FINANCIAL REGULATION

Fed Proposes Looser Rules for Large U.S. Banks

Proposal marks one of the most significant rollbacks of bank regulations since Trump took office

The Federal Reserve's rollback of bank rules would affect large U.S. lenders including U.S. Bancorp., Capital One Financial, and more than a dozen others. PHOTO: MARK LENNIHAN/ASSOCIATED PRESS

By Ryan Tracy

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WASHINGTON—The Federal Reserve announced one of the most significant rollbacks of bank rules since President Trump took office with a proposal for looser capital and liquidity requirements for large U.S. lenders.

The changes would affect large U.S. lenders including U.S. Bancorp , Capital One Financial Corp. , and more than a dozen others. The largest U.S. banks, including JPMorgan Chase & Co., wouldn't see any significant rule changes, and some in the industry thought the proposal didn't go far enough.

The draft proposal, approved by a 3-1 vote at a Wednesday meeting of the Fed's governing board, would divide big banks into four categories based on their size and other risk factors. Regional lenders would be either entirely released from certain capital and liquidity requirements, or see those requirements reduced. They could also, in some cases, be subject to less frequent stress tests.

The proposals received a mixed reaction from banks. While some trade groups praised it, Greg Baer—president of the Bank Policy Institute, which represents large banks—said the proposal "does not do enough to tailor regulations." He said, for instance, the plan doesn't include changes to the Fed's primary stress tests for big banks or to rules affecting foreign-owned banks with U.S. footprints. Fed officials said they were planning future proposal in those areas.

The plan divided the Fed, with Trump-appointed regulators and the Fed's lone Obama-appointed official taking opposite sides. Fed Chairman Jerome Powell said the proposal would cut the regulatory burden "while maintaining the most stringent requirements for firms that pose the greatest risks."

Fed governor Lael Brainard dissented. The Obama appointee said the policy changes "weaken the buffers that are core to the resilience of our system" and raise "the risk that American taxpayers again will be on the hook."

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The most significant changes in the Fed's proposal would affect banks with assets between $100 billion and $250 billion, a group that includes BB&T Corp. , SunTrust Banks Inc. and others. Those firms would no longer have to follow the so-called liquidity coverage ratio, which requires firms to hold assets they can sell for cash in a pinch.

The proposal also would offer those banks more flexibility in how gains and losses in securities portfolios affect their capital levels, which could reduce the amount of capital they must maintain.

Banks with assets of $100 billion to $250 billion might also be released next year from the Fed's annual stress tests, which publicly grade banks on whether they could continue lending during a severe recession.

Wednesday's proposal didn't directly address that question, but Fed Vice Chairman for Supervision Randal Quarles said he expected the Fed to move from annual public exams on those banks to a two-year cycle, with 2019 as an "off-cycle" year.

Banks with assets of $250 billion to $700 billion—or other firms that trip certain risk thresholds such as $75 billion in nonbank assets or cross-border exposure—also would receive flexibility around how their capital requirement reflects unrealized gains and losses. Under the plan, they would receive a long-sought goal: a relaxed liquidity-coverage-ratio requirement, about 70% to 85% of the one they currently face.

This group includes U.S. Bancorp, PNC Financial Services Group Inc., and Capital One, which have argued for years that the Fed's liquidity rules treated them too harshly.

The Fed said the liquidity-rule changes could reduce the amount of liquid assets big banks must hold by about $43 billion, or about 2.5% of the amount held by banks with more than $100 billion in assets. The impact will vary for individual firms, however. Fed officials said they would continue to "stress test" big banks' liquidity, and in some cases stress-testing requirements can be stricter than the rules the Fed is proposing to relax.

Fed officials say they didn't see conclusive evidence on how the liquidity-rule changes could affect lending. In general, a financial company following a looser liquidity rule could have more freedom to jettison Treasury bonds or other safe assets and expand riskier, more profitable activities such as loans. The firm might also be able to lower interest rates on deposits, because the rule effectively taxes deposits that regulators judge are likely to leave the bank in a crisis.

House Financial Services Committee Chairman Jeb Hensarling (R., Texas) praised the proposal, saying it "takes us a great distance towards the goal" of rolling back overly restrictive bank rules. Congress gave regulators that task under a law enacted earlier this year.

Although the largest U.S. banks got little help from Wednesday's proposal, the Fed moved earlier this week to make another change they have long advocated. The Fed proposal would reduce the capital banks have to hold against derivatives exposures by changing the way centrally cleared derivatives are treated in capital calculations. Current rules make little distinction between less-risky centrally cleared derivatives and uncleared contracts.

—Gabriel T. Rubin contributed to this article.

Write to Ryan Tracy at ryan.tracy@wsj.com