

## Financial Institution Compliance Update



May 06, 2014

*This communication is designed to provide you with quick snapshots and timely perspective on recent regulatory developments.*

### A Guideline for the Federal Reserve Recently Issued Enhanced Prudential Standards for Banks

#### Overview

On March 27, 2014 the Federal Register published the Federal Reserve System's amendment to Regulation YY of 12 CFR Part 252 entitled "Enhanced Prudential Standards for Bank Holding Companies and Foreign Organizations."

The new regulation establishes a number of additional regulatory requirements for large U.S. bank holding companies and foreign banking organizations that are designed to increase the sustainability and resiliency of U.S. banking operations. The regulation was required by Section 165 of the "Dodd-Frank Wall Street Reform and Consumer Protection Act."

The Federal Register notification may be found [here](#).

These standards include a broad range of liquidity, risk management, and capital requirements that will significantly impact the risk management and compliance requirements of most large bank holding companies.

#### Contact us

If you have specific questions regarding the regulatory content and commentary of this message, please contact:

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## Requirements for U.S. bank holding companies

The table below summarizes the key requirements for U.S. bank holding companies.

Bank Size	New Regulation Requirements
Total consolidated assets of more than \$10 billion but less than \$50 billion	<ul style="list-style-type: none"><li>• Company-run stress tests</li></ul>
Total consolidated assets equal to or greater than \$10 billion but less than \$50 billion (if publicly-traded)	<ul style="list-style-type: none"><li>• Establishment of a risk committee</li><li>• Establishment of risk management function</li></ul>
Total consolidated assets of \$50 billion or more	<ul style="list-style-type: none"><li>• Risk-based and leverage capital requirements</li><li>• Establishment of risk management function</li><li>• Establishment of a risk committee</li><li>• Liquidity risk-management, stress-testing, and buffers</li><li>• Supervisory stress tests</li><li>• Company-run stress tests</li><li>• Debt to equity limits ("grave threat determination")</li></ul>

Publicly traded bank holding companies with \$10 billion or more in assets

Publicly traded bank holding companies with total consolidated assets of \$10 billion or more (as of June 30, 2014) are required to implement the enhanced prudential standards by July 1, 2015. As noted above, the new standards require banks holding companies in this category to establish risk committee for their global banking operations. These risk committees are required to:

- Have a written charter approved by the board.
- Meet at least quarterly (or sooner if necessary) and maintain records of its meetings, including risk-management decisions.

Minimum membership standards for risk committees include:

- At least one member must have experience in identifying, assessing, and managing risk exposures of large, complex firms.
- Be chaired by a director who:
  - Is not an officer or employee of the bank holding company and has not been an officer or employee of the bank holding company during the previous three years.
  - Is not a member of the immediate family of a person who is, or has been within the last

three years, an executive officer of the bank holding company.

- Is an independent director under Item 407 of the Securities and Exchange Commission's Regulation S-K; or would qualify as an independent director under the listing standards of a national securities exchange, as defined.
- In addition to the risk committee requirements, the new standards require bank holding companies in this category to implement risk management frameworks that are appropriate for the structure, risk profile, complexity, activities, and size of the bank holding companies.

The risk management function must include:

- Policies and procedures establishing risk-management governance, risk-management procedures, and risk-control infrastructure for the bank's global operations.
- Processes and systems for implementing and monitoring compliance with such policies and procedures. The related policies and procedures must include:
  - Processes and systems for identifying and reporting risks and risk-management deficiencies (including emerging risks) and ensuring effective and timely implementation of actions to address emerging risks and risk-management deficiencies for the holding company's global operations.
  - Processes and systems for establishing managerial and employee responsibility for risk management.
  - Processes and systems for ensuring the independence of the risk-management function.
  - Processes and systems to integrate risk management and associated controls with management goals and its compensation structure for its global operations.

Bank holding companies with assets of \$50 Billion or more

For bank holding companies with total consolidated assets of \$50 billion or more, the new standards include a formal risk management function along with a number of enhanced liquidity and stress testing requirements. The additional "risk management" requirement includes:

- The board of directors must:
  - Approve the acceptable level of liquidity risk that the bank holding company may assume in connection with its operating strategies (liquidity risk tolerance) at least annually.
  - Receive and review, at least semi-annually, information provided by senior management to determine whether the bank holding company is operating in accordance with its established liquidity risk tolerance.
  - Must approve and periodically review the liquidity risk-management strategies, policies, and procedures established by senior management.
- The risk committee (or a designated subcommittee of such committee composed of members of the board of directors) must approve:
  - Contingency funding plans at least annually.
  - Any material revisions to the plan prior to the implementation of such revisions.
- Senior Management must:
  - Establish and implement strategies, policies, and procedures designed to effectively manage the risk that the bank holding company's financial condition or safety and

soundness would be adversely affected by its inability or the market's perception of its inability to meet its cash and collateral obligations (liquidity risk). The board of directors must approve the strategies, policies, and procedures.

- Oversee the development and implementation of liquidity risk measurement and reporting systems.
- Determine at least quarterly (or more often if changes in market conditions, liquidity position, risk profile or financial conditions warrant) whether the bank holding company is operating and has established procedures regarding the preparation of such information.
- Report to the board of directors or the risk committee regarding the bank holding company's liquidity risk profile and liquidity risk tolerance at least quarterly (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition of the company warrant).
- Approve new products and business lines and evaluate the liquidity costs, benefits, and risks of each new business line and new product that could have a significant effect on the company's liquidity risk profile.
- Review, at least annually, significant business lines and products to determine whether any line or product creates or has created any unanticipated liquidity risk, and to determine whether the liquidity risk of each strategy or product is within the company's established liquidity risk tolerance.
- Review the cash-flow projections at least quarterly (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition of the bank holding company warrant) to ensure that the liquidity risk is within the established liquidity risk tolerance.
- Establish liquidity risk limits and review the company's compliance with those limits at least quarterly (or more often, if changes in market conditions or the liquidity position, risk profile, or financial condition of the company warrant).
- Approve the liquidity stress testing practices, methodologies, and assumptions at least quarterly, and whenever the bank holding company materially revises its liquidity stress testing practices, methodologies or assumptions;
- Review the liquidity stress testing results at least quarterly.
- Review the independent review of the liquidity stress tests.
- Approve the size and composition of the liquidity buffer established at least quarterly.

In addition, a bank holding company with total consolidated assets of \$50 billion or more must establish and maintain a review function that is independent of management functions that execute funding to evaluate its liquidity risk management. This independent review function also includes numerous requirements.

#### Requirements for foreign banks with US Operations

The requirements for foreign banks with US operations are similar to the US based requirements with various modifications including the establishment of US based bank holding companies with an additional requirement that US non-branch banks with total assets of \$50 billion or more requiring a US intermediate holding company being established for these operations.

What do these new banking changes mean for you?

These new regulations will be a "game changer" for many banking operations.

- From a risk management perspective, we expect companies will need to perform a comprehensive review of their current risk management governance structure and overall risk management framework to determine that they meet the compliance requirements of the new regulations.
- In addition to review of the risk framework, we envision significantly more board involvement in approving risk appetites, tolerances and enhancements to existing “risk assessments” and policy and procedure documentation to demonstrate compliance.
- We believe the evaluation of the existing framework should include a comparison of a bank’s current risk management practices against a globally framework such as the Enterprise Risk Management Framework prepared by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) or other widely recognized enterprise risk management framework. From this evaluation, resourcing, technology support and a program management office should be evaluated to ensure timely compliance.

Contact us if you have any questions regarding these standards. We have a team of professionals currently working with clients to help ensure organizations meet these requirements. Visit [Experis Finance](#) to learn more about how we can assist your organization.

