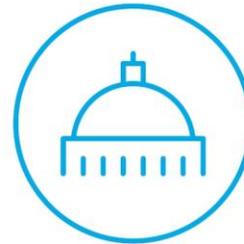


Reg Pulse



Federal Reserve Board announces final rule to establish SCCL for US BHCs and FBOs – do you know your counterparty exposure?

On June 14, 2018, the Federal Reserve Board (FRB) unanimously voted to pass the final rule to establish single-counterparty credit limits (SCCL) for covered large US bank holding companies (BHCs) and foreign banking organizations (FBOs). The final rule, which aims to limit the amount of exposure that large banks can maintain with a single counterparty, is generally aligned with the proposed rule issued in March 2016. Also, the rule represents the first instance of the FRB applying the new enhanced prudential standard (EPS) thresholds to specific classes of institutions as prescribed in the recently passed regulatory relief legislation (*S.2155, Economic Growth, Regulatory Reform, and Consumer Protection Act*).¹

Below are key takeaways from the final rule:

- Regulatory relief legislation thresholds** – Consistent with the regulatory relief legislation, the limits in the final rule will apply **to all US GSIBs and US BHCs with consolidated assets of at least \$250 billion in assets**. FBOs with global consolidated assets of greater than \$250 billion in assets will be subject to limits as will any of their intermediate holding company subsidiaries (IHCs) that have \$50 billion or more in assets. The FRB will consider, at a future date, the extent to which EPS should apply to and be tailored for US BHCs and FBO parents with total consolidated assets between
- \$100 billion and \$250 billion. US BHCs and FBOs with less than \$100 billion in consolidated assets are excluded from SCCL (Please see the applicability table below).
- US BHCs** – Consistent with the proposed rule, US BHCs will be limited to a credit exposure of no more than 25% of their Tier 1 capital to a single counterparty. US BHCs considered GSIBs also face a stricter 15% of their Tier 1 capital limit on their aggregate net credit exposure to another GSIB or to any nonbank financial company supervised by the FRB (“major counterparty”).
- FBOs** – FBOs with more than \$250 billion in total consolidated assets at the parent bank level will face a combined US operations (CUSO) limit to a single counterparty equal to 25% of the FBO’s Tier 1 capital. IHCs with total consolidated assets (CA) over \$50 billion will face a limit for exposures to any counterparty equal to 25% of the IHC’s total capital, whereas IHCs with CA between \$250 billion and \$500 billion will be subject to a limit equal to 25% of the IHC’s Tier 1 capital. FBOs considered GSIBs and IHCs with CA greater than \$500 billion will also be subject to a stricter limit equal to 15% of their respective Tier 1 capital for exposures to major counterparties. Exemption of application of standards at the CUSO level can be received by certifying that comparable standards are being applied by home country supervisors.

- **Focus on larger institutions** – The rule reinforces the FRB’s practice of establishing heightened standards for domestic and foreign institutions with more than \$250 billion in consolidated assets. It is worth noting that the originally proposed threshold criteria of \$10 billion in foreign exposures has been dropped in the final rule.
- **Credit exposure calculation** – The final rule will allow firms to use valuation approaches for certain derivatives and securities financing that have been approved for capital calculation purposes, generally leading to lower values.
- **Reporting form 2590** – Reporting form FR 2590 will capture the credit exposures of a respondent organization to its top 50 counterparties on a quarterly basis.
- **Simplification of exposure limits application** –The final rule reflects the principles of simplicity and transparency by defining the firms and counterparties that are scoped into the rule based on clear and well understood accounting standards.
- **Signals commitment to international standards**– FRB’s finalization of this rule is in line with maintaining alliance with international standards (although the final Basel Committee on Banking Supervision (BCBS) large exposure framework’s compliance date is January 1, 2019).
- **Effective date** – US and foreign GSIBs to comply by January 1, 2020, and all other covered companies and covered foreign entities to comply by July 1, 2020.

Background

Following the financial downturn, regulators have focused on limiting interconnectedness between large financial institutions, including through limiting credit exposure to a single counterparty. The FRB proposed to apply EPS including SCCL requirements to US BHCs first in December 2011 and FBOs in December 2012. However, the February 2014 EPS final rule deferred inclusion of SCCL for future rulemaking for both BHCs and FBOs. The FRB noted that it was participating in the BCBS’s initiative to develop a similar large exposure regime applicable to all global banks, and expressed intent to consider this effort in developing SCCL requirements in the US.

In April 2014, the BCBS finalized its large exposure framework, setting forth a common standard for measuring, aggregating, and controlling single name concentration risks across jurisdictions. This included a general limit of 25% of a bank’s Tier 1 capital applied to all of a bank’s exposures to a single counterparty or a group of connected counterparties and a 15% limit applied to exposures between banks designated as G-SIBs.

In March 2016, the FRB re-proposed its rule to SCCL for US BHCs, FBOs, and IHCs that was largely in line with the BCBS framework. President Trump signed the bipartisan regulatory relief legislation (S.2155) in May 2018, which raised the statutory asset thresholds related to the imposition of EPS. Two years since the re-proposed rule and a month since the regulatory relief bill was signed, the FRB finalized the SCCL and employed the new thresholds from the relief legislation for the first time.

Implications of the FRB final rule

Entities	Applicability ¹	Aggregate Net Credit Exposure	Counterparty Type ³	Capital Base	Credit Limit
US BHCs	Covered Companies CA ≥ \$250 billion	BHC's	Any	BHC's Tier 1 capital	25%
	Major Covered Companies US GSIBs	BHC's	Major	BHC's Tier 1 capital	15%
		BHC's	Any	BHC's Tier 1 capital	25%
Covered Foreign Entities² a) FBOs with total global CA ≥ \$250 billion, and b) IHCs of FBOs that meet threshold in item a) and that have CA ≥ \$50 billion	US IHCs CA ≥ \$50 billion; CA < \$250 billion	IHC's	Any	IHC's total regulatory capital ⁴	25%
	US IHCs CA ≥ \$250 billion; CA < \$500 billion	IHC's	Any	IHC's Tier 1 capital	25%
	FBOs	CUSO	Any	FBO's Tier 1 capital	25%
	Major US IHCs CA ≥ \$500 billion	IHC's	Major	IHC's Tier 1 capital	15%
		IHC's	Any	IHC's Tier 1 capital	25%
	Major FBOs FBO GSIBs	CUSO	Major	FBO's Tier 1 capital	15%
		CUSO	Any	FBO's Tier 1 capital	25%

¹ CA – Total Consolidated Assets, ² FBOs that demonstrate compliance with the global SCCL standard in their home country can be exempted from the CUSO requirement, but their IHC subsidiaries will still need to comply with the requirements, ³ "Any" refers to the aggregated net credit exposure to any counterparty that do not fall under the category of "major" (major counterparties are GSIBs or any nonbank financial company supervised by the FRB), ⁴ Represents the IHC's total regulatory capital plus the balance of its allowance for loan and leases losses (ALLL) not included in Tier 2 capital.

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Tailoring of Application – Although the final rule is generally aligned to the proposed rule issued in March 2016, the final rule has further narrowed the applicable scope of SCCL to focus on GSIBs and BHCs with at least \$250 billion in assets, reflecting the new thresholds from the regulatory relief legislation S.2155. The FRB has indicated their intent to assess the extent to which the Board will apply SCCL and other EPS rules to banking entities with assets between \$100 billion and \$250 billion. With respect to any US IHCs of FBOs with total assets of \$50 billion or more, the basic limit structure remains unchanged from the draft SCCL proposal.

Reduced Regulatory Burden – The final rule **reduces regulatory burden and simplifies aggregation and consolidation standard of counterparty** "subsidiary" and "affiliate" using common accounting standards, and allows for broader usages of measurement methodologies for credit exposure of

securities financing transactions. The use of common accounting convention would simplify economic interdependence and control tests for connecting counterparties.

Infrastructure Build could be significant – The final rule will require the applicable banking entities to make adjustments to their current exposure calculations methodologies, netting criteria, and reporting capabilities in order to calculate exposure versus limits on a daily basis or with buffers that account for limitations in capabilities. Moreover, entities must establish unique counterparty identifiers, while also **enhancing their governance processes and controls** with more defined responsibilities for risk control across both Finance and Treasury functions. Business practice and processes could need refinement in order to coordinate credit exposures across business divisions – for example, risk limits and risk tolerances.

Daily Monitoring & Reporting for IHCs and CUSO – Exposure aggregation will be required across business divisions for both IHCs and the CUSO. Moreover, reporting of counterparty exposures and quarterly filing of the **FR2590 report** (credit exposures of a firm to its top 50 counterparties) will increase the need for monitoring of credit transactions and compliance with the final rule.

What's next?

While the final rule itself has not materially departed from the FRB's proposed rule on SCCL, it is clear that as a result of the recently passed regulatory relief legislation, the applicability of SCCL has been narrowed for both US and foreign firms. Furthermore, this represents the first case where the FRB has applied the new thresholds, and provides a window into how the FRB may apply the thresholds in future revisions to regulations and guidance. The new threshold application from the final rule

showed that smaller US IHC subsidiaries of larger FBOs remain in scope. In fact, all current IHCs remain in scope as all of their parents have consolidated assets greater than \$50 billion. As we observe the new thresholds come into play with this final rule, banking entities must nimbly adapt to the changing regulatory landscape in the industry and understand how their organization fits into not just the final rule to establish the SCCL, but also their other required regulatory frameworks.

With limited time for preparation until the scheduled 2020 go-live date, organizations may contact Deloitte for assistance with strategic planning, preparation, and implementation of infrastructure and processes changes towards compliance with SCCL.

As further developments occur, Deloitte will issue additional updates as appropriate.

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Endnotes

¹S.2155 [Economic Growth, Regulatory Relief, and Consumer Protection Act](#) was signed into law on May 24, 2018. Details of the legislation can be found in the [Reg Pulse Blog](#).

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