule also changes the definition of qualifying characteristics to include firms with "good" composite ratings. Previously, only firms with "outstanding" composite ratings were eligible. The rule also makes parallel changes to the agencies' regulations governing the onsite examination cycle for U.S. branches and agencies of foreign banks; and
- An amendment to the agencies' liquidity rules to expand the definition of high-quality liquid assets (HQLA) to include certain eligible municipal securities.

Proposed HVCRE definition: On September 18, the federal banking agencies invited public comment on a proposal to modify the agencies' capital rules for high volatility commercial real estate exposures (HVCRE) as required by EGRRCPA. To ensure consistent application of the revised HVCRE exposure definition, the agencies also propose to interpret certain terms in the revised definition in a manner generally consistent with their usage in other relevant regulations or in the Call Report, where applicable. The changes, when finalized, would apply to all banking organizations subject to the agencies' capital rules.

Upcoming features in "ViewPoint"

Stay tuned for the coming "ViewPoint Live." In addition to our regular review of banking conditions, we will discuss developments in fintech. Also, remember to check back here for the registration link for this special event and to read the articles that will be published next quarter. In the meantime, take a look at our examiners' perspectives on consumer compliance in Keeping Ahead of a Changing Bank Environment.

As always, we welcome your comments or questions. Please share your feedback at ViewPoint@atl.frb.org.

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