December 23, 2011

Federal Reserve Proposes Enhanced Prudential Standards and Early Remediation Requirements For Large BHCs and Nonbank SIFIs

This summary describes proposed rules issued by the Federal Reserve System to implement the enhanced supervisory and prudential requirements in Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Comments on the proposed rules are due by **March 31, 2012**.

The package of enhanced prudential standards (the "**Proposal**") includes the following:

Capital and Leverage

- The Proposal would impose two significant capital requirements:
  - Large BHCs and Nonbank Covered Companies[1] would be subject to a minimum Tier 1 Common Risk-Based Capital Ratio of 5% as a result of being required to comply with the Federal Reserve's capital planning final rule, which is effective on December 30, 2011.
  - Nonbank Covered Companies would generally be required to comply with bank regulatory capital and leverage requirements, subject to any case-by-case exceptions the Federal Reserve may grant.

Liquidity

- The Proposal would require Covered Companies to comply with a formal regulatory liquidity standard, the first time such a standard has been applied to bank holding companies in the United States.
- Covered Companies would be required to hold a sufficient quantity of "highly liquid assets" on hand to survive a projected 30-day liquidity crisis and would also be required to put in place monitoring and compliance regimes.
- The board of directors, risk committee and senior management of Covered Companies would be subject to new liquidity risk management and governance requirements, including periodic review and approval of liquidity risk models.
- The liquidity requirements of the Proposal are similar, but not identical, to the Basel Committee's Liquidity Coverage Ratio, which the Federal Reserve will implement at a later date.

Single Counterparty Exposure Limits

- The Proposal generally caps the net exposure, measured on a consolidated basis, of any Covered Company and its subsidiaries to any counterparty and its subsidiaries at 25% of the capital and surplus of the Covered Company.
- In the case of Major Covered Companies – of which there are currently seven in the United States – the Proposal caps their exposures to each other at 10% of capital and surplus.

[1] Please see the chart later in this introduction for definitions of the different types of institutions covered in the Proposal.

- The Proposal provides rules for measuring gross and net exposures, and limits are tied to aggregate net exposures.

Risk Management and Risk Committee Requirements

- The Proposal would require that each Covered Company and publicly-traded Medium BHC establish a risk committee of the board of directors to document and oversee, on an enterprise-wide basis, the risk management practices of the company's worldwide operations.
- The Proposal would require each Covered Company to employ a chief risk officer who reports directly to the risk committee and the chief executive officer and who has sufficient expertise and stature to provide the company with an objective assessment of the risks taken by the company.

Stress Testing

- The Federal Reserve proposes to conduct annual supervisory stress tests of Covered Companies, which will build on earlier stress testing efforts such as the Supervisory Capital Assessment Program ("**SCAP**") and Comprehensive Capital Analysis and Review ("**CCAR**").
- Each year, Covered Companies must also conduct two company-run stress tests. By contrast, Medium Depository Institutions are only required to conduct annual company-run stress tests.
- The Federal Reserve proposes to publish summaries of the supervisory stress test results, which would include company-specific information. Companies must also publish a summary of their company-run stress test results.
- The stress testing requirements are designed to work in tandem with the capital planning rule.

Early Remediation

- A Covered Company will be subject to remediation actions under the early remediation regime if it falls into one of the four remediation levels: heightened supervisory review, initial remediation, recovery, and resolution assessment.
  - **Level 1**: **Heightened Supervisory Review**. Occurs when there are signs of financial distress or material risk management weaknesses such that further decline of the company is probable.
  - **Level 2**: **Initial Remediation**. Will result in restrictions on capital distributions, acquisitions and asset growth.
  - **Level 3**: **Recovery**. Will result in a prohibition on growth and capital distributions, capital raising requirements and limits on executive compensation, and may result in management changes, limits on transactions with affiliates and additional requirements on a case-by-case basis.
  - **Level 4**: **Resolution Assessment**. The Federal Reserve will consider whether to make a written recommendation that the Covered Company be placed into resolution under Title II of the Dodd-Frank Act. Such recommendation would be one of the "three keys" required to invoke the orderly liquidation authority—the Federal Deposit Insurance Company ("**FDIC**") and Treasury would also have to agree.

Since the Proposal treats different types of financial institutions differently, for the convenience of the reader, here is a chart showing the way the Proposal divides institutions.

Abbreviation	Categories of Financial Institutions
Large BHCs	Bank holding companies ("**BHCs**") with $50 billion or more in consolidated assets.
Nonbank Covered Companies	Nonbank financial companies designated by the Financial Stability Oversight Council ("**FSOC**") for Federal Reserve oversight under Section 113 of the Dodd-Frank Act.
Covered Companies	Nonbank Covered Companies and Large BHCs.
Medium BHCs	BHCs (other than foreign banking organizations) that have between $10 billion and $50 billion in total consolidated assets.
Medium Depository Institutions	Savings and loan holding companies ("**SLHCs**") that have $10 billion or more in consolidated assets; state member banks that have $10 billion or more in consolidated assets; and Medium BHCs.
Major Covered Companies	BHCs with $500 billion or more in consolidated assets and all Nonbank Covered Companies.

The Proposal is as significant for what it does *not* do as for what it does. Despite press reports, the Proposal does not contain the Basel Committee on Banking Supervision's (the "**Basel Committee**") surcharge on global systemically important banks but states that the Federal Reserve will implement the G-SIB surcharge by 2014, with effectiveness phased in from 2016 to 2019. The Proposal also makes clear that the Federal Reserve plans to finalize its implementation of the Basel III capital rules before moving ahead with the G-SIB surcharge.

With respect to Nonbank Covered Companies, the Proposal would, on the one hand, apply the same set of enhanced prudential standards to Nonbank Covered Companies as it would to Large BHCs. On the other hand, the Federal Reserve states that it will "thoroughly assess the business model, capital structure, and risk profile" of a Nonbank Covered Company following its systemic designation by the FSOC to determine how the enhanced prudential standards should apply.

The Proposal also does not, in general, cover foreign banking organizations. The Federal Reserve will develop requirements applicable to foreign banking entities, including any extraterritorial application of Sections 165 and 166 of the Dodd-Frank Act, at a later time. In addition, until July 21, 2015, most sections of the Proposal do not apply to the U.S. BHC subsidiary of a foreign banking organization that is relying on Supervision and Regulation Letter SR 01-01. The sections of the Proposal that apply to a U.S. BHC subsidiary of a foreign banking organization before July 21, 2015 (the date specified by Section 171(b)(4)(E) of the Dodd-Frank Act) are the liquidity requirements, the risk management requirements and the debt-to-equity limits.

The Proposal would not apply to savings and loan holding companies other than with respect to company-run stress testing requirements. As the primary supervisor of SLHCs, the Federal Reserve intends to issue a separate proposal to extend the enhanced standards and early remediation requirements in the Proposal to SLHCs with "substantial banking activities." The Federal Reserve will not impose company-run stress testing, enhanced prudential standards or early remediation requirements on SLHCs until it has established risk-based capital requirements for such entities. The Federal Reserve believes SLHCs with "substantial banking activities" to include any SLHC with total consolidated assets equal to or greater than $50 billion that (1) has savings association subsidiaries which make up 25% or more of its total assets or (2) controls one or more savings associations with total consolidated assets of $50 billion or more.

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Capital and Leverage

- **All Covered Companies**
  - ***General Requirement***. All Covered Companies must comply with, and hold capital commensurate with, the requirements of any regulations adopted by the Federal Reserve relating to capital plans and stress tests, including the Federal Reserve's capital planning final rule (the "**Capital Planning Final Rule**").
- **Minimum 5 Percent Tier 1 Common Risk-Based Capital Ratio**. The Capital Planning Final Rule requires a pro forma Tier 1 Common ratio above 5 percent under expected and stressed conditions.
  - Tier 1 Common = Tier 1 Capital minus non-common equity elements of Tier 1 Capital based on the current bank capital rules.
  - The Tier 1 Common ratio will be replaced by Basel III's Common Equity Tier 1 ratio when Basel III is implemented.
- **Basel III and G-SIB Surcharge**
  - ***Future Proposals***. The Proposal does not include the Basel III capital requirements or the "G-SIB" surcharge developed by the Basel Committee and adopted by the Financial Stability Board in November 2011. But each are intended to be a "key part" of the Federal Reserve's approach to implementing the Section 165-mandated enhanced risk-based capital and leverage standards.
  - ***Basel III***. Based on Governor Daniel K. Tarullo's November 9, 2011 speech, the banking agencies' Basel III rule proposal is expected in the first quarter of 2012.
  - ***G-SIB Surcharge***. The commentary indicates that the Federal Reserve anticipates adopting regulations to implement the G-SIB surcharge in the United States, to Covered Companies "or a subset," in 2014, with the capital surcharge requirements phased-in from 2016 to 2019.
- **Nonbank Covered Companies**
  - ***BHC Capital and Leverage Standards***. In addition to the general requirements above for all Covered Companies, Nonbank Covered Companies must comply with the Federal Reserve's minimum risk-based and leverage capital requirements for BHCs.
  - ***Capital Requirements***. Nonbank Covered Companies must hold capital sufficient to meet:
    - Minimum Tier 1 risk based capital ratio of 4 percent
    - Minimum Total risk-based capital ratio of 8 percent
    - Minimum Tier 1 leverage ratio of 4 percent
  - ***Timing***. A Nonbank Covered Company must comply with:
    - Capital and leverage requirements within 180 days following the date of its designation by the FSOC as a Nonbank Covered Company; and
    - Regulations relating to capital plans and stress tests, including the Capital Planning Final Rule, from September 30 of a calendar year in which it was designated at least 180 days before September 30 of the same calendar year.
  - ***Reporting***. Covered Companies must report their risk-based capital and leverage ratios on a quarterly basis and must notify the Federal Reserve immediately upon ascertaining a failure to meet such requirements.

Liquidity

General Requirements

- **Covered Companies**. The liquidity requirements apply in the same manner to Large BHCs and Nonbank Covered Companies, all of which are Covered Companies for these requirements.
- **Foreign Bank Subsidiaries**. Unlike most provisions of the Proposal, the liquidity requirements apply to U.S. bank holding company subsidiaries of foreign banking organizations currently relying on Supervision and Regulation Letter SR 01-01.
- **General**. The Proposal would impose qualitative requirements on Covered Companies to manage liquidity risk, but does not set quantitative liquidity requirements. Quantitative requirements will be implemented for Covered Companies (or a subset) in a second stage, through one or more proposals derived from or consistent with the Basel III liquidity standards – the Liquidity Coverage Ratio and the Net Stable Funding Ratio.
- **Qualitative Requirements**. The qualitative requirements consist of:
  - corporate governance provisions for the oversight of a Covered Company's liquidity risk management, and
  - qualitative liquidity requirements relating to:
    - cash-flow projections;
    - liquidity stress testing;
    - a liquidity buffer;
    - a Contingency Funding Plan;
    - specific limits on potential sources of liquidity risk;
    - monitoring; and
    - documentation.

Corporate Governance

- **Board of Directors Responsibilities**. Under the Proposal, a Covered Company's board of directors is ultimately responsible for a Covered Company's liquidity risk and must oversee the Covered Company's liquidity risk management processes and review and approve the liquidity risk management strategies, policies and procedures set by the Covered Company's senior management. The board of directors also has the following specific responsibilities:
  - ***Annual Establishment and Review of Risk Tolerance***. The Covered Company's liquidity risk tolerance must be established by the board of directors at least annually based on the Covered Company's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors. The board of directors must review information provided by management semi-annually to ensure compliance with the Covered Company's liquidity risk tolerance.
  - ***Annual Approval of Contingency Funding Plan***. The board of directors must review and approve the Contingency Funding Plan ("**CFP**"), described below, at least annually and whenever the CFP is materially revised.
- **Risk Committee Responsibilities**
  - ***Review of Business Lines and Products***. A Covered Company's risk committee (or a subcommittee thereof) must review for liquidity risk and compliance with the Covered Company's liquidity risk tolerance:

- at least annually, each existing significant business line and product; and
- prior to implementation, each significant new business line and product, both under current conditions and under liquidity stress.

- ***Quarterly Reviews***. A Covered Company's risk committee must also, at least quarterly:
  - review the cash-flow projections, described below, that are for periods of over 30 days;
  - review and approve, as applicable, the liquidity stress testing and results (described below);
  - approve the size and composition of the liquidity buffer (described below);
  - review and approve the specific limits described below and the Covered Company's compliance with the limits; and
  - review liquidity risk management information.
- ***Periodic Review***. A Covered Company's risk committee must periodically review the independent valuation of the liquidity stress tests described below.
- ***Establishment of Management Report Procedures***. The risk committee (or a subcommittee) must establish procedures governing the content of senior management reports relating to liquidity risk.

- **Senior Management Responsibilities**. Senior management is responsible for establishing and implementing strategies, policies, and procedures for managing liquidity risk at the Covered Company.
  - ***Specific Responsibilities***. Responsibilities include overseeing the development and implementation of liquidity risk measurement and reporting systems, cash-flow projections, liquidity stress testing, the liquidity buffer, the CFP, specific limits, and monitoring procedures.
  - ***Upward Reporting***. Senior management must regularly report to the risk committee on the liquidity risk profile of the Covered Company and provide the necessary information to the board (or risk committee) to facilitate its oversight of liquidity risk management.
- **Independent Review**. A Covered Company must establish a review function, independent of the functions that execute funding (e.g., treasury group), that:
  - at least annually, reviews and evaluates the adequacy and effectiveness of the Covered Company's liquidity risk management processes;
  - assesses whether the Covered Company's liquidity risk management complies with applicable legal and regulatory requirements; and
  - reports noncompliance and other material liquidity risk management issues to the board of directors or the risk committee.
- **Cash-Flow Projections**. A Covered Company must produce comprehensive cash-flow projections based on assets, liabilities, and off-balance-sheet exposures over short-term and long-term periods that are appropriate to its capital structure, risk profile, complexity, activities, size, and other risk-related factors.
  - ***Daily Updates***. A Covered Company must update short-term cash-flow projections daily.
  - ***Monthly Updates***. A Covered Company must update long-term cash-flow projections at least monthly.
- **Liquidity Stress Testing**. A Covered Company must conduct stress tests of its cash-flow projections at least monthly, and use the results of the stress tests to determine its liquidity buffer and its CFP.
  - ***Requirements***. Stress tests must comply with the following requirements:

- **Multiple Scenarios**. Liquidity stress testing must incorporate a range of scenarios that may affect the Covered Company's liquidity, based on a Covered Company's balance-sheet exposures, off-balance-sheet exposures, business lines, organizational structure, and other characteristics, and must have separate stress scenarios to address market stress, idiosyncratic stress, and combined market and idiosyncratic stresses.
- **Impact of Other Market Participants**. Tests must address both the potential impact of market disruptions on the Covered Company and the potential actions of other market participants experiencing liquidity stresses under the same market disruptions.
- **Forward-Looking**. Tests must be forward-looking and must incorporate a range of potential changes in a Covered Company's activities, exposures, and risks, as well as changes to the broader economic and financial environment.
- **Multiple Time Horizons**. Tests must include an overnight, 30-day, 90-day, and one-year time horizon.

- ***Stress Test Assumptions***. Tests must be based on the following assumptions:
  - **Highly Liquid Assets**. "Highly liquid assets" include cash, securities issued by the U.S. government, a U.S. government agency or a U.S. government-sponsored entity, and any other asset that the Covered Company "demonstrates to the satisfaction of the Federal Reserve" meets the criteria for high liquidity.
    - ***Criteria include***:
      - low credit and market risk;
      - traded in an active secondary two-way market with observable market prices, committed market makers, a large number of market participants and high trading volume; and
      - type of asset investors have historically purchased in periods of market distress affecting market liquidity.
    - ***Plain Vanilla Corporate Bonds***. The commentary indicates that plain vanilla corporate bonds (that is, bonds that are neither structured products nor subordinated debt) issued by a non-financial company with a strong financial profile could meet the criteria.
  - **First 30 Days of a Stress Scenario**. In the first 30 days of a stress scenario, a Covered Company can only use highly liquid assets that are unencumbered as cash-flow sources to offset projected funding needs.
  - **Stress Scenarios Beyond 30 Days**. Beyond the first 30 days of a stress scenario, a Covered Company can use highly liquid assets that are unencumbered ***and*** other appropriate funding sources as cash-flow sources to offset projected funding needs.
  - **Fair Market Value Adjustments**. If an asset is used as a cash-flow source to offset projected funding needs, the fair market value of the asset must be discounted to reflect any credit risk and market volatility of the asset.

- ***Stress Test Process and Systems Requirements.*** Stress tests must be administered in accordance these requirements:
  - **Policies and Procedures**. A Covered Company must adopt policies and procedures documenting its stress testing practices, methodologies, assumptions and use of each stress test, and providing for periodic revisions to stress testing practices as risks change and techniques evolve.

- **Control and Oversight**. A Covered Company must have an effective system of control and oversight to ensure that each stress test is designed in accordance with the Proposal, and that the stress test process and assumptions are validated by an independent function.
- **Management Information Systems and Data Processes**. A Covered Company must maintain management information systems and data processes sufficient to collect data and other information relating to stress tests.

- ***Liquidity Buffer***. A Covered Company must maintain a liquidity buffer in accordance with these requirements:
  - **Highly Liquid Assets**. The buffer must consist of highly liquid assets (as described above) and must be sufficient to meet projected net cash outflows and the projected loss or impairment of existing funding sources for 30 days over a range of liquidity stress scenarios.
  - **Size of Buffer Based on Stress Testing**. A Covered Company must determine the size of its liquidity buffer based on the liquidity stress tests.
  - **Fair Market Value Adjustments**. Assets included in the liquidity buffer must be discounted to reflect any credit risk and the market volatility of the asset.
  - **Asset Diversification**. Highly liquid assets included in the liquidity buffer must be sufficiently diversified.
- ***Contingency Funding Plan***. A Covered Company must develop a CFP, updated at least annually, to address liquidity needs in stress events. The CFP must meet the following requirements:
  - incorporate quantitative information generated by liquidity stress testing to:
    - identify stress events that have a significant impact on liquidity;
    - assess the level and nature of the liquidity impact that may occur during identified liquidity stress events;
    - assess available funding sources and needs; and
    - identify alternative funding sources that may be used during liquidity stress events.
  - include an event management process that outlines how the Covered Company will respond to and manage liquidity stress events.
  - include procedures for monitoring emerging liquidity stress events based on early warning indicators.
  - A Covered Company must periodically test the operational elements of its CFP.

- **Specific Limits**. A Covered Company must establish and maintain limits on potential sources of liquidity risk, including:
  - concentrations of funding by instrument type, single counterparty, counterparty type, secured and unsecured funding, and other liquidity risk identifiers;
  - the amount of specified liabilities that mature within various time horizons; and
  - off-balance-sheet exposures and other exposures that could create funding needs during liquidity stress events.
  - The size of these limits must reflect the Covered Company's capital structure, risk profile, complexity, activities, size, other appropriate risk-related factors, and established liquidity risk tolerance.

- **Monitoring and Documentation**. A Covered Company must establish and maintain procedures in accordance with the following requirements:
  - ***Collateral Monitoring***. Procedures must permit the Covered Company to:
    - calculate collateral positions in a timely manner, including:
      - the value of assets pledged relative to the amount of security required under the relevant contract; and
      - unencumbered assets available to be pledged;
    - monitor the levels of available collateral by legal entity, jurisdiction, and currency exposure;
    - monitor shifts between intraday, overnight, and term pledging of collateral; and
    - track operational and timing requirements associated with accessing collateral at its physical location.
  - ***Legal Entities, Currencies and Business Line Monitoring***. Procedures must permit the Covered Company to:
    - monitor and control liquidity risk exposures and funding needs within and across significant legal entities, currencies, and business lines; and
    - maintain sufficient liquidity with respect to each significant legal entity in light of legal and regulatory restrictions on the transfer of liquidity between legal entities.
  - ***Intraday liquidity positions***. Procedures must permit the Covered Company to:
    - monitor and measure expected daily gross liquidity inflows and outflows;
    - manage and transfer collateral when necessary to obtain intraday credit;
    - identify and prioritize time-specific obligations so that they can be met as expected;
    - settle less critical obligations as soon as possible;
    - control the issuance of credit to customers where necessary; and
    - consider the amounts of collateral and liquidity needed to meet payment systems obligations when assessing the Covered Company's overall liquidity needs.
  - ***Monitoring of Specific Limits***. A Covered Company must monitor its compliance with the specific limits described above.
  - ***Documentation***. A Covered Company must adequately document all material aspects of its liquidity risk management processes and its compliance with the requirements of the Proposal and submit the documentation to the risk committee.
- **Future Quantitative Standards**. The commentary to the Proposal notes that the Basel Committee has agreed on two liquidity standards, the Liquidity Coverage Ratio ("**LCR**") and the Net Stable Funding Ratio, which will be phased in beginning in 2015 and 2018, respectively. The commentary indicates that the Federal Reserve, in conjunction with other federal banking agencies, intends to adopt liquidity standards derived from or consistent with the Basel III standards.
- **Comparison with the LCR**. Although the Proposal is similar to the LCR in certain respects, particularly its requirement for a Covered Company to hold highly liquid assets sufficient to meet a 30-day liquidity stress scenario, the Proposal differs from the LCR:
  - ***Quantitative Assumptions***. The LCR prescribes quantitative assumptions for calculating the liquidity stress period, including assumptions about deposit run-off rates, funding run-off rates, and the loss of derivatives payables, among others. The Proposal, by contrast, does not provide

similar quantitative assumptions, but instead directs Covered Companies to develop their own assumptions.

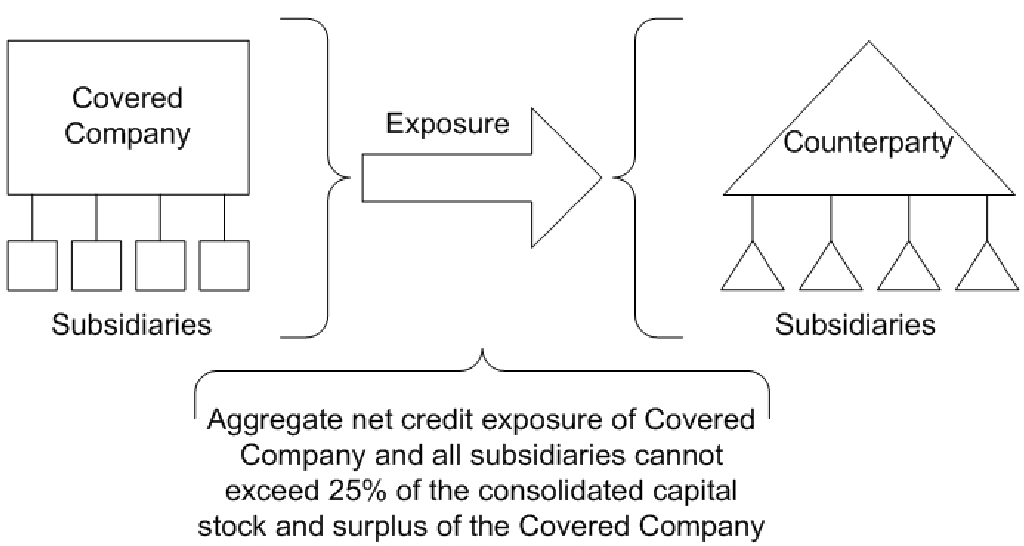
- ***One Level vs. Two Levels of Assets***. The LCR divides the pool of "high-quality liquid assets" (in LCR terminology) into two categories, Level 1 and Level 2 assets, with Level 1 assets being of the highest quality and Level 2 assets being subject to a minimum 15% haircut and an overall 40% cap. The Proposal, by contrast, creates a single class of highly liquid assets with no prescribed haircuts or caps.
- ***Scope of Highly Liquid Assets***. The LCR identifies a range of assets that qualify as either Level 1 or Level 2 assets, including cash; central bank reserves; certain securities of sovereigns, central banks, non-governmental PSEs and multilateral institutions; and certain corporate bonds and covered bonds. The Proposal, by contrast, expressly identifies only cash, securities issued or guaranteed by the U.S. government, a U.S. government agency or a U.S. government-sponsored entity (and, accordingly to the commentary, plain vanilla corporate bonds) as highly liquid assets.
- ***Securities of Non-U.S. Sovereigns, Fannie Mae and Freddie Mac***. Unlike the LCR, the Proposal does not expressly include the securities of non-U.S. sovereigns in its list of highly liquid assets. In addition, the securities of Fannie Mae and Freddie Mac may receive better treatment under the Proposal than under the LCR.

Single-Counterparty Exposure Limits

The Single-Counterparty Exposure Limits cap the exposure that any Covered Company and its subsidiaries (as defined below) may have, on a consolidated basis, to any counterparty and its subsidiaries, with more stringent limits placed on the exposures of the very largest BHCs and all Nonbank Covered Companies to each other.

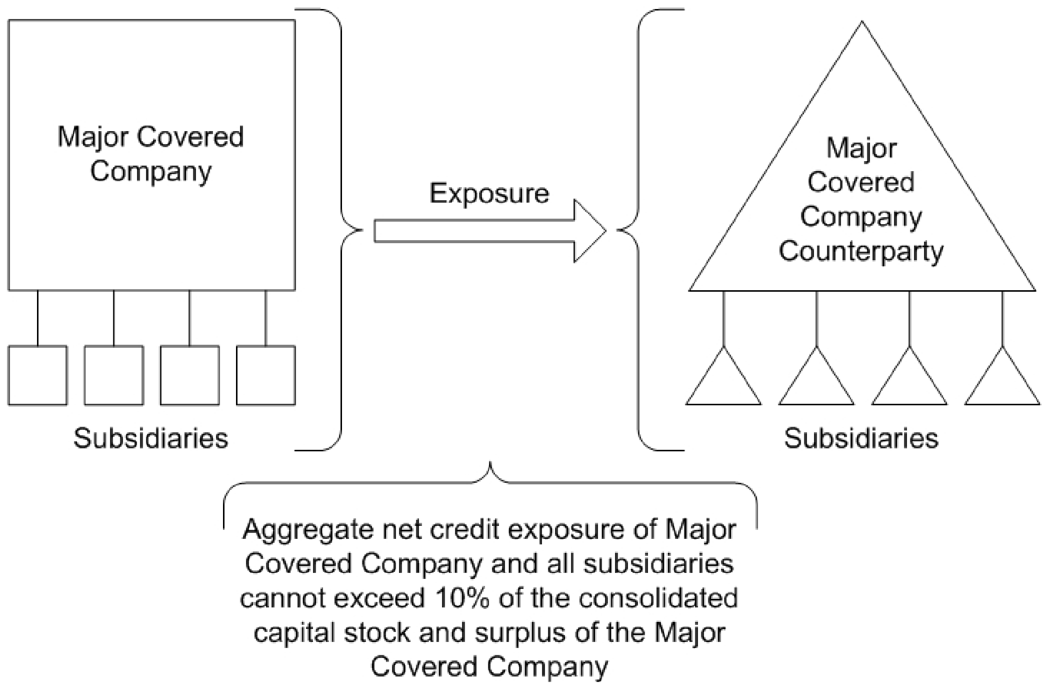
- **General Limit of 25% for Covered Companies**. A Covered Company, together with its subsidiaries, may not have an aggregate net credit exposure to any unaffiliated counterparty, together with its subsidiaries, that exceeds 25% of the Covered Company's consolidated capital stock and surplus.
  - For purposes of this rule, a Covered Company is any Large BHC or Nonbank Covered Company.

General Exposure Limits



- **Limit of 10% For Major Covered Companies**. A Major Covered Company, together with its subsidiaries, may not have an aggregate net credit exposure to any other Major Covered Company, together with its subsidiaries, that exceeds 10% of the first Major Covered Company's consolidated capital stock and surplus.
  - For purposes of this rule, a Major Covered Company is a BHC with $500 billion or more in consolidated assets or ***any*** Nonbank Covered Company.
  - As of December 2011, seven BHCs meet the standard for a Major Covered Company. The FSOC has not yet designated any Nonbank Covered Company.

Major Covered Companies' Exposure Limits



- **Capital Stock and Surplus**. A Covered Company calculates its capital stock and surplus based on its most recent Form FR Y-9C, in the case of BHCs, or based on the regulatory report required by the Federal Reserve, in the case of Nonbank Covered Companies, measuring:
  - the Covered Company's total capital, under the capital adequacy guidelines applicable to the Covered Company; and
  - the balance of the allowance for loan and lease losses of the Covered Company not included in Tier 2 capital in the capital adequacy guidelines applicable to the Covered Company.
- **Compliance Dates**. Covered Companies to which the Proposal applies at its adoption, and companies that become Covered Companies before September 30, 2012, must comply with Single-Counterparty Exposure Limits beginning on October 1, 2013.
  - ***Subsequent Covered Companies***. A company that becomes a Covered Company after the adoption of the Proposal must comply with these requirements beginning on the first day of the fifth quarter following the date on which it became a Covered Company (e.g., if a company becomes a Covered Company on February 1, 2014, it must comply beginning on April 1, 2015).
- **Covered Companies**. A "Covered Company" is any Large BHC or Nonbank Covered Company. A Large BHC ceases to be a Covered Company if its consolidated assets decline to less than $50 billion.

- **Subsidiaries**. The credit exposure limits are determined with reference to the Covered Company and its subsidiaries, on the one hand, and the counterparty and its subsidiaries, on the other hand. If, for example, a Covered Company has 100 subsidiaries and its counterparty has 200 subsidiaries, the aggregate net credit exposure of the Covered Company is based on the aggregate net credit exposure of the Covered Company and all of its 100 subsidiaries to the counterparty and all of its 200 subsidiaries.
- **Different Standards for "Subsidiary"**. The standard for determining a subsidiary is more limited under the Proposal than under the Bank Holding Company Act (the "**BHC Act**") and certain portions of the Federal Reserve's Regulation Y, essentially keeping out the controlling influence and other subjective tests.
  - ***"Subsidiary" Under the Proposal***. Under the Proposal, a company controls another company if the first company:
    - owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company;
    - owns or controls 25 percent or more of the total equity of the company; or
    - consolidates the company for financial reporting purposes.
  - ***Certain Funds and Vehicles Are Not "Subsidiaries" Under the Proposal***. A fund or vehicle that is sponsored or advised by a company would not be considered a subsidiary of the company under the Proposal unless it otherwise meets the ownership or financial reporting control standards. Accordingly, exposures to such funds or vehicles would not be consolidated for the exposure limits.
    - The commentary to the release indicates that the Federal Reserve is considering whether the exclusion of these funds and vehicles (including special purpose vehicles, as discussed below) is appropriate. The release notes that many money market mutual fund sponsors, including banking organizations, supported their money market mutual funds during the crisis in order to enable those funds to meet investor redemption requests without having to sell assets into then-fragile and illiquid markets.
- **Scope of "Counterparties."** The Proposal defines "counterparty" to include:
  - for a natural person, the person and members of the person's immediate family;
  - for a company, the company and all of its subsidiaries, collectively;
  - for the United States, the United States and all of its agencies and instrumentalities (excluding States and political subdivisions of States), collectively;
  - for a State, the State and all of its agencies, instrumentalities and political subdivisions (including any municipalities), collectively; and
  - for a foreign sovereign entity, the foreign sovereign entity and all of its agencies, instrumentalities and political subdivisions, collectively.
  - ***Note on Counterparty Exemptions***. As described below, credit exposures to the U.S. government are exempted from the limits, but not credit exposures to States or foreign sovereigns.
- **Special Purpose Vehicles**. The Proposal's commentary states that, in the context of collateralized debt obligations or other obligations issued by a special purpose vehicle, the failure to look through the special purpose vehicle to the sponsor or to the issuer of the underlying securities may improperly mask a Covered Company's exposures. The Proposal further states that, under the Federal Reserve's reservation of authority, it may look through special purpose vehicles to either the sponsor

or the underlying issuer, or may set a concentration test to determine whether to look through special purpose vehicles.

- **Credit Transactions**. The Proposal limits a Covered Company's aggregate net credit exposures to counterparties and defines credit exposures as "credit transactions" with counterparties, which include:
  - any extension of credit to the counterparty, including loans, deposits, and lines of credit, but excluding advised or other uncommitted lines of credit;
  - any repurchase or reverse repurchase agreement with the counterparty;
  - any securities lending or securities borrowing transaction with the counterparty;
  - any guarantee, acceptance or letter of credit (including any confirmed letter of credit or standby letter of credit) issued on behalf of the counterparty;
  - any purchase of, or investment in, securities issued by the counterparty;
  - any credit exposure to the counterparty in connection with a derivative transaction between the Covered Company and the counterparty;
  - any credit exposure to the counterparty in connection with a credit derivative or equity derivative transaction between the Covered Company and a third party, the reference asset of which is an obligation or equity security of the counterparty; and
  - any transaction that is the functional equivalent of the above, and any similar transaction that the Federal Reserve determines to be a credit transaction for purposes of this subpart.
- **Calculation of Net Credit Exposure**. A Covered Company calculates its net credit exposures, together with those of its subsidiaries, from credit transactions to a counterparty and its subsidiaries through different formulae tied to the type of credit exposure. For the most part, a Covered Company first calculates its gross credit exposure and applies adjustments to determine its net credit exposure. The table below summarizes the basic approach to calculating the net credit exposures of different categories of exposures. Certain details have been omitted in the interest of presentation.

Net Credit Exposure Calculations	
Type of Exposure	**Net Credit Exposure**
Repurchase and reverse repurchase transactions subject to a bilateral netting agreement	▪ Net credit exposure associated with the netting agreement
Securities lending and borrowing transactions subject to a bilateral netting agreement	▪ Net credit exposure associated with the netting agreement

Net Credit Exposure Calculations	
Type of Exposure	**Net Credit Exposure**

Credit transactions (including securities financing transactions as well as derivatives transactions)	▪ Gross credit exposure (or, in the case of securities financing transactions, the net credit exposure determined as above), ***minus***
	▪ adjusted market value of any eligible collateral, ***provided that***
	  ▪ adjusted market value of the eligible collateral is included in exposure to issuer,
	  ▪ the eligible collateral is not used to reduce any other counterparty exposures, ***and***
	  ▪ the exposure to the issuer of the collateral does not exceed the exposure to the credit counterparty.
	Note: The gross credit exposure to the issuer of the eligible collateral cannot exceed the gross credit exposure to the counterparty in the credit transaction.

Unused portion of certain extensions of credit	▪ For a letter of credit, the unused portion, to the extent that the Covered Company does not have any legal obligation to advance additional funds, until the counterparty provides the amount of adjusted market value of qualifying collateral required with respect to the entire used portion
Eligible guarantees	▪ Gross credit exposures in a credit transaction may be reduced by any amount of any eligible guarantees from an eligible protection provider, ***provided that*** ▪ the guarantees are included in the gross credit exposure to the eligible protection provider, ***and*** ▪ the exposure to the eligible protection provider does not exceed the exposure to the credit counterparty.
Eligible credit and equity derivatives	▪ Gross credit exposures in a credit transaction may be reduced by the notional amount of any eligible credit or equity derivative from an eligible protection provider that references the counterparty, ***provided that*** ▪ the face amount of the eligible credit and equity derivative is included in the gross credit exposure to the eligible protection provider, ***and*** ▪ the exposure to the eligible protection provider does not exceed the exposure to the credit counterparty.
Other eligible hedges	▪ Gross credit exposure in a credit transaction may be reduced by the face amount of a short sale of the counterparty's debt or equity security.

- **Eligible Collateral.** Eligible Collateral, as used in the calculation of net credit exposure, means collateral in which the Covered Company has a perfected, first-priority security interest (or, outside of the United States, the legal equivalent thereof), with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent, and is in the form of:
  - cash on deposit with the Covered Company (including cash held for the Covered Company by a third-party custodian or trustee);

- debt securities (other than mortgage- or asset-backed securities) that are bank-eligible investments;
- equity securities that are publicly traded; and
- convertible bonds that are publicly traded.

- **Haircuts**. Haircuts are applied to eligible collateral in accordance with applicable rules for sovereign entities, corporate and municipal bonds that are bank-eligible investments and other eligible collateral.
  - The haircut amounts have been omitted from this summary in the interest of presentation, but may be found on pages 146-47 of the Federal Reserve's December 20, 2011 release.
- **Calculation of Gross Credit Exposure**. A Covered Company calculates its gross credit exposures, together with those of its subsidiaries, to a counterparty and its subsidiaries through different formulae tied to the type of exposure. The table below summarizes the basic approach to calculating the gross credit exposures of different categories or exposures.

Gross Credit Exposure Calculations	
Type of Exposure	**Gross Credit Exposure**
Loans to a counterparty	▪ The amount owed by the counterparty to the Covered Company under the transaction.
Debt securities issued by the counterparty	▪ The greater of the amortized purchase price or market value, for trading and available for sale securities, and ▪ The amortized purchase price, for securities held to maturity.
Equity securities issued by counterparty	▪ The greater of the purchase price or market value.
Repurchase agreements	▪ The market value of securities transferred by the Covered Company to the counterparty; ***plus*** ▪ The amount directly above multiplied by the applicable collateral haircut to the securities transferred by the Covered Company to the counterparty.
Reverse repurchase agreements	▪ The amount of cash transferred by the Covered Company to the counterparty.
Securities borrowing transactions	▪ The amount of cash collateral plus the market value of securities collateral transferred by the Covered Company to the counterparty.
Securities lending transactions	▪ The market value of securities lent by the Covered Company to the counterparty; ***multiplied by*** ▪ The haircut applicable to the securities lent by the Covered Company to the counterparty.
Committed credit lines to a counterparty	▪ The face amount of the credit line.

Gross Credit Exposure Calculations	
Type of Exposure	**Gross Credit Exposure**
Guarantees and letters of credit on behalf of a counterparty	▪ The lesser of the face amount or the maximum potential loss to the Covered Company on the transaction.
Derivatives transactions between Covered Company and counterparty (not subject to qualifying master netting agreement)	▪ The sum of: ▪ the current exposure of the derivatives contract equal to the greater of the mark-to-market value of the derivatives contract or zero; ***and*** ▪ the potential future exposure of the derivatives contract, calculated by multiplying the notional principal amount of the derivatives contract by the appropriate conversion factor.[2]
Derivatives transactions between the Covered Company and the counterparty (subject to a qualifying master netting agreement)	▪ The exposure at default amount calculated under 12 CFR part 225, Appendix G, § 32(c)(6).
Credit or equity derivatives transactions between the Covered Company and a third party	▪ The lesser of the face amount of the transaction or the maximum potential loss to the Covered Company on the transaction.

- **Qualifying Master Netting Agreement**. For purposes of the above rules, a "qualifying master netting agreement" means a legally enforceable bilateral agreement such that:
  - the agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including bankruptcy, insolvency, or similar proceeding of the counterparty;
  - the agreement provides the Covered Company the right to accelerate, terminate and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon event of bankruptcy, insolvency or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdiction;
  - the Covered Company has conducted sufficient legal review to conclude with a well-founded basis (and has maintained sufficient written documentation of that legal review) that the agreement meeting the requirements of the above paragraph and that in the event of a legal challenge (including one resulting from default or from bankruptcy, insolvency or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding and enforceable under the law of the relevant jurisdiction;
  - the Covered Company establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and
  - the agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the

[2] Conversion factors have not been reproduced in these bullets but may be found on page 143 of the Federal Reserve's December 20, 2011 release.

agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter is a net creditor under the agreement).

- "**Bilateral Netting Agreement**" is not defined in the Proposal.

- **Daily Compliance**. Covered Companies must comply with these requirements on a daily basis, measured at the end of each business day, and submit monthly compliance reports.

- **Consequences of Noncompliance**. In the event of noncompliance, a Covered Company will receive a 90-day grace period (or such other period determined by the Federal Reserve) to come into compliance if it uses its reasonable efforts to return to compliance.
  - ***No New Credit Transactions***. During the 90-day grace period, a Covered Company cannot engage in any additional credit transactions with the counterparty, ***unless*** the Federal Reserve determines such transactions would be necessary or appropriate.
  - ***Criteria for New Transaction Waivers***. In considering a request to waive the additional transactions prohibition during the 90-day grace period, the Federal Reserve will consider:
    - a decrease in the Covered Company's capital stock and surplus;
    - the merger of the Covered Company with another Covered Company;
    - a merger of two unaffiliated counterparties; or
    - any other circumstance the Federal Reserve determines is appropriate.

- **Exemptions**. The following categories of credit exposures are exempt from the Single-Counterparty Exposure Limits:
  - direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, the United States and its agencies;
  - direct claims on, and the portions of claims that are directly and fully guaranteed as to principal and interest by, Fannie Mae and Freddie Mac, only while operating under the conservatorship or receivership of the Federal Housing Financial Agency, and any additional obligations issued by a U.S. government sponsored entity as determined by the Federal Reserve;
  - intraday credit exposure to a counterparty; and
  - any transaction that the Federal Reserve exempts if the Federal Reserve finds that such exemption is in the public interest and is consistent with the purpose of this subsection.

- **Not Exempted**. Credit exposures to the U.S. government are exempted from the limits, but not credit exposures to States or foreign sovereigns. This is consistent with the definition of "highly liquid assets" in the liquidity section, which does not automatically include any securities issued by non-U.S. sovereigns or States.

Risk Management and Risk Committee Requirements

The Proposal would require each Covered Company and publicly-traded Medium BHC to establish a risk committee of the board of directors to document and oversee, on an enterprise-wide basis, the risk management practices of the company's worldwide operations. The Proposal would impose more stringent risk management and risk committee requirements on Covered Companies than on Medium BHCs.

- **Coverage of Rule**. Each Covered Company and publicly-traded Medium BHC is required to establish a risk committee of the board of directors. Medium BHCs that are ***not*** publicly traded are not subject to the risk committee requirements.

- Section 165(h) of the Dodd-Frank Act states that the Federal Reserve must require each ***publicly-traded*** Nonbank Covered Company and each ***publicly-traded*** BHC to establish a risk committee. The Proposal is broader and covers all Nonbank Covered Companies and BHCs, whether or not publicly traded.

- **General Requirements**
  - Each Covered Company and publicly traded Medium BHC must establish a risk committee of the board of directors to document and oversee, on an enterprise-wide basis, the risk management practices of the company's worldwide operations.
  - In addition, a Covered Company is required to employ a chief risk officer who reports directly to the risk committee and the chief executive officer of the company, and who has sufficient expertise and stature to provide the company with an object assessment of the risks taken by the company.
  - The risk committee of a Covered Company must report directly to the Covered Company's board of directors and receive and review regular reports from the Covered Company's chief risk officer.

- **Risk Committee Structure**. A risk committee must:
  - ***Charter***. Have a written charter approved by the company's board of directors;
  - ***Risk Management Expertise***. Have at least one member with risk management expertise written formal that is commensurate with the company's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors; and
  - ***Independent Director***. Be chaired by an "independent director," defined to mean:
    - For publicly traded companies, a member of the board of such company who: (1) is not an officer or employee of the company and has not been an officer or employee of the company during the previous three years; and (2) is not a member of the immediate family (as defined in the Federal Reserve's Regulation Y) of a person who is, or has been within the last three years, an executive officer of the company (as defined in the Federal Reserve's Regulation O); and (3) is an independent director under Item 407 of Regulation S-K of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**").
    - For non-publicly traded companies, a member of the board of such company who meets the requirements in subparagraphs (1) and (2) immediately above, and whom the company demonstrates to the satisfaction of the Federal Reserve as someone who would qualify as an independent director under the listing standards of a national securities exchange if the company were publicly traded on a national securities exchange (these listing standards generally include limitations on compensation paid to the director or directors family member by the company and prohibitions on material business relationships between the director and the company).
    - In the commentary, the Federal Reserve states that for independent directors of nonpublicly traded companies, it will make independence determinations on a case-by-case basis, and in addition to the criteria specified in the rules, will analyze other indicia of independence, including compensation limitations and business relationship prohibitions.
    - The Federal Reserve requests comments on whether it would be appropriate to require the membership of a risk committee to include more than one independent director and, if so, under what circumstances.
  - ***Meet with Regularity and Keep Records***. Meet with appropriate frequency and maintain records of proceedings and decisions.

- **Responsibilities of Risk Committee**: The risk committee must oversee the operation of, on an enterprise-wide basis, an appropriate risk management framework commensurate with the company's capital structure, risk profile, complexity, activities, size and other appropriate risk-related factors.
  - ***Risk Management Framework***. A company's risk management framework must include:
    - risk limitations appropriate to each business line of the company;
    - appropriate policies and procedures relating to risk management governance, risk management practices, and risk control infrastructure for the enterprise as a whole;
    - processes and systems for identifying and reporting risks and risk management deficiencies, including emerging risks, on an enterprise-wide basis;
    - monitoring of compliance with the company's risk limit structure and policies and procedures relating to risk management governance, practices, and risk controls across the enterprise;
    - effective and timely implementation of corrective actions to address risk management deficiencies;
    - specification of management's and employees' authority and independence to carry out risk management responsibilities; and
    - integration of risk management and control objectives in management goals and the company's compensation structure.
- **Enhanced Risk Management Standards for Covered Companies**. The following additional requirements apply to Covered Companies:
  - ***The Risk Committees of Covered Companies*** must:
    - be a stand-alone committee that is not housed within another committee or part of a joint committee;
    - report directly to the Covered Company's board of directors; and
    - receive and review regular reports from the Covered Company's chief risk officer.
  - ***Chief Risk Officer***. A Covered Company must employ a chief risk officer who:
    - has risk management expertise that is commensurate with the company's capital structure, risk profile, complexity, activities, size, and other risk-related factors that are appropriate;
    - is appropriately compensated and incentivized to provide an objective assessment of the risks taken by the company;
    - reports directly to both the risk committee and chief executive officer of the company; and
    - directly oversees the following responsibilities on an enterprise-wide basis:
      - allocating delegated risk limits and monitoring compliance with such limits;
      - implementation and ongoing compliance with, appropriate policies and procedures relating to risk management governance, practices, and risk controls and monitoring compliance with such policies and procedures;
      - developing appropriate processes and systems for identifying and reporting risks and risk-management deficiencies, including emerging risks, on an enterprise-wide basis;
      - managing risk exposures and risk controls within the parameters of the company's risk control framework; and
      - monitoring and testing of the company's risk controls;

- reporting risk management deficiencies and emerging risks to the enterprise-wide risk committee; and
- ensuring that risk management deficiencies are effectively resolved in a timely manner.

Stress Tests

- **Supervisory Stress Test**. The Federal Reserve proposes to conduct annual supervisory stress tests of Covered Companies using three economic and financial market scenarios. The tests build upon the Federal Reserve's earlier stress-testing efforts, including SCAP and CCAR, and are intended as a way of assessing a Covered Company's capital adequacy.
- **Company-Run Stress Tests**. Each year, Covered Companies must conduct both an annual company-run stress test ***and*** an additional company-run stress test. Medium Depository Institutions are only required to conduct an annual company-run stress test
  - The thresholds for Medium Depository Institutions are determined based on the average of total consolidated assets reported on their four most recent quarterly regulatory reports.
- **General Approach**. Similar to the capital analyses required under the Federal Reserve's CCAR, the supervisory and company-run stress tests in the Proposal would generally involve making forward-looking estimates of projected revenues, losses, reserves and pro forma capital levels under ***each*** stress scenario for ***each*** quarter over a planning horizon of at least nine quarters.
- **Publication of Results**. The Federal Reserve proposes to make public a summary of the supervisory stress test results, including company-specific information. In addition, companies must publish a summary of their company-run stress test results. The Federal Reserve has separately stated that it intends to make firm-specific disclosures as part of the Capital Planning Final Rule process. It is unclear whether the level of public disclosure under the Proposal exceeds that contemplated by the Federal Reserve for the Capital Planning Final Rule.
- **Confidentiality**. The confidentiality of data and other information submitted to the Federal Reserve will be determined in accordance with FOIA and the Federal Reserve's general rules regarding availability of information.
- **Close Relationship to Capital Planning**. The Federal Reserve expects that a Covered Company will integrate into its capital plan, as one part of the underlying analysis, the results of its company-run stress tests. Moreover, the results of both the supervisory and company-run stress tests will be used by the Federal Reserve in evaluating a Covered Company's capital plan.

Annual Supervisory Stress Tests

- **General approach to stress testing**
  - ***Stress Scenarios***. At least three scenarios (baseline, adverse and severely adverse) will be published by the Federal Reserve before each annual stress test. Scenarios consist of future paths of economic and financial variables over the planning horizon, e.g. real GDP, unemployment, equity and property prices. Note that under the Capital Planning Final Rule, Large BHC capital plans must assume four scenarios: firm-defined baseline, supervisory baseline, firm-defined stressed scenario and supervisory stress scenario.
  - ***Methodology for Estimating Losses and Revenues***. The Federal Reserve notes that the supervisory stress tests under the Proposal build on its earlier stress-testing efforts under its SCAP and CCAR. The Federal Reserve will ***separately*** publish an overview of its methodology for the supervisory stress tests and has stated that it will generally include models to estimate

losses on certain assets (e.g., loans and trading book assets) and models to estimate how a Covered Company's balance-sheet changes over time.

- ***Data Collection***. The Federal Reserve will require each Covered Company to submit consolidated data and any other information that it determines are necessary for it to perform the stress test. The Federal Reserve will issue a ***separate*** information collection proposal.

- **Post-Stress Test Actions**
  - ***Update Living Will***. A Covered Company must make updates to its resolution plan as the Federal Reserve determines appropriate, based on the stress test results, ***within 90 days*** of the Federal Reserve publishing the summary results.
  - ***Other Actions***. A Covered Company must take stress test results into account in making changes, as appropriate, to its capital structure; its exposures, concentrations, and risk positions; any plans of the Covered Company for recovery; and for improving overall risk management.
  - Stress test results may also trigger early remediation requirements (described below).
- **Publication of Company-Specific Results**
  - The Federal Reserve proposes to publish a high-level summary of the supervisory stress test results for ***each*** Covered Company, including:
    - estimated losses, including overall losses on loans by subportfolio, available-for-sale and held-to-maturity securities, trading portfolios and counterparty exposures;
    - estimated pre-provision net revenue;
    - estimated allowance for loan losses; and
    - estimated pro forma regulatory and other capital ratios.
  - Prior to publication, the Federal Reserve will inform each company of its results and explain the information that it expects to make public.
  - In connection with the Capital Planning Final Rule, the Federal Reserve has stated that it intends to "disclose its estimates of revenues and losses, as well as pro forma, post stress capital ratios for each of the 19 [largest] BHCs." The Federal Reserve did not disclose individual results of its 2011 supervisory stress tests but released firm-specific results after the SCAP stress tests in 2009.
- **Steps and Timeline for Supervisory Stress Tests**
  - Proposed steps in the annual supervisory stress test cycle and general timeframes for each step are summarized in the following table:

Process Overview of Annual Supervisory Stress Testing Cycle **(using data collected as of September 30, except for trading and counterparty data, for a planning horizon of at least nine calendar quarters)**	
Step	**Proposed Timeframe**
1. Federal Reserve publishes scenarios for upcoming annual cycle	No later than mid-November
2. Covered Companies submit regulatory reports and any other required information	By mid-November
3. Federal Reserve completes supervisory stress tests and compiles results	By mid-February

Process Overview of Annual Supervisory Stress Testing Cycle (using data collected as of September 30, except for trading and counterparty data, for a planning horizon of at least nine calendar quarters)	
Step	**Proposed Timeframe**
4. Federal Reserve communicates individual company results to Covered Companies	By early March
5. Federal Reserve publishes a summary of the supervisory stress test results	By early April

- **Effective Date / Phase-In**
  - Any company that is Covered Company on the effective date of the Proposal must comply immediately.
  - Any BHC that becomes a Covered Company no less than 90 days before September 30 of a calendar year must comply from September 30 of that year onwards.
  - Any nonbank financial company that becomes a Covered Company no less than 180 days before September 30 of a calendar year must comply from September 30 of that year onwards.

Company-Run Stress Tests

- **Scope of Application and Frequency**
  - A Covered Company must conduct both (1) an annual stress test and (2) an additional stress test.
  - Medium Depository Institutions are only required to conduct an annual stress test.
  - To minimize any undue burden associated with multiple entities within one parent structure having to meet the Proposal's requirements, the Federal Reserve will coordinate with other bank regulators.
- **Methodology**. Similar to the capital analyses required under CCAR, a company must calculate, as part of its annual or additional company-run stress tests, how each of the following are impacted during each quarter of the stress test planning horizon (at least nine quarters), for each stress scenario:
  - potential losses, pre-provision net revenues, allowance for loan losses, and future pro forma capital positions over the planning horizon; and
  - capital levels and capital ratios, including regulatory and any other capital ratios specified by the Federal Reserve.
- **Stress Scenarios**
  - ***Annual Stress Test***. Federal Reserve expects to provide companies with the same scenarios it will use to conduct the supervisory stress tests.
  - ***Additional Stress Test***. A Covered Company is required to develop and employ its ***own scenarios*** reflecting a minimum of three scenarios – baseline, adverse, and severely adverse.
- **Policies, Procedures and Oversight**
  - Companies must establish a system of controls, oversight and documentation (including policies and procedures) to ensure stress testing processes are effective in complying with the rules. These must be approved and annually reviewed by board and senior management.

  - Policies and procedures must describe stress testing practices and methodologies, validation and use of stress tests results and processes for updating a company's stress testing practices.
  - Each Covered Company must describe in its policies processes for scenario development for the additional stress test.
- **Reporting Results to the Federal Reserve**. Each company must report results and additional information about the stress tests to the Federal Reserve. The Federal Reserve will publish a ***separate*** information collection proposal.
- **Review of Test Results and Post-Stress Test Actions**
  - The Federal Reserve intends to provide feedback to each company regarding its review of the company's stress test processes and results.
  - A company must take into account the Federal Reserve's analysis of its company-run stress test results in developing and updating its capital plan ***and*** in making changes, as appropriate, to its capital structure (including the level and composition of capital); its exposures, concentrations, and risk positions; any plans for recovery and resolution; and to improve overall risk management.
- **Publication of Results by a Company**
  - A company must publish, on its website or in any other forum reasonably accessible to the public, a summary of its company-run stress test results within ***90 days*** of submitting its required report to the Federal Reserve. The summary must include the following:
    - description of types of risks included in stress test;
    - for each Covered Company, high-level description of scenarios developed by the company for its additional stress test;
    - general description of methodologies employed to estimate losses, revenues, allowance for loan losses, and changes in capital positions over the planning horizon; and
    - aggregate losses, pre-provision net revenue, allowance for loan losses, net income, and pro forma capital levels and capital ratios over the planning horizon under each scenario.
  - Multiple entities within the same organization may publish summaries of their results on the parent company's website or in another form along with the parent company's summary.
- **Steps and Timeline for Company-Run Stress Tests**
  - Proposed steps in the annual and additional company-run stress tests cycle and general timeframes for each step are summarized in the following table:

Process Overview of Annual and Additional Company-Run Stress Test Cycles **(with Annual Test using data as of September 30 and Additional Test using data as of March 31)**	
Step	**Proposed Timeframe**
Annual Company-Run Stress Test Cycle for All Covered Companies and Over $10 Billion Companies	
1. Federal Reserve publishes scenarios for upcoming annual cycle	No later than mid-November
2. Covered Companies submit regulatory reports and any other required information	By January 5
3. Federal Reserve completes supervisory stress tests and compiles results	By early April

Process Overview of Annual and Additional Company-Run Stress Test Cycles (with Annual Test using data as of September 30 and Additional Test using data as of March 31)	
Step	**Proposed Timeframe**
Annual Company-Run Stress Test Cycle for All Covered Companies and Over $10 Billion Companies	
Additional Company-Run Stress Test Cycle for Covered Companies	
4. Federal Reserve communicates individual company results to Covered Companies	By July 5
5. Federal Reserve publishes a summary of the supervisory stress test results	By early October

- **Effective Date / Phase-In**
  - A company must comply as of the effective date if, as of the effective date, it is a either a Large BHC or a Medium Depository Institution.
    - However, an SLHC that has more than $10 billion in consolidated assets is not subject to company-run stress testing requirements until SLHCs become subject to minimum risk-based capital and leverage requirements.
  - For a nonbank company that becomes a Covered Company no less than 180 days before March 31 or September 30 of a calendar year, the nonbank company must comply beginning on March 31 or September 30, as applicable.
  - For a BHC that becomes a Covered Company no less than 90 days before March 31 or September 30 of a calendar year, the BHC must comply beginning on March 31 or September 30, as applicable.
  - For a company that becomes a Medium Depository Institution no less than 90 days before September 30 of a calendar year, the company must comply beginning on September 30, subject to the limitation on SLHC compliance noted above.

Relationship between Stress Tests and Capital Plans

- The supervisory and company-run stress tests are important aspects of a company's forward-looking capital planning process.
- The close relationship between stress testing and capital planning is evident in the Federal Reserve's proposed process overview chart:

Process Overview of Annual Supervisory Stress Test and Capital Plan Cycle		
Supervisory Stress Test Steps	**Capital Plan Steps**	**Proposed Timeframe**
Regulatory reports submitted (using data as of Sept. 30 and other required information)		By mid-November
	Capital plan submitted (including individual results of company-run stress tests)	By January 5
Federal Reserve communicates results to each Covered Company		By early March

Process Overview of Annual Supervisory Stress Test and Capital Plan Cycle		
Supervisory Stress Test Steps	**Capital Plan Steps**	**Proposed Timeframe**
	Federal Reserve response to capital plan	By March 31
Federal Reserve publishes summary results of the supervisory stress test		By mid-April

Debt-to-Equity Limits for Covered Companies After "Grave Threat" Determinations by FSOC

- Upon a determination by the FSOC that a Covered Company poses a grave threat to U.S. financial stability and that the imposition of a debt-to-equity ratio is necessary to mitigate this threat, the Covered Company must maintain a debt-to-equity ratio of ***no more than 15-to-1***.
- **Definitions**. "Debt" and "equity" have the same meaning as "total liabilities" and "total equity capital" respectively, as calculated in a company's reports of financial condition. The 15-to-1 debt-to-equity ratio would be calculated as the ratio of total liabilities to total equity capital minus goodwill.
- **Compliance Period**. After receiving notice from the Federal Reserve that the FSOC has made a "grave threat" determination against it, a company would have 180 calendar days to comply with the 15-to-1 debt-to-equity ratio requirement.
- **Extension of Time**. A company may request an extension of time to comply with the debt-to-equity ratio requirement for up to two additional periods of 90 days each.
- **Lifting of Debt-to-Equity Ratio Requirement**. The FSOC may lift the debt-to-equity ratio requirement if it determines that the company no longer poses a grave threat to U.S. financial stability and the imposition of the requirement is no longer necessary.
- **Foreign Banking Entities**. Unlike most provisions of the Proposal, the debt-to-equity ratio limits can apply to U.S. bank holding company subsidiaries of foreign banking organizations currently relying on Supervision and Regulation Letter SR 01-01.

Early Remediation Requirements

Remediation Categories

- A Covered Company would be subject to an increasingly stringent set of early remediation requirements as its financial condition deteriorates. The four levels of remediation review are:
  - ***Level 1: Heightened Supervisory Review***. Occurs when there are signs of financial distress or material risk management weaknesses such that further decline of the company is probable. Level 1 remediation would require the Federal Reserve to produce a report on the elements evidencing deterioration within 30 days and determine whether the institution should be elevated to a higher level of remediation.
  - ***Level 2: Initial Remediation***. Will result in restrictions on capital distributions, acquisitions and asset growth. The Proposal would require Covered Companies that are subject to Level 2 remediation to enter into a non-public memorandum of understanding with the Federal Reserve to establish an action plan for improving its financial condition.

- ***Level 3: Recovery***. Will result in a prohibition on growth and capital distributions, requirements to raise additional capital and limits on executive compensation, and may result in management changes and additional requirements on a case-by-case basis. The Proposal would require Covered Companies that are subject to Level 3 remediation to enter into a written agreement or other form of formal enforcement action with the Board that would specify that it must raise capital and take other actions to improve capital adequacy. A Covered Company that triggers Level 3 remediation would, among other things, be prohibited from:
    - making any capital distributions;
    - increasing the compensation of, or paying any bonus to, its senior executive officers or directors;
    - permitting its average total assets or average total risk-weighted assets during any calendar quarter to exceed average total assets or average total risk-weighted assets during the previous quarter; or
    - directly or indirectly acquiring any interest in any company, establishing or acquiring any office or other place of business or engaging in any new line of business.

  The Federal Reserve could also require a Covered Company under Level 3 remediation to conduct new elections for its board of directors, dismiss directors or senior executive officers that have been in office for more than 180 days, hire senior executive officers approved by the Federal Reserve, or limit transactions with its affiliates.

- ***Level 4: Resolution Assessment***. The Federal Reserve will consider whether to recommend to make a written recommendation that the Covered Company be placed into resolution under Title II of the Dodd-Frank Act. Such recommendation would be one of the "three keys" required to invoke the orderly liquidation authority—the FDIC and Treasury would also have to agree. There is no reference to resolution under the Bankruptcy Code.

- **Annex A** provides additional information about the remediation actions required at each level.

Triggering Events

- Various triggering events determine whether a Covered Company falls into one of the four remediation categories. **Annex B** provides additional information about the triggering events for each of the remediation categories.
    - ***Types of Triggering Events***. The Proposal specifies triggering events related to:
        - **Capital and Leverage**
            - The release indicates that revisions may be made to the Proposal's regulatory capital triggers in the future to conform to Basel III implementation (or any revised capital standards).
        - **Stress Tests**
            - The Proposal would use the results of the stress test under the severely adverse scenario to trigger early remediation. The lower the regulatory capital ratios under the stress test, the more stringent the required remedial actions would be.
        - **Risk Management**
            - Risk management triggering events occur if the Covered Company manifests signs of weakness, multiple deficiencies or substantial non-compliance with the enhanced risk management and risk committee requirements.
            - The terms "signs of weakness" and "substantial non-compliance" are not defined.

- **Liquidity**
  - Like the risk management triggers, liquidity triggering events occur based on signs of weakness, multiple deficiencies or substantial non-compliance with the liquidity requirements of the Proposal, and those terms are not defined.
  - The release indicates that the Federal Reserve considered an explicit quantitative liquidity trigger but was concerned that such a trigger could exacerbate funding pressures at affected Covered Companies.
- **Market Indicators**
  - The Federal Reserve is not using an explicit quantitative liquidity trigger, or nonperforming loans and loan concentrations balance sheet measures as triggers.
  - The Federal Reserve is not proposing to use market-based triggers to subject companies to early remediation levels 2, 3, or 4. The release notes that this is because the Federal Reserve was concerned that if market indicators are used to trigger corrective actions in a regulatory framework, market prices may adjust to reflect this use and potentially become less revealing over time. The Proposal indicates that the Federal Reserve will reassess this issue in the future.
  - The Federal Reserve will publish for notice and comment the market-based triggers and thresholds on an annual basis (or less frequently if the Federal Reserve determines that changes to the regime are appropriate) rather than specify them in the Proposal.
  - The Federal Reserve seeks comment on the market-based indicators in the proposed regime for both equity-based and debt-based indicators.
    - ***Equity-Based Indicators***
      - **Expected Default Frequency**. Measures the expected probability of default in the next 365 days.
      - **Marginal Expected Shortfall**. The expected loss on the company's equity when the overall market declines by more than a certain amount.
      - **Market Equity Ratio**. The ratio of market value of equity to market value of equity plus book value of debt.
      - **Option-implied Volatility**. The option-implied volatility of a firm's stock price is calculated from out-of-the-money option prices using a standard option pricing model, reported as an annualized standard deviation in percentage points by Bloomberg.
    - ***Debt-Based Indicators***
      - **Credit Default Swaps**. The Federal Reserve uses credit default swaps offering protection against default on a 5-year maturity, senior unsecured bond by a financial institution.
      - **Subordinated Debt (Bond) Spreads**. The Federal Reserve uses financial companies' subordinated bond spreads with a remaining maturity of at least 5 years over the Treasury rate with the same maturity or the LIBOR swap rate published by Bloomberg.
  - The Federal Reserve seeks comment on whether the triggers should be time-variant or time-invariant.
    - ***Time-Variant Triggers***

    - To be used on all six market indicators above.
    - Capture changes in the value of a company's market-based indicator relative to its own past performance and the past performance of its peers (using a rolling 5-year window).
    - Peer groups would be determined on an annual basis.
    - Heightened supervisory review would be required if at least one market indicator's median value is above the 95th percentile of the firm's or median peer's market indicator 5-year rolling window time series.
      - Measured at 22 consecutive days, either at its level, 1-month change, or 3-month change, both absolute and relative to the median of a group of predetermined low-risk peers.
  - ***Time-Invariant Triggers***
    - Capture changes in the value of a company's market-based indicators relative to the historical distribution of market-based variables over a specific fixed period of time and across a predetermined peer group.
    - To be used on all market indicators except Market Equity Ratio.
    - Would trigger heightened supervisory review if the median value for the company over 22 consecutive business days was above the threshold for any of the market indicators.
    - Proposed calibrated thresholds are:
      - credit default swaps: 44 basis points
      - subordinated debt (bond) spreads: 124 basis points
      - marginal expected shortfall: 4.7%
      - option-implied volatility: 45.6%
      - expected default frequency: 0.57%
- ***Two-Way Notice Requirement***. The Federal Reserve must give notice to the Covered Company of the event and required remediation action if a triggering event occurs. A Covered Company is also required to provide notice to the Federal Reserve if it becomes aware of a triggering event or a change in condition that should result in a change in the remediation category to which it is subject.
- ***Subject to Requirements until Notified***. The Covered Company will remain subject to early remediation requirements until the Federal Reserve provides written notice that the Covered Company's financial condition no longer warrants the application of the requirement.

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Annex A: Remediation Actions

Specified remediation actions are mandatory except as otherwise noted below.

	Level 1	Level 2	Level 3	Level 4
Heightened Supervisory Review	Targeted review to determine whether to apply Level 2 remediation actions	N/A	N/A	N/A
Capital Distributions	N/A	No distributions in quarter in excess of 50% of average net income in preceding two quarters	No distributions	N/A
Asset Growth Limits	N/A	No growth in daily average total assets in quarter or year in excess of 5% QoQ/YoY	No QoQ growth in average total assets	N/A
RWA Growth Limits	N/A	No growth in daily average RWAs in quarter or year in excess of 5% QoQ/YoY	No QoQ growth in average total RWAs	N/A
Acquisitions/Expansion	N/A	Prior Federal Reserve approval required for controlling acquisitions in any company	Prohibition of any acquisitions, establishment of offices and engaging in new business lines	N/A
Enforcement Actions	N/A	Non-public MOU	Written agreement with capital-raising requirements (divestiture orders a potential consequence)	N/A
Activities Restrictions	N/A	Federal Reserve ***may*** impose limitations or conditions on conduct or activities	Federal Reserve ***may*** impose limitations or conditions on conduct or activities	N/A
D&O Compensation	N/A	N/A	No pay increases or bonuses	N/A
D&O Removal and Appointment	N/A	N/A	Federal Reserve may require board elections, D&O dismissals or employment of Federal Reserve-approved officers	N/A
Affiliate Transactions	N/A	N/A	Federal Reserve ***may*** restrict transactions with affliates	N/A
Resolution Assessment	N/A	N/A	N/A	Federal Reserve consideration of written recommendation that Covered Company be placed into OLA receivership

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Annex B: Remediation Triggering Events

A Covered Company is subject to the highest remediation level for which it satisfies any triggering condition.

	Level 1	Level 2**	Level 3**	Level 4
Risk-Based Capital (RBC) Ratios and Leverage Ratio Levels	Federal Reserve determines Covered Company's capital structure, capital planning processes or amount of capital held is not commensurate with the level and nature of risks to which it is exposed	10% > RBC ratio ≥ 8% or 6% > Tier 1 RBC ratio ≥ 4% or 5% > Tier 1 leverage ratio ≥ 4%	Two complete consecutive quarters of Level 2 RBC capital or leverage ratios or 8% > RBC ratio ≥ 6% or 4% > Tier 1 RBC ratio ≥ 3% or 4% > Tier 1 leverage ratio ≥ 3%	RBC ratio < 6% or Tier 1 RBC ratio < 3% or Tier 1 leverage ratio < 3%
Stress Tests	Noncompliance with Federal Reserve capital plan and stress testing rules	Results under severely adverse scenario in any quarter of planning horizon pursuant to supervisory stress test reflect: 5% > Tier 1 RBC ratio ≥ 3%	Results under severely adverse scenario in any quarter of planning horizon pursuant to supervisory stress test reflect: Tier 1 RBC ratio < 3%	N/A
Enhanced Risk Management and Risk Committee Standards	Signs of weakness in meeting standards	Multiple deficiencies in meeting standards	Substantial noncompliance in meeting standards	N/A
Enhanced Liquidity Risk Management Standards	Signs of weakness in meeting standards	Multiple deficiencies in meeting standards	Substantial noncompliance in meeting standards	N/A
Market Indicators	Median value of any market indicator exceeds the applicable threshold for the breach period	N/A	N/A	N/A

** Some RBC ratios shown in Table 4 on pages 97-99 of the Proposal do not match the language in proposed §252.163. The ratios shown in this Annex B match the language in proposed §252.163.

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