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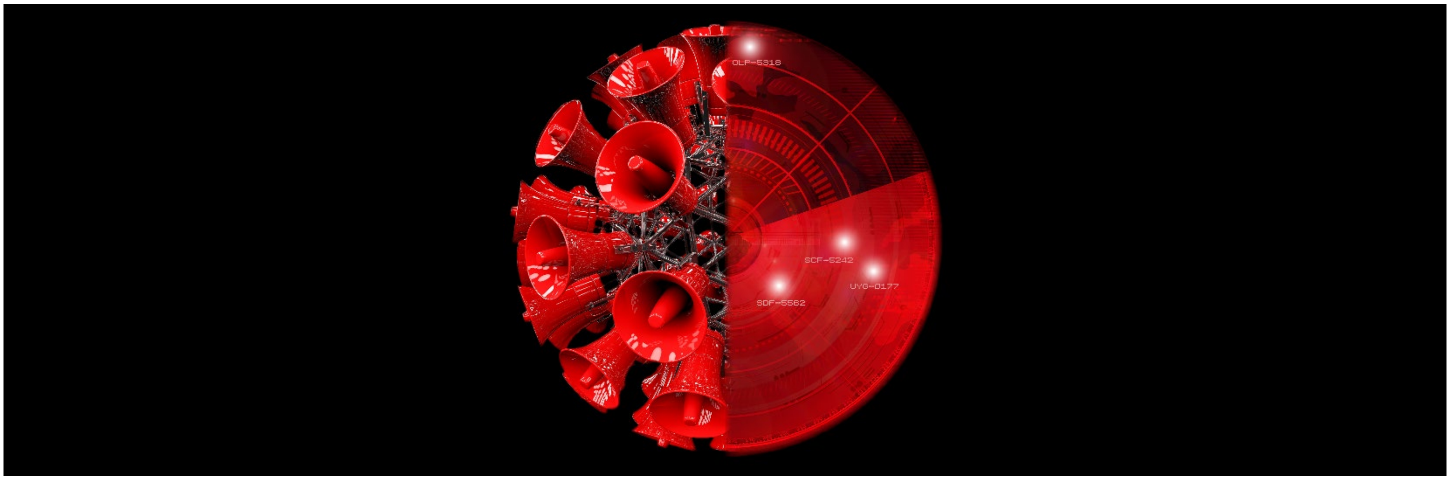

Federal Reserve Board Proposes tailoring Prudential Standards for foreign banking organizations

On April 8th, 2019, the Federal Reserve Board (FRB) proposed tailoring the post-crisis regulatory framework for foreign banking organizations (FBOs) Enhanced Prudential Standards (EPS). In line with the approach to the FRB's November 2018 proposal to tailor EPS for large, domestic banking institutions by size, complexity, business model and risk of each firm, the proposal creates a comparable model for foreign banks. In his remarks, according to FRB Vice Chairman for Supervision Randal Quarles, the proposal will create a "level playing field between foreign banks operating in the United States and domestic firms of similar size and business models" and will give "due regard to the principle of national treatment."[1] The proposal was required by the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[2]

Applicability

The proposed framework includes two proposals: one issued exclusively by the FRB,[3] and a second issued jointly by the FRB, Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation (FDIC).[4] Consistent with the EGRRCPA, the proposed framework would raise the applicability of EPS for institutions with $50 billion to $100 billion in US assets.[5]

Key takeaways

- **Prudential standard categories:** The proposals assign FBOs to one of four categories each with its own set of tailored requirements based on the risk profile of its US operations, as measured by size and other risk-based measures.[6] The criteria for the categories are set forth below in order of proposed tailoring:[7]
    - **Category II:** Applies to FBOs with more than $700 billion in US assets or more than $75 billion in cross-jurisdictional activity.
        - ***Liquidity:*** *A FBO will also qualify for Category II's liquidity requirements if it has more than or equal to $75 billion in weighted short-term wholesale financing.*

- **Category III:** Applies to FBOs to which category II does not apply, and have more than $250 billion in US assets or more than $75 billion in non-bank assets, weighted short-term wholesale funding, or off-balance sheet exposure.
    - ***Liquidity:*** *A FBO will qualify for Category III's liquidity requirements if it has less than $75 billion in weighted short-term wholesale financing.*
- **Category IV:** Applies to FBOs to which categories II-III do not apply, and have between $100 and $250 billion in US assets.
- **Other FBOs:** Applies to FBOs with between $50 billion and $100 billion in US assets and more than $100 billion in global assets.
    - ***Liquidity:*** *A FBO will be subject to home country liquidity requirements if it has more than $250 billion in global assets.*

- **FBO EPS tailoring is modest:** The risk management requirements for Large Institution Supervision Coordination Committee (LISCC) firms and large FBO (LFBO) firms would remain the same. Relief was provided to FBOs with less than $100 billion in US assets) in terms of regulatory requirements such as Comprehensive Capital Analysis and Review (CCAR) and company-run and supervisory stress testing. EPS would now be applied for institutions with over $100 billion US assets.

- **Category IV impact is where tailoring is most evident:** The only difference in capital requirements between Category II and Category III is the frequency of company-run stress tests (annual versus a two year cycle, respectively). Category IV firms would find the biggest relief.

- **US Intermediate Holding Company (IHC) requirement remains:** The FRB decided to keep the $50 billion U.S. non-branch asset threshold for the IHC requirement.

- **Additional thresholds:** The framework is a complex web of thresholds to model and monitor, complicating peer comparisons going forward. The new definitions will create additional data gathering needs and aggregation efforts (e.g. the Consolidated US Operations [CUSO] data changes) across reporting including the FRY-15.[8]

- **Maintaining BAU capability:** Firms across Category II and III will need to maintain BAU capabilities and carefully monitor their risk profile against the categories on an ongoing basis. The regulatory examinations and practical business reasons will demand it to maintain the appropriate level of controls, such as in the case of liquidity reporting moving from monthly to daily for Category III.

- **Continuous monitoring required**: The introduction of new categorization criteria such as cross-jurisdictional activity will pose an additional burden on organizations to measure and identify where the firm stands vis-à-vis the categories and their regulatory requirements. Firms should be aware of where they stand on an ongoing basis (as opposed to a spot, quarter, or month-end view) and triggers for a change in Category – these effectively can be viewed as binding constraints on business model changes going forward. Regulatory strategy meets business strategy.

- **Branch liquidity rules – impact is TBD:** The FRB deferred the decision but requested comments on whether standardized liquidity requirements should be imposed on US branches and agencies of FBOs, and what would be the approaches for doing so.

Key metrics driving categorization

Apart from US assets, cross-jurisdictional activity and weighted short-term wholesale funding (wSTWF) are the two criteria driving categorization.

- **Cross-jurisdictional activity:** A FBO would measure cross-jurisdictional activity as the sum of the cross-jurisdictional assets and liabilities of its combined US operations or its US intermediate holding company, as applicable, excluding intercompany liabilities and collateralized intercompany claims. Specifically, the proposed cross-jurisdictional activity indicator would exclude liabilities of the combined US operations or US intermediate holding company that reflect transactions with non-US affiliates.
- **Weighted short-term wholesale funding:** Weighted short-term wholesale funding would include exposures between the US operations of a foreign banking organization and its non-US affiliates, as reliance on short-term wholesale funding from affiliates can contribute to a firm's funding vulnerability in times of stress.

Net-net applicable prudential standards

Organizations that fall within the four categories would be subjected to the following prudential standards, based on their size and risk profile.

<table>
<tr><th colspan="3" rowspan="2">Application of Regulatory Capital Requirements and Capital-Related EPS (determined based on an IHC level assets and risk based indicators)</th><th>Category II</th><th>Category III</th><th>Category IV</th><th rowspan="2">FBOs with $50b to $100b IHC assets and ≥ $100b global assets</th></tr>
<tr><th>≥ $700b IHC Assets or ≥ $75b in cross-jurisdictional activity</th><th>≥ $250b IHC assets or ≥ $75b in nonbank assets, wSTWF, or off-balance sheet exposure</th><th>Other firms with $100b to $250b IHC assets</th></tr>
<tr><td>IHC</td><td>IHC</td><td>U.S. IHC Requirement</td><td colspan="4">✓</td></tr>
<tr><td rowspan="7">Capital</td><td rowspan="4">Stress Testing</td><td>CCAR</td><td colspan="2">✓
(annual)</td><td>✓
(two-year cycle)</td><td>x</td></tr>
<tr><td>Company-run stress testing</td><td>✓
(annual)</td><td>✓
(two-year cycle)</td><td>x</td><td>x</td></tr>
<tr><td>Supervisory stress testing</td><td colspan="2">✓
(annual)</td><td>✓
(two-year cycle)</td><td>x</td></tr>
<tr><td>Capital plan submission (annual)</td><td colspan="3">✓</td><td>x</td></tr>
<tr><td rowspan="2">Risk-based capital</td><td>Countercyclical Buffer</td><td colspan="2">✓</td><td>x</td><td>x</td></tr>
<tr><td>Opt-out of AOCI capital impact</td><td>x</td><td colspan="3">✓</td></tr>
<tr><td>Leverage Capital</td><td>Supplementary leverage ratio</td><td colspan="2">✓</td><td>x</td><td>x</td></tr>
<tr><th colspan="3">Application of Standardized Liquidity Requirements, Liquidity-Related EPS & Other EPS (determined based on the CUSO of FBO)</th><th>≥ $700b CUSO Assets or ≥ $75b in CUSO cross-jurisdictional activity or > $75b in CUSO wSTWF</th><th>≥ $250b CUSO assets or ≥ $75b in CUSO nonbank assets, wSTWF, or off-balance sheet exposure (or, for Liquidity Reqs, with < $75b in CUSO wSTWF)</th><th>Other firms with $100b to $250b CUSO assets</th><th>FBOs with $50b to $100b CUSO assets and ≥ $250b global assets</th></tr>
<tr><td rowspan="5">Liquidity</td><td rowspan="2">Standardized Liquidity</td><td>Liquidity coverage ratio</td><td>✓
(daily)</td><td>✓
(reduced daily 70-85%)</td><td>✓
(70-85% monthly LCR if wSTWF ≥ $50b; if < $50b, no LCR)</td><td>x</td></tr>
<tr><td>Net stability funding ratio (proposed)</td><td>✓
(daily)</td><td>✓
(reduced daily 70-85%)</td><td>✓
(70-85% monthly NSFR if wSTWF ≥ $50b; if < $50b, no NSFR)</td><td>x</td></tr>
<tr><td rowspan="3">Internal Liquidity</td><td>Liquidity stress tests</td><td colspan="2">✓
(monthly)</td><td>✓
(quarterly)</td><td>✓
(home country stress)</td></tr>
<tr><td>Liquidity risk management</td><td colspan="2">✓</td><td>✓
(reduced)</td><td>x</td></tr>
<tr><td>Report FR 2052a</td><td>✓
(daily)</td><td colspan="2">✓
(monthly)</td><td>x</td></tr>
<tr><td rowspan="3">Other EPS</td><td rowspan="2">Single Counterparty Credit Limit</td><td>Home Country SCCL consistent with BASEL</td><td colspan="2">✓</td><td colspan="2">✓
(if global assets ≥ $250bn)</td></tr>
<tr><td>IHC-level SCCL</td><td colspan="2">✓</td><td>x</td><td>x</td></tr>
<tr><td>Risk Management</td><td>U.S. Risk Committee and Chief Risk Officer</td><td colspan="4">✓</td></tr>
</table>

Legend: "**✓**" – categories where corresponding requirement is applicable ; "**x**" – categories where corresponding requirement is not applicable
Glossary: wSTWF – weighted short-term wholesale funding; IHC – intermediate holding company; AOCI – accumulated other comprehensive income; CCAR – Comprehensive Capital Analysis and Review;
Source: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190408a.htm

- **Category II**: Category II firms would be subject to the currently applicable capital and liquidity requirements.

- **Category III**: Category III firms would be subject to the same capital requirements as Category II firms, apart from conducting a company-run stress test on a bi-annual basis, being able to opt out of Accumulated Other Comprehensive Income (AOCI). Category III firms find relief in a reduced liquidity coverage ratio (LCR) and net stability funding ratio.

- **Category IV**: Category IV firms would no longer be required to complete company-run stress tests and would complete supervisory stress tests on a two-year cycle. Category IV firms would be exempt from calculating a supplementary leverage ratio and would be exempt from intermediate holding company (IHC) single counterparty credit limits (SCCL). Category IV firms would be exempt from liquidity coverage and net stability funding ratios if their wSTWF are less than $50 billion. In addition, Category IV firms will find relief in relaxed timelines for internal liquidity requirements (stress tests, risk management, and reporting).

- **Other FBOs**: FBOs that do not qualify for Categories II-IV based on their risk profile are still subject to the US IHC and risk management requirements. If their global assets are greater than $250 billion, they are subject to home country SCCL consistent with Basel, and home country stress tests.

Summary

The proposed tailoring of EPS for FBOs is intended to "maintain the resilience built up across the US financial system over the past decade, while at the same time making appropriate adjustments for firms that present less risk."[12] Firms subject to the tailoring should analyze their business profiles and risk characteristics relative to the proposed categories for opportunities to calibrate their business models. Industry comments are due on June 21, 2019.

In addition, the FRB has also recently proposed to amend resolution planning requirements for domestic and foreign banking organizations.[13] As further developments occur, Deloitte will issue additional updates as appropriate.

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Endnotes:

1. Statement by Vice Chairman Randal Quarles (Apr. 8, 2019), available at https://www.federalreserve.gov/newsevents/pressreleases/99A5C407E998418CB2CB9DDB85C54B0B.htm
2. The EGRRCPA was signed into law on May 24, 2018. It increased the asset threshold for a banking organization to be designated as a systemically important financial institution (SIFI) from $50 billion to $100 immediately after enactment with a further increase 18 months after enactment.
3. Federal Reserve, Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies (Apr. 8, 2019), available at https://www.federalreserve.gov/newsevents/pressreleases/files/foreign-bank-fr-notice-120190408.pdf.
4. OCC, Federal Reserve, FDIC, Proposed changes to applicability thresholds for regulatory capital requirements for certain U.S. subsidiaries of foreign banking organizations and application of liquidity requirements to foreign banking organizations, certain U.S. depository institution holding companies, and certain depository institution subsidiaries (Apr. 8, 2019), available at: https://www.federalreserve.gov/newsevents/pressreleases/files/foreign-bank-fr-notice-220190408.pdf. The proposal is consistent with a separate proposal issued by the Board that would apply certain prudential standards to foreign banking organizations based on the same categories. In addition, it proposes the application of a standardized liquidity requirement to certain U.S. depository institution holding companies that meet specified criteria relating to their liquidity risk profile.
5. For IHC and capital standards, "U.S. assets" refers to U.S. non-branch assets. For liquidity and other standards, "U.S. assets" refers to combined U.S. assets, including U.S. subsidiaries, branches, and agencies. FBOs with limited U.S. presence and global assets of $100 billion or more would be subject to certain minimum standards.
6. Other risk-based measures include cross-jurisdictional activity, nonbank assets, off balance sheet exposure, and weighted short-term wholesale funding. These measures would be calculated for combined U.S. operations.
7. Category I applies to US global systemically important banks (G-SIBs) and the and capital and liquidity requirements these firms face. The FRB proposed the requirements on October 31, 2018.
8. Federal Reserve: FR Y-15 Banking Organization Systemic Risk Report, available at: https://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDaRHakir9P9vg
9. IHC criteria: $50b in US Non Branch Assets
10. Capital criteria: U.S Assets refers to Non Branch Assets
11. Other requirements and liquidity requirements: US assets refers to CUSO Assets
12. Statement by Chairman Jerome Powell (Apr. 8, 2019), available at https://www.federalreserve.gov/newsevents/pressreleases/powell-opening-statement-20190408.htm
13. Federal Reserve Board and Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking: Resolution Plans Required (April 8, 2019), available at: https://www.federalreserve.gov/aboutthefed/boardmeetings/files/resolution-plans-fr-notice-20190408.pdf