

Proposed Changes to Large Firm Prudential Framework

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On October 31, 2018, the Federal Reserve Board (the “FRB”) and the other federal banking agencies issued two proposals that would modify the prudential framework for U.S. banking organizations with \$100 billion or more in total consolidated assets. The first proposal, issued jointly by the federal banking agencies (the “capital and liquidity thresholds proposal”), would change the thresholds for the application of various regulatory capital and liquidity standards. The second proposal (the “enhanced prudential standards proposal”), issued by the FRB, would revise the enhanced prudential standards framework implemented under the Dodd-Frank Act. The comment deadline for the proposals is January 22, 2019.

Notable aspects of the proposals include the following:

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- The thresholds for application of the advanced approaches capital rules would be modified from the current thresholds of \$250 billion in assets and \$10 billion in foreign exposures to \$700 billion in assets and \$75 billion in cross-jurisdictional activity.
- Some firms no longer would be subject to the liquidity coverage ratio (the “LCR”) or the proposed net stable funding ratio (the “NSFR”).
- For some firms required to participate in the FRB’s comprehensive capital analysis and review (“CCAR”) program, the quantitative assessment would occur every two years rather than annually.
- Savings and loan holding companies that are not substantially engaged in insurance underwriting or commercial activities (“covered SLHCs”) would be subject to new requirements involving supervisory and company-run stress testing, risk management, single-counterparty credit limits, and liquidity risk management, stress testing and buffers.
- The proposals do not address the prudential framework for foreign banking organizations or how the proposed stress capital buffer ([previously discussed here](#))

would be incorporated into the modified CCAR program. Separate proposals on these issues are forthcoming from the FRB.

For reference, a redline showing the proposed changes to the regulatory text is available [here](#).

Proposed category definitions. The four categories of firms contemplated by the proposals and the standards that would apply to each category are described below, along with charts illustrating the proposed requirements.

Category I. Category I would include the U.S. global systemically important bank holding companies (“GSIBs”), as identified under the FRB’s GSIB surcharge rule. The only change the proposal would make for these firms would be to eliminate the mid-cycle company-run Dodd-Frank Act stress testing (“DFAST”) requirement, as called for by the Economic Growth, Regulatory Relief and Consumer Protection Act ([previously discussed here](#)).

Category II. Category II would include bank holding companies (“BHCs”) and covered SLHCs with \$700 billion or more in total consolidated assets or \$75 billion or more in cross-jurisdictional activity that are not otherwise subject to Category I standards.

- Cross-jurisdictional activity would be defined as the sum of cross-jurisdictional assets and liabilities as reported on the FRB’s FR Y-15 form.
- These metrics effectively would become the new advanced approaches thresholds, replacing the existing \$250 billion in assets and \$10 billion foreign exposures thresholds.

Category III. Category III would include BHCs and covered SLHCs that are not subject to Category I or II standards that have \$250 billion or more in total consolidated assets or \$75 billion or more in any one or more of: (1) nonbank assets; (2) weighted short-term wholesale funding (“wSTWF”); and (3) off-balance-sheet exposures, as determined by the average of the four most recent consecutive quarters using the following methodologies:

- Nonbank assets would be calculated in accordance with the instructions to the FRB’s FR Y-9LP form.
- wSTWF would be calculated in accordance with the instructions to the FRB’s FR Y-15 form.

- Off-balance-sheet exposures would be total exposure, calculated in accordance with the instructions to the FRB's FR Y-15 form, minus total consolidated assets, as reported on the FR Y-9C.

Category IV. Category IV includes BHCs and covered SLHCs with at least \$100 billion in total consolidated assets that are not subject to any other category.

GSIB alternative. The capital and liquidity thresholds proposal seeks comment on whether firms should instead be categorized by GSIB score. The proposal suggests the following thresholds:

- Category I: method 1 score of 130 or more.
- Category II: method 1 score between 60 and 80 or method 2 score between 100 and 150.
- Category III: method 1 score between 25 and 45 or method 2 score between 50 and 85.
- Category IV: method 1 score less than 25 or method 2 score less than 50 to 85.

The discussion in the proposal regarding this alternative is not entirely clear for two reasons. First, there are gaps in the score ranges that would be used to define categories. Second, it is not clear if the agencies envision that an asset test would be used in conjunction with a GSIB score test.

Moving between categories. Firms would be required to report quarterly on the metrics used to determine their category. Movement between categories would occur as follows:

- **A firm would drop to a lower category** once it fell below all of the indicator bands for its current category in each of the four most recent quarters. (Note that metrics are not averaged across quarters for this purpose.)
- **A firm would move to a higher category** once it rose above at least one indicator band, as determined by the average value of that indicator over the preceding four quarters.

The conditions for moving between categories are constructed to make it significantly easier to be moved to a more stringent category than to be moved to a less stringent one due to the use of averages for determining whether a firm moves to a higher category but not for determining movement to a lower category. The requirements for the new

category would take effect on the first day of the second quarter following the change in the firm’s category.

Application to subsidiary institutions. Under the capital and liquidity thresholds proposal, the same capital requirements would apply to a subsidiary depository institution of a holding company that would apply to the holding company itself. For quantitative liquidity requirements, subsidiary depository institutions of a holding company subject to the full LCR and proposed full NSFR with \$10 billion or more in assets at the depository institution level also would be subject to the full LCR and proposed full NSFR. For Category III firms, the level of the LCR or NSFR requirement applicable to a subsidiary depository institution subsidiary with \$10 billion or more in assets would be the same as the level that would apply to the parent holding company.

Standards under each category. The following charts illustrate the requirements that would apply to each category:

Proposed Applicability of Capital Standards

Regulatory Requirement	Category I	Category II	Category III	Category IV
GSIB surcharge (for BHCs only)	Applies	No Longer/Not Applicable	No Longer/Not Applicable	No Longer/Not Applicable
Enhanced supplementary leverage ratio (for BHCs only)	Applies	No Longer/Not Applicable	No Longer/Not Applicable	No Longer/Not Applicable
Total loss-absorbing capacity (for BHCs only)	Applies	No Longer/Not Applicable	No Longer/Not Applicable	No Longer/Not Applicable
Advanced approaches	Applies	Applies	No Longer/Not Applicable	No Longer/Not Applicable
Mandatory Use of SA-CCR (Proposed)	Applies	Applies	No Longer/Not Applicable	No Longer/Not Applicable
AOCI opt-out not available	Applies	Applies	No Longer/Not Applicable	No Longer/Not Applicable
Supplementary leverage ratio	Applies	Applies	Applies	No Longer/Not Applicable
Countercyclical capital buffer	Applies	Applies	Applies	No Longer/Not Applicable
Standardized approach	Applies	Applies	Applies	Applies
Tier 1 leverage ratio	Applies	Applies	Applies	Applies

Applies
 Requirement Reduced
 No Longer/Not Applicable

Proposed Applicability of Capital Stress Testing

Regulatory Requirement	Category I	Category II	Category III	Category IV
Annual Comprehensive Capital Analysis and Review (CCAR)	Includes quantitative and qualitative assessment	Includes quantitative and qualitative assessment	Includes quantitative and qualitative assessment	<ul style="list-style-type: none"> No qualitative assessment Quantitative assessment reduced to biennial, with annual capital plan submission
Supervisory stress testing (baseline, adverse and severely adverse scenarios)	Annual	Annual	Annual	Reduced to biennial.
Company-run stress testing (baseline, adverse and severely adverse scenarios)	Annual	Annual	<ul style="list-style-type: none"> Reduced to biennial Internal stress testing with annual capital plan submission 	Internal stress testing with annual capital plan submission
FR Y-14 reporting				Reduced pursuant to forthcoming proposal

Proposed Applicability of Liquidity Standards

Regulatory Requirement	Category I	Category II	Category III	Category IV
Full liquidity coverage ratio			Scaled (70-85%) version if <\$75B in wSTWF	
Proposed full net stable funding ratio			Scaled (70-85%) version if <\$75B in wSTWF	
Daily FR 2052a submission			Reduced to monthly if <\$75B in wSTWF	Remains monthly requirement, but reporting tailored
Monthly internal stress testing				Reduced to quarterly
Liquidity risk management				Tailored liquidity risk management*
Liquidity buffer				

* Includes monthly collateral position evaluation (reduced from weekly), limiting risk limits to activities relevant to firm, and reduced complexity for intraday liquidity risk exposure monitoring.

Applies
 Requirement Reduced
 No Longer/Not Applicable

Proposed Applicability of Other Enhanced Prudential Standards

Regulatory Requirement	Category I	Category II	Category III	Category IV
Single Counterparty-Credit Limits	More stringent G-SIB to G-SIB limit applies			
Risk Management Requirements				
Public Company Risk Committee Requirement				



Applies



Requirement Reduced



No Longer/Not Applicable

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Please do not hesitate to contact us with any questions.

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