Banking Organization Systemic Risk Report - Fed Proposed Form FR Y-15

Executive Summary

The Federal Reserve Board ("Fed") recently published a notice of proposed information collection that would introduce a new Form FR Y-15, *The Banking Organization Systemic Risk Report*, which would collect consolidated systemic risk data from certain large U.S. Bank Holding Companies ("BHCs") and U.S. Savings and Loan Holding Companies ("SLHCs"), as well as aggregated systemic risk data on the U.S. operations of certain Foreign Banking Organizations ("FBOs"). The Fed states that it would use the information for all three reporting groups to assess the systemic risk implications of proposed mergers and acquisitions and may also use it to determine whether an institution is a domestic systemically important institution. In addition, the Fed would submit the BHC data to the Basel Committee on Banking Supervision ("Basel Committee") for use in determining whether an institution is a global systemically important bank ("G-SIB") and, if so, what additional capital requirements would be applied.

U.S. BHCs and SLHCs with $50 billion or more of total consolidated assets and FBOs with $50 billion or more of assets in their combined U.S. operations (including branches) would be required to complete the FR Y-15. As proposed, the new form would capture information as of December 31st of each year and would be due to the Fed within 45 calendar days after the December 31st as of date. The comment period closed on October 19, 2012.

Background

Authorization

The systemic risk data to be reported on the FR Y-15 is authorized by Sections 163 (*Appraisals*), 165 (*Enhanced prudential standards and supervision for nonbank financial companies supervised by the Board of Governors and certain bank holding companies*), and 604 (*Reports and examinations of holding companies; regulation of functionally regulated subsidiaries*) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act"). The Fed issued a proposed rule in December 2011 that would establish enhanced prudential standards pursuant to Section 165 (see Regulatory Practice Letter 12-04). Although SLHCs and FBOs are covered by the requirements of Section 165, the Fed's proposed rule did not generally include SLHCs or FBOs with U.S. banking operations noting that the Fed would issue separate proposed rules at a later date.

Basel Committee G-SIB Final Rule

In November 2011, the Basel Committee released final rules for the assessment methodology and additional loss absorbency requirements attributable to G-SIBs. The assessment methodology is based on an indicator-based approach and comprises five broad categories of systemic risk that are weighted equally: size, interconnectedness, lack of readily available substitutes or financial institution infrastructure, global (cross-jurisdictional) activity and complexity.

Under the final rule, G-SIBs will be initially assigned one of four additional capital requirements, which will range from 1.0 percent to 2.5 percent of risk-weighted assets. Going forward, the requirement could be raised to 3.5 percent if a G-SIB substantially increases its systemic footprint. The magnitude of loss must be met with Common Equity Tier 1 ("CET1") as defined by the Basel III framework.

The higher loss absorbency requirements will be introduced in parallel with the Basel III capital conservation and countercyclical buffers between January 1, 2016 and year end 2018 becoming fully effective on January 1, 2019. Before implementation on January 1, 2016, national jurisdictions must implement official regulations and / or legislation by January 1, 2014. Thresholds for the metrics to be used with the indicator-based approach are expected to be fixed and disclosed by the Basel Committee in November 2014 based on year end-2013 data. The additional loss absorbency requirement implemented in January 2016 will also be based on the year end-2013 data.

U.S. Basel III Proposed Rule

In June 2012 the Fed issued proposed rules (jointly with the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation) to revise and replace the agencies' current capital rules to implement in the United States the Basel III capital framework. As proposed, the rules would become effective January 2013 though provisions for the Basel III liquidity requirements and the surcharges for G-SIBs were not included but are expected to be forthcoming.

Description

The new Form FR Y-15 is intended to mirror the data collected by the Basel Committee to assess the global systemic importance of banks and would collect information that reflects five components of a bank's global systemic footprint: size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity. The information would be reported on the following schedules:

Schedule A – Size Indicators

The size metric is identical to the total exposures value used in the leverage ratio and would be calculated using both on- and off-balance sheet data. On-balance sheet items would include:

- Total on-balance sheet assets,
- Netted and unnetted securities financing transactions,
- Securities received as collateral in securities lending,
- Cash collateral received in conduit securities lending transactions,
- Derivative exposures with a net positive fair value, and
- Cash collateral netted against net positive derivative exposures.

Off balance sheet items would include:

- Potential future exposure of derivatives,
- Total notional amount of credit derivatives sold,
- Credit derivatives sold net of related credit protection bought,
- Off-balance sheet items with a 0 percent credit conversion factor ("CCF"),
- Unconditionally cancellable credit card commitments,
- Other unconditionally cancellable commitments, and
- Off-balance sheet items with a 20 percent, 50 percent or 100 percent CCF.

Certain regulatory adjustments to Tier 1 capital would also be collected.

Schedule B – Interconnectedness Indicators

For the purpose of the interconnectedness indicators, financial institutions are defined as including banks (and other deposit-taking institutions), securities dealers, insurance companies, mutual funds, hedge funds, and pension funds. Central banks and other public sector bodies (e.g. multilateral development banks) are excluded, but state-owned commercial banks are included.

The Interconnectedness Indicators Schedule is comprised of three subcategories:

Intra-financial system assets – This would be comprised of:

- All funds deposited with or lent to other financial institutions,
- Undrawn committed lines extended to other financial institutions,
- Holdings of secured debt securities, senior unsecured debt securities, subordinated debt securities, commercial paper, certificates of deposit, and stock (including par and surplus of common and preferred shares),
- Offsetting short positions in relation to stock holdings,
- Net positive current exposure of securities financing transactions,
- Net positive fair value of over-the-counter ("OTC") derivatives (including collateral held if it is within the master netting agreement),
- Potential future exposure of OTC derivatives, and
- Fair value of collateral that is held outside of the master netting agreements.

Intra-financial system liabilities – This would include:

- All funds deposited by banks and non-bank financial institutions,
- Undrawn committed lines obtained from other financial institutions,
- Net negative current exposure of securities financing transactions,
- Net negative fair value of OTC derivatives (including collateral provided if it is within the master netting agreement),
- Potential future exposure of OTC derivatives, and
- Fair value of collateral that is provided outside of the master netting agreements.

Securities issued by the bank – This would include:

- Secured, senior unsecured and subordinated debt securities,
- Commercial paper,
- Certificates of deposit, and
- Stock (including par and surplus of common and preferred shares).

Schedule C – Substitutability Indicators

The Substitutability Indicators Schedule would include the total value of all payments sent by the bank (and the total value of all payments sent on behalf of other institutions), for the reporting year, in a variety of currencies including: Australian dollars, Brazilian real, Canadian dollars, Swiss francs, Chinese yuan, EU euros, Pound sterling, Hong Kong dollars, Indian rupee, Japanese yen, Swedish krona, and United States dollars. All outgoing payments would be included regardless of whether the payments were initiated directly via a payment system or indirectly via an agent bank. The reported payment totals would reflect gross payment activity (i.e., they would not be netted against any incoming payments). It also would include the value of assets the bank holds as a custodian on behalf of customers, equity underwriting activity, and debt underwriting activity.

Schedule D – Complexity Indicators

The Complexity Indicators Schedule would include:

- OTC derivatives cleared through a central counterparty,
- OTC derivatives cleared bilaterally,
- Held-for-trading securities ("HFT"),
- Available-for-sale securities ("AFS"),
- Securities for which the fair value option is elected ("FVO"),
- Total stock of Level 1 assets as well as total stock of Level 1 assets under HFT, AFS or FVO accounting treatment,
- Total stock of Level 2 assets and total stock of Level 2 assets under HFT, AFS or FVO accounting treatment,
- Adjustment to stock of high quality liquid assets due to cap on Level 2 assets,
- Held-to-maturity securities, and
- Assets valued using Level 3 measurement inputs.
  (*Note: Levels 1 and 2 assets are defined in Basel III: International Framework for liquidity risk measurements, standards and monitoring. Level 3 assets are illiquid assets where fair value can only be estimated.*)

Schedule E – Cross-jurisdictional Activity Indicators

The Cross-jurisdictional Activity Indicators Schedule would include:

- Total foreign claims on an ultimate risk basis,
- Foreign liabilities (excluding local liabilities in local currency),
- Foreign liabilities to related offices, and
- Local liabilities in a local currency.

Schedule F – Ancillary Indicators

The Ancillary Indicators Schedule would include:

- Total liabilities,
- Retail funding,
- Nondomestic and total net revenue and total gross revenue,
- Equity market capitalization,
- Gross value of all cash and gross fair value of securities lent in securities financing transactions,
- Gross value of all cash and gross fair value of securities borrowed in securities financing transactions,
- Gross positive fair value of OTC derivatives transactions,
- Gross negative fair value of OTC derivatives transactions,
- Unsecured settlement/clearing lines provided, and
- Number of jurisdictions.

The Fed indicates that certain data collected on the proposed Form FR Y-15 are also collected in other reports submitted to the Fed (e.g., FR Y-9C and FFIEC 009). If the banking organization files these reports at the same level of consolidation as is required for the FR Y-15, the duplicate data items do not need to be reported and may be left blank.

Entities Required to Submit Reporting Form FR Y-15

The Fed proposes that the new Form FR Y-15 reporting requirements would apply to:

- U.S. BHCs with $50 billion or more of total consolidated assets;
- U.S. SLHCs with $50 billion or more of total consolidated assets;
- FBOs with $50 billion or more of assets in their combined U.S. operations (including branches); and
- U.S. institutions designated as G-SIBs by the Basel Committee in the previous reporting period even if they do not meet the assets threshold.

Total assets would be determined as of December 31st of the reporting period. As drafted, the new Form FR Y-15 would be required to be signed and attested by the Chief Financial Officer of the reporting banking organization (or by the person performing the equivalent function).

Timing

As proposed, new Form FR Y-15 would be implemented for data collection as of December 31, 2012 in order for the information to be used in the next Basel Committee G-SIB data collection exercise scheduled for February 2013. Submissions would be required in electronic format within 45 days of the December 31st as of date beginning with December 31, 2012 and annually thereafter. It would be made publicly available through the FFIEC (Federal Financial Institutions Examination Council) Web site.

Commentary

The implementation of Sections 165 and 166 of the Dodd-Frank Act addresses shortcomings that were observed during the economic crisis that began in 2008. At that point in time, there was limited information available to regulators on counterparty exposures and interconnectivities between firms that threatened the broader market.

The FR Y-15 is the first significant new systemic risk reporting requirement called for as part of the Dodd-Frank Act. The Fed estimates that the FR Y-15 will be filed by approximately 25 domestic BHCs, 15 SLHCs, and 23 FBOs providing additional data to support macroprudential supervisory efforts.

It is likely that additional reporting targeted at specific institution types or activities will be forthcoming as the Fed and other regulatory agencies seek to better understand and assess the interrelationships and exposures of the largest financial institutions operating within the U.S. As noted within the enhanced prudential supervision guidance (Proposed Regulation YY), the provisions outlined in the proposed rule would further increase transparency from an enterprise risk management and capital adequacy viewpoint.

As the shift in regulatory focus becomes more centered in systemic risk and the interconnectivity amongst institutions, bank management should be cognizant of the implications arising from this proposed reporting and should consider the need for possible changes and enhancement to existing governance, risk management, MIS, liquidity and other oversight monitoring practices.

The new report will increase the regulatory reporting requirements and associated risks with respect to data integrity and aggregation. Firms will continue to be challenged as new reporting and categorizations of data present challenges on a technological and systems level as well as a personnel resource level. Initially, interpretation of the new reporting requirements will also be challenging.

Accordingly, the complexities of ensuring that an institution is able to file accurate and timely FR Y-15 reports suggests that management should begin preparations as soon as possible to allow for trial runs and to identify and remediate data, systems, or other operational challenges. In addition, the SLHCs, which are still new to Fed reporting, are likely to encounter further challenges in ensuring that they are ready to file the reports.

Contact us:
This is a publication of KPMG's
Financial Services Regulatory Practice

Contributing authors:
Hugh Kelly, Principal: hckelly@kpmg.com
Philip Aquilino, Managing Director: paquilino@kpmg.com
Paul Cardon, Director: pcardon@kpmg.com

Earlier editions are available at:
http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/regulatory-practice-letters/Pages/Default.aspx