KPMG

Regulatory Alert

Financial Services Regulatory Insight Center

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Proposed FBO framework for prudential standards

KPMG is issuing this Regulatory Alert to highlight key features of interagency proposals rules to tailor regulatory requirements for FBOs to their size, U.S. presence, and risk profile.

Key points

- The Federal Reserve, FDIC, and OCC jointly proposed a new supervisory framework to tailor the application of prudential standards and capital and liquidity rules for foreign banking organizations based on the size and risk profile of their U.S. assets.
- The framework is designed to align with the framework proposed for domestic banking organizations.
- Cross-jurisdictional activity and weighted short-term wholesale funding are used as key risk indicators for determining if full liquidity requirements are required.

The Federal Reserve, FDIC, and OCC have jointly proposed two new rules that would tailor regulatory requirements for foreign banking organizations (FBOs) based on their U.S. risk profiles. The rules would generally align the application of enhanced prudential standards to FBOs, including their U.S. intermediate holding companies (IHCs) and the IHC's insured depository institution subsidiaries, with the new framework previously proposed for domestic banking organizations (see related KPMG Regulatory Alert here).

- The first rule would revise the framework for application of the prudential standards to FBOs with total global consolidated assets of $100 billion or more and a "significant" U.S. presence that is based on the size of their U.S. assets (i.e., $100 billion or more in combined U.S. assets (assets of the U.S. IHC plus U.S. branches and agencies)) and the materiality of certain risk-based factors, including cross-jurisdictional activity, nonbank assets, off-balance sheet exposure, and weighted short-term wholesale funding (wSTWF).
- The second rule would modify the application of liquidity and capital requirements for the FBOs' U.S. IHCs and their depository institution subsidiaries based on asset size and risk factors, including cross-jurisdictional activity, nonbank assets, off-balance sheet exposure, and wSTWF. An FBO's combined U.S. operations would be the basis for applying the liquidity standards. However, the IHC's assets (total U.S. consolidated assets) would be the basis for applying the capital standards.
- An FBO would be assigned to one of three standards categories, Category II, III, or IV, based on a combination of its assets and risk factors for each of the prudential, liquidity, and capital measures (Category I is reserved for U.S. global systemically important banking organizations only). As such, an FBO could be subject to different standards categories for its prudential, liquidity, and capital requirements.

- Comments on both proposals are due to the agencies by June 21, 2019.

Highlights of the proposed standards framework and categories follow.

Note: Category I standards, which would apply to U.S. GSIBs, would not apply to any FBO or U.S. IHC.

Prudential Standards: FBOs with combined U.S. assets of $100 billion or more would be required to meet enhanced prudential standards. They would be assigned to one of three standards categories based on the following criteria for their combined U.S. assets.

- Category II – FBOs with $700 billion or more in combined U.S. assets or $75 billion or more in cross-jurisdictional activity would have to meet risk-management standards, capital and liquidity requirements, and single-counterparty credit limit (SCCL) requirements. SCCL requirements would be applied to the IHC.
- Category III – FBOs that are not subject to Category II standards and that have $250 billion or more combined U.S. assets or $75 billion or more in nonbank assets, wSTWF, or off-balance sheet exposure would have to meet risk-management standards, capital and liquidity requirements, and SCCL requirements. SCCL requirements would be applied to the IHC.
- Category IV – FBOS with at least $100 billion in combined U.S. assets that do not meet any of the thresholds for Categories II or III would be placed in Category IV. They would be required to meet risk-management standards and capital and liquidity requirements. SCCL requirements would apply if the FBO has global consolidated assets of $250 billion or more.

  FBOs with total consolidated assets of $100 billion or more but less than $50 billion in combined U.S. assets would be required to maintain a U.S. risk committee and make an annual certification; those with more than $50 billion in combined U.S. assets would be required to maintain a U.S. risk committee and have a U.S. chief risk officer.

Liquidity Standards: An FBO's applicable standards category for liquidity would be determined based on the FBO's combined U.S assets and applied to the IHC and any depository institution subsidiaries of the IHC that have $10 billion or more in assets (covered depository institution).

- Category II – Category II liquidity standards would apply to FBOs with $700 billion or more in combined U.S. assets or $75 billion or more in cross-jurisdictional activity. These standards would include full liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements for the U.S. IHC and covered depository institutions. In addition, Category II liquidity standards would maintain the existing enhanced prudential standards for liquidity risk management, monthly internal liquidity stress testing, and liquid asset buffer requirements, and daily liquidity data reporting.
- Category III – Category III liquidity standards would apply to FBOs that are not subject to the Category II liquidity standards and that have $250 billion or more combined U.S. assets or $75 billion or more in nonbank assets, wSTWF, or off-balance sheet exposure. To the extent the FBO has $75 billion or more in wSTWF, the IHC and any covered depository institution would be subject to the full LCR and NSFR; when the wSTWF is less than $75 billion, a reduced LCR and NSFR would apply. Category III liquidity standards would also require FBOs to maintain liquidity risk management, monthly internal liquidity stress testing, and liquid asset buffer requirements as well as require monthly liquidity data reporting.
- Category IV – Category IV liquidity standards would apply to FBOS with at least $100 billion in combined U.S. assets that do not meet any of the thresholds for liquidity standards of Categories II or III. The Category IV standards would include reduced LCR and NSFR requirements only if the combined U.S. operations of the FBO have $50 billion or more in wSTWF. In addition, Category IV liquidity standards would include reduced liquidity risk management requirements, quarterly internal liquidity stress testing, and liquid asset buffer requirements. Monthly liquidity data reporting would be required.

Capital Standards: FBOs that have a U.S. IHC with total consolidated assets of $100 billion or more would be required, along with any depository institution subsidiary of the IHC, to meet capital standards. The three capital standards categories would apply based on the following criteria for the U.S. IHC:

- Category II – Capital II standards would apply to IHCs with $700 billion or more in total consolidated assets or $75 billion or more in cross-jurisdictional activity. The capital standards would require the IHC to submit an annual capital plan, participate annually in the Comprehensive Capital Analysis and Review (CCAR), conduct annual company-run stress testing, and be subject to annual supervisory stress testing. In addition, these standards would include the supplementary leverage ratio, countercyclical capital buffer, and requirement to recognize most elements of AOCI (accumulated other comprehensive income).
- Category III – Category III standards would apply to IHCs that are not subject to the Category II capital standards and that have $250 billion or more in total consolidated assets or $75 billion or more in nonbank assets, wSTSF, or off-balance sheet exposure. IHCs would be required to submit an annual capital plan, participate annually in CCAR, and be subject to annual supervisory stress testing; company run stress testing would be required every two years. In addition, Category III standards would include the supplementary leverage ratio and countercyclical capital buffer.
- Category IV – Category IV standards would apply to IHCs with at least $100 billion in combined U.S. assets that do not meet any of the thresholds specified for the Category II or III capital standards. IHCs would be required to submit an annual capital plan though there would be more flexibility to use estimates; they would be required to participate in CCAR and supervisory stress testing every two years.

In addition to the above proposals, the agencies are:

- Specifically seeking comment on whether to impose standardized liquidity requirements (LCR and NSFR) on the U.S. branches and agencies of FBOs.
- Not proposing to raise the assets threshold for establishing a U.S. IHC (the current rule requires FBOs with U.S. nonbranch assets of $50 billion or more to form a U.S. IHC).
- Using a measure of "cross-jurisdictional activity" that excludes cross-jurisdictional liabilities to non-U.S. affiliates and cross-jurisdictional claims on non-U.S. affiliates to the extent that these claims are secured by eligible financial collateral.
- Proposing to apply LCR and NSFR requirements to U.S. depository institution holding companies that meet the requirements for Category IV standards under the domestic interagency proposal and have $50 billion or more in wSTWF. The agencies note that no U.S. depository institution holding company meets these criteria.
- Proposing modifications to the Federal Reserve's SCCL rule to align the application thresholds with proposed thresholds for other prudential standards. As proposed, the SCCLs would apply to the combined U.S. operations of an FBO subject to Category II or Category III standards, or an FBO with $250 billion or more in total consolidated assets. FBOs would continue to be able to comply with the SCCLs by certifying they meet comparable home country standards on a consolidated basis.

  The SCCLs would also apply separately to a U.S. IHC subject to Category II or Category III standards. In particular, the proposal would apply a uniformed aggregate net credit exposure limit of 25% of Tier 1 Capital for all counterparties, and would remove the bifurcated treatment regarding i) exposures to SPVs, ii) application of the economic interdependence and control relationship tests, and iii) daily monitoring and compliance. All applicable U.S. IHCs would need to meet these requirements rather than only U.S. IHCs with $250 billion or more in total consolidated assets. (Click here to reach KPMG's Regulatory Alert on the SCCL Rule.)
- Separately proposing to amend the rule implementing resolution planning requirements under the Dodd-Frank Act's Section 165, Enhanced supervision and prudential standards, including aligning with the tailoring proposals for domestic banking organizations and FBOs. (See KPMG Regulatory Alert here.)

KPMG Perspectives

The proposals are consistent with the basic framework proposed for domestic banking organizations last fall as they assign FBOs to standards categories with increasingly stringent requirements based on the FBO's

U.S. operations, including asset size, complexity, cross-border activity, business model, and risk profile.

The proposal would eliminate the U.S. risk committee requirements that apply for FBOs with less than $50 billion in combined U.S. assets, however the Federal Reserve indicates that it will continue to review the risk management practices through the supervisory process and will expect these FBOs to establish risk management processes and procedures that are appropriate for their business models and risk profiles.

FBOs must consider the potential that the use of the risk indicators, including cross-jurisdictional activity, nonbank assets, wSTWF, and off-balance exposures, could result in assignments to different standards categories for the determination of their separate prudential, capital, and liquidity requirements and may also be different than the category that would have been assigned if based solely on asset size.

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