Banking and Finance Law Daily Wrap Up, TOP STORY—Fed proposes fine-tuning capital review, easing burden on smaller banks, (Sept. 26, 2016)

Banking and Finance Law Daily Wrap Up

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The Federal Reserve Board is proposing changes to its annual Comprehensive Capital Analysis and Review that would relieve large but noncomplex firms from the requirement to complete the qualitative assessment. The proposal would benefit bank holding companies and foreign companies' intermediate holding companies that have between $50 billion and $250 billion in consolidated assets, on-balance sheet foreign exposures of less than $10 billion, and consolidated nonbank assets of less than $74 billion, the Fed said. Related reporting requirements also would be eased.

On the other hand, another part of the proposal would reduce the ability of a CCAR organization with an accepted capital plan to increase its anticipated capital distributions without prior Fed approval.

CCAR explained. The CCAR is an annual assessment of each large financial firm's capital adequacy. It has two aspects—a qualitative assessment and a quantitative assessment. The qualitative assessment looks at whether the firm's capital planning processes are reliable, while the quantitative assessment looks at whether the firm is expected to be able to maintain post-stress capital levels higher than the regulatory minimum over the period covered by the test.

In principal, if the Fed objects to a firm's capital plan on either basis, the firm is prohibited from making any capital distributions without securing the Fed's consent. However, the Fed says it usually has allowed a firm to continue to pay dividends at the previous year's level in the case of a qualitative objection.

Proposed amendments. Under the proposal, the Fed would no longer object to a large noncomplex firm's capital plan on the basis of unresolved supervisory issues or concerns about the plan's assumptions, analysis, or methodologies. Objections based on a quantitative assessment still would be possible.

As explained by the proposal, a covered firm may make distributions that are included in its capital plan, as long as the Fed did not object to the plan. Higher distributions require Fed approval. However, well-capitalized BHCs have been permitted by regulation to increase the total distribution to up to 1 percent of tier 1 capital without seeking approval. This is referred to as the *de minimis* exception.

The proposal would reduce the *de minimis* exception to only .25 percent of tier 1 capital. It also would provide that the second quarter of each year, when the Fed conducts the CCAR, would be a "blackout period" during which a company could not submit a notice that it was taking advantage of the *de minimis* exception. Requests for increases beyond .25 percent of tier 1 capital could not be submitted during that period, either.

Comments on the proposal must be received by Nov. 25, 2016.

Future proposals. Fed Governor Daniel K. Tarullo explained the Fed's thinking and outlined possible future amendments in remarks prepared for the Yale School of Management Leaders Forum. According to Tarullo, the proposed changes are results of a review of the Dodd-Frank Act stress test (DFAST) and CCAR program that began after the 2015 testing cycle.

The Fed's review developed three key issues that need to be addressed, Tarullo said:

1. The CCAR has been adjusted to align with some, but not all, of the regulatory agencies' regulatory capital rule changes in the past six years.
2. The DFAST and CCAR need to consider macroprudential issues better, including the indirect risks to bank capital that result from events such as funding and liquidity disruptions and asset fire sales.

3. The CCAR qualitative assessment imposed excessive burdens on noncomplex financial companies.

The current proposal addresses the third issue, Tarullo said. He does not anticipate proposals addressing the first or second until early next year.

One possibility for addressing the first issue is replacing the 2.5-percent capital conservation buffer with a stress capital buffer (SCB) equal to the maximum decline in a firm's common equity tier 1 capital ratio under the severely adverse DFAST scenario. "This would generally result in a significant increase in capital requirements applicable to the GSIBs," the Fed governor warned.

The SCB would help incorporate macroprudential elements into the CCAR, in Tarullo's opinion. Changes in the DFAST design framework are being considered that also would help.

He added that the Fed is considering ways to increase DFAST and CCAR transparency. A decision to release more detailed information on results already has been reached.

MainStory: TopStory CapitalBaselAccords DoddFrankAct FinancialStability PrudentialRegulation