

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 252**

**Regulation YY; Docket No. R-1706**

**RIN 7100-AF80**

**Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company**

**Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations: Eligible Retained Income**

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Interim final rule with request for comments.

**SUMMARY:** In light of recent disruptions in economic conditions caused by the coronavirus disease 2019 (COVID-19) and current strains in U.S. financial markets, the Board is issuing an interim final rule that revises the definition of eligible retained income for purposes of the Board's total loss-absorbing capacity (TLAC) rule. The revised definition of eligible retained income will make any automatic limitations on capital distributions that could apply under the TLAC rule more gradual and aligns to recent action taken by the Board and the other Federal banking agencies in the capital rule.

**DATES:** The interim final rule is effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Comments on the interim final rule must be received no later than [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESS:** You may submit comments, identified by Docket No. R-1706; 7100-AF80, by any of the following methods:

- Agency website: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- E-mail: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include docket and RIN numbers in the subject line of the message.
- FAX: (202) 452-3819 or (202) 452-3102.
- Mail: Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments will be made available on the Board's web site at

<http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons or to remove personally identifiable information at the commenter's request. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room 146, 1709 New York Avenue, NW, Washington, DC 20006, between 9:00 a.m. and 5:00 p.m. on weekdays. For security reasons, the Board requires that visitors make an appointment to inspect comments. You may do so by calling (202) 452-3684.

**FOR FURTHER INFORMATION CONTACT:**

Anna Lee Hewko, Associate Director, (202) 530-6360, Constance Horsley, Deputy Associate Director, (202) 452-5239, Juan Climent, Manager, (202) 460 2180, Sean Healey, Lead Financial Institution Policy Analyst, (202) 912-4611, Division of Supervision and Regulation; Benjamin McDonough, Assistant General Counsel, (202) 452-2036, or Mark Buresh, Senior Counsel, (202) 452-5270, Legal Division, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, NW, Washington, DC 20551. Users of Telecommunication Device for Deaf (TDD) only, call (202) 263-4869.

## **SUPPLEMENTARY INFORMATION:**

### **Table of Contents**

- I. Background
- II. The Interim Final Rule
- III. Impact Assessment
- IV. Administrative Law Matters
  - A. Administrative Procedure Act
  - B. Congressional Review Act
  - C. Paperwork Reduction Act
  - D. Regulatory Flexibility Act
  - E. Use of Plain Language

#### **I. Background**

In December 2016, the Board issued a final rule (TLAC rule) to require the largest domestic and foreign banking organizations operating in the United States to maintain a minimum amount of total loss-absorbing capacity (TLAC), consisting of a minimum amount of long-term debt (LTD) and tier 1 capital.<sup>1</sup> In addition, the TLAC rule prescribed certain buffers above the minimum TLAC amounts that could result in limitations on the capital distributions and certain discretionary bonus payments of a firm. The final rule also included a separate requirement that these companies maintain a minimum amount of LTD.

The TLAC rule applies to the largest and most systemic U.S. banking organizations (U.S. GSIBs) and the U.S. operations of the largest and most systemic foreign banking organizations

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<sup>1</sup> 82 FR 8266 (January 27, 2017); 12 CFR part 252, subparts G and P.

(covered IHCs), because the failure or material financial distress of these companies has the greatest potential to disrupt U.S. financial stability (collectively, covered companies).<sup>2</sup>

The TLAC and LTD requirements in the final rule build on, and serve as a complement to, the regulatory capital requirements in the Board’s capital rule.<sup>3</sup> Banking organizations subject to the capital rule must maintain a minimum amount of regulatory capital and maintain a capital buffer above the minimum capital requirements in order to avoid restrictions on capital distributions and discretionary bonus payments.<sup>4</sup> The requirements in the capital rule take the form of ratios of different forms of regulatory capital to risk-based and leverage-based measures of assets.

The requirements of the TLAC rule are based on many of the same measures as those that are in the capital rule. For example, the TLAC requirements are based on the risk-based and leverage-based measures used in the capital rule and the TLAC rule also includes buffer requirements in addition to the minimum TLAC requirements (TLAC buffer requirements) that function in a manner similar to the buffer requirements in the capital rule.

As with the capital rule, the TLAC buffer requirements were established to encourage better capital conservation by covered companies and to enhance the resilience of the banking

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<sup>2</sup> See 12 CFR 252.60; 12 CFR 252.160.

<sup>3</sup> While capital rule’s requirements are intended to ensure that a banking organization has sufficient capital to remain a going concern, the objective of the TLAC rule is to reduce the financial stability impact of the failure of a covered company by requiring sufficient loss-absorbing capacity on both a going concern and a gone-concern basis. A firm’s regulatory capital, and especially its equity capital, is likely to be significantly or completely depleted in the lead up to a bankruptcy or resolution. Thus, if a firm is to re-emerge from resolution with sufficient capital to successfully operate as a going concern, there must be a source of capital for the firm. The TLAC rule therefore requires covered companies to maintain LTD because LTD can absorb losses and serve as a source of capital in resolution.

<sup>4</sup> See 12 CFR part 217.

system during stress periods.<sup>5</sup> In particular, the TLAC buffer requirements were intended to limit the ability of covered companies to distribute capital in the form of dividends and discretionary bonus payments and therefore strengthen the ability of covered companies to continue lending and conducting other financial intermediation activities during stress periods. A covered company with TLAC levels that fall short of the TLAC buffer requirements faces limitations on capital distributions and discretionary bonus payments, in a manner designed to parallel the restrictions on capital distributions and discretionary bonus payments under the capital rule.

## **II. The Interim Final Rule**

The Board, together with the other federal banking agencies (collectively, the agencies), recently revised a core aspect of the buffer requirements in the capital rule, the definition of “eligible retained income.”<sup>6</sup> The Board is now issuing this interim final rule to carry over this change to the TLAC buffer requirements.

Before these revisions to the capital rule, the limitations on capital distributions could have been sudden and severe if a banking organization was to experience even a modest reduction in its capital ratios, undermining the ability of the banking organization to use its capital buffers. This same concern applies to covered companies and the TLAC buffer requirements because, as noted, the TLAC buffers uses the former definition of eligible retained income.

The interim final rule revises the definition of eligible retained income under the TLAC rule to be consistent with the recently revised definition of eligible retained income in the capital

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<sup>5</sup> 78 FR 62018, 62034 (Oct. 11, 2013).

<sup>6</sup> 85 FR 15909 (March 20, 2020).

rule. By modifying the definition of eligible retained income and thereby allowing covered companies to use their capital buffers in a more gradual manner, the interim final rule should help to promote lending activity and other financial intermediation activities by covered companies and avoid compounding negative impacts on the financial markets.<sup>7</sup>

Under the TLAC rule, if a covered company's TLAC levels fall within its TLAC buffer requirements, the maximum amount of capital distributions and discretionary bonus payments it can make is a function of its eligible retained income. The original definition of eligible retained income under the TLAC rule, as under the capital rule, was four quarters of net income, *net* of distributions and associated tax effects not already reflected in net income. Under a benign business environment, some covered companies may decide to distribute all or nearly all of their net income. Because the measure of eligible retained income subtracts capital distributions made during the previous year, a period of sudden stress following a period of relatively benign conditions could result in very low or zero eligible retained income. In this or similar scenarios, a covered company could face sudden and severe distribution limitations even if its TLAC ratio only marginally falls below applicable buffer requirements.

Recent events have suddenly and significantly impacted financial markets. The spread of COVID-19 has disrupted economic activity in many countries. In addition, financial markets have experienced significant volatility. The magnitude and persistence of the overall effects on the economy remain highly uncertain. In light of these developments, covered companies may realize a sudden, unanticipated drop in capital ratios. This could create a strong incentive for

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<sup>7</sup> The interim final rule does not make changes to any other rule or regulation that may limit capital distributions or discretionary bonus payments by covered companies.

covered companies to limit their lending and other financial intermediation activities in order to avoid facing abrupt limitations on capital distributions.

To better allow a covered company to continue lending during times of stress, the Board is issuing the interim final rule to revise the definition of eligible retained income in the TLAC rule to the greater of (1) a covered company's net income for the four preceding calendar quarters, net of any distributions and associated tax effects not already reflected in net income, and (2) the average of a covered company's net income over the preceding four quarters. This definition will apply with respect to all of the TLAC buffer requirements under the TLAC rule.<sup>8</sup> This definition is consistent with the recently revised definition of eligible retained income in the capital rule.<sup>9</sup>

This interim final rule is intended to facilitate use by a covered company of its TLAC buffers as intended and serve as a financial intermediary and source of credit to the economy. As noted, this revision would reduce the likelihood that a covered company is suddenly subject to abrupt and restrictive distribution limitations in a scenario of lower than expected TLAC levels.

*Question 1: What would be the advantages and disadvantages of defining eligible retained income as the average of a covered company's net income over the preceding four quarters instead of the greater of (i) a covered company's net income for the four preceding calendar quarters, net of any distributions and associated tax effects not already reflected in net*

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<sup>8</sup> Under the TLAC rule, a U.S. GSIB is subject to the external TLAC risk-weighted buffer, which sits above the minimum risk-based TLAC requirement, and the external TLAC leverage buffer, which sits above the minimum total-leverage exposure-based TLAC requirement. 12 CFR 252.63(c). Similarly, a covered IHC is subject to covered IHC TLAC buffer, which sits above the minimum risk-based TLAC requirement. 12 CFR 252.165(d).

<sup>9</sup> 85 FR 15909 (March 20, 2020).

*income, and (ii) the average of a covered company’s net income over the preceding four quarters?*

*Question 2: Under what circumstances, if any, should a covered company be restricted from making any capital distributions?*

### **III. Impact Assessment**

As discussed above, the revised definition of eligible net income in the interim final rule allows a covered company to more gradually reduce distributions as it enters stress, and provides a covered company with stronger incentives to continue to lend in such a scenario. On the other hand, by enabling a covered company to gradually decrease capital distributions as it enters stress (rather than mandating a sharp decrease), the rule could incrementally reduce the covered company’s loss-absorption capacity in stress.

The definition of eligible retained income affects the distributions of covered companies with TLAC levels within their TLAC buffer requirements. It does not have an impact on minimum TLAC or LTD levels, *per se*. As such, the revised definition of eligible retained income in the interim final rule is not likely to have any noticeable effect on the TLAC or LTD requirements applicable to covered companies.

### **IV. Administrative Law Matters**

#### ***A. Administrative Procedure Act***

The Board is issuing the interim final rule without prior notice and the opportunity for public comment and the delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA)).<sup>10</sup> Pursuant to section 553(b)(B) of the APA, general notice and the opportunity for public comment are not required with respect to a rulemaking when an “agency

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<sup>10</sup> 5 U.S.C. 553.

for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”<sup>11</sup>

The Board believes that the public interest is best served by implementing the interim final rule immediately upon publication in the Federal Register. As discussed above, the spread of COVID-19 has disrupted economic activity in the United States. In addition, U.S. financial markets have featured extreme levels of volatility. The magnitude and persistence of COVID-19 on the economy remain uncertain. In light of the current market uncertainty, covered companies have a strong incentive to limit their lending activity in order to avoid facing abrupt restrictions on distributions. By making the automatic limitations on a covered company’s distributions more gradual as the covered company’s TLAC levels decline, the interim final rule would allow covered companies to focus on continuing to lend to creditworthy households and businesses rather than on managing their TLAC levels and reducing the potential of exacerbating negative impacts on the financial markets. For these reasons, the Board finds that there is good cause consistent with the public interest to issue the rule without advance notice and comment.<sup>12</sup>

The APA also requires a 30-day delayed effective date, except for (1) substantive rules which grant or recognize an exemption or relieve a restriction; (2) interpretative rules and statements of policy; or (3) as otherwise provided by the agency for good cause.<sup>13</sup> Because the rule relieves a restriction, the interim final rule is exempt from the APA’s delayed effective date requirement.<sup>14</sup>

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<sup>11</sup> 5 U.S.C. 553(b)(3)(B)

<sup>12</sup> 5 U.S.C. 553(b)(3)(B); 553(d)(3).

<sup>13</sup> 5 U.S.C. 553(d).

<sup>14</sup> 5 U.S.C. 553(d)(1).

While the Board believes that there is good cause to issue the rule without advance notice and comment and with an immediate effective date, the Board is interested in the views of the public and requests comment on all aspects of the interim final rule.

***B. Congressional Review Act***

For purposes of Congressional Review Act, the OMB makes a determination as to whether a final rule constitutes a “major” rule.<sup>15</sup> If a rule is deemed a “major rule” by the Office of Management and Budget (OMB), the Congressional Review Act generally provides that the rule may not take effect until at least 60 days following its publication.<sup>16</sup>

The Congressional Review Act defines a “major rule” as any rule that the Administrator of the Office of Information and Regulatory Affairs of the OMB finds has resulted in or is likely to result in (A) an annual effect on the economy of \$100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies or geographic regions, or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.<sup>17</sup>

For the same reasons set forth above, the Board is adopting the interim final rule without the delayed effective date generally prescribed under the Congressional Review Act. The delayed effective date required by the Congressional Review Act does not apply to any rule for which an agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rule issued) that notice and public procedure thereon are impracticable,

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<sup>15</sup> 5 U.S.C. 801 *et seq.*

<sup>16</sup> 5 U.S.C. 801(a)(3).

<sup>17</sup> 5 U.S.C. 804(2).

unnecessary, or contrary to the public interest.<sup>18</sup> In light of current market uncertainty, the Board believes that delaying the effective date of the rule would be contrary to the public interest. In addition, as discussed above, the revised definition of eligible retained income in the interim final rule is not likely to have any significant effect on the requirements of the TLAC rule.

As required by the Congressional Review Act, the Board will submit the final rule and other appropriate reports to Congress and the Government Accountability Office for review.

#### ***C. Paperwork Reduction Act***

In accordance with the requirements of the Paperwork Reduction Act (PRA), an agency may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Board has reviewed this interim final rule pursuant to authority delegated by the OMB and has determined that it does not contain any collections of information pursuant to the PRA.

#### ***D. Regulatory Flexibility Act***

The Regulatory Flexibility Act (RFA)<sup>19</sup> requires an agency to consider whether the rules it proposes will have a significant economic impact on a substantial number of small entities.<sup>20</sup> The RFA applies only to rules for which an agency publishes a general notice of proposed rulemaking pursuant to 5 U.S.C. 553(b). As discussed previously, consistent with section 553(b)(B) of the APA, the Board has determined for good cause that general notice and

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<sup>18</sup> 5 U.S.C. 808.

<sup>19</sup> 5 U.S.C. 601 *et seq.*

<sup>20</sup> Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of \$600 million or less and trust companies with total assets of \$41.5 million or less. *See* 13 CFR 121.201.

opportunity for public comment is unnecessary, and therefore the Board is not issuing a notice of proposed rulemaking. Accordingly, the Board has concluded that the RFA's requirements relating to initial and final regulatory flexibility analysis do not apply.

Nevertheless, the Board seeks comment on whether, and the extent to which, the interim final rule would affect a significant number of small entities.

#### ***E. Use of Plain Language***

Section 722 of the Gramm-Leach-Bliley Act<sup>21</sup> requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board has sought to present the interim final rule in a simple and straightforward manner. The Board invites comments on whether there are additional steps it could take to make the rule easier to understand. For example:

- Has the Board organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the regulation clearly stated? If not, how could the regulation be more clearly stated?
- Does the regulation contain language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?
- What else could we do to make the regulation easier to understand?

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<sup>21</sup> 12 U.S.C. 4809.

## **List of Subjects**

### **12 CFR Part 252**

Administrative practice and procedure, Banks, banking, Credit, Federal Reserve System, Holding companies, Investments, Qualified financial contracts, Reporting and recordkeeping requirements, Securities.

## **BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

### **12 CFR Chapter II**

#### **Authority and Issuance**

For the reasons stated in the preamble, the Board of Governors of the Federal Reserve System amends 12 CFR chapter II as follows:

#### **PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY)**

1. The authority citation for part 252 is revised to read as follows:

**Authority:** 12 U.S.C. 321–338a, 481–486, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3101 *et seq.*, 3101 note, 3904, 3906–3909, 4808, 5361, 5362, 5365, 5366, 5367, 5368, 5371.

#### **Subpart G—External Long-term Debt Requirement, External Total Loss-absorbing Capacity Requirement and Buffer, and Restrictions on Corporate Practices for U.S. Global Systemically Important Banking Organizations**

2. Section 252.63 is amended by revising paragraph (c)(2)(i) to read as follows:

##### **§ 252.63 External total loss-absorbing capacity requirement and buffer.**

\* \* \* \* \*

(c) \*\*\*

(2) \*\*\*

(i) *Eligible retained income.* The eligible retained income of a global systemically important BHC is the greater of:

(A) The global systemically important BHC's net income, calculated in accordance with the instructions to the FR Y-9C, for the four calendar quarters preceding the current calendar quarter, net of any distributions and associated tax effects not already reflected in net income; and

(B) The average of the global systemically important BHC's net income, calculated in accordance with the instructions to the FR Y-9C, for the four calendar quarters preceding the current calendar quarter.

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**Subpart P—Covered IHC Long-Term Debt Requirement, Covered IHC Total Loss Absorbing Capacity Requirement and Buffer, and Restrictions on Corporate Practices for Intermediate Holding Companies of Global Systemically Important Foreign Banking Organizations**

3. Section 252.165 is amended by revising paragraph (d)(2)(i) to read as follows:

**§252.165 Covered IHC total loss-absorbing capacity requirement and buffer.**

\* \* \* \*

(d) \*\*\*

(2) \*\*\*

(i) *Eligible retained income.* The eligible retained income of a Covered IHC is the greater of:

(A) The Covered IHC's net income, calculated in accordance with the instructions to the FR Y-9C, for the four calendar quarters preceding the current calendar quarter, net of any distributions and associated tax effects not already reflected in net income; and

(B) The average of the Covered IHC's net income, calculated in accordance with the instructions to the FR Y-9C, for the four calendar quarters preceding the current calendar quarter.

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By order of the Board of Governors of the Federal Reserve System, March 23, 2020.

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Ann Misback,  
*Secretary of the Board.*