

## **Federal Advisory Council**

On February 8, 2013, the Federal Advisory Council met with the Board of Governors to discuss the Board's proposed rulemaking on enhanced prudential standards and early remediation requirements for foreign banking organizations and foreign nonbank financial companies (Docket No. 1438). The Council provided written views, which are provided below.

### **Domestic Regulation of Foreign Banking Organizations**

**The Federal Reserve has recently proposed significant changes to the regulation of foreign banking organizations in the United States. What are the Council members' views and concerns regarding this proposal? How would the proposal affect banking competition in the United States and the competitiveness of U.S. banks abroad?**

- As noted, the Federal Reserve's recent proposal regarding the regulation of foreign banking organizations (FBOs) in the United States marks a significant change in the approach taken by the Federal Reserve since the adoption of the International Banking Act of 1978. Many members of the Council believe that the proposal establishes a balance between the regulation of foreign and domestic financial institutions in the U.S. while acknowledging concerns that foreign regulators may impose similar restrictions on U.S. operations in host countries.
- The proposal also raises a number of issues that merit attention. For example, the "one size fits all" mandate requiring FBOs to operate through an intermediate-level holding company (IHC) may work well for some, but it does not take into account the various forms of doing business in the United States that the Federal Reserve has long permitted FBOs to adopt. As a result, IHC capital will be effectively trapped in this country, making consolidated capital management more challenging and making global resolution of internationally active firms more difficult.
- The proposal also opens the door for the Balkanization of capital regimes globally as other prudential regulators may feel obligated to respond in a similar fashion. Existing frameworks for global coordination could be replaced by individual sovereign regulation, making global risk management challenging and systemic risk more difficult to control. While most would agree that the depth and severity of the recent financial crisis calls for effective responses to guard against the recurrence of such an event, even in the context of the orderly liquidation authority granted to the FDIC under Title II of the Dodd-Frank Act, there is a recognition that there is more than one path to the successful resolution of large, complex financial entities. The "single point of entry" model proposed by the FDIC is but one of a number of approaches that may be taken in the resolution process. Alternative business models for FBOs operating in the United States should continue to be considered as well.
- Similarly, forcing all U.S. branch and agency operations of FBOs to maintain a portion of their liquidity buffer in the United States takes into account neither the capital and liquidity structure of the foreign parent nor the comparability of that parent's home country regulatory regime. In adopting a uniform approach to all FBO branch and agency operations in the United States, the Federal Reserve effectively does away with the source

of strength assessments that have long been applied for these and other purposes and that have long served as the basis of international cooperation.

- Finally, in some cases, the proposal to require IHCs to hold minority interests in U.S. companies that are deemed to be controlling interests as defined in the Bank Holding Company Act could result in adverse tax consequences as well as punitive treatment under the Basel III capital guidelines. There should be some flexibility in the final rule that emanates from the proposal regarding the legal entity holding such investments so that the Federal Reserve is able to obtain a “line of sight” over the investments while at the same time having such investments housed in the legal entity that is already managing these tax and capital issues.