

INSIGHTS

## Opt-Out Election for AOCI Under Basel III Approaches

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The beginning of 2015 marked the implementation of Basel III for community banks including the changes to required capital ratios. Although community banks have been preparing for the implementation for months, one of the first official mile markers relates to the one-time opportunity to opt-out of the changes to treatment of accumulated other comprehensive income (AOCI) components. If an institution elects to opt-out, then the institution may continue treating AOCI items in a manner consistent with risk-based capital rules in place prior to January 2015.

The permanent opt-out election must be made by the institution on its Call Report, FR Y-9C or FR Y-9SP, as applicable, for the first reporting period after January 1, 2015 and a parent holding company must make the same election as its subsidiary bank. If the institution does not opt-out, then the institution will not have an opportunity to change its methodology in future periods.

In evaluating and structuring mergers and acquisitions, financial institutions should be mindful of the impact of the AOCI election. If the two financial institutions involved in the transaction have made the same election, the surviving institution must continue with that election. In the instance that only one of the institutions that is involved in a merger transaction has opted out, the surviving bank has the opportunity to choose whether or not to make the election by the first regulatory reporting date after the transaction.

The general expectation is that most community banks will make the one-time opt-out election on their reports for the first quarter of 2015 in large part to avoid potential volatility of capital levels. With many other elements of Basel III and the actual impact are to be seen, community banks should be mindful as year-end Call Reports and filings are in process to properly make the desired election.