Banking and Finance Law Daily Wrap Up, FINANCIAL STABILITY—OCC issues final rule on revised standards for recovery planning by large banks, (Oct. 21, 2024)

Banking and Finance Law Daily Wrap Up

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The agency amended its enforceable recovery planning guidelines to apply them to the largest banks, federal savings associations, and federal branches of foreign banks, incorporate a testing standard, and clarify the role of non-financial risk in recovery planning.

The Office of the Comptroller of the Currency has amended its enforceable recovery planning guidelines to apply them to the largest banks, federal savings associations, and federal branches of foreign banks in final guidelines effective Jan. 1, 2025. Under the guidelines, insured national banks, federal savings associations, and federal branches of foreign banks with average total consolidated assets of $100 billion or more will have to follow the enforceable recovery planning guidelines of the Office of the Comptroller of the Currency.

Following 2018 amendments to its guidelines, which raised the applicability threshold to banks with consolidated assets of $250+ billion, up from the earlier $50 billion threshold, the OCC found that several insured depository institutions with total consolidated assets under the $250 billion threshold and who were not subject to recovery planning failed in early 2023 (see *Banking and Finance Law Daily*, June 25, 2024). Therefore, the agency proposed expansion of the recovery planning guidelines to financial institutions with $100 billion or more in consolidated assets. The Final Rule also revises the guidelines to incorporate a testing standard and to clarify the role on non-financial, including operational and strategic, risk in recovery planning.

Threshold. The revised guidelines will apply to any banks with average total consolidated assets equal to or greater than $100 billion. According to the final rule, the OCC believes that the $100 billion threshold is appropriate because “the agency has observed that banks at or above this size generally have a level of risk, complexity, and interconnectedness at which recovery planning is most beneficial.” Banks with average total consolidated assets of less than the $100 billion threshold may also be a “covered bank” if the OCC determines that the bank is “highly complex or otherwise presents a heightened risk” than warrants application of the guidelines. A change was also made to clarify that when calculating the threshold, “average total consolidated assets” is to be based on the “total assets” line, not the “average total consolidated assets” line, of the Call Report for the four most recent consecutive quarters.

Testing. The new guidelines contain a testing provision that states that covered banks should validate the effectiveness of their recovery plans. Although the guidelines do not specify specific, prescriptive testing that must be conducted, testing under the new guidelines “should be appropriate for the bank’s individual size, risk profile, activities, and complexity, including the complexity of its organizational and legal entity structure.” Testing could be done by simulating severe financial and non-financial stress scenarios to confirm that the plan is likely to work as intended. According to the final rule’s preamble, testing should ensure that the plan’s triggers appropriately reflect the covered bank's particular vulnerabilities and will, in practice, provide timely notice of increasingly severe stress, ranging from warnings of the likely occurrence of severe stress to its actual existence. The testing should also enable the management and board to verify the covered bank has identified credible options that it is prepared to carry out; it should also provide similar assurances regarding other plan elements, according to the preamble. Testing must be conducted periodically, no less than annually, and should consider each element of the recovery plan. The plan must also be tested following any significant changes to the recovery plan made in response to a material event. Covered banks must revise their recovery plans as appropriate following testing.

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Non-financial risk. Although the current guidelines do not specifically reference non-financial risk, the new guidelines contain changes to ensure that covered banks "should appropriately consider both financial risk and non-financial risk (including operational and strategic risk)." To accomplish this, the OCC conformed changes to the definitions of "recovery" and "trigger" and to the recovery plan elements of "trigger" and "impact assessments" to reflect this change. A reference to "resilience program" was also added to provide an additional example of an operational risk plan with which a covered bank should align its recovery plan.

Compliance. The final rule becomes effective Jan. 1, 2025; however, the new guidelines offer covered banks time to implement the changes and to both develop a testing framework and conduct testing. Banks that are currently covered banks will have 12 months to amend their recovery plans to address non-financial risk and an additional six months to comply with the new testing provision. Banks that are not currently covered by the guidelines but will become covered banks after the final rule's effective date will have 12 months to develop their recovery plan and an additional 12 months to comply with the testing provision. Banks or other financial institutions that become covered banks after the effective date of the final guidelines will have 12 months to develop their recovery plan and an additional 12 months to comply with the testing procedure.

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