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Proposal and Comment Information

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On behalf of the Institute of International Bankers, please find the attached comments responding to Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations.

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August 14, 2025

By Electronic Mail

Ann E. Misback
Secretary
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20th Street and Constitution Avenue, N.W.
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Re: Proposed Revisions to the Large Financial Institution Rating System, with Comments on Potential Changes Relevant to Internationally Headquartered Financial Institutions (Docket No. OP-1868)

The Institute of International Bankers (the "IIB") respectfully submits this letter for consideration by the Board of Governors of the Federal Reserve System (the "FRB") regarding the FRB's proposed revisions to the Large Financial Institutions ("LFI") rating system (the "Proposal").[1]

The IIB represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. The IIB's members consist principally of international banks that operate branches, agencies, bank subsidiaries and broker-dealer subsidiaries in the United States. Several of the IIB's members have subsidiary intermediate holding companies ("IHCs") that are evaluated under the LFI rating system.

The IIB strongly supports the FRB's proposed revisions to the LFI rating system outlined in the Proposal. If adopted as proposed, the changes would increase transparency and predictability of the LFI ratings system and would mitigate the current disproportionate effects of a single Deficient-1 component rating (typically the governance and controls component) on "well managed" status. Especially in light of the implications of a loss of "well managed" status, including the imposition of restrictions on non-banking activities and investments under Section 4(m) of the Bank Holding Company Act (the "BHCA"), the IIB views reforms to the LFI rating system (and other ratings frameworks, as noted below) as an urgent policy priority for the FRB.

The IIB agrees with and supports the comments and analysis in the letter submitted by the Bank Policy Institute and the American Bankers Association regarding the

[1] Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, 90 Fed. Reg. 31641 (July 15, 2025).

Proposal (the "BPI-ABA Letter"), including the BPI-ABA Letter's focus on the negative consequences for banking organizations that flow from ratings downgrades in the LFI framework. In response to Question 6 in the Proposal,[2] the IIB also agrees with BPI and the ABA that the FRB should, as soon as possible, propose and adopt changes to the RFI/C(D) ratings and CAMELS ratings to further implement the policy objectives of the Proposal (including, in the case of the latter, eliminating or modifying the current "management" component).

The IIB writes separately to address two additional topics of importance to internationally headquartered financial institutions. The first is the need for changes to the ROCA and Combined U.S. Operations ("CUSO") ratings systems that apply to the U.S. branches and operations of foreign banking organizations ("FBOs"), which are both mentioned in Question 6 in the Proposal.[3] These changes are necessary to align with the policy judgments in the Proposal and to ensure national treatment for FBOs, as CUSO and ROCA ratings downgrades have had the same negative consequences for FBOs as ratings downgrades in the LFI framework The second is the need to make the definition of "well managed" for purposes of determining the eligibility of an FBO for status as a financial holding company ("FHC") under the Gramm-Leach-Bliley Act ("GLBA") amendments to the BHCA more transparent, understandable and predictable. In the last part of our letter, we identify a number of other changes that would improve the bank supervisory framework and approach to examination ratings.

1. Comparable Changes to the ROCA and CUSO Ratings System

FBOs with U.S. branches currently receive a composite ROCA rating, with component ratings for Risk Management, Operational Controls, Compliance, and Asset Quality, for each of their U.S. branches. For FBOs with more than one branch, the FBO also receives a combined ROCA rating for all of the branch offices on an aggregated basis.[4] In addition, so-called multi-office FBOs receive a separate CUSO rating covering U.S. branch offices and U.S. nonbank subsidiaries.[5] These ratings are distinct from an LFI rating for an IHC subsidiary of an FBO (or an RFI/C(D) rating for a subsidiary bank holding company ("BHC") that qualifies for that framework), and a CAMELS rating for a subsidiary depository institution.

As discussed in Part 2 below, FRB staff has taken the position that, in order for an FBO to qualify as an FHC, its "well managed" status depends on having a combined ROCA rating of 2 or better and a CUSO rating of 2 or better.[6] This means that both ratings define

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2 See Proposal, 90 Fed. Reg. at 31646.

3 See id.

4 See, e.g., Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations, SR 00-14 (SUP), Oct. 23, 2000, Revised Oct. 1, 2020, including Attachment ("SR 00-14").

5 See id; see also Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations, SR 08-9, Oct. 16, 2008, Revised Oct. 1, 2020, including Attachment B.2.

6 See Proposal, 90 Fed. Reg. at 31648. For FBOs that have a depository institution subsidiary, the subsidiary also needs to be "well managed" with a CAMELS rating of 2 or better, and for FBOs with a BHC

"well managed" status for an FBO, and both ratings therefore play a pivotal role in matters such as being able to make acquisitions and investments in reliance on an FBO's status as an FHC.

ROCA ratings are, with the exception of the asset quality component, focused on risk and controls, and in practice have been evaluated based on policies, procedures and risk management infrastructure, and less on financial condition. The definitions of the ROCA components illustrate clearly how the focus of ROCA ratings is overwhelmingly on non-financial risks.[7] The current ROCA framework therefore results in a disconnect between ratings and financial condition. In addition, as in the current LFI framework for "well managed" status, deficiencies in a single component in the ROCA ratings can result in the downgrade of the composite ROCA rating, thereby resulting in an overall determination that an FBO is "not well-managed." The FRB's guidance on ROCA ratings specifically indicates that a combined rating of a 3 (which would result in the loss of well-managed status) may be assigned when "risk management, operational controls, <u>or</u> compliance is <u>individually</u> viewed as unsatisfactory."[8]

ROCA rating downgrades have also typically been subject to the same types of "double-counting" or cross-component contamination effects as those described in the BPI-ABA Letter. If an examiner detects a deficiency in a branch's anti-money laundering program, for example (its policies and procedures, training, independent testing, etc.), this deficiency can in practice drive the "R," "O" and "C" components, leaving only the "A" rating as independently based on a consideration related to financial condition. This effect usually translates into a downgraded composite ROCA rating, even when it essentially involves a single compliance deficiency. Even the "A" rating is subject to this effect. Weaknesses in a branch's credit risk management systems can result in a downgrade of all four component ratings, even when the branch's assets are performing and the branch is in sound financial condition.[9]

The implications of this "double counting" effect, which leads to even greater emphasis on governance issues, are even more acute for ROCA ratings. This is because three-quarters (three out of the four) of the components focus on what corresponds to governance and controls, compared to one-third in the LFI rating, and one-fifth in the CAMELS rating. The consequence is that a single governance issue could cause poor component ratings in more than half of the ROCA component ratings, without offsetting consideration of financial condition.

The CUSO rating is similarly based overwhelmingly on non-financial risks, and a single compliance deficiency can and frequently does translate into a downgraded CUSO rating (which is given as a single rating, without separate component ratings). Thus, to the extent that the CUSO rating independently defines "well managed" status, it raises similar concerns as the

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subsidiary, the BHC needs to be "well managed" under the applicable LFI/RFI framework (and, by extension, an IHC needs to be "well managed" under the LFI framework).

7 <u>See</u> <u>SR 00-14</u>.

8 <u>Id., Attachment</u> at 14 (emphasis added).

9 In preparing this comment letter, the IIB neither solicited nor received confidential supervisory information. The IIB received general feedback from members about FRB ratings, and in some cases suggestions from outside counsel based on experience with FBO ratings (but not including any bank-specific information).

concerns articulated in the Proposal in relation to how "well managed" status is defined based on LFI ratings.

This inherent flaw in the CUSO rating (excessive focus on non-financial risks) is compounded by the generality and vagueness of CUSO rating standards. The CUSO rating is based on "an assessment of all risk factors, and (1) all elements of the ROCA rating system, (2) quality of risk management oversight employed by all levels of management in the FBO's U.S. operations, and (3) the examinations of all entities of the FBO conducted during the year."[10] The generality of this standard makes it even more likely that a single component (e.g., in the ROCA ratings, feeding into the CUSO rating) can determine a 3 CUSO rating. As in the case of ROCA ratings, the FRB's guidance on CUSO ratings specifically indicates that a combined rating of a 3 (which would result in the loss of well-managed status) may be assigned when "<u>either</u> risk management, operational controls, <u>or</u> compliance is <u>individually</u> viewed as unsatisfactory."[11] Because they are based on a higher level of generality across multiple underlying ratings systems, depending on how an FBO's U.S. operations are organized (ROCA, CAMELS, LFI/RFI), CUSO ratings are even less transparent and predictable, and they are more prone to disproportionate influence of non-financial risk issues.

These two features of the ROCA and CUSO ratings framework – excessive focus on non-financial risks/risk management, and the ability of a single component to determine the composite rating and resulting well-managed status – are inconsistent with the changes proposed for the LFI ratings-based "well managed" definition. We fully support the approach of the Proposal in addressing these fundamental concerns, and we urge the FRB as a next step and as a matter of priority to extend the policy judgments in the Proposal to the ROCA and CUSO ratings framework. In doing so, the FRB will also have an opportunity to make other improvements to the ROCA and CUSO ratings.

In our view, the FRB should:

1. At a minimum, amend its supervisory guidance applicable to the CUSO and ROCA ratings to remove the concept that any of risk management, operational controls, or compliance viewed individually can result in an unsatisfactory composite rating.

2. Issue guidance that increases transparency around how the single composite CUSO rating is operationalized to reflect the underlying entity ratings (e.g., LFI/RFI and ROCA). The current underlying entity ratings assess similar areas, but their methodologies are not uniform and it remains opaque how the underlying entity ratings are considered together in deriving the single composite CUSO rating.

3. Consider including liquidity as a component feature of FBO ratings, consistent with the prioritization of liquidity risk management in bank supervisory policy, especially since March 2023.

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[10] SR 00-14, Attachment at 11.

[11] <u>Id., Attachment</u> at 12 (emphasis added).

4. As a broader project, re-assess the entire FBO supervisory ratings model, including definitions and scope of ratings, in order to (a) simplify the ratings framework, (b) increase transparency and predictability, (c) adopt greater consistency across applicable FBO ratings, and (d) achieve a more balanced emphasis on financial risks and safety and soundness.

The first and second of these changes should be considered in parallel with the Proposal. The third change would appear to be an overdue revision to modernize FBO ratings. We recognize that the fourth suggestion would require additional time and consideration. The IIB and its members would be pleased to meet with the staff of the FRB to discuss specific concerns that could be addressed as part of this broader project.

The IIB also urges the FRB to propose and adopt, as soon as possible, comparable changes to the way in which FBOs are determined to be "well managed" to take into consideration the factors identified in this letter and the BPI-ABA Letter. The precise contours of those changes will need to be defined based on the differences between the ROCA/CUSO framework and the LFI framework. In the case of the ROCA and CUSO ratings, it will likely be necessary to revise the way the CUSO rating and the composite ROCA ratings are derived. The revised methodology would take into consideration, and appropriately balance, not only the risk and controls-related factors currently captured in the ratings but also the overall financial condition and potential effects on the safety and soundness of the branch, CUSO and potential effects on U.S. financial stability. It would be important for this revised composite rating methodology to be based on well-articulated analysis that is separate from, and not overly dependent on, any one or two component ratings. However, the IIB would welcome any proposal for comment that includes reforms to the way the current ROCA and CUSO ratings systems are used to define "well managed" status to align with the policy objectives outlined in the Proposal in relation to the LFI rating system.

Adopting comparable reforms for FBOs' "well managed" status based on ROCA and CUSO ratings is also compelled by the FRB's long-standing policy of national treatment and competitive equality for FBOs. It would be inconsistent with national treatment if a U.S. BHC, as a result of the changes in the Proposal, could remain "well managed" following a downgrade to Deficient-1 of the governance and controls rating (but not a downgrade to other ratings more focused on financial condition), while an FBO would lose "well managed" status based on a downgrade in its composite ROCA rating or its CUSO rating based on a controls deficiency (the typical scenario for a ROCA or CUSO rating downgrade).

In addition, for purposes of FHC status, which is arguably the most important implication of the "well managed" standard, the GLBA amendments to the BHCA specifically require that the FRB apply "comparable capital and management standards to a foreign bank that operates a branch … in the United States giving due regard to the principle of national treatment and equality of competitive opportunity."[12] Thus, adopting changes to the "well managed" standard for FBO FHCs that are comparable to the changes in the Proposal is not only consistent

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12 GLBA, Section 103, codified at 12 U.S.C. § 1843(l)(3). See 65 Fed. Reg. 3785, 3788 (Jan. 25, 2000) (interim rule) ("FBO FHC Interim Rule"); 66 Fed. Reg. 400, 408 (Jan. 3, 2001) (the "FHC Final Rule").

with the FRB's general policy of national treatment but also explicitly required by the BHCA for FBO FHCs.

2. Increased Transparency in the "Well Managed" Standard for FBOs

Since the passage of the Dodd-Frank Act, and more specifically since the effective date of Section 606 of the Dodd-Frank Act, the FRB's standards for determining an FBO's "well managed" status as it relates to FHC eligibility, has been notoriously opaque. The Proposal notes in passing in the Economic Analysis portion of the preamble that an FBO's "well managed" status is based on its ROCA and CUSO ratings.[13] However, this view is not reflected in the FRB's relevant regulation (Regulation Y) or any published supervisory guidance. In addition, in practice, the FRB and Reserve Banks have been inconsistent in their articulation of the role of ROCA and CUSO ratings in determining "well managed" status in connection with notices sent under Section 4(m) of the BHCA imposing restrictions on an FHC's non-banking activities and investments.

The FRB's regulatory definition of "well managed" for FBOs for purposes of FHC eligibility (in Regulation Y) is based on an FBO's combined ROCA rating.[14] This standard was adopted as part of the FRB's implementation of the GLBA,[15] which required the FRB to adopt definitions of "well capitalized" and "well managed" for FBOs comparable to the ones for U.S. banking organizations (as noted above). At the time, the FHC definition of "well managed" for U.S. BHCs was based on a BHC's subsidiary bank CAMELS rating. Thus, the FRB concluded that a comparable standard for FBOs would be based on branch ROCA ratings for FBOs.[16]

In 2010, Section 606 of the Dodd-Frank Act changed the definition of "well managed" for U.S. BHCs to be based not only on the BHC's subsidiary bank ratings but also on the ratings of the BHC itself. The IIB understands that FRB staff took the position that this statutory change for U.S. BHCs would mean that for FBOs, "well managed" status should be based not only on FBO ROCA ratings but also on FBO CUSO ratings.

The FRB did not amend its Regulation Y definition of "well managed" for FBOs (which implemented the GLBA in the FHC Final Rule) to reflect this interpretation, and FRB staff did not articulate it in a supervisory letter or, as far as we are aware, any other published guidance. FRB staff apparently took the view that the new standard was a self-implementing effect of Section 606 of the Dodd-Frank Act, effective as of the effective date of that provision.

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13 See Proposal, 90 Fed. Reg. at 31648.

14 See 12 C.F.R. § 225.90(c)(1). The definition also refers to needing to meet standards "comparable to those required of U.S. bank owned by [an FHC]." 12 C.F.R. § 225.90(c)(3).

15 See FBO FHC Interim Rule, 65 Fed. Reg. at 3788-89. The FBO FHC Interim Rule based the "well managed" test on each of an FBO's branch ROCA rating (requiring each branch to have a ROCA rating of 2 or better). In response to comments from the IIB and others, the determined revised this approach in the FHC Final Rule to base the standard on the FBO's combined ROCA rating. See FHC Final Rule, 66 Fed. Reg. at 409.

16 See FBO FHC Interim Rule, 65 Fed. Reg. at 3788-89; FHC Final Rule, 66 Fed. Reg. at 609.

While the reference in the Economic Analysis section of the Proposal to the well managed standard for FBOs (being based on CUSO and ROCA ratings) reflects this previously unpublished FRB staff view, and this interpretation is thus now public, in our view that reference is not sufficient to make the standard transparent and predictable. Ideally, the FRB would amend its Regulation Y definition to conform to staff's view of the standard. Alternatively, the Division of Supervision and Regulation could issue a supervisory letter articulating this view. At a minimum this view should be articulated and explained in the preamble to a relevant rulemaking. The reference to staff's position that a FBO's "well managed" status requires a satisfactory CUSO and ROCA rating in the Economic Analysis section of the Proposal will not be easy for FBOs or FRB and Reserve Bank staff to find. This issue is further compounded by the fact that this clarification is contained in a proposal that addresses the LFI rating system and not FBO standards.[17]

The consequences of losing "well managed" status can be important, including restrictions on an FHC's U.S. nonbanking activities and investments. Consequently, making the standard for "well managed" transparent, understandable and predictable should be a priority for the FRB. In parallel with the reforms to the ratings systems described above (related to the ROCA and CUSO ratings themselves and their role in defining "well managed"), we urge the FRB to publish its current view of how the relevant ratings determine well-managed status for FBO FHCs in a more readily accessible format.

3. Additional Changes

The IIB would also urge the FRB to consider additional reforms to the bank supervisory framework, which we believe would align with the policy priorities articulated in the Proposal.

a. *Transparency*. In our view, the bank examination process would benefit from greater transparency concerning priorities among areas of supervisory focus. FRB staff should articulate these priorities in advance, effectively sharing with supervised institutions the priorities that practically guide the examiners in their reviews. The FRB should also publish clearer guidance regarding the materiality thresholds for matters requiring attention and matters requiring immediate attention. As noted above in Part 1, and more generally, the FRB should also explain in greater detail how ratings are derived. This extends to LFI ratings as well as all of the other ratings that can apply to FBOs. In the case of LFI ratings, greater clarity regarding the term "effective" and more granular

17 In this respect, it would be somewhat like the FRB's guidance regarding FBOs' flexibility to design their U.S. Risk Committee for purposes of Regulation YY. In response to comments by the IIB, the FRB helpfully clarified a number of points, including flexibility for FBOs with a two-tiered board structure (supervisory board and management board), flexibility to use structures other than the head office Risk Committee, etc.). However, the FRB published this guidance in the preamble to a reporting form change (revisions to the FR Y-7). This helpful guidance has been all but lost because it is not easy to find and was not codified in a regulation or included in a supervisory letter or even reflected in the instructions to the FR Y-7. This has meant that many FBOs are not aware of the guidance, and it has not been given due regard in practice.

descriptions of what is evaluated in the Governance and Controls component would make the ratings more predictable and transparent.

b. *Oversight, consistency and accountability*. The FRB should develop more rigorous mechanisms for oversight of Reserve Bank examinations, and the FRB should explain how ratings are initially developed, reviewed internally in the Federal Reserve System, checked for horizontal consistency and calibrated to align with FRB supervisory policies and priorities. The FRB should develop, or enhance, mechanisms for supervised institutions to challenge examination findings without risking short- or long-term retribution in the examination process.

In our view, the FRB is in a unique position to reassess, with a broad perspective, the efficacy and efficiency of the U.S. bank supervisory framework, including for the U.S. operations of FBOs. At a time when the U.S. banking industry is fundamentally sound, and when policymakers are focused on ensuring that the U.S. banking system is robust, competitive and capable of supporting economic growth, the FRB can propose and adopt meaningful reforms to critical components of bank supervision and regulation.

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We appreciate your consideration of our comments. We would also appreciate the opportunity to discuss any of these recommendations, or any other matters related to international banks, at your convenience.

If we can answer any questions or provide any further information, please contact me at 646-213-1147, bzorc@iib.org or Stephanie Webster, General Counsel, at 646-213-1149, swebster@iib.org.

Very truly yours,

Beth Zorc

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