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# Another Dodd-Frank Tax on Size: The Fed Charges for Big-Bank Supervision

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**An obscure section of the Dodd-Frank Act has been implemented by the Federal Reserve, to be effective later this year. Traditionally the Federal Reserve has not charged examination or similar fees for institutions under its supervision, but Congress determined that the largest institutions should be assessed an amount intended to reimburse the Federal Reserve for supervising them. This will likely impose an additional aggregate cost on the order of $400 to $500 million per year on these institutions, thereby further hiking up the price of size.**

Section 318 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires that the Federal Reserve collect a total amount of assessments from the largest bank and thrift holding companies equal to the total expenses that it estimates are "necessary or appropriate" to carry out the Federal Reserve's supervisory and regulatory responsibilities.[1] The Federal Reserve adopted a final regulation on August 15, called Regulation TT, to be effective on October 25. The first notice of assessment is expected to be sent shortly after October 25 and will likely be payable by December 15. Thereafter, notices of assessment are scheduled to be sent by June 30 of each year and paid by September 15.

1 The Dodd-Frank Act is at Pub. L. 111-204, 124 Stat. 1376 (July 21, 2010). Section 318 is codified at a new Section 11(s) of the Federal Reserve Act (the designation should be Section 11(t) since Dodd-Frank also enacted another Section 11(s)). The Comptroller and FDIC were granted explicit authority by Section 318 to impose additional fees on their supervised institutions for any examinations or other costs incurred by them in connection with supervising the largest institutions. The final regulation is on the Federal Reserve's website at http://www.federalreserve.gov/newsevents/press/bcreg/20130816a.htm. It has not been published in the Federal Register as of the date of this memorandum. The proposed regulation is at 78 Fed. Reg. 23162 (April 18, 2013).

Imposing an assessment for supervision and regulation is contrary to Federal Reserve tradition. Unlike the Comptroller of the Currency, which funds itself from fees and assessments on national banks, or the Federal Deposit Insurance Corporation, which relies mainly on deposit insurance premiums, virtually all of the Federal Reserve's costs of operation are funded from the earnings on its assets, which for decades have been far in excess of its actual costs. As a result, it pays the excess to the US Treasury after closing its books each year.[2] It has resisted imposing charges in part because the banking institutions subject to its supervision are mostly chartered or licensed by the States, which generally impose their own fees, and the concern was that there would be excessive costs of supervision if both the States and the Federal Government required reimbursement for supervision. In Dodd-Frank, that concern went by the boards for the largest institutions.

The assessments will operate as follows:

- Foreign and domestic bank holding companies (but not foreign banks with a US branch or agency and not a US subsidiary bank) with total average consolidated assets of $50 billion or more, and nonbank systemically important financial companies so designated by the Financial Stability Oversight Council, are subject to the assessment.[3]
- The Federal Reserve will calculate annually, beginning with calendar year 2012, the total costs of its staff in Washington as well as supervisory and regulatory staffs at the Federal Reserve Banks. For the years 2012, 2013 and 2014, it will use 2012 numbers. For 2015 and thereafter, it will use the average of the total costs of the current year plus the previous two years in order to avoid large year-to-year fluctuations.
  - It seems fair to characterize the Federal Reserve's categories of costs allocable to regulation and supervision of the largest institutions as expansive. It includes expenses attributable to administering off-site examinations, conducting stress tests, assessing resolution plans, developing and administering regulations and supervisory guidance, engaging in enforcement actions, processing applications and notices, and implementing "a macro-prudential supervisory approach." It also includes costs of activities "integral" to supervision such as staff training, research, processing of reports, automated data processing services, administration and travel.
  - Using a cost accounting system in place for Reserve Bank budgeting and reporting, the portion of time of personnel attributable to assessable activities is to be estimated and applied to all salary and pension expenses attributable to supervision of the largest institutions as well as a portion of support and overhead divisions, including the legal division.
- The total cost will be allocated among the covered institutions proportionally based on their average consolidated assets at the end of each calendar quarter. Worldwide assets are included for domestic institutions while only US assets are included for foreign companies, subject to various adjustments.

[2] For calendar year 2012, earnings exceeded $90 billion, of which over $88 billion was paid to the Treasury. See the Federal Reserve's report at http://www.federalreserve.gov/newsevents/press/other/20130315a.htm.

[3] Asset totals will be collected from Form FR Y-9C filed by domestic companies and from Form FR Y-7Q filed by foreign companies. Form FR Y-7Q will be amended so that all foreign companies subject to the assessment will report their total consolidated assets quarterly, and the average of those numbers will be used. Until the revision is in place, foreign companies will use their annual number for 2012 and the average of 2012 and 2013 as their number for 2013.

- Because foreign bank holding companies do not currently file an annual report showing total US assets calculated pursuant to the new regulation, the Federal Reserve's Form FR Y-7Q will be revised so that all foreign companies of the requisite size will have to report total US assets, calculated in the manner set forth in the regulation, on a quarterly basis.[4] For 2012 and 2013, the Federal Reserve apparently will make the calculations. Only US assets will be used for calculation purposes because the Federal Reserve supervises only their US operations.
- A request by commenters to deduct non-financial assets, such as merchant banking investments, from total consolidated assets under this calculation was denied, except that foreign banks can deduct certain foreign-related US holdings (so-called "Section 2(h) companies").

- Notices of the amount of each institution's assessment will be sent by June 30 in 2014 and thereafter; for 2013, the notice will be sent soon after the effective date of October 25. An institution may appeal the determination that it is subject to assessment (that is, because it is below the $50 billion asset cut-off) and the calculation of its assessable assets, within 30 days of June 30. The Federal Reserve will endeavor to respond within 15 days. Payment is due by September 15, and late payments are subject to interest charges.
  - The Federal Reserve's determination of its total assessment costs is not subject to appeal inasmuch as the institutions will not have access to the Federal Reserve's internal cost numbers and accordingly would not have sufficient information to mount a challenge.
  - Unlike other payments to the Federal Reserve, such as the cost of priced check collection and similar services, the amounts paid by companies will not be retained by the Federal Reserve but rather passed on directly to the US Treasury. There was no elaboration of the reasons for this procedure in the proposal or final regulation, and nothing in Dodd-Frank appears to require it.

The Federal Reserve said that it estimates that it will collect about $440 million from 70 institutions for the 2012 assessment period. Purely on an arithmetic average basis, this would amount to about $6.3 million per institution; however, of course, the larger institutions will pay proportionally more. The nature and riskiness of the assets of each institution are not taken into account. Thus, an institution with a huge Treasury securities book due to its status as a primary dealer may be assessed proportionally more than would a comparable non-dealer institution. The Federal Reserve explicitly declined to make subjective judgments about each institution's assets in determining a company's assessable assets in order to enhance the objectivity and transparency of the process.

Although the amount of the assessment for the largest institutions is likely not to be significant in comparison to their individual total revenues and expenses, it constitutes yet another increased cost required by the enhanced supervision required by Dodd-Frank. It can be characterized as effectively yet another tax on bank size.

4 The regulation sets out the line items of particular reports filed by foreign companies that will be used to make the calculation.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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