BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date:	February 7, 2014
To:	Board of Governors
From:	Governor Tarullo DKT
Subject:	Final rules to implement the enhanced prudential standards of section 165 of the Dodd-Frank Act

Attached are a memorandum to the Board and a Federal Register notice regarding a draft final rule to implement certain of the enhanced prudential standards of section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for bank holding companies and foreign banking organizations with $50 billion or more in total consolidated assets.

The draft final rule would establish enhanced liquidity and enhanced risk management requirements for U.S. top-tier bank holding companies with total consolidated assets of $50 billion or more.[1] For foreign banking organizations, the draft final rule would establish a U.S. intermediate holding company requirement for foreign banking organizations with $50 billion or more in U.S. non-branch assets and impose enhanced risk-based and leverage capital requirements, liquidity requirements, risk management requirements, and stress test requirements on foreign banking organizations with total consolidated assets of $50 billion or more. In addition, the draft final rule would establish a risk committee requirement for publicly traded bank holding companies and foreign banking organizations, each with total consolidated assets of $10 billion or more, and a stress testing requirement for foreign banking organizations with total consolidated assets of $10 billion or more.

Staff seeks the Board's approval by vote at an open meeting to publish in the Federal Register the attached draft final rule and to make technical and minor wording changes to the document as necessary to prepare the document for publication.

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[1] Enhanced risk-based and leverage capital requirements and stress testing requirements for BHCs with total consolidated assets of $50 billion or more large BHCs were previously adopted. In 2011, the Board issued the capital plan rule requiring capital plans and governing capital distributions for BHCs with total consolidated assets of $50 billion or more, and in 2012, the Board issued final stress test rules for BHCs with total consolidated assets of greater than $10 billion.

The Committee on Bank Supervision has reviewed the draft final rule, and I believe it is ready for the Board's consideration.

Attachments

TO: Board of Governors

DATE: February 7, 2014

FROM: Staff[1]

SUBJECT: Final rules to implement the enhanced prudential standards of section 165 of the Dodd-Frank Act

ACTION REQUESTED: Approval of the attached final rule to implement certain of the enhanced prudential standards of section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for bank holding companies (BHCs) and foreign banking organizations (FBOs).[2] Staff also requests authority to make technical and minor wording changes to the attached materials to prepare them for publication in the Federal Register.

EXECUTIVE SUMMARY:

Scope of Application:

- The final rule applies enhanced prudential standards to BHCs and FBOs with total global consolidated assets of $50 billion or more.[3] Staff expects that 24 U.S. top-tier BHCs and approximately 100 FBOs would be subject to enhanced prudential standards under the draft final rule, and estimates that between 15 and 20 of those FBOs would be required to form a U.S. intermediate holding company (IHC).
- The final rule imposes stress testing requirements on FBOs with total consolidated assets of more than $10 billion and risk committee requirements on BHCs and FBOs that meet this threshold and are publicly traded.
- The final rule does not apply to nonbank financial companies supervised by the Board. The preamble notes that the Board will apply enhanced prudential standards to individual nonbank financial companies by rule or order.

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

[2] Pub. L. No. 111-203, 124 Stat. 1376, 1423-1432; see 12 U.S.C. § 5365.

[3] An FBO 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.

Timing.

- U.S. top-tier BHCs will be subject to the final rule's requirements beginning on January 1, 2015; FBOs will be subject to the final rule's requirements beginning on July 1, 2016.

Enhanced prudential standards for U.S. top-tier BHCs

- **Liquidity requirements**. A BHC with total consolidated assets of $50 billion or more must meet liquidity risk management standards, conduct internal liquidity stress tests, and maintain a 30-day buffer of highly liquid assets.
- **Risk management requirements**. A BHC with total consolidated assets of $50 billion or more must establish an enterprise-wide risk committee and appoint a chief risk officer.
- **Enhanced risk-based and leverage capital requirements and stress testing requirements** for large BHCs were previously adopted. In 2011, the Board issued the capital plan rule requiring capital plans and governing capital distributions for BHCs with total consolidated assets of $50 billion or more, and in 2012, the Board issued final stress test rules for BHCs with total consolidated assets of greater than $10 billion.

Enhanced prudential standards for FBOs

- **IHC requirement.**
  - An FBO with U.S. non-branch assets of $50 billion or more must hold its U.S. subsidiaries under an IHC. The IHC is subject to enhanced prudential standards on a consolidated basis. U.S. branches and agencies of an FBO may continue to operate outside of the IHC.
- **Risk-based and leverage capital requirements.**
  - An IHC of an FBO is subject to the risk-based and leverage capital standards applicable to BHCs (other than the advanced approaches capital rules, unless it specifically opts in). The IHC is also subject to the Board's capital plan rule.
  - An FBO with total consolidated assets of $50 billion or more must certify that it meets consolidated capital adequacy standards established by its home country supervisor that are consistent with the Basel Capital Framework.
- **Liquidity requirements.**
  - The U.S. operations of an FBO with combined U.S. assets of $50 billion or more must meet liquidity risk management standards and conduct internal liquidity stress tests.
  - The U.S. branches and agencies of an FBO must maintain a liquidity buffer in the United States for the first 14 days of a 30-day liquidity stress test. The IHC must maintain a liquidity buffer in the United States for a 30-day liquidity stress test.
  - An FBO with total consolidated assets of $50 billion or more but combined U.S. assets of less than $50 billion must 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.

- **Risk management requirements**.
  - An FBO with combined U.S. assets of $50 billion or more must establish a U.S. risk committee at either its IHC board of directors or its FBO board of directors that oversees the risk management function for its combined U.S. operations (branch and non-branch activities). The FBO must appoint a U.S. chief risk officer in the United States.
  - If the risk committee for the combined U.S. operations is not at the IHC, an IHC must have its own risk committee that oversees the risk management function for the IHCs operations. The risk committee may also serve as the U.S. risk committee for the combined U.S. operations.

The proposed single counterparty credit limits and early remediation requirements are still under development and are not included in the draft final rule.

BACKGROUND:

In order to prevent or mitigate risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities of, large, interconnected financial institutions, section 165 directs the Board to establish prudential standards for BHCs and FBOs with total consolidated assets of $50 billion or more and nonbank financial companies that the Financial Stability Oversight Council (Council) has designated for supervision by the Board (nonbank financial companies supervised by the Board).

The prudential standards must include enhanced risk-based capital, leverage capital, liquidity, risk-management, and stress test requirements and single counterparty credit limits.[4] The Board must also impose a 15-to-1 debt-to-equity limit on companies that the Council has determined pose a grave threat to the financial stability of the United States.[5] Section 165 permits the Board to establish other prudential standards that it

[4] 12 U.S.C. 5365(b)(1).

[5] 12 U.S.C. 5365(j).

determines are "appropriate," including three enumerated standards—a contingent capital requirement, enhanced public disclosures, and short-term debt limits.

While most of the enhanced prudential standards requirements in section 165 apply to BHCs with total consolidated assets of $50 billion or more and nonbank financial companies supervised by the Board, the statute directs the Board to issue regulations applying certain standards to BHCs with total consolidated assets of $10 billion or more. In particular, the Board is directed to require publicly traded BHCs with total consolidated assets of $10 billion or more to establish risk committees.[6] In addition, the Board is required to issue regulations imposing company-run stress test requirements on BHCs, state member banks, and savings and loan holding companies with total consolidated assets of more than $10 billion.[7]

On December 11, 2011, the Board invited comment on proposed rules to implement sections 165 and 166 (which requires early remediation of firms experiencing financial distress) for domestic BHCs with total consolidated assets of $50 billion or more and domestic nonbank financial firms supervised by the Board (domestic proposal). The domestic proposal also contained the capital stress testing requirement for BHCs with total consolidated assets of $10 billion or more and the risk committee requirement for BHCs that meet this threshold and are publicly traded. On December 14, 2012, the Board invited comment on proposed rules to implement sections 165 and 166 for FBOs with total consolidated assets of $50 billion or more and foreign nonbank financial companies supervised by the Board as well as the capital stress testing requirements for FBOs with total consolidated assets of more than $10 billion and the risk committee requirement for FBOs that meet this $10 billion threshold and are publicly traded (foreign proposal, and, together with the domestic proposal, the proposals). The domestic and foreign proposals contained similar enhanced prudential requirements. The foreign proposal would have required FBOs with total consolidated assets of $50 billion or more

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[6] See 12 U.S.C. 5365(h).

[7] 12 U.S.C. 5365(i).

and U.S. non-branch assets of $10 billion or more[8] to establish an IHC and organize its U.S. subsidiaries under that IHC.[9]

The Board received approximately 100 public comments on the domestic proposal and approximately 60 on the foreign proposal from U.S. and foreign firms, public officials (including members of the Congress and foreign regulators), public interest groups, private individuals, and other interested parties.

STANDARDS APPLICABLE TO BHCs

A. Enhanced Risk-Based and Leverage Capital Requirements

The draft final rule, consistent with the proposal, affirms as an enhanced prudential standard the previously-issued capital plan and stress testing (CCAR) requirements for BHCs with total consolidated assets of $50 billion or more (2011 capital plan rule).[10] The 2011 capital plan rule requires BHCs with total consolidated assets of $50 billion or more to submit annual capital plans to the Federal Reserve in which they must report the results of a nine-quarter capital stress test and demonstrate their ability to maintain capital above the Board's minimum risk-based capital ratios over the stress test horizon. (See Attachment, pp. 26-28.)

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[8] The proposal would have calculated U.S. non-branch assets as the sum of the consolidated assets of each top-tier U.S. subsidiary, excluding section 2(h)(2) companies. Section 2(h)(2) of the Bank Holding Company Act allows qualifying FBOs to retain certain interests in foreign commercial firms that conduct some business in the United States.

[9] On October 9, 2012, the Board issued a final rule implementing the supervisory and company-run stress-testing requirements for BHCs and for nonbank financial companies supervised by the Board. 77 Federal Register 62378; 77 Federal Register 62396 (October 12, 2012).

[10] 12 CFR 225.8. See 76 Federal Register 74631 (December 1, 2011). The 2011 capital plan rule currently applies to all U.S. bank holding companies with $50 billion or more in total consolidated assets, except for those BHCs that have relied on Supervision and Regulation Letter 01-01. Supervision and Regulation Letter 01-01 (January 5, 2001), available at: http://www.federalreserve.gov/boarddocs/srletters/2001/sr0101.htm.

B. Risk Management Requirements

The domestic proposal would have required a publicly traded BHC with total consolidated assets of $10 billion or more and a BHC with total consolidated assets of $50 billion or more (regardless of whether it is publicly traded) to establish a risk committee of the board of directors chaired by an independent director and with at least one member that has risk management expertise commensurate with the size and complexity of the company. BHCs with total consolidated assets of $50 billion or more would have been required to have a chief risk officer with risk management expertise and corporate authority commensurate with the size and complexity of the BHC.

Some commenters expressed the view that the proposed definition of "risk management expertise"—a qualification for both the risk committee member and the chief risk officer —was too narrow. Other commenters asserted that the domestic proposal would inappropriately assign managerial and operational responsibilities to the risk committee. The draft final rule would revise the "risk management expertise" requirement to focus on an individual's experience in identifying, assessing, and managing exposures of large, complex financial firms.[11] (See Attachment, pp. 36-39.) In addition, the draft final rule would clarify the risk committee's responsibilities to be oversight responsibilities. (See Attachment, p 32.)

C. Liquidity Requirements

The proposed liquidity requirements would have required BHCs with total consolidated assets of $50 billion or more to comply with liquidity risk management requirements, conduct internal liquidity stress tests, and hold a buffer of highly liquid assets based on the results of such stress tests. The preamble to the domestic proposal explained that the proposed liquidity requirements were designed to complement the quantitative liquidity coverage ratio (LCR) developed by the Basel Committee, which the

[11] For a publicly traded BHC with total consolidated assets of at least $10 billion but less than $50 billion, the draft final rule would recognize that risk management experience in a non-financial field could satisfy the requirement of the rule.

Board intended to implement through a separate rulemaking process.[12] The proposed liquidity stress test requirements were based on firm-specific stress scenarios and assumptions tailored to the specific products and risk profile of the company, whereas the LCR would be based on a standard stress scenario and standardized assumptions, permitting comparison across firms.

While commenters generally expressed support for the liquidity requirements in the domestic proposal, a few commenters asserted that the liquidity risk management requirements inappropriately would assign operational responsibilities to the board of directors. In addition, commenters requested that the Board expand the categories of assets that qualify as highly liquid assets and clarify that assets eligible under the U.S. implementation of the LCR (when finalized) could qualify as highly liquid assets under the domestic and foreign proposals.[13]

In light of comments, the draft final rule would reassign certain of the proposed liquidity risk management responsibilities from the risk committee of the board of directors to senior management. (See Attachment, pp. 57-59.) The draft final rule would maintain the proposed definition of highly liquid assets, but the preamble would clarify that any assets that qualify as high-quality liquid assets under the proposed U.S. LCR would be liquid under most scenarios. (See Attachment, pp. 76-77.)

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[12] The Board released its proposal to implement the Basel III liquidity coverage ratio (proposed U.S. LCR) in October 2013. See Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, 78 FR 71818 (November 29, 2013).

[13] The proposed definition of highly liquid assets included cash and securities issued or guaranteed by the U.S. government, a U.S. government agency, or a U.S. government-sponsored entity, and any asset that the BHC demonstrated to the satisfaction of the Federal Reserve: (i) has low credit and market risk; (ii) is traded in an active secondary two-way market that has observable market prices, committed market makers, a large number of market participants, and a high trading volume; and (iii) is the type of asset that investors historically have purchased in periods of financial market distress during which liquidity is impaired.

STANDARDS APPLICABLE TO FBOs

The foreign proposal would have established enhanced prudential standards for FBOs with total consolidated assets of $50 billion or more that would address the financial stability risks posed by the U.S. operations of FBOs. The proposed enhanced prudential standards were tailored to address the concentration, complexity, and interconnectedness of the U.S. operations of FBOs. In addition, the proposed standards were broadly consistent with the standards applicable to BHCs with total consolidated assets of $50 billion or more, in order to promote equality of competitive opportunity between BHCs and FBOs.

In recognition of the home country supervisory regime applicable to FBOs, the foreign proposal would have continued to permit U.S. branches and agencies of FBOs to operate in the United States on the basis of their home country capital and rely on home country capital requirements, stress testing standards, and governance structures to implement elements of the enhanced capital, stress testing, liquidity, and risk management regime for FBOs. The foreign proposal would not have imposed a cap on cross-border intragroup flows.

While some commenters supported the proposal as an enhancement of U.S. financial stability, many commenters criticized the proposal, particularly the proposed IHC requirement and the attendant capital, capital planning, stress testing, and liquidity requirements for the IHC. These comments are discussed below.

A. IHC Requirement

The foreign proposal would have mandated that an FBO with total consolidated assets of $50 billion or more and U.S. non-branch assets of $10 billion or more form an IHC and hold its interest in any U.S. subsidiary, other than a company held pursuant to section 2(h)(2) of the Bank Holding Company Act (a section 2(h)(2) company), through the IHC.[14] The IHC would have been subject to enhanced prudential standards on a consolidated basis, including risk-based and leverage capital requirements, capital planning, stress testing, and liquidity requirements. The IHC proposal was designed to provide a platform for supervising and regulating the U.S. operations of FBOs on a consistent basis and to further the financial stability objectives of the Dodd-Frank Act.

As noted above, many commenters criticized the proposed IHC requirement and application of enhanced prudential standards to the IHC. For instance, commenters argued that the IHC requirement and application of local capital and liquidity requirements would prevent the FBO from centrally managing its resources and reduce the FBO's flexibility to respond to stress in other parts of the organization. In addition, commenters argued that the proposed IHC requirement would be inconsistent with international regulatory coordination and cooperation, and could negatively impact cross-border resolution.

The draft final rule would maintain the proposed IHC requirement and the attendant capital and liquidity requirements for several reasons. While the proposed IHC requirement could incrementally increase costs and reduce flexibility of internationally active banks that primarily manage their capital and liquidity on a centralized basis, it would increase the resiliency of the U.S. operations of an FBO, the ability of the U.S. operations to respond to local stresses, and the stability of the U.S. financial system. A firm that relies significantly on centralized resources may not be able to provide support to all parts of its organization.[15] The draft final rule reduces the need for an FBO to

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[14] The term "subsidiary" was defined in the proposal using the Bank Holding Company Act definition. The foreign proposal would have provided the Board flexibility in exceptional circumstances to permit an FBO to establish multiple IHCs or use an alternative organizational structure to hold its interest in U.S. subsidiaries.

[15] 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. Committee on the Global Financial System, Funding patterns and liquidity management of internationally

contribute additional capital and liquidity to its U.S. operations during times of home country or other international stresses, thereby reducing the likelihood that a banking organization that comes under stress in multiple jurisdictions will be required to choose which of its operations to support. Finally, requiring FBOs to maintain financial resources in the jurisdictions in which they operate subsidiaries is consistent with existing Basel Committee agreements and international regulatory practice. U.S. banking organizations operate in overseas markets that apply local regulatory requirements to commercial and investment banking activities conducted in locally incorporated subsidiaries. The draft final rule would establish a regulatory approach to FBOs that is similar in substance to that in other jurisdictions. (See Attachment, pp. 98-109.)

International regulatory coordination will continue to be important. The preamble to the draft final rule reiterates that the Board has long worked to foster cooperation among international regulators and will continue to work with its international counterparts to strengthen the global financial system and financial stability. The preamble also observes that localized stress on internationally active financial institutions may trigger divergent national interests and increase systemic instability. The draft final rule, through the application of enhanced prudential standards to the U.S. operations of FBOs, would ensure that FBOs maintain financial resources in the United States more proportionate to their risk profiles, and lessen the likelihood that pro-cyclical actions would be required in a crisis. The preamble notes that an IHC would facilitate an orderly cross-border resolution of an FBO with large U.S. subsidiaries by providing one top-tier U.S. holding company to interface with the parent FBO in a single-point-of-entry resolution conducted by its home country resolution authority (which is the preferred resolution strategy of many FBOs) or to serve as the focal point of a separate resolution of the U.S. operations of an FBO in a multiple-point-of-entry resolution (which is the preferred resolution strategy of other FBOs). (See Attachment, pp. 109-113.)

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active banks, CGFS Papers No 39 (May 2010), available at: http://www.bis.org/publ/cgfs39.pdf.

Commenters questioned whether the IHC requirement was an appropriate prudential standard under the statutory framework. They also questioned whether the foreign proposal adequately reflects consideration of home country standards or gives due regard to national treatment and equality of competitive equity.

Section 165 does not itself require that an FBO establish an IHC. However, section 165 permits the Board to establish any supplemental prudential standard for covered companies that the Board determines to be appropriate. Section 165 does not define what it means for an additional prudential standard to be appropriate, though it would be consistent with the standards of legal interpretation to look to the purpose of the authority to impose the requirement. In this case, section 165 specifically explains that its purpose is to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions.[16] The IHC requirement directly addresses the risks to the financial stability of the United States by increasing the resiliency of the U.S. operations of large FBOs. The IHC requirement also provides for a consistent approach to capital, liquidity, and other prudential requirements across all U.S. subsidiaries and a single nexus for risk management of a FBO's U.S. subsidiaries, increasing the safety and soundness of these U.S. operations. In addition, the IHC will facilitate application of the enhanced risk-based and leverage capital, liquidity, and risk-management requirements to FBOs, each of which are mandated standards under the Dodd-Frank Act. (See Attachment, pp. 113-117.)

Section 165 also requires the Board, in applying all of the enhanced prudential standards under that section to FBOs, to give due regard to the principle of national treatment and equality of competitive opportunity, and to take into account the extent to which an FBO is subject to comparable consolidated supervision in its home country. The IHC requirement facilitates a level playing field between foreign and U.S. banking

[16] Section 165(a)(1) of the Dodd-Frank Act; 12 U.S.C. 5365(a)(1).

organizations operating in the United States, in furtherance of national treatment and competitive equity, by applying comparable standards to FBOs as apply to U.S. banking organizations. In particular, a U.S. firm that proposes to conduct both banking operations and nonbank financial operations must (with a few limited exceptions) form a bank holding company or savings and loan holding company subject to consolidated supervision and regulation by the Board. The IHC requirement subjects FBOs with large U.S. banking operations to comparable organizational and prudential standards.

The draft final rule takes into account home country standards as required by section 165. In recognition of the home-country supervisory regime applicable to foreign banks, the draft final rule would continue to permit foreign banks to operate through branches and agencies in the United States on the basis of their home-country capital. Accordingly, the draft final rule would not directly apply risk-based or leverage capital standards or stress testing standards to U.S. branches and agencies of FBOs. In addition, the proposed and final risk management standards provide flexibility for FBOs to rely on home-country governance structures to implement the draft final rule's risk-management requirements by generally permitting an FBO to establish a risk committee for its combined U.S. operations as a committee of its global board of directors. (See Attachment, pp. 104-107.)

While taking home country standards into account, the draft final rule also recognizes that foreign jurisdictions do not calibrate or construct their home country standards to address U.S. exposures or the potential impact of those exposures on the U.S. financial system. The consideration of the home country standards applicable to FBOs must be done in light of the general purpose of section 165, which is "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities," of these firms. The draft final rule, with the requirement that large FBOs establish an IHC and look to home country standards in operating branches in the United States, attempts to balance these two considerations.

Commenters argued that the Board should revise the IHC requirement by raising the asset threshold for the IHC requirement from $10 billion to $50 billion in U.S. non-branch assets or permitting FBOs to form "virtual" intermediate holding companies. In light of these comments and the applicable considerations under section 165, the draft final rule would raise the threshold for IHC formation from $10 billion to $50 billion in U.S. non-branch assets.[17] This threshold will reduce the burden on FBOs with a smaller U.S. footprint, but will maintain the IHC requirement for the larger FBOs that present greater risks to U.S. financial stability.

However, the draft final rule would not permit an institution to form a "virtual" IHC. A virtual IHC would retain a fractured organizational structure that can reduce the effectiveness of attempts of the FBO to manage the risks of its U.S. operations. It also would not enable the Board to apply the enhanced prudential standards transparently and consistently across the U.S. operations of FBOs, hindering achievement of the policy goals and implementation of section 165 of the Dodd-Frank Act. A virtual structure would also not materially enhance the ability to resolve the U.S. operations of an FBO. (See Attachment, pp. 143-145.)

Under the foreign proposal, an FBO that met the threshold for the IHC requirement on July 1, 2014, would have been required to establish an IHC by July 1, 2015, unless the time were extended by the Board. An FBO that met or exceeded the asset thresholds after July 1, 2014, would have been required to establish an IHC within 12 months after it met or exceeded the asset threshold, unless that time were adjusted by the Board.

Many commenters requested that the Board provide a longer period for compliance with the IHC requirement in order to facilitate and reduce the burden of the

[17] The final rule defines U.S. non-branch assets as the sum of the consolidated assets of each top-tier U.S. subsidiary, excluding section 2(h)(2) companies and subsidiaries of a U.S. branch or agency acquired to secure or collect debt previously contracted in good faith by that branch or agency.

corporate reorganizations needed to achieve compliance with the requirement. In response to comments, the draft final rule would postpone the initial compliance date for FBOs from July 1, 2015, to July 1, 2016.[18] The extended transition period would provide FBOs that exceed the asset threshold on the effective date of the rule with a reasonable transition period during which to prepare for the structural reorganization required by the draft final rule, as well as to comply with the enhanced prudential standards. In order to ensure that an FBO is taking the necessary steps towards meeting the rule's requirements, the draft final rule would require the FBO to submit an implementation plan on January 1, 2015 outlining its proposed process to come into compliance with the rule's requirements. (See Attachment, pp. 138-141.)

B. Risk-Based and Leverage Capital Requirements

Under the foreign proposal, an IHC would have been subject to risk-based and leverage capital requirements in the same manner as if it were a domestic BHC. An IHC with total consolidated assets of $50 billion or more would have been required to comply with the Board's capital plan rule.[19] The foreign proposal would have also required an FBO 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.[20] These proposed standards were designed to help ensure that these organizations have sufficient capital in the United States.

Many commenters criticized the capital and capital planning requirements, arguing that the Board should look to the capital adequacy of the parent and not separately

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[18] On July 1, 2016, the IHC would be required to hold the FBO's ownership interest in any U.S. BHC and U.S. subsidiaries representing 90 percent of the FBO's assets not held under the BHC. The draft final rule would also provide an FBO until July 1, 2017, to transfer any residual U.S. subsidiaries to the IHC.

[19] 12 CFR 225.8.

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

impose capital requirements on the U.S. operations of an FBO. For instance, commenters expressed concern that the proposed leverage capital requirements would cause foreign banks to withdraw from some U.S. financial markets, adversely affecting those markets. Other commenters argued that the proposal would increase systemic instability by increasing concentration among U.S. bank holding companies.

These comments assume that an FBO would choose to reduce its U.S. activities rather than comply with the requirements under the draft final rule. Some FBOs, however, will be able to meet the new IHC capital requirements by retaining more earnings in their U.S. operations or by contributing equity capital held at the parent to the IHC without having to do an external capital raise. In addition, these comments fail to account for the broader changes in the regulatory environment in which FBOs and their U.S. competitors operate. For example, under the draft final rule, U.S. bank holding companies with consolidated assets of $50 billion or more are subject to enhanced prudential standards parallel to those applied to IHCs, thus balancing the effect of the foreign proposal on competition and concentration of activities among domestic and FBOs.

To mitigate transitional costs for FBOs and the U.S. economy that may occur from the capital requirements and other aspects of the draft final rule, the draft final rule generally extends the initial compliance date for FBOs from July 1, 2015 to July 1, 2016. Furthermore, the leverage ratios of the draft final rule will not become applicable to the IHC until January 1, 2018. This extended transition period should help FBOs manage the costs of moving capital to the United States, and therefore should mitigate the impact that capital requirements might otherwise have on the IHC. (See Attachment, pp. 151-155.)

Commenters also asserted that application of the advanced approaches risk-based capital rules to IHCs would result in burdensome and duplicative internal models-based systems for determining risk-weighted assets. In addition, some commenters requested that the Board modify the requirement that an IHC comply with leverage capital requirements and requested that the Board allow instruments additional to those qualifying as regulatory capital under the Board's capital regulations to count as regulatory capital for an IHC.

In light of commenters' concerns regarding the burden of maintaining multiple internal models-based systems to calculate regulatory capital, the draft final rule does not apply the advanced approaches risk-based capital rules to IHCs, even if the IHC is a BHC. This modification responds to comments about duplicative model-based calculations required for the IHC. (See Attachment, pp. 156-157.) The capital adequacy of an IHC will be addressed by standardized risk-based capital rules, leverage rules, and capital planning and supervisory stress testing requirements.

The Board has longstanding experience applying leverage measures as complements to risk-based capital measures to banking organizations with a range of business models. From a safety-and-soundness perspective, each type of requirement offsets potential weaknesses of the other, and the two sets of requirements working together are more effective than either would be in isolation. The final rule therefore applies leverage requirements to the IHC as proposed. However, as described above, the final rule generally delays application of the leverage capital requirements to the IHC until January 1, 2018.

The draft final rule would not recognize alternative forms of capital that do not meet the criteria for capital instruments under the Board's capital rules for BHCs. The types of capital instruments that the Board recognizes in its revised capital rule are those that provide robust loss-absorbency at times of stress. The instruments cited by the commenters are not similarly loss-absorbent and may be contingent forms of capital support that could be ineffective if both the U.S. and the home-country operations experienced simultaneous stress. Furthermore, requiring the same types of capital instruments for IHCs and U.S. bank holding companies is consistent with national treatment and equality of competitive opportunity.

C. Risk Management

The foreign proposal would have required FBOs with global consolidated assets of $10 billion or more to certify that they have a risk committee that oversees the risk management practices of the combined U.S. operations[21] of the company and has at least one member with appropriate risk expertise.[22] FBOs with combined U.S. assets of $50 billion or more would have been subject to additional U.S. risk committee requirements and would have been 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. The foreign proposal would have required the U.S. chief risk officer to be employed by a U.S. subsidiary or U.S. office of the FBO.

Many commenters urged the Board to defer to home country risk management standards rather than impose separate requirements on FBOs. The proposed requirements were intended to address the financial stability risks posed by the U.S. operations of FBOs. By requiring a risk management function for the combined U.S. operations, the proposed requirements would enable FBOs effectively to aggregate, monitor, and report risks across their U.S. legal entities on a timely basis and facilitate the ability of U.S. supervisors to understand risks posed to U.S. financial stability by the U.S. operations of foreign banks.

While FBOs generally are subject to consolidated risk-management standards in their home countries, consolidated risk-management practices have not always ensured that a FBO fully understands the risks undertaken by its U.S. operations. For example,

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[21] The combined U.S. operations of a FBO include its U.S. branches and agencies and U.S. subsidiaries (other than any section 2(h)(2) company, if applicable).

[22] This requirement would apply to an FBO 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 FBOs 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 FBOs with total consolidated assets of $10 billion or more to establish a risk committee.

these practices generally have not supported the ability of large FBOs to aggregate, monitor, and report risks across their U.S. legal entities in an effective and timely manner. In light of the risks posed by FBOs with a large U.S. presence to U.S. financial stability, the draft final rule would require FBOs to establish a risk committee to oversee risk management for its combined U.S. operations and employ a U.S. chief risk officer to aggregate and monitor risks of the combined U.S. operations. (See Attachment, pp. 178-179.) The draft final rule would also clarify that the U.S. chief risk officer would have to be located in the United States, as well as employed by a U.S. subsidiary or U.S. office of the FBO. (See Attachment, p. 188.)

In addition, if the risk committee for the combined U.S. operations is not at the IHC, the draft final rule would require an IHC to establish and maintain a risk committee of its board of directors to oversee the risk management of the IHC. This risk committee could, but would not be required to, serve as the U.S. risk committee for the combined U.S. operations of the FBO.

D. Liquidity Requirements

The foreign proposal would have imposed liquidity risk-management, liquidity stress testing, and liquidity buffer requirements for FBOs with combined U.S. assets of $50 billion or more that were largely parallel to those proposed for large domestic BHCs. In light of the fact that FBOs operate through U.S. branches and agencies and U.S. subsidiaries, the foreign proposal would have required the FBO to conduct liquidity stress tests and maintain liquidity buffers sufficient to cover projected funding needs over a 30-day stress test horizon separately for U.S. branches and agencies and for the IHC. The IHC would have been required to maintain its entire 30-day liquid asset buffer in the United States, whereas the U.S. branches and agencies of an FBO would have been required to hold liquid assets to cover the first 14 days of their projected funding needs in the United States, and could keep their remaining buffer at their parent. In calculating the liquidity buffers, the foreign proposal would not have permitted FBOs to use internal (i.e., interaffiliate) cash sources to offset external funding needs.

Commenters requested that the Board eliminate these requirements and rely on an FBO's consolidated and enterprise-wide liquidity risk management systems and liquidity resources. Alternatively, commenters requested that the Board revise the liquidity risk management requirements to provide more flexibility for FBOs and to permit internal cash flow sources to offset third-party cash flow needs for purposes of calculating the liquidity buffer requirement. Moreover, commenters requested that the Board modify the liquidity requirements for U.S. branches and agencies so that the branch and agency network would only need to hold a 14-day liquidity buffer.

While maturity transformation is central to the bank intermediation function, it can also pose risks from both a firm-specific perspective and a broader financial stability perspective. For example, as discussed above, in a circumstance where multiple parts of an FBO come under stress simultaneously, a firm that manages its liquidity on a centralized basis may not have sufficient resources to provide support to all parts of the organization; indeed, during the recent financial crisis, many foreign organizations relied on substantial amounts of Federal Reserve lending to meet liquidity needs in the United States. (See Attachment, pp. 191-192.)

The draft final rule includes the proposed limit on the use of internal cash sources to offset external funding needs in order to limit the liquidity risks to the U.S. operations of FBOs under circumstances when the U.S. operations and the foreign bank parent experience simultaneous funding pressures. (See Attachment, pp. 214-2222.) The draft final rule would eliminate the requirement for an FBO to hold a liquidity buffer to cover the funding needs of its U.S. branches and agencies during the second half of the 30-day stress test in order to reduce burden on foreign banks without lessening the size of the buffer in the United States. (See Attachment, pp. 226-227.) The draft final rule would also clarify certain responsibilities of the risk committee and the chief risk officer, consistent with adjustments made in the draft final rule for BHCs described above.[23] Other than with respect to this modification and clarifications parallel to those made for

[23] See Section C in Standards Applicable to U.S. BHCs.

domestic firms, the draft final rule would retain the substance of the proposed liquidity requirements.

The foreign proposal would have applied a more limited set of liquidity requirements to FBOs with a smaller U.S. presence. An FBO with total global consolidated assets of $50 billion or more but combined U.S. assets of less than $50 billion would have been required to report annually to the Board the results of an internal liquidity stress test consistent with the Basel Committee principles for liquidity risk management[24] (either on a consolidated basis or for its combined U.S. operations). If an FBO did not satisfy this requirement, its U.S. branches and agencies would have been subject to intragroup funding restrictions. The draft final rule would finalize these requirements substantively as proposed. (See Attachment, pp. 232-233.)

E. Stress Testing

Under the foreign proposal, an FBO would have been subject to stress testing requirements at its IHC, if any, and with respect to its remaining U.S. operations. First, an FBO's IHC would have been subject to stress-testing requirements that are consistent with the rules applicable to BHCs.[25] Second, the FBO would have been required to be subject to a consolidated capital stress testing regime administered by the FBO's home-country supervisor, meet the home-country supervisor's minimum standards, and in some cases provide information to the Board about the results of home country stress testing. If these conditions were not met, the U.S. branches and agencies of the foreign bank would have been subject to an asset maintenance requirement, and if the FBO did not

[24] See Principles for Sound Liquidity Risk Management and Supervision (September 2008), available at: http://www.bis.org/publ/bcbs144.htm.

[25] IHCs with total consolidated assets of greater than $10 billion but less than $50 billion would have been subject to the annual company-run stress testing requirements set forth in subpart H of Regulation YY. IHCs with total consolidated assets of $50 billion or more would have been subject to subparts F and G of Regulation YY, which require annual supervisory stress tests by the Board and semi-annual company-run stress tests.

have an IHC, the FBO would have been required to conduct an annual stress test of its U.S. subsidiaries.

Most commenters expressed the view that the Board should fully defer to the home country stress-testing regime and limit its assessment to information contained on home-country stress test reports, rather than separately impose stress-testing requirements on the IHC. Commenters suggested that reporting requirements should be more limited for IHCs than for BHCs, and that public disclosure requirements should be waived.

The draft final rule would raise the threshold for formation of an IHC from $10 billion in U.S. non-branch assets to $50 billion, thereby limiting the scope of application of the stress testing requirements, but would otherwise retain the requirements substantively as proposed. The draft final rule would subject IHCs to supervisory and company-run stress tests in order to assess the capital adequacy of the IHC and its ability to continue operations in the United States during a period of stress. The reporting requirements would be parallel to those applicable to BHCs, as this information is necessary for the Board to conduct its supervisory stress test and to evaluate the results of an IHC's internal stress test. The public disclosure requirements would also be parallel to those applicable to BHCs in order to provide information to market participants and enhance transparency. (See Attachment, pp. 240-243.)

Under the foreign proposal, FBOs and foreign savings and loan holding companies with total global consolidated assets of $10 billion or more would have been subject to stress testing requirements that rely on the home-country stress test standards similar to those described above. The draft final rule would include these requirements without change. (See Attachment, pp. 256-259.)

OTHER STANDARDS

Section 165 provides that the Board must require a BHC and FBO with $50 billion or more in total consolidated assets and a nonbank financial company supervised by the Board to maintain a debt-to-equity ratio of no more than 15-to-1, upon a determination by the Council that the company poses a grave threat to U.S. financial stability and that the imposition of the requirement is necessary to mitigate that risk. Consistent with the proposals, the draft final rule would define the 15-to-1 debt-to-equity limitation and adopt procedures for its implementation. (See Attachment, pp. 84-88 and 259-261.)

Many commenters representing nonbank financial companies asserted that the proposed enhanced prudential standards were inappropriate for nonbank financial companies in light of their varied business models, activities, and existing regulatory regime. In order to allow the Board to more appropriately tailor the standards to nonbank financial companies, the draft final rule provides that the Board will apply enhanced prudential standards to such companies by rule or order. The expectation is that nonbank financial companies that are similar in activities and risk profile to BHCs likely will be made subject to enhanced prudential standards similar to those that apply to BHCs. For those that differ from BHCs in their activities, balance sheet structure, risk profile, and functional regulation, more tailored standards would be applied. In either case, the Board will provide nonbank financial companies with notice and opportunity to comment prior to determination of their enhanced prudential standards.

CONCLUSION: Based on the foregoing, staff recommends that the Board approve the attached draft final rule and related Federal Register notice. Staff also seeks approval to publish the draft final rule in the Federal Register and to make technical and minor wording changes to the draft final rule in order to prepare it for publication in the Federal Register.

Attachment