Banking and Finance Law Daily Wrap Up, TOP STORY—Fed proposals would align prudential standards with risk profiles, (Oct. 31, 2018)

Banking and Finance Law Daily Wrap Up

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The Federal Reserve Board published two proposals to establish a revised framework for applying prudential standards to large U.S. banking organizations based on risk, consistent with section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). The proposals were announced at its Oct. 30, 2018, open meeting.

The first draft notice—Prudential standards for large bank holding companies and savings and loan holding companies—is a Fed-only proposal that would tailor the application of prudential standards to U.S. bank holding companies and apply enhanced standards to certain large savings and loan holding companies. The second draft notice—Proposed changes to applicability thresholds for regulatory capital and liquidity requirements—which would be issued jointly with the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, is a proposal to tailor the application of the agencies' capital and liquidity rules.

The proposals seek to more closely align the regulatory requirements that apply to large banking organizations with their risk profiles. The proposed framework would not apply to the U.S. operations of foreign banking organizations.

Four categories of standards. The proposals present four categories of prudential standards that reflect the different risks of firms in each group of large U.S. banking organizations:

- Category IV: Most firms with $100 billion to $250 billion in total assets would be subject to significantly reduced requirements. These firms would no longer be subject to standardized liquidity requirements or a requirement to conduct and publicly disclose the results of company-run capital stress tests.
- Category III: Firms with $250 billion or more in assets, or firms with at least $100 billion in assets that exceed certain risk thresholds, would be subject to enhanced standards that are tailored to the risk profile of these firms.
- Category II: Firms of global scale—those with very significant size ($700 billion or more in total assets) or cross-jurisdictional activity ($75 billion or more)—would be subject to more stringent prudential standards (based on global standards developed by the Basel Committee on Banking Supervision) and other prudential standards appropriate to very large or internationally active banking organizations.
- Category I: U.S. global systemically important bank holding companies (GSIBs) would remain subject to the most stringent standards.

The adjustments would significantly reduce regulatory compliance requirements for firms subject to Category IV standards, modestly reduce requirements for firms subject to Category III standards, and largely keep existing requirements in place for firms subject to Category I and II standards.

Powell statement. In his opening statement at the October 30 meeting, Fed Chairman Jerome Powell said the Fed will "continue to incorporate size into its evaluations of risk, but size is only one factor. The proposals we are considering would enhance our framework by introducing additional measures of risk." Powell said proposals would prescribe materially less stringent requirements on firms with less risk, while maintaining the most stringent requirements for firms that pose the greatest risks to the financial system and the economy.

Quarles in agreement. In his statement at the meeting, Randal K. Quarles, the Fed's Vice Chairman for Supervision, said the proposals embody an important principle: "the character of regulation should match the character of a firm." He said the purpose of the package of proposed changes is not to reduce the capital adequacy or liquidity resiliency of the U.S. regional bank holding companies. Instead, Powell hopes that "firms will see reduced regulatory complexity and easier compliance with no decline in the resiliency of the U.S. banking system."

Brainard sees risk. In her statement, Fed Governor Lael Brainard, said the proposals under consideration go beyond the provisions of EGRRCPA by relaxing regulatory requirements for domestic banking institutions that have assets in the $250 to $700 billion range, and they "weaken the buffers that are core to the resilience of our system. This raises the risk that American taxpayers again will be on the hook."

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