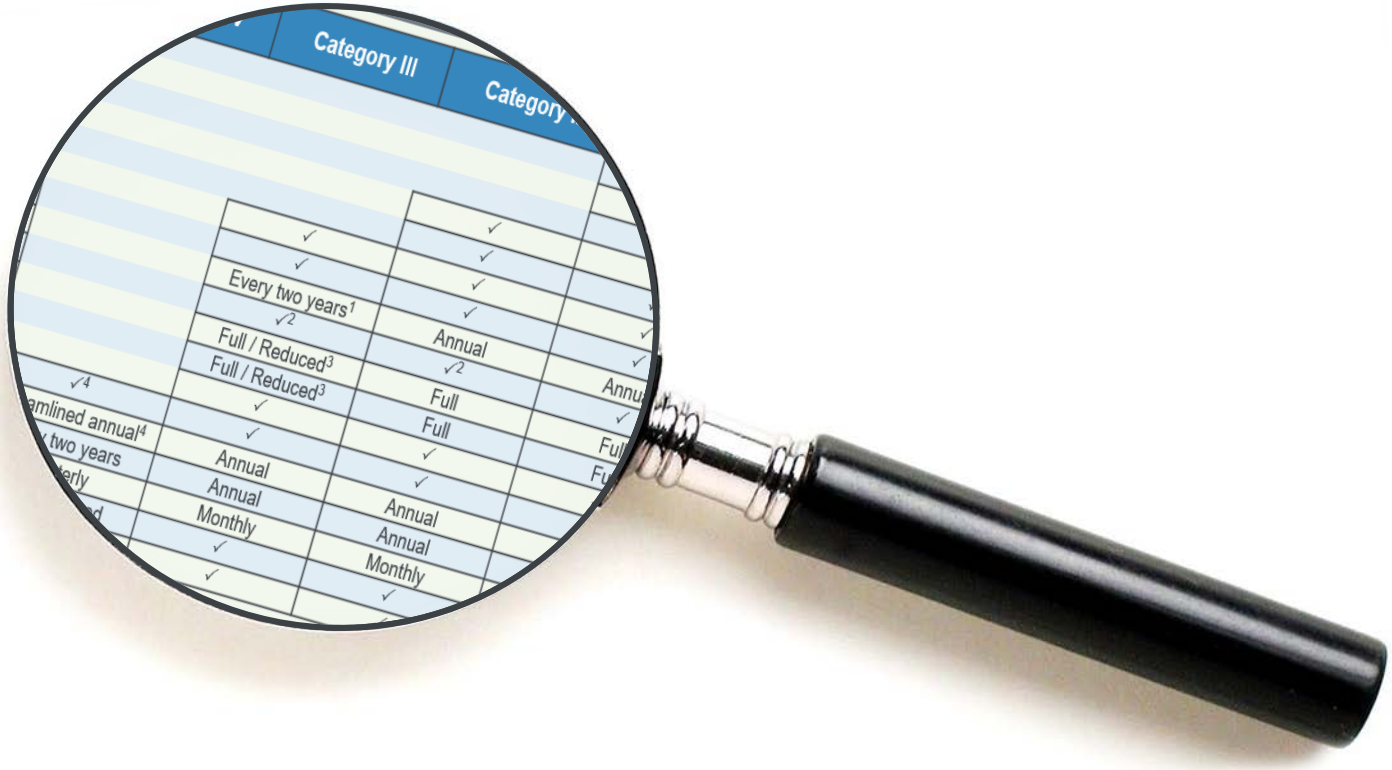
# A New Cut: Federal Reserve and U.S. Banking Agencies Propose Tailored Regulatory Framework

December 10, 2018




Davis Polk

Davis Polk & Wardwell LLP

# Table of Contents

# I. Introduction

# A New Round of Tailoring

- The move away from a one-size-fits-all regulatory framework based on asset size continues.
- Congress acted in the Economic Growth, Regulatory Relief and Consumer Protection Act (**EGRRCPA**) of 2018 to:
  - **increase the general asset threshold from $50B to $250B** for most of the enhanced prudential standards (**EPS**) under Section 165 of the Dodd-Frank Act; and
  - authorize the Federal Reserve to determine which EPS should apply to firms **between $100B and $250B** in total consolidated assets.
- On October 31, 2018, the Federal Reserve proposed **tailoring the EPS** for firms with $100B or more in assets in its proposed rule, and the three U.S. banking agencies proposed corresponding tailoring of their **Basel III capital and liquidity rules**.
- The proposed rules make changes that would apply only to **U.S. banking organizations** – the U.S. banking agencies will propose rules applicable to foreign banking organizations (**FBOs**) through a separate proposal.

# Overview of the Proposed Rules

- The proposals would tailor the agencies' existing rules by creating four main categories of U.S. banking organizations – **Categories I through IV** – determined by a combination of the following risk-based indicators:

  - the U.S. GSIB assessment methodology,
  - size,
  - cross-jurisdictional activity,
  - weighted short-term wholesale funding (**STWF**),
  - nonbank assets, and
  - off-balance sheet exposure.

# Overview of the Proposed Rules (cont'd)

- The **category of a firm**, and in certain cases the extent to which the firm meets or exceeds one of the risk-based indicator thresholds, determines the specific EPS and capital and liquidity requirements applicable to the firm.
  - See **page 16** for more detail on the categorization framework.
  - See **page 32** for more detail on the specific requirements applicable to each category of firms.

- Overall, the proposals would:
  - for the eight **U.S. GSIBs**, leave existing requirements **virtually unchanged**
  - make **meaningful changes** to requirements applicable to U.S. **regional banks** that have **≥ $100B and < $700B in total consolidated assets** and < $75B in cross-jurisdictional activity and weighted STWF.

# Structure of the Two Proposed Rules

- **Federal Reserve's Proposed Rule:** Proposes changes to EPS established through the **Federal Reserve's own regulations**:
  - supervisory and company-run Dodd-Frank Act Stress testing (**DFAST**),
  - liquidity risk management, stress testing and buffer requirements,
  - risk committee and risk management requirements, and
  - single-counterparty credit limits (**SCCL**).
- **U.S. Banking Agencies' Proposed Rule:** Proposes changes to the agencies' **Basel III capital and liquidity rules**:
  - applicability of the advanced approaches for calculating counterparty credit risk,
  - recognition of accumulated other comprehensive income (**AOCI**) in Common Equity Tier 1 (**CET 1**) capital**,**
  - countercyclical capital buffer (**CCyB**),
  - the supplementary leverage ratio (**SLR**),
  - the liquidity coverage ratio (**LCR**), and
  - the proposed net stable funding ratio (**NSFR**).

# Summary of Requirements Applicable by Category

| | Category IV | Category III | Category II | Category I – U.S. GSIBs |
|---|---|---|---|---|
| TLAC requirement | | | | ✓ |
| GSIB surcharge | | | | ✓ |
| Enhanced SLR | | | | ✓ |
| Advanced approaches risk weights | | | ✓ | ✓ |
| AOCI recognized in capital | | | ✓ | ✓ |
| CCyB (if deployed) | | ✓ | ✓ | ✓ |
| SLR | | ✓ | ✓ | ✓ |
| Company-run DFAST | | Every two years[1] | Annual | Annual |
| SCCL | | ✓[2] | ✓[2] | ✓ |
| LCR | | Full / Reduced[3] | Full | Full |
| Proposed NSFR | | Full / Reduced[3] | Full | Full |
| Qualitative CCAR | | ✓ | ✓ | ✓ |
| Proposed stress buffer requirements | ✓[4] | ✓ | ✓ | ✓ |
| Quantitative CCAR | Streamlined annual[4] | Annual | Annual | Annual |
| Supervisory DFAST | Every two years | Annual | Annual | Annual |
| Internal liquidity stress testing | Quarterly | Monthly | Monthly | Monthly |
| Liquidity risk management | Slightly tailored | ✓ | ✓ | ✓ |
| Risk committee and risk management | ✓ | ✓ | ✓ | ✓ |

1. A Category III firm would be required to submit internal stress test results to the Federal Reserve as part of its annual capital plan submission, but would be required to publicly disclose its company-run DFAST results only once every two years.
2. A Category II or III firm's aggregate net credit exposure to a single counterparty would be capped at 25% of tier 1 capital, which currently applies under the Federal Reserve's SCCL rule to U.S. BHCs that are not GSIBs and ≥ $250B in total consolidated assets.
3. A reduced LCR and NSFR of between 70 and 85% of the relevant full requirement would apply to a Category III firm with < $75B of weighted STWF.
4. The Federal Reserve stated that its final stress buffer requirements rule and a forthcoming capital planning proposal will require a Category IV firm to submit a streamlined annual capital plan, but that the stress loss portion of a Category IV firm's stress buffer requirements would be updated every two years (to align with the two-year supervisory DFAST cycle for Category IV firms), whereas the planned distributions portion of the stress buffer requirements would be updated annually (based on the firm's annual capital plan).

# II. Scope of Applicability

# The Federal Reserve's Proposed Rule

- Makes changes to EPS that would apply to the top-tier U.S. bank holding companies (**BHCs**) and extends EPS, including the SCCL, to covered savings and loan holding companies (**SLHCs**).

**Definition of a covered SLHC**

A **covered SLHC** is any SLHC that is **not**:

- a top-tier SLHC that is a **grandfathered unitary SLHC** that derives 50% or more of its total consolidated assets or total revenues from activities that are **not** financial in nature under Section 4(k) of the Bank Holding Company Act,
- a top-tier depository institution holding company that is an **insurance underwriting company**, or
- a top-tier depository institution holding company that holds 25% or more of its total consolidated assets in **subsidiaries that are insurance underwriting companies** (other than assets associated with credit risk insurance).

# The Federal Reserve's Proposed Rule

- Raises the asset threshold for applicability of its **capital planning rule** (Section 225.8 of Regulation Y) to BHCs **≥ $100B**.
  - Also amends the definition of "**large and noncomplex bank holding company**" in the capital planning rule to conform to changes to EPS.
- Makes changes to the following Federal Reserve **reports** to conform to changes to EPS:
  - **FR 2052a** – Complex Institution Liquidity Monitoring Report;
  - **FR Y-9C/LP/SP/ES/CS** – Consolidated Financial Statements for Holding Companies;
  - **FR Y-14A/O/M** – Capital assessments and Stress Testing; and
  - **FR Y-15** – Banking Organization Systemic Risk Report.

# The Joint Proposed Rule

- The U.S. banking agencies' joint proposed rule makes changes to the agencies' **capital rules** that would apply to:
  - U.S. BHCs, covered SLHCs and their respective insured depository institutions (**IDIs**), in each case that are currently subject to the capital rules, and
  - any IDI that **does not have a parent** BHC or covered SLHC.
- The U.S. banking agencies' joint proposed rule makes changes to the agencies' **liquidity rules** that would apply to:
  - Category I – III U.S. BHCs and covered SLHCs and their respective IDIs with **≥ $10B** in total consolidated assets, and
  - any IDI that otherwise meets the Category I – III criteria applicable to BHCs and covered SLHCs.

# III. Additional Forthcoming Rulemakings

# FBO EPS Rule

- The proposed rules **do not** make any changes to EPS that apply to FBOs, including U.S. intermediate holding companies (**IHCs**) of FBOs, or to the U.S. capital and liquidity requirements applicable to an IHC or any IDI subsidiary or BHC subsidiary of an FBO.
- Instead, the Federal Reserve will propose a **separate rule** to tailor EPS applicable to FBOs and to apply U.S. capital and liquidity requirements to the U.S. operations of FBOs
  - The FBO proposal will reflect principles of **national treatment** and **equality of competitive opportunity**, as directed by Section 165(b)(2) of the Dodd-Frank Act.
  - In testimony before the House Financial Services Committee, Federal Reserve Vice Chairman for Supervision Quarles stated that the FBO tailoring proposal will **not** apply the same EPS requirements to FBOs in **identical fashion** as for U.S. banking organizations but rather will take into account FBOs' different legal structures and the relationship of an FBO's U.S. operations to its foreign parent company and affiliates.
  - The FBO proposal is expected "early next year," according to Vice Chairman Quarles.

# Capital Planning and Resolution Planning Rules

## Capital Planning Rule

- Federal Reserve will propose **separate changes** to its capital planning rule, including:
  - Applying capital planning and proposed stress buffer requirements to **covered SLHCs** with ≥ $100B in total consolidated assets, and
  - Making other amendments to take into account the four categories of firms and their respective capital planning and proposed stress buffer requirements, especially for Category IV firms.

## Resolution Planning Rules

- The proposed rules **do not** make any changes to the Federal Reserve's and FDIC's resolution planning rules.
- Federal Reserve and FDIC will propose **separate changes** to their joint resolution planning rules, including:
  - Raising the **threshold for applicability** for U.S. BHCs to **≥ $100B** in total consolidated assets, and
  - Making other amendments to the applicability of resolution planning requirements to firms **≥ $100B < $250B** in total consolidated assets.

# IV. Categories of Firms

# Categories of Firms

- Both the Federal Reserve's and the banking agencies' proposed rules create four categories of firms: **Categories I through IV**.
- Under the proposed rules, the category of firm determines the applicability of the following EPS and capital and liquidity requirements:

**EPS**

- Supervisory and company-run DFAST, including related reporting requirements
- Liquidity risk management, stress testing and buffer, including related reporting requirements
- Risk committee and risk management
- SCCL

**Capital and Liquidity Requirements**

- GSIB surcharge
- The requirement to reflect AOCI in CET 1 capital
- CCyB, if deployed
- Advanced approaches for calculating risk-weighted assets
- SLR and enhanced SLR
- LCR
- Proposed NSFR
- Capital planning/CCAR (to be proposed in separate capital planning rule proposal)

# Category I and II Firms

**Category I**

- Applies to **U.S. GSIBs**
- Determined by existing U.S. GSIB assessment methodology under applicable provisions of the Federal Reserve's capital rules

**Category II**

- Firms that are **not U.S. GSIBs** and that have:
  - **≥ $700B in total consolidated assets**, or
  - **≥ $100B** in total consolidated assets <u>and</u> **≥ $75B in cross-jurisdictional activity**

- The Federal Reserve describes Category II as consisting of U.S. BHCs that are **very large** or have **significant international activity**.
  - The standards applicable to Category II firms are based on those developed by the Basel Committee on Banking Supervision (**BCBS**) and other standards appropriate to very large or "internationally active" organizations.
  - This category thus appears to define the U.S. equivalent of "internationally active" banks to which the BCBS Basel III capital and liquidity standards are intended to apply globally.
  - Category II is intended to promote "competitive equity" among U.S. firms and their non-U.S. peers and competitors and to reduce opportunities for regulatory arbitrage.
  - The Federal Reserve stated that consistency of standards can also facilitate U.S. firms' regulatory compliance in foreign markets.
  - These statements suggest that the Federal Reserve may create a corresponding category for FBOs in its separate, forthcoming tailoring proposal for FBOs.

# Category III and IV Firms

**Category III**

- Firms that are not in Category I or II and that have:
  - **≥ $250B in total consolidated assets**, or
  - **≥ $100B** in total consolidated assets and **≥ $75B** in any of the three following **specific risk indicators**:
    - Weighted STWF
    - Nonbank assets, or
    - Off-balance sheet exposure

**Category IV**

- Firms that are not in Category I, II or III and that have **≥ $100B in total consolidated assets**
  - i.e., ≥ $100B < $250B asset firms that do not meet or exceed <u>any</u> of the specific risk-based indicators

# Criteria for Categorization of Firms

## U.S. GSIB Assessment Methodology

- Currently, the GSIB assessment methodology only applies to advanced approaches U.S. BHCs.
- The U.S. banking agencies' joint proposed rule would amend the relevant definition of "advanced approaches Board-regulated institution" to include:
  - A **top-tier U.S. BHC or SLHC** that is not a consolidated subsidiary of another BHC or SLHC that uses the advanced approaches to calculate its risk-based capital requirements, and that:
    - Is a **U.S. GSIB**,
    - Is a **Category II firm**, or
    - **Has a subsidiary IDI** that is required or has elected to use the **advanced approaches** to calculate its risk-based capital requirements.
- Advanced approaches U.S. BHCs must currently calculate whether they are U.S. GSIBs on an annual basis by **December 31**.
- The GSIB assessment methodology uses two different methods, **Method 1** and **Method 2**, and is based on the **higher** of the two scores produced by the two methods.
  - Method 2 is calibrated to produce **higher scores** than Method 1.

# Criteria for Categorization of Firms

## U.S. GSIB Assessment Methodology (cont'd)

**Method 1 Metrics.** Method 1 measures five main categories of systemic indicators and associated indicator weights:

- **Size** – measured by total exposures
- **Interconnectedness** -- measured by:
  - Intra-financial system assets
  - Intra-financial system liabilities
  - Securities outstanding
- **Substitutability** – measured by:
  - Payments activity
  - Assets under custody
  - Underwritten transactions in debt and equity markets
- **Complexity** – measured by:
  - Notional amount of OTC derivatives
  - Trading and available for sale (**AFS**) securities
  - Level 3 assets
- **Cross-jurisdictional activity** – measured by:
  - Cross-jurisdictional claims
  - Cross-jurisdictional liabilities

**Method 2 Metrics.** Method 2 measures five main categories of systemic indicators and associated coefficient values:

- Four categories are **the same as Method 1** – size, interconnectedness, complexity, cross-jurisdictional activity
- Method 2 replaces substitutability category with **weighted STWF**, measured by:
  - Four main categories of STWF and four periods of remaining maturity

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators

- The thresholds for all of the risk-based indicators under the proposed rules – size, cross-jurisdictional activity, weighted STWF, nonbank assets and off-balance sheet exposure – would be based on the **average level** of each indicator measured over the **preceding four calendar quarters**.
  - If a firm has not been reporting a relevant indicator for four calendar quarters, the measurement is based on the most recent quarter or consecutive quarters, as applicable.
- **Neither** of the proposed rules includes any mechanism for **periodically adjusting** the thresholds to take into account the effects of, e.g., economic growth.
  - As a result, firms are at risk of "**category creep**" if the banking sector grows in line with overall economic growth.
- Apart from size, the threshold for the specific risk-based indicators is a **uniform ≥ $75B**.
  - The Federal Reserve stated that it may consider modifications to this threshold if the level and distribution of any indicator substantially changes in the future

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Size:**
  - Measured by total consolidated assets
  - As reported on FR Y-9C

**Schedule HC—Consolidated Balance Sheet**

| Dollar Amounts in Thousands | | BHCK | Amount | |
|---|---|---|---|---|
| **Assets** | | | | |
| 1. Cash and balances due from depository institutions: | | | | |
| a. Noninterest-bearing balances and currency and coin[1] | | 0081 | | 1.a. |
| b. Interest-bearing balances:[2] | | | | |
| (1) In U.S. offices | | 0395 | | 1.b.(1) |
| (2) In foreign offices, Edge and Agreement subsidiaries, and IBFs | | 0397 | | 1.b.(2) |
| 2. Securities: | | | | |
| a. Held-to-maturity securities (from Schedule HC-B, column A) | | 1754 | | 2.a. |
| b. Available-for-sale securities (from Schedule HC-B, column D) | | 1773 | | 2.b. |
| c. Equity securities with readily determinable fair values not held for trading[3] | | JA22 | | 2.c. |
| 3. Federal funds sold and securities purchased under agreements to resell: | | | | |
| a. Federal funds sold in domestic offices | BHDM | B987 | | 3.a. |
| b. Securities purchased under agreements to resell[4] | BHCK | B989 | | 3.b. |
| 4. Loans and lease financing receivables: | | | | |
| a. Loans and leases held for sale | | 5369 | | 4.a. |
| b. Loans and leases, held for investment | B528 | | | 4.b. |
| c. LESS: Allowance for loan and lease losses | 3123 | | | 4.c. |
| d. Loans and leases, held for investment, net of allowance for loan and lease losses (item 4.b minus 4.c) | | B529 | | 4.d. |
| 5. Trading assets (from Schedule HC-D) | | 3545 | | 5. |
| 6. Premises and fixed assets (including capitalized leases) | | 2145 | | 6. |
| 7. Other real estate owned (from Schedule HC-M) | | 2150 | | 7. |
| 8. Investments in unconsolidated subsidiaries and associated companies | | 2130 | | 8. |
| 9. Direct and indirect investments in real estate ventures | | 3656 | | 9. |
| 10. Intangible assets (from Schedule HC-M) | | 2143 | | 10. |
| 11. Other assets (from Schedule HC-F) | | 2160 | | 11. |
| 12. Total assets (sum of items 1 through 11) | | 2170 | | 12. |

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Cross-jurisdictional activity:**
  - Measured by the sum of cross-jurisdictional assets and cross-jurisdictional liabilities, as reported on FR Y-15

**Schedule E—Cross-Jurisdictional Activity Indicators**

| U.S. Dollar Amounts in Thousands | RISK | Amount | |
|---|---|---|---|
| **Cross-Jurisdictional Claims** | | | |
| 1. Foreign claims on an ultimate-risk basis | M422 | | 1. |
| **Cross-Jurisdictional Liabilities** | | | |
| 2. Foreign liabilities (excluding local liabilities in local currency) | M423 | | 2. |
| a. Any foreign liabilities to related offices included in item 2 | M424 | | 2.a. |
| 3. Local liabilities in local currency | M425 | | 3. |
| 4. Total cross-jurisdictional liabilities (sum of items 2 and 3, minus item 2.a) | M426 | | 4. |

  - In the banking agencies' proposed rules, this threshold is intended to replace the alternative threshold of ≥ $10B of on-balance sheet foreign exposures (as reported on FFIEC 009) in defining which firms are subject to the advanced approaches for calculating risk-based capital requirements

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Cross-jurisdictional activity (cont'd):**
  - Compared to FFIEC 009, cross-jurisdictional activity reported on FR Y-15 excludes derivatives positions
    - Basel Committee's revised GSIB assessment methodology, which is expected to be implemented in national jurisdictions by January 2021 and to determine GSIB surcharges from January 2023, modifies the definition of cross-jurisdictional activity to include both derivatives assets and liabilities
    - To the extent this change is reflected both in the U.S. GSIB assessment methodology and in Form FR Y-15, measurement of cross-jurisdictional activity indicator could change
  - Federal Reserve views firms with significant cross-border activities as requiring more sophisticated management of the risks of ring-fencing by jurisdictions in times of stress, which could impede the movement of resources from one jurisdiction to another
  - Meeting or exceeding the cross-jurisdictional activity threshold:
    - converts a Category III firm into a Category II firm
    - converts a Category IV firm directly into a Category II firm

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Weighted STWF:**
  - Calculated in accordance with Method 2 of U.S. GSIB assessment methodology
  - As reported on FR Y-15

**Schedule G—Short-Term Wholesale Funding Indicator**

| U.S. Dollar Amounts in Thousands | (Column A) Remaining Maturity of 30 Days or Less | | (Column B) Remaining Maturity of 31 to 90 Days | | (Column C) Remaining Maturity of 91 to 180 Days | | (Column D) Remaining Maturity of 181 to 365 Days | | |
|---|---|---|---|---|---|---|---|---|---|
| | RISK | Amount | RISK | Amount | RISK | Amount | RISK | Amount | |
| **Short-term Wholesale Funding** | | | | | | | | | |
| 1. First tier: | | | | | | | | | |
| a. Funding secured by level 1 liquid assets | Y838 | | Y839 | | Y840 | | Y841 | | 1.a. |
| b. Retail brokered deposits and sweeps | Y842 | | Y843 | | Y844 | | Y845 | | 1.b. |
| c. Unsecured wholesale funding obtained outside of the financial sector | Y846 | | Y847 | | Y848 | | Y849 | | 1.c. |
| d. Firm short positions involving level 2B liquid assets or non-HQLA | Y850 | | Y851 | | Y852 | | Y853 | | 1.d. |
| e. Total first tier short-term wholesale funding (sum of items 1.a through 1.d) | Y854 | | Y855 | | Y856 | | Y857 | | 1.e. |
| 2. Second tier: | | | | | | | | | |
| a. Funding secured by level 2A liquid assets | Y858 | | Y859 | | Y860 | | Y861 | | 2.a. |
| b. Covered asset exchanges (level 1 to level 2A) | Y862 | | Y863 | | Y864 | | Y865 | | 2.b. |
| c. Total second tier short-term wholesale funding (sum of items 2.a. and 2.b) | Y866 | | Y867 | | Y868 | | Y869 | | 2.c. |
| 3. Third tier: | | | | | | | | | |
| a. Funding secured by level 2B liquid assets | Y870 | | Y871 | | Y872 | | Y873 | | 3.a. |
| b. Other covered asset exchanges | Y874 | | Y875 | | Y876 | | Y877 | | 3.b. |
| c. Unsecured wholesale funding obtained within the financial sector | Y878 | | Y879 | | Y880 | | Y881 | | 3.c. |
| d. Total third tier short-term wholesale funding (sum of items 3.a through 3.c) | Y882 | | Y883 | | Y884 | | Y885 | | 3.d. |
| 4. All other components of short-term wholesale funding | Y886 | | Y887 | | Y888 | | Y889 | | 4. |
| 5. Total short-term wholesale funding, by maturity (weighted sum of items 1.e, 2.c, 3.d, and 4) | Y890 | | Y891 | | Y892 | | Y893 | | 5. |

| U.S. Dollar Amounts in Thousands | RISK | Amount | |
|---|---|---|---|
| 6. Total short-term wholesale funding (sum of item 5, Columns A through D) | Y894 | | 6. |
| 7. Average risk-weighted assets | Y895 | | 7. |

| | RISK | Percentage | |
|---|---|---|---|
| 8. Short-term wholesale funding metric (item 6 divided by item 7) | Y896 | | 8. |

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Weighted STWF (cont'd):**
  - Weightings by residual maturity, whether funding is secured or not, types of collateral, and counterparty characteristics are intended to measure the risk of runnable liabilities and resulting fire sales, as well as interconnectedness and contagion risk
  - Meeting or exceeding the weighted STWF threshold:
    - Converts a Category IV firm into a Category III firm
    - Subjects a Category III firm to the full (100%) LCR and proposed NSFR

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Nonbank assets:**
  - Measured by average amount of equity investments in nonbank subsidiaries (including Edge Act or Agreement subsidiaries, but excluding federal savings associations)
  - As reported on FR Y-9LP

**Schedule PC-B—Memoranda—Continued**

| Dollar Amounts in Thousands | BHCP | Amount | |
|---|---|---|---|
| 16. Notes payable to special-purpose subsidiaries that issued trust preferred securities (included in Schedule PC, item 18.b and item 5.b above) | C255 | | 16. |
| 17. Total nonbank assets of a holding company subject to the Federal Reserve Board's capital plan rule. (To be completed only by a top-tier holding company that is subject to the Federal Reserve Board's capital plan rule (12 CFR 225.8) | HK02 | | 17. |

  - Intended to measure a firm's business and operational complexity and its resulting resolvability risk, as well as a firm's potential interconnectedness

# Criteria for Categorization of Firms

## Specific Risk-Based Indicators (cont'd)

- **Off-Balance Sheet Exposure**
  - Measured as total exposure (as reported on FR Y-15) minus total consolidated assets (as reported on FR Y-9C)

**Schedule A—Size Indicator**

| U.S. Dollar Amounts in Thousands | RISK | Amount | |
|---|---|---|---|
| **Total Exposures** | | | |
| 1. Derivative exposures: | | | |
| a. Current exposure of derivative contracts | M337 | | 1.a. |
| b. Potential future exposure (PFE) of derivative contracts | M339 | | 1.b. |
| c. Gross-up for derivatives collateral | Y822 | | 1.c. |
| d. Effective notional amount of written credit derivatives | M340 | | 1.d. |
| e. Cash variation margin included as an on-balance sheet receivable | Y823 | | 1.e. |
| f. Exempted central counterparty legs of client-cleared transactions included in items 1(a) and 1(b) | Y824 | | 1.f. |
| g. Effective notional amount offsets and PFE adjustments for sold credit protection | Y825 | | 1.g. |
| h. Total derivative exposures (sum of items 1.a. through 1.d, minus the sum of items 1.e through 1.g) | Y826 | | 1.h. |
| 2. Securities financing transaction (SFT) exposures: | | | |
| a. Gross SFT assets | M334 | | 2.a. |
| b. Counterparty credit risk exposure for SFTs | N507 | | 2.b. |
| c. SFT indemnification and other agent-related exposures | Y827 | | 2.c. |
| d. Gross value of offsetting cash payables | Y828 | | 2.d. |
| e. Total SFT exposures (sum of items 2.a through 2.c, minus item 2.d) | Y829 | | 2.e. |
| 3. Other on-balance sheet exposures: | | | |
| a. Other on-balance sheet assets | Y830 | | 3.a. |
| b. Regulatory adjustments | M349 | | 3.b. |
| 4. Other off-balance sheet exposures: | | | |
| a. Gross notional amount of items subject to a 0% credit conversion factor (CCF) | M342 | | 4.a. |
| b. Gross notional amount of items subject to a 20% CCF | M718 | | 4.b. |
| c. Gross notional amount of items subject to a 50% CCF | M346 | | 4.c. |
| d. Gross notional amount of items subject to a 100% CCF | M347 | | 4.d. |
| e. Credit exposure equivalent of other off-balance sheet items (sum of 0.1 times item 4.a, 0.2 times item 4.b, 0.5 times item 4.c, and item 4.d) | Y831 | | 4.e. |
| 5. Total exposures prior to regulatory deductions (sum of items 1.h, 2.e, 3.a, and 4.e) | Y832 | | 5. |

**Schedule HC—Consolidated Balance Sheet**

| Dollar Amounts in Thousands | | | BHCK | Amount | |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| 1. Cash and balances due from depository institutions: | | | | | |
| a. Noninterest-bearing balances and currency and coin[1] | | | 0081 | | 1.a. |
| b. Interest-bearing balances:[2] | | | | | |
| (1) In U.S. offices | | | 0395 | | 1.b.(1) |
| (2) In foreign offices, Edge and Agreement subsidiaries, and IBFs | | | 0397 | | 1.b.(2) |
| 2. Securities: | | | | | |
| a. Held-to-maturity securities (from Schedule HC-B, column A) | | | 1754 | | 2.a. |
| b. Available-for-sale securities (from Schedule HC-B, column D) | | | 1773 | | 2.b. |
| c. Equity securities with readily determinable fair values not held for trading[3] | | | JA22 | | 2.c. |
| 3. Federal funds sold and securities purchased under agreements to resell: | | | | | |
| a. Federal funds sold in domestic offices | BHDM | B987 | | | 3.a. |
| b. Securities purchased under agreements to resell[4] | BHCK | B989 | | | 3.b. |
| 4. Loans and lease financing receivables: | | | | | |
| a. Loans and leases held for sale | | | 5369 | | 4.a. |
| b. Loans and leases, held for investment | B528 | | | | 4.b. |
| c. LESS: Allowance for loan and lease losses | 3123 | | | | 4.c. |
| d. Loans and leases, held for investment, net of allowance for loan and lease losses (item 4.b minus 4.c) | | | B529 | | 4.d. |
| 5. Trading assets (from Schedule HC-D) | | | 3545 | | 5. |
| 6. Premises and fixed assets (including capitalized leases) | | | 2145 | | 6. |
| 7. Other real estate owned (from Schedule HC-M) | | | 2150 | | 7. |
| 8. Investments in unconsolidated subsidiaries and associated companies | | | 2130 | | 8. |
| 9. Direct and indirect investments in real estate ventures | | | 3656 | | 9. |
| 10. Intangible assets (from Schedule HC-M) | | | 2143 | | 10. |
| 11. Other assets (from Schedule HC-F) | | | 2160 | | 11. |
| 12. Total assets (sum of items 1 through 11) | | | 2170 | | 12. |

  - The Federal Reserve's proposed rule will amend FR Y-15 to add Off-Balance Sheet Exposure as a separate line item
  - Complements the asset size indicator, which reflects on-balance sheet assets

# Alternative Scoring Approach for Categorization of Firms

- The Federal Reserve and the U.S. banking agencies also proposed an **alternative approach** for determining which categories apply to firms.
- Under the alternative approach, a firm's category would depend on:
  - the **size** of the firm, and
  - either its **Method 1** or **Method 2** score under the U.S. **GSIB assessment methodology**.
- The Federal Reserve conducted an analysis of GSIB scores as of December 31, 2017 of U.S. BHCs and covered SLHCs with ≥ $100B in total consolidated assets and provided an illustration of how the alternative scoring approach could determine the relevant four categories of firms (summarized on the following page).
- The Federal Reserve stated that if it adopted the alternative approach, it would set a **single score** within the listed ranges of Method 1 and Method 2 scores indicated on the following page.

# Alternative Scoring Approach for Categorization of Firms (cont'd)

- **Category I:** U.S. GSIBs – i.e., any firm with a Method 1 score ≥ 130

- **Category II:** Firms that are not U.S. GSIBs and that have:
  - ≥ $100B in total consolidated assets, <u>and</u>
    - Method 1 score ≥ 60 < 80 or
    - Method 2 score ≥ 100 < 150

- **Category III:** Firms that are not in Category I or II and that have:
  - ≥ $100B < $250B in total consolidated assets, <u>and</u>
    - Method 1 score ≥ 25 < 45 or
    - Method 2 score ≥ 50 < 85

- **Category IV:** Firms that are not in Category I, II or III and that have:
  - ≥ $100B in total consolidated assets

# V. Requirements Applicable to Categories of Firms

# Category I Requirements – U.S. GSIBs

**Federal Reserve – EPS:**

- **No change** to EPS applicable to U.S. GSIBs, **except** for the elimination of mid-cycle (i.e., semi-annual) company-run DFAST effective in 2020 cycle.
  - This change would apply to **all** U.S. BHCs and is intended to comply with EGRRCPA's requirement to change frequency of mid-cycle company-run DFAST to "periodic."

**U.S. Banking Agencies – Capital and Liquidity Requirements:**

- **No change** to capital and liquidity requirements applicable to U.S. GSIBs or to their IDIs, **except**:
  - The calculation of the ≥ $10B total consolidated assets threshold for application of LCR / proposed NSFR requirements to IDIs of U.S. GSIBs changes from the most recent year-end to average total consolidated assets over the four most recent calendar quarters.
  - This change would apply to **all** U.S. BHCs' and covered SLHCs' IDI subsidiaries subject to the ≥ $10B total consolidated assets threshold for applicability of the LCR and proposed NSFR requirements (i.e., Category I, II and III firms).

# Category II Requirements

- Category II firms would be subject to all EPS and capital and liquidity requirements **except** those that apply solely to U.S. GSIBs:
  - TLAC final rule
  - GSIB surcharge
  - Enhanced SLR

**Federal Reserve – EPS:**

- **Risk management and risk committee requirements**, including responsibilities for liquidity risk management

# Category II Requirements

- **Liquidity risk management requirements**, including:
  - Independent review function to evaluate liquidity risk management
  - Cash flow projections covering short-term and long-term time horizons, updated daily (short-term) and monthly (long-term)
  - Contingency funding plan, updated at least annually and when warranted by changes in market and idiosyncratic conditions
  - Liquidity risk limits, including on:
    - Concentration in sources of funding
    - Amount of liabilities maturing within various time horizons
    - Off-balance sheet exposures
  - Collateral monitoring policies and procedures, including **weekly** calculation of collateral positions
  - Procedures for monitoring and controlling liquidity risk exposures and funding needs across significant legal entities, currencies and business lines
  - Procedures for monitoring intraday liquidity risk exposures, including:
    - Monitoring and measuring expected daily gross liquidity inflows and outflows
    - Managing and transferring collateral to obtain intraday credit
    - Considering amounts of collateral and liquidity needed to meet payment systems obligations

# Category II Requirements

- **Liquidity stress testing and buffer requirements**, including:
  - **Monthly** liquidity stress tests covering the following planning horizons: overnight, 30 days, 90 days, one year
  - Liquidity buffer consisting of unencumbered, highly liquid assets to meet projected net stressed cash flow needs over the 30-day planning horizon
  - **Daily** liquidity monitoring reporting on Form FR 2052a
    - Removal of ≥ $10 trillion assets under custody threshold for applicability of daily FR 2052a reporting requirements
- **Annual supervisory and company-run DFAST**, including:
  - Supervisory stress test conducted by Federal Reserve and public disclosure of results by Federal Reserve
  - Company-run stress test conducted by BHC or covered SLHC and public disclosure of summary of results by company
  - FR Y-14 reporting requirements, including requirement to conduct annual internal stress test and report results to Federal Reserve in connection with submission of annual capital plan
- **SCCL** applicable to a “covered company”, including:
  - Aggregate net credit exposure limit of 25% of Tier 1 capital to any counterparty

# Category II Requirements

**U.S. Banking Agencies – Capital and Liquidity Requirements:**

- **Advanced approaches capital requirements**
  - Meet the definition of "advanced-approaches Board-regulated institution"
  - Must reflect the impact of AOCI in CET 1 capital and thus in regulatory capital
  - Must calculate its risk-based capital ratios in accordance with the advanced approaches and deduct the amount of expected credit loss in excess of eligible credit reserves from CET 1 capital
    - Only when the firm has completed its parallel run process and been advised by its applicable federal banking supervisor that it must begin calculating its risk-based capital requirements under subpart E of the applicable capital rule

# Category II Requirements

- **Advanced approaches capital requirements (cont'd)**
  - Must calculate its risk-based capital ratios in accordance with the standardized approach and, if the firm is also calculating its risk-based capital ratios in accordance with the advanced approaches, must report the lower of the standardized approach and the advanced approaches risk-based capital ratios for each risk-based capital ratio
  - In connection with separate Standardized Approach for Counterparty Credit Risk (**SA-CCR**) proposal:
    - May elect to use SA-CCR or internal models methodology (**IMM**) for calculating derivatives exposure and RWA amount of central counterparty (**CCP**) default fund contributions under the advanced approaches
    - May use SA-CCR for calculating derivatives exposures and RWA amount of CCP default fund contributions under the standardized approach
    - Must use SA-CCR for calculating SLR total leverage exposure arising from derivative contracts

# Category II Requirements

- **SLR**
  - Subject to the SLR
- **CCyB**
  - Subject to CCyB, if deployed
- **LCR**
  - Subject to full LCR – i.e., 100% outflow adjustment percentage
- **Proposed NSFR**
  - Subject to full NSFR – i.e., 100% of required stable funding amount

**Capital Planning Requirements – under a separate, forthcoming Federal Reserve proposal:**

- Annual capital planning requirements
- Quantitative and qualitative assessment of capital plan by Federal Reserve

# Category III Requirements

- For a firm with **≥ $250B of total consolidated assets or ≥ $10B of total on-balance sheet foreign exposures** that currently uses the advanced approaches for calculating risk-based capital requirements, Category III represents a **meaningful change** to its capital and liquidity requirements:
  - Not required to calculate advanced approaches risk-weighted assets (**RWAs**) for counterparty credit risk
  - Not required to recognize AOCI in CET 1 capital and thus regulatory capital – thereby relieved of volatility arising from, e.g., unrealized gains or losses on AFS debt securities
  - Qualifies for reduced LCR and proposed NSFR requirements calibrated at 70 – 85% of full requirements if firm has < $75B of weighted STWF
  - Qualifies for reduced frequency of liquidity monitoring reporting from daily to monthly if firm has < $75B of weighted STWF

**Federal Reserve – EPS:**

- **Risk management and risk committee requirements**, including responsibilities for liquidity risk management

# Category III Requirements

- **Liquidity risk management requirements**, including:
  - Independent review function to evaluate liquidity risk management
  - Cash flow projections covering short-term and long-term time horizons, updated daily (short-term) and monthly (long-term)
  - Contingency funding plan, updated at least annually and when warranted by changes in market and idiosyncratic conditions
  - Liquidity risk limits, including on:
    - Concentration in sources of funding
    - Amount of liabilities maturing within various time horizons
    - Off-balance sheet exposures
  - Collateral monitoring policies and procedures, including **weekly** calculation of collateral positions
  - Procedures for monitoring and controlling liquidity risk exposures and funding needs across significant legal entities, currencies and business lines
  - Procedures for monitoring intraday liquidity risk exposures, including:
    - Monitoring and measuring expected daily gross liquidity inflows and outflows
    - Managing and transferring collateral to obtain intraday credit
    - Considering amounts of collateral and liquidity needed to meet payment systems obligations

# Category III Requirements

- **Liquidity stress testing and buffer requirements**, including:
  - **Monthly** liquidity stress tests covering the following planning horizons: overnight, 30 days, 90 days, one year
  - Liquidity buffer consisting of unencumbered, highly liquid assets to meet projected net stressed cash flow needs over the 30-day planning horizon
  - If ≥ $75B of weighted STWF – **daily** liquidity monitoring reporting on Form FR 2052a
    - Removal of ≥ $10 trillion assets under custody threshold for applicability of daily FR 2052a reporting requirements
  - If < $75B of weighted STWF – **monthly** liquidity monitoring reporting on Form FR 2052a
- **Supervisory and company-run DFAST**, including:
  - **Annual** supervisory stress test conducted by Federal Reserve and public disclosure of results by Federal Reserve
  - **Biennial** (in even years) company-run stress test conducted by BHC or covered SLHC and public disclosure of summary of results by company
  - FR Y-14 reporting requirements, including requirement to conduct **annual i**nternal stress test and report results to the Federal Reserve in connection with the submission of its **annual** capital plan
    - Between years of company-run DFAST, Category III firm would still be subject to annual internal stress test requirement for its capital plan submission, but results are reported solely to Federal Reserve and are not publicly disclosed
- **SCCL** applicable to a "covered company", including:
  - Aggregate net credit exposure limit of 25% of Tier 1 capital to any counterparty

# Category III Requirements

**U.S. Banking Agencies – Capital and Liquidity Requirements:**

- **Standardized approach capital requirements**
  - Not an "advanced-approaches Board-regulated institution"
  - May opt out of recognizing AOCI in CET 1 capital and thus regulatory capital
    - The U.S. banking agencies requested comment on alternative approach of requiring recognition of AOCI in regulatory capital to Category III top-tier parent holding company, but not to any of its IDI subsidiaries
  - Calculates risk-based capital ratios in accordance with the standardized approach
  - In connection with separate SA-CCR proposal, may elect to use SA-CCR or continue to use current exposure method (**CEM**) for calculating derivatives exposures
- **SLR**
  - Subject to the SLR
  - SLR currently applies only to advanced approaches institutions, but U.S. banking agencies' proposal would apply SLR to Category III firms as well
  - In connection with separate SA-CCR proposal, may elect to use SA-CCR or continue to use CEM for calculating SLR total leverage exposure arising from derivative contracts

# Category III Requirements

- **CCyB**
  - Subject to the CCyB, if deployed
  - The CCyB, if deployed, currently would apply only to advanced approaches institutions, but the U.S. banking agencies' proposal would apply CCyB to Category III firms as well
- **LCR**
  - Calibration of LCR requirements would depend on whether Category III firm meets or exceeds the weighted STWF threshold:
    - If ≥ $75B of weighted STWF, would be subject to full LCR – i.e., 100% outflow adjustment percentage
    - If < $75B of weighted STWF, would be subject to reduced LCR – i.e., 70% - 85% outflow adjustment percentage, depending on how the agencies finalize the proposal
  - In either case, the LCR would include the maturity mismatch add-on
  - The U.S. banking agencies' joint proposed rule eliminates the current distinction in methodology between the full LCR (which includes the maturity mismatch add-on) and the modified LCR (which excludes the maturity mismatch add-on

# Category III Requirements

- **Proposed NSFR**
  - Calibration of NSFR requirements would depend on whether Category III firm meets or exceeds the weighted STWF threshold:
    - If ≥ $75B of weighted STWF, would be subject to full NSFR – i.e., 100% of required stable funding amount
    - If < $75B of weighted STWF, would be subject to reduced NSFR – i.e., 70% - 85% of required stable funding amount, depending on how the agencies finalize the proposal

**Capital Planning Requirements – under a separate, forthcoming Federal Reserve proposal:**

- Annual capital planning requirements
- Quantitative and qualitative assessment of capital plan by Federal Reserve
  - The Federal Reserve's proposed EPS rule amends the definition of "large and noncomplex bank holding company" to refer to a Category IV firm but not a Category III firm
  - As a result, for Category III firms that currently have < $250B in average total consolidated assets and < $75B in average total nonbank assets, the Federal Reserve's proposed rule would increase the scrutiny of their capital plans by subjecting any of these firms to the Federal Reserve's qualitative assessment in CCAR.

# Category IV Requirements

- Compared to the current EPS, capital and liquidity, and capital planning requirements applicable to a firm with ≥ $100B of total consolidated assets, Category IV represents **meaningful change** to its EPS and liquidity requirements:
  - Reduced frequency of liquidity stress testing and liquidity monitoring reporting requirements
  - Reduced frequency of supervisory DFAST and elimination of company-run DFAST
  - Elimination of LCR and proposed NSFR

**Federal Reserve – EPS:**

- **Risk management and risk committee requirements**, including responsibilities for liquidity risk management

# Category IV Requirements

- **Liquidity risk management requirements**, including:
  - Independent review function to evaluate liquidity risk management
  - Cash flow projections covering short-term and long-term time horizons, updated daily (short-term) and monthly (long-term)
  - Contingency funding plan, updated at least annually and when warranted by changes in market and idiosyncratic conditions
  - Liquidity risk limits consistent with established liquidity risk tolerance and that reflect its capital structure, risk profile, complexity, activities and size
  - Collateral monitoring policies and procedures, including **monthly** calculation of collateral positions
  - Procedures for monitoring and controlling liquidity risk exposures and funding needs across significant legal entities, currencies and business lines
  - Procedures for monitoring intraday liquidity risk exposures consistent with the firm's capital structure, risk profile, complexity, activities and size

# Category IV Requirements

- **Liquidity stress testing and buffer requirements**, including:
  - **Quarterly** liquidity stress tests covering the following planning horizons: overnight, 30 days, 90 days, one year
  - Liquidity buffer consisting of unencumbered, highly liquid assets to meet projected net stressed cash flow needs over the 30-day planning horizon
  - **Monthly** liquidity monitoring reporting on Form FR 2052a
- **Biennial supervisory DFAST**, including:
  - Biennial (in even years) supervisory stress test conducted by Federal Reserve and public disclosure of results by Federal Reserve
  - FR Y-14 reporting requirements, including requirement to conduct annual internal stress test and report results to Federal Reserve in connection with submission of annual capital plan
    - But the Federal Reserve intends to reduce FR Y-14 reporting requirements for Category IV firms in separate, forthcoming capital planning proposal (see below)
- **No company-run DFAST**
- **No SCCL**

# Category IV Requirements

**U.S. Banking Agencies – Capital and Liquidity Requirements:**

- **Standardized approach capital requirements**
  - As a general matter, the same capital requirements as currently apply to firms with < $250B in total consolidated assets and < $10B of on-balance sheet foreign exposures
  - Not an "advanced-approaches Board-regulated institution"
  - May opt out of recognizing AOCI in CET 1 capital and thus regulatory capital
  - Calculates risk-based capital ratios in accordance with the standardized approach
  - In connection with separate SA-CCR proposal, may elect to use SA-CCR or continue to use CEM for calculating derivatives exposures
- **No SLR**
  - Subject solely to the U.S. Tier 1 leverage ratio

# Category IV Requirements

- **No CCyB**
  - Is subject solely to capital conservation buffers applicable to standardized approach firms – i.e.., currently the capital conservation buffer and, when finalized, the stress capital buffer (and any other finalized stress buffer requirements)
  - In finalizing its proposed stress buffer rule, the Federal Reserve intends to apply stress buffer requirements to Category IV firms as follows:
    - Updated annually to reflect planned capital distributions
    - Updated biennially to reflect stress loss projections (presumably because Federal Reserve would only conduct supervisory DFAST every two years)
- **No LCR**
- **No proposed NSFR**

# Category IV Requirements

**Capital Planning Requirements – under a separate, forthcoming Federal Reserve proposal:**

- Annual capital planning requirements
  - Category IV firms would estimate revenues, losses, reserves and capital levels based on forward-looking analyses, taking into account idiosyncratic risks
  - But would not be required to submit results of (or, presumably, to conduct) internal stress tests on FR Y-14A
  - Federal Reserve intends to provide revised capital planning guidance to allow more flexibility in how Category IV firms perform capital planning

# VI. Determination and Reporting, Initial Applicability and Changes in Category

# Determination and Reporting of Category

- A firm with ≥ $100B of average total consolidated assets would be required to **determine its applicable category at least quarterly** and **report** size and other risk-based indicators on a **quarterly basis**.
- Categories and requirements applicable to categories would apply based on the **average level** of each indicator over the **preceding four calendar quarters**.
- A firm would **remain within** a category (and therefore subject to the applicable requirements of that category) until:
  - It no longer meets the indicators for its current category in **each of the four most recent calendar quarters**, or
  - It meets the criteria for **another category** based on an **increase** in the average level of one or more indicators over the preceding four calendar quarters.
    - This approach is consistent with the current provisions for applicability or cessation of EPS.

# Initial Applicability of Requirements

### Risk Management and Risk Committee

- The risk management and risk committee requirements applicable to U.S. BHCs and covered SLHCs with ≥ $50B of total consolidated assets are initially applicable on the **first day of the ninth quarter** following the date on which the firm meets or exceeds the threshold.

### Liquidity Risk Management and Liquidity Stress Testing

- The liquidity risk management and liquidity stress test requirements applicable to U.S. BHCs and covered SLHCs with ≥ $100B of total consolidated assets are initially applicable on the **first day of the fifth quarter** following the date on which a firm meets or exceeds the threshold.

### Capital Planning

- The capital planning requirements applicable to U.S. BHCs and covered SLHCs with ≥ $100B of total consolidated assets are initially applicable:
  - If the threshold is met on or before September 30, beginning January 1 of the **next** calendar year
  - If threshold is met after September 30, beginning January 1 of the **second** calendar year after meeting the threshold

# Changes in Category

- Any change in requirements that result from a change in category would become effective on the **first day of the second quarter** following the change in category.
- For a firm that changes categories **from Category III to Category II** and becomes an advanced approaches institution for purposes of the applicable capital rule:
  - As under the existing capital rule, it would reflect the impact of **AOCI** in CET 1 capital and thus in regulatory capital starting on the **first day of the second quarter** following the date on which it became a Category II firm.
  - It would not calculate its **risk-based capital ratios** in accordance with the advanced approaches or deduct the amount of expected credit loss in excess of eligible credit reserves from CET 1 capital until it had **completed its parallel run process** and been **advised by its applicable federal banking supervisor** that it must begin calculating its risk-based capital requirements under subpart E of the applicable capital rule.
  - It would continue to be subject to the **SLR** and the **CCyB**, to the extent the CCyB is deployed, because as a Category III firm it would have already been subject to both requirements.

# Davis Polk Contacts

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.


| | | |
|---|---|---|
| **John Banes** | **212 450 4116** | john.banes@davispolk.com |
| **Luigi L. De Ghenghi** | **212 450 4296** | luigi.deghenghi@davispolk.com |
| **Randall D. Guynn** | **212 450 4239** | randall.guynn@davispolk.com |
| **Jai R. Massari** | **202 962 7062** | jai.massari@davispolk.com |
| **Gabriel D. Rosenberg** | **212 450 4537** | gabriel.rosenberg@davispolk.com |
| **Margaret E. Tahyar** | **212 450 4379** | margaret.tahyar@davispolk.com |
| **Andrew Rohrkemper** | **212 450 3207** | andrew.rohrkemper@davispolk.com |
| **Greg Swanson** | **212 450 3374** | greg.swanson@davispolk.com |