CLEARY GOTTLIEB

ALERT MEMORANDUM

Foreign Bank Tailoring Proposals: Summary and Observations

April 17, 2019

Last week, the federal banking agencies released much-anticipated proposals to tailor the application of enhanced prudential standards and capital and liquidity requirements for the U.S. operations of FBOs. The agencies issued related proposals for U.S. banking organizations in October of last year, and so far it appears that the agencies will look to finalize the proposals on the same timetable.

The agencies also requested comment on whether to impose standardized liquidity requirements on the U.S. branches and agencies of FBOs, an idea likely to generate significant controversy.

The foreign bank proposals would use a categorization system based on size and risk-based indicators that is similar in many respects to the categorization system previously proposed for U.S. banking organizations. However, the way the thresholds for the categories would be measured and applied to foreign banks' U.S. operations raises significant issues.

The proposal would reduce EPS requirements for some foreign banks that have smaller U.S. footprints or whose business mix does not implicate the proposed risk-based indicators as significantly. Some other foreign banks may actually see increased regulatory requirements. Standards such as the single-counterparty credit limit and standardized liquidity requirements would be made stricter or apply to more foreign banks than under existing regulations. And all affected foreign banks would become subject to new data collection, measurement and reporting requirements, adding significant burden compared to the current framework.

The proposals also would depart from current practice by calibrating standards for intermediate holding companies not only based on the size and risk profile of the IHC but also based on the size and risk-based indicators at the parent foreign bank's combined U.S. operations, including its branches and agencies.

A clear theme cutting across many aspects of the proposals is a continued and even heightened focus on liquidity risks. This appears in the Board's proposed calibration methodology and in the application of liquidity-related standards. It also was the impetus for the questions the agencies have posed regarding potential new standardized liquidity requirements for branches and agencies.

In this memorandum we have summarized the highlights of the proposal and questions posed by the agencies, and we offer our observations on some of the key considerations that the proposals present for foreign banks and other market participants.

The charts in the Appendix provide a comparison between the domestic and FBO proposals.

Comments on the proposals are due June 21, 2019.

I. Background

Last week, the Federal Reserve Board (the "**Board**") released two proposals to tailor the application of enhanced prudential standards ("**EPS**") to large foreign banking organizations ("**FBOs**"):

- A Board-only release that would tailor the application of EPS to the U.S. operations of FBOs (the "**Board proposal**");[1] and
- A joint release with the Federal Deposit Insurance Corporation ("**FDIC**") and the Office of the Comptroller of the Currency ("**OCC**") regarding the application of capital and liquidity rules to the U.S. operations of FBOs, which also solicits comment on whether to apply a standardized liquidity requirement to U.S. branches and agencies of FBOs (the "**interagency proposal**").[2]

The Board proposal and the interagency proposal (the "**FBO proposals**") follow companion proposals that the Board, the FDIC and the OCC (the "**Agencies**") issued on October 31, 2018 to tailor application of EPS and capital and liquidity rules to large U.S. banking organizations (the "**domestic proposals**"). As in the domestic proposals, affected FBOs and their U.S. intermediate holding companies ("**IHCs**") would be assigned to categories. In the case of FBOs, the categorization would be based on the size of and risk-based indicators related to their U.S. operations. Larger size and greater amounts attributable to the risk-based indicators would result in more stringent requirements.

II. Categorization – Summary, Questions and Observations

Summary of FBO Proposals:

- Two-tier measurement of risk-based indicators:
  - The FBO proposals would divide FBOs and their IHCs into four categories based on the same size thresholds and types of risk-based indicators that would apply to U.S. banking organizations under the domestic proposals, with the exception of a modified calculation methodology for the cross-jurisdictional activity ("**CJA**") risk-based indicator.
  - FBOs would need to separately calculate the size and risk-based indicators for their combined U.S. operations ("**CUSO**") and for their IHCs. An IHC may be in a different (lower) category than the FBO's CUSO.
    - Risk management, liquidity and single-counterparty credit limit ("**SCCL**") standards would generally apply to an FBO (and its IHC, regardless of its standalone category) on the basis of CUSO attributes.

[1] "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-1-20190408.pdf.

[2] "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-2-20190408.pdf.

        - Most regulatory capital and capital stress testing standards would apply solely to an IHC and solely on the basis of the IHC's attributes.

    - Risk-based indicator scores would be derived mainly from the Board's Form FR Y-15. Currently, only IHCs are required to file the FR Y-15, but under the FBO proposals, an FBO would also be required to file the FR Y-15 for its CUSO and branch and agency network so that data on the four risk-based indicators may be collected at those levels.

    - The categories are described below:

        - **<u>Category I</u>** would include U.S. bank holding companies ("**BHCs**") that are global systemically important banks ("**GSIBs**"); no FBO or IHC would be placed in this category.

        - **<u>Category II</u>** would include FBOs or IHCs with combined U.S. assets of $700 billion or more or with $75 billion or more in CJA in their U.S. operations.

        - **<u>Category III</u>** would include FBOs or IHCs with combined U.S. assets of $250 billion or more (that are not in Category II) or with $75 billion or more in at least one of three risk-based indicators in their U.S. operations: nonbank assets, weighted short-term wholesale funding ("**wSTWF**") or off-balance sheet exposure.

        - **<u>Category IV</u>** would include FBOs or IHCs with combined U.S. assets of $100 billion or more that are not in Categories II or III.

    - The FBO proposals also describe a reduced set of regulations that would apply to FBOs or IHCs with less than $100 billion in combined U.S. assets (which, therefore, would not fall into any of the Categories). These regulations mostly defer to home country standards or generally applicable capital requirements.

- <u>Risk-based Indicators</u>: As in the domestic proposal, in addition to size, crossing certain dollar amount thresholds in one or more of four risk-based indicators would dictate an FBO's or an IHC's category placement:

    - *Cross-jurisdictional activity*:

        - The CJA indicator is the sum of "cross-jurisdictional claims" and "cross-jurisdictional liabilities" for an FBO's CUSO or for an IHC.

            - Claims and liabilities would be derived from the Board's Form FR Y-15, which collects systemic risk data and cross-references data from other filings, such as the Country Exposure Report on Form FFIEC 009.

        - The FBO proposals include a proposed modification to the claims and liabilities calculations related to non-U.S. affiliates of the CUSO and IHC. For FBOs, the proposal would exclude:

            - all liabilities of the U.S. operations to non-U.S. affiliates, and

            - claims by the U.S. operations on non-U.S. affiliates secured by eligible financial collateral.

  - "Financial collateral" would include those assets specified in the Agencies' capital rule,[3] and would be subject to haircuts, certain requirements as to form (e.g., cash on deposit, publicly traded convertible bonds, etc.) and requirements as to security interests (in general, a perfected first-priority security interest or legal equivalent thereof outside of the United States).

  - The FBO proposals would modify certain other calculations related to CJA to the extent that they are based on the current Form FFIEC 009. In addition to collateral offset, the CJA calculation would also allow certain securities financing transactions to be calculated on an "ultimate risk basis," i.e., taking into account the jurisdiction of the collateral issuer rather than the counterparty, in contrast to the current FFIEC 009 calculation methodology. The FBO proposals request comment on other modifications to the FFIEC 009 calculations.

  - The FBO proposals request comment on two possible alternatives to the related-party exclusions:

    - excluding transactions by the U.S. operations with non-U.S. affiliates from the CJA measurement altogether, or

    - not excluding non-U.S. affiliate transactions at all, but raising the $75 billion threshold (at which CJA triggers a Category II placement for an FBO or an IHC) to, for example, $100 billion.

- *Nonbank assets*: The nonbank assets indicator measures a CUSO's or an IHC's investment in nonbank subsidiaries. The nonbank assets indicator is consistent with the nonbank assets indicator in the domestic proposals as well as the nonbank assets measurement in the current capital plan rule.[4] In the current capital plan rule, the nonbank assets measurement is used to create a distinction between a "large and noncomplex" BHC or IHC (non-GSIB, non-LISCC BHC or IHC with $50 billion or more, but less than $250 billion, in total consolidated assets, and less than $75 billion in nonbank assets) and a "large and complex" BHC or IHC. The FBO proposals would amend the capital plan rule to instead define "large and noncomplex" as a Category IV BHC or IHC.[5]

- *Off-balance sheet exposure*: The off-balance sheet exposure indicator measures a CUSO's or an IHC's off-balance sheet exposure by calculating the difference between total exposure and on-balance sheet assets, where "total exposure includes on-balance sheet assets plus certain off-balance sheet exposures, including derivative exposures, repo-style transactions, and other off-

[3] 12 C.F.R. §§ 3.2, 217.2, 324.2.

[4] 12 C.F.R. § 225.8(d)(2).

[5] 12 C.F.R. § 225.8(d)(9). Large and noncomplex BHCs (including IHCs, but not firms subject to the Large Institution Supervision Coordinating Committee ("**LISCC**") supervisory framework) were exempted from the "qualitative" review under CCAR effective with the 2017 CCAR cycle. *See* 82 Fed. Reg. 9308 (Feb. 13, 2017). While large and complex BHCs and LISCC firms were still subject to the qualitative review in 2017 and after, the Board recently amended the capital plan rule to exempt certain BHCs, and eventually IHCs, from the qualitative review. *See* footnote 16 below and its accompanying text. In addition, LISCC firms and large and complex firms are subject to the more stringent supervisory expectations for capital planning set forth in Board SR Letter 15-18 (Dec. 18, 2015). *See also* Board SR Letter 15-19 (Dec. 18, 2015) (less stringent expectations for large and noncomplex firms).

balance sheet exposures (such as commitments)."[6] The off-balance sheet exposure indicator is consistent with the off-balance sheet exposure indicator in the domestic proposals.

- *Weighted short-term wholesale funding*: The wSTWF indicator measures reliance on short-term (one year or less) and generally uninsured funding from wholesale counterparties, including brokered retail deposits and sweeps. The wSTWF indicator is consistent with the wSTWF indicator in the domestic proposals. The wSTWF indicator serves as both a threshold for general application of Category III standards, as well as a separate threshold for applying standardized liquidity requirements.

  - As further described in Section IV below on Liquidity:

    - $75 billion or more in wSTWF would (i) trigger Category III status for an FBO's CUSO, (ii) require its IHC, if any, to follow more stringent Category II liquidity coverage ratio ("**LCR**") and net stable funding ratio ("**NSFR**") standards and (iii) require an FBO with a Category III status CUSO to file the liquidity report on Form FR 2052a on a daily, rather than monthly, basis; and

    - less than $75 billion in all risk-based indicators and less than $250 billion in U.S. assets would result in an FBO's CUSO or IHC being placed within Category IV, under which the LCR and NSFR would not apply, <u>except</u> if the CUSO had $50 billion or more in wSTWF, in which case its IHC would apply a reduced monthly LCR and NSFR requirement (this modification was also made to the domestic proposals and, therefore, would also be applicable to U.S. BHCs).

  - In addition, although certain transactions by the U.S. operations with non-U.S. affiliates are proposed to be excluded from the CJA calculation, such transactions would not be excluded when calculating wSTWF.

- <u>Alternative Scoring Approach</u>*:* As in the domestic proposals, the FBO proposals request comment on an alternative to the risk-based indicator approach to categorization. The alternative scoring criteria – which would continue to apply capital standards in accordance with the IHC's categorization – would be based on (i) the size of the FBO's or IHC's combined U.S. assets and (ii) the FBO CUSO's or IHC's method 1 or method 2 score under the existing scoring methodology that identifies U.S. GSIBs and their appropriate risk-based capital surcharges.[7] The categorization of an FBO or IHC would occur on an annual basis under this risk-scoring method.

  - As mentioned, although IHCs are currently required to file the Form FR Y-15, under the FBO proposals, an FBO would be required to start filing the Form FR Y-15 for its IHC, CUSO and branch and agency network to reflect the attributes of the U.S. operations. This would be the case regardless of whether this alternative scoring approach is used, as the risk-based indicators are also derived from the FR Y-15.

- <u>Depository Institution Subsidiaries</u>: These subsidiaries generally would be subject to the requirements applicable to their parent FBO's or IHC's category, except for certain liquidity rules

[6] Board proposal at 39. *See also* the total leverage exposure calculation for the supplementary leverage ratio in 12 C.F.R. §§ 3.10(c)(4), 217.10(c)(4), 324.10(c)(4).

[7] *See* Form FR Y-15.

that would apply only to depository institution subsidiaries that have $10 billion or more in total assets.

SELECTED QUESTIONS FROM THE FBO PROPOSALS

- Whether to apply EPS similar to those applicable to U.S. GSIBS (which are subject to Category I) to FBOs and IHCs that have a comparable systemic risk profile to U.S. GSIBs.
- Whether the use of a size threshold drives changes in an FBO's business model and risk profile in ways that other risk-based indicators do not.
- Extensive questions on the CJA indicator, including:
  - the advantages and disadvantages of excluding transactions with non-U.S. affiliates and of recognizing the value of collateral for certain transactions with non-U.S. affiliates;
  - whether other positions should be excluded from the CJA measurement or whether other calculation methodologies appearing in the FFIEC 009 and FR Y-15 reports should be changed; and
  - whether there are alternative measures for an FBO's cross-border activity, and how those alternatives would align with the CJA indicator in the domestic proposals.
- Whether other risk-based indicators should be considered.
- Where the level of the risk-based indicators should be set (with supporting data).
- If the Board were to use wSTWF, nonbank assets and off-balance sheet exposure as triggers for Category II status (rather than only Category III status), what the higher thresholds of such indicators should be (with supporting data).

OBSERVATIONS:

- No FBO is in Category I, which remains applicable only to U.S. GSIBs. However, IHCs (in any category) whose parents are GSIBs must maintain a minimum amount of internal total loss-absorbing capacity ("**TLAC**") and eligible long-term debt ("**LTD**"). In the domestic proposals, only Category I U.S. BHCs must meet these requirements. The Board did not mention TLAC or LTD in the FBO proposals as risk-reducing for IHCs relative to similarly sized U.S. BHCs, nor did the Board include these requirements in the accompanying visual charts for FBOs showing the other EPS applicable to FBOs and IHCs under Regulation YY.
- The Board's revisions to the CJA indicator for inter-affiliate transactions reflect comments that foreign banks have made for several years regarding the problems created by using "foreign exposure" as a standard for calibrating EPS for IHCs. The Board's revisions address some, but not all, of these objections, and foreign bank commenters are likely to suggest additional changes.
- According to the Board, no FBO is currently projected to be in Category II. Based on Board projections, however, a majority of FBOs that meet one or more of the risk-based indicators for Category III would nonetheless be subject to the full (not reduced, as otherwise would apply to Category III) LCR and NSFR due to reliance on wSTWF.

- While the various categories are defined by both size and risk factors, risk factors were the determining consideration for the FBOs that are projected to be in Categories II or III.
  - The key factors for the FBOs appear to be nonbank assets (principally broker-dealer activities) and reliance on wSTWF. CJA appeared not to be a key factor in placement.
  - Although the Board did not release projected categories for IHCs, the same dynamics are likely to determine their categorization. This is because the size and risk data of IHCs is included in the CUSO data that determines the categorization of their parent FBOs.
  - Limitations on publicly available data make it difficult to project whether in fact one or more FBOs would be subject to a different categorization for their CUSO and IHC (although this is a distinct possibility).
  - For the domestic proposals, by contrast, risk factors were the determining consideration for only one institution.
- The standards that would apply to each FBO and IHC remain to be determined, since the distribution of CUSOs and IHCs among Categories II, III and IV and the stringency of standardized liquidity requirements within Categories III and IV will be based on data that is not yet available.
  - The proposed categorization framework would require new reporting across the CUSO because FBOs currently report the risk-based indicators only with respect to their IHCs, if any, and based solely on the IHC’s size and risk profile. Although the Board partially projected categories, the data necessary to determine the applicable standards for each FBO are not currently available (either to the Board or to the public). As a result, it will be challenging for commenters to evaluate the impact of the FBO proposals or determine whether the thresholds are appropriately calibrated.
  - The modifications proposed to the CJA definition in the FBO proposals for certain non-U.S. affiliate transactions likely affected the distribution of FBOs between Categories II and III, thus making this categorization highly dependent on information about non-U.S. affiliate relationships that is not currently publicly available and on whether those modifications will be adopted as proposed.
  - The Agencies also requested comment on whether to modify the wSTWF definition to account for inter-affiliate transactions. Unlike in the CJA calculation, the Agencies did not propose to remove certain transactions with non-U.S. affiliates from the wSTWF calculation. The increased significance of wSTWF under the FBO proposals as a driver behind the applicability and stringency of liquidity requirements (and the modifications to the domestic proposals regarding wSTWF), means that an exclusion of borrowing from non-U.S. affiliates is likely to be an area of significant comment.
- The applicable category of enhanced risk management, liquidity and SCCL standards for an IHC would be determined based on the size and risk profile of an FBO’s CUSO. For an FBO with an IHC in a lower category than its CUSO, the IHC would benefit in the tailored framework from its own size and risk attributes with respect to capital and stress testing, but would be “tainted” by assets and risk attributes outside the IHC in determining the other applicable EPS. In some cases, the IHC would be subject to more stringent regulations even if its affiliated branches and agencies were able to comply with U.S. requirements by certifying to compliance with similar home country standards. That the new two-tier framework may be a key driver of applicable EPS will be

controversial, especially in light of the clear emphasis over several years post-financial-crisis on structural reform (e.g., IHC formation, resolution planning and U.S. risk committee requirements) as a primary mechanism to address vulnerabilities.

III. Capital — Summary, Questions and Observations

Summary of FBO Proposals:

- Regulatory capital and capital stress testing standards would apply to the IHC and would be calibrated solely based on the IHC's categorization; the Board notes that the proposed structure, as it does currently, "recognizes that U.S. branches and agencies do not maintain regulatory capital separately from their foreign parents."[8]
  - Any U.S. BHC or depository institution subsidiary of a FBO that is not required to form an IHC "would continue to be subject to the generally applicable capital requirements under the agencies' regulatory capital rule."[9]
- The Board proposal addresses the application of the capital plan, CCAR, supervisory stress testing, company-run stress testing and FR Y-14 reporting requirements for IHCs; the interagency proposal addresses capital standards with respect to an IHC and its depository institution subsidiaries.[10]
- Category II IHCs (and their depository institution subsidiaries):
  - *General*: The Board would not apply the advanced approaches risk-based capital framework to IHCs (i.e., IHCs would no longer be required to opt out in order to avoid being subject to the framework).
    - However, Category II IHCs would be subject to several requirements that apply to advanced approaches organizations under current capital rules:
      - a minimum supplementary leverage ratio ("**SLR**") of 3 percent,
      - the requirement to recognize most elements of accumulated other comprehensive income ("**AOCI**") in regulatory capital, and
      - the countercyclical capital buffer (currently set at 0).
    - The interagency proposal also clarifies the applicability of certain pending rulemakings that reference advanced approaches organizations. For purposes of the pending capital simplifications proposal[11] and the pending proposal to adopt the standardized approach for

8 Board proposal at 14.

9 Board proposal at 14 n. 23.

10 In this discussion of capital requirements for IHCs, the reference to IHCs also means "any of their depository institution subsidiaries."

11 "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996," 82 Fed. Reg. 49984 (Oct. 27, 2017).

counterparty credit risk for derivatives exposures ("**SA-CCR**"),[12] the Agencies would treat Category II, but not Category III or IV, IHCs as "advanced approaches banking organizations." For example, under the SA-CCR proposal, advanced approaches banking organizations would be required to use SA-CCR for calculating their risk-based capital ratios and to use a modified version of SA-CCR for calculating total leverage exposure under the SLR.

- *Dodd-Frank Act Stress Testing ("**DFAST**"):* Category II IHCs would remain subject to annual supervisory stress testing, FR Y-14 reporting and company-run stress testing. However, company-run stress testing under the FBO proposals is required only annually rather than mid-cycle.

- *Comprehensive Capital Analysis and Review ("**CCAR**"):* Category II IHCs would continue to submit an annual capital plan that is subject to CCAR.

▪ Category III IHCs (and their depository institution subsidiaries):

- *General*: Category III IHCs would not be subject to (or be required to opt out of) the advanced approaches risked-based capital rules under either the domestic or the FBO proposals.

  - However, they would be subject to two requirements that apply to advanced approaches organizations under current capital rules:

    - a minimum SLR of 3 percent, and

    - the countercyclical capital buffer.

  - Category III IHCs would be permitted to opt out of including any elements of AOCI in regulatory capital.

  - The interagency proposal also clarifies the applicability of certain pending rulemakings that reference advanced approaches organizations. For purposes of the pending capital simplifications proposal and the pending SA-CCR proposal, the Agencies would treat Category III and IV IHCs as non-advanced approaches banking organizations. For example, under the SA-CCR proposal, Category III and IV IHCs could elect to use SA-CCR for calculating derivative exposures in connection with risk-based capital ratios and the SLR or to continue to use the current exposure method.

- *DFAST:* Category III IHCs would remain subject to annual supervisory stress testing, FR Y-14 reporting and company-run stress testing. As with Category II IHCs, for the company-run stress test, the mid-cycle company-run stress test would be eliminated. The frequency of public disclosure of company-run stress tests for Category III IHCs would also be reduced to every other year rather than annually.

- *CCAR*: Category III IHCs would continue to submit an annual capital plan that is subject to CCAR.

12 "Standardized Approach for Calculating the Exposure Amount of Derivative Contracts," 83 Fed. Reg. 64660 (Dec. 17, 2018).

- Category IV IHCs (and their depository institution subsidiaries):
  - *General:* Category IV IHCs would not be subject to the SLR or the countercyclical capital buffer, and would be permitted to opt out of including any elements of AOCI in regulatory capital.[13]
  - *DFAST*: Category IV IHCs would remain subject to supervisory stress testing and FR Y-14 reporting. However, supervisory stress testing would only occur every other year rather than every year. In addition, company-run stress testing would be eliminated, along with the requirement to publicly report the results of a company-run stress test.
  - *CCAR*: Category IV IHCs would continue to submit an annual capital plan, but would be subject to CCAR only every other year.[14]
    - In connection with a pending capital plan proposal describing a new "stress capital buffer,"[15] the Board indicated that it would make adjustments to the stress buffer requirements to align these requirements with the two-year supervisory stress testing cycle.
      - For example, planned dividends could be updated annually in determining the stress capital buffer but projected losses may be updated only every other year.
      - The Board may also require a firm to resubmit its capital plan if there have been, or are likely to be, material changes to the last capital plan submitted. In addition, a firm may request that the Board recalculate its stress capital buffer.
    - Moreover, in connection with future capital planning guidance, the Board anticipates creating more capital plan flexibility for Category IV firms.
- Smaller U.S. Presence FBOs:
  - *Risk-based and leverage capital requirements*: If the FBO has total global consolidated assets of $250 billion or more, but less than $100 billion in combined U.S. assets it must certify compliance with home country capital adequacy standards.
  - *Stress Testing:* FBOs with less than $50 billion in total global consolidated assets would no longer be required to be subject to a home-country capital stress testing regime. FBOs that have total global consolidated assets of $250 billion or more and do not fall into Category II, III or IV would continue to be required to undertake a home-country supervisory stress test annually. FBOs that have total global consolidated assets of $100 billion or more but less than

13 See the description of capital standards for Category III above with regard to the applicability of certain pending rulemakings that reference advanced approaches organizations.

14 The Board already has exempted certain IHCs from supervisory stress testing, company-run stress testing and capital plan submission for the year 2019 in connection with the Economic Growth, Regulatory Relief, and Consumer Protection Act ("**Regulatory Relief Act**"). These IHCs include BBVA Compass Bancshares, Inc.; BMO Financial Corp.; BNP Paribas USA, Inc.; MUFG Americas Holdings Corporation; RBC US Group Holdings, LLC; and Santander Holdings USA, Inc. *See* "2019 Extended Stress Test Cycle Firms," available at https://www.federalreserve.gov/supervisionreg/ccar.htm, for letters issued to IHCs.

15 "Amendments to the Regulatory Capital, Capital Plan and Stress Test Rules," 83 Fed. Reg. 18160 (Apr. 25, 2018).

$250 billion and do not fall into Category II, III or IV would be required to undertake a home-country supervisory stress test biennially.

SELECTED QUESTIONS FROM THE FBO PROPOSALS:

- Considerations for the Board in providing Category IV IHCs with more flexibility under the capital planning rule.

- Whether complexity generated by the application of the SLR and the countercyclical capital buffer to Category III organizations (even though advanced approaches would not apply to such organizations) could increase compliance costs for large banking organizations and make it more complex for market participants to compare capital adequacy of IHCs.

OBSERVATIONS:

- The Agencies would create more vectors for the application of the SLR and the countercyclical buffer to IHCs. Under existing capital rules and under the FBO proposals, $250 billion of assets would result in an IHC being subject to the SLR and countercyclical buffer. However, while the current capital rules also require application of those requirements at $10 billion of foreign exposure, regardless of size, the FBO proposals would trigger application at $75 billion of any one of CJA, nonbank assets, wSTWF or off-balance sheet exposure.

- IHCs would receive the same relief from stress testing requirements as domestic BHCs in the same categories, with one exception. The CCAR "qualitative" assessment would remain applicable to LISCC or "large and complex" IHCs based on a Board change to the capital plan rule effective in March 2019.[16] These CCAR firms are required to participate in four CCAR cycles and successfully pass the qualitative evaluation in the fourth year to no longer be subject to this requirement. The fourth year for IHCs will generally be the 2020 CCAR cycle. Unless a firm has received a qualitative objection in the immediately preceding year, no firm would receive qualitative objections in or after the 2021 CCAR cycle.

IV. LIQUIDITY — SUMMARY, QUESTIONS AND OBSERVATIONS

SUMMARY OF FBO PROPOSALS:

- In contrast to the capital and stress testing standards, the size and risk attributes of an FBO's CUSO dictate the applicability of the standardized liquidity requirements. In addition, most of the standardized liquidity requirements (LCR and NSFR) would apply only to the IHC, but would be based on the CUSO category regardless of the separate category that the IHC may be in.

- As discussed in Section VIII below, the Agencies have separately requested comment on whether and how standardized liquidity requirements should be applied to FBOs' U.S. branch and agency networks, which could be the subject of a future notice of proposed rulemaking.

- Unlike the current liquidity rules, the application of LCR and NSFR requirements to an IHC would not depend on whether the IHC is a depository institution holding company. Rather, LCR and NSFR requirements would be applied to all IHCs.

16 *See* 84 Fed. Reg. 8953 (Mar. 13, 2019).

- Category II FBOs:
  - *LCR/NSFR:* An IHC of a Category II FBO would be required to comply with full standardized liquidity requirements, specifically the full daily LCR and NSFR requirements. In addition, full LCR and NSFR requirements would apply to any depository institution subsidiary that has $10 billion or more in total assets.
  - *Regulation YY Liquidity Requirements:* Category II FBOs would remain subject to existing liquidity risk management, monthly internal liquidity stress testing and liquidity buffer requirements under the EPS rules.
  - *Liquidity Reporting:* Category II FBOs would be required to provide daily liquidity data reporting under Form FR 2052a. Some Category II FBOs currently report FR 2052a data on a monthly basis; for those firms, frequency of required FR 2052a reporting would increase.
- Category III FBOs:
  - *LCR/NSFR*: An IHC of a Category III FBO would be required to comply with full or reduced standardized liquidity requirements, depending upon the wSTWF risk-based indicator.
    - An IHC of a Category III FBO with less than $75 billion in wSTWF in the CUSO would be required to comply with reduced daily LCR and NSFR requirements. (Separately, the Agencies have requested comment on the percentage of the full requirements that the reduced requirements should represent, and have proposed that the number be between 70-85%.)
    - An IHC of a Category III FBO with $75 billion or more in wSTWF in the CUSO would be required to comply with full daily LCR and NSFR requirements.
    - In addition, full or reduced LCR and NSFR requirements would apply to any depository institution subsidiary with total assets of $10 billion or more based on the same wSTWF thresholds described above.
  - *Regulation YY Liquidity Requirements:* Category III FBOs would remain subject to existing liquidity risk management, monthly internal liquidity stress testing and liquidity buffer requirements under the EPS rules.
  - *Liquidity Reporting*: Similar to the application of the LCR and NSFR, liquidity data reporting for Category III FBOs would key off the level of wSTWF in the CUSO.
    - Category III FBOs with less than $75 billion in wSTWF in the CUSO would be required to provide monthly liquidity data reporting under Form FR2052a.
    - Category III FBOs with $75 billion or more in wSTWF in the CUSO would be required to provide daily liquidity data reporting under Form FR2052a, like Category II FBOs.
- Category IV FBOs:
  - *LCR/NSFR*: The IHC of a Category IV FBO would not be subject to standardized liquidity requirements unless the CUSO of the Category IV FBO relies heavily on wSTWF.

        - An IHC of a Category IV FBO with less than $50 billion in wSTWF in its CUSO would not be subject to LCR and NSFR requirements.
        - An IHC of a Category IV FBO with $50 billion or more but less than $75 billion in wSTWF in its CUSO would be subject to <u>reduced monthly</u> LCR and NSFR requirements. The LCR would be required to be calculated on the last business day of each applicable month, rather than each business day.
            - Unlike for Category II and III FBOs, no depository institution subsidiaries of Category IV FBOs would be subject to LCR or NSFR requirements, even if their IHCs are elevated to the reduced monthly LCR and NSFR requirements.
        - The FBO proposals also proposed conforming changes to the treatment of Category IV U.S. BHCs, requiring that Category IV U.S. BHCs with $50 billion or more in wSTWF comply with reduced monthly LCR and NSFR requirements. However, according to the Board, currently no Category IV U.S. BHC would meet this wSTWF threshold.
    - *Regulation YY Liquidity Requirements*: Category IV FBOs would be subject to reduced liquidity risk management, stress testing and buffer requirements under the EPS rules.
        - Category IV FBOs would continue to be required to maintain a liquidity buffer at their IHCs that is sufficient to meet the projected net stressed cash-flow need over the 30-day planning horizon under the internal liquidity stress test and a liquidity buffer at their U.S. branches and agencies that is sufficient to meet projected needs over the first 14 days of a stress test with a 30-day planning horizon.
        - The FBO proposals would reduce the frequency of required internal liquidity stress testing to quarterly, rather than monthly.
        - The FBO proposals would also modify the liquidity risk management requirements for Category IV FBOs.
            - First, Category IV FBOs would be permitted to calculate collateral positions on a monthly basis, rather than weekly.
            - Second, the establishment of liquidity risk limits should be consistent with the established liquidity tolerance risk for the CUSO of the Category IV FBO and the risk profile of such FBO and would not need to consider activities or risks that are not relevant to the CUSO.
            - Third, while the FBO proposals would continue to require that Category IV FBOs establish and maintain procedures for monitoring intraday risk, they would not specify the elements of those procedures.
- <u>Smaller U.S. Presence FBOs</u>:
    - FBOs with $250 billion or more in total global consolidated assets and less than $100 billion in combined U.S. assets would be required to report the results of an internal liquidity stress test for either the consolidated FBO or the CUSO on an annual basis.

- LCR Mechanics for FBOs:
  - The FBO proposals would place the requirement to calculate and maintain HQLA at the IHC on the FBO, rather than on the IHC itself.
  - Similarly, with regard to operational control and monetization requirements, the FBO proposals suggest that the FBO's liquidity management function should be the business unit to comply with these requirements. However, the business unit must ensure that HQLA are available for use by the IHC and not controlled, transferable or able to be monetized by an overseas entity or business function for purposes other than for the IHC. In addition, the HQLA would be required to be held at the IHC and in accounts in the United States.
  - The FBO proposals would not import into the LCR the limitation from the Regulation YY liquidity buffer rule that prohibits the offset of inflow amounts from affiliates of the IHC against external outflows. The Agencies noted that, while the current LCR inflow limitation does not fully capture the risk that non-US affiliates may be unwilling or unable to return funds to U.S. entities in stress and while the restriction on inflow amounts from affiliates in the current Regulation YY rules is "an important part" of the liquidity rules for FBOs, not importing such limitation into the LCR would align with Basel III standards and allow for more direct comparability between FBO and domestic LCR calculations. The Agencies asked for feedback on this question.
- Public Disclosure:
  - The interagency proposal would require public disclosure of LCR and NSFR, along with certain components of each ratio's calculation, on a quarterly basis and in a prominent manner.

SELECTED QUESTIONS FROM THE FBO PROPOSALS:

- The advantages and disadvantages of applying the LCR requirements to an FBO with respect to its IHC, rather than requiring, for example, an IHC to be responsible for calculating its own LCR.
- Whether the Board should consider modifications with respect to the definition of HQLA specifically for FBOs and IHCs.
- In what ways, if any, would the requirement to hold HQLA in the United States at the IHC affect an FBO's U.S. operations.
- Whether, for purposes of the LCR, the Agencies should prevent or otherwise limit an FBO from assuming reliance on inter-affiliate inflows to offset third-party net cash outflows.
- The advantages and disadvantages of including in or excluding from the wSTWF indicator positions of the U.S. branches and agencies of an FBO with the parent FBO or other non-U.S. affiliates, with particular consideration given to gross "due from" and gross "due to" positions with the parent FBO or other non-U.S. affiliates.
- How the proposed public disclosure requirements with respect to an IHC should be adjusted to assess the functioning of the standardized liquidity requirements and support market discipline.

OBSERVATIONS:

- The standardized liquidity proposals would generally impose the LCR and NSFR on a larger set of FBOs and may increase the stringency of those requirements as applied to an IHC based on the activities in branches and agencies outside the IHC.
  - The FBO proposals would apply the LCR and NSFR to all IHCs of FBOs that meet the appropriate thresholds. Currently, the LCR and the proposed NSFR would only apply to an IHC that is also a depository institution holding company. This expansion would bring into scope IHCs that have never before had to comply with the LCR.
  - In addition, currently only depository institution holding companies or depository institutions that meet the relevant criteria on a standalone basis are subject to the LCR and the proposed NSFR. Under the FBO proposals, the applicability of the LCR and NSFR to an IHC or a subsidiary depository institution would be determined based on characteristics of the CUSO. Therefore, high levels of CJA or wSTWF at an FBO's branches or agencies may determine whether full LCR and NSFR are applied to such FBOs' IHC and depository institution subsidiaries.
- In addition, as noted above, the Agencies did not propose to exclude short-term funding from non-U.S. affiliates from the wSTWF measure, as they did with regard to CJA. This difference appears to have made wSTWF a more influential risk-based indicator in terms of categorizing FBOs than CJA would be.
- The shift in the importance of wSTWF in the FBO proposals from the domestic proposals is evident in the significant increase in stringency of LCR requirements based on a relatively narrow band of changes in wSTWF. A CUSO that has $49 billion in wSTWF and that does not otherwise meet the criteria for placement in Category III would be in Category IV and would not have its IHC subjected to the LCR at all. A CUSO that has $76 billion in wSTWF would not only trigger the requirements for Category III status generally, but because wSTWF is the risk-based indicator that increases the CUSO category, its IHC would be subject to the full daily LCR as a Category II firm.
- Similar to the domestic proposals, the FBO proposals do not apply all of the flexibility that applies to the current "modified" LCR when applying the "reduced" LCR for Category III and IV FBOs. While reduced LCR Category IV FBOs' IHCs would perform the LCR calculation on a monthly basis, like the current modified LCR firms, the Category III reduced LCR FBOs would have to apply the reduced LCR on a daily basis. In addition, the following "modified" benefits would not be carried over into the "reduced" LCR:
  - Exclusion of the maturity mismatch add-on to the total net cash outflow calculation;
  - 70% factor (which may be increased to as much as 85% under the domestic and FBO proposals); and
  - Exemption for depository institution subsidiaries (other than for Category IV FBOs whose IHC is elevated to the reduced monthly LCR).

  Indeed, in the discussion of transition periods, a formerly "modified" LCR firm would be given a transition period that would permit continued application of the modified requirements for one year before it would need to transition to either the reduced or full LCR.

V. Other Proposed Changes to EPS Rules – Summary, Questions and Observations

A. Single Counterparty Credit Limits

Summary of FBO Proposals:

- Category II and III FBOs:
  - Category II and III FBOs would be required to comply with the SCCL at the level of the CUSO, but may continue to comply by certifying to the Board that they meet large exposure standards on a consolidated basis established by their home-country supervisors that are consistent with the Basel large exposures framework.
  - Category II and III FBOs would also be required to comply with the SCCL at the level of the IHC, with the following changes to the SCCL rule finalized in summer 2018:[17]
    - the heightened requirements applicable to "major IHCs" (an IHC with $500 billion or more in total assets) would be eliminated (there are currently no major IHCs);
    - all IHCs would be subject to a uniform aggregate net credit exposure limit to a single counterparty equal to 25 percent of tier 1 capital (in the current SCCL, IHCs with between $50 billion and $250 billion in total assets would apply the limits against a base of total capital and surplus); and
    - IHCs with between $50 billion and $250 billion in total assets would no longer be exempt from applying the more complex economic interdependence and control relationship tests and special purpose vehicle ("**SPV**") look-through requirements.
- Category IV FBOs:
  - In another change from the 2018 final SCCL rule, a Category IV FBO would not be required to comply with the SCCL at either the level of the CUSO or the IHC, unless it has $250 billion or more in total global consolidated assets (regardless of the size of the CUSO or IHC), in which case it must comply with the SCCL at the level of the CUSO, but may continue to comply by certifying to the Board that it meets large exposure standards on a consolidated basis established by its home-country supervisor that are consistent with the Basel large exposures framework.
- Smaller U.S. Presence FBOs:
  - If an FBO is not categorized under the FBO proposals, but has $250 billion or more in total global consolidated assets, it must comply with the SCCL at the level of the CUSO, but may continue to comply by certifying to the Board that it meets large exposure standards on a consolidated basis established by its home-country supervisor that are consistent with the Basel large exposures framework.

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17 *See* Cleary Gottlieb, "Single-Counterparty Credit Limits: Industry Comment and Relief Act Lead to Tailored Final Rule" (June 28, 2018), available at https://www.clearygottlieb.com/-/media/files/alert-memos-2018/single-counterparty-credit-limits-industry-comment-and-relief-act-lead-to-tailored-final-rule.pdf.

SELECTED QUESTIONS FROM THE FBO PROPOSALS:

- The advantages and disadvantages of changing the 2018 final SCCL rule to apply the treatment of exposures to SPVs, the economic interdependence and control relationship tests, and the modified capital base to IHCs with less than $250 billion in assets of Category II FBOs or Category III FBOs.

OBSERVATIONS:

- The final SCCL rule published in 2018 already treated IHCs differently from similarly situated U.S. BHCs by applying a modified form of SCCL to IHCs with $50-$250 billion in total consolidated assets, when U.S. BHCs below $250 billion in total consolidated assets were not required to apply the SCCL. The changes put forth in the FBO proposals would exacerbate this difference, by not only increasing the requirements for Category II and III FBOs, but also by basing an IHC's SCCL categorization on attributes of the CUSO rather than those of the IHC.
  - Furthermore, the Board justifies this application by stating that SCCL "that are based on and apply only to one aspect of [an FBO's] operations in the United States can create an incentive to concentrate risk elsewhere in the organization's operations."[18]
    - Although the Board has expressed concern that the IHC framework put in place in 2016 may have caused IHCs and their subsidiaries to shift assets to U.S. branches and agencies of FBOs, increasing the stringency of the SCCL to IHCs and basing that stringency on attributes of the CUSO outside the IHC would appear to imply that the Board is also concerned about shifting risk from branches and agencies to the IHC or its subsidiaries.
    - However, an FBO's branch/agency network would not appear to have an incentive to transfer additional risk into an IHC, as the existing capital and liquidity rules of the post-Dodd-Frank framework, the IHC structural requirements, the smaller IHC limit, Sections 23A and 23B of the Federal Reserve Act and other factors would in fact create disincentives to moving risk into the IHC, even before the FBO proposals' increase in SCCL stringency on the IHC. Therefore, the justification for greater stringency of SCCL requirements at the IHC does not appear to be supported.
- The FBO proposals significantly amend the scope of application to FBOs of the SCCL rules just finalized last year. Although several IHCs of Category IV FBOs may receive relief, FBOs that remain subject to the SCCL would generally face more stringent standards.
  - The IHCs of Category IV FBOs (approximately 4 of the 12 IHCs, based on the Board's estimates) would be exempt from the SCCL, leading to a reduction in compliance costs for such IHCs. Category IV FBOs with $250 billion or more in total global consolidated assets would still need to certify compliance with home-country SCCL standards at the level of the CUSO.
  - However, the FBO proposals would increase the compliance burden on IHCs with less than $250 billion in total assets of Category II FBOs and Category III FBOs, subjecting such IHCs to requirements that were previously only applicable to larger IHCs. In particular, these IHCs would have modified denominators based on tier 1 capital and would also have to apply the

18 Board proposal at 13.

more complex and burdensome economic independence test and the SPV look-through requirements.

- ◦ In addition, 6 of the 8 IHCs in Category II or III (based on the Board's estimates) land in those categories not because of the size of the IHC (each IHC has under $250 billion of total assets, which is the key factor in relation to the flexibility provided under the current SCCL rules), but because of a risk-based indicator at the CUSO level.

- ▪ The current SCCL rule is due to be effective in January 2020 for U.S. and foreign GSIBs, or July 2020 for all other firms. The SCCL rule provides flexibility to the CUSO of several banks, by providing for compliance through certification to the Board that the FBO meets large exposure standards on a consolidated basis established by its home-country supervisor that are consistent with the Basel large exposures framework. Some FBOs have asked for additional flexibility if their home country is delayed beyond the U.S. SCCL effective dates in putting in place the Basel III large exposure framework. The Board has not yet granted relief, and the FBO proposals make no mention of this timing issue.

B. Risk Management

Summary of FBO Proposals:

- ▪ The FBO proposals raise the total global consolidated asset threshold for application of the risk-committee requirements to FBOs, but does not change the substance of the risk-committee requirements for these FBOs.
  - ◦ FBOs with less than $50 billion in total global consolidated assets would not be subject to risk-committee requirements. However, the Board would expect to review risk management practices through the supervisory process and require that such FBOs put in place risk management processes and procedures appropriate for their risks.
  - ◦ FBOs with:
    - • $50 billion or more, but less than $100 billion, in total global consolidated assets, and
    - • $100 billion or more in total global consolidated assets, but less than $50 billion in combined U.S. assets,

    would be required to maintain a U.S.-focused risk committee at their home country board of directors level and make a certification to that effect.
  - ◦ FBOs with total global consolidated assets of $100 billion or more and $50 billion or more in combined U.S. assets would be required to comply with the more detailed risk committee and risk management requirements in Regulation YY, including the Chief Risk Officer requirement.
  - ◦ Consistent with the Regulatory Relief Act, criteria related to the publicly traded nature of the FBO would be removed as an indicator of stringency of application of the risk management provisions.

C. Intermediate Holding Company

Summary of FBO Proposals:

- The FBO proposals would not revise the $50 billion U.S. non-branch asset threshold for the IHC formation requirement.
- The FBO proposals would remove the IHC implementation plan requirements, which were intended to facilitate 2016 initial compliance with the IHC requirement. Going forward, IHC formation will be assessed through the supervisory process.
- The FBO proposals would also clarify the process for requesting an alternative structure for an IHC, allowing a request in the context of a reorganization, anticipated acquisition or prior to formation of an IHC, and shorten the time period for the Board's expected action with respect to such requests from 180 days to 90 days.

Observations:

- The Board did not request comment on this point, but it is expected that some FBOs, particularly those without IHCs or those with smaller U.S. operations, may comment on the IHC threshold.

D. HQLA

Summary of FBO Proposals:

- The FBO proposals solicit comment on whether assets that qualify as highly liquid assets under the Regulation YY liquidity buffer requirement should be more closely aligned with the definition of HQLA under the current LCR rule.
- Regulation YY defines highly liquid assets to include cash, certain securities issued or guaranteed by the U.S. government or a U.S. government-sponsored enterprise, and "other assets" that a firm can demonstrate to the Board meet specific liquidity criteria.
  - Guidance in relation to the Regulation YY definition indicated that the Board would expect HQLA to satisfy the liquidity buffer requirements. The FBO proposals state that the Board is considering whether to make that more explicit, so that HQLA instruments would not need to be analyzed under the "other assets" portion of the Regulation YY definition.
  - The Regulation YY definition is intended to be more flexible, allowing FBOs to determine whether there may be instruments other than those more specifically described in the HQLA definition and the highly liquid asset definition that could be used to satisfy the liquidity buffer requirement.

Selected Questions from the FBO Proposals:

- Whether the enumerated list of highly liquid assets should be expanded to include any or all of certain categories of HQLA or certain assets that are HQLA.

- Whether “cash” should be clarified to mean Reserve Bank balances and foreign withdrawable reserves, to more closely align with the definition of HQLA.
- Whether there are advantages or disadvantages of requiring FBOs to separately demonstrate that the HQLA meet other requirements in Regulation YY for highly liquid assets.
- Whether the Board should add other requirements for highly liquid assets, such as requiring an FBO to take into account potential conflicts to a business or risk management strategy stemming from monetization of these assets.

OBSERVATIONS:

- To the extent that the alignment between the definitions of highly liquid assets and HQLA would provide a safe harbor under the EPS rule for assets that are eligible HQLA under LCR, this change would appear to be a welcome simplification.
  - However, some of the statements made by the Board in relation to the highly liquid asset definition may be surprising given that it has generally been assumed that HQLA would meet the highly liquid asset definition without an extensive review of the liquidity characteristics pursuant to the “other assets” prong of that definition.[19]
  - Furthermore, to the extent that the Board implies that before-the-fact notification to or approval of the Board under the “other assets” prong is required, that also is likely to be surprising to banking institutions given that the flexibility afforded by the Regulation YY definition has been interpreted over the last 5 years to be something that could be reviewed after-the-fact in a supervisory or examination context.
- In addition, any such alignment should not foreclose the possibility that firms may demonstrate to the Board that assets that do not qualify as eligible HQLA under LCR are still highly liquid for purposes of the EPS rule.

VI. TRANSITION PERIODS – SUMMARY, QUESTIONS AND OBSERVATIONS

SUMMARY OF FBO PROPOSALS:

- Initial Effective Date*:*
  - An FBO would initially be required to determine the category of standards to which its CUSO or IHC may be subject based on a trailing four-quarter average of the levels for each indicator, including size.

19 *See* 79 Fed. Reg. 17240, 17300 (Mar. 14, 2014) (“the final rule does not specifically enumerate assets other than securities issued or guaranteed by the United States, a U.S. government agency, or a U.S. government-sponsored enterprise, or eliminate any assets from consideration for inclusion as highly liquid assets, although, consistent with the domestic final rule, the Board anticipates that high-quality liquid assets under the proposed U.S. LCR will qualify as highly liquid assets for purposes of the buffer”).

- Except as may be permitted for the LCR and NSFR (as described immediately below), compliance with the requirements of a CUSO's or IHC's category would be mandated within one year of the adoption of the final rule.
- *LCR / NSFR*:
  - On the initial effective date:
    - If an IHC is already subject, as a BHC, to the full LCR, then compliance is required by the IHC and any depository institution subsidiary with $10 billion or more in total assets on the final rule's effective date, whether the LCR is full or reduced.
    - If an IHC is already subject, as a BHC, to the modified LCR:
      - — For one year following the rule's initial effective date, an IHC would be permitted to calculate LCR on a monthly basis, to not include the maturity mismatch add-on and to use a 70% LCR factor; any depository institution subsidiary with $10 billion or more in total assets would not be required to comply with the LCR during that year; and
      - — After that one year period, the IHC and any depository institution subsidiary with $10 billion or more in total assets would be required to begin complying with the full or reduced LCR as of the first day of the calendar quarter following the one year anniversary of the initial effective date of the final rule.
    - If an IHC is not subject to the LCR prior to the initial effective date of the final rule, but would become subject based on its category, then that IHC and any depository institution with $10 billion or more in total assets would be required to comply with the full or reduced LCR on the first day of the calendar quarter following one year after the initial effective date of the final rule.

▪ Shifting Between Categories; Cessation of Applicability

- An FBO would move down to a less stringent category only if it no longer meets the indicators for its current category in each of the four most recent calendar quarters.
- An FBO would move up to a more stringent category only if it meets one or more of the indicators averaged over the preceding four calendar quarters.
- If an FBO moves to a different category, standards for the new category would become applicable on the first day of the second quarter following the date on which the FBO met the criteria for the new category.
- *LCR/NSFR*:
  - After the initial effective date:
    - With regard to the LCR rule, if an FBO becomes subject to the daily calculation requirement sometime after the initial effective date, a special transition to the daily requirement is provided—an IHC would calculate monthly for three quarters and begin calculating daily on the first day of the fourth quarter after becoming subject to the requirement.

  - Once the LCR or proposed NSFR applies to an IHC or covered depository institution subsidiary, the IHC or depository institution would be subject to the requirements until the relevant agency determines that it would not be appropriate to apply the requirements. This is consistent with the current LCR and proposed NSFR requirements.

- Effective and compliance dates for the NSFR will be addressed when the NSFR rule is finalized

SELECTED QUESTIONS FROM THE FBO PROPOSALS:

- Whether the Board should determine the category of standards applicable to an FBO on an annual basis, instead of on a quarterly basis.

- Whether the Board should provide FBOs with additional time to conform to new requirements that are triggered by moving into a more stringent category.

OBSERVATIONS:

- We expect that it will be comparatively easier to move into a more stringent category than to move to a less stringent category because moving up is determined based on a four-quarter average (an outlier quarter would not "reset the clock"), whereas moving down is determined based on meeting the lower thresholds for each of the preceding four quarters (a single quarter above a threshold would "reset the clock").

- We expect that commenters may request additional transition time for the new framework beyond the LCR and NSFR timelines described above, as the framework is not solely "deregulatory." In particular, FBOs that were not previously subject, could become subject to:

  - additional metrics calculations and reporting requirements across the CUSO;

  - more stringent liquidity requirements and, for some, new initial application of the LCR and NSFR;

  - more stringent SCCL requirements; and

  - the SLR.

VII. REPORTING FORMS – SUMMARY, QUESTIONS AND OBSERVATIONS

SUMMARY OF FBO PROPOSALS:

- The FBO proposals would amend several reporting forms to accommodate the proposed revisions to the framework for FBOs.

  - *FR Y-7 (Annual Report of FBOs)*: Item 5 (regarding compliance with Regulation YY) would be amended to bring it in line with the revised applicability thresholds and other regulatory changes consistent with the Board's July 2018 statement on the Regulatory Relief Act. Among other changes, Items 5(b) and 5(c)'s descriptions would be updated to conform to asset size thresholds under the FBO proposals with respect to risk committees, and to eliminate references to FBOs that are publicly traded, as that distinction would be eliminated under the FBO proposals.

- *FR Y-7Q (Capital and Asset Report for FBOs)*: Changes to FR Y-7Q would reflect the new size thresholds applicable to FBOs.
- *FR Y-9C (Consolidated Financial Statements for Holding Companies)*: FR Y-9C would be amended to further clarify requirements for IHCs subject to Category III capital standards, namely, the need to comply with the SLR and countercyclical capital buffer requirements.
- *FR Y-14 Suite of Documents, including FR-Y 14A, FR-Y 14M, and FR-Y 14Q (Capital Assessments and Stress Testing)*: These forms would be amended to increase the threshold for IHCs that would be required to submit these forms to $100 billion or more in IHC consolidated assets, and to make changes to the definitions of "large and complex" (above Category IV) and "large and noncomplex" (Category IV and below) to conform them to changes in section 225.8(d)(9).[20]
- *FR Y-15 (Banking Organization Systemic Risk Report)*: To allow the Board to determine the applicable categories under the FBO proposals, an FBO would be required to report for its IHC, branch and agency network and CUSO. Currently, only the FBO's IHC, if any, is an FR Y-15 reporter.
- *FR 2052a (Complex Institution Liquidity Monitoring Report)*: As described previously, the frequency of filing the FR 2052a would depend on an FBO's category and level of wSTWF. The FBO proposals would remove FBOs with less than $100 billion in combined U.S. assets from the scope of FR 2052a reporting requirements entirely.

SELECTED QUESTIONS FROM THE FBO PROPOSALS:

- Challenges to requiring FR Y-15 systemic risk data for the CUSO of a FBO, including in relation to system modifications and the amount of time that would be required to implement those modifications.
- What other approaches the Board should consider for collecting FR Y-15 data.

OBSERVATIONS:

- The requirement for an FBO to report data on the FR Y-15 for its CUSO is a new, and potentially onerous, reporting requirement intended to allow the Board to categorize FBOs for purposes of liquidity, SCCL and other requirements. The FBO proposals would result in increased reporting burdens for FBOs both relative to domestic peers and relative to current requirements. We expect that this new requirement may present data integrity and measurement issues for FBOs, as the CUSO asset base is not typically subject to separate consolidation for financial reporting purposes.

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20 We anticipate that similar changes will be made to the SR letters that set forth the supervisory expectations for capital planning. *See* Board SR Letter 15-18 (Dec. 18, 2015) (more stringent expectations for LISCC and large and complex firms); Board SR Letter 15-19 (Dec. 18, 2015) (less stringent expectations for large and noncomplex firms).

VIII. LIQUIDITY REQUIREMENTS FOR U.S. BRANCHES AND AGENCIES – SUMMARY, QUESTIONS AND OBSERVATIONS

SUMMARY OF REQUEST FOR COMMENT:

- The FBO proposals apply standardized liquidity requirements to FBOs' IHCs, but not to FBOs' U.S. branch and agency networks.
- In the FBO proposals, the Agencies request comment on whether and how standardized liquidity requirements should be applied to FBOs' U.S. branch and agency networks, which could be the subject of a future notice of proposed rulemaking.
- In its rationale for this request for comment, the Agencies noted the potential of liquidity vulnerabilities at FBOs' U.S. branch and agency networks to "generate significant risks in the United States."[21] The Agencies cite the risk profile and scale of FBOs' U.S. branches and agencies, as well as the ability of funding vulnerabilities at an FBO's U.S. branch and agency network and an FBO's U.S. subsidiary to affect one another.
- The Agencies requested comment on two approaches for applying standardized liquidity requirements to FBOs' U.S. branch and agency networks. The Agencies would also like to receive comment on other potential approaches.
  - Under the first approach (the "**LCR-based approach**"), an FBO would "calculate and maintain an LCR with respect to its U.S. branches and agencies on an aggregate basis."[22] The stringency of the liquidity requirements under the LCR-based approach would depend on the attributes of the FBO's CUSO. In the FBO proposals, the standardized liquidity requirements that would be applicable to IHCs are also dependent on such attributes.
  - Under the second approach (the "**simplified liquidity requirement approach**"), FBOs would maintain "an amount of liquid assets exceeding a prescribed percentage (for example 20 percent) of the total aggregate U.S. branch and agency network assets."[23] The Agencies describe this as potentially creating a floor to the current liquidity buffer requirements in Regulation YY.
    - The Agencies did not propose what assets would qualify under the simplified liquidity requirement approach and how the requirement would be calibrated, and they request comment on these aspects. The Agencies suggest that potential approaches are to use criteria that are also used for other liquidity requirements, or to use some form of assets that meet HQLA criteria under the LCR rule.
  - The Agencies describe the LCR-based approach as "more sensitive to liquidity risk" and the simplified liquidity requirement approach requirement as "simpler."[24]

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21 Interagency proposal at 98.

22 Interagency proposal at 102.

23 Interagency proposal at 108.

24 Interagency proposal at 101.

- The Agencies also request comment on how any future requirement should take into account the status of U.S. branches and agencies as part of a larger organization.

SELECTED QUESTIONS FROM THE FBO PROPOSALS

- LCR-Based Approach
  - Which definitions and calculations in the LCR rule should be adjusted and in what ways, in relation to application to branches and agencies of FBOs.
  - How and in what ways the definition of HQLA should differ when applied to an FBO's U.S. branch and agency network as opposed to under the LCR rule.
  - How to take into account the transferability of assets between U.S. branches and agencies in order to determine the eligible HQLA.
  - A number of other technical questions about topics such as inflow and outflow amounts under the LCR rule and the calculation of the HQLA amount.
- Simplified Liquidity Requirement Approach
  - The advantages and disadvantages of – and the incentives created by – the possibility that this requirement "would tend to result in lower requirements for [FBOs] with greater measures of liquidity risk and higher requirements for [FBOs] with lower measures of liquidity risk."[25]
  - How a requirement based on asset size should take into account off-balance sheet exposures.
- A general call for other approaches for standardized liquidity requirements for an FBO's U.S. branches and agencies, including "a rationale for any alternative approach[,] a detailed description of how the approach could mechanically operate in conjunction with existing statutory and regulatory requirements" and the advantages and disadvantages of any alternative approach.[26] Supporting data from commenters is encouraged.

OBSERVATIONS:

- Application of a standardized liquidity requirement to U.S. branches and agencies of FBOs would represent a significant policy shift from the traditional approach in Regulation YY to permit branches and agencies to rely on a combination of home-country standards and principles-based liquidity buffer requirements. The current approach is in recognition of the fact that branches and agencies are already subject to standardized liquidity rules as part of a larger banking organization and are not separate legal entities.
- Vice Chair Quarles noted in prepared remarks[27] accompanying the FBO proposals that this approach would be "novel in the realm of international regulation" and invited "robust public

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[25] Interagency proposal at 109.

[26] Interagency proposal at 111.

[27] "Opening Statement on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks by Vice Chair for Supervision Randal K. Quarles" (Apr. 8, 2019), available at https://www.federalreserve.gov/newsevents/pressreleases/99A5C407E998418CB2CB9DDB85C54B0B.htm.

discourse" both in the United States and abroad on the advantages and disadvantages of imposing such a requirement. To the extent any standardized liquidity requirement would require additional prepositioning of HQLA in the United States, foreign regulators may express reservations regarding the interplay of this rule with their own liquidity and resolution regimes.

- Governor Brainard noted in prepared remarks[28] that the Board had stated in 2014 that it would implement an LCR standard applicable to FBOs' CUSOs. She stated that the FBO proposals "[do] not achieve that objective" and "[do] not address the important liquidity risks associated with the U.S. branch and agency networks of these firms."

- A key apparent justification for considering the application of a standardized liquidity rule to U.S. branches and agencies of FBOs is data showing significant discount window borrowing during the financial crisis. The FBO proposals, however, omit discussion of the terms and conditions that are associated with discount window borrowing designed to mitigate credit risk to the Federal Reserve System. The FBO proposals are also silent regarding the adequacy of the existing standards in Regulation YY (which were imposed after the financial crisis), including liquidity buffers, liquidity stress testing and liquidity risk management, coupled with both home country standards and safety and soundness standards imposed by the licensing authority for the branch or agency, to mitigate the risks seen in the financial crisis.

- The Agencies also asserted that funding vulnerabilities at U.S. branches and agencies of an FBO can cause heightened liquidity risk exposure at an FBO's U.S. subsidiaries (and vice versa) and, relatedly, that a standardized liquidity requirement can help prevent transmission of risks between the segments of an FBO's U.S. operations. Notably absent from the comment solicitation, however, is an example of a liquidity risk that has been transmitted from a branch or agency to a subsidiary (whether a depository institution or a broker-dealer). Moreover, to the extent these concerns are tied to observable dynamics during the financial crisis, it is also unclear why a higher ring fence is necessary at this juncture given the significant separation that has already been imposed between an FBOs' U.S. subsidiaries on the one hand and its branches and agencies on the other.

- The Agencies have also noted that a source of these risks is the reliance by branches and agencies on dollar short-term wholesale funding (to a larger degree than U.S. BHCs) to finance long-term U.S. dollar-denominated project and trade finance around the world. Absent from the comment solicitation, however, is a discussion of how these risks should be weighed in consideration of the substantial benefits that trade financing provides to U.S. and international businesses and how access to dollars from U.S. funding markets can make dollar-denominated assets more attractive in financial markets outside the United States.

- The Agencies indicated that the consistency of the U.S. version of LCR with the Basel III LCR should make compliance less burdensome and facilitate integrated liquidity risk management. However, the Agencies did not mention the various "gold-plated" or "super-equivalent" requirements incorporated into the U.S. version of LCR, including a cumbersome requirement to add on to the minimum LCR and HQLA if there are maturity mismatches between inflows and outflows over the measurement period, as well as differences in assets that constitute HQLA and differences in inflow/outflow assumptions.

[28] "Statement on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks by Governor Lael Brainard" (Apr. 8, 2019), available at https://www.federalreserve.gov/newsevents/pressreleases/3B1F641BEB4A485B994EBC38165F0F3B.htm.

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Appendix

Proposed Capital and Stress Testing Requirements for U.S. Banking Organizations and Intermediate Holding Companies (IHCs)

For these requirements, IHC categorization is by IHC-level assets and risk-based indicators.

Category I (U.S.) U.S. GSIBs	No Category I Equivalent for Foreign Banking Organizations	Category II (U.S.) ≥ $700b Total Assets or ≥ $75b in Cross-Jurisdictional Activity	Category II (FBO) ≥ $700b IHC U.S. Assets or ≥ $75b in IHC Cross-Jurisdictional Activity	Category III (U.S.) ≥ $250b Total Assets or ≥ $75b in NBA, wSTWF, or Off-Balance Sheet Exposure	Category III (FBO) ≥ $250b IHC U.S. Assets or ≥ $75b in IHC NBA, wSTWF, or Off-Balance Sheet Exposure	Category IV (U.S.) $100b to $250b Total Assets	Category IV (FBO) $100b to $250b IHC U.S. Assets	Other Firms (U.S.) $50b to $100b Total Assets	IHCs with $50b to $100b IHC U.S. Assets
TLAC/LTD			**Internal TLAC/LTD***		**Internal TLAC/LTD***		**Internal TLAC/LTD***		
Stress Testing • Annual CCAR • Annual company-run stress testing/ disclosure • No mid-cycle stress test • Annual DFAST • Annual capital plan submission		**Stress Testing** • Annual CCAR • Annual company-run stress testing/ disclosure • No mid-cycle stress test • Annual DFAST • Annual capital plan submission	**Stress Testing** • Annual CCAR • Annual company-run stress testing/ disclosure • No mid-cycle stress test • Annual DFAST • Annual capital plan submission	**Stress Testing** • Annual CCAR • Annual company-run stress testing • Company-run stress test disclosure every other year • No mid-cycle stress test • Annual DFAST • Annual capital plan submission	**Stress Testing** • Annual CCAR • Annual company-run stress testing • Company-run stress test disclosure every other year • No mid-cycle stress test • Annual DFAST • Annual capital plan submission	**Stress Testing** • CCAR every other year • No company-run stress testing/ disclosure • DFAST every other year • Annual capital plan submission	**Stress Testing** • CCAR every other year • No company-run stress testing/ disclosure • DFAST every other year • Annual capital plan submission		
Risk-based capital • GSIB surcharge • Advanced approaches • Countercyclical Buffer • No opt-out of AOCI capital impact		**Risk-based capital** • Advanced approaches • Countercyclical Buffer • No opt-out of AOCI capital impact	**Risk-based capital** • Countercyclical Buffer • No opt-out of AOCI capital impact	**Risk-based capital** • Countercyclical Buffer • Allow opt-out of AOCI capital impact	**Risk-based capital** • Countercyclical Buffer • Allow opt-out of AOCI capital impact	**Risk-based capital** • Allow opt-out of AOCI capital impact	**Risk-based capital** • Allow opt-out of AOCI capital impact	**Risk-based capital** • Allow opt-out of AOCI capital impact	**Risk-based capital** • Allow opt-out of AOCI capital impact
Leverage Capital • Enhanced supplementary leverage ratio		**Leverage Capital** • Supplementary leverage ratio	**Leverage Capital** • Supplementary leverage ratio	**Leverage Capital** • Supplementary leverage ratio	**Leverage Capital** • Supplementary leverage ratio	**Leverage Capital**	**Leverage Capital**	**Leverage Capital**	**Leverage Capital**

This chart and the following chart were adapted from visuals that accompanied the domestic and FBO proposals.

Glossary: AOCI – accumulated other comprehensive income; CCAR – Comprehensive Capital Analysis and Review; CJA – cross-jurisdictional activity; CUSO – combined U.S. operations; DFAST – Dodd Frank Act Stress Test; FBO – foreign banking organization; GSIB – global systemically important bank; IHC – intermediate holding company; LCR – liquidity coverage ratio rule; LTD – long-term debt; NBA – non bank assets; NSFR – net stable funding ratio proposed rule; TLAC – total loss absorbing capacity; wSTWF – weighted short-term wholesale funding

*Requirement only applies to IHCs of GSIB parents.

Proposed Liquidity and Other Requirements for U.S. Banking Organizations and Intermediate Holding Companies (IHCs)

Under the FBO proposal, the liquidity and SCCL requirements applicable to IHCs depend on the categorization of the CUSO of the FBO's IHC. The below chart highlights the CUSO categories and what requirements would apply at the level of the IHC.

	Category I (U.S.) U.S. GSIBs	**No Category I Equivalent for Foreign Banking Organizations**	**Category II (U.S.)** (or, for Liquidity Stds, Cat III plus ≥ $75b in wSTWF)	**Category II (FBO) ≥ $700b CUSO U.S. Assets or ≥ $75b in CUSO CJA** (or, for Liquidity Stds, Cat III plus ≥ $75b in CUSO wSTWF)	**Category III (U.S.)** (or, for Liquidity Stds, with < $75b in wSTWF)	**Category III (FBO) ≥ $250b CUSO U.S. Assets or ≥ $75b in CUSO NBA, wSTWF, or Off-Balance Sheet Exposure** (or, for Liquidity Stds, with < $75b in CUSO wSTWF)	**Category IV (U.S.)**	**Category IV (FBO) $100b to $250b CUSO U.S. Assets**	**Other Firms (U.S.) $50b to $100b Total Assets**	**FBOs with ≥ $100b Global Assets and $50b to $100b U.S. Assets**
Liquidity	**Standardized** • Full daily LCR (100%) • Full daily NSFR (100%) **Reporting** • Report FR 2052a daily **Firm-specific** • Liquidity stress tests (monthly) • Liquidity risk management		**Standardized** • Full daily LCR (100%) • Full daily NSFR (100%) **Reporting** • Report FR 2052a daily **Firm-specific** • Liquidity stress tests (monthly) • Liquidity risk management	**Standardized** • Full daily LCR (100%) • Full daily NSFR (100%) **Reporting**** • Report FR 2052a daily **Firm-specific**** • Liquidity stress tests (monthly) • Liquidity risk management	**Standardized** • Reduced daily LCR (70-85%) • Reduced daily NSFR (70-85%) **Reporting** • Report FR 2052a monthly **Firm-specific** • Liquidity stress tests (monthly) • Liquidity risk management	**Standardized** • Reduced daily LCR (70-85%) • Reduced daily NSFR (70-85%) **Reporting**** • Report FR 2052a monthly **Firm-specific**** • Liquidity stress tests (monthly) • Liquidity risk management	**Standardized** • Reduced monthly LCR and NSFR (70-85%) if wSTWF ≥ $50b • No LCR/NSFR otherwise **Reporting** • Report FR 2052a monthly **Firm-specific** • Liquidity stress tests (quarterly) • Reduced liquidity risk management	**Standardized** • Reduced monthly LCR and NSFR (70-85%) if wSTWF ≥ $50b • No LCR/NSFR otherwise **Reporting**** • Report FR 2052a monthly **Firm-specific**** • Liquidity stress tests (quarterly) • Reduced liquidity risk management		**Home country requirements**** • Home country liquidity stress test if global assets ≥ $250b
SCCL	**SCCL** • More restrictive 15% limit to "major" parties		**SCCL** • Modified to be applicable even if < $250b	**SCCL** • CUSO must meet home country SCCL consistent with Basel • IHC-level SCCL (no limited application afforded to $50b - $250b IHCs)	**SCCL** • Modified to be applicable even if < $250b	**SCCL** • CUSO must meet home country SCCL consistent with Basel • IHC-level SCCL (no limited application afforded to $50b - $250b IHCs)	**SCCL** • Does not apply	**SCCL** • CUSO must meet home country SCCL consistent w/Basel if global assets ≥ $250b • IHC exempt	**SCCL** • Does not apply	**SCCL** • CUSO must meet home country SCCL consistent w/Basel if global assets ≥ $250b • IHC exempt
Risk management	**Risk Management** • Risk committee • Chief risk officer		**Risk Management** • Risk committee • Chief risk officer	**Risk Management** • U.S. risk committee • Chief risk officer	**Risk Management** • Risk committee • Chief risk officer	**Risk Management** • U.S. risk committee • Chief risk officer	**Risk Management** • Risk committee • Chief risk officer	**Risk Management** • U.S. risk committee • Chief risk officer	**Risk Management** • Risk committee • Chief risk officer	**Risk Management** • U.S. risk committee • Chief risk officer

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**Requirements apply at the level of the CUSO.