The Age of “Tailoring”: Prudential Regulation Revisited
January 11, 2019
Proposed Changes to the Asset Thresholds for Capital and Liquidity Rules and Dodd-Frank Enhanced Prudential Standards

January 2019 – American Bar Association Banking Law Committee
Overview and Background

- On October 31, 2018, the Federal banking agencies jointly proposed significant changes to the regulatory capital and liquidity frameworks and the Federal Reserve proposed corresponding changes to several of its enhanced prudential standards (EPS) implemented under Sec. 165 of the Dodd-Frank Act.

- Broadly consistent with the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), these proposals would reshape how U.S. bank holding companies (BHCs) and certain savings and loan holding companies (SLHCs) with assets ≥ $100 billion are classified for purposes of the capital, liquidity and EPS requirements. BHCs with < $100 billion in total assets would be exempt from EPS.

- The proposals would establish four new, risk-based categories for U.S. banking organizations with assets ≥ $100 billion. The scope and stringency of prudential requirements would increase based on the risk profile of the category, with the U.S. BHCs identified as global systemically important BHCs (GSIBs) generally subject to the most stringent requirements.

- Key changes under the proposals include:
  - A revised definition of “Advanced Approaches” and “internationally active” banking organizations, which traditionally have been subject to the full array of standards developed by the Basel Committee on Banking Supervision;
  - Application of EPS to non-insurance, non-commercial SLHCs with assets ≥ $100 billion; and
  - The proposals do not specify an effective date, but the comment period runs through January 22, 2019. We expect the earliest the proposals would become effective is January 1, 2020.

- The proposals would not alter the capital, liquidity or EPS rules for the U.S. operations of foreign banking organizations (FBOs), including intermediate holding companies (IHCs). The Federal Reserve has indicated that it will issue a separate proposal to address the tailoring of the capital, liquidity and EPS rules to the U.S. operations of foreign banks.
The proposals would categorize U.S. BHCs and certain SLHCs with assets ≥ $100 billion into one of four new, risk-based categories (illustrated below).

In addition to total assets, new thresholds based on cross-jurisdictional activity, non-bank assets, short-term wholesale funding and off-balance sheet exposures would distinguish among non-GSIBs (Categories II to IV).

The holding company’s categorization would generally determine the categorization and range of prudential requirements applicable to its insured depository institution (IDI) subsidiaries.

<table>
<thead>
<tr>
<th>Category</th>
<th>Proposed Criteria</th>
<th>Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category II</td>
<td>≥ $700 billion Total Assets OR ≥ $75 billion in Cross-Jurisdictional Activity</td>
<td>Northern Trust</td>
</tr>
<tr>
<td>Category III</td>
<td>≥ $250 billion Total Assets OR $100 billion in Total Assets AND ≥ $75 billion in Non-Bank Assets, weighted Short-Term Wholesale Funding (wSTWF) OR Off-balance sheet exposure</td>
<td>U.S. Bancorp The PNC Financial Services Group, Inc. Capital One Financial Corp. The Charles Schwab Corp.</td>
</tr>
<tr>
<td>Category IV</td>
<td>Other firms with ≥ $100 billion but ≤ $250 billion Total Assets</td>
<td>BB&amp;T Corp. SunTrust Inc. American Express Ally Financial Citizens Financial Fifth Third KeyCorp Regions Financial M&amp;T Bank Huntington Discover</td>
</tr>
</tbody>
</table>
Tailored Application of Requirements across the New Categories

- The proposals would significantly tailor prudential requirements for Category III and IV firms.
- Category I and II firms would receive no benefits, other than elimination of the Mid-Cycle Dodd-Frank Act stress test (DFAST).

### Proposed Requirements by Category

<table>
<thead>
<tr>
<th></th>
<th>Category I</th>
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<tr>
<td>U.S. GSIBs</td>
<td></td>
<td>≥ $700 billion Total Assets or ≥ $75 billion in Cross-Jurisdictional Activity</td>
<td>≥ $250 billion Total Assets or ≥ $75 billion In Nonbank Assets, wSTWF, or Off-balance sheet exposure</td>
<td>Other firms with $100 billion to $250 billion Total Assets</td>
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<tr>
<td><strong>Risk-Based Capital</strong></td>
<td>• GSIB surcharge&lt;br&gt;• Advanced Approaches&lt;br&gt;• Countercyclical Buffer&lt;br&gt;• No opt-out of accumulated other comprehensive income (AOCI) capital impact</td>
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<tr>
<td><strong>TLAC/Long-term debt</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Capital</td>
<td></td>
<td>Leverage capital</td>
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<tr>
<td></td>
<td></td>
<td>• Leverage ratio&lt;br&gt;• Enhanced supplementary leverage ratio</td>
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<td>• Leverage ratio</td>
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<tr>
<td>Stress Testing</td>
<td>• Subject to CCAR; qualitative and quantitative review&lt;br&gt;• Annual capital plan submission&lt;br&gt;• Annual company-run DFAST stress testing&lt;br&gt;• Annual DFAST supervisory stress testing</td>
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<tr>
<td></td>
<td></td>
<td>• No Mid-Cycle DFAST</td>
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<td>• Supervisory DFAST stress testing (two-year cycle)&lt;br&gt;• No Mid-Cycle DFAST</td>
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Note: Changes from current rules highlighted in orange.
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| **Liquidity**                     | • Full LCR (100%)  
• Full NSFR (100%) | • Full LCR (100%)  
• Full NSFR (100%) | • Reduced LCR (70-85%)†  
• Reduced NSFR (70-85%)† | • No LCR  
• No NSFR |
| **Section 165 Liquidity Requirement** | • Liquidity stress tests (monthly)  
• Full liquidity risk management requirements | • Liquidity stress tests (monthly)  
• Full liquidity risk management requirements | • Liquidity stress tests (monthly)  
• Full liquidity risk management requirements | • Liquidity stress tests (quarterly)  
• Modified liquidity risk management requirements |
| **Other**                         | • Single Counterparty Credit Limit  
• Resolution Plan (Fed+FDIC)  
• OCC Recovery Plan | • Single Counterparty Credit Limit  
• Resolution Plan (Fed+FDIC)  
• OCC Recovery Plan | • Single Counterparty Credit Limit  
• Resolution Plan (Fed+FDIC)††  
• OCC Recovery Plan (just ≥ $250b in assets, as proposed) | • Resolution Plan (Fed+FDIC)†† |

†For Category III firms with wSTWF of $75 billion or more, Full (100%) LCR and NSFR requirements would apply. For Category III firms with less than $75 billion in wSTWF, the proposal requests comment on reducing the LCR and NSFR requirements to a level between 70-85%.

†† Fed and FDIC indicated that they expect to issue a separate proposal to tailor the Resolution Plan requirements for Category III and IV banks.

*Note: Change from current rules highlighted in orange.*
Related Matters

- **Alternative Tailoring Framework.** As an alternative to the tailoring thresholds proposed, the agencies have requested comment on an alternative framework that would tailor application of the rules based on asset size and GSIB scores. Under this alternative methodology, the thresholds for Category II-IV firms would be:
  - **Category II:** ≥ $100 billion assets & GSIB score of ≥ 60-80 (Method 1) or 100-150 (Method 2)
  - **Category III:** ≥ $100 billion assets & GSIB score of ≥ 25-40 (Method 1) or 50-85 (Method 2)
  - **Category IV:** Other firms with ≥ $100 billion in assets

- **Tailoring of Dodd-Frank Act Sec. 165(d) Resolution Plan Requirements:** The Federal Reserve proposal foreshadows a forthcoming joint Federal Reserve-FDIC rulemaking to “further differentiate resolution planning requirements for large firms.”
  - That proposal could incorporate existing supervisory guidance into the rules and formalize the two-year resolution planning cycle.

- **“Downstream” Impact on Other Regulations:** Various other banking regulations, including, for example, the OCC’s Heightened Standards and the Recovery Plan Guidelines, and the FDIC’s IDI Resolution Plan requirements, incorporate the since-revised $50 billion Dodd-Frank Act asset threshold or the current “Advanced Approaches” thresholds ($250 billion assets or $10 billion foreign exposure).
  - It is unclear at this time whether or how the application of these other rules and guidelines may be adjusted in light of the proposals.
Memorandum

Federal Reserve Proposes Rules to Tailor Enhanced Prudential Standards for U.S. Banking Organizations

November 5, 2018

On October 31, 2018, the Federal Reserve issued a pair of proposed rulemakings—one issued by the Federal Reserve alone and another issued jointly by the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation—that together would tailor the application of certain enhanced prudential standards under Section 165 of the Dodd-Frank Act to U.S. banking organizations based on four categories of risk profiles to which varying prudential standards would apply. The proposed rules follow the increase of the asset size threshold for general application of enhanced prudential standards from $50 billion to $250 billion under the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (the “Reform Act”). Consistent with Congress’ mandate under the Reform Act for the Federal Reserve to take into consideration risk-based factors (other than asset size alone) when determining whether to apply enhanced prudential standards to banking organizations with at least $100 billion in assets, the proposed rules would delineate the four categories of standards based on asset size and other factors such as the degree of a firm’s cross-jurisdictional activity, reliance on short-term wholesale funding, nonbank assets, and off-balance sheet exposures. In particular, the proposal includes the following categories:

- **Category I Firms**: U.S. global systemically important bank holding companies (“GSIBs”) would remain subject to the most stringent standards.

- **Category II Firms**: Firms with at least $700 billion in total assets or at least $75 billion in cross-jurisdictional activity would be subject to more stringent prudential standards (excluding GSIB-specific requirements).

- **Category III Firms**: Firms with at least $250 billion in total assets or at least $100 billion in total assets and at least $75 billion of a risk-based indicator (e.g., weighted short-term wholesale funding,