

Terry Campbell
President
Tel: (416) 362-6093 Ext. 211
Fax: (416) 362-8903
tcampbell@cba.ca

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Mr. Robert deV. Frierson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Dear Mr. deV. Frierson:

Re: CBA¹ Comments on the U.S. Federal Reserve's Proposed Rule: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies

Thank you for the opportunity to comment on the Federal Reserve's Proposed Rule: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies ("Proposed Rule").

The CBA's largest members – which includes those that would be impacted the greatest by the Proposed Rule – are also members of the Institute of International Bankers (IIB) and the Institute of International Finance (IIF). We acknowledge the leadership the IIB has taken on this issue over the past year and support the comment letters submitted by the IIB and the IIF.

As the Federal Reserve is aware, the U.S. and Canada have enjoyed a longstanding positive relationship, cemented by deep interlinkages between our markets, similar political and social cultures, and a long history of support by Canadian banks of their U.S. operations as evidenced, for instance, by Canada's strong rankings under U.S. regulators' Strength of Support Assessment Program. Most importantly, the U.S. and Canada have in common robust and comprehensive frameworks for the regulation of banks and other systemically important financial institutions, as well as a political and regulatory agenda aimed at preventing a recurrence of the circumstances that contributed to the 2008 financial crisis.

¹ The Canadian Bankers Association works on behalf of 55 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

In this letter, we wish to share some views on the Proposed Rule from both a global perspective, as well as from a Canadian banking perspective. We will also outline the strength of the Canadian regulatory and supervisory framework, as well as the ongoing cooperation of Canadian regulators with their U.S. counterparts. Finally, we believe that the Federal Reserve should give strong consideration to a “substituted compliance” framework or an approach tailored to individual foreign banking organizations (FBOs) in the Proposed Rule that would take into account an FBO’s equivalent home country regulation, the cooperation of a home country regulator with the Federal Reserve, and the strength of an individual FBO.

Increased Fragmentation

The CBA believes that the impacts of the Proposed Rule would run counter to the broader global regulatory objective of greater cross-border cooperation and coordination in supervision. In Canada, banks are regulated and supervised at the federal level by the Office of the Superintendent of Financial Institutions (OSFI) on a consolidated basis. This framework for regulation and supervision allows Canadian banks to prudently deploy capital and liquidity in an efficient manner, in accordance with domestic and international standards, and according to a bank’s business model and strategy. Doing so provides strength to the consolidated entity and its component parts.

We believe that the Proposed Rule would limit the ability of some of the largest CBA members to deploy capital and liquidity efficiently and effectively, making global risk management and funding much more difficult to accomplish. Further, we are also concerned that this proposal could lead to similar initiatives in other jurisdictions in the future. We believe that the establishment of jurisdictional-specific requirements in multiple jurisdictions will lead to a more costly and less resilient global financial system. We do not believe this is something the international regulatory community wishes to see.

Bank of Canada Governor Mark Carney² has recently referred to the negative consequences of ring fencing the capital and liquidity of local entities within jurisdictions. “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 globally.”

Significant U.S. Operations

Several large Canadian banks have significant operations in the U.S. We believe this is beneficial to the Canadian banking system but also beneficial to the American system as well. Each of these banks bring a strong reputation, a strong capital base and good management practices, all overseen by a strong regulator within a robust supervisory framework. We believe this is exactly what American policymakers and regulators would like to see in their banking system.

² Remarks by Bank of Canada Governor Mark Carney: “Rebuilding Trust in Global Banking”, 7th Annual Thomas d’Aquino Lecture on Leadership - Lawrence National Centre for Policy and Management - Richard Ivey School of Business - Western University, February 25, 2013.

At the very least, these measures send the wrong signal. They cast a wide net over banks from outside the U.S. and fail to distinguish between those whose risk profiles could cause concern to the U.S. financial system and those that do not. The Proposed Rule needlessly raises the cost of operating in the U.S. for those banks which pose little risk. Further, the one size fits all approach will have a particularly negative impact on smaller institutions that just meet the thresholds. For those below the thresholds, this proposal could effectively be a barrier to expansion in the U.S.

Trapped Capital and Liquidity

The CBA's assessment of the Proposed Rule is that it would generally result in higher capital and liquidity requirements for the U.S. operations of Canadian banks. For some banks, it would require that pools of liquidity normally held within the home country, on a consolidated basis, would be required to be held within the U.S., thereby complicating risk management. There is also a strong concern that this capital and liquidity could be 'trapped' in the U.S., in the sense that there would be no certainty as to whether the Canadian bank parent would be able to repatriate this capital and liquidity during times of stress. We believe that such an outcome would be detrimental to the overall stability of Canadian banks, which in turn could have implications for those bank's operations in other jurisdictions.

Consolidated capital and liquidity levels may, in the end, be much greater than envisioned or even desired by global regulators, especially if other jurisdictions implement similar requirements and all banks are required to operate at the "gold standard" level adopted by each jurisdiction in which they operate. We believe that this development would not be consistent with the objectives of the Basel Committee, and as such, could have unforeseen supervisory and economic impacts.

Increased Capital Requirements for Large Canadian Banks

The Proposed Rule incorporates, in its early remediation triggers, a Basel III leverage ratio test on the consolidated FBO that is higher than the 3% Basel III minimum, in advance of the 2018 implementation date set by the Basel Accord. Canadian banks are currently required by OSFI to conform to a leverage test and will, in time, comply with the Basel III initial leverage ratio of 3%. We believe it would be inappropriate for the Federal Reserve to impose higher requirements on FBOs without appropriately calibrating such requirements to the jurisdictions on which they are imposing. We believe home country regulators, with track records of strong supervision, are in the best position to determine target capital ratios for an FBO.

Again, such an approach ignores the differences between historically prudently managed FBOs and those that are not.

Strong OSFI Regulation and Supervision

It is widely acknowledged that the Canadian banking sector performed relatively well during the global financial crisis in comparison to banking sectors in other jurisdictions. No Canadian bank was in danger of failing and no Canadian bank received a bailout. Due to prudent risk management practices at Canadian banks, and stringent regulation and supervision by OSFI, Canadian banks entered the global financial crisis well-capitalized and held adequate amounts of

liquidity. In addition, Canadian banks continued to be able to access various sources of funding during the crisis, unlike many of their international counterparts.

The Canadian banking sector is characterized as having a strong legislative, policy, regulatory and supervisory framework. OSFI often requires Canadian banks to exceed minimum international regulatory requirements, and in many cases, ahead of schedule. For example:

- at the request of OSFI, Canadian banks met the full Basel III common equity tier 1 capital requirements of 2019 as of January 1, 2013, forgoing the six-year transition period provided by the Basel Committee. Even prior to the financial crisis, for many years, OSFI required Canadian banks to hold tier 1 capital and total capital ratios that were materially above international minimum requirements (seven percent and ten percent, respectively, rather than the global minimums of four percent and eight percent).
- Canadian banks will adopt the Basel liquidity coverage ratio (LCR) in full by 2015, forgoing the four year phase in period.
- OSFI has also long required banks in Canada to operate within a leverage ratio (i.e., a maximum “assets-to-capital” multiple (ACM)).
- Canada already has large exposure limits in place that are comparable to those in the Proposed Rule.
- Canadian banks with significant operations in the U.S. have all been designated as domestic systemically important banks (D-SIBs) in Canada, and will be subject to more intensive supervision by OSFI.
- OSFI has had an ‘early intervention’ framework (akin to the proposed ‘early remediation’ approach in the Proposed Rule) for years. It is likely that OSFI would take its own actions immediately in response to any identified deficiencies in a Canadian bank.
- at the request of OSFI, the large Canadian banks have developed an extensive road-map to implement the recommendations of the FSB’s Enhanced Disclosure Task Force, well ahead of other jurisdictions. OSFI expects timely implementation and has made these disclosures a requirement for Canadian D-SIBs.
- Canada was an early adopter of Recovery and Resolution Plans (RRPs). Canadian D-SIBs have well-developed RRP’s and the trapping of capital and liquidity under the Proposed Rule would interfere with these plans.

These are just several examples of how Canadian banks have long been held to requirements of the highest order. We believe that the quality of the regulatory and supervisory framework in Canada is comparable to that in the U.S., and that the Proposed Rule should recognize this. Moreover, we believe it is important to foster a climate of cooperation amongst regulators who work closely together on a regular basis. This is important generally but it is particularly important in the Canada-U.S. context. We believe that context and the strong regulatory regime in Canada make mutual recognition an appropriate option.

Proposed Substituted Compliance Regime

The CBA believes that those banks that are regulated within strong home country frameworks and are early adopters of Basel III capital and liquidity guidelines should be distinguished from those that are not and that inherently create more risk to the U.S. financial system.

The CBA believes that the Federal Reserve should give strong consideration to incorporating a “substituted compliance” framework in the Proposed Rule, similar to what is currently being

discussed by some CBA members, OSFI, and the Commodity Futures Trading Commission for OTC Derivatives requirements. This framework would allow FBOs that are subject to a broadly equivalent regulatory and supervisory framework in their home country to be exempt from – or subject to less onerous provisions of - the Proposed Rule. Alternatively, we believe the Federal Reserve could institute a supervisory framework for FBOs where specific concerns with individual FBOs can be identified and supervisory requirements tailored for those individual FBOs to ensure U.S. financial stability concerns are addressed. This approach is expanded upon in the IIB and IIF submissions referenced earlier.

Further, the CBA believes the Federal Reserve should focus initially on those banks designated as G-SIBs. These banks present a majority of the risks for which the Federal Reserve is concerned, principally systemic risk.

The incorporation of a substituted compliance framework in the Proposed Rule would help meet the aim of the Federal Reserve to increase the stability of the U.S. financial system without raising the cost of operating in the U.S. for those banks which pose little risk.

Thank you for taking these comments into consideration. I would be pleased to discuss these issues further at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Campbell", written in a cursive style.