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British Bankers' Association response to the Federal Reserve System proposal: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Regulation YY; Docket No. R-1438; RIN 7100 AD 86)

Introduction

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services representing members on the full range of UK and international banking issues. It has more than 200 banking members that are active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. All the major banking groups in the UK are members of our association as are large international EU banks, US and Canadian banks operating in the UK and a range of other banks from the Middle East, Africa, South America and Asia, including China. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum from deposit taking and other more conventional forms of retail and commercial banking to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management. Members include banks headquartered in the UK, as well as UK subsidiaries and branches of foreign banks, many of which will have operations in the United States, and on behalf of all of which the BBA is pleased to respond.

Summary

The BBA welcomes the opportunity to comment on the proposed rules entitled "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies"[1]. We acknowledge the goals of the Federal Reserve and support enhancing global stability through development of bank supervisory standards which are to globally agreed and adhered to.

The BBA would like to highlight our principal concerns of the proposed requirements for Foreign Banking Organisations ("FBOs"):

- The requirement for FBOs to restructure their US subsidiaries into an intermediate holding company ("IHC") and imposing localised capital and liquidity requirements on them would cause significant disruption to many of our largest members in the conduct of their US operations. The proposed definition for US operations takes a very expansive view and includes companies that are not wholly owned by the FBO, creating onerous and complex operational issues. It does not include foreign operations which are supported from within the US which is key to actually resolving the IHC.

[1] Federal Reserve System "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies" (Dec 2012) http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121214a.pdf

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- The proposal would effectively require FBOs on a parent consolidated basis to meet US minimum risk-based capital and leverage ratios greater than required under Basel III. These proposals are inconsistent with home regulatory treatment and restrict support from a foreign parent's capital and liquidity support.

- The proposals are a departure from cross-border coordination and cooperation as an effective tool for the supervision of internationally active banks. This may encourage reciprocal measures from regulators in other jurisdictions leading to further fragmentation of banking supervision. We urge the Board to acknowledge international agreements and principles regarding home-host coordination. We encourage engagement with home regulators of FBOs to limit the extraterritorial nature of these proposals.

- The proposed single counterparty credit limits ("SCCLs") would subject FBOs to multiple and overlapping credit exposure limits when combined with home country regulatory requirements for credit exposures to a single counterparty.

- We urge the Board to extend the exposure exclusion from the SCCL to high-quality (0% risk weight) non-US sovereign obligations in-line with the European Commission's large exposure framework. The current proposals would disrupt the market for non-US sovereign debt leading to decreased liquidity of these instruments which would increase systemic risk.

- FBOs will need to evaluate their US business returns and the barriers for entry in light of higher initial and ongoing costs of operating in the US market under the proposals. This may encourage FBOs to reduce their US presence which may create risks for the US financial stability and economy.

- The proposed risk management provisions are too prescriptive to accommodate the variety of existing prudent and efficient risk management practices at FBOs which may have diverse management frameworks and operate their businesses across multiple jurisdictions.

- Our members are concerned that the implementation of these proposals is required by 1st July 2015. Such a timescale will be particularly challenging with regards forming the legal and tax structure of an intermediate holding company, as well as the associated operational complexity this will entail.

Questions asked in the proposal

We offer comments to specific questions asked by the Board in the proposal.

<u>Foreign nonbank financial companies</u>

Question 1: Should the Board require a foreign nonbank financial company supervised by the Board to establish a U.S. intermediate holding company? Why or why not? What activities, operations, or subsidiaries should the foreign nonbank financial company be required to conduct or hold under the U.S. intermediate holding company?

We do not believe that there are sufficient benefits in requiring a foreign nonbank financial company to establish an IHC to outweigh the additional material costs that this supervisory restructuring will create. We urge the Board to note the points we have already highlighted and the potential impact on economic stability and growth its proposals will have.

In particular, the leverage ratio requirements for non-bank financial companies will be particularly punitive (see response to question 15).

Question 2: If the Board required a foreign nonbank financial company supervised by the Board to form a U.S. intermediate holding company, how should the Board modify the manner in which the enhanced prudential standards and early remediation requirements would apply to the U.S. intermediate holding company, if at all? What specific characteristics of a foreign nonbank financial company should the Board consider when determining how to apply the enhanced prudential standards and the early remediation requirements to such a company?

The proposals seem to be difficult to align to the memorandum of understanding[2] between the FDIC and the Bank of England published on 10 December 2012. The proposals undermine the notion of consolidated supervision, and would require additional burdens, as both full US requirements and non-US requirements would apply.

Early remediation should consider the fact that the US subsidiaries are part of a larger group; that is, a strong global parent stands behind it in the great majority of cases, so triggering early remediation on the basis of buffers above minima is inappropriate.

The framework should not require actions on the IHC based activities it carries out in its on home country.

We also note that the proposals favour branch activities, to the detriment of the policy aims.

Question 3: Does the proposal effectively promote the policy goals stated in this preamble and help mitigate the challenges with cross-border supervision discussed above? Do any aspects of the policy create undue burden for supervised institutions?

The proposal broadly promotes the policy goals however it encourages balkanisation of capital and liquidity as it does not recognise comparable cross-border supervision and is dismissive of the ability to coordinate supervision of cross-border institutions. This increases fragmentation of banking supervision which is against the tenet of cross-border supervision established by the Basel Committee.

Question 4: What challenges are associated with the proposed phase-in schedule?

These timescales for implementation by 1st July 2015 are particularly challenging to meet with regards to changes required for management information systems in addition to the legal and tax structure consequences associated with forming an IHC. Moreover, the implementation schedule contrasts the liquidity requirements following the Basel III update[3] on liquidity rules which will phase-in the liquidity coverage ratio from 2015 until 1st January 2019.

[2] "Resolving Globally Active, Systemically Important, Financial Institutions"
See http://www.bankofengland.co.uk/publications/Documents/news/2012/nr156.pdf

[3] Basel Committee on Banking Supervision, "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" (Jan 2013). See http://www.bis.org/publ/bcbs238.pdf

We urge the Board to follow a similar Basel III phase-in period of the proposals beyond July 2015 to reduce the material disruption to the orderly strengthening of banking systems or the ongoing financing of economic activity.

Question 5: What other considerations should the Board address in developing any phase-in of the proposed requirements?

There is a need for flexibility. For example, ambitious plans for incorporation should be submitted to the Board by 2015, and be finalised in 2019.

Regulatory comparability determinations for calculation methodologies and reporting requirements would help to shorten implementation timelines

<u>Requirement to Form a U.S. Intermediate Holding Company</u>

Question 6: What opportunities for regulatory arbitrage exist within the proposed framework, if any? What additional requirements should the Board consider applying to a U.S. branch and agency network to ensure that U.S. branch and agency networks do not receive favorable treatment under the enhanced prudential standards regime?

UK banks are subject to enhanced prudential requirements on a global basis (including US exposures), which meets the terms of Section 165. As such there is no need to apply this as proposed in the NPR.

Not to do so would potentially result in an unlevel playing field, likely result in extra costs for our members, reduce the potency of the finalised Basel framework and open up the possibility of regulatory arbitrage.

Question 7: Should the Board consider an alternative asset threshold for purposes of identifying the companies required to form a U.S. intermediate holding company, and if so, what alternative threshold should be considered and why? What other methodologies for calculating a company's total U.S. assets would better serve the purposes of the proposal?

We have reservations whether an asset threshold is a suitable approach to identify the requirement to form an IHC. The IHC requirement should be considered on a case-by-case basis with consideration of whether there are concerns regarding home country supervision, parent bank capitalisation, or US subsidiary deficiencies.

If an asset threshold is used, we recommend a more nuanced scale of FBO category asset category which is empirically supported. This is particularly relevant for the single counterparty credit limit where the reduction of exposure limit from 25% to 10% for larger FBOs is too severe and has not been sufficiently justified.

Only financial assets should count towards the calculation. The threshold of $10bn seems very low.

Question 8: Should the Board provide an exclusive list of exemptions to the intermediate holding company requirement or provide exceptions on a case-by-case basis?

Given the size and complexity of many FBOs granting exceptions on a case-by-case basis is likely to be required.

Question 9: Is the definition of U.S. subsidiary appropriate for purposes of determining which entities should be held under the U.S. intermediate holding company?

It is not necessary to require every US subsidiary to be brought under an IHC. The proposed definition takes a very expansive view and includes companies that are not wholly owned by the FBO, creating onerous operational issues. It also does not include foreign operations that are supported from within the US, which is key for actually resolving the IHC.

FBOs where a government entity has a controlling stake should be exempt from the IHC requirements. This would be consistent with Section 4 of the Bank Holding Company Act which allows relief to government-owned entities.

Question 10: Should the Board consider exempting any other categories of companies from the requirement to be held under the U.S. intermediate holding company, such as controlling investments in U.S. subsidiaries made by foreign investment vehicles that make a majority of their investments outside of the United States, and if so, which categories of companies?

Non financial activities and private equity investments should also be excluded.

Also, USD funding conduits for foreign operations, subsidiaries below a defined deminimis threshold (subject to a cap) and asset management operations that do not require liquidity / capital should be excluded.

Question 11: What, if any, tax consequences, international or otherwise, could present challenges to a foreign banking organization seeking to (1) reorganize its U.S. subsidiaries under a U.S. intermediate holding company and (2) operate on an ongoing basis in the United States through a U.S. intermediate holding company that meets the corporate form requirements described in the proposal?

The reorganisation required for US subsidiaries to operate an IHC may conflict with home country tax requirements.

Question 12: What other costs would be associated with forming a U.S. intermediate holding company? Please be specific and describe accounting or other operating costs.

The formation of a US IHC will increase operating costs for Risk Management (stress testing and counterparty credit risk), Liquidity Management and the cost of potential systems developments needed to implement the standards required by these proposals.

In addition, it is doubtful that wider risk management systems can remain aligned creating increased operational risk. Furthermore duplicative model approvals would be required.

Question 13: What impediments in home country law exist that could prohibit or limit the formation of a single U.S. intermediate holding company?

We are not aware of any legal impediments however we did not have legal representation at our member discussions.

Question 14: Should the Board adopt an alternative process in addition to, or in lieu of, the post-notice procedure described above? For example, should the Board require a before-the-fact application? Why or why not?

A post-notification application is appropriate however this on the basis that the Board allows engagement with FBOs as the application is being formed and provides guidance during the application process.

Risk-Based Capital Requirements and Leverage Limits

Question 15: Are there provisions in the Board's Basel III proposals that would be inappropriate to apply to U.S. intermediate holding companies?

The US Tier 1 leverage ratio will have a punitive impact when applied to US non-bank subsidiaries which will require some FBOs to rethink the extent of their US business. Also, the Basel III leverage ratio does not become binding until 1st January 2018 compared to the proposed US 2015 timeframe.

Global banks are subject to Basel standards. We have a particular issue with applying the leverage ratio on a sub-consolidated basis, as US banks are not subject to this creating a competitive issue.

Question 16: In what ways, if any, should the Board consider modifying the requirements of the capital plan rule as it would apply to U.S. intermediate holding companies? For example, would the capital policy of a U.S. intermediate holding company of a foreign banking organization differ meaningfully from the capital policy of a U.S. bank holding company?

The capital policy should not be considered on a standalone basis, but in the context of the subsidiaries forming part of a global organisation and its approach to dividends and other capital distributions.

Question 17: What challenges would foreign banking organizations face in complying with the proposed enhanced capital standards framework described above? What alternatives should the Board consider? Provide detailed descriptions for alternatives.

The proposed capital standards framework will introduce onerous operational processes which will be challenging to meet by 2015.

Question 18: What concerns, if any, are raised by the proposed requirement that a foreign banking organization calculate regulatory capital ratios in accordance with home country rules that are consistent with the Basel Accord, as amended from time to time? How might the Federal Reserve refine the proposed requirement to address those concerns?

We would appreciate some clarification on how the Board intends to assess this. The evaluation of whether capital ratios are consistent with the Basel Accord should allow some flexibility and focus on basic consistency with the material elements thereof.

Question 19: Should the Board require a foreign banking organization to meet the current minimum U.S. leverage ratio of 4 percent on a consolidated basis in advance of the 2018 implementation of the international leverage ratio? Why or why not?

We support restraining excessive leverage however we urge the Board to not proceed with an application on a geographic and sub-consolidated basis. The design of the ratio complicates compliance when performed outside of the bank or group.

Moreover, the proposed minimum leverage ratio is in advance of the international implementation. The 3 percent leverage ratio in Basel III will undergo a 4 year parallel run before its implementation and we recommend that any changes to the capital ratio should follow a comparable parallel run to assess the calibration. Moreover, the proposed capital ratio differs from the 3 percent Basel III capital ratio, which would require our members to run two capital ratio calculations prior to 2018.

Liquidity Requirements

Question 20: Is the Board's approach to enhanced liquidity standards for foreign banking organizations with significant U.S. operations appropriate? Why or why not?

This is not appropriate as the Board's approach to liquidity standards would require an FBO to maintain separate liquidity buffers for each its US branches and its IHC whilst domestic US BHCs would be only subjected to a single liquidity requirement for their combined global operations. FBOs would be forced to hold liquidity among multiple geographic and legal entities.

There should be a consolidated liquidity standard and co-ordination with home-country supervisors to avoid this cross-border allocation of capital and leverage. The Board's approach to liquidity standards should be aligned with Basel III liquidity rules which revised the implementation time frame for 100% liquidity standards to 2019[4].

Question 21: Are there other approaches that would more effectively enhance liquidity standards for these companies? If so, provide detailed examples and explanations.

See response to question 20 above.

Question 22: The Dodd-Frank Act contemplates additional enhanced prudential standards, including a limit on short-term debt. Should the Board adopt a short-term debt limit in addition to, or in place of, the Basel III liquidity requirements in the future? Why or why not?

This short-term debt limit should not be adopted, or replace, the Basel III liquidity requirements to limit the extraterritorial nature of these proposals.

[4] Basel Committee on Banking Supervision, "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" (Jan 2013). See http://www.bis.org/publ/bcbs238.pdf

Question 23: Should foreign banking organizations with a large U.S. presence be required to provide cash flow statements for all activities they conduct in U.S. dollars, whether or not through the U.S. operations? Why or why not?

It would not be necessary to provide such a granular level of cash flow statements on the basis that other liquidity controls such as the liquidity stress tests would already provide an indication of potential liquidity issues.

Question 24: What challenges will foreign banking organizations face in formulating and implementing liquidity stress testing described in the proposed rule? What changes, if any, should be made to the proposed liquidity stress testing requirements (including the stress scenario requirements) to ensure that analyses of the stress testing will provide useful information for the management of a company's liquidity risk? What alternatives to the proposed liquidity stress testing requirements, including the stress scenario requirements, should the Board consider? What additional parameters for the liquidity stress tests should the Board consider defining?

Where an FBO is subject to home country liquidity stress-testing, the Board should look to make regulatory comparability determinations. This is consistent with the stress testing principles set by the Basel committee for liquidity risk management.

Question 25: The Board requests feedback on the proposed approach to intragroup flows as well as the described alternatives. What are the advantages and disadvantages of the alternatives versus the treatment in the proposal? Are there additional alternative approaches to intracompany cash flows that the Board should consider? Provide detailed answers and supporting data where available.

We have no further specific comments for this point.

Question 26: Should U.S. branch and agency networks be required to cover net internal stressed cash flow needs for days 15 to 30 of the required stress scenario within the United States? Should U.S. branch and agency networks be required to hold the entire 30-day liquidity buffer in the United States?

We do not believe that it should be a requirement to hold the 30 day liquidity buffer in the US as the branch is part of the parent PLC and specific statement of support from the parent should suffice beyond day 14.

FBOs should be required to meet Basel III (or equivalent) liquidity standards. Imposition of ring-fenced liquidity for US operations will force many FBOs to reconsider the business they conduct in the US.

Question 27: The Board requests comment on all aspects of the proposed definitions of highly liquid assets and unencumbered. What, if any, other assets should be specifically listed in the definition of highly liquid assets? Why should these other assets be included? Are the criteria for identifying additional assets for inclusion in the definition of highly liquid assets appropriate? If not, how and why should the Board revise the criteria?

The list of eligible collateral should be broadened to include high quality securities issued by sovereigns which are used extensively as collateral to secure transactions such as OTC derivative and repo trades. Their exclusion from the proposal may disrupt the market for non-US sovereign debt and increase the potential for systemic risk as well as individual countries' funding costs.

Question 28: Should the Board require matching of liquidity risk and the liquidity buffer at the individual branch level rather than allowing the firm to consolidate across U.S. branch and agency networks? Why or why not?

There should not be a liquidity buffer requirement for branches and agencies given that liabilities are generally due and payable at the head office as well as the branch (as stated in standard ISDA documentation language).

US bank holding companies are be permitted to maintain a single liquidity buffer for their consolidated global operations. FBOs would be held to higher liquidity requirements than US BHCs.

Question 29: Should U.S. intermediate holding companies be allowed to deposit cash portions of their liquidity buffer with affiliated branches or U.S. entities? Why or why not?

We have no further specific comments for this point.

Question 30: In what circumstances should the cash portion of the liquidity buffer be permitted to be held in a currency other than U.S. dollars?

The cash portion of the liquidity buffer should not be restricted solely to US dollars. It should be permitted to be held any currency that is highly liquid and exchangeable into US dollars. This is consistent with the Basel III liquidity coverage ratio and home country definitions of highly liquid assets.

Question 31: Should the Board provide more clarity around when the liquidity buffer would be allowed to be used to meet liquidity needs during times of stress? What standards would be appropriate for usage of the liquidity buffer?

There are limited details included in the proposal on the circumstances under which the liquidity buffer could be utilised. Our members would appreciate further details on how a liquidity buffer can be used in times of stress.

Question 32: Are there situations in which compliance with the proposed rule would hinder a foreign banking organization from employing appropriate liquidity risk management practices? Provide specific detail.

We have no further specific comments for this point.

Question 33: Should foreign banking organizations with a large U.S. presence be required to establish and maintain limits on other potential sources of liquidity risk in addition *to the specific sources listed in the proposed rule? If so, identify these additional sources of liquidity risk.*

No, as an FBO will be subject to home country liquidity standards and controls.

Question 34: The Board requests comment on all aspects of the proposed rule. Specifically, what aspects of the proposed rule present implementation challenges and why? What alternative approaches to liquidity risk management should the Board consider? Are the liquidity management requirements of this proposal too specific or too narrowly defined? If, so explain how. Responses should be detailed as to the nature and effect of these challenges and should address whether the Board should consider implementing transitional arrangements in the proposal to address these challenges.

No further specific comments for this point.

<u>*Single Counterparty Credit Limit*</u>

Question 35: What challenges would a foreign banking organization face in implementing the requirement that all subsidiaries of the U.S. intermediate holding company and any part of the combined U.S. operations are subject to the proposed single counterparty credit limit?

Our members may face implementation challenges to ensure that their systems can provide an aggregate view of counterparty exposures within the required time frame. Special considerations should apply to non financial investments.

Question 36: Because a foreign banking organization may have strong incentives to provide support in times of distress to certain U.S.-based funds or vehicles that it sponsors or advises, the Board seeks comment on whether such funds or vehicles should be included as part of the U.S. intermediate holding company or the combined U.S. operations of the foreign banking organization for purposes of this rule.

We do not believe there is any rationale for this specific proposal. It should be a concern for the home supervisor and there is no justification for its inclusion here. It would worsen the negative effects of undermining free flow of capital and the economic benefits this has provided.

Question 37: How should exposures to SPVs and their underlying assets and sponsors be treated? What other alternatives should the Board consider?

These should be excluded on the basis that they are covered by home supervision and existing requirements

Question 38: Should the definition of "counterparty" differentiate between types of exposures to a foreign sovereign entity, including exposures to local governments? Should exposures to a company controlled by a foreign sovereign entity be included in the exposure to that foreign sovereign entity?

Exposures to a company controlled by a foreign sovereign entity should not necessarily be included if they are deemed to be of a suitable credit quality that would be maintained independently from the sovereign entity.

The proposal would discriminate in favour of US government securities as the exemption from capture within the SCCL creates a real competitive advantage for the US government over other sovereigns which also seek to preserve the liquidity of their government issuances.

Question 39: What additional credit exposures to foreign sovereign entities should be exempted from the limitations of the proposed rule?

We believe that sovereign debt securities that are assigned a specific risk weighting factor of 1.6 or less should be exempt. This standard with be consistent with the liquidity framework under Basel III.

Question 40: What other alternatives to the proposed definitions of capital stock and surplus should the Board consider?

We see no reason to change definition.

Question 41: Should the Board adopt a more nuanced approach, like the BCBS approach, in determining which foreign banking organizations and U.S. intermediate holding companies would be treated as major foreign banking organizations or major U.S. intermediate holding companies or which counterparties should be considered major counterparties?

UK banks already operate under Large Exposure regime and the BCBS is currently considering similar rules. Single counterparty credit limits should hold for this.

UK banks are granted an exemption for gilts however trading with US subsidiaries will be challenged as UK subsidiaries of US banks do not have the same exemption.

Question 42: Should the Board introduce more granular categories of foreign banking organizations or U.S. intermediate holding companies to determine the appropriate credit exposure limit? If so, how could such granularity best be accomplished?

The reduction of exposure limit from 25% to 10% for larger FBOs is too severe and not empirically supported or sufficiently justified. We recommend that a more granular and nuanced scale of FBO category is developed which comprises both quantitative and qualitative indicators.

<u>Measuring gross credit exposure</u>

Question 43: The Board seeks comment on all aspects of the valuation methodologies included in the proposed rule.

Regulatory comparability determinations are key. Where a firm has already deployed valuation methodologies meeting home country standards they should not be required to implement a new local US approach to valuation modelling if their existing approach is comparable. For example, many of our members operate under the Large Exposures regime.

Question 44: The Board requests comment on whether the proposed scope of the attribution rule is appropriate or whether additional regulatory clarity around the attribution rule would be appropriate. What alternative approaches to applying the attribution rule should the Board consider? What is the potential cost or burden of applying the attribution rule as described above?

There is limited guidance provided for the attributions rule so we request additional regulatory clarity on the aspect of this rule.

Eligible collateral

Question 45: Should the list of eligible collateral be broadened or narrowed? Should a covered entity be able to use its own internal estimates for collateral haircuts as permitted under Appendix G to Regulation Y?

The list of eligible collateral should be broadened to include high quality sovereign instruments which are commonly used as collateral for OTC derivative trades.

Own estimates for collateral haircuts should be appropriate on the basis that they have been approved by home regulators.

Question 46: Is recognizing the fluctuations in the value of eligible collateral appropriate?

This fluctuation should be already factored into the collateral haircuts.

Question 47: What is the burden associated with the proposed rule's approach to changes in the eligibility of collateral?

We have no further specific comments for this point.

Question 48: Is the approach to eligible collateral that allows the covered entity to choose whether or not to recognize eligible collateral and shift credit exposure to the issuer of eligible collateral appropriate?

We have no specific comments on this question.

Unused credit lines

Question 49: What alternative approaches, if any, to the proposed treatment of the unused portion of certain credit facilities should the Board consider?

We have no specific comments on this question.

Eligible guarantees

Question 50: Are there any additional or alternative requirements the Board should place on eligible protection providers to ensure their capacity to perform on their guarantee obligations?

We have no specific comments on this question.

Question 51: Should a covered entity have the choice of whether or not to fully shift exposures to eligible protection providers in the case of eligible guarantees or to divide an exposure between the original counterparty and the eligible protection provider in some manner?

We have no specific comments on this question.

Other eligible hedges

Question 52: What types of derivatives should be eligible for mitigating gross credit exposure?

We support the use of credit and equity derivatives for mitigating gross credit exposure.

Question 53: What alternative approaches, if any, should the Board consider to capture the risk mitigation benefits of proxy or portfolio hedges or to permit U.S. intermediate holding companies or any part of the combined U.S. operations to use internal models to measure potential exposures to sellers of credit protection?

We have no specific comments on this question.

Question 54: Would a more conservative approach to eligible credit or equity derivative hedges be more appropriate, such as one in which the U.S. intermediate holding company or any part of the combined U.S. operations would be required to recognize gross notional credit exposure both to the original counterparty and the eligible protection provider?

We have no specific comments on this question.

Question 55: What temporary exceptions should the Board consider, if any?

We have no specific comments on this question.

Question 56: Would additional exemptions for foreign banking organizations be appropriate? Why or why not?

We have no specific comments on this question.

Risk Management

Question 57: Should the Board require that a company's certification under section 252.251 of the proposal include a certification that at least one member of the U.S. risk committee satisfies director independence requirements? Why or why not?

We do not believe that an independent director is necessary to achieve the goals of the US risk committee.

Question 58: Should the Board consider requiring that all U.S. risk committees required under the proposal not be housed within another committee or be part of a joint committee, or limit the other functions that the U.S. risk committee may perform? Why or why not?

We recommend greater flexibility to the governance structure of US risk committees taking into account the status of the US IHC as part of the broader enterprise-wide group. It is reasonable for a US risk committee to be housed within a Global risk committee as part of the risk management governance structure of the FBO.

Responsibilities of the U.S. risk committee

Question 59: As an alternative to the proposed U.S. risk committee requirement, should the Board consider requiring each foreign banking organization with combined U.S. assets of $50 billion or more to establish a risk management function solely in the United States, rather than permitting the U.S. risk management function to be located in the company's home office? Why or why not? If so, how should such a function be structured?

It should not be mandatory for FBOs with assets of over $50bn of US assets to establish a risk management function solely in the US. The FBO should meet local regulatory standards that govern the FBO's consolidated risk management functions and the Board should defer to home regulator judgements. Moreover, the $50bn threshold seems relatively low for this requirement and we urge the Board to take a more tailored approach to its assessment of the risk management if an FBO.

Question 60: Should the Board consider requiring or allowing a foreign banking organization to establish a "U.S. risk management function" that is based in the United States but not associated with a board of directors to oversee the risk management practices of the company's combined U.S. operations? What are the benefits and drawbacks of such an approach?

It is reasonable for the US risk management function to be associated with the US board of directors in the oversight of the risk management practices of the US operations as part of the risk management governance framework; however an FBO should not be constrained to this requirement. A more flexible and tailored approach to risk management should be applied.

Question 61: Should the Board consider allowing a foreign banking organization with combined U.S. assets of $50 billion or more that has a U.S. intermediate holding company subsidiary and operates no branches or agencies in the United States the option to comply with the proposal by maintaining a U.S. risk committee of the company's global board of directors? Why or why not?

We have no specific comments on this question.

Question 62: Is the scope of review of the risk management practices of the combined U.S. operations of a foreign banking organization appropriate? Why or why not?

The wide scope of review is not appropriate as it does not consider that the home country regulator will already conduct reviews of the risk management practices at consolidated group level. We urge the Board to consider the extent of home country standards and adopt more flexible and tailored approach to risk management that reflects the actual risks of an FBO.

Question 63: What unique ownership structures of foreign banking organizations would present challenges for such companies to comply with the requirements of the proposal? Should the Board incorporate flexibility for companies with unique or non traditional ownership structures into the rule, such as more than one top-tier company? If so, how?

Special purpose vehicles and sponsored money market funds etc. need to be considered too.

Question 64: Is it appropriate to require the U.S. risk committee of a foreign banking organization to meet at least quarterly? If not, what alternative requirement should be considered and why?

We see no value in stipulating a meeting frequency, which should be tailored to the organisation's needs.

Independent member of the U.S. risk committee

Question 65: Should the Board require that a member of the U.S. risk committee comply with the director independence standards? Why or why not?

We do not believe that an independent director is necessary to fulfil the responsibilities and goals of the US risk committee and this should generally be deferred to home country supervisors for judgements regarding appropriate independence standards.

Question 66: Should the Board consider specifying alternative or additional qualifications for director independence? If so, describe the alternative or additional qualifications. Should the Board require that the chair of a U.S. risk committee satisfy the director independence standards, similar to the requirements in the December 2011 proposal for large U.S. bank holding companies?

We do not believe this is required. This decision should be left to the Board of the FBO and the home country supervisor.

U.S. chief risk officer

Question 67: Would it be appropriate for the Board to permit the U.S. chief risk officer to fulfil other responsibilities, including with respect to the enterprise-wide risk management of the company, in addition to the responsibilities of section 252.253 of this proposal? Why or why not?

It is not appropriate to apply a restriction on the US chief risk officer to fulfil other responsibilities within the enterprise-wide risk management of the company on the basis there are no conflicts of interest and it does not inhibit their role as US CRO.

Question 68: What are the challenges associated with the U.S. chief risk officer being employed by a U.S. entity?

This will increase agency costs for the parent company.

Question 69: Should the Board consider approving alternative reporting structures for a U.S. chief risk officer on a case-by-case basis if the company demonstrates that the proposed reporting requirements would create an exceptional hardship or under other circumstances?

We support more flexibility on alternative reporting structures.

Question 70: Should the Board consider specifying by regulation the minimum qualifications, including educational attainment and professional experience, for a U.S. chief risk officer?

We do not believe that the chief risk officer should be required to hold specific educational or professional requirements.

The Board may consider that it would be appropriate for it to review potential candidates to ensure they do indeed have the necessary competency commensurate with the size and complexity of the US operations they are responsible for, including the ability to robustly challenge other members of the risk committee or executive board members.

Question 71: What alternative responsibilities for the U.S. chief risk officer should the Board consider?

The real issues are with finance, which does not need to be independent.

Question 72: Should the Board require each foreign banking organization with total consolidated assets of $50 billion or more and combined U.S. assets of less than $50 billion to designate an employee to serve as a liaison to the Board regarding the risk management practices of the company's combined U.S. operations? A liaison of this sort would meet annually, and as needed, with the appropriate supervisory authorities at the Board and be responsible for explaining the risk management oversight and controls of the foreign banking organization's combined U.S. operations. Would these requirements be appropriate? Why or why not?

An FBO with over $50 billion or more would naturally have a person or team that would be the Board's contact for such affairs. We do not object to the specific designation of an employee in this case however there should be an exemption for FBO's below this $50 billion threshold.

<u>Stress Test Requirements</u>

Question 73: What other standards should the Board consider to determine whether a foreign banking organization's home country stress testing regime is broadly consistent with the capital stress testing requirements of the Dodd-Frank Act?

The Board should specify what these stress testing standards would be in practice rather than specify how a home country supervisor conducts their stress testing regime.

Question 74: Should the Board consider conducting supervisory loss estimates on the U.S. branch and agency networks of large foreign banking organizations by requiring U.S. branches and agencies to submit data similar to that required to be submitted by U.S. bank holding companies with total consolidated assets of $50 billion or more on the FR Y-14? Alternatively, should the Board consider requiring foreign banking organizations to conduct internal stress tests on their U.S. branch and agency networks?

We do not believe the Board should conduct supervisory loss estimates on the US branch and agency networks of large foreign banking organisations as these losses are borne by the parent. Liquidity stresses are already applicable.

Moreover, it does not make any sense to apply stress testing requirements to a portion of an overall operation, especially since the liabilities of the branch and agency network will generally also be due and payable at the head office.

Asset maintenance requirement

Question 75: Should the Board consider alternative asset maintenance requirements, including definitions of eligible assets or liabilities under cover or the percentage?

We urge the Board to expand the list of eligible assets to be consistent with the assets available under Basel III for the liquidity coverage ratio[5].

Question 76: Do the proposed asset maintenance requirement pose any conflict with any asset maintenance requirements imposed on a U.S. branch or agency by another regulatory authority, such as the FDIC or the OCC?

We have no specific comments on this question.

Stress test of U.S. subsidiaries

Question 77: What alternative standards should the Board consider for foreign banking organizations that do not have a U.S. intermediate holding company and are not subject to broadly consistent stress testing requirements? What types of challenges would the proposed stress testing regime present?

We have no specific comments on this question.

Question 78: Should the Board consider alternative prudential standards for U.S. operations of foreign banking organizations that are not subject to home country stress test requirements that are consistent with those applicable to U.S. banking organizations or do not meet the minimum standards set by their home country regulator?

We have no specific comments on this question.

[5] Basel Committee on Banking Supervision, "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" (Jan 2013). See http://www.bis.org/publ/bcbs238.pdf

Question 79: Should the Board consider providing a longer phase-in for foreign banking organizations with combined U.S. assets of less than $50 billion?

We support a longer phase-in for smaller FBOs with US assets of less than $50 billion as they are likely to require relatively more onerous implementation to meet the standards in the proposals.

Question 80: Is the proposed asset maintenance requirement calibrated appropriately to reflect the risks to U.S. financial stability posed by these companies?

We have no specific comments on this question.

Question 81: What alternative standards should the Board consider for foreign banking organizations that do not have a U.S. intermediate holding company and are not subject to consistent stress testing requirements? What types of challenges would the proposed stress testing regime present?

We have no specific comments on this question.

Debt-to-Equity Limits

Question 82: What alternatives to the definitions and procedural aspects of the proposed rule regarding a company that poses a grave threat to U.S. financial stability should the Board consider?

We have no specific comments on this question.

Early Remediation

Question 83: Should the Board consider a level outside of the specified range? Why or why not?

We have no specific comments on this question.

Capital trigger

Question 84: The Board seeks comment on the proposed risk-based capital and leverage triggers. What is the appropriate level within the proposed ranges above and below minimum requirements that should be established for the triggers in a final rule? Provide support for your answer.

We have no specific comments on this question.

Question 85: The Board seeks comment on how and to what extent the proposed risk-based capital and leverage triggers should be aligned with the capital conservation buffer of 250 basis points presented in the Basel III rule proposal.

We have no specific comments on this question.

Question 86: What alternative or additional risk-based capital or leverage triggering events, if any, should the Board adopt? Provide a detailed explanation of such alternative triggering events with supporting data.

Whilst we understand that the US Prompt Corrective Action regime is built around hard triggers of the type described we would prefer to characterise the proposed trigger as early warning signals (rather than hard triggers) that will catalyse further discussion. We believe the latitude that our preferred approach of viewing quantitative metrics as triggers for discussion, rather than triggers for action is particularly relevant to g-SIBs

Question 87: What additional factors should the Board consider when incorporating stress test results into the early remediation framework for foreign banking organizations? What alternative forward looking triggers should the Board consider in addition to or in lieu of stress test triggers?

We fully support the use of forward looking stress testing on a consolidated basis. These tests are used to identify the post-stress capital positions but as the Board recognises they are standardised across all covered companies and based on particular scenario(s) which play out over a period of time. It may be that some covered companies may be more susceptible, depending on their business model to a jump to default failure as opposed to a slow burn one so the rapidity with which a covered company could progress to level 4 must be taken into account.

Question 88: Is the severely adverse scenario appropriately incorporated as a triggering event? Why or why not?

We have no specific comments on this question.

Question 89: The Board seeks comment on triggers tied to risk management. Should the Board consider specific risk management triggers tied to particular events? If so, what might such triggers involve? How should failure to promptly address material risk management weaknesses be addressed by the early remediation regime? Under such circumstances, should companies be moved to progressively more stringent levels of remediation, or are other actions more appropriate? Provide a detailed explanation.

We of course agree with the Board that a covered company with weak risk management systems and controls should be required to improve them or otherwise face the threat of the imposition of remediation tools. However in many cases it will not be able to swiftly introduce the required improvements so we believe that the covered company and the Board should agree to a pragmatic implementation programme over a realistic timetable with additional sanctions only being introduced if it becomes apparent that the company is materially deviating from it.

Market indicators

Question 90: Should the Board include market indicators described in section G—Potential market indicators and potential trigger design of this preamble in the early remediation regime for the U.S. operations of foreign banking organizations? If not, what other market indicators or forward-looking indicators should the Board include?

As we have cautioned above the strict use of triggers, be they based on regulatory or market based metrics should be approached with caution, in part because of the risk of them becoming a self-fulfilling prophecy.

We prefer that the proposed triggers, particularly in the early stage of the remediation process, are viewed as stimuli for increasingly robust discussions with management, who at that stage are still answerable to shareholders and responsible for running the covered company

Question 91: How should the Board consider the liquidity of an underlying security when it chooses indicators for the U.S. operations of foreign banking organizations?

A number of metrics could be considered as being indicative of degrees of liquidity, including bid-offer spread, number of market maker quoting firm, price changes in daily traded volumes (based on information available from a global trade depository) and price volatility although it is of course unlikely that any one of thee metrics will perfectly explain liquidity premia.

Question 92: Should the Board consider using market indicators to move the U.S. operations of foreign banking organizations directly to level 2 (initial remediation)? If so, what time thresholds should be considered for such a trigger? What would be the drawbacks of such a second trigger?

We do not believe the movement of a covered company to Level 2 (initial remediation) should be based solely on market triggers - which will just be one of a number of factors in the decision process. Even entry into initial remediation will have a significant impact (as we recognise it is designed to do) on the way a covered company operates. Such a decision should not be taken mechanistically.

Question 93: To what extent do these indicators convey different information about the short-term and long-term performance of foreign banking organizations that should be taken into account for the supervisory review?

Both sets of indicators, long and short term, should have a bearing on supervisory decisions but we suspect that the most damaging types of failure will come out of left field, suggesting that short term indicators should be more highly weighted in the decisions process.

Question 94: Should the Board use peer comparisons to trigger heightened supervisory review for foreign banking organizations? How should the peer group be defined for foreign banking organizations?

The objective of the Board's rule is to reduce the perception that some financial institutions, not just banks, are too big to fail and to ensure that never again should tax payer funding be used to bail-out a failing institution. We fully support this objective and therefore believe that peer group review should be based on a broader range of financial companies identified by the type of activity they undertake rather than regulatory classification. We are aware that the Financial Stability Board is continuing to address this through its analysis of the shadow banking system and counsel that the Board's eventual approach should be informed by the results of the FSB's work.

Question 95: How should the Board account for overall market movements in order to isolate idiosyncratic risk of foreign banking organizations?

We have no specific comments on this question.

Question 96: What additional monitoring requirements should the Board impose to ensure timely notification of trigger breaches?

Current supervisory approaches are sufficient to monitor potential breaches of remediation triggers.

Question 97: Should the Board provide an exception to the prior approval requirement for de minimis acquisitions or other acquisitions in the ordinary course? If so, how would this exception be drafted in a narrow way so as not to subvert the intent of this restriction?

We have no specific comments on this question.

Question 98: The Board seeks comment on the proposed mandatory actions that would occur at each level of remediation. What, if any, additional or different restrictions should the Board impose on distressed foreign banking organizations or their U.S. operations?

We have no specific comments on this question.

Question 99: The Board seeks comment on the proposed approach to market based triggers detailed below, alternative specifications of market-based indicators, and the potential benefits and challenges of introducing additional market-based triggers for remediation levels 2, 3, or 4 of the proposal. In addition, the Board seeks comment on the sufficiency of information content in market-based indicators generally.

We have no specific comments on this question.

Question 100: The Board is considering using both absolute levels and changes in indicators, as described in section G—Potential market indicators and potential trigger design. Over what period should changes be calculated?

We support the use of trend based information which we believe is likely to provide a better indication of market perception that point-in-time data.

As liquidity conditions can change very quickly we would encourage the Board to look for rapidly developing micro bursts within the storm system as these are likely to be the most damaging.

Question 101: Should the Board use both time-variant and time-invariant indicators? What are the comparative advantages of using one or the other?

Both time-variant and time-invariant based triggers may be useful as indicators but we caution against creating an over-engineered system to calculate the relevant thresholds - supervisory judgement based on good market intelligence of which market indicators can be one useful component, will always be necessary.

Question 102: Is the proposed trigger time (when the median value over a period of 22 consecutive business days crosses the predetermined threshold) to trigger *heightened supervisory review appropriate for foreign banking organizations? What periods should be considered and why?*

See response to question 101.

Question 103: Should the Board use a statistical threshold to trigger heightened supervisory review or some other framework?

See response to question 101.

Please contact the following if you have any questions arising from our response:

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