

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: September 15, 2020
To: Board of Governors
From: Staff¹
Subject: Draft proposed rule to conform the Board’s capital planning and related stress testing requirements to its prudential standards tailoring framework

ACTIONS REQUESTED: Approval of the attached draft proposed rule that would (i) update the Board’s capital planning and related stress test requirements and reporting forms to be consistent with the Board’s prudential standards tailoring framework and (ii) seek comment on the Board’s existing capital planning guidance applicable to firms of all sizes to inform potential future updates. In addition, staff seeks authority to make technical or minor changes to the draft proposed 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 finalized a prudential standards tailoring rule to establish four categories of increasingly strict standards for large banking organizations.²
- To conform to the tailoring rule, the proposal would remove company-run stress test requirements and implement biennial supervisory stress tests for firms in the lowest risk category, those subject to “Category IV” standards.
- The proposal would also change certain assumptions about material business changes under stress to be consistent with recent changes to the Board’s stress testing rules.

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² See 84 FR 59032 (November 1, 2019). For firms subject to Category IV standards, the tailoring rule eliminated company-run stress testing requirements 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).

- The proposal solicits comment on all aspects of the Board’s guidance on capital planning, in light of recent changes to relevant regulations and as part of the Board’s ongoing practice of reviewing its policies to ensure that they are having their intended effect.
- The proposal would not affect the calculation of firms’ capital requirements.

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, in conjunction with stronger capital requirements implemented in the Board’s capital rule, 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 ratio from 5 percent in 2009 to 12 percent in 2019.

Following passage of EGRRCPA, the Board issued a final rule in November 2019 that established a revised framework for applying prudential standards to large firms. The framework more closely aligns prudential standards to such firms’ risk profiles by establishing four categories of increasingly strict standards based on indicators designed to measure the risk profile of a firm (*see Appendix A for the criteria of the four categories and firms’ current categories for capital planning and stress testing requirements*).³ To implement provisions from

³ The final rule increased the threshold for general application of these standards from \$50 billion to \$100 billion in total consolidated assets.

EGRRCPA, the tailoring rule made two key changes to the stress testing rules for firms subject to Category IV standards. First, the rule removed the requirement for firms subject to Category IV standards to conduct company-run stress tests as defined in the Board's stress testing rules. 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 establishment of a stress capital buffer requirement, creating a single, risk-sensitive capital framework for large banking organizations, known as the stress capital buffer.⁴ The stress capital buffer rule included several changes to the assumptions embedded in the supervisory stress test, including the exclusion of material business plan changes from the stress capital buffer requirement calculation, and instead requires material changes to a firm's business plan resulting from a merger or acquisition to be incorporated into a firm's capital and risk-weighted assets upon consummation of the transaction.

II. Capital planning standards

The capital plan rule requires firms to annually submit a capital plan to the Board.⁵ The capital plan must include an assessment of the expected uses and sources of capital that reflects the firm's size, complexity, risk profile, and scope of operations, assuming both expected and

⁴ See 85 FR 15576 (March 18, 2020). The stress capital buffer requirement is calculated as the maximum decline in a firm's common equity tier 1 capital ratio over the supervisory stress test planning horizon plus four-quarters of planned common stock dividends.

⁵ Originally, as a part of the capital plan rule, the Federal Reserve could object to a firm's capital plan based on a qualitative assessment. A subsequent rulemaking changed this requirement such that after CCAR 2020 no firm will be subject to a potential qualitative objection if the firm successfully passed several qualitative evaluations. See 84 FR 8953 (March 13, 2019). All firms subject to the capital plan rule have successfully passed the required number of qualitative evaluations such that no firms are subject to the qualitative objection going forward. As a result, the proposal would revise the capital plan rule to remove references to the qualitative objection.

stressful conditions. The assessment must include estimates of projected revenues, losses, reserves, and pro forma capital levels under a range of scenarios, including any scenarios provided by the Federal Reserve and at least one scenario designed by the firm that stresses the specific vulnerabilities of the firm's risk profile and operations.

Mandatory elements of a capital plan: Under the proposal, firms subject to Category IV standards would continue to be required to submit a capital plan to the Board annually. The proposal, however, would align the capital plan and tailoring rules by generally removing from the capital plan rule the requirement for firms subject to Category IV standards to calculate forward-looking projections of capital under scenarios provided by the Board.⁶ Moreover, under the proposal, firms subject to Category IV standards would no longer be required to report their company-run stress test results on the FR Y-14A.⁷ Removing the reporting requirements would provide these firms additional flexibility to focus their stress projections based on the materiality of their business lines. Such firms would continue to be required to provide a forward-looking analysis of income and capital levels under expected and stressful conditions, including under a scenario designed by the firm that stresses the specific vulnerabilities of the firm.

Calculation and timing of stress capital buffer requirements for firms subject to Category IV standards: Firms subject to Category IV standards are currently subject to

⁶ The proposal 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.

⁷ In order to be able to assess whether a firm's planned capital distributions included in its capital plan would be consistent with any effective capital distribution limitations that would apply under the firm's BHC baseline projections, as required by the capital plan rule, the proposal would add four line items to the FR Y-14A Schedule C - Regulatory Capital Instruments, as this schedule is filed by all firms subject to the capital plan rule.

supervisory stress testing on a biennial cycle. Under the proposal, in a year in which a firm subject to Category IV standards undergoes a supervisory stress test, the firm would receive a stress capital buffer requirement based on the results of that stress test. In the alternating year, the firm generally would receive an updated stress capital buffer requirement that reflects the firm's updated planned common stock dividends.⁸

A firm subject to Category IV standards may prefer to receive an updated stress capital buffer requirement in a year in which it would not generally be subject to the supervisory stress test. The proposal would allow a firm subject to Category IV standards to elect to participate in the supervisory stress test in the year in which the firm would not normally be subject to the supervisory stress test, which would result in a new stress capital buffer requirement being calculated during that year.⁹ Moreover, consistent with the existing capital plan rule, a firm subject to Category IV standards that has undergone a material change to its risk profile, financial condition, or corporate structure since it last submitted the capital plan to the Board would be required to resubmit its capital plan to the Board.¹⁰ If a firm resubmits its capital plan because of a material change, the Board may recalculate its stress capital buffer requirement and may use a new severely adverse scenario.

⁸ The proposal includes a request for public comment on whether the Board should adopt a definition of common stock dividends for the purposes of the capital plan rule. The definition would be any payment of cash to shareholders in proportion to the number of shares they own. This definition would include payments of cash to parent organizations irrespective of whether the amount paid is debited from the firm's retained earnings.

⁹ To ensure the Board is provided sufficient notice that the firm is participating in the supervisory stress test, the firm would need to make its election by December 31 of the year preceding the year in which it seeks to opt in to the supervisory stress test. The proposal includes a transition provision to provide additional time for the 2021 stress test cycle.

¹⁰ All firms subject to the capital plan rule are required to resubmit their capital plans in the event of a material change. *See* 12 CFR 225.8(e)(4).

Conforming change to capital plan rule definition: The proposal would update the terminology in the capital plan rule to conform to the terminology used in the tailoring framework by removing the term “large and noncomplex bank holding company” and replacing it with the definition of a firm subject to Category IV standards. As a result, a firm that has over \$75 billion of weighted short-term wholesale funding, cross-jurisdictional activity, or off-balance sheet exposure would be subject to more stringent capital planning requirements. This proposed change would result in minor reporting requirement differences relative to those in effect today for a single firm.

III. Proposed changes to stress testing rules

Business plan changes: For its 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 effect on the firm’s capital adequacy and funding profile, which is consistent with the stress capital buffer requirement. To help ensure alignment in the assumptions under the supervisory and company-run stress tests, the proposal would clarify that the Board and firms would exclude the effects of unconsummated material business plan changes in the supervisory and company-run stress tests conducted pursuant to the Dodd-Frank Act.¹¹ The proposal also includes conforming changes to the Stress Testing Policy Statement and the FR Y-14 regulatory reports.¹²

¹¹ Firms subject to Category I through III standards would be required to report two sub-schedules for all items on the FR Y-14A, Schedule A – Summary: (1) DFAST, where a firm would not incorporate the effects of business plan changes and (2) CCAR, where a firm would incorporate the effects of business plan changes. The DFAST schedules would be reported under supervisory scenarios and the CCAR schedules would be reported under the supervisory severely adverse scenario and at least one BHC baseline and stress scenario.

¹² Under the Paperwork Reduction Act (PRA), the Board must undertake a review prior to revising a collection of information. The Office of Management and Budget has delegated to the Board the authority to review and approve collection of information requests and requirements

Changes for savings and loan holding companies: The proposal would include a change to the stress testing rules for covered savings and loan holding companies, so that the capital distribution assumptions for these firms would match the assumptions for comparable bank holding companies. The proposal would also address an omission in the Board's company-run stress test requirements by requiring that all savings and loan holding companies with more than \$250 billion in assets publicly disclose the results of their company-run stress tests, similar to the requirement for bank holding companies.¹³

IV. Impact Analysis

The changes in the proposal would not affect the calculation of firms' capital requirements. Specifically, the proposal would not change the calculation of capital requirements, including the stress capital buffer requirement, for firms subject to Category IV standards. 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.

pursuant to the PRA. The current annual burden for the FR Y-14 is estimated to be 835,444 hours, and would increase to 841,528 hours with the proposed revisions.

The Board must invite public comment on the revisions to the FR Y-14 reports outlined in the proposal; the estimated burden; suggestions for improvements to the quality, utility, and clarity of the information; and suggestions to minimize the burden on the respondents, and must evaluate any comments received before finalizing the collection. The draft proposed rule invites comment on a proposal to extend the FR Y-14 reports for three years, with the revisions described above.

¹³ Pursuant to the PRA, this change would constitute a revision to the Board's FR LL information collection. The current annual burden for the FR LL is estimated to be 145 hours, and would not change with the proposed revision. The draft proposed rule invites comment on a proposal to extend the FR LL information collection for three years, with this revision.

V. Request for comment on Board guidance on capital planning

The proposal also requests comment on what if any adjustments the Board should consider making to its existing guidance on capital planning for firms of all sizes in light of the recent tailoring and stress capital buffer rules and as part of its ongoing practice of reviewing its policies to ensure that they are having their intended effect and remain effective.

RECOMMENDATIONS:

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

Appendix A

List of BHCs, IHCs and SLHCs by Category for Capital Plan and Stress Testing Rules¹⁴

Category I	Category II	Category III	Category IV
U.S. GSIBs	≥ \$700b Total Assets or ≥ \$75b in Cross-Jurisdictional Activity	≥ \$250b Total Assets or ≥ \$75b in NBA, wSTWF, or Off-balance sheet exposure	Other firms with \$100b to \$250b Total Assets
Bank of America Bank of New York Mellon Citigroup Goldman Sachs JPMorgan Chase Morgan Stanley State Street Wells Fargo	Northern Trust	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	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 Synchrony Financial

¹⁴ Categories are as of the second quarter of 2020.