



Americans for Financial Reform
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April 30, 2013

Robert deV. Frierson,
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551.

Re: Enhanced Prudential Standards and Early Remediation Requirements For Foreign Banking Organizations and Foreign Non-Bank Financial Companies (Docket No. R-1438; RIN 7100 AD 86)

Dear Mr. Frierson:

Americans for Financial Reform (“AFR”) appreciates this opportunity to comment on the above-referenced Proposed Rules (the “Proposed Rules”) by the Board of Governors of the Federal Reserve System (the “Board”) proposing regulations that set out enhanced prudential standards for foreign banking organizations and foreign non-bank financial companies.

AFR is a coalition of more than 250 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups along with prominent independent experts.

General Comments

Americans for Financial Reform strongly supports the approach to foreign banking organizations laid out in these Proposed Rules. The Proposed Rules are a sensible and measured response to three pressing issues concerning the regulatory treatment of foreign banks:

- 1) The incentive for foreign banks to ‘free ride’ on the U.S. safety net, using subsidies from the U.S. government to benefit their global operations.
- 2) The need to ensure that adequate capital and liquidity is available for the U.S. operations of foreign banks, so that U.S. financial stability is preserved in stressful conditions.
- 3) The requirement to apply Dodd-Frank prudential reforms equally to foreign-owned and domestic U.S. banking operations, so that there is an even playing field.

Any one of these considerations could justify the steps set out in these Proposed Rules. Together, they constitute an overwhelming case for action. It is striking that critics of the Proposed Rules

have not laid out an alternative mechanism to address these pressing problems, apparently proposing instead to rely on Basel arrangements for consolidated supervision that manifestly did not work in the financial crisis.¹

Foreign-owned banks operating in the U.S. market constitute a major part of the American banking system, holding over one fifth of domestic banking assets today.² Over the decade prior to the financial crisis, the size and funding pattern of foreign-owned bank changed in ways that increased the risks generated by this subsector. First, the size of the sector grew rapidly over the years just prior to the financial crisis. Second, while U.S. agencies and subsidiaries of foreign banks had previously acted mainly as a channel for foreign funds to be loaned in the U.S., during the years prior to the financial crisis these entities also became a major conduit to channel short-term wholesale funding from U.S. money markets as long-term loans to the foreign parent bank.³

This funding pattern increased the instability of these U.S. operations, even as their role in the U.S. economy was growing. When the financial crisis of 2007-2009 occurred, this instability manifested itself in several ways. First, foreign banks withdrew funding from U.S. markets and transferred it back to the foreign parent, reducing lending in the U.S. This created economic harm and intensified the impact of the crisis on the real economy.⁴ Second, when these transfers were inadequate to absorb the shock of the financial crisis, foreign banks received a substantial bail-out from the U.S. government. Half of the top 20 recipients of assistance from Federal Reserve liquidity programs were foreign banks, and at peak such banks received over \$2 trillion in liquidity assistance. For many major programs (such as the commercial paper funding facility), well over half of funds were disbursed to foreign-owned banking entities.⁵ Even these figures underestimate the total amount of assistance received by foreign banks, as they do not include the swap lines used to extend dollar credit to foreign central banks, much of which was then loaned by the central bank recipients to foreign banks in their jurisdictions.⁶

The events of the crisis highlight the first two issues listed above. The U.S. has the largest and most liquid financial markets in the world, and the U.S. dollar plays a unique role as the world's reserve currency. These considerations create large incentives for foreign banking entities to be active in U.S. markets and to accumulate large liabilities to U.S. counterparties. In the event of a crisis, this creates significant incentives for the U.S. government to in effect bail out foreign-

¹ Barnier, Michel, "Letter to Ben Bernanke Regarding Intermediate Holding Company Requirement", Brussels, Belgium, April 18, 2013.

² Goulding, William and Daniel Nolle, "[Foreign Banks In The U.S.: A Primer](#)", Board of Governors of the Federal Reserve System International Finance Discussion Paper Number 1064, November 2012.

³ Tarullo, Daniel, "[Regulation of Foreign Banking Organizations](#)", November 28, 2012; Goulding, William and Daniel Nolle, "[Foreign Banks In The U.S.: A Primer](#)", Board of Governors of the Federal Reserve System International Finance Discussion Paper Number 1064, November 2012

⁴ Cetorelli, Nicola and Goldberg, Linda S., "[Follow the Money: Quantifying Domestic Effects of Foreign Bank Shocks in the Great Recession](#)", FRB of New York Staff Report No. 545, February 1, 2012.

⁵ See Table 8 and Figure 10, Government Accounting Office, "[Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance](#)", GAO-11-696, July, 2011.

⁶ See Appendix 9, op. cit., Government Accounting Office.

owned banks, as occurred on a very large scale in the recent crisis. Thus, steps must be taken to prevent foreign entities from free riding on the U.S. safety net. Such free riding forces U.S. taxpayers to subsidize foreign financial entities, and also creates harmful economic incentives in the global financial system. In addition, the financial crisis also revealed that unstable funding patterns for foreign banks can lead to large-scale exit of foreign funds from the U.S. market in times of financial instability, creating a harmful shock to the U.S. economy.

The Dodd-Frank Act (the ‘DFA’) was of course passed in direct response to the events of the financial crisis. The DFA required significant new prudential protections for U.S. banks, and specifically required that these protections be extended to foreign-owned banks operating in the U.S. as well.⁷ These protections include heightened capital, liquidity, and risk management standards, as well as limits on single-counterparty exposures.

The U.S. obviously cannot and should not supervise the entire global operations of a foreign bank. So it is difficult to see how these new prudential limits can possibly be applied to foreign-owned U.S. operations unless some steps are taken to ensure minimum levels of liquidity and capital in the U.S. operations on a stand-alone basis. The failure to do this prior to the financial crisis led to a situation in which large foreign banks actually held negative capital, and did not have adequate liquidity provision.⁸ Thus, the proper implementation of Dodd-Frank and the equal treatment of U.S. and foreign-owned banks in the U.S. market require regulatory changes.

This Proposed Rule contains straightforward and common-sense steps to address the problems laid out above. Foreign banks with significant U.S. operations are required to have a separate U.S. risk manager, to ensure that short-term liquidity needs in their U.S. operations can be satisfied with the resources available to their U.S. entities, and that equity capital is available to U.S. operations. Stress testing procedures must be conducted that are specific to the U.S. operation. In addition, foreign banks operating through U.S. subsidiaries are required to create an intermediate holding company to facilitate management and measurement of U.S. exposures.

Americans for Financial Reform endorses these steps as necessary to protect the U.S. economy and U.S. taxpayers. They are also necessary to create competitive balance between U.S. owned banks and foreign-owned banks operating in the U.S. market.

Some have criticized the Proposed Rules as supposedly creating a competitive disadvantage for foreign banks and ‘ring-fencing’ capital and liquidity in the U.S. But this is deeply misleading. Instead, in the absence of rules like these, foreign banking operations in the U.S. will receive an unfair subsidy due to the possibility of implicit backing by the U.S. safety net without accompanying prudential protections. Furthermore, the supposed ‘ring-fencing’ of resources in U.S. operations simply reflects the necessary alignment of liquidity and capital with the assets

⁷ See Sections 165 and 171 of the Dodd Frank Act.

⁸ The excellent comment by Unite Here lays out these issues in detail, with special attention to the example of Deutsche Bank. See Unite Here, “[Letter Re Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies](#)”, April 29, 2013.

that they are intended to service. Without such alignment, the experience of the financial crisis demonstrates that adequate provisioning for U.S. operations may not occur. It is incumbent on critics of this proposal to present an actual solution to the problems revealed in the financial crisis. It makes no sense to simply assume the Basel regime of consolidated home-country supervision will address the issues laid out above, as it did not do so prior to and during the financial crisis.

As a final note, since this proposal lays out the application of the Board's proposed implementation of Section 165 of the DFA to foreign banks, it also discusses many elements of the Board's proposed Section 165 rules. In our comment of April 30th, 2012 AFR laid out a number of criticisms of the Section 165 proposal, and made recommendations concerning capital adequacy, rules for prompt corrective action, and the need to include restrictions on extremely short-term funding in any liquidity requirements.⁹ Our comments on and support of this rule reflect our strong support for extending requirements consistently to foreign banking organizations and are focused primarily on that issue. They do not reflect a change in our views of the strengths and weakness of the Board's proposed approach under Section 165 more generally, and are not oriented toward providing additional comments on those issues.

Additional Specific Comments And Responses to Questions

Question 1: Should the Board require a foreign nonbank financial company supervised by the Board to establish a U.S. intermediate holding company?

Yes. The same considerations which call for the establishment of an intermediate holding company at a foreign-owned banking organization will frequently apply to a foreign non-bank financial company. The experience of Deutsche Bank and its ability to de-register its subsidiary Taunus Corporation show that numerous investment banking activities can be organized into a non-bank subsidiary of a foreign bank.¹⁰

Question 6: What opportunities for regulatory arbitrage exist within the proposed framework, if any? What additional requirements should the Board consider applying to a U.S. branch and agency network to ensure that U.S. branch and agency networks do not receive favorable treatment under the enhanced prudential standards regime?

Two thirds of foreign bank assets are currently held in branch and agency networks, not subsidiaries.¹¹ The choice not to require an intermediate holding company for foreign branch and agency networks, along with the legal difficulties in identifying liquidity and capital resources in a branch network separately from the global consolidated bank, could thus open up significant

⁹ Americans for Financial Reform, "[Letter Re RIN 7100-AD-86: Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies](#)", April 30, 2012.

¹⁰ Unite Here, "[Deutsche Bank's U.S. Capital Dodge](#)"

¹¹ Goulding, William and Daniel Nolle, "[Foreign Banks In The U.S.: A Primer](#)", Board of Governors of the Federal Reserve System International Finance Discussion Paper Number 1064, November 2012.

arbitrage possibilities. Some of these issues are addressed in various parts of the Proposed Rules that do extend various capital and liquidity requirements to branch and agency networks. However, the enforcement of these requirements given the legal status of a branch network remains unclear. The Board must continue to monitor the organization of foreign banking companies and take additional steps to limit liquidity mismatches and ensure equity investment if necessary.

Question 18: What concerns, if any, are raised by the proposed requirement that a foreign banking organization calculate regulatory capital ratios in accordance with home country rules that are consistent with the Basel Accord, as amended from time to time?

The Basel requirements are intended to be a floor and individual nations may exceed these standards in their domestic banking sector. AFR believes that the international Basel capital standards are too low, and that U.S. banks should be held to a higher standard. Foreign banking organizations operating in the U.S. should be held to similar standards as those imposed on U.S. banks, not to a Basel standard if this standard is lower than the U.S. requirement.

Furthermore, the measurement and enforcement of capital requirements differs substantially between jurisdictions. Recent research by the BCBS Regulatory Consistency Assessment Program (RCAP) has found extreme variation in the measurement of risk-weighted assets between banks.¹² The study found that over one-quarter of this variation was directly due to supervisory choices, and it is likely that some of the remaining bank-specific variation was also indirectly related to supervisory practices. U.S. regulators have an interest in consistent capital treatment for financial firms active in the U.S. market.

Question 19: Should the Board require a foreign banking organization to meet the current minimum U.S. leverage ratio of 4 percent on a consolidated basis in advance of the 2018 implementation of the international leverage ratio? Why or why not?

AFR believes that proper competitive balance in the U.S. and the protection of the U.S. financial system require that foreign banking organizations be held to U.S. standards in cases where these standards exceed the Basel floor, either in levels of capital or in the phase-in dates for various requirements. This would imply that foreign banking organizations should be required to meet any U.S. standards that exceed Basel minimums.

Question 22: The Dodd-Frank Act contemplates additional enhanced prudential standards, including a limit on short-term debt. Should the Board adopt a short-term debt limit in addition to, or in place of, the Basel III liquidity requirements in the future? Why or why not?

Yes, we believe that explicit short term debt limits, as authorized in the Dodd-Frank Act, are a necessary addition to any liquidity requirements adopted under Basel III. In AFR's April 30th,

¹² Basel Committee on Banking Supervision, "[Regulatory Consistency Assessment Program – Analysis of Risk-Weighted Assets for Market Risk](#)", Bank for International Settlements, January, 2013.

2012 comment on Section 165 we made this argument in detail.¹³ We refer you to pages 7 to 8 of that comment for specific arguments related to this recommendation.

Question 27: The Board requests comment on all aspects of the proposed definitions of highly liquid assets and unencumbered. What, if any, other assets should be specifically listed in the definition of highly liquid assets? Why should these other assets be included? Are the criteria for identifying additional assets for inclusion in the definition of highly liquid assets appropriate? If not, how and why should the Board revise the criteria?

As discussed in our April 30th comment, a central issue in the design of a liquidity buffer is that assets which appear ‘safe’ during normal times may not be liquid during a systemic event. The types of assets specifically listed in the Proposed Rule (cash and U.S. government securities) have a proven record of retaining liquidity under systemic stress. However, it is crucial that any other liquid asset meet criterion iii of the proposed test for ‘other assets’ to be included in the liquidity buffer (CFR 76650) – that is, they must have a strong historical record as a ‘flight to quality’ asset. Tests i and ii for ‘other assets’ on p. CFR 76650 – the current existence of a liquid market with low credit risk and low price volatility – are qualities that may not be durable to a systemic event. Furthermore, they will be less likely to be durable if assets are designated as eligible for liquidity buffers on these criteria alone, as such designation will trigger additional selling during times of systemic stress.

Question 74: Should the Board consider conducting supervisory loss estimates on the U.S. branch and agency networks of large foreign banking organizations by requiring U.S. branches and agencies to submit data similar to that required to be submitted by U.S. bank holding companies with total consolidated assets of \$50 billion or more on the FR Y-14? Alternatively, should the Board consider requiring foreign banking organizations to conduct internal stress tests on their U.S. branch and agency networks?

As mentioned in the response to Question 6 above, the differential treatment of foreign-owned branch and agency networks is a potentially significant weakness in this proposal. We thus urge the Board to gather data from such networks similar to the data gathered from U.S. bank holding companies, conduct supervisory loss estimates, and also require foreign banking organizations to conduct internal stress tests on their U.S. branch and agency networks. This will go some distance to equalizing their treatment with foreign-owned subsidiaries and also with U.S. banks.

Thank you for the opportunity to comment on these Proposed Rules. Should you have any questions, please contact Marcus Stanley, AFR’s Policy Director, at (202) 466-3672 or marcus@ourfinancialsecurity.org.

¹³ Americans for Financial Reform, “[Letter Re RIN 7100-AD-86: Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies](#)”, April 30, 2012.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services

- Home Defender's League
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS

- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Affiliates

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA

- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M

- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET

