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## INSTITUTE OF INTERNATIONAL BANKERS

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August 31, 2012

Mr. Michael Gibson  
Director  
Division of Banking Supervision and Regulation  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington, DC 20551

Re: Section 165 of the Dodd-Frank Act and its Application to Foreign Banking Organizations

Dear Mr. Gibson:

I am pleased to submit for your consideration a white paper entitled "Application of Heightened Prudential Standards under Section 165 of the Dodd-Frank Act to Systemically Important Foreign Banking Organizations." This paper, prepared at the direction of the Board of the Institute of International Bankers (IIB), is intended to inform the dialogue as the Board of Governors of the Federal Reserve Board (Board) considers how best to apply the enhanced prudential standards framework established by the Dodd-Frank Act (DFA) in a manner that is both consistent with the purposes of DFA and the Board's existing framework for supervising foreign banking organizations (FBOs).

The white paper focuses on the heightened capital and liquidity components of the enhanced standards provided under Section 165 and describes guiding principles that the IIB believes can inform the Board's analysis and suggests an approach for their implementation. To be clear, under the framework, we propose the Board would conduct a more rigorous analysis of those FBOs whose activities are potentially relevant to U.S. financial stability, and impose heightened capital and liquidity requirements in a manner designed to address relevant systemic risks posed by that particular entity. The framework would provide transparent and appropriately detailed criteria for this heightened evaluation, while also permitting the Board to consider and adapt to developments in international and home country supervision and changes in both domestic and global market conditions. Importantly, this framework may be appropriate for multilateralization among the other global prudential supervisors.

While we recognize that the Board is likely to view all FBOs with global consolidated assets of \$50 billion or more as within the scope of Section 165, the focus of this white paper is on the implementation of Section 165 to the very small subset of FBOs whose U.S. operations could actually be considered to present risks to U.S. financial stability. In this paper, we do, however, strongly urge the Board to appropriately tailor the application of Section 165 to FBOs with U.S. operations that are not relevant to U.S. stability. Additionally, the \$50 billion threshold creates "cliff" issues for FBOs just above or below the threshold; those just above (or just below but growing) may consider exiting their U.S. operations to

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The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

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avoid an onerous implementation of Section 165 and the relative disadvantage vis-à-vis institutions not subject to Section 165.

Please do not hesitate to contact me should you wish to discuss these matters further.

Sincerely,

A handwritten signature in black ink that reads 'Sarah A. Miller'. The signature is fluid and cursive, with the first name 'Sarah' being the most prominent.

Sarah A. Miller  
Chief Executive Officer

cc: Mark van der Weide  
Barbara Bouchard  
Anna Lee Hewko  
Constance M. Horsley  
Michael Hsu  
Linda Jeng  
Kwayne L. Jennings  
Molly E. Mahar  
Richard Naylor II



August 31, 2012

**Application of Heightened Prudential Standards under Section 165  
of the Dodd-Frank Act to Systemically Important Foreign Banking Organization**

Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)<sup>1</sup> directs the Board of Governors of the Federal Reserve System (the “Board”) to establish heightened capital, liquidity and other requirements (the “Dodd-Frank Enhanced Standards”) for certain large bank holding companies.<sup>2</sup> In December 2011, the Board issued a notice of proposed rulemaking to implement the Dodd-Frank Enhanced Standards for U.S. bank holding companies and designated U.S. nonbank financial companies, deferring a proposed rulemaking for foreign banking organizations (“FBOs”), in part due to difficult practical and legal issues.<sup>3</sup> Recognizing the unique challenges that the Board faces in adapting the Dodd-Frank Enhanced Standards to systemically important FBOs, this paper describes guiding principles that we believe should inform the Board’s analysis and suggests an approach to implementing the heightened capital and liquidity components of the Dodd-Frank Enhanced Standards.

Key to the Board’s application of Section 165 to FBOs is an assessment of the FBO’s home supervisory framework, taking into account measures that home country supervisors have taken to implement heightened standards for systemically significant banking organizations on a global, consolidated basis. Whether an FBO poses a threat to U.S. financial stability depends critically on the robust implementation of internationally agreed standards by the FBO’s home country regulators. As a result, if the objectives of Section 165 are to be met, application of Section 165 to FBOs must take into account international financial services regulatory reform efforts and the supervisory regimes of the jurisdictions in which the FBOs are headquartered.

International and various home country systemic risk reforms are rapidly taking shape. As national financial reform efforts, including those in the United States, continue to develop, the widely recognized need for greater harmonization of procedures and substantive rules for the regulation and resolution of systemically important financial institutions (“SIFIs”) continues to drive international collaboration and coordination. It will therefore be important that the Board’s implementation of Section 165 for FBOs be structured so that it can adapt to home country supervisory and regulatory standards as they are finalized and refined.

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<sup>1</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> Section 165 also directs the Board to establish heightened capital, liquidity and other requirements for nonbank financial companies designated by the Financial Stability Oversight Council (“FSOC”) for supervision by the Board.

<sup>3</sup> See 77 Fed. Reg. 594, 597-98 (Jan. 5, 2012).



## INSTITUTE OF INTERNATIONAL BANKERS

Another challenge for the Board in applying the Dodd-Frank Enhanced Standards to FBOs stems from the variety in organizational structures FBOs have adopted in the United States to conduct their banking and other financial businesses. FBOs have organized their U.S. operations in significantly different ways depending on their business objectives, presenting a range of risk profiles. Consequently, the Board's application of the Dodd-Frank Enhanced Standards to FBOs will require a case-by-case analysis of those structures, consistent with the calibration of heightened standards contemplated in Section 165.

The Institute of International Bankers (the "Institute") represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. These institutions play an important role in meeting the credit and risk management needs of U.S. borrowers, especially businesses. In the aggregate, our members' U.S. operations have approximately \$3.2 trillion in banking assets and include substantial investment banking and other nonbank activities, and our members contribute more than \$50 billion each year to the economies of major cities across the country in the form of employee compensation, tax payments to local, state and federal authorities, and other operating and capital expenditures.

Internationally headquartered banks are an important source of competition and funding in critical markets. For example, they provide 25% of all commercial and industrial bank loans made in the United States and contribute to the depth and liquidity of U.S. financial markets. The role of international banks in U.S. markets thereby contributes to U.S. financial stability. Absent participation by FBOs, the supply of wholesale financial services in the United States would be significantly more concentrated and therefore far more vulnerable to disruptions if one or more large domestic institutions curtailed its activities or exited a product market.

In this white paper, we propose a framework for applying two key components of the heightened prudential standards in Section 165—capital and liquidity—to FBOs whose U.S. banking and other financial operations are systemically significant in the United States.<sup>4</sup> While we recognize that the Board is likely to view all FBOs with global consolidated assets of \$50 billion or more as within the scope of Section 165,<sup>5</sup> the focus of this white paper is on the implementation of Section 165 as applied to the very small subset of FBOs whose U.S.

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<sup>4</sup> The other heightened prudential standards required under Section 165 include standards regarding the concentration of counterparty risk, stress testing and governance procedures relating to risk management. The Institute would welcome the opportunity to discuss separately its views regarding application of these additional standards to FBOs in a separate submission.

<sup>5</sup> See 77 Fed. Reg. at 597 (stating that Section 165 applies to "any foreign banking organization that has banking operations in the United States and that has global consolidated assets of \$50 billion or more"); 76 Fed. Reg. 67,323, 67,326 (Nov. 1, 2011) (applying the Board's bank holding company resolution planning requirement to FBOs with \$50 billion or more in global consolidated assets and tailoring the requirements to FBOs). While we have respectfully disagreed with the Board's interpretation of the scope of Section 165 on this point, we recognize that the Board's eventual proposed rule implementing Section 165 for FBOs is likely to take a similar approach.



## INSTITUTE OF INTERNATIONAL BANKERS

operations could actually be considered to present risks to U.S. financial stability, a group of FBOs we refer to as “SI-FBOs.”<sup>6</sup>

The Institute recognizes that robust supervision and regulation of SIFIs and systemic risk are crucial to enhancing U.S. and global financial stability. The recent financial crisis sharply illustrated the consequences of a failure (or the perception of a likely failure) of a SIFI. National governments and financial regulators have sought to strengthen individual financial institutions and to reduce the risk that the failure of a SIFI could harm national or international financial systems.

National governments and supervisors are understandably concerned about potential threats to host country financial stability and host country creditors from the activities of global SIFIs headquartered in other jurisdictions. It is therefore not surprising that there has been ongoing consideration of possible national measures to address these concerns, such as the subsidiarization of host country bank activities or the consolidation of all host country activities into a local holding company subject to host country capital and liquidity standards. In our view, however, international coordination and cooperation remain essential to effectively supervising global SIFIs; national actions in isolation, whether by host or home country supervisors, will necessarily be insufficient. Moreover, to the extent that national efforts designed to address potential host country exposures to SIFIs cause FBOs to pull back from the provision of financial services in the host country, the host country’s financial system could become far more concentrated and vulnerable to financial shocks as domestic SIFIs become relatively larger and less substitutable. Finally, these national actions will likely lead to reciprocal actions by other jurisdictions, which would have broad effects on the global banking system and result in significant harm to U.S. financial stability and the U.S. economy.

The Institute applauds the ongoing international efforts to implement harmonized capital, leverage, liquidity and other reforms, including the development and implementation of the “Basel III” framework and the efforts of the Financial Stability Board (“FSB”) to develop a global framework for recovery and resolution planning. We encourage continued efforts to develop and implement global capital, liquidity and leverage standards for SIFIs and stand ready to work with the Board, other national supervisors and international organizations to foster their continued development and consistent implementation.

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<sup>6</sup> The Institute would welcome the opportunity to discuss separately the implementation of Section 165 vis-à-vis FBOs that are not SI-FBOs. As a general principle, the Institute urges the Board to consider how to implement appropriately Section 165 for FBOs with smaller U.S. operations, including by calibrating the requirements based on the systemic footprint of an FBO’s U.S. operations. We also note that the \$50 billion threshold creates “cliff” issues for institutions just above or below this threshold; those just above (or just below but growing) may consider exiting their U.S. operations to avoid an onerous implementation of Section 165 and the relative disadvantage vis-à-vis institutions not subject to Section 165.



## **Executive Summary**

SI-FBOs are subject to home country supervision on a consolidated basis, including home country implementation of heightened prudential standards for systemically significant banking organizations, which apply on a global basis to SI-FBOs and their subsidiaries. Especially in the post-financial crisis regulatory reform environment, close and effective coordination among supervisory authorities in jurisdictions with major financial centers becomes vital, and the risks associated with uncoordinated responses and duplicative requirements become severe.

In our view, the Board's Section 165 authority is best viewed—and will be most effective when implemented—as an extension and enhancement of the existing framework under which the Board supervises the U.S. activities of an FBO and evaluates the global strength and home country supervision of the FBO. At the same time, we recognize that implementing the Dodd-Frank Enhanced Standards for FBOs involves unique challenges. Among other factors, FBOs' U.S. business objectives result in a variety of organizational structures and formats, including U.S. subsidiary banks, U.S. bank holding companies, U.S. nonbank affiliates and direct branches and agencies, and these structural differences can have implications for the potential systemic risks that SI-FBOs present.

Taking into account the evolving and institution-specific nature of many relevant factors (especially home country implementation of international standards), development of Dodd-Frank Enhanced Standards for SI-FBOs will require a framework that can accommodate these variables. In this white paper, we describe the principles that we believe should guide the Board's consideration of such a framework for SI-FBOs as it relates to Section 165's enhanced capital and liquidity standards:

- The need to focus as a starting point on SI-FBOs as consolidated organizations, as called for in Section 165 and other provisions of Dodd-Frank<sup>7</sup> and consistent with longstanding Board principles of FBO supervision and regulation;
- The importance of home-host coordination in the area of systemic risk supervision, including Dodd-Frank's requirement that the Board take into account the extent to which SI-FBOs are subject to comparable home country standards;
- The potential consequences of unilateral host country approaches, including fragmentation of capital and liquidity, increased concentration and diminished competition in host country markets (exacerbating threats to financial stability), and reduced availability of credit, an especially grave concern during times of economic strain; and

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<sup>7</sup> See, e.g., Sections 115, 121 and 173.



## INSTITUTE OF INTERNATIONAL BANKERS

- The importance of a robust framework that addresses varying structures and risk profiles and evolving home country and international supervisory approaches.

Under the framework we propose, the Board would conduct a more rigorous analysis of FBOs whose activities are potentially relevant to U.S. financial stability, and impose heightened capital and liquidity requirements in a manner designed to address relevant systemic risks. The Board would first evaluate the U.S. systemic risks presented by an individual FBO and its U.S. operations. This evaluation would include careful consideration of the risk profile of the FBO's U.S. operations and their interconnection with other activities of the FBO, existing functional and capital regulation of U.S. activities (including whether U.S. subsidiaries exceed applicable regulatory standards), the strength of the FBO's non-U.S. parent, and the current home country supervisory and legal framework applicable to the FBO. Home country supervisory and legal considerations would include the applicable resolution regimes, whether the consolidated organization is subject to robust supervisory authority and whether the U.S. operations have a liquid and well capitalized parent subject to effective implementation of the globally agreed enhanced standards for SIFIs. The Board's framework would provide transparent and appropriately detailed criteria for this heightened evaluation, which we propose in Part II.A of this white paper, while also permitting the Board to consider and adapt to developments in international or home country supervision and to changes in market conditions in the United States and elsewhere.

These evaluations would provide the basis for the Board to determine whether to impose specific and targeted systemic risk-reducing capital or liquidity requirements on a SI-FBO's U.S. operations or take other measures to address systemic risk. Any such measures would be focused on those U.S. operations whose risks to financial stability are not addressed through other means, such as home country regulation, consolidated capital and liquidity standards, complementary U.S. functional regulation, etc.

In our view, a robust framework of heightened scrutiny and targeted measures to reduce risks to U.S. financial stability posed by the U.S. operations of SI-FBOs would be far more effective than any generally applicable structural or other requirements that could be designed for SI-FBOs. Overly broad capital and liquidity measures that target all FBOs, or paint all the U.S. operations of a SI-FBO with the same broad brush would be both over- and under-inclusive, needlessly burdening the Board's limited supervisory resources with regulation of operations that do not pose systemic risks, while potentially failing to fully address pockets of risk not reached by existing measures. Such an approach is likely to discourage FBO activity in the United States, potentially reducing competition and diversity in the markets for systemically important services and products. In addition, fixed, generally applicable approaches would fail to address the reality that international, home country, and U.S. financial reform efforts continue at varying paces, and future developments in and implementation of foreign or global reforms could alter the risk profiles of SI-FBOs and their U.S. operations significantly.

Another advantage of the framework we propose is its ability to leverage and extend the Board's existing supervisory approaches for overseeing U.S. FBO operations,



## **INSTITUTE OF INTERNATIONAL BANKERS**

allowing the Board to efficiently implement heightened requirements targeted directly to those operations and entities that present risks to U.S. financial stability. The Board's existing oversight of the U.S. operations of FBOs, including its recently strengthened and restructured on-site examination approaches, provides a framework for obtaining additional information regarding activities of potential systemic importance and for imposing tailored capital or liquidity requirements to address risks to U.S. financial stability.

Part III of this white paper addresses several potential Board concerns regarding the implications of SI-FBOs' U.S. operations for U.S. financial stability. These include a lack of first-hand information regarding the global risk profiles of SI-FBOs, special issues associated with U.S. broker-dealer subsidiaries of SI-FBOs, the possibility that home country reforms could lead banks to "ring-fence" their home country retail banking operations from international and wholesale banking operations, risks presented by U.S. branches and agencies of international banks, and the lack of an effective cross-border resolution regime. In Part III, we explain how a framework that takes into account institution-specific factors and evolving standards would be a superior approach to addressing each of these potential concerns.

Especially in view of the vital role that internationally headquartered banks play in the U.S. economy, it is critical that the Board's approach to implementing the Dodd-Frank Enhanced Standards meet its ultimate objective—reducing U.S. systemic risk—without unduly constraining the U.S. operations of SI-FBOs. Equally important, the Board should ensure that it does not depart from applicable Dodd-Frank requirements or internationally agreed approaches to cross-border banking supervision in its application of the Dodd-Frank Enhanced Standards to SI-FBOs. We believe the framework that we propose in this white paper meets these objectives.





## **I. Background and Guiding Principles**

In the wake of the recent U.S. financial crisis, the United States sought to address the unique risks presented by the potential failure of SIFIs through a number of reforms in the Dodd-Frank Act.<sup>8</sup> The Dodd-Frank Enhanced Standards are intended to reduce the risk of the insolvency of a covered SIFI during future stress events by, among other things, requiring these entities to consider the impact of potential periods of stress and maintain sufficient capital and liquidity (and limit leverage) to avoid an insolvency or threat of insolvency that could adversely affect U.S. financial stability.<sup>9</sup>

The U.S. operations of FBOs are a significant and important portion of the U.S. financial system. The U.S. operations of FBOs, including SI-FBOs, cannot and should not be regulated in the same way as U.S. SIFIs because the U.S. operations of an FBO are only one part of a global organization that is supervised and regulated primarily by authorities in its home country.

### **A. A Focus on the Consolidated Entity**

Section 165 focuses on SIFIs as consolidated organizations. For U.S.-headquartered banking organizations, this focus is clear, as the heightened prudential standards will be applied by the Board to the top-tier parent on a consolidated basis. Similarly, for many SI-FBOs, heightened prudential standards will be applied by home country supervisors on a consolidated basis. We believe that the language and structure of Section 165 contemplates a focus on FBOs as consolidated organizations as a starting point. For example, Section 165 specifically directs the Board to take into consideration comparable home country requirements that apply to FBOs, which by definition would apply to FBOs on a consolidated basis. A focus on consolidated enterprises is a long-standing principle of the international framework for the cross-border regulation of banking operations.<sup>10</sup>

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<sup>8</sup> In addition to Section 165, Dodd-Frank provides for Board authorities to mitigate systemic risk, additional regulation of derivatives markets, and new authority for the orderly liquidation of financial companies. See generally Dodd-Frank, Titles I, II, and VII.

<sup>9</sup> See, e.g., Dodd-Frank § 165(a)(1) (Section 165 standards intended to prevent or mitigate risks to the financial stability of the United States, including those that could arise from the material financial distress or failure of large, interconnected financial institutions); 77 Fed. Reg. at 598-99 (“covered companies would have to demonstrate to the Board that they have robust, forward-looking capital planning processes that account for their unique risks and that permit continued operations during times of economic and financial stress”); *id.* at 604 (“establishing minimum quantitative liquidity standards will improve the capacity of firms to remain viable during a liquidity stress”).

<sup>10</sup> See, e.g., Basel Committee on Banking Supervision (the “Basel Committee”), Consolidated Supervision of Banks’ International Activities (Mar. 1979) (“it should be a basic principle of banking supervision that the authorities responsible for carrying it out cannot be fully satisfied about the soundness of individual banks unless they are in a position to examine the totality of each bank’s business worldwide.”)



This focus is logical in the context of U.S. systemic risk regulation. The perception of—and actual—strength of an operating financial or banking subsidiary is closely linked to the strength of its top-tier parent. In addition, effective liquidity, capital and risk management require consideration of all the obligations and resources of the entities involved, which are most appropriately viewed on a consolidated basis from the top of the group. Precisely because of the need to consider the entire corporate group, the Institute has commented on the Board’s pending proposed rule implementing Section 165 for U.S. bank holding companies to urge the Board to tailor the final rule to U.S. bank holding companies controlled by FBOs.<sup>11</sup> Consideration of the consolidated entity within which these subsidiary bank holding companies operate is appropriate. Likewise, U.S. operations of SI-FBOs that are owned or controlled outside of a U.S. bank holding company should be considered in the broader context of the SI-FBO’s other global operations and home country supervision, with appropriate consideration given to the home country implementation of globally agreed enhanced standards for SIFIs.

B. The Importance of International Coordination in Cross-border Banking Regulation

1. *Longstanding and current principles*

International coordination of home and host country regulation of financial institutions is a longstanding priority for supervisors of internationally active banks, including the Board. The international commitment to this objective has only strengthened in the wake of the recent financial crisis. Precisely because of the cross-border nature of global SIFIs, international coordination in their enhanced supervision and regulation is vital. International responses to the crisis have stressed global coordination in the regulation of systemically significant banks, and they have acknowledged the importance of host country recognition of effective consolidated supervision. Cross-border coordination strengthens home and host country supervisory regimes, and supervisory colleges and other information-sharing mechanisms inform host country supervisors’ independent judgments regarding the capital and liquidity strength of international firms. Congress and the Board have long recognized the continuing need for cooperation and coordination among national regulators in the regulation of FBOs, and Congress reaffirmed these principles in Dodd-Frank.

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<sup>11</sup> In our comment letter of April 30, 2012, we urged the Board to consider the broader context of benefits from and obligations to parent FBOs in which these U.S. bank holding company subsidiaries operate. Available at [http://www.federalreserve.gov/SECRS/2012/May/20120511/R-1438/R-1438\\_043012\\_107220\\_582244408948\\_1.pdf](http://www.federalreserve.gov/SECRS/2012/May/20120511/R-1438/R-1438_043012_107220_582244408948_1.pdf). This context continues to evolve. For example, the Basel Committee recently released a proposal for a principles-based framework for the enhanced supervision of domestic systemically important banks. See Basel Committee, Consultative Document: A Framework for Dealing with Domestic Systemically Important Banks (the “D-SIB Proposal”) (June 2012).



For nearly forty years, the Basel Committee has led international efforts to coordinate the regulation of the banking industry and developed principles for the allocation of supervisory responsibility between home and host jurisdictions. From the beginning, the allocation of responsibility for capital and liquidity regulation were central issues, as was international coordination. In the words of the Basel Committee's first report on the subject, "adequate supervision of foreign banking establishments, without unnecessary overlapping, calls for contact and co-operation between host and parent supervisory authorities."<sup>12</sup> As the Basel Committee and its recommendations have developed, international coordination has remained a core principle:

- "Adequate supervision of banks' foreign establishments calls not only for an appropriate allocation of responsibilities between parent and host supervisory authorities but also for contact and cooperation between them. It has been, and remains, one of the Committee's principal purposes to foster such cooperation both among its member countries and more widely."<sup>13</sup>
- "[Recommendations for cross-border information sharing] are designed to encourage more regular and structured collaboration between supervisors, with a view to improving the quality and completeness of the supervision of cross-border banking, while not in any way seeking to supplant the discrete responsibilities of host and parent supervisors."<sup>14</sup>
- "The statement [of mutual cooperation between national supervisors] should demonstrate the commitment of the supervisors in country A and country B to the principles of effective consolidated supervision and cooperation between banking supervisors, and to their respective responsibilities, as laid down in the Basel Committee's Concordat and Core Principles for Effective Banking Supervision."<sup>15</sup>
- "There will need to be enhanced and pragmatic cooperation among supervisors with legitimate interests. The home country supervisor should lead this coordination effort."<sup>16</sup>

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<sup>12</sup> Basel Committee, Report to the Governors on the Supervision of Banks' Foreign Establishments, p. 2 (Sept. 1975); see *id.* at pp. 3-4 (discussing the appropriate roles of host and parent supervisors in the regulation of liquidity and solvency).

<sup>13</sup> Basel Committee, Principles for the Supervision of Banks' Foreign Establishments, p. 1 (May 1983).

<sup>14</sup> Basel Committee, Information Flows Between Banking Supervisory Authorities, p. 2 (Apr. 1990).

<sup>15</sup> Basel Committee, Essential Elements of a Statement of Cooperation Between Banking Supervisors (May 2001).

<sup>16</sup> Basel Committee, High-level Principles for the Cross-border Implementation of the New Accord (August 2003) (Principal 4).



2. *Home and host country responsibilities and coordination post-crisis*

The fundamental allocation of home and host country responsibility by the Basel Committee remains unchanged following the recent financial crisis. This includes host country recognition of home country consolidated regulation where appropriate and a strong emphasis on cooperation, appropriate sharing of information and coordination in the supervision of internationally active banks.<sup>17</sup> Indeed, international consensus regarding the value of cross-border coordination appears to be stronger, as the Finance Ministers and Central Bank Governors of the G20 recently reaffirmed.<sup>18</sup>

At the same time, the Basel Committee and others have recognized host country concerns with this structure and are working to address them. The FSB recently announced programs for establishing the FSB as a more permanent and financially autonomous body with a more vigorous role in monitoring member implementation of agreed standards.<sup>19</sup> The FSB is engaged in comprehensive “peer reviews”.<sup>20</sup> These include both jurisdiction-specific reviews, which involve a comprehensive review of the financial supervisory and resolution regimes of a specific country, as well as thematic reviews, which provide a cross-country comparison of a specific aspect of financial regulation (e.g., deposit insurance regimes).<sup>21</sup> In addition, the FSB framework for resolution authority and planning provides for host country recognition of the home country resolution of cross-border institutions, but acknowledges the appropriateness of unilateral host country action in certain circumstances.<sup>22</sup> The FSB’s peer reviews of home

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<sup>17</sup> Compare Basel Committee, High-level Principles for the Cross-border Implementation of the New Accord (Aug. 2003), with Basel Committee, Consultative Document: Core Principles for Effective Banking Supervision (Dec. 2011) (Principle 3: Cooperation and Collaboration and Principle 13: Home-host relationships). See generally Basel Committee, Good Practice Principles on Supervisory Colleges (Oct. 2010).

<sup>18</sup> Communiqué of Finance Ministers and Central Bank Governors of the G-20, paragraph 4 (Oct. 14-15, 2011).

<sup>19</sup> See FSB, Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability (“FSB Progress Report”), Section 3 (June 19, 2012) (discussing member progress on improving capacity to resolve SIFIs and on improving the intensity and effectiveness of SIFI supervision); *id.* at Section 11 (discussing reforms for strengthening the independence and financial autonomy of the FSB). The Leaders and Finance Ministers of the G20 endorsed these efforts. See G20 Leaders Declaration, para. 38 (June 19, 2012); Communiqué of Finance Ministers and Central Bank Governors of the G-20, para. 7 (June 19-20, 2012).

<sup>20</sup> See FSB Progress Report, Section 10 (discussing completed and planned peer reviews).

<sup>21</sup> See, e.g., FSB, Peer Review of Switzerland (Jan. 25, 2012); FSB, Thematic Review on Deposit Insurance Systems (Feb. 8, 2012).

<sup>22</sup> See FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, p. 13 (Oct. 2011) (“FSB Resolution Framework”) (“Legislation and regulations in jurisdictions should not contain provisions that trigger automatic action in that jurisdiction as a result of official intervention or the initiation of resolution or insolvency proceedings in another jurisdiction, while reserving the right of discretionary national action if necessary to achieve domestic stability in the absence of effective international

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country regulation, increased monitoring of member implementation of agreed standards, and consideration of host country concerns in its substantive recommendations will continue to strengthen the basis for appropriate host country recognition of the consolidated capital, liquidity and leverage oversight of home country regulators.

Dodd-Frank recognizes the importance of coordination and consultation with home country regulators. Dodd-Frank directs the Board to consider home country supervision of FBOs in connection with the implementation of Section 165<sup>23</sup> and consult with home country regulators or consider home country regulation in connection with other actions required or permitted by Dodd-Frank.<sup>24</sup> The Board has also long acknowledged the importance of international coordination in the regulation of cross-border institutions, as underscored by Governor Tarullo’s recent statement before the U.S. Senate regarding international coordination in the implementation of capital, liquidity, resolvability and other reforms.<sup>25</sup>

**C. Consequences of Unilateral Host Country Measures**

Although the broad international consensus in favor of cross-border coordination and cooperation in the regulation of banking institutions survived the recent crisis, concerns have emerged regarding the vulnerability of host country financial stability to the insolvency or perceived risk of insolvency of a SIFI headquartered in a different jurisdiction that maintains operations in the host country. The FSB has recognized and sought to address these concerns through a variety of measures, including consistent, verifiable implementation of internationally agreed capital and liquidity standards and, perhaps most importantly, through its efforts to harmonize and strengthen the prudential supervision of SIFIs across jurisdictions.

As recently described by the President of the Federal Reserve Bank of New York, “[a]t times, policies are designed with the goal of being ‘best’ at the national level. Yet the resulting mix of national policies is distinctly inferior to what a well-coordinated global regime

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cooperation and information sharing.”); see also FSB, Thematic Peer Review of Resolution Regimes (Aug. 3, 2012).

<sup>23</sup> Dodd-Frank § 165(b)(2)(A).

<sup>24</sup> See, e.g., Dodd-Frank § 113(b)(2)(H) (requiring consideration of home country regulation when determining whether a foreign nonbank financial company should be subject to heightened prudential standards); Dodd-Frank § 113(f)(3) (requiring FSOC to consult with home country supervisors when making an emergency determination that a foreign nonbank financial company is subject to heightened prudential standards); Dodd-Frank § 121(d) (directing the Board to consider home country regulation if it promulgates regulations regarding application to foreign financial companies of its authority to mitigate a “grave threat to the financial stability of the United States” posed by a SIFI ).

<sup>25</sup> International Harmonization of Wall Street Reform: Orderly Liquidation, Derivatives, and the Volcker Rule: Hearing before the S. Comm. on Banking, Housing and Urban Affairs, 112th Cong. (Mar. 22, 2012) (statement of Governor Daniel K. Tarullo) (“Gov. Tarullo Hearing Statement”).



could have produced.”<sup>26</sup> In addition, “regulatory harmonization and cooperation, by necessity requires trust and a willingness to share relevant information across jurisdictions. A corollary to this is that national regulators need to be willing to constrain their unilateral actions somewhat in order to facilitate engagement and cooperative solutions on a global basis.”<sup>27</sup>

Pending development of robust and internationally coordinated minimum standards, approaches to systemic risk supervision that are unduly focused on domestic resources present acute risks for all global banking organizations, including those headquartered in the United States. They also indirectly threaten the global economic recovery in the short term and global financial stability in the long term. The fragmentation of capital and liquidity that would result from unilateral host country approaches is well recognized, and the ensuing effects on the availability of credit and other financial services are clear. Less well recognized but of considerable importance is the potential for fragmentation to increase concentration, and thereby increase systemic risk vulnerabilities, within national markets. Consequently, the systemic risk supervisors in all jurisdictions, especially the financial centers of the global economy, must be mindful of the need to balance their own host country interests against broader international considerations.

Work remains to be done in international fora such as the FSB and the Basel Committee to finalize and standardize the reforms of prudential regulation, capital and liquidity requirements and recovery and resolution regimes applicable to SIFIs. At a minimum, the Board’s host country implementation of Section 165 for SI-FBOs should take into account these international considerations and developments. More broadly, the Board should continue to cooperate in those fora to establish international standards and accountability for implementation of those standards as the principal means to address its concerns regarding threats to U.S. financial stability posed by SI-FBOs.

In our view, the Board should exercise its Section 165 authority to act to strengthen a SI-FBO’s U.S. operations where, based on the Board’s overall assessment of the SI-FBO and the robustness of its supervision and regulation on a consolidated basis by its home country authority, the Board determines such action to be necessary to address concerns related to U.S. systemic risk. However, it would be harmful rather than beneficial to the financial stability and economic strength of the United States to impose new U.S.-territorial capital and liquidity requirements (*i.e.*, requirements that credit only capital and assets held in the United States) on the U.S. operations of an FBO beyond those capital and liquidity requirements that already apply (*e.g.*, to U.S. insured depository institutions owned by FBOs (“IDIs)). Instead, such action should be directed at the specific operations that give rise to systemic risk concerns.

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<sup>26</sup> William C. Dudley, Remarks at the Swiss National Bank-International Monetary Fund Conference, Zurich (May 8, 2012), available at <http://www.newyorkfed.org/newsevents/speeches/2012/dud120508.html>.

<sup>27</sup> *Id.*





Unduly U.S.-centric approaches to the implementation of Section 165 for SI-FBOs would restrict the cross-border flow of capital and assets. New U.S.-territorial capital and liquidity requirements would limit or prevent the flow of capital and liquid assets out of the United States to affiliates, which would in turn discourage institutions from moving resources into the United States because of the risk that they will not be available for future transfers back out. This would cause a retrenchment in the credit available from FBOs to U.S. businesses generally, with significant macroeconomic implications. For example, FBOs were five of the top ten loan “bookrunners” in 2011, providing over \$325 billion in credit.<sup>28</sup> Twenty-five percent of total commercial and industrial lending in the United States is provided by FBOs,<sup>29</sup> and FBO-owned lenders were four of the top ten agricultural lenders in 2011.<sup>30</sup> In addition, a retrenchment of FBOs could lead to further concentration in the U.S. OTC (and exchange-traded) derivatives markets, increasing the exposure of the U.S. financial system to larger U.S. headquartered institutions.<sup>31</sup> U.S. requirements that failed to recognize the availability of capital and liquidity from foreign parents and affiliates would result in the inefficient duplication of capital and liquidity reserves, removing resources from the global financial system.

A U.S. decision not to recognize liquidity and capital held outside the United States would also likely result in similar actions in other jurisdictions (applicable to the host country operations of U.S. banking organizations in those jurisdictions). This would fragment global capital and liquidity regulation, with each jurisdiction requiring that capital and liquidity be held in that jurisdiction, and create further macroeconomic harm from the retrenchment of credit and the sidelining of capital and liquidity. In addition, such a collapse of international coordination and recognition in the regulation of capital and liquidity—core supervisory concerns—could lead to the fragmentation of banking supervision more generally, threatening the basic tenets of cross-border supervision established through the Basel Committee. Such an outcome would hurt all internationally active banking organizations, including U.S.-headquartered bank holding companies.

By reducing credit and other resources available from institutions outside the United States, new U.S.-territorial capital and liquidity requirements could ultimately harm financial stability by limiting diversity and competition in financial markets. U.S. markets would become more concentrated in U.S.-headquartered institutions, and FBOs would be less available

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<sup>28</sup> See Thomson Reuters LPC League Tables. Available at <http://www.loanpricing.com/analysis/leaguetables.php>.

<sup>29</sup> See Board Share Data for 2011 and the first quarter of 2012. Available at <http://www.federalreserve.gov/releases/iba/jboshtr.htm>.

<sup>30</sup> See American Bankers Association, Top 100 Farm Lenders Ranked by Dollar Volume, available at <http://www.aba.com/Solutions/AgBanking/Documents/Top100AgBanksbyDollarVolume.pdf>.

<sup>31</sup> See generally Fitch Ratings, Derivatives and U.S. Corporations: Six Firms Continue to Dominate as Dodd-Frank Act Lurks (June 2012) (more than 75% of the derivatives assets and liabilities of the 100 U.S. firms surveyed are held by six large bank holding companies).



as sources of liquidity and capital during periods of market or general economic stress. In addition, it may be less-regulated shadow banking entities, rather than larger U.S. financial companies, that partially replace the credit provided by FBOs. This would decrease transparency and fail to provide the intended benefit to U.S. stability sought in applying the Dodd-Frank Enhanced Standards to larger entities active in the wholesale financial markets. In addition, the restrictions could impede the appropriate allocation of resources by an FBO and its home country regulators during periods of stress to the institution, limiting the ability of home country regulators to respond quickly and decisively to challenges to the strength of the FBO and therefore potentially increasing the likelihood of the failure of the institution and the resulting harm (systemic or not) to the U.S. financial markets and economy.

Effective application of the Dodd-Frank Enhanced Standards to SI-FBOs would not be well served by heavy and blunt instruments. A robust implementation targeted at real risks to U.S. financial stability posed by specific U.S. operations will be both less harmful to the U.S. economy and global supervisory coordination and more effective in ensuring U.S. financial stability in the interconnected global financial system.

Finally, while this white paper focuses on the implementation of Section 165, the principles and proposed framework described below are broadly applicable. We would advocate this approach be adopted internationally and applied to the heightened host country regulation of SIFIs generally. To the extent that some jurisdictions adopt approaches that broadly impose capital or liquidity requirements on host country activities but provide for case-by-case waivers or other exceptions that take consolidated home country supervision and requirements into account,<sup>32</sup> the end result under such approaches may in some cases be similar to that of the framework we propose below. However, we believe that a clear framework for evaluating each firm's home country supervision and resources prior to imposing heightened host country requirements is the superior approach. Using a firm-by-firm analysis as the starting point will more directly address systemic risk than the consideration of an application for a waiver, and targeted measures designed to address systemic risk will be more effective than the removal or modification of general requirements.

D. Challenges of Implementing the Dodd-Frank Enhanced Standards for FBOs

We recognize that application of the Dodd-Frank Enhanced Standards to FBOs presents the Board with unique challenges. The range of regulatory, corporate and management structures resulting from the diverse business activities of FBOs in the United States presents a significant impediment to broadly applied approaches. The developing international supervisory

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<sup>32</sup> See, e.g., Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”) 12 (general liquidity requirements that are applicable to U.K. branches of foreign firms); BIPRU 12.8 (permitting case-by-case modification or waiver of requirements to recognize the intra-group and cross-border management of liquidity).





landscape and the inherent limitations of the Board in its role as host country supervisor also create challenges.

1. *Legal, funding and capital structures of U.S. operations vary greatly*

While all are subject to consolidated home country supervision, FBOs conduct their U.S. banking and nonbanking operations using a variety of legal, funding, and capital structures. Some FBOs engage in U.S. banking activities through uninsured branches or agencies, some of which are among the largest U.S. banking institutions by assets. Other FBOs control one or more IDI subsidiaries, either alone or together with uninsured banking offices. FBOs can choose to own such IDI subsidiaries through a U.S. bank or thrift holding company or directly without a holding company. Most FBOs conduct some degree of U.S. nonbanking activities through U.S. affiliates, including U.S. broker-dealers, insurance companies, commercial and consumer lending companies, etc. For FBOs that control a U.S. bank or thrift holding company, they may choose whether to control their U.S. nonbanking affiliates through the U.S. bank or thrift holding company, or through a separate holding company or chain of ownership, or combinations of the foregoing.

The capital and funding structures of U.S. operations are also varied. U.S. branches and agencies may raise funding in the United States and serve as an important source of dollar funding for the home office of an FBO, or be primarily dependent on lending from the home office to finance U.S. operations. Similarly, the capital structures of U.S. operations vary significantly. The U.S. regulatory capital framework has long included both compliance with domestic capital requirements and recognition that reliance on the strength of the parent foreign bank may be appropriate.<sup>33</sup> The capital levels of U.S. broker-dealer subsidiaries may also vary. While all broker-dealers are subject to the capital adequacy regulations of the Securities Exchange Commission (“SEC”) under its net capital rule<sup>34</sup> and supervision of the Financial Industry Regulatory Authority (“FINRA”), FBOs may choose among various methods for capitalizing their U.S. broker-dealer affiliates. Regardless of the method selected, the broker-dealer’s capital is maintained at a level that exceeds SEC requirements.

The variety of formats of the U.S. operations of FBOs and the related variation of their relationship to and integration with non-U.S. operations do not lend themselves to a single set of universally applicable heightened prudential standards for SI-FBOs. Such an approach would in many cases duplicate or needlessly add to effective home country supervision while in some instances failing to address risks presented by unique U.S. operations of FBOs. This would be particularly inefficient because only a handful of FBOs have systemically significant U.S.

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<sup>33</sup> A U.S. bank holding company owned and controlled by a foreign bank is subject to the requirements of the so-called “Collins Amendment” (Dodd-Frank § 171), in some instances on a phased-in basis. While the Collins Amendment thus is relevant to assessing the capital adequacy of such bank holding companies, it does not apply to foreign banks themselves.

<sup>34</sup> See 17 C.F.R. § 240.15c3-1.



operations. Approximately twenty FBOs have U.S. operations with total assets of \$50 billion or more, and it is highly unlikely that the operations of all twenty are significant to U.S. financial stability. In light of the range of legal structures and nature of activities of SI-FBOs, it would be burdensome and inefficient to design and apply requirements to them that are intended to address all issues raised by the different structures and risk profiles of the few SI-FBOs.<sup>35</sup>

2. *Home country and international reforms continue at varying paces, complicating the Board's role as host country supervisor*

While there is broad international consensus regarding the need for heightened prudential regulation of SIFIs, the timelines in effect for different jurisdictions, as well as the pace of international efforts to develop a framework for international coordination, are in many cases not aligned with U.S. timeframes for U.S.-headquartered institutions. Dodd-Frank has imposed specific requirements and specific deadlines for rules implementing the Dodd-Frank Enhanced Standards, while other jurisdictions are in various stages of statutory or regulatory implementation of comparable requirements.<sup>36</sup> Indeed, several jurisdictions are ahead of the United States in the implementation of international standards; for example, implementation of the Basel III capital rules in Japan and Switzerland is final.<sup>37</sup> The Board's initial implementation of the Dodd-Frank Enhanced Standards for FBOs will therefore need to account for uncertainty as to the final scope and impact of similar home country regulations. This factor distinguishes the implementation of Section 165 for FBOs from the implementation of Section 165 for U.S. bank holding companies, where the Board can control the relative timing of the implementation of various standards.

These timing issues are not limited to the Dodd-Frank Enhanced Standards and comparable regulation. A wide range of other reforms intended to strengthen the global financial system and large financial institutions are either not yet agreed at the international level or not yet implemented in many jurisdictions.<sup>38</sup> While not directly comparable to the Dodd-Frank

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<sup>35</sup> As noted above, the Institute urges the Board to appropriately tailor the application of the Dodd-Frank Enhanced Standards to foreign banking organizations covered by Section 165 with U.S. operations that are not relevant to U.S. stability. This tailoring could take such forms as U.S. asset thresholds for coverage, scaling and simplification of requirements for these organizations, and appropriate recognition of home country liquidity and capital requirements. This approach is especially appropriate for those FBOs that have \$50 billion or more in total consolidated assets globally but whose U.S. operations have total assets of less than \$50 billion—and in many instances substantially less than \$50 billion. We note that such FBOs account for the overwhelming majority of FBOs that will be subject to Section 165 under the approach it appears the Board will adopt in implementing Dodd-Frank's \$50 billion total consolidated asset threshold.

<sup>36</sup> See, e.g., Basel Committee, Report to G20 Leaders on Basel III Implementation (June 2012).

<sup>37</sup> See id; Swiss Financial Market Supervisory Authority ("FINMA") Press Release of July 18, 2012, available at <http://www.finma.ch/e/aktuell/Pages/mm-rs-umsetzung-b2-tbtf-20120718.aspx>.

<sup>38</sup> As Governor Tarullo discussed during a recent Senate hearing, the Board and the Federal Deposit Insurance Corporation (the "FDIC") continue to work to implement existing agreements and to identify additional opportunities for international cooperation. See Gov. Tarullo Hearing Statement.



Enhanced Standards, recovery and resolution planning, derivatives clearing and other regimes will alter—perhaps dramatically—the risk profile of the activities of FBOs in the United States and the information available to the Board. For example, the continuing development of the framework for cross-border cooperation in recovery and resolution planning, particularly information sharing and cooperation in the crisis management groups,<sup>39</sup> likely will provide the Board with ongoing information regarding the strength and structure of many FBOs. In addition, it is likely that any SI-FBO that is not a global SIFI will be classified as a domestic systemically important bank in its home jurisdiction. International coordination of the supervision of “D-SIBs” is only in its preliminary stages. In our view, the Board’s implementation of heightened prudential standards for FBOs necessarily will need to take these developments into account.

Against this backdrop of developing home country and international regulation, the Board must operate within the inherent limitations of its role as a host country supervisor of FBOs. As discussed in Part I.B, these include an international framework and norm of appropriate recognition of consolidated home country regulation, as well as limited oversight of the governance of the organization (e.g., the highest levels of strategic planning and risk management, which are generally conducted at the board and senior management levels of the top-tier parent entity).

E. Suggested Principles for Applying Section 165 to FBOs

1. *Global consolidation*

In our view, the development of approaches to apply the Dodd-Frank Enhanced Standards to an FBO should start with a consolidated view of the activities of the entire group. Meaningful implementation of the liquidity, capital and other components of Section 165 is not possible without this consolidated view. Further, an implementation of the Dodd-Frank Enhanced Standards (or of comparable requirements of a non-U.S. jurisdiction) that “consolidated” an entity at a level other than the top-tier holding company would create the possibility of overlapping and inconsistent regulation of SIFIs under different national regimes. Such designation of “sub-SIFIs” would also be inconsistent with the Board’s proposed global asset test in the notice of proposed rulemaking.<sup>40</sup>

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<sup>39</sup> See generally FSB Resolution Framework.

<sup>40</sup> While we maintain our view that Section 165 should not apply to FBOs with less than \$50 billion in assets in their U.S. operations, this threshold matter is independent of the question of where in the organizational structure of a covered foreign banking organization the Dodd-Frank Enhanced Standards should be implemented and tested. We also recognize that the Board’s proposed rule regarding the implementation of Section 165 for U.S. bank holding companies would apply to a U.S. bank holding company that is owned by an FBO. See note 5, above. In our comment letter of April 30, 2012, we recognized the Board’s statutory requirement to take this approach but suggested that the Board reflect in any final rule the fact that such bank holding companies are part of a larger global FBO with a non-U.S. parent. Over time, we would

Continued....



2. *Look to comparable home country standards*

Compliance with Section 165’s directive to consider comparable home country supervision will require the consideration of both the home country regime applicable to a consolidated entity and the effect of that regime on the U.S. operations of the specific covered institution. Home country implementation of globally agreed standards for SIFIs will strengthen a SI-FBO’s capital and liquidity positions and enhance its risk management. While individual analysis of each SI-FBO is appropriate, we expect these analyses will generally confirm that the home country implementation of heightened standards for SIFIs has reduced the systemic risk profile of the U.S. operations of SI-FBOs.

In the case of home country regimes, we believe the Board’s existing framework for evaluating home country capital regulations is the appropriate model. Because of the parallel statutory language and closely related substantive issues, the Board’s implementation of Section 165 should parallel that of the Gramm-Leach-Bliley Act (“GLBA”)<sup>41</sup> provision regarding an FBO’s qualification as a “financial holding company”. Section 165 directs the Board to “give due regard to the principle of national treatment and equality of competitive opportunity” and “take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States” in applying the standards set forth in Section 165.<sup>42</sup> This language parallels the statutory criteria for extending to an FBO the powers available to a financial holding company under the GLBA. That provision directs the Board to “apply comparable capital and management standards to a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, giving due regard to the principle of national treatment and equality of competitive opportunity.”<sup>43</sup>

Congress clearly intended the Board to draw on the well developed framework for evaluating whether the consolidated home country regulation of an FBO is comparable to U.S. regulation of bank holding companies when it evaluates whether SI-FBOs are subject to home country standards comparable to the Dodd-Frank Enhanced Standards. Indeed, the directive to look to comparable home country supervision is even clearer in Section 165. Whereas the GLBA requirement to “apply comparable standards” makes no direct reference to home country standards and could have been read as a directive to create and impose comparable standards, Section 165’s directive to “take into account . . . home country standards that are comparable” is a clear mandate to evaluate home country standards and to credit them where comparable to U.S. requirements. The closely related subject matter—home country regulation of capital levels and other core prudential

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expect that supervision and regulation of SI-FBOs would adopt a more comprehensive and coordinated approach to the SI-FBO’s cross-border operations in the United States.

<sup>41</sup> Pub. L. No. 106-102, 113 Stat. 1338 (1999).

<sup>42</sup> Dodd-Frank § 165(b)(2).

<sup>43</sup> 12 U.S.C. § 1843(l)(3).



## INSTITUTE OF INTERNATIONAL BANKERS

matters—underscores the intent behind the use of parallel language. Just as the Board looks to home country implementation of the Basel Accord for the GLBA’s “well capitalized” requirement,<sup>44</sup> so too should it look to home country implementation of the Basel Committee’s and FSB’s SIFI-related provisions as the starting point for implementation of Section 165 for SI-FBOs.

3. *Analyze and tailor heightened prudential requirements to each FBO individually*

Compliance with Section 165’s directive to consider the extent to which the FBO is subject to comparable home country regulation can also be read to contemplate an analysis of the effect of that regime on the U.S. operations of the FBO. FBOs’ various business objectives result in a range of legal and operational formats for their U.S. operations, and the interaction between these structures and home country regimes should be considered in implementing and applying the Dodd-Frank Enhanced Standards to SI-FBOs. This analysis should credit the effects of comparable home country regulation. If home country regulation is comparable, and the SI-FBO is in compliance with those requirements, the Board should impose additional heightened requirements only where pockets of unaddressed risk in the institution’s U.S. operations threaten U.S. financial stability in a way that is not addressed by home country standards.

In addition to the mandate to consider home country standards, Section 165 grants the Board authority to tailor the application of the Dodd-Frank Enhanced Standards by differentiating among categories or individual companies on the basis of risk-related factors.<sup>45</sup> The Board should exercise this authority to tailor the application of the Dodd-Frank Enhanced Standards to the diverse risk profiles presented by SI-FBOs. The Board’s existing oversight of these institutions, including its strengthened on-site examinations of firms,<sup>46</sup> currently provide the Board with significant information on each SI-FBO and provide a framework for obtaining any additional information necessary to individually analyze and address the systemic risk profile of each SI-FBO. Careful tailoring will avoid mismatches between the risks presented by a particular institution and the impact of the Dodd-Frank Enhanced Standards on that institution.

Consideration of the risks presented by categories and individual companies will allow the Board the flexibility to be forward-looking and act decisively to address real risks to financial stability. The Board’s limited resources should be focused on the particular structures and activities that could present real risks to U.S. financial stability, rather than the enforcement of categorical approaches applicable to all SI-FBOs.

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<sup>44</sup> See 12 C.F.R. § 225.90-.92.

<sup>45</sup> Dodd-Frank § 165(a)(2) (capital structure, riskiness, complexity, financial activities and size are specifically enumerated, but the Board may consider any other risk-related factor it deems appropriate).

<sup>46</sup> See Sarah J. Dahlgren (Executive Vice President, Federal Reserve Bank of New York), Remarks at the New York Bankers Association Financial Services Forum (Nov. 11, 2011) (“Dahlgren Remarks”) (discussing recent restructuring of on-site supervision).



In this regard, we do not propose that the Board should wait until threats to U.S. financial stability materialize before imposing heightened standards. We recognize the potential limitations of such an approach, including dependence on a rapid supervisory action and the possibility of procyclical effects. Rather, the tailoring we suggest would allow the Board to address—proactively—specific systemic risks through targeted measures instead of addressing theoretical systemic risks through generic measures.

## **II. Proposed Approach**

We believe there is only one viable approach for applying the Dodd-Frank Enhanced Standards to SI-FBOs. The Board should adopt a framework for applying heightened scrutiny to the circumstances of and risks presented by each institution—including evaluation of any potentially comparable home country standards—and determining the appropriate tailored application of the Dodd-Frank Enhanced Standards to any FBO whose U.S. operations are systemically significant (the “SI-FBO Framework”). Evaluation of each institution and the determination of the applicable requirements would occur under a framework set out in Board regulations transparently developed through the Board’s public rulemaking process. The SI-FBO Framework would allow the full consideration of all factors relevant to the relationship between the U.S. operations of a SI-FBO and U.S. financial stability, adjustments for developments in the institution’s home country supervisory requirements and decisive and effective actions to address actual risks presented by SI-FBOs.

### **A. Heightened Standards for Evaluating Capital and Liquidity Supporting U.S. Operations**

The SI-FBO Framework would require supervisory analysis of the need for additional U.S.-based capital and liquidity standards for the U.S. operations of a SI-FBO on an institution-by-institution basis. The purpose of this analysis would be to determine whether targeted heightened capital or liquidity standards are necessary to prevent or mitigate risks to the financial stability of the United States from these operations. The criteria for this analysis should be flexible and inclusive to capture the full range of considerations relevant to an FBO’s U.S. operations and home country regulatory context. This analysis should include consideration of:

- The scope, nature, scale and risk profile of U.S. activities of the FBO (both its banking and nonbanking operations);
- The degree and nature of interconnection between the organization’s banking and nonbanking activities in the United States, and their interconnection with activities outside the United States;
- The extent and character of the U.S. regulation of functionally regulated entities in the United States, including IDIs, branch and agency offices, broker-dealers, swaps dealers and insurance companies;





## INSTITUTE OF INTERNATIONAL BANKERS

- The financial strength of the top-tier entity of the FBO (and, if relevant, of other affiliates);
- Information available through the FBO's recovery and resolution planning, including its formal U.S. submissions, submissions in other jurisdictions available to the Board, and information available to the Board through recovery and resolution coordination with other regulators (e.g., through the crisis management group for the firm or other international cooperation arrangements);
- Other information available to the Board from home country (or other host country) supervisors; and
- The home country supervisory and regulatory context of the FBO.

The Board's heightened evaluation of a SI-FBO's home country supervisory and regulatory context should likewise be conducted broadly, including consideration of existing and planned elements of the home country supervisory and legal framework relevant to the operations, stability and potential recovery or resolution of the SI-FBO. Home country implementation of the Basel Committee's international capital and liquidity framework (including Basel II and Basel III) would be central elements, as would any "G-SIB" or other capital "surcharge". We believe that the Board should also consider additional factors less directly related to capital and liquidity but also relevant to U.S. financial stability. For example, the insolvency regime and any special resolution regime applicable to the SI-FBO will likely be relevant, as will the hierarchy of creditor preferences and its impact on the availability of funds to satisfy depositors and other creditors of U.S. operations. If the result of the Board's analysis is a determination that the consolidated capital and liquidity measures applicable to the SI-FBO are comparable to the Dodd-Frank Enhanced Standards, and that—after adjusting for the effects of the applicable insolvency regime and other relevant aspects of the home country regulatory and legal framework—the U.S. operations of the SI-FBO are adequately covered by these requirements, the Board should generally defer to the SI-FBO's consolidated home country supervision.

The case-by-case analysis of SI-FBOs and their home country supervisory context under the SI-FBO Framework likely will require SI-FBOs to provide the Board with information of greater detail and broader scope than the Board's current supervisory approaches would require and that would be needed with respect to FBOs that are not SI-FBOs. The Institute recognizes that the SI-FBO Framework could result in more intrusive inquiries by the Board regarding the home country operations and supervision of SI-FBOs as well as applicable legal regimes. While we would expect that international cooperation and coordination among the home and host country supervisors of SI-FBOs will be an efficient source of high-quality information in these areas, we understand that additional information burdens are a likely implication of the heightened degree of supervision contemplated by the SI-FBO Framework.



B. Addressing U.S. Systemic Risk

The SI-FBO Framework should provide for targeted application of heightened capital and liquidity requirements to specific U.S. operations, taking into account any Board assessment of home country supervision and regulation or its coverage of U.S. operations, or the adequacy of the functional regulation of U.S. entities. Examples of such heightened targeted measures could include:

- limitations on “due from” positions in a branch or agency office;
- heightened asset maintenance requirements for a branch or agency office;
- supplemental capital requirements to mitigate risks arising from activities in a broker-dealer subsidiary; and
- supplemental capital or liquidity requirements for specific U.S. activities or classes of transactions conducted by a SI-FBO determined to be relevant to U.S. financial stability.

By targeting specific operations, the Board can ensure that U.S. systemic liquidity or capital concerns are fully addressed and that supervisory resources are not “diluted” through application to U.S. operations or entities that do not pose systemic risks. This targeting of heightened standards also avoids the duplication of requirements for other U.S. operations for which home country standards and functional U.S. regulation are sufficient.

1. *Legal authority*

The Board’s longstanding supervisory and regulatory authority over FBOs was expanded and supplemented by Dodd-Frank for purposes of addressing risk to U.S. financial stability. The Board has historically supervised the combined U.S. operations of FBOs in close coordination with other state and federal supervisors, assigning the U.S. operations a combined “ROCA” rating and the foreign parent a “SOSA” ranking.<sup>47</sup> The Board has generally asserted authority to do so under the International Banking Act and the Foreign Bank Supervision Enhancement Act.<sup>48</sup> Although the GLBA imposed restraints on the ability of the Board directly

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<sup>47</sup> See Board SR Letter 08-9, Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008); Board SR Letter 00-14, Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (Oct. 23, 2000) (“SOSA rankings reflect an assessment of a foreign bank’s ability to provide support for its U.S. operations. The ROCA system represents a rating of the risk management, operational controls, compliance and asset quality of an FBO’s U.S. activities.”).

<sup>48</sup> See *id.*; 12 U.S.C. §§ 3102, 3105.





to examine certain U.S. entities that are functionally regulated by another U.S. agency,<sup>49</sup> Dodd-Frank specifically repealed these restrictions.<sup>50</sup>

Beyond repealing these GLBA restrictions, Dodd-Frank provided the Board with additional authorities to address systemic risks posed by non-U.S. SIFIs. Section 165 provides the Board with clear authority to act to address risks to U.S. financial stability posed by FBOs. In our view, the Board’s authority to address systemic risk is best viewed—and will be most effective—as an extension and enhancement of the Board’s existing framework for supervision of the U.S. operations of FBOs and evaluation of their global strength and home country supervision.

In addition, Section 121 of Dodd-Frank authorizes the Board to condition or require the termination of specific activities of a SIFI if it determines that the institution poses a grave threat to the financial stability of the United States.<sup>51</sup> The Board also has the authority to order a branch or agency office of an FBO to terminate its activities if the FBO presents a risk to the stability of the U.S. financial system and its home jurisdiction “has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk.”<sup>52</sup> We recognize that these provisions of Dodd-Frank may be viewed as extraordinary remedies that are intended to be rarely—if ever—invoked. However, they remain important backstops to the Board’s implementation of its Section 165 authority and therefore are relevant to the consideration of what supervisory standards are necessary to regulate SI-FBOs. In addition, they demonstrate Congress’ clear expectation that other jurisdictions would address the risks posed by SIFIs headquartered outside the United States. They also demonstrate Congress’ intent that the Board evaluate heightened home country supervision of SI-FBOs and, by implication, rely on home country supervision where robust and effective.

These authorities give the Board clear authority to examine, closely monitor, and in some cases directly supervise, the U.S. activities of FBOs.

## 2. *Extending the existing framework of FBO supervision*

In our view, the Board’s Section 165 authority would best be implemented as a robust, practical extension of existing authorities and frameworks focused on systemic risk. By operating through existing structures, the Board can leverage its current supervision and experience with FBO operations in the United States. By extending the existing framework and supervisory tools, the Board can directly target sources of risk.

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<sup>49</sup> See GLBA §§ 111, 113 (amending 12 U.S.C. § 1844(c) and enacting 12 U.S.C. § 1848a).

<sup>50</sup> See Dodd-Frank § 604(c).

<sup>51</sup> See Dodd-Frank § 121(a).

<sup>52</sup> See Dodd-Frank § 173(b)(3).



For example, assume that an FBO with both a U.S. branch office and a U.S. banking subsidiary has a large “due from” position in the branch office (i.e., the U.S. branch is funding the non-U.S. offices of the foreign bank) that the Board determines is relevant to U.S. financial stability. If home country capital and liquidity requirements applicable to this FBO do not sufficiently address the Board’s concern, this can be remedied directly by limiting the due from position, rather than through a capital requirement applicable to the U.S. operations of the FBO more generally. The cost and impact of such a general requirement would likely be much larger than one targeted to the risk identified by the Board, as its effect would be spread across all U.S. operations, and it would burdensomely duplicate the capital requirements already imposed on the U.S. bank subsidiary and the foreign bank parent. Likewise, if the Board were to make a finding that a U.S. broker-dealer affiliate presented risks to U.S. financial stability, the Board could address those risks through targeted capital or liquidity measures rather than requirements imposed on the aggregate U.S. operations of the FBO. As discussed in greater detail in Part III.B, substantial information is available to the Board regarding capital and leverage levels, liquidity levels and management, and the securities, commodities and derivatives activities of broker-dealers. The Board’s Section 165 authority ensures that it could act directly to address any specific risks to financial stability presented by the broker-dealer’s activities, for example through supplemental capital requirements or through instrument or market-specific restrictions on activities.

In these examples, the Board’s Section 165 authority extends the Board’s existing examination and supervision of the FBO’s combined U.S. operations to permit the Board to require clear action by the FBO to address systemic risk. In addition, the Board’s recent enhancements to its on-site supervision, including the focus on understanding the overall activities of and risks to each firm, provide additional high quality information for monitoring and evaluating FBOs individually and tailoring to each firm any measures necessary to address systemic risk.<sup>53</sup> This framework and interagency coordination provide the Board with detailed insight into the risk profile of an FBO that can be leveraged to closely monitor any potential systemic risks.

Section 165 and the other provisions of Dodd-Frank described above give the Board clear authority directly to intervene to address any risks to U.S. financial stability, and this targeted intervention would be more effective and less burdensome than creating or increasing capital requirements applicable to an FBO’s U.S. operations generally.

C. Inefficiencies and Risks of General Requirements and Restructuring of U.S. Operations

In sharp contrast to a targeted approach, imposing broad requirements applicable to the U.S. operations of the SI-FBOs in isolation from their foreign parents and affiliates would be a revolutionary departure from longstanding U.S. and international principles of home-host

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<sup>53</sup> See Dahlgren Remarks.



coordination, and could harm U.S. economic health. Such U.S. requirements and the likely reciprocal actions of other jurisdictions would artificially restrict the global flow of capital. They would also remove assets and capital from productive use in the financial system to satisfy U.S. standards that duplicate home country consolidated requirements. These harms would occur regardless of whether new U.S.-territorial capital and liquidity requirements were imposed by requiring actual restructuring of U.S. operations into a single U.S. holding entity or through a “virtual” U.S. holding company. In our view, U.S. efforts to increase financial stability would be far better directed at ensuring the robust and comparable home country regulation of all SIFIs than attempting to wall off the U.S. operations of SI-FBOs from their operations in the rest of the world.

New U.S.-territorial approaches would be particularly harmful in the context of U.S. branch and agency offices of FBOs (e.g., requiring the actual or synthetic “roll up” of these offices into a U.S. banking subsidiary). This would eliminate the bank’s home office (and non-U.S. branch offices) as direct sources of credit and assets—only assets in the United States would be directly available to the bank’s U.S. operations. These and the other costs and consequences described in the Subsidiary Requirement Study conducted by the Board with the Department of the Treasury weigh heavily against any such “roll up” approach.<sup>54</sup> Because a U.S.-territorial approach would not credit home country capital or liquidity, it could increase dramatically the capital and liquidity requirements for U.S. operations—the parent FBO could be obligated to hold capital and liquidity for these operations at the group’s top-tier entity, and the U.S. entity would be required to capitalize and hold liquidity for the same operations separately at the U.S. level. An FBO would be reluctant to increase—and might sharply reduce—the assets and activities of its U.S. banking operations.

Even setting aside the radical departure from longstanding U.S. and international home-host regulation and the risks of harm to that international framework, U.S. stability and the U.S. economy discussed in greater detail in Part I.C, a U.S.-territorial approach would be unwarranted by the actual risks to U.S. financial stability posed by the U.S. operations of FBOs. There are only a small number of SI-FBOs. Many of these systemically significant operations are limited to specific areas of the U.S. financial markets (e.g., wholesale lending, short-term borrowing, and capital markets activities). This limited scope of activities weighs heavily in favor of targeted solutions to address the specific risks raised by these activities. Broader measures are unnecessary in the case of the other U.S. activities of FBOs and potentially insufficient to address concentrated risks from specific activities.

The limited risk to U.S. financial stability presented by SI-FBOs can also be seen through the experience of the recent financial crisis. To our knowledge, none of the studies of the causes of the U.S. financial crisis have pointed to the U.S. operations of SI-FBOs as a

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<sup>54</sup> See generally U.S. Department of the Treasury and Board, Subsidiary Requirement Study (Dec. 18, 1992).



## INSTITUTE OF INTERNATIONAL BANKERS

disruptive force or significant contributing factor.<sup>55</sup> Broadly applicable requirements would be inconsistent with the overall scale of the systemic risk presented by the U.S. operations of FBOs. While the Board's implementation of Section 165 should be forward looking in identifying and addressing systemic risk, it should also be appropriately scaled to the potential risks being mitigated.

In our view, the Board should continue to leverage its longstanding policies regarding the regulation of FBOs' U.S. operations and directly regulate SI-FBO activities in their existing legal structures. Dodd-Frank provides the Board with clear authority to act through these structures where U.S. financial stability is implicated. In light of the continuing development of home country measures to strengthen and regulate non-U.S. SIFIs, it would be, at best, premature to address the risks to U.S. financial stability posed by those institutions through a measure as costly and disruptive as requiring FBOs generally to restructure their U.S. activities.

Further, an approach based on restructuring and broadly applicable requirements would not allow the Board the ability to adapt to comply with its mandate to consider the effects of home country supervision. In light of this mandate, it is vital that the Board retain the ability to reflect the effects of comparable home country regulation in any application of the Dodd-Frank Enhanced Standards. The differentiation of home country regulation on an institution-specific basis is an important procedural benefit of the SI-FBO Framework that facilitates compliance with this mandate.

Even an approach that considered home country regulations at the time of the final rulemaking would not be sufficient to address Section 165's mandate in light of the continuing development of national and international reform efforts. The SI-FBO Framework allows for consideration and tailoring to the unique complexities created by the interaction among those home country regimes, the developing U.S. regulatory landscape and the scope and legal structure of each SI-FBO's U.S. operations. As all of these pieces continue to move, the SI-FBO Framework would allow the Board to continue to evaluate—and where prudent to protect U.S. financial stability, adjust—the capital and liquidity standards applicable to each FBO in response to these movements.

The SI-FBO Framework would permit the Board to finalize regulations that clearly describe the framework for applying the Dodd-Frank Enhanced Standards to SI-FBOs while also permitting the appropriate consideration of each organization's home country supervisory structure and any future developments to those structures. This procedural approach

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<sup>55</sup> See, e.g., Financial Crisis Inquiry Commission, *Financial Crisis Inquiry Report* (Jan. 2011) (discussing at length role and experiences of U.S. firms in the financial crisis that began in 2007); Bank for International Settlements: Committee on the Global Financial System, *Long-term Issues in International Banking* (July 2010) (discussing findings that foreign bank activities in a country “reduce procyclical lending behavior” and that “local lending by foreign banks was more stable during the recent crisis than cross-border lending, which depends to a greater extent on the health of the parent institution.”)



is also helpful to the Board in complying with its mandate to consider home country regulation and would be consistent with appropriate host country practice under the Basel Committee's framework for cross-border coordination.

### **III. Potential Supervisory Concerns**

We understand that there are a number of concerns regarding the cross-border operations of SI-FBOs and their implications for U.S. financial stability that could lead the Board to consider new U.S-territorial capital and liquidity requirements. In Part III of this white paper, we discuss these concerns and explain how the SI-FBO Framework would be a superior method to implement Section 165 in light of the potential concerns.

#### **A. Lack of Complete First-hand Information Regarding the Global Risk Profile of FBOs**

While there are inherent information limitations in the Board's role as a host country supervisor, these limitations cannot be fully addressed through the application of the Dodd-Frank Enhanced Standards. Under the SI-FBO Framework, the Board would retain full access to all information regarding an FBO's U.S. operations through its current direct oversight of those operations.<sup>56</sup> In addition, as discussed above, we anticipate that the Board will likely request additional information directly from an FBO when conducting its heightened analysis of the potential systemic risk of the FBO's U.S. operations. These sources of information will be key to understanding any risks the FBO may pose to U.S. financial stability and to the Board effectively exercising its Section 165 authority to address these risks.

Insight into the risk profile of a SI-FBO's global activities would come from the Board's evaluation of the home country supervisory framework and standards applicable to the FBO, and from information available from home and other host country supervisors. Recently strengthened FSB and Basel Committee programs designed to confirm that standards are implemented and calculated consistently across jurisdictions will give the Board additional assurance that the information it receives as a host supervisor will be adequate. While focused on the impact on U.S. operations, the Board's evaluation of home country supervision will also provide insight into the consolidated supervision of the FBO's global operations. This insight will be supplemented by firm-specific information available to the Board from the firm's other supervisors. Information sharing through firm-specific crisis management groups is a key area of international cooperation and should provide the Board with high-quality information on the global risk profile and strength of FBOs. While the framework for crisis management groups and other international collaboration continues to evolve, cross-border information sharing regarding SIFIs must become comprehensive and vigorous.

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<sup>56</sup> See Part II.B.2.



The SI-FBO Framework would allow the Board to consider all information available regarding each institution, adjust the application of the Dodd-Frank Enhanced Standards to any U.S. operations as any lack of information warrants and recalibrate the application of the Dodd-Frank Enhanced Standards as the information available for a particular institution changes. By contrast, an approach that imposes direct Board supervision of non-U.S. operations or forces the restructuring of U.S. operations would be a sharp departure from international principles and would be premature prior to the full development and testing of the developing international information-sharing framework. Capital, liquidity or other measures targeted to specific entities or activities where the absence of information is relevant to systemic risk will be far more effective than blanket measures.

**B. Risk Profile of Broker-Dealer Subsidiaries of SI-FBOs**

1. *Close monitoring of broker-dealer affiliates of SI-FBOs and targeted intervention are the most appropriate means to implement the Dodd-Frank Enhanced Standards*

Most if not all SI-FBOs conduct significant investment banking operations in the United States through one or more SEC-registered broker-dealer affiliates. These affiliates typically engage in a range of securities-related activities, including market-making, M&A advisory, brokerage, custody, and clearing services. Broker-dealer affiliates also participate in derivatives, futures and commodities markets. The capital adequacy and liquidity of broker-dealer affiliates is subject to SEC and FINRA supervision and regulation, and a broker-dealer's exposures are also subject to consolidated capital and liquidity requirements at the level of the FBO parent.

Because of fundamental differences between banking and broker-dealer capital regimes and risk profiles, implementation of the Dodd-Frank Enhanced Standards should not be premised on an assessment of broker-dealer capital or leverage based unduly on bank regulatory capital concepts. Instead, the Board should actively monitor the activities of the U.S. broker-dealer affiliates of SI-FBOs for systemic risks not addressed by their functional regulation or other measures. In addition to the information available to the Board through its direct supervision of the SI-FBO under Section 165, the Board maintains pre-Dodd-Frank authority to examine functionally regulated subsidiaries directly.<sup>57</sup> Broker-dealer calculation of net capital rule compliance, implementation of FINRA's best practices for liquidity management, and broker-dealer leverage-related reporting to FINRA are all important sources of supplemental information for the Board. The Board should use these sources and its supervisory authority to carefully monitor the current and planned future capital and leverage levels of the broker-dealer and its affiliates, as well as its liquidity management and planning processes.

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<sup>57</sup> See, e.g., Board SR Letter 08-9, Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 2008) (Attachment B.1).





Under the SI-FBO Framework, the Board would consider all of this information on an institution-specific basis, in connection with the applicable home supervisory regime and the manner in which the SI-FBO's U.S. broker-dealer subsidiary integrates into its legal structure and interacts with other U.S. operations. If the Board concludes from this analysis that the activities of the U.S. broker-dealer or its affiliates present a pocket of risk to U.S. financial stability not addressed by home country or U.S. functional supervision and regulation, the Board can, and should, address this risk using its Section 165 authority. In that case, appropriate Board actions could include additional capital or liquidity measures as appropriate to address the relevant risk to U.S. financial stability (which capital or liquidity the SI-FBO could choose to hold in the broker-dealer directly or in a U.S. parent of the broker-dealer), or imposing other risk-mitigating measures.

As discussed above, the Board has the authority to address systemic risk through its supervision of broker-dealer affiliates of SI-FBOs. Congress removed limitations on the Board's authority to supervise functionally regulated entities in Dodd-Frank.<sup>58</sup> This expansion, together with the Board's general authority under the International Banking Act and its authority to address systemic risk under Section 165, provide the Board with authority to impose additional capital or liquidity requirements or take other similar measures where the Board determines that, under the specific circumstances of the institution and its role in the U.S. financial system, the broker-dealer poses a risk to U.S. financial stability. This targeted approach is the most effective for addressing these otherwise unaddressed risks and will be more effective than more diffuse requirements applicable to all U.S. operations.

2. *Broker-dealers and banks are fundamentally different, and their respective capital regulations reflect this difference*

The risks presented by a U.S. broker-dealer affiliate are fundamentally different than the risks presented by a commercial bank affiliate or branch or agency of an FBO. The asset and liability mix of a broker-dealer entity's balance sheet is typically significantly different than the mix that one would find on a banking entity's balance sheet. The assets acquired, held and sold by a broker-dealer are generally highly liquid securities, while loans and other traditional bank assets are far less liquid.<sup>59</sup> In addition, broker-dealers' assets and liabilities are largely subject to mark-to-market accounting, while traditional banking assets and liabilities are not.<sup>60</sup> Because of these asset characteristics, broker-dealers face relatively greater market risk than banks, while banks generally face relatively greater credit and liquidity risks.

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<sup>58</sup> See Dodd-Frank § 604(c).

<sup>59</sup> While it is true that the parent company of a broker-dealer or its non-broker-dealer affiliates may hold less liquid assets, these would not typically be held in a broker-dealer.

<sup>60</sup> See SEC, Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting, p. 47 (Dec. 30, 2008), available at <http://www.sec.gov/news/studies/2008/marktomarket123008.pdf> (comparing the percentage of broker-dealer and bank assets that are carried at mark-to-market or similar values).



These and other characteristics are reflected in the fundamentally different approaches to capital regulation under the SEC’s net capital rule applicable to broker-dealers, and the minimum capital ratios applicable to banks.<sup>61</sup> While both regimes are intended to ensure the capital strength and solvency of the institution, the underlying rationale for the net capital rule is one of customer and counterparty protection.<sup>62</sup> The net capital requirements generally treat illiquid assets relatively harshly, regardless of their credit quality. For example, illiquid securities, illiquid collateralized debt obligations (other than very high-quality mortgage backed securities), over-the-counter derivatives, all loans (other than margin loans that comply with applicable margin regulations) and other assets such as real estate, etc., have 100% deductions under the net capital rule, effectively requiring dollar-for-dollar capital to be held against such assets, substantially more capital than if held by a bank. Bank capital rules have a higher tolerance for certain types of asset risk traditionally associated with banking and recognize that it is appropriate and desirable for banks to carry illiquid assets such as loans. On the other hand, the net capital rules generally require less capital for repurchase agreements involving U.S. government or agency securities than is required under the bank capital regime, reflecting greater reliance on collateralization of such instruments.

In short, the fundamental differences in the approach and context of the broker-dealer and bank capital requirements make a meaningful comparison of the two regimes difficult, if not impossible. Determining whether the broker-dealer regulatory framework allows broker-dealers to operate in a manner that presents greater risks of insolvency than banking entities would involve not only the “apples to oranges” comparison of the two capital regimes discussed above but also a detailed analysis of the differences in their business and asset mix, as well as the other regulatory and market factors that affect their risk. Even if possible, a comparison of the relative pros and cons of the two different regulatory frameworks offers very little on the ultimate question of how to implement Section 165 for SI-FBOs. That question should instead depend more significantly on the actual risks presented by the broker-dealer affiliates of the small handful of SI-FBOs at issue.

Moreover, reform of broker-dealer liquidity and leverage practices and requirements continues to develop in the wake of the recent financial crisis. FINRA has strengthened its oversight of broker-dealer liquidity and leverage. In 2010, FINRA issued detailed guidance regarding funding and liquidity risk management practices for broker-dealers.<sup>63</sup> This guidance provides best practices for robust risk monitoring and reporting, stress testing, contingency funding planning and other measures intended to address liquidity risks. In addition, FINRA is closely monitoring broker-dealer leverage and considering

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<sup>61</sup> Compare 17 C.F.R. §.240.15c3-1, with 12 C.F.R. pt. 3.

<sup>62</sup> See 68 Fed.Reg. 62,872, 62,872 (Nov. 6, 2003) (“The principal purposes of the net capital rule are to protect customers and other market participants from broker-dealer failures and to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the need for a formal proceeding or financial assistance from the Securities Investor Protection Corporation.”).

<sup>63</sup> FINRA, Regulatory Notice 10-57 (Nov. 2010).





implementing leverage limits.<sup>64</sup> Further, the U.S. Commodity Futures Trading Commission (“CFTC”) imposes capital requirements for broker-dealers engaged in activities regulated by the CFTC. The CFTC has substantially increased several of these requirements following the financial crisis, and a rulemaking regarding additional swaps-related requirements is currently pending.<sup>65</sup>

The SI-FBO Framework would permit the Board to focus on the actual activities and capital and liquidity levels of U.S. broker-dealer SI-FBO affiliates. This would enable the Board to consider whether the securities, derivative and commodity activities of each SI-FBO present systemic risks not addressed by SEC and CFTC requirements and supervision or home country supervision, capital requirements and liquidity requirements. The SI-FBO Framework would also permit the Board to consider the impact of future developments in SEC and CFTC requirements as those agencies continue to implement regulations mandated by Dodd-Frank and reevaluate related requirements.

C. Home Country Regimes Could Segregate FBOs’ Retail Operations from their U.S. Wholesale Operations

In addition to adopting enhanced capital and liquidity standards, some jurisdictions are considering other supplemental reforms, including some analogous to those in Dodd-Frank. Some reforms may involve structural changes, including separation of domestic retail banking operations. These structural requirements could resemble various U.S. restrictions such as the remaining elements of Glass-Steagall and Sections 23A and 23B of the Federal Reserve Act. However, at this time, it remains unclear to what extent these types of reforms will be adopted, and there are ongoing international discussions among bank supervisory and resolution authorities that are expected to inform these approaches as they continue to evolve.

Importantly, such structural approaches are intended to be additional measures for protecting systemically important functions, which would supplement—not replace—implementation of international standards for enhanced capital and liquidity requirements and resolvability improvements for SIFIs. For example, there have been no indications that any of these measures are viewed in the jurisdictions considering them as alternatives to the Basel III capital and liquidity reforms or FSB principles for SIFI resolution.

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<sup>64</sup> FINRA, Regulatory Notice 10-44 (Sept. 2010) (A firm with a leverage ratio of greater than 20 to 1, after excluding U.S. Treasury and U.S. government agency inventory, must report this to FINRA and provide additional detail regarding its balance sheet. FINRA and the firm then recalculate the ratio excluding other government-guaranteed assets. FINRA is also considering a rulemaking regarding leverage limits.).

<sup>65</sup> See 17 C.F.R. § 1.17 (adjusted net capital requirements applicable to introducing brokers and futures commission merchants). This requirement, which sharply increased the required level of capital for certain noncustomer positions held by futures commission merchants, went into effect in early 2010. See 74 Fed. Reg. 69,279 (Dec. 31, 2009). See 76 Fed. Reg. 27,802 (May 12, 2011) (proposing capital requirements for swap dealers and major swap participants).



The SI-FBO Framework would enable the Board to monitor these reforms and to address directly any impact on the risk profile of the U.S. operations of any affected SI-FBO if and when these and similar measures come into effect. It would not be appropriate for any broadly applicable U.S. regulatory approach to be premised on assumptions about future specific home country developments.

1. *U.K. and Swiss approaches should not be prejudged*

We understand that reforms adopted or proposed in the United Kingdom and Switzerland have been a primary focus of potential concerns regarding approaches that would segregate home country systemically important retail banking activities from other activities. However, the evolving nature of these approaches underscores the importance of adopting a framework that is sufficiently robust to address any actual risks that these approaches could present to U.S. financial stability. This aspect will also be important to allow these approaches to be evaluated in the context of the entire home country supervisory regime that applies to affected SIFIs, especially as the bank supervisory authorities in the United Kingdom and Switzerland are expected to continue to exercise strong, consolidated oversight over SIFIs headquartered in those jurisdictions.

The United Kingdom is continuing to consider a “ringfencing” regime for certain retail EU activities of U.K. banks. This approach is in the preliminary stages of the legislative and regulatory process; it was proposed in broad terms in the Independent Commission on Banking’s Final Report,<sup>66</sup> and in response the Government has indicated its support for ring-fencing the European deposit activities of U.K. banks and recently issued a white paper proposal broadly in line with the recommendations in the Commission Report.<sup>67</sup> The ringfencing approach would require EU deposit-taking (and possibly other activities) by a U.K. bank to occur only in a separate legal entity, a “ringfenced bank”, that is prohibited from conducting other activities (e.g., provide any services to financial institutions except for certain specifically permitted services).<sup>68</sup> The ringfenced bank would be subject to separate capital and liquidity requirements, and to restrictions on operational and other exposures to its affiliates.<sup>69</sup>

The U.K. White Paper does not address in detail the various reforms under development at the EU level, including the European Commission’s recently published final proposal for a directive establishing a framework for recovery and resolution of banking groups. It therefore remains unclear what types of approaches ultimately will be adopted for

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<sup>66</sup> See Final Report of the U.K. Independent Commission on Banking (Sept., 2011) (“Commission Report”).

<sup>67</sup> See H.M. Treasury, *Banking Reform: Delivering Stability and Supporting a Sustainable Economy* (June 2012) (the “U.K. White Paper”); H.M. Treasury, *The Government Response to the Independent Commission on Banking*, p. 9 (Dec. 2011).

<sup>68</sup> See U.K. White Paper at pp. 15-17, 19-21.

<sup>69</sup> See Commission Report at pp. 25-27.



U.K.-headquartered banks as the United Kingdom and the EU continue to consider functional restrictions on deposit-taking entities.

Although Switzerland has adopted a statute and regulatory guidance addressing “too big to fail” concerns, they give the covered Swiss SIFIs broad discretion in satisfying the requirements of the statute, and the Swiss SIFIs and regulators continue to explore various implementation options. In addition, there are indications that the Swiss framework may further evolve in light of ongoing consideration of, among other things, implications for the international operations of Swiss banking organizations. As this process continues, the likely features and impact of the resolution of a Swiss SIFI will emerge.

Switzerland’s general financial reform law provides for broad reforms to the regulation of Swiss SIFIs, including heightened capital and liquidity requirements.<sup>70</sup> This law also includes a mandate for SIFIs to develop an “emergency plan” for the continuation in the event of threatened insolvency of functions that are systemically important to the Swiss national economy, and the Swiss Financial Market Supervisory Authority (“FINMA”) issued recovery and resolution planning guidance that includes requirements for the Swiss emergency plan.<sup>71</sup> This Swiss requirement does not dictate a specific approach for maintaining these functions (*i.e.*, it does not mandate “ring-fencing” or any other particular approach). The Swiss Statute, by design, provides Swiss SIFIs with significant discretion in how they structure their resolution and recovery plans, including the Swiss emergency plan component.<sup>72</sup>

As is the case in the United States, after finalizing regulations for resolution planning, Swiss authorities and SIFIs have proceeded to the next phase of weighing the pros and cons of various approaches to SIFI resolution possible under those regimes. Swiss SIFIs have not yet developed these plans and are weighing a number of approaches to satisfying the emergency plan requirement, including “bail in” approaches, the use of a bridge bank, or contingent structural separations. Once the initial plans are developed and submitted, we would anticipate that the approaches will continue to evolve as the regulators provide feedback and Swiss SIFIs file subsequent plans. The impact of a Swiss emergency plan and any related restructuring of activities on the non-Swiss operations of the SIFI could vary greatly depending on the strategy selected and its precise implementation. Further, there is likely to be significant interaction between these planning efforts and the revision of the Swiss Banking Insolvency Ordinance currently underway.<sup>73</sup> Lastly, approaches developed by Swiss SIFIs in consultation

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<sup>70</sup> See BG vom 30. Sept. 2011 (Stärkung der Stabilität im Finanzsektor), Federal Law of Sept. 30, 2011 (Strengthening the Stability of the Financial Sector) (the “Swiss Statute”) AS 2012.811 (Switz.).

<sup>71</sup> See Swiss Statute, Sec. V, Art. 9, ¶ 2.d; Sec. V, Art. 8, ¶ 1; FINMA, Recovery and Resolution Guidance Plan, pp. 29-33 (Mar. 26, 2012).

<sup>72</sup> See Swiss Federal Council, Dispatch on strengthening financial sector stability (too big to fail), pp 3-4 (Apr. 20, 2010), available at <http://www.news.admin.ch/NSBSubscriber/message/attachments/22798.pdf>.

<sup>73</sup> See FINMA, Draft Banking Insolvency Ordinance FINMA: Key Points (Jan. 16, 2012), available at <http://www.finma.ch/e/regulierung/anhoeerungen/Documents/kp-biv-finma-e.pdf>.



with their home country supervisors are also likely to be influenced by ongoing discussions and coordination among Swiss, U.K. and U.S. supervisory authorities.

The evolving character of pending reforms in the United Kingdom and Switzerland underscores the weakness of adopting broadly applicable structural requirements for SI-FBOs, and at the same time illustrates the benefits of adopting an approach that takes into consideration the specific systemic risks presented by individual SI-FBOs, including as a result of home country legal and regulatory requirements. At best, it would be premature to develop a U.S. approach to SI-FBO regulation based on assumptions regarding the ultimate outcomes of pending reform proposals in other countries. By instead adopting the SI-FBO Framework, the Board will retain discretion to address any actual systemic risks that arise from evolving home country measures.

An assessment of these actual systemic risks will also need to take into account the broader home country supervisory framework that applies to SIFIs in the United Kingdom and Switzerland. There is no reason to believe that either U.K. or Swiss bank supervisory authorities will retreat from their current and historical places as leading bank supervisors exercising strong and consistent consolidated oversight over SIFIs and other banks headquartered in those countries. That consolidated oversight will continue to apply not only to the SIFI's home country/EU retail banking operations but also to its wholesale and international banking operations. By taking into account these broader home country supervisory considerations, the SI-FBO Framework will allow the Board to more specifically and realistically evaluate the potential systemic risks posed by SI-FBOs and tailor any appropriate supervisory measures in response to those risks accordingly.

2. *Like other aspects of home country regulatory regimes, any divergent treatment of nationally important functions from global operations should be evaluated in the context of the specific institution and regulatory regime and in the context of U.S. regulations*

Any Swiss and U.K. measures, or any similar developments in other jurisdictions, should be evaluated in the context of affected FBOs and their U.S. operations. For example, despite the requirement that it address Swiss systemically important functions, a Swiss recovery and resolution plan adopted by a Swiss SIFI that provides for a “bridge bank” may decrease the risk of failure for U.S. operations because such an approach may entail transferring U.S. operations together with the Swiss systemically important functions (and other assets and operations) to a new, well capitalized institution. Indeed, this bridge bank approach, being explored by Swiss supervisory authorities recently, appears closely to resemble the bridge holding company strategy that the FDIC has developed for exercising its “Orderly Liquidation Authority” under Title II of Dodd-Frank.<sup>74</sup> Similarly, to the extent that the U.K. approach

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<sup>74</sup> See, Remarks by Martin J. Gruenberg Acting Chairman, FDIC to the Federal Reserve Bank of Chicago Bank Structure Conference (May 10, 2012), available at <http://www.fdic.gov/news/news/speeches/chairman/spmay1012.html>; Systemic Resolution Advisory Continued....



clarifies how a U.K. SIFI would be resolved in the event of insolvency, this predictability may enforce market discipline and decrease the potential impact of the SIFI's insolvency on global or U.S. financial stability. It is also highly unlikely that these new strategies and approaches will be developed in a vacuum. We expect that the final approaches for each SIFI will be influenced by international coordination, including through the firm-specific "crisis management groups" called for by the FSB's Resolution Framework.

In addition, these measures are being undertaken as part of broader efforts to reduce the risk of insolvency and improve the resolvability of all SIFI operations. Indeed, the Swiss and U.K. developments do, and other components of home country SIFI regulation may, go beyond, rather than replace, international standards and comparable U.S. regulations. The regulatory guidance for Swiss resolution planning places it as one component of a much broader recovery and resolution planning mandate applicable to the entire institution. Further, FINMA intends to implement a "Swiss finish" to the Basel III requirements, imposing national requirements beyond Basel III standards.<sup>75</sup> The preliminary U.K. proposal would also not impede or diminish the application of Basel III capital and liquidity requirements to the consolidated SIFI or broader recovery and resolution planning efforts, and the ultimate outcome of continued interest of U.K. (and some other EU) supervisors in "gold plating" Basel III and CRD IV standards remains uncertain.

While a key goal of these U.K. and Swiss measures and reforms like them—including Dodd-Frank—is to reduce the need for extraordinary assistance to troubled financial institutions, the proposals do not go so far as to prohibit such assistance, which may remain available as international and national efforts to insulate global financial stability from the risk of insolvency of SIFIs continue. In addition, it would be inappropriate for the Board's regulation of the U.S. operations of FBOs to discount or penalize home country supervisors' efforts to eliminate the need for government intervention during periods of stress, as the United States shares this goal.

To the extent that the U.K. ringfencing proposal is implemented, and as Swiss supervisors and SIFIs and those in other jurisdictions continue to develop and refine their resolution planning and insolvency reforms, the SI-FBO Framework would allow the Board to consider and address any systemic issues. Importantly, under the SI-FBO Framework, the Board could—and should—consider not only the potential of home country government support or specialized resolution procedures that relate to home country operations, but also the impact of those measures on the U.S. operations of each relevant FBO individually. Given the range of reforms that home country jurisdictions could undertake, the only viable approach for effective host country regulation by the Board is to consider each as it arises and evaluate its implications for the U.S. operations of FBOs relevant to U.S. financial stability. By allowing the Board to

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Committee of the FDIC Meeting Minutes (Jan. 25, 2012), *available at* [http://www.fdic.gov/about/srac/2012/2012-01-25\\_minutes.pdf](http://www.fdic.gov/about/srac/2012/2012-01-25_minutes.pdf).

<sup>75</sup>

See FINMA, Addressing "Too Big To Fail": The Swiss SIFI Policy (June 23, 2011).



## INSTITUTE OF INTERNATIONAL BANKERS

consider the actual risks presented by home country legal or regulatory requirements, the SI-FBC Framework provides the Board with effective tools to address any systemic risks with measures specifically targeted to those risks.

### D. U.S. Branch and Agency Office Liabilities and Assets

U.S. branch and agency offices of foreign banks present a unique risk profile, including the risk of asset and liability mismatches. Because these offices are not separate legal entities, U.S. capital requirements and other related measures are not directly applicable. This is not a new challenge, however, and the Board can and should leverage and extend existing supervision of these operations. These existing tools are more than sufficient to apply heightened capital and liquidity standards to the branch and agency office operations of SI-FBOs. In our view no additional structural measures or requirements should be imposed on branches and agencies as part of the Board's implementation of Section 165. For example, even if the Board had legal authority to do so, it should not require a restructuring of a branch or agency into a U.S. depository subsidiary.

The Office of the Comptroller of the Currency ("OCC"), state regulators and the Board closely monitor the assets and liabilities of branch and agency offices.<sup>76</sup> There are a significant number of large wholesale branch and agency operations in New York operating under state licenses. The New York Department of Financial Services ("NYDFS") has supervisory authority over these foreign banking operations. Both the OCC and the NYDFS monitor "due from" positions in branch and agency offices of foreign banking organizations, which can indicate an imbalance in the assets and liabilities of that office that is offset by cash or other assets owing from the home (or other branch) office of the bank. They also monitor asset quality and other factors relevant to liquidity management. These existing frameworks permitted the close monitoring of the U.S. branch and agency offices of European banks as concerns regarding their exposure to sovereign debt caused many market participants to reduce their exposures to these branches and agency offices in 2011.

These mechanisms are of particular importance because of the powers under state and federal laws allowing to the NYDFS and the OCC to "ring-fence" assets of a branch or agency office under certain circumstances (including the insolvency of the foreign bank). Section 606.4 of the New York Banking Law ("NYBL") provides the New York Superintendent of Financial Services (the "Superintendent") with broad discretion to ring-fence the assets of branches and agencies of FBOs licensed in New York. Pursuant to Section 606.4(a), the Superintendent has the discretion to take possession of certain property and business of an FBO that has a New York-licensed branch or agency for a variety of reasons, including the insolvency

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<sup>76</sup> See Board SR Letter 00-14, Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (Oct. 23, 2000).





## INSTITUTE OF INTERNATIONAL BANKERS

of the branch or agency office or the FBO's head office.<sup>77</sup> All property of the branch or agency (wherever such property is located) and all business and property of the FBO in the State of New York form a liquidation estate, which is available first to satisfy third-party creditors of the branch or agency office and then to satisfy creditors of other U.S. branches or agencies of the FBO in liquidation; only after the payment in full of all such claims may the Superintendent turn any remaining assets over to the head office.<sup>78</sup>

For federal branches of FBOs licensed under the International Banking Act of 1978, a similar ringfence insolvency regime applies, only with national scope. All of the assets of the branch (wherever such assets are located) and all of the assets of the foreign banking organization in the United States, including all of the assets of any state- or federally-licensed branch or agency, become part of the liquidation estate. Such assets are applied first to claims of third-party creditors of the federal branch or branches and then to creditors of any other state-licensed branches; any remaining assets are turned over to the FBO or the liquidation or administration proceedings in respect thereof.<sup>79</sup>

In light of the federal, New York and other state ringfencing regimes, branch and agency office asset maintenance requirements protect counterparties of FBO branches and agencies. These requirements operate much like capital requirements (in the past, New York imposed generally applicable requirements at levels comparable to the capital requirements applicable to U.S. banks), and are currently a key tool in the supervision of branch and agency offices of FBOs.<sup>80</sup> In implementing the Dodd-Frank Enhanced Standards, the Board should leverage this existing regulatory structure for monitoring the asset quantity, quality and net "capital" position of branches and agency offices.

As discussed above in Part II.B.2, the Board has full access to all information on branch and agency assets and liabilities and closely monitors "due from" positions, including in

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<sup>77</sup> The grounds on which the Superintendent may take possession of a branch or agency include the initiation of liquidation proceedings with respect to the bank in its home jurisdiction or elsewhere or a finding that there is reason to doubt the branch or agency's ability or willingness to pay its creditors in full, in addition to the grounds set forth in Section 606.1 by which the Superintendent may take possession of any other banking organization under its jurisdiction. Certain of the grounds set forth in Section 606.1 permit the Superintendent to take possession of the branch or agency prior to any insolvency of the branch, agency or head office of the FBO.

<sup>78</sup> See NYBL § 606.4(b).

<sup>79</sup> 12 U.S.C. § 3102(j).

<sup>80</sup> See Board SR Letter 00-14, Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (Oct. 23, 2000); 3 CRR-NY 52.1; 12 C.F.R. § 28.20. There are currently no generally applicable asset maintenance requirements. Instead, asset maintenance requirements are imposed on an institution-specific basis as appropriate—primarily in connection with supervisory concerns regarding the U.S. operations of an FBO or the ability of the parent FBO to support those U.S. operations if needed. See Board SR Letter 00-14, Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (Oct. 23, 2000).



connection with its current examination of U.S. branches and agencies. This includes recently strengthened on-site examinations of systemically important firms. Further, Section 165 gives the Board clear authority to supervise “due from” positions and asset maintenance more generally. Finally, the firm-specific crisis management groups and other developing international information-sharing regimes will be an important source of additional information regarding the SI-FBO’s assets and liabilities.

Under the SI-FBO Framework, the Board can closely monitor the mix and net value of assets and liabilities in branch and agency offices. Further, in times of stress in relevant markets or in cases of idiosyncratic crises affecting particular institutions or countries, the Board can (and does) regulate “due from” positions more actively to insure that the asset and liability mix of an FBO’s U.S. branch and agency offices is appropriate for its role in U.S. financial stability. The implementation of Section 165 to SI-FBOs should extend this practice, using the SI-FBO Framework to apply heightened standards for capital and liquidity to the branch and agency offices of SI-FBOs.

E. Resolution of Cross-border Firms

The absence of a universal or international regime for the resolution of cross-border financial institutions and the uncertainty as to how the insolvency of a SIFI would affect various creditors is at the heart of any risk that the SIFI may pose to national or global financial stability. This is, however, currently an inherent limitation on the effectiveness of both home and host country supervision, and one that the SI-FBO Framework addresses explicitly by including the effects of home country resolution and creditor preference regimes as part of the Board’s consideration of the home country supervisory and regulatory context.

The FSB has recognized both the risks of the fragmentation of efforts to resolve troubled firms and the concerns of host country supervisors regarding the impact of home country resolution decisions on host country operations. To address these issues, the FSB has developed a framework that calls for transparency, close coordination and information-sharing among supervisors in the development of recovery and resolution plans for cross-border firms.<sup>81</sup> The FSB has also called for host countries to give effect to home country actions, while allowing for unilateral host country action in cases of an overriding concern of host country stability or inadequate home country responses.<sup>82</sup>

While the FSB efforts will improve predictability in cross-border resolutions and therefore reduce any related systemic risks, they will not create universally applicable procedures or substantive law for cross-border resolution. Effective host country supervision of SIFIs will require an understanding, enhanced by cooperation under the FSB framework, of the applicable insolvency regimes as they relate to each specific institution and its U.S. operations. The

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<sup>81</sup> See generally, FSB Resolution Framework.

<sup>82</sup> Id. Implementation of this host country “safety valve” remains in preliminary stages.





absence of international agreement on procedures or substantive law for the resolution of cross-border firms does not *per se* dictate any particular host country approach to regulating systemic risk. Rather, the Board will need to understand the U.S. operations' connections to those in other jurisdictions, the legal form of U.S. operations (e.g., branch offices as compared to a bank subsidiary, the placement of U.S. subsidiaries in the global legal structure of the firm) and how these connections and structures will interact in the event of an actual insolvency under applicable U.S. and home country insolvency regimes. From this analysis, including appropriate consideration of areas where it has incomplete information or effects of resolution are unclear, the Board can then identify and mitigate any risks to U.S. financial stability.

The SI-FBO Framework would allow the Board to tailor the Dodd-Frank Enhanced Standards to address these risks, and to focus limited supervisory resources on those entities and activities that actually pose a risk to U.S. financial stability. It calls for the Board to consider each FBO separately, including consideration of applicable home country insolvency regimes and how these regimes interact with actual U.S. operations and the resulting impact on U.S. financial stability. The SI-FBO Framework then provides for direct action to address specific issues identified in this analysis. While we strongly support the continuing efforts to harmonize the resolution regimes applicable to global SIFIs, we believe the SI-FBO Framework provides the Board the appropriate tools it needs to ensure that uncertainty and inconsistency in the resolution of global SIFIs does not threaten U.S. financial stability.

F. Reducing the Chances of a “Run” on the U.S. Operations of FBOs

Heightened U.S.-territorial capital and liquidity requirements may be seen as attractive measures to prevent a “run” on the U.S. operations of an FBO by increasing confidence that those operations would survive the insolvency of the home country parent. Such requirements have significant costs and risks, as discussed in Part I.C. Because of the wide range of activities and formats of FBOs' U.S. operations, there may be distinct “pockets” of risk. In that narrow circumstance, targeted U.S.-territorial capital and liquidity requirements may be necessary to mitigate risks to U.S. financial stability if these risks are not addressed by the factors considered under the SI-FBO Framework (e.g., home country consolidated capital and liquidity requirements or U.S. functional regulation). When necessary, such requirements should be applied to the specific entity or activity in which the risks reside.

Heightened requirements that are broadly applicable to all U.S. operations of an FBO would likely over-burden other U.S. operations that are sufficiently capitalized and liquid while also failing fully to address the pocket of risk identified by the Board that arises from activities of a specific entity or type. Their implementation and monitoring would also unnecessarily burden the limited resources of U.S. bank supervisors. Because targeted rather than general requirements are the best approach to addressing systemic risk, there would be no benefit to restructuring FBO activities into an actual or synthetic U.S. holding company; capital and liquidity requirements targeted at the subsidiary entity or activities with risks that are not addressed by other measures would remain the most effective tool for addressing those risks.



#### **IV. Conclusion**

In our view, a robust framework for applying the Dodd-Frank Enhanced Standards to FBOs—one that builds on existing supervisory oversight and is tailored to each banking organization—is the only viable approach to accomplish the goals of Section 165. Such an approach would allow the Board directly and decisively to address any systemic risks posed by the U.S. operations of SI-FBOs and focus limited supervisory resources on actual sources of real risk to U.S. financial stability. This approach would also allow the Board to consider on an institution-specific basis the impact of the continuing evolution of international and home country efforts to strengthen oversight of SIFIs.

In sharp contrast, measures that impose blanket requirements that FBOs restructure their U.S. operations and hold segregated capital and liquidity in those new structures—without due consideration of the availability and support of capital and liquidity available to these operations from non-U.S. parents and affiliates—would have significant implications for U.S. financial stability and could have unintended macroeconomic effects. Such measures would discourage FBO activity in the United States, reducing volume, competition and diversity in U.S. financial markets, thereby increasing concentration and detracting from the stability of the U.S. financial system. Reduction of FBO participation in U.S. markets, particularly the commercial credit markets, would also hamper macroeconomic growth.

We urge the Board to consider the SI-FBO Framework and the principles discussed in this white paper as it develops its proposal for the implementation of Section 165 for FBOs. The Institute would be pleased to assist the Board as it considers these important issues, and we would welcome the opportunity to discuss the SI-FBO Framework and global SIFI supervision more generally with the Board and all other interested parties.