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Mr Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
U.S.A. - Washington, DC 20551

Email

Brussels, 18 April 2013

Subject: *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Regulation YY, Docket Number 1438, RIN 7100 AD 86)*

Dear Mr deV. Frierson,

Set up in 1960, the European Banking Federation (EBF) is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 4500 European banks: large and small, wholesale and retail, local and cross-border financial institutions. The EBF is committed to supporting EU policies to promote the single market in financial services, in general, and in banking activities, in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

The EBF appreciates the opportunity to comment on the proposed rules (Proposal) published by the Board of Governors of the Federal Reserve System (the Board) that would implement the enhanced prudential standards required to be established under Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or DFA) and the early remediation requirements required to be established under Section 166 DFA for foreign banking organizations (FBOs) and foreign nonbank financial companies supervised by the Board.

The EBF acknowledges and supports the U.S. authorities' efforts to enhance financial stability through robust supervision and regulation. At the same time, the EBF wishes to stress the necessity to balance the development of enhanced bank supervisory standards against both the urgent task of promoting U.S. and European economic recovery and the need to harmonize and coordinate the development and implementation of the complex financial reform effort currently underway, including reforms proposed by the Financial Stability Board and the Basel Committee on Banking Supervision.

In this respect, the EBF has serious concerns regarding the Proposal and its negative impact on cross-border banking activities[1]. More specifically, points are listed herewith.

- Obligatory Intermediate Holding Company (IHC) structure

  EBF's main concern is that the Proposal imposes an IHC structure on FBOs' U.S. subsidiaries (e.g. banks, broker-dealers, insurance companies), when their U.S.-incorporated activities exceed the – rather low – asset threshold of USD 10bn.

[1] The EBF supports the detailed comment letter that will be submitted by the Institute of International Bankers (IIB) and, thus, restricts this comment letter to a brief description of the main arguments against the Proposal.

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All the IHCs will be subject to U.S. Bank Holding Companies' (BHC) capital, and liquidity requirements. This *one size fits all* approach is not required under Section 165 DFA and does not take into account the various forms of doing business in the U.S. that the Federal Reserve has traditionally permitted FBOs to adopt. In addition, as the EBF argues further below, the imposition of the IHC structure and its related capital and liquidity requirements would discriminate FBOs *vis-à-vis* their U.S. competitors and invite similar ring-fencing approaches to host-country regulation by other jurisdictions, endangering both internationally coordinated financial reform and efficient global financial markets.

The Proposal is likely to disrupt significantly the way in which many of the largest FBOs conduct their U.S. financial services operations. In fact, these new capital and liquidity requirements, especially when imposed on newly created IHCs, are likely to discourage many FBOs from committing themselves to U.S. financial markets. In addition, a significant number of FBOs are close to the USD 10bn threshold and it is probable that they would shrink, or even terminate, their U.S. non-branch operations. In this case, the U.S. financial markets and the broader U.S. economy would suffer, especially at a time when the U.S. economic recovery remains fragile, and global economic conditions remain uncertain.

- Proposal exceeds statutory requirements and does away with established deference to home-country supervision

The Proposal fails to follow the statutory directives in Section 165 DFA that require the Board to focus on systemically important banking organizations at the consolidated level, to take into account the FBOs home-country rules and whether those rules are subject to comparable standards on a consolidated basis, to respect the principle of national treatment and equality of competitive opportunity, and to follow a more tailored framework that would reflect actual risks to financial stability.

Under the Proposal, even FBOs from a country whose capital standards are stricter than those in the U.S. would still need to form and separately capitalize an IHC. In other words, the IHC standards would regulate the U.S. operations of an FBO as if they were separate, independent entities, denying the IHC the benefit of its parent global capital and liquidity support in a way that is not comparable to how U.S.-headquartered banking organizations are regulated. As a result, IHC capital and liquidity will be effectively trapped in the U.S., making FBOs' consolidated management more challenging and global recovery and resolution of internationally active firms more difficult.

Furthermore, FBOs would have to allocate capital and liquidity according to host-country rules in addition to their consolidated home-country rules, while U.S. banks would have consistent consolidated home-country capital and liquidity requirements, giving the latter more flexibility and lower cost, and, thus, creating a non-level playing field, both in the U.S. and in global finance.

- Violation of the principle of national treatment and equality of competitive opportunity

As described above, the ring-fencing approach – both within the IHC structure, and, with regard to liquidity requirements, for the U.S. branch and agency networks of FBOs – would discriminate FBOs against their U.S. competitors from a global, home-host regulatory perspective. In particular:

- IHC requirement for FBOs with non-bank financial subsidiary activities

  Even when restricting the perspective to U.S. territory, the IHC requirement goes beyond what is required for some U.S.-headquartered banking organizations, in that FBOs with non-bank financial subsidiary activities (e.g. a broker-dealer) in the U.S. would still be obliged to establish an IHC subject to U.S. bank holding company (BHC) requirements, while an U.S.-headquartered holding company that is not a BHC (e.g. an investment banking group) would not. In this case, a broker dealer will be subject to strict capital rules, leverage ratios and supervisory stress tests by the Federal Reserve (Fed), on top of U.S. Securities and Exchange Commission's (SEC) capital regulations at the U.S. legal entity level and home-country capital at the consolidated level.

- Restructuring cost and tax implication

  BHCs are not subject to an equivalent requirement to form lower-tier, geographically limited holding companies subject to BHC-regulation by the Fed. The requirements applicable to IHCs could hamper the ability of FBOs to manage capital and liquidity centrally and could increase overall funding costs of FBOs, as compared to BHCs. The restructuring of FBOs' U.S. operations could further result in higher taxes and other significant costs.

- Lack of support from non-U.S. operations

  A BHC is permitted to take account of collateral, offsets, funding or other support from its non-U.S. operations when complying with the requirements of the proposed rules for the implementation of Sections 165 and 166 DFA for U.S.-headquartered banks (Domestic Proposal), whereas, under the Proposal, an FBO with U.S. operations is not allowed to do so. This approach constitutes a clear violation of the core U.S. policy of national treatment and competitive equality and could distort the actual capital and liquidity needs or counterparty credit exposures of FBOs' U.S. operations.

- Distortion of liquidity needs for FBOs

  The Proposal would require an FBO to maintain separate liquidity buffers for its U.S. branches and its IHC, while BHCs would be subject to only one liquidity requirement for their global combined operations. Furthermore, in terms of the composition of the buffer, the Proposal is punitive for FBOs, since it does not automatically permit FBOs to count home-sovereign debt as highly liquid assets for purposes of the liquidity buffer, while U.S. sovereign debt automatically qualifies.

- Single Counterparty Credit Limits (SCCLs)

  IHCs subject to SCCLs would have their credit exposure measured against the capital of the IHC, while BHCs subject to SCCLs would measure their credit exposure against their global consolidated capital, resulting in much lower exposure limits for the IHC of an FBO than the U.S. operations of an equivalently sized BHC. What is more, FBOs would be subject to a cross-trigger provision that would prevent lending by anyone of an FBO's combined U.S. operations, including its U.S. branches, in the event of the IHC's SCCL to a particular counterparty being breached. Conversely, BHCs would not be subject to limits on lending based on the exposure of one part of the BHC's operations.

- Operational burden from the implementation and maintenance of multiple prudential regimes

  FBOs would be subject to multiple, overlapping and redundant prudential requirements encompassing capital, leverage, liquidity, stress test and SCCLs. Consequently, FBOs would have to bear much higher operating and compliance costs, in order to satisfy the requirements of both their home-country and Fed-specific rules. Due to the overarching IHC requirement for all bank and non-bank subsidiaries of FBOs, some IHCs would be mechanically pushed over the threshold to become an advanced-approach bank according to the Fed's Basel III rule, and would have to implement five different sets of capital calculations, namely: (i) home-country advanced approaches; (ii) home-country Basel I floor (extended indefinitely in 2009); (iii) U.S. advanced approaches; (iv) the U.S. Collins amendment floor calculation (which renders the benefits of the U.S. advanced approaches largely moot); and (v) the SEC net capital rule for broker-dealer subsidiaries. Compliance costs could therefore be significant. It should be also mentioned that the Proposal is neither consistent with the Basel Accord's capital ratio calculations nor with the Basel III phase-in, which extends to 2019.

- Early Remediation Cross Trigger

  FBOs would be subject to a cross-trigger provision on capital and leverage ratios whereby, if either an FBO's combined U.S. operations (including U.S. branches) or its IHC activates an early remediation trigger, both the IHC and the FBO's combined U.S. operations would generally be subject to remediation measures, even if the triggering event is wholly attributable to the IHC or to the FBO's U.S. branches and non-U.S. operations. In contrast, the early remediation triggers for BHCs are solely based on the BHC's global consolidated operations. The extraterritorial reach of this provision is indeed highly debatable. Furthermore, it is inappropriate to impose unilaterally - via these triggers - higher capital and leverage requirements than the minimum set by Basel III.

Hence, whether under a global or U.S. territorial perspective, EBF perceives a clear discrimination which is not in line with the principle of national treatment as enshrined in both U.S. banking law (International Banking Act of 1978) and WTO law (Article XVII of the General Agreement on Trade in Services (GATS) and the U.S.'s commitment under the 5th protocol to the GATS).

- <u>Lack of tailor-made approach</u>

The Proposal reflects minimal attempts to tailor, as authorized by Congress, the Section 165 DFA standards to U.S. systemic risk emanating from FBOs. These standards impose costly and burdensome requirements on dozens of FBOs that present no risk to U.S. financial stability, and apply categorical requirements to FBOs with more substantial operations that fail to take into account relevant factors. In reality, the Proposal as such is expected to apply to over 100 FBOs, many of which conduct limited U.S. banking operations and have no meaningful systemic footprint. Conversely, the Domestic Proposal as regards Section 165 DFA standards will only apply to 25 U.S. BHCs.

- Impact on international regulatory coordination

The EBF considers the Proposal to complicate international regulatory coordination. The EBF strongly believes that, in line with the G20 regulatory reform agenda and the strong efforts of the Financial Stability Board (FSB) and international standard-setting bodies to implement it on a global scale, cross–border coordination and cooperation is essential for the effective regulation and supervision of banks with international activities. Thus, the approach taken by Congress in the statute (comparable home-country standards) would be in line with the G20 agenda and create incentives for home-country supervisors to coordinate and cooperate in the development of internationally harmonized standards for all banking organizations with an international presence. While national regulators may implement these international standards somewhat differently, they still could, and should be recognized by host-country regulators as comparable and equivalent to their own requirements. In contrast, the approach taken by the Board in the Proposal to ring-fence FBOs' assets, liquidity, and capital in the U.S., instead of giving due regard to their home-country prudential requirements (as Section 165 DFA calls for), does not favour such cooperation and coordination, and is inconsistent with the development of global resolution schemes and strategies. In fact, the development of such schemes - that would always take into account the diversity of business models - could effectively lead to achieving an orderly resolution mechanism with minimal risk to taxpayers.

The risk that other countries will adopt measures in response to the Proposal should also not be overlooked. Such actions would have adverse implications for all global banks, including U.S.-headquartered banks conducting business abroad, thereby creating a trend that would only lead to further fragmentation of global financial services regulation. This would also lead to more fragmented and concentrated financial markets in the U.S. and elsewhere, with all the negative effects this would have on the affected economies, including their financial stability.

- Impact on Transatlantic Trade and Investment Partnership (TTIP) negotiations

The Proposal may also complicate the envisaged TTIP negotiations (an initiative announced on 13 February 2013 by U.S. President Barack Obama, European Council President Herman Van Rompuy, and European Commission President José Manuel Barroso). One of the most important elements of the future TTIP may well be a transatlantic regulatory alliance that will be based on mutual trust, co-operation and recognition of home-country rules. In this regard, many regulatory and supervisory differences need to be mutually recognized, not least in the field of banking, securities and other financial services. Conversely, duplicative regulation is unnecessary, costly and ultimately undermines efficient control and supervision. What is more, any final rulemaking which violates the principle of national treatment and equality of competitive opportunity would possibly create an issue that would have to be dealt with in the TTIP negotiations. Therefore, in the view of the EBF, the Proposal could pose another obstacle to the successful conclusion of the TTIP negotiations, which are expected to be complex and ambitious.

The EBF suggests that, instead of ring-fencing the U.S. operations of FBOs in terms of capital, liquidity and other prudential standards without regard to their home-country regulation, the Fed should, in line with the statutory language of Section 165 DFA, continue its long-standing approach of giving due regard to home-country rules of FBOs. Any additional measures should address real systemic risks in the U.S. and should only apply on a case-by-case basis.

Besides, the Fed's concern expressed in the Proposal regarding lack of information about foreign banks, seems to understate the existing oversight supervisory powers, which the Fed uses to demand large amounts of real-time data from FBOs (not confined to their U.S. operations), as well as the existing mechanisms of cooperation with relevant home-country regulators including supervisory colleges and bilateral supervisory exchanges of information. In any event, Fed's concerns can be better dealt with international cooperation and effort (including on cross-border recovery and resolution), rather than with ring-fencing FBOs' U.S. operations.

It is worth mentioning that strong criticism for the Proposal comes not only from the foreign banking community, but also from broader representatives of the U.S. banking industry and members of the Congress. The Board's Federal Advisory Council raised similar concerns[2] during its meeting of 8 February 2013 with the Board of Governors. Similar arguments were also raised by the Chairman Emeritus of the House Committee on Financial Services, Congressman Spencer Bachus, in his letter of 14 March 2013 to the Board[3].

We would hope that you find our comments and concerns constructive and would like to thank you in advance for taking them into consideration for your future work on the final rules that would implement Sections 165 and 166 of the Dodd-Frank Act.

Yours sincerely,

Guido Ravoet
Chief Executive

[2] The Federal Advisory Council's written views can be found in the link below:
http://www.federalreserve.gov/SECRS/2013/March/20130304/R-1438/R-1438_022713_110980_576250983880_1.pdf
[3] The letter can be found in the link: http://www.iib.org/associations/6316/files/Bachus_Letter_to_Bernanke.pdf