

For Release Upon Delivery
11:00 a.m., July 11, 2013

TESTIMONY OF
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before the
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

July 11, 2013

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Johnson, Ranking Member Crapo, and members of the Committee, thank you for the opportunity to discuss those provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act) that reduce systemic risk and improve financial stability. The global financial crisis was unprecedented in its severity and exposed a number of fundamental weaknesses in the regulation of the financial system. In response, Congress passed the Dodd-Frank Act, which contains the most comprehensive reforms to the financial system since the Great Depression. These reforms address systemic issues that contributed to the crisis, strengthen the oversight, regulation, and resolution provisions applicable to large financial institutions, and promote greater market stability by, among other things, increasing the transparency and oversight of swaps and other derivatives activities, and mandating that the largest bank holding companies and systemically significant nonbank companies prepare resolution plans demonstrating how they can be resolved in a bankruptcy proceeding. The Act requires federal regulators to put in place new buffers and safeguards to protect against future financial crises, such as requiring enhanced prudential capital and liquidity standards for large, complex banks, and provides federal regulators with a number of new tools to help avoid future problems. While many of the rules to implement these reforms are still being developed, once in place they will serve to reduce systemic risk and add to the resiliency of the largest financial institutions and, ultimately, our economy.

As economic conditions have improved, so has the condition of the institutions the Office of the Comptroller of the Currency (OCC) supervises. These institutions have made significant progress in repairing their balance sheets with stronger capital, improved liquidity, and timely recognition and resolution of problem loans. For national

banks and federal savings associations, tier 1 common equity is at 12.3 percent of risk-weighted assets, up from its low of just over 9 percent at the end of 2008.¹ The current capital leverage ratio is now about 9 percent, which is up almost a third from its recent low. Reliance on volatile funding sources has dropped from its fall 2006 peak of 46 percent of total liabilities to 22 percent today. Asset quality indicators are improving with charge-off rates declining for all major loan categories. Indeed, for all but residential mortgages, charge-off rates have now dropped below their post-1990 averages.

While these are positive developments, there remains much to do, and we are continuing to stress that institutions must stay vigilant about monitoring new and existing risk. This is certainly not the time to dispense with this renewed focus on risk management and, as I discuss in my testimony, the OCC is actively raising the bar on our supervisory expectations for the largest banks we oversee.

In response to the Committee's letter of invitation, my testimony will cover actions we have taken to improve financial stability through enhanced prudential regulation and supervision, to finalize those rules for which the OCC has independent rule writing authority, and to strengthen risk-based capital, liquidity, and leverage. I will also address developments regarding the provisions of Title VII of the Act, our work with other federal banking agencies regarding the resolution of any failing systemically important financial institution under Title II, and the Volcker Rule. Finally, I will conclude with a discussion of how the Act has affected the OCC's regulation of the many community banks and thrifts we supervise and an update on the status of certain interagency Dodd-Frank Act regulations.

¹ Performance and financial data are based on March 31, 2013 Call Report information.

I. Improving Financial Stability through Enhanced Prudential Regulation and Supervision

As I have noted in previous testimony,² large banks are critical to the proper functioning of the capital markets and to a vital economy and thus need to be regulated and supervised more rigorously than less systemically important banks. In applying the lessons we learned from the financial crisis, the OCC is focusing on improving its supervisory program and has increased expectations for the largest banks. In addition, the OCC has increased collaboration and coordination with both domestic and international regulators in order to leverage our collective resources and supervise our institutions more efficiently and effectively. The OCC has also worked diligently to complete all rulemakings required by the Act both where the OCC has authority to issue rules independently and in collaboration with the other regulators on interagency rules. We believe that these actions will result in a stronger and safer banking system.

A. Improving Supervision

Examiner Oversight

The financial crisis underscored the importance of bank supervision and the role of examiner judgment, along with strong regulation and robust analytics, as cornerstones of a healthy financial system. While laws and regulations take a long view and cannot be easily tailored to new developments, our examiners pay close attention to changes in the financial environment generally and changes in individual risk profiles specifically. This proactive approach helps to identify and correct emerging issues before they become major problems. Our examiners are seasoned professionals who bring the benefit of

² <http://www.occ.treas.gov/news-issuances/congressional-testimony/2012/pub-test-2012-86-written.pdf>

sound judgment and years of experience to their work. This work demonstrates the importance of having examiners' "boots on the ground" to better communicate our expectations and to ensure that these expectations are met.

Heightened Expectations

Higher supervisory expectations for the large banks we oversee, together with bank management's implementation of these expectations, are consistent with the broad goal of the Dodd-Frank Act to strengthen the financial system. We believe that this increased focus on strong corporate governance and risk management will both help to maintain the balance sheet improvements achieved since the financial crisis and make these institutions better able to withstand the impact of future crises. For example, as part of this increased focus, we have communicated our expectations for independent directors to present a credible challenge to bank management and to have a thorough understanding of the bank's risks. Informed directors can better question the propriety of strategic initiatives and assess the balance between risk-taking and reward. We also expect these banks to have strong audit and risk management functions, and we directed bank audit and risk management committees to perform gap analyses relative to the OCC's standards and industry practices and to close the identified gaps. While more work is required, I am pleased to say that progress is being made in closing identified gaps.

Our views on heightened expectations for strong corporate governance and risk management also extend to the way banks define and communicate risk tolerance expectations across the company. For example, our examiners are directing banks to complement existing risk tolerance structures with measures that address the amount of

capital or earnings that may be at risk on a firm-wide basis, the amount of risk that may be taken in each line of business, and the amount of risk that may be taken in each of the key risk categories monitored by the banks.

The OCC is reinforcing these heightened expectations through our ongoing supervisory activities and frequent communication with bank management and boards of directors. Examiners prepare and discuss with bank management a quarterly analysis of each large bank's progress toward meeting the OCC's heightened expectations. In addition, each bank's Report of Examination now includes an overall rating of how the bank is meeting these heightened expectations.

Another OCC initiative that complements our views on heightened expectations is the idea of legal entity structure simplification. The OCC is working with the large banks we oversee to reduce the number and complexity of legal entities within their organizations and to ensure that remaining legal entities are properly aligned with the banks' key lines of business. While we understand that banks may need time and will likely incur some expense in undertaking such restructuring, we believe it will greatly improve transparency, resolvability, risk management, and governance at the largest banks we supervise.

Risk Identification

The OCC's National Risk Committee (NRC) contributes to our supervisory responsibilities by monitoring the condition of the federal banking system as a whole as well as emerging threats to the system's safety and soundness. The NRC also monitors evolving business practices and financial market issues and helps to shape our supervisory efforts to address emerging risk issues. NRC members include senior agency

officials who supervise banks of all sizes, as well as officials from the legal, policy, and economics departments. The NRC helps to formulate the OCC's annual bank supervision operating plan that guides our supervisory strategies for the coming year. The NRC also publishes the *Semiannual Risk Perspective* report to provide information to the industry and to the general public on issues that may pose threats to the safety and soundness of OCC-regulated financial institutions. This report is part of our effort to make our supervision priorities more transparent to the boards and management of national banks and federal savings associations. We believe the institutions we supervise can better calibrate their own risk management strategies by understanding the OCC's supervisory strategies and the emerging risks the agency is focused on. The most recent report, published in June of this year, presents data on the operating environment, the condition and performance of the banking system, and trends in funding, liquidity, interest rate risk, and regulatory actions.³

B. Domestic Collaboration and International Coordination

Domestic Collaboration

While the OCC has always sought to coordinate our supervisory efforts with other federal banking agencies, the Dodd-Frank Act has made interagency collaboration even more critical. This collaboration allows the agencies to contribute their unique expertise and to reduce unnecessary duplication.

Therefore, we have increased our efforts to work with the other federal banking agencies and recently implemented a number of guiding principles for interagency coordination with the Board of Governors of the Federal Reserve System (FRB) and the

³ <http://el.occ/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2013.pdf>

Federal Deposit Insurance Corporation (FDIC). Thus, for the largest national banks and thrifts, examiners are more closely coordinating with the FRB and FDIC to develop supervisory strategies that will promote more efficient and effective allocation of resources to key priorities and risks, while reducing redundant or duplicative supervisory activities. We have also invited our prudential regulatory partners to attend meetings of the OCC's NRC to share more promptly information about risks.

The OCC and the other federal banking agencies also have entered into a memorandum of understanding (MOU) with the Bureau of Consumer Financial Protection (CFPB) that clarifies how the agencies will coordinate their supervisory activities consistent with the Act. The objective of the MOU is to minimize unnecessary regulatory burden, avoid duplication of effort, and decrease the risk of conflicting supervisory directives. The MOU specifically addresses cooperation on scheduling examinations and other supervisory activities as well as information sharing.

International Coordination

The OCC has also been working internationally to coordinate supervisory efforts following the financial crisis and the passage of the Dodd-Frank Act. The international Basel III agreements incorporated many of the lessons relating to bank capital that the global community learned from the financial crisis. As members of the Basel Committee on Bank Supervision (Basel Committee), the federal banking agencies had a critical role in the development of these enhanced capital standards, and the final rule that I approved on July 9th and that is described more fully in my testimony reflects many of those key provisions.

The OCC also has taken a leading role in international discussions relating to cross-border resolutions. The OCC is a member of the Basel Committee's Cross-Border Bank Resolutions Group and participates in the Financial Stability Board's Cross-Border Crisis Management Group. In addition, the OCC participates in firm-specific Crisis Management Groups and Supervisory Colleges and is engaged with the other U.S. banking agencies in developing Cooperation Agreements with foreign jurisdictions that will allow for information sharing and coordination in future crises affecting large, cross-border financial institutions.

The OCC is also playing a leading role internationally in improving supervisory practices and principles and overseeing the timely, consistent, and effective implementation of Basel Committee standards around the world.

C. Dodd-Frank OCC Rulemakings

In response to the Committee's request to discuss the status of the rules required by the Dodd-Frank Act, I am pleased to report that all of the rules that the OCC has authority to issue independently have been completed. This includes rules relating to lending limits (section 610), stress testing (section 165(i)(2)), the removal of references to credit ratings (section 939A), and retail foreign exchange transactions (section 742). A summary of each of these rules follows.

Lending Limits

The Dodd-Frank Act directly addressed concentrations of credit by requiring banks to account for derivatives and securities financing transactions under the lending limit rules. Both of these categories of instruments contributed to systemic risk during the crisis, in part, due to lack of transparency around exposures. Under the National

Bank Act, the total loans and extensions of credit by a national bank to a person outstanding at one time may not exceed 15 percent of the unimpaired capital and unimpaired surplus of the bank if the loan is not fully secured, plus an additional 10 percent of unimpaired capital and unimpaired surplus if the loan is fully secured. Section 610 of the Dodd-Frank Act amended the definition of “loans and extensions of credit” to include any credit exposure to a person arising from a derivative transaction, or a repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction (collectively, securities financing transactions), between a national bank and that person.

The OCC published a final rule on June 25, 2013. The final rule provides significant flexibility for meeting these new requirements, particularly for smaller-sized institutions, by offering national banks and savings associations three methods for calculating the credit exposure of most derivative transactions, a special rule for measuring the exposure of credit derivatives, and three methods for calculating such exposure for securities financing transactions. These methods vary in complexity and permit institutions to adopt compliance alternatives that fit their size and risk management requirements, consistent with safety and soundness and the goals of the statute. To permit institutions the time necessary to conform their operations to the amendments implementing section 610, the OCC has extended the temporary exception period for the application of these new lending limit rules through October 1, 2013.

Stress Testing

The use of stress tests during the financial crisis played a critical role in restoring confidence in the U.S. banking system, and Congress codified further use of stress testing

as a regulatory tool through several provisions of the Dodd-Frank Act. On October 9, 2012, the OCC published a final rule that implements section 165(i) of the Dodd-Frank Act, which requires national banks and federal savings associations with total consolidated assets over \$10 billion to conduct annual stress tests pursuant to regulations prescribed by their respective primary financial regulator.

The final rule defines “stress test,” establishes methods for the conduct of the company-run stress test that must include at least three different scenarios (baseline, adverse, and severely adverse), establishes the form and content of reporting, and compels covered institutions to publish a summary of the results of the stress tests. The requirements for these company-run stress tests are separate and distinct from the supervisory stress tests, also required under section 165(i), that are conducted by the FRB. Nevertheless, we believe these efforts are complementary, and we are committed to working closely with the FRB and the FDIC to coordinate the timing of, and the scenarios for, these tests.

On November 15, 2012, the OCC and other regulators released the stress scenarios for the company-run stress tests covering baseline, adverse, and severely adverse conditions. Covered institutions with more than \$50 billion in assets conducted their first stress tests under the rule and reported and disclosed the results. The OCC is reviewing the results as part of its ongoing supervision of these institutions.

Removal of References to Credit Ratings from OCC Regulations

On June 13, 2012, the OCC published a final rule to implement section 939A of the Dodd-Frank Act by removing references to credit ratings from the OCC’s non-capital regulations, including the OCC’s investment securities regulation, which sets forth the

types of investment securities that national banks and federal savings associations may purchase, sell, deal in, underwrite, and hold. These revisions became effective on January 1, 2013.

Under prior OCC rules, permissible investment securities generally included Treasury securities, agency securities, municipal bonds, and other securities rated “investment grade” by nationally recognized statistical rating organizations such as Moody’s, S&P, or Fitch Ratings. The OCC’s final rule revised the definition of “investment grade” to remove the reference to credit ratings and replaced it with a new non-ratings-based creditworthiness standard. To determine that a security is “investment grade” under the new standard, a bank must perform due diligence necessary to establish: (1) that the risk of default by the obligor is low; and (2) that full and timely repayment of principal and interest is expected. Generally, securities with good to very strong credit quality will meet this standard.

The OCC recognized that some national banks and federal savings associations needed time to make the adjustments necessary to make “investment grade” determinations under the new standard. Therefore, the OCC allowed institutions nearly six months to come into compliance with the final rule.

To aid this adjustment process, the OCC also published guidance to assist institutions in interpreting the new standard and to clarify the steps they can take to demonstrate that they meet their diligence requirements when purchasing investment securities and conducting ongoing reviews of their investment portfolios.

Retail Foreign Exchange Transactions

On July 14, 2011, the OCC published its final retail foreign exchange transactions rule (Retail Forex Rule) for national banks and federal branches and agencies of foreign banks. The Retail Forex Rule imposes a variety of consumer protections — including margin requirements, required disclosures, and business conduct standards — on foreign exchange options, futures, and futures-like transactions with retail customers (persons that are not eligible contract participants under the Commodity Exchange Act). To promote regulatory comparability, the OCC worked closely with the Commodity Futures Trading Commission (CFTC), Securities Exchange Commission (SEC), FDIC, and FRB in developing the Retail Forex Rule and modeled the Retail Forex Rule on the CFTC’s rule.

After the transfer of regulatory authority from the Office of Thrift Supervision, the OCC updated its Retail Forex Rule to apply to federal savings associations. This interim final rule with request for comments was published on September 12, 2011. The OCC also proposed last October to update its Retail Forex Rule to incorporate the CFTC’s and SEC’s recent further definition of “eligible contract participant” and related guidance. The OCC is currently working to finalize that proposal.

II. Strengthening Capital and Liquidity

A. Comprehensive Revisions to Capital Rules

Earlier this week, the OCC joined the other federal banking agencies in issuing comprehensive revisions to the capital rules that incorporate changes to the international capital framework published by the Basel Committee as well as certain elements of the Dodd-Frank Act (domestic capital rules) that we believe will strengthen our nation’s

financial system by reducing systemic risk and improving the safe and sound operation of the banks we regulate. Strong capital standards are critical to moderate economic downturns and position the banking system to serve as a catalyst for recovery by ensuring that financial institutions stand ready to lend throughout the economic cycle.

The recent financial crisis was marked by significant concerns about the riskiness of assets and the ability of bank capital to absorb losses. Internationally, the OCC was part of the effort to strengthen standards that produced Basel III. The domestic capital rules constitute a parallel effort to address the same broad concerns about capital and risk. A number of the changes adopted in the domestic capital rules complement the capital provisions in the Dodd-Frank Act. Importantly, the agencies have calibrated the new standards to reflect the nature and complexity of the different institutions they regulate. Therefore, although some requirements apply to all national banks and federal savings associations, many requirements will apply only to the largest banking organizations that engage in complex or risky activities.

Some of the more significant revisions in the domestic capital rules include increasing both the quantity and the quality of capital necessary to meet minimum regulatory requirements, enhancing the minimum leverage ratio requirements for the largest banks, incorporating incentives to clear more derivatives transactions through regulated central counterparties, and adding stress assessments into many of the risk-based capital requirements. Additionally, the agencies issued a proposal that would further increase the leverage ratio requirements applicable to the largest, most complex banking organizations.

Increased Quantity and Improved Quality of Required Capital

The domestic capital rules increase the quantity and improve the quality of the capital that national banks and federal savings associations must hold to meet their regulatory requirements. The rule does this by narrowing the definition of regulatory capital and raising the overall minimum required levels of capital. The rule also establishes a new capital measure called Common Equity Tier 1 (CET1). This measure includes only the forms of capital that proved to be the most reliably loss absorbing during the financial crisis and subsequent economic downturn. The domestic capital rules require national banks and federal savings associations to have CET1 capital equal to at least 4.5 percent of their risk-weighted assets.

In addition to the regulatory minimums, the domestic capital rules apply a capital conservation buffer requirement to all national banks and federal savings associations and a countercyclical capital buffer requirement to banking organizations subject to the advanced approaches rules (*i.e.*, those with assets in excess of \$250 billion or foreign exposures of more than \$10 billion).

The capital conservation buffer consists of an additional amount of CET1 capital equal to 2.5 percent of a national bank's or federal savings association's risk-weighted assets.⁴ A banking organization that fails to hold enough CET1 capital to satisfy the buffer requirement will face restrictions on its ability to issue and pay dividends and to make discretionary bonus payments. During the recent financial crisis and economic downturn, some banking organizations continued to pay dividends and substantial discretionary bonuses even as their financial condition weakened; the capital

⁴ Therefore, to meet both the regulatory minimum, plus the capital conservation buffer requirement, a bank will have to have CET1 capital equal to or greater than 7 percent of its total risk-weighted assets.

conservation buffer will limit such practices and force banking organizations to conserve capital for periods of economic distress.

The countercyclical capital buffer can be activated in an expansionary credit cycle to increase regulatory capital requirements during periods of rapid growth. The goal of this requirement is to reduce excesses in lending and to protect against the effects of weakened underwriting standards. The countercyclical capital buffer would increase the capital conservation buffer for advanced approaches banking organizations by as much as another 2.5 percent of their risk-weighted assets.

A separate surcharge on systemically important banks (the so-called “SIFI surcharge”), which is to be the subject of a separate rulemaking, would add another 1 percent to 2.5 percent of risk-weighted assets to the risk-based capital requirements of the largest banks. The cumulative effect of the countercyclical buffer and the potential SIFI requirement is that during an upswing in the credit cycle, some large U.S. banks may be required to hold CET1 equal to as much as 12 percent of their risk-weighted assets, and this level could rise further should the systemic footprint of these banks increase.

Leverage Ratio Capital Requirements

Under the domestic capital rules, all banking organizations must meet a minimum leverage ratio requirement designed to constrain the build-up of leverage and reinforce the risk-based requirements with a non-risk-based backstop.

To be considered “adequately capitalized” from a leverage ratio perspective, all national banks and federal savings associations must have tier 1 capital equal to at least 4 percent of their total on-balance sheet assets. The minimum ratio for a bank to be “well capitalized” is 5 percent. Applying both risk-based capital requirements and leverage

capital requirements is appropriate because the two different standards work together to offset potential weaknesses and reduce incentives for regulatory capital arbitrage.

For national banks and federal savings associations subject to the advanced approaches rules, the domestic capital rules add a “supplemental leverage ratio” requirement. The supplemental leverage ratio requirement provides that an advanced approaches bank may not be considered “adequately capitalized” unless it has tier 1 capital equal to at least 3 percent of its *leverage exposure*, which is equal to the bank’s on-balance sheet assets *plus* a credit equivalent amount that represents the bank’s off-balance sheet exposures. Because large banking organizations often have large off-balance sheet exposures through different kinds of lending commitments, derivatives, and other activities, the 3 percent supplemental leverage ratio requirement is expected to be a more demanding standard than the current 4 percent leverage ratio requirement.

The OCC, together with the FRB and FDIC, just issued a proposal that would substantially increase the minimum supplemental leverage ratio requirement applicable to the largest and most complex banking organizations.⁵ Under the new supplemental leverage ratio proposal, the largest and most systemically important banks would be required to maintain an even higher ratio of tier 1 capital to leverage exposure in order to be deemed “well capitalized.” A higher supplemental leverage requirement for such institutions would place additional private capital at risk before calling upon the federal deposit insurance fund or the federal government’s resolution mechanisms. The OCC expects that this higher requirement would become the *de facto* minimum if finalized as

⁵ The proposal would apply to any U.S. top-tier bank holding company (BHC) with at least \$700 billion in total consolidated assets or at least \$10 trillion in assets under custody and any insured depository institution subsidiary of such a BHC.

proposed because large banking organizations generally engage in activities that are permitted only for institutions that are well capitalized.

The OCC will carefully consider comments received on this proposal from all stakeholders.

Incentives to Clear Derivatives through Central Counterparties

While the domestic capital rules include a number of changes to the way banks calculate risk-weighted assets that will improve the risk-sensitivity of the rules, among the more important provisions from a systemic perspective are new requirements that provide strong incentives for banks to clear derivatives through regulated central counterparties. Under the domestic capital rules, when a national bank or federal savings association clears a derivatives transaction through a qualifying central counterparty, the risk-based capital requirement applied to the exposure will be substantially lower than the requirement that otherwise would apply had the transaction not been cleared through the central counterparty.

Clearing more transactions through regulated central counterparties will help improve the safety and soundness of the derivatives market through greater netting of exposures, the establishment and enforcement of collateral requirements, and by encouraging market transparency.

Market Risk Capital Requirements

On August 30, 2012, the OCC published revisions to the market risk capital requirements that apply to national banks engaged in significant trading activities. The revisions to the market risk capital rule substantially increased the overall capital requirements applicable to trading activities, in large part by requiring banking

organizations to incorporate stressed economic conditions into their market risk models, adding prudential requirements to improve risk management, and adding disclosure requirements that provide transparency to market participants with regard to the calculation of a bank's market risk capital requirement.

The revised market risk rule also requires the OCC's prior written approval before a banking organization may use a model to calculate its market risk capital requirements. The rule requires a national bank to notify the OCC if it plans to (1) make a change to an approved model that would result in a material change to the bank's risk-weighted assets; (2) extend the use of an approved model to a new business line or product type; or (3) make any material change to its modeling assumptions.

In addition, the U.S. agencies are participating in the Basel Committee's fundamental review of the capital requirements for trading positions. In the second half of 2013, the Committee plans to publish a proposal for comment based on this review. At that point, the U.S. agencies will consider, subject to notice and comment, whether further changes in their market risk capital rules are necessary.

B. Enhanced Liquidity Standards

The maintenance of adequate liquidity is central to the proper functioning of financial markets and the banking sector. During the financial crisis, a number of banks, including some with adequate capital levels, encountered difficulties because they did not appropriately manage their liquidity. The stress on the international banking system resulted in significant government actions both globally and at home. To address future liquidity shortfalls, the federal banking agencies and the Basel Committee took some immediate and initial steps to address liquidity risk management.

In 2008, the Basel Committee published detailed guidance (Basel Liquidity Principles) on the risk management and supervision of liquidity risk. In 2010, the federal banking agencies, the National Credit Union Association, and the Conference of State Bank Supervisors issued an “Interagency Policy Statement on Funding and Liquidity Risk Management” (Liquidity Risk Policy Statement) that incorporates elements of the Basel Liquidity Principles and includes additional liquidity risk management principles previously issued by the agencies. The Liquidity Risk Policy Statement describes the process that institutions should follow to appropriately identify, measure, monitor, and control their funding and liquidity risk. In addition, the Liquidity Risk Policy Statement emphasizes the importance of cash flow projections, diversified funding sources, stress testing, a cushion of liquid assets, and a formal well-developed contingency funding plan as primary tools for measuring and managing liquidity risk.

To complement the Basel Liquidity Principles, in 2010, the Basel Committee issued “Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools” (Basel III Liquidity Framework). The Basel III Liquidity Framework introduces two explicit minimum liquidity ratios — the Liquidity Coverage Ratio and the Net Stable Funding Ratio — to assist a banking organization in maintaining sufficient liquidity during periods of financial distress.

These ratios are intended to achieve two separate but complementary objectives. The Liquidity Coverage Ratio, with a 30-day time horizon, addresses short-term resilience by ensuring that a banking organization has sufficient high quality liquid resources to offset cash outflows under acute short-term stresses. The Net Stable Funding Ratio seeks to promote longer-term resilience by creating additional incentives

for a banking organization to fund its ongoing activities with stable sources of funding. Its goal is to limit over reliance on short-term wholesale funding during times of robust market liquidity and to encourage better assessment of liquidity risk across all on- and off-balance sheet items.

The Basel Committee included a lengthy implementation timeline for both ratios to provide regulators the opportunity to conduct further analysis and to make changes as necessary. The federal banking agencies are developing a proposed rule to implement the 30-day Liquidity Coverage Ratio in the U.S. for large banking organizations, which we hope to issue for comment by the end of the year.

The Basel III Liquidity Framework's standards, once fully implemented, will complement overall liquidity risk management practices that have been informed and refined by the Liquidity Risk Guidance issued in 2010 and the enhanced liquidity standards proposed by the FRB, in consultation with the OCC, as part of the heightened prudential standards under section 165 of the Dodd-Frank Act.

III. Financial Stability Oversight Council (FSOC)

The Dodd-Frank Act established FSOC with the overarching mission to identify risks to the financial stability of the United States, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system. As a member of FSOC, the OCC regularly interacts with the other financial regulatory agencies to address these types of issues. FSOC enhances the agencies' collective ability to fulfill this critical mission by establishing a formal process for the agencies to exchange information and to probe and discuss the implications of emerging market, industry, and regulatory developments for the stability of the financial system. Through the work of its

committees and staff, FSOC also provides a structured framework and metrics for tracking and assessing key trends and potential systemic risks.

Nonbank SIFI Determinations

In section 113 of the Act, Congress gave FSOC the authority to determine that certain nonbank financial companies would be supervised by the FRB and subject to heightened prudential standards, after an assessment as to whether material financial distress at such companies would pose a threat to the financial stability of the United States. In accordance with its 2012 final rule and interpretive guidance, FSOC voted on June 3, 2013 to issue proposed determinations for three nonbank financial companies, and on July 9th, FSOC announced that it made a final determination for two of those companies, General Electric Capital Corporation, Inc. and American International Group, Inc. The third company has requested a hearing. A number of additional provisions apply to designated companies. For example, they would immediately be subject to the FRB's examination authority, enforcement actions under 12 U.S.C. § 1818, and assessments by the FRB and the Office of Financial Research. FSOC also is considering additional nonbank financial companies for proposed determinations.

FMU Designations

Title VIII of the Act charges FSOC with the responsibility for identifying and designating systemically important financial market utilities (FMUs). To process payments and settle securities, derivatives, and futures transactions between financial institutions safely and efficiently, our financial system relies on certain established protocols and intermediaries, including FMUs that operate multilateral payment, clearing, or settlement systems among financial institutions.

The Act subjects designated FMUs to heightened supervision by one of three agencies: (1) the SEC in the case of securities clearing agencies; (2) the CFTC in the case of derivatives clearing organizations; and (3) the FRB for all other FMUs (on either a direct or back-up basis). FSOC determines whether to designate an FMU as systemically important on a case-by-case basis, after assessing the FMU's market activities and the effect its failure or disruption would have on critical markets, financial institutions, or the broader financial system. In accordance with a final rule and interpretive guidance issued by the FSOC in July 2011, FSOC designated eight entities as systemically important FMUs on July 18, 2012.⁶ FSOC also monitors the financial markets and periodically determines whether designation status should remain in place for each FMU or whether it should designate additional FMUs.

Once designated, an FMU is subject to periodic examination by the SEC, CFTC, or FRB, as appropriate. Designated FMUs are also subject to operating rules promulgated by these agencies and must give their supervising agency advance notice of any material changes to their operations. Designated FMUs are subject to enforcement proceedings by their supervising agency for breach of these requirements, for unsafe or unsound practices, or for other violations of law, in accordance with 12 U.S.C. § 1818(b).

Other FSOC Authority

In addition to the authority to designate nonbank financial companies and FMUs as systemically important, Congress gave FSOC other tools to address systemic risk. For example, under section 120 of the Act, FSOC has the authority to recommend that the

⁶ These entities are: The Clearing House Payments Company, L.L.C., on the basis of its role as operator of the Clearing House Interbank Payments System, CLS Bank International, Chicago Mercantile Exchange, Inc., The Depository Trust Company, Fixed Income Clearing Corporation, ICE Clear Credit LLC, National Securities Clearing Corporation, and The Options Clearing Corporation.

primary financial agencies apply new or heightened standards and safeguards for a financial activity or practice conducted by firms under their respective jurisdictions should FSOC determine that the conduct of such an activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among financial institutions, the U.S. financial markets, or low-income, minority, or underserved communities. FSOC exercised this authority on November 13, 2012, with respect to money market mutual funds.

In addition, section 121 of the Act provides that affirmation by two-thirds of FSOC is required in those cases where the FRB determines that a large, systemically important financial institution poses a grave threat to the financial stability of the U.S. such that limitations on the company's ability to merge, offer certain products, or engage in certain activities are warranted, or if those actions are insufficient to mitigate risks, the company should be required to sell or otherwise transfer assets or off-balance sheet items to unaffiliated entities.

IV. Derivatives – Title VII

During the financial crisis, the lack of transparency in derivatives transactions among dealer banks and between dealer banks and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. To address this uncertainty, sections 723 and 763 of the Dodd-Frank Act generally require swaps and security-based swaps to be cleared through registered derivatives clearing organizations or clearing agencies (collectively, clearinghouses) and traded on regulated exchanges. Sections 725 and 763 provide the CFTC and SEC enhanced authority over their respective clearinghouses in recognition

that by performing centralized activities, clearinghouses concentrate risks and create interdependencies between and among them and their participants.

To further increase transparency and aid financial regulators in monitoring and mitigating systemic risk, sections 728, 729, 763, and 766 establish swap data repositories and require all swaps and security-based swaps to be reported to such repositories.

Pursuant to sections 731 and 763, national banks that are “swap dealers” must register with the CFTC, and those that are “securities-based swap dealers” must register with the SEC. Banks that must register become subject to all of the substantive requirements under Title VII for their swap activities. At this time, eight national banks have provisionally registered as swap dealers. The OCC has provided comments to the CFTC and SEC on rules implementing Title VII when consulted in accordance with Title VII.

Sections 731 and 764 of the Dodd-Frank Act require the OCC, together with the FRB, FDIC, Federal Housing Finance Agency, and Farm Credit Administration, to impose minimum margin requirements on non-cleared derivatives for swap dealers and major swap participants that are banks. The OCC, together with these other agencies, published a proposal on May 11, 2011, to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants (swap entities) that are subject to agency supervision. To address systemic risk concerns, consistent with the Dodd-Frank Act requirement, the agencies proposed to require swap entities to collect margin for all uncleared transactions with other swap entities and with financial counterparties. However, for low-risk financial counterparties, the agencies proposed that a swap entity

would not be required to collect margin as long as its margin exposure to a particular low-risk financial counterparty does not exceed a specific threshold amount of margin. Consistent with the minimal risk that derivatives transactions with commercial end users pose to the safety and soundness of swap entities and the U.S. financial system, the proposal also included a margin threshold approach for these end users, with the swap entity setting a margin threshold for each commercial end user in light of the swap entity's assessment of credit risk of the end user. The proposed margin requirements would apply to new, non-cleared swaps or security-based swaps entered into after the proposed rule's effective date.

Given the global nature of major derivatives markets and activities, international harmonization of margin requirements is critical, and we are participating in efforts by the Basel Committee on Bank Supervision (BCBS) and International Organization of Securities Commissions (IOSCO) to address coordinated implementation of margin requirements across G-20 nations. The BCBS-IOSCO working group issued a consultative document in July of 2012, seeking public feedback on a broad policy framework for margin requirements on uncleared swap transactions that would be applied on a coordinated and non-duplicative basis across international regulatory jurisdictions. We and the other U.S. banking agencies and the CFTC re-opened the comment periods on our margin proposals to give interested persons additional time to analyze those proposals in light of the BCBS-IOSCO consultative framework. The banking agencies' comment period closed on November 26, 2012. Many commenters focused on the treatment of commercial end users, urging the agencies to adopt the exemptive approach suggested by the BCBS-IOSCO proposal.

The BCBS-IOSCO working group published a second consultative paper for public comment on February 15, 2013. This paper describes most of the guiding principles for the over-the-counter margin regime envisioned by the BCBS and IOSCO. The comment period closed on March 15th of this year, and the BCBS-IOSCO working group continues its discussions with its parent committees to finalize a regulatory template to guide the participating jurisdictions to a coordinated regulatory structure on uncleared swap margin issues. The OCC and the other agencies continue to monitor these discussions so that U.S. and foreign regulators can coordinate next steps.

Finally, section 716 of the Dodd-Frank Act prohibits the provision of federal assistance to a national bank swap dealer,⁷ unless the dealer limits its swap activities. Specifically, the swap activities must be limited to (1) hedging and similar risk mitigating activities; and (2) acting as a swaps entity for swaps involving rates or reference assets permissible for investment by a national bank under 12 U.S.C. Section 24(Seventh). Credit default swaps are not permissible under the second exception unless cleared by a derivatives clearing organization or clearing agency as provided in section 716.

Section 716 also requires the OCC to grant national banks a transition period of up to 24 months to comply with the statute beginning on July 16, 2013. In establishing the appropriate transition period, the statute directs the OCC to consider the potential impact of the bank's divestiture or cessation of "activities that require registration as a swaps entity" on specific statutory factors. "Activities that require registration" include both swap activities covered by the prohibition in section 716 as well as those specifically

⁷ In this testimony, "swap dealer" refers to both a securities-based swap dealer regulated by the SEC and a swap dealer regulated by the CFTC.

excluded from the prohibition and thus allowed within the bank.⁸ Further, the statute directs the OCC to consider the impact of divestiture or cessation of those swap activities on mortgage lending, small business lending, job creation, and capital formation versus the potential negative impact on insured depositors and the deposit insurance fund of the FDIC. The OCC also may consider other factors as appropriate.

Consistent with these statutory mandates, the OCC granted seven national banks a 24-month transition period in order to come into conformance with the prohibitions without unduly disrupting lending activities and other functions the statute required us to consider.

Because the framework for derivatives is still being formulated under Title VII, banks that are covered by section 716 have generally not had sufficient clarity to assess how to and where to push out the swaps subject to the prohibition. The prudential regulators, CFTC, and SEC are still issuing proposed rules, final rules, guidance, and exemptive orders to implement Title VII. Although the Title VII regulatory structure is still being implemented, section 716 goes into effect on July 16, 2013. The transition periods will allow banks to develop a transition plan providing for an orderly cessation or divestiture of swaps activities based on a more developed Title VII regulatory framework.

V. Volcker Rule

Section 619 of the Dodd-Frank Act is intended to prohibit certain high-risk proprietary trading and private fund investment activities of banking entities and to limit the systemic risk of such activities. Specifically, section 619 prohibits a banking entity

⁸ Consideration of both covered and excluded swaps, as required by the statute, is appropriate if customers request the transfer of all swaps to a bank affiliate in order to preserve the netting benefits that come from transacting with a single counterparty.

from engaging in proprietary trading and having ownership interests in, or relationships with, a hedge fund or private equity fund, while at the same time permitting certain client-oriented financial services that may technically fall within the statutory prohibitions.

On October 11, 2011, the OCC, FDIC, FRB, and the SEC issued proposed rules implementing the requirements of section 619. The agencies received more than 19,000 comments covering a wide range of perspectives on nearly every aspect of the proposed rule. Overall, commenters urged the agencies to simplify the final rule, to reduce compliance burdens for entities that do not engage in significant trading or covered fund activities, and to address unintended consequences of the proposed rule. Some commenters urged the agencies to adopt a final rule that would set forth fairly prescriptive standards and narrowly construed permitted activity exemptions, as they believed this would minimize potential loopholes and the possibility of evasion. Other commenters urged the agencies to adopt a more flexible, principles-based approach in the final rule, as they believed this would reduce burden and lessen possible unintended consequences.

The OCC, together with the other agencies, continues to devote significant time and resources to developing final rules consistent with the statutory language and with careful consideration to the comments we received including, for example, comments on distinguishing permissible market-making-related activities from prohibited proprietary trading and defining what is a covered fund. To ensure, to the extent possible, that the rules implementing section 619 are comparable and provide for consistent application, the agencies have been regularly consulting with each other and will continue to do so.

The agencies have made significant progress toward developing a final rule that is faithful to the language of section 619 and maximizes bank safety and soundness and financial stability at the least cost to the liquidity of the financial markets, credit availability, and economic growth.

VI. Resolution Authority

The Dodd-Frank Act contains a number of resolution-related provisions that will arm the federal banking agencies with the information and authority to ensure that planning needed for an organized resolution of the largest and most systemically significant firms is in place.

Living Wills

Section 165 of the Act requires the largest bank holding companies and FSOC-designated nonbank financial companies to prepare a plan for rapid and orderly resolution in the event of material financial distress or failure.⁹ While the statute assigns the oversight of these companies' resolution planning to the FRB and the FDIC, the OCC's experience and expertise as the primary supervisor of the national bank subsidiaries of the largest bank holding companies positions us to make an important contribution to that work. The three agencies are collaborating accordingly. In addition, we expect that the resolution plans, particularly as they are developed and are refined over time, will provide information that is helpful not only to resolution planning but also to our ongoing supervision. An OCC multi-disciplinary team is currently developing supervisory strategies with respect to the use of data underlying the resolution plans.

⁹ A requirement that institutions file resolution plans also had been a recommendation of the Basel Committee's Cross-Border Bank Resolution Working Group, in which the U.S. banking agencies participated. Jurisdictions in addition to the U.S. also are requiring institutions to file such plans.

Recovery Planning

In conjunction with resolution planning, some institutions are also preparing recovery plans outlining the steps they would take, as going concerns, to remain viable in the case of severe financial pressure. Recovery planning is critical to ensuring the resilience of a firm's core business lines, critical operations, and material entities. Recovery planning as a discipline is integrated with resolution planning, capital and liquidity planning, and other aspects of financial contingency, crisis management, and business continuity planning. The OCC believes that recovery planning must be an integral part of institutions' corporate governance structures and processes, be subject to independent review, and be effectively supported by reporting to the board and its committees. As the primary supervisor for national banks and federal savings associations, the OCC has an important interest in how recovery planning is carried out. For this reason, the OCC has worked closely with other regulators to provide appropriate informal supervisory guidance for recovery planning, and further coordination is underway.

Orderly Liquidation Authority

In response to the financial crisis, Congress provided to the FDIC in Title II of the Dodd-Frank Act the Orderly Liquidation Authority (OLA). The OLA's provisions are aimed at addressing two policy goals — mitigating the systemic risk that is presented when large financial firms enter the bankruptcy process, and minimizing the moral hazard that arises when investors believe that firms are likely to be granted a government bail-out to save them from bankruptcy and prevent systemic problems. The OLA provisions aim to address apparent weaknesses inherent in the core features of

bankruptcy when resolving systemically important financial institutions while minimizing moral hazard. Thus, Title II gives the FDIC broad discretion in how it funds the resolution process and how it pays out creditors. The FDIC can seek to exercise its discretion in a way that will minimize moral hazard. Title II also changes the way in which qualified financial contracts (QFC) are treated, providing the FDIC with 24 hours to transfer QFCs as compared with the bankruptcy process under which QFCs are not subject to a stay.

VII. Dodd-Frank Impact on Community Banks

The Committee has also requested the OCC to discuss how the Dodd-Frank Act has affected our regulation of community banks and thrifts. The Act is primarily directed toward larger financial institutions, but it does broadly amend some laws in ways that affect the entire banking sector, including community banks and thrifts.

The OCC is sensitive to the necessary differences in supervision between large banks and community banks, and we are taking steps to reduce the burden and expense smaller institutions bear in reviewing and implementing new regulatory requirements.

We believe it is important to assess the potential impact of our regulations on smaller-sized institutions and, where the OCC has rulemaking authority under the Dodd-Frank Act, we have tailored our regulations to accommodate concerns of community banks and thrifts. For example, in the recently released lending limits rule, we provided significant additional flexibility for smaller institutions by allowing them to use a simple look-up table to calculate particular exposures. The companion guidance to our rulemaking to remove credit ratings from our investment securities regulations similarly seeks to reduce burden. In implementing these provisions of the Act, our goal has been

to meet the objectives of the statute while recognizing the effectiveness of the existing tools and analyses that well-managed community banks and thrifts have routinely used to aid their credit analysis and investment decisions.

We have also reexamined the ways in which we explain and organize our rulemakings to better help community bankers understand the scope and application of the rules to their institutions. For example, the recently released domestic capital rules are accompanied by a 12-page interagency community bank guide and an OCC-issued 2-page pamphlet that helps banks navigate through an otherwise dense and complex rulemaking. The pamphlet is attached as Appendix A hereto. We plan to use this or a variant of this approach in more of our rulemakings to enable community banks and thrifts to more easily determine which provisions apply to them and whether they should comment on proposed rulemakings. Similarly, in October 2012, we provided guidance to clarify that the OCC does not expect community banks to conduct stress tests like those required for larger banks (OCC Bulletin 2012-33). As part of our outreach activities with community bankers, we also regularly welcome input regarding additional ways to improve our communications with community banks and thrifts.

These initiatives are complemented by the efforts of our examiners to serve as a resource to the institutions we supervise. We remain committed to having our examiners work and live in the same communities as the banks they supervise. This allows examiners to develop an in-depth understanding of the local market and to better anticipate and discuss risks with these institutions.

Most recently, the OCC published a new booklet titled *A Common Sense Approach to Community Banking*.¹⁰ The booklet is intended in part to convey our views about the types of practices that make a community bank excel. The booklet reviews topics important to community bankers and highlights those time-tested concepts that all financial institutions should understand and apply to their business.

We also note that under the Dodd-Frank Act, the CFPB has exclusive authority to prescribe regulations administering certain enumerated federal consumer financial laws. With respect to this rulemaking authority, the CFPB is required to consult with the prudential regulators prior to proposing a rule and during the rulemaking process “regarding consistency with prudential, market, or systemic objectives” administered by the prudential regulators. This consultation process provides an avenue for the OCC to make the CFPB aware of concerns expressed by all banks, including the community banks and thrifts we supervise. The consultation process has enabled the OCC to have meaningful input in the CFPB’s regulatory process. The OCC has taken this responsibility seriously and has provided comment to the CFPB. For example, the OCC recently submitted a comment letter to the CFPB to express the OCC’s views on the CFPB’s qualified mortgage proposal regarding interpretations on loan originator compensation. The CFPB’s final rule incorporated these suggestions, and we look forward to continuing to provide similar input on issues of concern to our banks and thrifts.

¹⁰ <http://el.occ/publications/publications-by-type/other-publications-reports/common-sense.pdf>

VIII. Update on Status of Dodd-Frank Rulemakings

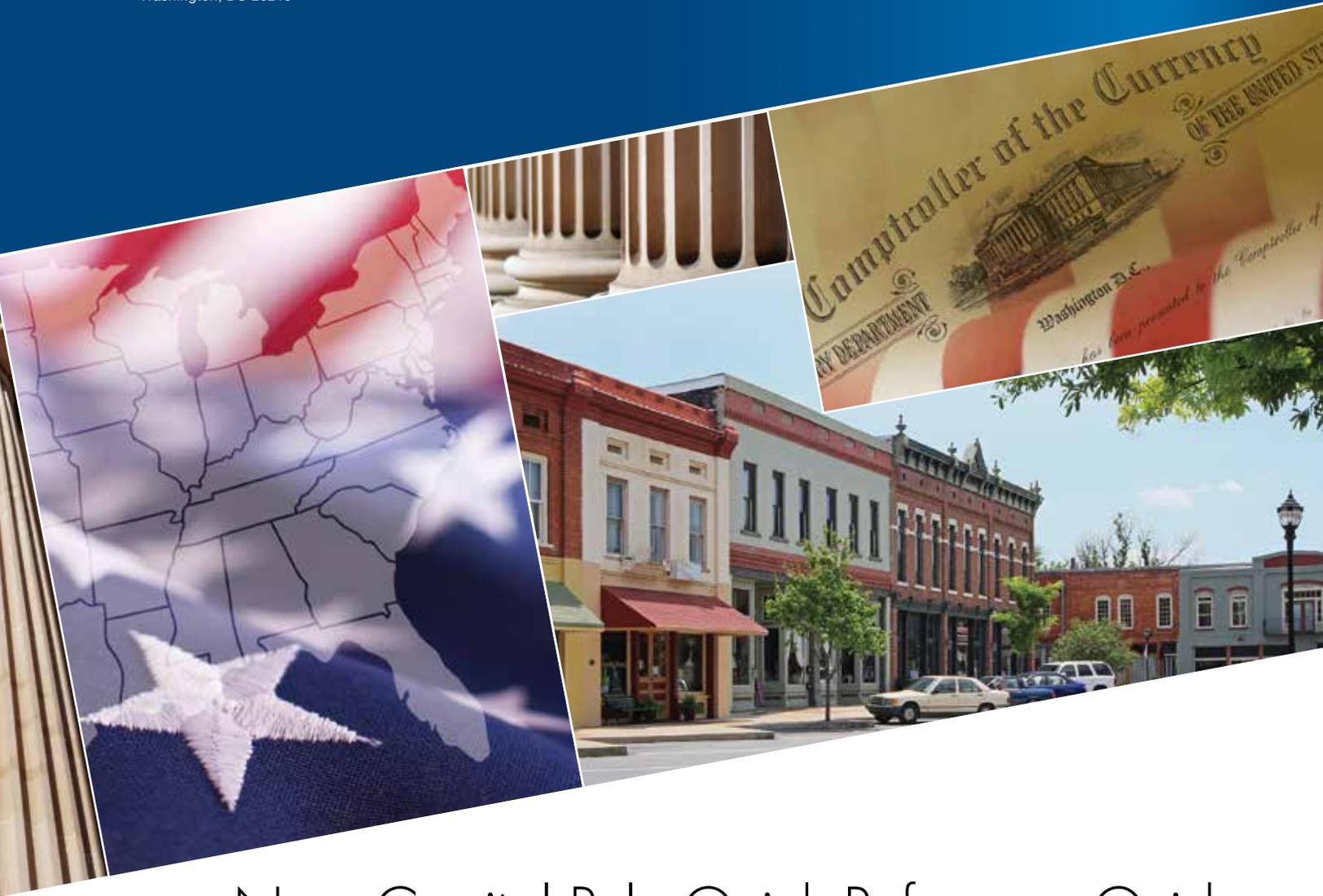
As discussed earlier, all of the significant rules for which the OCC has independent rule writing authority have been completed. The joint interagency rule on appraisals for higher-priced mortgage loans (section 1471) has also been finalized.

With respect to other rules that require interagency action that are yet to be completed, the OCC is continuing to work cooperatively with our colleagues at other agencies. These rules include those addressing credit risk retention (section 941), the Volcker Rule (section 619), source of strength requirements (section 616(d)), margin and capital requirements for covered swap entities (sections 731 and 764), incentive-based compensation (section 956), automated valuation models used to estimate collateral value (section 1473(q)) and reporting activities of appraisal management companies (section 1473(f)(2)). The OCC has committed the necessary resources to these efforts, and we remain mindful of the need to complete these rules in the near term.

Conclusion

I appreciate the opportunity to appear before this Committee and to update you on the work the OCC has done to address systemic risk concerns at our largest institutions. The Dodd-Frank Act contains a number of tools to address systemic risk, and it is important that we avail ourselves of those tools by completing as quickly as possible the outstanding rules. We believe it is essential to supplement the rules with an equally vigorous approach to supervision. We look forward to keeping the Committee apprised of our progress.

Appendix A



New Capital Rule Quick Reference Guide for Community Banks

New Capital Rule Quick Reference Guide for Community Banks

The new capital rule implements revisions to the risk-based regulatory capital framework for national banks and federal savings associations (collectively, banks). This quick reference tool is a high-level summary of the aspects of the new rule that are generally relevant for smaller, non-complex banks that are not subject to the market risk rule or the advanced approaches capital rule. This quick reference guide does not carry the force and effect of law. The new rule, which can be found on the OCC's Web site along with a Community Bank Guide, sets forth the revised capital standards. Community banking organizations become subject to the new rule on January 1, 2015.

Key Changes From the June 2012 Proposals

Residential Mortgage Exposures: Relative to the existing rules, the risk-based capital treatment of residential mortgage exposures remains unchanged, with available risk weights including 50 percent and 100 percent and a safe harbor from recourse treatment for loans sold with certain repurchase triggers such as early default clauses.

Accumulated Other Comprehensive Income (AOCI) Filter:

Banks have a one-time irrevocable option to neutralize certain AOCI components, comparable to the treatment under the prior rules. If banks do not exercise this option, AOCI will be incorporated into common equity tier 1 capital (CET1), including unrealized gains and losses on all available-for-sale securities.

Trust Preferred Securities (TRuPS): Holding companies with assets less than \$15 billion as of December 31, 2009, or organized in mutual form as of May 19, 2010, are allowed to grandfather into tier 1 capital. TRuPS issued before May 19, 2010, are subject to a maximum of 25 percent of tier 1 capital.

Risk-Weighted Assets (RWA)

- The new rule increases risk weights for past-due loans (150 percent risk weight for the portion that is not guaranteed or secured) and high-volatility commercial real estate exposures (150 percent risk weight), and increases credit conversion factors (CCF) for certain short-term loan commitments (20 percent CCF).
- The new rule expands recognition of collateral and guarantors in determining RWAs.

Capital Requirements & PCA

The new rule revises Prompt Corrective Action (PCA) capital category thresholds to reflect the new capital ratio requirements and introduces CET1 as a PCA capital category threshold.

PCA Capital Category	Threshold Ratios			
	Total RBC* ratio	Tier 1 RBC* ratio	CET1 RBC* ratio	Tier 1 Leverage ratio
Well capitalized	10%	8%	6.5%	5%
Adequately capitalized	8%	6%	4.5%	4%
Undercapitalized	< 8%	< 6%	< 4.5%	< 4%
Significantly undercapitalized	< 6%	< 4%	< 3%	< 3%
Critically undercapitalized	Tangible Equity/Total Assets ≤ 2%			

*RBC = risk-based capital

- The new rule removes references to credit ratings.
- For securitization exposures, the new rule establishes due diligence requirements and introduces an approach for assigning regulatory capital that does not rely on external credit ratings.
- Relative to the existing rules, the treatment of corporate and retail loans and U.S. government (and related) entities remains unchanged.

Transition Schedule for New Ratios and Capital Definitions for Community Banks

Year (as of Jan. 1)	2015	2016	2017	2018	2019
Minimum CET1 ratio	4.5%	4.5%	4.5%	4.5%	4.5%
Capital conservation buffer	N/A	0.625%	1.25%	1.875%	2.50%
CET1 plus capital conservation buffer	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1*	40.0%	60.0%	80.0%	100.0%	100.0%
Minimum tier 1 capital	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum tier 1 capital plus capital conservation buffer	N/A	6.625%	7.25%	7.875%	8.5%
Minimum total capital	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum total capital plus conservation buffer	N/A	8.625%	9.25%	9.875%	10.5%

* Including threshold deduction items that are over the limits.

N/A means not applicable.

Common Equity Tier 1 Capital

The sum of common stock instruments and related surplus net of treasury stock, retained earnings, AOCI, and qualifying minority interests—less applicable regulatory adjustments and deductions that include AOCI (if irrevocable option to neutralize AOCI is exercised).

Mortgage-servicing assets, deferred tax assets, and investments in financial institutions are limited to 15 percent of CET1 and 10 percent of CET1 individually.

Additional Tier 1 Capital

Noncumulative perpetual preferred stock, tier 1 minority interests, grandfathered TRuPS, and Troubled Asset Relief Program instruments—less applicable regulatory adjustments and deductions.

Tier 2 Capital

Subordinated debt and preferred stock, total capital minority interests not included in tier 1, allowance for loan and lease losses not exceeding 1.25 percent of risk-weighted assets—less applicable regulatory adjustments and deductions.

Capital Conservation Buffer

The new rule requires banks to hold CET1 in excess of minimum risk-based capital ratios by at least 2.5 percent to avoid limits on capital distributions and certain discretionary bonus payments to executive officers and similar employees.

Capital Conservation Buffer (as a percentage of RWA)	Maximum Payout Ratio (as a % of the previous four quarters of net income)
Greater than 2.5%	No payout limitation applies
Less than or equal to 2.5% and greater than 1.875%	60%
Less than or equal to 1.875% and greater than 1.25%	40%
Less than or equal to 1.25% and greater than 0.625%	20%
Less than or equal to 0.625%	0%

