Balance Sheet Growth and the Community Bank Leverage Ratio

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Issue Update

Since the onset of the COVID-19 pandemic, many community banks have experienced significant unexpected balance-sheet growth. Two key reasons are an influx of deposits generally, as bank customers conserved and increased their liquidity in the face of the pandemic, and, for a number of banks, rapid implementation in 2020-2021 of the Paycheck Protection Program (PPP), which resulted in approximately $525 billion in new loans in less than five months. PPP loans are fully guaranteed by the Small Business Administration, and their balances have begun to decline as borrowers meet the program's forgiveness terms. Apart from PPP loans, many banks are holding much of the additional deposit growth in reserves, short-term Treasury securities, and other assets presenting extremely low risk, while loan growth is hampered by economic uncertainty due to the pandemic.

Why It Matters

As a result of these developments, many community banks have experienced deterioration in leverage ratios, essentially the ratio of the institution's tier 1 capital to its average total consolidated assets as reported in regulatory filings. The Community Bank Leverage Ratio (CBLR), available by election to banks and holding companies having total consolidated assets of less than $10 billion, is set at a minimum of 9% (temporarily reduced to 8% during the pandemic crisis, but now reinstated). If bank assets and liabilities expand without concurrent increases in capital, the bank's leverage ratio deteriorates, notwithstanding negligible increases in risk posed by government-guaranteed loans and securities and increased reserves. The pandemic-related balance-sheet growth appears to be lingering for many banks.

Recommended Action Items

Congress should give regulators flexibility to adjust the leverage ratio floor established in the Dodd Frank Act to prevent capital constraints on banks' ability to support their communities.

Urge Congress to support the Community Bank Relief Act of 2021 (S.3409/ H.R.6145), introduced by Senator Jerry Moran (R-KS) and Representative Tracey Mann (R-KS), which would require the Federal banking agencies to develop a CBLR to apply during the period beginning on January 1, 2022, and ending on December 31, 2024, that is not less than 8 percent and not more than 8.5 percent.