"Off the Rack": Federal Reserve Finalizes Tailoring Rules with Few Changes

October 11, 2019

The Federal Reserve has finalized its rules to further tailor the regulatory framework for enhanced prudential standards and the U.S. Basel III capital and liquidity requirements applicable to domestic banking organizations and foreign banking organizations (**FBOs**). We refer to these rules together as the Final Tailoring Rules.[1] The Final Tailoring Rules will become effective 60 days from their publication in the Federal Register.

Compared to the proposed rules that the Federal Reserve issued in October 2018 (for domestic firms)[2] and in April 2019 (for FBOs),[3] the Final Tailoring Rules make very few changes. In particular:

- with one exception related to the U.S. intermediate holding companies (**IHCs**) of FBOs, the calibration and calculation of the thresholds and risk-based indicators for determining the categories of firms remain unchanged, notwithstanding the numerous comments made by banking organizations and trade organizations on these aspects of the proposed rules; and
- with the exception of the calibration of the U.S. Basel III liquidity requirements applicable to Category III and IV domestic firms and U.S. IHCs of FBOs, there are no changes in the substance of the various enhanced prudential standards and U.S. Basel III capital and liquidity requirements applicable to each category of domestic firm, U.S. IHC or FBO.

We will publish visual memoranda explaining in more detail these and other aspects of the Final Tailoring Rules. In the meantime, we set out a few key observations here.

Changes to the Proposal

Calibration of U.S. Basel III Liquidity Requirements. In the proposed rules, the Federal Reserve had sought comment on how the reduced Liquidity Coverage Ratio (**LCR**) and reduced proposed Net Stable Funding Ratio (**NSFR**) should be calibrated, and had proposed a range between 70% and 85% of the full requirements. The Final Tailoring Rules adopt two different reduced LCR and proposed NSFR requirements:

- 85% of the full LCR and proposed NSFR for **Category III firms** with less than $75 billion of weighted short-term wholesale funding (**STWF**);[4] and

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[1] The final rule to tailor the application of **enhanced prudential standards** was adopted by the Federal Reserve. The final joint rule to tailor the application of **the U.S. Basel III capital and liquidity rules** was approved by the Federal Reserve and will need to be approved by the FDIC and OCC as well. The latter two regulators are expected to adopt the final joint capital and liquidity tailoring rule in the coming days.

[2] Our visual memorandum on the proposed tailoring rule for domestic banking organizations is available **here**.

[3] The FBO tailoring proposal also proposed a change to the U.S. Basel III liquidity requirements that would apply to domestic Category IV firms.

[4] As under the proposed rules, Category III firms with $75 billion or more of weighted STWF will be subject to the full LCR and full proposed NSFR.

- 70% of the full LCR and proposed NSFR for **Category IV firms** with $50 billion or more of weighted STWF.[5]

Consistent with the proposed rules, the Final Tailoring Rules eliminate the distinction in methodology between the full LCR (with maturity mismatch add-on) and the modified LCR (without maturity mismatch add-on), which generally applied to U.S. bank holding companies and covered savings and loan holding companies (**SLHCs**) with total consolidated assets between $50 billion and $250 billion.

The Final Tailoring Rules do not include a finalized NSFR, and the Federal Reserve indicated that comments received on the proposed NSFR will be addressed when that rule is finalized.

CUSO Risk Profile vs. IHC Risk Profile. Unlike the proposed tailoring rules for FBOs, the Final Tailoring Rules will apply the U.S. Basel III liquidity requirements and the single-counterparty credit limit (**SCCL**) requirements to a U.S. IHC based solely on the thresholds and risk-based indicators of the U.S. IHC rather than those of the FBO's combined U.S. operations (**CUSO**), which include any U.S. branches and agencies of the FBO. Based on our review of comment letters filed in response to the proposed tailoring rules for FBOs, 20 out of 21 commenters who addressed this issue recommended that requirements applicable to U.S. IHCs should apply to U.S. IHCs based only on the U.S. IHC's risk profile, and this change is consistent with those comments.

Modest Reporting Relief. The Final Tailoring Rules provide modest reporting relief compared to the proposed rules. For example, FBOs will not be required to complete the Form FR Y-15 with respect to their U.S. branches and agencies, and all Category IV firms will be permitted to report on Form FR 2052a on a T+10 basis, rather than a T+2 basis as would have been required for certain Category IV firms under the proposed rules. Covered SLHCs will benefit from a longer period of time to submit their first Form FR Y-14 reports.

No Changes or No Action For Now

Thresholds and Risk-Based Indicators Finalized As Proposed. With the exception of the very few changes indicated above, the Final Tailoring Rules do not include:

- Changes to the proposed thresholds at which firms become subject to any regulatory Category, including by not indexing any threshold for inflation;
- Additions or removals of any proposed risk-based indicators used to categorize firms; or
- Changes to the calibration or calculation of any proposed risk-based indicators.

No Proposal on Standardized Liquidity Requirements for FBOs' U.S. Branches and Agencies. The Federal Reserve stated that it continues to consider whether it should develop and propose a standardized liquidity requirement for the U.S. branches and agencies of FBOs. Specifically, in his **opening statement** yesterday, Vice Chairman for Supervision Randal K. Quarles noted that he had "received direct feedback on this issue from [the Federal Reserve's] peer bank supervisors in other jurisdictions, who were grateful that we didn't rush to judgment about the correct course of action" and that he looked forward to "continuing the dialogue at the international level." Commenters on the FBO tailoring proposal strongly opposed such a requirement, noting that this could lead to further regulatory fragmentation. It appears that the Federal Reserve, in light of these comments, intends to work on an internationally coordinated approach to address branch and agency liquidity requirements.

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[5] As under the proposed rules, Category IV firms with less than $50 billion of weighted STWF will not be subject to an LCR or proposed NSFR requirement.

The requirement that an FBO with total CUSO assets of $100 billion or more maintain a liquidity buffer for its U.S. branches and agencies sufficient to meet their projected net stressed cash flow needs for 14 days remains a part of the liquidity requirements under the Final Tailoring Rules.

Key Definitional Changes to Capital Plan Rule Not Finalized. The Federal Reserve did not finalize its proposed amendments to the definitions of "large and complex" and "large and noncomplex" bank holding companies for purposes of its capital plan rule. Noting that it had received a number of comments about its capital planning requirements, the Federal Reserve remarked only that it intends "separately to propose modifications at a future date to capital planning requirements to incorporate the proposed risk-based categories."

Category Projections

We have included as an appendix to this memorandum the visuals published by the Federal Reserve with the Final Tailoring Rules. These visuals show, among other things, the Categories into which the Federal Reserve projects that domestic banking organizations, U.S. IHCs and FBOs with respect to their CUSOs will be placed, based on currently available data. Notably, the Federal Reserve's projections indicate that no U.S. IHCs of FBOs will be subject to Category II standards.[6]

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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[6] As under the proposal, no FBOs will be subject to Category I standards, either with respect to their U.S. IHC or with respect to their CUSOs.

Appendix – Federal Reserve Visuals

Requirements for Domestic and Foreign Banking Organizations*

	Category I U.S. GSIBs	Category II ≥ $700b Total Assets or ≥ $75b in Cross-Jurisdictional Activity	Category III ≥ $250b Total Assets or ≥ $75b in nonbank assets, wSTWF, or off-balance sheet exposure	Category IV Other firms with $100b to $250b Total Assets	Other Firms $50b to $100b Total Assets
Capital	**TLAC/Long-term debt** **Stress Testing** • Annual company-run stress testing • Annual supervisory stress testing • Annual capital plan submission **Risk-Based Capital** • GSIB surcharge • Advanced approaches • Countercyclical Buffer • No opt-out of AOCI capital impact **Leverage capital** • Enhanced supplementary leverage ratio	**Stress Testing** • Annual company-run stress testing • Annual supervisory stress testing • Annual capital plan submission **Risk-Based Capital** • Advanced approaches • Countercyclical Buffer • No opt-out of AOCI capital impact **Leverage capital** • Supplementary leverage Ratio	**Stress Testing** • Company-run stress testing every other year • Annual supervisory stress testing • Annual capital plan submission **Risk-Based Capital** • Countercyclical Buffer • Allow opt-out of AOCI capital impact **Leverage capital** • Supplementary leverage ratio	**Stress Testing** • Supervisory stress testing (two-year cycle) • Annual capital plan submission **Risk-Based Capital** • Allow opt-out of AOCI capital impact **Leverage capital**	**Risk-Based Capital** • Allow opt-out of AOCI capital impact **Leverage capital**
SCCL	**Single-counterparty credit limits (SCCL)** • BHC/IHC level SCCL • FBOs: Meet home country requirement	**SCCL** • BHC/IHC level SCCL • FBOs: Meet home country requirement	**SCCL** • BHC/IHC level SCCL • FBOs: Meet home country requirement	**SCCL** • FBOs: Meet home country requirement if global assets≥$250B	**SCCL** • FBOs: Meet home country requirement if global assets≥$250B
Liquidity (Holding Company)	**Standardized** • Full daily LCR (100%) • Proposed full daily NSFR† (100%)	**Standardized** • Full daily LCR (100%) • Proposed full daily NSFR† (100%)	**Standardized** • If wSTWF < $75b: Reduced daily LCR and NSFR† (85%) • If wSTWF ≥ $75b: Full daily LCR and proposed NSFR† (100%)	**Standardized** • If wSTWF < $50b: No LCR [or proposed NSFR]‡ • If wSTWF ≥ $50b: Reduced monthly LCR and proposed NSFR† (70%)	
Liquidity (Combined U.S. Operation)	**Reporting** • Report FR 2052a daily **Internal** • Liquidity stress tests (monthly) • Liquidity risk management	**Reporting** • Report FR 2052a daily **Internal** • Liquidity stress tests (monthly) • Liquidity risk management	**Reporting** • If wSTWF < $75b: Report FR 2052a monthly • If wSFWF ≥ $75b: Report FR 2052a daily **Internal** • Liquidity stress tests (monthly) • Liquidity risk management	**Reporting** • Report FR 2052a monthly **Internal** • Liquidity stress tests (quarterly) • Tailored liquidity risk management	
Holding Company	U.S. IHC Requirement	U.S. IHC Requirement	U.S. IHC Requirement	U.S. IHC Requirement	U.S. IHC Requirement

*Certain requirements for a foreign bank are determined by the risk profile of its intermediate holding company, whereas other requirements are determined by the risk profile of the firm's combined U.S. operations. Capital and standardized liquidity standards are determined by the risk profile of the intermediate holding company and other standards are determined by the risk profile of the firm's combined U.S. operations. Other foreign banks with limited U.S. presence and global assets of $100 billion or more would be subject to certain minimum standards. † The proposed net stable funding ratio (NSFR) rule will not be finalized as a result of the tailoring final rule. ‡ This is a Davis Polk addition.

Glossary: wSTWF – weighted short-term wholesale funding; HCs –bank, savings and loan, or intermediate holding company; CUSO – combined U.S. operations; AOCI – accumulated other comprehensive income; CCAR – Comprehensive Capital Analysis and Review; LCR – liquidity coverage ratio.

Appendix – Federal Reserve Visuals

List of Domestic Firms by Projected Category (based on estimated data)‡

	Category I U.S. GSIBs	Category II ≥ $700b Total Assets or ≥ $75b in Cross-Jurisdictional Activity	Category III ≥ $250b Total Assets or ≥ $75b in NBA, wSTWF, or Off-balance sheet exposure	Category IV Other firms with $100b to $250b Total Assets	Other firms $50b to $100b Total Assets
U.S. Domestic Banking Org.	Bank of America Bank of New York Mellon Citigroup Goldman Sachs JPMorgan Chase Morgan Stanley State Street Wells Fargo	Northern Trust	Capital One Charles Schwab PNC Financial U.S. Bancorp	Ally Financial American Express BB&T Corp. Citizens Financial Discover Fifth Third Huntington KeyCorp M&T Bank Regions Financial SunTrust Inc. Synchrony Financial	Comerica Inc. CIT Group Inc. E*TRADE Financial NY Community Bancorp Silicon Valley Bank

List of Foreign Firms by Projected Category (standards vary by legal entity)

	Category I U.S. GSIBs	Category II ≥ $700b Total Assets or ≥ $75b in Cross-Jurisdictional Activity	Category III ≥ $250b Total Assets or ≥ $75b in NBA, wSTWF, or Off-balance sheet exposure	Category IV Other firms with $100b to $250b Total Assets	Other firms $50b to $100b Total Assets
Intermediate Holding Company			Barclays* Credit Suisse Deutsche Bank HSBC Toronto-Dominion UBS	Bank of Montreal BNP Paribas MUFG Royal Bank of Canada Santander	BBVA
Combined U.S. Operations		Barclays Credit Suisse Deutsche Bank MUFG	HSBC Mizuho Royal Bank of Canada Toronto-Dominion UBS	Banco Santander Bank of Nova Scotia Bank of Montreal BBVA BNP Paribas BPCE Société Genéralé Sumitomo Mitsui	Canadian Imperial Crédit Agricole I & C bank of China Norinchukin Rabobank

‡ Projected categories are based on data for Q1 2019. Actual categories would be based on 4-quarter averages. For certain measures for foreign banks, conservative assumptions were used to estimate incomplete data.

* Identifies firms that would be subject to Category III standards with weighted short-term wholesale funding of more than $75 billion. Firms subject to Category III standards with weighted short-term wholesale funding of $75 billion or more would be subject to full standardized liquidity requirements.