TEXAS DEPARTMENT OF BANKING	Bank Name/City:
	Charter #:
	Exam Date:
	Performed By:

#5 – Capital and Dividends

Assignment Overview

Adequate capital is essential to absorb losses not covered by earnings; support asset growth; provide protection to depositors; and ensure public confidence in the banking system. The examiner's role is to evaluate the adequacy of capital in light of the bank's current condition and operations, considering growth trends, new activities, and other strategic initiatives. Both qualitative and quantitative factors are used in the evaluation of capital since a high level of capital does not necessarily guarantee adequacy. It is also important to assess the capital structure and ownership of the organization to determine the extent of potential future support from existing shareholders.

For additional guidance, refer to FDIC Risk Management Manual of Examination Policies, Section 2.1 – Capital and the DOB's Reference Material document applicable to this procedure.

Instructions

IMPORTANT! These procedures are designed to promote critical thinking. As you complete this procedure, keep in mind that your comments should include what you looked at, what you found, and your conclusions. It is your narrative that should tell the story for a reader who may not be familiar with this bank.

Examiners must follow the instructions below and the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations. If there is a conflict between these Instructions and the Examiner Bulletin, the Instructions prevail. Documentation should support weaknesses and criticisms. All examiners performing these procedures must be listed above in the "Prepared By" section.

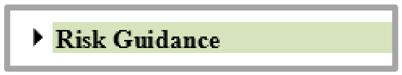
Examiners are responsible for exercising sound judgment and utilizing reasonable investigative and analytical skills to arrive at an accurate assessment of the risk profile of this segment of the institution's operations.

Evaluation Factors, Risk Guidance, and Comments

The focus of this procedure is to evaluate and address each of the Evaluation Factors.

The focus of this procedure is to evaluate and address each of the Evaluation Factors. The Risk Guidance is provided to guide the examiner in developing a full and complete analysis for the Evaluation Factor. Documenting responses in the Risk Guidance section is not required. All conclusions should be documented in the Conclusion box for the Evaluation Factor. **Examiners will use their discretion to determine when to comment on a risk guidance item, considering what data or findings merit emphasis and which are secondary or of little importance.** The examiner is expected to write a comment in the Conclusions box that is complete and supportive of findings, recommendations, and ratings. Do not write a comment to refer to the Risk Guidance.

The examiner may also address areas not included in the Risk Guidance section as it is not intended to be all inclusive.



To view the Risk Guidance, click on the arrow to the left of the "Risk Guidance" text.
To Hide the Risk Guidance, click on the arrow again.

Documentation

Supporting documentation should include the standard required documents identified in the Reference Documents section for each Evaluation Factor.

- Embedded documents should be named such that the reviewer will know the contents.
- If a required document will not be included for any reason, DO NOT DELETE the document title, instead, check either:
    - "Not Included" and add a reason why OR
    - "N/A" if a document is not applicable.
- Any other relevant documents may be added to fully support the examiner's findings. These documents may be embedded in the Reference Documents section.
- If a document needs to be reference in more than one Evaluation Factor comment, include a reference in the comment indicating the Evaluation Factor where the document can be found.

Documentation is to be sufficient to allow an audit trail of the examiner's thought process and all significant findings.

Violations of Regulations

Violations of regulations should be addressed under the appropriate Evaluation Factor. Indicate compliance using the drop-down box next to the regulation in the Compliance section. Address non-compliance in the Comment section.

Yes = In compliance

No = Not in compliance

Not Applicable = Requirements in the regulation do not apply. For example, if there were no dividends paid, then the regulation related to approval of dividends would reflect "Not Applicable".

Nonconformance with Policy

Adherence with best practices identified in Department and federal financial regulatory policy/guidance should be addressed under the Comments for the appropriate Evaluation Factor. Indicate if the bank adheres to the best practices using the drop-down box next to the appropriate policy in the Adherence to Policy section. Comments regarding best practices should be summarized in the Summary Comments.

Summary Comments and Conclusions

The Summary Comments and Conclusions should be a high-level summary that highlights the examiner's material findings and conclusions. A description of what to include in the Summary Comments and Conclusions is provided. These comments are not intended to be a report ready comment and will contain comments that may not be report worthy. Summary comments must support the Summary Rating.

The EIC will determine if the use of bullet points is appropriate for completing the Summary Comments and Conclusions. *The SEIC/EIC will have discretion in determining what is included in the Report of Examination.*

Navigating this Procedure

This procedure can be easily navigated by clicking on View from the Word menu bar then selecting Navigation Pane found in the Show section. All headings in this document will appear on the left side of the screen, for easy navigation through the document.

Performing alternate or expanded procedures not listed with these guidelines may be necessary to complete this risk analysis.

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Summary of Findings

#5 Capital - Summary Comment and Conclusions

Document conclusions regarding the adequacy of the bank's capital levels in relation to the risk profile of the institution as well as management's ability to properly identify, measure, monitor, and control those risks. Include recommendations for implementing best practices from policies and Management's responses to weaknesses. *The SEIC/EIC will determine what to include in the report of examination.*

Summary Rating: **Click to Select Rating**

Definitions for Summary Ratings –

CAMELS: 1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient

Ratings Matrix.xlsm

Violations

Prepare a comment for any violation cited. Include management's response.

Preliminary Review

Review the following items:

- Examination Scope Memo
- Prior Examination Capital comments
- Last State Examination Capital workpapers
- External/Internal Audit findings concerning capital
- Audit Scope
- Balance Sheet
- UBPR
- Call Report
- Strategic Plan
- Capital Plan
- Stock Books

The capital review should be coordinated with examiners reviewing other component areas of the bank, in particular earnings and credit risk as they relate to dividends and capital adequacy. Coordination with the examiner can reduce burden on the bank and prevent duplication of examination efforts.

Capital Analysis

EVALUATION FACTOR 1:
Review the last examination, most recent internal/external audit, and correspondence to identify any recommendations, violations, Matters Requiring Attention, or regulatory enforcement actions. Determine Board and Management's efforts to comply with or correct noted deficiencies or concerns.

Reference Documents	Conclusions – Evaluation Factor 1
Prior Examination Criticisms and/or Audit Exceptions ☐ N/A ☐ Not Included Copy of Management Response/Corrective Action ☐ N/A ☐ Not Included Other Supporting Documents:	

EVALUATION FACTOR 2:
Determine the adequacy of capital levels, including the composition and quality given the size, complexity, and risk profile of the bank.

Risk Guidance

1. **Consider the level of capital in relation to the following:**
   a. Risk profile;

b. Level, quality, and sustainability of earnings;

c. Level of the allowance for loan and lease losses and any additional provisions that are expected;

d. Quality of assets and credit administration practices;

e. Level of concentrations;

f. Level of planned growth;

g. Balance sheet composition and liquidity needs;

h. Dividend plans;

i. Off-balance sheet obligations;

j. Pending litigation; and

k. Impact of the parent holding company (source of strength or not).

2. Determine the PCA Capital category for the bank.

a. Review capital ratios under the Prompt Corrective Action (PCA) standards in **APPENDIX A**.

Refer to 12 CFR 324 Subpart H – Prompt Corrective Action (PCA) (FDIC supervised banks) or 12 CFR Chapter II Part 208 Subpart D §208.43, Regulation H, FRB member banks).

b. If the bank is less than "Well Capitalized" determine compliance:

i. Determine compliance to operational limitations in 12 CFR 324.404– Capital Restoration Plans. (12 CFR 208.44 state FRB member banks)

ii. Determine compliance to operational limitations in 12 CFR 324.405– Mandatory and Discretionary Supervisory Actions Under Section 38. (12 CFR 208.45 state member banks).

iii. Determine compliance to operational limitations in 12 CFR 337.6 – Brokered Deposits in Undercapitalized Insured Depository Institutions.

iv. Determine compliance to operational limitations in FDICIA 12 USC 1831o (d)(1) and (2) – Capital Distributions Restricted and Management Fees Restricted

3. If management has plans for stock repurchases consider:

a. Are buy-backs consistent with the organization's strategic plans?

b. Does the bank have a minimum target capital ratio?

c. Does the repurchase plan have target share prices, volumes, and timing?

d. If applicable, has the parent notified the FRB and received a nonobjection letter?

4. **Consider dividend practices and plans and determine if they are consistent with the maintenance of adequate capital levels or are required for debt service.**

   a. Determine if dividends are paid for shareholder return or for debt service requirements.

      i. Is the level of dividends paid in relation to net income reasonable?

   b. Consider if dividends are in line with the bank's strategic and capital plans.

   c. If dividends were paid:

      i. Were they properly approved by the Board as required in the Texas Business Organizations Code 21.302?

      ii. Are dividend discussions adequate?

5. **Assess compliance with applicable laws and regulations.**

   a. Determine compliance with Part 364 Appendix A Section G of the FDIC Rules and Regulations for safety and soundness standards related to Asset Growth. An institution should ensure its asset growth is prudent considering the effect of growth on the institution's capital.

   b. For member banks, is the bank compliant with 12 CFR § 208.5 - Dividends and other distributions?

   c. Determine if the bank has plans to or has opted into the Community Bank Leverage Ratio (CBLR) framework which became effective on January 1, 2020. (See Federal Register - Final Rule 10/9/20)

      i. Qualifying banking organizations can opt into the CBLR framework beginning with their March 31, 2020 regulatory reporting forms.

      ii. If opting in to the CBLR framework: (1) Determine if the bank meets the eligibility requirements; and (2) Review the bank's capital ratios to determine compliance.

6. **Review the bank's capital conservation buffer, and the appropriateness of any distributions and discretionary bonus payments. Refer to APPENDIX C for information regarding the capital conservation buffer**.

   a. Verify compliance with 12 CFR 324.11 Subpart B (FDIC supervised banks) and 12 CFR Chapter II Part 208, Subpart A Section 208.5, Regulation H (FRB member banks). Refer to FIL-40-2014 regarding dividend requests from S-Corp banks.

Compliance with Regulations	
Approval of dividends under Texas Business Organizations Code 21.302	***Select Response***
Asset Growth under Appendix A, Part 364 of FDIC Rules and Regulations	***Select Response***
Capital withdrawal under 12 CFR 324.11 (Non-member) or 12 CFR 208.5, Regulation H (Member)	***Select Response***
PCA Capital Category	
Is Bank "Less than Well Capitalized?	***Select Response***
If "Less than Well-Capitalized, Indicate Compliance	
Operational limitations in 12 CFR 324.404– Capital Restoration Plans (Non-member) or 12 CFR 208.44 (Member)	***Select Response***
Operational limitations in 12 CFR 324.405– Mandatory and Discretionary Supervisory Actions Under Section 38 (Non-member) or 12 CFR 208.45 (Member)	***Select Response***
Operational limitations in 12 CFR 337.6 – Brokered Deposits in Undercapitalized Insured Depository Institutions	***Select Response***
Operational limitations in FDICIA 12 USC 1831o (d)(1) and (2) – Capital Distributions Restricted and Management Fees Restricted.	***Select Response***

Reference Documents	**Conclusions – Evaluation Factor 2**

EVALUATION FACTOR 3:
Evaluate the adequacy of the capital planning process and determine whether the Board has adopted effective capital and dividend policies and plans.

Risk Guidance

1. **Determine if there is a Board approved Capital Plan/Policy and Dividend Policy. If there is not a Capital Plan, determine if the Strategic Plan addresses the capital plan.**

2. **Consider the appropriateness of the bank's capital and dividend policies.**

   a. Consider whether the plan(s):

      i. Are consistent with the Board's risk appetite;

      ii. Provide for compliance with applicable laws;

      iii. Include appropriate targets and limits for minimum capital ratios, dividends, and capital levels;

      iv. Include triggers and corresponding actions if capital drops to a certain level;

      v. Promote capital preservation;

      vi. Include appropriate contingency plans; and

      vii. Include the availability of possible capital sources such as funding by insiders, utilizing external sources, taking out debt at the holding company level, or selling additional stock.

3. **Assess the availability of additional capital sources.**

   a. Determine the support and strength of the holding company, if applicable.

      i. If a parent company is present, what is the current structure?

      ii. If the holding company currently has outstanding debt, consider the following:

1. How much debt is currently outstanding?
2. What are the terms of the debt?
3. Does the bank make dividend payments to reimburse the holding company for debt service payments?
    a. If so, does the bank have enough earnings to make the necessary payments?

iii. Does the bank or holding company have ability to raise capital, if necessary?

1. Can the holding company sell additional stock?
2. Can the holding company acquire capital through other markets?
3. Are sources of capital limited or adequate?

Reference Documents	Conclusions – Evaluation Factor 3

EVALUATION FACTOR 4:
Review Corporate Governance to determine the adequacy of Board and management oversight to identify, measure, monitor, and control the risks within the institution.

Risk Guidance

1. **Consider the reporting and monitoring structure such as:**
    a. Are reports provided to the Board and/or management to compare targets to actual capital ratios?
    b. Are the reports accurate and effective?
    c. Does management appropriately respond to triggers in place to maintain appropriate capital levels?
    d. Does management perform stress tests and incorporates the results into capital maintenance plans?

i. Assess the stress-testing method utilized and

ii. Evaluate underlying assumptions and whether or not they are reasonable

2. **Consider if management is adequately monitoring and managing concentration risk? See APPENDIX B for specific criteria.**

3. **Confer with other examiners regarding concentrations and the need to complete the concentration page in the ROE.**

Reference Documents	Conclusions – Evaluation Factor 4

Evaluation Factor 5:
Determine the effectiveness of the system of internal controls and the independent review function for capital.

Risk Guidance

Consider the following:

1. **Independent review functions:**

    a. The scope should be commensurate with the risk profile of the institution and typically include, but not be limited to, the following:

        i. Proper controls in place over the posting, reconciliation, and handling of capital related accounts.

        ii. A reconciliation and review of Call Report schedules relating to capital.

        iii. Proper controls, such as segregation of duties, in place over dividend checks including the authorization of

        iv. Proper controls over stock certificates and the stock book.

    b. Timely reporting to the Board

c. Management response *as needed*.

2. Process and controls in place to ensure that call report schedule RC-R is accurate.

3. Process for maintaining model integrity (i.e., models are kept current, sufficient training and controls on data input, etc.)

4. Compliance with applicable laws and regulations.

a. Determine if the calculations of Tier 1 and Tier 2 capital appear correct under the revised capital rules,12 CFR Part 324 (Non Member) and 12 CFR Part 217 (Member), or whether the bank needs to make any revisions.

   i. Consider balancing and reconciling the capital accounts (all categories of Tier 1 and 2) to the general ledger and verify that any capital schedules are accurately reported in the call report.

b. Ensure any transfers and reductions are in accordance with Section 32.103 of the Texas Finance Code, and 12 CFR 303.241 (FDIC), and 12 CFR 208.5 (FRB) .

c. Determine compliance with deferred tax assets reporting restrictions, specifically, 12 CFR Part 324.22.

d. If the bank's capital structure includes treasury stock, determine compliance under Texas Finance Code 34.102.

OPTIONAL*: If there are any concerns noted in the factors listed above, or if there is evidence of missing stock certificates or improper activities within the stock certificates/stock book, then notify the examiner working the audit procedure and consult with the EIC to determine if Call Report reconciliation should be performed.*

Compliance with Regulation	
Calculations of Tier 1 and Tier 2 capital appear correct under the revised capital rules, 12 CFR Part 324 (Non Member) and 12 CFR Part 217 (Member)	***Select Response***
Non-qualifying capital instruments or non-qualifying minority interest under 12 CFR Part 324.20-21 (Non-member) or 12 CFR Part 217.20-21 (Member)	***Select Response***
Transfers and reductions under TFC §32.103	***Select Response***
Transfers and reductions under 12 CFR 303.241 (Non-member) or 12 CFR 208.5 (Member)	***Select Response***
Deferred tax asset reporting restrictions under 12 CFR 324.22	***Select Response***
Treasury stock compliance under TFC § 34.102	***Select Response***

Reference Documents	Conclusion -Evaluation Factor 5

EVALUATION FACTOR 6:
Determine directorate control both individually and aggregately, any shareholder with 5% or more of ownership/control, and if there has been a change in ownership since the last examination.

Risk Guidance

1. **Review stockholder list for any change in ownership since the last exam.**
   a. Note directorate control, individually and aggregate.
   b. Identify any shareholder with 5% of more in ownership or control.

i. Note: Ownership and control can be split between two individuals (bank officer, spouses, minor children, etc.)

c. If change in ownership occurred, ensure compliance with TFC 33.001.

2. **Consider balancing the stock book to the current shareholder list if unusual activity is noted or if controls surrounding the stock book are not adequate.** When review is completed initial and date the back of the last certificate.

3. **For publicly traded intuitions, refer to EDGAR, the SEC's database of company filings to find 10-Ks(annual report), 10-Qs (quarterly reports), 8-Ks (change in material status), DEF 14A (helpful for stock ownership, executive salaries, etc.) and 13Gs (beneficial ownership).**

4. **If the bank has 2,000 shareholders or more and is a non-member bank, determine that it has registered with the Securities and Exchanges Commission as required by 12 CFR 335.**

Compliance with Regulation	
Change in Control under TFC §33.001	***Select Response***
2,000 shareholders or more and non-member bank, compliance with SEC under 12 CFR 335	***Select Response***

Reference Documents	Conclusions – Evaluation Factor 6
Shareholder List ☐ N/A ☐ Not Included Correspondence with Banking Commissioner, if applicable ☐ N/A ☐ Not Included Other Supporting Documents:	

Reference Documents	Conclusions – Evaluation Factor 6

APPENDIX A

PROMPT CORRECTIVE ACTION
(AS OF JANUARY 1, 2015)

PCA CAPITAL CATEGORY	Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	CET1 Risk-Based Capital Ratio	Tier 1 Leverage Ratio	Capital Order or Directive
Well Capitalized	≥ 10%	≥ 8%	≥ 6.5%	≥ 5%	NO
Adequately Capitalized	≥ 8%	≥ 6%	≥ 4.5%	≥ 4% [1]	
Undercapitalized	< 8%	< 6%	< 4.5%	< 4% [2]	
Significantly Undercapitalized	< 6%	< 4%	< 3%	< 3%	

PCA CAPITAL CATEGORY	RATIO	Capital Order or Directive
Critically Undercapitalized	Tangible Equity /Total Assets ≤ 2%	

[1] Beginning January 1, 2018. for an advanced approaches bank (as defined in 12 CFR §208.41), the supplementary leverage ratio is > 3%

[2] Beginning January 1, 2018. for an advanced approaches bank (as defined in 12 CFR §208.41), the supplementary leverage ratio is < 3%

Tangible Equity Ratio

The tangible equity ratio is defined as tier 1 capital *plus* outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital *divided by* total assets

Risk Weights

Category	Capital Rule	Section
Cash	0%	Subpart D, §.32(l)(1)
Direct and unconditional claims on the U.S. government, its agencies, and the Federal Reserve	0%.	Subpart D, §.32(a)(1)(i)
Claims on certain supranational entities and multilateral development banks	0%	Subpart D, §.32(b)
Cash items in the process of collection	20%	Subpart D, §.32
Conditional claims on the U.S. government	20%	Subpart D, §.32(a)(1)(ii)
Claims on government- sponsored enterprises (GSEs)	20% on exposures other than equity exposures and preferred stock. 100% on GSE preferred stock.	Subpart D, §.32(c)
Claims on U.S. depository institutions and National Credit Union Administration-insured credit unions	20% Unchanged unless the instrument is an equity exposure or required to be deducted.	Subpart D, §.32(d)(1)
Claims on U.S. public sector entities (PSEs)	20% for general obligations. 50% for revenue obligations.	Subpart D, §.32(e)(1)
Industrial development bonds	100%	Subpart D, §.32
Claims on qualifying securities firms	100% See corporate exposures below.	Subpart D, §.32(f)

Category	Capital Rule	Section
One- to four-family loans	50% if first lien, prudently underwritten, owner occupied or rented, not 90 days or more past due or carried in nonaccrual status, is not restructured or modified. 100% otherwise.	Subpart D, §.32(g)
One- to four-family loans modified under Home Affordable Modification Program	50% and 100% The banking organization must use the same risk weight assigned to the loan prior to the modification so long as the loan continues to meet other applicable prudential criteria.	Subpart D, §.32(g)(3)
Loans to builders secured by one- to four-family properties presold under firm contracts	50% if the loan meets all criteria in the regulation. 100% if the contract is cancelled. 100% for loans not meeting the criteria..	Subpart D, §.32(h)
Loans on multifamily properties	Substantively unchanged. Clarified and updated the manner in which the rule defines these exposures.	Subpart D, §.32(i)
Corporate exposures and consumer loans	100% unless the exposure is an investment in an instrument included in the regulatory capital of another financial institution.	Subpart D, §.32(f)

Category	Capital Rule	Section
Commercial real estate (CRE)	100%. 150% for high volatility commercial real estate (HVCRE), which is a subset of CRE, and defined as a credit facility that, prior to conversion to permanent financing, finances or has financed the acquisition, development, or construction of real property, ***unless*** the facility finances: (1) one- to four-family residential properties; (2) certain community development projects; (3) the purchase or development of agricultural land; or (4) commercial real estate projects that meet the criteria in the rule, including criteria regarding the loan-to-value ratio and capital contributions to the project.	Subpart D, §.32(j)
Past-due exposures	150% for the portion that is not guaranteed or secured (does not apply to sovereign exposures). One- to four-family loans that are past due 90 days, or more are assigned a 100% risk weight.	Subpart D, §.32(k)

Category	Capital Rule	Section
Assets not assigned to a risk weight category, including fixed assets, premises, and other real estate owned	100%.	Subpart D, §.32(l)(5)
Mortgage-backed securities (MBS), asset-backed securities (ABS), and structured securities	Two general approaches—gross-up approach and simple supervisory formula approach. May also choose to risk weight a securitization exposure at 1,250%.	Subpart D, §.42, §.43, and §.44
Equity exposures	Range of risk weights between 0 and 600% depending on the entity and whether the equity is publicly traded.	Subpart D, §.51 and§.52
Equity exposures to investment funds	There is a 20% risk weight floor on investment fund holdings.. Risk weight is the same as the highest risk weight investment the fund is permitted to hold. (Now called the Simple Modified Look-Through Approach) A banking organization may assign risk weight on a pro rata basis based on the investment limits in the fund's prospectus (now called the Alternative Modified Look-Through Approach) A third treatment (called the Full Look-Through Approach) has been introduced and it risk weights each asset of the fund (as if owned directly) and multiplies by the banking organization's proportional ownership in the fund.	Subpart D, §.53
Claims on foreign governments and their central banks, foreign banking organizations, and foreign public sector entities	Risk weight depends on Country Risk Classification (CRC) applicable to the sovereign and whether the sovereign has defaulted within the previous five years.	Subpart D, §.32(a)(2) to (6), (d)(2) and (e)(2) to (6)

Category	Capital Rule	Section
Conversion factors for off-balance sheet items	0% for the unused portion of a commitment that is unconditionally cancellable by the banking organization; 20% for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; 20% for self-liquidating, trade-related contingent items; 50% for the unused portion of a commitment with an original maturity of more than one year that is not unconditionally cancellable; 50% for transaction-related contingent items (performance bonds, bid bonds, warranties, and standby letters of credit); 100% for guarantees, repurchase agreements, securities lending and borrowing transactions, financial standby letters of credit, and forward agreements and certain credit- enhancing representations and warranties that are not securitization exposures.	Subpart D, §.33
Derivative contracts	Conversion to an on-balance sheet amount based on current exposure plus potential future exposure and a set of conversion factors. No risk weight cap.	Subpart D, §.34

Category	Capital Rule	Section
Guarantees	Recognizes guarantees from eligible guarantors: sovereign entities, certain international organizations, such as the Bank for International Settlements, Federal Home Loan Banks, Farmer Mac, a multilateral development bank, a depository institution, a bank holding company, a savings and loan holding company, a foreign banking organization, a qualifying central counterparty banking organization, or certain entities that have investment grade debt. Substitution approach that allows the banking organization to substitute the risk weight of the protection provider for the risk weight ordinarily assigned to the exposure	Subpart D, §.36
Collateralized transactions	The new rule provides two approaches for recognizing a broader range of financial collateral: Substitute risk weight of collateral for risk weight of exposure, sometimes with a 20 percent risk weight floor. (Now called the Simple Approach) Includes a new treatment (called the Collateral Haircut Approach) that is available only for eligible margin loans, repo-style transactions, and collateralized derivative contracts.	Subpart D, §.37
MSAs, certain DTAs arising from temporary differences, and certain significant investments in the common stock of unconsolidated financial institutions	Items that are not deducted are subject to a 250 percent risk weight.	Subpart D, §.32(l) and§.52

Return to Evaluation Factor 2

APPENDIX B

1. Consider concentrations in credit, funding, and correspondent banking relationships.
2. Concentrations are defined as obligations, direct and indirect, according to the following guidelines:
   a. Asset concentrations of 25% or more of Tier 1 Capital plus the entire ALLL for banks that have not adopted CECL; or (2) Tier 1 Capital plus the ACL related to loans and leases for banks that have adopted CECL, or Tier 1 Capital (for securities and all other) by:
      (1) individual borrower,
      (2) Small, interrelated group of individuals,
      (3) single repayment source with normal credit risk, or
      (4) individual project.

   b. Concentrations of 100% or more of Tier 1 Capital plus the entire ALLL for banks that have not adopted CECL; or (2) Tier 1 Capital plus the ACL related to loans and leases for banks that have adopted CECL; or T1C (for securities and all other) by:
      (1) industry,
      (2) product line (Product lines are common programs used by an institution that target specialty lending within a broad loan category, such as leveraged financing, accounts receivable, home equity, row crops, farm equipment, and subprime.),
      (3) type of collateral, or
      (4) short term obligations of one financial institution or affiliated group (For the purposes of concentration identification, short-term obligations represent Federal Funds Sold with a maturity of one day or less or Federal Funds Sold under a continuing contract, and resale agreements that have an original maturity of one business day (or is under a continuing contract) and are in immediately available funds in domestic offices.).

   c. Funding concentrations representing 10 % or more of Total Assets by a single funding source. (Funding “types” could include funding categories or programs that may be sensitive to interest rates or have other common risk factors)

   d. Commercial Real Estate guidelines also define concentrations in the 2006 Interagency Guidance: Concentrations in Commercial Real Estate Lending Sound Risk Management Practices.
      (1) Total reported loans for construction, land development, and other land represent 100% or more of Tier 1 Capital plus the ALLL or the ACL related to loans and leases; or

(2) Total commercial real estate loans represent 300% or more of Tier 1 Capital plus the ALLL or the ACL related to loans and leases, *and* the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50% or more during the prior 36 months.

Per 2006 Interagency Guidance:

- CRE loans are land development and construction loans (including 1- to 4-family residential and commercial construction loans) and other land loans.
- CRE loans also include loans secured by multifamily property, and nonfarm nonresidential property where the primary source of repayment is derived from rental income associated with the property (that is, loans for which 50 percent or more of the source of repayment comes from third party, nonaffiliated, rental income) or the proceeds of the sale, refinancing, or permanent financing of the property.
- Loans to real estate investment trusts (REITs) and unsecured loans to developers also should be considered CRE loans for purposes of this Guidance if their performance is closely linked to performance of the CRE markets.
- **Excluded** from the scope of this Guidance are loans secured by nonfarm nonresidential properties where the primary source of repayment is the cash flow from the ongoing operations and activities conducted by the party, or affiliate of the party, who owns the property.

3. Review Board minutes to determine that proper capital discussions are held and that an assessment of risk, including concentration monitoring, occurs to properly supervise capital adequacy.

Return to Evaluation Factor 4

APPENDIX C

Capital Conservation Buffer

The capital conservation buffer is designed to strengthen an institution’s financial resilience during economic cycles. Beginning January 1, 2016, financial institutions will be required to maintain a capital conservation buffer as shown in the table below in order to avoid restrictions on capital distributions and other payments.

Year	CET1 Capital Conservation Buffer
2016	0.625%
2017	1.25%
2018	1.875%
2019	2.50%

If a bank’s capital conservation buffer falls below the amount listed in the table above, its maximum payout amount for capital distributions and discretionary payments declines to a set percentage of eligible retained income based on the size of the bank's buffer. The following table reflects the maximum payout ratio for the fully phased in capital conservation buffer beginning January 1, 2019. For the maximum payout ratios during the transition period (January 1, 2016 through December 1, 2018), refer to Section 32.400(a)(2).

Capital Conservation Buffer (% of RWA)	Maximum Payout Ratio (% of Eligible Retained Income)
Greater than 2.5%	No payout limitation
Less than or equal to 2.5% and greater than 1.875%	60%
Less than or equal to 1.875% and greater than 1.25%	40%
Less than or equal to 1.25% and greater than 0.625%	20%
Less than or equal to 0.625%	0%

The types of payments subject to the restrictions include dividends, share buybacks, discretionary payments on tier 1 instruments, and discretionary bonus payments. It is important to note that the FDIC maintains the authority to impose further restrictions and require capital to be commensurate with the bank’s risk profile.

A bank cannot make capital distributions or certain discretionary bonus payments during the current calendar quarter if its eligible retained income is negative, and its capital conservation buffer was less than 2.50 percent as of the end of the previous quarter. Eligible retained income is a bank's net income as reported in its Call Reports for the four calendar quarters preceding the current quarter, net of any capital distributions, and certain discretionary bonus payments that were made during those four quarters.

To calculate the capital conservation buffer for a given quarter, each minimum risk-based capital requirement in Part 324 is subtracted from the institution's corresponding capital ratios. The following ratios would be subtracted from the institution's corresponding ratio to derive the buffer amount:

- Common equity tier 1 risk-based capital ratio minus 4.5 percent;
- Tier 1 risk-based capital ratio minus 6 percent; and
- Total risk-based capital ratio minus 8 percent.

The lowest of the three measures would represent the institution's capital conservation buffer and is used to determine its maximum payout for the current quarter. To the extent a bank's capital conservation buffer is 2.50 percent or less of risk-weighted assets, the bank's maximum payout amount for capital distributions and discretionary payments would decline.

The FDIC may permit an FDIC-supervised institution that is otherwise limited from making distributions and discretionary bonus payments to make a distribution or discretionary bonus payment upon an institution's request, if the FDIC determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the FDIC-supervised institution.

Source: FDIC Risk Management Manual of Examination Policies

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