April 08, 2014

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision

SUBJECT: Final Rule – *Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions.*

Summary: On August 20, 2013, the FDIC, together with the Board of Governors of the Federal Reserve System ("Federal Reserve Board") and the Office of the Comptroller of the Currency ("OCC") (collectively, the "agencies"), published in the *Federal Register* a notice of proposed rulemaking seeking public comment on a proposal to strengthen the agencies' leverage ratio standards for large, interconnected U.S. banking organizations ("enhanced supplementary leverage ratio standards NPR" or "NPR"). Maintenance of a strong capital base among the largest, most interconnected U.S. banking organizations is particularly important because capital shortfalls at these institutions have the potential to result in significant adverse economic effects and contribute to systemic distress on both a domestic and international scale. In addition, higher capital standards for these institutions would place additional private capital at risk before the Deposit Insurance Fund and the FDIC's resolution mechanisms would be called upon, and reduce the likelihood of economic disruptions caused by problems at these institutions. FDIC staff believes that higher leverage capital standards, in particular, would reduce the likelihood of resolutions and allow regulators more time to tailor resolution efforts in the event they are required. By further constraining the use of leverage, higher capital leverage standards also could offset possible funding cost advantages that these institutions may enjoy as a result of real or perceived implicit Federal support.

Concur:

Richard J. Osterman, Jr.
Acting General Counsel

Staff is seeking the approval of the FDIC Board of Directors ("Board") of the attached final rule, which is substantively identical to the NPR. The final rule would apply to any U.S. top-tier bank holding company ("BHC") with at least $700 billion in total consolidated assets or at least $10 trillion in assets under custody ("covered BHC") and any insured depository institution ("IDI") subsidiary of these BHCs (together, "covered organizations"). In the revised regulatory capital rule adopted by the agencies in July 2013 ("2013 revised capital rule"), the agencies established a minimum supplementary leverage ratio of 3 percent, consistent with the minimum leverage ratio adopted by the Basel Committee on Banking Supervision ("BCBS"), for banking organizations subject to the agencies' advanced approaches risk-based capital rules. This final rule would establish enhanced supplementary leverage ratio standards for covered BHCs and their subsidiary IDIs. Under the final rule, an IDI that is a subsidiary of a covered BHC would maintain a supplementary leverage ratio of at least 6 percent to be "well capitalized" under the agencies' prompt corrective action ("PCA") framework. The final rule adopted by the Federal Reserve Board also would require covered BHCs to maintain a supplementary leverage ratio buffer of 2 percent above the minimum supplementary leverage ratio requirement of 3 percent ("leverage buffer"). The leverage buffer functions like the capital conservation buffer for the risk-based capital ratios in the 2013 revised capital rule. A covered BHC that maintains a leverage buffer of tier 1 capital in an amount greater than 2 percent of its total leverage exposure would not be subject to the limitations on distributions and discretionary bonus payments defined in the 2013 revised capital rule.

Recommendation: That the Board issue the attached final rule and authorize its publication in the *Federal Register*.

Discussion:

Background

The recent financial crisis showed that some financial companies had grown so large, leveraged, and interconnected that their failure could pose a threat to overall financial stability, as the sudden collapses or near-collapses of major financial companies were among the most destabilizing events of the crisis. As a result of the imprudent risk taking of major financial companies and the severe consequences to the financial system and the economy associated with their disorderly failure, the U.S. government (and many foreign governments in their home countries) intervened on an unprecedented scale to reduce the impact or prevent the failure of these companies and the attendant consequences for the broader financial system.

Accordingly, a major thrust of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") is to mitigate the threat to financial stability posed by systemically important financial companies.[1] The Dodd-Frank Act addresses this problem with a multi-pronged approach: a new orderly liquidation authority for financial companies (other than banks and insurance companies); the establishment of the Financial Stability Oversight Council empowered with the authority to designate nonbank financial companies for Federal Reserve Board oversight; stronger regulation of major bank holding companies and designated nonbank financial companies; and enhanced regulation of over-the-counter derivatives, other core financial markets, and financial market utilities. The new regulatory framework established under the Dodd-Frank Act augments and complements the agencies' existing authorities to require banking organizations to maintain capital well above the minimum requirements for safety and soundness purposes.[2]

Supplementary Leverage Ratio

In July, 2013, the Board approved for publication in the *Federal Register* an interim final rule that strengthened the existing risk-based and leverage capital requirements applicable to all banking organizations in a manner consistent with enhancements to the international capital framework adopted by the BCBS, and certain provisions of the Dodd-Frank Act: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule* ("Basel III interim final rule").[3] Among other requirements, the Basel

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[1] Pub. L. 111-203, 124 Stat. 1376 (2010).
[2] *See e.g.,* The PCA capital categories and related implantation in 12 U.S.C. 1831o, and the capital adequacy provisions of 12 U.S.C. 3907.
[3] 78 FR 55340 (Sept. 10, 2013). The OCC and the Federal Reserve Board issued a joint final rule that is substantively identical to the FDIC's Basel III interim final rule (78 FR 62018 (Oct. 11, 2013)). Today, also before the Board is a rule that would implement as final the Basel III interim final rule. The Basel III

III interim final rule establishes a "supplementary" leverage ratio of tier 1 capital to total leverage exposure, applicable to banking organizations subject to the advanced approaches risk-based capital requirements. Beginning in 2018, such banking organizations must satisfy a minimum supplementary leverage ratio requirement of 3 percent. The supplementary leverage ratio is consistent with the international leverage ratio requirement adopted by the BCBS.

Proposed Rule and Comments

On August 20, 2013, the agencies published in the *Federal Register* the enhanced supplementary leverage ratio standards NPR to strengthen the agencies' leverage ratio standards for large, interconnected U.S. banking organizations.[4] Specifically, under the NPR, an IDI subsidiary of a covered BHC would be required to satisfy a 6 percent supplementary leverage ratio to be considered well capitalized for PCA purposes. Covered BHCs would be required to maintain a leverage buffer of greater than 2 percent (in addition to the 3 percent supplementary leverage ratio requirement under the 2013 revised capital rule). The agencies sought comment on all aspects of the proposed rule and received 27 public comments. Generally, comments from financial services firms, banking organizations, banking trade associations and other industry groups were critical of the NPR, while comments from organizations representing smaller banks and public interest advocacy groups generally were supportive.

Commenters on the NPR raised concerns with respect to the applicability and appropriate calibration of the enhanced supplementary leverage ratio standards. For example, commenters that were critical of the proposal stated that it would adversely affect the competitive position of advanced approaches banking organizations relative to domestic and foreign competitors. These commenters also expressed concern that the NPR could make the leverage ratio the binding regulatory capital ratio for advanced approaches banking organizations, contrary to the objectives of the BCBS in adopting a leverage ratio and its longstanding role in the United States as an ultimate constraint on a banking organization's leverage. In contrast, commenters supportive of the NPR encouraged the agencies to extend its application to all advanced approaches banking organizations and strengthen the enhanced leverage ratio standards.

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final rule would adopt the Basel III interim final rule without any substantive changes and only makes limited technical revisions.

[4] 78 FR 51101 (Aug. 20, 2013).

A number of commenters also expressed concerns regarding the denominator of the supplementary leverage ratio measure, total leverage exposure. In particular, commenters criticized the agencies for advancing the implementation of the enhanced supplementary leverage ratio standards in the United States while the BCBS considered revisions to the international supplementary leverage framework, as described in a 2013 BCBS consultative document.[5] The commenters noted that the consultative document proposed various revisions to the denominator measure for the international leverage ratio that, if adopted in the United States, would increase capital requirements relative to the amount required using the total leverage exposure measure under the Basel III interim final rule. The commenters encouraged the agencies to delay adoption of the NPR in final form until the BCBS issues a final international leverage ratio framework.

Staff believes that these concerns are addressed in a separate notice of proposed rulemaking (that is also before the Board today), which would seek public comment on revisions to the denominator of the supplementary leverage ratio, consistent with the latest BCBS consultative paper on the Basel III leverage ratio framework ("2014 NPR").[6]

Final Rule

The final rule would adopt a leverage buffer for covered BHCs and a 6 percent well-capitalized threshold for subsidiary IDIs of covered BHCs effective on January 1, 2018. The final rule applies to any U.S. top-tier BHC with more than $700 billion in total consolidated assets or more than $10 trillion in assets under custody and any IDI subsidiary of such BHCs.

Under the final rule, a covered BHC that maintains a leverage buffer of tier 1 capital in an amount greater than 2 percentage points of its total leverage exposure would not be subject to limitations on its distributions and discretionary bonus payments. If the covered BHC maintains a leverage buffer of 2 percentage points or less, it would be subject to increasingly stricter limitations on such payouts. An IDI that is a subsidiary of a covered BHC would be required to satisfy a 6 percent supplementary leverage ratio to be considered well capitalized for PCA purposes.

[5] *See Revised Basel III leverage ratio framework and disclosure requirements - consultative document* (June 2013) available at http://www.bis.org/publ/bcbs251.htm.
[6] *See, Basel III leverage ratio framework and disclosure requirements* (January 2014).

All advanced approaches banking organizations must calculate and begin reporting their supplementary leverage ratios beginning in the first quarter of 2015. However, the mandatory compliance date for the enhanced supplementary leverage ratio standards set forth in the final rule is January 1, 2018.

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