

Federal Reserve Proposes Significant Changes to Foreign Bank Prudential Framework

April 15, 2019

On April 8, 2019, the Federal Reserve Board (the “FRB”) proposed significant changes to the prudential framework applicable to foreign banking organizations (“FBOs”). The FRB and the Office of the Comptroller of the Currency (the “OCC”) issued a parallel proposal focused on the applicability thresholds for regulatory capital and liquidity requirements.¹ Comments on the proposals are due by June 21, 2019. Below, is an overview of the proposals. We anticipate publishing a separate analysis of the FRB proposal to revise the regulation implementing resolution planning requirements of section 165(d) of the Dodd-Frank Act, which was issued at the same time.²

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The proposals would create three categories of prudential standards for FBOs with \$100 billion or more in combined U.S. assets (“Covered FBOs”) and U.S. intermediate holding companies (“IHCs”) with \$100 billion or more in total consolidated assets (“Covered IHCs”). The three categories are meant to correspond to the second, third and fourth categories that the FRB proposed on October 31, 2018 for large U.S. firms (the “domestic proposal”; see our [prior analysis](#)), using similar risk indicators as in the domestic proposal, such as asset size, cross-jurisdictional activity, reliance on short-term wholesale funding, nonbank assets, and off-balance sheet exposure. These indicators generally would be measured on a four-quarter average basis. The FRB is not proposing a category for FBOs that would correspond with “Category I” for U.S. firms, which category would consist solely of the U.S. global systemically important bank holding companies. In addition, the agencies have requested comment on whether to apply the liquidity coverage ratio (the “LCR”) and the proposed net stable funding ratio (the “NSFR”) to U.S. branches and agencies of FBOs, but did not propose to do so.

Notable aspects of the proposals include the following:

- Although the proposals reduce requirements for Covered FBOs and Covered IHCs in many respects, some IHCs that are not bank holding companies (“BHCs”) would be

¹ The Federal Deposit Insurance Corporation (the “FDIC” and, collectively with the FRB and the OCC, the “agencies”) is expected to issue a similar proposal in the near future.

² The FDIC also is expected to issue a similar proposal for the 165(d) resolution planning requirements in the near future.

subject to the LCR and the proposed NSFR for the first time, as well as certain other prudential standards.

- The application of certain requirements to IHCs, including the LCR, the proposed NSFR and single-counterparty credit limits (“SCCL”), would depend on the categorization of the FBO, rather than the IHC itself.
- The SCCL rule would be revised in the following ways (see our [prior analysis](#) of the SCCL rule). All IHCs of a Category II or III FBO would be subject to an aggregate net credit exposure limit to a single counterparty equal to 25 percent of tier 1 capital (as compared to total regulatory capital, which is the SCCL denominator for some firms under the current SCCL rule). The requirements relating to exposures to securitization vehicles, investment funds and special purpose vehicles, the application of the economic interdependence and control relationship tests, and compliance requirements also would apply to all such IHCs. IHC subsidiaries of Category IV firms would not be subject to the SCCL on a standalone basis.
- In order to facilitate categorization, many FBOs would be required to start reporting on the FRB’s form FR Y-15, regardless of whether the FBO has an IHC or BHC subsidiary.

Proposed category definitions. The three 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 II. Category II would include Covered FBOs and Covered IHCs with \$700 billion or more in an asset measure (combined U.S. assets for Covered FBOs and total consolidated assets for Covered IHCs, referred to below as “Covered Assets”) or \$75 billion or more in cross-jurisdictional activity.

- 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.
- The measure of cross-jurisdictional activity is meant to mirror the measurement for U.S. firms under the domestic proposal, with adjustments to exclude liabilities that reflect liabilities to non-U.S. affiliates (such as internal long-term debt required under the FRB’s total loss-absorbing capacity rule) and intercompany claims collateralized by financial collateral.
- The FRB requested comment on the following alternatives to adjusting the measure for cross-jurisdictional activity for FBOs: (1) excluding all claims and liabilities arising from transactions with non-U.S. affiliates; or (2) not permitting any

exclusions for intercompany claims and liabilities, but raising the threshold (e.g., to \$100 billion in cross-jurisdictional activity).

Category III. Category III would include Covered FBOs and Covered IHCs with \$250 billion or more in Covered Assets or at least \$75 billion in any one or more of: (1) total nonbank assets; (2) weighted short-term wholesale funding (“wSTWF”); or (3) off-balance-sheet exposures, as determined by the average of the four most recent consecutive quarters using the following methodologies:

- Nonbank assets for a Covered IHC would be calculated in accordance with the instructions to the FRB’s FR Y-9LP form; nonbank assets for a Covered FBO would be calculated as the sum of assets of the FBO’s nonbank U.S. subsidiaries, excluding any companies held under Bank Holding Company Act section 2(h)(2), and any equity investments in unconsolidated subsidiaries, excluding any section 2(h)(2) companies.
- 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 of the Covered IHC or Covered FBO, calculated in accordance with the instructions to the FRB’s FR Y-15 form, minus total Covered Assets.

Category IV. Category IV would include Covered FBOs and Covered IHCs that are not subject to any other category.

Other FBOs. Other FBOs subject to enhanced prudential standards would include FBOs that are not Covered FBOs that have \$50 billion or more in global assets. These FBOs may be subject to additional enhanced prudential standards, depending on whether they meet additional thresholds.

Measurement of Risk Indicators. For a Covered FBO, each risk indicator would be measured with respect to the FBO’s combined U.S. operations (“CUSO”); for a Covered IHC, it would be measured with respect to the IHC on a consolidated basis. In order to facilitate collection of risk indicator data, each Covered FBO would be required to report on the FRB’s form FR Y-15 (Schedules H through N) with respect to its U.S. branches and agencies, IHCs and CUSO, regardless of whether the FBO has an IHC or BHC.

GSIB alternative. The proposals seek comment on whether firms should instead be categorized by their scores under the FRB’s Global Systemically Important Bank Holding Company assessment methodology as applied to a Covered FBO or a Covered IHC. The proposals suggest the following thresholds:

- Category II: method 1 score between 60 and 80 or method 2 score between 100 and 150.
- Category III: Covered Assets of \$250 billion or more, or between \$100 billion and \$250 billion and a method 1 score that meets or exceeds a minimum score between 25 and 45, or a method 2 score that meets or exceeds a minimum score between 50 and 85.
- Category IV: a method 1 or method 2 score less than the minimum score threshold for Category III.

Moving between categories. Covered FBOs and Covered IHCs 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.³

Other Changes. Other changes contemplated by the proposals include:

- The proposals would modify the domestic proposal to provide that the LCR and proposed NSFR would apply to a domestic Category IV firm on a reduced basis if the firm has \$50 billion or more in wSTWF (the domestic proposal would not have applied the LCR and NSFR to such a firm), consistent with the proposals for FBOs (as further described below).

³ The initial applicability and transitions for reporting forms may differ from the applicability of the standards themselves.

- The proposals would revise the definition in the FRB’s capital plan rule of “large and noncomplex” banking organization to mean a Category IV firm. Consequently, firms that are not currently subject to the Comprehensive Capital Analysis and Review (“CCAR”) qualitative assessment (including, for example, firms exempted from CCAR for the 2019 cycle) could become subject to both the quantitative and qualitative assessment for the 2020 CCAR cycle.⁴ The FRB said that it intends at a future date to revise its capital planning guidance to align with the proposed categories of standards and to allow more flexibility in how Category IV firms perform capital planning.
- The proposals would not raise the U.S. non-branch asset threshold that would trigger the requirement for an FBO to establish an IHC. The proposal would, however, eliminate the formal requirement to submit an IHC implementation plan. In lieu of the formal requirement, the FRB stated that implementation planning would be reviewed as a part of the supervisory process. In addition, the proposals would make conforming and other changes to the process for requesting an alternative organization structure for an IHC.
- The FRB is considering whether to revise the scope of liquid assets eligible for the Regulation YY liquidity buffer to be consistent with “high quality liquid assets” under the LCR.
- For foreign savings and loan holding companies, the proposals would apply company-run stress testing requirements if the foreign savings and loan holding company has more than \$250 billion in total consolidated assets.

Standards under each category. The following charts illustrate the requirements that would apply to each category. These standards apply separately to Covered FBOs and Covered IHCs. For example, an FBO with \$100 billion in Covered Assets (including \$51 billion in U.S. non-branch assets) would be a Covered FBO and would be required to form an IHC, but the IHC would not be subject to most of the capital and capital stress testing requirements applicable to Covered IHCs, because the IHC itself would not meet the threshold to be a Covered IHC.

⁴ The FRB stated earlier this year that certain firms would not be required to submit capital plans to the FRB in 2019. The FRB also stated that it would exempt from the qualitative component firms that have participated in CCAR for four consecutive years and have completed the final year’s qualitative component without objection.

Category II

Covered FBOs

\$700 billion or more in combined U.S. assets or \$75 billion or more in cross-jurisdictional activity

Covered IHCs

\$700 billion or more in total consolidated assets or \$75 billion or more in cross-jurisdictional activity

Requirement applies

Requirement does not apply (or does not apply directly)

Regulatory Requirement	Category II FBO	Branches & Agencies of a Category II FBO	IHC Subsidiary of a Category II FBO			
			Category II IHC ^d	Category III IHC	Category IV IHC	Other IHC
Capital Standards						
Standardized approach	Must be subject to home country Basel-compliant standards					
Tier 1 leverage ratio						
Supplementary leverage ratio						
Countercyclical capital buffer						
AOCI opt-out not available						
Mandatory use of SA-CCR (Proposed)						
Treated as “advanced approaches banking organization” under capital simplification proposal						
Capital Stress Testing						
Comprehensive Capital Analysis and Review (CCAR)	Must be subject to home country capital stress testing regime that meets certain minimum requirements if FBO has U.S.		Annual	Annual	Biennial (even years) [†]	
Supervisory stress testing			Annual	Annual	Biennial (even years) [†]	

^d There is some ambiguity in the proposed regulatory text, but we believe the below reflects the agencies’ intent regarding Category II IHCs.

* The FBO would be required to certify to the FRB that it meets capital adequacy standards on a consolidated basis established by its home country supervisor that are consistent with the regulatory capital framework published by the Basel Committee on Banking Supervision.

Regulatory Requirement	Category II FBO	Branches & Agencies of a Category II FBO	IHC Subsidiary of a Category II FBO			
			Category II IHC [†]	Category III IHC	Category IV IHC	Other IHC
Annual capital plan submission	branch or agency ^{**}					
Company-run stress testing			Annual	Biennial (even years)		
FR Y-14 reporting						
Liquidity						
Liquidity coverage ratio ^{***}			Full (daily) version	Full (daily) version	Full (daily) version	Full (daily) version
Net stable funding ratio ^{***}			Full (daily) version	Full (daily) version	Full (daily) version	Full (daily) version
FR 2052a submission ^{****}	Daily	Daily	Daily	Daily	Daily	Daily
Liquidity stress testing	Monthly CUSO stress testing and reporting of home country liquidity stress testing	Monthly	Monthly	Monthly	Monthly	Monthly
Liquidity risk management	Applies to CUSO	Applies to CUSO (not separately to branches and agencies)				
Liquidity buffer						
Other						
Single Counterparty-Credit Limits (SCCL) ^{*****}	For CUSO, FBO may satisfy requirement by certifying as to compliance with home country, Basel-compliant framework					
IHC Requirement	Must form IHC if \$50B non-branch asset threshold is met					

[†] The FRB plans to propose changes to the stress capital buffer proposal to align with this two-year cycle.

^{**} The FBO must be subject on a consolidated basis to a capital stress testing regime that meets certain minimum requirements, and must conduct such stress tests, or be subject to a supervisory stress test and meet any minimum standards set by its home country supervisor with respect to those stress tests.

^{***} The LCR and proposed NSFR also would apply to certain IHC and Category II and III FBO depository institution subsidiaries with \$10 billion or more in total consolidated assets.

^{****} Assumes each IHC, branch and agency is a “material entity.”

^{*****} See discussion regarding the SCCL on page 2.

Regulatory Requirement	Category II FBO	Branches & Agencies of a Category II FBO	IHC Subsidiary of a Category II FBO			
			Category II IHC ^D	Category III IHC	Category IV IHC	Other IHC
Risk Committee		Applies to CUSO (not separately to branches and agencies)				
Risk Management		Applies to CUSO (not separately to branches and agencies)				
FR Y-15 reporting						

Category III

Covered FBOs

\$250 billion or more in combined U.S. assets or at least \$75 billion in any one of: (1) total nonbank assets; (2) wSTWF; or (3) off-balance sheet exposures and not subject to Category II

Covered IHCs

\$250 billion or more in total consolidated assets or at least \$75 billion in any one of: (1) total nonbank assets; (2) wSTWF; or (3) off-balance sheet exposures and not subject to Category II

Requirement applies

Requirement does not apply (or does not apply directly)

Regulatory Requirement	Category III FBO	Branches & Agencies of a Category III FBO	IHC Subsidiary of a Category III FBO		
			Category III IHC	Category IV IHC	Other IHC
Capital Standards					
Standardized approach	Must be subject to home country Basel-compliant standards				
Tier 1 leverage ratio					
Supplementary leverage ratio					
Countercyclical capital buffer					
AOCI opt-out not available					
Mandatory use of SA-CCR (Proposed)					
Treated as “advanced approaches banking organization” under capital simplification proposal					
Capital Stress Testing					
Comprehensive Capital Analysis and Review (CCAR)	Must be subject to home country capital stress testing regime that meets certain minimum requirements if FBO has U.S. branch or agency**		Annual	Biennial (even years) [†]	
Supervisory stress testing			Annual	Biennial (even years) [†]	

* The FBO would be required to certify to the FRB that it meets capital adequacy standards on a consolidated basis established by its home country supervisor that are consistent with the regulatory capital framework published by the Basel Committee on Banking Supervision.

** The FBO must be subject on a consolidated basis to a capital stress testing regime that meets certain minimum requirements, and must conduct such stress tests, or be subject to a supervisory stress test and meet any minimum standards set by its home country supervisor with respect to those stress tests.

† The FRB plans to propose changes to the stress capital buffer proposal to align with this two-year cycle.

Regulatory Requirement	Category III FBO	Branches & Agencies of a Category III FBO	IHC Subsidiary of a Category III FBO		
			Category III IHC	Category IV IHC	Other IHC
Annual capital plan submission					
Company-run stress testing			Biennial (even years)		
FR Y-14 reporting					
Liquidity					
Liquidity coverage ratio ^{***}			Full (daily) LCR unless <\$75B in wSTWF, in which case a scaled (70-85%) version applies	Full (daily) LCR unless <\$75B in wSTWF, in which case a scaled (70-85%) version applies	Full (daily) LCR unless <\$75B in wSTWF, in which case a scaled (70-85%) version applies
Net stable funding ratio ^{***}			Full (daily) NSFR unless <\$75B in wSTWF, in which case a scaled (70-85%) version applies	Full (daily) NSFR unless <\$75B in wSTWF, in which case a scaled (70-85%) version applies	Full (daily) NSFR unless <\$75B in wSTWF, in which case a scaled (70-85%) version applies
FR 2052a submission ^{****}	Daily if wSTWF ≥\$75B, otherwise monthly	Daily if FBO's wSTWF ≥\$75B, otherwise monthly	Daily if FBO's wSTWF ≥\$75B, otherwise monthly	Daily if FBO's wSTWF ≥\$75B, otherwise monthly	Daily if FBO's wSTWF ≥\$75B, otherwise monthly
Liquidity stress testing	Monthly CUSO stress testing and reporting of home country liquidity stress testing	Monthly	Monthly	Monthly	Monthly
Liquidity risk management	Applies to CUSO	Applies to CUSO (not separately to branches and agencies)			
Liquidity buffer					
Other					
Single Counterparty-Credit Limits (SCCL) ^{*****}	For CUSO, FBO may satisfy requirement by certifying as to compliance with home country, Basel-compliant framework				
IHC Requirement	Must form IHC if \$50B non-branch asset threshold is met				

^{***} The LCR and proposed NSFR also would apply to certain IHC and Category II and III FBO depository institution subsidiaries with \$10 billion or more in total consolidated assets.

^{****} Assumes each IHC, branch and agency is a "material entity."

^{*****} See discussion regarding the SCCL on page 2.

Regulatory Requirement	Category III FBO	Branches & Agencies of a Category III FBO	IHC Subsidiary of a Category III FBO		
			Category III IHC	Category IV IHC	Other IHC
Risk Committee		Applies to CUSO (not separately to branches and agencies)			
Risk Management		Applies to CUSO (not separately to branches and agencies)			
FR Y-15 reporting					

Category IV

Covered FBOs

\$100 billion or more in combined U.S. assets and not subject to Category II or III

Covered IHCs

\$100 billion or more in total consolidated assets and not subject to Category II or III

Requirement applies

Requirement does not apply (or does not apply directly)

Regulatory Requirement	Category IV FBO	Branches & Agencies of a Category IV FBO	IHC Subsidiary of a Category IV FBO	
			Category IV IHC	Other IHC
Capital Standards				
Standardized approach	Must be subject to home country Basel-compliant standards*			
Tier 1 leverage ratio				
Supplementary leverage ratio				
Countercyclical capital buffer				
AOCI opt-out not available				
Mandatory use of SA-CCR (Proposed)				
Treated as “advanced approaches banking organization” under capital simplification proposal				
Capital Stress Testing				
Comprehensive Capital Analysis and Review (CCAR)	Must be subject to home country capital stress testing regime that meets certain minimum requirements if FBO has U.S. branch or agency**		Biennial (even years)†	
Supervisory stress testing			Biennial (even years)†	
Annual capital plan submission				

* The FBO would be required to certify to the FRB that it meets capital adequacy standards on a consolidated basis established by its home country supervisor that are consistent with the regulatory capital framework published by the Basel Committee on Banking Supervision.

** The FBO must be subject on a consolidated basis to a capital stress testing regime that meets certain minimum requirements, and must conduct such stress tests, or be subject to a supervisory stress test and meet any minimum standards set by its home country supervisor with respect to those stress tests.

† The FRB plans to propose changes to the stress capital buffer proposal to align with this two-year cycle.

Regulatory Requirement	Category IV FBO	Branches & Agencies of a Category IV FBO	IHC Subsidiary of a Category IV FBO	
			Category IV IHC	Other IHC
Company-run stress testing				
FR Y-14 reporting				
Liquidity				
Liquidity coverage ratio			Monthly Scaled (70-85%) version if \geq \$50B in wSTWF, else no LCR	Monthly Scaled (70-85%) version if \geq \$50B in wSTWF, else no LCR
Net stable funding ratio ^{***}			Monthly Scaled (70-85%) version if \geq \$50B in wSTWF, else no NSFR	Monthly Scaled (70-85%) version if \geq \$50B in wSTWF, else no NSFR
FR 2052a submission ^{****}	Monthly	Monthly	Monthly	Monthly
Liquidity stress testing	Quarterly CUSO stress testing and reporting of home country liquidity stress testing	Quarterly	Quarterly	Quarterly
Liquidity risk management	Tailored liquidity risk management ^{††}	Applies to CUSO (not separately to branches and agencies)		
Liquidity buffer				
Other				
Single Counterparty-Credit Limits (SCCL) ^{*****}	Applies to CUSO if global assets \geq \$250B; FBO may satisfy requirement by certifying as to compliance with home country, Basel-compliant framework			
IHC Requirement	Must form IHC if \$50B non-branch asset threshold is met			
Risk Committee		Applies to CUSO (not separately to branches and agencies)		

^{****} Assumes each IHC, branch and agency is a “material entity.”

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

^{*****} See discussion regarding the SCCL on page 2.

Regulatory Requirement	Category IV FBO	Branches & Agencies of a Category IV FBO	IHC Subsidiary of a Category IV FBO	
			Category IV IHC	Other IHC
Risk Management		Applies to CUSO (not separately to branches and agencies)		
FR Y-15 reporting				

Other

FBOs with less than \$100 billion in combined U.S. assets

Requirement applies

Requirement does not apply (or does not apply directly)

Regulatory Requirement	Other FBO	Branches & Agencies of an Other FBO	IHC Subsidiary of an Other FBO
Capital Standards			
Standardized approach	Must be subject to home country Basel-compliant standards if global assets \geq \$250B*		
Tier 1 leverage ratio			
Supplementary leverage ratio			
Countercyclical capital buffer			
AOCI opt-out not available			
Mandatory use of SA-CCR (Proposed)			
Treated as “advanced approaches banking organization” under capital simplification proposal			
Capital Stress Testing			
Comprehensive Capital Analysis and Review (CCAR)	Must be subject to home country capital stress testing regime that meets certain minimum requirements if FBO has U.S. branch or agency if global assets \geq \$100B**		
Supervisory stress testing			
Annual capital plan submission			
Company-run stress testing			
FR Y-14 reporting			
Liquidity			
Liquidity coverage ratio			
Net stable funding ratio			
FR 2052a submission			

* The FBO would be required to certify to the FRB that it meets capital adequacy standards on a consolidated basis established by its home country supervisor that are consistent with the regulatory capital framework published by the Basel Committee on Banking Supervision.

** The FBO must be subject on a consolidated basis to a capital stress testing regime that meets certain minimum requirements, and must conduct such stress tests, or be subject to a supervisory stress test and meet any minimum standards set by its home country supervisor with respect to those stress tests.

Regulatory Requirement	Other FBO	Branches & Agencies of an Other FBO	IHC Subsidiary of an Other FBO
Liquidity stress testing	Subject to internal liquidity stress testing (with respect to home country or CUSO) if global assets \geq \$250B		
Liquidity risk management			
Liquidity buffer			
Other			
Single Counterparty-Credit Limits (SCCL) ^{*****}	Applies to CUSO if global assets \geq \$250B; FBO may satisfy requirement by certifying as to compliance with home country, Basel-compliant framework		
IHC Requirement	Applicable if global assets \geq \$100B, in which case must form IHC if \$50B non-branch asset threshold is met		
Risk Committee ^{†††}	Applicable if global assets \geq \$50B	Applies to CUSO if global assets \geq \$50B (not separately to branches and agencies)	
Risk Management	Applicable if global assets \geq \$100B	Applies to CUSO if global assets \geq \$100B (not separately to branches and agencies)	
FR Y-15 reporting			

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Please do not hesitate to contact us with any questions.

^{*****} See discussion regarding the SCCL on page 2.

^{†††} FBOs with global assets between \$50 billion and \$100 billion, and FBOs with global assets of \$100 billion or more, but less than \$50 billion in combined U.S. assets would be required to maintain a risk committee and make an annual certification to that effect. FBOs with global assets of \$100 billion or more and \$50 billion or more in combined U.S. assets would be required to comply with more detailed risk-committee and risk management requirements, including the requirement to have a U.S. chief risk officer.



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