

# Client Alert

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November 20, 2018

## Agencies Propose a More Tiered Approach to Large Bank Supervision

On October 31, 2018, the federal banking agencies released two separate proposals that, if adopted, would create a more consistent tiered approach to large bank supervision – in other words, supervision of banking organizations with at least \$100 billion in total consolidated assets. The proposals would establish four categories of standards and apply them to institutions based on the risk they pose to the financial system. The new tiered approach would apply to U.S. banking organizations with respect to the application of (i) the regulatory capital rule; (ii) the liquidity coverage ratio (LCR) rule; (iii) the proposed net stable funding ratio (NSFR) rule; and (iv) certain enhanced prudential standards (EPS) contained in Regulation YY, in particular, standards regarding capital planning requirements, supervisory and company-run stress testing, liquidity risk management, stress testing, and buffer requirements; risk-management and risk committee requirements; and single counterparty credit limits.

The proposal related to the regulatory capital rule, the LCR rule, and the proposed NSFR rule (the “Capital and Liquidity Proposal”) was released jointly by the Office of the Comptroller of the Currency (OCC), the Board of Governors and the Federal Reserve System (“Federal Reserve”), and the Federal Deposit Insurance Corporation (FDIC and, together with the OCC and Federal Reserve, the “Agencies”). The proposal related to EPS (the “EPS Proposal” and, together with the Capital and Liquidity Proposal, the “Tailoring Proposals”) was separately released by the Federal Reserve.<sup>1</sup>

The supplementary information to the Tailoring Proposals provides background information and a detailed discussion of the proposed changes, suggestions of alternative approaches, and a total of 57 questions from the Agencies for public comment. Comments on the Tailoring Proposals are due by January 22, 2019.

In the post-financial crisis reforms, the Agencies imposed, and have proposed, greater capital and liquidity standards for large banks through the 2013 adoption of revisions to the regulatory capital rule;<sup>2</sup> the 2014 adoption of the LCR rule;<sup>3</sup> and the 2016 proposed rule to implement the NSFR requirement.<sup>4</sup> Currently, these rules and the proposed rule are tailored based on whether a banking organization uses the standardized approach (i.e., standardized approach banking organizations)<sup>5</sup> or uses both the standardized approach and the advanced

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<sup>1</sup> The Tailoring Proposals also would make changes to reporting forms and reporting frequency; such changes are not discussed in this client alert.

<sup>2</sup> 12 C.F.R. part 217.

<sup>3</sup> 12 C.F.R. part 249.

<sup>4</sup> Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 81 Fed Reg. 35123 (June 1, 2016).

<sup>5</sup> Standardized approach banking organizations have total consolidated assets of less than \$250 billion and total on-balance sheet foreign exposure of less than \$10 billion.

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approaches (i.e., advanced approaches banking organizations)<sup>6</sup> for calculating risk-based capital ratios. Additional capital requirements also apply to U.S. global systemically important BHCs (GSI - BHCs). Less stringent requirements under the LCR rule and the proposed NSFR rule apply to banking organizations that are not advanced approaches banking organizations, but have more than \$50 billion in total consolidated assets.

In separate post-financial crisis reforms, the Federal Reserve adopted Regulation YY pursuant to Section 165 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") to implement EPS for large banking organizations.<sup>7</sup> With respect to U.S. banking organizations, the application of EPS is currently tiered by an institution's asset size with different requirements applicable to the following categories: banking organizations<sup>8</sup> with total consolidated assets of more than \$10 billion but less than \$50 billion (with additional standards for publicly traded bank holding companies in the same size range); bank holding companies with \$50 billion or more in total consolidated assets; and U.S. GSI - BHCs.

The Tailoring Proposals are a result of efforts by the Agencies to identify areas where additional tailoring of their supervisory approach to large banking organizations may be warranted. In addition, certain tailoring and changes to the scope of regulations are required by amendments to the Dodd-Frank Act that were recently adopted through the passage of S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Regulatory Relief Act").

## REGULATORY RELIEF ACT

As described in our earlier [client alert](#), Section 401 of the Regulatory Relief Act raised the thresholds for the application of EPS. Specifically, the Regulatory Relief Act raised the threshold for statutorily required application of EPS from institutions with \$50 billion or more in total consolidated assets to institutions with \$250 billion in total consolidated assets (which is defined to also include U.S. GSI - BHCs, regardless of asset size). While the mandatory threshold was raised to \$250 billion, the Regulatory Relief Act retained the Federal Reserve's authority to apply any EPS to institutions with total consolidated assets of \$100 billion or more, but less than \$250 billion.<sup>9</sup> Under the Regulatory Relief Act, the Federal Reserve is required to tailor the application of EPS on an individual basis or category; previously, such tailoring was optional.

While implementing the four-category tailoring approach, the EPS Proposal would also implement the Regulatory Relief Act's exclusion from most EPS for institutions with less than \$100 billion in total consolidated assets.<sup>10</sup> In addition, the EPS Proposal would raise the threshold for applicability of the risk committee requirements to all bank holding companies with \$50 billion or more in total consolidated assets. Currently, the risk committee

<sup>6</sup> Advanced approaches banking organizations include banking organizations with \$250 billion or more in total consolidated assets or \$10 billion or more in total on-balance sheet foreign exposure and their depository institution subsidiaries.

<sup>7</sup> 12 C.F.R. part 252.

<sup>8</sup> Certain EPS are currently applicable to savings and loan holding companies and state member banks within this threshold, in addition to bank holding companies.

<sup>9</sup> The Regulatory Relief Act still requires a risk committee for publicly traded bank holding companies with \$50 billion in total consolidated assets or more.

<sup>10</sup> The EPS Proposal will also make changes to Regulation Y to align the threshold for applicability of the bank holding company capital planning requirements to the threshold for application of EPS, setting it at \$100 billion or more in total consolidated assets.

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requirement is also applicable to publicly traded bank holding companies with \$10 billion or more in total consolidated assets. Further, the threshold for the risk management requirements (i.e., the appointment of a Chief Risk Officer) would be raised to \$100 billion or more in total consolidated assets.

The Agencies also intend to issue a proposal to implement Section 201 of the Regulatory Relief Act, which requires the Agencies to revise the capital requirements applicable to certain banking organizations with less than \$10 billion in total consolidated assets. The Federal Reserve also intends to propose at a later date amendments to its capital plan rule<sup>11</sup> and, together with the FDIC, seek public comments on a proposal that would address the resolution plan requirements for firms with consolidated assets in the range of \$100 billion to \$250 billion.

## SCOPE

The EPS Proposal would apply to top-tier U.S. bank holding companies and covered savings and loan holding companies;<sup>12</sup> it would not apply to foreign banking organizations, including to an intermediate holding company of a foreign banking organization.<sup>13</sup>

The Capital and Liquidity Proposal would apply the same category of standards to both the top-tier U.S. bank holding company and its subsidiary depository institutions. Similar to the EPS Proposal, the supplementary information of the Capital and Liquidity Proposal states that “the proposal would not amend the capital and liquidity requirements applicable to an intermediary holding company or its subsidiary depository institution or the bank holding company of a foreign banking organization” and that the proposal would also not change the requirements applicable to Federal branches or agencies of foreign banking organization.

The Tailoring Proposals indicate that the Federal Reserve continues to consider the appropriate way for assigning the U.S. operations of foreign banking organizations to the proposed four categories of standards and intends to release at a later date a separate proposal with respect to foreign banking organizations, which will account for principles of national treatment and equality of competitive opportunity.

## CATEGORIES OF STANDARDS

Below, we set forth the four categories that would be established by the Tailoring Proposals<sup>14</sup> and the requirements applicable to each category. As mentioned above, with regard to the Capital and Liquidity Proposal, each Category’s standards apply not only to the top-tier bank holding companies but also to their banking subsidiaries.

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<sup>11</sup> 12 C.F.R. § 225.8.

<sup>12</sup> See 12 C.F.R. § 217.2 (defining “covered savings and loan holding company”). The EPS Proposal will, in general, subject large savings and loan holding companies to the same requirements as bank holding companies in the same category, except with respect to Category I, since GSIB is not defined to include covered savings and loan holding companies under 12 C.F.R. § 217.2.

<sup>13</sup> The EPS Proposal also does not include changes with regard to EPS applicable to nonbank financial institutions supervised by the Federal Reserve or company-run stress test requirements applicable to state member banks.

<sup>14</sup> In addition to the applicability thresholds outlined below, the Agencies seek comments on an alternative approach for differentiating requirements for banking organizations using an aggregate “score” across multiple measures of risk.

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The most stringent standards, **Category I**, would apply to GSI - BHCs, determined by the existing methodology under the Federal Reserve's surcharge rule.<sup>15</sup>

The Agencies propose that the determination of the applicability of the remaining categories of standards, Category II – IV, should be based on an institution's risk profile, as well as the institution's size, cross-jurisdictional activity, weighted short-term wholesale funding, nonbank assets, and off-balance sheet exposures. Specifically:

- **Category II** standards would apply to banking organizations with \$700 billion or more in total consolidated assets or \$75 billion or more in cross-jurisdictional activity that are not subject to Category I;
- **Category III** standards would apply to banking organizations that have \$250 billion or more in total consolidated assets or \$75 billion or more in any of the following indicators: nonbank assets,<sup>16</sup> weighted short-term wholesale funding, or off-balance-sheet exposures; and
- **Category IV** standards would apply to banking organizations that do not fall within Categories I to III and have at least \$100 billion in total consolidated assets.

The chart on the following page provides a high-level summary of the standards associated with each category.<sup>17</sup>

## CONCLUSION

The Tailoring Proposals are complex, and institutions will have to use the two-and-a-half-month comment period to analyze the applicability and effects of the proposals. However, the Tailoring Proposals appear to be in line with the Agencies' longstanding principle of tailoring regulatory requirements to a firm's specific risk. In particular, the Tailoring Proposals would apply risk-based standards to determine whether a firm with total assets between \$100 million and \$250 billion would be subject to more stringent (Category III) or less stringent (Category IV) standards.

## Contact:

**Henry M. Fields**  
(213) 892-5275  
[hfields@mofo.com](mailto:hfields@mofo.com)

**Oliver I. Ireland**  
(202) 778-1614  
[oireland@mofo.com](mailto:oireland@mofo.com)

**Jiang Liu**  
(212) 468-8008  
[jiangliu@mofo.com](mailto:jiangliu@mofo.com)

**Barbara R. Mendelson**  
(212) 468-8118  
[bmendelson@mofo.com](mailto:bmendelson@mofo.com)

**Marc-Alain Galeazzi**  
(212) 336-4153  
[mgaleazzi@mofo.com](mailto:mgaleazzi@mofo.com)

**Meghan E. Dwyer**  
(212) 336-4067  
[meghandwyer@mofo.com](mailto:meghandwyer@mofo.com)

**Mark R. Sobin**  
(212) 336-4222  
[msobin@mofo.com](mailto:msobin@mofo.com)

<sup>15</sup> 12 C.F.R. Part 217, Subpart H.

<sup>16</sup> Nonbank assets would include the average amount of equity in an institution's nonbank subsidiaries. This calculation would not include investments in savings institutions but would include assets in Edge Act and Agreement Corporations. Weighted short-term wholesale funding would be calculated in the same manner as required by the FR Y-15 report. Off-balance sheet exposures would be calculated by subtracting total exposure, as defined for purposes of the FR Y-15 report, from total consolidated assets, as reported on the FR Y-9C.

<sup>17</sup> The Federal Reserve has also published a helpful-high level chart of the proposed requirements and how the different categories would apply to different types of banking organizations (see [Proposed Requirement Chart](#)).

**APPLICABLE STANDARDS FOR EACH CATEGORY**

<b>Applicable Standards</b>	<b>Category I</b>	<b>Category II</b>	<b>Category III</b>	<b>Category IV</b>
Capital Requirements	TLAC/Long-term debt; GSIB surcharge (holding company-level only); countercyclical capital buffer; capital conservation buffer; common equity tier 1 capital; tier 1 capital; total capital; leverage	Countercyclical capital buffer; capital conservation buffer; common equity tier 1 capital; tier 1 capital; total capital; leverage	Countercyclical capital buffer; capital conservation buffer; common equity tier 1 capital; tier 1 capital; total capital; leverage	Capital conservation buffer; common equity tier 1 capital; tier 1 capital; total capital; leverage
Calculation of Capital Ratios	Advanced Approaches + Standardized Approach	Advanced Approaches + Standardized Approach	Standardized Approach only <sup>18</sup>	Standardized Approach only
Recognize AOCI in Regulatory Capital	No opt-out	No opt-out	Opt-out permitted	Opt-out permitted
Supplementary Leverage Ratio	Enhanced Supplementary Leverage Ratio	Applicable	Applicable	Not applicable
Liquidity Coverage Ratio and Proposed Net Stable Funding Ratio	Full requirement for firm and any depository institution subsidiary with \$10 billion or more	Full requirement for firm and any depository institution subsidiary with \$10 billion or more	Full requirement for firms with weighted short-term wholesale funding of \$75 billion or more; other firms subject to less stringent requirement; <sup>19</sup> consolidated subsidiaries with \$10 billion or more in total consolidated assets subject to same requirements as parent	Not applicable
Stress Tests	CCAR qualitative and quantitative; annual supervisory; annual company run	CCAR qualitative and quantitative; annual supervisory; annual company run	CCAR qualitative and quantitative;; annual supervisory; biennial company run	CCAR quantitative; biennial supervisory
Annual Capital Plan	Required	Required	Required	Required
Liquidity Requirements	Liquidity risk management; monthly internal liquidity stress testing; liquidity buffer	Liquidity risk management; monthly internal liquidity stress testing; liquidity buffer	Liquidity risk management; monthly internal liquidity stress testing; liquidity buffer	Modified liquidity risk management requirement; <sup>20</sup> quarterly internal liquidity stress testing; and liquidity buffer
Single-Counterparty Credit Limits	Applicable	Applicable	Applicable	Not applicable

<sup>18</sup> The Agencies have previously released a proposal that, if adopted, would require advanced approaches banking organizations (i.e., Category I and II firms) to use the standardized approach for counterparty credit risk for derivatives exposures (SA-CCR) for calculating risk-based capital ratios (the "SA-CCR Proposal"). The proposal would also require such banking organizations to use SA-CCR for calculating the total leverage exposure for purposes of the supplemental leverage ratio. In the Capital and Liquidity Proposal, the Agencies state that, if the SA-CCR Proposal is adopted, Category III firms will be able to elect to use SA-CCR for such purposes.

<sup>19</sup> The Agencies propose to mitigate the requirements by multiplying components of the full LCR and NSFR calculation by a factor that reduces their stringency. The Agencies are requesting comment on how a less stringent requirement can be implemented.

<sup>20</sup> Modifications to the liquidity risk management requirements for Category IV firms include: calculation of collateral positions on a monthly, rather than weekly, basis; requirement to establish risk limits to monitor liquidity risk only for activities relevant to the institution; and fewer elements required for monitoring intraday liquidity risk exposures.

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## Financial Services Team

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### California

Alexis A. Amezcua	(415) 268-6557
Elizabeth Balassone	(415) 268-7585
Roland E. Brandel	(415) 268-7093
Sarah N. Davis	(415) 268-7478
Henry M. Fields	(213) 892-5275
Joseph Gabai	(213) 892-5284
Angela E. Kleine	(415) 268-6214
Jim McCabe	(415) 268-7011
James R. McGuire	(415) 268-7013
Mark David McPherson	(212) 468-8263
Ben Patterson	(415) 268-6818
Sylvia Rivera	(213) 892-5734
William L. Stern	(415) 268-7637
Nancy R. Thomas	(213) 892-5561
Lauren Lynn Wroblewski	(415) 268-6458

### New York

Robert J. Baehr	(212) 336-4339
James M. Bergin	(212) 468-8033
Meghan E. Dwyer	(212) 336-4067
David J. Fioccola	(212) 336-4069
Marc-Alain Galeazzi	(212) 336-4153
Adam J. Hunt	(212) 336-4341
Jessica Kaufman	(212) 336-4257
Mark P. Ladner	(212) 468-8035
Jiang Liu	(212) 468-8008
Barbara R. Mendelson	(212) 468-8118
Michael B. Miller	(212) 468-8009
Jeffrey K. Rosenberg	(212) 336-4130
Mark R. Sobin	(212) 336-4222
Joan P. Warrington	(212) 506-7307

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### Washington, D.C.

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Marcie Brimer	(202) 887-6932	Steven M. Kaufmann	(202) 887-8794
Rick Fischer	(202) 887-1566	Jeremy R. Mandell	(202) 887-1505
Adam J. Fleisher	(202) 887-8781	Elyse S. Moyer	(202) 778-1616
Natalie A. Fleming Nolen	(202) 887-1551	Obrea O. Poindexter	(202) 887-8741
Calvin D. Funk	(202) 887-6930	Sean Ruff	(202) 887-1530
Susan I. Gault-Brown	(202) 887-1597	Trevor R. Salter	(202) 887-1527
Julian E. Hammar	(202) 887-1679	Nathan D. Taylor	(202) 778-1644
Oliver I. Ireland	(202) 778-1614	Jennifer S. Talbert	(202) 887-1563
Crystal N. Kaldjob	(202) 887-1687		