ALERT MEMORANDUM

Federal Reserve Finalizes “Stress Capital Buffer”

Risk-based capital requirements for GSIBs increase, but broad relief from post-stress leverage requirements for all CCAR firms

March 16, 2020

On March 4, the Federal Reserve finalized a significant integration of its stress testing regime with its ongoing supervisory capital requirements, by introducing a new “stress capital buffer” requirement for firms subject to the Federal Reserve’s CCAR supervisory stress tests. An institution-specific stress capital buffer will be determined for each CCAR firm as part of the 2020 CCAR exercise and is intended to take effect October 1, 2020. However, given the uncertainty and stress in the market caused by COVID 19 mitigation measures, it remains to be seen whether the Federal Reserve could modify the implementation timeline.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors.

NEW YORK

Hugh C. Conroy, Jr.
+1 212 225 2828
hconroy@cgsh.com

WASHINGTON

Allison H. Breault
+1 202 974 1532
abreault@cgsh.com

Zachary L. Baum
+1 202 974 1873
zbaum@cgsh.com

The Federal Reserve’s supervisory stress test regime is, and almost certainly will continue to be, the binding capital constraint on most CCAR firms. The Federal Reserve touts the stress capital buffer and related changes as “simplifying” and part of its “recent efforts to improve the efficiency and risk-sensitivity of its regulations”.

One key simplification is the elimination of the “pass/fail” quantitative assessment. Accordingly, CCAR now becomes primarily an exercise in calculating a CCAR firm’s stress capital buffer. Beginning October 1, 2020, the stress capital buffer will become a day-to-day ongoing capital requirement in order for CCAR firms to avoid restrictions on capital distributions. This ends the prior CCAR regime’s single-point-in-time approach to evaluating capital plans, which allowed CCAR firms’ pre-stress-test capital to decrease (within bounds) in between the CCAR supervisory stress tests.

The final rule generally adopts the proposal released in April 2018, but includes several welcome modifications. Significantly, the Federal Reserve formally discarded the proposed “stress leverage buffer” that would have applied to the Tier 1 leverage ratio and eliminated post-stress leverage capital requirements. CCAR firms no longer must maintain Tier 1 capital above the minimum Tier 1 leverage ratio or minimum supplementary leverage ratio throughout the nine quarters of the hypothetical stress scenario in order to avoid restrictions on their capital distributions. But one anticipated modification to eliminate the requirement to “prefund” one year of common stock dividends was not incorporated into the final rule, despite Vice Chair Quarles’ stated support in recent remarks. Other modifications, such as permitting CCAR firms not to incorporate material business plan changes into the calculation of their stress capital buffer and elimination of the pre-approval requirement for capital distributions above a CCAR firm’s original planned distributions, will provide more flexibility to make distributions.

Included below are (i) an illustration (Figure 1) of the U.S. risk-based total capital and buffer requirements (including the stress capital buffer) as they compare to the Basel capital framework, (ii) a graphical timeline (Figure 2) for the annual implementation of the stress capital buffer and (iii) a summary of and certain key observations on the final rule.

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Figure 1 – Stress Capital Buffer Comparison (maximum ratios shown)

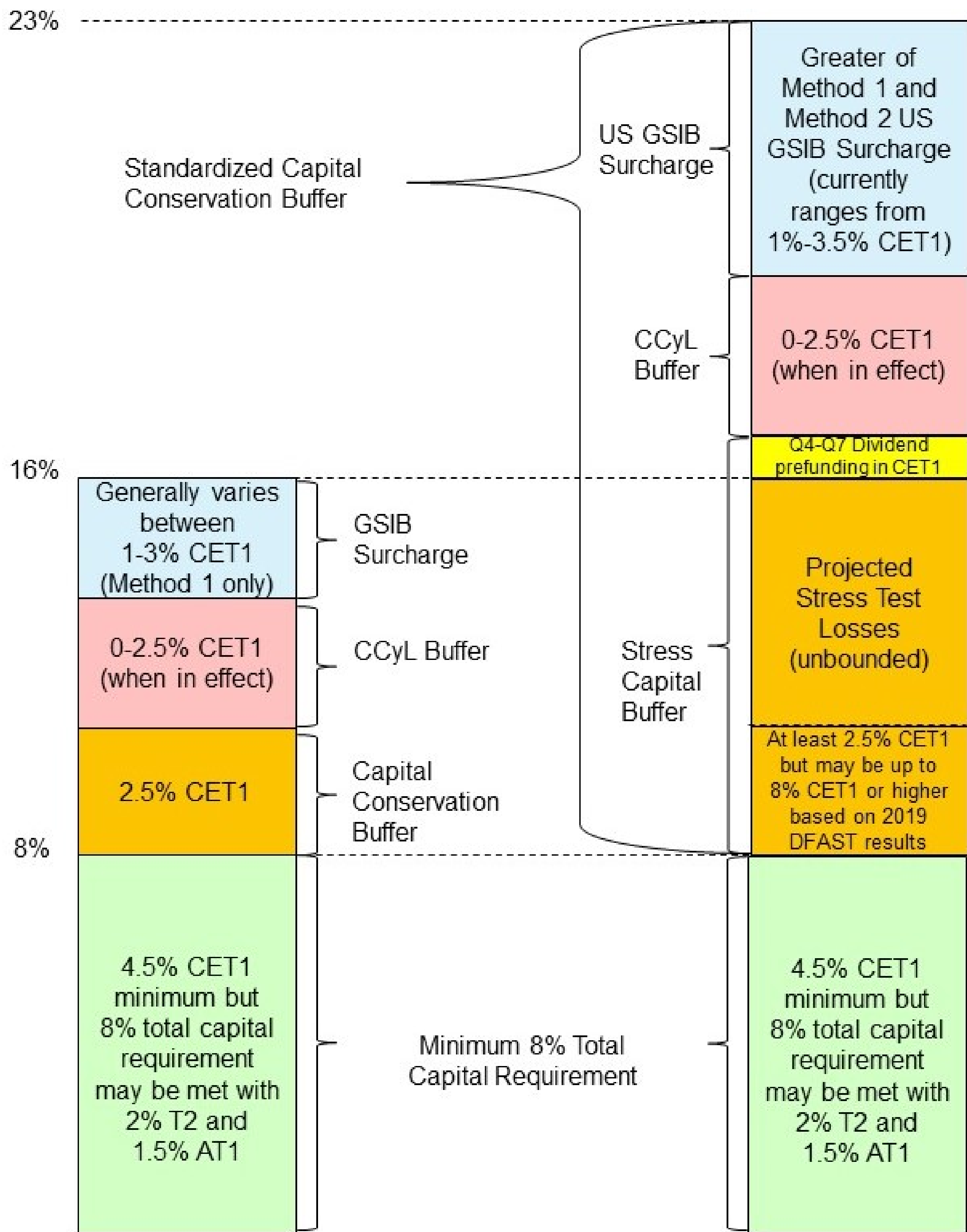
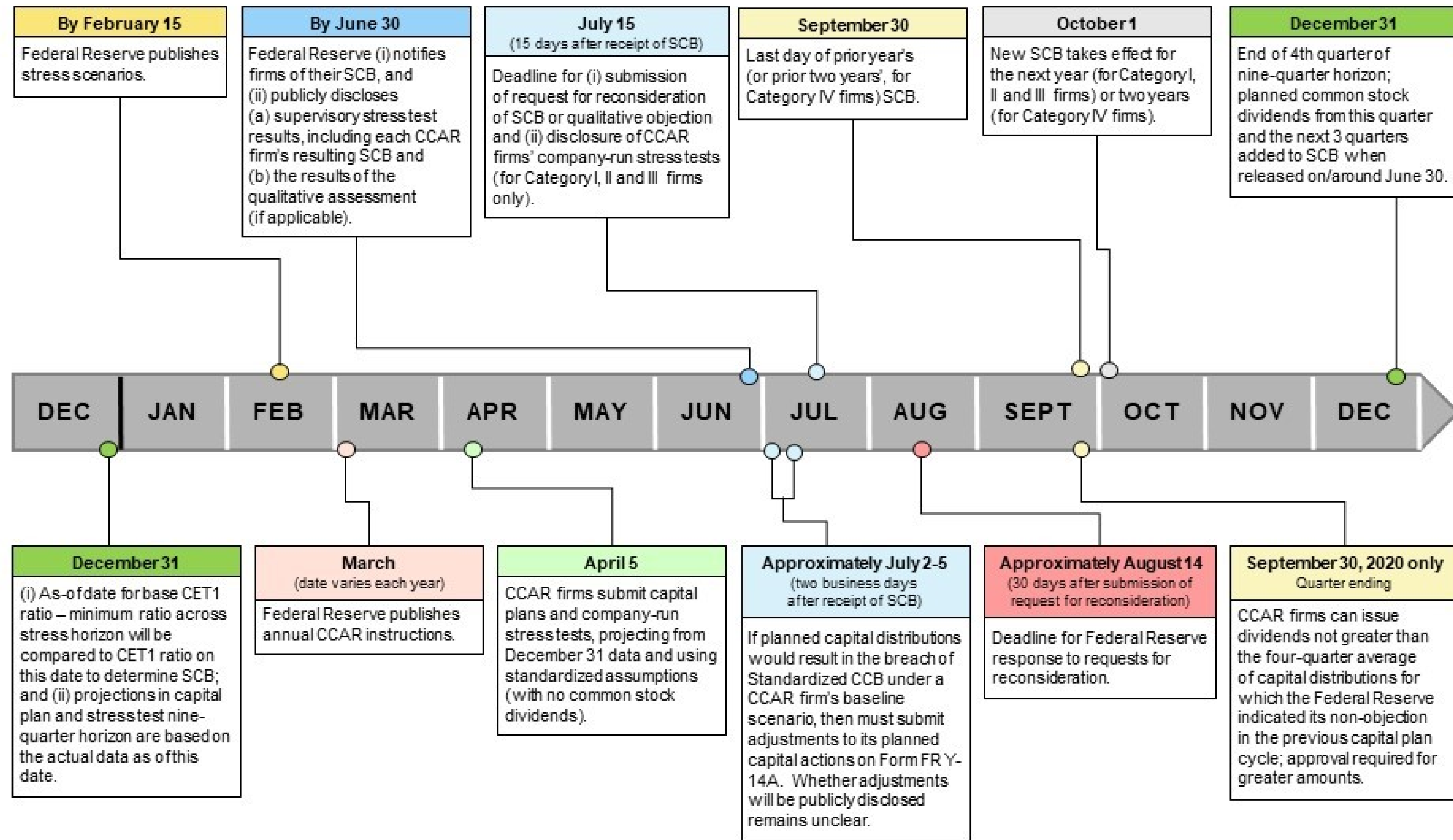


Figure 2 – Stress Capital Buffer Timeline



Overview of the Final Rule

The stress capital buffer rule ("SCB rule") purports to simplify the Federal Reserve's current capital and stress testing requirements by tailoring the capital conservation buffer ("CCB") to incorporate the post-stress losses of a subject firm ("CCAR firm") under the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR").

— ***Scope of Application.*** The SCB rule is relevant only for CCAR firms, *i.e.*:

- bank holding companies ("BHCs") with total consolidated assets of $100 billion or more; and
- intermediate holding company subsidiaries ("IHCs") of foreign banking organizations ("FBOs"), if the IHC has total consolidated assets of $100 billion or more.

These are the BHCs and IHCs identified in Categories I through IV under the Federal Reserve's recently revised enhanced prudential standards. Non-CCAR firms are not materially impacted by the SCB rule. For non-CCAR firms, the capital conservation buffer remains a fixed 2.5% of common equity tier 1 ("CET 1").

— ***The Stress Capital Buffer and its Calibration.*** The SCB rule redesigns the CCB for CCAR firms by replacing the fixed 2.5% CCB with a dynamic and bespoke "stress capital buffer" ("SCB"). A CCAR firm's SCB will be recalibrated with each CCAR supervisory stress test (annually for Category I, II and III firms, and every other year for Category IV firms). The SCB is the sum of:

(i) the maximum projected decline in a CCAR firm's CET 1 capital ratio (starting with the actual ratio as of December 31 immediately prior to the CCAR nine-quarter horizon) under the CCAR supervisory severely adverse stress scenario (expressed as a percentage of risk-weighted assets ("RWA")), and

(ii) a CCAR firm's planned common stock dividends for the fourth through seventh quarters of the nine-quarter CCAR planning horizon (expressed as a percentage of projected RWA for the quarter in the CCAR horizon in which the firm's projected CET 1 capital ratio reaches its minimum under the supervisory severely adverse scenario).

The SCB would have a 2.5% floor. Based on 2019 Dodd-Frank Act Stress Test ("DFAST") results, the SCB for CCAR firms could have ranged between 2.5% and over 8%, although the median decline in CET 1 for all CCAR firms was approximately 3%.[1]

— ***Elimination of the Quantitative "Pass/Fail".***

- Under the SCB rule, the CCAR process largely becomes an exercise to establish and re-calibrate a CCAR firm's SCB (each year for Category I, II and III firms, and every other year for Category IV firms), because it eliminates any *quantitative* objection or pass/fail component as a result of CCAR.
- In this way, however, the rule transforms the "single-point-in-time" quantitative objection based on stressed forecasts into a day-to-day ongoing capital requirement. As a result, the CCAR quantitative assessment effectively remains, operationalized through the SCB as a daily requirement for CCAR firms to maintain their risk-based capital ratios above their post-stress buffer requirements in order to avoid restrictions on capital distributions.
- The elimination of the quantitative objection is significant from a leverage capital perspective, as discussed in greater detail in the Key Observations below. Elimination of the quantitative assessment effectively removes the post-stress Tier 1 leverage and supplementary leverage ratio ("SLR") requirements because a CCAR firm may breach these minimum requirements (4% and 3%, respectively) in the

[1] Federal Reserve, Dodd-Frank Act Stress Test 2019: Supervisory Stress Test Methodology and Results, p. 27.

supervisory adverse stress scenario without "failing" CCAR, without being required to revise its planned capital distributions and without needing to increase its buffers.

- In March 2019, the Federal Reserve eliminated the qualitative objection for most CCAR firms, including all U.S. BHCs. IHCs that are in the Large Institution Supervision Coordinating Committee portfolio or that are "large and complex" firms remain subject to the qualitative assessment for the 2020 CCAR cycle. If most of these IHCs successfully pass the qualitative evaluation this year, they will no longer be subject to a potential qualitative objection.

— ***Reconsideration Procedure.***

- Any CCAR firm will be able to submit a request for reconsideration of its resulting SCB (or qualitative objection, if any) within 15 calendar days of receipt of its SCB and CCAR results. The Federal Reserve intends to respond within 30 days of a request for reconsideration, but since a CCAR firm's SCB will not take effect until October 1, the procedure could effectively give the Federal Reserve approximately three months to render its determination.
- Prior to October 1, a CCAR firm will be able to continue to make capital distributions that were included in its last annual capital plan to which the firm received a non-objection.

— ***What Happens After CCAR Calculation of the SCB?***

- *Incorporation of the SCB into a Standardized Capital Conservation Buffer.* The SCB will be incorporated into a broader buffer named the "standardized approach capital conservation buffer" ("Standardized CCB"). All CCAR firms must calculate their risk-based capital ratios under the standardized approaches, including Category I and Category II firms that are subject to the advanced approaches and the so-called Collins Amendment.

  The Standardized CCB calculation would be the aggregate of a CCAR firm's:

  (i) SCB (floored at 2.5%);

  (ii) any countercyclical capital buffer ("CCyl Buffer") that may be in effect (for Category I, II and III firms); and

  (iii) for global systemically important BHCs ("GSIBs") only, the greater of the firm's GSIB surcharge under method 1 (which aligns with the Basel capital framework's GSIB surcharge) and method 2 (which reflects a firm's reliance on short-term wholesale funding and generally results in a higher surcharge) ("U.S. GSIB Surcharge").

- *Post-CCAR Adjustments to Planned Capital Distributions.* Each CCAR firm must then review its own BHC *baseline* scenario and assess whether its planned capital distributions could still be accomplished, taking into account its new Standardized CCB.

  If any planned distribution would cause a CCAR firm to dip into its Standardized CCB under its baseline scenario, the firm must:

  (i) reduce its capital distributions to ensure they would be permitted based on its baseline scenario; and

  (ii) notify the Federal Reserve of such adjustments within two business days of receipt of its SCB by resubmitting the Form FR Y-14A summary schedule reflecting the SCB requirement and its reduced planned capital distributions.

  Whether a CCAR firm's adjustments to its planned capital actions would be subject to public disclosure is not clear from the 2020 CCAR instructions or the SCB rule, which provides that the Federal Reserve "may" release information related to such adjustments but does

not require such disclosures.[2] Under the current CCAR process, the Federal Reserve releases the post-stress capital ratios of all of the CCAR firms (both without and with a firm's modifications to its planned capital actions to avoid a CCAR "fail").

— ***Ongoing Application of the Standardized CCB.***

- On a daily basis, CCAR firms are required to maintain the Standardized CCB above their minimum CET 1 risk-based, Tier 1 risk-based and total risk-based capital requirements. If any one of a CCAR firm's risk-based capital ratios dips into the Standardized CCB zone, the firm will become subject to increasing restrictions on its capital distributions and discretionary bonus payments.
- The rule applies the Standardized CCB *only* at the level of the top-tier consolidated BHC and/or IHC, and thus does *not* change the application of the current static 2.5% CCB to a CCAR firm's insured depository institution ("IDI") subsidiaries. In addition, non-CCAR firms will continue to apply the static 2.5% CCB.
- The nine CCAR firms that are subject to the "advanced approaches" capital calculation methodologies (i.e., the U.S. GSIBs in Category I and the U.S. institution subject to Category II) are also subject to an advanced approaches capital conservation buffer ("Advanced CCB") above their advanced approaches minimum requirements. The calibration of the Advanced CCB is identical to the Standardized CCB, but instead of incorporating the SCB, the Advanced CCB includes a fixed 2.5% CET 1 requirement (i.e., the current CCB). The maximum payout ratios are consistent across the various capital buffers, including the Standardized CCB, Advanced CCB and enhanced supplementary leverage ratio buffer.

— ***Restrictions on Distributions Applicable in the Buffer Zone.***

- The SCB rule does not alter the general framework that requires incremental restrictions on distributions and bonus payments as a firm falls further into the Standardized or Advanced CCB range.
- However, the SCB rule revises the definition of "eligible retained income" in an effort to address the potential for a dip into the buffer zone to result in an immediate decrease in distributions and bonus payments to a very low amount or to zero, primarily in the scenario where a banking organization has distributed all or a significant amount of its retained earnings over the last four quarters.
  - For a CCAR firm with an SCB greater than the 2.5% floor, its potential restrictions on distributions and bonus payments will be based on the firm's *average* net income for the preceding four quarters (without regard to distributions or tax effects) as calculated in accordance with the FR Y-9C instructions (rather than the *aggregate* of the previous four quarters of net income, adjusted to reflect distributions and associated tax effects not already reflected).
  - A CCAR firm subject to a 2.5% SCB or a non-CCAR firm will not benefit from this change.

— ***Elimination of Prior Approval for Distributions.*** In a change from the proposal, the SCB rule provides CCAR firms with flexibility to increase their planned capital distributions in excess of the amount included in their capital plans without prior approval, provided that such distributions would not cause the firm's capital ratios to breach its buffers. However, CCAR firms must notify the

[2] 12 CFR 225.8(h)(5).

Federal Reserve of any distribution not previously included in its capital plan within 15 calendar days following the distribution. In addition, the rule would not change the prior approval requirements that continue to apply to redemptions of Additional Tier 1 or Tier 2 capital instruments.

— ***Income Limitation on Dividends Revised.*** The rule also clarifies that the Federal Reserve will no longer apply heightened scrutiny to planned dividends that would exceed 30% of a CCAR firm's after-tax net income available to common shareholders, primarily because CCAR firms must effectively prefund their dividends, through their SCB, for the intervening year between CCAR cycles. This limitation was not part of the stress testing regulations, and had previously only been highlighted in the Federal Reserve's instructions and guidance to CCAR firms.

— ***Distinction Between CCAR and DFAST Collapsed.*** The SCB rule collapses the prior distinction between the DFAST and the CCAR supervisory stress tests in several ways:

- As a procedural matter, the SCB rule eliminates the current multi-step process whereby the Federal Reserve (i) runs the DFAST supervisory stress test based on assumed standardized capital actions, (ii) discloses the DFAST supervisory stress test results publicly, (iii) discloses confidentially to the CCAR firms their CCAR stress test results incorporating planned capital actions, (iv) provides the CCAR firms with the opportunity (typically over a weekend) to modify their planned capital actions and submit revised data and (v) later discloses publicly the CCAR stress test results (including both the "before" and "after" results from the CCAR firms' modifications to planned capital actions).
- Under the SCB rule, a new timeline for CCAR results applies, as illustrated in Figure 2 above. CCAR firms will continue to submit their planned capital actions for the nine-quarter stress horizon, but the Federal Reserve will:
  - run its supervisory stress test in the severely adverse scenario using only the DFAST assumptions (which have been modified under the SCB rule by, among other things, including an assumption that *no* common stock dividends are issued during the nine quarters), and
  - use the result of its supervisory stress tests to size a firm's SCB requirement.[3]
- The SCB rule places more responsibility in the hands of each CCAR firm, particularly because there is no pass/fail component. Each CCAR firm will, as noted above, take its SCB and apply it to its own planned capital actions under its own baseline scenario to determine if the capital actions could be undertaken without causing the firm to breach its new buffers.

— ***Revisions to CCAR Assumptions.***

- *Capital Actions.* By collapsing the DFAST and CCAR stress tests, the SCB rule does not incorporate planned capital actions into the stress test, thus eliminating an irrational assumption in the CCAR test that a firm would carry out nine quarters of its planned capital actions even under stress and even when applicable buffer requirements would make such distributions impossible.

  A CCAR firm will, however, include in its SCB and its Standardized CCB (i.e., "prefund") four quarters of planned common stock dividends (but not repurchases or redemptions). However, as with the current DFAST assumptions, the Federal Reserve will assume that payments (equal to the stated dividend or contractual interest or principal due in a quarter) on all

[3] The SCB rule provides that the Federal Reserve "will provide a [BHC] with notice of its stress capital buffer requirements … by June 30" which is also same date the CCAR instructions provide as a deadline for the Federal Reserve's publication of the CCAR results. Accordingly, it is unclear whether CCAR firms will be notified of their SCB before its publication in the CCAR results.

outstanding Additional Tier 1 and Tier 2 capital instruments will continue uninterrupted. Therefore, in effect, these payments will be enveloped within the capital reductions that become part of the firm's SCB, and effectively prefunded across the nine-quarter horizon through a different mechanism.

- *Static Balance Sheet.* In CCAR exercises up to this point, the Federal Reserve has projected each firm's balance sheet in the supervisory stress test using models that assume that banks will respond to increased credit demand in a stress scenario, typically by increasing lending and thereby increasing a firm's total assets. Recognizing the unrealistic nature of this assumption, the SCB rule revises the models to include an assumption that firms maintain a constant level of assets over the stress test horizon.

  Additionally, the rule provides an assumption that a firm's leverage ratio denominator and total RWA would generally remain unchanged over the planning horizon.

- *Material Business Plan Changes.* In a simplifying change from the proposal, the SCB rule does not incorporate material business plan changes in a firm's SCB requirement. For example, planned issuances of common or preferred stock in connection with a planned merger or acquisition (and their associated dividends) need not be included in a firm's nine-quarter projections. A firm's capital plan should nevertheless describe the changes. The Federal Reserve indicated that such issuances will be taken into account when they actually occur, and a CCAR firm may be required to resubmit its capital plan (with the potential for a recalibrated SCB) if the changes are material.

- *Different Assumptions for Company-Run Stress Tests.* The 2020 CCAR instructions provide that for the 2020 company-run stress tests, firms should follow the capital action assumptions set forth in the stress test rules as of the April 6, 2020 submission date of their capital plans. However, for the supervisory stress tests, the Federal Reserve will use the capital action assumptions set forth in the SCB rule. Accordingly, the CCAR instructions and the preamble acknowledge that, for 2020, the results of the company-run and supervisory stress tests will not be comparable.[4]

— ***Revisions to Regulatory Reports.*** The SCB rule also modifies two reports, the Consolidated Financial Statements for Holding Companies Report (FR Y-9C) and the Capital Assessments and Stress Testing Report (FR Y-14A), to collect information regarding the SCB requirement.

- *FR Y-9C.* The proposal would add line items to collect the information necessary to monitor a firm's performance quarterly, including information regarding a firm's SCB, U.S. GSIB Surcharge, CCyl Buffer, Standardized CCB, Advanced CCB, eligible retained income and capital distributions.

- *FR Y-14A.* The SCB rule adds line items to collect (generally annually) similar information necessary to evaluate planned capital actions under a firm's baseline scenario. A firm is required to report its capital distributions on the FR Y-14A filed under its initial capital plan on April 5 and, if the firm decides to reduce its planned distributions as a result of its review of its SCB, the firm will use the FR Y-14A to resubmit adjusted numbers within two business days.

— ***Effective Dates.***

- A CCAR firm's SCB requirement will be effective on October 1 of each year and remain in effect for a full calendar year for Category I, II and III firms. The Federal Reserve stated

[4] 2020 CCAR Instructions, p. 15; Preamble to the SCB rule, p. 34.

definitively that the SCB rule will be effective by the time of release of CCAR results in June 2020, and therefore each CCAR firm's first SCB will be in effect from October 1, 2020.

- Because Category IV firms are subject to CCAR only every other year, their SCB remains effective for two years. This year (2020) is a CCAR year for these firms, so their first SCB will also be in effect from October 1, 2020.
- The new annual CCAR cycle timeline is depicted in Figure 2 above.

Key Takeaways

— ***Stress leverage buffer and post-stress leverage requirements eliminated.*** As Vice Chair Quarles previewed in a September 2019 speech, the final rule does not include the proposed stress leverage buffer requirement. However, perhaps more significantly, the final rule eliminates Tier 1 post-stress leverage requirements that currently apply to CCAR firms as a function of the quantitative assessment, which is eliminated under the final rule.

- *Elimination of Tier 1 post-stress leverage requirements may allow firms to reduce their Tier 1 management buffers*. Because the final rule eliminates the quantitative pass/fail assessment, and the SCB will not include any leverage component, a CCAR firm that does not maintain a Tier 1 or SLR above the minimum requirements (4% and 3%, respectively) under the CCAR supervisory severely adverse stress scenario would not face any self-executing restrictions on its ability to make capital distributions. Accordingly, the SCB rule would appear to permit firms to reduce their management buffers with respect to Tier 1 requirements as Governor Brainard suggests in her dissent—in other words, if a CCAR firm's Tier 1 capital fell below the Tier 1 leverage or SLR requirements under the prior CCAR regime, it would have "failed" CCAR on quantitative grounds and therefore would have been required to resubmit its capital plan with commensurate reductions in its planned capital distributions.
- However, Federal Reserve Vice Chair Quarles notes in his statement supporting the rule that "eliminating the post-stress leverage measure removes [incentives to hold riskier assets], but does not reduce the amount of [required] common equity capital by one jot."
- In addition, the rule would not change the enhanced supplementary leverage ratio ("eSLR") requirements that apply to GSIBs (a 2% buffer, resulting in a 5% SLR requirement at the parent holding company level, and a requirement at the IDI subsidiary level to maintain an SLR of 6% to be considered "well-capitalized"). The eSLR may only be satisfied with Tier 1 capital. The eSLR proposal that was released in conjunction with the SCB proposal in April 2018 would replace the current static 2% eSLR buffer with a dynamic measure based on 50% of the firm's U.S. GSIB surcharge (the higher of method 1 and method 2). The Federal Reserve has yet to indicate a timeline for when or whether these proposed modifications to the GSIB buffer will be finalized.

— ***SCB should reduce Tier 1 capital requirements for most CCAR firms although CET 1 requirements for GSIBs will increase***. The impact assessment accompanying the SCB rule generally indicates required Tier 1 capital levels will decline in the aggregate across CCAR firms in Categories II, III and IV by approximately $49 billion (a 12% decrease relative to current requirements) and CET 1 levels will decline in the aggregate by $35 billion (a 10% decrease). For the U.S. GSIBs, Tier 1 capital levels are not expected to change, while aggregate CET 1 levels are expected to increase by $46 billion (a 7% increase). Governor Brainard's dissent attributes projected declines in required Tier 1 and CET 1 capital to "the rule's substantial reduction in the requirement to prefund distributions [other than four quarters of dividends] and, to a lesser extent, the elimination of any stress leverage requirement (for tier 1) and the assumption of a flat balance sheet."

- The increase for GSIBs arises because the rule effectively incorporates the U.S. GSIB Surcharge as an additional buffer over and above the SCB. In contrast, the current approach does not require CCAR firms to satisfy the GSIB buffer in stress conditions—a CCAR firm must only maintain its capital above the Basel III minimum levels across the nine-quarter horizon. Therefore, in past CCAR exercises, the capital maintained to keep a CCAR firm's ratios above those minima "counted" toward satisfaction of

the U.S. GSIB Surcharge from a day-to-day compliance perspective. Under the final rule however, the U.S. GSIB Surcharge will effectively be applied "post-stress" since it sits "atop" the SCB as a component of the new Standardized CCB—in other words, capital needed to satisfy the SCB on a day-to-day basis will now be in addition to capital needed to satisfy the U.S. GSIB Surcharge.

- The Federal Reserve rejected commenters' concerns that the SCB would be redundant with the U.S. GSIB Surcharge. The Federal Reserve also dismissed commenters' requests to consider changes to the U.S. GSIB Surcharge as part of the SCB rulemaking.

— ***Dividend prefunding requirement preserved***. The dividend prefunding requirement remains unchanged from the proposal despite prior remarks by Vice Chair Quarles that indicated he supported its elimination in favor of either (i) activating the CCyl Buffer in a manner similar to the 1% CCyl Buffer that is currently applicable under standard risk conditions in the United Kingdom, or (ii) raising the floor of the SCB from 2.5% to 3%. Neither of these alternatives was adopted, or even alluded to, in the preamble.

- *Adverse Impact for IHCs Disregarded*. Moreover, the SCB rule summarily dismissed commenters' concerns regarding the dividend prefunding requirement and its particularly punitive impact on IHCs, which unlike the publicly traded CCAR firms, often deploy dividends instead of share repurchases (which are not subject to the prefunding requirement) because of their nature as subsidiary organizations. For that reason, an IHC's dividends to its parent also tend to be significantly larger relative to its capital base than a domestic BHC's ordinary dividends to public shareholders. Therefore, the dividend prefunding requirement has the potential to inflate inappropriately the SCBs of IHCs.

— ***Interplay with the CCyl Buffer.*** Although Vice Chair Quarles had indicated in prior statements that the Federal Reserve had been considering the implementation of a non-zero CCyl Buffer in the United States as an alternative to the dividend prefunding requirement, the preamble includes no discussion of the level of CCyl Buffer, which is generally determined on an interagency basis annually. No announcement has been made confirming that the CCyl Buffer will remain at 0% for 2020, although a statement regarding the level of the CCyl Buffer for the coming year is generally made in the first quarter.[5] The Federal Reserve rejected commenters' requests to eliminate the CCyl Buffer if the SCB is adopted and dismissed assertions that the CCyl Buffer is redundant with the SCB. The preamble reiterates that the CCyl Buffer is a macroprudential tool intended to strengthen the resiliency of financial firms and the financial system, by allowing the Federal Reserve to raise capital standards when credit growth in the economy becomes excessive, a prospect that seems increasingly unlikely in the near term given the adverse economic impacts of COVID 19,[6] particularly with the Federal Reserve's recent announcement encouraging banks to dip into their capital buffers as they lend to borrowers affected by COVID 19.[7] It is unclear how and whether this announcement will affect the ultimate

[5] The Federal Reserve policy statement on the CCyl Buffer indicates it expects to consider at least once per year the applicable level of the U.S. CCyl Buffer. 12 CFR Part 217, Appendix A. The Federal Reserve's most recent determination to maintain a CCyl Buffer of 0% was made in March 2019. See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.htm.

[6] For example, on March 11, 2020, the Bank of England cut its CCyl Buffer from 1% to 0%, (after previously announcing a target of for its CCyl Buffer of 2% by the end of 2020). The Danish Finance Ministry has announced a similar reduction in its CCyl Buffer from 1.5% to 0%.

[7] Federal Reserve Actions to Support the Flow of Credit to Households and Businesses (Mar. 15, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm.

implementation and effectiveness timeline of the SCB rule.

— ***Mandatorily convertible LTD issued under the TLAC rule not recognized for purposes of SCB requirements.*** The Federal Reserve declined commenters' requests to permit recognition of eligible internal long-term debt issued by IHCs to satisfy TLAC requirements as CET1 for purposes of the SCB, given its mandatory conversion feature. The preamble notes that "providing [such IHCs] greater flexibility to satisfy the buffers would be inconsistent with the general principle that larger and more systemic firms be subject to more stringent and risk-sensitive requirements." In addition, the Federal Reserve noted that "the loss-absorbing capacity of long-term debt issued under the [Federal Reserve's] TLAC rule is not identical to the loss-absorbing capacity of CET1 capital as the way in which long-term debt could absorb losses varies by circumstance."

However, the preamble did not address the potential for convertible instruments more generally to be deemed CET 1 for purposes of CCAR if such instruments were issued by a broader set of institutions. While the Federal Reserve could have used the preamble to shut down entirely the possibility that convertible instruments could be recognized on an as-converted basis in future supervisory stress tests, it seems notable that the preamble did not take that approach.

The SCB rule does not alter the TLAC buffers for U.S. GSIBs and IHCs that have been in place since 2019. If covered firms breach these buffers, they would also become subject to restrictions on capital distributions (even while remaining above the applicable SCB).

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