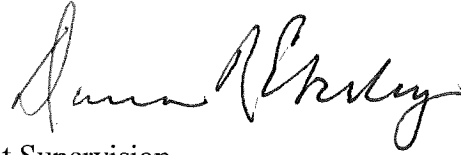
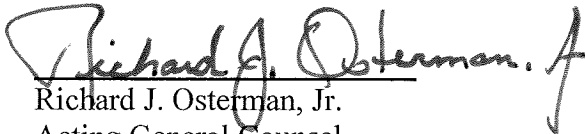


DATE: September 3, 2014
MEMORANDUM TO: Board of Directors
FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision
SUBJECT: Liquidity Coverage Ratio Final Rule



Recommendation: Staff recommends that the FDIC Board approve and issue the attached final rule to implement a liquidity coverage ratio (LCR or final rule) applicable to all (1) bank holding companies, savings and loan holding companies that do not have significant insurance operations, and depository institutions with \$250 billion or more in total assets or \$10 billion or more in on-balance sheet foreign exposure;¹ and (2) depository institutions with \$10 billion or more in total consolidated assets that are consolidated subsidiaries of one or more of the foregoing. The quantitative liquidity requirements included in the LCR final rule are consistent with liquidity standards adopted by the Basel Committee on Banking Supervision (BCBS) in January 2013.

Concurrence:



Richard J. Osterman, Jr.
Acting General Counsel

¹ Total consolidated assets for the purposes of the proposed rule would be as reported on a covered banking organization's most recent year-end Consolidated Reports of Condition and Income (call report) or Consolidated Financial Statements for Bank Holding Companies, Federal Reserve Form FR Y-9C (or, for SLHCs not required to report on the FR Y-9C, its estimated total consolidated assets as of the most recent year end, calculated in accordance with the instructions to the FR Y-9C). Foreign exposure data would be calculated in accordance with the Federal Financial Institution Examination Council 009 Country Exposure Report.

If approved, the final rule will be issued jointly by the FDIC, the FRB, and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies). The final rule will be incorporated into the FDIC's codified regulations as part 329 and will have an effective date of January 1, 2015. Concurrently, if approved by the Board of Governors of the Federal Reserve System, the FRB will apply a modified version of the LCR to certain depository institution holding companies (subsidiary insured depository institutions would not be subject to this requirement) with total consolidated assets greater than \$50 billion.

I. Introduction

On November 29, 2013, the agencies invited public comment on a proposed rule (proposed rule or proposal)² to implement a liquidity coverage ratio requirement, consistent with the international liquidity standards published by the BCBS.³ The BCBS published the international liquidity standards in December 2010 as a part of the Basel III reform package⁴ and revised the standards in January 2013 (as revised, the Basel III Revised Liquidity Framework).

The proposed rule would have established a quantitative minimum liquidity coverage ratio that builds upon the liquidity coverage methodologies traditionally used by banking organizations to assess exposures to contingent liquidity events. The proposed rule would have required a covered company to maintain an amount of unencumbered high-quality liquid assets (HQLA amount) sufficient to meet the total stressed net cash outflows over a prospective 30 calendar-day period. The proposal was designed to complement existing supervisory guidance

² OCC, FRB, FDIC, "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 FR 71818 (November 29, 2013).

³ The BCBS is a committee of banking supervisory authorities that was established by the central bank governors of the G10 countries in 1975. Documents issued by the BCBS are available through the Bank for International Settlements Website at <http://www.bis.org>.

⁴ BCBS, "Basel III: International framework for liquidity risk measurement, standards and monitoring" (December 2010), available at <http://www.bis.org/publ/bcbs188.pdf>.

and the more qualitative liquidity requirements that the FRB issued, in consultation with the OCC and the FDIC, pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).⁵ The proposed rule also would have established transition periods for conformance with the requirements.

The agencies sought public comment on all aspects of the proposed rule and received over 100 public comments from U.S. and foreign firms, public officials (including state and local governments and members of Congress), public interest groups, private individuals, and other interested parties. In addition, agency staff held more than 25 meetings with members of the public and obtained supplementary information from certain commenters. Commenters generally supported the purpose of the proposed rule to create a standardized minimum liquidity requirement, but raised concerns with certain requirements in the proposal that they believed to be super-equivalent (i.e., more restrictive) than the Basel III Revised Liquidity Framework, such as applying the LCR to some subsidiaries, providing for less granular treatment of corporate bonds, assessing mismatches inside of 30 days, requiring higher outflow rates for commitments to financial sector entities, and imposing a higher run-off rate for some brokered deposits. Commenters also raised concerns regarding the relatively narrow scope of assets that qualified for inclusion as HQLA, including many comments supporting the inclusion in HQLA of municipal securities; took issue with the method for calculating the HQLA amount; advocated specific outflow and inflow rates; criticized the proposed daily calculation of the LCR (as contrasted with the Basel III Revised Liquidity Framework's monthly calculation); expressed

⁵ See FRB, "Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations," 79 FR 17240 (March 27, 2014) (FRB's Regulation YY); OCC, FRB, FDIC, OTS, and NCUA, "Interagency Policy Statement on Funding and Liquidity Risk Management," 75 FR 13656 (March 22, 2010) (Interagency Liquidity Policy Statement).

concerns over the accelerated timetable for implementation; and articulated various other technical and substantive concerns.

The agencies have carefully considered and, in the preamble of the final rule, have responded to the specific comments received on the proposed rule. Further, to address several of the concerns raised by commenters on the requirements of the proposed rule, and to enhance the overall effectiveness of the final rule, the agencies have made several significant changes to the final rule, discussed in section III of this Memorandum.

II. Overview of the Final Rule

A. Scope

The final rule establishes a minimum liquidity coverage ratio applicable to all (1) bank holding companies, savings and loan holding companies that do not have significant insurance operations, and depository institutions with \$250 billion or more in total assets or \$10 billion or more in on-balance sheet foreign exposure;⁶ (2) depository institutions with \$10 billion or more in total consolidated assets that are consolidated subsidiaries of one or more of the foregoing (collectively, covered companies).⁷ The preamble to the final rule states that the agencies do not intend to apply the LCR to community banks.

⁶ Total consolidated assets for the purposes of the proposed rule would be as reported on a covered banking organization's most recent year-end Consolidated Reports of Condition and Income (call report) or Consolidated Financial Statements for Bank Holding Companies, Federal Reserve Form FR Y-9C (or, for SLHCs not required to report on the FR Y-9C, its estimated total consolidated assets as of the most recent year end, calculated in accordance with the instructions to the FR Y-9C). Foreign exposure data would be calculated in accordance with the Federal Financial Institution Examination Council 009 Country Exposure Report.

⁷ The proposed rule also applied to nonbank financial companies designated by the FSOC for supervision by the Board of Governors of the Federal Reserve System (FRB) under section 113 of the Dodd-Frank Act (nonbank SIFIs) that do not have significant insurance operations. The FRB decided not to apply the final rule to such companies, but intends to make the final rule applicable to nonbank SIFIs by order and may tailor the application of the LCR requirements of this part to the nonbank SIFI based on the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the nonbank SIFI. Upon the effectiveness of such an order, the final rule will apply to a nonbank SIFI's depository institution subsidiaries with \$10 billion or more in total consolidated assets.

The agencies have reserved the authority to apply the final rule to an entity not in one of the categories described above if it is determined that the application of the liquidity coverage ratio would be appropriate in light of the entity's asset size, level of complexity, risk profile, scope of operations, or risk to the financial system. A covered company would remain subject to the final rule until its primary Federal supervisor determines in writing that application of the final rule to the company is no longer appropriate in light of these same factors.⁸

There is currently one⁹ FDIC-supervised institution that would be subject to the requirements of the final rule.¹⁰

B. Liquidity Coverage Ratio

The final rule will require a covered company to maintain an amount of eligible HQLA meeting the criteria set forth in the final rule (the numerator of the ratio) that is no less than 100 percent of its total net cash outflows over a 30-day period (the denominator of the ratio), as calculated in accordance with the final rule. The final rule requires a covered company to calculate its liquidity coverage ratio daily, as of a time certain selected by the covered company that cannot be changed without the written approval of its appropriate Federal banking agency.

C. The Numerator: High Quality Liquid Assets

HQLA makes up the numerator of the liquidity coverage ratio subject to criteria and limitations that are meant to ensure that a covered company's HQLA amount only includes

⁸ The agencies also are reserving the authority to require a covered banking organization to hold an amount of HQLA greater than otherwise required under the proposed rule, or to take any other measure to improve the covered bank's liquidity risk profile, if liquidity requirements as calculated under proposed rule are not commensurate with liquidity risks.

⁹ Staff anticipates that a second FDIC-supervised institution will be subject to the LCR upon the FRB's issuance of an order making the LCR applicable to a nonbank SIFI.

¹⁰ The FRB also is proposing on its own to implement a modified version of the liquidity coverage ratio as an enhanced prudential standard for bank holding companies and savings and loan holding companies without significant insurance or commercial operations that, in each case, have \$50 billion or more in total consolidated assets. The FRB's proposal is not part of the common text that the Board is being asked to approve as part of this case but is amendatory text that is part of the FRB's rulemaking.

assets with a high potential to generate liquidity through sale, repurchase agreement, or other monetization during a stress scenario. These assets possess the characteristics associated with the most liquid assets that covered companies typically hold. In identifying the types of assets that would qualify as HQLA, staff considered the following categories of liquidity characteristics, which are generally consistent with those of the Basel III Revised Liquidity Framework: risk profile, market-based characteristics, and central bank eligibility.

D. The Denominator: Net Cash Outflows

Net cash outflows make up the denominator of the liquidity coverage ratio. The final rule assigns run-off and draw down rates to various sources of on- and off-balance sheet funding based on the historical behavior and characteristics of those funding sources during periods of liquidity stress. These outflow rates are multiplied by the outstanding balances of each category of funding to arrive at the applicable outflow amount, and then summed to determine the total cash outflow amount.

The total cash outflow amount generally may be offset by cash inflows, which are calculated by multiplying the outstanding balances of various types of contractual receivables by the inflow rates that are reflective of potential stresses the bank may face during the 30-day stress period. However, total expected cash inflows are limited to 75 percent of total expected cash outflows. This limitation is designed to account for the possibility that a portion of expected cash inflows may become unavailable in a short-term stressed environment, and staff believes that, at a minimum, at least one-quarter of the total expected cash outflow amount should be covered by HQLA.

E. Liquidity coverage ratio shortfall

The final rule requires a covered company to report immediately to its appropriate Federal banking agency when its LCR falls below the minimum required level. Staff recognizes that a covered company may need to use its HQLA during a period of liquidity stress that exceeds normal business fluctuations. To the extent that use of HQLA may cause a covered company's LCR to fall below the minimum requirement, staff is of the view that supervisory actions should not discourage or deter a covered company from using its HQLA.

If a covered company's LCR is below the minimum requirement for three consecutive business days¹¹ or if the covered company's appropriate Federal banking agency determines that the covered company is otherwise materially noncompliant with the requirements of the final rule, the covered company is required to provide to the appropriate Federal banking agency a plan for achieving compliance with the minimum liquidity requirement and all other requirements of the final rule. The plan must include:

- (1) an assessment of the covered company's liquidity position;
- (2) the measures the covered company has taken and will take to achieve full compliance with the final rule, including, as applicable:
 - (A) a plan for adjusting the covered company's risk profile, risk management, and funding sources in order to achieve full compliance with this part;
 - (B) a plan for remediating any operational or management issues that contributed to noncompliance with the final rule;

¹¹ During the transition period when a covered company is calculating its LCR monthly, if the covered company's liquidity ratio is below the minimum requirement for any calculation date that is the last business day of the applicable calendar month, or if the appropriate Federal banking agency has determined that the covered company is otherwise materially noncompliant final rule, the covered company must promptly consult with the appropriate Federal banking agency to determine whether the covered company must provide to the appropriate Federal banking agency a plan for achieving compliance with the minimum liquidity requirement and all other requirements of the final rule.

- (3) an estimated timeframe for achieving full compliance with the final rule; and
- (4) a commitment to report to the appropriate Federal banking agency no less than weekly on progress to achieve compliance in accordance with the plan until full compliance with the final rule is achieved.

In addition, the final rule makes clear that each agency may, at its discretion, take additional supervisory action to address noncompliance with the established minimum liquidity coverage ratio.

F. Transitions and timing

The final rule will require the largest and most complex covered companies – global systemically important banks (GSIBs)¹² – and their consolidated subsidiaries to calculate the LCR on the last business day of each calendar month from January 1, 2015, to June 30, 2015, and on each business day from July 1, 2015, onward. Recognizing commenters’ concerns regarding the operational difficulty for organizations that were not already subject to daily liquidity reporting requirements, staff has amended the transition periods in the final rule to require all other covered companies to calculate the LCR on the last business day of each calendar month from January 1, 2015, and on each business day from July 1, 2016, onward. As in the proposed rule, the final rule will require covered companies to comply with the minimum liquidity coverage ratio as follows: 80 percent on January 1, 2015; 90 percent on January 1, 2016; and 100 percent on January 1, 2017, and thereafter. The transition period accounts for the potential implications of the final rule on financial markets, credit extension, and economic growth and seeks to balance these concerns with the final rule’s important role in promoting a more robust and resilient financial sector. The information gathered from a subset of the covered

¹² Consistent with other recent rulemakings, the agencies have used a threshold of \$700 billion or more in total consolidated assets or \$10 trillion or more in assets under custody to define GSIBs.

companies indicates that most covered companies should have little difficulty meeting these requirements.

G. Reporting

Staff anticipates implementing reporting and public disclosure requirements in a separate NPR. In the meantime, covered companies will be responsible for calculating the LCR monthly or daily, in accordance with the transition provisions, maintaining policies and procedures for the implementation of the LCR, and providing information to the appropriate Federal banking agency as requested.

III. Significant Changes to the Proposed Rule

To address concerns raised by a number of commenters, certain adjustments have been made to the final rule. With respect to the inclusion of corporate debt securities as HQLA, the agencies have removed the requirement that such corporate debt securities be traded on a public exchange in order to qualify for inclusion as a liquid asset, although such securities still must be liquid and readily-marketable.

Additionally, the agencies have expanded the pool of publicly traded common equity shares that may be included as liquid assets. Under the final rule, a publicly traded common equity share is eligible for inclusion as a liquid asset if it is included in the Russell 1000 Index instead of the narrower S&P 500. With this expansion, the agencies have removed the provision that would have permitted a covered company to include publicly traded equity securities listed on another index upon demonstration to the agencies that the equities listed on it are as liquid and readily-marketable as those in S&P 500.

One area that was not changed but that was heavily commented on primarily by local governments, was the exclusion of municipal securities from HQLA. Commenters expressed

concern that the exclusion of municipal securities from HQLA could lead to higher funding costs for municipalities, which could affect local economies and infrastructure. Consistent with the proposed rule, the final rule does not include state and municipal securities as HQLA because the liquidity characteristics of municipal securities range significantly, and many of these assets do not exhibit the characteristics required for inclusion in HQLA.

With respect to the calculation of a covered company's HQLA amount, the agencies agree with certain comments received regarding the treatment of secured preferred deposits in the unwind calculation required to determine the adjusted excess HQLA amount. The agencies are therefore removing secured funding transactions that are specific collateralized deposits, namely municipal deposits, and certain corporate trust deposits, which are required by law to be collateralized, from the unwind calculation.

The agencies have also amended certain elements of the calculation of net cash outflows. The methodology for determining the maximum cumulative peak net outflow has been modified to address certain issues relating to the treatment in the proposed rule of non-maturity outflows. The revised methodology focuses more explicitly on the maturity mismatch of contractual outflows and inflows under the rule as well as overnight funding from financial institutions. The agencies have also amended the definition of those services related to clearing, custody, and cash management, referred to as operational services, as well as the list of requirements that must be met to qualify for the reduced outflow rate for deposits related to such services receive. In making these amendments, the agencies have addressed certain issues raised by commenters relating to the types of operational services that would be covered by the rule, as well as the requirement to exclude from operational deposits certain deposits associated with prime brokerage services under the proposed rule.

Finally, changes have been made to the rule's transition periods to address concerns raised by commenters that the transition periods set forth in the proposed rule would not have provided covered companies with enough time to establish the required infrastructure to ensure compliance with the proposed rule's requirements, including the daily calculation requirement of the proposed rule. In particular, the agencies have extended the dates by which certain covered companies must meet the daily LCR calculation requirement, and covered companies initially will be required to calculate the LCR on a monthly basis beginning January 2015. GSIBs and their consolidated subsidiaries will begin calculating a daily LCR on July 1, 2015, and all other covered companies will begin calculating a daily LCR on July 1, 2016.

IV. Conclusion

Staff recommends that the Board approve and issue the attached final rule and authorize its publication in the *Federal Register*, which would establish a quantitative liquidity coverage ratio requirement for covered FDIC-supervised institutions. In addition to promoting a covered bank's liquidity in times of financial market distress, the uniform LCR requirement will provide the FDIC with current and forward-looking information to assist in appraisal of a covered company's HQLA balanced against a reasonable assessment of net outflows, help the FDIC to better identify potential downside risks and the potential impact of adverse outcomes on the liquidity of covered companies, and assist the FDIC in ensuring the financial stability not just of covered FDIC-supervised banks and covered companies, but also the broader economy. In this way, staff believes the LCR will be an important tool for the FDIC in its roles as primary Federal supervisor of FDIC-supervised institutions, as insurer of deposits, and as orderly liquidator of complex financial institutions.

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