26 April 2013

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

Re: **Proposed Rule on Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies; Docket No. R–1438; RIN 7100 AD 86**

Ladies and Gentlemen:

The Global Financial Markets Association ("GFMA")[1] appreciates the opportunity to comment on the proposed rule issued by the Board of Governors of the Federal Reserve System ("Federal Reserve") on *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies.*[2] GFMA is an international financial trade association that includes financial institutions that are the largest participants in national and global banking and financial markets. These institutions, which nearly all conduct banking and other financial activities in the United States, will be directly or indirectly affected by the Federal Reserve's proposal.

GFMA recognizes that the profile of the US operations of some foreign banking organizations ("FBOs") has changed substantially in recent years and understands the Federal Reserve's concerns about the financial stability risks that global financial institutions can pose to host country financial systems.[3] However, GFMA believes that the proposed rule will exacerbate, rather than mitigate, these financial stability risks and harm the global economy. Specifically, the proposal would:

- Take the extraordinary step of "ring-fencing" capital and liquidity in the United States, making these resources extremely difficult to deploy to the FBO's operations experiencing stress in other countries—an action that will encourage countries around the world to ring-fence, which could lead to a truly balkanized global financial system;

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[1] The Global Financial Markets Association ("GFMA") brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. For more information on GFMA, please visit http://gfma.org/about/.

[2] 77 Fed. Reg. 76,628 (Dec. 28, 2012).

[3] *See id.* at 76,630.

- Impose the extraordinary ring-fencing requirement without taking into account—as expressly required by the Dodd-Frank Act[4]—the extent to which an FBO is subject to home country prudential standards that are comparable to US standards;

- Discriminate against the US subsidiaries of FBOs, in conflict with the longstanding US principle of "national treatment";

- Undercut substantial international efforts to develop credible cross-border resolution regimes as well as future international cooperation on financial policymaking;

- Interfere with foreign regulators' ability to supervise their own institutions;

- Require costly, overlapping, and potentially inconsistent compliance regimes between the US and home country regulators; and

- Increase the marginal cost of FBOs doing business in the US, which could cause some firms to exit the US market or not enter the US market in the first instance.

Accordingly, as discussed in more detail below, GFMA strongly urges substantial modifications of the proposed rule to eliminate its ring-fencing requirements and other provisions that would impede global cooperation in the supervision and resolution of FBOs.[5]

At the very least, such provisions should be subject to a quantitative impact study before they are included in any final rule. In addition, any overlapping regulatory burdens should be minimized, and the final rule should also provide for meaningful consultation, coordination, and input from home country supervisors before actions are taken against an FBO's US operations. Finally, if any portion of the proposal is implemented, the effective date of the final regulation should be harmonized with the effective dates of other recent or imminent proposals, such as proposed rules on capital, liquidity, and single counterparty credit limits; otherwise, piecemeal implementation will impose even greater compliance costs and may result in further confusion in the implementation of the various new US requirements applicable to FBOs.

I. The proposal's "ring-fencing" requirement would balkanize corporate structures, capital, and liquidity of FBOs operating in the US and encourage foreign governments to adopt similar ring-fencing approaches in their own jurisdictions.

The Federal Reserve's proposed rule would require a larger FBO operating in the US to form an intermediate holding company ("IHC") to own the FBO's US subsidiaries.[6] This new

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").

[5] We note that the types of concerns expressed in this letter are shared not just by financial institutions, but by foreign governments as well. *See, e.g.*, Letter from Michael Ambühl, State Secretary for International Financial Matters, Swiss Finance Department, Swiss Confederation to Neal Wolin, Deputy Secretary of the Treasury (April 23, 2013).

[6] The proposal requires FBOs with total consolidated assets of $50 billion or more and combined US assets (excluding assets of US branches and agencies) of $10 billion or more to establish a US IHC to hold assets of its non-branch US operations. 77 Fed. Reg. 76,680 (proposed 12 C.F.R. § 252.201(a)).

IHC would be subject to consolidated US bank holding company ("BHC") regulatory requirements—even if the IHC owned no US banks.[7] If implemented, this approach would "ring-fence" the IHC's capital and liquidity in the US so that they could not be effectively used in other countries.

The new IHC requirement would be a sharp departure from the Federal Reserve's longstanding US policy of promoting the efficient flow of capital in the global financial system by generally allowing an FBO flexibility to determine the best corporate structure for its US operations. This flexibility has long allowed an FBO to optimize its use of capital and liquidity in its worldwide operations—to deploy resources where they are most needed—just as US firms have enjoyed similar flexibility in other jurisdictions to optimize their own deployment of capital and liquidity. GFMA believes that the proposal's abrupt new change in policy to embrace ring-fencing—especially by a global leader like the United States whose actions are often emulated by other countries—will inevitably lead to greater balkanization of capital and liquidity around the world. That in turn will increase, not decrease, systemic risk.

For example, absent the IHC requirement, an FBO could quickly redirect excess capital from a healthy subsidiary in the US to a troubled subsidiary in another jurisdiction; this ability to direct the flow of funds would plainly allow the FBO to help weather periods of significant economic stress in other countries. If the IHC requirement were implemented, however, the Federal Reserve would have considerable authority over the capital structure of the IHC.[8] Such authority could pose a substantial regulatory roadblock to an FBO's ability to redirect excess capital trapped in the US but not needed for US operations. Private market participants, recognizing the increased risk posed by locally ring-fenced funds, would be less willing to provide capital to the parent FBO. As a result, a troubled subsidiary outside the US and the consolidated FBO could be more susceptible to confidence issues and even failure—with the potential for severe spillover stress and economic dislocations. Thus, the proposed balkanization of an FBO's corporate structure and capital would decrease the likelihood of eventual recovery during periods of stress and increase the likelihood of eventual resolution.

The proposed IHC requirement raises similar concerns regarding the effective deployment of an FBO's global liquidity. Indeed, interference with the quick movement of liquidity around the FBO's global operations raises the specter that local lenders of last resort will have to be called upon more frequently to provide emergency liquidity funding for an FBO's local operations. That is, such lender of last resort lending would be more likely to occur because excess liquidity trapped in the US (or in a jurisdiction adopting a similar measure, perhaps in retaliation for adoption of the current proposal), could not be redeployed rapidly to another jurisdiction where it is needed by the FBO to continue its operations.

More broadly, the proposed rule sends a message that the US government now believes that FBOs and foreign governments should no longer be trusted to provide adequate support for distressed operations in host jurisdictions. Such a unilateral signal from the United States, as a world leader, provides a strong incentive to other countries to take similar actions to

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[7] *See id.* at 76,635, 76,680 (proposed 12 C.F.R. § 252.201).

[8] *See, e.g.*, 12 C.F.R. §§ 225.4, 225.8.

ring-fence capital and liquidity in their own jurisdictions—measures that would impede efficient capital flows and the effective supervision and resolution of cross-border financial institutions. Mark Carney, Governor of the Bank of Canada and Chairman of the Financial Stability Board ("FSB"), recently highlighted these concerns: "[S]ome supervisors are moving to ensure that subsidiaries in their jurisdictions are resilient on a stand-alone basis. . . . Left unchecked, these trends could substantially decrease the efficiency of the global financial system. . . . [and] a more balkanized system that concentrates risk within national borders would reduce systemic resilience globally."[9]

GFMA recognizes that some countries other than the US are perceived to have taken similar steps towards ring-fencing capital and liquidity.[10] GFMA has the same strong concerns about ring-fencing wherever it occurs. As a result, we believe that the Federal Reserve should not respond to perceived ring-fencing actions by foreign authorities by advancing its own ring-fencing proposal. Instead, the Federal Reserve should lead an international effort to oppose ring-fencing actions in all jurisdictions. The US has long been a leader in the global economy and a champion for international cooperation in international financial policymaking. Its abrupt about-face toward preemptive ring-fencing will undercut that cooperation and provide "oxygen" for an international trend toward inward-focused supervision and resolution—which would lead to major disruptions in the global financial system rather than the cooperation, consistency, and stability that is clearly required.

II. The proposed rule contravenes the express mandate of the Dodd-Frank Act to account for home country consolidated supervision of FBOs.

In establishing enhanced prudential standards for an FBO, the Dodd-Frank Act expressly requires the Federal Reserve 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."[11] By imposing a "one-size-fits-all" requirement on all FBOs—especially the ring-fencing requirement—the proposed rule ignores this express statutory directive.

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[9] Remarks by Mark Carney to the Richard Ivey School of Business, Western University (Feb. 25, 2013), *available at* http://www.bis.org/review/r130226c.pdf. As Chairman of the Financial Stability Board, Governor Carney reiterated this sentiment in a recent letter to the G20: "We need to continue to re-build confidence in the long-term robustness of the global financial system and resist pressures to ring-fence national markets." Letter from Mark Carney, Chairman of the Financial Stability Board, to the G20 Ministers and Central Bank Governors (Apr. 15, 2013). And he went even further in later remarks, characterizing ring-fencing requirements as "supportive of an element of financial repression, because you are capturing assets within your home jurisdiction." Kate Davidson, *Carney Warns About Forcing Banks to Ring-Fence Their Foreign Operations*, POLITICO (Apr. 18, 2013) (quoting Mark Carney at an event hosted by Thomson Reuters at the National Press Club).

[10] For example, some have pointed to UK standards that ring-fence capital and liquidity. *See, e.g.*, Alex Barker & Tom Braithwaite, *EU Warns US on Bank 'Protectionism*,' FINANCIAL TIMES (Apr. 22, 2013); Balkanised Banking: The Great Unravelling, THE ECONOMIST (April 20, 2013). However, the UK standards are more flexible than the proposed IHC requirement and create incentives for cooperation between the UK and home country supervisors. *See, e.g.*, Financial Services Authority, Policy Statement 09/16, Strengthening Liquidity Standards 22 (Oct. 2009) ("In practice, we expect that many of the affected firms will apply for, and receive, modifications of the self-sufficiency requirement.").

[11] Dodd-Frank Act § 165(b)(2)(B) (codified at 12 U.S.C. § 5365(b)(2)(B)).

In addressing this statutory requirement, it is simply not sufficient to assert, as the proposal does, that "relying solely on home country implementation of the enhanced prudential standards would . . . present challenges" because "[s]everal of the Act's required enhanced prudential standards are not subject to international agreement."[12] Indeed, as the proposal itself recognizes, many of the enhanced prudential standards for larger FBOs are, in fact, subject to international agreements and are being implemented by home countries.[13] For example, the critically important enhanced standards for capital and liquidity for the largest firms are being adopted consistently and subject to international agreement by major countries around the world.[14] Likewise, the Basel Committee has recently proposed a supervisory framework to limit and control large credit exposures to address concentration risk with respect to individual counterparties[15]—a proposal that addresses the same concerns that the Federal Reserve seeks to address in its proposed enhanced prudential standard for single counterparty credit limits ("SCCL").[16] The FSB also recently found that "major legislative reforms have already been undertaken by some FSB jurisdictions . . . to develop new, or revise existing, resolution regimes," while other jurisdictions "are in the process of adopting those reforms to further strengthen their resolution regimes."[17] Although additional work needs to be done, the Federal Reserve is *required* by the Dodd-Frank Act to take the adoption of such enhanced prudential standards in other countries into account when applying US prudential standards to a particular FBO operating in the US, yet the proposal fails to do so.

III. The Federal Reserve's proposal discriminates against FBOs and is contrary to the longstanding US principle of "national treatment."

The Federal Reserve's proposed rule would impose US BHC capital requirements on the US IHC of an FBO.[18] As a result, the IHC would have to satisfy these requirements using only the capital held in its US subsidiaries; it could not draw on any excess capital held by its parent banking organization or by that organization's foreign subsidiaries. In contrast, a US BHC, in meeting the same US capital requirements, would be able to draw on excess capital held in its foreign subsidiaries. Thus, while the proposed rule purports to apply the same capital treatment to a

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[12] 77 Fed. Reg. 76,637.

[13] *See id.* at 76,639 ("The international regulatory community has made substantial progress on strengthening consolidated bank capital standards in response to the crisis."); *id.* at 76,661 ("The BCBS recently reviewed the implementation of these stress testing principles at its member countries and concluded that, while countries are in various stages of maturity in their implementation of the BCBS's principles, stress testing has become a key component of the supervisory assessment process as well as a tool for contingency planning and communication.").

[14] *See, e.g.*, Basel Committee on Banking Supervision, Report to G20 Finance Ministers and Central Bank Governors on Monitoring Implementation of Basel III Regulatory Reform (April 2013); Basel Committee on Banking Supervision, Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools (January 2013); Basel Committee on Banking Supervision, Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement (November 2011).

[15] Basel Committee on Banking Supervision, Consultative Document: Supervisory Framework for Measuring and Controlling Large Exposures (March 2013).

[16] *See* 77 Fed. Reg. 76,653.

[17] Financial Stability Board, Thematic Review on Resolution Regimes: Peer Review Report 8 (April 11, 2013).

[18] *See* 77 Fed. Reg. 76,681 (proposed 12 C.F.R. § 252.212).

BHC owned by a US company and an IHC owned by an FBO, its practical effect is plainly discriminatory: the capital requirement for the IHC would be substantially more restrictive.

Such discriminatory and disparate treatment of FBOs is contrary to the longstanding US principle of "national treatment," under which the US operations of an FBO are supposed to be subject to the same rules that apply to the US operations of US banking organizations. Indeed, the proposed treatment is fundamentally at odds with the express statutory provision in the International Banking Act that directs the Federal Reserve to regulate FBOs "in the same manner and to the same extent that bank holding companies" are regulated under the US Bank Holding Company Act.[19] Similarly, the proposed treatment of FBOs is inconsistent with the express requirement in Dodd-Frank to "give due regard to the principle of national treatment and equality of competitive opportunity."[20]

This discriminatory effect of the proposed rule is substantially magnified where all or a substantial majority of the assets of an FBO's US IHC is held in a securities broker-dealer subsidiary. Such an IHC-owned broker-dealer would effectively be required to hold substantially more capital under the US BHC capital rules than under the US Securities and Exchange Commission ("SEC") net capital rule applicable to all US broker-dealers. For example, if the only or most substantial US subsidiary owned by the IHC were a US broker-dealer, then that broker-dealer would be required to meet the US BHC's minimum required capital and leverage ratios—even if the resulting required capital would be substantially higher than the amount required by the SEC's net capital rule, as would very likely be the case, especially due to the US leverage ratio requirement. In that context, the IHC could not count excess capital held by its parent FBO, whether in its own banking operations or in other non-US subsidiaries, to offset any shortfall between the net capital required under the SEC rule for the broker-dealer and the minimum capital required for the IHC. In essence, the higher US BHC capital requirements would supersede the lower SEC capital requirement. In contrast, a US BHC that owns a US broker-dealer can meet that same type of shortfall by drawing on the excess capital of all its other, worldwide subsidiaries, including its US bank subsidiary; in that case, the US BHC capital requirements would *not* supersede the SEC capital requirement for the broker-dealer subsidiary.[21]

Moreover, by effectively imposing US BHC capital requirements on IHC-owned broker-dealers, the Federal Reserve's proposal is at odds with section 5(c)(3) of the Bank Holding Company Act, which prohibits the Federal Reserve from imposing "rules, guidelines, standards, or requirements on any functionally regulated subsidiary of a bank holding company," including a securities broker-dealer.[22] Where the sole or predominant asset of an IHC is a broker-dealer

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[19] 12 U.S.C. § 3106(a).

[20] Dodd-Frank Act § 165(b)(2)(A) (codified at 12 U.S.C. § 5365(b)(2)(A)).

[21] The fact that the BHC leverage ratio capital requirement would often result in higher required capital for a US broker-dealer than the SEC's net capital rule in no way reflects a deficiency in the SEC's regulatory capital regime. Instead, the SEC's rule, which is crafted to reflect the relative liquidity and marked-to-market value of assets held in the broker-dealer, is much better tailored to the particular risks involved with securities positions. The BHC leverage ratio is not so tailored and by definition does not take into account the relative riskiness of particular securities positions. In any event, to the extent that there are concerns about the adequacy of SEC capital rules, these should be addressed by the SEC for all broker-dealers, not just those owned by FBOs.

[22] 12 U.S.C. § 1844(c)(3)(A), (c)(5)(B)(i).

subsidiary, the Federal Reserve's proposal would effectively be imposing on the broker-dealer subsidiary exactly the type of capital requirement that section 5(c)(3) expressly proscribes.

With regard to liquidity, the proposal requires an FBO to maintain separate liquidity buffers for its US branches and its IHC, while a US BHC would be subject to only one consolidated liquidity requirement for its global combined operations. Thus, a US BHC could take account of collateral, offsets, funding or other support from its non-US operations to comply with the proposal, while an FBO's IHC could not. Again, this result is plainly at odds with the national treatment principle. In addition, the proposal does not automatically permit an FBO to count home country sovereign debt as a highly liquid asset for purposes of the liquidity buffer,[23] as would be the case under home country rules. By contrast, US sovereign debt automatically qualifies as a highly liquid asset (even though it may have a lower credit rating than other sovereigns),[24] thereby potentially providing US BHCs with an advantage relative to an FBO that may specialize in and hold an inventory of home country sovereign debt. This, too, is discriminatory.

Finally, the SCCL included as an enhanced prudential standard in a separate Federal Reserve proposed regulation, which would apply both to US BHCs and to IHCs, would likely be much more restrictive for IHCs: because an IHC is likely to be much smaller than competitor US BHCs, the SCCL applicable to the IHC is likely to be much smaller as well—and therefore more restrictive.[25] In addition, if an IHC's SCCL to a particular counterparty became binding, the IHC's parent FBO would be subject to a cross-trigger provision that would prevent lending by any of the FBO's combined US operations, including the FBO's US branch.[26] This requirement has the potential to subject the combined US operations of an FBO to a more stringent SCCL than its US BHC competitors.

IV. The Federal Reserve's unilateral proposal to ring-fence capital and liquidity is at odds with efforts by both US and foreign governments to develop credible cross-border resolution regimes, which depend fundamentally on trust and cooperation.

By ring-fencing capital and liquidity within the US, the Federal Reserve's proposal implicitly appears to assume that the US cannot rely on cross-border multilateral or bilateral cooperation with respect to the cross-border resolution of failed financial institutions. This assumption is unwarranted given the significant progress achieved in the past few years among the US, UK, Europe, and other G-20 countries to develop a robust framework for cross-border resolution. Effective cross-border resolution regimes rely fundamentally on international cooperation, information exchange, and trust—both before and during a resolution.[27] In fact,

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[23] *See* 77 Fed. Reg. 76,682 (proposed 12 C.F.R. § 252.220).

[24] *See id.*

[25] *See id.* at 76,690 (proposed 12 C.F.R. § 252.242).

[26] *See id.* at 76,693 (proposed 12 C.F.R. § 252.245(c)).

[27] *See, e.g.*, Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions* 3 (Oct. 2011) (providing that an effective resolution regime should "provide a mandate in law for cooperation, information exchange and coordination domestically and with relevant foreign resolution authorities before and during a resolution"); International Monetary Fund, *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination* 5 (June 11,

"recent experience demonstrates that the more interconnected and integrated international financial institutions become, the more disruptive and value-destroying uncoordinated local resolution actions are likely to be."[28]

For instance, in the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, the FSB identified resolution planning and institution-specific cross-border cooperation agreements ("COAGs") as a key way to address the risks of foreign firms failing in a host jurisdiction.[29] In particular, as part of these COAGs, home and host jurisdictions should "duly consider[] the potential impact of their resolution actions on the financial stability of other jurisdictions" and "share all relevant information . . . to ensure that the plans are consistent and help prepare for a coordinated resolution of the whole firm."[30] Likewise, the Federal Deposit Insurance Corporation ("FDIC") and Bank of England suggested in a recent joint paper that the "single point of entry" and "bail-in" approaches to resolution depend fundamentally on host country regulators *not* taking actions to ring-fence local operations of a foreign bank that fails.[31] Instead, in the context of single point of entry or bail-in resolutions, host country regulators should be able to rely on and trust the home country regulator to take steps to ensure that the resolution process results in necessary capital and liquidity flowing to local operations in the host jurisdiction.[32] Indeed, "[f]urther progress on these cross-border challenges will require significant coordination among U.S. regulators and the key foreign central banks and supervisors for the largest financial firms."[33]

This is not to say, however, that "multiple point of entry" resolutions, where distressed subsidiaries in host jurisdictions are allowed to fail and be resolved under host jurisdiction insolvency regimes, are inappropriate. To the contrary, where organizations choose *voluntarily* to operate in multiple jurisdictions through subsidiaries, multiple point of entry may be the resolution approach that is most appropriate. GFMA strongly believes, however, that *mandatory* subsidiarization and regulatory ring-fencing of capital and liquidity is not appropriate.

In this context, rather than building on recent substantial international efforts to address cross-border failures and resolutions, the Federal Reserve's proposal appears to undercut

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2010) ("[A] resolution framework will be ineffective unless it is accompanied by a robust cross-border coordination mechanism.").

[28] International Monetary Fund, *Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination* 12 (June 11, 2010).

[29] *See* FSB, *Key Attributes*, at 14–15, Annex 1.

[30] *Id.* at Annex 1 ¶¶ 3.2 & 3.3.

[31] *See* Bank of England & Federal Deposit Insurance Corporation, *Resolving Globally Active, Systemically Important, Financial Institutions: A Joint Paper* (Dec. 10, 2012).

[32] *See, e.g.*, European Commission, *Proposal for a Directive of the European Parliament and of the Council*, 2012/0150 (COD) 12, n. 15 (June 6, 2012) (noting in the proposal to establish a comprehensive EU framework for the recovery and resolution of financial institutions that "a tool consisting in the ring fencing of an institution would not be compatible with the framework").

[33] Speech by Jerome H Powell, Member of the Board of Governors of the Federal Reserve System, to the Institute of International Bankers 2013 Washington Conference (March 4, 2013), *available at* http://www.bis.org/review/r130305b.pdf.

existing arrangements and understandings. By unilaterally and preemptively ring-fencing local operations in advance of resolutions, the proposal sends the strong message that the US does not trust foreign governments and FBOs to cooperate and provide support to US operations in times of stress. That message is plainly at cross purposes with the type of multilateral cooperation that is widely recognized as essential to effective cross-border resolution.[34] It also weakens the incentive for other countries to achieve multilateral and bilateral cross-border resolution regimes, and importantly, weakens the incentive for other countries to implement the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*. Indeed, the proposed rule could have the effect of encouraging foreign governments and their banks *not* to support the US subsidiaries of FBOs because it signals that the US has preemptively trapped all the capital and liquidity it will need in the context of a resolution. In short, by unilaterally imposing a ring-fencing regime based on a prediction that cross-border resolution regimes will not work, the proposed rule could undercut the very type of international coordination *necessary* for such regimes to work—thereby potentially having the perverse effect of making the prediction a self-fulfilling prophecy.

In addition, the FBO proposal is premature given the substantial reforms that international regulators already have adopted to increase bank safety and soundness, reduce the likelihood of the failure of systemically important financial institutions, and enhance resolution regimes.[35] For instance, the Basel III Framework significantly strengthens the quality of capital, raises minimum capital ratios, requires a new leverage ratio, imposes several additional capital buffers, and introduces liquidity requirements for large, internationally active banks.[36] Likewise, a number of governments have taken substantial actions to implement robust resolution regimes to handle the failure of systemically important financial institutions, consistent with the FSB's guidelines.[37] Taken together, these measures should increase domestic and foreign banking organizations' loss absorbency and resiliency; significantly reduce the risk of bank failure; and enhance the effectiveness of cross-border resolution. They should also bolster governments' confidence and trust in the effectiveness of supervisory and resolution regimes of one another. In this context, where so much international progress is being made, unilateral ring-fencing proposals would constitute substantial steps backward, and will likely reduce the motivation for other jurisdictions to continue the difficult and important work required to progress toward a unified approach to resolution.

V. The proposal's early remediation triggers would interfere with foreign regulators' ability to supervise their own institutions and require unilaterally higher requirements than internationally agreed Basel standards.

Historically, the Federal Reserve's regulation of FBOs has been primarily focused on the FBO's US operations. Unfortunately, the proposed rule sharply breaks with this precedent. Specifically, the proposal's remediation requirements can be triggered based on a decline in capital by the consolidated capital of the FBO as a whole—*even where the FBO continues to exceed the consolidated*

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[34] *See supra* note 27.

[35] *See, e.g.*, Letter from Mark Carney, Chairman of the Financial Stability Board, to G20 Financial Ministers and Central Bank Governors (April 16, 2012).

[36] *See supra* note 13 & 14.

[37] *See supra* note 17.

capital requirements of its home country. For example, if an FBO's leverage ratio were less than 75–125 basis points *above* the home country's minimum leverage ratio capital requirement, then the Federal Reserve could impose substantial remediation actions on the US operations of the FBO even where the home country had decided not to pursue remedial action against the FBO.[38] This proposed unilateral imposition of remedial requirements based on home country capital levels—without required consultation with home country supervisors—would constitute a disturbing degree of extraterritorial regulation that would surely cause needless friction with supervisors and governments outside the US.

GFMA recommends either that incorporation of the FBO's home country requirements into the FBO's remediation triggers be dropped from the final rule, or that such triggers not be effective until and unless the FBO's home country regulator has had an opportunity to object to the Federal Reserve's actions against the FBO. If the FBO's home country objects, the Federal Reserve should undertake good faith discussions with the FBO's home country regulator to develop a consensus plan for remediation of the FBO's US operations.

VI. Compliance with the proposal will needlessly result in hundreds of millions of dollars spent on overlapping systems and compliance regimes to implement the same global standards adopted by the Basel Committee.

Under the proposal, US branches of an FBO would sensibly remain subject to only those Basel capital requirements imposed by its home country on its global operations, including its US operations. As a result, the FBO's US branch would need to incur the systems and compliance costs necessary to satisfy its home country's particular capital regulation regime, but it would not need to also incur the substantial additional compliance costs of separately complying with the US's different regime for implementing the same global standard.

Unfortunately, the proposed rule adopts an entirely different approach with respect to any IHC that is required to be established. There, the IHC would still need to comply with the consolidated capital requirements implementing the Basel Committee standards that are imposed on its parent FBO by the FBO's home country supervisor. In addition the IHC would need to comply with the full panoply of US capital requirements that apply to US BHCs. While these US BHC requirements are intended to implement the very same Basel Committee standards, they do so in some fundamentally different ways than approaches taken in other countries. As a result, the proposed rule would require an FBO with an IHC to develop new models, adopt new systems, and hire new personnel to comply with the additional US regulatory requirements. In many cases these extra measures would require significant time and very substantial additional resources to implement, even though the US standards fundamentally overlap with those of other countries.

For example, an FBO's IHC subject to the Advanced Approaches of the Basel Accords would be required to comply with the exceptionally detailed but different qualification requirements and implementation regimes of both its home country and the US regarding model approvals, reporting, systems, and many other requirements. Such an IHC would additionally need to comply with the US Standardized Approach, even though the proposed US version of this capital

[38] *See, e.g.*, 77 Fed. Reg. 76,668, 76,701 (proposed 12 C.F.R. § 252.282(a)(1)(i)). This trigger would occur even when the FBO's US IHC did not otherwise independently trigger the Federal Reserve's remedial requirements.

standard differs considerably from the international standard (especially with respect to mortgages and credit ratings) and even though the Standardized Approach would not be required in its home country. Likewise, an IHC would need to comply with the US stress test and capital planning regime using US calculations for risk weights, not home country calculations.

These and other "extra" US requirements will be extremely costly for IHCs, and are unnecessary in light of the fact that the consolidated FBO is subject to consolidated requirements that are already designed to achieve compliance with the same global capital standards. Even if the final rule includes some version of the IHC proposal—and GFMA strongly believes it should not—significant modifications should be made to ease the compliance burden on FBOs that are subject to substantially similar requirements in their home countries. Indeed, such modifications would be fully consistent with the previously described Dodd-Frank provision *requiring* the Federal Reserve to take into account an FBO's home country standards when imposing enhanced US prudential requirements on the FBO's US operations.

VII. FBOs represent a substantial proportion of the US financial institutions market and discriminatory measures against them will increase their costs of doing business in the US in a way that could harm the US economy.

The US has long welcomed FBOs to the US financial marketplace. As a result, FBOs hold over 20 percent of all bank assets in the US,[39] and foreign-owned banks hold over half of all reserves at Federal Reserve Banks.[40] As discussed above in section VI, the proposed rule would substantially increase FBOs' US compliance costs through overlapping—and potentially inconsistent—regulatory requirements. If the rule is adopted as proposed, FBOs would be forced to assess whether the benefits of operating in the US outweigh these substantial compliance costs. Thus, at the margin, the Federal Reserve's proposal could discourage FBOs from establishing initial branches or agencies in the US so as not to become subject to the proposal's substantial new restrictions.[41] Moreover, FBOs with a significant nonbanking presence in the US but a limited banking presence may be encouraged to end their US banking presence in order to avoid the proposed rule's extra restrictions on the FBO's nonbanking activities that do not apply to their US competitors.[42] Such a result would lead to increased concentration of the US banking market.

The proposal would also lead to significant inefficiencies in the allocation of capital and liquidity and drive up costs, the impact of which would fall, at least in part, on end-users and customers, with negative consequences for economic growth. To the extent that the proposal is

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[39] William Goulding & Daniel E. Nolle, Board of Governors of the Federal Reserve System, *Foreign Banks in the U.S.: A Primer*, International Finance Discussion Papers No. 1064r, Fig. 1 (Nov. 2012) (data as of the third quarter of 2011).

[40] *Id.* at 15–16 & Fig. 8 (data as of the third quarter of 2011).

[41] *See, e.g.*, Balkanised Banking: The Great Unravelling, THE ECONOMIST (April 20, 2013) (citing a recent report by Oliver Wyman and Morgan Stanley finding that subsidiarization rules could trim return on equity for international banks by two to three percent, which might lead banks to reduce cross-border activities).

[42] *See, e.g.*, Remarks by Timothy Lane, Deputy Governor of the Bank of Canada to the Weatherhead Center for International Affairs, Harvard University (Feb. 11, 2013), *available at* http://www.bis.org/review/r130212e.pdf ("To the extent that conflicting, duplicate, and/or extra-territorial regulations make cross-border activity disproportionately costly, they may create incentives for financial institutions to concentrate their activities in their own jurisdictions.").

emulated in other jurisdictions, this negative impact on economic growth would be multiplied. Moreover, to the extent that each FBO holds in excess of the minimum capital and liquidity in local jurisdictions imposing ring-fencing requirements akin to the Federal Reserve's proposal, it may result in significantly higher *de facto* capital requirements than were ever intended by the Basel Committee or US regulators. If FBOs "have to build up substantially more capital and substantially more liquidity . . . it will come at a cost, in terms of the cost of capital and availability of capital, [and] the ease of cross-border finance."[43] For these reasons, as described below in section VIII, the Federal Reserve should conduct a thorough impact study of the consequences of the proposal if it chooses to proceed with the ring-fencing requirement.

Finally, while undoubtedly not intended, the proposal appears antithetical to the US government's historically strong commitment to global free trade in goods and services. The global economy is inextricably linked through free trade agreements as a result of this strong commitment. By establishing barriers in the underlying market for financial intermediation, the proposed rule has the potential to offset years of progress made by the US toward broader economic cooperation with foreign governments and trading partners. It could also harm the US jobs market, impair financial intermediation, and reduce competition and choices for US customers and counterparties of foreign banks.[44]

GFMA therefore believes it is critical for the US to continue to promote and adhere to principles of international cooperation, including in the cross-border resolution context. For all of the reasons discussed above, adopting the rule as proposed would be fundamentally inconsistent with these principles.

VIII. Any final rule should be modified to eliminate the ring-fencing provisions; at the very least, the Federal Reserve should conduct an impact study to assess the effect of such provisions before they are adopted and should apply an appropriate transition period.

In any final rule, the counterproductive ring-fencing provisions should be eliminated. GFMA believes that the objectives of these provisions would be far better accomplished by enhanced focus on proposals that will improve the efficacy of international cooperation arrangements among home and host country regulators of FBOs. Such an approach would bolster the continued development of credible and coordinated resolution regimes, as evidenced by the recent and significant cooperative effort of the Bank of England and the FDIC.[45]

In the alternative, any ring-fencing proposal should be imposed only as a last resort. That is, the Federal Reserve should in the first instance enter into individually negotiated agreements with home country regulators that ensure adequate support by an FBO for its US operations; this course of action would be fully consistent with the Dodd-Frank requirement to take into account

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[43] Kate Davidson, *Carney Warns About Forcing Banks to Ring-Fence Their Foreign Operations*, POLITICO (April 18, 2013) (quoting Mark Carney at an event hosted by Thomson Reuters at the National Press Club).

[44] *See* Remarks by Timothy Lane, Deputy Governor of the Bank of Canada to the Weatherhead Center for International Affairs, Harvard University (Feb. 11, 2013), *available at* http://www.bis.org/review/r130212e.pdf ("[B]arriers to the movement of capital may carry a significant cost, in the form of lost economic efficiency and growth.").

[45] *See supra* section IV.

any comparable standards imposed by an FBO's home country regulator. Only if such efforts fail should the Federal Reserve have the authority to ring-fence the FBO's US operations.

In all events, if the Federal Reserve decides to proceed with the ring-fencing provisions as proposed, it should conduct a transparent quantitative impact study of their potential effect before including them in any final rule. Moreover, any final rule should allow FBOs the flexibility to adopt alternative IHC structures—whether or not in the form of multiple IHCs—so long as the desired levels of capital and liquidity are held in the US in support of US operating subsidiaries. Such an approach would preserve the objectives of the proposal while avoiding significant and unnecessary restructuring costs. Likewise, any final rule should minimize unnecessary and overlapping implementation burdens of FBOs subject to similar home country requirements. It should also provide for meaningful consultation, coordination, and input from home country supervisors before actions are taken against an FBO's US operations. Finally, before any final regulation becomes effective, it should provide for a transition period that is harmonized with the transition periods of other recent or imminent proposals, such as proposed rules on capital, liquidity, and single counterparty credit limits; otherwise, piecemeal implementation will impose even greater compliance costs and may result in further confusion in the implementation of the various new US requirements applicable to FBOs.

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GFMA appreciates this opportunity to comment on the Federal Reserve's proposal. If you have any questions, please contact the undersigned.

Sincerely,

Simon Lewis
CEO, GFMA