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

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

Dear Mr. deV. Frierson,

The Institute of International Finance (IIF) welcomes the opportunity to comment on the Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (the "proposed rule").[1] As a global association of financial institutions, the IIF has focused its comments on the international implications of the proposed rule and the likely effects it will have on international finance, cross-border cooperation, and economic growth, among other issues.[2]

The IIF and its members have major concerns with the proposed rule as it relates to the development of sound and consistent global financial regulation. In many ways, the proposed rule sends a message that the US lacks confidence in the global financial regulatory framework and that it has chosen to pursue a separate course from the international regulatory program of the G20, the Financial Stability Board ("FSB"), the Basel Committee and other international bodies. Underlying the proposed rule is the clear assumption that cross-border cooperation cannot be relied upon during a period of stress. That assumption is unwarranted, in light of the significant progress undertaken to improve cross-border cooperation, and may undermine efforts to develop the global regulatory framework further. This perspective is concerning at a time when substantial progress has been and is being made on the G20 international program, particularly with respect to recovery and resolution issues, capital and liquidity.

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[1] 77 Fed. Reg. 76,628, Dec. 28, 2012. Note that high-level concerns of the Institute's Board of Directors about the proposal have been communicated in a letter of March 18, 2013 to Chairman Bernanke.
[2] Detailed comments on the proposed rule from the point of view of banking institutions operating in the US as a host country are being provided by the Institute of International Bankers, and for insurance institutions by the American Council of Life Insurers, and this letter will not attempt to address the many issues arising from that perspective.

Furthermore, it is at the least perplexing that the proposed rule, which dismantles important aspects of established international cooperation, is being proposed at the same time the US and EU have committed to a broad trade negotiation aimed at reducing barriers to trade and investment.[3]

The implications of the proposed rule extend beyond the US. In all likelihood, the proposed rule would, if finalized, open a window for change in the general tenor of policymaking at the national and international levels, with the focus of regulatory change shifting toward regulatory protectionism, ring-fencing and obligatory subsidiarization.[4] While it is true that certain other countries have proposed or have taken measures that go somewhat in the direction of the proposed rule, the proposed rule is more complex and burdensome.[5] It is noteworthy that major financial markets such as Switzerland are committed to establishing global cooperation agreements for one group-wide resolution plan. National plans, such as the Swiss emergency plan, which deal with the orderly resolution of systemically relevant functions from a purely local view, are only fallback provisions, if international cooperation fails. Similarly, under the "Vickers" structural model, the non-retail, global operations of UK banks would not be outside the G20 global regulatory regime, including resolution.[6] Vickers and other analogous national proposals, in addition, do not prohibit or discount the notion that the parent entity will support its foreign operations during periods of stress.

It is the strong sense of the international community – including public-sector as well as private-sector voices – that finalization of the FBO rule as proposed would represent a turning point that would decisively influence the further course of international regulatory relations. Bank of Canada Governor and FSB Chairman Mark Carney summarized the concerns neatly: "Fearful that support from parent banks cannot be counted upon in times of global stress, some supervisors are moving to ensure that subsidiaries in their jurisdictions are resilient on a stand-alone basis. Measures to ring fence the capital and liquidity of local entities are being proposed. Left unchecked, these trends could substantially decrease the efficiency of the global financial system. In addition, a more balkanized system that concentrates risk within national borders would reduce systemic resilience

[3] A recent paper by the Atlantic Council suggests boldly that a much broader initiative should be undertaken, going in a forward direction, rather than cutting back: "We need a new type of agreement that will eliminate barriers to economic growth and spur creativity and investment both domestically and across the Atlantic. This challenge demands an innovative framework: a broad-reaching multilateral pact that blends transatlantic economic cooperation … with flexibly and rigor reminiscent of the world's most successful security agreement." Atlantic Council, *An Economic NATO: A new Alliance for a New Global Order*, Feb. 21, 2013.
[4] Financial institutions have chosen a wide variety of organizational structures for their overseas operations. Operation through various types of subsidiaries has worked well for certain business models, but requirements to adopt a certain structure are objectionable because of the reduced flexibility to adapt to a given group's needs and circumstances that they carry.
[5] This complexity results in part from the application to branch and agency networks of additional local requirements as well as to the requirements imposed on IHCs and other subsidiaries, all of which are more complex than they would need to be if appropriate deference were applied to home-country supervision and regulation.
[6] The proposed rules states that "several other national authorities have adopted modifications to or have considered proposals to modify their regulation of internationally active banks within their geographic boundaries," (77 Fed. Reg. 76,631) citing, among other examples, the Independent Commission on Banking's *Final Report Recommendations* September 2011), otherwise known as the Vickers Report. While the Vickers Report proposed the creation of a ring-fence around the UK retail entity, the wholesale and investment banking operations outside the ring-fence would otherwise be subject to an orderly resolution in accordance with the *Key Attributes*.

globally."[7] Similar concerns have been raised by European officials.[8] And the general issue of regulatory fragmentation, of which the proposal is a symptom, is of broad concern to the US government as well.[9]

Private-sector analysis increasingly focuses on the same concerns. Fragmentation has been a growing concern of the IIF and its Board of Directors for some time. From an analytical perspective, a recent report by the McKinsey Global Institute defined the stakes quite clearly: "Today global financial markets are at an inflection point. One path leads to a more balkanized structure that relies primarily on domestic capital formation and concentrates risks within local banking systems, while another points toward a healthier model of financial globalization that corrects the pre-crisis excesses while supporting more robust economic growth. Achieving this second outcome will require concerted actions by policy makers and financial institutions."[10]

Indeed, the impetus this rule would create would lead to a balkanization of global finance, the result of which would be reduced global liquidity, higher funding costs for borrowers, and a more fragile financial system, or one with different, and quite likely unanticipated, vulnerabilities. It is not difficult to see that widespread adoption of measures such as the proposed rule, which ring-fence liquidity and assets for the protection of one market, would have substantial, negative effects, fragmenting resources and *de-facto* multiplying capital and liquidity requirements, to the detriment of the global economy.

The IIF recommends that the Board revisit the proposed rule and adapt it so that it is more closely aligned with the G20's global program. Doing so would not jeopardize the substantive statutory goals of enhanced supervision or protection of financial stability in the US. Rather, the best course for the US, and for the broader international community, would be to recognize the work that has already been done internationally and to prioritize completion of the G20 program to improve and enhance consistent international regulatory standards, and the international cooperation necessary to their success. Should the Board not choose such an approach, this letter

[7] *See* Mark Carney, *Rebuilding Trust in Global Banking*, Feb. 25, 2013.
[8] *See* Michel Barnier, European Commissioner for Internal Market and Services, *Why Global Markets Require Global Rules – and US-EU Cooperation*, Feb. 15, 2013. *See also* Duncan Wood, *US Foreign Bank Plans Threaten Bail-in System, Says Finma*, Risk Magazine, Apr. 5, 2013. Mark Branson, Head of Banks division at FINMA, observes that resolution by the home country authority would become more difficult in a system in which the liquidity and capital are localized. *See also* letter from Michel Barnier to Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System (Apr. 18, 2013) (on file with the Federal Reserve Board).
[9] *See* Mary Miller, U.S. Under Secretary of the Treasury for Domestic Finance, *Remarks at the Annual Washington Conference of the Institute of International Bankers*, Mar. 4, 2013: "We have made real progress internationally…and must continue to do so….Progress remains uneven internationally and significant work remains. In particular, we must be careful to avoid a fragmentation in financial regulation internationally, which can lead to uneven regulation, unequal treatment, constrained capital flows, and increased uncertainty."
[10] McKinsey Global Institute, *Financial Globalization: Retreat or Reset?,* Feb. 28, 2013, p. 1. The report also finds that "[w]ith the ramifications of the financial crisis still unfolding and new regulations being implemented, two starkly different futures are possible. In one, the world remains on its current trajectory, with little financial market development and subdued capital flows. Although such an outcome may reduce the risk of a future financial crisis, slower economic growth may become the new normal. An alternative scenario would involve a 'reset' of the financial systems that corrects past excesses while enabling financial deepening and globalization to resume." *Financial Globalization*, p. 6.

proposes some risk-appropriate alternatives to the full, unilateral promulgation of the proposed rule, which could alleviate some of its downsides while still protecting the Board's goals and purposes.

I. A Shift in Policy

a. Shift in Federal Reserve Policy. The proposed rule signals a major paradigm shift in policy. The Federal Reserve has traditionally given foreign banks substantial freedom of choice to decide how they structure and manage their operations, so long as the FBO's home-country supervisory standards are consistent with US standards and the foreign parent would be able to act as a source of strength. The long-standing approach of relying on consolidated supervision by home-country authorities has allowed for greater cross-border banking and improved flows in capital and liquidity. Requiring FBOs to create intermediate holding companies ("IHCs") will severely limit the ability of FBOs to make important structural decisions that take into account clients' needs, efficiency and other factors.[11] It is striking that the Dodd-Frank Act does not mandate that FBOs create IHCs, for the good reason that there are other ways, including via greater reliance on international regulation, which is contemplated in the Act, to achieve its risk-mitigation goals.[12]

The impact of the proposal on FBOs in the US will vary depending on the structure of their current establishments and business models but, while some will feel less immediate impact than others, the global implications of the change of mentality are of concern to all.

b. Shift in US Policy. The IIF is concerned that the proposed rule also marks a change in broader US policy. The substantial burdens the proposed rule would create would likely cause some foreign banks to reconsider the scale and scope of their US operations. In particular, the resulting higher costs (on top of home-country and other international regulatory changes, and parallel ring-fencing actions in other jurisdictions) would force international banks to assess whether the benefits to operating abroad outweigh these costs.

This shift is especially troubling because of the US's past leadership in developing international banking regulation. This is one of the reasons why finalization of the proposed rule would be a significant inflection point, likely to turn other countries away from the consistency and cooperation on which the G20 program is predicated. . While elements of this trend toward balkanization and ring-fencing may arguably have been initiated elsewhere, it is not sufficient to say that the US is merely reacting to others' initiatives, which ignores the critical role that the US has in setting the course and direction of international policymaking.

c. Shift in International Policy. Implementation of the proposed rule will likely trigger a domino effect toward regulatory fragmentation and balkanization of global finance, all of which will have significant implications for global financial stability and the global economy.

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[11] The IHC proposal creates specific issues with respect to broker-dealers and insurance companies owned by FBOs (or designated non-bank financial companies). The details will be discussed at length in letters being prepared by other associations; however, the IIF shares and endorses their concerns about the specific new burdens created for such businesses. In both cases, the result appears to be to impose on such businesses capital and liquidity requirements that are at odds with other bodies of regulation and ill-adapted to the specificities of their businesses, their capital structures, and the risks they face.

[12] [12] *See* 77 Fed. Reg. 76,631, 76,632.

Ring-fencing, in particular, poses serious problems for the growth of global finance and the stability of the international economic system.[13] First, it traps or restricts use of liquidity and thereby can place firms in a much more precarious position at the global level. It can deprive firms of the ability to redeploy their resources as needed in periods of stress. Second, at the national level, ring-fencing creates an incentive for other countries to impose restrictions on capital or liquidity as soon as possible, especially in times of crisis. Other jurisdictions – even those without similar ring-fence positions – will be less inclined to cooperate with a ring-fencing regime out of a concern that the ring-fencing jurisdiction will not reciprocate. Finally, the policy of ring-fencing in effect multiplies capital and liquidity requirements. The amount of capital and liquidity required for most groups, on a cumulative basis, would be higher than what would otherwise be necessary, with a dampening effect on credit supply.[14] In other words, the requirement to meet multiple specific standards, if most major jurisdictions adopted similar measures, and the management necessity to top-up capital and liquidity to avoid violating standards in multiple jurisdictions would have the effect of increasing capital and liquidity requirements already designed to be rigorous on a group-wide basis.[15] To minimize the burdens associated with meeting multiple standards, it is likely that some FBOs will pull back to their home markets, leading to greater concentration of domestic banking assets in the larger domestic banks (both in the US and globally), causing the financial system as a whole to become more vulnerable to disruption.

It is difficult to assess the extent of these effects, because it is not yet known how far the ripples of additional ring-fencing will extend, or how great the demands of various jurisdictions will be. It is, however, virtually certain that any extension of ring-fencing requirements will have these effects of compounding capital and liquidity requirements that may otherwise be in line with international standards, resulting in burdens on credit-creating capacity that are unintended and unnecessary.[16] Global adoption of the proposed approach will certainly make it much more difficult and inefficient to manage funding and liquidity centrally, to the detriment of both microprudential and macroprudential efficiency.

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[13] The proposed rule contains numerous examples of ring-fencing, the most notable being the requirements that all IHCs hold enough local capital to meet all US capital requirements and that the US branch network and the IHC each maintain a separate liquidity buffer of high-quality liquid assets equal to net stressed cash flow needs over a 30-day stressed horizon.

[14] With respect to capital, the proposed rule states that the Board may decide at a future date to apply a quantitative risk-based capital surcharge to US IHCs that are determined to be domestic systemically important banking organizations ("D-SIBs"). 77 Fed. Reg. 76,640. A firm that has been designated a global systemically important banking organization ("G-SIB"), according to Basel III and home country capital standards, would be subject to increased capital surcharges and would, therefore, be deemed well-capitalized and capable of supporting its US-based IHC. Assuming that a G-SIB has complied with the Basel III capital requirements, it seems unnecessary to apply an additional D-SIB surcharge to a G-SIB's US-based IHC, unless the Board finds sufficient reason to do so in particular cases, on a "Pillar 2" basis.

[15] While capital can in principle flow through equity injections and dividends, and thus is not definitively "trapped," firms' flexibility in moving capital will be constrained, more than today in many cases, by (a) the management necessity to keep an additional "extra" over regulatory requirements in most or all affected countries, and (b) by the need to include capital movements in capital plans subject to regulatory approval, which may cause greater or lesser delays depending on the supervisor, but which will certainly add time and other burdens on the ability to move capital to meet needs or exploit opportunities in other countries.

[16] The recent KPMG report, *Evolving Banking Regulation, EMA Edition* (February, 2013), makes this point, *e.g.*, at p. 16.

These considerations would negatively affect internationally active US banks as well. This part of the problem is sometimes described as "retaliation," but that is perhaps the wrong word: other countries would feel compelled to act, to avoid risk of loss of liquidity or assets to their own jurisdictions, to build up similar self-protection resources to those foreseen by the proposed rule, and to take into account the US's negative assessment of the prospects of global solutions and regulatory cooperation in case of need. Any country or regulatory authority that did not take the US actions into account would be running appreciable domestic political risks that would be hard to counter if an authority wanted to take a different, more internationalist path. Some might couch this in retaliatory terms, but the effects would be deeper than that.

The consequences of this shift are thus broader than "retaliation." The proposed rule would significantly undercut the improved communications and cooperation process that have developed among supervisors since the crisis and would undermine the bases on which the necessary international trust must be built. Reversion back to a more national approach to regulation would most likely reverse the current trend toward increased international transparency. The proposed rule would also weaken the incentive for other countries to implement the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("*Key Attributes*"). The result is that it would turn a fear of insufficient trust and coordination among international authorities into a reality and likely worsen the problem that it is intended to fix. It would therefore also make it less likely that the full benefits of single-point-of-entry resolution would be available to US banks for which it is appropriate.

II. Inconsistencies with the International Framework

As noted previously, the argument on which the proposed rule rests – that cross-border coordination will fail during a crisis[17] – is a perception that the IIF believes is overstated and premature, given the substantial and widely acknowledged progress on the (still incomplete) G20 agenda. The international community, through the FSB, through bilateral discussions, such as those between the Bank of England and the Federal Deposit Insurance Corporation ("FDIC"), and through private-sector analysis, has made significant progress on international resolution standards and effective cross-border cooperation. While much needs to be done to complete the progress thus begun, the IIF believes it is important that the G20 program be carried out in its entirety and that the US lend its full support to this initiative.

It is to be expected that authorities in a crisis will act in what they perceive to be their own jurisdictions' best interests. But the better route – better both for going-concern regulation of firms in a vital global economy and for the outcomes that can be expected in any country if a firm fails – would be to focus on strengthening international cooperation so that each country can be assured its

[17] For example, the proposed rule states: "Actions by a home country to constrain a banking organization's ability to provide support to its foreign operations, as well as the diminished likelihood that home-country governments of large banking organizations would provide a backstop to their banks' foreign operations, have called into question one of the fundamental elements of the Board's current approach to supervising foreign banking organizations – the ability of the Board, as a host supervisor, to rely on a foreign banking organization to act as a source of strength to its U.S. operations when the foreign banking organization is under stress." 77 Fed. Reg. 76,631 (Dec. 28, 2012).

best interests are served by maximizing the recoverable value in a firm, and minimizing value destruction, neither of which will be served if the approach of the proposed rule is generalized.

a. Inconsistencies with the G20 Program. Since the start of the financial crisis, the G20 has consistently supported developing stronger cooperation and coordination among its member states on financial oversight matters and has encouraged its member states to work jointly to develop consistent regulation and cross-border solutions.[18] This is an ongoing process, which the proposed rule would undermine.

b. Inconsistencies with the FSB's Key Attributes. On the issue of resolution, the FSB has had success in creating a uniform set of standards for cross-border cooperation and coordination, expressed through the *Key Attributes*. The *Key Attributes* clearly specify what is expected of home and host jurisdictions when it comes to information sharing, the recovery and resolution planning process, the implementation of resolutions, and other matters.[19] These policies are aimed at solving the problems of cross-border cooperation and coordination and overcoming limited access to timely information. The process of developing and implementing these uniform standards is ongoing (both for "single point of entry" and "multiple point of entry" solutions). Importantly, the FSB is monitoring the implementation of the *Key Attributes* to ensure consistency across jurisdictions.[20] The proposed rule, however, does not acknowledge or take account for the FSB's work in this area, with no mention made of the *Key Attributes*. It is important that the proposed rule and future Board rules be consistent with the standards established in the *Key Attributes*, and the final rule, or perhaps an accompanying rule, should set out as clearly and affirmatively as possible how the US intends to meet its commitment to those standards.

There is no hint in the proposed rule of how the US proposes to meet the commitments of the G20 or the *Key Attributes* to develop and enhance international consistency and cross-border cooperation and coordination. The *Key Attributes*, for example, require that "[j]urisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of a mutual recognition process or by taking measures under the domestic resolution regime

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[18] The G20 communique from 2008, for instance, noted that "our financial markets are global in scope, [and] therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability." (See *Declaration: Summit on Financial Markets and the World Economy*, Nov. 15, 2008.) Two years later, the member states reaffirmed their pledge to "continue working on ensuring cooperation among jurisdictions in financial institution resolution proceedings." (See *The G20 Toronto Summit Declaration*, June 26-27, 2010.) Similar statements were made again in 2012, with special mention given to the "ongoing work by the FSB on adherence to supervisory and regulatory information exchange and cooperation standards." (See *G20 Leaders Declaration*, June 18-19, 2012.)

[19] The *Key Attributes* requires, *inter alia*: that the resolution authorities take into account the impact their actions may have on other jurisdictions; that authorities avoid taking actions that could trigger instability elsewhere; that the statute authorizing resolution also encourage cooperative solutions with foreign authorities; that institution-specific cooperation agreements set out the process of coordination among home and host authorities; and that jurisdictions remove impediments to the appropriate exchange of information.

[20] *See, e.g.*, FSB, *Thematic Peer Review of Resolution Regimes: Questionnaire*, Aug. 3, 2012.; FSB, *Handbook for FSB Peer Reviews*, Dec. 19, 2011; FSB, *A Coordination Framework for Monitoring the Implementation of Agreed G20/FSB Financial Reforms*, Oct. 18, 2011.

that support and are consistent with the resolution measures taken by the foreign home resolution authority."[21]

c. Inconsistencies with the FDIC-Bank of England Initiative on Resolution. Progress continues to be made, as well, on a bilateral basis. Shortly before the release of the Board's proposed rule, the FDIC and the Bank of England published a joint paper describing a set of resolution strategies for globally active, systemically important financial institutions.[22] The paper was noteworthy for several reasons. First, as a document, it was indicative of the fact that support for developing a robust cross-border framework for resolution remains strong and that work on this issue continues to develop. [23] Second, the paper itself helped advance the argument for greater cross-border cooperation, stating that "[t]o be successful, [the resolution of a G-SIFI] will require close cooperation between home and foreign authorities."[24]

Furthermore, the proposed rule raises questions about the "single point of entry" model to resolution, on which the FDIC-Bank of England paper was based.[25] Under the proposed rule, it is not entirely clear how a resolution under the "single point of entry" model would take place, if the parent entity were located outside the US. If anything, it appears that the proposed rule implicitly calls for a "multiple point of entry" resolution, in which the US subsidiaries, through the IHC, and the parent entity (and perhaps also the US branch-agency network) would be resolved separately. Although "multiple point of entry" would clearly be appropriate for some groups, the FSB has made it clear that both approaches need to be considered in establishing cross-border resolution policies

d. Other areas of Concern: Large Exposures. While it is not the intent of this paper to review each and every provision of the proposed rule, it is significant to note that many of the provisions touching on topics other than resolution and liquidity, which are the primary focus of this letter, are the subject of intense work and increasingly demanding requirements at the international level. For example, the Basel Committee is working on new international standards on regulation of large exposures. When completed, that work will upgrade the existing international standards on large exposures and concentrations and, among other things, appears likely to affect affiliate exposures significantly. As a result, the specific counterparty limits included in the proposed rule are likely to be redundant to home-country limits for branches and agencies and group-wide limits for holding companies in the US. Given the extensive US input into the Basel Committee's deliberations on this as on other major topics, it is difficult to see why the specific rules proposed as to such exposures of FBOs in the US would be necessary[26] (although, as to holding companies and subsidiaries, revised

[21] Key Attribute 7.5.

[22] *See Resolving Globally Active, Systemically Important, Financial Institutions*, December 10, 2012.

[23] The paper also noted: "A key part of the work undertaken the U.S. and the U.K. has been to identify the regulatory obligations of foreign authorities in response to a resolution originated by a home authority. Where any impediments to effective whole group resolution have been identified, authorities are in the process of exploring methods to overcome them."

[24] With respect to paragraph 38 of the joint paper, the IIF is concerned that the disadvantages of ring-fencing outweigh the advantages, for the reasons given herein.

[25] While the joint paper mainly focuses on the "single point of entry" approach, Paragraph 37 correctly reflects the suitability and relevance of the "multiple point of entry" approach in certain cases.

[26] To the extent that the Federal Reserve may be motivated, in part, by a distrust of home-country oversight of FBOs, it should be noted that the Basel Committee and the FSB are carefully monitoring and reviewing the implementation of the various new international standards. This would surely apply to the regulation of

rules may be necessary in the fullness of time to provide for appropriate articulation of US rules with home-country rules for locally incorporated entities).

e. Inconsistencies with the US supervisory framework. The proposed rule also gives inadequate consideration to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requirement that the Board examine the extent to which a 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.[27] While the proposed rule briefly acknowledges this requirement,[28] minimal weight is given to home-country standards. The plain words of the Dodd-Frank statute imply a much more substantial intent on the part of Congress to fit US regulation into a robust global structure of supervision and regulation.[29]

The proposed rule also deviates from the Federal Reserve's long-standing framework for overseeing FBOs, which has historically allowed for supervisory discretion in determining the extent to which the parent entity is capable of extending resources to its US entities. The Federal Reserve, for years, has conducted Source of Strength Assessments ("SOSA") of the US entities of foreign banks, which takes into consideration the financial profile of the FBO; the FBO's home-country banking supervisory system; the demonstrated capabilities of the home country in dealing with banking problems; and the degree of transfer risk associated with the FBO's home country and any other countries in which the FBO has major operations.[30] It is reasonable to update past regulatory practices, but there is no necessity to turn so sharply away from the long experience and basic international outlook of well-established US precedent, especially in light of the specific congressional mandate to take into account foreign regulation.[31] In contrast, the proposed rule assumes the parent entity will be unable or unwilling to provide support, regardless of the many factors that inform the firm's SOSA rating. While the proposed rule states that the reliance on FBO groups and home supervisors was shaken by the experience of the crisis, which cannot be denied, it does not give sufficient credence to the huge effort made since the crisis to remedy the regulatory and supervisory problems that caused justifiable concern. It ignores the improvements made by firms to corporate governance and risk governance,[32] and it ignores the many market as well as

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large exposures, when completed, but is true now of the work being done by Basel on the Basel Accord implementation generally.

[27] *See* 12 U.S.C. 5365(b)(2)(B).

[28] *See, e.g.*, 77 Fed. Reg. 76,631, 76,632.

[29] In addition, as argued more fully in the IIB's letter cited above, the proposed rule is at odds with the Bank Holding Company Act ("BHC Act") of 1956 insofar as it would give the Federal Reserve oversight of capital standards for FBO-owned broker-dealers. Section 5(c)(3) of the Bank Holding Act specifies that the Board may not impose any capital or capital adequacy rules on a functionally regulated subsidiary, including broker-dealers, of bank holding companies, so long as they comply with the applicable capital requirements of the Securities and Exchange Commission. 12 U.S.C. § 1844(c)(3). While the Dodd-Frank Act, in many respects, extended the Board's supervisory oversight of functionally regulated subsidiaries, Congress specifically left the limitations imposed on the Federal Reserve by Section 5(c)(3) intact.

[30] *See* FRB Supervisory Letter SR 00-14 (SUP), *Guidelines for Implementing the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations*, Oct. 23, 2000.

[31] *See* 12 U.S.C. 5365(b)(2)(B).

[32] *See* FSB Report, *Thematic Review on Risk Governance: Peer Review Report*, Feb. 12, 2013; *and* IIF and Ernst & Young Report, *Progress in Financial Services Risk Management: A Survey of Major Financial Institutions*, June 21, 2012. As the IIF-Ernst & Young report also indicates, firms do have a considerable amount of work yet to do to bring governance fully up to standard.

regulatory changes. While, of course, the US banking agencies cannot let down their guard, the guidance of the Dodd-Frank Act on how to enhance regulation and supervision of FBOs would clearly allow such an approach building.

III. How to proceed within the Existing Institutional Framework

The proposed rule, based on experience during the crisis, does raise serious concerns about the ability of US authorities to supervise, regulate and resolve large FBOs operating in the US. In particular, it points to the risk that home and host jurisdictions might place restrictions on the movement of assets across borders during a crisis and the limited or uneven access that host jurisdictions have to timely information.[33]

However, a more constructive approach for the purposes of building a robust international framework would be to eliminate the remaining material inconsistencies or gaps at the international level, through the G20, the FSB, and the Basel Committee or through the supervisory colleges.[34, 35] It is understood that the FSB (with respect to the common data template[36]), the Senior Supervisors Group, and the Basel Committee are working on international information-sharing issues. Completing the work being done by the FSB and other international authorities to improve international data exchange among regulators should go a long way to meeting the concerns expressed in the proposed rule. In addition, rapidly evolving technology will make it much more feasible in the near future to manage data for supervisory purposes; new analytic tools being deployed in the private sector should enable authorities to analyze vast quantities of data and more closely monitor risks.[37] The process begun in these various strands should be brought together into a concerted international program to take advantage of the post-crisis focus on international supervision issues and resolve, once and for all, these issues. The IIF addressed this problem in some detail in its 2012 report on *Making Resolution Robust*.[38]

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[33] The considerable amount of access that the Federal Reserve currently has to information on the US and Group operations of FBOs is not fully accounted for in the proposed rule, and the view that the Federal Reserve cannot access timely information seems unwarranted. The Federal Reserve already receives substantial amounts of timely information about the activities engaged in by FBOs, both in the US and at the Group level.

[34] As Governor Daniel Tarullo recently noted, "international arrangements both reflect and try to compensate for, [the] web of divided and overlapping domestic authority." Governor Daniel K. Tarullo, *International Cooperation in Financial Regulation*, Feb. 22, 2013. The point here is that the priority should be to complete and systematize those international arrangements, for example on information exchange, rather than turning away from them in ways that will undercut incentives for further improvement in the future. See also a statement the same day by an ECB Board Member: "Coming together is a beginning, staying together is progress, working together is a success." Joerg Assmussen, *The Future of Global Economic Governance*, Feb. 22, 2013.

[35] For information on the development of supervisory colleges, see Basel Committee on Banking Supervision, *Good Practice Principles on Supervisory Colleges*, Oct. 2010. See also FSB, *Global Adherence to Regulatory and Supervisory Standards on International Cooperation and Information Exchange: Status Update*, Nov. 2, 2012.

[36] *See* FSB Report, *Understanding Financial Linkages: A Common Data Template for Global Systemically Important Banks*, Oct. 2011. The FSB has formed a working group to develop proposals for a common data template, which is ongoing.

[37] *See* McKinsey Global Institute, *Financial Globalization: Retreat or reset?*, Feb. 28, 2013, p. 10.

[38] *See Making Resolution Robust – Completing the Legal and Institutional Frameworks for Effective Cross-Border Resolution of Financial Institutions*, *e.g.*, pp. 44, 48.

With respect to individual firms, the US should work with firms' colleges and Crisis Management Groups ("CMGs") to deal with cooperation and information sharing.[39] This should be handled through institution-specific cross-border cooperation agreements, per the *Key Attributes*. Such agreements should address the process for information sharing among home and host authorities, both before and during a crisis, and provide an outline of home- and host-country responsibilities in exercising resolution powers.[40]

The proposed rule is said to be necessary to avoid extraterritorial application of US law to the home offices and other operations of FBOs.[41] The IIF is concerned to avoid extraterritoriality whenever possible, and the argument made on avoiding it is based on assumptions about the inadequacy of international standards and of other countries' implementation of them. Once again, it needs to be stressed that if there are such concerns – and of course they are normal given the incomplete state of the restructuring of international regulation – the only appropriate solution in light of the G20 commitments and the need for maximum financial efficiency of the global economy is for the US and the G20 to press to work out the remaining issues and build up the infrastructure of the FSB and associated institutions as expeditiously as possible. It is backwards and self-defeating to build up protectionism ostensibly in order to avoid extraterritoriality.

Despite the objections made in the proposed rule to the suggestion of extraterritorial application of US law in the absence of inward-looking provisions such as those proposed, the proposed rule itself would likely have extraterritorial effects. One example of this is the early remediation triggers, which may impose, at the parent level, minimum risk-based capital and leverage requirements that are different from and perhaps more burdensome than what are specified in the Basel III standards, and possibly in conflict with the basis of calculation of such other firms. It is likely that these extraterritorial effects would cause tensions with supervisors and regulators outside the US if not corrected in the final rule.

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[39] *See* Sarah Dahlgren, *Supervisory Reforms for Global Banks: Remarks at the Center for Transnational Legal Studies Seminar on the impact of U.S. Regulatory Reform on Global Banks*, Federal Reserve Bank of New York, Feb. 12, 2013, identifying ways to enhance the supervision of FBOs. In particular, the remarks point to the enhancement of supervisory colleges as an important element in improving the exchange of information among supervisors. As noted in those remarks, the improvement of the colleges extends beyond greater information exchange; it should include "making sure that core colleges are appropriately constructed and reflect the key jurisdictions necessary to get a full picture of the risks of the firm; ensuring that the dialogue between supervisors and firms in college settings is robust and that the engagement among all parties is sufficiently high; and providing clear and direct feedback following supervisory colleges, both between supervisors and to the firm." The colleges should also provide a forum to "reinforce more consistent application of global standards." And of course, colleges need to take care to coordinate their activities with those of CMGs for the same institutions.

[40] *See* Key Attribute 9.1.

[41] *See* Governor Daniel K. Tarullo, *Regulation of Foreign Banking Organizations*, Nov. 28, 2012: "It is difficult to see how reliance on [the prevailing firm-by-firm approach to foreign banking regulation] can be effective in addressing risks to U.S. financial stability, at least in the absence of extraterritorial application of our own standards and supervision, and perhaps not even then." Also, 77 Fed. Reg. 76,632: "Several of the [Dodd-Frank] Act's required prudential standards are not subject to international agreement…As a result, monitoring compliance with any enhanced prudential standards at the consolidated foreign banking organization would be difficult and may raise concerns of extraterritorial application of the standards."

IV. Balkanization of Global Finance and its Consequences

By requiring FBOs to ring-fence liquidity and capital within IHCs, and, separately, within branch and agency networks, the proposed rule would impose significant new burdens on banks operating internationally. The inefficiencies that this would create, as a global standard, would tend to undermine or eliminate the benefits that integrated, wholesale global finance can provide, particularly with respect to diversification and lower funding and lending costs.[42] Trapped pools of liquidity create costs that have to be factored into the pricing of customer products in affected markets. The proposal would also, in some circumstances, cause FBOs to have less flexibility in choosing the markets in which the fund themselves, which would not only raise costs but increase concentration risk.

To the extent that banks pull back to their home markets, the reduction in competition would leave the US and possibly other national markets more concentrated and, therefore, more fragile

a. Effects of Ring-Fencing on Financial Stability. Ring-fencing would undoubtedly lead to distortions in individual markets, as credit supply would be determined more heavily by requirements of local deployment capital and liquidity. [43]

The proposed rule would put impediments on the ability to deploy liquidity and capital to stress points in other jurisdictions, thus raising the fragility of the global financial system. Each affiliate would effectively become cut off to a substantial degree from the rest of the group. What would develop would be a structure of individual islands, in which each market must rely to a much greater extent on the resources immediately at hand (including, of course, local lender-of-last-resort facilities). The ability of firms to redirect liquidity resources would be greatly diminished, and the result would be a more brittle financial system.[44] Even to the extent that firms would have surplus

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[42] As noted in the McKinsey Global Institute's *Financial Globalization*, "Tightly restricting foreign banks and capital inflows may reduce the risk of financial contagion and sudden reversals of capital, but it also limits the benefits that foreign players can bring to a financial sectors, such as greater capital access and competitions…[T]he objective of building a competitive, diverse, and open financial sector deserves to be a central part of the policy agenda." *Financial Globalization*, p. 9.

[43] *See* McKinsey & Co., *The State of Global Banking – In Search of a Sustainable Model*, Sept. 2011, pp. 19-21 for an assessment of how increasing investment levels, in conjunction with slower savings growth, may lead to capital scarcity in certain developing markets. Studies, such as McKinsey report, suggest that the imposition of additional burdens on capital and further restrictions on the movement of capital and liquidity, when investment demand is growing, will have an adverse effect on economic growth in these particular markets and, likely, on global growth. While it is not the responsibly of the Federal Reserve to act in accordance with the best interests of the global economy, it should be mindful of the implications and distortions its actions may have on the global economy.

[44] *See* Committee on the Global Financial System, *Funding Patterns and Liquidity Management of Internationally Active Banks*, CGFS Papers, No. 30, May 2010. According to the report, "Under crisis conditions, constraints on intragroup fund transfers may exacerbate problems. The ability to shift funds across jurisdictions was an important instrument of crisis management for many international banks." The proposed rule states that while some FBOs "were aided by their ability to move liquidity freely during the crisis," this also "created a degree of cross-currency funding risk and heavy reliance on swap markets that proved destabilizing." The extent to which these factors, in fact, "proved destabilizing" during the crisis is unclear, and the proposed rule does not indicate whether the risks of this model outweighed the benefits.

capital in required local entities, there would typically be, as in the US, capital-planning delays in authorizing dividing the capital up to the group. The effect would in fact be greater than just meeting the limits established by each country, because firms would maintain substantial management cushions in each place, in order to avoid slipping into violation (or, if the paradigm of the proposed rule is widely followed) possibly finding themselves in automatic early-intervention situations.

b. Effects on Recovery and Resolution. Recovery would be constrained in such an environment. The range of credible options for dealing with liquidity pressures would in effect narrow to what is feasible in a particular jurisdiction, irrespective of the untapped resources that may be available elsewhere in the same group. This situation becomes even more difficult in light of the early remediation framework and the hard triggers[45] that are imposed (through the capital and leverage requirements, for both the parent and the IHC, and through the stress tests) and in light of the constraints placed on enterprise-wide risk management.

Given that the recovery process would become more likely (under the early remediation framework), yet resources would be more limited (because of ring-fencing), resolution would become a more probable outcome both for any local affiliate and for groups as a whole that experience stress in one place but are constrained from responding effectively. This is likely to make both local affiliates and global groups more brittle and more likely to slide from possible recovery to inevitable resolution.

The absence of any reference to cross-border coordination, especially under Level 4 remediation, which would effectively be the resolution stage, is particularly striking. Any unilateral action in the US under such provisions would inevitably have destabilizing effects, possibly trigger group resolution that could have been avoided, and undermine the ability of other jurisdictions to manage resolution in their respective jurisdictions. In contrast to a well-coordinated cross-border recovery and resolution process, such unilateral actions are likely to increase value destruction and anomalous or unfair results, with similarly situated creditors getting unequal results purely as a result of where their claims are booked.

A specific concern of FBOs and home regulators is the extent to which the proposed rule would allow the US authorities to hollow out an international group by putting important parts of it into resolution, potentially draining resources available to the group as a whole at an undervalue. Insofar as the early remediation provisions of the proposal trigger off the parent's risk-based capital and leverage positions, the concern arises whether, in an extreme case, a perfectly healthy US IHC or subsidiary could be thrown into resolution and transferred for a small amount, depriving the parent of the substantial value thereof. Such may not be the intent (and there would be good arguments that such healthy US IHC or subsidiary could not be thrown into resolution under Title I or Title II of the Dodd-Frank Act or transferred at a low value), but the concern exists and cannot be dismissed easily. It would be most helpful if the US authorities could address, without creating binding intent for specific cases, the concerns that foreign parents and home regulators may have about extracting fair value from US entities in resolution. Assurances of general intent to produce a

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[45] In general, a strong recovery process would alert management of issues relating to instability well before hard triggers would, and, even more importantly, hard triggers lack the flexibility needed to allow banks to cope with specific situations, either idiosyncratic or systemic.

result that would be fair to all claimants regardless of where in the world their claims arise, in line with the *Key Attributes*,[46] would be most helpful.

Additional complications may arise in cases where the parent entity triggers early remediation action and the IHC is over-capitalized. Under certain circumstances, the US IHC would be prohibited from reallocating capital to the parent entity and, thus, indirectly prevented from providing support to the *US branch and agency* network in a time of stress. It is foreseeable here that the structural rigidities implied by the proposal could not only exacerbate the troubles of the group as a whole but thereby contribute indirectly to the failure of the US branch and agency network, despite adequate resources that might otherwise be available through the IHC. The absence of any fungibility of excess funds between the IHC and the branch and agency network, as well as the group as a whole, adds to likelihood that the branch operations will fall into resolution.

c. Effects on Liquidity Management. The liquidity discussion is built on legitimate concerns about the experience of the crisis, although in fact experience varied materially across firms and their countries of origin;[47] however, it ignores the very substantial progress made on improvement of liquidity regulation and supervision, and internal practices in firms, since 2007.[48] Moreover, at least in its current state, the proposal causes confusion as to how the US rules for FBOs will align with the forthcoming Basel III liquidity requirements. Although reference is made to future implementation thereof, many of the provisions in the proposal appear to be inconsistent with the international proposals, and there is no indication of how the inconsistencies should be managed to avoid egregious inefficiencies or different regulations' working at cross-purposes. Similarly, the governance provisions include very detailed strictures that appear to intrude unnecessarily into parallel governance, risk-management, internal and supervisory reporting, collateral management, audit and independent review, stress-testing, and IT requirements being imposed by FBOs' home jurisdictions.

Although it is stated that the FBO liquidity buffer is not intended to increase overall consolidated liquidity requirements, it will certainly, in most cases, have that effect. This is for

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[46] *See* Key Attribute 7.4.

[47] For an analysis of liquidity management by globally active banks during the recent crisis, see Nicola Cetorelli and Linda Goldberg, *Liquidity Management of U.S. Global Banks: Internal Capital Markets in the Great Recession*, Federal Reserve Bank of New York Staff Report No. 511. The report concludes that, during shocks, parent banks tend to shift liquidity within the organization on the basis of a "locational pecking order," which factors in the importance of affiliate locations for the parent revenue stream. Further, the report finds that, from the host-country perspective, "macroeconomic transmission from foreign banks may be less a function of its overall openness and more related to the particular distribution of foreign bans engaged in their economy, the balance sheets of those foreign banks, and the mode of operations within the country."

[48] In his recent (February 25, 2013) speech, *Rebuilding Trust in Global Banking*, Governor Mark Carney acknowledged, "In the past few years, there have been some improvements, including better accounting for off-balance-sheet securitisations, and enhanced disclosures of credit risk and the transfers of financial assets." The Basel Committee's *Principles for Sound Liquidity Risk Management and Supervision* (September, 2008) and the recently revised Basel III requirements for the Liquidity Coverage Ratio very substantially change the context of liquidity-risk management, and it is unproductive to base new requirements primarily on old concerns, not taking into account subsequent developments. On the industry side, the IIF published *Principles of Liquidity Risk Management* (March, 2007) shortly before the crisis to assist the industry in thinking about liquidity-risk management issues (its recommendations were updated in 2008 and 2009), and a joint IIF and Ernst & Young report, *Progress in Financial Services Risk Management* (June, 2012) shows substantial progress made, although more is required.

several reasons. First, it imposes separate calculations and requirements to maintain liquid assets that are incremental to home-country assets. Even if all aspects of such calculations (and the definition of liquid assets) were consistent with international separate requirements necessarily imply greater aggregate impact than do group-wide requirements for the reasons already mentioned, *viz.* that a firm would need to manage its liquidity to stay comfortably above local requirements and that such "extra buffers" would not be available for efficient global liquidity management. The effect is highly likely to be compounded if, as very clearly threatened, the FBO proposal leads to a general ratcheting-up of local liquidity requirements on a national basis. Second, the requirement to hold specific assets in the US could constitute a *de-facto* encumbrance of such assets, which will further complicate risk management (perhaps requiring them to be subtracted from home-country resources), and contribute to the growing problem of "collateral famine" of high-quality assets for liquidity and derivatives-margin and other collateral purposes. Moreover, to the extent that regulators are concerned about the extent of encumbrance of banks' balance sheets, the resulting blockage of resources in the US will compound the problem rather than make it more manageable. Third, the inefficiencies created will unnecessarily compound management problems (and the requirement to maintain resources at third-party banks may contribute to issues with home and US counterparty limits). Fourth, the rigidities created will make it harder for groups to address localized problems that would be manageable but might be magnified if not addressed promptly. Fifth, the calculations themselves, based on prescriptive stress assumptions, will generally not align with internal or home-country calculations, thus increasing the burden. These complexities are of course compounded by the need to maintain separately calculated buffers for both the branch and agency network and the IHC.

A further fundamental issue, which compounds all the foregoing, is that the proposal effectively demands a fundamental shift in the bases of liquidity-risk management. Liquidity is now managed much more tightly than before the crisis, and problems such as the underpricing of liquidity internally and externally have been corrected, for both business and regulatory reasons; however, that much-improved liquidity risk management is generally predicated on managing to severe but plausible stresses and close analysis of specific risks. The proposal shifts to mandating management to assumptions of failure both of the US operations and of groups. This implies a greater burden on firms – and thus on the global economy – than a more risk-sensitive approach.

The Basel Committee's *Principles for Sound Liquidity Risk Management and Supervision* cautions that "[a] bank should actively monitor and control liquidity risk exposures and funding needs within and across legal entities, business lines and currencies, taking into account legal, regulatory and operational limitations to the transferability of liquidity."[49] In light of this principle, an approach that would impose further territorial limitations for institutions to manage based on assumptions of failure of US operations or failure to deliver obligations due to them by non-US entitles of the same group (especially foreign branch-to-US branch obligations), even if these entities had the legal obligation and capacity to repay, would further complicate and unduly increase the cost of liquidity risk management, particularly updated approaches. Furthermore, the interrelation of the liquidity requirements with early remediation requirements raises the question of whether operation of such requirements in the US could destabilize recovery efforts at the group level.

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[49] Basel Committee on Banking Supervision, *Principles for Sound Liquidity Risk Management and Supervision*, p. 17, Principle 6.

The most appropriate response would be to revise the proposals fundamentally, (a) to align them with the Basel III liquidity provisions as finalized, to avoid all the complexities and level-playing field issues that arise from multiple requirements for the same things across jurisdictions, (b) to allow for substantial reliance on home-country supervisors, in accordance with the G20 program and international standards, and (c) as discussed elsewhere herein, to remedy the gaps in international information sharing or cooperation through colleges of supervisors and CMGs that may exist.

However, assuming it is judged necessary nonetheless to fall back on specific, local requirements, such requirements could still be tailored much more appropriately to support vibrant international markets with a minimum of local obstacles to global efficiency.

One way to do this would be to use a risk-based approach that would be more reasonable in terms of efficient use of resources from a group point of view and better suited to a cooperative supervisory regime. Thus, a bank that has a strong liquidity position in compliance with the Basel III requirements, maintains good liquidity-risk management in accordance with the Basel *Principles for Sound Liquidity Risk Management and Supervision*, and receives strong home-country supervision, also in accordance with international norms, should have greater scope to manage liquidity of its US branches, agencies, and subsidiaries within the confines of its home-country regulation and internal risk management. There is already a hint of such approach in the exception to the custody requirements that allows branch and agency networks to maintain assets outside the US. That exception is itself quite unnecessarily narrow, but shows how a bank could provide a risk assessment that would exempt it from most or all of the liquidity provisions as proposed, provided the conditions of group and supervisory conformity are maintained.

The rule could thus allow strong banks to manage liquidity risk on a going-concern basis and consistently with their global positions and needs, while protecting the US market from the dangers stressed in the proposal. This would have the additional benefit of adding an incentive to maintain a strong group-wide position that would benefit global stability.

d. Effect on International Economic System. Inevitably the international economic system will continue to globalize, as the G20 has recognized; to support growth of the international economy, a global financial system is necessary.[50] The ease and efficiency with which the international economic system develops will depend on whether the regulatory system underlying global finance is consistent, coherent, and rigorous. The best approach, for the purposes of stimulating global economic growth, would be a consistent and coherent regulatory system applied internationally, with the necessary cooperation agreements and facilities for information sharing to give supervisors in each country the assurances they need to act in a coherent way, generally following home-country leadership.[51]

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[50] Again, the G20 has consistently supported the development of a globalized financial system. For instance, the 2012 G20 communique noted, "We reaffirm our shared interest in a strong and stable international financial system…We are committed to the timely, full and consistent implementation of agreed policies in order to support a stable and integrated global financial system and to prevent future crises." ("G20 Leaders Declaration," June 18-19, 2012.)
[51] *See Making Resolution Robust*, pp. 20, 47-51.

V. Alternatives

The vision of this letter is that the Board would restructure its approach to work wherever possible through the international regulatory structure envisioned by the G20. This could largely be done by greater reliance in appropriate cases on foreign regulators that are also striving to meet the G20 standards. If the Board is not comfortable with such a solution by the point in time that the Section 165 rules are to be finalized, there are alternatives to meet the Board's concerns, which would not short-circuit an appropriately international solution as the G20 changes work their way through the international system.

a. Risk-appropriate alternatives. Among the variety of ways in which the Board could achieve its statutory objectives, without having to resort to the measures detailed in the proposed rule, would be to apply a less-burdensome set of standards for foreign banks whose home-country regulatory regimes meet internationally agreed capital, liquidity and resolution criteria.[52]

The Board does not necessarily need to adopt an entirely new framework; the Federal Reserve has relied on the SOSA ratings, for over a decade, as the primary tool for assessing an FBO's ability to provide capital and liquidity support to its US operations. These ratings (and further Pillar 2 analysis as appropriate) should at least help to inform the Board on the extent to which a particular FBO may, or may not, require additional enhanced oversight. On the liquidity side, the more risk-based approach described above would indicate a more flexible but still conservative way to deal with liquidity issues.

SOSA-type assessments should in fact be made substantially easier from now on as a good deal more relevant information will be available through the FSB and Basel Committee peer-review processes. Thus, the requirements of the proposed rule could be applied on a more risk-based plane, which would fit better with both the international regulatory program and the home-country regulations of those countries (*i.e.*, the great majority of financially significant countries) that adopt the international regulatory standards.

b. Phase-in Linked to International Developments. One way to manage reservations about other jurisdictions' implementation of the capital, liquidity, resolution, and other provisions of the international program, while not inviting criticism for undue focus on the domestic market at the expense of the global market, would be to make it explicitly clear that the proposal would be phased in, but subject to completion of the necessary legislation or regulations in other countries, with respect to institutions headquartered in such countries. This is a variant on the mutual-recognition proposals made above, but would more overtly create incentives for other countries to proceed with the G20 program, rather than to back away from it.

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[52] On a limited number of issues, the proposed rule explicitly relies on home-country or international standards. For example, certain FBOs would be required to meet the home country's risk-based capital and leverage standards at the consolidated level that are consistent with internationally agreed risk-based capital and leverage standards, including those that are part of the Basel III agreement. 77 Fed. Reg. 76,635. The proposed rule would also allow FBOs to apply home-country standards for the purposes of meeting stress test requirements and certain risk management requirements. 77 Fed. Reg. 76,632. In general, the proposed rule should expand on this approach and rely more on home-country standards that meet international principles.

Thus, the proposal could be disapplied if the Federal Reserve determines, based peer reviews and other available data, that a given jurisdiction substantially has adopted and applied the standards envisioned by the G20 program, or portions of it could be disapplied as appropriate (if, say, a jurisdiction meets resolution and risk management, but not liquidity, standards). Generally, such decisions would presumably be made on a jurisdiction-by-jurisdiction basis.

This would of course require some delay in the full implementation of at least those portions of the proposed rule the implementation of which would require substantial investments for structural, legal and IT changes by firms, especially those that would be difficult to undo, such as the IHC requirement. However, a reasonable delay, perhaps to be coordinated with the FSB and Basel regulatory phase-in schedules, would allow all jurisdictions to implement their changes and would be much less disruptive than immediate implementation without regard to international developments.

This would entail examination of other countries' regulatory regimes, but that is not new (*cf.* the SOSA standards) and, again, it would now be better grounded, given the extensive peer review processes being undertaken by the FSB, Basel Committee, and other international bodies.

On the other hand, this approach would also invite more concerted consultations with other countries, both multilaterally through institutions such as the FSB, and bilaterally, to assure that all parties understand the implications of each other's actions, which is especially important for resolution, where unilateral action in one jurisdiction can have grave effects in others.

This moderate, phased and tailored approach could of course be combined with firm-specific measures as described in the next section, depending on the facts and circumstances applicable to firms from a given jurisdiction.

c. Firm-specific arrangements. Another alternative would be for the Board to apply a different standard in cases where the global group and the home country have provided a commitment to allow the parent entity to support subsidiaries in the US. Such commitments could be tailored to the risks, structure, and size of US operations of the relevant group and could include appropriate keepwell agreements or guarantees (with home supervisory approval), and might extend to the use of internal or external contingent convertibles or other instruments in the capital structures of subsidiaries of FBOs in the US.

The IIF understands the Board's concerns about the willingness and ability of an FBO to provide support to its US operations, at least as to subsidiaries; banks will never want to be in a position of not supporting a branch, the obligation of which generally constitutes the full obligation of the parent. But again, significant progress has been made to overcome potential problems relating to cooperation and coordination and, further, these concerns do not outweigh the benefits derived from international cooperation that would be lost if the proposed plan were implemented. If the Board remains convinced that its oversight of FBOs should be strengthened, then the rule should take a more risk-based approach, adjusting for the unique risk profile of each bank and its legal framework. Further, the rule should incorporate a meaningful assessment of an FBO's home-country regime vis-à-vis the *Key Attributes* and make any necessary adjustments to the recovery and resolution provisions in the rule, particularly those relating to early remediation, on a case-by-case basis.

VI. Additional Recommendations

a. Full Impact Assessment Essential. Given the broad significance of the proposed rule for FBOs, for the US market, and for global finance, a full economic impact assessment is essential. While it is understood that the Board's staff has done some economic analysis in the process of devising the proposed rule, that analysis and the underpinning data should be made available for public debate and comment: impact assessments of this sort are very demanding and a full debate could only help elucidate the issues and the trade-offs involved.[53] In particular, the Federal Reserve should focus on the critical role that FBOs currently play in US markets, especially in securities and derivatives markets; the potential effects of the proposed rule on the scale and scope of FBO participation in US markets; and the resulting effects on market concentration and financial stability. This should occur before finalization of the proposed rule.

b. Including Global Impacts. In conducting a public impact assessment, it would be wise to consider the implications that the proposed rule would have not just if adopted in the US, but also if it becomes the global standard. An impact study should include the likely effects of the proposed rule on US and *global* growth and stability. No such study would be complete without assessing the effects if similar measures were taken in all the major global markets, including at least those that are represented in the G20.

c. Overlaps with International Standards. On a related note, the Federal Reserve should consider, and offer guidance on, how the application of the proposed rule will overlap with the implementation of various new international standards, particularly Basel III. It is unclear currently how the provisions of the proposed rule will be sequenced alongside the new international standards relating to liquidity, large exposures and other matters. [54] At a minimum, greater consideration and guidance should be given to the timing aspects of the proposed rule.

VII. Conclusions

If the proposed plan is implemented, it will set a harmful precedent and one that other jurisdictions will likely follow. The resulting acceleration of regulatory fragmentation would undercut the benefits of global finance for markets around the world. The outcome would be higher costs for banks operating in the US and, in turn, higher costs for borrowing; the inefficiencies and loss of resilience of trapped pools of liquidity; less competition from international banks in local markets; and greater distrust among regulators.

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[53] To an extent, the proposed rule provides an incentive for banks at the various thresholds to reduce the size of their balance sheets. Given the effects that the proposed rule may have on the size of banks, it would be worthwhile as well for the Federal Reserve to examine the economies, and perhaps diseconomies, of scale associated with international banking and where the appropriate thresholds may lie. Further research is required on this and should be pursued before the proposed rule is implemented.

[54] For example, the Basel III requirements will be phased-in annually through 2019. Implementation of the proposed plan should, at the very least, align with that of Basel III.

The IIF remains hopeful that the Board will choose to reconsider the proposal and revise it so that it is in line with the G20 commitments to enhanced global supervision and consistent, coordinated cross-border resolution.

If necessary, the Board could increase its comfort level with the international regime while yet avoiding the unfortunate impact that the IIF and many others foresee on the development of international standards by adopting the interim and risk-based measures suggested above.

Very truly yours,