November 6, 2018

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision

SUBJECT: ***Notice of proposed rulemaking.*** Proposed changes to applicability thresholds for regulatory capital requirements and liquidity requirements

Recommendation: Staff recommends that the FDIC Board (Board) approve publication in the *Federal Register* of the attached Notice of Proposed Rulemaking (NPR or proposal) that would establish a revised framework for large U.S. banking organizations and their subsidiary depository institutions (banking organizations) for determining application of the regulatory capital rule, the liquidity coverage ratio (LCR) rule, and the proposed net stable funding ratio (NSFR) rule based on such organizations' risk profile. The NPR would establish four categories of standards for banking organizations with total assets of $100 billion or more and apply capital and liquidity requirements tailored for banking organizations subject to each category:

- Category I standards would apply to U.S. Global Systemically Important Banks (GSIBs).
- Category II standards would apply to banking organizations with $700 billion or more in total assets, or $100 billion or more in total assets and $75 billion or more in cross-jurisdictional activity.

Concur:

Charles Yi
General Counsel

- Category III standards would apply to banking organizations with $250 billion or more in total assets or $100 billion or more in total assets and $75 billion or more in: nonbank assets, weighted short-term wholesale funding, or off-balance-sheet exposures.
- Category IV standards would apply to banking organizations with at least $100 billion and less than $250 billion in total assets and less than $75 billion in the following risk-based indicators: nonbank assets, weighted short-term wholesale funding, or off-balance-sheet exposures.

The proposal would not amend the capital and liquidity requirements applicable to intermediate holding companies of foreign banking organizations.

If approved, the NPR would be issued jointly by the FDIC, the Board of Governors of the Federal Reserve System (FRB), and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies) and would be published in the *Federal Register* with a comment period that would end on January 22, 2019.

Recommendation: Staff recommends that the Board approve the NPR and authorize its publication in the *Federal Register* with a public comment period that would end on January 22, 2019.

Discussion:

I. Background

Since the 2007-2009 financial crisis, the agencies have implemented or proposed measures to strengthen banking organizations' overall risk management, capital, and liquidity positions. For example, in 2013, the agencies adopted a revised regulatory capital rule (capital rule) that, among other things, addressed weaknesses in the regulatory framework that became apparent in the 2007-2009 financial crisis.[1] In addition, the agencies adopted the LCR rule in 2014, which established a quantitative liquidity requirement[2] that subject entities maintain an amount of high-quality liquid assets (HQLA) equal to or greater than their projected total net cash outflows over a prospective 30 calendar-day period. Also, on June 1, 2016, the agencies invited comment on a proposed rule to implement an NSFR requirement[3] that would establish a quantitative metric to measure and help ensure the stability of the funding profile of a banking organization over a one-year time horizon.

Many of the agencies' current rules, including the capital rule, the LCR rule, and the proposed NSFR rule, differentiate among banking organizations based on one or more risk indicators, such as total asset size and foreign exposure. Specifically, the capital rule categorizes banking organizations into two groups: (i) banking organizations with total consolidated assets of less than $250 billion and total on-balance sheet foreign exposure of less than $10 billion (standardized approach banking organizations)[4] and (ii) banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure, together with depository institution subsidiaries of banking organizations meeting those thresholds (advanced approaches banking organizations).[5]

With respect to liquidity, the LCR rule and the proposed NSFR requirement also distinguish between banking organizations based on total asset size and foreign exposure with more stringent requirements applied to advanced approaches banking organizations and to their depository institution

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[1] The FRB and OCC issued a joint final rule on October 11, 2013 (78 FR 62018) and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). On April 14, 2014 (79 FR 20754), the FDIC adopted the interim final rule as a final rule with no substantive changes.

[2] *See, e.g.*, 12 CFR part 329 (FDIC).

[3] "Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements; Proposed Rule," 81 FR 35124 (June 1, 2016).

[4] *See* 12 CFR part 217, subparts D &E (FRB); 12 CFR part 3 (OCC), Subparts D &E; 12 CFR part 324, subparts D & E (FDIC).

[5] *See* 12 CFR part 217.1(c), 12 CFR part 217.100(b) (FRB); 12 CFR part 3.1(c), 12 CFR part 3.100(b) (OCC); 12 CFR part 324.1(c), 12 CFR part 324.100(b) (FDIC). GSIBs form a sub-category of advanced approaches banking organizations.

subsidiaries with total consolidated assets equal to $10 billion or more.[6]

Since implementing these measures, the agencies have assessed whether tailoring for large banking organizations is appropriate and have developed this proposal that would distinguish applicable capital and liquidity standards on the basis of size, complexity, and overall risk profile, consistent with safety and soundness. The proposed categories and criteria would also account for changes to the enhanced prudential standards requirements made by section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[7] The proposal would also align with a separate proposal issued by the FRB designed to tailor the application of prudential standards to U.S. bank holding companies and apply enhanced standards to certain large savings and loan holding companies based on the same categories.

II. Scoping Thresholds

The proposal's categories for the application of capital and liquidity standards would apply to national banks, state member banks, state nonmember banks, savings associations, top-tier U.S. bank holding companies, and top-tier savings and loan holding companies that are not substantially engaged in insurance or commercial activities with assets greater than $100 billion. The agencies are proposing to (i) amend the scope of certain aspects of the regulatory capital rule and the LCR rule and (ii) re-propose the scope of the NSFR rule. The proposal would also update the current regulatory distinction between advanced approaches and standardized approach banking organizations and tailor the foregoing requirements to large entities according to risk-based indicators.[8]

[6] *See* 12 CFR 249.1.
[7] Pub. L. No. 115-174, 132 Stat. 1296 (2018). EGRRCPA raised the $50 billion minimum asset threshold for general application of enhanced prudential standards to $250 billion, and provides the FRB with discretion to apply standards to bank holding companies with total assets of between $100 billion and $250 billion.
[8] This proposal is part of the agencies' ongoing effort to review their respective capital and liquidity requirements to determine how best to tailor their application based on the size, complexity, and overall risk profile of banking organizations. Consistent with these efforts, the agencies also intend to issue a proposal to implement Section 201 of EGRRCPA, which

The proposal would establish four categories of standards applicable to banking organizations with total assets of $100 billion or more based on size, cross-jurisdictional activity, weighted short-term wholesale funding, off-balance sheet exposure, and nonbank assets.[9]

The first, and most stringent, set of standards (Category I) would apply to U.S. GSIBs and their subsidiary depository institutions.[10] The agencies would use the methodology under the FRB's GSIB surcharge rule to determine which banking organizations are subject to the Category I standards.[11]

The second set of standards (Category II) would apply to banking organizations with $700 billion or more in total consolidated assets or $75 billion or more in cross-jurisdictional activity, and that are not subject to Category I standards, and to their subsidiary depository institutions. The proposal would amend the agencies' capital and liquidity regulations to replace the current $10 billion foreign exposure threshold with a $75 billion cross-jurisdictional activity threshold.[12]

The third set of standards (Category III) would apply to banking organizations with $250 billion or more in total consolidated assets or those with $100 billion or more, but less than $250 billion, in total consolidated assets that also have at least $75 billion or more in any of the following indicators: (i) nonbank assets, (ii) weighted short-term wholesale funding, or (iii) off-balance-sheet exposures; and that are not subject to Category I or II standards. Category III standards also would apply to subsidiary depository institutions of Category III banking organizations.

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requires the agencies to revise capital requirements applicable to certain banking organizations with less than $10 billion in total consolidated assets. *See* Pub. L. No. 115-174, 132 Stat. 1296 (2018).

[9] As an alternative to this thresholds-based approach, the proposal requests comment on the use of the GSIB identification methodology under the FRB's GSIB surcharge rule to determine the applicable category of standards for banking organizations with $100 billion or more in total assets. See 12 CFR part 217, Subpart H.

[10] For Category I-III banking organizations, for purposes of the liquidity standards, only subsidiary depository institutions with total assets of $10 billion or greater would be covered under this proposal.

[11] *See* 12 CFR part 217 subpart H; *see also* "Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Final Rule," 80 FR 49082 (Aug. 14, 2015).

[12] The proposed cross-jurisdictional activity indicator would include foreign liabilities in addition to foreign assets.

The fourth set of standards (Category IV) would apply to banking organizations with at least $100 billion in total consolidated assets that do not meet any of the thresholds specified for Categories I through III. The Category IV standards would not include the LCR or NSFR requirements, and as a result, such banking organizations would generally face the same capital and liquidity regulatory requirements as banking organizations under $100 billion in total consolidated assets.

The proposed thresholds applicable to Category II-IV banking organizations would apply based on the average level for each indicator over the preceding four calendar quarters; and the proposal would apply the same category of tailoring standards to both the top-tier holding company and its subsidiary depository institutions. The proposal would not amend the capital and liquidity requirements applicable to intermediate holding companies of foreign banking organizations.

III. Proposed Regulatory Framework

1. Category I Standards

U.S. GSIBs are subject to the most stringent prudential standards, which reflect the heightened risks these banking organizations pose to U.S. financial stability. Accordingly, U.S. GSIBs would remain subject to the most stringent capital and liquidity requirements, including requirements based on standards developed by the Basel Committee on Banking Supervision (BCBS). Category I capital standards would include a requirement to calculate risk-based capital ratios using the advanced approaches; the U.S. leverage ratio; the enhanced supplementary leverage ratio; the GSIB surcharge; the requirement to recognize most elements of Accumulated Other Comprehensive Income (AOCI) in regulatory capital; and the amount of the countercyclical capital buffer, if applicable. Category I liquidity standards would include the full LCR requirement and proposed NSFR requirement.

Consistent with current requirements, a subsidiary depository institution of a banking organization subject to the full LCR and proposed NSFR requirements with $10 billion or more in total consolidated assets would be required to meet the LCR and NSFR requirements. Currently, the $10 billion consolidated asset threshold is measured based on the most recent year-end Consolidated Report of Condition and Income. The proposal would amend the LCR and proposed NSFR rules to measure this threshold based on the value of total consolidated assets over the four most recent calendar quarters.

2. Category II Standards

Under the proposal, the capital and liquidity standards based on and developed by the BCBS for large or internationally active banking organizations would continue to apply to banking organizations subject to Category II standards. These standards would include the full LCR and proposed NSFR requirements, advanced approaches capital requirements, and the supplementary leverage ratio. Banking organizations subject to Category II standards would also be required to recognize most elements of AOCI in regulatory capital. Banking organizations subject to Category II standards would also be required to expand their capital conservation buffer by the amount of the countercyclical capital buffer, if applicable. As under existing requirements, the proposed Category II capital standards would apply to the depository institution subsidiaries of banking organizations subject to Category II standards, and the LCR and proposed NSFR requirements would apply to depository institution subsidiaries with total consolidated assets of $10 billion or more.

3. Category III Standards

a. Capital.

Under the proposal, Category III capital standards would include the U.S. generally applicable risk-based capital requirements, the U.S. leverage ratio, and the supplementary leverage ratio. The agencies would also retain the countercyclical capital buffer as part of the Category III standards under the proposal given these banking organizations' significant role in financial intermediation in the United

States individually and as a group. The supplementary leverage ratio would apply to banking organizations subject to Category III standards given their size and risk profile. For example, firms subject to the Category III standards include banking organizations with material off-balance sheet exposures that are not accounted for in the traditional U.S. tier 1 leverage ratio. Banking organizations subject to Category III standards would not be required to apply advanced approaches capital requirements. In addition, the proposal would amend the definition of capital for additional tier 1 and tier 2 instruments in the agencies' capital rule for banking organizations subject to Category III standards.

b. *Liquidity.*

Banking organizations that would be subject to Category III standards are currently subject to the full LCR requirement, with the exception of banking organizations with less than $250 billion in total assets. In addition, banking organizations that are subject to the full LCR requirement would be subject to the full NSFR requirement under the agencies' proposed NSFR rule.

Under the proposal, Category III standards would include full or reduced LCR and proposed NSFR requirements, depending on the banking organization's level of weighted short-term wholesale funding. A Category III banking organization would be subject to the full LCR and proposed NSFR requirements if it has weighted short-term wholesale funding of $75 billion or more. For banking organizations subject to Category III standards with weighted short-term wholesale funding of less than $75 billion, the proposal would reduce the stringency of the LCR and proposed NSFR requirements, proposed between 70 and 85 percent of the full LCR and proposed NSFR requirement.[13] These banking

[13] The denominator of the reduced LCR would equal the net cash outflows calculated under the full LCR requirement, multiplied by a factor that reduces its stringency. Similarly, the denominator of the NSFR would equal the required stable funding requirement calculated under the full NSFR requirement, multiplied by a factor that reduces its stringency.

organizations would be subject to reduced LCR and the proposed NSFR requirements, as they have less reliance on short-term wholesale funding.

The proposal would not alter other aspects of the LCR and the proposed NSFR calculations. Banking organizations would continue to calculate their LCR on each business day and include the maturity mismatch add-on in the calculation. The proposal would apply Category III LCR and proposed NSFR requirements to a depository institution that has total consolidated assets of $10 billion or more and that is a subsidiary of a company subject to the Category III standards in the same manner as the standards apply to the parent banking organization.

4. Category IV Standards

Relative to current requirements, the proposed Category IV standards would reduce liquidity and, in certain circumstances, capital requirements to reflect these banking organizations' lower risk profile and lesser degree of complexity relative to other large banking organizations.

a. *Capital.*

Under the proposal, the Category IV capital standards would include the U.S. generally applicable risk-based capital requirements and the U.S. leverage ratio. The proposal would not apply the countercyclical capital buffer and the supplementary leverage ratio applicable under Category III.

b. *Liquidity.*

Under the proposal, Category IV standards would not include an LCR or NSFR requirement for these banking organizations given their smaller systemic footprint and limited size relative to other large banking organizations.[14]

[14] These banking organizations would continue to be subject to the internal liquidity stress testing requirements at the consolidated holding company level under the FRB's regulations, which include a 30 calendar-day period and 1-year time horizon, respectively.

Conclusion: FDIC staff recommends that the Board approve the attached NPR and authorize its publication in the *Federal Register* with a public comment period that ends on January 22, 2019.

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