Financial Services Management

Capital Planning Construct

Cite

FRB, Final Rule, Amendments to Capital Planning and Stress Testing Requirements for Large Bank Holding Companies, Intermediate Holding Companies and Savings and Loan Holding Companies

Recommended Distribution:

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Websites:

https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20210119a1.pdf

Impact Assessment

- Structural change to the capital construct is less likely given the Board's failure to address it despite seeking comment on how to do so.
- Category IV banking organizations gain considerable stress-test and SCB relief.
- IHCs retain some competitive advantage.
- SLHCs lose a remaining edge over BHCs.

Overview

Although the FRB in its proposal indicated that this rulemaking would also begin consideration of the U.S. large-bank capital framework post-COVID,[1] its final rule largely confines itself to aligning stress-test standards with the 2019 tailoring rule[2] and stress capital buffer (SCB)[3] for Category IV banking organizations. The most significant change from the proposal applies the new capital-planning and SCB standards to large savings-and-loan holding companies (SLHCs), eliminating one of the last remaining advantages enjoyed by these charters in comparison with bank holding companies.

[1] See **CAPITAL226**, *Financial Services Management*, October 5, 2020.

[2] See **SIFI34**, *Financial Services Management,* October 23, 2019.

[3] See **CAPITAL225**, *Financial Services Management*, March 11, 2020.

Impact

Due to the Fed's invitation for commenters also to address broad questions of how the large-bank capital rules should operate after the pandemic eases, many commenters laid out views on significant structural issues. These included matters such as climate risk – a major Biden Administration consideration – as well as numerous capital-planning regulatory changes not addressed in the NPR, renewing a materiality criterion for capital reporting, the standards governing IHCs, including the leverage ratio in the stress test, and the SCB's volatility. The Board's initial request for views suggested a significant change is under consideration after the pandemic eases, but the omission of any comment on these answers makes its next steps most unclear. It is possible, however, that the FRB deferred emerging issues because it plans later this year finally to act on the Basel IV package of changes to the standardized approach,[4] the internal ratings-based approach,[5] and a new operational risk-based capital construct.[6] This may be such a daunting agenda that still more fundamental changes were deemed out of reach in the near term, especially if the FRB also prioritizes buffer reviews following FSB statements on this issue from Vice Chairman Quarles. Congress is, however, likely to press hard on the question of climate change.[7]

The Fed also suggested in the NPR that it would rewrite the definition of common stock dividends to tighten it. This would have had particularly significant implications for IHCs with regard to payments to parent companies, and the Board thus decided to defer action. As a result, IHCs continue to have flexibility in how they upstream capital to parent companies for purposes of regulatory reporting, stress testing, and the SCB. The Board does indicate that it will continue to consider this question, to reduce any competitive advantages for IHCs but provides no insight into when it might begin to do so. Given that this would now take a freestanding rule, action in the foreseeable future is unlikely.

What's Next

This final rule was issued on January 19. The rule is effective sixty days after publication in the *Federal Register*. Relevant supervisory guidance will also be updated, although the Board provides no timeframe for doing so.

Analysis

A. SLHCs

As noted, this rule brings these entities under the capital-plan and SCB standards if they fall into Categories II, III, or IV. The first capital plan under this rule for

4 See **CAPITAL221**, *Financial Services Management, January 2, 2018.*

5 See **CAPITAL222**, *Financial Services Management, January 4, 2018.*

6 See **OPSRISK21**, *Financial Services Management,* August 19, 2020.

7 FedFin Issue Brief: **Going Green: The Future of U.S. Climate-Risk Financial Policy**, October 26, 2020.

covered firms on the effective date is due April 5, 2022; the SCB will apply until the first year in which the FRB conducts a supervisory stress test. No opt-out or other alternatives sought by commenters is allowed.

B. Qualitative Judgment

A 2019 rule stated that no firm would be subject to a qualitative objection if it passed several qualitative tests. All companies having done so, the potential for qualitative objections is removed from the capital-planning rule.

C. Category IV Banking Organizations

The rule aligns the capital-planning rule with tailoring and the SCB by eliminating from the planning rule the requirements that Category IV companies calculate certain forward-looking projections under supervisory standards, with the Board reserving the right to mandate more projections under macroeconomic or other circumstances as needed. The FRB will also review Category IV company capital-planning procedures annually in conjunction with other supervisory activities.

Many reporting requirements that force planning granularity are also eliminated. Even so, Category IV banks, like all others, are required to measure and manage material risk under adverse scenarios, including unexpected ones. Capital planning will remain a criterion for each Category IV company Fed rating. Category IV companies may also update calculation of CET1 frequency to every two years, but elect to participate in CCAR in off years.