New Prudential Framework for Domestic and Foreign Banking Organizations

November 1, 2019

On November 1, 2019, the Federal Reserve Board (the "FRB"), the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC," and collectively with the FRB and OCC, the "agencies") published two rulemakings that will establish a revised prudential framework applicable to large U.S. banking organizations and foreign banking organizations ("FBOs") based on their risk profiles: (1) a rule that tailors the application of the agencies' capital and liquidity rules to large banking organizations;[1] and (2) a FRB-only rule that tailors the application of FRB-only enhanced prudential standards to large banking organizations, and applies the prudential standards to certain savings and loan holdings companies[2] (together, the "final rules").

Below we summarize these tailoring rules, highlighting material differences from the original proposals published on April 8, 2019 (for FBOs) and on October 31, 2018 (for U.S. firms) (collectively, the "Proposals") and providing charts that illustrate the requirements that apply to each category established under the new prudential framework. The final rule revising the regulation implementing resolution planning requirements of section 165(d) of the Dodd-Frank Act is addressed in a separate Debevoise In Depth.[3]

Overview of New Prudential Framework. The new prudential framework is intended to tailor existing regulations for domestic and foreign banking organizations to more closely match their risk profiles. This tailoring framework was developed in response to the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Regulatory Relief Act," previously discussed here), which requires certain of the changes made by the final rules. The final rules modify the application of various capital, liquidity and other prudential standards to large U.S. banking organizations and FBOs by creating four categories of prudential standards that increase in stringency based on risk-based indicators that measure asset size, cross-jurisdictional activity, weighted short-term wholesale funding ("wSTWF"), nonbank assets and off-balance sheet

1 84 Fed. Reg. 59230 (Nov. 1, 2019).

2 84 Fed. Reg. 59032 (Nov. 1, 2019).

3 The Debevoise In Depth addressing final rule for resolution planning is available here.

exposure. These indicators generally are measured on a four-quarter average basis. The new framework applies to U.S. bank holding companies ("BHCs") with $100 billion or more in total consolidated assets ("Covered BHCs"), savings and loan holding companies ("SLHCs") that are not substantially engaged in insurance underwriting or commercial activities with $100 billion or more in total consolidated assets ("Covered SLHCs"), 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 final rules also tailor certain standards for FBOs with $50 billion or more in global assets.

For reference, a redline showing the changes to the regulatory text is available here.

Notable Changes from the Proposals. Significantly, the agencies made no changes to the proposed thresholds or risk-based indicators that are used to determine applicable requirements. This includes declining requests to index the thresholds for the risk-based indicators and, for FBOs, declining to expand the exclusion for interaffiliate transactions beyond the proposed exclusion for cross-jurisdictional activity. Although the final rules largely adopt the Proposals as proposed, the final rules include notable changes, such as:

FBOs

- Under the final rules, quantitative liquidity requirements, *i.e.*, the liquidity coverage ratio ("LCR") and proposed net stable funding ratio ("proposed NSFR") applicable to an IHC of an FBO, are based on the consolidated risk characteristics of the IHC rather than those of the combined U.S. operations ("CUSO") of its parent FBO, which would have had the effect of using the FBO's U.S. branch and agency operations to trigger IHC-level requirements.

- Similarly, the single-counterparty credit limit ("SCCL") requirements for IHCs are based on the risk profile of the IHC rather than on the risk profile of the CUSO of its parent FBO. As a result, only IHCs subject to Category II or III standards are separately subject to the SCCL rule. Certain IHCs with less than $250 billion in total consolidated assets will be subject to certain requirements under the SCCL for the first time (with respect to exposures to special purpose vehicles, the economic interdependence and control tests, and the daily compliance requirement). The final rules provide these IHCs with additional transition time, until January 1, 2021, to come into compliance with these more stringent requirements. The final rules also remove the more stringent SCCL that would have applied to "major U.S. intermediate holding companies."[4]

- The final rules do not raise the U.S. non-branch asset threshold that would trigger the requirement for an FBO to establish an IHC. The final rules do, however, eliminate the formal requirement to submit an IHC implementation plan. In lieu of the formal requirement, the FRB stated that implementation planning for a new IHC would be reviewed as a part of the supervisory process. In addition, the final rules make conforming and other changes to the process for requesting an alternative organization structure for an IHC.

Liquidity

- In the Proposals, the agencies requested comment on the calibration of the reduced LCR and proposed NSFR requirements at a level between 70% and 85% of the full LCR requirement. Under the final rules, a Category III firm with wSTWF of less than $75 billion is subject to reduced LCR and proposed NSFR requirements calibrated at 85% of the full requirement. A Category IV firm with wSTWF of $50 billion or more is subject to reduced LCR and proposed NSFR requirements calibrated at 70% of the full requirement. BHCs that are not Covered BHCs would not be subject to the LCR.[5]

- The final rules revise the scope of liquid assets eligible for the Regulation YY liquidity buffer to be consistent with "high quality liquid assets" ("HQLA") under the LCR. The agencies also clarified that although the Regulation YY liquidity buffer does not specific haircut or concentration limits for specific asset classes, the agencies clarified that the requirement that a firm discount the fair value of assets in the buffer and the requirement for diversification effectively impose such requirements.[6] Notwithstanding the alignment of "liquid assets" eligible for the Regulation YY liquidity buffer and HQLA under the LCR, the FRB declined to incorporate the LCR's more prescriptive requirements for demonstrating the operational capacity to control and monetize assets.

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4 The FRB noted that no IHCs currently meet the $500 billion asset threshold that would have triggered this classification.

5 Currently, BHCs that do not meet the applicability thresholds for the full LCR must comply with a 70% scaled version of the LCR. 12 CFR pt. 249, subpt. G.

6 By its terms, the diversification requirement under 12 CFR 252.35(b)(3)(v), 157(c)(7)(v) does not apply to cash and securities issued or guaranteed by the United States, a U.S. government agency or a U.S. government-sponsored enterprise.

- The agencies state that in order for a liquidity management function to demonstrate that it has the ability to monetize HQLA to satisfy the operational requirements for HQLA under the LCR, the banking organization should be able to demonstrate its ability to monetize the assets and make the proceeds “continuously available” to the liquidity management function.

- The final rules require all banking organizations subject to an LCR requirement (full or reduced) to include a maturity mismatch add-on in their LCR calculations.

- The final rules do not apply the LCR (or proposed NSFR) to U.S. branches and agencies of FBOs on a standalone basis. The agencies said that they intend to further consider how to address concerns regarding the liquidity risk profiles of foreign banking organizations’ U.S. operations.

Capital Stress Testing

- As required by the Regulatory Relief Act, the final rules remove the “adverse” scenario from the list of required scenarios in the FRB’s stress testing rules, reducing the number of required stress test scenarios from three to two. This removal will take effect for the 2020 stress test cycle.

- Notwithstanding the fact that firms subject to Category III standards will only be required to conduct biennial company-run stress tests, the FRB clarified that such firms would be required to conduct an internal stress test, and report the results on the FR Y-14A in connection with their annual capital plan submissions.

- The FRB did not finalize the proposed revisions to the definition in the FRB’s capital plan rule of “large and noncomplex” banking organizations to mean a Category IV firm. Although the FRB stated that it “intends to provide greater flexibility to banking organizations subject to Category IV standards in developing their annual capital plans,” it deferred these and other changes to a later rulemaking to amendment its capital plan rule.

Regulatory Reporting

- The FRB will not require FBOs to provide standalone data on their U.S. branches and agencies on the FR Y-15. FBOs also will not be required to calculate average risk-weighted assets for their CUSO in Column B on Schedule N, line item 7 on the FR Y-15, but will be required to calculate and report certain elements of the LCR and regulatory capital rules.

- For all Category IV firms that are subject to FR 2052a reporting on a monthly basis, the FRB will require these firms to submit data on a T+10 basis, regardless of their level of wSTWF.

- The final rules provide Covered SLHCs with an extended amount of time to file their first reports.

Category definitions. The four categories of firms under the new prudential framework and the standards that apply to each category are described below, along with charts illustrating the proposed requirements.

Category I. Category I includes the U.S. global systemically important bank holding companies ("U.S. GSIBs"), as identified under the FRB's GSIB surcharge rule. The only change in the final rules for these firms is the elimination of the mid-cycle company-run Dodd-Frank Act stress testing ("DFAST") requirement, required by the Regulatory Relief Act.

Category II. Category II includes BHCs (other than U.S. GSIBs), Covered SLHCs, 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 BHCs, Covered SLHCs and Covered IHCs, referred to below as "Covered Assets") or at least $75 billion or more in cross-jurisdictional activity.

- Cross-jurisdictional activity is defined as the sum of cross-jurisdictional assets and liabilities as reported on the FRB's FR Y-15 form.

- These metrics effectively become the new advanced approaches thresholds, replacing the existing $250 billion in assets and $10 billion in foreign exposures thresholds.

- For Covered FBOs and Covered IHCs, the measure of cross-jurisdictional activity is adjusted 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.

Category III. Category III includes Covered BHCs, Covered SLHCs, Covered FBOs and Covered IHCs that are not subject to Category I or II standards that have $250 billion or more in Covered Assets or $75 billion or more in any one or more of: (1) total nonbank assets; (2) 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 are calculated in accordance with the instructions to the FRB's FR Y-9LP form. Nonbank assets for a Covered FBO are 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 is calculated in accordance with the instructions to the FRB's FR Y-15 form.
- Off-balance-sheet exposures is defined as total exposure, calculated in accordance with the instructions to the FRB's FR Y-15 form, minus total Covered Assets.

Category IV. Category IV includes all other Covered BHCs, Covered SLHCs, Covered FBOs and Covered IHCs.

Other BHCs and Covered SLHCs. Other BHCs and SLHCs subject to risk management and risk committee requirements include BHCs and SLHCs with $50 billion or more in total consolidated assets.

Other FBOs. Other FBOs subject to risk management and risk committee requirements and certain other enhanced prudential standards include FBOs with $50 billion or more but less than $100 billion in Covered Assets, depending on whether they meet additional thresholds.

Line Items for Risk-Based Indicators. The line items for risk-based indicators may be found on the FR Y-15 as follows:

	BHC	**IHC**	**CUSO**
Size	Schedule A, Line M4	Schedule H, Column A, Line M4	Schedule H, Column B, Line M4
Cross-jurisdictional activity	Schedule E, Line 5	Schedule L, Column A, Line 4	Schedule L, Column B, Line 4
Nonbank assets	Schedule A, Line M6	Schedule H, Column A, Line M6	Schedule H, Column B, Line M6
Short-term wholesale funding	Schedule G, Line 6	Schedule N, Column A, Line 6	Schedule N, Column B, Line 6
Off-balance sheet exposure	Schedule A, Item M5	Schedule H, Column A, Line M5	Schedule H, Column B, Line M5

Moving between categories. Firms are required to report quarterly on the metrics used to determine their category. Movement between categories occurs 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 generally would take effect on the first day of the second quarter following the change in the firm's category.[7]

The final rules also provide special transition periods with respect to LCR requirements.

- Covered BHCs and Covered IHCs that were subject to the LCR immediately prior to the effective date are required to comply with the applicable requirement on the effective date. An IHC that was not previously subject to the LCR that becomes subject to an LCR requirement would be required to comply with the applicable LCR requirement one year following the effective date of the final rule, at which time the IHC would be required to comply with the LCR on each business day or, in the case of a Category IV IHC, on the last business day of the applicable calendar month.

- A banking organization subject to the LCR that becomes subject to a higher outflow adjustment would be able to continue using a lower outflow rate for two quarters. A banking organization that becomes subject to a lower outflow adjustment would be able to use the lower percentage immediately, as of the first day of the subsequent quarter.

- A banking organization that moves from Category IV to another Category would have one year to begin complying with daily LCR calculation requirements.

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

Timelines for Initial Categorizations and Reporting Under the Final Rule. The following chart sets forth the timelines for firms to come into compliance with the new reporting requirements.

<table>
<tr><th></th><th>BHC</th><th>Covered SLHC</th><th>IHC</th><th>CUSO</th></tr>
<tr><td>Date for first categorization under tailoring framework</td><td colspan="3">Effective date of final rules (based on averages using the four most recent FR Y-15 and FR Y-9LP filings)</td><td>Submission date of FR Y-15 (as of June 30, 2020)</td></tr>
<tr><td>First as-of date of amended FR Y-15</td><td colspan="2">June 30, 2020</td><td colspan="2">June 30, 2020 (as of this date, top-tier FBOs will report the FR Y-15 on behalf of their IHC and CUSO)</td></tr>
<tr><td>First as-of date for amended FR 2052a</td><td colspan="2">June 30, 2020</td><td colspan="2">October 1, 2020 (until this date, an FBO should report the FR 2052a with the same frequency and as-of date as the FBO was required to report on September 1, 2019)</td></tr>
<tr><td>First as-of date for amended FR Y-14A</td><td>Next report after effective date of final rule</td><td>December 31, 2021</td><td>Next report after effective date of final rule</td><td>N/A</td></tr>
<tr><td>First as-of date for amended FR Y-14Q</td><td>Next report after effective date of final rule</td><td>June 30, 2020</td><td>Next report after effective date of final rule</td><td>N/A</td></tr>
<tr><td>First as-of date for amended FR Y-9C</td><td colspan="3">Next report after effective date of final rule</td><td>N/A</td></tr>
<tr><td>First as-of date for amended FR Y-7Q</td><td colspan="2">N/A</td><td colspan="2">Next report after effective date of final rule</td></tr>
<tr><td>First as-of date for amended FR Y-7</td><td colspan="2">N/A</td><td colspan="2">Next report after effective date of final rule (fiscal year-end 2020)</td></tr>
</table>

Standards under each category. The following charts illustrate the requirements that apply to each category.[8] As noted above, certain requirements apply to IHCs based on the category of their parent FBOs. An IHC subsidiary of a Category II, III or IV FBO will be referred to as a Category II, III or IV FBO IHC, respectively.

■ Requirement Applies □ Requirement Does Not Apply

Capital Requirements for BHCs and IHCs

Regulatory Requirement	Category I BHC	Category II BHC/IHC	Category III BHC/IHC	Category IV BHC/IHC	Other BHC/IHC
TLAC/Long-term debt	■	Applies to IHC subsidiaries of GSIBs			
GSIB surcharge (for BHCs only)	■				
Enhanced Supplementary leverage ratio	■				
Advanced approaches	■	U.S. BHCs only[9]			
Mandatory use of SA-CCR	■	■			
AOCI opt-out not available	■	■			
EGRPRA capital simplification not applicable[10]	■	■			
Supplementary leverage ratio	■	■	■		
Countercyclical capital buffer	■	■	■		
Standardized approach	■	■	■	■	■
Tier 1 leverage ratio	■	■	■	■	■

8 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.

9 An IHC may elect to apply advanced approaches. In addition, a BHC subsidiary of an FBO may elect not to apply advanced approaches with the prior written approval of the FRB.

10 Certain banking organizations are subject to simpler regulatory capital requirements for mortgage servicing assets, certain deferred tax assets arising from temporary differences and investments in the capital of unconsolidated financial institutions, as well as for the treatment of minority interest that is includable in regulatory capital.

Capital Stress Testing and Related Requirements for BHCs and IHCs

Regulatory Requirement	Category I BHC	Category II BHC/IHC	Category III BHC/IHC	Category IV BHC/IHC	Other BHC/IHC
Supervisory stress testing	Annually	Annually	Annually	Biennially	
Company-run stress testing[11]	Annually	Annually	Biennially[12]		
Capital plan submission	Annually	Annually	Annually	Annually	
FR Y-14 reporting					

Liquidity and Related Requirements for BHCs and IHCs

Regulatory Requirement	Category I BHC	Category II BHC/IHC	Category III BHC/IHC	Category IV BHC/IHC	Other BHC/IHC
Full Liquidity coverage ratio and net stable funding ratio (proposed)[13]			If wSTWF < \$75b: Reduced daily LCR (85%) If wSTWF ≥\$75b: Full daily LCR (100%)	If wSTWF < \$50b: No LCR If wSTWF ≥\$50b: Reduced monthly LCR (70%)	
Internal liquidity stress testing	Monthly	Monthly	Monthly	Monthly if Category II or III FBO IHC Quarterly if BHC or Category IV FBO IHC	Monthly if Category II or III FBO IHC Quarterly if Category IV FBO IHC None if BHC or other IHC
Liquidity risk management[14]	Untailored	Untailored	Untailored	Untailored if Category II or III FBO IHC Tailored[15] if BHC or Category IV FBO IHC	Untailored for Category II or III FBO IHC Tailored for Category IV FBO IHC None if BHC or other IHC
Liquidity buffer					Applies to IHC with Covered FBO parent

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[11] The FRB may require more frequent company-run stress testing as needed.

[12] Firms subject to Category III standards would be required to conduct an internal stress test, and report the results on the FR Y-14A, in connection with its annual capital plan submission.

[13] Requirements also apply to depository institution subsidiaries of Category I, II or III firms with \$10 billion or more in total consolidated assets.

[14] Does not apply separately to any IHC.

[15] 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.

Regulatory Requirement	Category I BHC	Category II BHC/IHC	Category III BHC/IHC	Category IV BHC/IHC	Other BHC/IHC
					N/A if BHC or other IHC
FR 2052a[16]	Daily (T+2)	Daily (T+2)	Daily (T+2) if (A) Category II FBO IHC or (B) (i) BHC or Category III FBO IHC and (ii) wSTWF ≥$75b) Monthly (T+2) if (A) BHC or Category III FBO IHC and (B) wSTWF <$75b	Daily (T+2) if (A) Category II FBO IHC or (B) Category III FBO IHC with wSTWF ≥$75b Monthly (T+2) if Category III FBO IHC with wSTWF <$75b Monthly (T+10) if BHC or Category IV FBO IHC	Daily (T+2) if (A) Category II FBO IHC or (B) Category III FBO IHC with wSTWF ≥$75b Monthly (T+2) if Category III FBO IHC with wSTWF <$75b Monthly (T+10) if Category IV FBO IHC N/A if BHC or other IHC

Other Enhanced Prudential Standards for BHCs and IHCs

Regulatory Requirement	Category I BHC	Category II BHC/IHC	Category III BHC/IHC	Category IV BHC/IHC	Other BHC/IHC
Single Counterparty-Credit Limits (SCCL)	More stringent GSIB to GSIB limit applies				
Risk Committee Requirement					Applies to BHC only if total consolidated assets ≥$50b.
Risk Management Requirements					
FR Y-15 reporting					Applies to IHC if FBO parent is Covered FBO

16 Assumes each IHC is a "material entity" as defined in the FR 2052a instructions.

Enhanced Prudential Standards for FBOs

Regulatory Requirement	Category II FBO	Category III FBO	Category IV FBO	Other FBO
Home Country Capital Certification[17]				Applicable if global assets ≥$250b
Home Country Capital Stress Testing Certification[18]	Annually	Annually	Biennially	Applicable if global assets ≥$100b (at least biennially if global assets <$250b and annually if global assets ≥$250b)
Liquidity Stress Testing[19]	Monthly	Monthly	Quarterly	Subject to reporting of global or CUSO internal liquidity stress testing if global assets ≥$250b
Liquidity Risk Management	Untailored	Untailored	Tailored[20]	
Liquidity Buffer[21]				
Single Counterparty-Credit Limits (SCCL)[22]			Applies if global assets ≥$250b	Applies if global assets ≥$250b
Requirement to form IHC if $50b non-branch asset threshold is met				Applicable if global assets ≥$100b
Risk Committee				Applicable if global assets ≥$50b[23]
Risk Management				Applicable if global assets ≥$100b
FR 2052a[24]	Daily (T+2)	Daily (T+2) if wSTWF ≥$75b Monthly (T+2) if wSTWF < $75b	Monthly (T+10)	
FR Y-15[25]				

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17 The FBO will 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.

18 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.

19 Applies separately to CUSO, U.S. branches and agencies and any IHC.

20 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.

21 Applies separately to U.S. branches/agencies and any IHC.

22 May satisfy requirement by certifying as to compliance with Basel-compliant, home country framework.

23 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.

24 Includes standalone reporting for any "material entities," which may include any IHCs, branches or agencies.

25 Applies separately to CUSO and any IHC.

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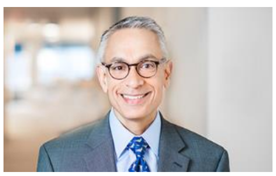

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