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Regulatory Update and 2019 Preview

by Rob McDonough
Senior Research Manager, Angel Oak Capital Advisors, LLC

Regulatory Update and 2019 Preview

There have been several significant regulatory changes to the financial services environment in 2018, and more are anticipated in 2019. Following is a brief summary of some of the most significant of those changes.

Stress Testing

Randal Quarles, Vice Chair for Supervision at the Fed, announced that changes to ease stress testing requirements would be issued in the near future. The goal would be to make the annual DFAST and CCAR stress test scenarios more consistent and to coordinate the release of results with the banks' annual reports. The proposals will also recommend that banks with less than $250 billion in assets be exempted from the 2019 tests as they are set to enter a two-year evaluation schedule under a different Fed regulatory process.

Leverage Ratio Off-Ramp

The FDIC has proposed the implementation of a Community Bank Leverage Ratio (CBLR) election for banking institutions below $10 billion in total assets. Banks with less than $10 billion in assets could elect this "off-ramp" to be exempted from other Basel risk-based capital requirements. The election would be available if they maintain a 9% tangible equity-to-assets ratio and hold less than 20% in off-balance sheet exposures, 5% or less of assets in trading assets and liabilities, 25% or less in mortgage servicing assets, and 25% or less in deferred tax assets (DTAs). The proposal provides details about the calculation of the CBLR, the election process, and how the agencies would handle situations when banks' leverage ratios deteriorate.

Fannie, Freddie, and FHFA Leadership

Treasury Secretary Steven Mnuchin will soon be appointing new heads of Fannie Mae, Freddie Mac and the Federal Housing Finance Agency, potentially leading to a plan to recapitalize the GSEs and remove them from conservatorship. Current FHFA president Mel Watt's term ends January 6, 2019 and Fannie Mae CEO Tim Mayopoulos steps down October 15, 2018 and Freddie Mac CEO Don Layton is resigning in the second half of 2019. The leading candidate for Watt's position is current OCC Comptroller Joseph Otting. Trump administration appointments have tended to favor deregulation and a reduction in the government's role in housing and financial markets.

Streamlining Call Reports

The three federal banking agencies announced a proposal to reduce reporting requirements for banks with total assets of less than $5 billion that do not engage in certain complex or international activities. The proposal would reduce existing quarterly Call Report data items by approximately one-third. The Federal Reserve Board and the OCC also are proposing similar reduced reporting for certain uninsured institutions that they supervise with less than $5 billion in total consolidated assets that meet the same criteria.

Supervisory Guidance vs. Regulation

Bank regulators and the Bureau of Consumer Financial Protection recently issued an Interagency Statement confirming that supervisory guidance does not have the force of law and that bank examiners should not take enforcement actions based on supervisory guidance. The statement reaffirms the status of guidance under existing law. The Bank Policy Institute and the American Bankers Association are asking for regulators to formalize the Interagency Statement in the form of a binding regulation to ensure its consistent application over time.

Large Bank Regulatory Relief

The Fed has proposed a new framework that would more closely match the regulations for large banking organizations with their risk profiles. Banks would be sorted into categories based on several factors:

- Banks with $100 billion to $250 billion in total consolidated assets would no longer be subject to standardized liquidity requirements. They would remain subject to firm-developed liquidity stress tests and regulatory liquidity risk management standards. Additionally, these firms would no longer be required to conduct company-run stress tests and their supervisory stress tests would be moved to a two-year cycle, rather than annual. These reduced requirements would reflect the lower risk profile of these firms.
- Banks with $250 billion or more in total consolidated assets or material levels of the other risk factors that are not global systemically important banks (GSIBs) would have their standardized liquidity requirements reduced to reflect their more stable funding profile but remain subject to a range of enhanced liquidity standards. In addition, the firms would be required to conduct company-run stress tests on a two-year cycle, rather than semi-annually. The firms would remain subject to annual supervisory stress tests.
- Banks in the highest risk categories – including the GSIBs – would not see any changes to their capital or liquidity requirements.

Summary

The number and scope of regulatory changes are welcomed by many institutions, particularly smaller institutions that perceive the regulatory burden has been too high in the past. It will be interesting to see where the leadership changes at the agency and administrative levels take future regulations.

About the Author: Rob McDonough

Rob is the Senior Research Manager of Angel Oak Capital Advisors, LLC, an asset manager with $10 billion in assets under management focused on structured credit investment strategies and the securitization of mortgage-related assets. He currently coordinates the firm's research and publication activities on a variety of financial and risk management topics. He previously led Angel Oak's financial institution advisory practice, managing client engagements which included risk model validations, strategic and regulatory stress testing implementations, and investment portfolio risk and performance assessments. Rob was Angel Oak's Chief Risk Officer from 2012-2014 and initiated the organization's enterprise-wide risk management framework and SEC compliance program.

Rob is also the President and CEO of a financial services consultancy specializing in risk management consulting and training for institutions managing market, credit, operational, and other risks. He is a consultant and instructor for the Investment Training and Consulting Institute, Inc. and a Certified Investments and Derivatives Auditor (CIDA). He is also an instructor for many other organizations and industry groups including GFMI.

Rob started his career with the Federal Reserve System, where for twelve years he was an economic analyst and a capital markets safety and soundness examiner. His primary focus was regulatory policy development as well as assessing the condition of large complex domestic and international financial institutions. He developed significant field work experience in conducting safety and soundness examinations for banks and holding companies domestically and internationally. Rob also chaired a Federal Reserve System-wide committee to design, develop and deliver training for selected capital markets examiners across the country. This training was also implemented in a number of foreign central banks.

After leaving the Federal Reserve System in 1998, Rob joined Accenture as a Senior Manager in the Financial Services Industry Group, where he headed a joint task force responsible for defining and implementing the post-merger organizational structure for First Union's Brokerage Division's IT department.

Rob is a charter holder of the Bank Administration Institute's Certified Risk Professional (CRP) designation and the ITCI Certified Investments and Derivatives Auditor (CIDA). Rob has delivered capital markets and risk management seminars to financial institutions across the US as well as in 28 countries throughout LATAM, Asia Pacific, and Europe.

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PO Box 388
Jericho, NY 11753-0388
+1 516 935 0923
www.GFMI.com