



# INSTITUTE OF INTERNATIONAL BANKERS

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Legislative and Regulatory Activities Division  
Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street, S.W. Suite 3E-218, Mail Stop 9W-11  
Washington, D.C. 20219

Re: OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches, Integration of 12 CFR Parts 30 and 170 (Docket ID OCC-2014-0001)

Ladies and Gentlemen:

The Institute of International Bankers (“IIB”) appreciates the opportunity to comment on the “Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches” (the “Proposed Guidelines” or the “Proposal”) published by the Office of the Comptroller of the Currency (“OCC”).<sup>1</sup> We have joined in the letter also signed by the American Bankers Association, The Financial Services Roundtable and the Securities Industry and Financial Markets Association (“the Joint Associations Letter”), which addresses the Proposal as it broadly applies to the various types of banking organizations covered by the Proposed Guidelines, and in particular insured national banks and federal savings associations. As the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States, we are writing separately to address issues raised by the Proposal specifically with respect to federal branches,<sup>2</sup> both insured and uninsured. In addition, we address certain questions regarding application of the Proposed Guidelines to national banks that arise by virtue of the fact that a national bank is a subsidiary of a bank headquartered outside the United States (a “foreign bank”).

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<sup>1</sup> 79 Fed. Reg. 4282 (January 27, 2014).

<sup>2</sup> Except as otherwise indicated by the context, references herein to “federal branches” include “federal agencies”.



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As a preliminary matter, it is our understanding that at present there is no federal branch with average total consolidated assets of \$50 billion or more<sup>3</sup> but that several federal branches are included in the heightened expectations program (or at least are subject to certain aspects of the heightened expectations). It is our further understanding that, as a practical matter, “heightened expectations” (in whatever form and to whatever extent) would apply to not more than one insured federal branch.

Taking into account these understandings, and based on the considerations discussed below, we respectfully submit the following recommendations:

- Rather than “reserv[ing] the authority to modify the Guidelines as necessary to tailor the application of the Guidelines to [insured federal branches’] operations”,<sup>4</sup> we urge the OCC to delay any decision regarding application of the Guidelines to an insured federal branch pending a more definite determination of what such tailoring contemplates, including with respect to the structure and operation of independent risk management and internal audit functions and the role of the foreign bank’s governing body.
- The “heightened expectations” currently applied to certain uninsured federal branches need not, and should not, be codified as a separate regulation. However, to provide examiners appropriate guidance, it would be appropriate to formalize them in a written document (such as a policy statement or through interpretive guidance). These expectations should not be modified to incorporate any aspect of the final Guidelines to which an uninsured federal branch is not already subject without the opportunity for further public comment.
- Regardless of whether a federal branch is insured or uninsured, and whether set forth in a regulation (Appendix D to Part 30) or in some other type of written document, the heightened expectations as applied to federal branches should be principles-based, providing each branch considerable flexibility to apply them in a manner best suited to its circumstances and appropriately taking into account the fact that the branch operates as an office within the context of the risk governance framework established by the foreign bank that is overseen by the bank’s governing body all in accordance with applicable home country requirements.
- It is essential that the OCC, in connection with developing and implementing the Proposed Guidelines (as well as any heightened expectations that would apply apart from

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<sup>3</sup> See the Federal Reserve’s most recent “Structure Data for the U.S. Offices of Foreign Banking Organizations” (<http://www.federalreserve.gov/releases/iba/201306/bytype.htm>).

<sup>4</sup> *Id.* at 4285 note 12.



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the specific provisions of Appendix D to the Part 30 regulations), coordinate closely with the Federal Reserve to ensure consistency between its requirements and those prescribed for foreign banks under the regulations promulgated by the Federal Reserve under Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“DFA”). This coordination should include appropriate adjustments to the time provided to come into full compliance with the applicable heightened expectations to reflect the July 1, 2016 effective date of those regulations.

### **APPLICATION TO FEDERAL BRANCHES**

#### **A. The Risk Governance Framework**

A robust risk governance framework, coupled with effective oversight by a bank’s governing body, is fundamental to maintaining and strengthening bank safety and soundness. The IIB and its members support the OCC’s efforts to enhance standards and practices in this area. Indeed, the national bank subsidiaries and federal branches of several IIB member banks currently are subject to the set of “heightened expectations” developed by the OCC in the last several years, and those banks have undertaken, and are continuing to undertake, substantial efforts to meet these expectations.

As discussed at length in the Joint Associations Letter, the Proposal takes an overly prescriptive, “one-size-fits-all” approach the rigidity of which would be counterproductive to achieving its intended purposes. The adverse consequences of this approach are magnified by the extent to which the Proposed Guidelines would isolate a national bank from its parent bank holding company’s risk governance framework. The Joint Associations Letter well describes and addresses the difficulties presented by such an approach as applied to national banks. We respectfully submit that such an approach is at least equally problematic if applied to federal branches.

First, and most fundamentally, a federal branch operates as a U.S. office of a substantially larger and more complex global banking entity, whereas a national bank is a banking entity that operates separately from its bank holding company parent. The Joint Associations Letter stresses the need to integrate appropriately the risk governance framework of a national bank with that of its parent. These considerations are even more pronounced in the case of a federal branch, which, as a component of a larger global banking entity, operates within a broader, enterprise-wide risk management framework that includes independent risk management and internal audit functions.<sup>5</sup>

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<sup>5</sup> Regarding internal audit, the Joint Associations Letter highlights problems with requiring an assessment of the degree to which a bank’s risk governance framework is consistent with “leading industry practices”, and there is even less clarity under the Proposal with respect to the frame of reference for making such an assessment in the context of a federal branch.



Similarly, the Joint Associations Letter raises serious concerns regarding the application of the “three lines of defense” contemplated under the Proposal, and in particular the inclusion of functions in the “front line unit” that heretofore have not been generally recognized as “front line” in nature. The potential for conflict between the configuration of the three lines of defense contemplated by the Proposal and the manner in which the relevant control functions are organized in other countries is profound. To the extent that a federal branch would be required to conform to the proposed configuration, notwithstanding how that configuration relates to the larger control framework within which the branch operates as an office of the foreign bank, there is a significant risk of the “tail wagging the dog” in connection with implementing the Proposed Guidelines.

Second, and in further elaboration of this consideration, superimposing on a federal branch strictly prescribed requirements for how it structures its risk governance framework, including the organization, operation and interrelationships among its various business lines and control functions, not only may fail to give due regard to the larger framework within which the federal branch operates, but also bears the substantial risk of creating an overly rigid and formalistic framework which impedes effective risk management. Like national banks – and, indeed, like banking organizations in general – federal branches have adopted a variety of structures, policies and practices to manage their risks which reflect differences in their size, level of complexity, mix of business operations and home country requirements. We believe the better and more effective approach is to prescribe principles for which a banking entity (whether a national bank or a federal branch) will be held accountable (whether pursuant to a specific regulation or as a more general matter of safety and soundness) and then permit the banking entity the flexibility to put those principles into effect as it believes is best suited to its circumstances.

#### **B. Responsibilities of the Banking Entity’s Governing Body**

The foregoing concerns carry through as well to the parts of the Proposed Guidelines prescribing the oversight responsibilities of a covered banking entity’s governing body. The Preamble to the Proposed Guidelines takes note that an insured federal branch itself does not have a board of directors (and, of course, the same is true for an uninsured federal branch), but does not further address how this quite stark difference from a national bank should be reflected in the Guidelines. The responsibilities assigned to a bank’s governing body are matters of profound importance to the proper and effective application of the Guidelines to federal branches.<sup>6</sup> In thinking about the appropriate corporate governance structure for a federal branch

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<sup>6</sup> The Proposed Guidelines state, without further elaboration of the rationale or consideration of its implications, that in the case of a foreign bank “the board of directors means the managing official in charge of the branch.” See 79 Fed. Reg. at 4297 note 1). Applied in the context of the Proposed Guidelines, this approach leads to significant adverse consequences that surely are unintended. For example, under the Proposed Guidelines the managing official in charge of the branch would be responsible for the following functions, among others, each of which has the potential to create conflicts of interest that would undermine the effectiveness of the Guidelines:



in the context of “heightened expectations” we believe the following two considerations are especially relevant:

- The structure should take into account (i) the OCC's policy considerations underpinning the Proposed Guidelines, (ii) the products and services offered by the branch, (iii) the size and scope of the branch's activities, and (iv) the existing governance and control structure of the branch's foreign bank.
- In all cases, the OCC retains the authority as part of the examination process to require or recommend that a branch select a different method of compliance, if in its judgment, the branch's corporate governance would not meet the Proposed Guideline's requirements.

**C. The Importance of “Tailoring”; Like Treatment of Insured and Uninsured Federal Branches**

These considerations are reflective of a more deeply-rooted shortcoming of the Proposed Guidelines as applied to insured federal branches. The Proposal notes the “unique nature” of insured federal branches, which forms the basis for a reservation of authority “to modify the Guidelines as necessary to tailor the application of the Guidelines to these entities’ operations.”<sup>7</sup> We strongly support the need for such tailoring and believe that further attention must be devoted to addressing the challenges presented in applying to insured federal branches guidelines that have been designed with a very different structure in mind – a national bank that is organized as a separate corporate entity. Rather than reserving the authority to modify the Guidelines as necessary to tailor them to insured federal branches, we urge the OCC to delay any decision regarding application of the Guidelines to an insured federal branch pending a more definite determination of what such tailoring contemplates, including with respect to the structure and operation of independent risk management and internal audit functions and the role of the foreign bank’s governing body.

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- Approve the risk governance framework and risk appetite statement prepared by independent risk management – yet the risk governance framework and risk appetite statement are required to include risk limits that apply to front line units that the managing official oversees.
  - Independent risk management would be required to report to the managing official in charge of the branch: (i) cases where its risk assessment materially differs from the front-line's risk assessment and (ii) risk limit breaches made by front line units – *i.e.*, independent risk management would escalate risks to the managing official of the branch, the same individual who is also responsible for front-line unit risk taking.

<sup>7</sup> See 79 Fed. Reg. at 4285 note 12. By way of example, the Proposal notes further that tailoring of the application of Part III of the Proposed Guidelines as applied to insured federal branches is expected “because these institutions do not have a Board.” Id.



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The considerations discussed above with respect to insured federal branches apply equally to uninsured federal branches. For purposes of the Proposed Guidelines, the two types of branches are distinguishable solely by the fact that the deposits of one are insured while those of the other are not. That difference is critical to how heightened expectations are enforced against federal branches – as an insured banking entity, an insured federal branch that is subject to the Proposed Guidelines would be subject to the enforcement regime provided for under Part 30 of the OCC’s regulations, whereas an uninsured branch would be subject to safety and soundness enforcement under 12 U.S.C. § 1818<sup>8</sup> – but is a matter of no importance with respect to the question of how they should be applied.

The Proposal explains that whether to apply the Proposed Guidelines to large, uninsured federal branches remains under consideration:

The OCC has not included uninsured entities, such as trust banks and Federal branches or agencies of foreign banks, in the scope of the proposed Guidelines because section 39 of the FDIA applies only to “insured depository institutions.” Currently, OCC examiners are informally applying certain aspects of the heightened expectations to select uninsured entities. The OCC is considering whether it would be appropriate to apply the provisions in the Guidelines to these entities. The Guidelines could be applied to these entities informally, as is the current practice with the heightened expectations, or the OCC could issue a separate regulation. If the OCC decides to apply the Guidelines informally, we may issue a policy statement to address issues raised by the application of the Guidelines to these institutions.<sup>9</sup>

The “heightened expectations” currently applied to certain uninsured federal branches need not, and should not, be codified as a separate regulation. However, to provide examiners appropriate guidance, it would be appropriate to formalize these expectations in a written document (such as a policy statement or through interpretive guidance). These expectations should not be modified to incorporate any aspect of the final Guidelines to which an uninsured branch is not already subject without the opportunity for further public comment.

### **ENSURING CONSISTENCY WITH THE FINAL FBO 165 RULES**

The final rules for large foreign banks adopted by the Federal Reserve under DFA Section 165 (as codified in Regulation YY, the “Final FBO 165 Rules”) present two issues when read in the context of the Proposed Guidelines:

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<sup>8</sup> See id. at 4285.

<sup>9</sup> Id.



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- In considering questions regarding the relationship with its parent entity in the case of a national bank that is owned by a foreign bank, which is the appropriate “parent entity” – the foreign bank or the U.S. “intermediate holding company” (“IHC”) that the foreign bank is required to establish under Section 165?<sup>10</sup>

As discussed below, we believe the appropriate parent entity is the U.S. IHC.

- In considering the application of “heightened expectations” (whether embodied in Guidelines incorporated into Part 30 of the OCC’s regulations or formalized in some other manner) to federal branches, how should the risk governance framework contemplated by the Proposed Guidelines relate to the requirements in the Final FBO 165 Rules to maintain a U.S. risk committee and, depending on the size of a foreign bank’s combined U.S. operations, designate a separate chief risk officer (“CRO”)?

Whether maintained as a committee of the foreign bank’s governing body or, where there is a U.S. IHC, as a committee of the U.S. IHC’s governing body, the U.S. risk committee exercises responsibilities and is subject to requirements that need to be carefully taken into account in connection with implementing the OCC’s heightened expectations. Ensuring consistency between the two sets of requirements is a matter that should be resolved in connection with addressing the other questions raised by the Proposal with respect to its application to federal branches, including in particular with respect to the responsibilities of the relevant governing body.

### **A. Location and Responsibilities of the U.S. Risk Committee under the Final FBO Section 165 Rules**

The Final FBO Section 165 Rules adopt a U.S.-enterprise wide approach to risk management, but provide a certain degree of flexibility with respect to where within a foreign bank’s structure responsibility for U.S. risk management is established, and impose additional responsibilities on banks with larger operations.

A foreign bank with combined U.S. assets of less than \$50 billion (*i.e.*, one which is not required to establish a U.S. IHC) is required annually to certify to the Federal Reserve that it maintains a committee of its global governing body that is responsible for overseeing the risk management policies of the foreign bank’s combined U.S. operations.<sup>11</sup> This committee may be

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<sup>10</sup> A foreign bank with non-branch U.S. assets of \$50 billion or more is required by the Final FBO 165 Rules to organize those activities under a U.S. IHC. Since a national bank with \$50 billion or more in total consolidated assets would be subject to the Proposed Guidelines, it is clear that any such national bank owned by a foreign bank will be a subsidiary of the foreign bank’s U.S. IHC.

<sup>11</sup> Section 252.144(a)(1) of Regulation YY.



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maintained on a standalone basis or operate as part of the bank's enterprise-wide risk committee and must have at least one member with risk management expertise, which may be satisfied as long as the experience includes the identification, assessment and management of risk of large, complex, but not necessarily financial, firms. There is no requirement that the committee maintain a specific number of independent directors.<sup>12</sup>

A foreign bank with combined U.S. assets of \$50 billion or more (*i.e.*, one which may be required to establish a U.S. IHC depending on the amount of non-branch U.S. assets) is required to maintain a U.S. risk committee that approves and periodically reviews the risk management policies of the combined U.S. operations and oversees risk management framework for the combined U.S. operations.<sup>13</sup> The U.S. risk committee must include at least one member with risk management expertise, which must be satisfied by having experience with the identification, assessment and management of risk of large, complex financial firms and at least one independent director.<sup>14</sup>

Foreign banks with combined U.S. assets of \$50 billion or more which do not operate in the United States through a branch or agency are required to establish and maintain the U.S. risk committee as a committee of the U.S. IHC's governing body.<sup>15</sup> Those that operate in the United States through U.S. branches or agencies and are not required to establish a U.S. IHC must maintain the U.S. risk committee as a committee of the foreign bank's governing body. If such a foreign bank's U.S. branch/agency operations are combined with non-branch operations conducted through a U.S. IHC, then the U.S. risk committee may be maintained as a committee of the governing body of either the foreign bank or the U.S. IHC.<sup>16</sup> However, because a U.S. IHC is required to have its own U.S. risk committee, and that committee may also serve as the U.S. risk committee for the foreign bank's combined operations,<sup>17</sup> as a practical matter it is highly likely that the U.S. risk committee of such a foreign bank would be maintained as a committee of the U.S. IHC's governing body. Restated, it is highly likely that the U.S. risk

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<sup>12</sup> Section 252.144(a)(2) of Regulation YY.

<sup>13</sup> Section 252.155(a)(1) of Regulation YY. That risk management framework must be "commensurate with the structure, risk profile, complexity, activities, and size of [the foreign bank's] combined U.S. operations and consistent with its enterprise-wide risk management policies." In addition the framework must include specific features set forth in the Rules. See Section 252.155(a)(2) of Regulation YY.

<sup>14</sup> Section 252.155(a)(5) of Regulation YY. The same requirements apply to IHCs pursuant to Section 252.153(e)(3)(iv) of Regulation YY.

<sup>15</sup> Section 252.155(3)(i) of Regulation YY.

<sup>16</sup> Section 252.155(a)(3)(ii) of Regulation YY.

<sup>17</sup> Section 252.153(e)(5) of Regulation YY.



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committee of a foreign bank with combined U.S. assets of \$50 billion or more will be maintained as a committee of the foreign bank's governing body only if the foreign bank is not required to establish an IHC.

The Final FBO 165 Rules further require that a foreign bank with combined U.S. assets of \$50 billion or more or its U.S. IHC, if any, appoint a U.S. chief risk officer ("CRO"), who must be employed and located in a U.S. operation of the bank (*i.e.*, a U.S. branch or agency, IHC (if any) or other subsidiary), demonstrate required expertise, fulfill specified responsibilities and report directly to the U.S. risk committee and the global CRO.<sup>18</sup>

### **B. National Bank Subsidiaries of Foreign Banks**

As discussed above, a national bank that is subject to the Proposed Guidelines and that is a subsidiary of a foreign bank will be a subsidiary of the foreign bank's U.S. IHC upon its establishment (the U.S. IHC will itself be a bank holding company by virtue of its ownership of the national bank). Prior to the establishment of the U.S. IHC, the national bank will remain a subsidiary of the foreign bank's top-tier U.S. intermediate bank holding company. In either case, the concerns discussed in the Joint Associations Letter regarding the relationship between a national bank and its parent are equally applicable to a national bank subsidiary of a foreign bank. For these purposes, we believe it is appropriate to treat the top-tier U.S. holding company as the "parent" of the national bank, and especially so upon the establishment of an IHC inasmuch as, as discussed above, it is highly likely that in that case the U.S. risk committee will be located at the IHC.

### **C. Determining the Relationship Between A Foreign Bank's U.S. Risk Committee and Its Federal Branch**

Whether established as a committee of the governing body of the foreign bank or of a U.S. IHC, the U.S. risk committee required under DFA Section 165 exercises risk management responsibilities for the entirety of the foreign bank's U.S. operations, including any federal branch. Consequently, there is a significant prospect that the Proposed Guidelines would result in duplication and potential conflict in the management of federal branch's risks if the requirements are not properly coordinated with and adapted to the required responsibilities of the U.S. risk committee. For example, the U.S. risk committee must oversee a risk management framework that includes, among other requirements, processes and systems to ensure the independence of the risk-management function of the combined U.S. operations and, as the case may be, the U.S. IHC.<sup>19</sup> Likewise, conflicts and overlap in the roles of the Chief Risk Executive under the Proposed Guidelines and the CRO under the Final FBO 165 Rules must be avoided (as discussed in the Joint Associations Letter, "dual hatting" is one means to address these concerns).

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<sup>18</sup> Section 252.155(b) of Regulation YY.

<sup>19</sup> Sections 252.153(e)(3)(ii)(B)(3) and 252.155(a)(2)(ii)(C) of Regulations YY.



**D. Timing Considerations**

Adapting the Proposed Guidelines to the circumstances of federal branches and the requirements of the Final FBO165 Rules presents significant challenges and calls for a deliberate and well-coordinated approach, especially in view of the fact that some form of “heightened expectations” already are being applied to certain federal branches and foreign-owned national banks and are continuing to develop. It is essential that foreign banks be provided sufficient time to incorporate the heightened expectations into the U.S. risk management frameworks called for under the Final FBO 165 Rules. Accordingly, this coordination should include appropriate adjustments to the time provided to come into full compliance with the applicable heightened expectations to reflect the July 1, 2016 effective date of the Final FBO 165 Rules.

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We appreciate the OCC’s consideration of our comments on the Proposal. Please contact the undersigned if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Coffman', written over a horizontal line.

Richard Coffman  
General Counsel