Federal Reserve Proposes Rule Prohibiting Mergers Between Banks Exceeding Industry Liability Cap

On May 8, 2014, the Federal Reserve Board released a proposal that would prevent one financial institution from combining with another financial institution if the ratio of the resulting financial institution’s liabilities exceeds 10 percent of the aggregate consolidated liabilities of all financial institutions. The proposal would implement Section 622 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 622 of the Dodd-Frank Act amended the Bank Holding Act of 1956 by limiting the concentration of large financial firms.

Companies Impacted by the Proposal

The proposal would affect U.S. depository institutions, bank holding companies, and foreign banks or companies treated as bank holding companies under the Bank Holding Company Act. In addition, the proposal would affect savings and loan holding companies, companies that control an insured depository institution, and nonbank financial companies designated for supervision by the Financial Stability Oversight Council (FSOC). However, financial companies not affiliated with an insured depository institution, such as insurance companies, would not be subject to the provisions of this proposal unless they were already designated as systemically important by the FSOC.

Determining a Bank’s Liabilities

The proposal would measure the liabilities of a financial firm as total risk-weighted assets minus total regulatory capital under the risk-based capital rules. For insurance companies or other nonbank financial companies supervised by the Board of Governors of the Federal Reserve, the proposal would define their liabilities as the assets of the company as specified by the Board of Governors. Also, for foreign banking organizations, the
The proposal would only consider the liabilities of their U.S. operations as relevant for applying the concentration limit. The liabilities of any companies that are not subject to consolidated risk-based capital rules would be calculated using generally accepted accounting principles (GAAP) or other appropriate accounting standards until these firms are subject to risk-based capital rules.

To measure the aggregate financial sector liabilities, the proposal would calculate the average of the financial sector liabilities as of December 31 of each of the preceding two calendar years. By July 1 of each year, the Federal Reserve would publish the aggregate financial sector liabilities as of December 31 for the preceding calendar year as well as the average of the financial sector liabilities for the preceding two calendar years. This two-year average would remain in effect from July 1 of the year that the aggregate financial sector liabilities information was released until June 30 of the following year.

**Exceptions to the Concentration Limit**

If one of the banks in a proposed merger is in default or in danger of default, then the proposal would allow the two banks to execute their merger subject to prior written approval by the Federal Reserve Board. Mergers between two banks that would result only in a de minimis increase in the resulting financial company would be exempt from this proposal. De minimis mergers would be defined as acquisitions in which the increase in the total consolidated liabilities of a bank does not exceed $2 billion, as long as total de minimis acquisitions by the company did not exceed this amount during the 12 months before the date of the transaction.

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**Federal Regulation**

**Justice Department**

*BNP Paribas Reaches $8.9 Billion Settlement After Admitting to Violating U.S. Sanction Laws*

On June 30, 2014, BNP Paribas S.A. pleaded guilty to conspiring to violate the International Emergency Economic Powers Act and the Trading with the Enemy Act by processing billions of dollars of transactions through the U.S. financial system on behalf of Sudanese, Iranian, and Cuban entities subject to U.S. economic sanctions. As a result, BNP Paribas has agreed to pay a record $8.9 billion for processing banned transactions from 2004 to 2012 involving Sudan, Iran, and Cuba. In addition, the bank will have to suspend its U.S. dollar clearing operations through its New York branch and other affiliates for a year and terminate or separate 13 executives from the firm, including its group chief operating officer.

According to the Justice Department, BNP Paribas went to elaborate lengths to conceal prohibited transactions, cover its tracks, and deceive U.S. authorities even after being told by its own lawyers that the bank’s operations were illegal. The majority of the illegal payments from 2004 to 2012 were made on behalf of sanctioned entities in Sudan in which the bank processed about $6.4 billion through the U.S. between July 2006 and June 2007. Methods through which BNP Paribas hid its illegal operations from U.S. authorities included processing Sudanese transactions through a sophisticated system of satellite banks disguising the connection between sanctioned Sudanese entities and BNP Paribas as well as stripping any blocked Cuban wire messages of references to Cuban entities and resubmitting the new wire messages to the U.S. for processing as one lump sum payment.
Credit Suisse Reaches $2.6 Billion Settlement After Pleading Guilty to Fostering U.S. Tax Evasion

On May 19, 2014, Credit Suisse AG pleaded guilty to conspiracy to aid and assist U.S. taxpayers in filing false tax returns and other documents with the Internal Revenue Service. As part of the plea agreement, Credit Suisse AG, the bank subsidiary of Credit Suisse Group AG, agreed to pay a total of $2.6 billion in restitution and fines for helping U.S. citizens hide assets in offshore bank accounts to evade paying taxes. Under the terms of the settlement, $1.8 billion will go to the Department of Justice for the U.S. Treasury, $100 million to the Federal Reserve, and $715 million to the New York State Department of Financial Services.

In addition, Credit Suisse acknowledged that it operated an illegal cross-border banking business and knowingly and willfully aided U.S. clients to avoid paying taxes for decades prior to and through 2009. By pleading guilty, Credit Suisse has agreed to make a complete disclosure of its cross-border activities, cooperate in treaty requests for account information, provide detailed information as to other banks that transferred funds into secret accounts or that accepted funds when secret funds were closed, and to close the accounts of clients who fail to comply with U.S. reporting obligations. While Credit Suisse did not have to surrender the names of account holders, the new information that Credit Suisse is required to hand over is designed to help U.S. authorities track down specific account holders.

Federal Reserve System
Fed Makes Bank of America Resubmit Capital Plan and Halt Capital Distribution After Stress Test Error

On April 28, 2014, the Federal Reserve required that Bank of America Corporation must resubmit its 2014 capital plan to the Federal Reserve for approval following the discovery of an error in Bank of America’s stress test submission to the Federal Reserve. As part of the Federal Reserve’s annual Comprehensive Capital Analysis and Review (CCAR) program required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Bank of America has to supply the Federal Reserve with its capital plan. In March 2014, the Federal Reserve approved of Bank of America’s 2014 capital plan and its planned capital distribution.¹

However, Bank of America discovered errors in how the bank calculated losses on some structured notes issued by Merrill Lynch. Merrill Lynch was an investment bank that Bank of America acquired in January 2009 during the financial crisis in 2008. Since Bank of America had underrated losses on those structured notes that it acquired from Merrill Lynch, Bank of America’s capital levels were lower than what the bank had reported to the Federal Reserve during the 2014 CCAR. As a result, to make sure that Bank of America is adequately capitalized, the Federal Reserve required that Bank of America has to resubmit its 2014 capital plan to account for the bank’s newly calculated capital level. Until then, the Federal Reserve would not permit Bank of America to exceed its 2014 capital distributions such as dividend payments on stock.

On May 27, 2014, Bank of America resubmitted its new capital plan to the Federal Reserve for review. The Federal Reserve has 75 days to respond with its verdict.

Fed Grants Four Banks Six-Month Extension for Resubmitting Capital Plans

On June 24, 2014, the Federal Reserve extended the deadline for four large banks to resubmit their capital plans by six months. The Federal Reserve originally rejected the capital plans of these four banks — Citigroup,
Inc.; HSBC North America Holdings, Inc.; RBS Citizens Financial Group, Inc.; and Santander Holdings USA, Inc. — in March 2014 for failing the Federal Reserve’s CCAR on qualitative grounds.²

The four banks were supposed to resubmit their new capital plans on June 26, 2014, but now the four banks will have until January 5, 2015, to address capital weaknesses identified by the Federal Reserve earlier this year. While the four banks may have received an extension to resubmit their capital plans, these banks will still not be able to increase their capital distributions until the Federal Reserve approves a new capital plan.

Fed Proposes Changes for Capital Planning and Stress Testing
On June 12, 2014, the Federal Reserve released a proposal that would alter the date when banks would have to file their capital plans and stress test results to the Federal Reserve. The proposed rule would shift the start date of the capital plans and stress test cycles from October 1 of a calendar year to January 1 of the following calendar year. As a result, bank holding companies with more than $50 billion in total consolidated assets would have to submit their capital plans and stress test results by April 5, while bank holding companies with between $10 billion and $50 billion in total consolidated assets would have to submit their capital plans and stress test results by July 31. Savings and loan holding companies and state member banks subject to stress tests under the Dodd-Frank Act would also be required to submit their results several months later than under the current rules. The new schedule would start with the 2015–2016 capital plan and stress test cycles.

Basel Committee on Banking Supervision
Basel Committee Finalizes Framework on Measuring and Controlling Large Credit Exposures
On April 15, 2014, the Basel Committee issued final rules designed to tighten existing limits on the concentration of a bank’s credit exposure. Originally proposed in March 2013, the new framework will replace the Basel Committee’s existing guidelines from 1991.³ Effective January 1, 2019, the framework seeks to establish greater consistency in the way banks and supervisors measure, aggregate, and control exposures to single counterparties.

The new guidelines have eased some of the requirements from the original proposal regarding counterparty credit limits, as the final rules set a general exposure limit for all banks to a single counterparty or a group of connected counterparties at 25 percent of a bank’s tier 1 capital. Under the previously proposed framework, this general limit would have been either 25 percent of a bank’s common equity tier 1 (CET1) capital or 25 percent of a bank’s tier 1 capital.⁴

However, the new guidelines did tighten restrictions on how much credit exposure global systemically important banks (G-SIB) can have with each other. Whereas the proposed framework would have limited a G-SIB from having more than 10 percent to 15 percent of its CET1 or tier 1 capital exposed to another G-SIB institution, the final rules set this limit at 15 percent of a G-SIB’s tier 1 capital. Other changes include raising

² For more information on why the Federal Reserve rejected the capital plans of these four banks on qualitative grounds, see Banking Legislation & Policy, Volume 33, Number 1.
³ To read about the original proposed framework from March 2013, see Banking Legislation & Policy, Volume 32, Number 1.
⁴ CET1 capital includes common stock and retained earnings. Tier 1 capital is mostly composed of CET1, but it includes some other forms of capital as well, such as noncumulative, nonredeemable preferred stock. See Basel III for more information.
the reporting threshold of large credit exposures to 10 percent of a bank’s eligible capital base instead of the original 5 percent and modifying the treatment of certain credit default swaps used as hedges in a bank’s trading book to more closely align with the Basel Committee’s risk-based capital framework.

**Federal Housing Finance Agency**

*FHFA Proposes Minimum Liquid Assets Requirement for Private Mortgage Insurers*

On July 10, 2014, the Federal Housing Finance Agency (FHFA) proposed revised eligibility requirements for Fannie Mae and Freddie Mac to approve private mortgage insurers that provide mortgage insurance owned or guaranteed by the two government-sponsored enterprises. The FHFA will accept comments on this proposal until September 8, 2014.

Designed to ensure that these mortgage insurers will have the ability to withstand a severe stress event, the new eligibility requirements would force mortgage insurers doing business with the government-sponsored enterprises to hold liquid assets of at least 5.6 percent of their portfolio to cover their risk exposure. Depending on other risk factors, such as a mortgage’s loan-to-value ratio and a homebuyer’s credit score, the mandatory minimum level of liquid assets that these mortgage insurers have to maintain could increase to match the extra risk exposure. Examples of liquid assets include cash, bonds, and shares of common or preferred stock as long as the stock is publicly traded and the mortgage insurer has the ability to sell its shares at any time.

**National Credit Union Administration**

*NCUA Mandates Stress Tests for Credit Unions with More Than $10 Billion in Assets*

On April 24, 2014, the National Credit Union Administration (NCUA) approved a final rule requiring all federally insured credit unions with more than $10 billion in assets to develop and maintain a capital plan and to undergo stress testing. Designed to determine if the largest credit unions have enough capital to survive times of financial duress, affected credit unions will have to submit an annual capital plan to the NCUA for approval. The NCUA will conduct stress tests on these capital plans starting this year. However, should any of these credit unions meet certain benchmarks after three years of stress testing, the final rule would allow these successful credit unions to conduct their own stress tests instead of the NCUA. For the first three years, the results of any stress testing will remain confidential.

**Office of the Comptroller of the Currency**

*OCC Raises Regulatory Fees on Banks with More Than $40 Billion in Assets*

On July 9, 2014, the Office of the Comptroller of the Currency (OCC) agreed to increase the assessments on national banks and federal savings associations with total assets of more than $40 billion. Beginning on September 30, 2014, the marginal assessment rate for these institutions will increase by 14.5 percent. Ranging from 0.32 percent to 14 percent, the average increase in assessments for affected national banks and federal savings associations will be 12 percent. This decision to raise regulatory fees for these institutions finalizes an OCC proposal from April 28, 2014. National banks and federal savings associations with no more than $40 billion in total assets will not face any increase in their assessment rates.

*Banking Legislation & Policy* is prepared by the Research Department. For further information, contact Michael Slonkosky at 215-574-3450 or michael.slonkosky@phil.frb.org. To subscribe to this publication, go to http://www.philadelphiafed.org/philscriber/user/dsp_content.cfm.