WEST BANCORPORATION INC
Form 10-K
March 05, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT of 1934
For the fiscal year ended December 31, 2014

or

o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number: 0-49677

WEST BANCORPORATION, INC.
(Exact name of registrant as specified in its charter)

IOWA	42-1230603
(State of incorporation or organization)	(I.R.S. Employer Identification No.)
1601 22nd STREET, WEST DES MOINES, IOWA	50266
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: (515) 222-2300

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Each Exchange on Which Registered
Common Stock, No Par Value	The Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2014, was approximately $238,003,048.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the most recent practicable date, March 3, 2015.

16,018,734 shares Common Stock, no par value

DOCUMENTS INCORPORATED BY REFERENCE

The definitive proxy statement of West Bancorporation, Inc., which was filed on March 5, 2015, is incorporated by reference into Part III hereof to the extent indicated in such Part.

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"SAFE HARBOR" CONCERNING FORWARD-LOOKING STATEMENTS

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are “forward-looking statements” within the meanings of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report. These forward-looking statements are generally identified by the words “believes,” “expects,” “intends,” “anticipates,” “projects,” “future,” “may,” “should,” “will,” “strategy,” “opportunity,” “will be,” “will likely result,” “will continue,” or similar references, or references to estimates, predictions or future events. Such forward-looking statements are based upon certain underlying assumptions, risks and uncertainties. Because of the possibility that the underlying assumptions are incorrect or do not materialize as expected in the future, actual results could differ materially from these forward-looking statements. Risks and uncertainties that may affect future results include: interest rate risk; competitive pressures; pricing pressures on loans and deposits; changes in credit and other risks posed by the Company's loan and investment portfolios, including declines in commercial or residential real estate values or changes in the allowance for loan losses dictated by new market conditions or regulatory requirements; actions of bank and nonbank competitors; changes in local and national economic conditions; changes in regulatory requirements, limitations and costs; changes in customers' acceptance of the Company's products and services; and any other risks described in the “Risk Factors” sections of this and other reports made by the Company. The Company undertakes no obligation to revise or update such forward-looking statements to reflect current or future events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

PART I

ITEM 1. BUSINESS

General Development of Business

West Bancorporation, Inc. (the Company or West Bancorporation) is an Iowa corporation and a bank holding company registered under the Bank Holding Company Act of 1956, as amended (BHCA). The Company was formed in 1984 to own West Des Moines State Bank, an Iowa-chartered bank headquartered in West Des Moines, Iowa. West Des Moines State Bank is now known as West Bank. West Bank is a business-focused community bank that was organized in 1893. The Company's primary activity during 2014 was the ownership of West Bank. The Company's and West Bank's only business is banking, and therefore, no segment information is presented in this report.

The Company operates in three markets: central Iowa, which is generally the greater Des Moines metropolitan area; eastern Iowa, which is the area including and surrounding Iowa City, and Coralville, Iowa; and the Rochester, Minnesota, area.

The Company's vision is to achieve and sustain a position of industry envy and admiration. Our financial performance goal is to be in the top quartile of our benchmarking peer group, which in 2014 consisted of 16 publicly traded peer financial institutions. The fiscal year ended December 31, 2014 was a great year for the Company and West Bank as measured by the following four key metrics:

l	Return on average assets:	1.32	%
l	Return on average equity:	15.19	%
l	Efficiency ratio:	49.93	%

l	Texas ratio:	2.71	%

Based on peer group analysis using September 30, 2014 data, Company results through the third quarter were in the top quartile of our peer group. We currently believe our fiscal year 2014 results will remain in the top quartile once comparable peer results are available.

For the third year in a row, our Company was named a "Sm-All Star" by the investment banking firm Sandler O’Neill + Partners. This list is composed of top-performing small-cap banks and thrifts in the United States. For purposes of this analysis, small-cap companies are those with a market value between $25 million and $2.5 billion. Out of 443 comparable banks across America, only 35 were named as 2014 Sm-All Stars. West Bancorporation was the sole Iowa or Minnesota bank holding company on the list and one of very few in the Midwest. Only one other bank holding company in the nation has received this honor three years running. The criteria used to determine the 2014 Sm-All Stars concentrated on growth, profitability, credit quality and capital strength.

The Company continued to grow in 2014, as loans outstanding at the end of 2014 totaled $1.18 billion compared to $992 million at the end of 2013, an increase of 19.4 percent. Total deposits grew 9.2 percent during 2014 compared to balances as of December 31, 2013. We believe the pipeline for new business is strong as we continue to focus efforts on sales through strengthening existing relationships and developing new relationships.

The Company's Rochester, Minnesota, office, which opened in March 2013, experienced strong growth in 2014. After almost two years of operations, this location had approximately $51 million of loans outstanding as of December 31, 2014. It is expected that this office will continue to have a strong growth rate in 2015. The staff was increased to four people with the addition in March 2015 of an experienced lender. In January 2014, the Company purchased land in Rochester, Minnesota. The Company plans to begin construction of a full-service facility on this land in 2015, with an expected opening date in the spring of 2016. The Company believes that southeastern Minnesota is a desirable market and an economic bedrock due to the strength and projected growth of the Mayo Clinic.

On October 30, 2014, the Company sold its former main office in eastern Iowa, located in downtown Iowa City, to a local developer. The terms of the agreement included our ability to retain occupancy until construction of our new eastern Iowa main office in Coralville, Iowa, was completed, which we opened for business on January 21, 2015. Our investment in this new facility signifies our belief in the strength of that market. As a result of the opening of our new office, we vacated our former office effective January 15, 2015.

One of the keys to our operating success in 2014 was an improvement in net interest income despite the pressure on our net interest margin due to the continuation of historically low interest rates. This is a challenge the Company will continue to face in 2015. Our net interest margin increased by 11 basis points to 3.59 percent for the year ended December 31, 2014, as a result of an increase in the average volume of interest-earning assets and reductions in interest rates on deposits.

In the fourth quarter of 2014, we changed the way we provide residential mortgage loan products to our customers. The Company now has retail staff in each of our banking locations who can offer residential mortgage loans. In the past, we had mortgage bankers in only select locations. The changes included the outsourcing of underwriting and processing functions, which will reduce our operating costs. West Bank will receive a fee for each loan originated.

Also contributing to our higher 2014 earnings was the continued improvement in credit quality. As of December 31, 2014, total nonperforming assets declined to $4.2 million, or 0.26 percent of total assets, compared to $10.6 million, or 0.73 percent of total assets, as of December 31, 2013. The Company believes that an appropriate level of resources is devoted to collection and disposal of these assets.

The Company declared and paid common stock dividends totaling $0.49 per share in 2014 and declared a $0.14 dividend on January 28, 2015 payable on February 25, 2015 to stockholders of record on February 11, 2015. The Company expects to continue paying regular quarterly dividends in the future. The capital position of the Company was strong at December 31, 2014. The Company's tangible common equity ratio at December 31, 2014 was 8.68 percent.

Description of the Company's Business

West Bank provides full-service community banking and trust services to customers located primarily in the Des Moines and Iowa City, Iowa, and the Rochester, Minnesota, metropolitan areas. West Bank has eight offices in the Des Moines area, one office in Iowa City, one office in Coralville and one office in Rochester, Minnesota. West Bank offers all basic types of credit to its customers, including commercial, real estate and consumer loans. West Bank offers trust services, including the administration of estates, conservatorships, personal trusts and agency accounts.

West Bank offers a full range of deposit services, including checking, savings, money market accounts and time certificates of deposit. In addition, West Bank also offers internet, mobile banking and treasury management services, which help to meet the banking needs of its customers and communities. Treasury management services offered to business customers include cash management, client-generated automated clearing house transactions, remote deposit and fraud protection services. Also offered are merchant credit card processing and corporate credit cards.

West Bank's business strategy emphasizes strong business and personal relationships between West Bank and its customers and the delivery of products and services that meet the individualized needs of those customers. West Bank also emphasizes strong cost controls, while striving to achieve an above average return on equity and return on assets. To accomplish these goals, West Bank focuses on small to medium-sized businesses in the local markets that traditionally wish to develop an exclusive relationship with a single bank. West Bank has the size to provide the personal attention required by local business owners and the financial expertise and entrepreneurial attitude to help businesses meet their financial service needs.

The market areas served by West Bank are highly competitive with respect to both loans and deposits. West Bank competes with other commercial banks, many of whom are subsidiaries of other bank holding companies, savings and loan associations, credit unions, mortgage companies and other financial service providers. According to the FDIC's Summary of Deposits, as of June 30, 2014, there were 35 banks and savings and loan associations operating within Polk County, Iowa, where seven of West Bank's offices are located. As of the same date, West Bank ranked fourth based on total deposits of all banking offices in Polk County. As of June 30, 2014, there were 19 banks and savings and loan associations within Johnson County, Iowa, which includes Iowa City and Coralville. Three West Bank offices were located in Johnson County as of June 30, 2014. As of the same date, West Bank ranked fourth based on total deposits of all banking offices in Johnson County. West Bank also has one office located in Dallas County, Iowa. For the entire state of Iowa, West Bank ranked eighth in terms of deposit size as of June 30, 2014. West Bank also has one office located in Rochester, Minnesota.

Some of West Bank's competitors are locally controlled, while others are regional, national or international companies. The larger national or regional banks have certain competitive advantages due to their ability to undertake substantial advertising campaigns and allocate their investment assets to out-of-market geographic regions with potentially higher returns. Such banks also offer certain services, for example, international and conduit financing transactions, which are not offered directly by West Bank. These larger banking organizations also have much higher legal lending limits than West Bank, and therefore, may be better able to service large regional, national and global commercial customers.

In order to compete to the fullest extent possible with the other financial institutions in its primary market areas, West Bank uses the flexibility and knowledge of its local management, Board of Directors and community advisors. West Bank seeks to capitalize on customers' desire to do business with a local institution. This includes emphasizing specialized services, local promotional activities, and personal contacts by West Bank's officers, directors and employees. In particular, West Bank competes for deposits principally by offering depositors a variety of deposit programs, convenient office locations and hours and other personalized services. West Bank competes for loans primarily by offering competitive interest rates, experienced lending personnel with local decision-making authority, flexible loan arrangements and quality products and services.

West Bank also competes with the general financial markets for funds. Yields on corporate and government debt securities and commercial paper affect West Bank's ability to attract and hold deposits. West Bank also competes for funds with money market accounts and similar investment vehicles offered by brokerage firms, mutual fund companies, internet banks and others. The competition for these funds is based almost exclusively on yields to customers.

The Company and West Bank had approximately 178 full-time equivalent employees as of December 31, 2014.

Supervision and Regulation

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, our growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Iowa Superintendent of Banking (the Iowa Superintendent), the Board of Governors of the Federal Reserve System (the Federal Reserve), the Federal Deposit Insurance Corporation (the FDIC) and the Bureau of Consumer Financial Protection (the CFPB). Furthermore, taxation laws administered by the

Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board, securities laws administered by the Securities and Exchange Commission (the SEC) and state securities authorities, and anti-money laundering laws enforced by the U.S. Department of the Treasury (the Treasury) have an impact on our business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to our operations and results, and the nature and extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of financial institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than stockholders. These federal and state laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates, and the payment of dividends.

This supervisory and regulatory framework subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that are not publicly available and that can impact the conduct and growth of their business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and West Bank. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

Financial Regulatory Reform

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) into law. The Dodd-Frank Act represented a sweeping reform of the U.S. supervisory and regulatory framework applicable to financial institutions and capital markets in the wake of the global financial crisis, certain aspects of which are described below in more detail. In particular, and among other things, the Dodd-Frank Act: (i) created a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; (ii) created the CFPB, which is authorized to regulate providers of consumer credit, savings, payment and other consumer financial products and services; (iii) narrowed the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expanded the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; (iv) imposed more stringent capital requirements on bank holding companies and subjected certain activities, including interstate mergers and acquisitions, to heightened capital conditions; (v) with respect to mortgage lending: (a) significantly expanded requirements applicable to loans secured by 1-4 family residential real property, (b) imposed strict rules on mortgage servicing, and (c) required the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5 percent of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards; (vi) repealed the prohibition on the payment of interest on business checking accounts; (vii) restricted the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater; (viii) in the so-called “Volcker Rule,” subject to numerous exceptions, prohibited depository institutions and affiliates from certain investments in, and sponsorship of, hedge funds and private equity funds and from engaging in proprietary trading; (ix) provided for enhanced regulation of advisers to private funds and of the derivatives markets; (x) enhanced oversight of credit rating agencies; and (xi) prohibited banking agency requirements tied to credit ratings. These statutory changes shifted the regulatory framework for financial institutions, impacted the way in which they do business and have the potential to constrain revenues.

Numerous provisions of the Dodd-Frank Act were required to be implemented through rulemaking by the appropriate federal regulatory agencies. Many of the required regulations have been issued and others have been released for public comment, but are not yet final. Although the reforms primarily targeted systemically important financial service providers, their influence is expected to filter down in varying degrees to smaller institutions over time. Our management will continue to evaluate the effect of the Dodd-Frank Act; however, in many respects, the ultimate impact of the Dodd-Frank Act will not be fully known for years, and no current assurance may be given that the Dodd-Frank Act, or any other new legislative changes, will not have a negative impact on the results of operations and financial condition of the Company and West Bank.

The Increasing Regulatory Emphasis on Capital

Regulatory capital represents the net assets of a financial institution available to absorb losses. Because of the risks attendant to their business, depository institutions are generally required to hold more capital than other businesses, which directly affects earnings capabilities. While capital has historically been one of the key measures of the financial health of both bank holding companies and banks, its role became fundamentally more important in the wake of the global financial crisis, as the banking regulators recognized that the amount and quality of capital held by banks prior to the crisis was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, establish strengthened capital standards for banks and bank holding companies, require more capital to be held in the form of common stock and disallow certain funds from being included in capital determinations. Once fully implemented, these standards will represent regulatory capital requirements that are meaningfully more stringent than those in place historically.

The Company and Bank Required Capital Levels. Bank holding companies have had to comply with less stringent capital standards than their bank subsidiaries and have been able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis as stringent as those required for insured depository institutions. As a consequence, the components of holding company permanent capital known as “Tier 1 Capital” were restricted to those capital instruments that are considered to be Tier 1 Capital for insured depository institutions. A result of this change is that the proceeds of hybrid instruments, such as trust preferred securities, are being excluded from Tier 1 Capital over a phase-out period. However, if such securities were issued prior to May 19, 2010 by bank holding companies with less than $15 billion of assets, they may be retained, subject to certain restrictions. Because the Company has assets of less than $15 billion, it is able to maintain its trust preferred proceeds as Tier 1 Capital but will have to comply with new capital mandates in other respects and will not be able to raise Tier 1 Capital in the future through the issuance of trust preferred securities.

The minimum capital standards effective as of December 31, 2014 were:

- A leverage requirement, consisting of a minimum ratio of Tier 1 Capital to total adjusted average quarterly assets of 3 percent for the most highly rated banks with a minimum requirement of at least 4 percent for all others, and

- A risk-based capital requirement, consisting of a minimum ratio of Total Capital to total risk-weighted assets of 8 percent and a minimum ratio of Tier 1 Capital to total risk-weighted assets of 4 percent.

For these purposes, “Tier 1 Capital” consisted primarily of common stock, noncumulative perpetual preferred stock and related surplus less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total Capital consisted primarily of Tier 1 Capital plus “Tier 2 Capital,” which included other non-permanent capital items, such as certain other debt and equity instruments that do not qualify as Tier 1 Capital, and West Bank’s allowance for loan losses, subject to a limitation of 1.25 percent of risk-weighted assets. Further, risk-weighted assets for the purpose of the risk-weighted ratio calculations were balance sheet assets and off-balance sheet exposures to which required risk weightings of 0 percent to 100 percent were applied.

The capital standards described above are minimum requirements and were increased beginning January 1, 2015 under Basel III, as discussed below. Bank regulatory agencies uniformly encourage banks and bank holding companies to be “well-capitalized” and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is “well-capitalized” may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept, rollover or renew brokered deposits. Under the capital regulations of the FDIC and Federal Reserve, in order to be “well capitalized,” a banking organization, for the year ending December 31, 2014, must have maintained:

- A leverage ratio of Tier 1 Capital to total assets of 5 percent or greater,

- A ratio of Tier 1 Capital to total risk-weighted assets of 6 percent or greater, and

- A ratio of Total Capital to total risk-weighted assets of 10 percent or greater.

The FDIC and Federal Reserve guidelines also provide that banks and bank holding companies experiencing internal growth or making acquisitions would be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines indicate that the agencies will continue to consider a “tangible Tier 1 leverage ratio” (deducting all intangibles) in evaluating proposals for expansion or to engage in new activities.

Higher capital levels could also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve’s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 Capital less all intangible assets), well above the minimum levels.

Prompt Corrective Action. A banking organization's capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized," in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to sell itself; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2014: (i) West Bank was not subject to a directive from the FDIC to increase its capital, and (ii) West Bank was "well-capitalized," as defined by FDIC regulations. As of December 31, 2014, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Dodd-Frank Act requirements.

The Basel International Capital Accords. The risk-based capital guidelines described above are based upon the 1988 capital accord known as "Basel I" adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, as implemented by the U.S. federal banking regulators on an interagency basis. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as "Basel II," for large or "core" international banks (generally defined for U.S. purposes as having total assets of $250 billion or more, or consolidated foreign exposures of $10 billion or more). Basel II emphasized internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on a strengthened set of capital requirements for banking organizations around the world, known as Basel III, to address deficiencies recognized in connection with the global financial crisis. Basel III was intended to be effective globally on January 1, 2013, with phase-in of certain elements continuing until January 1, 2019, and it is currently effective in many countries.

U.S. Implementation of Basel III. In July of 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the Basel III Rule). In contrast to capital requirements historically, which were in the form of guidelines, Basel III was released in the form of regulations by each of the regulatory agencies. The Basel III Rule is applicable to all financial institutions that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies other than "small bank holding companies" (generally bank holding companies with consolidated assets of less than $1 billion).

The Basel III Rule not only increased most of the required minimum capital ratios effective January 1, 2015, but it also introduced the concept of Common Equity Tier 1 Capital, which consists primarily of common stock, related surplus (net of Treasury stock), retained earnings, and Common Equity Tier 1 minority interests subject to certain regulatory adjustments. The Basel III Rule also expanded the definition of capital by establishing more stringent criteria that instruments must meet to be considered Additional Tier 1 Capital (Tier 1 Capital in addition to Common

Equity Tier 1 Capital) and Tier 2 Capital. A number of instruments that qualified as Tier 1 Capital will not qualify, or their qualifications will change. For example, cumulative preferred stock and certain hybrid capital instruments, including trust preferred securities, will no longer qualify as Tier 1 Capital of any kind, with the exception, subject to certain restrictions, of such instruments issued before May 19, 2010, by bank holding companies with total consolidated assets of less than $15 billion as of December 31, 2009. For those institutions, trust preferred securities and other nonqualifying capital instruments currently included in consolidated Tier 1 Capital were permanently grandfathered under the Basel III Rule, subject to certain restrictions. Noncumulative perpetual preferred stock, which qualified as simple Tier 1 Capital, will not qualify as Common Equity Tier 1 Capital, but will qualify as Additional Tier 1 Capital. The Basel III Rule also constrains the inclusion of minority interests, mortgage-servicing assets, and deferred tax assets in capital and requires deductions from Common Equity Tier 1 Capital in the event that such assets exceed a certain percentage of a banking institution's Common Equity Tier 1 Capital.

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The Basel III Rule requires as of January 1, 2015:

- A new ratio of minimum Common Equity Tier 1 Capital equal to 4.5 percent of risk-weighted assets;
-