



March 8, 2018

Dear Senator,

On behalf of Americans for Financial Reform, we are writing to urge you to vote for Senator Brown's foreign bank amendment to S 2155. This amendment would guarantee that enhanced prudential safeguards remain in place at the U.S. operations of foreign mega-banks.<sup>1</sup> The text concerning foreign banks added in Section 401(g) of the substitute amendment attempts to preserve the discretionary authority of the Federal Reserve concerning foreign bank regulation, but does not guarantee that enhanced prudential standards will remain in place at such banks.

S 2155 removes the requirement for enhanced prudential safety and soundness standards at banks from \$50 billion to \$250 billion in size. This size range includes or could include the U.S. subsidiaries of eleven major international banks, holding \$1.7 trillion in total U.S. assets.<sup>2</sup> This includes subsidiaries of Credit Suisse, Deutsche Bank, HSBC, Santander, Mitsubishi UFG, and others. These entities differ from U.S. banks of similar size in that they are subsidiary operations of much larger global banks, which are among the largest banks in the world. Combined, the parent companies of U.S. banking subsidiaries that could be affected by S 2155 hold *\$17.2 trillion* in total assets, an amount larger than the entire U.S. economy.

The relationship between foreign bank subsidiaries and their powerful global parents means that they also pose a fundamentally different and greater systemic risk to the U.S. economy than U.S. banks of similar size. During the 2007-2009 financial crisis, six of the largest fourteen participants in Federal Reserve emergency assistance programs to financial institutions were foreign banks. Combined, those six foreign banks received \$4.5 trillion in U.S. government credit assistance.<sup>3</sup> Post-crisis research has established how foreign bank operations in the U.S. became a conduit for dollar borrowing globally, resulting in U.S. financial system exposures far greater than the nominal size of foreign banking subsidiaries within the U.S.<sup>4</sup> More recently, a study by the Office of Financial Research has found that systemic risk metrics for U.S. subsidiaries of foreign banks significantly exceed systemic risk metrics for similarly sized U.S. banks, and that the measured difference is understated due to lack of data on foreign bank

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<sup>1</sup> Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of coalition members is available at <http://ourfinancialsecurity.org/about/our-coalition/>

<sup>2</sup> Based on current FFIEC data on bank holding company size. We include HSBC North America Holdings, which currently has \$286 billion in on balance sheet U.S. assets but could easily shrink to be \$250 billion or below in size.

<sup>3</sup> Felkerson, James, "A Detailed Look at the Fed's Bailout by Funding Facility and Recipient", Levy Economics Institute Working Paper No. 698, December, 2011. <http://bit.ly/1azy4Vn>

<sup>4</sup> Goulding, William and Daniel Nolle, "Foreign Banks in the U.S.: A Primer", International Finance Discussion Papers No. 164, Board of Governors of the Federal Reserve System, November, 2012. <http://bit.ly/2Ica8B3>

activities. The study called for the regulation of foreign banks in the U.S. to be strengthened by incorporating more oversight of branches and agencies, not weakened.<sup>5</sup>

However, if S 2155 passes in its current form, there will be tremendous pressure to weaken the oversight and regulation of foreign bank subsidiaries in the U.S. After the financial crisis, the Federal Reserve changed its regulation of foreign banks to require ring-fencing of foreign banking operations through intermediate holding companies, in order to permit direct U.S. regulatory supervision of foreign banking operations. The purpose of these changes was to end the failed practice of deference to the foreign home country regulators to enforce safety and soundness regulation. This model failed before the financial crisis. Given the continuing weakness of, e.g., the European banking sector, it would certainly fail again today.<sup>6</sup>

These changes in Federal Reserve regulation of foreign banks were justified specifically by reference to the \$50 billion line in Dodd-Frank.<sup>7</sup> Changing this line without requiring the Federal Reserve to maintain strong regulation of foreign bank subsidiaries would almost certainly result in significantly weakening or ending U.S. regulatory enforcement of enhanced prudential standards at these entities. Treasury Secretary Mnuchin has already stated this is Trump Administration policy.<sup>8</sup>

The added Section 401(g) in the substitute amendment to S 2155 does not address this problem. It does add a legal defense that the Federal Reserve could use if a bank attempted to use the language of S 2155 to sue the Fed to overturn current foreign bank rules. However, it in no way requires the Trump Administration to retain enhanced rules for oversight of U.S. foreign bank subsidiaries in the \$50 to \$250 billion range. The Brown amendment would do exactly this by requiring subsidiaries of foreign megabanks to continue to be treated like U.S. banks over \$250 billion in size. Given the true significance and systemic risk of these entities, this is the right course of action. We urge you to vote for the Brown amendment.

Thank you for your attention to this matter. For more information please contact AFR's Policy Director, Marcus Stanley, at [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org) or 202-466-3672.

Americans for Financial Reform

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<sup>5</sup> Office of Financial Research, "Size Alone is Not Sufficient to Identify Systemically Important Banks", OFR Viewpoint 17-04, October 26, 2017. <http://bit.ly/2y8teXz>

<sup>6</sup> The Economist, "American Banks Have Recovered Well, Many European Banks Much Less So", Economist Special Report, May 6, 2017; <http://econ.st/2sek3hJ>

<sup>7</sup> "The Board believes that establishing a minimum threshold for forming a U.S. intermediate holding company at \$50 billion helps to advance the principle of national treatment and equality of competitive opportunity in the United States by more closely aligning standards applicable to the U.S. non-branch operations of foreign banking organizations under section 165 with the threshold for domestic U.S. bank holding companies that are subject to enhanced prudential standards under Title I of the Dodd-Frank Act." See CFR 17272 in the Federal Reserve Board's final rule on enhanced prudential standards, available at <http://bit.ly/2FPTKW1>.

<sup>8</sup> See transcript of January 30<sup>th</sup>, 2018 Banking Committee hearing on the annual report of the Financial Stability Oversight Committee, Treasury Secretary Mnuchin's response to Senator Brown's questions.