

Date: January 12, 2021
To: Board of Governors
From: Staff¹
Subject: Draft final rule to conform the Board's capital planning and related stress testing requirements to its prudential standards tailoring framework

ACTIONS REQUESTED: Approval of a draft final rule that would update the Board's capital planning and related stress testing requirements and associated reporting forms to be consistent with the final rule adopted in 2019 to tailor the Board's prudential standards. In addition, staff seeks authority to make technical or minor changes to the draft final rule prior to publication in the Federal Register.

EXECUTIVE SUMMARY:

- In November 2019, consistent with changes made by the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), the Board adopted a final rule to tailor prudential standards for large banking organizations (tailoring rule).² Under the tailoring rule, large banking organizations are slotted into one of four categories of prudential standards based on the systemic risk and complexity attributes of a banking organization. The most stringent prudential standards apply under Category I, and the least stringent prudential standards apply under Category IV.³
- The draft final rule would adopt changes to the capital plan and stress test rules to conform to the tailoring rule. Specifically, the final rule would:

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² Banking organizations include bank holding companies, U.S. intermediate holding companies of foreign banking organizations, and savings and loan holding companies not predominantly engaged in insurance or commercial activities (covered savings and loan holding companies).

³ See 84 FR 59032 (November 1, 2019). For firms subject to Category IV standards, consistent with EGRRCPA, the tailoring rule eliminated the requirement to conduct and publicly disclose the results of a company-run stress test, and required supervisory stress testing on a biennial cycle. A firm subject to Category IV standards has \$100 billion or more in total assets and does not meet the criteria for Category I, II or III standards (see Appendix A).

- Remove the company-run stress test requirements and implement biennial supervisory stress tests for firms subject to Category IV standards.
 - Allow firms subject to Category IV standards to elect to participate in the supervisory stress test in a year in which the firm would not otherwise be subject to the supervisory stress test in order to receive an updated stress capital buffer requirement.
 - Change certain assumptions about material business changes under stress to be consistent with recent changes to the Board's stress test rules.
- The draft final rule would also apply capital planning and stress capital buffer requirements to covered savings and loan holding companies in the same manner as they apply to bank holding companies.
 - These requirements will promote the safety and soundness of covered savings and loan holding companies by ensuring they maintain capital commensurate with their risk profile and activities.
 - The draft final rule would not affect the calculation of capital requirements for bank holding companies and U.S. intermediate holding companies of foreign banking organizations. The draft final rule would subject covered savings and loan holding companies to the stress capital buffer requirement for the first time, which could increase the capital requirements for such a firm to be equal to those of a similarly situated bank holding company.
 - Separate from the draft final rule, staff plans to update the applicability of two supervisory letters (SR 15-18 and SR 15-19) to align with the tailoring framework such that SR 15-18 is applicable to firms subject to Category I standards, and SR 15-19 is applicable to firms subject to Category II or III standards.
 - The draft final rule would extend and revise reporting requirements associated with capital planning and stress testing.⁴
 - The changes would be effective 60 days following the date of publication in the *Federal Register* and most elements of the rule would be effective for the 2021 capital planning and stress testing cycle.

⁴ Specifically, the draft final rule would extend for three years, with revision, the following information collections: the Capital Assessments and Stress Testing Reports (FR Y-14), the Reporting and Disclosure Requirements Associated with Regulation LL (FR LL), and the Reporting, Recordkeeping, and Disclosure Requirements Associated with Regulation YY (Enhanced Prudential Standards) (FR YY).

DISCUSSION:

I. Background

Following the 2008-2009 financial crisis, the Board adopted stress testing and capital planning requirements to ensure that large banks could survive a severe recession and continue lending to households and businesses. The Board's capital plan rule requires large firms to develop and maintain capital plans—which help determine their ability to make shareholder distributions, such as dividends and repurchases—supported by robust processes for assessing their capital adequacy. The Board's stress testing and capital planning framework, together with strong minimum capital requirements adopted after the financial crisis, have significantly improved the resilience of the U.S. banking system. Over the past decade, large banks have more than doubled their common equity tier 1 capital (CET1) ratio from 5 percent in 2009 to over 12.5 percent in 2020.

Following the passage of the EGRRCPA in 2018, the Board issued a final rule in November 2019 to revise the framework for applying prudential standards to large firms (tailoring rule).⁵ The tailoring rule more closely aligns the application of prudential standards to firms' risk profiles by establishing four categories of standards that increase in stringency based on five risk-based indicators (see Appendix A for the criteria of the four categories and firms' current categories for capital planning and stress testing requirements). To implement other

⁵ Section 401 of EGRRCPA increased the threshold for general application of prudential standards and directed the Board to apply such standards in a manner that takes into considerations a banking organization's capital structure, risk, complexity, size, financial activities, and any other risk-related factors the Board considers appropriate. In applying such standards, EGRRCPA also requires the Board to find that application of prudential standards are appropriate to prevent or mitigate risks to U.S. financial stability or to promote the safety and soundness of banking organizations.

provisions of EGRRCPA, the tailoring rule made two key changes to the stress test rules for firms subject to Category IV standards.⁶ First, the tailoring rule removed the requirement for firms subject to Category IV standards to conduct and publicly disclose the results of a company-run stress test. Second, the tailoring rule changed the frequency of the supervisory stress test for firms subject to Category IV standards from annual to biennial.

The Board more recently adopted a final rule to integrate its capital planning and regulatory capital requirements through the implementation of a single, risk-sensitive capital framework for large banking organizations (stress capital buffer rule). The stress capital buffer rule included several changes to the assumptions embedded in the supervisory stress test, including the assumption to exclude material business plan changes from the stress capital buffer requirement calculation. Instead, material changes to a firm's business plan resulting from a merger or acquisition are incorporated into a firm's capital and risk-weighted assets once the merger or acquisition is consummated.

II. Summary of proposal and comments received

On October 7, 2020, the Board issued a proposed rule (proposed rule or proposal) that would have modified the Board's capital planning and stress capital buffer requirements to be more consistent with the tailoring framework.⁷ The proposed rule would have aligned the Board's capital planning and stress capital buffer requirements with the tailoring rule. Specifically, for firms subject to Category IV standards, the proposal would have generally removed the requirement under the capital plan rule to calculate forward-looking projections of capital under scenarios provided by the Board, consistent with the removal of company-run

⁶ See Public Law 115-174, 132 Stat. 1296 (2018).

⁷ See 85 FR 63222 (October 7, 2020).

stress test requirements.⁸ The proposed rule also would have amended the frequency of the calculation of the CET1 ratio decline for purposes of the stress capital buffer requirement, by reducing it from an annual to biennial requirement, while providing the ability to voluntarily participate in the supervisory stress test in a year in which a firm would not generally be subject to the supervisory stress test.⁹

The proposal also would have changed the stress test rules to align with the tailoring and stress capital buffer final rules. Specifically, the proposed changes would have included clarifications to the assumptions related to business plan changes, introduced revisions to the capital action assumptions for savings and loan holding companies, and required certain savings and loan holding companies to publicly disclose their stress test results in a manner consistent with the public disclosure requirements for bank holding companies with similar risk profiles.

Additionally, the proposal solicited comment on several topics, including all aspects of the Federal Reserve's capital planning guidance, a definition of "common stock dividend" for purposes of the capital plan rule, and the application of the capital plan rule to covered savings and loan holding companies.

The Board received thirteen comments from banking organizations, public interest groups, trade organizations, and individuals. While commenters were generally supportive of the proposed changes, some commenters expressed concern or requested clarification on parts of the proposal, such as changes to capital planning requirements, the calculation and timing of the

⁸ Under the proposal, such firms would no longer have been required to submit the forward-looking projections in the granular form prescribed by the FR Y-14A, Schedule A – Summary, Schedule B – Scenario, Schedule F – Business Plan Changes, and Appendix A – Supporting Documentation.

⁹ A firm that elects to participate in the supervisory stress test during a year in which it is not subject to the requirement would receive an updated decline in its CET1 ratio for purposes of the stress capital buffer requirement.

stress capital buffer requirement, and regulatory reporting changes for firms subject to Category IV requirements. In addition, commenters responded to the items on which the proposal specifically solicited comments.

III. Overview of Draft Final Rule

A. Changes to mandatory elements of a capital plan for firms subject to Category IV standards

To align with the stress test rule changes following the passage of EGRRCPA, the draft final rule would revise the capital planning requirements for firms subject to Category IV standards. Under the draft final rule, firms subject to Category IV standards would not be required to calculate forward-looking projections of capital under scenarios provided by the Board.¹⁰ Firms subject to Category IV standards would also not be required to report company-run stress test results on the relevant FR Y-14A reporting schedules, though these firms would still be required to provide forward-looking analyses of income and capital levels under stress in their capital plans.¹¹

B. Calculation and timing of stress capital buffer requirements for firms subject to Category IV standards

The draft final rule would align the frequency of the calculation of the stress capital buffer requirement with the frequency of the supervisory stress test (that is, both would occur

¹⁰ The draft final rule would allow the Board, under certain circumstances, based on the macroeconomic outlook or based on the firm's risk profile, financial condition or corporate structure, to require a firm subject to Category IV standards to submit a capital plan under scenarios provided by the Board.

¹¹ In order to ensure that planned capital distributions are consistent with any effective capital distribution limitations, the draft final rule updates the FR Y-14A, Schedule C to include line items to provide the necessary information. These line items are effective for the December 31, 2020, submission.

every other year for firms subject to Category IV standards).¹² The proposal would have allowed a firm subject to Category IV standards to elect to participate in the supervisory stress test in a year in which the firm would not normally be subject to the supervisory stress test in order to receive an updated stress capital buffer requirement.

Commenters generally supported the opt-in election set forth in the proposal. One commenter argued that the opt-in election could undermine the credibility of the stress testing framework, as firms that choose not to participate may be perceived as being in weaker condition. However, a firm's decision to elect to participate could stem from various factors, such as recent significant changes to the firm's risk profile or corporate structure. In order to reduce burden and provide flexibility for firm-specific requests, the draft final rule would allow firms subject to Category IV standards to elect to participate in the supervisory stress test in a year in which the firm would not otherwise be subject to the supervisory stress test. In response to comments requesting additional time to opt-in to the stress test, the deadline for a firm to opt-in would generally be January 15 of any year in which a firm would not be required to participate in the supervisory stress test, and April 5, 2021, for the 2021 stress testing cycle.¹³

C. Align assumptions in company-run and supervisory stress tests

For purposes of the supervisory stress test, the Board does not incorporate the impact of expected changes to a firm's business plan that are likely to have a material impact on the firm's capital adequacy and funding profile. To align the assumptions under the supervisory and company-run stress tests, the draft final rule would exclude the effects of unconsummated

¹² The firm would receive an updated stress capital buffer requirement reflective of the firm's updated planned common stock dividends during a year in which it did not participate in the supervisory stress test.

¹³ In the proposal, the opt-in date was February 15 for the 2021 cycle and December 31 of the prior year for subsequent cycles.

material business plan changes in the stress tests conducted pursuant to the Dodd-Frank Act. The draft final rule would also include conforming changes to the Stress Testing Policy Statement and the FR Y-14 regulatory reports.¹⁴

D. Application of capital planning requirements and stress test rule changes for covered savings and loan holding companies

Application of capital planning requirements: The proposal solicited comment on whether to apply capital planning and stress capital buffer requirements to large covered savings and loan holding companies.¹⁵ The Board received two comments on this aspect of the proposal. Commenters suggested the Board provide large covered savings and loan holding companies the ability to voluntarily comply with these requirements, particularly for those covered and savings and loan holding companies that pose less risk. One commenter asserted that capital planning requirements should be appropriately tailored to the risk profile of large covered savings and loan holding companies and requested a transition period until at least the 2024 capital planning cycle for the application of requirements.

The draft final rule would apply capital planning and stress capital buffer requirements to large covered savings and loan holding companies in the same manner as they apply to large bank holding companies. As noted in the tailoring rule, large covered savings and loan holding companies engage in many of the same activities and face similar risks as large bank holding companies. These requirements will help ensure that large covered saving and loan holding

¹⁴ Firms subject to Category I through III standards would be required to report two sub-schedules for all items on FR Y-14A, Schedule A – Summary, one where a firm would incorporate the effects of material business plan changes and one where a firm would not incorporate these effects. All firms would be required to report similar sub-schedules for all items on FR Y-14A, Schedule – Regulatory Capital Instruments. These revisions to the FR Y-14A will be effective as of the December 31, 2020 FR Y-14A submission.

¹⁵ A covered savings and loan holding company is a savings and loan holding company not predominantly engaged in insurance or commercial activities (*see* 12 CFR 217.2).

companies have robust systems and processes that incorporate forward-looking projections of revenue and losses to monitor and maintain their internal capital adequacy, and that they can meet their obligations to creditors and other counterparties, as well as continue to serve as financial intermediaries through periods of financial and economic stress.

Staff believe the requirements are sufficiently tailored to the characteristics of large covered savings and loan holding companies as they incorporate the tailoring framework discussed above. In addition, the Board's capital planning and stress capital buffer requirements are designed to increase in stringency as the complexity and risk profile of a firm increases—for example, a firm's capital plan must include an assessment of the expected uses and sources of capital over the planning horizon that reflects the firm's size, complexity, risk profile, and scope of operations.

To give effect to the application of such requirements, the draft final rule also would apply capital planning reporting requirements to covered savings and loan holding companies.¹⁶

To provide an appropriate amount of time to comply with the stress testing and capital planning requirements, the capital plan requirements for large covered savings and loan holding companies would provide the same transition period applicable to large bank holding companies. Accordingly, a large covered savings and loan holding company that becomes subject to capital planning requirements as of the effective date of this rule would be required to submit its first capital plan on April 5, 2022.

¹⁶ Similar to bank holding companies, covered savings and loan holding companies subject to Category II or III standards will be required to submit FR Y-14A, Schedule A – Summary, Schedule B – Scenario, Schedule E – Operational Risk, and Schedule F – Business Plan Changes. Covered savings and loan holding companies subject to Category II, III or IV standards will be required to submit FR Y-14A, Schedule C – Regulatory Capital Instruments.

Stress test rule changes: The tailoring rule applied company-run and supervisory stress test requirements to large savings and loan holding companies in the same manner as they apply to bank holding companies of a similar size and risk profile. Consistent with this change, the draft final rule would modify the capital distribution assumptions used for purposes of the stress tests applicable to these firms to apply in the same manner as they do currently for bank holding companies. In addition, the draft final rule would update the Board's company-run stress test rules to require that all savings and loan holding companies with more than \$250 billion in assets publicly disclose the results of their company-run stress tests.

E. Guidance on capital planning and definition of common stock dividend in capital plan rule

Capital planning guidance: In the proposal, the Board requested comment on all aspects of its guidance on capital planning for firms of all sizes, consistent with its ongoing practice of reviewing its policies to ensure that they are having their intended effect. The Board received numerous comments on its capital planning guidance, including several comments related to the appropriate scope of the various capital planning guidance elements.

To align the Board's capital planning guidance with the tailoring framework, staff is separately revising some of its capital planning guidance. As revised, SR 15-18 would be applicable to firms subject to Category I standards, and SR 15-19 would be applicable to firms subject to Category II or III standards. The Board has previously articulated principles on sound capital planning for all firms subject to the capital plan rule.¹⁷

In addition to comments related to the scope of the guidance, the Board received comments related to general changes to the capital planning guidance and specific clarifications and tailored changes. Several commenters noted that the guidance should not be prescriptive or

¹⁷ See Capital Plans, 76 FR 74631, 74634 (Dec. 1, 2011).

create requirements on firms. Additionally, several commenters urged the Board to publish future proposed revisions for public comment, or to provide more detail and rationale for reexamining the guidance. In response, staff is considering what if any aspects of the Board’s supervisory guidance could be improved.

Definition of a common stock dividend: The draft final rule would summarize the comments received on the potential definition of a “common stock dividend” for the capital plan rule. The draft final rule notes that the Board will continue to consider this issue.

F. Paperwork Reduction Act (PRA)

In connection with the proposed rule, the Board solicited comment on revisions to the FR Y-14, FR LL, and FR YY information collections that would have reflected the changes proposed in the proposed rule. No comments were received on this aspect of the proposal, and the draft final rule would extend these information collections for three years, with the proposed revisions, as well as certain other revisions to account for changes between the proposed rule and the final rule.¹⁸

IV. Impact analysis

Covered savings and loan holding companies have not been subject to supervisory stress testing requirements to date. One firm would become subject to the requirements based on third quarter 2020 data and this firm is currently constrained by its leverage requirement. It is estimated that this firm’s stress capital buffer would need to be over 2.75 times the median of firms’ 2020 stress capital buffers for there to be an increase in its capital requirements.

¹⁸ These collections of information comply with the PRA, and the information is not available from other sources. With these revisions, the estimated annual burden of the FR Y-14A/Q/M reports would increase by 6,084 hours to 841,528 hours; the estimated annual burden of the FR LL would increase by 10,339 hours to 10,484 hours; and the estimated annual burden of the FR YY would increase by 1 hour to 27,752 hours.

For all other firms, the draft final rule would not change the calculation of capital requirements. The regulatory reporting aspects of the proposal would introduce some additional compliance burden on firms subject to Category I through III standards, while significantly reducing compliance burden on firms subject to Category IV standards.

RECOMMENDATIONS:

For the reasons discussed above, staff recommends that the Board approve the attached draft final rule. Staff also recommends that the Board authorize staff to make technical or minor changes to the attached materials prior to publication in the Federal Register.

Appendix A

List of BHCs, IHCs and SLHCs by Category for Capital Plan and Stress Test Rules¹⁹

<p>Category I</p> <p>U.S. GSIBs</p>	<p>Category II</p> <p>≥ \$700b Total Assets or ≥ \$75b in Cross-Jurisdictional Activity</p>	<p>Category III</p> <p>≥ \$250b Total Assets or ≥ \$75b in NBA, wSTWF, or Off-balance sheet exposure</p>	<p>Category IV</p> <p>Other firms with \$100b to \$250b Total Assets</p>
<p>Bank of America Bank of New York Mellon Citigroup Goldman Sachs JPMorgan Chase Morgan Stanley State Street Wells Fargo</p>	<p>Northern Trust</p>	<p>Barclays US Capital One Credit Suisse USA Charles Schwab Deutsche Bank USA DWS USA HSBC North America PNC Financial Toronto-Dominion Truist UBS Americas U.S. Bancorp</p>	<p>Ally Financial American Express BMO Financial BNP Paribas USA Citizens Financial Discover Fifth Third Huntington KeyCorp M&T Bank MUFG Americas Regions Financial RBC USA Santander Holdings USA</p>

¹⁹ Categories are as of the third quarter of 2020.