

DATE: December 18, 2018

MEMORANDUM TO: The Board of Directors

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

SUBJECT: Notice of Proposed Rulemaking: Company-Run Stress Testing Requirements for FDIC-supervised State Nonmember Banks and State Savings Associations

Recommendation: Staff recommends that the FDIC Board of Directors (“Board”) approve and authorize publication of the attached notice of proposed rulemaking entitled “Company-Run Stress Testing Requirements for FDIC-supervised State Nonmember Banks and State Savings Associations” (“proposed rule”). The proposed rule would implement section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (“EGRRCPA”) by amending the FDIC’s stress testing regulations at 12 CFR Part 325 (“Part 325”). Specifically, the proposed rule would raise Part 325’s applicability threshold from \$10 billion to \$250 billion, revise the frequency of required stress tests from annual to periodic, and reduce the number of required stress testing scenarios from three to two. The proposed rule would also make certain conforming and technical changes previously included in an April 2018 notice of proposed rulemaking, which was largely superseded by the enactment of EGRRCPA. FDIC staff has developed the proposed rule in coordination with staff of the Board of Governors of the Federal Reserve System (“FRB”) and the Office of the Comptroller of the Currency (“OCC”), and it is anticipated that the FRB and OCC will contemporaneously issue consistent and comparable proposed rules.

Concurrence:

Charles Yi
General Counsel

Background

As originally enacted, section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (“Dodd-Frank Act”) required a financial company, including an insured depository institution, with total consolidated assets of more than \$10 billion and regulated by a primary federal regulatory agency, to conduct annual company-run stress tests (“stress tests”) using “baseline,” “adverse,” and “severely adverse” scenarios. Section 165(i)(2)(C) also required each primary federal regulator to issue consistent and comparable rules to implement the annual stress testing requirements. In October 2012, the FDIC, FRB, and OCC (collectively “Agencies”) issued such rules,² with the FDIC’s rules incorporated in Part 325.³

Section 401 of EGRRCPA amended section 165(i)(2) by: (1) raising the minimum asset threshold for stress tests from \$10 billion to \$250 billion; (2) replacing the requirement for “annual” stress tests with a requirement for “periodic” stress tests; and (3) eliminating the “adverse” scenario requirement. The EGRRCPA amendments become effective eighteen months after enactment, which is November 24, 2019.

Prior to EGRRCPA’s enactment, the FDIC issued a notice of proposed rulemaking on April 2, 2018, that proposed certain revisions to Part 325 (“April NPR”).⁴ Certain changes proposed in the April NPR are no longer relevant as a result of EGRRCPA.⁵ However, other

¹ 12 U.S.C. § 5365(i)(2).

² 77 FR 62417 (October 15, 2012) (FDIC); 77 FR 62380 (October 12, 2012) (Federal Reserve); 77 FR 61238 (October 9, 2012) (OCC).

³ The FDIC’s stress test rule was originally incorporated as Subpart C of Part 325. Following the rescission of Subparts A and B of Part 325, Part 325 consists exclusively of the stress test rule and the stress test rule is no longer designated as Subpart C. 83 FR 17737 (April 24, 2018).

⁴ 83 FR 13880 (April 2, 2018).

⁵ Notably, Part 325 differentiates between “\$10 to \$50 billion covered banks” and “over \$50 billion covered banks,” with different requirements applying to each subcategory, and the April NPR proposed extending the transition period in which covered banks that migrated from “\$10 to \$50 billion covered banks” to “over \$50 billion covered banks” would have to comply with the requirements applicable to “over \$50 billion covered banks.” Section 401 of

revisions originally proposed in the April NPR remain necessary to maintain consistency between the FDIC's stress testing regulations and those of the FRB and the OCC.

Proposed Rule

Covered Banks

Consistent with section 401 of EGRRCPA, the proposed rule would amend Part 325 by revising the term "covered bank" to mean a state nonmember bank or state savings association with over \$250 billion in total consolidated assets. The proposed rule would also eliminate Part 325's differentiation of requirements for "\$10 to \$50 billion covered banks" and "over \$50 billion covered banks."

Frequency of Stress Testing

Consistent with section 401 of EGRRCPA, the proposed rule would amend Part 325 to implement section 401's requirement for "periodic" stress testing by generally requiring covered banks to conduct, report, and publish results of a stress test once *every two years*, beginning on January 1, 2020, and continuing every even-numbered year thereafter (*i.e.*, 2022, 2024, 2026, etc.). The proposed rule would also add a new defined term, "reporting year," to facilitate this change. A covered bank's reporting year would be the year in which a covered bank must conduct, report, and publish its stress test, and as noted above, would be every even-numbered year for most covered banks. However, covered banks that are subsidiaries of global systemically important bank holding companies or bank holding companies that have \$700 billion or more in total assets or cross-jurisdictional activity of \$75 billion or more would be required to conduct, report, and publish stress tests results on the same schedule as their bank

EGRRCPA renders this aspect of the April NPR moot by requiring stress testing by financial companies with over \$250 billion in total consolidated assets.

holding companies, which would be *annually* under rules proposed by the FRB.⁶ Accordingly, some covered banks would have a biennial reporting year, while others would have an annual reporting year, and the dates and deadlines in the FDIC’s stress testing rule would be effective for each reporting year for a covered bank. For example, a biennial reporting covered bank preparing its 2022 stress test would rely on financial data available as of December 31, 2021; use stress test scenarios provided by the FDIC no later than February 15, 2022; provide its report of the stress test to the FDIC by April 5, 2022; and publish a summary of the results during the period starting June 15 and ending July 15 of 2022. Based on experience to date, FDIC staff believes that a biennial stress testing cycle would be appropriate for most covered banks. In addition, requiring covered banks to conduct stress tests in the same reporting years would also enable the FDIC to continue to make comparisons across banks for supervisory purposes and to assess macroeconomic trends and risks to the banking industry.

Removal of Adverse Scenario

As amended by section 401 of EGRRCPA, section 165(i)(2) no longer requires the use of the “adverse” stress testing scenario. The Agencies’ experience has been that the “adverse” stress-testing scenario has provided limited incremental information beyond what is already provided under the other scenarios. Therefore, the proposed rule would remove the “adverse” scenario, but would maintain the requirement to conduct stress tests under the “baseline” and “severely adverse” scenarios.

⁶ Only covered banks that are consolidated under holding companies that are required by the FRB to conduct stress tests annually (i.e., subsidiaries of the largest and most systemically important banking organizations) would be required to conduct annual stress tests under the proposed rule. This would be consistent with the Agencies’ long-standing policy of applying similar standards to holding companies and their subsidiary banks.

Transition Process for Covered Banks

Under the proposed rule, an FDIC-supervised institution that is a covered bank as of December 31, 2019 would be required to conduct stress testing in the 2020 reporting year. An FDIC-supervised institution that first becomes a covered bank after December 31, 2019, would be required to conduct its first stress test in the first reporting year that begins more than three calendar quarters after the date it becomes a covered bank. For example, if a bank first becomes a covered bank on March 31 of a non-reporting year (e.g., 2023), that bank must report its first stress test in the subsequent reporting year (i.e., calendar year 2024). However, if the same bank becomes a covered bank on April 1, 2023, it would skip the 2024 reporting year (which begins less than three quarters from April 1, 2023) and the subsequent non-reporting year (2025), and report its first stress test in the 2026 reporting year. As with other aspects of the stress test rule, the FDIC reserves the authority to change the transition period for a particular covered bank as appropriate under specific circumstances.

The proposed rule would not establish a transition period for covered banks that move from a biennial stress testing requirement to an annual stress testing requirement. The FDIC expects that such covered banks would be able to anticipate and make arrangements for this development. To the extent that particular circumstances warrant an extension, the FDIC could do so based on its reservation of authority and supervisory discretion.

Review by the Board of Directors

Currently, Part 325 requires a covered bank's board of directors, or a committee of the board, to approve and review stress testing policies and procedures as warranted, but no less frequently than annually.⁷ The proposed rule would revise the frequency of this requirement

⁷ 12 CFR § 325.5(a)(2).

from “annual” to “once every reporting year” in order to make board review consistent with the covered bank’s stress testing cycle.

Reservation of Authority

Part 325 currently includes a reservation of authority, pursuant to which the FDIC may revise the frequency and methodology of the stress testing requirements as appropriate for a particular covered bank.⁸ The NPR would amend this reservation of authority to clarify that the FDIC reserves the authority to exempt a covered bank from the requirement to conduct a stress test in a particular reporting year.

New Range of As-of Dates for Trading Scenarios Component

Part 325 currently requires a covered bank with significant trading activities to include trading and counterparty components in its adverse and severely adverse scenarios.⁹ The trading data to be used in this component is as of a date between January 1 and March 1 of a calendar year. On February 3, 2017, the FRB published a final rule that extended this range to run from October 1 of the calendar year preceding the year of the stress test to March 1 of the calendar year of the stress test.¹⁰ On February 23, 2018, the OCC published a final rule making the same change.¹¹ The proposed rule would make the same change to Part 325 (as was originally proposed in the April NPR). Extending this date range would ensure consistency with FRB and OCC rules and increase the FDIC’s flexibility to choose an appropriate as-of date.

Other Changes

As originally proposed in the April NPR, the proposed rule would also remove certain obsolete transitional language in Part 325 that was adopted to facilitate a 2014 shift in annual

⁸ 12 CFR § 325.1(c).

⁹ 12 CFR § 325.4(c).

¹⁰ 82 FR 9308 (Feb. 3, 2017).

¹¹ 83 FR 7951 (Feb. 23, 2018).

stress testing cycle dates and is no longer necessary. The NPR also proposes technical edits to account for the redesignation of the FDIC stress test rule as the entirety of Part 325 rather than “subpart C” of Part 325,¹² and would remove the reference to supervisory guidance in the rule’s provisions related to methodologies and practices.¹³

Expected Effects of the Proposed Rule

As described above, the proposed rule would conform Part 325 to section 165(i)(2), as amended by section 401 of EGRRCPA. Most significantly, section 401 raises the applicability threshold from \$10 billion to \$250 billion. As a result of section 401, approximately 30 FDIC-supervised institutions will be excluded from section 165(i)(2)’s requirements. Currently, there are zero state nonmember banks and state savings associations that exceed the \$250 billion threshold. Therefore, Part 325, as amended by the proposed rule, would not immediately apply to any FDIC-supervised institutions.

Conclusion

Staff recommends that the Board approve publication of the attached notice of proposed rulemaking in the Federal Register, with a comment period that would extend to February 19, 2019.

Staff Contacts

Pete Hirsch, Division of Risk Management Supervision, (202) 898-6751

Ryan Sheller, Division of Risk Management Supervision, (202) 412-4861

Annmarie Boyd, Legal Division, (202) 898-3714

Benjamin Klein, Legal Division, (202) 898-7027

¹² See 83 FR 17737 (April 24, 2018).

¹³ 12 CFR § 325.5(b)(1).