INSTITUTE OF INTERNATIONAL BANKERS

299 PARK AVENUE, 17TH FLOOR, NEW YORK, N.Y. 10171
TELEPHONE: (212) 421-1611 FACSIMILE: (212) 421-1119
HTTP://WWW.IIB.ORG

LAWRENCE R. UHLICK
EXECUTIVE DIRECTOR AND GENERAL COUNSEL
DIRECT E-MAIL: LUHLICK@IIB.ORG

September 17, 2004

By Electronic Mail

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Attn: Comments/Legal ESS

Re: Proposed Rule: International Banking (RIN 3064-AC85)

Dear Mr. Feldman:

We are submitting this letter in response to the request of the Federal Deposit Insurance Corporation (the "FDIC") for comment on various proposed amendments to its international banking regulations contained in part 347 (the "Proposed Amendments").[1] The Institute of International Bankers (the "Institute") represents internationally headquartered financial institutions from over 40 countries, and our members include international banks that operate FDIC-insured branches and subsidiaries in the United States. Our comments address those portions of the Proposed Amendments relating principally to insured U.S. branches of international banks (*i.e.*, the proposed amendments to subpart B of part 347 and to portions of subpart J of part 303).

[1] 69 Fed. Reg. 43060 (July 19, 2004).

1. Introduction and Executive Summary

As explained in our August 25, 2004 letter to Chairman Powell and Vice Chairman Reich (a copy of which is enclosed), our December 22, 2003 submission to the FDIC set forth the legal and policy justifications for four separate proposals designed to reduce the regulatory burden and facilitate the continued operation of FDIC-insured U.S. branches of international banks: adoption of a risk-based asset pledge requirement, facilitating the relocation of grandfathered FDIC-insured branches, permitting transferability of grandfathered branches, and permitting "wholesale" branches of international banks to obtain "optional" FDIC insurance.

Each of these proposals has been addressed in the Proposed Amendments, and we appreciate, in particular, the FDIC's efforts to move toward a risk-based asset pledge requirement and to facilitate the relocation of grandfathered insured branches. However, we believe the Proposed Amendments reflect an unnecessarily restrictive approach to these and other issues. In several instances, the proposal justifies this more cautious approach by references to the perceived inherent risks posed by FDIC-insured branches of international banks and the "policy" behind the 1991 statutory prohibition on establishment of additional FDIC-insured branches.[2] However, we believe that much greater emphasis needs to be given to the following key considerations:

- Only 12 grandfathered FDIC-insured branches with total assets of approximately $8 billion remain.
- The statutory prohibition on establishment of additional FDIC-insured branches was adopted without serious debate in an atmosphere dominated by the BCCI scandal.
- Since that prohibition was enacted, there have been substantial changes in the U.S. and international regulatory and supervisory regimes applicable to international banks.
- No losses have been suffered by the FDIC (in the case of insured branches) or by U.S. creditors of any U.S. office of an international bank.

[2] *See*, *e.g.*, 69 Fed. Reg. 43068 ("unlike their domestic counterparts, the activities, assets, and personnel of foreign banks operating insured branches in the United States are, in large part, outside the jurisdiction of the United States."); 69 Fed. Reg. 43070 ("directors of a foreign bank are not usually subject to the U.S. jurisdiction, and domestic branch personnel . . . could be transferred beyond the reach of U.S. authorities"); 69 Fed. Reg. 43069 (footnote omitted) (". . . difficult to reconcile the concept that Congress imposed the subsidiary requirement with regard to domestic retail deposit activity requiring deposit insurance for the protection of the FDIC with the implicit assumption that Congress did not believe such protection was needed with regard to wholesale branches of foreign banks.").

- Following enactment of the 1991 statutory prohibition on the establishment of new FDIC-insured branches, the principle of "investor choice" was explicitly endorsed in a Congressionally-mandated study by the U.S. Department of Treasury and the Federal Reserve Board. This principle specifically permits banking organizations to choose the most efficient organizational form (*i.e.*, either branches or subsidiaries) for their U.S. banking operations.

- Facilitating the operation of FDIC-insured branches of foreign banks would increase access to banking services by members of ethnic communities.

- The FDIC has positioned itself as a leader in efforts to reduce unnecessary regulatory burdens on the industry.

For these and other reasons set forth in our earlier submissions, we recommend that the Proposed Amendments be modified to:

- eliminate the proposed two percent "floor" to the asset pledge requirement, and continue to permit non-negotiable certificates of deposit ("CDs") to qualify as eligible assets,

- clarify that grandfathered branches may be moved on an interstate as well as intrastate basis,
- permit transferability of grandfathered FDIC-insured branches,
- permit, or at least not foreclose, "optional" FDIC insurance for wholesale branches,
- permit insured branches to continue to compute their asset maintenance requirement based on average liabilities for the preceding quarter rather than on "daily liabilities," and
- consistent with the approach taken by other federal banking regulators, abandon the proposal to assert extraterritorial examination authority over non-U.S. offices and affiliates of international banks and instead work cooperatively with home country supervisors and the Basel Committee on Banking Supervision to address any concerns.

These recommendations are discussed in more detail below.

2. <u>Asset Pledge (proposed section 347.209)</u>

Risk-Based Approach

We strongly support the proposal to replace the existing fixed five percent asset pledge requirement with a risk-based approach to setting the amount of the pledge based on the specific circumstances of each branch. However, we believe that the proposed two percent minimum pledge requirement should be eliminated in favor of either (i) a completely risk-based requirement, or (ii) a smaller minimum.

The purpose of the asset pledge is to protect the insurance fund against the "risks entailed in insuring the domestic deposits of a foreign bank whose activities, assets, and personnel are in large part outside the jurisdiction of the United States."[3] The development and global acceptance of Basel risk-based capital standards, recent advances in risk-based bank supervision, increased focus on enhancing the responsibilities of home country supervisors in the consolidated supervision of internationally active banks, and substantially increased coordination between home and host country supervisors have substantially mitigated the risks against which the asset pledge was intended to protect. Moreover, assets held by an insured branch pursuant to FDIC's asset maintenance

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[3] 12 U.S.C. § 1815(c)(4).

requirement and subject to FDIC examination and supervision provide effective protection of depositors and the FDIC's insurance guaranty. And, viewed in the context of the fact that there are only 12 remaining FDIC-insured branches with total assets of slightly over $8 billion (compared to more than 9,000 insured banks with nearly $10 trillion in assets), the magnitude of any remaining risk to the deposit insurance fund attributable to insured branches is minimal.

Furthermore, asset pledge requirements do not apply to U.S. banks, and the asset pledge requirement imposed by the FDIC on insured branches adversely affects the earnings and liquidity of those branches by requiring them to maintain and pledge specific amounts of generally lower-yielding assets. Any asset pledge requirement therefore places insured branches at a competitive disadvantage. In light of the FDIC's explicit statutory obligation to try to avoid creating such a competitive disadvantage in implementing its asset pledge authority,[4] it should take more than the generalized concerns expressed in the preamble to justify retaining a minimum pledge of two percent.

Finally, we note that several states that have recently modified their own asset pledge requirements have adopted a risk-based approach with no minimum pledge or

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[4] *See,* 12 U.S.C. § 1815(c)(4).

with a minimum pledge that is less than the two percent minimum being proposed by the FDIC.[5]

Accordingly, we urge the FDIC to eliminate or at least reduce the proposed two percent minimum pledge requirement.

Non-Negotiable Certificates of Deposit

Described as a "clarification," the proposed elimination of non-negotiable CDs as eligible assets for asset pledge purposes would in fact reverse the FDIC's specific 1984 decision on this issue and unnecessarily increase the burdens on the 12 remaining grandfathered FDIC-insured branches.[6] We recognize that requiring only negotiable CDs may offer somewhat greater protection to the FDIC upon liquidation of one of the 12 remaining insured branches. However, any incremental benefits to the FDIC would

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[5] *See,* Illinois Department of Financial and Professional Regulation, Division of Banks and Real Estate, Bureau of Banks and Trust Companies, "Asset Maintenance and Pledging Guidelines for Illinois Foreign Banking Offices" (imposing no asset pledge for certain well-managed institutions); New York Banking Codes, Rules and Regulations § 322.1(a) (imposing a one percent floor). Similarly, the Office of the Comptroller of the Currency supports a statutory amendment to permit it to adopt a risk-based institution-by-institution approach for establishing the capital equivalency deposit requirement for federal branches and agencies of international banks. Testimony of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, Before the Senate Comm. on Banking Housing and Urban Affairs, at 12 (June 22, 2004) (available at http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=120).

[6] *See*, 49 Fed. Reg. 20714 (May 16, 1984) (proposal); 49 Fed. Reg. 49614 at 49615-6 (December 21, 1984) (final rule).

appear to be clearly outweighed by the immediate and practical burdens associated with forcing those branches to substitute negotiable CDs or other eligible assets for non-negotiable CDs that have been treated as eligible assets for over 20 years. Maintaining flexibility to include non-negotiable CDs for asset pledge purposes is also important in light of the practical burdens associated with obtaining waivers of offset for negotiable CDs. Accordingly, we recommend that the FDIC continue to permit use of non-negotiable CDs to satisfy the asset pledge requirement.

3. <u>Moving an Insured Branch of an International Bank (proposed section 303.184)</u>

In its December 22 submission, the Institute expressed concern that section 303.41(b) of the FDIC's regulations, a provision relating to domestic banks, would be applied to insured branches of international banks. Such an interpretation could have effectively precluded an insured branch from moving outside its immediate neighborhood and retaining its grandfathered insured status. We therefore appreciate and support the statement in the preamble to the Proposed Amendments that the domestic bank "relocation" provisions are not intended to limit an insured branch's ability to move and retain its insured status. We also welcome the proposed amendment to section 303.184, which would expressly make available expedited processing for the <u>intra</u>state movement of an insured branch.

We assume that the FDIC will subject a proposed <u>inter</u>state movement of an insured branch to standard processing and, in the absence of compelling reasons otherwise, will permit the insured branch to retain its insured status regardless of the fact that the appropriate state licensing authorities may require a new license for the moved branch. Nevertheless, we recommend that the FDIC include appropriate language in the preamble to any final rule clarifying this point.

4. <u>Transferability of Grandfathered Insured Branches (proposed section 347.206(d))</u>

In response to our proposal that the FDIC <u>permit</u> transferability of the 12 remaining grandfathered FDIC-insured branches, the Proposed Amendments would expressly <u>prohibit</u> transferability ". . . except in certain merger and acquisition transactions that the FDIC determines are not designed, or motivated by the desire, to avoid compliance with section 6(d)(1) of the International Banking Act . . ."[7]

Our December 22 submission included a legal memorandum containing what we continue to believe are compelling legal arguments supporting the conclusion that the grandfather rights of an FDIC-insured branch should survive the sale or transfer of the

[7] 69 Fed. Reg. 43080.

insured branch from one international bank to another. In the preamble to the Proposed Amendments, the FDIC places significant weight on language contained in a one paragraph 1992 opinion in concluding that it "is not persuaded that a change in position is justified."[8] However, the 1992 opinion addressed the permissibility of establishing additional FDIC-insured branches by an international bank already operating a grandfathered insured branch, a situation that in no way could be described as consistent with the plain language of the statute and is thus clearly distinguishable from the transferability issue.

The FDIC also relies on the purported Congressional policy behind section 6(d) of the Federal Deposit Insurance Act. However, as noted above, that provision was adopted without serious debate and should not be given broad effect beyond its specific requirements. In any event, Congress specifically grandfathered FDIC-insured branches existing at the time and did not provide for termination of those grandfather rights upon a change in control or other transfer, despite having done so in other grandfather provisions of the same statute.[9] Accordingly, permitting the grandfathered status of the remaining 12 FDIC-insured branches to survive a transfer of the branch would not be fundamentally

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[8] 69 Fed. Reg. 43067 (referring to FDIC Advisory Opinion 92-12).

[9] *See*, *e.g.*, 12 U.S.C. §§ 1831a(d)(2)(C); 1831a(f)(5).

inconsistent with the 1991 Congressional determination that international banks seeking to engage in new domestic retail activity do so through subsidiaries rather than branches.

In short, we continue to believe that there is more than adequate legal authority for the FDIC to conclude that grandfathered status survives transferability. Therefore, we urge the FDIC to reconsider its position and permit the sale or transfer of the remaining 12 grandfathered insured branches to another international bank without forfeiting the branch's grandfather status.[10]

5. Optional Insurance for Wholesale Branches

In response to our December 22, 2003 submission, the Proposed Amendments request comment on whether the FDIC should exercise its undisputed statutory authority to permit "wholesale" branches of international banks (*i.e.*, those branches that are not engaged in domestic retain deposit activities requiring FDIC insurance) to obtain

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[10] By requiring a specific determination of "proper" motivation in a "merger and acquisition transaction," the Proposed Amendments could even call into question the survival of grandfather rights following a change in control of the parent international bank, a result that presumably is unintended. *See*, *e.g.*, Commerzbank AG, Federal Reserve Board Order Approving the Formation and Acquisition of a Bank Holding Company (March 15, 1999) (permitting the continued operation of three grandfathered insured branches of Korea Exchange Bank following Commerzbank's acquisition of a controlling interest in Korea Exchange Bank). Accordingly, regardless of its treatment of the broader transferability issue, the FDIC should clarify in any final rule that changes in control of the parent international bank will not terminate the grandfathered status of existing insured branches.

"optional" FDIC insurance. Although the FDIC formally requests comment on the issue, the discussion in the preamble leaves little doubt as to the FDIC's position.

We appreciate that this proposal raises several policy issues. Nevertheless, we continue to believe that many of the FDIC's concerns (*e.g.*, potential impact on the FDIC insurance fund) are misplaced or can be adequately addressed by other means.

Accordingly, if the FDIC is not prepared at this time to permit optional insurance for wholesale branches, we respectfully request that no action be taken to foreclose this statutory option so that we can continue to explore ways to address the FDIC's concerns.

6. Asset Maintenance (proposed section 347.210)

According to the preamble, the proposed computational change to "daily third party liabilities" from average liabilities for the preceding quarter is designed to address the narrow problem of a branch winding up its activities and having to maintain assets based on the prior quarter's operations. The FDIC believes that this change should not be burdensome on the remaining 12 FDIC-insured branches. However, the mere requirement to change a longstanding calculation method imposes systems and other burdens on insured branches. Simply stated, we see no reason to impose this change on the remaining 12 branches when the problem that the FDIC seeks to address can continue to be resolved on a case-by-case basis or pursuant to a specific modification to the existing asset maintenance requirement that is limited to branches that are winding down their operations.

7. Commitment to Provide Information (proposed section 347.204)

The FDIC proposes, in section 347.204(a)(1)(i), to assert extraterritorial examination authority over non-U.S. offices and affiliates of international banks.[11] This proposal would reverse the FDIC's longstanding position dating back to the time the original international bank regulations were adopted in 1979.[12] At that time, the FDIC recognized that, despite its broad statutory authority to conduct extraterritorial examinations, home country laws typically would prohibit the FDIC from doing so. Accordingly, the FDIC adopted a compromise under which it asserted examination authority only over U.S. branches and affiliates and required an agreement to provide information concerning the operations of non-U.S. offices and affiliates.

The proposed departure from this longstanding and practical position represents a disturbing assertion of extraterritorial jurisdiction, clearly conflicts with home country

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[11] While the specific provision appears limited to international banks applying for deposit insurance for *de novo* bank subsidiaries, its implications are potentially much broader.

[12] 44 Fed. Reg. 40060 (Jul. 9, 1979).

prohibitions, and is inconsistent with the positions taken by the Office of the Comptroller of the Currency and the Federal Reserve Board in similar contexts.[13]

Even apart from these significant policy concerns, the proposal appears largely unnecessary. As drafted, the Proposed Amendments would provide for a waiver of the extraterritorial examination provision if the Federal Reserve Board has determined that the international bank in question is subject to "comprehensive consolidated supervision."[14] As a matter of law, the Federal Reserve must find CCS before it can approve an international bank's application under Section 3 of the Bank Holding Company to acquire of establish a U.S. commercial bank subsidiary.[15] Thus, as a practical matter, virtually all applications to the FDIC that would trigger the proposed new requirement would be eligible for a waiver.

For these reasons, we strongly urge the FDIC to delete this troublesome provision from any final amendments.

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[13] 12 C.F.R. § 28.12(b)(2); 12 C.F.R. §§ 211.24(c)(2)(v) and 211.26.

[14] *See*, proposed section 347.204(b)(1). 69 Fed. Reg. 43080.

[15] 12 U.S.C. § 1842(c)(3)(B); 12 C.F.R. § 225.13(a)(4). Similarly, the Office of Thrift Supervision will not approve the acquisition of control of a savings association by a foreign bank that is not subject to CCS. 12 C.F.R. § 574.7(c)(2)(iv).

We appreciate this opportunity to provide our comments on the Proposed Amendments. We continue to believe that additional regulatory flexibility can be provided for FDIC-insured branches of international banks without compromising safety and soundness or the FDIC insurance fund, and we look forward to further constructive discussions with the FDIC on these issues.

Sincerely,

Lawrence R. Uhlick

Lawrence R. Uhlick
Executive Director and General Counsel

Enclosure