

# Foreign Banks: Overview of Dodd-Frank Enhanced Prudential Standards Final Rule

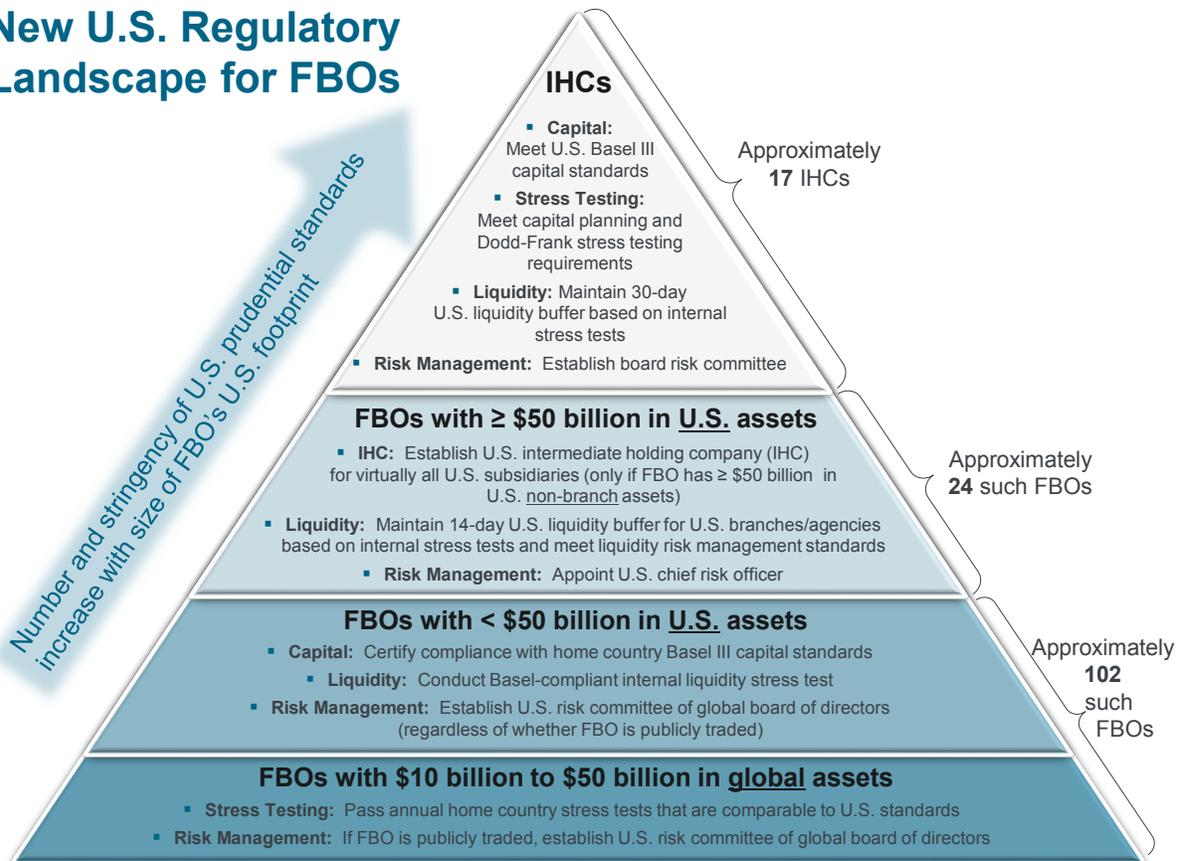
February 24, 2014

This visual summary provides an overview of key aspects of the Dodd-Frank enhanced prudential standards (EPS) final rule that applies to foreign banking organizations with  $\geq$  \$50 billion in total *global* consolidated assets (Large FBOs).

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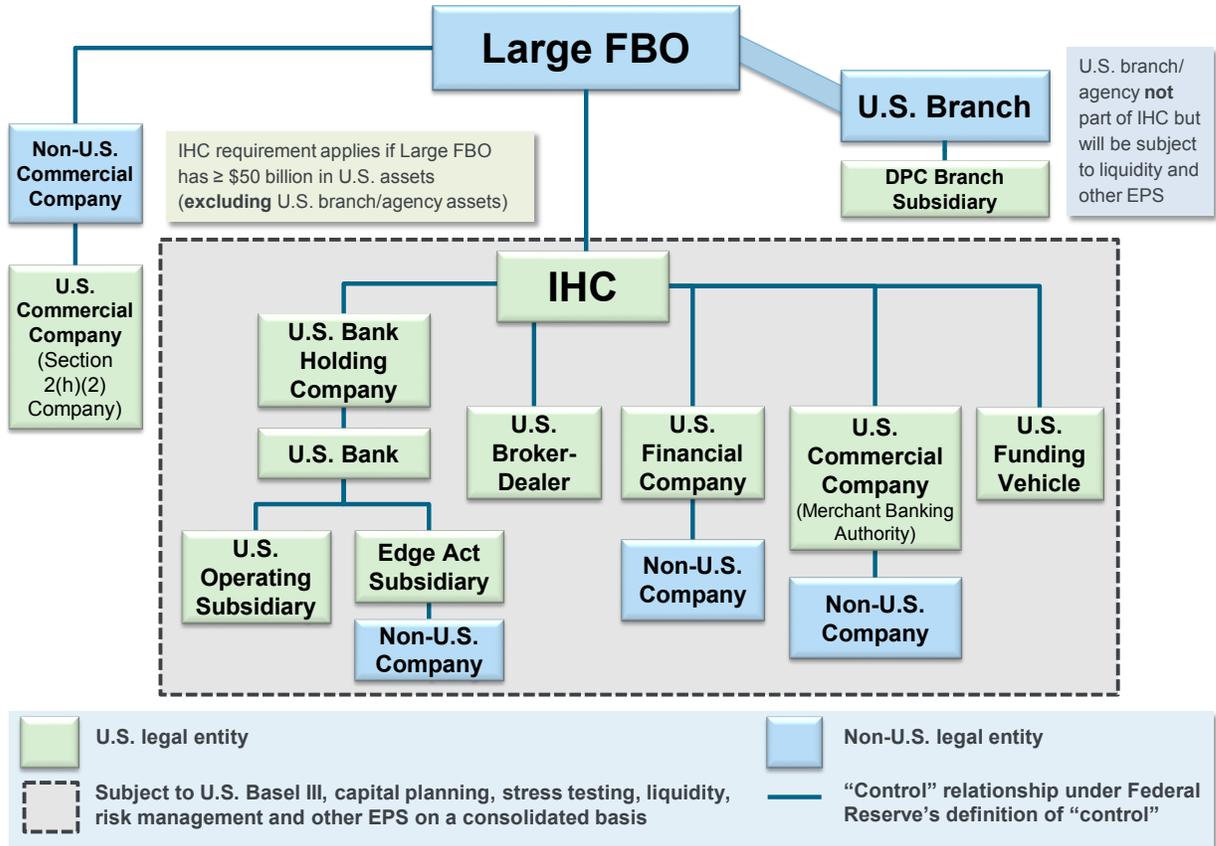
## New U.S. Regulatory Landscape for FBOs



Many details are omitted from this visual overview

# 1. Key Takeaways

## Large FBO's U.S. Operations under IHC



- **Compliance timing:** General compliance date for the IHC requirement and EPS is **July 1, 2016**. For detailed compliance dates, see [Key Compliance Dates for Large FBOs Subject to IHC Requirement](#).
- **Tiered approach for applying EPS to Large FBOs:** Under the tiered approach, the most burdensome requirements will apply to FBOs with  $\geq$  \$50 billion in U.S. assets. Fewer requirements will apply to Large FBOs with limited U.S. footprints and smaller FBOs.
  - **Large FBOs with limited U.S. footprints:** A Large FBO that is not subject to the IHC requirement must still comply with new EPS, including liquidity, stress testing and risk management requirements. See [Overview of EPS Applicable to a Large FBO with < \\$50 Billion in U.S. Assets](#).
  - **Focus on a Large FBO's U.S. operations:** Like the proposed rule, most of the EPS in the final rule focus on a Large FBO's U.S. operations. However, certain provisions require a Large FBO to demonstrate that the prudential regulatory regime in its home country is comparable to U.S. and international standards.
- **Higher, \$50 billion threshold for IHC requirement:** The requirement to establish a top-tier U.S. intermediate holding company (IHC) will apply to any Large FBO with U.S. assets (excluding U.S. branch/agency assets) of  $\geq$  **\$50 billion**.
  - The \$50 billion threshold will require approximately 17 Large FBOs to establish IHCs, including at least 12 of the 21 non-U.S. global systemically important banks (G-SIBs). The

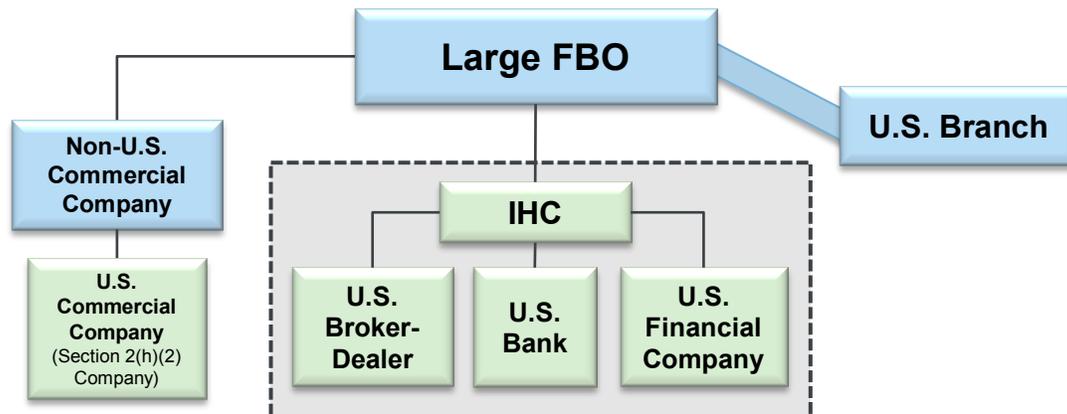
\$10 billion threshold in the proposed rule would have required approximately 26 Large FBOs to establish IHCs.

- **New IHC implementation plan requirement:** A Large FBO with U.S. assets (excluding U.S. branch/agency assets) of  $\geq$  \$50 billion as of June 30, 2014 must submit an implementation plan by **January 1, 2015** outlining its proposed process to come into compliance with the IHC requirement. The Federal Reserve will review the IHC implementation plan for reasonableness and achievability.
- **All U.S. companies “controlled” by a Large FBO must be placed underneath an IHC:** Like the proposed rule, the final rule relies on the Bank Holding Company Act (BHC Act) definition of control, including the facts-and-circumstances-based controlling influence test.
  - The final rule provides that a Large FBO must transfer **all** of **its** ownership interests in a U.S. subsidiary to the IHC and may not retain any ownership interest in the U.S. subsidiary directly or through non-U.S. affiliates. However, the final rule does **not** require a Large FBO to be the 100% owner of any U.S. subsidiary. In other words, a Large FBO is not required to buy out other, unaffiliated third-party investors in a U.S. subsidiary.
  - Alternative organizational structures (e.g., multiple IHCs) require discussions with, written submission to, and approval by, the Federal Reserve.
  - Establishing an IHC involves complex corporate structuring, regulatory, capital, liquidity, tax and corporate governance considerations and significant legal analysis. See [Key Issues Related to Establishing an IHC](#).
- **IHC subject to U.S. Basel III, capital planning, stress testing and other EPS:** Regardless of whether an IHC controls a U.S. bank, an IHC will be subject to: U.S. Basel III (Davis Polk visual memo [here](#)); capital planning and Dodd-Frank company-run and supervisory stress testing requirements (related Davis Polk materials [here](#)); qualitative and quantitative liquidity standards (related Davis Polk materials [here](#)); risk management standards and other Dodd-Frank EPS.
- **Limited adjustments to U.S. Basel III for IHCs**
  - An IHC will **not** be subject to the U.S. advanced approaches capital rules unless the IHC expressly opts in. However, an IHC that crosses the applicability threshold for the U.S. advanced approaches capital rules will still be subject to the **U.S. Basel III supplementary leverage ratio** and certain other capital requirements applicable to advanced approaches banking organizations.
    - The U.S. banking regulators have indicated that they intend to implement the Basel Committee’s January 2014 revisions to the Basel III leverage ratio. Davis Polk’s visual memo on the revised Basel III leverage ratio is available [here](#).
  - An IHC will still be subject to the U.S. Basel 2.5 market risk capital rule (and any successor regulation) if it crosses the relevant applicability threshold.
  - **All IHCs** will be subject to the U.S. Basel III capital rules (and any successor regulation), including the U.S. Basel III standardized approach for calculating risk-weighted assets (RWAs) for credit risk and the U.S. leverage ratio (ratio of Tier 1 capital to average total on-balance sheet assets).
    - Davis Polk’s U.S. Basel III standardized risk weights tool is available [here](#).
  - The date by which an IHC must comply with leverage ratio requirements is delayed until **January 1, 2018**.
- **Qualitative liquidity standards:** Broadly consistent with the proposed rule, the final rule requires U.S. branches/agencies and the IHC of a Large FBO with  $\geq$  \$50 billion in U.S. assets to

maintain **separate** liquidity buffers based on results of **internal** liquidity stress testing. The final rule and the preamble:

- Provide that U.S. branches/agencies are only required to maintain a U.S. liquidity buffer for the **first 14 days** of a 30-day stress scenario based on results of internal liquidity stress tests.
- State that high-quality liquid assets (HQLAs) as defined in the U.S. liquidity coverage ratio (LCR) proposal “would be liquid under most scenarios” for purposes of satisfying the liquidity buffer requirement.
- Clarify that the qualitative liquidity standards are designed to complement the quantitative Basel III liquidity standards, *i.e.*, the LCR and net stable funding ratio (NSFR).
- **U.S. Basel III quantitative liquidity framework:** The Federal Reserve stated that it intends, through future separate rulemakings, to implement the LCR and NSFR for the U.S. operations of **some or all** Large FBOs with ≥ \$50 billion in U.S. assets.
- **Risk management requirements:** Consistent with the proposed rule, the U.S. risk committee requirement applies to both Large FBOs as well as publicly traded FBOs with ≥ \$10 billion in total *global* consolidated assets (Public Mid-size FBOs).
- **Single counterparty credit limits (SCCLs) not part of final rule:** The Federal Reserve is conducting a quantitative impact study and will take into account the Basel Committee’s large exposures regime before finalizing SCCLs. Davis Polk’s overview of the Basel Committee’s proposed large exposures regime is available [here](#).
- **Early remediation framework not part of final rule:** The Federal Reserve will finalize the early remediation framework later this year.
- **U.S. BHC subsidiary of Large FBOs must comply with EPS pending compliance by the IHC:** U.S. BHC subsidiaries of a Large FBO must comply with EPS applicable to U.S. BHCs until an IHC is formed or designated and the IHC becomes subject to corresponding EPS.
- **More EPS to come:** There are numerous other prudential standards on the Federal Reserve’s 2014 regulatory agenda that are relevant for Large FBOs and their IHCs, including:
  - Implementing Basel Committee’s recent revisions to the Basel III leverage ratio, which will apply to the largest IHCs (Davis Polk visual memo [here](#))
  - Finalizing the U.S. LCR proposal (Davis Polk visual memo [here](#))
  - Proposing to implement Basel III NSFR (Davis Polk’s overview of Basel Committee’s proposed revisions to the NSFR [here](#))
  - Finalizing SCCLs and early remediation framework
  - Considering policy measures to address certain risks related to short-term wholesale funding (Davis Polk summaries [here](#))

## 2. Overview of EPS Applicable to a Large FBO Subject to IHC Requirement



### A. Requirements applicable to the IHC

- **U.S. Basel III capital requirements**, regardless of whether the IHC controls a U.S. bank.
  - Compliance with the U.S. leverage ratio is delayed until January 1, 2018.
  - An IHC with  $\geq$  \$250 billion in total consolidated assets **or**  $\geq$  \$10 billion of on-balance sheet foreign exposures will **not** be subject to the U.S. advanced approaches capital rules unless the IHC expressly opts in. However, the IHC will still be subject to:
    - U.S. Basel III supplementary leverage ratio (January 1, 2018 compliance date).
    - U.S. Basel III countercyclical buffer (if deployed).
    - Unrealized gains and losses flowing through to the IHC's Common Equity Tier 1 capital.
  - The Federal Reserve clarified that capital instruments issued by the IHC must meet the U.S. Basel III eligibility criteria — keepwell agreements, senior debt or parent guarantees would **not** qualify.
  - The IHC will **not** be required to make U.S. Pillar 3 disclosures if its Large FBO parent makes comparable disclosures in its home country.
- **Capital planning and Dodd-Frank stress testing requirements**
  - The Federal Reserve expects an IHC to reflect in its capital plan any parent support through guarantees and keepwell agreements.
  - However, in demonstrating its ability to maintain capital above minimum requirements under stress scenarios, the IHC would **not** be permitted to reflect these agreements as sources of capital.
  - Similarly, for Dodd-Frank stress testing purposes, the IHC must project its regulatory capital ratios **without** consideration of possible support from its foreign parent.
- **30-day U.S. liquidity buffer** requirement based on results of internal liquidity stress tests and liquidity risk management requirements.
- **Risk committee and risk management requirements:** The IHC must have its own risk committee, which may also serve as the Large FBO's U.S. risk committee. See [Risk Management Standards](#).

## B. Requirements applicable to the Large FBO and its U.S. branches/agencies

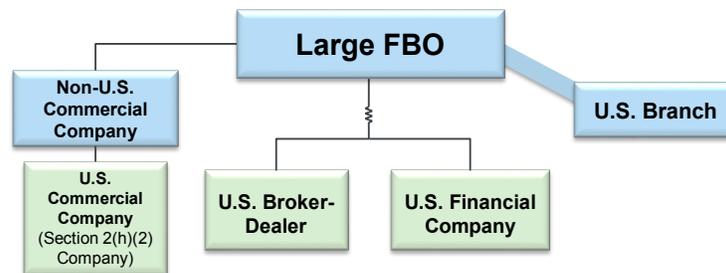
- **Home country capital certification for Large FBO:** The Large FBO must certify that it meets home country capital standards that are broadly consistent with the Basel capital framework, including Basel III.<sup>1</sup>
  - Noncompliance = The Federal Reserve may impose requirements, conditions, or restrictions relating to the activities or business operations of the Large FBO's U.S. operations.
- **Home country capital stress tests for Large FBO:** The Large FBO must be subject to and pass annual home country stress tests that are comparable to U.S. standards and must provide certain information to the Federal Reserve regarding its home country stress tests.
  - Specifically, the Large FBO's home country capital stress testing regime must include: **(1)** an annual supervisory capital stress test conducted by the Large FBO's home country supervisor or an annual evaluation and review by the home country supervisor of an internal capital adequacy stress test conducted by the Large FBO; and **(2)** requirements for governance and controls of stress testing practices by the Large FBO's management and board of directors (or equivalent thereof).
    - Davis Polk's summary of key features of the 2014 EU bank stress tests is available [here](#).
  - Noncompliance = **108%** U.S. asset maintenance (eligible assets<sup>2</sup> as % of average quarterly liabilities) requirement for U.S. branches/agencies, and the Federal Reserve may impose intragroup funding restrictions or additional liquidity requirements.
  - The final rule does **not** include a stress testing requirement for the Large FBO's U.S. branches/agencies.
- **Liquidity buffer requirement for U.S. branches/agencies:** U.S. branches/agencies are required to maintain a U.S. liquidity buffer for the first 14 days of a 30-day stress scenario based on results of internal liquidity stress tests. This buffer is separate from the IHC's liquidity buffer requirement.
- **U.S. risk management requirements for Large FBO:** The Large FBO must maintain a U.S. risk committee and appoint a U.S. chief risk officer (CRO).
  - Noncompliance = The Federal Reserve may impose requirements, conditions, or restrictions relating to the activities or business operations of the Large FBO's combined U.S. operations.
- **Single counterparty credit limits and early remediation framework:** To be finalized at a later date.

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<sup>1</sup> The Federal Reserve intends to take into account analysis regarding the comparability of home country capital standards to the Basel III capital framework, including those prepared in connection with the Basel Committee's Regulatory Consistency Assessment Programme (RCAP).

<sup>2</sup> The final rule narrows the definition of "eligible assets" by eliminating the discretion the Federal Reserve had proposed to give itself to include certain amounts due from affiliates located in the United States.

### 3. Overview of EPS Applicable to a Large FBO with < \$50 Billion in U.S. Assets



- General compliance date for EPS is **July 1, 2016**.
- **Home country capital certification for Large FBO:** The Large FBO must certify that it meets home country capital standards that are broadly consistent with the Basel capital framework, including Basel III. If the Large FBO's home country supervisor has not implemented Basel III, the Large FBO must demonstrate to the satisfaction of the Federal Reserve that it would meet or exceed Basel III standards on a consolidated basis were it subject to such standards.
  - Noncompliance = The Federal Reserve may impose requirements, conditions, or restrictions, including risk-based or leverage capital requirements, relating to the activities or business operations of the Large FBO's U.S. operations.
- **Home country capital stress tests for Large FBO:** The Large FBO must be subject to and pass annual home country stress tests that are comparable to U.S. standards.
  - Specifically, the Large FBO's home country capital stress testing regime must include: **(1)** an annual supervisory capital stress test conducted by the Large FBO's home country supervisor **or** an annual evaluation and review by the home country supervisor of an internal capital adequacy stress test conducted by the Large FBO; and **(2)** requirements for governance and controls of stress testing practices by the Large FBO's management and board of directors (or equivalent thereof).
    - Davis Polk's summary of key features of the 2014 EU bank stress tests is available [here](#).
  - Noncompliance = **105%** U.S. asset maintenance (eligible assets as % of average quarterly liabilities) requirement for U.S. branches/agencies and the Large FBO must conduct an annual stress test of its U.S. subsidiaries.
- **Internal liquidity stress tests for Large FBO:** The Large FBO must report the results of internal liquidity stress test that meets the Basel Committee's [principles for liquidity risk management](#) and must incorporate 30-day, 90-day, and one-year stress-test horizons.
  - Noncompliance = The Large FBO's combined U.S. operations must maintain a net due to funding position or a net due from funding position with non-U.S. affiliates of **≤ 25%** of third-party liabilities of U.S. operations on a daily basis.
- **U.S. risk management requirements for Large FBO:** The Large FBO must maintain a U.S. risk committee meeting certain requirements. See [Risk Management Standards](#).
  - Noncompliance = The Federal Reserve may impose requirements, conditions, or restrictions relating to the activities or business operations of the Large FBO's combined U.S. operations.
- **Single counterparty credit limits and early remediation framework:** To be finalized at a later date.

#### 4. Key Aspects of IHC Requirement

- **General requirement:** A Large FBO with U.S. assets (excluding U.S. branch/agency assets) of **≥ \$50 billion** must place all U.S. companies “**controlled**” by it underneath a top-tier U.S. IHC.
- **BHC Act definition of “control”:** A Large FBO “controls” a company if the Large FBO:
  - Directly or indirectly or acting through one or more other persons owns, controls, or has power to vote **≥ 25%** of any class of voting securities of the company;
  - Controls in any manner the election of a **majority of the directors** or trustees of the company; **or**
  - Directly or indirectly exercises a **controlling influence** over the management or policies of the company.
- **Whether “control” exists is fact-specific and depends on all the facts and circumstances.**
  - “Control” is broader than accounting consolidation; a Large FBO may “control” many unconsolidated companies.
  - Control can exist where a Large FBO’s ownership interest is anywhere between 5% and 25% of any class of a company’s voting securities and there are other indicia of control.
  - A company may be controlled by more than one legal entity.
  - **Controlling influence:** In assessing whether a firm directly or indirectly exercises a controlling influence over the management or policies of a company, the Federal Reserve considers a number of indicia of control, including, among other things:
    - The firm’s direct and indirect investment in the total equity of the company (both voting and non-voting).
    - Whether the company has another, larger controlling shareholder that is not affiliated with the firm.
    - The number and proportion of the firm’s representatives on the board of directors of the company and their positions.
    - The quality and quantity of direct and indirect business transactions and relationships between the firm and the company.
    - The existence of covenants or contractual terms in favor of the firm (e.g., veto rights), which limit the company’s discretion regarding key business decisions.
- **Calculating U.S. non-branch/agency assets**
  - Include all on-balance sheet assets of U.S. subsidiaries other than assets held by a DPC branch subsidiary<sup>3</sup> (**new exclusion in final rule**) or a Section 2(h)(2) company.<sup>4</sup>
  - The asset amount may be **reduced** by the amount corresponding to any balances and transactions between any top-tier U.S. subsidiaries that would be eliminated in consolidation if an IHC were already formed.

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<sup>3</sup> A DPC branch subsidiary is subsidiary of a U.S. branch/agency that holds assets acquired in the ordinary course of business for the sole purpose of securing or collecting debt previously contracted (DPC) in good faith by that branch or agency.

<sup>4</sup> Section 2(h)(2) of the BHC Act allows qualifying FBOs to retain their interest in foreign commercial firms that conduct business in the United States. This statutory exception was enacted in recognition of the fact that some foreign jurisdictions do not impose a clear separation between banking and commerce.

- The asset amount may **not** be reduced by the amount corresponding to balances and transactions between U.S. subsidiaries, on the one hand, and branches or agencies or non-U.S. affiliates, on the other.
- **General compliance timing:** A Large FBO with U.S. assets (excluding U.S. branch/agency assets) of ≥ \$50 billion as of **June 30, 2015**, must establish an IHC that is fully compliant with U.S. Basel III, qualitative and quantitative liquidity standards and other EPS (other than leverage ratio and stress-testing requirements) by **July 1, 2016**. For detailed compliance dates, see [Key Compliance Dates for Large FBOs Subject to IHC Requirement](#).
- **IHC implementation plan:** A Large FBO with U.S. assets (excluding U.S. branch/agency assets) of ≥ \$50 billion as of **June 30, 2014**, must submit an IHC implementation plan by **January 1, 2015** outlining its proposed process to come into compliance with the IHC requirement.
  - **Required contents of IHC implementation plan:**
    - A list of the Large FBO's U.S. subsidiaries setting forth the ownership interest in each subsidiary and an organizational chart showing the ownership hierarchy.
    - For each U.S. subsidiary that is a Section 2(h)(2) company or a DPC branch subsidiary, the name, asset size and a description of why the U.S. subsidiary qualifies as a Section 2(h)(2) company or a DPC branch subsidiary
    - Projected timeline for transfer of the Large FBO's ownership interests in U.S. subsidiaries to the IHC.
    - Quarterly pro forma financial statements and regulatory capital ratios for the IHC through January 1, 2018.
    - Projected timeline for, and description of, **all planned capital actions or strategies** for capital accumulation for the IHC to comply with U.S. Basel III.
    - Compliance plan for liquidity and risk management requirements in the final rule.
    - Any exemptions that may be sought or any plans to reduce U.S. non-branch/agency assets below \$50 billion for four consecutive quarters prior to July 1, 2016.
  - **Federal Reserve review:** The implementation plan is expected to facilitate dialogue between a Large FBO and the Federal Reserve. The Federal Reserve expects to evaluate all implementation plans, including those with respect to reducing assets, for reasonableness and achievability.
- **Large FBO's interests in U.S. subsidiaries to be held by IHC:** A Large FBO must transfer all of its ownership interests in a U.S. subsidiary, including subsidiaries of a U.S. branch/agency, to its IHC and may **not** retain any ownership interest in the U.S. subsidiary directly or indirectly through other subsidiaries.
  - However, the final rule does **not** require a Large FBO to be the 100% owner of any U.S. subsidiary. In other words, a Large FBO is not required to buy out other, unaffiliated third-party investors in a U.S. subsidiary.
  - Only Section 2(h)(2) companies and DPC branch subsidiaries may remain outside the IHC.
- **Phase-in requirement for transfer of a Large FBO's interests in U.S. subsidiaries to its IHC**
  - **By July 1, 2016:** A Large FBO must form or designate an IHC that holds the Large FBO's ownership interest in any U.S. BHC subsidiary, any insured depository institution (IDI) subsidiary, and U.S. subsidiaries representing 90% of the Large FBO's U.S. non-branch/agency assets not held under the BHC or the insured depository institution subsidiary.

- **By July 1, 2017:** All remaining assets of a Large FBO that are required to be held under an IHC must be transferred to the IHC.
- **Requests for alternative organizational structures:** Upon written request, the Federal Reserve may permit alternate or multiple IHC<sup>5</sup> structures based on considerations of: **(1)** whether applicable home country law would prevent the Large FBO from controlling its U.S. subsidiaries through a single IHC; or **(2)** where the activities, scope of operations or structure of the U.S. subsidiaries warrant consideration of alternative structures, such as where the Large FBO controls multiple lower-tier FBOs with separate U.S. operations.
  - The Federal Reserve does not expect to permit an alternative structure whose purpose or primary effect is to reduce the impact of regulatory capital rules or other prudential requirements.
    - The Federal Reserve stated that, generally, it is unlikely to permit a Large FBO to form a separate IHC for the sole purpose of holding a nonbank subsidiary separate from banking operations or to designate a company that is not a top-tier U.S. company as the IHC.
  - **Passivity commitments:** In narrow circumstances where a Large FBO's interest in a U.S. subsidiary is permitted to be held outside the IHC, the Federal Reserve expects to require passivity commitments or other supervisory agreements to limit the exposure to and transactions between the IHC and the subsidiary.
    - The Federal Reserve's standard passivity commitments typically include undertakings **not** to, among other things, enter into any banking or nonbanking transactions except for maintaining deposit accounts with a maximum aggregate balance of \$500,000 on substantially the same terms as those for unaffiliated persons.
    - Under certain circumstances, generally relating to pre-existing business relationships, the business relationship commitment is negotiable with the Federal Reserve.
  - **Procedures:** A Large FBO wishing to use an alternative organizational structure must submit a written request to the Federal Reserve by **January 4, 2016**. In practice, discussions with the Federal Reserve need to begin much earlier.
- **Source of strength:** Similar to a BHC, an IHC is required to serve as a source of strength only for its subsidiaries (if any) that are insured depository institutions.

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<sup>5</sup> If formation of more than one IHC is authorized, each of the IHCs generally will be treated as an IHC with \$50 billion or more in total consolidated assets even if its assets are below the threshold.

## 5. Key Issues Related to Establishing an IHC

- **Restructuring costs:** Restructuring operations to transfer subsidiaries to an IHC may include, among other things, costs associated with obtaining valuation opinions and third-party consents, restructuring transaction booking-trade flows, reallocating assets, revising employment contracts, novating contracts and guarantees, creating additional management and governance structures and systems for calculating and reporting capital and other regulatory standards, modifying information technology systems and establishing new governance and funding mechanisms.
- **Regulatory and other approvals:** A Large FBO must identify, prepare necessary documentation and obtain any required regulatory, customer, counterparty, vendor and creditor notifications and approvals to effect transfer of legal entities to the IHC.
  - **Section 23A:** Any anticipated request for waivers of Section 23A of the Federal Reserve Act in order to facilitate transfers to the IHC must be identified in the IHC implementation plan, and the actual waiver request must be made under the processes set forth in Section 23A, including notice and non-objection from the FDIC.
- **Punitive capital deductions:** Placing “controlled” but unconsolidated U.S. entities underneath an IHC can give rise to potentially punitive U.S. Basel III deductions for investments in the capital of unconsolidated “financial institutions” (broadly defined). Most investments in Volcker Rule covered funds made by a Large FBO’s U.S. subsidiaries will likely be deducted from the IHC’s Tier 1 capital.
- **Basel III minority interest rules:** Placing non-wholly owned consolidated subsidiaries underneath an IHC can result in U.S. Basel III’s and home country Basel III’s limited recognition of minority interests.<sup>6</sup>
- **Trapping capital and liquidity in the United States:** U.S. Basel III, capital planning, Dodd-Frank stress testing, tougher U.S. LCR and liquidity stress testing requirements mean that excess capital and liquidity will likely be trapped in the IHC.
  - This may hinder the ability of a Large FBO to recognize capital and liquidity resources trapped in the IHC for purposes of calculating its own capital and liquidity ratios under home country standards.
- **Earnings repatriation:** An IHC’s ability to distribute earnings to its foreign parent will depend on the IHC maintaining:
  - A Common Equity Tier 1 capital conservation buffer and, if applicable and deployed, a Common Equity Tier 1 countercyclical capital buffer above the minimum U.S. Basel III risk-based capital ratios in order to avoid restrictions on capital distributions and bonus payments to executive officers.
  - Capital levels above minimum risk-based and leverage capital ratios under the Federal Reserve’s supervisory stress scenarios in order to pass annual supervisory stress tests and to receive a non-objection from the Federal Reserve for its annual capital plan.

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<sup>6</sup> The final rule does not provide that a BHC subsidiary could be treated as a depository institution for purposes of recognition of minority interest. However, an existing, top-tier U.S. entity may be designated as the IHC, and the Federal Reserve noted that designating an existing BHC as the IHC would allow the Large FBO to use the BHC’s existing capital as the IHC’s capital.

## 6. Key U.S. Basel III Issues for IHCs

An IHC must generally comply with the same U.S. risk-based and leverage capital standards that apply to a U.S. BHC, including U.S. Basel III. This creates a number of issues, including:

- Significant differences between U.S. Basel III and home country Basel III regimes giving rise to multiple capital calculations and different capital optimization outcomes.
- Compliance with the U.S. leverage ratio and, in the case of the largest IHCs, the U.S. Basel III supplementary leverage ratio, may be burdensome where the IHC has a large broker-dealer subsidiary.
- Capital deduction for investments in the capital of unconsolidated “financial institutions” (broadly defined in U.S. Basel III) and certain Volcker Rule covered funds.
- U.S. Basel III’s and home country Basel III’s limited recognition of minority interests.
- Eligibility criteria for regulatory capital instruments under U.S. Basel III vs. home country Basel III regime.
- IHCs that cross the applicability threshold for the U.S. market risk capital rule (aggregate trading assets and trading liabilities of  $\geq 10\%$  of total assets or  $\geq \$1$  billion) will need to obtain separate approval from the Federal Reserve for their internal models. There may also be implications for the IHC’s Volcker Rule compliance program.

### High-Level Comparison of U.S. Basel III and Basel Committee’s Basel III Framework

Topic	U.S. Basel III	Basel Committee’s Basel III Framework
<b>Additional Tier 1 capital eligibility criteria</b>	<ul style="list-style-type: none"> <li>▪ Only instruments classified as equity under U.S. GAAP may qualify as Additional Tier 1 capital</li> <li>▪ This would generally prevent contingent capital instruments, which are generally classified as liabilities, from qualifying as Additional Tier 1 capital</li> </ul>	<ul style="list-style-type: none"> <li>▪ Instruments classified as liabilities for accounting purposes can be included in Additional Tier 1 capital if they have a principal loss absorption feature</li> </ul>
<b>Reliance on external credit ratings</b>	<ul style="list-style-type: none"> <li>▪ Dodd-Frank Act prohibits references to external credit ratings in federal regulations</li> <li>▪ U.S. Basel III standardized approach uses non-ratings based alternatives to determine standardized risk weights</li> </ul>	<ul style="list-style-type: none"> <li>▪ Standardized approach relies extensively on external credit ratings</li> <li>▪ Basel Committee may review such reliance</li> </ul>
<b>Derivatives exposures</b>	<ul style="list-style-type: none"> <li>▪ U.S. Basel III standardized approach does <b>not</b> permit use of the internal models methodology (IMM) to determine derivatives exposures</li> </ul>	<ul style="list-style-type: none"> <li>▪ The standardized approach permits use of IMM, subject to supervisory approval</li> <li>▪ Basel Committee has proposed a non-internal model method (NIMM) to determine derivatives exposures</li> </ul>

Topic	U.S. Basel III	Basel Committee's Basel III Framework
<b>Securities financing transactions</b>	<ul style="list-style-type: none"> <li>U.S. Basel III standardized approach does <b>not</b> permit use of the simple value-at-risk (VaR) approach</li> </ul>	<ul style="list-style-type: none"> <li>Standardized approach permits use of the simple VaR approach, subject to supervisory approval</li> </ul>
<b>Securitization exposures</b>	<ul style="list-style-type: none"> <li>Dodd-Frank Act prohibits references to external credit ratings in federal regulations</li> <li>U.S. Basel III removes ratings-based approach from hierarchy of approaches for calculating RWAs for securitization</li> </ul>	<ul style="list-style-type: none"> <li>Permits use of the ratings-based approach</li> <li>Basel Committee has proposed significant changes to the securitization framework (related Davis Polk materials <a href="#">here</a>)</li> </ul>
<b>Operational risk capital charge</b>	<ul style="list-style-type: none"> <li>No specific operational risk capital charge under the U.S. Basel III standardized approach</li> </ul>	<ul style="list-style-type: none"> <li>Contains 3 methods for calculating operational risk capital charge: <b>(1)</b> the Basic Indicator Approach; <b>(2)</b> the Standardized Approach; and <b>(3)</b> the Advanced Measurement Approaches (AMA)</li> </ul>

**Davis Polk U.S. Basel III Standardized Approach Interactive Risk Weights Tool**

We have developed an interactive web tool showing the standardized risk weights under the U.S. Basel III standardized approach. The interactive web tool is available at [USBasel3.com/tool](http://USBasel3.com/tool)

DavisPolk
U.S. Basel III Final Rule: Standardized Risk Weights Tool
Overview & Scope i

Type Of Exposure <small>Scroll and Click to View</small>	Existing Basel I-Based Risk Weights	U.S. Basel III Final Rule Standardized Risk Weights	Visual Comparison																								
<ul style="list-style-type: none"> <li>Corporate exposures</li> <li>Retail exposures</li> <li>Residential mortgage exposures</li> <li>High-volatility commercial real estate (HVCRE) loans</li> <li>Past due exposures</li> <li>OTC derivatives</li> <li>Collateralized transactions, including derivatives and securities financing transactions</li> <li>Cleared derivatives and securities financing transactions</li> <li>Recognizing the credit risk mitigation benefits of guarantees</li> <li>Securitization exposures</li> <li style="background-color: #004a7c; color: white; padding: 2px;"><b>Equity exposures</b></li> <li>Equity exposures to investment funds</li> <li>Unsettled transactions</li> <li>Default risk weight for items not specifically assigned to a risk weight category</li> </ul>	<ul style="list-style-type: none"> <li> <span style="color: #004a7c;">■</span> Deduct a portion of non-financial equity investments from Tier 1 capital, based on the aggregate adjusted carrying value of all non-financial equity investments held directly or indirectly by the banking organization as a percentage of its Tier 1 capital.                     </li> <li> <span style="color: #004a7c;">■</span> Equity exposures that are <b>not</b> deducted generally attract a 100% risk weight.                     </li> </ul>	<ul style="list-style-type: none"> <li> <span style="color: #004a7c;">■</span> <b>0%</b>: Equity exposures to a sovereign, certain supranational entities or an MDB whose debt exposures are eligible for 0% risk weight                     </li> <li> <span style="color: #004a7c;">■</span> <b>20%</b>: Equity exposures to a PSE                     </li> <li> <span style="color: #004a7c;">■</span> <b>100%</b>: Equity exposures to community development investment companies and small business investment companies, effective portion of a hedge pair and non-significant equity investments                     </li> <li> <span style="color: #004a7c;">■</span> <b>250%</b>: Significant investments in the capital of unconsolidated financial institutions that are not deducted from capital                     </li> <li> <span style="color: #004a7c;">■</span> <b>300%</b>: Publicly-traded equity exposures, including the ineffective portion of a hedge pair                     </li> <li> <span style="color: #004a7c;">■</span> <b>400%</b>: Non-publicly traded equity exposures                     </li> <li> <span style="color: #004a7c;">■</span> <b>600%</b>: Equity exposures to certain investment firms that would otherwise meet the definition of "traditional securitization" and have greater than immaterial leverage                     </li> </ul>	<div style="text-align: center;"> <p><b>Equity exposures</b></p> <table border="1" style="margin: 10px auto; border-collapse: collapse; font-size: 0.8em;"> <thead> <tr> <th>Category</th> <th>Existing Risk Weight</th> <th>Final Risk Weight</th> </tr> </thead> <tbody> <tr> <td>Publicly-traded equity exposures</td> <td>100%</td> <td>100%</td> </tr> <tr> <td>Non-publicly traded equity exposures</td> <td>100%</td> <td>400%</td> </tr> <tr> <td>Significant investments in capital of unconsolidated financial institutions</td> <td>100%</td> <td>250%</td> </tr> <tr> <td>Community development investment companies</td> <td>100%</td> <td>300%</td> </tr> <tr> <td>Small business investment companies</td> <td>100%</td> <td>400%</td> </tr> <tr> <td>Equity exposures to PSE</td> <td>100%</td> <td>20%</td> </tr> <tr> <td>Equity exposures to sovereigns, etc.</td> <td>100%</td> <td>0%</td> </tr> </tbody> </table> </div>	Category	Existing Risk Weight	Final Risk Weight	Publicly-traded equity exposures	100%	100%	Non-publicly traded equity exposures	100%	400%	Significant investments in capital of unconsolidated financial institutions	100%	250%	Community development investment companies	100%	300%	Small business investment companies	100%	400%	Equity exposures to PSE	100%	20%	Equity exposures to sovereigns, etc.	100%	0%
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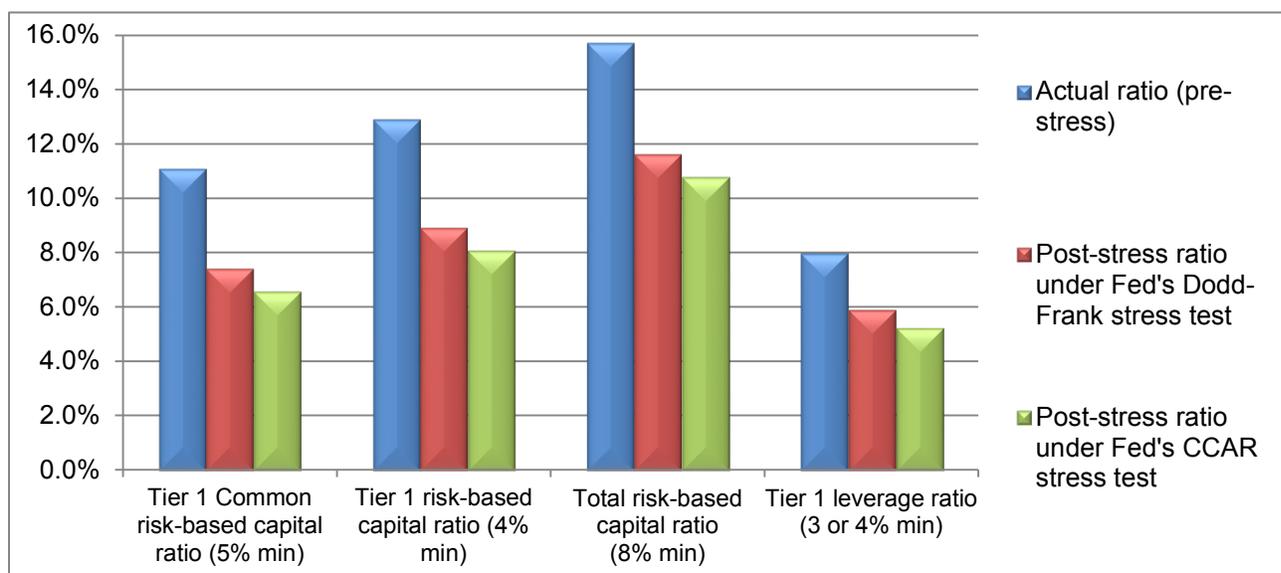
If you have any questions, please contact [basel3@davispolk.com](mailto:basel3@davispolk.com) or your regular Davis Polk contact.

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## 7. Key Capital Planning and Dodd-Frank Stress Testing Issues for IHCs

An IHC: **(1)** must conduct semi-annual Dodd-Frank company-run stress tests; **(2)** must submit an annual capital plan to the Federal Reserve; and **(3)** will be subject to annual Dodd-Frank supervisory stress tests and capital plan analysis conducted by the Federal Reserve.

- **Capital buffer above minimum requirements:** The severity of the Federal Reserve’s hypothetical stress test scenarios means that an IHC will likely need to maintain a large capital buffer on an on-going basis in order to maintain risk-based and leverage capital ratios above minimum requirements under stressed conditions. This has the practical effect of trapping excess capital in the IHC.
  - Receiving a capital plan objection from the Federal Reserve for quantitative **or** qualitative reasons generally means that distributions of earnings by the IHC to its foreign parent or other investors will **not** be permitted.
  - Davis Polk’s visuals of the Federal Reserve’s 2014 stress test scenarios are available [here](#).
  - Below is a chart showing the average actual (pre-stress) and post-stress capital levels of the 18 U.S. BHCs that were subject to the Federal Reserve’s 2013 Dodd-Frank and Comprehensive Capital Analysis and Review (CCAR) supervisory stress tests.
    - The difference between the blue bar (pre-stress capital ratios) and the red and green bars (post-stress capital ratios) reflect the impact of the Federal Reserve’s hypothetical stress scenarios on a firm’s capital position under a stress test.

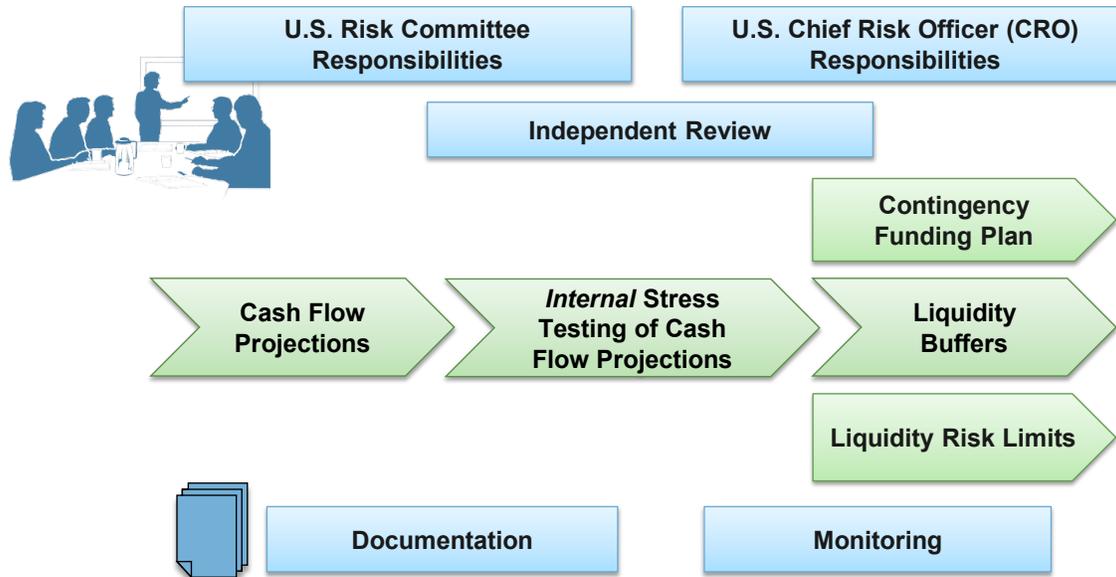


- **Responsibilities:** The capital planning and Dodd-Frank stress testing rules impose extensive responsibilities on the board of directors and senior management with respect to capital planning and stress testing processes and results.
- **Public disclosure:** Summaries of Dodd-Frank stress test results are publicly disclosed.
  - An IHC may disclose additional stress testing information beyond what is required by the Federal Reserve’s Dodd-Frank stress testing rules, including explanations of any differences between the stress testing methodologies of the IHC and its foreign parent that led to the divergent results.

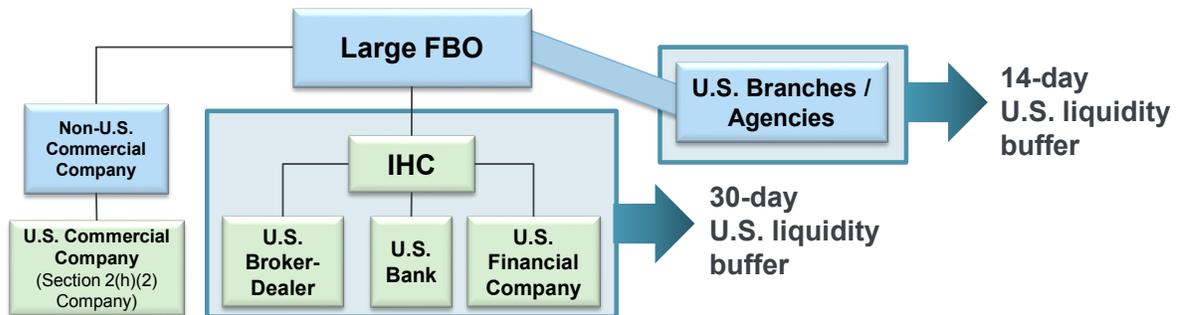
- **Compliance timing:** IHCs must submit capital plans to the Federal Reserve in January 2017 and comply with Dodd-Frank stress testing requirements beginning with the October 1, 2017 stress-test cycle. BHC and IDI subsidiaries of a Large FBO must continue to comply with capital planning and Dodd-Frank stress testing requirements until corresponding requirements applicable to the IHC become effective. For detailed compliance dates, see [Key Compliance Dates for Large FBOs Subject to IHC Requirement](#).

### 8. Liquidity Standards for a Large FBO with ≥ \$50 billion in U.S. Assets

- **U.S. Basel III quantitative liquidity framework:** The Federal Reserve stated that it intends, through future separate rulemakings, to implement the LCR and NSFR for the U.S. operations of **some or all** Large FBOs with ≥ \$50 billion in U.S. assets.
- **Components of EPS final rule’s qualitative liquidity framework:** The final rule, like the proposed rule, contains a qualitative liquidity framework for a Large FBO with ≥ \$50 billion in U.S. assets (**including** U.S. branch/agency assets), depicted as follows:



- **Internal liquidity stress testing requirements** are similar to those in the proposed rule. However, to reduce reporting burdens, the final rule requires that liquidity stress test results be made available to the Federal Reserve in a timely manner, rather than within 14 days, as originally proposed.
- **Size and content of liquidity buffers:** A Large FBO must maintain separate liquidity buffers for its U.S. branches/agencies and the IHC. Liquidity buffers must consist of unencumbered **highly liquid assets** that are sufficient to meet **net stressed cash flow needs**.



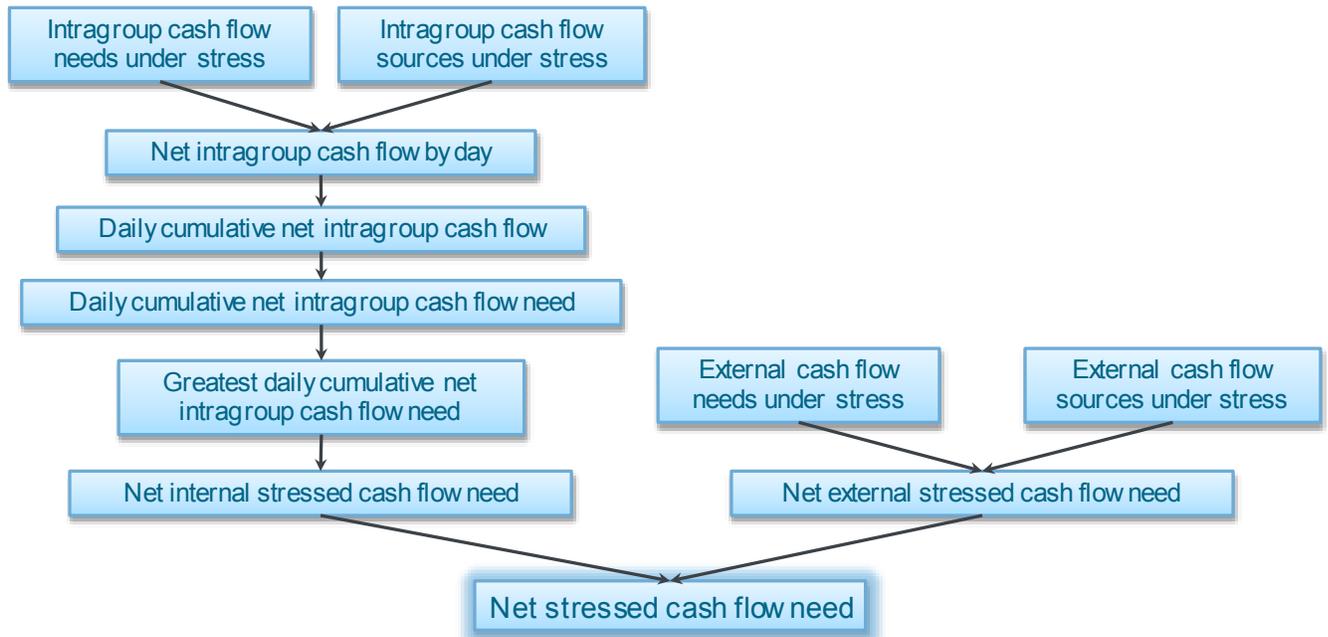
- **Highly liquid assets** in the final rule, like in the proposed rule, do not automatically include home country sovereign debt.
  - **HQLAs:** The preamble to the final rule states that HQLAs as defined in the U.S. LCR proposal “would be liquid under most scenarios.” However, the Large FBO must still:

- Make a liquidity profile demonstration to the Federal Reserve as required by the final rule;
- Meet the diversification requirement;<sup>7</sup> and
- Assign appropriate haircuts, which may be different from the haircuts prescribed for HQLAs in the U.S. LCR proposal.
- **Definition of HQLAs in U.S. LCR proposal:** The definition of HQLAs in the U.S. LCR proposal is **narrower** than in the Basel Committee’s revised LCR framework. For example, under the U.S. LCR proposal, HQLAs do **not** include securities issued or guaranteed by public sector entities (e.g., state, local authority or other governmental subdivision below the sovereign level), covered bonds or RMBS.
  - Davis Polk’s visual memo on the U.S. LCR proposal is available [here](#).
  - Davis Polk’s comparison of the European Banking Authority’s definition of HQLAs and the definition in the U.S. LCR proposal is available [here](#).
- The Federal Reserve clarified that highly liquid assets should **not** include assets required to be pledged or segregated for regulatory requirements, such as the OCC’s Capital Equivalency Deposit requirement or state law asset-pledge requirements.
- Cash held in deposit at other banks are loans and may constitute cash inflows, rather than highly liquid assets that count towards the liquidity buffer.
- **Unencumbered:** An asset is unencumbered if it:
  - Is free of legal, regulatory, contractual, or other restrictions on the ability of such company promptly to liquidate, sell or transfer the asset; **and**
  - Is **either**:
    - Not pledged or used to secure or provide credit enhancement to any transaction; **or**
    - Pledged to a central bank or a U.S. government-sponsored enterprise (GSE), to the extent potential credit secured by the asset is not currently extended by such central bank or U.S. government-sponsored enterprise or any of its consolidated subsidiaries.
- The final rule allows assets that are used as hedges to be considered “unencumbered” if they otherwise meet the above definition. In contrast, the *proposed* rule’s definition of unencumbered required that an asset not be designated as a hedge on a trading position.
- The Federal Reserve clarified that unencumbered highly liquid assets should generally not include assets pledged to a counterparty for provisional needs. In particular, assets pledged to clearing counterparties and assets subject to “banker’s liens” must be considered encumbered in most scenarios, as their encumbrance is an ongoing requirement for conducting business with such counterparties.
- **Prescribed method for calculating net stressed cash flow need:** Consistent with the proposed rule, the final rule prescribes a method for calculating net stressed cash flow need that:

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<sup>7</sup> The final rule excludes cash and securities issued by the United States, a U.S. government agency, or a U.S. government-sponsored enterprise from the diversification requirement.

- Distinguishes between external and internal stressed cash flow needs. Generally, internal cash flows **cannot** be used to offset external cash flows.
- Is designed to minimize maturity mismatches. Specifically, intragroup cash flow sources may offset intragroup cash flow needs of the U.S. branches/agencies or IHC **only** to the extent the term of the intragroup cash flow source is the same as or shorter than the term of the intragroup cash flow need.



▪ **Maintaining liquidity buffers in the United States:**

- The IHC must maintain its **full 30-day** liquidity buffer in the United States.
- The Large FBO's U.S. branches/agencies must maintain a liquidity buffer for the **first 14 days** of a 30-day stress scenario.
  - Unlike the proposed rule, the final rule does not condition the shorter 14-day buffer requirement for U.S. branches/agencies upon a Large FBO demonstrating that its home office or an affiliate can provide additional liquidity to the U.S. branches/agencies if needed.
  - However, the Federal Reserve stated that it expects Large FBOs would hold additional liquidity resources, either at the home office or in the United States, to protect against longer periods of funding pressure at their U.S. branches/agencies.
- The maintenance of the liquidity buffer in the United States means that the assets should be reflected on the balance sheet of the IHC or U.S. branches/agencies, as applicable.

▪ **Dipping into liquidity buffer:** The Federal Reserve noted that dipping into the liquidity buffer during periods of liquidity stress may, in certain circumstances, be beneficial for the safety and soundness of the institution and potentially for financial stability. The Federal Reserve anticipates that any supervisory decisions in response to a reduction of the liquidity buffer will take into consideration the particular circumstances surrounding the reduction.

- If a firm is experiencing idiosyncratic or systemic stress and is otherwise practicing good liquidity risk management, the Federal Reserve expects that supervisors would observe the

firm closely as it uses its liquid resources and work with the firm to determine how to rebuild these resources once the stress period has passed, through a plan or similar process.

- However, a supervisory or enforcement action may be appropriate when a firm's liquidity buffer is reduced substantially, or falls below its stressed liquidity needs as identified by the stress test, because of operational issues or inadequate liquidity risk management. Under these circumstances, a firm may be required to enter into a written agreement if it does not meet the liquidity buffer requirement within an appropriate period of time.
- **Liquidity risk management standards:** Compared with the proposed rule, the final rule contains broadly similar liquidity risk management standards, including specific responsibilities for the Large FBO's U.S. risk committee and U.S. CRO.
  - The final rule makes certain adjustments, for example by moving the responsibility for the approval of a contingency funding plan from the U.S. CRO to the U.S. risk committee.
- **Interaction with Basel III liquidity framework:** The internal liquidity stress testing and buffer requirements will exist alongside of, and are designed to complement, the Basel III LCR and NSFR.
  - A **key difference** between the LCR and the liquidity buffer requirement in the EPS final rule is that the former is based on prescribed cash inflow and outflow rates and assumptions under the standardized supervisory stress scenario, whereas the latter is based on the results of a Large U.S. BHC's **internal** liquidity stress testing.
  - Davis Polk's visual memo on the U.S. LCR proposal is available [here](#). Davis Polk's overview of the Basel Committee's proposed revisions to the NSFR is available [here](#).

## 9. Risk Management Standards

The risk management standards in final rule are **broadly similar** to the proposed rule.

- **U.S. risk committee:** Large FBOs and Public Mid-size FBOs must maintain a U.S. risk committee. Consistent with the proposed rule, the final rule imposes additional risk committee requirements for Large FBOs with  $\geq$  \$50 billion in U.S. assets (including U.S. branch/agency assets).
  - **Location:** A Large FBO with  $\geq$  \$50 billion in U.S. assets that conducts its operations through U.S. branches/agencies (in addition to its IHC, if any) may maintain its U.S. risk committee either as: **(1)** a committee of its global board of directors, on a stand-alone basis or as part of its enterprise-wide risk committee; or **(2)** a committee of the board of directors of its IHC, on a stand-alone basis or as a joint committee with the risk committee of its IHC.
    - A Large FBO that conducts its operations in the U.S. **solely** through an IHC must maintain its U.S. risk committee as a committee of the IHC's board of directors.
  - **Composition:** The U.S. risk committee for a Large FBO with  $\geq$  \$50 billion in U.S. assets must include **(1)** at least one member with experience in identifying, assessing, and managing risk exposures of large, complex **financial** firms;<sup>8</sup> and **(2)** at least one member who meets certain **independence** requirements.<sup>9</sup>
    - **Less stringent composition requirements for FBOs with limited U.S. footprints and smaller FBOs:** The U.S. risk committee of a Large FBO with  $<$  \$50 billion in U.S. assets or a Public Mid-size FBO is:
      - **Not** subject to the independent committee member requirement.
      - Required to have at least one committee member with experience in identifying, assessing, and managing risk exposures of large, complex firms, which may be acquired in a **non**banking or **non**financial field.
  - **Responsibilities:** U.S. risk committee responsibilities in the final rule are broadly similar to the proposed rule.
    - The U.S. risk committee of a Large FBO with  $\geq$  \$50 billion in U.S. assets must approve and periodically review the risk management policies of the Large FBO's combined U.S. operations.
    - Generally, members of a U.S. risk committee should **fully understand** the risk management policies and framework of the Large FBO's combined U.S. operations

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<sup>8</sup> In discussing the parallel risk committee requirement for large U.S. BHCs, the Federal Reserve stated that while the final rule requires only one member of the risk committee to have experience in identifying, assessing and managing risk exposures of large, complex financial firms, the Federal Reserve expects all risk committee members generally to have an understanding of risk management principles and practices relevant to the firm. The appropriate level of risk-management expertise for a firm's risk committee can vary depending on the risks posed by the firm to the stability of the U.S. financial system. According to the Federal Reserve, the risk committee of a firm that poses more systemic risk should have more risk committee members with commensurately greater understandings of risk management principles and practices.

<sup>9</sup> In discussing the parallel risk committee requirement for large U.S. BHCs, the Federal Reserve stated in the preamble to the final rule that a firm should determine the appropriate proportion of independent directors on the risk committee based on its size, scope, and complexity, provided that it meets the minimum requirement of one independent director. It noted that active involvement of independent directors can be vital to robust oversight of risk management and encourages firms to consider including additional independent directors as members of their risk committees. The Federal Reserve further noted that involvement of directors affiliated with the firm on the risk committee may complement the involvement of independent directors.

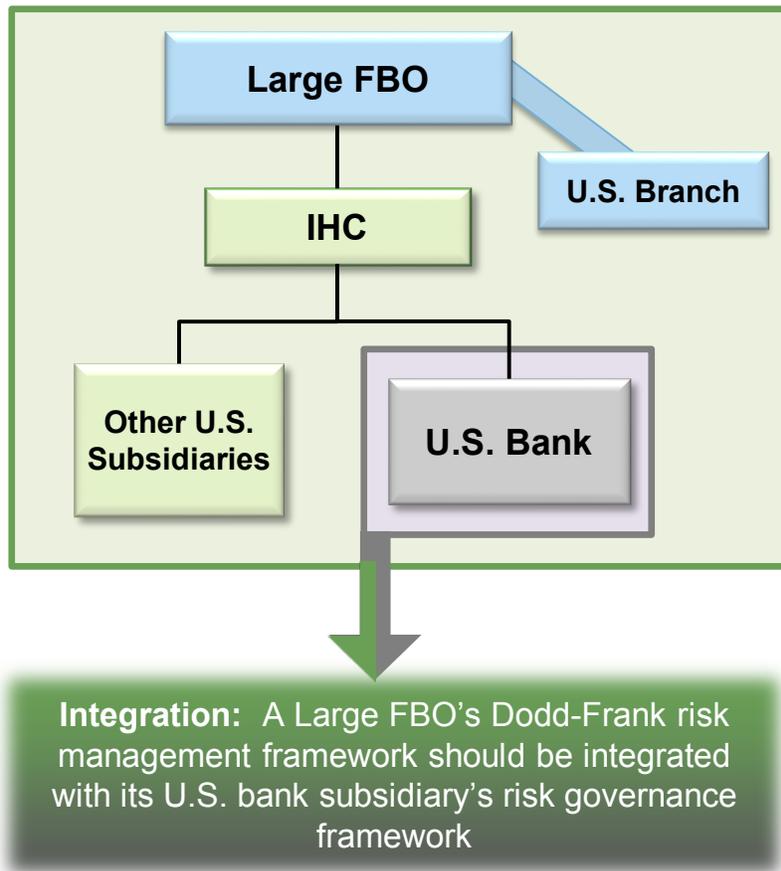
and have a **general understanding** of the risk management practices of the combined U.S. operations.

- **Combined U.S. operations** = IHC and its consolidated subsidiaries + U.S. branches/agencies.<sup>10</sup>
- **IHC risk committee:** An IHC must maintain a risk committee of the board of directors. The IHC's risk committee may also fulfill the responsibilities of the Large FBO's U.S. risk committee.
  - The IHC's risk committee must include **(1)** at least one member with experience in identifying, assessing, and managing risk exposures of large, complex **financial** firms; and **(2)** at least one member who meets certain **independence** requirements.
- **U.S. CRO requirement for Large FBOs with major U.S. footprints:** A Large FBO with ≥ \$50 billion in U.S. assets (including U.S. branch/agency assets) must employ a U.S. CRO with specified risk management expertise and responsibilities.
  - **Role:** The U.S. CRO will be the single point of contact within a Large FBO that will oversee the management of risks within the Large FBO's combined U.S. operations. U.S. CRO responsibilities in EPS final rule broadly similar to proposed rule.
    - The U.S. CRO may not also serve as the Large FBO's global CRO.
  - **Dual reporting:** The U.S. CRO must report directly to the U.S. risk committee and the Large FBO's global CRO, unless the Federal Reserve approves an alternative structure.
  - **Location:** The U.S. CRO must be employed by and located in a U.S. branch, agency, IHC or another U.S. subsidiary.
- **Risk management framework:** A Large FBO with ≥ \$50 billion in U.S. assets (including U.S. branch/agency assets) is required to adopt a risk management framework for its combined U.S. operations.
  - The required components of the risk management framework in the final rule are broadly similar to the proposed rule.
- **Existing risk management guidance:** Risk management standards in final rule supplement existing Federal Reserve risk management guidance and supervisory expectations.
- **Interaction with subsidiary bank risk governance framework:** Large FBOs with U.S. bank subsidiaries will need to consider the interaction between **(1)** the risk management framework required by the final rule; and **(2)** risk governance expectations or guidelines applicable to their U.S. depository institution subsidiaries (e.g., the OCC's proposed risk governance guidelines).

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<sup>10</sup> **Compare EPS final rule Section 252.2(e)** ("Combined U.S. operations of a foreign banking organization means: (1) Its U.S. branches and agencies, if any; and (2)(i) If the foreign banking organization has established a U.S. intermediate holding company, the U.S. intermediate holding company and the subsidiaries of such U.S. intermediate holding company; or (ii) If the foreign banking organization has not established a U.S. intermediate holding company, the U.S. subsidiaries of the foreign banking organization (excluding any section 2(h)(2) company, if applicable), and subsidiaries of such U.S. subsidiaries.")(emphasis added) **with Volcker Rule final regulations Section \_\_.20(d)(1)(ii)**("A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in Appendix A, if: . . . (ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section.")(emphasis added).

- Davis Polk's visual memo on the OCC's proposed risk governance guidelines for large national banks and federal savings associations is available [here](#).



## 10. Next Steps for Single Counterparty Credit Limits

- The Federal Reserve stated that it is conducting a quantitative impact study and will also take into account the Basel Committee's large exposures regime before finalizing SCCLs. Davis Polk's overview of the Basel Committee's March 2013 proposed large exposures regime is available [here](#).
- There are significant differences among the Basel Committee's proposed large exposures framework, the Federal Reserve's proposed SCCLs and the EU large exposures regime in CRD IV.
- **Overview of SCCLs in December 2012 proposed rule:** Under the proposed rule, SCCLs would apply on a consolidated basis to a Large FBO's IHC. Separate SCCLs would apply to the Large FBO's combined U.S. operations.
  - **SCCLs for IHC:** An IHC, together with its subsidiaries, would be prohibited from having an aggregate net credit exposure to any **unaffiliated** counterparty, together with the counterparty's subsidiaries, in excess of 25% of the **IHC's** consolidated "capital stock and surplus."
    - **IHC's capital stock and surplus** = IHC's total regulatory capital plus the excess allowance for loan and lease losses not included in the IHC's Tier 2 capital.
    - **Net credit exposure** = gross credit exposure arising from "credit transactions" after applying adjustments to take into account eligible credit risk mitigants.
  - **SCCLs for combined U.S. operations:** The combined U.S. operations of a Large FBO, together with any subsidiary of an entity within the combined U.S. operations, would be prohibited from having an aggregate net credit exposure to any **unaffiliated** counterparty, together with the counterparty's subsidiaries, in excess of 25% of the consolidated total regulatory capital of the **Large FBO**.
  - **More stringent SCCLs between major counterparties:** A quantitatively more stringent SCCL would apply between a major IHC, together with its subsidiaries, and any unaffiliated major counterparty, together with the counterparty's subsidiaries. A quantitatively more stringent SCCL would also apply between the U.S. operations of a major FBO, together with the U.S. operations' subsidiaries, and any unaffiliated major counterparty, together with the counterparty's subsidiaries.
    - The December 2012 proposed rule did **not** specify the more stringent SCCL, expressed as a percentage of capital stock and surplus, but stated that it will be aligned with the final SCCLs established by the Federal Reserve for major U.S. BHCs.
    - **Major counterparties include:**
      - U.S. BHC with ≥ \$500 billion in total consolidated assets.
      - IHC with ≥ \$500 billion in total consolidated assets.
      - FBO with ≥ \$500 billion in total global consolidated assets.
      - Nonbank financial company (of any size) that has been designated as systemically important by the U.S. Financial Stability Oversight Council.

## 11. Key Compliance Dates for Large FBOs Subject to IHC Requirement

<b>June 30, 2014</b>	<ul style="list-style-type: none"> <li>A Large FBO with U.S. assets (<u>excluding</u> U.S. branch/agency assets) of <math>\geq</math> \$50 billion as of June 30, 2014 must submit an implementation plan by January 1, 2015 outlining its proposed process to come into compliance with the IHC requirement.</li> </ul>
<b>January 1, 2015</b>	<ul style="list-style-type: none"> <li>A Large FBO that is required to establish or designate an IHC must submit IHC implementation plan to the Federal Reserve.</li> <li>U.S. bank and BHC subsidiaries of a Large FBO must begin complying with U.S. Basel III, subject to phase-in arrangements. <ul style="list-style-type: none"> <li>U.S. Basel III compliance date for SR 01-1 BHCs is July 21, 2015.</li> </ul> </li> <li>U.S. BHC subsidiaries of a Large FBO must begin complying with EPS applicable to U.S. BHCs until an IHC is formed or designated and the IHC becomes subject to corresponding EPS.</li> </ul>
<b>January 1, 2016</b>	<ul style="list-style-type: none"> <li>U.S. bank and BHC subsidiaries of a Large FBO become subject to the capital conservation buffer and, for the largest IHCs, the countercyclical capital buffer frameworks under U.S. Basel III, subject to phase-in arrangements.</li> </ul>
<b>January 4, 2016</b>	<ul style="list-style-type: none"> <li>A Large FBO seeking permission to establish alternative or multiple IHC structures or other tailoring must submit written request to the Federal Reserve. <ul style="list-style-type: none"> <li>In practice, discussions with the Federal Reserve need to begin much earlier.</li> </ul> </li> </ul>
<b>July 1, 2016</b>	<ul style="list-style-type: none"> <li>A Large FBO must form or designate an IHC that holds the Large FBO's ownership interest in any U.S. BHC subsidiary, any insured depository institution subsidiary, and U.S. subsidiaries representing 90% of the Large FBO's U.S. non-branch/agency assets not held under the BHC or the insured depository institution subsidiary.</li> <li>An IHC must begin complying with EPS (<i>e.g.</i>, U.S. Basel III, liquidity and risk-management requirements) and applicable regulatory reporting requirements, <i>other than</i> leverage ratio and stress testing requirements.</li> </ul>
<b>August 1, 2016</b>	<ul style="list-style-type: none"> <li>A Large FBO must notify the Federal Reserve of its formation or designation of an IHC and certify compliance with the IHC requirement and EPS.</li> </ul>
<b>January 2017</b>	<ul style="list-style-type: none"> <li>An IHC must submit its first annual capital plan to the Federal Reserve.</li> </ul>
<b>July 1, 2017</b>	<ul style="list-style-type: none"> <li>All remaining assets of a Large FBO that are required to be held under an IHC must be transferred to the IHC.</li> </ul>
<b>October 1, 2017</b>	<ul style="list-style-type: none"> <li>First Dodd-Frank stress-testing cycle begins for an IHC.</li> </ul>
<b>January 1, 2018</b>	<ul style="list-style-type: none"> <li>An IHC must begin complying with leverage ratio requirements — <i>i.e.</i>, the U.S. leverage ratio and, for the largest IHCs, the U.S. Basel III supplementary leverage ratio.</li> </ul>
<b>January 2018</b>	<ul style="list-style-type: none"> <li>An IHC must submit its second annual capital plan and results of its first annual Dodd-Frank company-run stress test to the Federal Reserve.</li> </ul>
<b>March 2018</b>	<ul style="list-style-type: none"> <li>An IHC must disclose summary results of its first annual Dodd-Frank company-run stress test under the supervisory severely adverse scenario.</li> <li>The Federal Reserve will disclose summary results of its first Dodd-Frank supervisory stress test of an IHC and its post-stress capital analysis of an IHC's capital plan.</li> </ul>
<b>July 2018</b>	<ul style="list-style-type: none"> <li>An IHC must submit its mid-year Dodd-Frank company-run stress tests to the Federal Reserve.</li> </ul>
<b>September 2018</b>	<ul style="list-style-type: none"> <li>An IHC must disclose summary results of its mid-year Dodd-Frank company-run stress test under its own severely adverse scenario.</li> </ul>

We plan to publish more detailed analysis, visuals and interactive tools relating to the enhanced prudential standards final rule. Our enhanced prudential standards resources are available at [USBasel3.com/EPS](http://USBasel3.com/EPS). Our capital and prudential standards blog can be accessed at [blog.usbasel3.com](http://blog.usbasel3.com)

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