

02-029

CHAPTER 127

Regulation #27

MINIMUM CAPITAL STANDARDS

Section 1. PURPOSE

9-B MRSA 412-A requires every financial institution to establish and maintain an adequate level of capital as set forth in rules adopted by the superintendent. The rules must address the composition of capital, minimum capital levels that must be maintained, and procedures that must be followed to restore capital if it falls below minimum standards. The purpose of this regulation is to satisfy the above requirements.

Section 2. AUTHORITY

This regulation is being promulgated pursuant to 9-B MRSA 412-A.

Section 3. DEFINITIONS

- "Allowance for loan and lease losses" means those general valuation allowances that have been established through charges against earnings to absorb losses on loans and lease financing receivables. Allowances for loan and lease losses exclude allocated transfer risk reserves relating to international lending and specific reserves created against identified losses.
- "Common stockholders' equity" means the sum of common stock and related surplus, undivided profits, disclosed capital reserves that represent a segregation of undivided profits, and foreign currency translation adjustments; less net unrealized losses on marketable equity securities.
- "Financial institution" has the same meaning that is set forth in 9-B MRSA 131.17.
- "Intangible assets" means those assets that are required to be reported as intangible assets in a banking institution's "Consolidated Reports of Condition and Income" (Call Report) or "Thrift Financial Report," as these reports may from time to time be revised.
- "Minority interests in consolidated subsidiaries" means minority interests in equity capital accounts of those subsidiaries that have been consolidated for the purpose of computing regulatory capital under this regulation, except that minority interests which fail to provide meaningful capital support are excluded from this definition.

- "Mortgage servicing rights" means those assets that represent the purchased rights to perform the servicing function for a specific group of mortgage loans that are owned by others. For purposes of determining regulatory capital under this regulation, purchased mortgage servicing rights will be recognized only to the extent the rights meet the conditions, limitations and restrictions described in Section 4(F)(2) of this regulation.
- "Noncumulative perpetual preferred stock" means perpetual preferred stock (and related surplus) where the issuer has the option to waive payment of dividends and where the dividends so waived do not accumulate to future periods nor do they represent a contingent claim on the issuer.
- "Perpetual preferred stock" means a preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder, and that has no other provisions that will automatically require future redemption of the issue. It includes those issues of preferred stock that automatically convert into common stock at a stated date. It excludes those issues, the rate on which increases, or can increase, in such a manner that would effectively require the issuer to redeem the issue.
- "Tier 1 capital" or "core capital" means the sum of common stockholders' equity, noncumulative perpetual preferred stock, and minority interests in consolidated subsidiaries, minus identified losses and minus all intangible assets (other than mortgage servicing rights eligible for inclusion in core capital pursuant to paragraph F of this section).
- "Total assets" means the average of total assets required to be included in a financial institution's Call Report or in a savings and loan association's Thrift Financial Report, minus intangible assets (other than mortgage servicing rights eligible for inclusion in core capital pursuant to Section 4(F)(2)), and less assets classified loss and any other assets that are deducted in determining Tier 1 capital.

Section 4. PROVISIONS OF THE REGULATION

- General rule. Financial institutions must maintain at least the minimum leverage capital requirement set forth in Section 4B. The capital standards in this regulation are the minimum acceptable for financial institutions whose overall financial condition is fundamentally sound, who are well-managed and who have no material or significant financial weaknesses. Notwithstanding the foregoing, the superintendent may require a financial institution to maintain a higher capital level based on the institution's particular risk profile. Where the superintendent determines that the financial history or condition, managerial resources and/or the future earnings prospects of a financial institution are not adequate, or where a institution has sizable off-balance sheet or funding risks, excessive interest rate risk exposure, or a significant volume of assets classified substandard, doubtful or loss or otherwise criticized, the

superintendent may determine that the minimum amount of capital for that institution is greater than the minimum standards stated in this section. These same criteria will apply to any financial institution making an application to the superintendent to merge or consolidate with another institution or acquire the assets and assume the liabilities of another institution where such application requires the superintendent to consider the adequacy of the institution's capital structure.

- Minimum leverage capital requirement.
 - The minimum leverage capital requirement for a financial institution shall consist of a ratio of Tier 1 capital to total assets of not less than 3% if the superintendent determines that the institution is not anticipating or experiencing significant growth and has well-diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and in general is considered a strong financial institution, rated composite 1 under the Uniform Financial Institutions Rating System (the CAMEL rating system) established by the Federal Financial Institutions Examination Council and adopted by the superintendent.
 - For all but the most highly-rated financial institutions meeting the conditions set forth in paragraph B(1) of this section, the minimum leverage capital requirement for a financial institution shall be 3% plus an additional cushion of at least 100 to 200 basis points and, therefore, shall consist of a ratio of Tier 1 capital to total assets of not less than 4%. In all cases, financial institutions should hold capital commensurate with the level and nature of all risks.
- Financial institutions with less than the minimum leverage capital requirement.
 - A financial institution operating with less than the minimum leverage capital requirement does not have adequate capital and, therefore, it has inadequate financial resources.
 - A financial institution having less than the minimum leverage capital requirement shall, within 60 days of the date as of which it fails to comply with the capital requirement, submit to the superintendent for review and approval a reasonable plan describing the means and timing by which the institution shall achieve its minimum leverage capital requirement.
- Exceptions. Notwithstanding the provisions of paragraphs A, B and C of this section, the superintendent may approve an application pursuant to the Maine Banking Code where capital adequacy must be considered if the superintendent finds that such approval is in the best interests of the public convenience and advantage or if the superintendent finds that the applicant has committed to and is in compliance with a reasonable plan to meet its minimum leverage capital requirement within a reasonable period of time.

- Inadequate capital as an unsafe and unsound practice or condition. Any financial institution which has less than its minimum leverage capital requirement may be deemed to be engaged in an unsafe and unsound practice pursuant to Title 9-B MRSA 231.1(A)(1). However, any financial institution that has entered into, and is in compliance with, a written agreement with the superintendent or has submitted to the superintendent, and is in compliance with a plan approved by the superintendent to increase its Tier 1 leverage capital ratio to such level as the superintendent deems appropriate and to take such other action as may be necessary for the institution to be operated so as not to be engaged in such an unsafe and unsound practice, will not be deemed to be engaged in an unsafe and unsound condition pursuant to Title 9-B MRSA 231.1(A)(1) on account of its capital ratios. The superintendent may take any enforcement action against a financial institution with capital above the minimum requirement if the specific circumstances deem such action to be appropriate.
- Miscellaneous.
 - Reservation of authority. Notwithstanding the definition of "Tier 1 capital" in Section 3(I) of this regulation, the superintendent may, if he finds a newly developed or modified capital instrument or a particular balance sheet entry or account to be the functional equivalent of a component of Tier 1 capital, permit one or more financial institutions to include all or a portion of such instrument, entry, or account as Tier 1 capital, permanently, or on a temporary basis, for purposes of this regulation. Similarly, the superintendent may, if he finds that a particular Tier 1 capital component or balance sheet entry or account has characteristics or terms that diminish its contribution to a financial institution's ability to absorb losses, require the deduction of all or a portion of such component, entry, or account from Tier 1 capital.
 - Treatment of purchased mortgage servicing rights. For purposes of determining regulatory capital under this regulation, purchased mortgage servicing rights will be deducted from assets and from equity capital to the extent that the rights do not meet the following conditions, limitations and restrictions:
 - An independent market valuation of the rights shall be performed at least annually and an estimated fair market value shall be calculated by the financial institution at least quarterly.
 - The rights shall be carried at a book value that does not exceed the discounted amount of estimated future net servicing income of the rights. Management of the financial institution shall review the carrying value at least quarterly and adjust the book value as necessary.

- For purposes of calculating regulatory capital under this regulation (but not for financial statement purposes), the rights will be reduced to an amount equal to the lesser of:
 - 90% of the fair market value of the rights, determined in accordance with paragraph (F)(2)(a) of this section; or
 - 90% of the original purchase price paid for the rights; or
 - 100% of the remaining unamortized book value of the rights, determined in accordance with paragraph (F)(2)(b) of this section.
 - Restrictions relating to capital components. To qualify as Tier 1 capital under this regulation, a capital instrument must not contain, or be subject to, any conditions, covenants, terms, restrictions, or provisions that are inconsistent with safe and sound banking practices. A condition, covenant, term, restriction, or provision is inconsistent with safe and sound banking practices if it:
 - Unduly interferes with the ability of the issuer to conduct normal banking operations;
 - Results in significantly higher dividends or interest payments in the event of deterioration in the financial condition of the issuer;
 - Impairs the ability of the issuer to comply with statutory or regulatory requirements regarding the disposition of assets or incurrence of additional debt; or
 - Limits the ability of the superintendent to take any necessary action to resolve a problem financial institution or failing financial institution situation. Other conditions and covenants that are not expressly listed in paragraphs (F)(3)(a) through (F)(3)(d) of this section also may be inconsistent with safe and sound banking practices.
- Federal regulations. It is recognized that the federal bank regulatory agencies have promulgated regulations establishing minimum capital requirements, including risk-based capital ratios. It is further recognized that there may exist differences in scope and coverage between this regulation and those promulgated by the federal banking agencies. It is not the intent of this regulation to include in capital any component not included by the appropriate federal banking agency. To the contrary, besides any other restriction or limitation stated herein, each financial institution must fully comply with the regulations of its applicable federal bank regulatory agency.

Section 5. Effective Date: November 25, 1992

BASIS STATEMENT

This regulation is being promulgated to implement the requirements of Title 9-B MRSA 412-A, which was enacted April 16, 1991. Section 412-A repealed outdated and separate capital requirements for savings banks, savings and loan associations, and trust companies and replaced them with a uniform requirement that every financial institution establish and maintain an adequate level of capital as set forth in rules adopted by the superintendent. Those rules must address the composition of capital, minimum capital levels that must be maintained, and procedures that must be followed to restore capital if it falls below minimum standards.

Section 412-A further requires that the state minimum capital level must at least equal the federal minimum level. The federal banking agencies have implemented regulations that measure capital adequacy using two formulas: (1) a leverage ratio of tangible equity to total assets; and (2) two risk-based capital ratios in which tangible equity plus certain debt and reserves are divided by risk-weighted assets plus a measure of off-balance sheet risk.

Minimum levels have been established for each of the ratios. In order to be consistent with federal requirements and minimize the burden on state-chartered financial institutions, this regulation parallels the minimum leverage capital requirements described in Part 325 of the Federal Deposit Insurance Corporation Rules and Regulations. The Bureau intends to amend this regulation as necessary to maintain consistency with federal regulations, in particular Part 325. While this regulation only deals with the first of the two formulas (the minimum leverage capital ratio), all financial institutions will nevertheless be subject to the risk-based capital requirements of their appropriate federal regulator.

Notice of this proposed regulation was published on July 7, 1992 and comments were solicited through August 7, 1992. The only comment received during the comment period was submitted by the Maine Association of Community Banks. The Association supports the change in the law and the use of a regulation, which adopts the minimum federal requirement as the minimum state requirement, to maintain consistency between federal and state rules.