Enhanced Prudential Standards for Large U.S. Bank Holding Companies

March 24, 2014

The U.S. Federal Reserve Board recently issued final rules to implement certain "enhanced prudential standards" for large U.S. bank holding companies with $50 billion or more in total consolidated assets. Certain of these requirements—notably, risk committee and capital stress testing requirements—also apply to certain bank holding companies with $10 billion or more in total consolidated assets.

The final rules, which were issued on February 18, 2014, come two years after the Federal Reserve issued proposed rules with respect to such domestic bank holding companies.[1] In contrast to the proposed rules, the final rules implement only portions of Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") relating to risk management, capital and leverage, liquidity, stress testing and debt-to-equity limits. Other aspects of the proposed rules, such as single-counterparty credit limits and Section 166's early remediation framework, remain under development, according to the Federal Reserve. Also, the final rules do not address short-term debt limits, which the Federal Reserve continues to evaluate, or resolution planning requirements, which were adopted in separate rulemakings.[2]

Enhanced prudential standards for nonbank financial companies that are designated by the Financial Stability Oversight Council ("FSOC") for Federal Reserve supervision due to their systemic importance ("nonbank SIFIs") are not included in the final rules. Instead, the Federal Reserve will apply standards to these institutions through a subsequently issued order or rule following an evaluation of the business model, capital structure and risk profile of each nonbank SIFI. In addition, savings and loan holding companies ("SLHCs") are not covered by the final rules (except that certain SLHCs may need to comply with capital stress testing requirements).

According to Federal Reserve Governor Daniel K. Tarullo, the adoption of these rules is "another component" of an "ongoing effort under Section 165 of the Dodd-Frank Act to put in place a set of prudential standards for large banking organizations that become progressively more stringent as the systemic importance of the regulated entity increases." A number of other important rules—relating to capital surcharges, a supplemental leverage ratio, minimum levels

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1 For a summary of the proposed rules, please see our memorandum titled, "Regulating Systemically Important Financial Companies," dated January 10, 2012, *available at* http://www.stblaw.com/about-us/news/details?id=9f945a72-f546-4ba5-ab5c-d19a47eeaec9.

2 Resolution planning, or "living will," requirements were adopted by the Federal Reserve and the Federal Deposit Insurance Corporation in 2011 and 2012, respectively. *See* Regulation QQ (76 Fed. Reg. 67323 (Nov. 1, 2011)) and 12 C.F.R. § 360.10 (77 Fed. Reg. 3075 (Jan. 23, 2012)).

of long-term debt, and quantitative liquidity standards—are expected to be finalized or proposed in the "coming months."

A. SCOPE OF APPLICATION

The final rules impose the following requirements on U.S. bank holding companies, generally depending on whether they have at least \$10 billion in total consolidated assets or at least \$50 billion in total consolidated assets.

Total Consolidated Assets	Requirements
> \$10 billion	Must: • Have a risk committee (if publicly traded and with at least \$10 billion) • Perform annual company-run stress test (if *over* \$10 billion)

≥ \$50 billion	All of the above, plus:
	• Must have a risk committee (even if not publicly traded) and chief risk officer
	• Liquidity requirements, including:
	  o Liquidity risk management requirements
	  o Liquidity stress testing requirements
	  o Liquidity buffer requirements
	• Potential additional risk-based capital and leverage requirements (common equity capital surcharge, additional leverage capital buffer, etc.)
	• Annual supervisory and annual/mid-cycle company-run stress tests
	• Potential debt-to-equity limits (upon "grave threat" determination)

B. COMPLIANCE TIMING

For U.S. bank holding companies ("BHCs") that have a class of stock that is publicly traded and have total consolidated assets of \$10 billion or more as of June 30, 2014, risk management and liquidity requirements apply beginning on July 1, 2015. For publicly traded BHCs with \$10 billion or more thereafter, compliance begins on the first day of the ninth quarter following the date on which they met or exceeded this asset threshold.

For BHCs that have total consolidated assets of \$50 billion or more as of June 30, 2014, risk management and liquidity requirements apply beginning on January 1, 2015. For BHCs with \$50 billion or more thereafter, compliance begins on the first day of the fifth quarter following the date on which they met or exceeded this asset threshold.

For BHCs that meet or exceed the \$50 billion threshold and are controlled by a foreign banking organization ("FBO"), domestic risk management and liquidity requirements apply from

January 1, 2015 to June 30, 2016.[3] Beginning on July 1, 2016, U.S. intermediate holding companies established by FBOs must comply with the risk management and liquidity requirements under the Federal Reserve's rules applicable to FBOs. These rules were also issued on February 18, 2014.[4]

Other enhanced prudential requirements, such as those relating to capital stress testing and resolution planning, have detailed phase-in considerations, but are not the primary focus of this memorandum.

C. RISK MANAGEMENT REQUIREMENTS

Section 165(b) of Dodd-Frank requires the Federal Reserve to establish overall risk management requirements for BHCs with total consolidated assets of $50 billion or more, while Section 165(h) requires the Federal Reserve to issue regulations requiring publicly traded BHCs with total consolidated assets of $10 billion or more to establish risk committees. Dodd-Frank also authorizes, but does not require, the Federal Reserve to impose the risk committee requirement on all publicly traded BHCs, regardless of their asset size. Under Dodd-Frank, a risk committee is responsible for the oversight of risk management practices on an enterprise-wide basis.

The final rules extend the risk committee requirement to all publicly traded BHCs with total consolidated assets of $10 billion or more but less than $50 billion. Accordingly, the Federal Reserve has not exercised its statutory authority to impose the risk committee requirement on all publicly traded BHCs. As discussed below, the final rules also require large BHCs with $50 billion or more in total consolidated assets to have a stand-alone risk committee, as well as a chief risk officer, regardless of whether such BHCs have a class of stock that is publicly traded.

In the preamble commentary accompanying the final rules, the Federal Reserve emphasized that the risk committee and overall risk management requirements in the final rules supplement, but do not replace, existing risk management guidance and supervisory expectations, including under the Federal Reserve's Supervision and Regulation Letter SR 08-8.

1. *Risk Committee*

The final rules require (i) publicly traded BHCs with total consolidated assets of $10 billion or more but less than $50 billion and (ii) BHCs with total consolidated assets of $50 billion or more (publicly traded or not) to establish and maintain a risk committee that approves and periodically reviews the risk management policies of the BHC's global operations and oversees

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[3] Because certain FBOs are required to form a top-tier U.S. intermediate holding company for their U.S. operations that complies with separate liquidity requirements beginning July 1, 2016, BHCs that are subsidiaries of FBOs no longer need to comply independently with the domestic liquidity requirements of the final rules after June 30, 2016.

[4] For a summary of the enhanced prudential standards for FBOs, please see our memorandum titled, "Federal Reserve Issues Final Regulations on Enhanced Prudential Standards for Foreign Banking Organizations," dated February 25, 2014, *available at* http://www.stblaw.com/about-us/news/details?id=01e6b595-b636-4230-b7f4-b1f236e7d358.

the operation of its "global risk management framework." For a BHC with $50 billion or more in total consolidated assets, the risk committee's responsibilities also include the requirement to approve the BHC's contingency funding plan (including any material revisions prior to implementation), which is discussed in Section D.1 of this memorandum.

a. Governance and Composition Requirements

The risk committee must:

- have a formal, written charter approved by the BHC's board of directors;
- meet at least quarterly (or more frequently if necessary) and fully document and maintain records of such proceedings, including risk management decisions;
- have at least one member[5] who has "experience in identifying, assessing, and managing risk exposures" of large, complex firms (in the case of smaller, public BHCs) or large, complex *financial* firms (in the case of large BHCs with at least $50 billion in assets);[6] and
- be chaired by a director who meets certain independence requirements.

With regard to the independence of the risk committee's chair, the final rules require that the director:

- not be an officer or employee of the BHC and not have been an officer or employee of the BHC during the previous three years;
- not be a member of the "immediate family" (as defined in Section 225.41(b)(3) of the Federal Reserve's Regulation Y) of a person who is, or has been within the last three years, an "executive officer" of the BHC (as defined in Section 215.2(e)(1) of the Federal Reserve's Regulation O); and
- qualify as an "independent" director under Item 407 of the SEC's Regulation S-K (if the BHC has an outstanding class of securities traded on a national securities exchange) or be an individual who would qualify as an independent director under the listing standards of a national securities exchange, as demonstrated to the satisfaction of the Federal Reserve (if the BHC does not have an outstanding class of securities traded on a national securities exchange).

Although only the chair of the risk committee is required to be independent, the Federal Reserve "encourages" BHCs to consider having additional independent directors as members,

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5 Even though only one member must have risk management-related expertise, the Federal Reserve expects all risk committee members to have a general understanding of risk management principles and practices relevant to the particular BHC. Also, the Federal Reserve expects a BHC that poses "more systemic risk" to have "more risk committee members with commensurately greater understandings of risk management principles and practices."

6 For smaller, publicly traded BHCs, an individual's risk management experience in a nonbanking or nonfinancial field may fulfill this requirement. For larger BHCs, the Federal Reserve has stated that a financial firm may include a bank, securities broker dealer or insurance company, provided that the individual's experience at such firm is relevant to the particular risk facing the BHC.

with the "appropriate proportion" determined by the BHC based on its size, scope and complexity. Also, the Federal Reserve acknowledged that the involvement of directors affiliated with the BHC on the risk committee may complement the involvement of independent directors.

For a large BHC with at least $50 billion in total consolidated assets, its risk committee must also:

- be a stand-alone, independent committee of the BHC's board of directors (rather than a joint risk/audit or risk/finance committee, for example);
- have as its "sole and exclusive function" the responsibility for the BHC's risk management policies and oversight of the operation of the BHC's global risk management framework; and
- report directly to the BHC's board of directors.

As such, while the risk committee would be prevented from having other substantive responsibilities at the parent BHC-level, it would not be prevented from serving as the risk committee for one or more subsidiaries of the BHC as long as the requirements of the final rules are otherwise satisfied. Also, the Federal Reserve clarified, in its preamble commentary, that the risk committee may have members who are on other board committees and that other board committees, such as audit or finance, may have some involvement in establishing a BHC's risk management framework.

b. *Oversight of the Global Risk Management Framework*

Each BHC must have a global risk management framework that is commensurate to its structure, risk profile, complexity, activities and size. A BHC's risk committee "oversees the operation of" the framework, although the final rules do not specify whether such framework must be established by the BHC's board of directors or the risk committee. The final rules are largely similar to the proposed rules on what the framework must address, except that the final rules do not require specific risk limitations on each business line of the BHC.

Each BHC's global risk management framework must include:

- policies and procedures establishing risk management governance, risk management procedures and a risk control infrastructure for the BHC's global operations;
- processes and systems for implementing and monitoring compliance with such policies and procedures;
- processes and systems for identifying and reporting risks and risk management deficiencies, including emerging risks, and ensuring effective and timely implementation of actions to address emerging risks and risk management deficiencies for its global operations;
- processes and systems for establishing managerial and employee responsibility for risk management;

- processes and systems for ensuring the independence of the risk management function; and
- processes and systems to integrate risk management and associated controls with management goals and the BHC's compensation structure for its global operations.

2. *Chief Risk Officer*

BHCs with total consolidated assets of $50 billion or more must appoint a chief risk officer ("CRO") with experience in identifying, assessing and managing risk exposures of large, complex financial firms. According to the preamble, the Federal Reserve expects a BHC to be able to demonstrate that the CRO's experience is relevant to the particular risks facing the BHC and commensurate with its structure, risk profile, complexity, activities and size.

The CRO is responsible for overseeing:

- the establishment of risk limits on an enterprise-wide basis and the monitoring of compliance with such limits;
- the implementation of and ongoing compliance with risk management policies and procedures, as well as the development and implementation of related processes and systems to monitor compliance; and
- the management of risks and risk controls within the parameters of the BHC's risk control framework, including the monitoring and testing of such controls.

The CRO is to report directly to both the risk committee and the chief executive officer and provide the risk committee with quarterly reports. The CRO must also be compensated and incentivized in a manner that will enable him or her to provide an "objective assessment" of the risks taken by the BHC. According to the preamble, the Federal Reserve does not regard this requirement as preventing a BHC from using discretion in adopting a compensation structure for its CRO, whether through its compensation committee or otherwise, as long as the CRO's ability to provide an objective assessment is not compromised. Also, this requirement supplements existing Federal Reserve guidance on sound incentive compensation, which cautions that incentive compensation received by employees in risk management and control functions should not be based substantially on the financial performance of the business units they overview.

D. LIQUIDITY REQUIREMENTS

Dodd-Frank directs the Federal Reserve to establish liquidity standards for BHCs with total consolidated assets of $50 billion or more. The final rules subject these companies to a set of enhanced liquidity risk management standards, liquidity stress testing requirements and liquidity buffer requirements, which build on guidance previously adopted by the Federal Reserve and other U.S. federal banking agencies.

The Federal Reserve noted in the preamble that it intends to use the supervisory process to supplement the final rules with horizontal reviews of the internal stress-testing methods, liquidity risk management, and liquidity adequacy of the largest, most complex BHCs. The Federal Reserve also noted that it is considering adopting a short-term debt limit.

1. *Enhanced Liquidity Risk Management Standards*

BHCs with $50 billion or more of total consolidated assets are subject to enhanced liquidity risk management standards that build on the Federal Reserve's existing supervisory guidance. These companies must take a number of prudential steps to manage liquidity risk:

- *Cash-flow Projections*—The BHC must produce comprehensive cash-flow projections, using reasonable assumptions and detail sufficient to reflect the capital structure, risk profile, size and complexity of the BHC, of cash flows arising from assets, liabilities and off-balance sheet exposures over short-term time horizons (updated daily) and long-term horizons (updated monthly). In the preamble to the final rules, the Federal Reserve noted that more frequent cash-flow reports may be appropriate for companies with more complex risk profiles or for all companies in times of stress.

- *Contingency Funding Plan*—The BHC must maintain, and at least annually update, a contingency funding plan commensurate with the BHC's capital structure, risk profile, size and complexity, setting forth strategies for addressing liquidity needs during stress events. Generally, the plan must identify potential liquidity stress events and their impacts on the BHC, assess available funding sources (including alternative funding sources) and funding needs during a stress event, specify an "action plan" that clearly describes the strategies to be employed to manage liquidity during a stress event, and include procedures for monitoring emerging stress events. The BHC must periodically test the components of the contingency funding plan to ensure its reliability in a stress event, including simulations to test communications and decision-making by management, and tests of the methods the BHC will use to secure funding. In the preamble to the final rules, the Federal Reserve stated that a BHC may incorporate into its contingency funding plans as potential sources of credit: (i) lines of credit, including Federal Home Loan Bank advances, provided that the plan incorporates the characteristics of such credit in times of liquidity stress; and (ii) discount window credit, provided that the plan describes the actions that would be taken to replace such funding with more permanent funding.

- *Liquidity Risk Limits*—The BHC must establish appropriate limits on liquidity risk that include (i) concentrations in various categories of funding sources, including by instrument type or counterparty type, single counterparty, and secured and unsecured funding; (ii) the amount of liabilities that mature within various time horizons; and (iii) off-balance sheet and other exposures that could create funding needs during stress events.

- *Liquidity Risk Monitoring*—The BHC must establish procedures for monitoring its collateral positions (at least weekly), levels of unencumbered assets available to be pledged and intraday liquidity risk exposure.

The final rules include a long list of affirmative steps that the board of directors and management of a BHC must take to oversee these liquidity risk management programs:

- *Role of Board of Directors and its Risk Committee*—The board of directors must (i) approve, at least annually, the BHC's acceptable liquidity risk tolerance, taking into account the BHC's capital structure, risk profile, complexity, activities, and size; (ii) review, at least semi-annually, information provided by senior management to assess whether the BHC is operating in accordance with its liquidity risk tolerance; and (iii) approve and periodically review the liquidity risk management strategies, policies and procedures established by senior management. Additionally, the risk committee of the board of directors must approve, at least annually, the contingency funding plan, which responsibility had been the board's under the proposed rules.

- *Role of Senior Management*—Senior management of the BHC must (i) establish and implement strategies, policies and procedures designed to effectively manage the risk that the BHC's financial condition would be adversely affected by its inability or the market's perception of its inability to meet its cash and collateral obligations; (ii) oversee the development of liquidity risk management systems; (iii) determine, at least quarterly, whether the BHC is operating in accordance with such procedures; (iv) report, at least quarterly, to the board of directors regarding the BHC's liquidity risk profile and liquidity risk tolerance; (v) approve new products and business lines and evaluate the liquidity costs, benefits and risks of each new product and business line that could have a significant effect on the BHC's liquidity risk profile, in each case before the new product or business line is offered; (vi) review, at least annually, significant products and business lines to determine whether they have created any unanticipated liquidity risk; (vii) review, at least quarterly, the BHC's cash flow projections for conformance with the BHC's liquidity risk tolerance; (viii) establish liquidity risk limits and review compliance with those limits at least quarterly; and (ix) at least quarterly, approve liquidity stress testing practices, review stress testing results, and approve the size and composition of the liquidity buffer, and periodically, review the independent review of the stress tests.

- *Independent Review Function*—The BHC must have a review function, independent of management functions that execute funding (*i.e.*, independent of its treasury operations), to evaluate liquidity risk management. This function must meet regularly, but no less frequently than annually, to review the effectiveness of the BHC's liquidity risk management processes, including stress testing, assess whether the BHC's liquidity risk management function complies with applicable law and sound business practices, and report material liquidity risk management issues to the board or its risk committee.

2. *Liquidity Stress Testing*

A BHC with $50 billion or more in total consolidated assets must conduct stress tests under a number of stress scenarios and time horizons to assess the potential impact on the BHC's cash flows, liquidity position, profitability and solvency. Stress tests must be conducted at least monthly and must be tailored to the BHC's capital structure, risk profile, complexity, activities and size. Each test must include scenarios reflecting: (i) adverse market conditions, (ii) an idiosyncratic stress event for the BHC, (iii) a combination of market and idiosyncratic stresses, and (iv) any additional stress scenarios that would be appropriate based on the financial condition and individual characteristics of the BHC. Each test must cover planning horizons (*i.e.*, lengths of time over which the stress projection extends) of: (a) an overnight horizon, (b) 30 days, (c) 90 days, (d) one year, and (e) any other time period appropriate for the particular BHC. Additionally, the BHC must establish a system of controls and oversight over stress testing processes to ensure that each stress test appropriately incorporates "conservative" assumptions, which must be approved by the BHC's U.S. CRO.

The final rules provide some guidance about the assets and liabilities to be incorporated into stress test results (and, by extension, liquidity management planning). Assets used as cash-flow sources must be diversified by collateral, counterparty, borrowing capacity, and other factors associated with an asset's liquidity risk. To the extent an asset is used as a cash flow source in the stress tests, it must be discounted to reflect any credit risk or market volatility. A line of credit does not qualify as a cash flow source for any stress test with a planning horizon of 30 days or less, but may count as a cash flow source for any longer planning horizon. Noting that some banks provided unanticipated liquidity support to their sponsored funds and similar conduits in the recent financial crisis, the Federal Reserve stated in the preamble that such vehicles must be incorporated into stress test results.

3. *Liquidity Buffers*

A BHC with $50 billion or more in total consolidated assets must maintain a liquidity buffer sufficient to meet its projected net stressed cash-flow need over the 30-day planning horizon under each stress scenario identified above.[7] The buffer must consist of highly liquid, unencumbered assets, discounted to fair market value.

Highly liquid assets include cash and securities issued or guaranteed by the United States, a U.S. government agency or a U.S. government-sponsored enterprise ("GSE"). Additionally, a BHC may demonstrate to the Federal Reserve that any other asset is a highly liquid asset if it:

- has low credit risk and market risk;
- is traded in an active secondary two-way market with committed market makers and independent bona fide offers to buy and sell, such that a price reasonably

7 The net stressed cash-flow need is the difference between the amount of the BHC's cash-flow need and the amount of its cash flow sources over the 30-day horizon.

related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a reasonable time period conforming with trade custom; and

- is a type of asset that investors historically have purchased in periods of financial market distress with impaired market liquidity.[8]

Unencumbered assets are those that (i) are free of legal, regulatory, contractual or other restrictions on the ability of the BHC to promptly sell or transfer them; and (ii) are not pledged or used to secure or provide credit enhancement to any transaction, except for any pledge to a central government or GSE to the extent potential credit secured by the asset is not currently extended by such central bank or GSE.[9] The buffer may not contain a "significant concentration" of any type of high-quality asset as measured by a number of characteristics, except for cash and securities issued or guaranteed by the United States, a U.S. government agency or GSE. The final rules do not define "significant concentration."

In the preamble to the final rules, the Federal Reserve stated that the BHC should periodically monetize a representative portion of its highly liquid assets, through repo or outright sale, in order to test its access to the market. The Federal Reserve also noted that in circumstances that would be beneficial to the safety and soundness of the BHC, the BHC may, in consultation with supervisors, temporarily reduce the amount of highly liquid unencumbered assets in its liquidity buffer below the amount required to withstand the 30-day stress scenarios.

E. CAPITAL AND LEVERAGE REQUIREMENTS

The final rules include a placeholder provision subjecting BHCs with total consolidated assets of $50 billion or more to any applicable capital planning and stress testing regulations adopted by the Federal Reserve.

In July 2013, the Federal Reserve released a final rule implementing capital standards under the Basel III international framework that represented a significant re-working of existing U.S. regulation of bank capital.[10] Also in July 2013, the Federal Reserve issued a proposal that would

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8 In response to comments requesting clarification on the treatment of reverse repo transactions secured by highly liquid assets, the Federal Reserve stated in the preamble that if a BHC is able to rehypothecate collateral that it holds that has pledged to it to secure a loan, but has not done so, it may count that collateral as a qualifying asset.

9 While the final rules do not make it explicit, the preamble clarifies that an asset used as a hedge position may qualify as an unencumbered asset.

10 New Regulation Q (12 C.F.R. Part 217) sets forth the Federal Reserve's revised capital framework, as adopted in July 2013. *See* 78 Fed. Reg. 62157 and 62285 (Oct. 11, 2013). For a summary of the revised capital framework, please see our memorandum titled, "Federal Reserve Adopts Final U.S. Bank Capital Standards Under Basel III," dated July 8, 2013, *available at* http://www.stblaw.com/about-us/news/details?id=55abe6b4-d81a-4e3c-9cb4-7fd02835c9eb. Among other things, the revised capital framework introduced a new minimum Common Equity Tier 1 ratio of 4.5%, raised the minimum Tier 1 capital ratio from 4% to 6%, and will subject all banking organizations to meet a 4% minimum leverage ratio. So-called "advanced approaches" banking organizations (generally those with consolidated total assets of at least $250 billion or

require U.S. top-tier BHCs with more than $700 billion in total consolidated assets or $10 trillion in assets under custody to maintain a supplemental leverage buffer of at least 2% *above* the minimum supplementary leverage capital requirement of 3%.[11] Compliance would be necessary to avoid restrictions on capital distributions and discretionary bonus payments to executive officers. Additionally, the Federal Reserve noted in the preamble to the final rules that it expects to propose additional prudential rules for large BHCs in the future, including a quantitative risk-based capital surcharge, for globally systemically important banks ("G-SIBs") identified by the Financial Stability Board.[12]

F. CAPITAL STRESS TESTING REQUIREMENTS

Section 165(i) of Dodd-Frank mandated that a set of forward-looking "stress tests" be conducted both by the Federal Reserve and by financial companies regulated by the Federal Reserve, including large BHCs with total consolidated assets of $50 billion or more, nonbank SIFIs, and SLHCs and state member banks with total consolidated assets of more than $10 billion. Such tests are intended to determine whether a particular institution has adequate capital to weather a severe economic downturn. In October 2012, the Federal Reserve finalized the implementation of these Dodd-Frank stress testing requirements ("DFAST").[13] Under the Federal Reserve's DFAST rules, BHCs with total consolidated assets of $50 billion or more and nonbank SIFIs must undergo an annual supervisory stress test, as well as annual and mid-cycle company-run stress tests. For BHCs with total consolidated assets between $10 billion and $50 billion and SLHCs and state member banks with total consolidated assets of more than $10 billion, only annual company-run stress tests are required. Compliance dates are not uniform, as there are important phase-in considerations based on asset size, nonbank SIFI status, and whether a U.S. BHC is currently relying on the Federal Reserve's Supervision and Regulation Letter SR 01-1.

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consolidated total on-balance sheet foreign exposures of at least $10 billion) would need to meet a supplementary leverage ratio of 3% (that is, on top of the 4% minimum leverage ratio).

11 *See* 78 Fed. Reg. 51101 (Aug. 20, 2013).

12 According to the preamble, the G-SIB capital surcharge would be based on the Basel Committee on Banking Supervision's approach and implementation timeframe. In July 2013, the Basel Committee published its methodology for assessing and identifying G-SIBs, including the "additional loss absorbency requirements" that will eventually apply to such institutions and that will take the form of a common equity surcharge, ranging initially from 1% to 2.5% of a G-SIB's total risk-weighted assets. *See* "Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement" (July 2013), *available at* http://www.bis.org/publ/bcbs255.pdf. Since November 2011, the Financial Stability Board has annually published a list of G-SIBs, placing each in one of four common equity capital surcharge buckets. In November 2013, the Financial Stability Board identified 29 G-SIBs on the basis of the Basel Committee's July 2013 methodology, including eight U.S. bank holding companies.

13 77 Fed. Reg. 62378 & 62396 (Oct. 12, 2012). Concurrent with the release of the Federal Reserve's DFAST rules, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency adopted similar rules for the insured depository institutions that they supervise. *See* 77 Fed. Reg. 61238 (Oct. 9, 2012); 77 Fed. Reg. 62417 (Oct. 15, 2012).

Generally, for large banking organizations with total consolidated assets of $50 billion or more, scenarios for a given cycle's supervisory and annual company-run stress tests are released by November 15 of each year, with the filing of company-run regulatory reports by January 5. As required by Dodd-Frank, the scenarios will describe hypothetical baseline, adverse and severely adverse conditions, with projections for key macroeconomic and financial variables (such as real GDP, the unemployment rate, and equity and property prices). These banking organizations must disclose their results in the period between March 15 and March 31. For the supervisory stress tests conducted by the Federal Reserve, results are communicated directly to the banking organization by March 31, with summary results published by the Federal Reserve by March 31.

The final rules do not make any changes to the Federal Reserve's previously issued DFAST rules. The DFAST rules are simply re-codified within the Federal Reserve's Regulation YY.

G. DEBT-TO-EQUITY LIMITS

Under Section 165(j) of Dodd-Frank, if the FSOC determines that a BHC with total consolidated assets of $50 billion or more (i) poses a "grave threat" to U.S. financial stability and (ii) the imposition of a debt-to-equity limitation is "necessary to mitigate" that threat, then the Federal Reserve must require the company to maintain a debt-to-equity ratio of no more than 15-to-1. The final rules define "debt" and "equity" as having the same meaning as "total liabilities" and "total equity capital," respectively, as calculated in a company's reports of financial condition. The 15-to-1 debt-to-equity ratio is calculated as the ratio of total liabilities to total equity capital minus goodwill.

A BHC that is subject to a "grave threat" determination by the FSOC will receive written notice from the FSOC. After receiving such notice, the BHC will have 180 calendar days to come into compliance with the prescribed debt-to-equity ratio requirement, although it may seek up to two extensions of 90 days each. The debt-to-equity ratio requirement will remain in effect until the FSOC determines that a particular BHC no longer poses a grave threat to U.S. financial stability and that the imposition of the leverage limitation is no longer necessary.

H. FUTURE ENHANCED PRUDENTIAL RULES

Sections 165 and 166 of Dodd-Frank require the Federal Reserve to issue regulations to implement a number of enhanced prudential standards for BHCs with $50 billion or more in total consolidated assets and for nonbank SIFIs. The final rules do not include enhanced prudential standards for nonbank SIFIs or implement several key enhanced prudential standards listed in the statute.

1. *Application to Nonbank SIFIs*

While the proposed rules would have generally subjected nonbank SIFIs to the same enhanced prudential standards as those applicable to large BHCs, the final rules do not apply to nonbank SIFIs. In the preamble, the Federal Reserve recognized that nonbank SIFIs may have a range of businesses and structures and that the enhanced prudential standards applicable to large BHCs may not be appropriate for all nonbank SIFIs. Instead, the Federal Reserve will thoroughly assess the business, capital structure and risk profile of each nonbank SIFI to determine whether and how enhanced prudential standards should apply, and will tailor the standards to each nonbank SIFI or category of nonbank SIFI. However, for those nonbank SIFIs that are similar in activities and risk profile to BHCs, the Federal Reserve expects to apply similar standards as those that apply to large BHCs.

In particular, the application of capital requirements to insurance companies—whether they have been designated as nonbank SIFIs or are SLHCs—raises significant policy issues in light of the distinctions in the business models and risk profiles of insurance companies and banking organizations. Indeed, many prominent members of Congress, including Senator Susan Collins—the sponsor of the so-called "Collins Amendment," or Section 171 of Dodd-Frank, which generally mandates that risk-based capital and leverage requirements not be "less than" the capital and leverage requirements applied to insured depository institutions—have urged the Federal Reserve to give appropriate consideration to such distinctions when establishing capital regulation for affected insurance companies. On March 11, 2014, a subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs heard testimony from Senator Collins, as well as from industry, policy and academic witnesses, on the need to find the "right" way to impose capital requirements on insurance companies.[14] It remains to be seen what course the Federal Reserve will take in applying capital requirements to insurance companies and whether concerns regarding the inappropriateness of "bank centric" capital regulation will be sufficiently addressed.

2. *Single Counterparty Credit Limits*

Section 165(e) of Dodd-Frank directs the Federal Reserve to establish standards that prohibit a large BHC or nonbank SIFI from having credit exposure to any unaffiliated company that exceeds 25% of the BHC or nonbank SIFI's capital stock and surplus (or such lower threshold if necessary to mitigate risks to U.S. financial stability). The proposed rules implemented this requirement with (i) a general limit on net credit exposures of a large BHC or nonbank SIFI to a single unaffiliated counterparty, and (ii) a more stringent limit applicable to net credit exposures between a BHCs or nonbank SIFI with over $500 billion in consolidated assets and a counterparty with over $500 billion in consolidated assets. The final rules do not finalize single counterparty credit limits, and the Federal Reserve noted in the preamble that before it does so, it intends to take into account global single exposure standards that the Basel Committee on Banking Supervision is currently developing.

3. *Early Remediation Framework*

To minimize the probability that a large BHC or nonbank SIFI will become insolvent and the potential harm of such insolvency to U.S. financial stability, Section 166 of Dodd-Frank directs the Federal Reserve to establish a framework for the early remediation of financial distress of

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14 *See* "Finding the Right Capital Regulations for Insurance Companies," Hearing Before the Subcomm. on Financial Institutions and Consumer Protection of the Senate Committee on Banking, Housing, and Urban Affairs, 113th Congress (Mar. 11, 2014), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=9974bd4e-f8ab-4e9a-940e-bfa8def6e737.

large BHCs and nonbank SIFIs. While the proposed rules included an early remediation framework, the final rules do not finalize these requirements.

4. Short Term Debt

Section 165(b) of Dodd-Frank permits the Federal Reserve to establish short-term debt limits for large BHCs and nonbank SIFIs. In the preamble to the final rules, the Federal Reserve noted that it is continuing to evaluate the benefits to systemic stability of imposing short-term debt limits.

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