June 21, 2019

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RE: Prudential Standards for Large Foreign Banking Organization; Revisions to Proposed Prudential Standards for Large Domestic Bank Holdings Companies and Savings and Loan Holding Companies (Federal Reserve Docket No. [R-1658]); and Proposed Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries (OCC Docket ID OCC–2018– 0037; Federal Reserve Docket No. R–1628; FDIC RIN 3064-AE96)

To Whom It May Concern:

The Americans for Financial Reform Education Fund (AFR Education Fund) appreciates the opportunity to comment on the above referenced Notices of Proposed Rulemaking (the "Proposals") concerning the regulation of foreign banking organizations ("FBOs") -- a release by the Federal Reserve Board (the "Board") release that modifies the application of enhanced prudential standards to the U.S. operations of FBOs (the "Board Proposal"), and a joint release by the Board, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (the "Interagency Proposal") on the application of capital and liquidity rules to U.S. operations of FBOs. AFR Education Fund is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

In many ways these proposals are similar to earlier proposals by the Agencies weakening prudential rules for U.S. banks, on which the AFR Education Fund has previously commented.[2] Like those proposals, this proposal purports to "tailor" prudential rules by weakening capital and liquidity requirements for banking organizations, in this case FBOs, based on their size and certain broad activity metrics. Some specific steps taken to weaken these rules are also similar.

The fundamental difference between these proposals and previous "tailoring" proposals is of course that these proposals apply to the U.S. subsidiaries of large foreign banks, and subsidiaries of large foreign banks differ fundamentally from U.S. banks of similar size. Regardless of the current size of their U.S. operations, foreign banks can easily draw on their international parent for additional resources. In contrast, U.S. banks of the same size cannot draw on an international parent and cannot gain additional financial resources without organic growth.

For this reason, counterparties will undertake financial commitments to a U.S. FBO that they would never undertake with a U.S. bank which had similar assets. This can easily be seen in public metrics of financial activity. The U.S. subsidiaries of banks like Deutsche Bank, UBS, Barclays, and Credit Suisse are not among the top twenty five U.S. banking organizations in terms of size, but they are very well represented among the top ten U.S. banks in key metrics of financial activity such as payments activity, underwriting activity, and intra-financial system exposures.[3]

This is just one example of the way in which U.S. FBOs of foreign megabanks can play a much larger role in economic activity than their U.S. asset size alone would indicate. Research demonstrates that in the years prior to the 2008 financial crisis, U.S. FBOs were used as conduits for much greater financial flows than a U.S. bank of similar size could ever have supported, and that this activity contributed substantially to systemic risk.[4] Because of their larger role in the U.S. financial system, foreign banking subsidiaries also received much greater credit support from the various Federal Reserve emergency programs during the financial crisis than U.S. banks of similar size.

The role of foreign banks in the 2008 financial crisis is the reason that, after the crisis, regulators acted to require FBOs to create intermediate holding companies that would better facilitate compliance with U.S. regulations. This effort to balance reliance on the home country regulator with better oversight by U.S. regulators was a direct response to observing the ways in which

[1] A list of coalition members is available at: http://ourfinancialsecurity.org/about/our-coalition/
[2] AFR Education Fund, "Letter Regarding Proposed Changes to Applicability Thresholds and Prudential Standards for Large Bank Holding Companies", January 22, 2019. Available at https://bit.ly/2NiRsX9
[3] See FR Y-15 Snapshot Reports for Systemic Risk Indicators, Reporting Date December 31, 2017, available at https://bit.ly/2Rx112T
[4] Goulding, William and Daniel Nolle, "Foreign Banks in the U.S.: A Primer", Board of Governors of the Federal Reserve System International Finance Discussion Paper No. 164, November, 2012, Available at https://bit.ly/2Ica8B3

foreign banks could and did generate risk to the financial system far beyond their nominal size. Unfortunately, the Proposals we are commenting on today would leave us with a system that does not do enough to ensure that foreign banks are regulated in proportion to their role in the U.S. financial system.

There are several reasons for this. First, the Proposals fail to fully update current rules to address current significant loopholes in the coverage of foreign banking activities. We believe it is crucial that prudential rules apply to the combined U.S. activities of foreign banks, including activities that take place in branch and agency networks. Currently, prudential rules apply only to activities taking place through the intermediate holding company (IHC) of the FBO. The exclusion of activities taking place through branches and agencies has recently triggered large-scale shifts of foreign banking activity into branches.[5]

The Proposals do lay some necessary groundwork for addressing this issue. For the first time, they would require regulatory reporting of crucial metrics based on the full combined U.S. operations (CUSO) of FBOs. Certain key regulatory elements such as the stringency of liquidity requirements will be determined based on CUSO activities, not simply activity flowing through the IHC. We support these changes.

However, the Proposals fail to apply the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) to all CUSO activity. This means that the liquidity risk of branches and agencies would not be reserved against under this proposal. This is a serious oversight. We urge the Agencies to address this remaining loophole by extending liquidity rules to all foreign banking activity. The role of foreign banks, including branches and agencies, as liquidity conduits was a critical driver of the systemic risk created by foreign banks during the 2008 crisis.

These Proposals also directly weaken existing prudential rules. A key element of the Board Proposal is the categorization of FBOs into tiers for the applicability of prudential rules. Banks with greater than $700 billion in CUSO assets or more than $75 billion in weighted short-term wholesale funding (wSTWF) would be placed into the highest liquidity categories, with full enforcement of liquidity rules. For the purpose of capital rules and stress testing, banks with over $250 billion in total U.S. IHC assets or more than $75 billion in a variety of other indicators (short term funding, non-bank assets, or off balance sheet exposures) would be placed in at least Category III, which requires annual CCAR and supervisory stress testing and the application of the supplementary leverage ratio (banks with below $700 billion in assets and less than $75 billion in cross-jurisdictional activity could opt out of AOCI capital).

However, banks which fall below these thresholds would receive lower levels of prudential oversight. For example, banks with under $75 billion in wSTWF would have reduced LCR and NSFR requirements, and banks with under $50 billion could escape these liquidity rules altogether. FBOs with under $250 billion in U.S. IHC assets and less than $75 billion in various

5 Robert Mackenzie Smith, "Branching Out: Foreign Banks Seek Shelter from Fed Rules", Risk Magazine, July 17, 2018. Available at https://bit.ly/2RxA6Em

metrics of short term funding, off balance sheet exposure, and cross-jurisdictional activity would move from annual to biennial stress testing and become exempt from the supplementary leverage ratio altogether. These represent significant reductions in regulatory requirements.

We are concerned that the thresholds used in the Proposals will be easily gamed by FBOs. While metrics based on CUSO activity are not yet available, on an IHC basis some of the largest and most important FBOs in the U.S. financial system, such as Barclays and Credit Suisse, are very close to the $250 billion size threshold at which capital requirements could be reduced. Based on current data it also appears that they could manage other metrics such as off balance sheet exposures, cross-border exposures, and wholesale funding exposures to fall below thresholds as well.

The Agencies have previously expressed concern regarding "cliff" or threshold effects in regulatory cutoffs. The Proposals offer numerous opportunities for financial institutions to take advantage of such thresholds in reducing regulatory requirements. This is especially concerning because a number of economically important metrics of bank activities, such as payments activity and intra-financial system exposures, are not included at all in regulatory thresholds. In general we believe that the size and risk cutoffs for full application of prudential rules ought to be significantly lower than they are in these Proposals. We may offer additional comments or data on this issue in the future.

The ability to arbitrage regulatory thresholds would be significantly increased if positions with the FBO parent bank, or non-U.S. subsidiaries of the parent bank, are exempted from being counted into the various metrics that determine the classifications. We generally believe that such positions need to be counted, particularly as regards short-term wholesale funding. The core assumption of the IHC framework is that resources located outside the U.S. organization may not be reliably available during periods of financial stress. This assumption implies that exposures to non-U.S. affiliates of the U.S. FBO should not be regarded as risk-free.

Thank you for the opportunity to comment on these Proposals. If you have questions, please contact Marcus Stanley, AFR's Policy Director, at 202-466-3672 or marcus@ourfinancialsecurity.org

Sincerely,

Americans for Financial Reform Education Fund