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HIGHLIGHTS

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- [Federal Reserve Grants Two-Year Extension on CLOs for Banks](#)

In addition, it summarizes [other notable legislative, regulatory, and judicial developments that occurred during the first quarter of 2014](#).

Federal Reserve Approves Heightened Supervisory and Regulatory Standards for Large U.S. and Foreign Banks

On February 18, 2014, the Federal Reserve Board finalized [new standards](#) that would strengthen the supervision and regulation of large U.S. bank holding companies (BHCs) and foreign banking organizations. The Federal Reserve originally proposed the final rules, which implement Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), for large U.S. bank holding companies and foreign banking organizations in December 2011 and

December 2012, respectively.¹ Section 165 of the Dodd-Frank Act mandates the Federal Reserve to establish enhanced prudential standards for systemically important financial companies, while Section 166 orders the Federal Reserve to create early remediation regimes for systemically important financial companies.

¹ For more information on the original proposal for large U.S. BHCs, see [Banking Legislation & Policy, Volume 30, Number 4](#). For more information on the original proposal for large foreign banking organizations, see [Banking Legislation & Policy, Volume 31, Number 4](#).

Designed to increase the resiliency of big banks, the rule applies to large U.S. BHCs, which will have to comply with the new standards by January 1, 2015. However, large foreign banking organizations affected by the rule will have until July 1, 2016, to meet the new requirements, a year later than was originally proposed.

Enhanced Prudential Standards for Large U.S. Banks

Like the proposal from December 2011, the final rule includes heightened capital planning and stress testing requirements for U.S. BHCs with at least \$50 billion in total consolidated assets. These requirements have been implemented through the Federal Reserve's annual Comprehensive Capital Analysis and Review exercises that started in 2011 as well as the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency's (OCC) annual Dodd-Frank Act stress tests that started in 2012. In addition, all affected U.S. BHCs will have to comply with increased risk-based capital and leverage ratios that were finalized in July 2013.

Other enhanced prudential standards that remain from this proposal include extra risk-management and liquidity risk-management standards for affected U.S. BHCs. These companies will have to conduct liquidity stress tests and hold a buffer of highly liquid assets based on projected funding needs during a 30-day stress event as part of the liquidity coverage ratio requirement finalized in October 2013. Certain affected U.S. BHCs designated as systemically important will have to maintain a debt-to-equity ratio of no more than 15 to 1, and publicly traded U.S. BHCs with total consolidated assets of at least \$10 billion still will have to establish enterprise-wide risk committees. However, unlike the 2011 proposal, the final rule will not implement any single-counterparty credit limits or early remediation requirements at this time.

Changes in Intermediate Holding Company Requirement for Foreign Banks

Like the proposal from December 2012, the final rule stipulates that each foreign banking organization with a large U.S. presence must establish a single intermediate holding company over its U.S. subsidiaries. However, the Federal Reserve has since raised the threshold for requiring foreign banking organizations to establish intermediate holding companies from \$10 billion to \$50 billion of U.S. nonbranch assets. U.S. nonbranch assets are defined as the sum of the consolidated assets of each of a foreign banking organization's top-tier U.S. subsidiaries as they exist in their current form, excluding branch and agency assets. As a result, the new rules forcing the creation of intermediate holding companies will affect fewer foreign banking organizations.

In addition, because of concerns about the cost of compliance, the final rule generally delays application of any leverage capital requirements to the intermediate holding companies of foreign banking organizations until January 1, 2018. Other than this, the intermediate holding companies are subject to the same enhanced prudential standards faced by U.S. BHCs.

Enhanced Prudential Standards for Large Foreign Banks

Like the proposal from December 2012, foreign banking organizations with both total consolidated assets of at least \$50 billion and U.S. assets of at least \$50 billion, including branch assets, will have to establish a U.S. risk committee and employ a U.S. chief risk officer for required risk-management operations on all U.S.-related activities. These affected foreign banking organizations will have to meet the same conditions as their U.S. counterparts, ranging from holding on to an appropriate buffer of highly liquid assets based on projected funding needs during a 30-day stress event to passing stress tests conducted by the Federal Reserve. The final

rules will not implement any single-counterparty credit limits or early remediation requirements mentioned in the 2012 proposal for foreign banking organizations at this time.

Foreign banking organizations with both total consolidated assets of at least \$50 billion but with U.S. assets of less than \$50 billion, including branch assets, are subject to enhanced prudential standards. However, as with the earlier proposal from 2012, these types of foreign banking organizations will not be subject to capital, liquidity, risk management, and stress testing requirements as stringent as larger foreign banking organizations.

Treatment of Nonbank Financial Companies Supervised by the Federal Reserve

Unlike the proposal from December 2011, the final rule will not be applicable to nonbank financial companies designated as systemically important for Federal Reserve supervision. While these particular nonbank companies are required to face enhanced prudential standards as mandated by the Dodd-Frank Act, the Federal Reserve has decided to tailor enhanced prudential standards specifically for each firm. Based on an evaluation of a nonbank financial company's business model, capital structure, and risk profile, each designated nonbank financial company will receive its own unique enhanced prudential standards.

Basel Committee Amends Proposed Leverage Ratio Requirements for Banks

On January 12, 2014, the Basel Committee on Banking Supervision (Basel Committee) approved [amendments](#) to the Basel III's leverage ratio framework and disclosure requirements originally proposed in June 2013.² The leverage ratio requirement, defined as a bank's tier 1 capital

² For more information on the original Basel III leverage ratio framework and disclosure requirements, see [Banking Legislation & Policy, Volume 32, Number 2](#).

(the Capital Measure) divided by a bank's average total consolidated assets (the Exposure Measure), will remain at 3 percent for all internationally active banking organizations. However, the Basel Committee agreed to several technical changes to the definition of a bank's Exposure Measure that would reduce the total amount of capital that banks must maintain.

Implementation of the Basel III leverage ratio requirements will remain unaffected by the new amendments. Starting on January 1, 2015, banks will still have to publicly disclose their Basel III leverage ratio. Any last minute adjustments to the definition and calibration of the leverage ratio will be completed by 2017, and banks will be expected to incorporate the leverage ratio standards by January 1, 2018.

Updates to the Proposed Leverage Ratio

Among the changes to the leverage ratio framework, the new version allows limited netting of securities financing transactions (SFTs), or transactions involving the loaning of a stock, derivative, or other security, with the same counterparty to reduce a bank's Exposure Measure. Netting allows a bank to consolidate the value of multiple transactions under a master agreement with a single counterparty. A bank may exclude from its Exposure Measure the value of any securities under SFTs where a bank has recognized the securities as an asset on its balance sheet. Any cash payables and cash receivables in SFTs with the same counterparty may only be measured net if certain criteria are met, such as if the transactions have the same explicit final settlement date.

Off-balance sheet items will now have to use the same credit conversion factors (CCFs) that are used in the Basel II framework's Standardized Approach for determining credit risk under the risk-based requirements, subject to a floor of 10 percent, instead of using a uniform 100 percent CCF. CCFs

convert a bank's off-balance sheet items into their credit exposure equivalent. In the treatment of derivative exposures, banks may use the cash variation margin exchanged between counterparties as a form of pre-settlement payment under certain circumstances, such as if the variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions.

To avoid double-counting exposures, a clearing member's trade exposures to qualifying central counterparties (QCCPs) associated with client-cleared derivatives transactions may be excluded as long as the clearing member has not guaranteed the performance of a QCCP to its clients in the event of a default by the QCCP. A QCCP is an entity licensed to operate as a central counterparty and approved by its relevant regulator to operate the products it offers. In addition, the effective notional amounts included in the Exposure Measure may be reduced by any negative change in fair value amount that has been incorporated into the calculation of tier 1 capital with respect to the written credit derivative.

Federal Regulators Approve Supplementary Leverage Ratio Standards for Largest U.S. Banks

On April 8, 2014, the Federal Reserve Board, the FDIC, and the OCC finalized [additional leverage ratio standards](#) for the largest systemically important U.S. banking organizations. Originally proposed in July 2013, the extra leverage ratio requirements apply to top-tier U.S. BHCs with at least \$700 billion in total consolidated assets or at least \$10 trillion in assets under custody (covered BHCs) as well as their insured depository institution (IDI) subsidiaries.³ All affected U.S. banking organizations will have to comply with the

supplementary leverage ratio standards by January 1, 2018.

The final supplementary leverage ratio requirements are substantively the same as the requirements from last year. Similar to the requirements proposed last year, covered BHCs will have to maintain a minimum supplementary leverage ratio of tier 1 capital to total assets of at least 5 percent instead of the current 3 percent level to avoid restrictions on capital distributions and discretionary bonus payments. IDI subsidiaries of covered BHCs will still have to maintain a minimum supplementary leverage ratio of 6 percent to be considered well capitalized under the three agencies' prompt corrective action framework.

Proposed Changes in the Denominator of the Supplementary Leverage Ratio

Also on April 8, 2014, the three agencies released proposed changes that would modify the calculation of the denominator for the supplementary leverage ratio (total leverage exposure) from the final rule. The proposed changes, which would apply to all banks, savings associations, BHCs, and savings and loan holding companies that are subject to the three agencies' advanced approaches risk-based capital rules, are designed to more closely align the agencies' supplementary leverage ratio standards with the Basel Committee's leverage ratio standards as proposed in January 2014.

Consistent with the Basel Committee's changes to its leverage ratio standards mentioned above, the proposed changes would revise the treatment of on- and off-balance sheet exposures to determine a bank's total leverage exposure. Under the proposed changes, a banking organization's total leverage exposure would include the effective notional principal amount of credit derivatives and other similar instruments. Banking organizations would

³ For more information on the proposed supplementary leverage ratio requirements, see [Banking Legislation & Policy, Volume 32, Number 2](#).

have to modify on-balance sheet amounts associated with derivative contracts and repo-style transactions, and they would have to revise the credit conversion factors applied to certain off-balance sheet exposures. Comments on the proposal will be accepted through June 13, 2014.

requirements would be eligible for this two-year extension.

Federal Reserve Grants Two-Year Extension on CLOs for Banks

On April 7, 2014, the Federal Reserve Board announced that it would give banks [two more years](#) to satisfy new Volcker Rule standards regarding banks' ownership in and sponsorship of existing collateralized loan obligations (CLOs). CLOs are securitization vehicles backed primarily by commercial loans, but they may also include other types of debt securities. The Volcker Rule prohibits banks from proprietary trading and restricts their ability to invest in covered funds, which include hedge funds and private equity funds. The Board decided that banks would have to divest themselves of any CLOs that met the definition of a covered fund.⁴

Originally, banks had until July 21, 2015, to meet the Volcker Rule's CLO requirements. However, to give banks extra time to conform to the new restrictions, the Federal Reserve decided to extend the deadline for compliance to July 21, 2017. As a result, banks may now maintain their current ownership in and sponsorship of CLOs for up to two years longer than they originally had planned. Other agencies in charge of enforcing the Volcker Rule standards, including the OCC, the FDIC, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, have agreed to respect the Federal Reserve's exemption for banks under their respective jurisdictions. Only CLOs existing on or before December 31, 2013, that were not otherwise exempt from the Volcker Rule's

⁴ For more information on the Volcker Rule, see [Banking Legislation & Policy, Volume 32, Number 4](#).

Federal Regulation

Federal Reserve System

Federal Reserve Releases Results of 2014 Stress Tests, Rejects the Capital Plans of Five U.S. Banks

On March 20, 2014, the Federal Reserve Board released the [results](#) of its stress tests for 30 of the largest U.S. banks. These stress tests, mandated as part of the Dodd-Frank Act, evaluate how well large financial institutions would fare under hypothetical economic and market shocks devised by the Federal Reserve. On top of the same 18 banks tested by the Federal Reserve last year, the Federal Reserve this year tested an additional 12 banks that have assets of at least \$50 billion.

Under the most extreme stress scenario, which features a deep recession with a sharp rise in the unemployment rate, a drop in equity prices of nearly 50 percent, and a decline in housing prices to the approximate levels seen in 2001, only Zions Bancorporation had its ratio of capital to its risk-weighted assets (tier 1 common capital ratio) fall below the Federal Reserve's threshold of 5 percent. Even after the Federal Reserve released [corrected versions](#) of all 30 banks' tier 1 common capital ratios on March 21, the Federal Reserve rejected Zions Bancorp's 2014 capital plan on March 26 because Zions Bancorp's ratio would fall to 3.6 percent.

Also, on March 26, 2014, the Federal Reserve released the [results](#) of its Comprehensive Capital Analysis and Review (CCAR) for these same 30 U.S. banks. The Federal Reserve uses CCAR to evaluate the capital planning processes and capital adequacy of the 30 financial institutions, including each bank's proposed capital actions such as dividend payments. The Federal Reserve rejected the capital plans for four of these 30 banks — Citigroup, Inc.; HSBC North America Holdings, Inc.; RBS Citizens Financial Group, Inc.; and Santander Holdings USA, Inc. — on qualitative grounds. These four banks, along with Zions Bancorp, will have to resubmit a new capital plan to the Federal Reserve within 90 days.

The Federal Reserve rejected the capital plan of Citigroup because Citigroup failed to meet the Federal Reserve's heightened supervisory expectations for the largest and most complex bank holding companies (BHCs) in all aspects of capital planning. Although the Federal Reserve believed Citigroup was making progress in improving its general risk-management and control practice, the Federal Reserve wanted Citigroup to speed up its implementation of reforms of the capital planning processes that had been agreed to in previous years. In addition, the Federal Reserve rejected the capital plans from HSBC and RBS Citizens due to significant deficiencies in their capital planning processes, including inadequate governance and weak internal controls. Meanwhile, the Federal Reserve rejected the capital plan from Santander due to widespread deficiencies across the BHC's capital planning processes such as problems with Santander's risk-identification and risk-management processes.

U.S. Appeals Court Rules in Favor of Federal Reserve's Rule on Debit Card Swipe Fees

On March 21, 2014, the U.S. Court of Appeals for the District of Columbia Circuit [upheld](#) a Federal Reserve regulation that controlled interchange fees on debit transactions. Under the Federal Reserve's rule, the interchange transaction fee was capped at 21 cents per transaction, along with a 5 basis point allowance to compensate issuers for fraud losses. The Federal Reserve's rule also mandated that at least two networks owned and operated by different companies be able to process transactions with at least one network for

signature transactions and at least one network for PIN transactions. The decision reverses a July 2013 U.S. District Court ruling that invalidated portions of this Federal Reserve regulation.⁵ The regulation, originally created in June 2011, established a cap on debit card interchange fees, prohibited network exclusivity arrangements, and limited routing restrictions as part of the Dodd-Frank Act.

In its unanimous ruling, the D.C. Circuit argued that the Federal Reserve's rule generally rests on reasonable interpretations of its authority granted under the Durbin Amendment of the Dodd-Frank Act. In the court's opinion, the language used in the Durbin Amendment was too confusing regarding Congress's description of incremental costs to determine Congress's intent in making the legislation. Combined with the powers Congress delegated to the Federal Reserve in drafting anti-exclusivity network provisions, the court felt the Federal Reserve's implementation of the Durbin Amendment's provisions was reasonable.

However, the D.C. Circuit did ask that the Federal Reserve clarify its explanation on transaction-monitoring costs. In July 2012, the Federal Reserve approved a final [rule](#) allowing a debit card issuer subject to the interchange fee standards to receive a fraud-prevention adjustment to cover costs incurred when an issuer investigates the source of a data breach or theft, or when an issuer attempts to stop any instances of fraud. While the court agreed with the Federal Reserve that transaction-monitoring costs may qualify both as costs specific to a particular transaction and as fraud-prevention costs for the network in general, the court would like the Federal Reserve to articulate a reasonable judgment for determining that transaction-monitoring costs properly fall outside of the fraud-prevention adjustment already approved two years ago.

Federal Regulators Allow Largest Banks to Use Advanced Approaches Framework

On February 21, 2014, the Federal Reserve and the Office of the Comptroller of the Currency (OCC) permitted certain large banking organizations to use the [Advanced Approaches framework](#) to determine their risk-based capital requirements. In July 2013, federal regulators finalized Basel III capital standards in the United States that heightened capital requirements for all U.S. banking organizations.⁶ Under the finalized U.S. Basel III capital standards, certain large internationally active banking organizations could start using the advanced approaches framework provided that these banking organizations are able to show their respective regulators that they can satisfy their risk-based capital requirements for four straight quarters. As of February 21, 2014, eight BHCs, eight national banks, and four state member banks were able to show their regulators that they successfully met all of the new risk-based capital requirements for four straight quarters.

These institutions, including The Bank of New York Mellon Corporation and JPMorgan Chase & Co., are banking organizations with at least \$250 billion in total consolidated assets or at least \$10 billion in total on-balance sheet foreign exposures. Therefore, these banking organizations may use their own internal models to weigh risk and will begin to disclose publicly their risk-based capital ratios as of the second quarter of 2014. Any BHCs using the Advanced Approaches framework will have to incorporate those changes into the capital planning and stress testing cycles starting on October 1, 2015.

⁵ For more information on the District Court's ruling, see [Banking Legislation & Policy, Volume 32, Number 3](#).

⁶ To read about the finalized U.S. Basel III capital standards, see [Banking Legislation & Policy, Volume 32, Number 2](#).

Federal Regulators Release Final Dodd-Frank Stress Test Guidelines for Midsize Banks

On March 5, 2014, the Federal Reserve, the Federal Deposit Insurance Corporation, and the OCC issued final guidelines detailing [supervisory expectations](#) for stress tests conducted on banks with between \$10 billion and \$50 billion in total consolidated assets. These types of banks will have to conduct annual company-run stress tests under [rules](#) issued by the three agencies in October 2012 as mandated by Section 165 of the Dodd-Frank Act. Midsize banks had to perform their first stress tests by March 31, 2014.

Designed to accommodate different risk profiles, sizes, and complexity for banks within this asset range, the final guidance describes general supervisory expectations for these banks' stress tests and provides examples of practices consistent with these expectations, such as how to estimate credit losses associated with loan portfolios and securities holdings. However, the final guidelines did confirm that midsize banks are not subject to the Federal Reserve's capital plan rule, the Federal Reserve's CCAR, Dodd-Frank Act supervisory stress tests, or related data collections that apply to BHCs with more than \$50 billion in total consolidated assets.

New York Fed Wins Appeal Regarding 2008 AIG Intervention

On January 29, 2014, the U.S. Court of Appeals for the Second Circuit [upheld](#) a U.S. District Court's ruling to dismiss a \$25 billion lawsuit filed by Starr International Company, Inc. against the Federal Reserve Bank of New York regarding the New York Fed's 2008 bailout of American International Group, Inc. Agreeing with the lower court's ruling, the Second Circuit court believed that the New York Fed's actions were constitutional to stabilize the U.S. financial system.⁷ In light of the 2008 financial crisis, the New York Fed could preempt Delaware fiduciary law and execute its bailout of AIG. This decision does not affect a separate lawsuit filed by Starr International, which sued the U.S. government in the U.S. Federal Court of Federal Claims also seeking \$25 billion in damages regarding the U.S. government's actions in the 2008 AIG bailout.

Basel Committee on Banking Supervision

Basel Committee Proposes Revisions to NSFR

On January 12, 2014, the Basel Committee on Banking Supervision (Basel Committee) released [revisions](#) to the Basel framework's Net Stable Funding Ratio (NSFR). As part of the Basel III Accord from September 2010, the NSFR is designed to force banks to maintain a stable funding profile in relation to their on- and off-balance sheet activities.⁸ The NSFR is calculated as the available amount of stable funding (ASF) divided by the required amount of stable funding (RSF), and this ratio must be greater than 100 percent. The available amount of stable funding is defined as those funds that are not likely to be withdrawn within a year, and the required amount of stable funding depends on the liquidity and residual maturities of an institution's assets, as well as those of its off-balance sheet exposures.

The NSFR standard will still become effective on January 1, 2018. The main revisions to the NSFR focus on reducing excessive volatility in the measure resulting from one event, improving the alignment of the NSFR with the Liquidity Coverage Ratio originally finalized in January 2013, and altering the NSFR's calibration to focus more attention on short-term funding sources. Other revisions include removing the distinction between

⁷ To read about the U.S. District Court's ruling, see [Banking Legislation & Policy, Volume 31, Number 4](#).

⁸ For more information on the Basel III Accord, see [Banking Legislation & Policy, Volume 29, Number 3](#).

secured and unsecured funding for funding from nonfinancial corporate customers that matures in less than one year and recognizing deposits held at other financial institutions for operating purposes, such as clearing and cash management purposes, as ASF.

The revisions also update the factors, or how much the various categories that make up ASF and RSF are weighted, used in calculating the NSFR. The ASF factors for stable nonmaturity deposits and term deposits would be increased, and RSF factors for unencumbered loans to retail and small business customers would be decreased. Other modifications include increasing RSF factors for high-quality liquid assets encumbered for a period of at least six months but less than a year and increasing RSF factors for interbank lending for a period of at least six months but less than year.

Basel Committee Finalizes Treatment of Derivatives-Related Transactions

On March 31, 2014, the Basel Committee approved [final rules](#) on the treatment of derivatives-related transactions in its capital adequacy framework. Originally proposed as the Non-Internal Model Method (NIMM) in June 2013, the new Standardized Approach (SA-CCR) standard will replace the Current Exposure Method and the Standardized Method for determining counterparty credit risk related to derivative transactions.⁹ The SA-CCR will also replace the Internal Model Method shortcut once the SA-CCR takes effect starting on January 1, 2017.

Under the SA-CCR, the Exposure at Default is defined as a multiple of the sum of the current market value of a financial instrument and a potential future exposure add-on component that would reflect potential changes in the financial instrument's market value. Among other revisions, the SA-CCR now incorporates a supervisory measure of duration for interest rate and credit derivative exposures and includes adjustments to take account of the differences in risk for margined and unmargined trades and for trades with different maturities.

Federal Housing Finance Agency

FHFA Agrees to Two Separate Billion-Dollar Settlements Regarding Mortgage-Backed Securities

On February 7, 2014, the Federal Housing Finance Agency (FHFA) agreed to a \$1.25 billion [settlement](#) with Morgan Stanley to resolve claims that Morgan Stanley sold faulty mortgage-backed securities in the run-up to the recent financial crisis. Under the terms of the agreement, Morgan Stanley will pay \$625 million to both Fannie Mae and Freddie Mac in regards to allegations that Morgan Stanley made untrue statements and material omissions about the private-label mortgage-backed securities purchased by the two government-sponsored agencies between 2005 and 2007. As part of the settlement, Morgan Stanley does not have to admit to any wrongdoing for its actions.

On March 26, 2014, the FHFA also agreed to a \$9.3 billion [settlement](#) with Bank of America Corporation to resolve claims that the Bank of America affiliates of Merrill Lynch and Countrywide Financial (both of which Bank of America acquired in 2008) misrepresented the quality of loans underlying residential mortgage-backed securities bought by Fannie Mae and Freddie Mac between 2005 and 2007. Under the terms of the agreement, Bank of America will repay Fannie Mae and Freddie Mac approximately \$5.8 billion in cash and buy back about \$3.5 billion worth of securities from the two government-sponsored enterprises to end

⁹ For more information on the NIMM, see [Banking Legislation & Policy, Volume 32, Number 2](#).

litigation claims against the bank. Like Morgan Stanley, Bank of America does not have to admit to any wrongdoing for its actions. Both the Morgan Stanley and the Bank of America settlements are part of the FHFA's ongoing effort to recoup losses incurred by the taxpayers after the U.S. government had to take control of Fannie Mae and Freddie Mac in 2008.

Securities and Exchange Commission

SEC Proposes Enhanced Standards for Systemically Important Clearing Agencies

On March 12, 2014, the Securities and Exchange Commission (SEC) proposed [new rules](#) that would enhance the oversight of clearing agencies deemed to be systemically important or that are involved in complex transactions, such as security-based swaps. Under the proposal, clearing agencies deemed to be systemically important would face new requirements regarding their financial risk management, operations, governance, and disclosures to market participants and the public.

A securities clearing agency generally acts as a middleman between the parties to a securities transaction, performing services ranging from ensuring that funds and securities are correctly transferred between parties to assuming the risks of a party defaulting on a transaction. The proposed rules would increase governance and comprehensive risk management standards such as establishing the qualifications of members of boards of directors for these systemically important clearing agencies. Other provisions in the proposed rules would strengthen financial risk management standards for systemically important clearing agencies. For example, the SEC would force systemically important clearing agencies to hold onto enough qualifying liquid resources to withstand the default by a participant and its common control affiliates (collectively known as a participant family) that would generate the largest aggregate payment obligation in extreme but plausible market circumstances.

Office of the Comptroller of the Currency

OCC Proposes Guidelines for Its Heightened Expectations of Large Banks

On January 16, 2014, OCC released a [proposal](#) detailing new standards that it would place on large national banks and federal savings associations to strengthen the governance and risk management practices of these institutions. The proposal is applicable to any insured national bank, insured federal savings association, or insured federal branch of a foreign bank with average total consolidated assets of at least \$50 billion as well as any institution with less than \$50 billion in assets that the OCC determines is highly complex or presents some sort of heightened risk.

The proposal details the roles and responsibilities of a large bank's organizational units in charge of designing and implementing its risk governance framework. These are the front-line, independent risk management, and internal audit units of a large bank. The guidelines also state that a large bank's board of directors should have at least two independent members who are not part of the large bank's or parent company's management and that this board of directors should actively oversee the large bank's risk-taking activities by evaluating management's recommendations and decisions. Failure to meet any of these provisions would result in the OCC issuing an enforceable order to the offending institution.

Federal Legislation

Proposed Legislation

Senators Johnson and Crapo Propose Updated Version of Corker-Warner GSE Bill

On March 16, 2014, Senators Tim Johnson (D-South Dakota) and Mike Crapo (R-Idaho) released [legislative text](#) that would alter the government's role in the U.S. housing market. The Johnson-Crapo text builds upon Corker-Warner legislation first proposed in June 2013 and would replace the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac with a new government entity called the Federal Mortgage Insurance Corporation (FMIC).¹⁰

Like the Corker-Warner bill, under the Johnson-Crapo text, the FMIC would oversee a common securitization platform and would take over responsibility for insuring the secondary mortgage market. The FMIC would replace the FHFA, and it would provide a catastrophic guarantee by insuring all mortgage-backed securities from approved private mortgage insurers if losses on any eligible mortgage-backed securities exceed 10 percent in value.

However, the Johnson-Crapo text does change some features of the Corker-Warner bill. Most notably, the Johnson-Crapo text would give depository institutions with up to \$500 billion in assets the ability to become members of a small lender mutual, in contrast to the \$15 billion size limit in Corker-Warner. The small lender mutual would provide its members with a cash window to sell individual, eligible mortgages and different pooling, aggregation, and securitization services. In addition, the Johnson-Crapo text would require a down payment of 3.5 percent for first-time homebuyers and 5 percent for all other homebuyers, instead of a down payment of 5 percent for all homebuyers, as well as establish an Office of Multifamily Housing in the FMIC, which is not mentioned in the Corker-Warner legislation.

Senator Collins Sponsors Legislation Clarifying Federal Reserve Regulations for Insurance Companies

On March 10, 2014, Senator Susan Collins (R-Maine) proposed legislation ([S.2102](#)) that would clarify the application of certain leverage and risk-based requirements by the Federal Reserve on insurance companies. As part of the Dodd-Frank Act, Section 171 states that the Federal Reserve must establish and enforce minimum leverage and risk-based capital requirements for insured depository institutions, depository institution holding companies, and nonbank financial companies that are supervised by the Federal Reserve.

Since the Federal Reserve does not believe that it has the authority to impose different capital standards for different firms, the Federal Reserve has not discriminated between insurance companies and other financial institutions when it has begun applying minimum capital standards on the institutions that it supervises. Therefore, to clarify the Federal Reserve's ability to regulate insurance companies, the proposed legislation would amend Section 171 of the Dodd-Frank Act so that the Federal Reserve will not have to place the same minimum capital standards on insurance companies as it does on other financial institutions that it oversees as long as these insurance companies are engaged in activities regulated as insurance at the state level.

¹⁰ To read about the Corker-Warner bill from June 2013, see [Banking Legislation & Policy, Volume 32, Number 2](#).

International Regulation

European Union

EU Releases Proposal to Ban Proprietary Trading by Large Banks

On January 29, 2014, the European Commission adopted a [proposal](#) that would prohibit the largest European banks from engaging in proprietary trading similar to the Volcker Rule approved by the U.S. in December 2013.¹¹ This proposal would prohibit a bank, and any entity belonging to its group, from engaging in proprietary trading in financial instruments, trading of physical commodities, and investing in hedge funds using a bank's own funds or borrowed capital. Broadly, a firm engages in proprietary trading when it trades financial instruments on its own account in an attempt to make a short-term profit.

In addition, this proposal would give banking supervisors the ability to separate certain trading and investment banking activities of a bank from a bank's deposit-taking section if banking supervisors deem that these trading activities threaten the stability of the bank or of the European Union (EU). Examples of such trading and investment banking activities include market making, investment and sponsorship of complex securitized products, and over-the-counter derivatives trading. Member states of the EU may apply for exemptions to this requirement if these member states want their own versions of this rule, so long as their versions are compatible with the restrictions put forth in the proposal. If the EU grants such an exemption to a nation, then the banks of that nation must abide by that nation's restrictions on trading and investment banking activities instead of the EU's restrictions.

The new legislative proposal must be approved by the EU member states and the European Parliament for it to become mandatory. This proposal will affect all European banks identified as being of global systemic importance with either total assets greater than €30 billion or total trading assets and liabilities exceeding €70 billion or 10 percent of their total assets.

¹¹ For more information on the Volcker Rule, see [Banking Legislation & Policy, Volume 32, Number 4](#).

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