BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DATE: December 7, 2012

TO: Board of Governors

FROM: Governor Tarullo DKT

SUBJECT: Proposed rules to implement the enhanced prudential standards and early remediation requirements of sections 165 and 166 of the Dodd-Frank Act for foreign banking organizations and foreign nonbank financial companies

Staff seeks the Board's approval to invite public comment on the attached proposed rules to implement the enhanced prudential standards and early remediation requirements of sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for foreign banking organizations and foreign nonbank financial companies designated by the Financial Stability Oversight Council (Council) for Board supervision (foreign nonbank financial companies). The public comment period would be open for a period of 90 days. Staff also requests authority to make technical and minor changes to the attached materials to prepare them for publication in the Federal Register.

I have reviewed these materials and believe they are ready for the Board's consideration at this time.

Attachments

TO: Board of Governors

FROM: Staff[1]

DATE: December 7, 2012

SUBJECT: Proposed rules to implement the enhanced prudential standards and early remediation requirements of sections 165 and 166 of the Dodd-Frank Act for foreign banking organizations and foreign nonbank financial companies

ACTION REQUESTED: Approval to invite public comment on the attached proposed rules to implement the enhanced prudential standards and early remediation requirements of sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act) for foreign banking organizations and foreign nonbank financial companies designated by the Financial Stability Oversight Council (Council) for Board supervision (foreign nonbank financial companies).[2] The public comment period would be open for a period of 90 days. Staff also requests authority to make technical and minor changes to the attached materials to prepare them for publication in the Federal Register.

EXECUTIVE SUMMARY:

General Elements

- Scope of Application:
    - The proposed rules generally would apply to foreign banking organizations with total global consolidated assets of $50 billion or more.[3] Staff estimates

[1] Messrs. Gibson, Van Der Weide, Lindo, Clark, Jennings, Naylor and Hsu and Mss. Bouchard, Hewko, Aiken, and Mahar (Division of Banking Supervision and Regulation), Mr. Kamin and Ms. Rice (Division of International Finance), and Mr. Alvarez, Mss. Misback and Schaffer, Mr. McDonough, Mss. Snyder and Graham (Legal Division).

[2] Pub. L. No. 111-203, 124 Stat. 1376, 1426-1427; see 12 U.S.C. §§ 5365, 5366.

[3] A foreign banking organization is a foreign bank that has a banking presence in the United States by virtue of operating a branch, agency, or commercial lending company subsidiary in the United States or controlling a bank in the United States; or any company of which the foreign bank is a subsidiary.

that approximately 107 foreign banking organizations would be subject to the proposal.

- The proposal also would apply to foreign nonbank financial companies.[4] However, the preamble notes that the Board would clarify how the standards would apply to any individual foreign nonbank financial company upon designation by the Council. No such designations have been made to date.

- Related Rulemakings. As explained below, the proposed standards for foreign banking organizations contained in this proposal are broadly consistent with the standards that have been proposed for large U.S. bank holding companies and U.S. nonbank financial companies. In December 2011, the Board sought comment on a proposal that would implement the enhanced prudential standards for large U.S. bank holding companies and U.S. nonbank financial companies designated by the Council for Board supervision (December 2011 proposal). In October 2012, the Board finalized the stress testing requirements contained in the December 2011 proposal for those U.S. institutions.[5] Differences between this proposal and the December 2011 proposal generally reflect the different regulatory framework and structure under which foreign banks operate and do not signal how the December 2011 proposal will be finalized for domestic companies.

- Timing. The proposed effective date for the rules is July 1, 2015. Delaying the effective date to July 1, 2015 would allow foreign banking organizations time to implement the requirements of the proposal.

- Tailoring. In general, the Dodd-Frank Act allows the Board to tailor the application of section 165 to different organizations based on a number of factors, including any risk-related factor the Board deems appropriate.
  - The proposal would apply a reduced set of requirements to the roughly 84 foreign banking organizations that each have total global consolidated assets of $50 billion or more but combined U.S. assets of less than $50 billion, in light of the limited risk to U.S. financial stability posed by these firms.[6] The proposal would apply a

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[4] The proposal would set forth the criteria that the Board would consider in determining whether a U.S. intermediate holding company should be established.

[5] See 12 CFR part 252, subparts F and G.

[6] In general, the proposal would measure combined U.S. assets of a foreign banking organization as the sum of (i) the four-quarter average of the total assets of each U.S. branch or agency of the foreign bank and (ii) the four-quarter average of the total consolidated assets of its U.S. intermediate holding company (as defined below). If the foreign banking organization had not established a U.S. intermediate holding company, "combined U.S. assets" would include the four-quarter average of the total consolidated

set of more stringent standards to the roughly 23 foreign banking organizations that each have combined U.S. assets of $50 billion or more.
    - A general description of the standards is set forth in Table 1.

- Consultation with Council: Board staff consulted with agencies represented on the Council in developing the proposed enhanced prudential standards and early remediation requirements, and the proposal reflects comments and other feedback provided as part of these consultations.

Proposed Enhanced Prudential Standards and Early Remediation Requirements

- U.S. Intermediate Holding Company Requirement:
    - The proposal generally would require a foreign banking organization with total global consolidated assets of $50 billion or more to organize its U.S. subsidiaries under a single U.S. intermediate holding company.
    - The U.S. intermediate holding company would be subject to enhanced prudential standards on a consolidated basis. U.S. branches and agencies of a foreign banking organization may continue to operate outside of the U.S. intermediate holding company.
    - A foreign banking organization with combined U.S. assets (excluding assets held by a U.S. branch or agency) of less than $10 billion would not be required to form a U.S. intermediate holding company.

- Risk-Based Capital and Leverage Requirements:
    - All U.S. intermediate holding companies would be subject to the same risk-based capital and leverage standards applicable to U.S. bank holding companies.
    - A U.S. intermediate holding company with total consolidated assets of $50 billion or more would be subject to the Board's capital plan rule governing capital distributions.
    - A foreign banking organization with total global consolidated assets of $50 billion or more would be required to certify that it meets capital adequacy standards established by its home country supervisor on a consolidated basis and that those standards are consistent with the Basel Capital Framework.

- Liquidity Requirements:
    - The U.S. operations of a foreign banking organization with combined U.S. assets of $50 billion or more would be required to meet liquidity risk management

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assets of each top-tier U.S. subsidiary of the foreign banking organization (other than a section 2(h)(2) company (as defined below)).

standards, conduct internal liquidity stress tests, and maintain a 30-day buffer of highly liquid assets.
  - The U.S. branch and agency network would be required to maintain the first 14 days of its 30-day buffer in the United States and would be permitted to meet the remainder of the requirement at the parent consolidated level. The U.S. intermediate holding company would be required to maintain the full 30-day buffer in the United States.
  - A foreign banking organization with total global consolidated assets of $50 billion or more but combined U.S. assets of less than $50 billion would be required to report the results of an internal liquidity stress test (either on a consolidated basis or for its combined U.S. operations) to the Board on an annual basis.

- Single-Counterparty Credit Limits:
  - The proposal would limit the credit exposure of both a U.S. intermediate holding company and the combined U.S. operations of a foreign banking organization to a single unaffiliated counterparty (adjusted to take into account collateral and other risk mitigants).
  - The proposal would establish a general limit of 25 percent of regulatory capital for credit exposure to a single counterparty, and a more stringent limit for credit exposure of a major U.S. intermediate holding company or the combined U.S. operations of a major foreign banking organization to a major counterparty.[7]
  - The proposal does not set a specific limit involving major firms, but indicates that the more stringent limit will be aligned with the limit adopted for major domestic bank holding companies (i.e., a limit between 10 percent and 25 percent).
  - All limits would include exposures to foreign sovereign governments and U.S. state and local governments; however, exposures to the U.S. federal government or a foreign banking organization's home country sovereign would be exempt.

- Risk Management and Risk Committee Requirements:
  - A foreign banking organization with total global consolidated assets of $10 billion or more would be required to certify that they maintain a U.S. risk committee.

[7] Major U.S. intermediate holding company is defined as a U.S. intermediate holding company with total consolidated assets of $500 billion or more. Major foreign banking organization is defined as a foreign banking organization with total global consolidated assets of $500 billion or more. Major counterparty is defined to include a bank holding company or foreign banking organization that has total consolidated assets equal to or greater than $500 billion and a nonbank financial company supervised by the Board.

    - In addition, a foreign banking organization with combined U.S. assets of $50 billion or more would be subject to additional U.S. risk committee requirements and a requirement to appoint a U.S. chief risk officer.

- Stress Test Requirements:
    - A U.S. intermediate holding company would be subject to the Board's stress testing rules as if it were a U.S. bank holding company.
    - A foreign banking organization with total global consolidated assets of $10 billion or more would be required to be subject to a home country stress testing regime that is broadly consistent with the Board's stress testing regime for U.S. bank holding companies or would be subject to additional requirements to help ensure the capital adequacy of their U.S. operations.

- Early Remediation Framework:
    - The combined U.S. operations of a foreign banking organization would be subject to early remediation triggers based on capital ratios, stress test results, market indicators, and liquidity and risk management weaknesses.
    - A foreign banking organization with combined U.S. assets of $50 billion or more that exceeds an early remediation trigger would be subject to a set of non-discretionary remediation actions imposed on its U.S. operations. Foreign banking organizations with a smaller U.S. presence would not be automatically subject to remediation actions.

BACKGROUND:

Under the current statutory framework, the Federal Reserve is responsible for the supervision and regulation of the combined U.S. operations of all foreign banking organizations. Other federal and state regulators are responsible for supervising and regulating certain parts of the U.S. operations of foreign banking organizations, such as branches, agencies, or bank and nonbank subsidiaries. The Federal Reserve's current approach to foreign banking organization oversight involves reliance on the home supervisor to effectively supervise a foreign banking organization on a global consolidated basis and on the consolidated parent to support its U.S. operations under both normal and stressed conditions.

U.S. regulators have generally allowed foreign banking organizations considerable flexibility in structuring their U.S. operations. Permissible U.S. structures for foreign banking organizations have included cross-border branching and holding direct and indirect bank and nonbank subsidiaries. U.S. banking law and regulation also allows well-managed and well-capitalized foreign banking organizations to conduct a wide range of bank and nonbank activities in the United States on conditions comparable to those applied to U.S. banking organizations.[8] As a result, the existing structure and activities of the U.S. operations of foreign banking organizations are highly diverse.

The current approach to foreign bank regulation has facilitated cross-border banking and increased global flows of capital and liquidity. However, the increased complexity, interconnectedness and concentration of the U.S. operations of foreign banking organizations that have emerged since this approach was first adopted, and the lessons learned during the crisis, have raised questions about its continued suitability.

During the lead up to the crisis, many foreign banking organizations used their U.S. operations to raise short-term debt in U.S. markets to fund longer-term assets held in other jurisdictions, exposing them to substantial amounts of liquidity risk in the United States. Many foreign banking organizations also significantly expanded their trading and capital markets activities in the United States in recent years, increasing the complexity and interconnectedness of their U.S. footprint. Similar to the largest, most complex U.S. banking organizations, some foreign banking organizations with large U.S. operations maintain dozens of U.S. legal entities, complicating their supervision. Further, some foreign banking organizations have maintained little or even negative capital at their U.S. bank holding company subsidiaries.

The financial crisis also revealed limitations on the ability of foreign banking organizations to act as a source of support to their U.S. operations under stressed conditions. In the wake of the crisis, some home country regulatory authorities have restricted the ability of banking organizations based in their home country to provide support to host country subsidiaries. In addition, the capacity and willingness of governments to act as a backstop to their largest financial institutions has declined around the world. Finally, despite recent attention from the international regulatory community,

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[8] 12 U.S.C. 1843(l)(1); 12 CFR 225.90.

challenges associated with the resolution of large cross-border financial institutions remain difficult to solve.

Congress has directed the Board, in the Dodd-Frank Act, to impose enhanced prudential standards on large foreign banking organizations. Fulfilling this Congressional mandate under the current approach to foreign bank regulation presents challenges and would result in standards that may not effectively address risks to the United States. Several of the Act's required enhanced standards are not subject to international agreements regarding their application. In addition, U.S. supervisors, as host authorities, have limited access to timely information regarding the global operations of foreign banking organizations. As a result, monitoring compliance with any enhanced prudential standards at the consolidated foreign banking organization would be difficult and may raise concerns of extraterritorial application of the standards.

This proposal would address these developments and challenges by requiring a consistent organizational structure—a U.S. intermediate holding company—for U.S. subsidiaries of foreign banking organizations, and by bolstering the local capital and liquidity positions of the U.S. operations of foreign banking organizations. The proposed standards are broadly consistent with the standards proposed for large U.S. bank holding companies and nonbank financial companies in the December 2011 proposal. Differences between this proposal and the December 2011 proposal generally reflect the different regulatory framework and structure under which foreign banks operate, and do not reflect potential modifications that may be made to the December 2011 proposal for domestic bank holding companies. Comments on this proposal will help inform how the enhanced prudential standards should be applied differently to foreign banking organizations. (See Attachment, pp.17-18).

The proposal would continue to allow foreign banking organizations to operate branches and agencies in the United States and would generally allow branches to continue to meet capital requirements at the consolidated level. Similarly, the proposal would not impose a cap on cross-border intragroup flows, thereby allowing foreign banking organizations in sound financial condition to continue to obtain U.S. dollar funding for their global operations through their U.S. operations. The proposal would, however, regulate liquidity in a way that increases the resiliency of the U.S. operations of foreign banking organizations to changes in the availability of funding.

Requiring additional local capital and liquidity buffers, like any prudential regulation, may incrementally increase costs and reduce flexibility of internationally active banks that primarily manage their capital and liquidity on a centralized basis. However, managing capital and liquidity on a local basis, in addition to on a global consolidated basis, can have benefits not just for financial stability generally, but also for firms themselves. During the crisis, the more decentralized global banks relied less on cross-currency funding and were less exposed to disruptions in international wholesale funding and foreign exchange swap markets than the more centralized banks.[9]

OVERVIEW OF THE PROPOSAL

This section highlights the most important aspects of the proposed rules.

A. Statutory requirements

Sections 165 and 166 of the Dodd-Frank Act direct the Board to impose a number of enhanced prudential standards and early remediation requirements on bank holding companies, including foreign banking organizations, with total consolidated assets of $50 billion or more and U.S. and foreign nonbank financial companies.[10] These enhanced prudential standards and early remediation requirements include risk-based capital and leverage requirements, liquidity requirements, risk management and risk committee requirements, resolution planning requirements, single-counterparty credit

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[9] Committee on the Global Financial System, Funding patterns and liquidity management of internationally active banks, CGFS Papers No 39 (May 2010), available at: http://www.bis.org/publ/cgfs39.pdf.

[10] See 12 U.S.C. 5311(a)(1) (defining the term "bank holding company" for purposes of Title I of the Dodd-Frank Act to include a foreign banking organization that is treated as a bank holding company for purposes of the Bank Holding Company Act, pursuant to section 8(a) of the International Banking Act). See supra note 3, for a description of a foreign banking organization.

limits, stress test requirements, a framework for early remediation of financial weaknesses, and a debt-to-equity limit for companies that the Council has determined pose a grave threat to financial stability.

This proposal would implement the enhanced prudential standards and early remediation requirements mandated by sections 165 and 166 for foreign banking organizations with $50 billion or more in total global consolidated assets, with the exception of resolution planning requirements, which have been implemented separately, and credit exposure reporting requirements, which will be proposed separately in the future.[11] In addition, the proposal includes an additional prudential standard that would require certain foreign banking organizations to establish a U.S. intermediate holding company.[12]

This proposal would also implement enhanced prudential standards and early remediation requirements for foreign nonbank financial companies; however, the preamble states that the Board would clarify how the standards would be tailored to any individual foreign nonbank financial company upon designation by the Council.

B. Requirement to Form a U.S. Intermediate Holding Company

The proposal would introduce a requirement that a foreign banking organization with $50 billion or more in total global consolidated assets organize its U.S. subsidiaries under a single U.S. intermediate holding company, which would be subject to the proposal's enhanced prudential standards and early remediation requirements on a

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[11] The Board and FDIC jointly issued a final rule to implement the resolution plan requirement in section 165(d) of the Dodd-Frank Act for foreign and domestic companies. This rule became effective on November 30, 2011.

[12] Under section 165(b)(1)(B) of the Dodd-Frank Act, the Board has authority to establish any prudential standard that it determines is appropriate. 12 U.S.C. 5365(b)(1)(B).

consolidated basis.[13] Foreign banking organizations with less than $10 billion in total non-branch U.S. assets would not be subject to this requirement.

The U.S. intermediate holding company requirement would be an integral component of the proposal's risk-based capital requirements, leverage limits, and liquidity requirements because it would enable the Board to impose these standards on a foreign banking organization's U.S. bank and nonbank subsidiaries on a consistent, comprehensive, and consolidated basis. In addition, the U.S. intermediate holding company would provide the Federal Reserve, as umbrella supervisor of the U.S. operations of foreign banking organizations, a platform to implement a consistent supervisory program across U.S. subsidiaries of those organizations. A U.S. intermediate holding company could also help facilitate the resolution or restructuring of the U.S. subsidiary operations of a foreign banking organization by providing one top-tier U.S. legal entity to be resolved or restructured. (See Attachment, pp. 39-41).

A foreign banking organization that is required to form a U.S. intermediate holding company under this proposal would be required to hold its interest in any U.S. subsidiary, other than a "section 2(h)(2) company," through the U.S. intermediate holding company.[14] To address exceptional circumstances, the Board would retain

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[13] The term "subsidiary" would be defined using the Bank Holding Company Act definition of control, such that a foreign banking organization would be required to transfer its interest in any U.S. subsidiary for which it: (i) directly or indirectly or acting through one or more other persons owned, controlled, or has power to vote 25 percent or more of any class of voting securities of the company; (ii) controlled in any manner the election of a majority of the directors or trustees of the company; or (iii) directly or indirectly exercised a controlling influence over the management or policies of the company.

[14] Section 2(h)(2) of the Bank Holding Company Act allows qualifying foreign banking organizations to retain their interest in foreign commercial firms that conduct some business in the United States. This long-standing statutory exception was enacted in recognition of the fact that some foreign jurisdictions do not impose a clear separation between banking and commerce. The current proposal would not require foreign banking organizations to hold section 2(h)(2) investments under the U.S. intermediate holding company because these commercial firms have not been subject to Board supervision and

flexibility to permit a foreign banking organization to establish multiple intermediate holding companies or use an alternative organizational structure to hold its U.S. subsidiaries. (See Attachment, p. 43).

C. Risk-Based Capital Requirements and Leverage Limits

The proposal would impose the same risk-based capital requirements and leverage limits on the U.S. intermediate holding company of a foreign banking organization as apply to domestic bank holding companies. The proposal would also require a foreign banking organization with total global consolidated assets of $50 billion or more to meet capital adequacy standards established by its home country supervisor that are consistent with the Basel Capital Framework.[15] (See Attachment, pp. 50-51). Staff anticipates that the capital adequacy standards for U.S. bank holding companies on the July 1, 2015 effective date of the proposal would incorporate the standards in the Basel III Accord.[16]

The proposal would also subject U.S. intermediate holding companies with total consolidated assets of $50 billion or more to the Board's capital plan rule (12 CFR 225.8). The capital plan rule would require these U.S. intermediate holding companies to submit annual capital plans to the Federal Reserve in which they demonstrate an ability to maintain capital above the Board's minimum risk-based capital and leverage ratios under both baseline and stressed conditions. A U.S. intermediate holding company that is unable to satisfy the capital plan rule's requirements generally

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foreign banking organizations often cannot restructure their foreign commercial investments.

[15] Basel Capital Framework means the regulatory capital framework published by the Basel Committee on Banking Supervision, as amended from time to time.

[16] At present, the Board's rules for calculating minimum capital requirements are found at 12 CFR part 225, Appendix A (general risk-based capital rule), 12 CFR part 225, Appendix D (leverage rule), 12 CFR part 225, Appendix E (market risk rule), and 12 CFR part 225, Appendix G (advanced approaches risk-based capital rule). A U.S. intermediate holding company that met the applicability thresholds under the market risk rule or the advanced approaches risk-based capital rule would be required to use those rules to calculate its minimum risk-based capital requirements, in addition to the general risk-based capital requirements and the leverage rule.

may not make any capital distributions until it provides a satisfactory capital plan to the Federal Reserve. (See Attachment, pp. 53-55).

The proposal would require all foreign banking organizations with $50 billion or more in total global consolidated assets to certify that the foreign banking organization meets, at the consolidated level, capital adequacy standards that are consistent with the Basel Capital Framework (including the Basel III Accord). Provided that the home country capital standards of a foreign banking organization are consistent with the Basel Capital Framework, that foreign banking organization would be permitted to use the standards established by its home country supervisor to determine the types of capital instruments that count as common equity tier 1 capital, additional tier 1 capital, and tier 2 capital and to calculate its risk-weighted assets. (See Attachment, pp. 55-57).

The proposal would not apply the U.S. leverage ratio to a foreign banking organization at the consolidated level. However, the proposal anticipates that the international leverage ratio, as set forth in the Basel III Accord, will be implemented internationally in 2018. At that time, the proposal would require foreign banking organizations with $50 billion or more in total global consolidated assets to comply with the international leverage ratio as implemented by their home country supervisor in a manner consistent with the Basel Capital Framework. (See Attachment, pp. 56-57).

If the Board determines that a foreign banking organization with $50 billion or more in total global consolidated assets does not meet capital adequacy standards at the consolidated level that are consistent with the Basel Capital Framework, the Board may impose conditions or restrictions on the U.S. operations of the company. (See Attachment, p. 57).

D. Liquidity Requirements

For foreign banking organizations with combined U.S. assets of $50 billion or more, the proposal would impose liquidity requirements largely similar to those set forth in the December 2011 proposal applicable to large domestic bank holding companies. The proposal would apply a more limited set of requirements to foreign banking organizations with a smaller U.S. presence.

With respect to the U.S. operations of foreign banking organizations with combined U.S. assets of $50 billion or more, the proposal would convert existing liquidity risk management guidance into rules.[17] (See Attachment, pp. 63-94). In addition, the proposal would require the U.S. operations of these foreign banking organizations to conduct internal liquidity stress tests and to maintain separate liquidity buffers for the U.S. branch and agency network and the U.S. intermediate holding company that are equal to their respective net stressed cash flow needs over a 30-day stressed horizon. (See Attachment, pp. 75-86). The proposal would require the U.S. intermediate holding company to maintain the assets comprising its 30-day liquidity buffer in the United States and would require the U.S. branch and agency network to maintain assets comprising the first 14 days of its 30-day liquidity buffer in the United States. (See Attachment, pp. 76-78). The foreign banking organization may maintain the remaining liquidity buffer for the U.S. branch and agency network outside the United States, provided that the foreign banking organization has demonstrated to the Board's satisfaction that it or an affiliate could provide the residual liquid assets to the U.S. branch and agency network if needed. (See Attachment, pp. 77-78).

A foreign banking organization with total global consolidated assets of $50 billion or more but combined U.S. assets of less than $50 billion would be required to report the results of an internal liquidity stress test (either on a consolidated basis or for its combined U.S. operations) annually to the Board. If a foreign banking organization did not satisfy this requirement, its U.S. branch and agency network would be subject to intragroup funding restrictions. (See Attachment, p. 95).

The preamble provides that the Board intends through future separate rulemakings to implement the quantitative liquidity standards included in the Basel III Accord for the

[17] The risk management standards would require a foreign banking organization, with respect to its combined U.S. operations, to adopt specific corporate governance practices regarding liquidity risk management, project cash flow needs over various time horizons, develop specific limits relating to liquidity metrics, and maintain a contingency funding plan.

U.S. operations of some or all foreign banking organizations with $50 billion or more in combined U.S. assets, consistent with the international timeline.

E. Single-Counterparty Credit Limits

Consistent with the December 2011 proposal, this proposal would impose a two-tier single-counterparty credit limit on the U.S. operations of foreign banking organizations with $50 billion or more in total global consolidated assets. First, the proposal would prohibit a U.S. intermediate holding company from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the U.S. intermediate holding company's regulatory capital, and it would prohibit the combined U.S. operations of a foreign banking organization from having aggregate net credit exposure to an unaffiliated counterparty in excess of 25 percent of the consolidated regulatory capital of the foreign banking organization. (See Attachment, p. 98).

Second, the proposal would impose a more stringent credit exposure limit between a major U.S. intermediate holding company or the combined U.S. operations of a major foreign banking organization and a major counterparty. This more stringent limit would be set to be consistent with the stricter limit established for major U.S. bank holding companies and U.S. nonbank financial companies. The stricter limit was proposed to be set at 10 percent in the December 2011 proposal. (See Attachment, pp. 98-99).

The Board received a large volume of comments on the single-counterparty credit limit framework included in the December 2011 proposal, including comments on many of the proposed credit exposure valuation methodologies and on the proposed stricter 10 percent threshold for exposures between major banking firms and major counterparties. Staff is currently analyzing these comments and is preparing a quantitative impact study related to the single-counterparty credit limit to help inform the rulemaking process. This proposal does not include a specific stricter limit for exposures to major counterparties, but proposes that the stricter limit on such exposures for foreign banking organizations would be consistent with whatever stricter limit may be set for domestic bank holding companies.

Consistent with the December 2011 proposal, this proposal would cover exposures to companies, foreign sovereign entities, and U.S. state and local governments, and would exempt exposures to the U.S. federal government (including U.S. federal government agencies as well as Fannie Mae and Freddie Mac, while in conservatorship). This proposal also would exempt exposures to a foreign banking organization's home country sovereign entity. (See Attachment, pp. 113-114).

F. Risk Management

This proposal requires foreign banking organizations that have total global consolidated assets of $10 billion or more to certify that they have a U.S. risk committee that has at least one member with appropriate risk expertise.[18] (See Attachment, pp. 117-119). In general, the company's enterprise-wide risk committee may serve as the U.S. risk committee. Foreign banking organizations with combined U.S. assets of $50 billion or more would be subject to additional U.S. risk committee requirements, including a requirement that at least one member of the committee be independent. (See Attachment, pp. 119-123). Foreign banking organizations with combined U.S. assets of $50 billion or more also would be required to appoint a U.S. chief risk officer responsible for implementing and maintaining the risk management framework and practices for the company's combined U.S. operations. (See Attachment, pp. 124-127). The proposal would require the U.S. chief risk officer to be employed by a U.S. subsidiary or U.S. office of the foreign banking organization.

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[18] This requirement would apply to foreign banking organizations with total consolidated assets of less than $50 billion only if that company were publicly traded. Section 165(b)(1)(A)(iii) of the Dodd-Frank Act requires that the Board establish enhanced overall risk management requirements for foreign banking organizations with $50 billion or more in total consolidated assets. Section 165(h) of the Dodd-Frank Act also directs the Board to issue regulations requiring publicly traded foreign banking organizations with total consolidated assets of $10 billion or more to establish a risk committee.

G. Stress Testing

Consistent with the Dodd-Frank Act, the proposal would impose stress testing requirements on foreign banking organizations that have total global consolidated assets of $10 billion or more.

The proposal would subject a U.S. intermediate holding company to the Board's stress testing rules as if it were a U.S. bank holding company.[19] As a result, U.S. intermediate holding companies with total consolidated assets of greater than $10 billion but less than $50 billion would be subject to subpart H of Regulation YY, which requires annual company-run stress tests. U.S. intermediate holding companies with total consolidated assets of $50 billion or more would be subject to subparts F and G of Regulation YY, which requires annual supervisory stress tests and semi-annual company-run stress tests. (See Attachment, pp. 130-133).

The proposal would take a different approach to the U.S. branches and agencies of a foreign banking organization because U.S. branches and agencies do not hold capital separately from their parent foreign banking organization.[20] Accordingly, the proposal would apply stress testing requirements to the U.S. branches and agencies by first evaluating whether the home country supervisor for the foreign banking organization conducts a stress test and, if so, whether the stress testing standards applicable to the consolidated foreign banking organization in its home country are broadly consistent with U.S. stress testing standards. If a foreign banking organization with combined U.S. assets of $50 billion or more is subject to a home country stress testing regime that is broadly consistent with the U.S. standards, the company could generally meet the stress test requirement in this proposal by submitting a high-level summary of annual stress test results for the consolidated company. However, if the U.S. branch and agency network

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[19] See 77 FR 62378 (October 12, 2012); 77 FR 62396 (October 12, 2012).

[20] Foreign banking organizations that are not required to form a U.S. intermediate holding company would be subject to similar stress testing requirements with respect to any U.S. subsidiary.

of a foreign banking organization with combined U.S. assets of $50 billion or more generally provides, on a net basis, funding to its parent, the foreign banking organization would be required to provide additional, more detailed information regarding the results of its annual consolidated capital stress test. (See Attachment, pp. 133-138). Foreign banking organizations with combined U.S. assets of less than $50 billion that are subject to and comply with a consistent consolidated capital stress test regime in their home country would not be required to submit results of their home country stress tests on an annual basis. (See Attachment, pp. 138-139).

If the foreign banking organization does not meet these stress testing requirements, its U.S. branch and agency network would be subject to an asset maintenance requirement.[21] (See Attachment, pp. 135-138).

The Dodd-Frank Act requires the Board to impose stress testing requirements on entities it regulates (including bank holding companies, state member banks, and savings and loan holding companies) with total consolidated assets of more than $10 billion.[22] Under the proposal, foreign savings and loan holding companies with total global consolidated assets of $10 billion or more are subject to the same requirements that would apply to foreign banking organizations that have a limited presence in the United States. Currently there are no foreign savings and loan holding companies operating in the United States. (See Attachment, pp. 138-140).

H. Debt-to-Equity Limitation

Section 165(j) of the Dodd-Frank Act provides that the Board must require a foreign banking organization with $50 billion or more in total global consolidated assets

[21] The Board may also subject the U.S. branch and agency network of a foreign banking organization with combined U.S. assets of $50 billion or more to additional liquidity requirements or intragroup exposure limits, on a case-by-case basis. Further, any U.S. subsidiary of a foreign banking organization that is not required to form a U.S. intermediate holding company would be subject to company-run stress test requirements.

[22] Section 165(i)(2) of the Dodd-Frank Act; 12 U.S.C. 5365(i)(2).

to maintain a debt-to-equity ratio of no more than 15-to-1, upon a determination by the Council that such company poses a grave threat to the financial stability of the United States and that the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States. The proposal would implement the debt-to-equity ratio limitation with respect to a foreign banking organization by applying a 15-to-1 debt-to-equity limitation on its U.S. intermediate holding company (or, if the foreign banking organization does not have a U.S. intermediate holding company, on each U.S. subsidiary) and a 108 percent asset maintenance requirement on its U.S. branch and agency network, if applicable. (See Attachment, pp. 140-142).

I. Early Remediation

Consistent with the December 2011 proposal, this proposed rule would establish a regime for the early remediation of financial distress at the combined U.S. operations of foreign banking organizations with $50 billion or more in total global consolidated assets.[23] The proposal would specify early remediation triggers based on regulatory capital ratios, stress test results, market-based indicators, and risk management weaknesses. (See Attachment, pp. 147-158). These triggers would lead to a set of mandatory remediation actions for all foreign banking organizations with combined U.S. assets of $50 billion or more. (See Attachment, pp. 158-166).

The regime is divided into four levels of remediation:

- Heightened supervisory review (Level 1), in which supervisors conduct a targeted review of the foreign banking organization's U.S. operations to determine if it should be moved to the next level of remediation;

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[23] Section 166 of the Dodd-Frank Act directs the Board to promulgate regulations providing for the early remediation of financial weaknesses at banking organizations with $50 billion or more in total consolidated assets, including foreign banking organizations. See 12 U.S.C. 5366.

- Initial remediation (Level 2), in which a foreign banking organization's U.S. operations are subject to an initial set of remediation measures, including restrictions on growth and capital distributions;
- Recovery (Level 3), in which a foreign banking organization's U.S. operations are subject to a prohibition on growth and capital distributions, restrictions on executive compensation, requirements to raise additional capital, and additional requirements on a case-by-case basis; and
- Recommended resolution (Level 4), in which the Board would consider whether the U.S. operations of the foreign banking organization warrant termination or resolution based on the financial decline of the combined U.S. operations and other relevant factors.

The proposal would tailor application of the proposed early remediation regime for foreign banking organizations with combined U.S. assets of less than $50 billion. These companies would be subject to the same triggers that apply to foreign banking organizations with a larger U.S. presence, but would not be subject to mandatory remediation actions. (See Attachment, pp. 166-167).

J. Timing of Application

As with domestic firms subject to enhanced prudential standards, the proposal would provide a long phase-in period to allow foreign banking organizations sufficient time to implement the requirements of the proposal. For foreign banking organizations with total global consolidated assets of $50 billion or more as of July 1, 2014, the enhanced prudential standards of this proposal would apply beginning on July 1, 2015. (See Attachment, p. 38-39).

Foreign banking organizations that cross the $50 billion global total asset threshold after July 1, 2014, would be required to form a U.S. intermediate holding company beginning 12 months after they reach the $50 billion threshold, unless accelerated or extended by the Board. These foreign banking organizations generally would be required to comply with the enhanced prudential standards (other than stress test requirements and the capital plan rule) beginning on the same date they are required to establish a U.S. intermediate holding company. Stress test requirements and the capital plan rule would be applied in October of the year after the year in which the foreign banking organization is required to establish a U.S. intermediate holding company. (See Attachment, pp. 38-39).

Generally, a foreign banking organization or U.S. intermediate holding company that is subject to the proposed requirements based on an asset threshold would remain subject to those requirements unless and until its assets remain continuously below the relevant asset threshold for four consecutive calendar quarters. If a foreign banking organization ceases to have a banking presence in the United States, it would no longer be subject to the proposed requirements.

CONCLUSION: The attached Federal Register notice invites comment on the proposed rules implementing enhanced prudential standards for foreign banking organizations related to (i) risk-based capital and leverage; (ii) liquidity; (iii) overall risk management, including the establishment of a risk committee; (iv) single-counterparty credit limits; (v) stress tests; (vi) debt-to-equity limits for foreign banking organizations that the Council has determined pose a grave threat to financial stability; and (vii) early remediation.

Staff recommends that the Board approve the attached proposed rules and invite public comment on the proposal. If approved, public comment on the proposed rule would be solicited through March 31, 2013. Staff also requests authority to make minor and technical changes to the draft proposed rules and Federal Register notice prior to publication (for example, to address any changes that may be requested by the Federal Register).

Attachment

Table 1: Scope of Application for FBOs

Global Assets	U.S. Assets	Summary of Requirements that apply	Approx. # of FBOs per category[24]
> $10 billion and < $50 billion	n/a	• Have a U.S. risk committee • Meet home country stress test requirements that are broadly consistent with U.S. requirements	29

> $50 billion	< $50 billion	All of the above, plus:
		• Meet home country capital standards that are broadly consistent with Basel standards
		• Single-counterparty credit limits[25]
		• Subject to an annual liquidity stress test requirement
		• Subject to DFA section 166 early remediation requirements
		• Subject to U.S. intermediate holding company (IHC) requirements:
		  ○ Required to form U.S. IHC if non-branch U.S. assets exceed $10 billion. All U.S. IHCs are subject to U.S BHC capital requirements
		  ○ U.S. IHC with assets between $10 and $50 billion subject to DFA Stress Testing Rule (company-run stress test)
			84

> $50 billion	> $50 billion	All of the above, plus: • U.S. IHC with assets >$50 billion subject to capital plan rule and all DFA stress test requirements (CCAR) • U.S. IHC and branch/agency network subject to monthly liquidity stress tests and in-country liquidity requirements • Must have a U.S. risk committee and U.S. Chief Risk Officer • Subject to non-discretionary DFA section 166 early remediation requirements	23

[24] Approximate number of foreign banking organizations as of September 30, 2012.

[25] Foreign banking organizations with assets of $500 billion or more and U.S. IHCs with assets of $500 billion or more would be subject to stricter limits.