



Understanding the Bank Capital Analysis

December 31, 2022

The semiannual Bank Capital Analysis (BCA) provides a data-based resource to aid the public in judging the capital strength of the banking industry across banks of different size and risk profiles. This article is designed to help make the BCA and similar publications more accessible.

Adequate capital is critically important for the safety and soundness of banks and overall financial stability. The Federal Reserve Bank of Kansas City's semiannual [Bank Capital Analysis](#) (BCA) provides a data-based resource to aid the public in judging the capital strength of the banking industry across banks of different size and risk profiles.

Without advanced knowledge of banking structures, regulation, and supervision, however, reports like the BCA are often difficult to understand. The information below is designed to help make the BCA and similar publications more accessible. These definitions and illustrations were developed in consultation with Sabrina Pellerin, Kansas City Fed senior risk specialist.

Types of banks

Global Systemically Important Banks/G-SIBs are banking organizations that could trigger a financial crisis if they failed. There are currently eight U.S. and 22 non-U.S. banking organizations that are designated as G-SIBs by the Financial Stability Board. GSIBs collectively had \$14.3 trillion at year-end 2022.

U.S. banking regulations have the following categories for tailored capital rules:

- **Category I:** These banks are G-SIBs and are subject to the most stringent regulatory standards.
- **Category II:** These firms are of global scale and hold \$700 billion or more in assets.
- **Category III:** These banks have \$250 billion or more in total assets.
- **Category IV:** These banks have between \$100 billion and \$250 billion in total assets.

The federal banking agencies have the following categories for supervision:

Large Banking Organizations (LBO): Category II, III and IV firms are considered LBOs, or large banking organizations. Category II and III banks, for which there are five, are required to report and maintain a minimum supplementary leverage ratio (SLR), which will be explained more below. The LBO group includes 16 bank holding companies and two depository institutions with no holding company as of December 31, 2022.

Regional Banking Organization (RBO): With an asset range of \$10 to \$100 billion, regional banks are bigger than community banks, but smaller than large banks. RBOs and community banks must report their tier 1 capital levels, which will be explained below. The RBO group includes 99 bank holding companies and five depository institutions with no holding company, as of December 31, 2022.

Community Banking Organization (CBO): Community banking organizations hold less than \$10 billion in total assets. The CBO group includes 3,894 depository institutions, as of December 31, 2022.

What is capital?

Bank capital is the investment that shareholders make in the bank. It is the cushion that absorbs losses while a bank is a going concern.

A bank's balance sheet is composed of assets (e.g., loans and securities), liabilities (e.g., deposits) and capital (or equity). Capital is what is left when you subtract total liabilities from total assets. A bank is exposed to potential losses on assets and has obligations to pay its liability holders (depositors and creditors).

Types of capital:

- **Tier 1** capital is the strongest form of capital. It includes stockholders' equity and retained earnings.
- **Tier 2** capital includes the allowance for loan losses and may include weaker forms of capital, such as cumulative preferred stock and subordinated debt.

Regulators calculate the total capital for all banks by adding their tier 1 and tier 2 capital together.

Leverage Ratio and Supplementary Leverage Ratio (SLR)

In the U.S., the Supplementary Leverage Ratio (SLR) is a regulatory measurement which calculates the amount of tier 1 capital large banks must hold relative to their total leverage exposure, which includes total assets and certain off-balance sheet items, like derivatives and loan commitments. In the U.S., Category I, II and III banks are subject to reporting their SLRs. In other countries this ratio is called the Basel III leverage ratio and non-U.S. G-SIBs must report it. Because of this, the SLR is a useful comparison tool of capital among the largest banks globally.

The tier 1 leverage ratio, on the other hand, does not include off-balance sheet items, which are negligible for all but the largest banking organizations. As such, the SLR can also be compared to the tier 1 leverage ratio for smaller banking organizations.

Leverage ratio measures like the SLR are simple and transparent ways to analyze bank capital across the financial sector. They are different from other regulatory capital ratios in that they do not require complex risk-weighting of different types of assets.

Conclusion

The BCA presents leverage ratios for U.S. G-SIBs, non-U.S. G-SIBs and U.S. large, regional and community banking organizations. By doing so, the BCA provides a horizontal comparison of capital among banking organizations.

Having adequate capital serves as a buffer against unexpected losses and insolvency. It also protects the taxpayer-backed federal safety net for banks, such as federal deposit insurance and the ability to borrow from the Federal Reserve Discount Window. Capital is particularly important for the largest systemically important banking organizations as protection against economy-wide financial instability.

The BCA is a useful tool for tracking capital trends, as well as point in time analysis, with the goal of promoting safety and soundness in the banking sector.
