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April 29, 2013

By Electronic Mail

Board of Governors of the Federal Reserve System
Attention: Robert deV. Frierson, Secretary
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Proposed Regulation YY: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Docket No. 1438 and RIN 7100-AD-86)

Ladies and Gentlemen:

I hereby enclose for your consideration a submission from Royal Bank of Canada ("RBC") containing our comments on the proposal published by the Board of Governors of the Federal Reserve System (the "Board"), to implement Sections 165 and 166 of the Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"), as they relate to enhanced supervision of the US operations of foreign banking organizations ("FBO Proposal").

Allow me to note from the outset that, particularly given the close relationship between Canada and the US, we share the Board's prudential and broader public policy objectives for US financial stability. Our concerns are therefore not with the Board's goals, but only certain aspects of the manner in which they are proposed to be achieved with respect to oversight of the US operations of foreign banking organizations ("FBOs").

Our overriding concern with the FBO proposal is the risk that it will create a more fragmented approach to regulation, particularly if other countries respond by moving forward with their own protectionist measures. A more fragmented framework will lead to regulatory conflicts and inefficiencies that will have the unintended consequence(s) of increasing systemic risk and negatively impacting economic growth. These outcomes are not compatible with the G20 goals. As the G20 leaders noted at the 2008 meeting in Washington, "our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards....and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability".[1]

Our key specific concerns with the FBO proposal include the following:

- branch liquidity requirements: the ring-fencing of liquidity requirements for branches operating in the US would significantly compromise the ability of an FBO to manage its liquidity on an efficient and effective global basis. This would raise concerns relating to: prudential/systemic risk, competitive inequities relative to US banks, and broader economic growth concerns. The cause for these concerns lies in the fact that the FBO would face higher costs and less flexibility in being forced to manage its operations on the basis of local liquidity pools whereas US banks could continue to manage their operations on a global basis. These proposed liquidity requirements for the branches of an FBO are also unnecessary given that they are part of the same legal entity as the parent bank. This

[1]Declaration of the G20 Summit on Financial Markets and the World Economy, Washington DC, November 15, 2008, http://www.g20.utoronto.ca/2008/2008declaration1115.html

is particularly true for a country like Canada which does not have a depositor preference regime in place (i.e. the US depositors of the FBO's US branches rank equally with the Canadian depositors of the parent bank);

- early remediation: our main concern with the early remediation provisions of the FBO proposal is the lack of a requirement for ongoing consultation with home country prudential regulators. We believe that this approach is fundamentally important in not only monitoring the consolidated risks of the enterprise, but also in determining the appropriate action to be taken if concerns do arise. Precipitous public action by a host country regulator may not only be unnecessary, but could have significant negative implications for the broader operations of the FBO falling under the responsibility of the home country regulator.

It appears that the US Congress sought to allay these types of concerns by expressly imposing on US regulators an obligation to take into consideration comparable home country standards when developing regulations to implement the statute. We respectfully encourage the Board to revisit its fulfillment of this particular mandate, and to that end, the attached submission outlines our recommended approach for a substitute compliance framework to meet the Board's prudential standards.

It is important to underscore the fact we are not seeking an arbitrary exemption for relief from the FBO requirements. Our request is for the Board to utilize the express discretion that has been conferred under paragraph 165(b)(2)(B) to "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". The specific approach that we are recommending to address our concerns would consist of the following:

1. substitute compliance framework: a robust set of criteria would be developed to determine which home country rules would be considered to meet or exceed the US FBO standard. Once this determination has been made, these comparable or "substitute" home country standards would apply to the FBO's US operations as an alternative to the proposed FBO requirements;
2. branch liquidity: the US branches of an FBO would be recognized as part of the legal entity of the parent bank and thus subject to the same robust regulatory requirements as the parent on a consolidated basis. This would mean that the FBO could calculate its liquidity according to home country regulatory rules and would not be required to specifically hold liquidity in its US branches (i.e. it could continue to manage its liquidity on a consolidated basis according to its global liquidity management model);
3. early remediation: a framework should be created to allow for close cooperation/consultation between the home and host regulators of the FBO. This approach would be fundamentally important in not only monitoring the consolidated risks of the enterprise, but also in determining the appropriate action to be taken if concerns do arise.

We believe that this proposed substitute compliance regime can address the Board's prudential and public policy objectives while at the same time avoiding the fragmentation concerns noted above. This approach would also be consistent with the broader international goals of working towards greater harmonization and regulatory cooperation.

In closing we thank you for the opportunity to comment and for your attention to this letter and the enclosed submission.

Yours truly,

Gordon Nixon

Attachment

RBC Submission in Response to Request for Comments to Proposed Regulation YY: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Docket No. 1438 and RIN 7100-AD-86)

INTRODUCTION

Royal Bank of Canada ("RBC"), makes this submission in response to the Board of Governors of the Federal Reserve System ("Board")'s request for comments on proposed Regulation YY, titled "Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies" ("the FBO proposal").

We thank the Board for the opportunity to offer our views, and indeed, for recognizing the importance of obtaining public input with respect to this groundbreaking proposal which would affect an important segment of the US banking community.

About RBC

RBC and its subsidiaries provide diversified global financial services and products, including personal and commercial banking, wealth management services, corporate and investment banking, property, casualty and life insurance, and transaction processing services to clients worldwide. RBC affiliates have been active participants in the US financial system since the establishment of RBC's first agency office in the US in 1899. We have a strong presence in the US, providing services to US consumers and institutional and corporate clients in 45 states. RBC operates in the US as a foreign banking organization that is a bank holding company (BHC) and a financial holding company under the *BHC Act*. RBC's US-regulated affiliates are supervised by the federal financial agencies, and various state regulators and self-regulatory organizations.

Our global activities, including our activities in the US, are supervised by our home regulator, the Office of the Superintendent for Financial Institutions (OSFI). Given the scope of our international operations, RBC understands, appreciates and supports the vital role that rigorous prudential regulation and supervisory oversight play in ensuring the stability of financial systems and market participants.

COMMENTARY ON THE PROPOSAL

I. The FBO Proposal Thwarts International Harmonization

We recognize and support the Board's efforts to ensure the resilience of banking organizations to withstand the sort of financial perils that contributed to and exacerbated the financial crisis. In particular, we agree that appropriate levels of capital and liquidity, prudent management of leverage, credit risk and contingency planning (including recovery and resolution plans), are fundamental to achieving preventative maintenance against future potential disasters. It is important to acknowledge however, that the US is not alone in having, and seeking to further implement, robust prudential regulations to govern banking and other financial activities.

The evolution to global interconnectedness that spawned the extraordinary scope of the financial crisis has forged unprecedented commonality of interests across borders. Certainly by virtue of its role as a leading participant in the G-20, Basel Committee on Banking Supervision (BCBS), Financial Stability Board (FSB), and other international standards setting bodies, the US is well-positioned to set an example of how objectives shared among global authorities should drive the agenda toward international harmonization of standards for oversight of globally active institutions. Yet, it appears that in developing the FBO proposal, the Board has departed from an internationally sensitive approach to prudential oversight of the US operations of internationally headquartered banking organizations.

We submit that the framework for enhanced supervision of US operations should reflect the global nature of financial markets and banking activities, and encourage common international standards. Rather than a proposal that internalizes standards in an unbalanced, nationalistic manner, the enhanced supervision framework should allow for substitute compliance where a bank's home country prudential requirements are substantially equivalent to US regulations, or otherwise address the same risks/meet the same policy objectives. To be clear, we are not seeking an exemption or relief from the FBO rules. Our proposal is that home country rules would apply to the FBO's US operations as an alternative (i.e. substitute) for the requirements set out in the FBO Proposal provided that an appropriate set of criteria are met.

We believe that this type of substitute compliance approach would enhance rather than compromise the regulation of an FBOs US operations. It would also encourage international harmonization and information sharing and avoid unnecessary fragmentation or disruption of global financial markets.

II. The FBO Proposal Encourages Fragmentation Of Global Markets

Fragmentation Trends

In November 2008, the G20 leaders moved to enhance the international financial infrastructure to promote coordination, including through the FSB. The role of the FSB is to "coordinate at the international level the work of national financial authorities and international standards setting bodies in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies."[1]

Flowing from these developments, the international community has moved forward with an ambitious international regulatory agenda that has encompassed areas that are included in the FBO rule, including capital, liquidity, risk management, single counterparty credit limits, and resolution and recovery plans. Extensive efforts and resources have also been committed to the use of vehicles such as colleges of supervisors, to promote and enhance strong cooperation and coordination between home and host country jurisdictions.

[1] For a description of the role and mandate of the FSB, please see the FSB website at http://www.financialstabilityboard.org/about/overview.htm

Unfortunately, it appears that national authorities are demonstrating difficulties adapting their approaches to the pursuit of a global prudential model. Recent developments indicate that some national authorities may be trending towards more inflexible national and protectionist standards. These measures are being designed without the benefit of taking a holistic view of the operations of an internationally active bank, causing fragmentation. The resulting fragmented approach to regulation could in turn reverse the progress to date in the global recovery.[2]

Recent comments from Mark Carney, Governor of the Bank of Canada and Chair of the FSB, summarize these concerns:

> *An open, resilient global financial system will be central to the transformation of the global economy. In order to achieve that, financial sector reform is a must. Over the last year, the main risk has been that a series of contingency measures could extend to a global scale the current European trend towards fragmentation.* ***Concerns over the effectiveness of cross-border resolution arrangements could encourage uncoordinated unilateral actions, leading to greater ring-fencing of capital and liquidity, and reducing the efficiencies and financial capacity of the global system.***
>
> *The focus on timely, full and consistent implementation of major reforms has increased as the policy work of developing standards in the priority reform areas has advanced.* ***Consistent implementation is essential to preserve the advantages of an open and globally integrated financial system.*** *Recent experience demonstrates that when mutual confidence is lost, the retreat from an open and integrated system can occur rapidly.* ***A return to a nationally segmented global financial system would reduce both systemic resilience and financial capacity for investment and growth.*** [3]

In our view, the current FBO Proposal too keenly resembles a protectionist approach, including by imposing on an FBO's US operations requirements that would be duplicative of, or even at odds with, home country prudential regulations. Further, there is a concern that other jurisdictions will respond by moving forward with their own protectionist measures. Within Canada, for example, our prudential regulator has already signaled its intention to impose jurisdiction-specific capital requirements through its solo capital rules, in part due to concerns relating to the ring fencing of capital in other jurisdictions. These retaliatory actions will only serve to exacerbate the systemic risk and negative economic growth implications referred to by Governor Carney above.

We believe, however, that if a more internationally calibrated framework were designed, the inherent value of the Board's underlying objectives could be realized without the growth-inhibiting, nationally segmented characteristics of the current Proposal.

Key Concerns

Branch Liquidity

One of our key concerns relates to the liquidity requirements imposed on the US branches of FBOs. Under this requirement, a liquidity buffer must be maintained in the US branches of the FBO. This imposes restrictions on the ability of the FBO to offset internal (within FBO entities) and external (third-party) funding flows, which will have a number of significant negative implications for systemic risks and economic growth:

[2] The Institute of International Finance (IIF) describes these fragmentation concerns in its April 16, 2013 letter to the IMF.
[3] Written submission by Mark Carney, Governor of the Bank of Canada to the Bank of England, http://www.bankofengland.co.uk/publications/Documents/other/treasurycommittee/other/carneytsc.pdf

- liquidity management during a crisis event: the ability to manage liquidity on a global basis provides important flexibility for a bank during a crisis (i.e. the flexibility to raise liquidity in markets that may be less impacted by the crisis). The requirement to pool liquidity on a jurisdictional basis (i.e. "trapped liquidity") will significantly curtail this flexibility, raising prudential/systemic risk concerns;
- inefficiencies/economic concerns: restrictions on the ability to manage liquidity on a consolidated basis will impose constraints on a bank's ability to meet liquidity requirements in an efficient and effective way. As these fragmentation concerns proliferate (e.g. as additional pools of liquidity are required to be maintained once retaliatory actions are taken in other jurisdictions) the net result will be to substantially increase global liquidity requirements beyond those set under Basel III standards. Costs will increase, consumers will be negatively impacted, and global economic activity will ultimately suffer the consequences.

It is also important to note that under the FBO rule, US domestic banks would not face the same constraints on their consolidated activities (i.e. the parent bank is housed in the US and their consolidated liquidity/management activities therefore do not face the same restrictions and ring fencing concerns). This will create significant competitive inequities/level playing field issues between an FBO facing the requirement to manage liquidity locally (i.e. separate pools) and a US domestic bank that can continue to manage its liquidity requirements on a global basis.

Early Remediation

Another key concern is with the early remediation provisions, and in particular, the lack of a requirement for ongoing consultation with home country prudential regulators. We believe that close cooperation among the home and host regulators of a globally active bank should be a fundamental requirement in not only monitoring the consolidated risks of the enterprise, but also in determining the appropriate action to be taken if issues do arise. There is a concern, for example, that taking a public remedial action against an FBO's US operations could create regulatory conflicts (e.g. by precipitating broader negative implications for the parent bank).

We expect that as a matter of policy, the Board would seek to avoid tying US supervisory intervention to circumstances that pose no threat to the US. Indeed the Proposal explains that its early remediation requirement for FBOs are "...tailored to address the risk to US financial stability posed by the US operations of foreign banking organizations..." [4] It is understandable that the Board might seek to identify and monitor non-U.S events for any FBO contagion risk that might impact US operations, but in our view the best source of timely, reliable information would stem from cooperative and confidential engagement with home country authorities. We submit that a knowledge-based approach, that looks holistically at the global organization, should be preferred to unilaterally-imposed automatic triggers.

Duplicative Requirements

We are concerned that the FBO proposal will result in the application of a duplicative layer of regulatory requirements that are already applied at the home country level. As will be described in the sections that follow, a country like Canada already has extensive regulatory requirements in areas like capital, liquidity, single counterparty credit limits, risk management, stress testing, leverage and early remediation. The need to create a separate infrastructure to

[4] See 77 Fed. Reg. a 76,667.

comply with the separate FBO requirements in these areas will add significant compliance costs for FBOs but for no meaningful added benefit from a regulatory perspective.

III. A Substitute Compliance Framework is a Viable Approach

(A) Legislative Authority

Not an Exemption Request

We believe that steps need to be taken to address the concerns we have noted above. As noted earlier, we are not seeking arbitrary relief or an across-the-board exemption from the FBO rules. The approach we are recommending is predicated on existing legislative authority and would involve the development of an express set of criteria to determine when a home country's regulatory standards would be considered sufficiently comparable to stand in the place of the Board's FBO rules. In cases where a country's standards no longer meet these requirements, the specifics of the US FBO rules could once again apply.

Legislative Provisions

The approach we are recommending is consistent with the authority provided to the Board for the FBO rule. Specifically, paragraph 165(b)(2)(B) of the *Dodd-Frank Act* states that the Board shall:

> (B) 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 US.

Alternative Set of Rules to Apply -- the "Substitute" Compliance Approach

In exercising its legislative mandate, we are proposing that the Board should develop a robust set of criteria to determine which home country rules would be considered to meet or exceed the US FBO standard. Once this determination has been made, these comparable or "substitute" home country standards would apply to the FBO's US operations as an alternative to the proposed FBO requirements. To be clear, our recommendation is that an alternate/comparable set of rules should apply, not that no rules would apply at all.

In concept this approach would be similar to the one currently under development by the Commodity, Futures Trading Commission (CFTC) on derivatives reforms under the *Dodd-Frank Act*. Under this approach, the CFTC will rely on home country regulators for significant portions of the requirements of the derivatives framework where the home country rules meet the substitute compliance standards of the CFTC. Additional detail on this is provided in the following section.

Substitute Compliance Criteria/Approach

Given that Basel III is the internationally agreed prudential global standard for capital and liquidity, it seems logical that an appropriate starting point in crafting a Section 165 substitute compliance regime would be to use compliance with Basel-III standards as a threshold qualification. Such qualification would form the basis for the Board's recognition of comparable home country standards as a substitute for the proposed FBO requirements, provided the Board and the relevant home country regulator(s) agree to close coordination and cooperation in overseeing the relevant banking organization(s).

As noted above, we do not envision that a "substitute compliance" framework would be an exemption from US requirements, nor should our comments be so interpreted. By "substitute compliance", we mean that as a base case:

- substitute compliance/alternative rules: the US operations of Basel III compliant FBOs would be deemed to meet US prudential requirements in respect of their US operations by continuing to follow (as an alternative/substitute) their home country rules for calculating capital, liquidity and credit exposure for those operations, so long as this is applied on a consolidated basis (for US subsidiaries, the portions(s) of each measure attributable to U.S. operating subsidiaries would be required to be identifiable and subject to monitoring and reporting to the Board);
- branch liquidity: the US branches of an FBO should be recognized as part of the legal entity of the parent bank and thus subject to the same robust regulatory requirements as the parent on a consolidated basis. This would mean that the FBO could calculate its liquidity according to its home country regulatory rules and would not be required to specifically immobilize excess liquidity in its US branches (i.e. it could continue to manage its liquidity on a global basis according to its consolidated liquidity management model);
- early remediation: a framework should be created to allow for close cooperation/consultation between the home and host regulators of the FBO. This approach would be fundamentally important in not only monitoring the consolidated risks of the enterprise, but also in determining the appropriate action to be taken if concerns do arise.

Of course additional detailed discussions would be required between the Board and FBO home country authorities on the specific details of this framework.

(B) Substitute Compliance Would Not Weaken US Standards

A substitute compliance alternative would be appropriate where home country regulatory standards address the key components of the Board's concerns[5]; require FBC compliance on a consolidated basis with capability for analysis at the underlying subsidiary and affiliate levels; incorporate adequate monitoring, stress testing, reporting and disclosure regimes; provide for supervisory oversight that includes intervention authority pursuant to early warning mechanisms; mandate documented capital, liquidity, recovery and resolution planning; and require adequate risk management, control and governance at the FBO.

In view of the Board's concerns with dissipating source-of-strength assurances, we propose that substitute compliance would be available to an FBO if the home and host country authorities reach mutually acceptable recovery and resolution protocols (for example, agreement not to impose prohibitions on cross-border movement of assets where the authorities are engaged in recovery or resolution of an international banking organization). In addition, ringfencing-like safeguards would apply as a matter of US supervisory intervention if the Board determined that substitute compliance had become ineffective and US operations of the FBO presented a threat to

[5] The key components being: risk-based capital and leverage limits; liquidity requirements; single counterparty credit limits; and early remediation (including debt-to-equity limits).

US financial stability. This type of approach should incent international authorities to ensure that the Board, as host supervisor, can rely on the parent FBOs to support their US operations.

If, due to national policies prioritizing home country obligations, a home country regulator is precluded from cooperating with the Board to develop a framework for substitute compliance, then perhaps for the institutions from these countries, continuance of US operations might be conditioned on stand-alone host country requirements.[6]

IV. Canada As An Example For Substitute Compliance

Overview

Measured against virtually any yardstick, we would submit that Canadian banks do not pose a systemic risk to the US, and that the Board could fully rely on OSFI, as the home country regulator, to enforce appropriate standards to support a substitute compliance framework. The table in the attached appendix illustrates how the robust Canadian requirements meet or exceed the FBO requirements. For example, Canadian banks already are Basel III compliant for capital (i.e. as of January 1, 2013, Canada is fully compliant with the 2019 requirements). In addition, Canada has been ahead of the curve in certain areas such as minimum liquidity metrics -- Canadian banks have operated under OSFI-imposed prudential liquidity requirements since 2009, before Basel announced discussions about the Liquidity Coverage Ratio.

To encourage the Board's serious consideration of our recommendations, by way of example we set forth below a brief high-level description of key elements of how the Canadian prudential framework focuses similarly on the Board's key concerns, and the concepts underlying the design of the Proposal.

(A) Risk-Based Capital and Leverage

Canada's risk-based capital and leverage requirements are extensive:

- the *Bank Act* requires federally chartered banks such as RBC to maintain adequate capital; OSFI oversees bank compliance with implementing regulations. The regulations apply to Canadian banking organizations on a consolidated basis;
- over and above Basel III standards, OSFI imposes a capital conservation buffer which can be satisfied only with common equity Tier 1 capital. For Advanced Approaches organizations like RBC, the OSFI capital requirements also include a capital floor to ensure adequacy of bank capital levels. These requirements are current; Canadian banks already meet these standards;
- most recently, OSFI has designated RBC a Domestic Systemically Important Bank (D-SIB) and, like the five other Canadian D-SIBs, a capital surcharge has been added to our regulatory requirements;
- internal as well as supervisory stress testing is required on a continuing periodic basis. Capital planning is documented and subject to approval by OSFI, which retains authority to limits on a bank's activities (e.g. restrict a bank's capital distributions);

[6] Canada maintains no protectionist policies that would disadvantage US customers of the US operations of Canadian banks. For example, we note the absence of a depositor preference regime and the fair ranking of our US branch obligations alongside obligations of Canadian branches of RBC.

- regarding leverage, for over twenty years Canadian banks have been subject to OSFI's "Assets-to-Capital Multiple", a requirement that incorporates monitoring, testing and reporting to ensure than banks do not violate OSFI's prescribed cap on assets.

(B) Liquidity Requirements

As with capital, the Canadian requirements are robust:

- the *Bank Act* requires Canadian banks to maintain adequate and appropriate forms of liquidity, and OSFI oversees the regulatory framework;
- Canada's liquidity framework requires that banking organizations implement and maintain a program for liquidity risk management, governance and controls that must include, among other things:
    - documented liquidity and funding policies (including contingency funding plans, and funding strategies that ensure diversification of funding sources) [7];
    - comprehensive liquidity stress testing;
    - a stock of high quality liquid assets;
    - management of intra-day liquidity risk; and
    - compliance with a Net Cumulative Cash Flow metric ("NCCF"). The calculation was established by OSFI in 2009 using a 6 month minimum survival horizon, which was increased to 20 weeks in August 2011. In light of the executory status of the Basel LCR, and the Board's desire for a transitional liquidity measure, we would underscore the relevance of the above-noted NCCF. The NCCF overlays a set of time-value metrics on top of liquidity needs determined by stress testing. It requires bank evaluation of liquidity needs over a series of short-term timeframes and in various currencies. Additional requirements mandate review against cash flow and maturity mismatches.[8]
    - OSFI expects its regulated institutions to focus heightened internal scrutiny on short-term funding needs, whether next-day or over specified intervals within a 30-day timeframe;
    - the above-described liquidity framework applies to Canadian banking organizations on a global basis, both within and outside of Canada.

With respect to liquidity requirements for the US branches of Canadian FBOs, as noted above, the Board's focus on the locality of branch liquidity will detract from the FBOs' ability to efficiently and effectively manage liquidity on a global basis. Ring fencing of liquidity will reduce flexibility during crisis circumstances and will increase costs. It is also important to note that RBC operates pursuant to home country laws that do not discriminate against host country obligations -- failure to meet obligations of its US branch, would be a failure of RBC at the parent level. As the parent would not allow its US branch to fail, the US branch is entitled (and assumed) to be able to rely on RBC's global liquidity resources. The same is true for RBC branches

[7] With respect to global operations, an important component of liquidity management involves the ability to acquire and manage a supply of liquid assets, in various currencies, including of course, US dollars. Contrary to these risk management objectives, the US Volcker Rule as proposed would extend its reach so as to prohibit proprietary trading even by non-US entities within a global banking organization.. We submit that so long as FBOs maintain at least the minimum required capital and liquidity, activities outside of the US should not be prohibited in the way the Volcker proposal currently provides.

[8] In conservative fashion, OSFI has stated that it may decide to maintain the NCCF even after implementation of the Basel LCR.

wherever located. The ability to direct liquidity wherever needed within the consolidated group plays an important role in our overall liquidity risk management practices.

We submit that given the robust home country framework, a US branch of a Canadian FBO should not be subject to immobilized US liquidity.[9]

<u>(C) Single Counterparty Credit Limits</u>

RBC applauds the Board's decision to engage a Quantitative Impact Study regarding the SCCL provisions of the proposal. We anticipate that in addition to the QIS, the Board will consider the recently released Basel paper on Large Exposures, and look for further industry commentary before finalizing the US SCCL regime. In the meantime, we offer the below summary description of Canada's credit exposure regime to support our position that a substitute compliance platform is an appropriate viable alternative to the imposition of separate US-based SCCL requirements.

OSFI long has recognized that concentrations of bank credit risk to any person may seriously affect a bank's financial condition. Canadian banking organizations must comply with credit exposure regulation that imposes, <u>at the consolidated</u> level, a 25% (of total capital) limit on aggregate credit exposure to any unaffiliated counterparty (or group of related counterparties).[10]

The counterparty credit limit applies regardless of any collateral that supports individual transactions (rendering unnecessary complex and confusing "eligible collateral" requirements such as contained in the Proposal). The OSFI regime requires that RBC incorporate all subsidiary exposures into counterparty credit calculations with the further condition that no parent or affiliate guarantee(s) may be used to reduce exposures to bring them into compliance with OSFI's limit. In addition, derivatives contracts are counted as "exposures", and may be reduced only if transactions are subject to valid contractual set-off.[11]

While under OSFI rules "credit exposure" is defined broadly, OSFI recognizes exclusions for sovereign debt that apply to more than just Canada's sovereign securities. Separately mandated requirements around country risk exposures (including concentration and market risk standards) are applied at the consolidated level to guard against inappropriate levels of sovereign risk. In this way credit risk management goals, co-exist with international harmonization efforts.

Significantly, notwithstanding the 25% limit, OSFI expects its banks to adopt lower counterparty limits and to employ the 25% cap only on an exceptional basis. Moreover, OSFI may impose reduced counterparty exposure limits on any banking organization.

<u>(D) Early Remediation</u>

As referenced at different points above, OSFI has authority to conduct supervisory intervention exercises as necessary to address stressed conditions wherever they may occur within the global operations of a Canadian bank. At the very least, home and host country communication is necessary to avoid conflicting supervisory actions that could exacerbate a bank's stressed condition.

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[9] In the Section 165 domestic proposal, the Board appears to value a holistic approach to management of bank liquidity given that the liquidity requirements for US banks are applied at the parent level.

[10] The Board notes that prior to the recent financial crisis, US banks were subject to single borrower limits but that such limits were not applied at the bank holding company level.

[11] OSFI "exposure" includes "the credit equivalent amount of foreign exchange, interest rate, equity and commodity contracts calculated in accordance with OSFI capital adequacy standards. The Board noted in the Proposal that failure to cover derivatives exposure was a weakness of US credit exposure regulation; the OSFI framework shares and addresses this concern.

This is especially important considering that as now proposed, the Board's early remediation triggers could be invoked based on events occurring outside of the US operations of Canadian banks.[12]

V. Concluding Remarks

In closing we would note that a calibrated and controlled substitute compliance regime would have important advantages over the approach of the current FBO Proposal:

- stronger prudential oversight for the Board: a substitute compliance regime would provide enhanced capacity for US regulatory authorities to view the US operations of FBOs in the context of the entire global enterprise. Whereas the current FBO is confined to a more narrow/regional perspective of a global bank's operations, a framework based on substitute compliance would better allow US authorities to assess the potential threat of the FBO to the US based on a consolidated assessment of risk. In this respect a substituted compliance regime would in fact do a better job in advancing the financial stability goals of the Board by providing a more holistic view of the overall safety and soundness of the institution;
- avoids fragmentation concerns: a substitute compliance regime would be consistent with the principle of reliance on home country regulation, which is a core component of international harmonization efforts. This more nuanced/coordinated approach would: avoid the risks of regulatory fragmentation; be more effective in managing systemic risks; and ensure that productive economic activity would not be negatively impacted;
- addresses competitive inequity concerns: the FBO rule's restrictions, including in areas like branch liquidity requirements, will impose significant constraints on the ability of a globally active FBO to manage its liquidity on a consolidated basis. The net result of this is that an FBO would be forced to manage its operations on the basis of local liquidity pools whereas a US domestic bank would still be allowed to manage its liquidity on a global basis, raising significant level playing field concerns. A substitute compliance regime would address these competitive inequities by allowing for home country regulation to continue to apply to banking operations on a consolidated basis, similar to the treatment afforded to a US domestic bank.

We urge the Board to be a leading force for the recovery of global markets. The fact is that financial markets are interconnected, and need to remain so to support commerce around the globe. Consequently, oversight of financial institutions needs to be interconnected in a positive way. Global prudential standards for enhanced supervision must be finely crafted and with no regard for retaliatory actions among nations, except to condemn them. Irrespective of whether some authorities may have acted precipitously to announce ring-fencing or similar protectionist policies, the Board can act independently as well as through the FSB to demonstrate that crudely formed protectionist measures are sure to harm national economies as institutions reduce or retreat from doing business in such jurisdictions. Such initiatives should be viewed as "measures of last resort".

[12] We refer the Board to the comment letter submitted by the Institute of International Bankers for a fuller discourse on the Proposal's potential impact on this issue.

Appendix

Canadian Substitute Compliance Framework

FBO Requirement	Canadian Rules	Canadian Requirements Meet or Exceed FBO Rules
Capital	• Canadian banks Basel III compliant with 2019 obligations as of January 1, 2013.	☑
Liquidity for the IHC and the branch	• OSFI imposes a Net Cumulative Cash Flow (NCCF) requirement over a 20 week period. The NCCF is a contingency-based measure of liquidity calculated by Canadian banks using applied assumptions and reported to OSFI monthly. The calculation was established by OSFI in 2009 using a 6 month minimum survival horizon, which was increased to 20 weeks in August 2011; • Canadian banks will be 100% LCR compliant as soon as practicable and certainly well in advance of the 2019 phase in period; • for branch liquidity, it is also important to emphasize that US branches of the Canadian bank are part of the same legal entity as the bank parent. Further, Canada does not have a depositor preference regime, meaning that the creditors of the US branch of a Canadian bank rank equally with the creditors of the Canadian parent bank.	☑
25% Single Counterparty Credit Limits	• 25% single counterparty large exposure limit imposed on consolidated basis (under a more rigorous set of rules that apply without regard for any collateral that supports individual transactions).	☑
Risk Management	• strict supervision of risk management practices by OSFI; • certain Canadian banks, including RBC, also have stand-alone risk management frameworks and senior risk officers in place in the US.	☑
Stress Testing	• OSFI and internal consolidated stress testing in place.	☑
Leverage	• consolidated leverage requirements in place through the asset to capital multiple, established by OSFI in 1991.	☑
Regulatory Intervention Regimes (e.g. early remediation: debt to equity requirements)	• OSFI has an early remediation plan framework in place; • Canadian banks must also follow comprehensive and extensive recovery and resolution planning requirements.	☑