April 5, 2019

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 for certain U.S. subsidiaries of foreign banking organizations and application of liquidity requirements to foreign banking organizations, certain U.S. depository institution holding companies, and certain depository institution subsidiaries.

Recommendation: Staff recommends that the FDIC Board (Board) approve publication in the *Federal Register* of the attached interagency notice of proposed rulemaking (NPR or proposal) that would invite comment on a proposal to determine the application of regulatory capital requirements to certain U.S. intermediate holding companies of foreign banking organizations and their depository institution subsidiaries according to risk-based categories. The interagency proposal also would establish standardized liquidity requirements with respect to certain U.S. operations of large foreign banking organizations and certain of their depository institution subsidiaries, based on the risk profile of the combined U.S. operations of the foreign banking organization. In addition, the Board of Governors of the Federal Reserve System (FRB) is not proposing but is seeking comment on potential approaches for applying standardized liquidity requirements to such foreign banking organizations with respect to their U.S. branch and agency networks in the NPR. The FRB also proposes to modify the December 2018 interagency notice of proposed rulemaking, *Proposed Changes to Applicability Thresholds for*

Concur:

James L. Anderson
Deputy General Counsel

Regulatory Capital and Liquidity Requirements[1] (interagency domestic tailoring NPR),[2] for purposes of determining the application of liquidity requirements to certain U.S. depository institution holding companies meeting specified criteria relating to their liquidity risk profile. Finally, the agencies are making certain technical amendments to the interagency domestic tailoring NPR.

The interagency proposal would generally align with the interagency domestic tailoring NPR issued by the FDIC, the FRB, and the Office of the Comptroller of the Currency (OCC) (collectively, agencies) that would revise the framework for the application of regulatory capital and liquidity requirements to large U.S. banking organizations and their subsidiary depository institutions.

Recommendation: Staff recommends that the Board approve the proposal and authorize its publication in the *Federal Register* for public comment ending June 21, 2019, approximately sixty days after the date of the April Board meeting.

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[1] "Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements," 83 FR 66024 (December 21, 2018).

[2] The FRB separately issued an FRB-only domestic tailoring notice of proposed rulemaking, "Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies," 83 FR 61408 (November 21, 2018).

I. Background

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.[3] The capital rule strengthened the capital requirements applicable to banking organizations, including U.S. banking organization subsidiaries of foreign banking organizations, by improving both the quality and quantity of regulatory capital and increasing the risk-sensitivity of required capital. In 2014, the agencies adopted the liquidity coverage ratio rule (LCR rule) to improve the banking sector's resiliency to liquidity stress and the ability of large and internationally active banking organizations to monitor and manage liquidity risk.[4] Banking organizations subject to the LCR rule must 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. On June 1, 2016, the agencies proposed a rule to implement a net stable funding ratio (NSFR) requirement for the same banking organizations that are subject to the LCR rule.[5] The NSFR proposed rule would establish a quantitative metric to measure and help ensure the stability of the funding of a banking organization over a one-year horizon.

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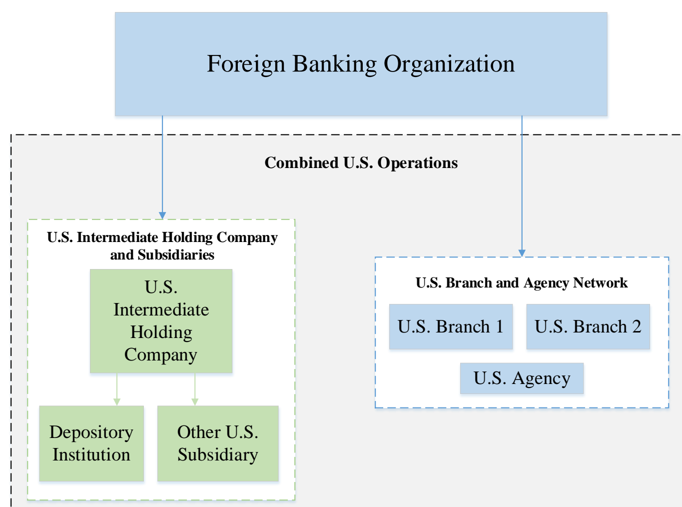
[3] The FRB and OCC issued a joint final rule on October 11, 2013 (78 FR 62018), and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). On April 14, 2014 (79 FR 20754), the FDIC adopted the interim final rule as a final rule with no substantive changes.

[4] *See* "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards," 79 FR 61440 (Oct. 10, 2014), codified at 12 CFR part 50 (OCC), 12 CFR part 249 (FRB), and 12 CFR part 329 (FDIC). The FRB also implemented enhanced prudential standards for the largest bank holding companies and foreign banking organizations. *See* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 FR 17240 (March 27, 2014) (the enhanced prudential standards rule), codified at 12 CFR part 252.

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

On December 21, 2018, the agencies published the interagency domestic tailoring NPR, which would establish a revised framework for large U.S. banking organizations and their subsidiary depository institutions for determining application of the capital rule, LCR rule, and the NSFR proposed rule on the basis of an organization's size, complexity, and overall risk profile.[6]

To maintain parity in the application of capital and liquidity requirements to both domestic and foreign banking organizations, the proposal generally aligns with the framework set forth in the interagency domestic tailoring NPR, with modifications to address the manner in which foreign banking organizations operate in the United States. The chart below provides a simplified illustration of how a foreign banking organization may structure its U.S. operations, and depicts the portion of those operations that would comprise its combined U.S. operations for purposes of this proposal.



II. Scoping Thresholds

The NPR would tailor, according to certain risk-based categories, the capital requirements applicable to U.S. intermediate holding companies[7] with total consolidated assets of $100 billion or

[6] *See* 83 FR 66024, *supra*, note 1.

[7] A foreign banking organization with U.S. non-branch assets of $50 billion or more must establish a U.S. intermediate holding company under 12 CFR 252.153.

more and their subsidiary depository institutions. The NPR also would tailor the liquidity requirements applicable to a foreign banking organization with respect to their combined U.S. operations[8] according to the proposed risk-based categories. Specifically, the FRB is proposing to require a foreign banking organization that meets certain criteria – including having combined U.S. assets[9] of $100 billion or more – to comply with LCR and proposed NSFR requirements with respect to any U.S. intermediate holding company. Also, the agencies are proposing to require any depository institution subsidiary that has $10 billion or more in assets and is a subsidiary of certain U.S. intermediate holding companies (covered depository institution subsidiary)[10] to comply with LCR and proposed NSFR requirements. Accordingly, under the proposal, a U.S. intermediate holding company or depository institution subsidiary of a foreign banking organization could be subject to different categories of standards for capital and liquidity.

III. Categories of Standards

The proposal would establish three risk-based categories of standards for determining the application of capital and standardized liquidity requirements to the U.S. operations of foreign banking

[8] The combined U.S. operations of a foreign banking organization include any U.S. subsidiaries (including any U.S. intermediate holding company, which would reflect on a consolidated basis any U.S. depository institution or other subsidiaries thereof), branches, and agencies.

[9] Combined U.S. assets means the sum of the consolidated assets of each top-tier U.S. subsidiary of the foreign banking organization (excluding any company whose assets are held pursuant to section 2(h)(2) of the Bank Holding Company Act, 12 U.S.C. 1841(h)(2), if applicable) and the total assets of each U.S. branch and U.S. agency of the foreign banking organization.

[10] The proposal would require a foreign banking organization to calculate and maintain an LCR and NSFR for any U.S. intermediate holding company subject to Category II, III and IV liquidity standards. In addition, the agencies are proposing to require covered depository institution subsidiaries of foreign banking organizations subject to Category II or III liquidity standards to calculate and maintain a minimum LCR and NSFR.

organizations — Categories II, III, and IV[11] — based on size, cross-jurisdictional activity, nonbank assets, weighted short-term wholesale funding, and off-balance sheet exposure.[12] In order to capture significant changes, rather than temporary fluctuations, in the risk profile of the U.S. intermediate holding company or the foreign banking organization's combined U.S. operations, a category of standards would apply based on the levels of each risk-based indicator over the preceding four calendar quarters.

Category II capital standards[13] would apply to a U.S. intermediate holding company, including any depository institution subsidiary thereof, that has $700 billion or more in total consolidated assets or $75 billion or more in cross-jurisdictional activity. Category II liquidity standards would apply to a foreign banking organization that has $700 billion or more in combined U.S. assets or $75 billion or more in cross-jurisdictional activity, with respect to its intermediate holding company and any covered

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[11] Under the interagency domestic tailoring NPR, Category I standards would apply only to U.S. Global Systemically Important Banks (GSIBs). Because the FRB's U.S. GSIB surcharge rule would not identify a foreign banking organization or U.S. intermediate holding company as a U.S. GSIB, Category I liquidity and capital requirements would not apply to any foreign banking organization or U.S. intermediate holding company under this proposal. *See* 12 CFR 217.400(b)(1), which excludes any bank holding company subsidiary of a foreign banking organization from the scope of the GSIB surcharge rule.

[12] As an alternative, the FRB is also requesting comment on a score-based approach, which would differentiate requirements for firms using an aggregated "score" across multiple measures of risk that is based on the methodology used by the FRB to identify global systemically important U.S. bank holding companies and apply risk-based capital surcharges to these firms. *See* 12 CFR part 217, subpart H.

[13] In October 2017, the agencies proposed simplifications to the capital rule including a simplified capital treatment for mortgage servicing assets, deferred tax assets arising from temporary differences that an institution could not realize through net operating loss carrybacks, investments in the capital of unconsolidated financial institutions, and minority interest. In December 2018, the agencies proposed to adopt the standardized approach for counterparty credit risk for derivatives exposures (SA-CCR) for calculating their risk-based capital ratios and a modified version of SA-CCR for calculating total leverage exposure under the supplementary leverage ratio. For purposes of these notices, the requirements that would apply to "advanced approaches banking organizations" would be included as Category II standards under this proposal and the requirements that would apply to "non-advanced approaches banking organizations" would be included as Category III or IV capital standards under this proposal.

depository institution subsidiary. The cross-jurisdictional activity measure is important because foreign banking organizations with U.S. operations that engage in significant cross-jurisdictional activity present complexities that support the application of more stringent standards. Cross-jurisdictional activity would be measured as the sum of the cross-jurisdictional assets and liabilities of the U.S. intermediate holding company or combined U.S. operations of a foreign banking organization. The proposal would exclude from this measure liabilities of U.S. operations of foreign banking organizations to their non-U.S. affiliates. Specifically, the proposed cross-jurisdictional activity indicator would exclude liabilities of the combined U.S. operations or U.S. intermediate holding company that reflect transactions with non-U.S. affiliates. Intercompany liabilities generally represent funding from the foreign banking organization to its U.S. operations and, in the case of certain long-term debt instruments, may be required by regulation. The proposed exclusion recognizes the benefit of the foreign banking organization providing support to its U.S. operations. Short-term funding from affiliates, which may pose heightened liquidity risks to the U.S. operations, would be captured in the proposal's measure of weighted short-term wholesale funding. Further, in recognition that the U.S. operations of foreign banking organizations have increased cross-jurisdictional activity due to their role within the foreign banking organization, the proposal would exclude from the measurement of cross-jurisdictional activity cross-jurisdictional claims on non-U.S. affiliates to the extent that these claims are collateralized by financial collateral[14] in a manner consistent with the collateral haircut approach in the agencies' capital rule.[15]

Category III capital standards would apply to a U.S. intermediate holding company, including any depository institution subsidiary thereof, that is not subject to Category II standards and has

[14] *See* the definition of "financial collateral" at 12 CFR 324.2.

[15] *See* 12 CFR 324.37.

$250 billion or more in total consolidated assets or has $100 billion or more in total consolidated assets and $75 billion or more in any of the following indicators: nonbank assets, weighted short-term wholesale funding, or off-balance sheet exposure. Category III liquidity standards would apply to a foreign banking organization (and any covered depository institution subsidiary thereof) that is not subject to Category II liquidity standards and the combined U.S. operations of which have $250 billion or more in assets or assets of at least $100 billion and $75 billion or more in any of the following indicators: nonbank assets, weighted short-term wholesale funding, or off-balance-sheet exposures. Under the proposal, nonbank assets would be measured as the average amount of assets in consolidated nonbank subsidiaries and any direct investments in unconsolidated nonbank subsidiaries. The amount of a banking organization's investment in nonbank subsidiaries provides a measure of the organization's business and operational complexity. Banking organizations with significant investments in nonbank subsidiaries are more likely to have complex corporate structures and funding relationships, and substantial inter-affiliate transactions that can add operational challenges. Weighted short-term wholesale funding[16] provides a measure of liquidity risk, as reliance on short-term, generally uninsured funding can make a banking organization vulnerable to large-scale funding runs. Weighted short-term wholesale funding would include exposures between the U.S. operations of a foreign banking organization and its non-U.S. affiliates, as reliance on short-term wholesale funding from foreign affiliates can contribute to the funding vulnerability of a foreign banking organization's U.S. operations in times of stress. Off-balance sheet exposure would be measured as the difference between total

[16] Specifically, short-term wholesale funding is the amount of a firm's funding obtained from wholesale counterparties or retail brokered deposits and sweeps with a remaining maturity of one year or less. Categories of short-term wholesale funding are then weighted based on four residual maturity buckets; the asset class of collateral, if any, backing the funding; and characteristics of the counterparty. Weightings reflect risk of runs and attendant fire sales. *See* 12 CFR 217.406 and Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 FR 49082 (August 14, 2015).

exposure and on-balance sheet assets. Total exposure includes on-balance sheet assets plus certain off-balance sheet exposures, including derivative exposures, repo-style transactions, and other off-balance sheet exposures, such as commitments. Like size, off-balance sheet exposure provides a measure of the extent to which customers or counterparties may be exposed to a risk of loss or suffer a disruption in the provision of services. In addition, off-balance sheet exposure can lead to significant future draws on liquidity, particularly in times of stress.

Category IV capital standards would apply to a U.S. intermediate holding company, including any depository institution subsidiary thereof, that has at least $100 billion in total consolidated assets and does not meet any of the thresholds for Category II or III capital standards. Category IV liquidity standards[17] would apply to a U.S. intermediate holding company of a foreign banking organization that has combined U.S. assets of $100 billion or more with $50 billion or more in weighted short-term wholesale funding and is not subject to Category II or III liquidity standards. Depository institution subsidiaries of Category IV foreign banking organizations would not be subject to the LCR or proposed NSFR.

Under the proposal, a U.S. intermediate holding company or depository institution subsidiary of a foreign banking organization could be subject to different categories of standards for capital and liquidity. Consider, for example, a foreign banking organization with combined U.S. assets of $400 billion, cross-jurisdictional activity of $80 billion at its combined U.S. operations, and a U.S. intermediate holding company with consolidated total assets of $260 billion and cross-jurisdictional activity of $40 billion. In this example, the foreign banking organization would be subject to Category II liquidity standards, including with respect to its LCR and NSFR calculation for any U.S. intermediate

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[17] In addition to the LCR and NSFR requirements that would be applied under the proposal, Category IV banking organizations would be subject to other liquidity requirements under the FRB's Regulation YY.

holding company, because the combined U.S. operations have more than $75 billion in cross-jurisdictional activity. Any covered depository institution subsidiary of the foreign banking organization in this example would likewise be subject to Category II liquidity standards. However, the U.S. intermediate holding company and any depository institution subsidiary thereof would be subject to Category III capital standards based on the U.S. intermediate holding company's total consolidated assets, which are more than $250 billion but less than $700 billion, and cross-jurisdictional activity, which is less than $75 billion.

For all categories, the proposal would require a foreign banking organization that meets the applicability criteria to calculate and maintain a minimum LCR and NSFR for its U.S. intermediate holding company. A covered depository institution subsidiary would also be required to calculate and maintain a minimum LCR and NSFR.

IV. Proposed Regulatory Framework

A. Category II Standards

i. *Capital*

In addition to the generally applicable capital requirements, the proposal would require a U.S. intermediate holding company and any depository institution subsidiary thereof that are subject to Category II standards to maintain a minimum supplementary leverage ratio of three percent. Category II banking organizations would also be subject to the countercyclical capital buffer, if applicable, and would be required to recognize most elements of accumulated other comprehensive income in regulatory capital. Consistent with current requirements, the U.S. intermediate holding company (and depository institution subsidiaries thereof) would not be required to calculate risk-based capital requirements using the advanced approaches under the capital rule, and would instead use the generally applicable risk-based capital requirements for calculating risk-weighted assets.

ii. *Liquidity*

The proposal would require a foreign banking organization subject to Category II standards to comply with the full LCR requirement, including calculation on each business day, as applied to its U.S. intermediate holding company, if any. In addition, the foreign banking organization would be required to comply with the full proposed NSFR requirement, as calculated by the foreign banking organization for its U.S. intermediate holding company. Covered depository institution subsidiaries of a foreign banking organization's U.S. intermediate holding company subject to Category II liquidity standards would also be subject to the full LCR and the proposed NSFR requirements.

B. <u>Category III Standards</u>

i. *Capital*

In addition to the generally applicable capital requirements, the proposal would require a Category III banking organization to maintain a minimum supplementary leverage ratio of three percent. Category III standards also would include the countercyclical capital buffer. Any depository institution subsidiary of a U.S. intermediate holding company that is subject to Category III capital standards would likewise be subject to Category III capital standards.

ii. *Liquidity*

The proposal would determine the LCR and the proposed NSFR requirements applicable to foreign banking organizations subject to Category III liquidity standards based on the weighted short-term wholesale funding of the organization's U.S. operations. A foreign banking organization subject to Category III standards that has $75 billion or more in weighted short-term wholesale funding at its combined U.S. operations would be subject to the same liquidity requirements as would apply under Category II standards—specifically, the full LCR requirement and the proposed NSFR requirement. A foreign banking organization subject to Category III standards that has less than $75 billion in weighted

short-term wholesale funding at its combined U.S. operations would be subject to reduced LCR and proposed NSFR requirements, proposed to be between 70 and 85 percent of the full LCR and NSFR.[18] The proposal would apply LCR and NSFR requirements to covered depository institution subsidiaries of foreign banking organizations subject to Category III liquidity standards at the same level that would apply to the foreign banking organization.

C. Category IV Standards

i. *Capital*

The proposal would require a U.S. intermediate holding company and any depository institution subsidiary thereof subject to Category IV standards to apply the generally applicable capital requirements. Category IV standards would not include the countercyclical capital buffer or the supplementary leverage ratio. As a result, such U.S. intermediate holding companies (and their depository institution subsidiaries) would be subject to the same capital requirements as U.S. intermediate holding companies with less than $100 billion in total consolidated assets.

ii. *Liquidity*

Under the proposal, no LCR or proposed NSFR requirement would apply to covered depository institution subsidiaries of foreign banking organizations subject to Category IV liquidity standards. A reduced LCR and NSFR requirement would apply to a foreign banking organization that meets the criteria for Category IV liquidity standards and has $50 billion or more in weighted short-term wholesale funding at its combined U.S. operations.

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[18] The denominator of the reduced LCR would equal the net cash outflows calculated under the full LCR requirement, multiplied by a factor between .70 and .85 that reduces its stringency. Similarly, the denominator of the NSFR would equal the required stable funding requirement calculated under the full proposed NSFR requirement, multiplied by a factor between .70 and .85 that reduces its stringency. The proposal invites comments on the amount of the reduction factor.

D. Amendment to Interagency Domestic Tailoring NPR

In this proposal, the FRB is proposing to amend the interagency domestic tailoring NPR and apply reduced LCR and NSFR requirements to a U.S. depository institution holding company that would be subject to Category IV standards under the domestic interagency proposal and has $100 billion or more in total consolidated assets and $50 billion or more in weighted short-term wholesale funding.

E. Technical Amendment

The proposal also includes a technical amendment to the interagency domestic tailoring NPR that would require changes in liquidity requirements that result from a change in category to take effect on the first day of the second quarter following the change in the banking organization's category.[19] The agencies also are making a technical amendment in both the capital and liquidity regulation text to clarify that a subsidiary depository institution of a depository institution would be categorized based on the risk profile of its parent depository institution.

Conclusion: FDIC staff recommends that the Board approve the attached proposal and authorize its publication in the *Federal Register* with a public comment period that ends on June 21, 2019, approximately sixty days after the April Board meeting.

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[19] 83 FR at 66033.