Japanese Bankers Association

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Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 Federal Deposit Insurance Corporation 550 17th Street, NW, Washington, DC 20429

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Docket No. R-1402; RIN No. 7100-AD62

Office of the Comptroller of the Currency 250 E Street, SW. Mail Stop 2–3 Washington, DC 20219

Docket ID OCC-2010-0009

Re: <u>Notice of Proposed Rulemaking on Advanced Capital Adequacy Framework</u> <u>Basel II; Establishment of a Risk-Based Capital Floor</u>

Ladies and Gentlemen:

The Japanese Bankers Association ("JBA") is an association of 139 Japanese banks and 45 non-Japanese banks with operations in Japan. Several of its member banks are active participants in US financial markets,¹ and in this regard, the JBA appreciates this opportunity to provide comments on the joint interagency notice of proposed rulemaking² ("the proposed rule" or "the proposal") published by the Office of the Comptroller of the Currency, the Federal Reserve System ("Federal Reserve"), and the Federal Deposit

¹ At this time, 10 Japanese banks have branches or agencies in the United States and 6 have banking or nonbanking subsidiaries or affiliates. Board of Governors of the Federal Reserve System, <u>Structure Data for the</u> <u>U.S. Offices of Foreign Banking Organizations</u> (Sept. 30, 2010).

² Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II; Establishment of a Risk-Based Capital Floor, 75 Fed. Reg. 82,318 (Dec. 30, 2010).

Insurance Corporation (collectively "the Agencies") on December 30, 2010. As stated, the proposal would "[a]mend the advanced risk-based capital adequacy standards to be consistent with certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act and amend the general risk-based capital rules to provide limited flexibility consistent with section 171(b) of the Act regarding recognition of the relative risk of certain assets generally not held by depository institutions."³

In their proposal, the Agencies seek both general comments as well as comments on four specific questions, including:

How should the proposed rule be applied to foreign banks in evaluating capital equivalency in the context of applications to establish branches or make bank or nonbank acquisitions in the United States, and in evaluating capital comparability in the context of foreign bank FHC declarations?⁴

The JBA believes that the proposal should not be applied extraterritorially to foreign banks, such as Japanese banks, that operate in the United States because it would: (i) be contrary to the language and intent of section 171 of the Dodd-Frank Act⁵ (the "Collins Amendment"); (ii) impose an unnecessary and costly burden on foreign banks and their parent organizations ("foreign banks"); and (iii) represent a significant departure from longstanding Federal Reserve policy of deferring to home country implementation of Basel capital requirements.

1. <u>Application of the Proposal to Foreign Banks is Directly Contrary to the Collins</u> <u>Amendment</u>

The Collins Amendment requires the Agencies to establish minimum leverage capital and minimum risk-based capital requirements, and it explicitly applies those minimum requirements to "insured depository institutions, depository institution holding

³ <u>Id.</u>

 $^{^{4}}$ <u>Id.</u> at 82,319.

⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").

companies, and nonbank financial companies supervised by the [Federal Reserve]."⁶ Foreign banks are not "insured depository institutions" nor are they "nonbank financial companies." Although foreign banks are "depository institution holding companies" for other purposes under the Federal Deposit Insurance Act, Congress explicitly excluded foreign banks from the definition of "depository institution holding companies" in the Collins Amendment when defining it to include a US holding company that is "owned or controlled by a foreign organization, <u>but . . . not . . . the foreign organization</u>" itself.⁷ Accordingly, we respectfully submit that, when Congress has deliberately chosen to exclude a specific category of institutions from a statutory provision, the Agencies responsible for implementing that provision should follow the clear language and intent of Congress, and not adopt, even as a matter of policy, a regulation or policy that is in direct contradiction to that language and intent. This is especially true when, as is the case with these provisions of the Collins Amendment, Congressional language and intent is consistent with, and based upon, the Federal Reserve's longstanding policy (discussed below) of deferring to the home country capital requirements.

Moreover, the US Supreme Court in the case of <u>Morrison v. Nat'l Australia Bank</u> <u>Ltd.⁸</u> recently reaffirmed the "'longstanding principle" that federal legislation applies only within the United States "'unless there is the affirmative intention of the Congress clearly expressed' to give a statute extraterritorial effect."⁹ The Court stated that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."¹⁰ It seems clear in the case of the Collins Amendment provision at issue, that not only was there no Congressional intent to apply it extraterritorially, but, indeed, as discussed above, the language specifically provides that it not be applied extraterritorially. Under these circumstances, we believe it particularly appropriate for the Agencies to bear in mind the longstanding principle reaffirmed most recently in <u>Morrison</u>, and exercise restraint in not applying the Collins Amendment to foreign banks outside the United States.

⁶ Pub. L. No. 111-203, §171(b)(1), (b)(2), 124 Stat. at 1436.

⁷ Pub. L. No. 111-203, §171(a)(3), 124 Stat. at 1436 (emphasis added).

⁸ 130 S. Ct. 2869 (2010).

⁹ <u>Id.</u> at 2877 (citations omitted)

¹⁰ <u>Id</u>. at 2878.

2. <u>Applying the Proposal Would Impose an Unnecessary and Costly Burden on</u> <u>Foreign Banks</u>

Consistent with Japan's international obligations under Basel II, Japanese regulations required Japanese banks that moved to the advanced internal ratings-based (AIRB) approach for credit risk to calculate a capital floor for a period of two years.¹¹ Accordingly, Japanese banks that have implemented the AIRB approach are no longer required to calculate a Basel I risk-based capital floor. Resuming Basel I capital calculations, in the absence of any Japanese or Basel II requirement to do so, would impose a significant financial and operational burden on Japanese banks that have moved to the AIRB approach.

Also, for the reasons outlined in Paragraph 49 of the Basel II framework¹² and in light of the recent agreement on Basel III and the expectation that countries will move toward Basel III adoption, setting any "permanent" rule based on Basel I at this juncture would be contrary to current international trends and expectations. Doing so would further compound the potential burdens imposed on foreign banks that are no longer subject to Basel I because not only would they have to begin calculating capital under both Basel I and Basel II, but depending on how the Agencies interpret the Collins Amendment, future changes to the US Basel I regime could exacerbate their compliance burdens despite the fact that such changes are not required by the Basel Accord or their home country regulator. It would be a step backwards to impose such cumbersome and redundant accounting and reporting requirements on foreign banks particularly when regulators have been striving to achieve consistent global capital standards. Indeed, the proposal would appear to undermine the goal, present since the inception of the Basel Accord in 1988, "of achieving convergence internationally in the measurement and assessment of capital adequacy."¹³ If other countries were to impose their special local capital requirements on US and other

¹¹ Japanese regulations still permit Japanese banks transitioning to AIRB to calculate the floor using the foundation internal ratings-based approach under Basel II rather than using Basel I.

¹² <u>See, e.g.</u>, Basel Committee on Banking Supervision, <u>International Conversion of Capital Measurement and</u> <u>Capital Standards</u> ¶ 49 (June 2004) ("However, the Committee recognizes that floors based on the 1988 Accord will become increasingly impractical to implement over time").

¹³ Board of Governors of the Federal Reserve System and Secretary of the Department of the Treasury, <u>Capital Equivalency Report</u> 11 (June 19, 1992) ("<u>1992 Capital Equivalency Report</u>").

non-local banks as a condition of doing business in those countries, the result would be balkanization, not convergence.

Requiring Japanese banks to make the additional calculations that would be necessary to comply with the proposed rule and incur significant costs to do so is also unnecessary from a safety and soundness perspective. The Federal Reserve has determined that Japanese banks are subject to comprehensive supervision on a consolidated basis ("CCS").¹⁴ Among the indicia that the Federal Reserve considers in assessing whether a country has met this standard is the extent to which the home country supervisor evaluates capital adequacy.¹⁵ In recent orders approving Japanese banking applications involving banks that have adopted Basel II¹⁶ as well as in older orders involving banks that calculated capital under Basel I,¹⁷ the Federal Reserve has determined that Japanese banks are subject to CCS. Accordingly, we believe it is reasonable and adequate for US regulators to accept in the United States the requirements established and accepted by home country regulators, particularly when the home country regulations are in line with the Basel framework, as is the case in Japan.

3. <u>Applying the Proposal to Foreign Banks Would Represent a Significant Departure</u> <u>from Longstanding Federal Reserve Policy</u>

In determining whether a foreign bank's capital is comparable or equivalent to that of a US bank for purposes of applications by foreign banks under the International Banking Act of 1978 ("IBA") and the Bank Holding Company Act of 1956, the Federal Reserve has deferred to the calculation of the Basel capital standards by the bank's home country regulator. To determine whether a foreign bank's capital is equivalent to the risk-based

¹⁴ See, e.g., Order Approving the Establishment of a Branch, the Shizuoka Bank, Ltd., Shizuoka, Japan, at 3 & n.9 (Sept. 23, 2008) (citing several prior Federal Reserve orders: <u>Mizuho Holdings, Inc.</u>, 89 Fed. Res. Bull. 181 (2003); <u>Mitsubishi Tokyo Financial Group, Inc.</u>, 87 Fed. Res. Bull. 349 (2001); and <u>The Fuji Bank, Limited</u>, 85 Fed. Res. Bull. 338 (1999)).

¹⁵ <u>See, e.g.</u>, Order Approving the Establishment of a Branch, the Shizuoka Bank, Ltd., Shizuoka, Japan, at 3 & n.7 (Sept. 23, 2008).

¹⁶ <u>See id.</u> at 3-4.

 ¹⁷ <u>Mizuho Holdings, Inc.</u>, 89 Fed. Res. Bull. 181 (2003); <u>Mitsubishi Tokyo Financial Group, Inc.</u>, 87 Fed. Res.
Bull. 349 (2001); and <u>The Fuji Bank, Limited</u>, 85 Fed. Res. Bull. 338 (1999).

capital and leverage requirements for US banks, the Federal Reserve relies on guidelines established pursuant to a study that was conducted in 1992.¹⁸

The 1992 study was mandated by Congress in the Foreign Bank Supervision Enhancement Act,¹⁹ and it concluded that "capital ratios should be equivalent, but not necessarily identical, to those required of U.S. banks."²⁰ Since then, the Federal Reserve has followed a capital equivalency approach to assessing the adequacy of foreign bank capital in applications and has not changed this approach and sought to apply US capital calculations extraterritorially.

After enactment of the Gramm-Leach-Bliley Act of 1999, the Federal Reserve initially considered and later decided not to adopt a 3 percent leverage ratio requirement for foreign banks as part of the "well-capitalized" standards required to become a Financial Holding Company ("FHC").²¹ In deciding against a leverage ratio test, the Federal Reserve observed that "home country supervisors of most foreign banks do not require a bank to meet or manage toward any specific leverage ratio and generally do not take it into account in the consolidated supervision of the bank."²² Similarly, as non-US regulators cease to require their banks to comply with Basel I, the Agencies should not re-introduce those requirements. Just as the Federal Reserve concluded that meeting the leverage ratio was not a necessary prerequisite to meeting FHC requirements, ²³ the Agencies should not view replicating the system of Basel I as a prerequisite to determining whether capital is comparable or equivalent. The Agencies have many other tools with which to make these judgments.

The Federal Reserve recognized that foreign regulators would implement capital requirements consistent with the internationally agreed upon framework but subject to slight differences due to variations in foreign markets, foreign types of financial

¹⁸ 75 Fed. Reg. at 82,319 ("The [Federal Reserve] has been making capital equivalency findings for foreign banks under the International Banking Act and the Bank Holding Company Act since 1992 pursuant to guidelines developed as part of a joint study by the Board and Treasury on capital equivalency."). ¹⁹ Pub. L. No. 102-242, § 214(b), 105 Stat. 2286 (1991) (codified at 12 U.S.C. § 3105(j)).

²⁰ <u>1992 Capital Equivalency Report</u> at 3.

²¹ 65 Fed. Reg. 3785 (Jan. 25, 2000); 66 Fed. Reg. 400 (Jan. 3, 2001)

²² 66 Fed. Reg. at 408.

²³ <u>Id.</u>

instruments, and foreign accounting practices, and it concluded in the 1992 study that this would "not necessarily have a substantive effect on overall safety and soundness"²⁴ and was necessary to achieve the broader policy objective of convergence of capital standards: "A fundamental premise of the [Basel] Accord is the acceptance of such differences in order to advance the international convergence of capital standards."²⁵ To depart from that policy objective now and impose specific US requirements extraterritorially on foreign banks would not only abrogate longstanding Federal Reserve practice but is contrary to the continuing efforts of global regulators to agree upon further refinements to international standards, such as the recently agreed to Basel III framework.

The Federal Reserve's longstanding policy of deference has also been consistent with the policy of national treatment, which requires that US and foreign banks be subject to similar regulatory requirements in like circumstances.²⁶ Recognizing that foreign banks are subject on a global basis to the implementation of Basel capital standards by their home country, the Federal Reserve quite rightly deferred to the home country requirement for calculating capital levels in connection with making the capital equivalency and comparability comparisons. We respectfully submit that the Collins Amendment does not require any change to this policy. Indeed, to subject foreign banks to a permanent Basel I floor would appear inconsistent with the longstanding application of national treatment principles under the IBA by subjecting foreign banks to requirements identical to those applicable to US banks, rather than to requirements equivalent to those applicable to US banks taking into account differing regulatory regimes and operations. In the present circumstances, the Federal Reserve should continue to defer to the calculation of capital requirements under the home country rule and not require Japanese banks to calculate and apply a permanent Basel I capital floor under US requirements.

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²⁴ <u>1992 Capital Equivalency Report</u> at 3.

 $^{^{25}}$ <u>Id.</u>

²⁶ S. Rep. No. 95-1073, at 2(1978) ("[The IBA] establishes the principle of parity of treatment between foreign and domestic banks in like circumstances.").

The JBA hopes that its comments will be helpful to the Agencies as they consider final adoption of the proposal, and we would be pleased to answer questions or provide additional information on any of the issues raised in this letter.

Respectfully submitted,

Japanese Bankers Association