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November 5, 2018

Regulatory Tailoring for Large U.S. Banking Organizations

Federal Bank Regulators Propose Significant Revisions to the Application of Enhanced Prudential Standards and Capital and Liquidity Requirements for Large U.S. Banking Organizations

SUMMARY

On October 31, the Federal Reserve Board adopted two proposed rules that would tailor how certain aspects of the post-crisis bank regulatory framework, including certain capital and liquidity requirements and other prudential standards, apply to large U.S. banking organizations. One of the rules is to be issued jointly by the FDIC, Federal Reserve and OCC.[1] The other was issued solely by the Federal Reserve.[2]

The proposals would assign all U.S. bank holding companies ("BHCs") and savings and loan holding companies not substantially engaged in commercial or insurance activities ("Covered SLHCs") with $100 billion or more in total consolidated assets to one of four categories based on their size and other "risk-based indicators." Those indicators are (1) cross-jurisdictional activity, (2) weighted short-term wholesale funding ("STWF"), (3) nonbank assets, (4) off-balance sheet exposure, and (5) status as a U.S. global systemically important bank holding company ("G-SIB"). The category to which an institution would be assigned would determine the capital and liquidity requirements to which it and its subsidiary depository institutions would be subject, as well as the enhanced prudential standards and capital planning requirements to which the holding company would be subject.

The proposals distinguish between U.S. G-SIBs and other large banking organizations. For U.S. G-SIBs and their subsidiary depository institutions, the proposals would eliminate the requirement to conduct semi-annual company-run stress tests but would otherwise not alter the capital and liquidity requirements, enhanced prudential standards, and capital planning requirements that currently apply to them. In

contrast, as described by Federal Reserve Vice Chairman for Supervision Quarles, the requirements and standards applicable to other large U.S. banking organizations would be tailored, based on size and the risk-based indicators, to reduce "regulatory complexity" and the "compliance burden."[3] Annex I of this Memorandum summarizes the capital and liquidity requirements, enhanced prudential standards, and capital planning requirements that would be applicable to firms in each of the four proposed categories.

The proposals expressly do not apply to foreign banking organizations with U.S. operations ("FBOs"), including Federal branches or agencies, any intermediate holding company ("IHC") of an FBO or any subsidiary depository institution of an IHC, although the Federal Reserve notes that it "plans to develop a separate proposal relating to [FBOs] and their U.S. operations."[4] Accordingly, references to BHCs and other firms in this document refer only to those with a U.S. top-tier entity.

The two proposals also reference a number of regulatory actions that are expected to be proposed or released by the Federal Reserve in the future, including:

- a proposal to amend its capital plan rule and comprehensive capital analysis and review ("CCAR") process, including revisions to align with the proposed removal of certain company-run stress testing requirements and proposed two-year supervisory stress testing cycle for certain BHCs, and to apply capital planning requirements to Covered SLHCs (*i.e.*, to include them in CCAR);[5]
- a proposal to amend annual company-run stress testing requirements applicable to state member banks to conform with changes made by the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"), enacted earlier this year;[6]
- a proposal to amend, with the FDIC, their joint resolution plan rule to address the applicability of resolution plan requirements for BHCs with between $100 billion and $250 billion in total consolidated assets and to adjust the scope and applicability of resolution plan requirements for BHCs that remain subject to them;[7] and
- as noted, a proposal to adjust the application of the post-crisis regulatory framework to FBOs and their U.S. operations, including to "reflect the principles of national treatment and equality of competitive opportunity."[8] The Federal Reserve notes that it is considering "the appropriate way to assign the U.S. operations of [FBOs] to the categories . . . described in th[e] proposal[s], in light of the special structures through which these firms conduct business in the United States."[9]

The Federal Reserve also intends to revise its guidance relating to capital planning, to align that guidance with the proposed categories of standards, and to allow more flexibility in how BHCs in the fourth proposed category (*i.e.*, firms with less than $250 billion in total consolidated assets and with risk-based indicators that do not exceed $75 billion) perform capital planning and develop their annual capital plans, which the Federal Reserve notes could entail requiring those BHCs to include in their annual capital plans estimates of revenues, losses, loan loss reserves, and capital levels based on a forward-looking analysis, but not requiring them to submit the results of company-run stress tests.[10]

Federal Reserve Board Chairman Powell, Vice Chairman Clarida, and Vice Chairman Quarles voted in favor of the proposals. Governor Brainard dissented, arguing that the proposed tailoring of prudential requirements for banking organizations with total consolidated assets of greater than $250 billion that are not U.S. G-SIBs would “go beyond the provisions” of EGRRCPA, reduce the “core resilience” of the U.S. financial system, and provide “little benefit to the institutions or the system.”[11]

The proposals would not significantly reduce the regulatory requirements applicable to U.S. G-SIBs, but would make changes not explicitly required by EGRRCPA to reduce the stringency of the post-crisis regulatory requirements applicable to smaller and less internationally active and complex large banking organizations. This approach, according to Chairman Powell, reflects the goal of the proposals—to “prescribe materially less stringent requirements on firms with less risk, while maintaining the most stringent requirements for firms that pose the greatest risks to the financial system and our economy.”[12]

Comments on the proposals are due on or before January 22, 2019.

BACKGROUND

EGRRCPA was signed into law on May 24. As discussed in our Memorandum to Clients published on that date, the statute generally preserves the fundamental elements of the regulatory framework established after the 2010 enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), but includes a variety of measures intended to result in meaningful regulatory relief for smaller and certain regional banking organizations.

Of particular note, EGRRCPA increased the statutory asset threshold (often referred to as the “SIFI” threshold), above which the Federal Reserve is required to apply the “enhanced prudential standards” (“EPS”) in Section 165 of Dodd-Frank to a BHC. The Dodd-Frank SIFI threshold was increased from $50 billion to $100 billion, effective as of May 24, the date of EGRRCPA’s enactment, with a further increase to $250 billion to occur 18 months after enactment. The Federal Reserve was authorized, during this 18-month “off-ramp” period, to exempt, by order, any BHC with between $100 billion and $250 billion in total consolidated assets from any EPS requirement.[13] EGRRCPA also granted the Federal Reserve the discretionary authority, after the SIFI threshold increase becomes effective, to apply any EPS to any BHC or BHCs with between $100 billion and $250 billion in total consolidated assets that would otherwise be exempt under the legislation. To exercise this discretionary authority, the Federal Reserve must (1) act by order or rule promulgated pursuant to Section 553 of the Administrative Procedure Act (requiring public notice and comment) and (2) determine that the application of the EPS is “appropriate . . . to prevent or mitigate risks to [U.S.] financial stability” or “to promote the safety and soundness of the [BHC] or [BHCs],” taking into consideration the BHC’s or BHCs’ capital structure, riskiness, complexity, financial activities, size, and “any other risk-related factors that the [Federal Reserve] deems appropriate.”[14] EGRRCPA also amended what was previously an area of regulatory discretion to require instead that the Federal Reserve, in prescribing EPS, differentiate among BHCs “on an individual basis or by category,” taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and “any other risk-related factors that the [Federal Reserve] deems appropriate.”[15]

EGRRCPA did not amend the existing regulations promulgated by the Federal banking agencies that were based on the original Dodd-Frank SIFI threshold, including regulations implementing EPS, nor did it require the Federal banking agencies to modify other regulations implementing other post-crisis regulatory reforms established under (but not required by) Dodd-Frank or other legal authorities. Accordingly, the agencies must amend their existing regulations to take into account the revised asset thresholds and other statutory changes. On July 6, the Federal banking agencies took initial steps to implement certain modifications made by EGRRCPA, releasing an interagency statement and a separate Federal Reserve statement. As described in our Memorandum to Clients, dated July 12, 2018, these statements outline positions that the agencies intend to take, until their underlying regulations are amended, to implement modifications that became effective upon, or shortly after, the enactment of EGRRCPA. Among other positions, the agencies effectively exempted BHCs and Covered SLHCs with total consolidated assets of less than $100 billion from almost all EPS and certain other prudential regulations as of the enactment of EGRRCPA, and also exempted other banking organizations, including depository institutions, with total consolidated assets of less than $100 billion from company-run stress testing requirements under Dodd-Frank ("DFAST").

The new proposals made on October 31 by the Federal Reserve would amend the agencies' regulations, consistent with the July statements, to render the EPS and certain other prudential regulations—except in respect of risk committees and related risk management requirements—inapplicable to BHCs and Covered SLHCs with total consolidated assets of less than $100 billion. The remainder of this Memorandum addresses how and to what extent EPS and other post-crisis regulatory reforms would apply, under the proposed rules, to U.S. banking organizations with $100 billion or more in total consolidated assets.

PROPOSED RISK-BASED CATEGORIES

Under both proposals, large U.S. BHCs and Covered SLHCs would be assigned to one of four risk-based categories of regulatory standards based on whether they have been identified as a U.S. G-SIB and the following five indicators:

- ***Size.*** The proposals would measure size based on a firm's total consolidated assets "as a simple measure of a banking organization's potential systemic impact as well as safety and soundness risks," as well as "a measure of the extent to which customers or counterparties may be exposed to a risk of loss or suffer a disruption in the provision of services if a banking organization were to experience distress, and . . . could transmit distress to other market participants" through asset fire sales.[16] The agencies also note that "the large size of a banking organization may give rise to challenges that may complicate resolution of the firm if it were to fail," and that the size of a banking organization can "be an indication of operational and managerial complexity" because "[a] larger banking organization operates on a larger scale, has a broader geographic scope, and generally will have more complex internal operations than a smaller banking organization."[17]
- ***Cross-Jurisdictional Activity.*** Cross-jurisdictional activity would be measured based on the sum of cross-jurisdictional assets and liabilities, each as reported on the FR Y-15.[18] Compared to the "foreign exposure" metric currently used to determine the application of certain requirements, the

cross-jurisdictional activity indicator includes foreign liabilities in addition to foreign assets, but does not include the assets and liabilities from positions in derivatives contracts.[19] Similar to the proposed size indicator, cross-jurisdictional activity, according to the agencies, "can affect the complexity of a banking organization and give rise to challenges that may complicate the resolution of such a banking organization if it were to fail."[20] The agencies further note that "foreign operations and cross-border positions add operational complexity" that "may require more sophisticated capital and liquidity management relating to risks of ring-fencing by one or more jurisdictions during stress," thereby "generating both safety and soundness and financial stability risks."[21]

- ***Nonbank Assets.*** Nonbank assets would be calculated as the average amount of nonbank assets, as reported on the FR Y-9LP and calculated in the same manner as for purposes of the Federal Reserve's capital plan rule.[22] Similar to other indicators, according to the agencies, nonbank assets provide "a measure of the organization's business and operational complexity." Firms with higher levels of nonbank assets, according to the agencies, present "heightened resolvability risk" due to the positive correlation between complexity and the impact of failure or distress.[23] The agencies further note that "[n]onbank activities may involve a broader range of risks than those associated with purely banking activities, and can increase interconnectedness with other financial firms," which, "[i]f not adequately managed . . . could present significant safety and soundness concerns and increase financial stability risks."[24]
- ***Weighted Short-Term Wholesale Funding.*** The proposed weighted measure of STWF would track the measure currently reported on the FR Y-15 by holding companies and would be consistent with the calculation used for purposes of the G-SIB surcharge rule.[25] The agencies state that as a "measure of a banking organization's liquidity risk," reliance on short-term funding from wholesale counterparties "can make a banking organization vulnerable to the consequences of large-scale funding runs," which may lead to "liquidity outflows resulting in the need to rapidly sell relatively illiquid assets to fund withdrawals and maintain . . . operations in a time of stress."[26] The agencies note that STWF also serves as a measure of interconnectedness and, similar to the size indicator, that asset fire sales could "provide a mechanism for transmission of distress" to other market participants, with both safety and soundness and financial stability implications.[27]
- ***Off-Balance Sheet Exposure.*** Off-balance sheet exposure would be measured as total exposure (as defined in the FR Y-15, which includes a banking organization's on-balance sheet assets plus certain off-balance sheet exposures, including derivative exposures, repo-style transactions, and commitments) less total consolidated assets (as reported on the FR Y-9C). Similar to the size indicator, off-balance sheet exposure, according to the agencies, provides "a measure of the extent to which customers or counterparties may be exposed to a risk of loss or suffer a disruption in the provision of services."[28] Noting that "banking organizations with significant off-balance sheet exposure may have to fund these positions in the market in a time of stress," the agencies explain that these exposures can "lead to significant future draws on capital and liquidity."[29] As "a measure of a banking organization's interconnectedness," the agencies further note that the "distress or failure of one party to a financial contract . . . can trigger disruptive terminations of these contracts that destabilize the defaulting party's otherwise solvent affiliates," which can "lead to disruptions in markets for financial contracts" such that "the effects of one party's failure or distress can be amplified by its off-balance sheet connections with other financial market participants."[30]

These risk-based indicators are intended to "generally track measures already used in the agencies' existing regulatory framework and . . . already publicly report[ed] at the holding company level" by subject firms.[31] A holding company with $100 billion or more in total consolidated assets would be "required to determine the category of standards to which it is subject"[32] and to "report size and other risk-based indicators on a quarterly basis" based on "the average levels of each indicator over the preceding four calendar quarters."[33] For a depository institution without a holding company, the proposals would require that the depository institution calculate—and report to its agency supervisory staff—these risk-based indicators based on the instructions to the relevant reports that are required to be filed by holding companies, including the FR Y-15 and the FR Y-9LP.[34] The proposal would apply the same category of standards to both the top-tier holding company and, where relevant under applicable capital and liquidity requirements, its subsidiary depository institutions.[35]

The following describes the bases on which large banking organizations would be assigned to the four categories:

- ***Category I.*** Category I standards would apply to U.S. G-SIBs. The agencies would use the existing methodology under the Federal Reserve's G-SIB surcharge rule[36] to determine which banking organizations would be subject to this "most stringent" category of standards.
- ***Category II.*** Category II standards would apply to banking organizations "that are very large or have significant international activity,"[37] including those that are not U.S. G-SIBs with $700 billion or more in total consolidated assets or at least $100 billion in total consolidated assets and $75 billion or more in cross-jurisdictional activity. The agencies would amend certain regulations that currently use "foreign exposure" as a metric to determine application of certain requirements and replace that metric with the cross-jurisdictional activity indicator.
- ***Category III.*** Category III standards would apply to banking organizations that are not subject to Category I or Category II standards and that have $250 billion or more in total consolidated assets or at least $100 billion in total consolidated assets and $75 billion or more in any of three indicators: nonbank assets, weighted STWF, or off-balance sheet exposures.
- ***Category IV.*** Category IV standards would apply to banking organizations with at least $100 billion in total consolidated assets that do not meet any of the additional thresholds specified for Categories I through III.

All banking organizations identified in an appendix to the Federal Reserve Board staff memorandum[38] released with the proposals would be included within their currently listed category of standards based on size alone as of June 30, 2018 or designation as a U.S. G-SIB—without taking into consideration any of the other risk-based indicators specified for each category—with the exception of the Category II firm (a holding company with less than $250 billion in total consolidated assets).[39] Annex II of this Memorandum reproduces the projected categorization of large U.S. banking organizations, as identified in the staff memorandum.

This proposed approach to determining which category of standards will apply to a given banking organization is intended to "allow banking organizations and the public to easily identify and predict what requirements will apply to a [firm], and what requirements would apply if the characteristics of a [firm] change"[40] and "not require additional compliance costs to track and report."[41] However, the proposals also request comment on "alternative scoping criteria," which would use the Federal Reserve's G-SIB identification methodology,[42] under which a banking organization's size and its score under one of two calculation methods would be used to determine which of the four categories would apply to the firm. The agencies note that because "large bank holding companies already submit to the [Federal Reserve] periodic public reports on their [G-SIB] indicator scores," use of the G-SIB identification methodology in this context "would promote transparency and economize on compliance costs" for these firms.[43]

REGULATORY TAILORING BY CATEGORY

As noted above, the proposals would apply the same category of standards to both the top-tier holding company and, with respect to applicable capital and liquidity requirements, its subsidiary depository institutions. In general, Covered SLHCs in a particular category would be subject to the same requirements as a BHC in that category, meaning that EPS requirements that do not currently apply to SLHCs would apply to these firms, including (depending on the category, as described below) supervisory and company-run stress testing, liquidity buffers, and single-counterparty credit limits. Covered SLHCs are currently subject to the Federal Reserve's regulatory capital and liquidity requirements, including the liquidity coverage ratio ("LCR") and proposed net stable funding ratio ("NSFR") requirements, based on the same asset-size and other thresholds as are currently applicable to BHCs. The Federal Reserve also indicates that it expects to propose to apply capital planning requirements to Covered SLHCs in the same manner as applicable to BHCs as part of a future proposal on the capital plan rule and CCAR.[44]

The following summarizes the prudential standards applicable to BHCs and Covered SLHCs that fall within the four categories.

- ***Category I.*** The proposals would continue to apply "the most stringent prudential standards" to firms in this category, to reflect "the heightened risks these banking organizations pose to U.S. financial stability."[45] Accordingly, under the proposals, the following standards would be applicable to Category I firms:
  - These firms would be subject to the same capital requirements currently applicable to them and their depository institution subsidiaries, including (i) both the advanced and standardized approaches,[46] (ii) the U.S. generally applicable leverage ratio, (iii) the enhanced supplementary leverage ratio, (iv) the G-SIB capital surcharge (at the holding company level only), (v) the requirement to recognize most elements of accumulated other comprehensive income ("AOCI") in regulatory capital, and (vi) the requirement to expand the capital conservation buffer by the amount of any applicable countercyclical capital buffer.
  - These firms would be subject to the same liquidity requirements currently applicable to them and their depository institution subsidiaries with $10 billion or more in total consolidated assets, including the full LCR requirement and the full proposed NSFR requirement.[47]
  - With one exception, these firms would be subject to the same EPS and capital planning requirements currently applicable to them at the holding company level, including (i) the quantitative and qualitative assessment of the firms' capital plans through CCAR, (ii) annual supervisory stress testing, (iii) annual capital plan submissions, (iv) FR Y-14 reporting, (v) liquidity risk management, (vi) monthly internal liquidity stress testing, (vii) liquidity buffer requirements, (viii) reporting of certain liquidity data on the FR 2052a on a daily basis,[48] and (ix) the more stringent single-counterparty credit limits applicable to U.S. G-SIBs.[49]
    - Dodd-Frank initially required that any BHC subject to EPS conduct a "semi-annual" company run stress test.[50] EGRRCPA revised this provision to require instead that any BHC subject to EPS conduct a "periodic" company-run stress test.[51] Because, "[i]n the Board's experience, the mandatory mid-cycle stress test has provided modest risk management benefits and limited incremental information to market participants beyond what the annual company-run stress test provides," these firms would be required to conduct an annual, but not a mid-cycle, company-run stress test effective beginning with the 2020 cycle.[52]

- ***Category II.*** The agencies propose to apply standards "consistent with standards developed by [the Basel Committee on Banking Supervision]" to firms in this category to "promote competitive equity among U.S. banking organizations and their foreign peers and competitors, and to reduce opportunities for regulatory arbitrage." Taking this approach, according to the agencies, "can facilitate U.S. banking organizations' regulatory compliance in foreign markets."[53] Accordingly, under the proposals, the following standards would be applicable to Category II firms:
  - These firms would be subject to the same capital and liquidity requirements applicable to Category I firms, as noted above, except for (i) the G-SIB capital surcharge, and (ii) the enhanced supplementary leverage ratio (the supplementary leverage ratio will apply to Category II firms).
  - At the holding company level, these firms would be subject to the same EPS applicable to Category I firms, as noted above, including the annual, but not mid-cycle, company-run stress test. Firms in this category would be subject to the single-counterparty credit limits, but would not be subject to the more stringent single-counterparty credit limits that apply to a G-SIB.[54]
  - At the holding company level, firms that would be in this category based on their level of cross-jurisdictional activity and have less than $250 billion in total consolidated assets are not currently subject to the single-counterparty credit limits and, if they also have less than $75 billion in average nonbank assets, the CCAR qualitative review. In addition, firms that would be in this category based on their level of cross-jurisdictional activity, as opposed to size, are not currently subject to daily liquidity reporting requirements on the FR 2052a unless they have $10 trillion or more in assets under custody.[55]
- ***Category III.*** Category III proposed standards are intended to "differentiate among banking organizations with $250 billion or more in total consolidated assets,"[56] but to also "reflect these banking organizations' heightened risk profiles relative to smaller and less complex banking organizations."[57] Accordingly, under the proposals, the following standards would be applicable to Category III firms:
  - These firms would no longer be subject to (i) advanced approaches capital requirements,[58] or (ii) the requirement to recognize most elements of AOCI in regulatory capital, but would remain subject to (i) the U.S. generally applicable leverage ratio, (ii) the supplementary leverage ratio,[59] and (iii) the requirement to expand the capital conservation buffer by the amount of any applicable countercyclical capital buffer.[60]
  - These firms would only be subject to the full LCR requirement and the proposed full NSFR requirement (100% in each case) if the firm has weighted STWF of $75 billion or more; all other Category III firms would be subject to "reduced" LCR and proposed NSFR requirements of between 70% and 85%.[61]
    - The denominator for the proposed reduced LCR would be equal to the net cash outflows calculated under the full LCR requirement, multiplied by a factor that reduces its stringency; similarly, the denominator for the proposed reduced NSFR would equal the required stable funding requirement calculated under the full NSFR requirement, multiplied by a factor that reduces its stringency (by a factor between 70% and 85% in each case).[62]
  - At the holding company level, these firms would be subject to the following EPS and capital planning requirements: (i) the quantitative and qualitative assessment of the firms' capital plans under CCAR; (ii) annual supervisory stress testing; (iii) biennial company-run stress testing under DFAST; (iv) annual capital plan submissions (including the results of an internal capital stress test); (v) FR Y-14 reporting; (vi) liquidity risk management; (vii) monthly internal liquidity stress testing; (viii) liquidity buffer requirements; (ix) reporting of certain liquidity data on the FR 2052a, with the frequency of reporting dependent on a firm's weighted STWF; and (x) single-counterparty credit limits, excluding the more stringent limits applicable to G-SIBs.
    - Category III firms would be required to conduct company-run stress tests under DFAST and publicly disclose the results of those stress tests once every two years, unlike Category I and

II firms, which would be required to conduct the stress tests and make the related disclosures annually.[63]

- Category III firms would be required to report liquidity data on the FR 2052a on a monthly basis. However, if a firm had $75 billion or more in weighted STWF, it would be required to submit FR 2052a data on a daily basis.[64]

- Notably, BHCs that would be included in this category based on their risk profile (*i.e.*, nonbank assets, weighted STWF, or off-balance sheet exposures), as opposed to their size, as well as any Covered SLHCs that would be included in this category, are not currently subject to the single-counterparty credit limits, which currently apply (subject to a compliance period that will end on July 1, 2020 for non-G-SIBs) only to U.S. G-SIBs and BHCs with $250 billion or more in total consolidated assets. Further, any firms that would be included in this category based on their weighted STWF or off-balance sheet exposures, as opposed to their size or nonbank assets, are not currently subject to the CCAR qualitative assessment, which currently does not apply to firms that are not U.S. G-SIBs and that have less than $250 billion in total consolidated assets and less than $75 billion in nonbank assets.

- ***Category IV.*** Category IV standards are intended to be less stringent, reflecting the fact that "these banking organizations generally have greater scale and operational and managerial complexity relative to smaller banking organizations, but less than banking organizations that would be subject to Category I, II, or III standards."[65] The Federal Reserve indicates that it expects to release a proposal for Category IV BHCs that would require them to continue to submit annual capital plans but that would revise the CCAR quantitative assessment so that it occurs on a biennial basis for these firms.[66] Firms subject to Category IV standards would otherwise generally be subject to the "same capital and liquidity requirements as banking organizations under $100 billion in total consolidated assets," but unlike those firms, "would be required to monitor and report certain risk-based indicators."[67] Accordingly, under the proposals, the following standards would be applicable to Category IV firms:

  - These firms would be excluded from the same capital requirements from which Category III firms are excluded, as noted above, and, in addition, would not be subject to the supplementary leverage ratio or the countercyclical capital buffer.

  - These firms would not be subject to any LCR or NSFR requirements.

  - At the holding company level, these firms would remain subject to the "core elements" of the liquidity and capital-related EPS and capital planning requirements, but these requirements would be "tailor[ed]" to reflect the "lower risk profile and lesser degree of complexity" relative to large firms in Categories I, II, and III.

    - In respect of capital-related EPS, these firms would be subject to supervisory stress testing every other year, instead of the annual supervisory stress testing applicable to firms in Categories I, II, and III.[68] Category IV BHCs would no longer be subject to company-run stress testing requirements, but would remain subject to the quantitative review of capital plans under CCAR (which the Federal Reserve expects to propose to conduct on a biennial instead of annual basis), to required annual capital plan submissions, and to the FR Y-14 reporting requirements.[69]

    - In respect of liquidity-related EPS, these firms would be subject to liquidity risk management requirements, but would be required to: (i) calculate collateral positions monthly, as opposed to weekly as is currently required; (ii) establish a more limited set of liquidity risk limits than are currently required; and (iii) monitor fewer elements of intraday liquidity risk exposures than are currently monitored. These firms would also be subject to liquidity stress testing quarterly, rather than monthly, and would be required to report a tailored set of liquidity data on the FR 2052a on a monthly basis. The liquidity buffer requirements for these firms would not change. The Federal Reserve noted that these liquidity-related EPS requirements would be "more tailored to a firm's risk profile and scope of operations than" the LCR requirements, which as noted above, would not apply to Category IV firms.[70]

ANNEX I

Application of Certain EPS, Capital and Liquidity Requirements to Large Banking Institutions				
	Category I U.S. G-SIBs	**Category II** ≥$700b Total Assets or ≥$75bn Cross-Jurisdictional Activity	**Category III** ≥$250b Total Assets or ≥$75bn in Nonbank Assets, Weighted STWF (wSTWF), or Off-Balance Sheet Exposure	**Category IV** Other Firms with $100b to $250b Total Assets
CAPITAL‡				
TLAC/ Long-Term Debt	✓			
Stress Testing: Company-Run (DFAST)	✓ (Annual)	✓ (Annual)	✓ (Every Two Years)	
Stress Testing: Supervisory	✓ (Annual)	✓ (Annual)	✓ (Annual)	✓ (Two-Year Cycle)
CCAR: Quantitative†	✓	✓	✓	✓ (Two-Year Cycle)
CCAR: Qualitative†	✓	✓	✓	
Annual Capital Plan Submission†	✓	✓	✓	✓
G-SIB Surcharge	✓			
Advanced Approaches±	✓	✓		
Countercyclical Capital Buffer	✓	✓	✓	
Opt-Out of AOCI Capital Impact			✓	✓
Generally Applicable Leverage Ratio	✓	✓	✓	✓
Supplementary Leverage Ratio	✓ (Plus Enhanced)	✓	✓	
LIQUIDITY				
LCR	✓	✓	✓ (Reduced unless ≥$75bn in wSTWF)*	
NSFR (Proposed)	✓	✓	✓ (Reduced unless ≥$75bn in wSTWF)*	
Liquidity Stress Tests	✓ (Monthly)	✓ (Monthly)	✓ (Monthly)	✓ (Quarterly)
Liquidity Risk Management	✓	✓	✓	✓ (Tailored)

Application of Certain EPS, Capital and Liquidity Requirements to Large Banking Institutions				
	Category I U.S. G-SIBs	**Category II** ≥$700b Total Assets or ≥$75bn Cross-Jurisdictional Activity	**Category III** ≥$250b Total Assets or ≥$75bn in Nonbank Assets, Weighted STWF (wSTWF), or Off-Balance Sheet Exposure	**Category IV** Other Firms with $100b to $250b Total Assets
Liquidity Buffer	✓	✓	✓	✓
FR 2052a Reporting	✓ (Daily)	✓ (Daily)	✓ (Monthly; daily if ≥$75bn in wSTWF)	✓ (Monthly)
CERTAIN OTHER ENHANCED PRUDENTIAL STANDARDS				
Risk Committee**	✓	✓	✓	✓
Risk Management**	✓	✓	✓	✓
Single-Counterparty Credit Limits	✓ (G-SIB-specific requirements)	✓	✓	

* The interagency proposal requests comment on reducing the LCR and NSFR requirements to a level between 70-85%.

† The current proposals do not amend the Federal Reserve's capital plan rule, but the Federal Reserve indicates that it expects to release a future proposal to do so.

‡ The interagency proposal notes that the agencies are still considering amendments to their capital rules that would take into account final Basel III reforms adopted by the Basel Committee on Banking Supervision in December 2017 (commonly referred to as "Basel IV").[71]

± The agencies note that there are currently additional outstanding notices of proposed rulemaking that reference the advanced approaches thresholds to set the scope of application, relating to (1) simplifications to the agencies' capital rules (issued October 2017) and (2) a standardized approach to calculating derivatives exposures, known as SA-CCR (issued October 2018). For purposes of considering and commenting on those proposals, the agencies note that requirements that would apply to "advanced approaches banking organizations" under those outstanding proposals would be included as Category I and II standards under the new proposals.

** Risk committee and related risk management requirements would also continue to apply to BHCs with total consolidated assets of between $50 billion and $100 billion, and would be required for Covered SLHCs with total consolidated assets of between $50 billion and $100 billion.

ANNEX II

List of Firms by Projected Category*				
Category I U.S. G-SIBs	**Category II** ≥$700b Total Assets or ≥$75bn Cross-Jurisdictional Activity	**Category III** ≥$250b Total Assets or ≥$75bn in Nonbank Assets, Weighted STWF, or Off-Balance Sheet Exposure	**Category IV** Other Firms with $100b to $250b Total Assets	**Other firms** $50b to $100b Total Assets
JPMorgan Chase Bank of America Citigroup Wells Fargo Goldman Sachs Morgan Stanley Bank of New York Mellon State Street	Northern Trust	U.S. Bancorp PNC Financial Capital One Charles Schwab	BB&T Corp. SunTrust Inc. American Express Ally Financial Citizens Financial Fifth Third KeyCorp Regions Financial M&T Bank Huntington Discover	Synchrony Financial Comerica Inc. E*TRADE Financial Silicon Valley Bank NY Community Bancorp

* This chart reproduces the appendix to the Federal Reserve Board staff memorandum. The categorization projected in that appendix is based on data for the second quarter of 2018. Under the proposals, actual categories would be based on four-quarter averages.

* * *

ENDNOTES

1 Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, *Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements* (Oct. 31, 2018), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20181031a1.pdf (hereinafter the "Interagency Proposal"). The OCC adopted the Interagency Proposal on October 31, 2018. As of the publication of this Memorandum, the FDIC has not yet announced its adoption of that proposal.

2 Board of Governors of the Federal Reserve System, *Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies* (Oct. 31, 2018), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20181031a2.pdf (hereinafter the "Federal Reserve Proposal").

3 Vice Chairman for Supervision Randal K. Quarles, *Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations*, at 3 (Oct. 31, 2018), *available at* https://www.federalreserve.gov/newsevents/pressreleases/quarles-opening-statement-20181031.htm (hereinafter the "Quarles Statement").

4 Interagency Proposal, at 17 (footnote 18).

5 Federal Reserve Proposal, at 11, 55, 58. *See* 12 C.F.R. § 225.8; Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 83 Fed. Reg. 18,160 (Apr. 25, 2018). For further information about the proposed stress capital buffer requirements, see our Memorandum to Clients, *Bank Capital Requirements, Capital Plans and Stress Tests: Federal Reserve Proposes Substantial Changes to CCAR and Its Capital Rules, Including New Stress Capital Buffer and Stress Leverage Buffer Requirements and the Elimination of the CCAR Quantitative Objection*, dated April 19, 2018, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Bank_Capital_Requirements_Capital_Plans_and_Stress_Tests.pdf.

6 Federal Reserve Proposal, at 14 (footnote 26).

7 Federal Reserve Proposal, at 11. *See* 12 C.F.R. Parts 243 and 318.

8 Federal Reserve Proposal, at 14-15.

9 Interagency Proposal, at 17 (footnote 18); Federal Reserve Proposal, at 14.

10 Federal Reserve Proposal, at 55-56.

11 Governor Lael Brainard, *Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations*, at 1 (Oct. 31, 2018), *available at* https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20181031.htm.

12 Chairman Jerome Powell, *Opening Statement on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations* (Oct. 31, 2018), *available at* https://www.federalreserve.gov/newsevents/pressreleases/powell-opening-statement-20181031.htm.

13 Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, § 401 (hereinafter "EGRRCPA").

14 *Id.* § 401(a)(1)(B)(iii).

15 *Id.* § 401(a)(1)(B)(i); *see* 12 U.S.C. § 5365(a)(2)(A).

16 Interagency Proposal, at 21-22.

17 Interagency Proposal, at 22.

18 Interagency Proposal, at 26. Because depository institutions are not required to report the information required by the FR Y-15, the agencies request comment specifically regarding how depository institutions should report a measure of foreign assets and liabilities for purposes of calculating cross-jurisdictional activity.

19 Interagency Proposal, at 26-27.

20 Interagency Proposal, at 26.

ENDNOTES (CONTINUED)

21 Interagency Proposal, at 26.

22 Federal Reserve Proposal, at 29 and footnote 58. Nonbank assets, for the purposes of the risk-based indicators, would be nonbank assets as reported on line item 17 of the PC-B Memoranda of the FR Y-9LP. Although the supplementary information in the proposals refers to "nonbank assets" as being "measured as the average amount of equity investments in subsidiaries" (Interagency Proposal, at 28), line item 17 of the PC-B Memoranda of the FR Y-9LP includes nonbank assets of consolidated nonbank subsidiaries and direct investments in unconsolidated nonbank subsidiaries, associated nonbank companies, and nonbank corporate joint ventures over which the relevant firm exercises significant influence. *See* Amendments to the Capital Plan and Stress Test Rules; Regulation Y and YY, 82 Fed. Reg. 9308, 9314 (footnote 37) (Feb. 3, 2017).

23 Interagency Proposal, at 28.

24 Interagency Proposal, at 29.

25 Interagency Proposal, at 27.

26 Interagency Proposal, at 27.

27 Interagency Proposal, at 28.

28 Interagency Proposal, at 29.

29 Interagency Proposal, at 29.

30 Interagency Proposal, at 30.

31 Interagency Proposal, at 20; Federal Reserve Proposal, at 22.

32 Interagency Proposal, at 36; Federal Reserve Proposal, at 38-39.

33 Interagency Proposal, at 37; Federal Reserve Proposal, at 39.

34 Interagency Proposal, at 20-21. The agencies invite comment on this aspect of the proposal, and what additional information could be incorporated into the Consolidated Reports of Condition and Income (Call Reports)—or other reports currently required of depository institutions—to replicate the calculation methodology for these indicators. *See* Interagency Proposal, Question 2, at 21.

35 The agencies invite comment on the advantages and disadvantages of assigning a category of standards to a subsidiary depository institution based on the category assigned to its top-tier parent holding company. *See* Interagency Proposal, Question 1, at 18.

36 *See* 12 C.F.R. Part 217, Subpart H.

37 Interagency Proposal, at 14; Federal Reserve Proposal, at 12.

38 Memorandum from Federal Reserve Board Staff to the Board of Governors re: Notice of Proposed Rulemaking to Tailor Prudential Standards (Oct. 24, 2018) (hereinafter the "Federal Reserve Board Staff Memorandum").

39 The categorization projected in the appendix to the Federal Reserve Board Staff Memorandum is based on data for the second quarter of 2018. Under the proposals, actual categories would be based on four-quarter averages.

40 Interagency Proposal, at 19-20; Federal Reserve Proposal, at 21.

41 Interagency Proposal, at 20.

42 *See* 12 C.F.R. Part 217, Subpart H.

ENDNOTES (CONTINUED)

[43] Interagency Proposal, at 33; Federal Reserve Proposal, at 35. The Federal Reserve conducted an analysis of the distribution of method 1 and method 2 G-SIB surcharge scores of BHCs and Covered SLHCs with $100 billion or more in total consolidated assets and invite comment on the following proposed categories (a single score within the listed ranges would be selected in a final rule using this approach to categorization): Category I would apply to U.S. G-SIBs—U.S. banking organizations with a method 1 score of 130 or more; Category II would apply to non-G-SIB U.S. banking organizations with at least $100 billion in total consolidated assets and a method 1 score between 60 and 80 or a method 2 score between 100 and 150; Category III would apply to U.S. banking organizations with total consolidated assets between $100 billion and $250 billion and a method 1 score between 25 and 45 or a method 2 score between 50 and 85 (although not expressly stated, the implication is that U.S. banking organizations with $250 billion or more in total consolidated assets that are not subject to Category I or Category II standards would be subject to Category III standards, as under the proposals); and Category IV would apply to U.S. banking organizations with at least $100 billion in total consolidated assets that do not meet any of the thresholds specified for Categories I through III.

[44] Federal Reserve Proposal, at 58.

[45] Interagency Proposal, at 40.

[46] The agencies are separately proposing to adopt the standardized approach for counterparty credit risk for derivatives exposures (SA-CCR) and to require advanced approaches banking organizations (banking organizations subject to Category I or II standards, under this proposal) to use SA-CCR for calculating their risk-based capital ratios and a modified version of SA-CCR for calculating total leverage exposure under the supplementary leverage ratio. Interagency Proposal, at 45.

[47] The Interagency Proposal would amend both the LCR rule and the proposed NSFR rule to measure the $10 billion subsidiary depository institution asset threshold based on the value of total consolidated assets over the four most recent calendar quarters. Interagency Proposal, at 42.

[48] References to submission of the FR2052a data on a daily basis indicate that such data would be required to be submitted for each business day.

[49] G-SIBs (and certain large FBOs and IHCs) are required to comply with the Federal Reserve's single-counterparty credit limits rule by January 1, 2020, with other covered firms required to comply by July 1, 2020. *See* Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations, 83 Fed. Reg. 38,460 (August 6, 2018). For more information about this rule, see our Memorandum to Clients, *Single Counterparty Credit Limits: Federal Reserve Board Finalizes Rule to Establish Single Counterparty Credit Limits*, dated June 18, 2018, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Federal_Reserve_Finalizes_Single_Counterparty_Credit_Limits.pdf.

[50] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L. No. 111-203, § 165(i)(2)(A), 124 Stat. 1376, 1430 (2010).

[51] EGRRCPA, § 401(a)(5)(B)(i)(II).

[52] Federal Reserve Proposal, at 41.

[53] Interagency Proposal, at 15.

[54] The single-counterparty credit limits to which these firms would be subject impose a limit on aggregate net credit exposure to a single counterparty of no more than 25% of tier 1 capital.

[55] Currently, U.S. firms are required to report liquidity information on the FR 2052a on a daily basis if they have $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody. The Federal Reserve Proposal would modify this requirement to instead require all Category I firms, all Category II firms, and Category III firms with weighted STWF of $75 billion or more to submit the FR 2052a reports on a daily basis.

[56] Interagency Proposal, at 43. The agencies' current regulatory framework applies the same capital and liquidity standards to all non-G-SIB banking organizations with total consolidated assets of $250 billion or more.

[57] Interagency Proposal, at 15.

ENDNOTES (CONTINUED)

58 The agencies note in the Interagency Proposal that the "standardized approach currently represents the binding risk-based capital constraint for all banking organizations" that would be subject to Category III standards, and that therefore "the agencies do not expect that the removal of these requirements would materially change the amount of capital that these banking organizations would be required to maintain." Interagency Proposal, at 45.

59 The Interagency Proposal notes that "firms subject to Category III standards include banking organizations with material off-balance sheet exposures that are not accounted for in the traditional U.S. tier 1 leverage ratio." Interagency Proposal, at 44.

60 The agencies are separately proposing to adopt SA-CCR and to require advanced approaches banking organizations (banking organizations in Category I or II, under these proposals) to use SA-CCR for calculating their risk-based capital ratios and a modified version of SA-CCR for calculating total leverage exposure under the supplementary leverage ratio. If the SA-CCR proposal were to be adopted, the agencies would allow a Category III firm to elect to use SA-CCR for calculating (i) derivatives exposure in connection with risk-based capital ratios, consistent with the SA-CRR proposal and (ii) total leverage exposure used to determine the supplementary leverage exposure (but a Category III firm would also be permitted to elect to continue to use the current exposure method for this calculation). Interagency Proposal, at 45.

61 Unlike the "modified" versions of the LCR and proposed NSFR that are currently applicable to BHCs with between $100 billion and $250 billion in total consolidated assets and less than $10 billion in on-balance sheet foreign exposure, the "reduced" versions of the LCR and proposed NSFR requirements included in the Interagency Proposal "would not alter other aspects of the LCR and NSFR calculations . . . relative to the full LCR and proposed NSFR requirements," including, for example, the requirements to calculate the LCR on each business day and to include the maturity mismatch add-on in the calculation. Interagency Proposal, at 50.

62 The Interagency Proposal would apply Category III LCR and proposed NSFR requirements to a depository institution that has total consolidated assets of $10 billion or more that is a consolidated subsidiary of a firm subject to Category III standards, at the same level (that is, full or reduced) that would apply to the parent banking organization. For those firms subject to "reduced" LCR and NSFR requirements, this differs from the "modified" versions of the LCR and proposed NSFR discussed in footnote 61 above, which do not apply to the depository institution subsidiaries of BHCs subject to the modified LCR or proposed modified NSFR.

The Interagency Proposal further notes that, consistent with Section 22(b) of the LCR rule, a banking organization subject to the proposed reduced LCR requirement would not be permitted to include in its HQLA amount eligible HQLA of a consolidated subsidiary except up to the amount of net cash flows of the subsidiary (as adjusted for the factor reducing the stringency of the requirement), plus any amount of assets that would be available for transfer to the top-tier holding company during times of stress without statutory, regulatory, contractual, or other supervisory restrictions; a similar restriction would apply under Section 108 of the NSFR proposed rule. The agencies request comment, however, on whether they should "consider the approach the [Federal Reserve] currently permits for holding companies subject to a modified LCR [whereby] . . . a company may include in its HQLA amount eligible HQLA held at a subsidiary up to 100 percent of the net cash outflows of the subsidiary," without adjusting such net cash outflows for the factor reducing the stringency of the requirement at the holding company level. Interagency Proposal, at 50, 52.

63 Under the Federal Reserve Proposal, Category III firms would be required to submit an annual capital plan, which includes the results of an internal capital stress test, and would be subject to annual supervisory stress testing, the results of which would be subject to public disclosure annually. As a result, the Federal Reserve notes that reducing the frequency of required disclosure of company-run stress test results "should reduce compliance costs without a material increase in safety and soundness or financial stability risks." Federal Reserve Proposal, at 48.

The Federal Reserve would impose the "reduced" frequency (*i.e.*, once every two years) of public disclosure of company-run stress test results by subjecting Category III firms to company-run stress testing every two years under the EPS rule, which requires public disclosure, 12 C.F.R. § 252.58, and to company-run stress testing every year under the capital plan rule, which does not, *see* 12 C.F.R. § 225.8. During the year when the company-run stress testing under the EPS rule would not apply, company-run stress testing would be required under the capital plan rule, without required public disclosure.

ENDNOTES (CONTINUED)

64 The Federal Reserve Proposal explains that the increased reporting frequency of the FR 2052a data for firms with $75 billion or more in weighted STWF is necessary because "a greater reliance on short-term wholesale funding may indicate more frequent rollover of liabilities and greater volatility in the funding profile of a firm." The greater potential for "sudden swings in . . . liquidity position" accordingly requires "greater need for supervisory monitoring of . . . liquidity risk." Federal Reserve Proposal, at 49.

65 Interagency Proposal, at 15.

66 Federal Reserve Proposal, at 55; Federal Reserve Board Staff Memorandum, at 15.

67 Interagency Proposal, at 16.

68 Vice Chairman Quarles indicated that he expected that, in connection with moving to a two-year cycle for supervisory stress testing for Category IV firms, the Federal Reserve would make 2019 an "off-cycle" year, such that the Federal Reserve would rely on "normal-course supervisory tools," rather than supervisory stress testing, for these firms in 2019. Quarles Statement, at 2.

69 The Federal Reserve expects to release a future capital plan proposal that would align with the proposed two-year supervisory stress testing cycle, including in respect of the stress buffer requirements for large BHCs proposed in April 2018. The Federal Reserve notes that it plans to propose that the stress buffer requirements would be updated annually to reflect a Category IV BHC's planned capital distributions, but only biennially to reflect supervisory stress loss projections. The future capital plan rule proposal is also expected to provide greater flexibility to Category IV firms in developing annual capital plans, without requiring the firms to submit the results of company-run stress tests on the FR Y-14A. The Federal Reserve also expects to release at a future date revisions to its guidance on capital planning to provide more flexibility to Category IV firms. Federal Reserve Proposal, at 55-56.

70 Federal Reserve Proposal, at 53.

71 Interagency Proposal, at 13. *See* Basel Committee, Basel III: Finalising Post-Crisis Reforms (Dec. 2017), *available at* https://www.bis.org/bcbs/publ/d424.pdf. For more information about these reforms, see our Memorandum to Clients, *Bank Capital Requirements: Basel Committee Releases Standards to Finalize Basel III Framework*, dated December 19, 2017, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Bank_Capital_Requirements_12192017.pdf.

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