

# Client Alert

July 12, 2018

## HVCRE Exposures: New Regulatory Guidance

By Henry M. Fields and Mark R. Sobin

As reported in a prior [Client Alert](#), financial services reforms enacted into law on May 24, 2018,<sup>1</sup> clarified the treatment of acquisition, development, and construction (ADC) loans characterized as high-volatility commercial real estate (HVCRE) exposures under the capital rules. Classification as an HVCRE exposure requires ADC loans to be risk-weighted at 150% under the capital rules, rather than the 100% risk-weighting accorded to other commercial loans.<sup>2</sup> The new legislation provides that, to be subject to the 150% risk weight, HVCRE exposures must meet a new, narrower definition of “HVCRE ADC loans.” In other words, unless an HVCRE exposure meets the HVCRE ADC loan definition, it is subject to a 100% risk weight (unless it would carry another risk weight by reason of other circumstances, such as being in default).

On July 6, 2018, the federal banking agencies<sup>3</sup> provided guidance on the impact of the legislative changes to the definition of HVCRE exposures (the “Guidance”).<sup>4</sup> The Guidance is timely as the federal banking agencies have not had time to conform regulations or call report instructions to the new legislation. By reason of the Guidance, banks now know that they can rely on the new law for characterizing HVCRE exposures in their June 30 call reports, which are due by the end of this month.

### PRINCIPAL TAKEAWAYS FROM THE GUIDANCE

- The legislative changes affecting the treatment of HVCRE exposures were effective immediately on May 24, 2018. As a result, depository institutions can assign the 150% risk weight to only those loans that meet the definition of “HVCRE ADC loans” under the statute.
- When reporting HVCRE exposures on their call reports, depository institutions may use available information to estimate and report as HVCRE exposures those loans that meet the definition of an “HVCRE ADC loan.” Depository institutions may refine these estimates as new information becomes available, but will not be required to amend previously filed reports. The Guidance provides an invitation for banks to re-characterize

<sup>1</sup> Section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). The text of EGRRCPA is available here: <https://www.congress.gov/115/bills/s2155/BILLS-115s2155enr.pdf>. For a summary of the provisions included within EGRRCPA, please see our Client Alert, available at: <https://media2.mofocom.com/documents/180522-financial-regulatory-reform.pdf>.

<sup>2</sup> See 12 C.F.R. § 324.2 (FDIC); 12 C.F.R. § 217.2 (Federal Reserve); 12 C.F.R. § 3.2 (OCC) (defining “HVCRE exposure”). The 150% risk weight for HVCRE exposures is designated at 12 C.F.R. § 324.32(j) (FDIC); 12 C.F.R. § 217.32(j) (Federal Reserve); 12 C.F.R. § 3.32(j) (OCC).

<sup>3</sup> The term “federal banking agencies” refers to, collectively, the Board of Governors of the Federal Reserve System (“Federal Reserve”); the Office of the Comptroller of the Currency (“OCC”); and the Federal Deposit Insurance Corporation (“FDIC”).

<sup>4</sup> The term “Guidance” refers to two separate statements from the federal banking agencies. First, the Federal Reserve issued the “Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),” which is available here: <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>. Second, the federal banking agencies jointly issued the “Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),” which is available here: <https://www.occ.gov/news-issuances/news-releases/2018/nr-ia-2018-69a.pdf>. Both statements take a consistent approach with respect to EGRRCPA’s changes to the treatment of ADC loans as HVCRE exposures. The Guidance also addresses other aspects of EGRRCPA not discussed in this Client Alert.

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as non-HVCRE exposures (using the new definition) those ADC loans previously reported as HVCRE exposures under the old definition, provided information is available to justify the re-characterization. For example, it is clear under the new law that ADC loans for owner-occupied premises are not HVCRE exposures. It also is clear under the new law that ADC loans made before January 1, 2015 are not HVCRE exposures. Banks can review their HVCRE classified portfolios to determine whether such re-characterizations are justified.

- Alternatively, depository institutions can continue to risk-weight and report HVCRE exposures according to the definition currently contained in the instructions to the call report (in other words, the definition under the old regime) pending further action from the federal banking agencies.
- Bank holding companies, savings and loan holding companies, and intermediate holding companies are permitted to estimate and report HVCRE exposures on Schedule HC-R, Part II of the FR Y-9C in a manner consistent with the approach taken by their subsidiary depository institutions, in conformance with the new law.<sup>5</sup>

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<sup>5</sup> The Guidance addresses the treatment of HVCRE exposures by such entities because of an ambiguity in the text of EGRRCPA with respect to the capital requirements applicable to depository institution holding companies. Under EGRRCPA's language, the new treatment of ADC loans as HVCRE exposures applies only to "depository institutions," a term which does not include depository institution holding companies. The Guidance recognizes the value of consistent characterization of HVCRE exposures at the holding company and bank levels.

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