INSTITUTE OF INTERNATIONAL BANKERS

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Direct: (646) 213-1147
Facsimile: (212) 421-1119
Main: (212) 421-1611
www.iib.org

SARAH A. MILLER
Chief Executive Officer
E-mail: smiller@iib.org

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Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
regs.comments@federalreserve.gov

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2–3
Washington, D.C. 20219
regs.comments@ooc.treas.gov

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
comments@FDIC.gov

Re: Comment on Joint Notice of Proposed Rulemaking Regarding Establishment of a Risk-Based Capital Floor – Board Docket No. R-1402; OCC Docket No.2010-0009; FDIC RIN 3064-AD58

Ladies and Gentlemen:

The Institute of International Bankers appreciates the opportunity to comment on the Joint Notice of Proposed Rulemaking to implement provisions of Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") regarding the establishment of a risk-based capital floor.[1] Specifically, our comments are provided in response to Question 1of the Proposal:

> 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?[2]

[1] 75 Fed. Reg. 82317 (Dec. 30, 2010) (the "Proposal").

[2] *Id.* at 82319.

As internationally headquartered banking organizations that engage in banking and other financial activities in the United States, the Institute's members have a direct and significant interest in not only how Section 171 might be applied to their U.S. insured depository institution and depository institution holding company subsidiaries, but also the implications the approach taken under Section 171may have more generally for how the capital of foreign banks is assessed for U.S. regulatory purposes.

Executive Summary

At the outset, we note that Section 171 of the Dodd-Frank Act applies only to insured depository institutions, depository institution holding companies and nonbank financial companies supervised by the Federal Reserve Board. Accordingly, foreign banks' U.S. insured depository institution subsidiaries, as well as their U.S. depository institution holding company subsidiaries,[3] are subject to Section 171. In responding to Question 1, our focus in this letter is on the separate question of whether Section 171 applies to foreign banks themselves.

Regarding that question, the Institute firmly believes that the proposed rule should not be applied in evaluating capital equivalency in the context of foreign banks' applications to establish branches or make bank or nonbank acquisitions in the United States, or in evaluating capital comparability in the context of their financial holding company ("FHC") declarations.

As discussed below, applying the proposed rule in the manner that Question 1 appears to contemplate would be (i) contrary to the provisions of the Dodd-Frank Act that expressly exclude Section 171's application to "foreign organizations," which term clearly includes foreign banks; and (ii) inconsistent with the longstanding U.S. approach to assessing the capital of foreign banks, to the extent such application would subject foreign banks to a U.S.-prescribed minimum capital requirement different from whatever minimum requirement might be prescribed under their home country capital standards and require them to calculate their capital on the basis of U.S. standards. We believe there is no justification for implementing Section 171 in this way, whether as a matter of policy or in the exercise of supervisory discretion, especially inasmuch as Section 171 plainly excludes foreign banks from its reach.

[3] Regarding those U.S. intermediate bank holding company subsidiaries of foreign banks that are covered by the Federal Reserve Board's Supervision and Regulation Letter 01-1 (January 5, 2001) ("SR 01-1"), we note that Section 171(b)(4)(E) delays the effectiveness of Section 171's requirements for five years after the date of enactment of the Dodd-Frank Act. In addition, Section 174(b) of the Dodd-Frank Act directs the Government Accountability Office ("GAO"), in consultation with Treasury and the agencies, to complete not later than 18 months after the date of enactment a study of capital requirements applicable to U.S. intermediate bank holding company subsidiaries of foreign banks. Section 174(b) requires that the study address specific considerations, including (i) the Federal Reserve's current policy as embodied in SR 01-1; (ii) the principle of national treatment and equality of competitive opportunity; (iii) the extent to which foreign banks are subject on a consolidated basis to home country capital standards comparable to United States capital standards; (iv) the potential effects a change in the policy set forth in SR 01-1 would have on U.S. banks operating abroad; and (v) the impact such a change would have on the cost and availability of credit in the United States. The Institute is looking forward to working with the GAO, Treasury and the agencies in addressing these very important issues.

Applying Section 171 to foreign banks potentially creates conflicts with applicable home country capital requirements and would be inconsistent with international efforts to promote consultation and coordination among regulatory authorities with respect to the oversight of internationally active financial institutions, including in the area of capital regulation. In addition, requiring foreign banks to calculate their capital on the basis of U.S. "generally applicable risk-based capital requirements" (or, indeed, any other U.S. capital requirement) would impose on foreign banks the needless burden and cost of having to conduct two parallel regulatory capital calculations – one as required by a foreign bank's home country based on home country standards and the other as required by U.S. authorities based on U.S. standards – and would have potentially adverse consequences for U.S. banks operating abroad.

The Dodd-Frank Act Expressly Provides that the Provisions of Section 171 Do Not Apply to Foreign Banks

Section 171 by its terms applies only to insured depository institutions, depository institution holding companies and nonbank financial companies supervised by the Federal Reserve Board. Foreign banks themselves clearly are not insured depository institutions. As defined in Section 102(a)(4)(D) of the Dodd-Frank Act, nonbank financial companies supervised by the Federal Reserve Board are those nonbank financial companies designated as such by the Financial Services Oversight Council pursuant to Section 113 of the Dodd-Frank Act. As provided in Section 102(a)(4)(A), foreign banks that themselves are either bank holding companies or are treated in the United States as bank holding companies are excluded from the definition of nonbank financial company for these purposes. Thus, a foreign bank with banking operations in the United States would be subject to Section 171 only if it is a "depository institution holding company."

Section 171(a)(3) of the Dodd-Frank Act defines the term "depository institution holding company" as follows:

> The term 'depository institution holding company' means a bank holding company or a savings and loan holding company (as those terms are defined in section 3 of the Federal Deposit Insurance Act) that is organized in the United States, including any bank or savings and loan holding company that is owned or controlled by a foreign organization, but <u>does not include the foreign organization</u>. (Emphasis added.)

There is no doubt that foreign banks are "foreign organizations" and as such are (i) expressly excluded from the definition of "depository institution holding company" and (ii) not subject to the requirements of Section 171.

This conclusion is consistent with the understanding of the intended scope of Section 171's coverage at the time its provisions were under consideration by the Senate, which was articulated as follows:

> It is not the intent nor, we believe, a correct reading of [Section 171] that these requirements would apply to any bank not chartered in the United States.[4]

Reflecting this understanding, paragraph (a)(3) was added during the course of the Conference Committee's consideration of the Dodd-Frank legislation in order to address the concerns regarding the scope of Section 171's requirements and their potential extraterritorial application.

The Agencies Thus Are Not Required To, and They Should Not, Depart from the Longstanding Approach of Referring to Applicable Home Country Requirements as the Basis for Their Assessments of the Capital of Foreign Banks for U.S. Regulatory Purposes

Given the express provisions of Section 171, we interpret Question 1 as inquiring whether, and if so to what extent, the agencies, either as a matter of policy or in the exercise of their supervisory discretion, should apply the requirements of Section 171 to foreign banks in any of the various contexts identified in Question 1, notwithstanding the unambiguous provisions of Section 171 and the clear Congressional intent that Section 171 not be applied to foreign banks. Applying Section 171 in this manner, and thereby imposing on them separate, U.S.-prescribed "minimum risk-based capital requirements" and requiring them to calculate their capital on the basis of U.S. requirements, would constitute a dramatic departure from the longstanding U.S. approach to assessing the capital of foreign banks for U.S. regulatory purposes based on the bank's home country standards.

In our view, this type of change in the U.S. approach to the capital regulation of foreign banks has such potentially profound implications that it should not be contemplated absent clear and convincing evidence that it is required by statute and that the resulting revisions to how foreign banks' capital is assessed for U.S. regulatory are necessary to remedy a serious defect in the existing approach, and even then only after the agencies have consulted at length with their counterparts in foreign banks' home countries. The Proposal offers no evidence that such an approach is either required by statute or otherwise necessary or that consultation with the agencies' foreign counterparts has occurred.

Foreign banks are subject to capital requirements prescribed by their home country authorities. In the case of a foreign bank whose home country applies capital standards consistent with those adopted by the Basel Committee on Banking Supervision (the "Basel Committee"),[5] the bank's capital ratios as calculated under those standards is accepted as the

[4] Letter, dated May 21, 2010, from FDIC Chairman Bair to Lawrence R. Uhlick, Chief Executive Officer, Institute of International Bankers, at 1.

[5] In 2010, the Financial Stability Institute ("FSI") updated its survey of countries around the world to measure the progress that has been made with respect to implementation of the revised international capital accords adopted by the Basel Committee in 2006 ("Basel II"). Of the 133 countries responding to the survey, the FSI found that 112 have implemented or are currently planning to implement Basel II. See "2010 FSI Survey on the Implementation of the New Capital Adequacy Framework," *Occasional Paper No. 9* (August 2010). As discussed below in the text

starting point for the U.S. regulatory assessment.[6] In the case of banks that are subject to Basel II's requirements, this assessment takes into account any transitional provisions implemented by the home country. If a foreign bank's home country has not adopted capital standards consistent with the Basel Committee's standards, then the foreign bank, rather than being able simply to utilize the ratios calculated under the home country standard as the basis for the U.S. regulatory assessment, is subject to finding by the Federal Reserve that its capital is equivalent to the capital that would be required of a U.S. banking organization.[7] That finding, however, is based on the assessment of the home country standards and does not call for the bank to calculate its capital using U.S. standards.

Thus, the analysis of a foreign bank's capital properly takes as its starting point the standards of the bank's home country and then undertakes to assess how those standards compare to the standards applicable to U.S. banking organizations under U.S. requirements. This approach neither gives complete deference to home country capital requirements nor requires a foreign bank strictly to abide by each of the U.S. requirements or to calculate its capital pursuant to U.S. rules. The purpose of the analysis is not to force the foreign bank to conform its capital to U.S. requirements, but instead to determine whether the foreign bank's capital as calculated under its home country requirements is sufficiently equivalent or comparable to that applicable to a similarly situated U.S. banking organization. This approach properly recognizes that for U.S. regulatory purposes there is no need to ascertain whether home country requirements are identical to those of the United States.

The agencies have considerable discretion in making these determinations, which they exercise fully without imposing on foreign banks any requirement to apply U.S. standards in calculating their capital ratios.[8] For example, if a foreign bank with a U.S. branch or agency seeks to operate in the United States as an FHC, it is required to satisfy the "well capitalized" requirement prescribed by the Gramm-Leach-Bliley Act by demonstrating that its risk-based tier 1 and total risk-based capital ratios are at least 6% and 10%, respectively. In order to engage in

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accompanying note 13, the Proposal itself recognizes that many foreign banks already operate under Basel II. Indeed, while the FSI did not identify the specific countries covered by its Survey, we believe that the great bulk of foreign banks that conduct banking operations in the United States are from those countries characterized in the FSI Survey as either already having implemented or planning to implement Basel II.

6 See, e.g., 12 C.F.R. 225.2(r)(3)(i)(A).

7 See, e.g., 12 C.F.R. 225.2(r)(3)(i)(B).

8 Indicative of the supervisory discretion exercisable by the Federal Reserve with regard to foreign bank-related capital questions generally, SR 01-1 (see note 3 above) expressly provides as follows:

> The Federal Reserve retains its supervisory authority to require any bank holding company, including a U.S. BHC owned and controlled by a foreign bank that meets the FHC standards, to maintain higher capital levels where such levels are appropriate to ensure that its U.S. activities are operated in a safe and sound manner. This authority may be exercised as part of ongoing supervision or through the application process.

the expanded financial activities permissible for FHCs, the foreign bank must meet these U.S.-prescribed minimum risk-based capital ratios, but, for those banks whose home countries have adopted risk-based capital standards consistent with those prescribed by the Basel Committee, the applicable ratios are those calculated on the basis of the bank's home country standards.[9] This approach is consistent with Section 4(l)(3) of the Bank Holding Company Act, which requires that the determination of whether a foreign bank is well capitalized for purposes of operating as an FHC be made in a manner that gives "due regard to the principle of national treatment and equality of competitive opportunity."[10]

In addition, the foreign bank's capital, as measured under home country standards, must be comparable to the capital of a U.S. bank owned by a domestic FHC.[11] For purposes of assessing comparability, the Federal Reserve may consider additional factors, including the composition of the foreign bank's capital, the ratio of the foreign bank's tier 1 capital to total assets ("leverage ratio"), home country accounting standards, the foreign bank's long-term debt ratings, its reliance on government support to meet capital requirements and whether it is subject to comprehensive supervision or regulation on a consolidated basis.[12]

The Federal Reserve has similarly broad discretion when assessing foreign banks' capital in each of the other contexts contemplated by Question 1. In all cases, the Federal Reserve also is able to consult with a foreign bank's home country authority regarding the bank's capital. In addition, where a foreign bank operates under home country requirements implementing Basel II, additional information regarding the bank's capital will be available as part of its Pillar III disclosure.

Thus, the existing U.S. approach to assessing the capital of foreign banks gives appropriate deference to home country standards while providing sufficient flexibility to ensure compliance with U.S. regulatory requirements. We do not read Section 171, or any other

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9 See 12 C.F.R. 225.90(b)(1)(i) and (ii).

10 Section 606 of the Dodd-Frank Act requires that, commencing on the "transfer date" prescribed under the Act, the "well capitalized" standard must be met by the bank holding company itself that seeks to operate as an FHC, and not just by each of its insured depository subsidiaries, thereby extending to U.S.-headquartered FHCs the same requirement that has been applied for many years to foreign bank FHCs that operate branches or agencies in the United States. Nothing in Section 606 calls for or suggests the need for changes in the Federal Reserve's approach to determining whether foreign banks themselves satisfy the FHC well capitalized standard. Indeed, Section 606 left in place the provisions of Section 4(l)(3) of the Bank Holding Company Act prescribing the manner in which this determination must be made.

11 See 12 C.F.R. 225.90(b)(1)(iii). In the case of a foreign bank whose home country has not adopted capital standards consistent with those of the Basel Committee, the bank must obtain a determination from the Federal Reserve Board that its capital is otherwise comparable to the capital that would be required of a U.S. bank owned by an FHC. See 12 C.F.R. 225.90(b)(2).

12 See 12 C.F.R. 225.92(e).

provision, of the Dodd-Frank Act as calling for any modification to this approach. We understand, moreover, that U.S. banks operating abroad likewise typically are not required to calculate their capital on the basis of another country's requirements; in these cases the other (host) country bases its assessment on the bank's capital as calculated under U.S. standards. In contemplating changes to the approach taken to the U.S. assessment of foreign banks' capital, consideration also should be given to the potential adverse consequences for such U.S. banks.

Especially significant, in each of the situations contemplated by Question 1 the Federal Reserve is directed by the applicable statutory provisions to assess a foreign bank's capital as an integral part of its review of the branch/bank/nonbank application or FHC declaration. As discussed above, the approach under Section 171 is very different – instead of indicating that a foreign bank's capital is a relevant consideration, the statute expressly provides that Section 171 is not applicable to foreign banks. Given these very important differences, we see no basis for importing the requirements of Section 171 into the consideration of a foreign bank's capital in any of these other contexts. Indeed, doing so would run expressly counter to the language of Section 171 and would defeat the Congressional intent <u>not</u> to apply Section 171's requirements to foreign banks.

Given the ample discretion the agencies are able to exercise in assessing the capital of foreign banks in connection with the regulation of their U.S. activities, there is no need to impose the additional requirement to calculate their risk-based capital according to the "generally applicable risk-based capital requirements" prescribed by the agencies. Those requirements apply the original risk-based capital standards adopted by the Basel Committee in 1988 ("<u>Basel I</u>"), as implemented in the United States. As the Proposal itself recognizes, many foreign banks already operate under the more advanced risk-based requirements prescribed by their home country authorities in accordance with Basel II.[13] While those banks have been, and many still are, subject to the transitional "floors" based on Basel I that are called for under Basel II (as implemented by the banks' home country authorities), at some point in the future they no longer will be required by their home country authorities to make any determination of their capital adequacy pursuant to Basel I and instead will apply the standards of Basel II, as modified by the revisions adopted by the Basel Committee regarding market risk, securitization exposures, counterparty credit risk, the composition of banks' capital and liquidity (collectively, "<u>Basel II.5 and Basel III</u>").[14]

These developments in foreign banks' home countries are taking place in accordance with the internationally agreed upon standards embodied in Basel II (as modified). The extraterritorial application of U.S. capital standards to foreign banks subject to Basel-based home

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[13] <u>See</u> 75 Fed. Reg. at 82319.

[14] <u>See</u> Revisions to the Basel II Market Risk Framework (July 2009); Enhancements to the Basel II Framework (July 2009); Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (December 2010); and Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring (December 2010).

country capital requirements would be inconsistent with the commitment by the United States to the promotion of a coordinated approach to the implementation of international regulatory capital standards underlying the Basel regime and endorsed by the G20 last November at the Seoul Summit.[15]

Further, requiring foreign banks to calculate their capital under U.S. generally applicable risk-based capital requirements as a condition to the expansion of their U.S. activities or the effectiveness of their declaration to operate in the United States as an FHC would impose on foreign banks the needless burden and costs of conducting parallel regulatory capital calculations – one as required by home country authorities and the other pursuant to the U.S. Basel I requirements. For those countries that abide by the Basel Capital Accords, most are either in the process of transitioning beyond the Basel I risk-based standards or have already shut down their Basel I processes. To impose the requirement that banks from these countries re-introduce a Basel I calculation methodology would require them to undertake costly and time consuming operational and technical changes in order to be compliant with the Proposal. In addition, the diversion of resources that would be required for this effort would have a direct and adverse impact on their ability to transition to the enhanced and more advanced Basel II.5 and Basel III standards that have been recently endorsed on a global and coordinated basis. In our view, no useful U.S. regulatory purpose would be served by any such requirement.

Conclusion

In summary, the provisions of Section 171 should not 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, or in evaluating capital comparability in the context of foreign bank FHC declarations. Applying Section 171 in this manner would be contrary to express provisions of Section 171; it would constitute an unnecessary and unjustified change in the longstanding U.S. approach to assessing the capital of foreign banks for U.S. regulatory purposes; and it would undercut the continuing international efforts to achieve greater consistency regarding the capital standards applicable to internationally active banks, with potentially adverse consequences for U.S. banks operating abroad.

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[15] See The G20 Seoul Summit, Leaders' Declaration (November 11-12, 2010) ¶ 29.

The Institute appreciates the opportunity to comment on the Proposal. Please contact the undersigned or the Institute's General Counsel Richard Coffman (rcoffman@iib.org; 646-213-1149) if we can provide any additional information or assistance.

Very truly yours,

Sarah A. Miller
Chief Executive Officer