# First take

A publication of PwC's financial services regulatory practice

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## Ten key points from the Fed's enhanced prudential standards final rule

1. **Delayed effective date and higher threshold:** Foreign Banking Organizations (FBOs) eked out several small victories in the final rule – in particular, the July 2015 compliance date has been pushed to July 2016 and smaller FBOs (i.e., those with under $50 billion in US non-branch assets) are no longer required to form an Intermediate Holding Company (IHC). The changes reflect the Federal Reserve's attempt to respond to FBOs' concerns, especially that smaller FBOs did not pose as much risk to US financial stability.
2. **Advanced Approaches gone:** Large FBOs (i.e., with over $50 billion in US non-branch assets) will benefit from cost and resource savings as compared to their US peers, because the final rule permits them to avert using the Advanced Approaches methodology for calculating their risk-based capital at the holding company level (even when tripping thresholds applicable to US BHCs). Furthermore, large FBOs do not need to implement the US leverage ratio until 2018, while US Advanced Approaches banks are subject to the ratio as of this year.
3. **Insurers scoped out:** US insurers which have been designated as nonbank SIFIs scored a hopeful victory with the rule's promise that the Federal Reserve will "tailor" the enhanced prudential standards (EPS) to them, particularly if the Federal Reserve believes an institution's risk profile is different from banks (e.g., with respect to balance sheet structure, or regulation). Policy makers have clearly heard the industry's repeated objections to a bank-centric model and have responded.
4. **Harder for FBOs to clear the EPS hurdle:** Generally, large US banks have less implementation work to do than their FBO peers since many of the standards have been in place for US banks for some time (e.g., stress testing). FBOs on the other hand are at the beginning of a very long journey, with a number of core decisions regarding booking models and business strategies in front of them. Further, they still have to implement some of the most sophisticated approaches to risk management including: capital stress testing, liquidity stress testing and buffer requirements, and enhancements to risk management.
5. **Consolidating risk governance:** Large US banks still have a heavy lift to meet the rule's risk management and governance requirements. Although the responsibilities of a Chief Risk Officer (CRO) and Enterprise Risk Committee (ERC) have been implemented on paper at many institutions, effective operational implementation is still far off (e.g., establishing clear CRO ownership and changing ERC composition).

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6. **Harder for FBOs – again:** For FBOs, the risk management and governance challenges are more profound, as FBOs need to transition aggregated financial and risk reporting to support the group CRO and Risk Committee. Reporting and accountability will likely need to migrate from where they currently reside to promote centralization – representing real change to people's day-to-day activities. FBOs will also have to manage several regulatory layers of risk governance including meeting the demands of their home regulator, the Federal Reserve at the IHC level, and the OCC or state regulator at the bank level.

7. **IHC implementation plan:** FBOs forming an IHC are required to file an implementation plan with the Federal Reserve by January 2015. It is our view that implementation plans will need to include rigorous capital analysis, asset growth projections, and a well documented implementation strategy.

8. **Getting below $50 billion:** FBOs looking to adjust their US assets to remain below the $50 billion threshold for non-branch assets face a double edged sword. On the positive side for FBOs, the rule deviates from the Federal Reserve's usual approach of viewing such capital management efforts unfavorably. On the negative side, the rule's approach requires firms seeking to remain below the threshold to detail their asset reduction strategy in a report due by January 2015.

9. **Liquidity matters:** The final rule reduces the liquidity buffer requirement (applied to branches of FBOs with $50 billion or more in US assets) from 30 days to 14 days. In our view, the impact of this change is likely minimal given that the peak net cash outflows of branches typically occurs during the first two weeks of a 30 day period. Meanwhile, casting a looming shadow, the rule's preamble signals that the Federal Reserve is considering additional rulemaking that would apply the US's Liquidity Coverage Ratio to IHCs.

10. **Rule omissions:** Omitted from the final rule are single counterparty credit limits (which was expected) and early remediation requirements. The Federal Reserve continues to develop its approach in these areas.

# *Additional information*

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