INSTITUTE OF INTERNATIONAL BANKERS

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Direct: (646) 213-1147
Facsimile: (212) 421-1119
Main: (212) 421-1611
www.iib.org

Sarah A. Miller
Chief Executive Officer
E-mail: smiller@iib.org

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regs.comments@federalreserve.gov

Ann E. Misback
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Dear Ms. Misback:

Re: Large Financial Institution Rating System; Regulations K and LL (Docket No. R-1569)

Dear Ms. Misback:

The Institute of International Bankers ("IIB") appreciates the opportunity to comment on the Federal Reserve Board's ("FRB") proposal to adopt a new rating system for its supervision of large financial institutions ("LFIs").[1] As discussed in the Proposal, the LFI Rating System is designed, among other things, to fully align with the FRB's current LFI Supervision Framework, and it would replace the RFI Rating System for evaluating LFIs. The Proposal would have a significant impact on covered institutions, both top-tier, U.S.-headquartered bank holding companies ("U.S. BHCs") and foreign banking organizations ("FBOs").

Our comments focus on aspects of the Proposal that are specific to FBOs and highlight the many uncertainties that are presented for them. As discussed below, we recommend that the FRB (i) consider the governance component of the Proposal, together with the integrally related BE Guidance and Management Proposals, holistically in order to provide FBOs full opportunity to analyze and comment on the proposals together, including their interrelationships, and (ii) finalize the three proposals (or, as appropriate, components thereof) concurrently.

Under the Proposal, an LFI's ratings would consist of three components – capital planning and positions, liquidity risk management and positions, and governance and controls.

[1] 82 Fed. Reg. 39049 (Aug. 17, 2017) (the "Proposal"). Capitalized terms in this letter have the meanings ascribed in the Proposal except as otherwise noted or required by the context.

Each component would be rated separately under a new four-category ratings scale, and there would be no standalone composite rating. To qualify as "well managed" for various other regulatory purposes, including eligibility to operate as a financial holding company ("FHC") under the Bank Holding Company Act, an LFI would be required to maintain for each of the LFI Rating System components a rating in one of the top two categories ("Satisfactory" or "Satisfactory Watch") – that is, a rating of "Deficient-1" or "Deficient-2" in any of the three components would preclude an LFI from being considered well managed, even if it were top-rated on each of the other two components.

The Governance and Controls component is intended to evaluate the effectiveness of an LFI's board of directors and management.[2] These assessments would be made based on the principles set forth in the FRB's "Proposed Guidance on Supervisory Expectation for Boards of Directors" (the "BE Guidance Proposal")[3] and its proposed guidance describing core principles of effective senior management, the management of business lines, and the independent risk management and controls for LFIs (the "Management Proposal" and such guidance, the "Management Guidance").[4]

The LFI Rating System is characterized as a "natural next step" in the build-out of the LFI Supervision Framework, and the transition to the new system accordingly is intended to be evolutionary and routine in most respects for affected firms. As stated in the Proposal, the FRB plans to assign initial LFI ratings to all "applicable firms" during 2018. However, owing to differences in the timing of supervisory cycles across the portfolios that comprise the LFI supervisory program, firms in one portfolio may receive their initial LFI ratings at different times during the year than firms in another portfolio. The Proposal explains that "if the LFI rating system is finalized before the additional governance and controls guidance is finalized, firms

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[2] U.S. BHCs that are part of the FRB's Large Institution Supervision Coordinating Committee ("LISCC") program also would be evaluated under the Governance and Controls component on the effectiveness of their resolution planning. FBOs, whether or not part of the LISCC program, would not be evaluated on the effectiveness of their resolution planning. We agree it is not necessary to include evaluation of resolution planning in the evaluation of FBOs' Governance and Controls, and we would add that it should not be incorporated into any Governance and Controls assessment of any FBO without prior notice and opportunity for public comment.

[3] 82 Fed. Reg. 37219 (Aug. 9, 2017). Today, the IIB submitted a letter addressing the IHC aspects of the BE Guidance Proposal (the "BE Guidance Letter").

[4] 83 Fed. Reg. 1351 (Jan. 11, 2018). The constituent parts of the Management Proposal were summarized in the LFI Rating Proposal ("the Proposal"), but not formally proposed at that time. This part of the Proposal was described as applicable only to domestic LFIs, although it was noted that "[a]djustments to extend applicability of this guidance to the U.S. operations of FBOs may be made prior to issuing the guidance for public comment" (quoting 82 Fed. Reg. at 39053, footnote 26). As formally proposed for comment several months after the Proposal, the Management Proposal applies to not only domestic LFIs, but also the combined U.S. operations of FBOs with combined U.S. assets of $50 billion or more (*i.e.*, those FBOs which are subject to the LFI Supervisory Framework).

would be evaluated using existing supervisory guidance until such time that the additional governance and controls guidance is finalized" (quoting 82 Fed. Reg. at 39053).

The IIB and its members support the FRB's goal of aligning the LFI Ratings System with the LFI Supervision Framework. We agree that aligning the two could benefit efficiency. We further support a ratings approach that is tied to objective criteria and focuses on firms' safety and soundness, promotes U.S. financial stability, and enhances the clarity and consistency of supervisory assessments and communication of supervisory findings and implications. We encourage further efforts in this direction, with the ultimate goal of achieving a clarified and even more robust focus on firms' strong financial condition and the oversight of risks to financial stability they may present, bearing in mind at all times, and with appropriate weight given to, the importance of compliance with laws and regulations.

Our comments below focus principally on the considerable uncertainty regarding the timing and scope of the application of the LFI Rating System to FBOs and especially the importance of clarifying the application of the Governance and Controls component. By comparison to FBOs, the application of the Governance and Controls component to U.S. BHCs, both LISCC firms and LBOs, is straightforward. This is not to say the Proposal raises no issues for these firms, but it is evident that both the proposed BE Guidance and Management Guidance have been developed with U.S. BHCs principally in mind, and they have been issued with respect to these firms as fully-developed proposals. By comparison, the BE Guidance Proposal does not apply to IHCs, pending the FRB's further consideration of how that guidance should be adapted for IHCs, and the Management Proposal's discussion of FBOs is presented from the perspective of adjusting the guidance for U.S. BHCs to take into account the fact that the combined U.S. operations of an FBO are part of a larger global organization, as opposed to an approach which deals directly and comprehensively with the unique aspects of FBOs' U.S. operations.

The prospect of rolling out the LFI Rating System to all "applicable firms" throughout 2018 magnifies the concerns prompted by these uncertainties, and the requirement that a firm have a sufficiently satisfactory rating for each of the three components in order to be considered well managed, and thus not face restrictions on commencement or expansion of certain activities (among other things), highlights the importance of clarifying supervisory expectations and adopting an appropriately deliberate approach to implementation.

Scope and Application of the Proposal

IHC FBOs and Other LFI FBOs. The Proposal seeks to fully align the FRB's rating system for LFIs with the LFI Supervision Framework. Just as the LFI Supervision Framework is not one-size-fits-all, but tailored to account for LISCC banks, "large and complex LFIs" and other non-LISCC banks, and for the thresholds for various enhanced prudential standards, so too the Proposal aims to be nuanced in the way it would apply to different firms. As regards FBOs, two approaches are being proposed. For those FBOs that are required to establish a U.S.

intermediate holding company ("IHC") pursuant to Regulation YY ("IHC FBOs"), the Proposal would apply outright to the IHCs. In addition, for all LFI FBOs, the FRB expects to use the LFI Rating System to inform future revisions to other supervisory rating systems used to assess the U.S. operations of FBOs,[5] and requests comments as to what specific issues to consider in this context.

The application to IHCs leaves open the question of how the FRB would consider the new ratings interacting with ratings for the combined U.S. operations ("CUSO") of IHC FBOs, as well as ratings for their U.S. branches and agencies on a standalone basis, both of which the Proposal leaves for future consideration. Moreover, the proposed elimination of a composite rating for IHCs does not address how an IHC FBO's CUSO would be assessed and how these assessments might affect an FBO's ability to commence new businesses or expand existing activities in the United States. Clarification on these matters is especially critical given the inclusion of CUSO as an integral part of the FBO regulatory regime established under Regulation YY.

These uncertainties in turn highlight broader concerns regarding the application of the new rating system to FBOs. As we address in our BE Guidance Letter, and will address as well in when we submit our comments on the Management Proposal, in adapting the new rating system to FBOs, it is essential to take an appropriately flexible approach that accounts for the structure of their U.S. operations, recognizes that those operations are conducted within the broader, global framework of banking organizations that are headquartered outside the United States, avoids prescribing standards for how they conduct and manage their non-U.S. activities, while at the same time providing for robust supervision of their U.S. activities.

<u>Capital and Liquidity Components.</u> The Proposal explains that the capital and liquidity components entail the application of existing regulatory requirements and supervisory processes, including, for the banks to which they are applicable, the Comprehensive Capital Analysis and Review ("CCAR") program, capital stress testing pursuant to Section 165 of the Dodd-Frank Act ("DFAST"), the liquidity coverage ratio ("LCR"), liquidity risk management requirements under Regulation YY and the Comprehensive Liquidity Analysis and Review program ("CLAR"). Where applicable, CCAR would "represent a material portion" of the work to be conducted for the relevant ratings pillar.[6] The components would be implemented in a manner that is "fully reflective of current supervisory practices and expectations."[7]

We strongly recommend that, when IHCs become subject to the capital and liquidity components, supervisory expectations be calibrated to give due regard to the relatively limited

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[5] See 82 Fed. Reg at 39050, footnote 4.

[6] See 82 Fed. Reg. at 39050.

[7] See 82 Fed. Reg. at 39052.

period of time during which they have been subject to these requirements and processes. For example, for some IHCs, 2018 is the first year in which they will be subject to both a full quantitative evaluation of their capital adequacy and a qualitative evaluation of their capital planning capabilities

BE Guidance. The dimensions of the Governance and Controls ratings component as applied to IHCs is less certain; the corresponding supervisory guidance is either still to be determined or is underdeveloped. Regarding the BE Guidance Proposal, and as discussed in our BE Guidance Letter, we agree with the exclusion of IHCs from the BE Guidance pending further consideration of how it should be refocused and adapted to the circumstances of IHCs as *intermediate*, U.S. subsidiaries of global banking organizations that are headquartered outside the United States. At the same time, and as discussed in the BE Guidance Letter, it is unclear how IHCs would be affected if the LFI Rating System went into effect *after* the adoption of final BE Guidance for U.S. BHCs, *but before* adoption of similar guidance with respect to IHCs.

Management Guidance. The Management Proposal applies to the combined U.S. operations of all FBOs within scope of the LFI Supervision Framework. Consistent with the intention to implement the LFI Rating System in 2018, the expectation is to finalize the Management Guidance for use in assigning initial ratings under that new rating system beginning in 2018. The Proposal explains that, for firms that would be subject to the Guidance but not subject to the proposed LFI Rating System – based on the considerations discussed above, this includes LFI FBOs that do not have an IHC – the Guidance would help inform the evaluation of the firm's overall safety and soundness and the effectiveness of its risk management practices.[8] For the benefit of these firms, it would be helpful to explain further how this process would operate in practice, how it might affect ratings, and whether it contemplates any material change from the level of current supervisory expectations.

More generally, we have identified several significant concerns and questions regarding the Management Proposal as it applies to both IHC FBOs and Non-IHC FBOs, which we are discussing with members and will address in our comments on that proposal. As it relates specifically to the LFI Rating System Proposal and IHCs, the Management Proposal raises the key question how IHCs would be rated under the Governance and Controls component when, in the best case under the timeline contemplated by the two proposals, the Management Guidance would be in place but the BE Guidance would not be finalized (and possibly might not yet have even been proposed). If only one of the two aspects of the Governance and Controls component were finalized, how would the assessment be made? If the assessment were based on existing supervisory guidance pending finalization of the BE Guidance, what would that mean in practice and what would be the implications for "well managed" determinations?

The foregoing considerations reinforce our overall concern that the process in place for the FBO-related aspects of all three proposals – the LFI Rating System, the BE Guidance and the

[8] See 83 Fed. Reg. at 1352, footnote 9.

Management Guidance – impedes the type of comprehensive and integrated input and assessment necessary to ensure the most effective implementation of the new rating system as applied to FBOs. As discussed in the separate letter we have submitted today, a copy of which is attached hereto, we recommend that the FRB adopt a holistic approach to all three proposals. Under this approach, as discussed in the BE Guidance Letter, the existing LFI Supervision Framework vis-à-vis governance would remain in place for IHCs during the interim period, and governance considerations relevant to the capital and liquidity components would be applied in a manner that ensures comparable treatment between IHCs and U.S. BHCs.

Implications for Other Supervisory Rating Systems Applicable to FBOs

We appreciate the FRB providing an opportunity for comment on specific issues it might consider when using the proposed LFI Rating System to inform future revisions to other supervisory rating systems used to assess the U.S. operations of FBOs.[9] The following considerations are of particular importance:

- In all instances, it is essential to remain mindful of the structural differences of U.S. branches and agencies of FBOs, as recognized in footnote 13 to SR letter 12-17.

  We do not believe the Proposal contemplates at the current time, or should require, reassessment or revision of the ROCA rating system, including the assignment of a combined ROCA rating. As discussed above, however, it is unclear how ROCA ratings would relate to ratings assigned under the LFI Rating System, including with regard to rating an FBO's combined U.S. operations.

- The relationship between ratings assigned under the LFI Rating System and an FBO's U.S. Composite Rating should be clarified.

  The discussion above addresses this consideration in the context of IHC FBOs' combined U.S. operations. Another context in which the impact of the Proposal should be considered and clarified is the proposed revisions to the PSR Policy. Specifically, the FRB proposes to revise Part II of the its PSR Policy to remove references to an FBO's SOSA rankings and FHC status as bases for determining the net debit cap and maximum daylight overdraft capacity of a U.S. branch or agency. In their place, the FRB proposes an approach based on an FBO's capital ratios as determined under home country standards. Specifically, an FBO whose home country adheres to the Basel Capital Accords would base its creditworthiness self-assessment on (i) its U.S. Composite Rating

[9] 82 Fed. Reg. at 39057 (Question 7). After giving effect to the elimination of the FBO Strength of Support Assessment ("SOSA") rankings in connection with finalizing the FRB's proposed modifications to the procedures for determining net debit caps and maximum daylight overdraft capacity of U.S. branches and agencies of FBOs under its Payment System Risk Policy (the "PSR Policy Proposal"), there are two primary U.S. rating systems applicable to FBOs: (i)) the branch and agency rating ("ROCA"); and (ii) the Combined U.S. Operations Rating (the "U.S. Composite Rating").

and (ii) the "prompt corrective action" designation that would apply to the FBO if it were subject to Regulation H. Neither the LFI Rating Proposal nor the PSR Policy Proposal addresses how the elimination of a composite rating under the LFI Rating System would affect these assessments, and thus the availability of intraday credit to U.S. branches.

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We appreciate your consideration of our comments. Please contact the undersigned if we can be of further assistance.

Sincerely,

Sarah A. Miller

Sarah A. Miller
Chief Executive Officer

INSTITUTE OF INTERNATIONAL BANKERS

ATTACHMENT TO THE FEBRUARY 15, 2018 IIB LETTER ON THE LARGE FINANCIAL INSTITUION RATING SYSTEM PROPOSAL (Docket No. R-1569)

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INSTITUTE OF INTERNATIONAL BANKERS

Sarah A. Miller
Chief Executive Officer
E-mail: smiller@iib.org

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Direct: (646) 213-1147
Facsimile: (212) 421-1119
Main: (212) 421-1611
www.iib.org

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regs.comments@federalreserve.gov

Ann E. Misback
Secretary
Michael S. Gibson
Director, Division of Banking Supervision and Regulation
Mark E. Van Der Weide
General Counsel
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Request for an Adjustment to the Timing and Method for Proposing and Adopting Guidance on Supervisory Expectations for Boards of Directors, a Large Financial Institution Rating System and Effective Senior Management and Risk Management

Dear Ms. Misback and Messrs, Gibson and Van Der Weide:

We are writing with a pressing concern regarding the way in which the Board has issued for comment its recent proposals (1) providing guidance on the Board's supervisory expectations for effective boards of directors (the "Board Effectiveness Proposal" and such guidance the "BE Guidance")),[1] (2) introducing a proposed new ratings system for large financial institutions, or "LFIs" (the "LFI Rating Proposal"),[2] and (3) proposing guidance describing core principles of effective senior management, the management of business lines, and independent risk management and controls for LFIs[3] (the "Management Proposal" and, together with the Board Effectiveness Proposal and the LFI Ratings Proposal, the "Proposals").

In short, the Board has provided a workable sequence and timing to review and comment comprehensively on the Proposals together as they apply to U.S.-headquartered bank holding companies ("U.S. BHCs"), but the same opportunity has not been provided with respect

1 82 Fed. Reg. 37219 (Aug. 9, 2017).

2 82 Fed. Reg. 39049 (Aug. 17, 2017).

3 83 Fed. Reg. 1351 (Jan. 11, 2018).

to the FBO-related aspects of the Proposals. We recommend below adjustments to the process to address this concern.

As the Board has recognized, the development of guidance for effective boards of directors, senior management, business line management, and independent risk management and controls for FBOs involves complexities not present for U.S. BHCs. These complexities chiefly stem from the fact that the U.S. operations of FBOs are part of global banking organizations, which themselves are subject to supervision and regulation by home country authorities on a consolidated basis, as well as home country corporate governance and other legal requirements. These considerations, coupled with the need to consider carefully and address directly and clearly the potential extraterritorial reach of the Board's oversight, call for a deliberate approach that gives FBOs meaningful opportunities to comment.

Last August, the Board published for comment the Board Effectiveness Proposal, which, it stated, would not apply to IHCs established pursuant to Regulation YY. Instead, the Board stated that it "anticipates proposing guidance on board effectiveness for IHCs at a later date"[4] and specifically requested comments on how the BE Guidance proposed for U.S. BHCs should be adapted to apply to IHC boards of directors. The IIB appreciates this measured approach, which will enable the Board the opportunity to develop guidance that appropriately and with due deliberation takes into account both the distinctive status of IHCs, vis-à-vis U.S. BHCs, as *intermediate* holding company subsidiaries of parent banks headquartered outside the United States and the particular governance challenges presented by vesting IHC boards with responsibility for their FBO's combined U.S. operations, which include U.S. branches that are not part of the IHC.

Today, the IIB submitted a letter addressing the IHC aspects of the Board Effectiveness Proposal (the "BE Guidance Letter"), and we look forward to commenting on a future proposal that is tailored specifically to the circumstances of IHCs. However, until that future guidance is proposed for comment, the IIB necessarily is unable to assess the Board Effectiveness component in relation to the LFI Rating Proposal and the Management Proposal.

In conjunction with issuance of the Board Effectiveness Proposal last August, the Board published the LFI Rating Proposal. In that Proposal, the Board indicated that the new LFI Rating System would apply to IHCs, but the Proposal left considerable uncertainty regarding how the Governance and Controls component of the new rating system would apply inasmuch as the Board at that time had not issued any guidance regarding how the two aspects of that component – Board Effectiveness and the management of core business lines and independent risk management and controls – would apply to IHCs. Today, the IIB submitted comments on the LFI Rating Proposal.

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4 82 Fed. Reg. at 37219, note 1.

Last month, however, the Board published for comment the Management Proposal, which, in contrast to the Board Effectiveness Proposal, applies to FBOs' combined U.S. operations (including their U.S. IHCs, as applicable). Yet the Management Proposal provides only limited explanation of how the proposed guidance would apply to FBOs and raises significant questions regarding what the Board intends. For example, the Management Proposal does not address how the Board's expectations of IHC boards of directors would relate to the expectations of senior management and an independent risk management function, since the Board has not yet published a Board Effectiveness proposal for IHCs. The IIB is consulting with its members on the Management Proposal and will submit comments on the Proposal.

The Board's most recent extension of the comment periods for the Board Effectiveness and LFI Rating Proposals has provided approximately 45 days to consider the relationships among those two proposals and the Management Proposal before the deadline for submitting comments on the first two. The review of the Proposals as they apply to U.S BHCs is based on fully-developed proposals designed specifically with the business models of these firms in mind. In contrast, as discussed above, the LFI Rating and Management Proposals do not comprehensively address how they apply to the specific circumstances of FBOs' U.S. operations, and the applicability of the BE Guidance to IHCs remains to be determined. We would respectfully submit that this process has not provided a sufficient opportunity to comment on the FBO-related aspects of the Proposals.

There is a straightforward way to address these concerns. The Board should, at a minimum:

- extend the comment period for the Management Proposal to end sixty days after the publication of a Board Effectiveness Proposal for IHCs.

However, we believe a more comprehensive response is called for to enable submission of meaningful comments on how all three Proposals should be adapted for FBOs, and thereby promote the Board's comprehensive assessment of the Proposals. In this context, the Board should:

- issue a Board Effectiveness Proposal for IHCs;

- issue a new Management Proposal for FBOs that specifically and comprehensively addresses the Board's expectations for FBOs in these areas, and allow comment on the governance component of the LFI Rating System in light of the FBO-specific proposals;[5] and

5 Ideally, the Board would issue a single proposal that covered all topics together as they relate to FBOs, but if the timing issues are addressed in the way we suggest then separate proposals would be workable.

- finalize all three proposals as applicable to FBOs together, with a single effective date.

Under this approach, and as we explain further in our BE Guidance Letter, once the LFI Rating Proposal is adopted in final form, the existing LFI supervision framework would remain in place for IHCs with respect to the governance component thereunder until the BE Guidance and Management Proposals, appropriately adapted for FBOs, are finalized.

The IIB looks forward to working with Board staff in the development of practical approaches to these issues that accomplish the Board's supervisory objectives. We would welcome the opportunity to meet with you and your colleagues to discuss our concerns. In the meantime, please contact the undersigned if we can be of further assistance.

Sincerely,

Sarah A. Miller

Sarah A. Miller
Chief Executive Officer