Institute of International Bankers

Advancing the interests of the International Banking Community in the United States

Executive Order 13772

U.S. Supervision and Regulation of International Banks:
Recommendations for the Report of the Treasury Secretary

April 28, 2017

Table of Contents

Introduction 4

Executive Summary 5

I. Balance Sheet and Capital Management 14

A. Intermediate Holding Company and Size Thresholds 14

1. The Federal Reserve Board's Intermediate Holding Company (IHC) Requirement Should Be Revised to Significantly Recalibrate the Requirements That Apply to IHCs 14

2. The Threshold for Applicability of Enhanced Prudential Standards Is Too Low and Captures an Inordinate Number of International Banks that Are Not Systemically Important to the U.S. Financial System 16

B. Capital and Liquidity 19

1. Capital Requirements for IHCs Are Duplicative of Home-Country Requirements and Should Be Tailored and Calibrated on an Institution-Specific Basis 19

2. IHC Capital Planning and Stress Testing Requirements Should Be Satisfied by Parent Bank Adherence to Home-Country Requirements 22

3. Inefficient Liquidity Buffer Requirements for International Bank Branches Should Be Eliminated 24

C. TLAC and Resolution Planning 27

1. The U.S. Internal TLAC Rules Should Be Revised to Encourage Lending to U.S. Businesses and to Support Foreign Banks' Global Resolution Strategies 27

2. U.S. Regulators Should Look First to Home-Country Resolution Plans and Only Impose Additional Requirements If Those Plans Do Not Adequately Address Risks to U.S. Financial Stability 31

D. Other Issues Based on Inappropriate or Undefined Size Thresholds 35

1. The Use of a Foreign Exposure Threshold as a Means of Imposing More Stringent Standards Should Be Eliminated 35

2. Designation to the Large Institution Supervision Coordinating Committee (LISCC) Portfolio Lacks Transparency and Creates Inefficiencies, Ineffectiveness and Inappropriate Tailoring 38

II. **Capital Markets** **41**

A. **The Volcker Rule** **41**

1. The Volcker Rule Is Fundamentally Flawed; If It Is Not Repealed, It Should Be Comprehensively Revised 41

2. Rulemaking and Interpretive Authority for the Volcker Rule Should Be Vested with a Single Regulator 44

3. The Volcker Rule Should Not Be Applied on an Extraterritorial Basis 46

4. The Volcker Rule's Treatment of Fund Activities Should Be Refocused and Tailored to Focus on the Core Policy of the Volcker Rule to Restrict Proprietary Trading in the United States 54

5. Adopting a Principles-Based Approach to the Volcker Rule's Trading Restrictions Would Enable Both U.S. and International Banks to More Efficiently Provide Beneficial Lending, Financial Intermediation and Market Liquidity 60

B. **Dodd-Frank Act Title VII Issues** **64**

1. Applying U.S. Rules to Otherwise Non-U.S. Transactions Because U.S.-Located Personnel Arrange, Negotiate or Execute Those Transactions Will Eliminate U.S. Jobs and Inhibit Effective Risk Management by Non-U.S. Dealers and Their Clients 64

2. Unduly Broad Application of the CFTC's Swap Dealer Registration Rules Will Limit the Ability of American Companies to Access Liquidity in Global Derivatives Markets or Funding from Bank Lenders 66

3. U.S. Regulators Have Taken an Unduly Limited Approach to Permitting Substituted Compliance with Regulatory Reforms in Non-U.S. Jurisdictions, Leading to Duplicative and Contradictory Requirements that Fragment the Global Derivatives Markets 68

4. The Extraterritorial Application of Certain Title VII Rules to Non-U.S. Dealers Conflicts with Local Privacy, Blocking and Secrecy Laws in Ways that Make It More Difficult for U.S. Clients to Access Liquidity from Non-U.S. Dealers and Hurts U.S. Dealers Operating Abroad 70

5. The CFTC and the SEC Have Implemented Parallel Title VII Reforms in Ways that Unnecessarily Diverge from Each Other and from Similar Reforms Adopted by Non-U.S. Regulators, Creating Undue Inefficiency and Completely Without a Corresponding Regulatory Benefit 72

III. Availability of Credit and Lending **74**

A. Leveraged Lending **74**

1. Application and Enforcement of the Agencies' Leveraged Lending Guidance Has Impeded Availability of Credit for Deserving U.S. Transactions 74

B. Single Counterparty Credit Limit **77**

1. The Manner in Which the Federal Reserve Board has Proposed to Apply a Single-Counterparty Credit Limit (SCCL) Would Impede the Availability of Credit in the United States 77

IV. Cross-Cutting Issues **81**

A. Risk Committee **81**

1. Greater Flexibility in Managing and Oversight of U.S. Risk Should be Provided to All International Banks; In Particular, International Banks Should Not Be Required to Maintain a U.S.-Focused Risk Committee at Their Home-Country Board of Directors 81

Introduction

The Institute of International Bankers (IIB) appreciates this opportunity to provide a series of recommendations for consideration by the Secretary of the Treasury as part of the study required by President Trump's Executive Order 13772. Our recommendations focus specifically on potential reforms that would improve the ability of internationally headquartered banking organizations operating in the United States (international banks) to promote U.S. economic growth.

Our members' U.S. operations perform a vital role in providing credit to U.S. businesses and liquidity to U.S. financial markets. Collectively, our members' U.S. operations hold approximately $5 trillion in bank and nonbank assets, fund 27% of all commercial and industrial bank loans made in the United States, constitute three of the top ten U.S. agriculture lenders and funded 71% of U.S. infrastructure loan volume over the last five years. Our members contribute to the employment of hundreds of thousands of employees in the United States, in the financial sector and related service sectors. As providers of credit and other financial services in the United States, our members add diversity and competitiveness to the U.S. financial services markets, help U.S. businesses grow and promote U.S. and international financial stability.

We have supported the ultimate goals of the responses to the 2008 credit crisis, including promoting U.S. and global financial stability and a sustainable economic recovery. We remain committed to ensuring that international banks operate in a safe and sound manner. At the same time, we laud the Trump Administration's initiative to re-examine the current state of U.S. financial services regulation. New regulations and supervisory requirements have been layered on both domestic and international banks since 2010, steadily and progressively, without this much-needed and overdue re-evaluation.

Beyond implementing the Dodd-Frank Act (which had its own flaws), U.S. regulators have innovated new requirements and standards. Indeed, the continuous development of new, more stringent standards and a strategy of keeping banks guessing about further requirements in the pipeline have become hallmarks of U.S. financial regulatory policy. This trend has made it all but impossible for banks to plan their strategies and make long-term investments in growth, including hiring, in the United States. This has been especially challenging for international banks navigating U.S., home country and other international regulations.

When asked, even senior officials from the U.S. financial services regulatory agencies have acknowledged that no agency or body (not the Financial Stability Oversight Counsel (FSOC), nor the Office of Financial Research) has stopped to evaluate the cumulative effects of the rules, regulations and guidance that have been adopted over the last seven years. In many cases, requirements were adopted in a way that assumed other requirements didn't exist, whether U.S. domestic or international. There has been no effort to step back and consider which requirements are now redundant or have gone too far.

The Treasury Secretary's study in response to Executive Order 13772 will be the first initiative to take that step back and understand what laws, rules, regulations and guidance make sense, and what has gone too far or created unintended consequences. It is not only timely but, we would submit, urgent. In 2015, international bank assets in the United States decreased by over $500 billion, largely due to Dodd-Frank implementation. That trend continued in 2016.

Executive Summary

Our paper makes a series of specific recommendations for laws, regulations and guidance that should be changed to further the Core Principles articulated in Executive Order 13772. We believe all of the Core Principles are important priorities. However, most of our recommendations are specifically oriented to making sure that U.S. bank regulation fosters economic growth and vibrant financial markets, and is efficient, effective and appropriately tailored. In particular, our recommendations are aimed at:

- Fostering economic growth and vibrant financial markets by eliminating excess costs and burdens placed on U.S. and international banks, particularly those that create incentives for international banks to reduce the scale of their U.S. operations or constrain their ability to provide credit and financial services to U.S. businesses.

- Preventing taxpayer-funded bailouts by ensuring that U.S. regulations support, rather than undermine, the global resolution strategies developed by international banks and their home regulators.

- Rationalizing the regulation of international banks to eliminate rules that are inefficient or ineffective and ensuring that rules are tailored to the actual business conducted by international banks and the risks (or lack thereof) they pose to U.S. financial stability.

- Restoring public accountability by supporting a transparent and clear regulatory framework and eliminating ambiguities and redundancies that may encourage regulatory agencies to regulate by discretion rather than clear rules.

While there are many areas for improvement in the post-crisis regulatory regime, as well as significant inconsistencies with the Core Principles articulated in Executive Order 13772, our paper focuses specifically on issues that are unique to international banks or have unique implications for international banks and their ability to promote U.S. economic growth and job creation.

Balance Sheet and Capital Management

We have two central recommendations related to the way U.S. regulations drive international bank balance sheet and capital management.

- First, the Federal Reserve Board's **intermediate holding company** (IHC) requirement should be **revised to significantly recalibrate** the requirements that apply to IHCs.
    - The IHC requirement, which was not required by Dodd-Frank or the Bank Holding Company Act (BHC Act), effectively "ring-fences" the U.S. bank and non-bank operations of international banks in the United States, causes international banks to hold even higher consolidated capital than would otherwise be required to comply with home-country rules implementing the Basel Capital Framework, limiting their ability to support U.S. economic growth, and has now contributed to European initiatives to

impose similar requirements on U.S.-headquartered banks (as we predicted several years ago).

- To mitigate the inefficiencies caused by the IHC requirement:

  - The threshold for requiring an IHC should focus on only those IHCs that are potentially significant to U.S. financial stability. This could be accomplished by raising the threshold substantially—from $50 billion in U.S. non-branch assets to $250 billion—or by creating a transparent risk-based analysis that applies the IHC requirement only to those institutions that pose systemic risk to the U.S. economy.

  - Capital and liquidity standards for IHCs should be adjusted to take into consideration the fact that an IHC is owned by an international bank that can act as a source of strength.

- Second, the Federal Reserve Board's **enhanced prudential standards** for systemically significant banking organizations **should be applied only to institutions that are in fact potentially significant to U.S. financial stability**.

  - We support general suggestions that have been made by other trade associations, Chairman Hensarling and even former Governor Tarullo and former Congressman Barney Frank that the size thresholds for enhanced prudential standards, including stricter capital and liquidity regulation, are too low and should be raised significantly above where they were set in the Dodd-Frank Act ($10 billion and $50 billion). This could be done by amending the threshold in Dodd-Frank to $250 billion or, alternatively, by tailoring a transparent risk-based standard to address systemic risk to the U.S. financial system.

  - Wherever the revised threshold is set, it should be clarified that the threshold applies to international banks **based on their U.S assets**, not their global assets. The Federal Reserve Board has interpreted the Dodd-Frank thresholds as based on global assets for international banks, leading to the absurd result that 110 international banks are considered systemically significant and subject to enhanced prudential standards, compared to only 26 U.S. bank holding companies (BHCs). Most of these 110 banks have very small U.S. footprints and are irrelevant to U.S. financial stability. In our view, the Federal Reserve Board could have interpreted the Dodd-Frank thresholds as based on U.S. assets, but it did not. The thresholds should be clarified, or the Federal Reserve Board should revisit its interpretation to undo this anomalous and burdensome result.

Beyond these core recommendations, we make several suggestions regarding changes to **capital, liquidity and related requirements** that apply to international banks and their U.S. IHCs, including:

- U.S. requirements imposed on IHCs should be tailored to take into account the support provided by the IHC's foreign parent and affiliates and the capital and liquidity available to an international bank's U.S. operations from outside the United States. Specifically:

- Separate, increased IHC-level capital and liquidity requirements should be reserved for circumstances where the Federal Reserve Board has made a determination that the IHC's non-U.S. parent would be unable to act as a source of strength (with regard to either capital and liquidity), either in the ordinary course or in a stress scenario.

- Capital and liquidity planning and stress testing should be revised to take into account the IHC's ability to source additional capital and liquidity from its parent and non-U.S. affiliates, and international bank stress testing should be conducted by the bank on a consolidated basis under home-country rules, with appropriate information provided to the Federal Reserve Board and other host country supervisors.

- In the case of IHCs, higher capital and liquidity standards should not be triggered by **thresholds based on foreign exposure**. The foreign exposure test was originally developed for determining which U.S. BHCs were large and internationally active, but it has since been borrowed as a threshold to increase the stringency of certain prudential rules. It is inappropriate for IHCs owned by international banks and it is not necessary to measure the size, complexity or systemic risk profile of either U.S. or non-U.S. institutions.

- The Federal Reserve Board's **Total Loss Absorbing Capacity (TLAC) rules** should be revised to make them better tailored to international banks, more effective and more efficient. The "internal" TLAC requirement imposed on U.S. IHCs of international banks should be changed so that it does not undercut the effectiveness of the global TLAC framework that applies to all internationally active banks. Specifically, the Federal Reserve Board's internal TLAC requirements for IHCs should:

  - Recognize the single-point-of-entry resolution strategies of most parent international banks under which only the top-most parent entity would enter resolution proceedings in its home country and subsidiaries, like the IHC, would be provided with the capital and liquidity support necessary to keep them solvent.

  - Be adjusted downward for single-point-of-entry IHCs to 75% of the equivalent for U.S. global systemically important banks (G-SIBs), recognizing both the availability of parent support described above and the substantially smaller footprints of IHCs as compared to U.S. G-SIBs.

  - Be revised to eliminate or significantly reduce the unnecessary and counter-intuitive long-term debt requirement.

  - Consistent with principles of national treatment, treat IHCs, the international bank parent of which has a global resolution strategy calling for the separate resolution of the IHC, the same as any comparably sized U.S. BHC, provided the IHC's operations are sufficiently ring-fenced from those of its international affiliates.

The combined effect of all of these features of the IHC framework, and the Federal Reserve Board's general approach to ring-fencing international bank capital and liquidity in the United States, is that international banks are further incentivized to shrink their U.S. operations, constraining their ability to invest in the United States, provide credit to U.S. businesses and boost employment and economic growth in the United States.

We also recommend changes to additional, non-IHC-related supervisory and regulatory requirements that indirectly affect international banks' balance sheet and capital management and create similar incentives to shrink U.S. operations.

- **Resolution planning (or "living will") requirements** for international banks should be fundamentally revised to defer in the first instance to home-country global resolution frameworks. Only if home-country global resolution strategies do not adequately address potential risks to U.S. financial stability should separate U.S. requirements be imposed, and then only on a more tailored basis. Many of the same problems with the resolution planning framework as it has evolved in the United States for domestic banks also affect international banks. In addition:

    - The U.S. resolution planning framework has been imposed on an excessively large number of international banks, most of which have tiny U.S. footprints. Of the 137 resolution plans submitted in 2015, 110 (over 80%) were from non-U.S. banks. The requirements are demonstrably out of proportion to actual systemic risk and wasteful of bank and supervisory resources.

    - For international banks with larger U.S. operations, the separate U.S. resolution plan requirement is duplicative of home-country resolution planning efforts and requires assumptions and the development of strategies that are directly contradictory to their global resolution strategy. The significant resources required by the current approach would be better spent on other business, compliance and risk management initiatives.

    - In our view, the solution to these problems is straightforward:

        - Banks with small U.S. operations (less than $250 billion in U.S. non-bank assets) should not be subject to a U.S. resolution planning requirement.

        - For banks with large U.S. operations ($250 billion or more of U.S. non-bank assets), the U.S. resolution planning process should focus on a review of the global resolution strategy for the bank to determine whether it adequately addresses risks to U.S. financial stability. If additional information is necessary to make such a determination, it should be tailored based on the nature and structure of the particular bank. We also support limiting the agencies responsible for reviewing resolution planning to the Federal Reserve Board.

- The Federal Reserve Board's process for placing large international banks into its **Large Institution Supervision Coordinating Committee (LISCC) portfolio** and subjecting them to stricter supervisory standards should be reformed to make it more transparent and objective.

- While the Federal Reserve Board has described the characteristics that would cause it to designate a bank as a LISCC firm, the way the Federal Reserve Board weights or scores these characteristics is opaque and appears to be highly subjective.

- Even though the decision placing an institution in the LISCC portfolio is opaque, the consequences are not. Some substantive (and burdensome) regulatory requirements, such as the Comprehensive Liquidity Analysis and Review (CLAR) regime and higher-tier capital planning expectations, are based primarily on LISCC status and affect the cost and availability of credit.

- To reform this process, and make the regulatory agencies more accountable, the Federal Reserve Board should adopt objective criteria through a notice and public comment process for designation of LISCC firms, apply those same criteria to allow a firm to exit the LISCC portfolio and create an appeal process for designations.

Capital Markets

Our single gravest concern regarding the implementation of Dodd-Frank in the capital markets area relates to the way the five agencies charged with implementing the **Volcker Rule** have extended its reach—far beyond Congress' original intent—to the non-U.S. operations of international banks. This has disrupted international banks' ability to trade with U.S. counterparties and trade through U.S. trading and clearing venues, it has hurt the U.S. companies that are customers and counterparties of international banks, it has discouraged new entrants into the U.S. banking system and it has generally negatively affected overall market liquidity.

- The Volcker Rule is fundamentally flawed, with numerous inherent problems that are not unique to its application to international banks, including its undue complexity, questionable policy basis and unintended consequences. To the extent the Volcker Rule is not repealed altogether, it should undergo a major review and revision to mitigate the adverse effects it has already created. Further implementation and enforcement of the Volcker Rule should be suspended until that review and revision is complete.

- Specifically for international banks, the chief flaw in the way the Volcker Rule has been interpreted and implemented is its extraterritorial reach. The final regulations implementing the Volcker Rule apply not only to the U.S. operations of international banks, but also to entirely non-U.S. operations—including transactions booked in head office, and even those with non-U.S. counterparties, where the risk resides outside the United States.

    - By extending the Volcker Rule's extraterritorial reach, the agencies have compounded its adverse effects on financial markets (including by impairing the ability of U.S. counterparties to reach additional sources of liquidity by transacting with non-U.S. financial institutions).

    - If it is retained in any form, the Volcker Rule should be returned to its originally intended scope for international banks—their U.S. operations.

  - The Volcker Rule should not apply to trading by international banks where the risk is booked outside of the United States. Among other things, international banks should be able to transact from outside the United States with U.S. companies, including using long-standing arrangements to access U.S. markets through an affiliated U.S. regulated broker.

  - Similarly, if an international bank permissibly sponsors or invests in a non-U.S. fund from outside the United States, the non-U.S. fund itself should not become subject to the Volcker Rule's limitations on sponsorship or investment in private equity or hedge funds or proprietary trading.

- As a related point, the scope of "private equity and hedge funds" should be returned to its originally intended purpose. With the creation of a new term, "covered funds," the agencies have caused the Volcker Rule to restrict a wide variety of fund, securitization and even unrelated intermediation and asset management activities in ways that Congress could not have intended. This problem is especially acute in the context of non-U.S. activities, where concepts based on U.S. regulatory definitions rapidly break down in application. A characteristics-based definition of private equity and hedge funds would significantly simplify this issue, especially outside the United States.

- The chief source of complexity and overbreadth arising from the Volcker Rule's proprietary trading prohibition is the presumption that all transactions in financial instruments are proprietary trading unless an institution can prove that the transaction meets the elements and conditions of regulator-determined exceptions and exclusions. Reversing this presumption, to preserve customer-driven market activity while targeting purely speculative proprietary trading, would go a long way toward improving how the Volcker Rule operates. It could also remove the multiple layers of policies, procedures and quantitative metrics required to "prove the negative proposition" that an institution does not engage in proprietary trading.

- More specifically, the proprietary trading prohibition should be clarified so that traditional funding and treasury operations are preserved. Effective funding, treasury and asset, liability and liquidity management operations are vital to a banking organization's ability to extend credit to U.S. businesses and participate in U.S. financial markets. Risks in a treasury function are typically hedged, managed and supervised in ways that should significantly mitigate any financial stability concerns in the area. Restricting the types of activities that may be used for these purposes may directly impair a bank's ability to make loans and ironically to manage its own safety and soundness.

  - For international banks, a prime example of this concern arises in the context of cross-currency swaps, FX funding swaps and other common cross-currency financing transactions, which are used to fund lending activities across borders. The Volcker Rule should not impede the movement of currencies for the purposes of providing credit and consummating transactions.

- An additional problem for international banks in the Volcker Rule relates to the ability to trade in foreign sovereign debt, which may include debt issued by the bank's home country and by host countries in which it operates. If the Volcker Rule remains, it should establish without doubt that U.S. and international banks can trade non-U.S. sovereign debt in an unrestricted manner similar to the complete exemption given to U.S. sovereign debt. Risk-based capital and other prudential requirements can be employed to control the risks associated with different types of sovereign debt.

- Rulemaking and interpretive authority for the Volcker Rule should be housed in a single prudential regulatory agency to increase regulatory accountability and rationalize and simplify the financial regulatory framework. The existing "working group" of five independent agencies is not "working". In the rulemaking phase, the process of drafting by committee was a significant factor behind many of the ambiguities and uncertainties in the final regulations. Since then, the working group has not been an efficient or effective forum to interpret those regulations. Giving one prudential regulatory agency sole rule-writing and interpretive authority would save regulatory resources and be a more efficient and far superior approach.

We also have significant concerns regarding the agencies' implementation of **Title VII of Dodd-Frank**, especially in the context of cross-border swaps and security-based swaps regulation. We have included recommendations to address circumstances where the agencies' broad extraterritorial application of Title VII reforms limits liquidity for U.S. persons and access to non-U.S. markets but does not mitigate risk to the United States.

- The Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) have imposed Title VII requirements on transactions between non-U.S. persons solely based on involvement of U.S.-located personnel in those transactions. Once these requirements are fully effective, they could lead non-U.S. clients to avoid transacting with U.S.-located personnel which, in turn, could eliminate a significant number of jobs in the United States. Because these requirements will apply to non-U.S. transactions that do not result in risk flowing to the United States, they should be eliminated.

- The CFTC has proposed to expand the extraterritorial reach of its swap dealer registration requirements to capture non-U.S. dealers providing liquidity to non-U.S. branches of U.S. banks and to non-U.S. subsidiaries of U.S. parent companies. The CFTC has also proposed to lower the de minimis threshold below which a person can transact without registering as a swap dealer. These proposals threaten to apply comprehensive swap dealer regulation to non-U.S. dealers with only a tenuous nexus to the United States, which could deter non-U.S. dealers from providing American companies market access and liquidity. The CFTC should not adopt either of these proposals.

- The U.S. agencies have applied Title VII reforms extraterritorially, resulting in entities being subject to both U.S. and home-country regulations. The cost of duplicative and conflicting regulations keeps U.S. firms from accessing non-U.S. markets and non-U.S. firms from investing in the United States. The U.S. agencies can address these issues by adopting a robust outcomes-based approach to granting "substituted" compliance for derivatives reforms.

- The SEC's security-based swap dealer registration rules, and the SEC's and CFTC's trade reporting requirements, potentially conflict with privacy, blocking and secrecy laws in the local jurisdictions of non-U.S. entities. These rules deter non-U.S. dealers from providing liquidity to U.S. markets, hurt U.S. dealers operating in non-U.S. jurisdictions and should be narrowed.

- The CFTC and SEC have failed to fully coordinate their implementation of Title VII reforms with each other or with non-U.S. regulators. As a result, the U.S. regulatory framework is unduly complicated and parties will be required to engage in costly and duplicative efforts to comply with both CFTC and SEC requirements. The SEC should re-propose their rules for security-based swaps to seek public comment on ways to simplify its regulatory regime by harmonizing with parallel rules adopted by the CFTC and non-U.S. regulators and leveraging existing regulatory efforts to comply with those rules.

Availability of Credit and Lending

Several regulatory initiatives adopted following the financial crisis directly affect international banks' ability to extend credit to U.S. borrowers, and many of these are ripe for reconsideration, as they threaten to impair U.S. economic growth.

- Our principal concern relates to the banking agencies' **leveraged lending guidance**, which has reduced the availability of credit and caused lending activities to migrate to the non-bank sector where they are not subject to bank supervision and regulation.
    - International banks are significant providers of loans and other credit products to U.S. borrowers that could be deemed "leveraged" under the banking agencies' guidance. These loans fund growth in the U.S. economy and the expansion of U.S. employment. Choking off this source of credit is inconsistent with the Core Principles.
    - The IIB supports sound credit risk management and appropriate supervisory oversight. However, as applied, the guidance has effectively become a prohibition on certain types of loans regardless of the overall quality of the credit and the risk-based capital a bank holds behind it.
    - The banking agencies' leveraged lending guidance should be revised to make it less rigid and more principles-based, and the banking agencies should apply the revised guidance without adopting proscriptive approaches that effectively prohibit certain types of loans.
- The Federal Reserve Board's proposed **Single Counterparty Credit Limit** (SCCL) for the U.S. operations of international banks would curtail the availability of credit in the United States and create inefficiencies and unnecessarily overlapping regulatory requirements. The proposal's attendant costs would provide at most only marginal benefits to U.S. financial stability.
    - U.S. branches of international banks are already subject to lending limits under state and/or federal law, and international banks are already subject to consolidated exposure limits similar to the SCCL. The proposed imposition of a new SCCL requirement on top of existing limits is unnecessary and should be abandoned.

- The application of an SCCL to the combined U.S. operations of an international bank should be rejected as redundant, unnecessary and an impediment to credit availability. An SCCL could be imposed on an international bank's IHC, but as recommended above, the threshold for the IHC requirement should be significantly increased or applied based on a transparent risk-based standard. Also several technical features of the SCCL should be revised, including the so-called "cross-trigger" feature of the SCCL and the treatment of home-country sovereign exposures.

- The Federal Reserve Board has proposed the SCCL twice, but in light of the remaining fundamental concerns with its negative implications for availability of credit in the United States, any further revisions should be put forward in a re-proposal subject to notice and public comment and not adopted in final form.

Cross-Cutting Issues

One additional area where U.S. regulation should be fundamentally changed to make it more tailored, effective and efficient is **the imposition of U.S. governance requirements** on international banks.

- Under current Federal Reserve Board regulations implementing the Dodd-Frank enhanced prudential standards, the board of directors of each of more than 100 international banks that are subject to the standards but are not required to establish an IHC must have a U.S. risk committee, regardless of the size of the bank's U.S. operations. By contrast, banks required to establish IHCs may locate the U.S. risk committee as a committee of the IHC board of directors. For most of these non-IHC banks, dedicating a committee of the global board of directors to oversight of U.S.-specific risks—as opposed to permitting them the flexibility to establish other arrangements that provide for effective board oversight of these risks—is completely disproportionate to the size and risk profile of their U.S. operations. A less prescriptive approach would avoid the anomaly of providing international banks with smaller U.S. footprints less flexibility in the design and location of their U.S. risk committee than is provided banks with substantially larger U.S. footprints.

- If the thresholds for enhanced prudential standards for international banks were revised to be based on U.S. assets (and not global assets), this would significantly address this issue. However, to the extent that U.S.-based risk management and risk committee requirements remain an element of the revised framework, they should be appropriately tailored so that they can be effective, efficient and not waste both bank and supervisory resources.

In sum, over time, the cumulative effect of applying disproportionate requirements to head offices of international banks will lead more and more banks to reconsider their decision to maintain banking operations in the United States (which are what trigger the requirements). If international banks withdraw from U.S. financial centers, it will mean loss of employment, diminished competition in U.S. financial markets, diminished financial stability and reduced diversity in providers of credit, with negative implications for U.S. business and job growth.

I. Balance Sheet and Capital Management

A. Intermediate Holding Company and Size Thresholds

1. The Federal Reserve Board's Intermediate Holding Company (IHC) Requirement Should Be Revised to Significantly Recalibrate the Requirements That Apply to IHCs

In early 2014, the Federal Reserve Board finalized its rulemaking on enhanced prudential standards applicable to international banks by imposing a structural reorganization requirement in addition to the legislatively mandated safety, soundness, capital, liquidity, stress testing and risk management standards. International banks with greater than $50 billion of U.S. non-branch assets are required to create a new IHC to hold all of their U.S. controlled subsidiaries. The IHC is then subjected to capital, liquidity, stress test, risk management and related requirements under generally applicable rules. The requirement to create an IHC was not based on any statutory mandate and was implemented by international banks only at considerable cost.

The IHC structure is a blunt instrument that was not appropriately calibrated to address systemic risk concerns. On the contrary, it has created significant costs to the U.S. economy by forcing reorganization of international banks' U.S. operations and causing many international banks to withdraw assets, personnel and product offerings from the U.S. market. The IHC requirement effectively "ring-fences" the U.S. bank and non-bank operations of international banks in the United States, causes international banks to hold even higher consolidated capital than required to comply with home-country rules implementing the Basel Capital Framework and has now contributed to European initiatives to impose similar requirements on U.S.-headquartered banks (as we predicted several years ago).

The global banking system has undergone significant changes, many of which have been imposed by regulations governing capital adequacy, liquidity, risk management, resolution planning and stress testing. The U.S. IHC structure for international banks imposes redundant regulation at a sub-consolidated level that has already been newly applied to an international bank's top-tier parent. As described in more detail below, every element of significant regulation applied to IHCs (including size thresholds, capital and liquidity standards, TLAC requirements and resolution planning mandates) creates an additional requirement that could be satisfied by U.S. regulatory review and supervision of materials provided by the consolidated organization under home-country rules. These costs significantly outweigh the benefits of the IHC structure, and now the European Commission has proposed to impose similar inefficiencies on U.S. banking organizations that operate in the EU.[1]

Due in large part to the layering of additional unnecessary requirements, we have witnessed a precipitous drop in the assets of international banks operating in the United States. In 2015, U.S. banking and broker-dealer assets of international banks declined by $500 billion, including a $230 billion decrease in banking assets. Notably, the significant decline in banking assets was one of only five yearly decreases in the last 35 years and the only decrease not related to a recession. This reduction in assets, which we

[1] European Commission Proposal for a Directive Amending Directive 2013/36/EU as Regards Exempted Entities, Financial Holding Companies, Mixed Financial Holding Companies, Remuneration, Supervisory Measures and Powers and Capital Conservation Measures (Nov. 23, 2016) (the EU IPU Proposal).

submit is largely due to the full panoply of regulations coming on-line, has served to limit international banks' ability to support U.S. economic growth, with diminished benefits to U.S. consumers and businesses. It also serves to concentrate activities and risks in other domestic banking sector participants, as well as the lesser regulated financial services sector.

Recommendation:

Both the concept and the implementation of the IHC requirement warrant a reevaluation and a comprehensive cost-benefit analysis. Many of the requirements applicable to the IHC could be replaced with discretionary supervisory tools that focus on analysis of the consolidated group support for U.S. operations. These tools could more effectively align with the Core Principles by enhancing regulatory efficiency, fostering appropriate tailoring and addressing a key source of regulatory redundancy. There are a number of specific and key modifications that would further the Core Principles, and we discuss these issues and our recommendations below.

Statute/Regulation/Guidance: Section 165 of the Dodd-Frank Act (12 U.S.C. § 5365); 12 C.F.R. Part 252, including 12 C.F.R. § 252.153; 79 Fed. Reg. 17,240 (Mar. 27, 2014).

2. *The Threshold for Applicability of Enhanced Prudential Standards Is Too Low and Captures an Inordinate Number of International Banks that Are Not Systemically Important to the U.S. Financial System*

The Dodd-Frank Act establishes asset-based thresholds of $10 billion and $50 billion to delineate those banking organizations that should be subject to more stringent regulation.[2] These thresholds were set "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, or ongoing activities, of large, interconnected financial institutions."[3]

Since 2010, many observers, including former Congressman Frank himself, as well as key regulatory officials have singled out these thresholds as too low and as the cause of significant regulatory burden for too many institutions that do not, in fact, pose financial stability risk. [4]

Furthermore, the manner in which the Federal Reserve Board has applied the threshold to international banks in regulations and guidance exacerbates the problem. Since the Dodd-Frank Act, the Federal Reserve Board has taken the view that, with regard to international banks, the $50 billion threshold applies to those institutions with global consolidated assets of greater than $50 billion, regardless of their U.S. footprint.[5] Under this interpretation, more than 110 non-U.S. institutions are required to adhere to some form of U.S. enhanced regulatory standard, while only 26 U.S. BHCs have consolidated assets greater than $50 billion. This is in contrast to the Financial Stability Board's (FSB's) determination that there are only 30 G-SIBs, only 8 of which are U.S. institutions.[6] Furthermore, of the 110 international banks with U.S. operations that are pulled into the U.S. systemic risk threshold, 59% (65) have less than $10 billion in U.S. assets and 79% (87) have less than $50 billion in U.S. assets.

---

2 See Dodd-Frank Act §§ 165(a), (h)(2) and (i)(2); 12 U.S.C. §§ 5365(a), (h)(2) and (i)(2).

3 Dodd-Frank Act § 165(a); 12 U.S.C. § 5365(a).

4 See, e.g., Daniel K. Tarullo, Governor, Federal Reserve Board, "Rethinking the Aims of Prudential Regulation" (May 8, 2014) ("Experience to date suggests to me, at least, that the line might better be drawn at a higher asset level--$100 billion, perhaps. Requirements such as resolution planning and the quite elaborate requirements of our supervisory stress testing process do not seem to me to be necessary for banks between $50 billion and $100 billion in assets. If the line were redrawn at a higher figure, we might explore simpler methods for promoting macroprudential aims with respect to banks above $10 billion in assets but below the new threshold."); Former Congressman Barney Frank, Transcript of "Getting Frank on Dodd-Frank", July 21, 2015 (size threshold likely a "mistake" and would "at least" index threshold); Systemic Risk Designation Improvement Act of 2016, H.R. 6392, 114th Cong. (as passed by House on Dec. 1, 2016, would replace automatic $50 billion with qualitative test to determine systemic risk).

5 See, e.g., 12 C.F.R. Part 252, Subparts L, M and N (various enhanced prudential standards applicable based on global consolidated asset levels); 12 C.F.R. § 243.2(f)(1)(iii) (international banks with greater than $50 billion of global consolidated assets are covered companies for resolution planning purposes). A number of regulations have been tailored based on the size of U.S. assets of an international bank, but the inclusion of international banks with greater than $50 billion of global consolidated assets in the category of firms to which more stringent regulation should apply has not been modified by the Federal Reserve Board.

6 FSB, 2016 list of global systemically important banks (Nov. 21, 2016) (the FSB 2016 G-SIB List).

The smaller the threshold, the more likely that smaller institutions either (i) cross the threshold and thereby incur costs not commensurate with their size or systemic risks (costs which are passed on to customers or which curtail business with customers) or (ii) spend resources to avoid exceeding the threshold (with one study finding that, for smaller institutions to avoid growth, they make money by increasing fees and charges related to existing business or they demand a premium on existing products to prepare for the possibility of greater regulatory costs[7]).

Therefore, in our view, neither (1) the focus of the thresholds on global consolidated assets nor (2) the size of the thresholds is sufficiently tailored to address those institutions that may affect the stability of the U.S. economy, in light of the fact that size is not a precise measurement of risk to financial stability. Recalibration on both fronts is necessary to avoid imposing unwarranted stringency of regulation on those entities that do not have a systemically important footprint in the United States.

Recommendations:

In order to free up capital to promote credit availability, to incentivize international banks to expand their U.S. operations (and thereby promote job creation and economic strength) and to reduce the costs of a threshold that does not have any empirical support, the following modifications should be made:

- The existing threshold of $50 billion of U.S. non-branch assets for triggering the IHC requirement was created through Federal Reserve Board regulation and is not dependent on the statutory threshold of the Dodd-Frank Act. Therefore, without need for statutory change, the IHC requirement for international banks should be modified. We support one of either:

  (1) increasing the threshold triggering creation of an IHC to $250 billion of U.S. non-branch assets of an international bank, or

  (2) establishing a risk-based analysis, similar to an analysis under the Federal Reserve Board's Form FR Y-15, to determine the effect solely of U.S. operations of international banks on U.S. financial stability; any such analysis should be based on transparent factors and trigger levels promulgated as clear rules or benchmarks subject to notice and comment by the Federal Reserve Board.

- Aside from the IHC requirement, which was a creation of the Federal Reserve Board rather than of statute, the statutory threshold for enhanced and more stringent regulatory standards should be increased to $250 billion or be calibrated to focus on transparent risk-based standards, as described above.

- Without need for statutory change, the Federal Reserve Board should modify the applicability of any size threshold or risk-based standard to international banks by applying it only to international banks' U.S. asset size or operations. This would more logically and closely align

[7] See Nicole Gelinas, Reforming Obama-Era Financial Regulation (Manhattan Institute Report, Apr. 2017) (discussing Christa Bouwman, Shuting Hu & Shane Johnson, Differential Bank Behaviors Around the Dodd-Frank Act Size Thresholds (forthcoming 2017-18)).

with the overall goal of addressing systemic risk to the U.S. financial system.

Statute/Regulation/Guidance: Sections 165(a), (h)(2) and (i)(2) of the Dodd-Frank Act (12 U.S.C. §§ 5365(a), (h)(2) and (i)(2)); 12 C.F.R. Part 252, Subpart O (requirements for IHC and for international banks with greater than $50 billion of both global and U.S. assets), including 12 C.F.R § 252.153 (IHC requirement based on $50 billion of U.S. non-branch assets); 12 C.F.R. Part 252, Subparts L, M and N (various enhanced prudential standards applicable based on global consolidated asset levels); 12 C.F.R. § 243.2(f)(1)(iii) (international banks with greater than $50 billion of global consolidated assets are covered companies for resolution planning purposes).

B. Capital and Liquidity

1. Capital Requirements for IHCs Are Duplicative of Home-Country Requirements and Should Be Tailored and Calibrated on an Institution-Specific Basis

The Federal Reserve Board's regulations imposing capital requirements on all IHCs trap capital in a manner that impedes cross-border financing flows, decreases lending by international institutions and results in the withdrawal by international banks from capital-intensive business lines in the United States.

The IHC requirement is not based on any statutory mandate and elements of the requirements applied to IHCs disregard Congress' directive to the Federal Reserve Board in the Dodd-Frank Act to take into account comparable home country supervision of foreign banks.[8] The current capital requirements unfairly disadvantage IHCs, which generally compete with large regional banks. Unlike these large regional banks, IHCs have foreign bank parents that are required to maintain minimum capital requirements significantly in excess of Basel III minimum ratios and are necessarily incentivized to ensure that their American operations' remain strongly capitalized. Unlike these foreign banks, U.S. banking organizations are not subject to any capital requirements by the Federal Reserve Board at the level of their intermediate holding companies. Foreign banks with U.S. operations should be treated similarly to U.S. banking organizations to ensure a level playing field both in the United States and for American banks abroad, which are increasingly vulnerable to ring-fencing requirements imposed by foreign regulators seeking to retaliate against an IHC requirement that is designed to trap capital in the United States.

Thus, foreign banks operating in the United States should be subject only to formal consolidated capital requirements at the level of their ultimate parent (under home country standards implementing the Basel III capital framework) and at the level of each functionally regulated subsidiary (where U.S. Basel III capital requirements apply to all depository institutions and similar capital requirements apply to broker-dealers, swaps dealers and insurance company subsidiaries).

The layering of capital requirements at the subsidiary IHC level means that IHCs are required to calculate and continuously monitor at least two very different capital requirements—the U.S. "standardized approach" as well as home-country "advanced" or models-based approaches. Most IHCs are also required to layer on a third calculation if its international bank parent is subject to the Basel I "floor" on the advanced approaches. This is in addition to multiple leverage ratio calculations (the U.S. generally applicable leverage ratio, the home-country implementation of the Basel leverage ratio and potentially the U.S. supplementary leverage ratio (SLR)). This complexity of compliance and reporting for IHCs imposes costs that are unjustified given that most IHCs have a U.S. footprint and operational profile in line with U.S. regional banks that are their peers in terms of asset size.

---

8 See Dodd Frank Act § 165(b)(2), 12 U.S.C. § 5365(b)(2) (Dodd-Frank Act's statutory mandate to "(A) give due regard to the principle of national treatment and equality of competitive opportunity; and (B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States"); Dodd-Frank Act § 169, 12 U.S.C. § 5369 ("The Board of Governors shall take any action that the Board of Governors deems appropriate to avoid imposing requirements under this subtitle that are duplicative of requirements applicable to bank holding companies and nonbank financial companies under other provisions of law.").

Furthermore, contrary to the previous assertions of U.S. regulators that the IHC capital rules would not require international banks to hold additional global capital, the requirements have caused international banks to incur substantial compliance costs and their subsidiaries to hold additional capital.[9] In particular, many international banks are subject to standalone home-country capital requirements which do not permit inclusion of capital held in consolidated subsidiaries, and therefore simply reallocating existing capital resources to the IHC may not be sufficient.[10]

We have already seen evidence that these requirements could ultimately harm American interests by encouraging foreign regulators to impose similar restrictions on U.S. banking organizations operating abroad, whether as retaliation or imitation. The European Commission recently proposed that certain non-EU banking organizations establish an intermediate parent undertaking (IPU) in the EU (similar to an IHC) over their EU operations under the EU IPU Proposal. The IPU will be subject to prudential regulation, including capital requirements, which could place American banking organizations operating in Europe under a similarly burdensome and unnecessarily duplicative capital regime.

Recommendations:

Accordingly, we urge the Treasury to recommend the following revisions to rationalize and simplify the Federal Reserve Board's enhanced prudential standards for international banks:

- Eliminate the requirement for all IHCs (whether or not they are BHCs) to comply with the risk-based and leverage requirements in the U.S. Basel III Rules so long as:
    - the IHC's parent international bank has certified to the Federal Reserve Board that it meets capital adequacy standards on a consolidated basis (including the assets in the IHC) under standards established by its home-country supervisor that are consistent with the Basel capital framework; and
    - any insured depository institution subsidiary of the IHC is in compliance with all applicable minimum risk-based and leverage requirements in the U.S. Basel III Rules.
- Certain capital requirements could be imposed on IHCs where circumstances warrant.

---

9 Yalman Onaran, European Banks Spend Billions to Get U.S. Units Fit for Fed, Bloomberg (Jun. 29, 2016).

10 See Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation (EU) No. 648/2012, 2013 O.J. L 176/2 (the Capital Requirements Regulation), Art. 6. In this case, the European Central Bank would have discretion to provide institution-specific waivers of these parent-only capital requirements. However, such waivers may only be granted where there are no material practical or legal impediments to prompt transfer of the subsidiary's capital back to the parent. In light of the Federal Reserve Board's capital planning rule (which effectively requires advance approval of all capital distributions over a nine-quarter planning horizon), as well as other impediments to distributions, it is at best unclear whether this condition for waiver of the parent-only capital requirement could be met.

Under this approach, any functionally regulated subsidiary of an IHC would remain subject on a separate, standalone basis to the capital requirements imposed by its functional regulator. For example, any U.S. insured depository institution subsidiaries of an IHC would remain subject to the U.S. Basel III Rules; its broker-dealer subsidiaries would remain subject to the SEC's net capital rules; and any swap dealer or insurance company subsidiaries would similarly remain subject to regulatory capital requirements appropriate to their operations as imposed by their functional regulators.

The Federal Reserve Board would retain its supervisory authority to require any IHC, including an IHC controlled by an international bank that meets home-country Basel standards, to maintain higher capital levels where such levels are appropriate to ensure that its U.S. activities are conducted in a safe and sound manner, to address an IHC's potential systemic risk to the U.S. financial system or to address weakness in capital at the IHC's parent company. This "Pillar 2" authority may be exercised as part of the Federal Reserve Board's ongoing supervision of the IHC, through notice, hearing and opportunity for appeal.

To the extent the Federal Reserve Board were to impose an IHC-level capital requirement on an individual IHC, it should calibrate such requirement by taking into account an international bank's consolidated capital, its home-country capital regime and the capitalization of its U.S. subsidiaries. The Federal Reserve Board's Strength of Support Assessment (SOSA) ratings, which play a fundamental role in the applications process and the ongoing supervision of international banks with U.S. operations, are a valuable tool that the Federal Reserve Board has long used to evaluate the availability and strength of an individual international bank parent's support for its U.S. operations in times of stress.

- While the IIB supports continued engagement with the Basel Committee on Banking Supervision, the Treasury and the Federal banking agencies should pause any implementation of additions to the Basel capital framework that would further increase capital requirements for all U.S. banking organizations, including revisions relating to the Fundamental Review of the Trading Book, until the cumulative impact of existing regulations can be assessed over a reasonable review period. This would be consistent with the overall goal of the Executive Order to re-evaluate the effects of the multi-layered post-crisis requirements.

Statute/Regulation/Guidance: 12 C.F.R. §§ 252.153(e), 217.1(c).

2. *IHC Capital Planning and Stress Testing Requirements Should Be Satisfied by Parent Bank Adherence to Home-Country Requirements*

The Federal Reserve Board has expanded the reach of stress tests, including the Comprehensive Capital Analysis and Review (CCAR), far beyond the Congressional mandate in the Dodd-Frank Act. Through the CCAR mechanism, large banks are effectively required to maintain excess capital now, well above the already elevated international standards, in order for their capital levels to continue to exceed regulatory minima at the conclusion of a hypothetical nine-quarter severely adverse set of conditions. Therefore, notwithstanding regulatory language that provides for specific minimum levels and buffers, the Federal Reserve Board is able to, outside of rulemaking procedures, require multiple percentage points higher capital levels for individual institutions.

For international banks, the inefficiency and arbitrary nature of this excess capital requirement is acutely intensified because international banks are required to run both (i) home-country stress tests at the global consolidated level and (ii) separate stress tests for their IHCs pursuant to the Federal Reserve Board's requirements at a sub-consolidated level. Should an international bank also own an insured depository institution with assets over $10 billion, this entity would be required to conduct a third layer of stress testing. Like U.S. banking organizations, international banks manage their capital and liquidity on a consolidated basis, and therefore rely on the flexibility to shift financial resources within the organization to the highest and best use, including, crucially, to a particular geographic or business operation in times of financial or market stress. The ultimate strength of a subsidiary organization resides in the ability to obtain support from the larger consolidated resources of the global enterprise. Yet, the current stress testing and capital planning requirements purposefully disregard the unique nature of the U.S. operations of international banks, their place in the larger organization and the possibility of receiving capital injections without going to the capital markets, thus trapping capital and liquidity inefficiently in the IHC.

***Recommendations*:**

Accordingly, we urge the Treasury to recommend the following revisions to the Federal Reserve Board's stress testing and capital planning standards for international banks:

- Require only that the top-tier international bank parent of an IHC submit to the Federal Reserve Board evidence of its participation in and results of home-country stress tests.

- Apply capital planning and stress testing requirements to IHCs only where there is demonstrated weakness in the organization, such as circumstances where:

  - the IHC's parent international bank has reported to the Federal Reserve Board results of stress testing under home-country standards that indicate the international bank parent would not maintain capital levels equal to at least the minimum requirements in the Basel Capital Framework under stressed conditions and during the stress horizon;

  - any insured depository institution subsidiary of the IHC has reported stress test results that indicate that it would not maintain capital levels equal to at least the minimum requirements under stressed conditions; or

- the Federal Reserve determines, after notice, hearing and opportunity for appeal, that the IHC's parent is not able to serve as a source of strength, the IHC's capital levels are not commensurate with its risk or that its capital planning processes are inconsistent with safety and soundness.[11]

If the Treasury determines not to incorporate these recommendations, we urge the Treasury nonetheless to recommend that the Federal Reserve Board:

- Employ stress testing as a supervisory tool only and eliminate the public disclosure of results;
- Eliminate the qualitative assessment portion of the CCAR for all IHCs;
- Prevent "backdoor" imposition of qualitative standards through the examination process; and
- Eliminate the requirement to conduct mid-cycle stress tests.

Public disclosure of CCAR results can have profound and disruptive market impacts for firms that "fail" either the quantitative or qualitative assessment. Furthermore, the attendant restrictions on capital distributions particularly impede a "failing" international bank's ability to manage risk effectively across the organization. Former Federal Reserve Board Governor Tarullo, who had been a leading proponent of increasing capital requirements, acknowledged that the CCAR qualitative assessment should be phased out for all banking organizations, including even the largest most complex banks.[12] Accordingly, we urge the Treasury similarly to endorse elimination of the qualitative component of CCAR, and to recommend that the repeal be meaningful and complete, and without Federal Reserve Board replacement of this regulatory requirement with "guidance" that is enforced in the manner of a regulation through the supervisory process.

Statute/Regulation/Guidance: 12 C.F.R. § 252.153(e). In addition, the Federal Reserve Board's instructions for its 2018 CCAR exercise, once issued, should reflect these revisions.

---

11 Our recommendation is intended to be consistent with our prior recommendation on the application of risk-based and leverage capital requirements—i.e., that minimum capital requirements as well as capital planning and stress testing should only be applicable to an IHC when individual circumstances warrant, after notice, hearing and opportunity for appeal.

12 Daniel K.. Tarullo, Governor, Federal Reserve Board, "Departing Thoughts" (Apr. 5, 2017) (Tarullo Departing Thoughts).

3. *Inefficient Liquidity Buffer Requirements for International Bank Branches Should Be Eliminated*

The liquidity buffer requirements applicable to U.S. branches of international banks with total consolidated assets, as well as combined U.S. assets, of greater than $50 billion are based on two critical but, we submit, mistaken assumptions: (1) that international banks will abandon their U.S. operations in favor of their non-U.S. operations, even though the market implications of actually letting material U.S. operations fail would likely stress the international bank to the point of collapse; and (2) that resources in other parts of the organization, or even in other offices of the same legal entity (the bank), would not be available to assist in meeting the payment obligations of the branch.

An international bank's U.S. branch network is currently required to hold a liquidity buffer of "highly liquid assets" sufficient to meet its net stressed cash flow needs for 14 days. This localized requirement traps liquidity at an international bank's U.S. branch network and prohibits reliance on liquidity available anywhere else in the international bank's consolidated group (including the IHC's U.S. operations) to meet expected short-term external cash flow needs. The analogous requirement applicable to IHCs also prohibits reliance on liquidity in the U.S. branch network or overseas to meet external cash flow needs. The liquidity requirement applicable to U.S. BHCs does not prevent the use of liquidity from other branches or subsidiaries to satisfy the regulatory minimum, provided there are no legal impediments to the free movement of liquidity between entities/branches. Therefore, the buffer requirement has increased liquidity costs for international banks in the U.S. financial markets and has trapped highly liquid assets that cannot be used for lending or redeployed to the capital markets. In addition, this requirement for branches of an international bank to trap liquidity in their U.S. operations encourages other jurisdictions to follow this example,[13] further compounding the risk of liquidity shortages in U.S. and global markets and potentially harming the ability of American financial institutions with operations in those jurisdictions to compete effectively and to lend efficiently.

Furthermore, the liquidity buffer requirement is both overbroad and unnecessary given the Federal Reserve Board's existing supervisory toolkit. Liquidity remains a core focus in the Federal Reserve Board's examinations of an international bank's individual branches as well as its combined U.S. operations. In addition, the Federal Reserve Board assigns a strength of support rating to international banks operating U.S. branches based on four major factors, the first of which is the financial profile of the international bank, including its liquidity. Branch examinations specifically review the liquidity and liquidity risk management of individual branches, and where exam results indicate weaknesses in these

---

[13] See, e.g., Daniele Nouy, Chair, Supervisory Board of the ECB, Statement at Press Conference on the ECB Annual Report on Supervisory Activities 2016 (Mar. 27, 2017) ("Third-country branches are subject to banking supervision, but at the national level and according to national standards. And these standards can greatly differ from one country to another. Some national supervisors, for instance, oblige third-country branches to have capital and liquidity of their own; others do not. All this runs counter to the idea of a level playing field in the euro area. It is an invitation to banks to engage in regulatory or supervisory arbitrage. Still, there might be a chance to address this topic as part of the current review of the European legislative framework … [O]ne easy correction to [the fact that large, third-country branches can operate in the EU without ECB oversight is t]he intermediate holding company that is on the table in the revision of the CRD IV/CRR, the branches should be attached, should be under this intermediate holding company for third countries, so would be also part of the SSM supervision because otherwise it is far too fragmented").

areas, the Federal Reserve Board has broad supervisory authority to impose an institution-specific liquidity buffer requirement through an enforcement action when warranted (either based on the liquidity position of the branch or its parent international bank).

Recommendations:

For these reasons, we urge the Treasury to recommend that the Federal Reserve Board revise its liquidity standards for international banks to:

- Eliminate the requirement for the U.S. branches of international banks to maintain a separate buffer of "highly liquid assets".

Even if the Treasury determines not to recommend elimination of the branch liquidity buffer requirement, we urge the Treasury to recommend to the Federal Reserve Board that:

- At a minimum, the liquidity buffer requirements should be appropriately tailored for international banks and IHCs to recognize liquidity inflows from the international bank's home office and other affiliates.

The Federal Reserve Board's rules governing liquidity buffers (for both branches of an international bank and IHCs) are currently determined based on unduly complex calculations. Internal cash flow sources from non-U.S. offices or from any affiliates (including inflows even within the U.S. from an international bank's branch network to its IHC and vice versa) are not permitted to offset short-term external cash flow needs. By contrast, U.S. banking organizations are permitted to rely on global sources of internal liquidity to meet their short-term external cash flow needs under the Federal Reserve Board's companion regulation. This bifurcation of internal and external cash flows has put significant pressure on defining the distinction between the two, is a cumbersome and inefficient calculation process that ignores organizational cash flow realities and has had unintended, adverse implications for the ordinary course financial intermediation that the U.S. operations of international banks regularly perform in order to deploy the international bank's global resources in the U.S.

- The U.S. rules implementing the Basel liquidity framework should not be expanded to apply to the U.S. branches of an international bank.

The Federal Reserve Board has also indicated on several occasions that it intends to propose new rules that would apply the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) to the combined operations (including the U.S. branches) of certain large foreign banking organizations.[14] The U.S. operations of international banks are already subject to the LCR (and will become subject to the NSFR) through the application of home country rules implementing the Basel liquidity framework to

[14] Liquidity Coverage Ratio: Liquidity Risk Management Standards, 79 Fed. Reg. 61,440, 61,447 (Oct. 10, 2014) (final rule implementing the LCR); Net Stable Funding Ratio: Liquidity Risk Management Standards and Disclosure Requirements, 81 Fed. Reg. 35,124, 35,128 (proposed June 1, 2016) (the NSFR Proposal).

their ultimate parent on a consolidated basis. Accordingly, there is no need to impose duplicative and potentially conflicting liquidity requirements on the U.S. operations of international banking organizations.

Statute/Regulation/Guidance: 12 C.F.R. § 252.157; 12 C.F.R. § 249.1(b)(1)(ii) (LCR); 81 Fed. Reg. 35,124 (proposed June 1, 2016) (the NSFR Proposal).

C. TLAC and Resolution Planning

1. The U.S. Internal TLAC Rules Should Be Revised to Encourage Lending to U.S. Businesses and to Support Foreign Banks' Global Resolution Strategies

The global TLAC standards developed by the FSB are designed to ensure that G-SIBs are able to be resolved in an orderly fashion without giving rise to systemic risk.[15] For most G-SIBs, this means adopting a single-point-of-entry (SPOE) resolution strategy, under which only the top-most parent entity would enter resolution proceedings in its home country and subsidiaries would be provided with the capital and liquidity support necessary to keep them in the market and out of insolvency proceedings. Other G-SIBs adopt a multiple-point-of-entry (MPOE) resolution strategy pursuant to which material subsidiaries operate independently from one another and will be resolved in an orderly manner in their jurisdiction of organization, separate from the G-SIB's non-U.S. operations.

The SPOE resolution approach requires the parent entity to maintain minimum levels of TLAC—equity capital and long-term debt that can be converted to equity during resolution to recapitalize the parent.[16] To provide advance support to subsidiaries (and to assure host regulators that local subsidiaries would be supported during resolution), loss-absorbing resources would also be "prepositioned" at subsidiaries in the form of "internal" TLAC.[17] This prepositioning would be accomplished by the subsidiary issuing equity or debt to its parent.

We support the FSB TLAC standard as a means of reinforcing structures that improve the resolvability of G-SIBs and of reducing the risks to taxpayers posed by such a resolution. Notably, this framework aligns the incentives of management and investors, reduces moral hazard and promotes cooperation between home and host authorities, which decreases the risk of discriminatory treatment of American banks abroad.

However, the <u>internal</u> TLAC rules adopted by the Federal Reserve Board undermine the effectiveness of the global TLAC framework.[18] Rather than reinforcing an SPOE resolution strategy, the U.S. TLAC Rule is premised on the assumption that the IHC itself could enter U.S. resolution proceedings and is calibrated to allow a separate resolution of the IHC—contrary to the global resolution plan for the international bank.[19] This assumption results in far higher levels of TLAC than if an SPOE resolution

---

15 <u>See</u> FSB, Total Loss-absorbing Capacity (TLAC) Term Sheet (Nov. 9, 2015) (the FSB Term Sheet).

16 This form of recapitalization—converting the debt of a distressed entity to equity—is the same approach taken in Chapter 11 bankruptcy proceedings for non-financial companies.

17 FSB Term Sheet, Items 16 Internal TLAC and 18 Size of the Internal TLAC Requirement.

18 Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (Jan. 24, 2017) (the TLAC Rule). The provisions of the TLAC Rule applicable to IHCs are codified at 12 C.F.R. §§ 252.160-167.

19 Although the internal TLAC rules contemplate different calibration levels for international banks pursuing different global resolution strategies, <u>all</u> internal TLAC calibrations, even those applicable to the IHCs of international banks pursuing an SPOE global resolution strategy, are established to address the situation where the IHC is "subjected to an orderly resolution in the United States [because] the foreign G-SIB is not

were assumed, because it ignores the fundamental basis of the SPOE strategy—the fact that the IHC (a subsidiary entity) would receive support from its parent entity during resolution.

Compounding this problem, the U.S. rules treat IHCs as though they pose the same risks to U.S. financial stability as U.S. G-SIBs by setting minimum internal TLAC requirements at near equivalent levels to the external TLAC levels requirements for U.S. G-SIBs.[20] This false equivalence ignores the fact that foreign banks' U.S. operations are a fraction of the size of U.S. G-SIBs,[21] engage in far more limited activities and benefit from the support of their home-country parent companies and resolution authorities.

Similarly, the requirement that a substantial portion of an IHC's TLAC be in the form of long-term debt further increases the effective TLAC requirements,[22] as equity capital maintained for other regulatory purposes (e.g., to satisfy stress-testing requirements) cannot be used to satisfy the debt requirement, notwithstanding the inherent loss-absorbing nature of such equity. Further, the U.S. rule's long-term debt requirement unduly constrains an international bank's means of supporting its U.S. operations. Prepositioning of loss-absorbing capacity at an IHC can be accomplished through equity alone (which is inherently loss-absorbing) or combinations of debt and equity. Likewise, support for an IHC can be provided in a variety of other ways, including parent guarantees, capital contribution agreements and similar structures. The international bank should have the flexibility to satisfy TLAC requirements (in excess of regulatory capital requirements), at least in part, in legally enforceable ways that accomplish the goals of the TLAC framework.

The Federal Reserve Board's TLAC rules for IHCs of MPOE G-SIBs are similarly excessive. These IHCs have separated their U.S. activities, assets and liabilities from those of the rest of the bank so that they can be resolved as standalone entities. The Federal Reserve Board appears to treat such IHCs as though their risks are equivalent to U.S. G-SIBs, solely because they are owned by a non-U.S. G-SIB.[23] The Federal

---

successfully resolved in an SPOE resolution or is otherwise unable to provide support to" the IHC. Id. at 8291-92.

20 Internal TLAC calibration levels are approximately ninety percent of equivalent external TLAC levels. Id. at 8290. See also 12 C.F.R. §§ 252.62 and 252.63 (establishing minimum external TLAC requirements) and 12 C.F.R. § 252.165 (establishing minimum internal TLAC requirements).

21 The average consolidated assets (as of Sept. 30, 2015) of the U.S. G-SIBs was $1.64 trillion, while the average consolidated assets of the IHCs subject to the U.S. TLAC Rule was $228 billion. For more details on this comparison, see page 21 of our TLAC comment letter (Feb. 19, 2016), https://c.ymcdn.com/sites/iib.site-ym.com/resource/resmgr/IIB_Comment_Letters/20160219IIB_TLACComments_fin.pdf (the IIB TLAC Letter).

22 For example, the IHC of a foreign bank pursuing an SPOE strategy must maintain TLAC equal to at least 16% of risk-weighted assets (RWA) and separately maintain TLAC-eligible long-term debt equal to at least 6% of RWA. See TLAC Rule, at 8291; 12 C.F.R. §§ 252.162 and 252.165 (establishing, respectively, minimum internal long-term debt and TLAC requirements).

23 12 C.F.R. § 252.165 (establishing minimum TLAC requirements for "resolution Covered IHCs." Such IHCs are permitted to issue TLAC to unaffiliated third-parties, like U.S. BHCs, but their minimum TLAC and LTD requirements are higher than for SPOE IHCs). Commenters urged the Federal Reserve Board to apply the same TLAC requirements to IHCs that apply to similarly situated U.S. banking organizations on the theory of national treatment. As the Federal Reserve Board acknowledged, the Dodd-Frank Act requires it to give due regard to national treatment and equality of competitive opportunity so that "neither U.S.

Reserve Board should instead recognize the separation between an MPOE IHC and its foreign banking parent and treat such IHCs the same as any other comparably sized U.S. BHC.

The Federal Reserve Board's excessively high TLAC requirements increase the cost to foreign banks of operating in the United States and constrain their ability to establish operations, hire U.S. personnel, grow their business and provide credit to U.S. businesses. By trapping excess resources in the United States, they inhibit the ability of foreign banks to dynamically allocate resources around the globe in response to stress or market conditions.[24] To decrease the amount of trapped capital in the United States, foreign banks naturally resort to limiting their U.S. operations to lower levels than they would under more flexible conditions and/or shifting jobs and capital out of the United States.

Recommendations:

The TLAC requirements for IHCs should support the global resolvability of international banks without diminishing competition in U.S. markets or constraining the availability of credit to U.S. borrowers. Some simple solutions could preserve the gains to financial stability originally intended by the rules but also preserve competition and cost savings in the U.S. economy. We recommend taking the following actions, each of which can be accomplished without statutory modifications and solely with adjustments to the rules cited below:

- Reduce the internal TLAC calibration for IHCs to levels that are approximately 75% of equivalent levels for U.S. G-SIBs, which is consistent with the FSB Standards. For IHCs that are not expected to enter resolution under the parent's global resolution strategy, that would mean reducing required levels as follows:
    - Reduce the RWA component from 16% to 13.5%;
    - Reduce the SLR component (for IHCs subject to the SLR) from 6% to 4.125%;
    - Reduce the Tier 1 leverage ratio (for IHCs not subject to the SLR) from 8% to 5.625%.[25]
- For IHCs that are expected to enter resolution under a global MPOE resolution strategy, the Federal Reserve Board should treat such IHCs the same as comparably sized U.S. BHCs and

---

banking organizations nor the U.S. operations of foreign banking organizations are unfairly disadvantaged." TLAC Rule at 8288. Nevertheless, the Federal Reserve Board rejected this approach on the theory that IHCs are not similarly situated to U.S. bank holding companies in the context of resolution because "they are connected to foreign G-SIBs, which affects the potential impact of their resolution, the contexts under which they will be resolved, and how their resolution will be conducted." Id. This theory does not apply, however, to MPOE IHCs that are sufficiently ring-fenced from the operations of their parent companies and have taken steps to be resolved separately in the United States.

24 As the Federal Reserve Board notes, "[the SPOE] approach is most effective when a foreign G-SIB parent has internal loss-absorbing capacity that can be freely allocated to whichever subsidiaries have incurred the greatest losses (including non-U.S. subsidiaries)." TLAC Rule, at 8291-92.

25 For more on the rationale for these calibration levels, see Section I.D of the IIB TLAC Letter.

only apply TLAC requirements to the same extent as applicable to such comparable U.S. entities.

- Eliminate the requirement for IHCs to maintain a minimum level of TLAC in the form of long-term debt, or, at the very least, significantly reduce the requirement.

- Allow greater flexibility in the loss absorbing instruments that could meet the TLAC requirement. In addition to equity and debt instruments, this could include legally-enforceable guarantees or capital contribution agreements.

Statutes/Regulations/Guidance: 12 C.F.R. § 252.160-167

2. *U.S. Regulators Should Look First to Home-Country Resolution Plans and Only Impose Additional Requirements If Those Plans Do Not Adequately Address Risks to U.S. Financial Stability*

Title I of the Dodd-Frank Act requires certain international banks to file plans periodically detailing how their U.S. operations would be resolved in the event of material financial distress. Supplemented by multiple rounds of guidance issued by the FDIC and Federal Reserve Board (without notice and comment), the resolution planning framework creates complex and burdensome requirements for international banks, many of which are also subject to resolution planning requirements in their home jurisdictions.

The U.S. resolution planning framework has been imposed on an excessively large number of international banks because the current rule applies to any bank with more than $50 billion in total consolidated assets worldwide irrespective of the portion of those assets in the U.S. This is not required by the Dodd-Frank Act. As a result, of the 137 resolution plans submitted in 2015, <u>110 (over 80%) were from non-U.S. banks</u>. The vast majority of international banks subject to the U.S. rules have total U.S. assets of less than $50 billion, with most having less than $10 billion. This illustrates the overreach of the rule, which should be limited to international banks that potentially could pose systemic risks for the U.S. financial system. With this goal in mind, it is clear that, for the vast majority of international banks, the rule imposes unnecessary burdens without any countervailing public benefit.

Further, the international banks with the largest U.S. operations are all subject to comprehensive resolution planning regimes in their home countries.[26] While the approach may vary from jurisdiction to jurisdiction, the home supervisors for these international banks have developed global resolution strategies that address the resolution of their U.S. operations. And U.S. regulators already have direct knowledge of these plans through their participation in the Crisis Management Groups (CMGs) for these banks.[27]

Where a resolution plan has been developed for an international bank with U.S. operations, the U.S. regulators should first look to that plan to determine whether it adequately addresses any potential threats to U.S. financial stability. Only in circumstances where the U.S. regulators determine that the global plan does not adequately address the resolution of the bank's U.S. operations should they ask for additional information. In such circumstances, consistent with the requirements of Section 165 of the Dodd-Frank Act to tailor prudential regulations based on the operations, structure and extent of home-

---

26 According to the latest FSB Peer Review, France, Germany, Spain, Switzerland and the UK (among others) all have statutory resolution and recovery planning regimes, while in Japan such requirements have been implemented through supervisory requirements. FSB, Second Thematic Review on Resolution Regimes – Peer Review Report (Mar. 18, 2016).

27 As described by the FSB, CMGs should "include the supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes of jurisdictions that are home or host to entities of the group that are material to its resolution" and act to "[enhance] preparedness for, and [facilitate] the management and resolution of, a cross-border financial crisis affecting the firm." Among other things, CMGs are specifically tasked with reviewing the resolvability of the bank. FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions §§ 7-8 (October 15, 2014).

country regulation of an international bank,[28] U.S. regulators should only impose additional resolution planning requirements for the U.S. operations to the extent necessary to fill any "gaps" in the global plan. A requirement to assess the global resolution plan for these international banks will encourage necessary coordination by the U.S. authorities with home country authorities, improve the cohesion of resolution planning, conform to the principle of home country supervision, and minimize unnecessary burdens on international banks while protecting the U.S. taxpayer.

By contrast, the current approach to U.S. resolution planning imposes one-size-fits-all and duplicative requirements that require many international banks to develop strategies for their U.S. operations that are in direct conflict with their global plans. For example, in newly issued guidance for the international banks with the largest U.S. operations, the FDIC and Federal Reserve Board require U.S. resolution plans to assume that the banks' IHCs will enter U.S. bankruptcy proceedings.[29] While this assumption may be consistent with the global resolution plans of the few international banks which plan a separate resolution of U.S. operations, it is directly contrary to the global plans of most international banks whose global plans focus on a SPOE resolution in the home country. These global plans have been developed by the home country authorities in coordination with host country authorities through CMGs. To require a deviation from these plans, and mandate the failure of the IHC, is also directly contrary to the stated objective of the Federal Reserve Board's recently adopted TLAC Rule, which was implemented to prevent the need for an IHC bankruptcy proceeding.[30] In short, U.S. resolution planning should, to the maximum extent possible, ensure conformity to the global plan. This is both consistent with Dodd-Frank and promotes global coordination to the direct benefit of U.S. interests.

Under the current approach, international banks must bear significant costs developing U.S. resolution plans that are duplicative of (and often contradictory to) their home-country plans. Further, international banks often must make costly changes to their U.S. operations in order to demonstrate that the plan meets the resolution planning assumptions required by U.S. authorities even though those assumptions contradict the developed global plan and there is no showing that the deviation is necessary to protect the U.S. financial system. This wastes the resources of the FDIC and Federal Reserve and of the international banks. The result is that the current approach to U.S. resolution planning directly contravenes the Administration's core principles of (i) making regulation efficient, effective, and appropriately tailored and (ii) fostering economic growth and vibrant financial markets through more rigorous regulatory

[28] See Section 165(a)(2)(A) and (b)(2) of the Dodd-Frank Act, 12 U.S.C. § 5365(a)(2)(A) and (b)(2).

[29] See Federal Reserve Board and FDIC, Guidance for 2018 §165(d) Annual Resolution Plan Submissions By Foreign-based Covered Companies that Submitted Resolution Plans in July 2015 at 4 (issued Mar. 23, 2017).

[30] In describing the requirement that internal TLAC long-term debt or "LTD" contain a clause enabling it to be converted to equity outside of an insolvency proceeding, the Federal Reserve Board explained that a "conversion trigger will allow covered IHCs that are in default or danger of default to be recapitalized through the conversion of eligible internal LTD to equity upon the occurrence of the trigger conditions in light of the losses that the covered IHC has incurred. Under certain circumstances, entry of a covered IHC into a resolution proceeding could pose a risk to the financial stability of the United States. Recapitalizing such a covered IHC outside of a resolution proceeding, and thereby reducing systemic risk, would advance the Dodd-Frank Act's goal of 'mitigat[ing] risks to the financial stability of the United States that could arise from the material financial distress' of the covered IHC without the need for government or taxpayer support." TLAC Rule at 8296 (internal citations omitted).

impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry.

Recommendations:

The following recommended modifications to the resolution planning regime applicable to international banks can be accomplished without statutory modifications and solely with adjustments to the rules and guidance cited below:

- Where a global resolution plan has been developed for an international bank with U.S. operations, U.S. regulators should look in the first instance to the global plan to determine whether it credibly addresses potential risks to U.S. financial stability and therefore satisfies the U.S. resolution planning requirement.

- If a bank's global resolution plan is determined not to adequately address potential risks to U.S. financial stability (or if there is no global resolution plan for the bank), per the Dodd-Frank Act requirement that the Federal Reserve Board should, when developing resolution planning requirements for foreign banks, give "due regard to the principle of national treatment" and "take into account the extent to which [a foreign bank] is subject to . . . home-country standards that are comparable to those applied . . . in the United States,"[31] the U.S. requirements should require only such additional information or analysis as necessary to determine whether the global resolution strategy adequately addresses potential risks to U.S. financial stability.

- If an international bank must develop a separate U.S. resolution plan, it should only need to demonstrate how its global resolution strategy, developed in coordination with its home-country supervisors, provides for the continuation or orderly resolution of its U.S. operations and avoids risks to U.S. financial stability; in such plans, international banks should not be required to make assumptions that are contrary to their home-country resolution strategy.

- Consistent with the notion of deferring to and supporting the global resolution strategy for the bank, and not requiring the separate resolvability of the IHC, the proposed regulations of the Federal Reserve Board, FDIC and OCC regarding the ability of counterparties to exercise early termination rights during resolution should not, if finalized, apply to IHCs.[32] At the very least, any IHC of any international bank that is subject to similar requirements in its home jurisdiction should be exempt from any finalized U.S. requirements.

---

31 Section 165(b)(2) of the Dodd-Frank Act, 12 U.S.C. § 5365(b)(2).

32 Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 81 Fed. Reg. 29,169 (proposed May 11, 2016); Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 81 Fed. Reg. 74,326 (proposed Oct. 26, 2016); Mandatory Contractual Stay Requirements for Qualified Financial Contracts, 81 Fed. Reg. 55,381 (proposed Aug. 19, 2016).

- In line with the U.S. Government Accountability Office's April 2016 recommendation to allow for longer than one year between resolution plan filings,[33] the timing and frequency of foreign filer's U.S. filings should be based on home-country standards.

- International banks with total U.S. non-bank assets of less than $250 billion should not be subject to any U.S. resolution planning requirements, including any requirement to file home-country plans.

Statutes/Regulations/Guidance: Section 165(d) of the Dodd-Frank Act (12 U.S.C. § 5365(d)); 12 C.F.R § 381; 12 C.F.R § 360.10; Guidance for 2013 § 165(d) Annual Resolution Plan Submissions by Foreign-based Covered Companies that Submitted Resolution Plans in 2012, released by the Federal Reserve Board and FDIC on April 15, 2013; Guidance for 2018 § 165(d) Annual Resolution Plan Submissions by Foreign-based Covered Companies that Submitted Resolution Plans in July 2015, released by the Federal Reserve Board and FDIC on March 24, 2017.

33 U.S. Gov't Accountability Office, GAO-16-341, Resolution Plans: Regulators Have Refined Their Review Processes but Could Improve Transparency and Timeliness 57 (2016).

D. Other Issues Based on Inappropriate or Undefined Size Thresholds

1. The Use of a Foreign Exposure Threshold as a Means of Imposing More Stringent Standards Should Be Eliminated

An institution's level of "foreign exposure" has increasingly been used as a threshold for triggering the application of more stringent regulatory requirements to U.S. BHCs and IHCs.[34] This requirement is an artificial construct of the Federal Reserve Board and not based on any statutory requirements. In light of the increased focus of international banks on the foreign exposure threshold since the 2016 requirement to establish IHCs, a number of issues and questions have emerged that we believe require elimination of the foreign exposure threshold.

Originally, the foreign exposure threshold was introduced (well before the Dodd-Frank Act) to identify those U.S. banking organizations that were sufficiently active internationally to warrant application of new, more flexible regulatory capital standards promulgated by the Basel Committee on Banking Supervision. However, with the proposal and adoption of a number of enhanced prudential standards under the Dodd-Frank Act over the past several years, the threshold has become increasingly divorced from this original purpose. Instead, the threshold has been used as a proxy for riskiness and complexity that triggers the application of more stringent requirements to those institutions that meet it.

At IIB's urging, the Federal Reserve Board recently removed the foreign exposure threshold as a criterion for distinguishing between (i) "non-complex" BHCs and IHCs that are exempt from the qualitative assessment under CCAR and (ii) "complex" BHCs and IHCs that are subject to the full CCAR qualitative assessment.[35] However, there are several other regulations, as well as proposed regulations, that still include the foreign exposure threshold, and it should be removed from those rules, too. Furthermore, the FFIEC 009 Instructions that detail the calculation methodology for the threshold have not been included as part of any of the enhanced prudential standard rulemakings that incorporate the foreign exposure threshold, notwithstanding their critical importance to how the threshold applies. The FFIEC 009 Instructions contain a number of presumptions and bright line rules that inexplicably increase the calculation of foreign exposure without sufficient policy rationale linking such presumptions and rules to risk or complexity.[36]

---

[34] On-balance sheet foreign exposures are generally calculated in accordance with the FFIEC 009 Country Exposure Report (the FFIEC 009) and accompanying instructions (as effective Sept. 2016) (the FFIEC 009 Instructions).

The foreign exposure threshold appears in a number of regulations (see, e.g., 12 C.F.R. §217.100(b)(1)(i)(B)(2) (regulatory capital rules); 12 C.F.R. § 249.1(b)(1)(ii) (LCR); 81 Fed. Reg. 35,124 (proposed June 1, 2016) (the NSFR Proposal); and 81 Fed. Reg. 14,328 (proposed Mar. 16, 2016) (the SCCL Proposal). In each of these regulations or proposed regulations, the threshold is designed to increase the severity of the rule for those institutions that cross the threshold.

[35] See Federal Reserve Board, Amendments to the Capital Plan and Stress Test Rules, 82 Fed. Reg. 9308 (Feb. 3, 2017) (CCAR Amendments).

[36] Some examples include: (i) although collateralized loans and other credit exposure can be shifted away from foreign exposure (perhaps to a foreign counterparty) and shifted to U.S. exposure if liquid U.S.

The foreign exposure threshold does little to identify actual risk or complexity, whether for IHCs or BHCs, and raises a number of issues that are specific to the nature of IHC subsidiaries of international banks. The Federal Reserve Board itself made the observation in the preamble to the CCAR Amendments that the mere size of foreign exposures tends to be over-inclusive when used as a metric for complexity.[37] Indeed, the Federal Reserve Board suggested that foreign exposures arising out of non-complex business activities should be viewed differently from exposures resulting from complex activities. Yet, the FFIEC 009 fails to incorporate this principle and treats every dollar of foreign exposure the same, without distinguishing exposures on the basis of their relative credit, liquidity or other risks.

An IHC is much more likely than a similarly sized and situated U.S. BHC to incur "foreign exposure" as calculated under the FFIEC 009 Instructions merely by engaging in (i) inter-affiliate transactions with its international bank parent or affiliates under standard enterprise-wide risk management practices, (ii) its role as an access point for U.S. dollars or high quality U.S. collateral for its affiliated organization and (iii) ordinary course transactions with a client base largely consisting of home-country customers and their U.S. subsidiaries (including when transacting with guaranteed U.S. subsidiaries).

The utility of the foreign exposure threshold as a metric to identify risks and complexity of an IHC is attenuated and has proven inappropriate. As the Federal Reserve Board noted in the CCAR Amendments, there are other measures, currently in use by the Federal Reserve Board and other bank regulators, that are better suited for measuring riskiness, complexity and interconnectedness of an institution.

Recommendations:

In order to promote international cooperation, preservation of a level playing field for U.S. and international banks and the cross-border flow of capital and financing resources:

- The foreign exposure threshold should be removed from all proposed regulations that have not yet been finalized (such as the SCCL Proposal and the NSFR Proposal) if they are ever

---

collateral (e.g., U.S. treasuries) is received, without explanation the same does not apply for reverse repurchase agreements or securities borrowing transactions (FFIEC 009 Instructions, Section II.F.5. at p. 13); (ii) the FFIEC 009 Instructions require gross counterparty exposure calculations, in contrast to the risk-based capital rules which would apply a net exposure concept to transactions such as repurchase agreements, securities borrowing, margin loans and derivatives; (iii) an IHC could potentially reach the foreign exposure threshold solely due to transactions with its international bank parent and foreign affiliates, grossly overstating the IHC's true risk and complexity (FFIEC 009 Instructions, Section II.E.1 at p. 11); and (iv) all exposures to a U.S. branch of an international bank are deemed to be foreign exposures (including exposure intra-U.S. of the IHC to its affiliate's U.S. branch as well as third party banks' exposure to U.S. branches of an international bank), regardless of whether the branch's head office writes a separate guarantee and notwithstanding mechanisms in U.S. federal and state law to mitigate risk to counterparties of a U.S. branch, thus penalizing exposure of U.S. and non-U.S. institutions to a U.S. branch of an international bank (FFIEC 009 Instructions, Sections II.F.3. at p. 12, and III.B. at p. 16).

[37] See CCAR Amendments at 9312 ("As a result, a metric aimed at accounting for complexity that is based solely on the size of a firm's foreign exposures, in this context, may be over-inclusive.").

adopted in final form; and

- Existing rules (such as the capital adequacy and LCR regulations) should be amended to remove the foreign exposure threshold.

Statute/Regulation/Guidance: The foreign exposure threshold appears in a number of regulations (see, e.g., 12 C.F.R. §217.100(b)(1)(i)(B)(2) (regulatory capital rules); 12 C.F.R. § 249.1(b)(1)(ii) (LCR); 81 Fed. Reg. 35,124 (proposed June 1, 2016) (the NSFR Proposal); and 81 Fed. Reg. 14,328 (proposed Mar. 16, 2016) (the SCCL Proposal)).

2. *Designation to the Large Institution Supervision Coordinating Committee (LISCC) Portfolio Lacks Transparency and Creates Inefficiencies, Ineffectiveness and Inappropriate Tailoring*

In 2012, the Federal Reserve Board established, through guidance rather than rulemaking, a "new framework" for supervision of large financial institutions,[38] under the auspices of the LISCC—a "collaborative body [designed to provide] System-wide and cross-disciplinary perspectives on the supervision of firms in the LISCC portfolio".[39] Yet, what originated as "coordinating" and "collaborating" has resulted in significant additional burden for institutions in the LISCC portfolio, and the Federal Reserve Board has also attempted to use designation to the LISCC portfolio (which is not subject to notice and comment, and carries with it no ability to appeal) as a criterion for imposing more stringent regulation.

The criteria by which the Federal Reserve Board has included firms in the LISCC portfolio are not transparent, particularly with regard to international banks. In addition to several U.S. BHCs, four international banks are currently included in the LISCC portfolio: Barclays PLC, Credit Suisse Group AG, Deutsche Bank AG and UBS AG. These institutions were not provided with ability to comment, debate or appeal—they were merely named to the portfolio. Other international banks, as well as other U.S. BHCs, cannot reasonably determine whether a periodic review of the portfolio of institutions by the Federal Reserve Board may result in their inclusion in the LISCC portfolio.[40] The lack of transparency and subjective nature of this process has led to perceptions that it is fundamentally results-oriented, and thus unfair.

The LISCC Framework indicates only that the LISCC portfolio consists of "the largest, most complex U.S. and foreign financial organizations subject to consolidated supervision by" the Federal Reserve Board.[41] The LISCC Website indicates that the Federal Reserve Board "takes into account a number of factors such as the size of the financial institutions, their interconnectedness, lack of readily available substitutes for the services they provide, their complexity and their global (cross-jurisdictional) activities."[42] While this list of characteristics is familiar as comprising the various indicators under the Federal Reserve Board's Form FR Y-15, the Federal Reserve Board has never publicly announced indicator score thresholds that would cause an institution to be included in the LISCC portfolio. Furthermore, while the 8 U.S. BHCs that are in the LISCC portfolio are also the only U.S. firms on the FSB 2016 G-SIB List, the 4 international banks in the LISCC portfolio are scattered on different tiers among the 22 non-U.S. institutions on the

---

38 Federal Reserve Board, Consolidated Supervision Framework for Large Financial Institutions, SR Letter 12-17 at 1 (Dec. 17, 2012) (LISCC Framework).

39 Federal Reserve Board, Governance Structure of the Large Institution Supervision Coordinating Committee (LISCC) Supervisory Program, SR Letter 15-7 at 2 (Apr. 17, 2015).

40 The Federal Reserve Board has indicated that "[t]he list of firms in the LISCC portfolio may be modified based on a review of the systemic importance of financial institutions doing business in the United States". Federal Reserve Board website, Large Institution Supervision Coordinating Committee (last updated July 14, 2016) (LISCC Website).

41 LISCC Framework at 2.

42 LISCC Website.

FSB's list and most of the other non-U.S. G-SIBs identified by the FSB also have significant U.S. operations.[43]

Understanding the potential likelihood of inclusion in the LISCC portfolio is critical, as the LISCC portfolio firms are subject to non-rule-based, discretionary burdens not imposed on non-LISCC firms.

- A LISCC international bank can have, based on the Federal Reserve Board's own study, anywhere from 9 to 21 on-site examiners, and can be subject to significant and voluminous data requests and multiple levels of continuous examination—exponentially greater burdens and oversight than those imposed on even large complex, but non-LISCC, international banks.[44]

- While many greater-than-$50 billion institutions are subject to the LCR, only LISCC firms are subject to the CLAR. Unlike CCAR which arguably is supported in concept by several regulatory provisions that have been subject to notice and comment rulemaking, the CLAR is not mentioned in any regulation and is imposed on LISCC firms based solely on the Federal Reserve Board's discretion. Furthermore, the CLAR requires adherence to requirements and the submission of information that are not part of the LCR rule.[45]

- LISCC designation also results in automatic inclusion in certain regulatory "tiers" designed for the most stringent regulation. For example, the Federal Reserve Board has created more stringent capital planning expectations for firms with more than $250 billion in total consolidated assets or more than $10 billion in foreign exposures. Yet, LISCC institutions are automatically in this "large and complex" category regardless of their asset or foreign exposure size, and apparently regardless of whether a LISCC firm that may currently exceed those thresholds reduces its asset or foreign exposure size.[46] As another example, under a Federal Reserve Board proposal to reduce burdens on certain institutions by creating exemptions from the CCAR qualitative assessment, the Federal Reserve Board would have made LISCC firms automatically ineligible for the relief.[47] It was not until the IIB urged the Federal Reserve Board to change this position that

---

[43] FSB 2016 G-SIB List.

[44] Thomas Eisenbach et. al., Supervising Large, Complex Financial Institutions: What Do Supervisors Do? 11-15 (Federal Reserve Bank of New York Staff Report No. 729, May 2015) (showing contrast between the regulation and information burdens imposed on LISCC portfolio firms and those imposed on large organizations outside the LISCC portfolio).

[45] See Daniel K. Tarullo, Governor, Federal Reserve Board, "Liquidity Regulation" (Nov. 20, 2014) (use of information "beyond those captured in the LCR"); Lael Brainard, Governor, Federal Reserve Board, "The Federal Reserve's Financial Stability Agenda" (Dec. 3, 2014) ("We use CLAR to analyze and adjust our supervisory program for emerging firm practices and risk areas not captured in the . . . LCR. For example, CLAR enables monitoring of firm liquidity positions for buildups of concentrations of risk beyond the 30-day threshold. It also allows us to look more closely at risks that may emanate from areas such as intraday credit, which are not captured within the LCR but are captured by firms' internal stress-testing frameworks.")

[46] See Federal Reserve Board, Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms, SR Letter 15-18 (Dec. 18, 2015).

[47] Amendments to the Capital Plan and Stress Test Rules, 81 Fed. Reg. 67,239 (proposed Sept. 30, 2016).

the agency clarified that a LISCC firm that was able to reduce its size below the thresholds for relief would be able to benefit from the relief.[48]

The lack of transparency with regard to the threshold or trigger for being designated a LISCC institution also, and perhaps more egregiously, denotes a level of arbitrariness and a lack of due process. Firms in the LISCC portfolio are notified that the Federal Reserve Board has designated them a LISCC firm. There is no debate, no comment period and, moreover, no ability to appeal. Yet, the Federal Reserve Board has created the LISCC construct under its own initiative and is, in its own discretion, applying significantly more stringent requirements and examination burdens on such firms once they are labeled as LISCC firms.[49]

Recommendations:

The Federal Reserve Board should tailor its regulations and guidance based on systemic importance, complexity and footprint solely in relation to the U.S. operations of international banks and should create transparent, and appealable, criteria when executing such tailoring. Without being able to understand the appropriate thresholds, the process becomes arbitrary and the results potentially unfair.

- The Federal Reserve Board should, through rulemaking subject to notice and comment, propose clear criteria and thresholds related to well-known metrics for being designated a LISCC institution. Such criteria should be based solely on U.S. operations of international banks.

- Once clear and understandable criteria are available, an institution should automatically be "de-designated" if it falls below such criteria.

- Even if designated, an institution should be provided a process for appealing such decision.

Statute/Regulation/Guidance: Federal Reserve Board, Consolidated Supervision Framework for Large Financial Institutions, SR Letter 12-17 (Dec. 17, 2012); Federal Reserve Board, Governance Structure of the Large Institution Supervision Coordinating Committee (LISCC) Supervisory Program, SR Letter 15-7 (April 17, 2015).

48 CCAR Amendments at 9313.

49 See also Press Release, House Financial Services Committee, Lack of Clarity and Due Process From Agencies Hinder Firms' Ability to Operate (Apr. 6, 2017) ("Key Takeaways from the Hearing [on increasing transparency in the financial regulatory system include]: Limited and ambiguous guidance from federal agencies in recent years has led to confusion for financial companies, impacting their ability to serve consumers and innovate. Evidence of limited due process and significantly delayed examination reports have also left financial institutions with a lack of clarity surrounding the federal agencies' interpretation of rules, making compliance with those rules more difficult.") (emphasis added).

II. Capital Markets

A. The Volcker Rule

1. The Volcker Rule Is Fundamentally Flawed; If It Is Not Repealed, It Should Be Comprehensively Revised

The Volcker Rule imposes restrictions on the ability of "banking entities", including both U.S. banking organizations and international banks with U.S. banking operations, to engage in "proprietary trading" and to "sponsor" or invest in "covered funds". As a policy, the Volcker Rule is not targeted at a primary cause of the financial crisis, but rather an hypothesis that consolidated banking organizations would be safer and more stable if they limit their activities to financial intermediation and lending, and not engage in proprietary trading with their own capital.[50]

As implemented, the Volcker Rule has gone far beyond this prudential proposition to regulate a vast array of conduct inside and outside of the United States and to impose onerous compliance burdens on a wide range of economically beneficial financial activities, such as market making and asset management. The need for the Volcker Rule has never been substantiated with more than anecdotal evidence, its implementation and enforcement have been largely divorced from its original purpose, and little regard has been given to the relative weight of the Volcker Rule's substantial costs against its speculative benefits.

Both the financial services industry and many of its commercial sector customers commented extensively during the rulemaking process on the excessive complexity of the Volcker Rule and its cumbersome and impractical implementing regulations that seek to determine the intent and effect of every trade undertaken worldwide. Many of these warnings have proven prescient, as the cost and complexity of compliance has burdened financial institutions of all sizes. These costs have proven detrimental to the functioning of both U.S. and global markets, as liquidity and capital formation suffer.[51]

Recently, senior regulators have also acknowledged that the Volcker Rule's complexity has imposed excessive costs relative to its speculative benefits. Among others:

---

50 See, e.g., Treasury Secretary Timothy F. Geithner: Hearing Before the Congressional Oversight Panel, 111th Cong. 46 (2009) (testimony of Treasury Timothy F. Geithner, Secretary, Treasury Department) (stating that "Now if you look at [the 2008 financial] crisis . . . most of the losses that were material . . . did not come from [proprietary trading] activities. They came overwhelmingly from what I think you can fairly describe as classic extensions of credit, particularly where they are backed by real estate."); Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing & Urban Affairs, 111th Cong. 28 (2010) (statement of Paul A. Volcker, Chairman, President's Econ. Recovery Adv. Bd.) (explaining that the Volcker Rule was designed to "look ahead" and try to prevent a future potential source of instability, and that it "certainly would not have solved the problem at AIG or solved the problem with Lehman Brothers, alone. It was not designed to solve those particular problems.").

51 See Jack Bao, Maureen O'hara & Alex Zhou, The Volcker Rule and Market-Making in Times of Stress, (Federal Reserve Board Finance and Economics Discussion Series No. 2016-102, Sept. 2016) (indicating a decrease in liquidity in certain markets).

- Federal Reserve Board Governor Jerome Powell, now the Chairman of the Federal Reserve's Board's Committee on Supervision and Regulation, has criticized the Volcker Rule's approach to proprietary trading, stating that: "What the current law and rule do is effectively force you to look into the mind and heart of every trader on every trade to see whether the intent . . . is proprietary trading or something else. And if that's the test you set yourself, you're going to wind up with tremendous expense and burden and . . . really quite marginal benefit."[52]

- Former Federal Reserve Board Governor Daniel Tarullo, the previous Chairman of the Committee on Supervision and Regulation when the Volcker Rule's implementing regulations were drafted, has admitted that "several years of experience have convinced me that there is merit in the contention of many firms that, as it has been drafted and implemented, the Volcker Rule is too complicated. Achieving compliance under the current approach would consume too many supervisory, as well as bank, resources relative to the implementation and oversight of other prudential standards. And although the evidence is still more anecdotal than systematic, it may be having a deleterious effect on market making, particularly for some less liquid issues."[53]

- William C. Dudley, President and CEO of the Federal Reserve Bank of New York, has suggested the Volcker Rule should be revisited: "[P]olicymakers might reexamine the implementation of the Volcker Rule to ensure that it is efficiently achieving its policy objectives. The fact is that most market-making activity has an element of proprietary trading."[54]

The Volcker Rule's attempt to segregate and prohibit "bad" proprietary trading from beneficial financial intermediation, client-facing asset management and capital formation activities is fundamentally flawed. The complexity of the implementing rules reflects the impossibility of the task. Concerns over risks from proprietary trading positions and fund activities are more effectively and precisely addressed with other tools, including in particular bank capital requirements and supervisory oversight of bank risk management systems. Meanwhile, the compliance burdens and limits imposed by the current framework restrict market liquidity and impede competition, capital formation and economic growth.

Recommendation:

If it is not repealed by Congress, then the regulatory agencies should be required to conduct a comprehensive cost-benefit analysis and a top-to-bottom reevaluation and revision of the Volcker Rule's implementing regulations. Because of the complexity and deleterious effects of the current regulations, regulatory supervision, examination and enforcement related to the Volcker Rule should be suspended

52 American Finance Association, Low Interest Rates and Financial Markets, YouTube (Jan. 30, 2017) (remarks of Federal Reserve Board Governor Jerome Powell at the Annual Meeting of the American Finance Association). See also Hazel Bradford, Time for a Post-Recession Review of 'What Worked and What Didn't' – Fed Governor, Pensions & Investments (Apr. 20, 2017); Steve Matthews, Fed's Powell Urges Congress to Take Another Look at Volcker Rule, Bloomberg (Jan. 7, 2017).

53 Tarullo Departing Thoughts.

54 William C. Dudley, President and CEO, Federal Reserve Bank of New York, "Principles for Financial Regulatory Reform" (Apr. 7, 2017) (Dudley Remarks).

pending such analysis, reevaluation and revision.

The IIB strongly supports a second look at the Volcker Rule. In our view, the Volcker Rule was flawed both in concept and in execution. Repeal or comprehensive revision of the Volcker Rule would further the Core Principles by enhancing regulatory efficiency and appropriate tailoring, would make supervisory resources available for other, more important prudential goals, would address a key source of arbitrary and unaccountable regulatory discretion and would enhance U.S. markets' ability to build wealth for American citizens.

The remainder of our recommendations with regard to the Volcker Rule focus on certain key changes particularly relevant to international banks that would further the Core Principles and that would foster U.S. and international market development. These issues and changes are discussed below.

Statute/Regulation/Guidance: Section 619 of the Dodd-Frank Act (12 U.S.C. § 1851); final rule[55] at 12 C.F.R. pt. 44 (Office of the Comptroller of the Currency (OCC)), 12 C.F.R. pt. 248 (Federal Reserve Board), 12 C.F.R. pt. 351 (FDIC), 17 C.F.R. pt. 255 (SEC); 17 C.F.R. pt. 75 (CFTC); final implementing releases at 79 Fed. Reg. 5536 (Jan. 31, 2014) (OCC, Federal Reserve Board, FDIC and SEC) and 79 Fed. Reg. 5808 (Jan. 31, 2014) (CFTC); Volcker Rule Frequently Asked Questions.

---

55 Each of the rulemaking agencies adopted substantially identical implementing regulations; for ease of reference, further citations to specific provisions of the final rule will refer to the implementing regulations adopted by the Federal Reserve Board.

2. *Rulemaking and Interpretive Authority for the Volcker Rule Should Be Vested with a Single Regulator*

The crippling complexity of the Volcker Rule's implementation was exacerbated by the decision to assign joint rulemaking and enforcement responsibility to five separate financial regulators (the Agencies).[56] Former Federal Reserve Board Governor Tarullo specifically identified the search for consistency across the five Agencies as one of the root causes of the implementing rules' complexity. In his view, "the inquiry into the intent of the bankers making trades to determine . . . whether the trades were legitimate market making" was a direct result of five agencies attempting to craft the rule to apply consistently to all manner of instruments. It has become "time-consuming", "unsuccessful" and, in his words, the Agencies need to "try something else".[57]

Involving five separate but equal Agencies in the Volcker Rule's implementation has also led to a profound lack of accountability and transparency, as a single Agency can stand in the way of consensus and block practical solutions to some of the Volcker Rule's many ambiguities, inefficiencies and unintended consequences.[58]

As just one example, in the second annual (March 2017) round of CEO attestations regarding banking organizations' Volcker Rule compliance programs, many banks filed their CEO attestations according to the same processes and procedures that the Agencies had accepted in the prior year, and were only told after the filing that the language used in the prior year would not be accepted. As a result, many financial institutions found it necessary to repeat their reporting-up processes, adding unnecessary costs to the process and absorbing resources away from productive financial services. [59] In normal circumstances this decision would have been communicated publicly with enough lead time before the next round of attestations to give banks time to adjust their internal processes. The difficulties of coordination and achieving consensus among the five Agencies appear to be directly responsible for this suboptimal outcome.

Similar examples abound among the requests for clarification or interpretive guidance that have been presented to the Agencies. Many of the "frequently asked questions" released by the Agencies have been helpful, but many more issues pending before the interagency working group remain unaddressed. Critical compliance questions that were raised with the Agencies in 2014 after initial promulgation of the implementing rules remain unanswered today. Multitudes of meetings have been devoted to various interpretive questions over the last 3 years that remain unresolved. In the context of international banking, the Agencies still have not provided sufficient guidance on the broad international issue of whether foreign funds that are completely permissible investments for international banks could

---

[56] The Agencies responsible for implementing the Volcker Rule are the OCC, Federal Reserve Board, FDIC, SEC and CFTC. 12 U.S.C. § 1851(b)(2).

[57] Tarullo Departing Thoughts.

[58] See Tarullo Departing Thoughts ("The first statutory problem is that five different agencies are involved. . . . [T]he disadvantages [of this approach] seem to dominate.")

[59] Most large banking organizations subject to the Volcker Rule have implemented extensive internal diligence processes, procedures and controls with subattestations covering various business lines in order to provide their CEO with support for the attestation mandated in the final rule.

nevertheless be "pulled back into" the Volcker Rule by being treated as an affiliate subject to the rule's restrictions. At the other end of the spectrum, even simple interpretive questions, such as which officers in an international bank are qualified to give the CEO attestation, and for which parts of the international bank, also remain outstanding.

In our view, regulations tend to work more efficiently and provide certainty to markets and the economy when an agency can act nimbly, speak with a single and consistent interpretive voice, and respond (in a timely fashion) when known ambiguities have the potential for negative effects or unintended consequences.

Recommendation:

Congress should amend the Volcker Rule to vest authority for rulemaking, interpretation and guidance in a single prudential regulator. Enforcement could remain with the relevant functional supervisors with expertise regarding their regulated institutions.

Centralizing rulemaking and interpretive authority for the Volcker Rule in a single regulator would further the Core Principles by vesting accountability in a single Agency and by streamlining the process for review and tailoring of the Volcker Rule to minimize inefficiencies and prevent undue interference in the financial markets. The Volcker Rule's statutory provisions appear in the BHC Act and form an element of prudential oversight of banking organizations in order to enhance the safety and soundness of their operations. From that perspective, a prudential banking regulator should be the single regulator named by Congress.

Statute/Regulation/Guidance: Section 619(b)(2) of the Dodd-Frank Act (12 U.S.C. § 1851(b)(2)).

3. The Volcker Rule Should Not Be Applied on an Extraterritorial Basis

The Volcker Rule was enacted as part of the BHC Act, a statute with broad global application. As implemented, the Volcker Rule applies a broad presumption that the holding companies of insured depository institutions and all of their affiliates and subsidiaries worldwide are covered by the rule, subject to a few narrow, limited exceptions. International banks are also "banking entities" for purposes of the Volcker Rule, and the Volcker Rule applies globally to the affiliates and subsidiaries of these international banks, whether or not those affiliates or subsidiaries are substantially involved in activities in the United States or otherwise are of material interest from a U.S. prudential supervisory perspective.

While the statutory coverage of entities was quite broad, the statute specifically contemplated preventing the Volcker Rule from affecting overseas activities of international banks.[60] These offshore exemptions derive from the understanding that the non-U.S. activities of international banks do not benefit from FDIC insurance, do not pose a risk to U.S. financial stability and do not create a risk of U.S.-taxpayer funded bailouts.[61] And yet, the final regulations promulgated by the Agencies did not implement faithfully these statutory exemptions for overseas activities. The regulations presume non-U.S. activity is covered unless the multiple conditions of a specific, narrow exemption for international banks can be satisfied. Therefore, as implemented, the final rule applies extraterritorially to a much broader scope of activities than is necessary to accomplish its policy goals or than was intended by Congress,[62] because the exemptions for non-U.S. activities are overly restrictive and in many cases not efficiently workable in practice.

In the past, the Federal Reserve Board's implementation of the extraterritorial limits of the BHC Act, including Section 4(c)(9) (referenced by the Volcker Rule), has drawn a much clearer territorial line than appears in the Volcker Rule's final regulations. Indeed, BHC Act regulations have permitted qualifying international banks to "engage in activities of any kind outside the United States", "engage directly in activities in the United States that are incidental to its activities outside the United States", and "own or control voting shares of any company that is not engaged, directly or indirectly, in any activities in the

60 See 12 U.S.C. § 1851(d)(1)(H) (permitting "proprietary trading conducted by a banking entity pursuant to paragraph (9) or (13) of section 4(c) [of the BHC Act], provided that the trading occurs solely outside of the United States and that the banking entity is not directly or indirectly controlled by" a U.S. banking entity); 1851(d)(1)(I) (similar permission for investments in, or sponsorship of, funds that are not offered or sold to U.S. residents).

61 See FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships With Hedge Funds & Private Equity Funds at 46 (Jan. 2011) (FSOC Volcker Study) ("[B]ecause of U.S. extra-territorial regulatory constraints, the statute does not restrict proprietary trading conducted by non-U.S. entities outside the United States. These entities are not eligible for discount window loans or federal depository [sic] insurance.").

62 See, e.g., 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley) ("[The Volcker Rule] recognize[s] rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law.").

United States, other than those that are incidental to the international or foreign business of such company".[63]

Conditions that subject offshore activity to the Volcker Rule discourage entry into the U.S. banking system from overseas due to concerns over the resultant limits that would be imposed on the foreign entrant's non-U.S. activities, leading to a reduction in foreign investment and related jobs in the U.S. financial and commercial sectors. The structure of the final rule's proprietary trading prohibitions and exemptions for offshore activities is especially problematic, because it discourages international banks from trading with U.S.-based customers and dealers in favor of their non-U.S. competitors, thereby creating risks and costs to U.S. customers, harming U.S. companies' access to markets and disadvantaging U.S. dealers. It also creates conflicts with international banks' home-country laws and regulations and supervisory standards, which creates unnecessary friction in negotiations between the U.S. and other countries regarding cross-border financial services and encourages other jurisdictions to adopt retaliatory measures applicable to U.S. banks that operate overseas.

In order to avoid these adverse effects, which serve no legitimate U.S. prudential purpose, the Volcker Rule's extraterritorial reach should be reined in and the Volcker Rule's restrictions should be limited to the "water's edge", as Congress intended. The original policy justification of the Volcker Rule was to protect the U.S. financial system and U.S. financial institutions from the risks of speculative proprietary trading. An appropriately tailored approach to implementing the Volcker Rule would limit its impact to the U.S. operations of international banks, rather than regulating the conduct of international banks outside of the United States, as described in more detail in the next four recommendations.

The Volcker Rule exemption for non-U.S. trading activities should be broadened to exempt all trading activities where the risk is booked outside of the United States

The non-U.S. trading and booking activities of international banks do not benefit from FDIC insurance, pose no risk to U.S. financial stability and create no risk of U.S.-taxpayer-funded bailouts. Accordingly, the statutory exemption for trading by an international bank outside of the United States (the so-called TOTUS Exemption) was designed to permit international banks to continue to engage in trading activities outside of the United States where the balance sheet risk was borne by foreign entities, not U.S. financial institutions. However, the final rule's conditions for relying on the TOTUS Exemption unnecessarily and inappropriately go beyond a focus on the location of the risk of the activity as principal to prohibit connections to the United States that have no bearing on risk to the U.S. financial system or U.S. financial institutions. These additional restrictions have a direct, negative impact on U.S. dealers, companies, and persons' access to market share, capital, liquidity and wealth generation opportunities.

Specifically, the TOTUS Exemption is unavailable for any trade where any of the banking entity's personnel that "arrange, negotiate or execute" the trade are located in the United States, or where the trade is conducted "with or through" any U.S. person or entity (including a U.S. counterparty to the trade), except in limited circumstances.[64] It also limits international banks' trading with the foreign

63 See 12 C.F.R. Part 211, Subpart B, and in particular 12 C.F.R. § 211.23(f)(1)-(3).

64 Such activities are often merely incidental to the principal activity conducted and booked outside the United States. See, e.g., footnote 63 above and accompanying text.

operations of U.S. financial institutions and other U.S. companies, because the TOTUS Exemption effectively requires the international bank to get representations from the foreign affiliate that none of the U.S. company's U.S.-based personnel are involved in arranging, negotiating or executing the trade. None of these limitations are relevant to the risk the international bank's trading activities present to the U.S. financial system, provided that the international bank's activities as principal are booked outside of the United States.

These restrictions have caused international banks to move key personnel involved in arranging, negotiating and executing trading to non-U.S. financial centers, harming U.S. financial sector employment and reducing efficiency by artificially separating trading personnel from the world's deepest and most robust financial markets. They also discourage international banks from trading with U.S. customers and counterparties and through U.S.-based financial intermediaries (because transactions with or through U.S. persons may still be covered by the Volcker Rule), thereby reducing market liquidity for U.S. market participants and market share for U.S. financial intermediaries.

Transactions by U.S. companies or persons with international banks broaden access to capital, liquidity and wealth. As a Core Principle, U.S. companies, financial institutions and customers should be able to make independent financial decisions to transact with international banks in order to participate in the marketplace and accumulate wealth. The decision by an international bank to book the risk of a transaction offshore should not increase the risk a U.S. counterparty faces in the transaction, and any U.S. dealer or other counterparty that is subject to the Volcker Rule would in any event be managing its own risk and compliance in the transaction. Increasing barriers to these cross-border transactions have only served to hinder expansion of the U.S. markets and economy.

Recommendation:

The TOTUS Exemption can be revised by the regulatory agencies without statutory change and, indeed, should be revised to execute more accurately the Congressional mandate to limit overseas application of the Volcker Rule and eliminate the restrictions on U.S. personnel of the international bank or its counterparty arranging, negotiating and executing trades and on trades conducted with or through U.S. entities (including the foreign operations of U.S. entities) that harm U.S. companies, financial institutions and persons.

Specifically, the TOTUS Exemption should be restated to exempt trading activity by any qualifying international bank that (i) is not directly or indirectly controlled by a banking entity organized in the United States, and (ii) books the trading position and associated risk as principal (including the financial obligation and ownership, and any financing directly provided for or risk related to that position) outside the United States. This would permit continuing trading in the United States through long-standing affiliate relationships (such as through permissible Rule 15a-6 arrangements), or, where customary, direct market access by the non-U.S. affiliate that books the transaction outside the United States.

Under our recommendation, the financial risks and any losses resulting from trading activities relying on the TOTUS Exemption would be borne by the international bank outside of the United States and subject to the activities limitations, capital requirements and other prudential requirements of their home (or host) jurisdiction. This would satisfy the core policy objective of the Volcker Rule—to protect the U.S.

financial system and U.S. banking organizations from the perceived risks of proprietary trading—while furthering the Core Principles by appropriately tailoring the Volcker Rule to focus on risks borne by the U.S. financial system and U.S. taxpayers, preventing the unnecessary expenditure of supervisory and compliance resources on non-U.S. activities of limited prudential interest in the United States, and removing artificial impediments to U.S. bank and investor participation in global financial markets.

***Statute/Regulation/Guidance*:** Section 619(d)(1)(H) of the Dodd-Frank Act (12 U.S.C. § 1851(d)(1)(H)); final rule at 12 C.F.R. § 248.6(e), and in particular § 248.6(e)(3)(i) (prohibition on U.S. personnel arranging, negotiating or executing the transaction) and § 248.6(e)(3)(v) (prohibition and various burdensome conditions on transacting with or through any U.S. entity).

The exemption for trading in foreign sovereign debt should be expanded to permit trading in foreign sovereign debt to the same extent as U.S. government debt

The Volcker Rule's exemption for trading in non-U.S. sovereign debt requires a fresh look. As currently written, its scope is limited and ambiguous, and calls into question the ability of both U.S. and international banks to trade home and host-country sovereign debt without restriction. The current rule takes a territorial approach to the permission, by allowing some entities to transact without Volcker Rule restrictions in the sovereign securities of the country in which the entity sits or, in some cases, the country in which the entity's parent sits. This narrow territorial approach only serves to fragment markets and segregate pools of liquidity. The exemption should be revised to ensure it does not interfere with the ability of U.S. and international banks to act as primary dealers, market makers and liquidity providers out of local offices, regional hubs and on a global basis, and to remove onerous market-making requirements that do not apply to these banks when trading U.S. sovereign debt.

Sovereigns need the liquidity that global banks (whether headquartered in or outside the United States) can provide. Many international banks and U.S. banking organizations serve as primary dealers to multiple sovereigns. In some cases, banking organizations that are subject to the Volcker Rule due to their U.S. operations are the principal intermediaries through which government financial and monetary policies operate. They also play critical roles as underwriters, market-makers and liquidity providers for sovereign, state, provincial and municipal debt issuances. Restrictions on the ability of banking organizations to continue to serve this critical liquidity provision, investment and intermediary role harm the governments they serve and make those U.S. and non-U.S. banking organizations less competitive in those markets than other banking organizations that do not have U.S. operations and therefore are not subject to the Volcker Rule's complex scheme of restrictions, exemptions and compliance and reporting requirements.

Currently both U.S. banking organizations and international banks are required, by the territorial approach described above, to segregate their trading activities among multiple exemptions—such as the narrow sovereign debt exemption for some entities or markets, or the TOTUS Exemption and the more onerous exemptions for market-making and underwriting activities for other entities or markets—that fail to efficiently cover all types of purchases and sales of sovereign debt across all affiliates and that impose a variety of restrictions, limitations and compliance burdens. For example:

- Ambiguities in the guidance provided in the preamble to the Agencies' implementing regulations as to which entities and branches within an international bank's affiliated group can transact in which sovereign securities outside the Volcker Rule has caused many international banks to rely on a patchwork of other exemptions. If a non-U.S. branch of an international bank trades sovereign debt with a non-U.S. counterparty, it may be able to rely on the TOTUS Exemption, but if it were to trade with a U.S. counterparty, it might need to comply with the Volcker Rule's market-making exemption, which would require adopting a complex and burdensome compliance, metric analysis and reporting framework.

- Certain foreign subsidiaries of a U.S. banking organization can trade in the sovereign debt of the country in which that subsidiary is located, but a regional hub outside of that country (e.g., a London regional hub seeking to trade other European sovereign debt) and the parent banking organization in the United States cannot rely on this formulation of the foreign sovereign debt exemption and would therefore need to comply with the more onerous market-making or underwriting exemptions to trade in the same sovereign debt instrument.

Recommendation:

The Agencies should expand the regulatory exemption for trading in non-U.S. government securities. The simplest solution would be a blanket exemption for all sovereign debt trading (the way that trading in U.S. government securities is exempted).

Given that the Agencies created the current sovereign debt exemption based on discretionary authority provided by Congress in Section 619(d)(1)(J) to the Agencies to create other exemptions, the expanded exemption could be accomplished without statutory change.

An expanded exemption for sovereign debt would further the Core Principles by leveling the playing field and facilitating more efficient sovereign debt trading operations for both U.S. and international banks, and would remove an irritant to foreign governments that discourages cooperation in international negotiations. The different levels of risk associated with different types of sovereign debt can be addressed in a more nuanced manner through risk-based capital and other prudential and supervisory requirements.

Statute/Regulation/Guidance: Sections 619(d)(1)(A) (U.S. sovereign and municipal securities) & (J) (discretionary authority) of the Dodd-Frank Act (12 U.S.C. §§ 1851(d)(1)(A) & (J)); 12 C.F.R. § 248.6(b).

Appropriate limits should be placed on the scope of non-U.S. entities subject to the Volcker Rule

The Volcker Rule applies globally to the affiliates and subsidiaries of international banks, whether or not those affiliates or subsidiaries are substantially involved in activities in the United States or otherwise are of material interest from a U.S. prudential supervisory perspective. The Volcker Rule exports the BHC Act's broad definition of control and affiliation in a manner not previously applicable to international banks given the general territorial limits of other BHC Act provisions.[65] Control or affiliation can be triggered by an investment representing only 25% of a class of voting securities or an investment that has "management control" from, e.g., more than minimal minority protective veto rights. As a consequence, minority-owned entities may be subject to Volcker Rule compliance burdens even when an international bank has no actual operational control over the entity. The scope of application of the BHC Act and Volcker Rule is often significantly broader than an international bank's home country rules defining which entities are within the international bank's regulatory and supervision perimeter.

For example, if a European bank with U.S. operations that is subject to the Volcker Rule makes a strategic minority investment in an Asian broker-dealer that is deemed "controlling" for BHC Act purposes, that Asian broker-dealer would become subject to the Volcker Rule and could not transact "with or through" any U.S. customer, counterparty or agent (applying the sweeping U.S. entity definition) without complying with the various requirements as to counterparty personnel, trading venue and clearing status. Similar situations arise frequently, and often result in disproportionate compliance burdens for minority-owned "affiliates" that have little or no connection to the United States. Such affiliates are often deterred from expanding into the United States or offering their products or services to U.S. persons (and boosting U.S. employment and liquidity to the U.S. financial markets) because it is easier for such a minority-owned entity to simply avoid U.S. connections rather than put in place a nuanced compliance plan (and, conversely, it is difficult for an international bank to monitor a minority-owned non-U.S. entity's compliance with the Volcker Rule because of lack of operational control over the entity).

Recommendation:

Nonconsolidated, minority-owned and operationally non-controlled non-U.S. investee companies of an international bank subject to the Volcker Rule should be excluded from the definition of "banking entity" and fully exempt from the Volcker Rule's prohibitions unless they themselves have Volcker Rule-triggering banking operations within the United States.

An example of this approach can be seen in the final swap margin rules promulgated by the OCC, FDIC, Federal Reserve Board, Farm Credit Administration and FHFA, which adopted accounting consolidation as the standard for determining subsidiary and affiliate status, after initially proposing a 25% "control" standard similar to that used in the BHC Act.[66] While the Volcker Rule statute applies the BHC Act control test to international banks when determining which affiliated entities are "banking entities" subject to the regulations, the Agencies created several carve-outs from the definition of "banking entity" in the final regulations and have subsequently exempted additional types of controlled entities from the Volcker Rule's prohibitions through informal guidance. Therefore, this recommendation could be adopted without statutory change, consistent with the manner in which the Federal Reserve Board has limited the extraterritorial application of other BHC Act provisions.

Excluding such non-U.S. entities would serve the Core Principles by appropriately tailoring U.S. regulation to focus on entities that have, or are operationally integrated with entities that have, banking

---

65 See footnote 63 above and accompanying text.

66 See 80 Fed. Reg. 74,840, 74,860 (Nov. 30, 2015).

operations in the United States. The activities of entities that would be excluded under this recommendation would present no risk of U.S.-taxpayer funded bailouts and are of quite limited prudential concern for U.S. regulators.

Statute/Regulation/Guidance: Section 619(h)(1) of the Dodd-Frank Act (12 U.S.C. § 1851(h)(1)); 12 C.F.R. § 248.2(c); Volcker Rule Frequently Asked Questions #14, Foreign Public Funds Sponsored by Banking Entities, dated June 6, 2015, and #16, Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds, dated July 16, 2015.

Consistent with the limitation of the Volcker Rule's substantive provisions to the "water's edge", the Agencies should also provide relief from application of disproportionate, burdensome and overly prescriptive compliance obligations to non-U.S. entities and entities engaged in a de minimis amount of covered activity.

If our recommendation to eliminate application of the Volcker Rule to activity booked outside the United States were adopted, then a significant source of the compliance burden (in the form of granular policies, procedures, systems, record-keeping and metrics requirements) would also be lifted from overseas entities.

If such recommendation were not adopted and activities booked to overseas entities were still subject to certain Volcker Rule restrictions, we believe that layering the granular and overly prescriptive compliance program requirements on whole entities or business lines overseas does not provide benefits to overall industry compliance, and merely creates running program maintenance costs that curtail availability of products and services. These requirements are especially disproportionate when applied to the non-U.S. affiliates of international banks, particularly if they engage in a relatively immaterial amount of (or, in many cases, no) U.S.-focused activity and do not have U.S. operations that would independently trigger application of the Volcker Rule. The result is a waste of Agency resources in the review and supervision of entities that would not be subject to Agency supervision under other U.S. or non-U.S. laws, for little if any marginal benefit.

Recommendations:

- The Agencies should clarify that the Volcker Rule's compliance program, attestation, reporting, metrics monitoring and prudential "backstop" provisions (conflicts of interest and high risk strategy/asset restrictions) stop at the water's edge, and do not apply to the non-U.S. operations of international banks. U.S.-based activities would continue to be subject to these requirements.

- Similarly, the Agencies should set a clear and transparent de minimis activity threshold, and exempt from the Volcker Rule's burdensome compliance obligations those entities or business lines (whether U.S. or non-U.S.) that have less than a "de minimis" level of potentially restricted activity. These thresholds could be set based on amounts of "open" risk within the entity or business unit.

Given the Volcker Rule's focus on risk to the U.S. financial system and U.S. taxpayers, it would further the Core Principles to focus the Agencies' examination and supervisory efforts on relevant U.S.-based activities in a proportional, tailored and efficient manner, as well as on relevant levels of activity that may cause risk. The current formulation of the rule absorbs the time and resources of both supervisors and international banks with compliance efforts focused on overseas or de minimis activities that present no risk of U.S.-taxpayer funded bailouts, are subject to regulation by home and host country regulators, and are of little or no prudential concern for U.S. regulators. For business units or entities with a de minimis level of potentially restricted activity, the compliance burden significantly outweighs the benefits. But, rather than designing further, ever more detailed exemptions and exclusions to capture these marginal occurrences, such entities should be excluded from the compliance program requirements, and a simple limit (e.g., based on P&L or risk) could serve as an efficient tool to monitor this activity.

As the scope and applicability of these compliance burdens was generally developed by the Agencies in the final rule and its appendices, this recommendation could be implemented without statutory change.

Statute/Regulation/Guidance: Sections 619(d)(2) & (e) of the Dodd-Frank Act (12 U.S.C. §§ 1851(d)(2) & (e)); final rule at 12 C.F.R. §§ 248.7, 248.15, 248.20 – 21 and Appendices A and B.

4. *The Volcker Rule's Treatment of Fund Activities Should Be Refocused and Tailored to Focus on the Core Policy of the Volcker Rule to Restrict Proprietary Trading in the United States*

The Volcker Rule prohibits banking entities, including international banks, from sponsoring or investing in private equity or hedge funds (defined as "covered funds" in the final rule) except pursuant to an exemption. The apparent policy rationale of this prohibition and related exemptions is to prevent evasion of the Volcker Rule's proprietary trading provisions through the use of commingled private investment vehicles and prevent bail-outs of private equity and hedge funds, but at the same time not restrict traditional asset management or investment management activities more broadly. Nevertheless, the manner of implementing the statutory provisions encroaches significantly on client-focused asset and investment management activities and does so on an unwarranted global basis.

Bona fide non-U.S. funds and other "non-covered" funds should be expressly exempted from compliance with the Volcker Rule

The Agencies used their discretion to exempt a number of types of funds and similar vehicles from the definition of "covered fund". These exclusions range from "foreign private funds" that have no U.S. investors (with regard to international bank investment or sponsorship activity) and foreign public funds that meet certain criteria to loan securitizations that meet narrowly defined criteria and U.S.-registered investment companies, among other vehicles.

Unfortunately, the utility of these exemptions (narrow as they are) was undermined by the way in which the final rule defines the scope of entities that are not deemed covered funds, and yet are still subject to the Volcker Rule. While investment in, structuring of and sponsorship of these exempt entities is permissible, these entities may themselves be deemed "banking entities" subject to the Volcker Rule's proprietary trading and covered fund restrictions if they are "controlled" by a banking entity for purposes of the BHC Act due to the banking entity's investment in or sponsorship of the fund. For example, for a foreign private fund structured as a partnership, under Federal Reserve Board precedents merely serving as general partner of a fund or controlling its board of directors with a nominal economic interest creates control under the BHC Act and could cause the partnership to be deemed a banking entity subject to the Volcker Rule. The result has been to call into question the status and compliance obligations of many wholly non-U.S. investment funds that are sponsored or receive investments from international banks, despite the lack of U.S. economic exposure or U.S. investors.

Resolution of this issue is extremely important to our international member banks, many of whom have extensive non-U.S. investments and asset management businesses that would be significantly affected if they were required to apply the Volcker Rule's proprietary trading and covered fund restrictions to foreign private funds. In an informal survey we conducted in September 2014, 18 respondent banks reported 2,313 foreign private funds over which they exercise control for purposes of the BHC Act and thus could be considered banking entities.[67] A 2015 European Banking Federation (EBF) survey of members revealed that eight of the eleven respondents would suffer severe or significant impacts on their non-U.S. asset management business due to the banking entity issues with controlled foreign private

[67] See, e.g., IIB Letter to Scott Alvarez (Sept. 12, 2014) (the IIB Letter).

funds. These eight institutions reported, in aggregate, in the range of 8,600 to 19,500 sponsored foreign funds.[68] We and other trade associations and individual banks have raised this issue with the staffs of the Agencies on numerous occasions over the last 3 years with no resolution.[69]

Similar issues arise for many other types of funds (U.S. and non-U.S.) that are specifically exempted from the definition of covered fund under the Volcker Rule. It could not have been intended that funds outside the scope of the Volcker Rule could be drawn back in merely based on their permissible relationships with banking entities.

Recommendation:

- Bona fide investment funds (pooled investment vehicles and managed accounts) excluded from the definition of covered fund because they are organized and offered outside of the United States in accordance with applicable local laws should not be considered banking entities, even if controlled by a banking entity due to sponsorship or investment by the banking entity.

- A similar exclusion should be provided for funds that are organized and offered pursuant to another valid exemption or exclusion from the definition of covered fund (e.g., foreign public funds, loan securitizations, registered investment companies, employees' securities companies, etc.).

Exempting these entities, which involve investments and activities that are permitted for international banks (and, in some cases, all banking organizations) under the Volcker Rule, from the definition of banking entity would further the Core Principles by refocusing the Volcker Rule's restrictions on risks from U.S. fund activities and specifically on the types of private equity funds and hedge funds that Congress judged created a risk of evasion of the Volcker Rule's proprietary trading restrictions.

The Agencies created several exemptions from the banking entity definition in the final rule, including an exemption for a "covered fund" controlled by a banking entity, and have subsequently exempted additional types of controlled funds from the Volcker Rule's prohibitions through informal guidance. The Agencies could similarly create the exemptions in this recommendation without statutory change.

Statute/Regulation/Guidance: Sections 619(d)(1)(I) & (h)(1) of the Dodd-Frank Act (12 U.S.C. §§ 1851(d)(1)(I) & (h)(1)); 12 C.F.R. §§ 248.2(c), 248.10(b) – (c), 248.13(b); Volcker Rule Frequently Asked Questions #14, Foreign Public Funds Sponsored by Banking Entities, dated June 6, 2015, and #16, Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds, dated July 16, 2015.

---

68 See, e.g., EBF Foreign Funds Advocacy Survey Responses (Jun. 2, 2015) (submitted to the Volcker Rule Working Group, Jun. 19, 2015).

69 See, e.g., IIB-SIFMA Letter to Scott Alvarez (Jul. 1, 2015); Letter from the EBF, Japanese Bankers Association, Canadian Bankers Association, and Australian Bankers' Association to the Volcker Rule Working Group (Jun. 9, 2015); IIB-SIFMA Letter and Outline to the Volcker Rule Working Group (May 20, 2015); Letter from SIFMA to Scott Alvarez (Oct. 20, 2014); IIB Letter.

The Volcker Rule's definition of covered fund is overly broad and not required by statute, and its exclusions are too narrowly defined, capturing many U.S. and non-U.S. entities within its scope that were not within the original intent of the rule

The Volcker Rule's statutory text defines hedge funds and private equity funds as issuers that rely on the specific exemptions from the Investment Company Act of 1940 (the 1940 Act) contained in Sections 3(c)(1) and 3(c)(7) of that Act (3(c)(1)/3(c)(7) Funds), "*or* such similar funds as the [Agencies] may, by rule . . . determine".[70] In the final rule, the Agencies adopted a definition for "covered fund" that includes all 3(c)(1)/3(c)(7) Funds, plus certain additional funds that the Agencies believed were similar to 3(c)(1)/3(c)(7) Funds, and provided exclusions for certain types of vehicles that the Agencies deemed should not be viewed as covered funds.

Sections 3(c)(1) and 3(c)(7) are broadly utilized exemptions from the 1940 Act for issuers that have fewer than 100 beneficial owners or that are owned exclusively by sophisticated investors (e.g., "qualified purchasers" as defined in the 1940 Act). Hedge funds and private equity funds commonly rely on these exemptions, but so do many other vehicles that are not private equity funds or hedge funds as commonly understood.

The statutory text provides the Agencies with an alternative approach—to define a class of "similar funds" by regulation. This alternative could have more closely followed the original intent to address private equity fund and hedge fund activities. The Agencies' approach has therefore resulted in an overly broad definition of covered fund that goes well beyond the original intent to capture private equity funds and hedge funds, and the list of enumerated exclusions fails to exclude many vehicles that are not equivalent to traditional private equity funds or hedge funds. For example, as currently crafted:

- Foreign mutual funds offered to retail investors outside of the United States that have been sold in private placements inside the United States are covered funds unless they meet the specific exclusion for "foreign public funds" under the final rule. That definition is more restrictive than necessary, and requires substantial diligence to determine whether a fund may qualify.

- Many privately placed U.S. and non-U.S. securitizations are deemed covered funds unless they meet the narrow exclusion for "loan securitizations" in the final rule. In conjunction with capital and risk retention rules, the Volcker Rule's treatment of securitization vehicles as covered funds has been a major contributor to the anemic progress towards reviving the securitization markets, which has had a knock-on effect on capital formation and the ability of financial institutions to lend efficiently.

- Special purpose vehicles created to hold securities to, e.g., facilitate margin lending or other securities financing, or to comply with foreign laws regulating ownership of securities (e.g., the local ownership requirements imposed by some jurisdictions), may be deemed to be covered funds, and therefore banking entities may be restricted from holding investments in such vehicles even though an investment by the banking entity in the underlying securities would be permissible.

---

[70] 12 U.S.C. § 1851(h)(2) (emphasis added).

Recommendation:

The Agencies should replace the current definition of covered fund with a characteristics-based definition—permitted by the statutory definition—that is focused on implementing the original purpose of the Volcker Rule's funds provisions (preventing evasion of the proprietary trading prohibition and certain fund activities deemed to be overly risky) and the commonly understood meaning of what constitutes a private equity fund or hedge fund.

A revised approach to defining "covered fund" would further the Core Principles by eliminating many of the unintended effects of the Volcker Rule on a variety of securities holding and investment vehicles that are not private equity funds or hedge funds and do not create the proprietary trading risks at which the Volcker Rule was targeted. This would expand investment opportunities for U.S. investors, support lending, capital formation and other beneficial economic activity and ensure the Volcker Rule's restrictions are appropriately tailored to its core policy concerns. The statute provides the Agencies with discretion to define covered funds as an alternative to using the 3(c)(1)/3(c)(7) Fund provision, and therefore this recommendation could be accomplished without statutory change.

Statute/Regulation/Guidance: Section 619(h)(2) of the Dodd-Frank Act (12 U.S.C. § 1851(h)(2)); 12 C.F.R. §§ 248.10(b) & (c).

Other fund issues of particular concern to international banks

Certain other issues raised by the Volcker Rule's fund provisions that are of particular concern for international banks are set forth in the following five recommendations.

Recommendation:

When considering whether a fund qualifies for the foreign public fund exclusion from the definition of covered funds, reliance should be placed on the qualification of the fund in its jurisdiction of organization or principal foreign markets as eligible for retail sales, rather than imposing specific conduct requirements based on the actual manner of the fund's offering.

The final rule exempts certain "foreign public funds" that have been offered or sold in private sales in the United States from the definition of covered fund, provided certain conditions are met. (Such funds would generally be 3(c)(1)/3(c)(7) Funds as a consequence of the U.S. marketing.) To qualify, a foreign public fund must, among other requirements, be authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and must sell ownership interests predominantly through one or more public offerings outside of the United States. The second condition creates a complicated, fact-specific assessment about the manner in which the fund has actually been offered, thereby limiting the utility of the exemption. It would be more efficient to defer to home-country regulation and rely on the home-country judgment about whether the fund is qualified for retail sales. This recommendation would require changes only to the Agencies' regulation.

Statute/Regulation/Guidance: 12 C.F.R. § 248.10(c).

Recommendation:

Banking entities should be permitted to hold investments in non-U.S. securitizations that are covered funds to the extent mandated by non-U.S. risk retention rules, just as banking entities are permitted to hold investments in U.S. securitizations to comply with U.S. risk retention rules.

This recommendation would require changes only to the Agencies' regulation.

Statute/Regulation/Guidance: 12 C.F.R. § 248.12(a)(2)(ii)(B).

Recommendation:

When calculating the aggregate investment limits for covered fund investments under the Volcker Rule's asset management exemption, an international bank's total capacity for covered fund investments should be based on its global Tier 1 capital, not its intermediate holding company's capital, in order to ensure equivalent treatment for U.S. and foreign banking entities.

This recommendation would require changes only to the Agencies' regulation.

Statute/Regulation/Guidance: Section 619(d)(4)(B) of the Dodd-Frank Act (12 U.S.C. § 1851(d)(4)(B)(vii); 12 C.F.R. § 248.12(c)(2).

Recommendation:

The restrictions on covered funds sharing a name with a banking entity or its affiliates should be eliminated.

U.S. banking organizations and international banks have both been required to engage in a costly effort to rename all their covered funds so that the group name and the name of any of its subsidiaries are not used in the name of the covered fund. This has been an expensive, unnecessary and opaque exercise that runs counter to a core financial reform goal of boosting transparency for investors. It is particularly inefficient when applied to an international bank that has numerous global affiliates with no contact to the United States. In addition, to the extent that covered funds are limited to private equity and hedge funds, investors in such funds are sophisticated and able to discern that the mere sharing of a name as a marketing tool does not denote an implicit guarantee of the entity by the banking organization. Full elimination of these restrictions could be efficiently accomplished through a change to the Volcker Rule statute, although the current restrictions could also be significantly relaxed through rulemaking or interpretive guidance.[71]

Statute/Regulation/Guidance: Sections 619(d)(1)(G)(vi) and (h)(5) of the Dodd-Frank Act (12 U.S.C. §§ 1851(d)(1)(G)(vi), (d)(1)(J) and (h)(5)); 12 C.F.R. §§ 248.10(d)(9)(iii) and 248.11(a)(6).

Recommendation:

The restrictions on banking entity employees investing in a banking entity's own sponsored funds should be eliminated.

Employee investments in bank-affiliated products should be encouraged to the fullest extent permissible under the current statute, in order to create alignment with bank clients who invest in those products. The Agencies should have appropriate discretion to interpret the scope of the employee restrictions without any statutory change, although a statutory amendment would provide a more definitive solution.

Statute/Regulation/Guidance: Section 619(d)(1)(G)(vii) of the Dodd-Frank Act (12 U.S.C. § 1851(d)(1)(G)(vii)); 12 C.F.R. § 248.11(a)(7).

71 We note that a bill to amend this statutory restriction was passed by the House on April 26, 2016 with strong bipartisan support (by a vote of 395-3). The Investor Clarity and Bank Parity Act, H.R. 4096, 114th Cong. § 2 (2016), is too limited in approach, however, because it would continue to prohibit the use of a name shared with an affiliated bank or BHC.

5. *Adopting a Principles-Based Approach to the Volcker Rule's Trading Restrictions Would Enable Both U.S. and International Banks to More Efficiently Provide Beneficial Lending, Financial Intermediation and Market Liquidity*

The Volcker Rule Should be Revised to Remove the Presumption that All Trading is "Proprietary", as that Presumption has Generated the Need to Burden Otherwise Permissible Activities with Policies, Procedures and Metrics

As described above, the Volcker Rule's trading restrictions are too complex and hinder banking organizations' ability to provide lending, intermediation and liquidity services. These restrictions burden all banks—big and small, U.S. and international—with onerous compliance obligations. One of the principal flaws that led to this unnecessary and onerous compliance burden is the presumption that all trading as principal is deemed to be impermissible proprietary trading unless a banking entity can prove that an exemption applies. This has led to the imposition of compliance policies, procedures and metrics on trading activities that were not proprietary trading prior to the advent of the Volcker Rule, and still do not constitute proprietary trading today, merely to "prove the negative". Examination under the Volcker Rule has only perpetuated this presumption with examiners asking how a desk knows that its general customer activity doesn't encompass some element of proprietary trading. This effort is misplaced and wasteful. As Federal Reserve Bank of New York CEO and President Dudley stated recently, most beneficial customer market-making activity "has an element of proprietary trading."[72]

Recommendation:

The current presumption that each purchase or sale is deemed to be a proprietary trade unless demonstrated to be outside of the trading account or otherwise excluded from the definition of proprietary trading should be reversed.

A principles-based approach that shifts the presumption toward permissibility of principal activity would give banking organizations more flexibility to provide beneficial market services in an efficient manner and reduce costs while still implementing Congressional intent. The original intent of the statute was to prohibit certain activities, and not regulate significant swaths of beneficial conduct. Instead of policies, procedures and metrics that try to address whether permissible market making, hedging or underwriting activities are in fact within a regulatory set of conditions, definitions and restrictions (which entails compliance programs that significantly interfere with the conduct of normal, permissible business), the rule should instead narrowly excise impermissible activity (with regard to which Chairman Volcker himself indicated "[y]ou know when you see it").[73] The Agencies should have appropriate

---

72 See Dudley Remarks.

73 See, e.g., Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing & Urban Affairs, 111th Cong. 7, 14 (2010) (statement of Paul A. Volcker, Chairman, President's Econ. Recovery Adv. Bd.) ("Similarly, every banker I speak with knows very well what 'proprietary trading' means and implies. . . .Well, I think the only answer I can give there is like pornography. You know it when you see it."). See also Andrew Clark, Paul Volcker Tells

discretion to interpret the definition of "proprietary trading" and "trading account" to be able to effect this recommendation without statutory change.

Statute/Regulation/Guidance: Sections 619(h)(4) & (6) of the Dodd-Frank Act (12 U.S.C. §§ 1851(h)(4) & (6)); 12 C.F.R. §§ 248.2(u), 248.2(x), 248.3(a) & (b).

The Volcker Rule should not interfere with traditional bank funding and treasury activities, including cross-border and cross-currency funding arrangements

A number of provisions of the final rule impose restrictions or affirmative compliance burdens on banking organizations' traditional treasury, funding and asset-liability management (ALM) functions. There is no good reason to treat these activities as potential sources of proprietary trading. Indeed, the 2011 FSOC study on implementation of the Volcker Rule specifically observed that "ALM activities are clearly intended to be permitted activities, and are an important risk mitigation tool. . . . A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbating excess liquidity conditions. These activities also serve important safety and soundness objectives."[74] Despite this, the final rule applies specific, prescriptive compliance burdens and restrictions that make it harder for banking organizations to fund and manage risk in their general business activities efficiently and centrally through treasury and financing functions, thereby reducing availability and raising costs for lending and other intermediation and market services.

One area of particular concern is how the Volcker Rule affects the use of cross-currency swaps, FX funding swaps and other common cross-currency financing transactions (FX Funding Transactions). FX Funding Transactions are critical to a global (both U.S. and non-U.S.) banking organization's ability to efficiently provide cross-border funding for loan originations, asset purchases, collateral/margin payments and movements and the payment of obligations, among other things. FX Funding Transactions are necessary to ensure that funds can be deployed within a global banking group where they are needed, in the appropriate currency. They provide an important mechanism for international banks to efficiently fund their U.S. operations and investments, and for U.S. banking organizations to efficiently fund their foreign operations.

FX Funding Transactions are ordinary course funding transactions that are the functional equivalent of a loan or repurchase agreement, e.g., a purchase of X currency with Y currency, coupled with an agreement to repurchase Y currency in the future with X currency. Their purpose is not to profit from short-term price movements or hedge other trading positions, but to fund an asset or other payment obligation or liquidity need in a specified currency. Excess home office liquidity (say, USD for a U.S. bank or JPY for a Japanese bank) can be converted on a short term basis to take advantage of this excess liquidity or

---

Senate: Risky Banking Activity is like Pornography, The Guardian (Feb. 2, 2010) ("Volcker told the Senate's banking committee it was entirely possible to define banks' 'proprietary trading', quipping that risky financial activity was 'like pornography: you know it when you see it.' Volcker told the committee: 'Every banker I speak with knows very well what proprietary trading means and implies.'").

74 FSOC Volcker Study.

cheaper funding to fund operations in other currencies.[75] Within the industry, these FX Funding Transactions are not viewed as derivative trading transactions. However, the "form" of the transactions (often using swaps documentation) has diverted attention away from their true substance as financing transactions and raised questions about whether FX Funding Transactions are subject to the Volcker Rule. Discussions with the Agencies over the last three years have not resulted in definitive guidance that these transactions should be exempted under the Volcker Rule.

These transactions are typically initiated by the treasury and liquidity management functions of a banking organization and would generally be subject to monitoring and restrictions based on the organization's liquidity risk management procedures, applicable laws and regulations (which may include the applicable liquidity coverage ratio) and/or applicable supervisory and examination guidance. Therefore, other tools are available to monitor and ensure the safety and soundness of the ALM, treasury and financing activity, rather than applying the Volcker Rule inappropriately to these activities.

Recommendation:

The final rule should be revised to provide a categorical, principles-based exemption for treasury, funding, ALM and similar functions from the Volcker Rule.

The current liquidity management exemption is too narrow to address the full scope of a banking organization's treasury, funding and ALM functions, and imposes unnecessary compliance burdens and restrictions on those activities that are covered by the exemption. As stated above, there are more efficient tools for ensuring that these activities are conducted in a safe and sound manner. A categorical, principles-based exemption for these traditional functions would further the Core Principles by removing inefficient compliance burdens on international banks and U.S. banking organizations, thereby permitting them to more effectively provide financing and liquidity to the U.S. economy. As noted above, the FSOC believed that the Agencies should have discretion, without statutory change, to effect this recommendation.

Statute/Regulation/Guidance: Sections 619(d)(1)(J) & (g)(2) of the Dodd-Frank Act (12 U.S.C. §§ 1851(d)(1)(J) & (g)(2)); 12 C.F.R. § 248.3(c)(3).

Recommendation:

FX Funding Transactions that are the functional equivalent of currency repurchase agreements or lending transactions should be excluded from the definition of proprietary trading, just as loans and repurchase agreements have been excluded in the final rule.

Excluding FX Funding Transactions would serve the Core Principles by allowing both U.S. and non-U.S. banking organizations to provide lending and other beneficial services inside and outside of the United States in an efficient manner. As the Agencies determined that they were able to exempt loans,

---

75 Other pockets of liquidity outside a bank's home country can also be used in this way.

repurchase agreements, and securities borrowing and lending transactions from Volcker Rule restrictions, this recommendation can be adopted without statutory change.

Statute/Regulation/Guidance: Sections 619(d)(1)(J) & (g)(2) of the Dodd-Frank Act (12 U.S.C. §§ 1851(d)(1)(J) & (g)(2)); 12 C.F.R. §§ 248.3(c)(2)(i), (iii) & (d)(1).

B. Dodd-Frank Act Title VII Issues

1. *Applying U.S. Rules to Otherwise Non-U.S. Transactions Because U.S.-Located Personnel Arrange, Negotiate or Execute Those Transactions Will Eliminate U.S. Jobs and Inhibit Effective Risk Management by Non-U.S. Dealers and Their Clients*

Non-U.S. dealers in swaps and security-based swaps (SBS) rely on U.S.-located personnel to effectively risk manage their U.S.-connected positions and provide front-office services to clients as part of their global business. U.S.-located personnel provide these services even in connection with swaps and SBS between non-U.S. persons (non-U.S. transactions), where the ultimate risk under the transactions is borne entirely by non-U.S. persons. By employing U.S.-located personnel, non-U.S. dealers also create financial sector jobs and expertise in the United States.

The CFTC and SEC have, through staff guidance (in the CFTC's case) or rulemakings (in the SEC's case), imposed Title VII requirements on non-U.S. transactions solely because U.S.-located personnel are involved in arranging, negotiating or executing those transactions.[76] In many cases, the parties to non-U.S. transactions are already subject to home-country regulation in connection with their derivatives activities.

So far, the agencies have delayed the effectiveness of this U.S. personnel test. Putting the test into effect is expected to cause non-U.S. clients to avoid interacting with U.S.-located personnel so they can avoid the costs of complying with additional, and possibly conflicting, U.S. regulation, including amending their trading documentation, changing the speed and size of their trading to adjust for public disclosure impacts and potentially changing where and how they access execution platforms and clearinghouses. As noted by a group of commercial end-users of derivatives, "end-users, who are using swaps to hedge or mitigate commercial risks associated with operating their businesses, will generally seek not to trade with non-U.S. [swap dealers] when trading with such foreign entities will unnecessarily subject them to duplicative regulatory requirements, increase costs and place them at a disadvantage compared with competitors who do not trade with such non-U.S. [swap dealers] and therefore do not have to incur such costs." [77]

---

[76] In 2013, the CFTC issued Staff Advisory No. 13-69, which would require non-U.S. swap dealers to comply with the CFTC's transaction-level requirements for swaps arranged, negotiated or executed using personnel or agents in the United States. The CFTC staff has subsequently issued a series of no-action letters delaying compliance with Advisory 13-69. See CFTC No-Action Letter 16-64 (Aug. 4, 2016) (delaying compliance with Advisory 13-69 until Sept. 30, 2017). See also Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, Proposed rule, 81 Fed. Reg. 71,946 (proposed Oct. 18, 2016) (proposing to apply certain of the CFTC's external business conduct standards to non-U.S. transactions arranged, negotiated or executed by U.S. personnel). The SEC's rulemaking for SBS dealers (SBSD) requires entities to count SBS between non-U.S. persons arranged, negotiated or executed by U.S. personnel towards their de minimis threshold calculation, 81 Fed. Reg. 8598 (Feb. 19, 2016), comply with external business conduct requirements for such SBS, 81 Fed. Reg. 29,960 (May 13, 2016), and comply with regulatory reporting and public dissemination requirements for such SBS, 81 Fed. Reg. 53,546 (Aug. 12, 2016).

[77] See Letter from the Coalition for Derivatives End-Users to the CFTC 3 (Mar. 10, 2014).

To remain competitive and accommodate these clients, non-U.S. dealers are expected in turn to implement compliance systems that eliminate U.S.-located personnel from arranging, negotiating and executing the clients' non-U.S. transactions. These systems will create barriers within entities and corporate groups based solely on the geographic location of personnel, to the detriment of globalized risk management and at increased cost to clients. [78] Personnel-based tests are also cumbersome to administer, requiring entities to make seemingly arbitrary distinctions about permitted activities of personnel based on their geographic location at any time. [79]

The increased costs of compliance and changes to market behavior will impede the ability of non-U.S. dealers to invest and participate in U.S. markets and could lead to the elimination of a significant number of jobs for U.S.-located personnel. The costs of these rules far exceed any risk-mitigating benefit. For non-U.S. transactions, the presence of U.S.-located personnel in arranging, negotiating or executing does not result in risk flowing to the United States.

Recommendation:

We recommend that both the CFTC and the SEC eliminate any U.S. personnel test from their swaps rules, either by withdrawing the relevant staff guidance (in the CFTC's case) or amending relevant rules (in the SEC's case).

Statute/Regulation/Guidance: CFTC Staff Advisory No. 13-69 (requiring non-U.S. swap dealers to comply with the CFTC's transaction-level requirements for swaps arranged, negotiated or executed using personnel or agents in the United States); CFTC No-Action Letter 16-64 (delaying compliance with Advisory 13-69 until September 30, 2017); Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, Proposed Rule, 81 Fed. Reg. 71,946 (Oct. 18, 2016) (proposing to apply a U.S. personnel test to certain external business conduct standards); 17 C.F.R. §§ 240.3a71-3 & 3a71-5 (SEC rules including non-U.S. SBS that are arranged, negotiated or executed by U.S. personnel in the SBSD de minimis threshold calculation); 17 C.F.R. §§ 240.15Fh-1 – 15Fh-6, 15Fk-1 (SEC external business conduct standards for SBSDs); 17 C.F.R. §§ 242.900-909 (Regulation SBSR, the SEC's rules for reporting and dissemination of SBS information).

---

78 The risk management associated with a swap or SBS is inextricably linked to its price. Non-U.S. dealers offer liquidity and prices based on risk management considerations across the global enterprise. Barriers preventing coordination between risk management and trading personnel could lead to dealers mispricing transactions or taking on surplus risk.

79 For example, if a client in Europe places an order near the end of the day that a non-U.S. dealer cannot finish executing until during U.S. market hours using U.S.-located personnel, a U.S. personnel test could subject that transaction to U.S. rules merely because of the time zone where it was executed.

2. *Unduly Broad Application of the CFTC's Swap Dealer Registration Rules Will Limit the Ability of American Companies to Access Liquidity in Global Derivatives Markets or Funding from Bank Lenders*

Two key developments could lead to a significant expansion of the CFTC's swap dealer registration requirement:

First, in October 2016, the CFTC proposed rules (the Registration Proposal)[80] that would expand the reach of swap dealer registration to cover non-U.S. dealers providing liquidity to the non-U.S. branches of U.S. banks or the non-U.S. subsidiaries of U.S. parent companies (both banks and commercial firms). The Registration Proposal represented a significant expansion of the CFTC's current cross-border regulatory approach (CFTC 2013 Guidance),[81] which went into effect only three years earlier.

Second, by end of 2018, the CFTC's de minimis threshold below which a person can transact before registering as a swap dealer is scheduled to decrease from $8 billion to $3 billion (calculated on a group-wide, rolling 12-month basis).[82] The CFTC staff has estimated the decrease will cause an additional 83 firms to register.[83]

Either individually, and especially if occurring together, the extra-territorial expansion of swap dealer registration rules and decrease in the de minimis threshold would bring a large number of non-U.S. dealers with very limited nexus to the United States within scope of comprehensive CFTC swap dealer regulation. These dealers' activities do not bear a "direct and significant" risk to the United States, which is a prerequisite for the CFTC to regulate them under Dodd-Frank. From a more practical perspective, the changes would limit the ability of American companies to hedge risks in non-U.S. markets by deterring non-U.S. dealers from trading with them, lest those non-U.S. dealers become subject to comprehensive CFTC regulation due only to a very small part of their overall business. Finally, swap dealers have expended significant resources to comply with the CFTC 2013 Guidance and existing $8 billion de minimis threshold, which are reflected in their internal organization, documentation and compliance processes and procedures. The CFTC has not provided a sufficient basis to justify such a significant change in policy and the resultant costs to swap dealers.

In addition, the existing de minimis threshold imposes unwarranted limitations on foreign banks' ability to conduct lending activity in the United States. Specifically, unlike U.S. insured depository institutions (IDIs), foreign banks are not permitted to exclude swaps entered into in connection with originating loans

80 Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71,946 (proposed Oct. 18, 2016).

81 Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

82 Order Establishing De Minimis Threshold Phase-In Termination Date, 81 Fed. Reg. 71,605 (Oct. 18, 2016).

83 Swap Dealer De Minimis Exception Preliminary Report, Table 19 (CFTC Staff Report, Nov. 18, 2015) (CFTC De Minimis Exception Report) (counting solely swap dealers in interest rate swaps and credit default swaps).

from their de minimis threshold (the Loan Origination Exclusion), even when they originate loans from their U.S. branches.[84] For many other purposes, a foreign bank's U.S. branch is treated the same way as a U.S. IDI.[85] The disparate treatment of U.S. IDIs and U.S. branches of foreign banks in this context makes it more difficult for foreign banks to extend credit to U.S. companies, without achieving any regulatory benefit.

Recommendation:

We recommend that the CFTC withdraw the Registration Proposal and permanently extend the existing $8 billion swap dealer de minimis threshold. We also recommend that the CFTC make the Loan Origination Exclusion available to U.S. branches and agencies of foreign banks.[86]

Statute/Regulation/Guidance: Commodity Exchange Act, Section 2(i) (defining the CFTC's extra-territorial jurisdiction); Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (Jul. 26, 2013); Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71,946 (proposed Oct. 18, 2016); Swap Dealer De Minimis Exception Preliminary Report, Commission Staff Report (Nov. 18, 2015); Order Establishing De Minimis Threshold Phase-In Termination Date, 81 Fed. Reg. 71,605 (Oct. 18, 2016); 17 C.F.R. § 1.3(ggg)(4) (CFTC swap dealer de minimis exception); 17 C.F.R. § 1.3(ggg)(5) (Loan Origination Exclusion).

---

84 See Commodity Exchange Act, § 1a(49)(A) ("[I]n no event shall an [IDI] be considered to be a swaps dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer."); 17 C.F.R. § 1.3(ggg)(5).

85 For example, prior to statutory amendments that clarified the matter, and therefore apparently without needing a statutory change, the Board of Governors of the Federal Reserve System adopted a regulation under the "Swaps Push-Out Rule," Section 716 of the Dodd-Frank Act, to say that the definition of IDI in that part of Title VII includes any uninsured U.S. branch or agency of a foreign bank. See 12 C.F.R. § 237.21. The CFTC could make a similar regulatory clarification.

86 We have also suggested some targeted modifications to other aspects of the swap dealer de minimis rules, which are discussed in our comment letter on the CFTC De Minimis Exception Report (Jan. 19, 2016), https://c.ymcdn.com/sites/iib.site-ym.com/resource/resmgr/IIB_Comment_Letters/20160119IIBDeMinimisReportLe.pdf. We continue to believe the CFTC should consider these modifications, which would expand the ability of foreign banks to provide liquidity in the United States.

3. *U.S. Regulators Have Taken an Unduly Limited Approach to Permitting Substituted Compliance with Regulatory Reforms in Non-U.S. Jurisdictions, Leading to Duplicative and Contradictory Requirements that Fragment the Global Derivatives Markets*

U.S. regulators have applied most Title VII reforms to cross-border derivatives activities and non-U.S. entities, even where non-U.S. regulators have concurrent jurisdiction and apply local regulatory requirements. This extraterritorial approach results in duplicative and conflicting regulatory requirements applicable to U.S. and non-U.S. entities and their counterparties. Non-U.S. entities subject to U.S. and non-U.S. regulations face increased compliance costs and the challenge of rationalizing conflicting requirements.[87] Efforts by foreign counterparties to avoid this duplicative regulation keep entities subject to U.S. regulation out of foreign markets and non-U.S. entities from investing in the United States. This dynamic leads to increasingly fragmented global markets and regionalized liquidity pools.[88]

These results can be avoided if U.S. regulators permit entities to comply with comparable non-U.S. regulations, in lieu of complying with U.S. regulations. Although most Title VII rules are potentially eligible for this "substituted compliance," for many key rules (e.g., mandatory clearing, mandatory trading, reporting and margin), U.S. regulators generally have not adopted the comparability determinations that would permit substituted compliance, have prevented U.S. persons from relying on substituted compliance and have imposed a "stricter-rule applies" condition that effectively imposes U.S. regulatory requirements on non-U.S. entities.[89]

Recommendation:

U.S. regulators should adopt a robust outcomes-based approach to granting substituted compliance for derivatives reforms. Such an approach should evaluate non-U.S. regulatory regimes holistically, with a presumption that foreign regimes that follow international standards are comparable. U.S. regulators should also make substituted compliance available to all entities transacting subject to foreign regulation, including U.S. persons.

---

87 Conflicts can arise as a result of inherent differences between the structure of regulatory regimes in jurisdictions. For example, the split jurisdiction between the CFTC and SEC based on products and entity types is not reflected in other jurisdictions. Issues of product and entity categorization make different regimes difficult to streamline even if such regimes are comparable on an holistic level.

88 See, e.g., ISDA, Cross-Border Fragmentation of Global Interest Rate Derivatives: Second Half of 2015 Update (May 10, 2016) (finding that after the adoption of CFTC rules requiring the registration of swap execution facilities, U.S. dealers' share of liquidity in the interdealer market for cleared euro-denominated swaps dropped from over 25% to less than 10%).

89 See, e.g., 81 Fed. Reg. 63,376 (Sept. 15, 2016) (CFTC comparability determination for Japanese margin requirements for uncleared swaps. The CFTC later issued no-action relief loosening the stricter-rule applies approach for certain aspects of the Japanese margin regime). Prudential Regulators have not yet issued any comparability determinations for non-U.S. margin requirements for uncleared swaps.

Statute/Regulation/Guidance: Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (Jul. 26, 2013); 17 C.F.R. § 23.160 (cross-border application of CFTC margin requirements for uncleared swaps); Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 63,376 (Sept. 15, 2016).

4. *The Extraterritorial Application of Certain Title VII Rules to Non-U.S. Dealers Conflicts with Local Privacy, Blocking and Secrecy Laws in Ways that Make It More Difficult for U.S. Clients to Access Liquidity from Non-U.S. Dealers and Hurts U.S. Dealers Operating Abroad*

Under the SEC's rules, a non-U.S. SBSD will be required, as part of its application for registration, to certify and provide an opinion of counsel that it can, as a matter of law, and will (1) provide the SEC with prompt access to its books and records and (2) submit to onsite inspection and examination by the SEC.[90] This requirement is problematic because it is not limited to those books and records related to a non-U.S. SBSD's U.S. activities, but rather to all of its books and records. A non-U.S. SBSD may not be able to provide such unfettered access without violating local blocking, privacy or secrecy laws to which the non-U.S. SBSD is subject. In such cases, non-U.S. SBSDs are not able to provide the required certification or opinion of counsel, which means they will not be able to register and provide liquidity in the U.S. SBS markets. Likewise, U.S. dealers will not be able to establish dealing operations in foreign affiliates because in many instances those affiliates will need to register with the SEC as an SBSD and comply with this same requirement; thus, the requirement also limits the ability of U.S. dealers to access foreign markets. Presented with a similar issue, the CFTC and National Futures Association (NFA) took a more practical approach premised on working with foreign regulators and regulated firms cooperatively to eliminate or otherwise resolve potential legal conflicts.[91] If non-U.S. regulators took a similarly expansive approach, requiring access to books and records in a manner inconsistent with U.S. laws, U.S. regulators would likely view those requirements as interfering with U.S. customer protection and supervisory objectives.

A similar difficulty arises in the SEC's requirement for all SBSDs to conduct a background check of each of their associated persons to verify that the person is not subject to statutory disqualification.[92] The SEC has taken an expansive view of the associated persons covered by this requirement, including non-U.S. personnel who do not interact with U.S. clients and certain back-office personnel. This requirement

---

90 17 C.F.R. § 240.15Fb2-4(c)(1).

91 The CFTC's swap dealer registration form similarly required a non-U.S. swap dealer to certify that it is not subject to any blocking, privacy or secrecy laws which would interfere with or create an obstacle to full inspection of the applicant's books and records by the CFTC, the Department of Justice ("DOJ") and NFA. To address the ensuing legal conflicts, the CFTC amended the form prior to swap dealer registration coming into effect to create an exception to this certification to the extent that the swap dealer has otherwise informed the CFTC in writing. See NFA Form 7R (requiring applicants to agree that "…subject to any applicable blocking, privacy or secrecy laws, the applicant's books and records will be available for inspection by the CFTC, the [DOJ] and NFA for purposes of determining compliance with the [Commodity Exchange] Act, CFTC Regulations and NFA Requirements.") (emphasis added). In its comparability determination for EU derivatives regulations, the CFTC explained that notwithstanding the change to the registration form, it retained its authority to access records held by registered swap dealers and noted that it was in ongoing dialogue with regulators and registrants in other jurisdictions on a bilateral and multilateral basis to address books and records issues. 78 Fed. Reg. 78,923, 78,924-25 n. 11 (Dec. 27, 2013). This approach allows non-U.S. entities to register as swap dealers and preserves flexibility for the CFTC to address any issues as they arise.

92 17 C.F.R § 240.15Fb6-2.

causes problems because background checks are not permitted by the local laws of certain jurisdictions. This requirement could prevent many firms—U.S. and non-U.S.—from registering as SBSDs and providing liquidity in the U.S. SBS markets. The SEC could address this issue by taking the same approach as the CFTC took in the context of swap dealer registration, which would be to construe the scope of covered associated persons more narrowly to focus only on those who raise U.S. customer protection considerations.[93]

Finally, both the SEC and the CFTC apply their trade reporting requirements to all of a non-U.S. dealer's SBS or swaps, respectively, even those with non-U.S. persons. Reporting those non-U.S.-facing SBS or swaps can also cause the non-U.S. dealer to violate local blocking, privacy or secrecy laws. So far, the CFTC has provided time-limited no-action relief to address this issue,[94] but the SEC has not indicated it will provide similar relief before its trade reporting rules take effect.

Recommendation:

To encourage non-U.S. dealers to provide liquidity in the United States and to facilitate the ability of U.S. dealers to establish operations abroad should they so desire, the SEC should eliminate or narrow the scope of its certification, legal opinion and background check requirements for SBSDs, the CFTC should permanently extend its trade reporting relief for non-U.S. swap dealers and the SEC should adopt parallel trade reporting relief for non-U.S. SBSDs.

***Statute/Regulation/Guidance*:** 17 C.F.R. § 240.15Fb2-4(c)(1); 17 C.F.R § 240.15Fb6-2; Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (Jul. 26, 2013); 17 C.F.R. § 242.901 (SEC reporting obligations for SBS).

---

93 The CFTC's definition of "associated person" does not include back or middle office personnel and the CFTC has granted no-action relief from background check requirements for non-U.S. personnel transacting solely with counterparties located outside of the United States.

94 CFTC No-Action Letters 12-46 (Dec. 7, 2012) and 13-41 (June 28, 2013) (granting time-limited no-action relief permitting counterparties subject to CFTC reporting requirements under Parts 45 and 46 to mask legal entity identifiers, other enumerated identifiers and other identifying terms for swaps with counterparties located in enumerated jurisdictions where reporting such information is subject to statutory or regulatory prohibitions); CFTC No-Action Letter 17-16 (Mar. 10, 2017) (extending no-action relief under Letters 12-46 and 13-41 until Sept. 1, 2017); CFTC No-Action Letter 16-79 (Nov. 21, 2016) (granting time-limited no-action relief from swap reporting requirements for non-U.S. swap dealers established in Australia, Canada, the European Union, Japan or Switzerland and that are not part of an affiliated group in which the ultimate parent entity is a U.S. swap dealer, major swap participant, bank, financial holding company or BHC. The relief extends until the earlier of (a) 30 days following the issuance of a comparability determination with respect to the reporting rules in the relevant jurisdictions and (b) Dec. 1, 2017).

5. The CFTC and the SEC Have Implemented Parallel Title VII Reforms in Ways that Unnecessarily Diverge from Each Other and from Similar Reforms Adopted by Non-U.S. Regulators, Creating Undue Inefficiency and Completely Without a Corresponding Regulatory Benefit

The CFTC and the SEC have adopted divergent rules to regulate swap dealers and SBSDs, respectively. As discussed above, the SEC has adopted a personnel-based test that will require a non-U.S. dealer to register with the SEC solely on the basis of SBS transactions with another non-U.S. person that are arranged, negotiated or executed by personnel located in the United States. The CFTC has not, to date, taken this unduly broad approach. The SEC has also adopted certification rules for SBSD registration that potentially conflict with non-U.S. privacy, blocking and secrecy laws, whereas the CFTC has taken a more practical approach to deal with such legal conflicts. In these areas, the SEC has sought to apply its requirements more expansively than the CFTC.

The agencies have also adopted divergent requirements in other areas of Dodd-Frank's derivatives reforms:

- External Business Conduct (EBC) Rules: The SEC's EBC rules deviate in minor ways from the CFTC's EBC rules that, nonetheless, will require market participants to engage in a substantial, and costly, re-documentation effort for economically similar products, without meaningfully increasing customer protections.[95]

- Reporting: The SEC's SBS reporting rules require parties to report unique data fields not required by the CFTC or other regulators[96] and, in some instances, require end-users of SBS to report this information.[97] The SEC would also require SBS data repositories to publicly disseminate block trade information immediately, which complicates workflows designed to comply with other reporting rules (such as the CFTC's) that do not take this approach.[98]

- Capital: Although the CFTC and SEC sought to coordinate their capital rules for swap dealers and SBSDs, their current proposals do not present a unified framework for dually registered

95 See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 81 Fed. Reg. 29,960 (May 13, 2016). For example, as part of its EBC rules the SEC declined to adopt a safe harbor permitting an SBSD to rely on written representations from counterparties in connection with the CFTC's EBC rules to satisfy due diligence requirements, even where the requirements are highly similar.

96 See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 81 Fed. Reg. 53,546 (Aug. 12, 2016); 17 C.F.R. § 242.906 (requiring SBS data repositories to identify, for each SBS, the "broker ID", "branch ID", "execution agent ID", "trading desk ID" and "trader ID").

97 17 C.F.R. § 242.906(a).

98 Compare 17 C.F.R. § 242.902 with 17 C.F.R. § 43, Appendix C.

swap dealers and SBSDs. The proposals also contemplate duplicative processes for obtaining agency approval to use internal models, even where the standards for approval are comparable.[99]

- Margin: The SEC has not yet proposed margin rules for SBS in line with the internationally agreed margin framework or the rules adopted by U.S. regulators. The SEC's current proposal is at odds with the requirements of other regulators' rules, for example, by penalizing SBSDs for segregating margin at third-party custodians, which is a requirement of the other rules.

The lack of effective coordination between the CFTC and the SEC (and among both agencies and non-U.S. regulators) has resulted in an unnecessarily complicated regulatory framework. Corporate groups are required to navigate different requirements to address the same issues, sometimes for the same entity, depending on the products they transact, even within the same asset classes. Divergent rules for economically similar products and entities (that are not, generally, regulated differently outside of the United States) unnecessarily complicates U.S. regulations, deterring entities from providing liquidity to U.S. markets and non-U.S. counterparties from transacting with U.S. entities outside of the United States.

Recommendation:

The SEC should re-propose all of its SBS rules, including ones it has already adopted, to seek public comment on ways to simplify its regulatory regime by harmonizing with parallel rules adopted by the CFTC and non-U.S. regulators and leveraging existing industry efforts to comply with those rules.

Statute/Regulation/Guidance: 17 C.F.R. § 240.15Fh-1 – 15Fh-6, 15Fk-1 (SEC external business conduct standards for SBSDs); 17 C.F.R. § 242.900-909 (Regulation SBSR, the SEC's rules for reporting and dissemination of SBS information); Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70,214 (proposed Nov. 23, 2012).

---

99 See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70,214 (Nov. 23, 2012) (requiring registered broker-dealers to obtain SEC approval to use internal models to calculate capital requirements); Capital Requirements of Swap Dealers and Major Swap Participants, 81 Fed. Reg. 91,252 (Dec. 16, 2016) (CFTC proposed capital requirements for swap dealers, requiring CFTC or NFA approval of internal models to calculate capital requirements).

III. Availability of Credit and Lending

A. Leveraged Lending

1. Application and Enforcement of the Agencies' Leveraged Lending Guidance Has Impeded Availability of Credit for Deserving U.S. Transactions

The OCC, the Federal Reserve Board and the FDIC issued in 2013 guidance on leveraged lending.[100] The agencies stated that "this final guidance is not being adopted as a rule" and "[t]he final guidance is not a rulemaking action".[101] Furthermore the leveraged lending guidance purports to allow for significant discretion by institutions subject to the guidance, based on the fact that the guidance constitutes "high-level principles", "institutions should be able to set their own definitions based on the characteristics of their portfolios", and an institution should identify and designate its own risk appetite.[102] Increases in capital, liquidity and risk management stringency in the post-crisis era (and in response to other regulations) should no doubt allow institutions to determine for themselves that even highly leveraged borrowers or transactions may be worthy of appropriate financing within an institution's own risk appetite.

The leveraged lending guidance (in contrast to previously issued guidance[103]) identifies several metrics for analyzing leveraged transactions,[104] on the premise of being part of a "range of acceptable leverage levels", a "general guide" for institutions, items "commonly assume[d] [to] . . . provide[] evidence" or "example[s] . . . [of] numerous definitions".[105] However, in practice, the agencies have enforced these metrics as bright line rules to prohibit transactions, and disallowed modifications by an institution's own definitions or risk appetite. The OCC has also reportedly taken a "'no exceptions' approach, meaning banks should never make a leveraged loan that [falls] outside the standards."[106] Such an approach is not described in the leveraged lending guidance. Yet, several institutions, including prominently several international banks, received stringent reprimands about adherence to the guidance.[107] In addition,

100 OCC, Federal Reserve Board and FDIC, Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17,766 (Mar. 22, 2013) (the leveraged lending guidance).

101 Id. at 17,769 – 17,770.

102 Id. at 17,766, 17,768 and 17,772.

103 See, e.g., Comptroller's Handbook, Leveraged Lending (Feb. 2008).

104 These include: defining a leveraged transaction to include those where a borrower's total debt-to-EBITDA exceeds 4.0X EBITDA or where a borrower's senior debt-to-EBITDA exceeds 3.0X EBITDA (id. at 17,771); concerns about a leverage level after planned asset sales in excess of 6.0X total debt-to-EBITDA (id. at 17,773); and the use of the ability to repay at least 50% of total debt over a 5-to-7 year period as a measure of adequate repayment capacity (id. at 17,775).

105 Id. at 17,768, 17,769, 17,771 and 17,774-75.

106 Ryan Tracy, Feds Win Fight Over Risky-Looking Loans, Wall St. J. (Dec. 2, 2015).

107 Id.; Gillian Tan & Ryan Tracy, Credit Suisse Loans Draw Fed Scrutiny, Wall St. J. (Sept. 16, 2014).

examiners have imposed their own discretion on other transactions to classify them as unsafe and unsound.[108]

Analysts at the Federal Reserve Bank of New York found a marked decrease in lending based on enforcement of the leveraged lending guidance, indicating that "leveraged lending as a share of total corporate lending . . . declines after the first quarter of 2013, suggesting the decline in leveraged lending does not merely reflect a decline in overall loan demand" and "[b]anks overseen by the [LISCC] . . . reduced their leveraged lending most aggressively in response to the guidance."[109] Other international observers found that banks, in response to the leveraged lending guidance, "decreased their share of speculative term-loan originations from 15 to 37 percent relative to all other syndicated term-loan originations regardless of risk and regardless of specification. . . . At foreign banks, the decline in share ranges from 27 to 40 percent . . ., whereas at U.S. banks, it ranges from 4 to 16 percent . . ."[110]

Recommendations:

The marked departure from prior principles-based guidance on leveraged lending to the enforcement of bright line, numerical rules has deterred financing of borrowers and transactions that would otherwise have been acceptable under many banking institutions' enhanced (post-crisis) risk management frameworks, institutions' increased capital and liquidity levels and institutions' own risk appetite determinations.

The agencies should revise the leveraged lending guidance to:

- Remove the bright-line numerical thresholds, or in the alternative, clearly instruct examiners that an institution's substantiated risk appetite and capital levels may override adherence to a strict numerical threshold;

- Indicate clearly that an institution's own guidelines and thresholds may exceed those in the leveraged lending guidance, that transactions can be consummated outside of the numerical guidelines and that there is not a "no exceptions" policy;

- Create parameters for safe harbors that will not be second-guessed by examiners after-the-fact;

108 See also Press Release, House Financial Services Committee, Lack of Clarity and Due Process From Agencies Hinder Firms' Ability to Operate (Apr. 6, 2017) ("'Financial companies are standing on regulatory quicksand, having to constantly shift in an effort to stay afloat. There are unending attempts to decipher a regulator's wants and needs, allowing little to no foundation on which to run a business,' said Chairman Blaine Luetkemeyer (R-MO). 'Ultimately, this world of ambiguous guidance, contradictory rules, and aggressive enforcement has led to confusion for financial companies seeking to comply with Dodd-Frank and other Obama-era rules. But the greatest impact is on the customers of those financial companies, who in many cases have been left clamoring for access to financial services, and paying more for the ones they've been able to retain.'")

109 Sooji Kim, Matthew Plosser & João Santos, Did the Supervisory Guidance on Leveraged Lending Work? (Federal Reserve Bank of New York Liberty Street Economics, May 16, 2016).

110 Paul Calem, Ricardo Correa & Seung Jung Lee, Prudential Policies and Their Impact on Credit in the United States (Federal Reserve Board International Finance Discussion Paper No. 1186, Nov. 2016).

and

- Make these changes subject to transparent notice and comment.

Statute/Regulation/Guidance: OCC, Federal Reserve Board, FDIC, Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17,766 (Mar. 22, 2013); OCC, Federal Reserve Board, FDIC, Frequently Asked Questions (FAQ) for Implementing March 2013 Interagency Guidance on Leveraged Lending (Nov. 7, 2014).

B. Single Counterparty Credit Limit

1. *The Manner in Which the Federal Reserve Board has Proposed to Apply a Single-Counterparty Credit Limit (SCCL) Would Impede the Availability of Credit in the United States*

As per the Dodd-Frank Act statutory mandate,[111] at the end of 2011, the Federal Reserve Board proposed an SCCL to limit credit exposure of Federal Reserve Board-regulated institutions, on a consolidated basis, to any one unaffiliated borrower/counterparty.[112] In response to criticism of the proposed SCCL's methodology, and evidence that the proposed SCCL could materially curtail credit in the United States, the Federal Reserve Board re-proposed the SCCL in 2016.[113]

The re-proposal continues to contain serious flaws that will limit credit availability and increase the cost of credit in the United States. We are not arguing for repeal of the Dodd-Frank Act provision on SCCL, but are raising necessary changes to the manner in which the Federal Reserve Board proposes in its regulations to apply the SCCL. Such implementation should adhere to the statutory requirements more consistently and avoid the troublesome effects on lending in the United States.

In the context of international banks, the SCCL should, at most, apply only to an international bank's IHC (if any) and should not apply to an international bank's branches or combined U.S. operations. There are multiple reasons for this important simplification and clarification of the reproposal:

- First, as a result of the SCCL proposal and existing exposure limit regulations already applicable to an international bank's U.S. operations, international banks would be required to comply with as many as five separate overlapping and redundant large exposure limits: (i) IHC-specific SCCLs (if applicable); (ii) separate SCCLs applied to an international bank's combined U.S. operations (including both U.S. branches and agencies as well as the U.S. IHC); (iii) federal and/or state lending limits already applicable to an international bank's U.S. insured depository institution subsidiaries (even if they are subsidiaries of an IHC); (iv) separate federal lending limits already applicable to an international bank's U.S. branch and agency network (even though such network would be part of the combined U.S. operations described in (ii) above); and (v) home-country large exposure limits already applied on a consolidated basis.
    - o The SCCL re-proposal would utilize government resources to police these multiple overlapping limits. The primary offender is the injection of a limit at the level of the "combined U.S. operations" (including branches) that is unnecessary and redundant.

111 Dodd-Frank Act § 165(e), 12 U.S.C. § 5365(e).

112 Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76,628 (proposed Dec. 28, 2012) (original international bank proposal); Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594 (proposed Jan. 5, 2012) (original domestic BHC proposal).

113 Single-Counterparty Credit Limits for Large Banking Organizations, 81 Fed. Reg. 14,328 (re-proposed Mar. 16, 2016).

- Furthermore, the reproposal fails to comport with the Dodd-Frank Act's statutory mandate to "(A) give due regard to the principle of national treatment and equality of competitive opportunity; and (B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home-country standards that are comparable to those applied to financial companies in the United States."[114]

- In addition to taking into account foreign standards that already apply to an international bank, it is also imperative that the SCCL requirements take into account standards already applicable to an international bank's operations in the U.S. to avoid creating a matrix of intertwined restrictions that can only serve to impede the availability of credit in the United States.[115]

- Second, the scope and number of international banks that would have to apply the SCCL is materially disproportionate to the more limited operational or systemic footprint of many international banks in the United States. Increasing operational and resource burdens on extensions of credit by smaller international banks negatively affects their participation in the U.S. markets and curtails their provision of credit to worthy enterprises. The SCCL reproposal would apply categorically as a U.S.-specific requirement to all international banks with $50 billion or more in global assets, regardless of the size of their U.S. operations.[116]

  Based on recent data, only 26 U.S. BHCs would be covered by the SCCL reproposal, but 110 international banks would have to comply with the SCCL requirements. While the absolute numbers are not by themselves determinative given the number of large international banks operating internationally, in our view these numbers are disproportionate to the relative importance of each of these international banks to the U.S. financial system. In particular, of the 110 international banks that would be subject to the Proposal, 59% (65) have less than $10 billion in U.S. assets and 79% (87) have less than $50 billion in U.S. assets. Applying the SCCL solely to the IHC would limit the effect on credit availability and limit the impact on U.S. businesses by ensuring application of the regulation to only those with sufficient U.S. assets to require creation of an IHC.

- Third, the SCCL reproposal contains a provision that would cripple credit availability even if an extension of credit were below a number of the limits described above as applicable to international bank U.S. operations.

  - The reproposal includes a "cross-trigger" provision that would prevent additional credit transactions to a particular counterparty by any of an international bank's combined U.S. operations (branches, agencies or other assets outside of an IHC) if the U.S. IHC's SCCL

---

114 Dodd Frank Act § 165(b)(2), 12 U.S.C. § 5365(b)(2).

115 See Dodd-Frank Act § 169 ("The Board of Governors shall take any action that the Board of Governors deems appropriate to avoid imposing requirements under this subtitle that are duplicative of requirements applicable to bank holding companies and nonbank financial companies under other provisions of law.").

116 See Section I.A.2. above with regard to modification of size thresholds for application of enhanced prudential standards to international banks.

to that particular counterparty were breached. The reproposal provides neither an explanation for the cross-trigger nor analytical or evidentiary support for it. The reproposal particularly handicaps the ability of international banks' U.S. operations to provide credit to worthy borrowers as it does not include a similar SCCL cross-trigger for U.S. BHCs.

- There is no reason why the SCCL should impede provision of credit by one part of the organization, provided it is within its large exposure or related limits, because another part of the organization may have exceeded its limits. The cross-trigger creates significant incentives for an international bank to shift banking, lending and derivatives activities to overseas branches in order to avoid the potential sudden curtailment of activity with regard to certain borrowers that could result from the operation of the cross-trigger on its U.S. operations. The cross-trigger may also have a chilling effect on lending to the maximum extent through an IHC, for fear of shutting down the international bank's U.S. credit operations to certain customers, especially in sectors in which international banks are particularly active such as agriculture and renewable energy.

- The redundant limitations and the cross-trigger are particularly acute problems when one examines the scope of U.S. entities that need to be aggregated by an international bank in order to determine compliance with the SCCL in the United States. The IHC or the combined U.S. operations must include exposures incurred by their "subsidiaries", defined as those entities that are "controlled" by the international bank and/or IHC under the BHC Act. "Control" can be found with regard to many entities that are not consolidated from a balance sheet or a risk management perspective (because, e.g., the entity is only 25% owned by the international bank or IHC). Not only does the international bank (and the same is true for a domestic BHC) not have operational control over such companies to be able to curtail their credit exposures, but they are not required to include such a company's assets on their balance sheet for accounting or capital adequacy purposes.

Recommendations:

In order to enhance access to credit in the United States:

- The SCCL should apply only to an international bank's U.S. IHC, based on parent company capital, in the same manner as the SCCL applies to a U.S. BHC. The IHC should be required to aggregate exposures only from entities that are consolidated with it from an accounting perspective.

- The SCCL should not apply to the international bank's combined U.S. operations as a separate application of the SCCL. In eliminating application to the combined U.S. operations, any "cross-trigger" provisions would also be eliminated.

- The IHC should benefit from provisions in the reproposal applicable to international banks, such as exemptions for exposures to an international bank's home-country sovereign.

- For those international banks that are not required to create an IHC, at most, an international bank with total U.S. assets of $250 billion or more should be required to confirm to the Federal Reserve Board that it meets, on a consolidated basis, the large exposure limits established by its home-country supervisor that are consistent with the Basel Committee's final standards setting out a supervisory framework for consolidated large exposure limits.

- The Federal Reserve Board should have flexibility in the final rule to further tailor the applicability of the SCCL to individual IHCs depending on individual circumstances, and to create exceptions where necessary.

- Existing U.S. lending limits would continue to apply to U.S. insured depository institutions and U.S. branches and agencies of international banks.

- These changes should be made in a new reproposal by the Federal Reserve Board, subject to notice and comment.

No changes would need to be made to the statutory language of Dodd Frank Act § 165(e) to accommodate the recommendations above.

Statute/Regulation/Guidance: Section 165(e) of the Dodd-Frank Act (12 U.S.C. § 5365(e)); 81 Fed. Reg. 14,328 (re-proposed Mar. 16, 2016); 77 Fed. Reg. 76,628 (proposed Dec. 28, 2012) (original international bank proposal); 77 Fed. Reg. 594 (proposed Jan. 5, 2012) (original domestic BHC proposal).

IV. Cross-Cutting Issues

A. Risk Committee

1. *Greater Flexibility in Managing and Oversight of U.S. Risk Should be Provided to All International Banks; In Particular, International Banks Should Not Be Required to Maintain a U.S.-Focused Risk Committee at Their Home-Country Board of Directors*

As mandated by the Dodd-Frank Act, the Federal Reserve Board has promulgated regulations requiring certain institutions to establish U.S. risk committees and to improve their risk management personnel and procedures. Those international banks with the largest U.S. operations are required to maintain a U.S. IHC.[117] The IHC, in turn, is required to have a risk committee of its board of directors and the international bank's overall U.S. risk committee may also be the risk committee of the board of directors of the IHC. Therefore, the risk committee for these international banks may be composed of U.S. persons that maintain roles in the U.S. operations. In contrast, ironically, the Federal Reserve Board's rules require that international banks that maintain a smaller U.S. footprint, and therefore have less effect on the U.S. economy, maintain the U.S. risk committee as a committee of their parent/home-country board of directors.

We understand the focus of the U.S. regulators on the concept of "tone at the top". Nevertheless, there are significantly more efficient ways to accomplish appropriate risk management and risk oversight of the U.S. operations than to place the U.S. risk oversight committee at the board of directors in an international bank's home country. Furthermore, the costs of maintaining and informing a top-tier parent board committee far outweigh, and indeed materially dilute, the benefits that may be gained by having such a committee at the board level. Overall, the effectiveness of a U.S. committee could be improved by allowing a committee formed from U.S. management serve as the required U.S. risk committee and requiring this committee to report periodically to the board of directors—the primary principle being to house the oversight and authority embodied in the U.S. risk committee closer to the U.S. operations.[118]

It is especially important for international banks that are not required to form an IHC—because they have less than $50 billion in U.S. non-branch assets—to have additional flexibility with regard to managing their U.S. operations. Many of the more than 100 non-IHC international banks captured by this requirement, including those that are publicly trades and have $10 billion or more in total global assets, in fact, have quite small U.S. footprints. Therefore, this requirement appears quite anomalous, as international banks with smaller U.S. footprints are not given nearly as much flexibility in the design and location of their U.S. risk committee as the more systemically important institutions.

---

117 12 C.F.R. § 252.153.

118 Indeed, the Federal Reserve Board indicated that the requirement for those international banks with IHCs to house a risk committee at the IHC board of directors was "an appropriate means for the U.S. risk committee to have exposure to the FBO's U.S. operations and to ensure that the U.S. risk committee is accessible to U.S. supervisors". Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240, 17,288 n. 131 (Mar. 27, 2014).

Recommendations:

To have the most efficient and tailored regulation on risk management, to address risks to the U.S. financial system more closely and to more closely align benefits of the risk committee requirements with its costs, the following more flexible standards should be adopted as modifications to the Federal Reserve Board's regulations:

- Eliminate the requirement for a U.S. risk committee housed at the home-country board of directors;
- For all international banks, allow creation of a U.S. risk committee in the U.S., including participation of U.S. non-director managers as well as any directors of U.S. entities that the organization believes are fit for the risk committee; and
- Require that this U.S. risk committee report periodically to the global risk committee of the home-country board.

Statute/Regulation/Guidance: 12 C.F.R. §§ 252.132 (publicly traded international bank with total consolidated global assets of at least $10 billion but less than $50 billion), 252.144 (international bank with total consolidated global assets of at least $50 billion, but less than $50 billion in combined U.S. assets), 252.155 (international bank with combined U.S. assets of at least $50 billion, whether or not required to maintain an IHC); Dodd-Frank Act § 165(h).[119]

---

119 No changes would need to be made to the statutory language of Dodd Frank Act § 165(h) to accommodate the recommendations above. Dodd-Frank Act § 165(h) does not require that the risk committee be housed at any board of directors and it certainly does not prohibit participation on the committee by non-director members of management, although there is permission for the Federal Reserve Board to insert requirements for participation by "independent directors". See Dodd-Frank Act § 165(h)(3) (the risk committee shall "(A) be responsible for the oversight of the enterprise-wide risk management practices of the nonbank financial company supervised by the Board of Governors or bank holding company described in subsection (a), as applicable; (B) include such number of independent directors as the Board of Governors may determine appropriate, based on the nature of operations, size of assets, and other appropriate criteria related to the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), as applicable; and (C) include at least 1 risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.")