June 11, 2019

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC–2018–0037

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket Nos. R–1628 and R-[1658]

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AE96

VIA ELECTRONIC MAIL: regs.comments@occ.treas.gov;
regs.comments@federalreserve.gov; comments@FDIC.gov

Re: Prudential Standards for Large Foreign Banking Organization; Revisions to Proposed Prudential Standards for Large Domestic Bank Holdings Companies and Savings and Loan Holding Companies (Federal Reserve Docket No. [R-1658]); and Proposed Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries (OCC Docket ID OCC–2018–0037; Federal Reserve Docket No. R–1628; FDIC RIN 3064-AE96)

Dear Sir or Madam:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on two recently released proposals pertaining to foreign banking organizations[1] ("**FBOs**"): (1) a Federal Reserve (the "**Fed**") release that seeks to

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[1] An FBO is a "foreign bank that operates a branch, agency, or commercial lending subsidiary in the United States; controls a bank in the United States; or controls an Edge corporation acquired after March 5, 1987; and any company of which the foreign bank is a subsidiary." Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding

tailor the application of enhanced prudential standards to the U.S. operations of FBOs (the "**Fed Proposal**")[2]; and (2) a joint release by the Fed, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (the "**Interagency Proposal**," and together with the Fed Proposal, the "**Proposals**") respecting the application of capital and liquidity rules to U.S. operations of FBOs.[3]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-five leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee applauds the agencies for seeking to tailor enhanced prudential standards, and capital and liquidity requirements on the U.S. operations of FBOs, based on size and risk-based indicators. However, the Committee has several concerns with the Proposals. First, the Proposals may result in disparate treatment of FBO's intermediate holding companies ("**IHCs**") as compared to U.S. bank holding companies ("**BHCs**"), because IHCs are subject to additional regulatory requirements for the activities of affiliated branches and agencies. The Committee supports equal treatment of IHCs and U.S. BHCs. Second, the Proposals treat short-term wholesale funding received by the U.S. operations of an FBO from foreign affiliates the same as short-term wholesale funding received from third parties. The Committee believes that short-term wholesale funding received from a foreign affiliate is more stable than short-term wholesale funding received from an unaffiliated entity and the Proposals risk measures should be revised accordingly. Third, the Committee is concerned about the Fed's request for comment regarding imposing standardized liquidity requirements on FBOs' U.S. branches and agencies. Doing so could result in higher liquidity requirements for FBOs' U.S. branches and agencies, which could increase the cost of borrowing in the United States. The Committee believes that liquidity requirements should not be imposed on FBOs' U.S. branches and agencies, so long as an FBO's parent bank is subject to appropriate liquidity requirements in their home jurisdiction.

Companies and Savings and Loan Holding Companies, 84 Fed. Reg. 21988, 5 n.1 (proposed May 14, 2019) (to be codified at 12 C.F.R. §§ 217, 225, 238 & 252) [hereinafter the Fed Proposal].

[2] Fed Proposal.

[3] Proposed changes to applicability thresholds for regulatory capital requirements for certain U.S. subsidiaries of foreign banking organizations and application of liquidity requirements to foreign banking organizations, certain U.S. depository institution holding companies, and certain depository institution subsidiaries, 84 Fed. Reg. 13814 (proposed Apr. 8, 2019) (to be codified at 12 C.F.R. §§ 217 & 249) [hereinafter the Interagency Proposal].

The Proposals

The Proposals seek to tailor the application of enhanced prudential standards and regulatory capital and liquidity requirements for FBOs with combined U.S. operations ("**CUSO**") of $100 billion or more.[4] The Proposals would place FBOs into one of four categories based on their size and risk profile.[5] The stringency of the regulatory requirements would vary based on the category into which the particular FBO was assigned.[6] For purposes of determining the applicable category, the Proposals would consider the size and risk profile of an FBO's CUSO, including its intermediate holding company ("**IHC**") and any U.S. branches or agencies.[7] The regulatory requirements impacted by the category assignments include capital and stress testing requirements, liquidity requirements, single counterparty credit limit requirements, and risk management requirements.[8]

Assigning Categories

The category assignment is based on asset size and four risk-based indicators: (1) cross-jurisdictional activity; (2) weighted short-term wholesale funding; (3) off-balance sheet exposure; and (4) nonbank assets.[9] The Categories are classified as Categories I, II, III, and IV, with I being subject to the most stringent regulatory requirements and IV the least.[10]

Category I would only include U.S. global systemically important BHCs and so does not apply to FBOs.[11] Category II would include FBOs with CUSO of $700 billion or more or $75 billion or more in cross-jurisdictional activity.[12] If an FBO's CUSO does not exceed either of these thresholds, but the FBO's CUSO has $75 billion or more in weighted short-term wholesale funding then the FBO's IHC would be subject to Category II standardized liquidity requirements.[13]

Category III would include FBOs with CUSO exceeding $250 billion (but less than $700 billion) or $75 billion or more in any of the following indicators: nonbank assets, weighted short-term wholesale funding or off-balance sheet exposure.[14] Finally, Category

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[4] Fed Proposal at 19–21. The CUSO of an FBO "include any U.S. subsidiaries (including any U.S. [IHC], which would reflect on a consolidated basis any U.S. depository subsidiaries thereof), any U.S. branches, and U.S. agencies." Fed Proposal at 9, n.11.

[5] Fed Proposal at 19–21; Interagency Proposal at 22–8.

[6] Fed Proposal at 19–21; Interagency Proposal at 22–8.

[7] Fed Proposal at 18; Interagency Proposal at 21, 33.

[8] Fed Proposal at 8–9.

[9] Fed Proposal at 19–22; Interagency Proposal at 22–8.

[10] Fed Proposal at 19–21; Interagency Proposal at 22–8.

[11] Fed Proposal at 18, n.28.

[12] *Id.* at 20.

[13] Interagency Proposal at 25–6.

[14] Fed Proposal at 20. But with respect to the standardized liquidity requirements, an IHC that falls within category III would need to be part of an FBO with less than $75 billion in weighted short-term wholesale funding. Interagency Proposal at 26.

IV would include FBOs with CUSO that exceed $100 billion but do not exceed any of the Category II or III asset or risk-based indicator thresholds.[15] FBOs with CUSO less than $100 billion are excluded from the Proposals.

Effect of Categories on Regulatory Requirements

The Proposals apply enhanced capital, liquidity, and prudential standards to an FBO's IHC depending on the Category to which the IHC has been assigned by the above described methodology. A few illustrative examples provide useful context as to the stringency of the regulatory requirements applied to an FBO's IHC. With respect to capital and stress testing requirements, a Category II IHC would be subject to the countercyclical capital buffer, supplementary leverage ratio, annual Fed-run stress testing, and annual company run stress testing.[16] However, a Category IV IHC would not be subject to the countercyclical capital buffer or the supplementary leverage ratio requirement, and would only be subject to Fed-run stress testing every other year.[17] With respect to liquidity requirements, a Category II IHC would be subject to the full liquidity coverage ratio ("**LCR**") and net stable funding ratio ("**NSFR**") requirements (once finalized), while a Category IV IHC would not be subject to the LCR or NSFR requirements, so long as the FBO's weighted short-term wholesale funding was less than $50 billion.[18]

Request for Comment on Standardized Liquidity Requirement for FBO Branches and Agencies

The Interagency Proposal also included a request from the Fed for comment on the potential of adopting standardized liquidity requirements with respect to U.S. branches and agencies of FBOs.[19] Specifically, the Fed signaled that it believes that adoption of a standardized liquidity requirement on FBO U.S. branches and agencies could "strengthen the overall resilience of the firm's U.S. operations to liquidity risks and help prevent transmission of risks between the various segments of the [FBO]."[20] The Interagency Proposal goes on to explain that such a requirement "would require these firms to align the location of liquid assets with the location of their liquidity risk in the United States, in order to ensure better protection against risks to the U.S. operations and to U.S. financial stability."[21] The Fed described two options it is considering to impose standardized liquidity requirements on U.S. branches and agencies. One option would apply the liquidity coverage ratio rule to the FBO with respect to its branches and agencies in the aggregate. The other approach would be to apply a requirement on the FBO based on the asset size of the FBO's U.S. branch and agency network.[22]

[15] Fed Proposal at 20–1.
[16] Interagency Proposal at 61–3; Fed Proposal at 51–4.
[17] Interagency Proposal at 66; Fed Proposal at 58–62.
[18] Interagency Proposal at 72–80.
[19] *Id.* at 98–111.
[20] *Id.* at 100.
[21] *Id.*
[22] *Id.* at 101.

The Committee's Concerns

The Committee has three concerns with the Proposals: (1) the potential for disparate treatment of FBOs' IHCs as compared to U.S. BHCs; (2) the methodology for determining short-term wholesale funding exposures for the U.S. operations of FBOs; and (3) the consequences of imposing standardized liquidity requirements on U.S. branches and agencies.

Disparate Treatment

The Committee believes that the Proposals should treat U.S. BHCs and FBOs equally for two primary reasons.

First, "the presence of foreign banking organizations in the United States brings competitive and countercyclical benefits to U.S. markets,"[23] because they provide credit to businesses, including foreign firms with U.S. operations, U.S. households, and contribute to the liquidity of U.S. financial markets.[24] For example, Fed data on U.S. branches and agencies of foreign banks shows that they hold over $191 billion of U.S. Treasuries and other bonds such as local, state, and corporate bonds, and have over $775 billion in loans including over $400 billion in commercial and industrial loans.[25] If FBOs are not treated equally by U.S. bank regulators, they may retrench from the U.S. market, thus depriving the U.S. market of essential sources of capital for economic growth and development.

Second, equal treatment is important for *U.S. banks* because they operate through subsidiaries, branches, and agencies in foreign jurisdictions. Disparate treatment of FBOs by U.S. regulators could result in reciprocal or retaliatory measures by other jurisdictions. Such policies would harm the global operations of U.S. banks, reduce cross-border capital flows and negatively impact economic outcomes, a major concern of the G-20.[26]

The Proposals application of the risk-based indicators creates a risk of disparate treatment of FBOs, because the regulatory requirements that apply to IHCs can increase in stringency based on the activities of a U.S. branch or agency of the FBO that is not within an IHC,[27] whereas the regulatory requirements imposed on U.S. BHCs are determined solely based on an analysis of the U.S. BHC itself. The disparate impact would be

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[23] Fed Proposal at 9.
[24] *Id.*
[25] Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, BD. OF GOVERNORS OF THE FED. RES. SYS., https://www.federalreserve.gov/data/assetliab/current.htm (last updated Mar. 29, 2019).
[26] *See, e.g.,* Eric Johnston, With six months to go until G20 summit in Osaka, Japan sets out its agenda, THE JAPAN TIMES (Dec. 23, 2018), https://www.japantimes.co.jp/news/2018/12/23/national/politics-diplomacy/six-months-go-g20-summit-osaka-japan-sets-agenda/#.XMxHSJNKg8Y (Japanese Foreign Minister noting that international coordination and cooperation in finance and trade is an important agenda item during Japan's G-20 presidency because "[t]here is a serious risk that unless a commitment to international cooperation and openness is restored, the world will retreat to one that is closed and fragmented, which history has shown time and again leads to instability and perverse economic outcomes.").
[27] Fed Proposal at 15 (providing illustrative structure of a FBO's U.S. operations).

particularly pronounced because U.S. branches and agencies of FBOs generally do not accept retail deposits like traditional commercial banks, so they are more likely to rely on short-term wholesale funding for their operations.[28] As a result, it is likely that an IHC would be subject to more stringent liquidity requirements due to the operation of an affiliated U.S. branch and agency than a similarly situated U.S. BHC.[29]

Calculation of Short-Term Wholesale Funding

The Committee is also concerned that the Proposals calculation of short-term wholesale funding treats exposures between an FBO's U.S. operations and its non-U.S. affiliates the same as short-term exposures between an FBO's U.S. operations and unaffiliated third parties.[30] The Committee believes that short-term funding from a foreign parent is more stable than short-term funding from unaffiliated third parties, because a parent withdrawing such funding from U.S. operations would have severe reputational risks on an FBO. The agencies should therefore consider reducing the contribution of short-term wholesale funding provided by an FBO's non-U.S. affiliates from the calculation of short-term wholesale funding for purposes of determining the appropriate regulatory category for an FBO's U.S. operations.

Potential Standardized Liquidity Requirements on U.S. Branches and Agencies

The Committee is concerned about the Fed's requests in the Interagency Proposal for comment on a potential standardized liquidity requirement applicable to U.S. branches and agencies of FBOs.

As an initial matter, the Interagency Proposal provides no empirical data quantifying the liquidity risks of U.S. branches and agencies. Indeed, it is unclear that any liquidity requirement (including the existing requirements discussed below) is necessary or appropriate at the branch level so long as a foreign parent bank itself is subject to appropriate liquidity requirements. The Interagency Proposal also does not address the adequacy (or lack thereof) of the Fed's own existing standards such as liquidity buffers and liquidity stress testing[31] and safety and soundness standards imposed by the relevant

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[28] Patrick Parkinson et al., Federal Reserve Announces Proposed Tailoring of Prudential Standards for FBOs, PROMONTORY, https://www.promontory.com/News.aspx?id=5032 (last visited May 14, 2019) ("U.S. operations of most FBOs have very limited access to retail deposits and instead rely heavily on short-term wholesale funding."); Eric S. Rosengren, President & Chief Executive Officer, Federal Reserve Bank of Boston, Remarks at the Global Interdependence Center's Conference on Capital Markets in the Post Crisis Environment (Sept. 29, 2011) (explaining that FBO branches and agencies depend to a large degree on short-term wholesale funding).

[29] Memorandum from Randal K. Quarles, Vice Chair for Supervision of The Bd. of Governors of the Fed. Res. Sys., *Notices of proposed rulemaking to align prudential standards for foreign banking organizations with those proposed for domestic banking organizations and to amend resolution planning requirements* 20 (Apr. 1, 2019).

[30] Fed Proposal at 40 ("Weighted short-term wholesale funding would include exposures between the U.S. operations of a foreign bank organization and its non-U.S. affiliates ….").

[31] *See* 12 C.F.R. § 252.157 (imposing liquidity buffer and stress testing requirements on FBOs with combined U.S. assets of $50 billion or more).

supervisor of the branch or agency.[32] For example, the Fed presently requires that branches maintain sufficient high quality liquid assets to cover net cash outflows over 14 days in a stress scenario that is designed by each bank.[33] And the Fed reviews compliance with that requirement, including whether the stress scenario designed by the bank is reasonable, as part of its supervisory oversight of branches.[34] However, the Fed's request for comments leaves the public in the dark about whether the Fed has fully examined the adequacy of those standards, and if so, why it believes those standards may not be adequate.

Imposing a standardized liquidity requirement on U.S. branches and agencies of FBOs implies that the Fed does not trust home country regulators that regulate the liquidity of foreign parent banks and would risk retaliatory moves by foreign jurisdictions against U.S. banks with branches operating overseas. Moreover, it could result in higher liquidity requirements of U.S. branches and agencies of FBOs that could increase borrowing costs for U.S. borrowers that receive funding from them. The Committee believes that the Fed should only consider a standardized liquidity approach if it justifies why it is necessary at the branch level, shows that the benefits clearly outweigh the costs and it is clear that current regulatory and supervisory standards and practices are insufficient. Such an analysis should be subject to public notice and comment.

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Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Prof. Hal S. Scott (hscott@law.harvard.edu), or Executive Director, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

John L. Thornton	Hal S. Scott	R. Glenn Hubbard
CO-CHAIR	PRESIDENT	CO-CHAIR

[32] *See, e.g.,* 12 C.F.R. Pt. 30 (Office of the Comptroller of the Currency safety and soundness standards that apply to federal branches of foreign banks and, in part, to their agencies).
[33] 12 C.F.R. § 252.157(c).
[34] 12 C.F.R. § 252 app. A at (1)(c); 12 C.F.R. § 225(f)(1)–(2).