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A Proposed Fundamental Shift in US Foreign Bank Supervision

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The Board of Governors of the Federal Reserve System ("Board") has devoted some time to considering how to address the potential threat to the financial stability of the United States posed by a foreign bank with banking operations in the United States ("foreign banking organization" or "FBO"). Proposed rules (the "Proposal") issued on December 14, 2012 conclude that the best, or at least most practical, solution is to require an FBO with a significant US presence to "ring-fence" in the United States capital and liquidity deemed sufficient to support its subsidiary bank and nonbanking operations in the United States.[1] If the Board adopts this ring-fencing approach to financial stability in its final regulation, one cannot help but wonder if other nations will follow suit with their own ring-fencing regimes.

The Proposal, if adopted, would require a systemically-important FBO—that is, one with at least US$50 billion in global consolidated assets—to corral its US bank, broker/dealer and other nonbank financial subsidiaries under a US intermediate holding company ("IHC") if the combined assets of those subsidiaries equal at least US$10 billion. If the IHC's assets total US$50 billion or more, the IHC would be required to maintain risk-based capital and liquid assets at levels required for a systemically-important US bank holding company. Dividends and any other capital distributions from the IHC would be limited to those pre-approved by the Board. Counterparty credit limits, stress testing, risk management requirements and other enhanced prudential standards would be applied to the IHC as well. Failure to meet the required standards would result in Board-imposed early remediation ranging from dividend restrictions to required asset sales and, ultimately, resolution of the IHC by US banking supervisors.

The proposed approach to enhanced supervision of FBOs represents a fundamental shift in the Board's longstanding approach to FBO supervision. The Proposal's capital and other enhanced prudential standards follow in large part those that the Board has proposed for large US bank holding companies—those with US$50 billion or more in global consolidated assets ("US BHC Proposal"). Both Proposals are intended to implement the Dodd-Frank Act requirement for more stringent, or enhanced, capital, liquidity and other standards for banking organizations deemed large enough to pose a threat to the financial stability of the United States. The Proposal, however, eschews the Board's traditional reliance on home country authorities to address prudential standards for the comprehensive consolidated supervision of an FBO's global activities, other than its US branches and agencies. The principle of national treatment is given added weight, but it appears reinterpreted to mean FBO supervision on the same, if not equivalent, basis as that for US bank holding companies and, importantly, direct supervision by the Board and not home country

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supervisors. Home country implementation of global financial reforms, though sharing the Dodd-Frank Act objective of financial stability, are not seen as forming a foundation sufficient to protect the US financial system.

The Proposal, if adopted, could well have a significant impact on the way an FBO chooses to conduct its bank and nonbank activities in the United States. Our goal in this Alert is to provide an overview of how the Proposal would apply to the activities that an FBO conducts or plans to conduct in the United States and those parts of the Proposal likely to have the greatest impact on the structure and conduct of US activities going forward.

Statutory Basis for the Proposal

The recent financial crisis has resulted in an unprecedented commitment among national banking supervisors to establish a global framework to avert a future global crisis. The US commitment to Basel III and other global reforms, though visible, is overshadowed by the Dodd-Frank Act and its central focus on mitigating any threat to the financial stability of the United States. The Board is charged with accomplishing that goal by implementing heightened or enhanced capital, liquidity and other prudential standards for US bank holding companies, FBOs and nonbank financial companies deemed to pose such a threat. The Dodd-Frank Act gives the Board significant latitude to implement rules to accomplish the statute's financial stability objective. The Proposal reflects that.

The Dodd-Frank Act establishes the irrebuttable presumption that the material financial distress or failure of a bank holding company with US$50 billion or more in total consolidated assets could pose a threat to the financial stability of the United States.[2] An FBO is treated as a bank holding company for this purpose.[3] An FBO with at least US$50 billion in total global consolidated assets, regardless of the geographic location of those assets, is deemed to be systemically important.

The Dodd-Frank Act requires more stringent capital, liquidity and other prudential standards for these *systemically-important* bank holding companies.[4] The US BHC Proposal, which was issued for comment at the end of 2011, proposed enhanced standards for US bank holding companies. The Proposal sets forth the Board's proposed equivalent rulemaking for FBOs.

The Dodd-Frank Act intends for enhanced supervision to supplement, not replace, the existing framework for supervising bank holding companies. For FBOs, the Dodd-Frank Act expressly requires that due regard be given to the principle of national treatment and equality of competitive opportunity and take into account the extent to which an FBO is subject to comparable home country supervision. The Board now seems to be emphasizing the former over the latter.

The Dodd-Frank Act also requires that the enhanced standards for an FBO reflect its systemic importance to the US financial system, including whether the FBO owns a US-insured depository institution, the size of its US operations and its source of funding, its interconnectedness with other systemically-important bank holding companies and nonbank financial companies, and its importance as a source of credit to American households and business, in particular underserved communities.[5] Although the comprehensiveness of home country prudential standards imposed and enforced by the home country supervisor is also a factor required to be considered, the Board is granted the broad authority to consider any other risk factors it deems appropriate and to establish any standards for a systemically-important bank holding company, including an FBO, that it deems appropriate.

The Proposal

The Board's Proposal is laid out in subparts, each covering a proposed standard and its applicability based on an FBO's size and scope of US operations. This Client Alert groups those requirements by FBO size on a global consolidated basis and US size to provide an overall picture of how the proposed standards may apply to a particular FBO.

The Proposal applies to any foreign bank with at least US$10 billion in global consolidated assets that has a US branch or agency or a commercial lending company (a New York Article XII investment company) or controls a US bank or Edge corporation, and to any company that controls such a foreign bank. Foreign banks that conduct only broker-dealer or other nonbank financial activities in the United States are treated as nonbank financial companies and would be subject to enhanced prudential standards only to the extent designated as systemically-important nonbank financial companies by the Financial Stability Oversight Council ("FSOC"). Designated nonbank financial companies are subject to enhanced prudential supervision by the Board. As contemplated by the Dodd-Frank Act, the Proposal notes the Board's intention to tailor enhanced prudential standards to any foreign nonbank financial company designated by the FSOC as systemically important.[6] To date, no nonbank financial company, US or foreign, has been designated by the FSOC for Board supervision.

The Dodd-Frank Act systemic designation for FBOs is based solely on global asset size, irrespective of assets located in the United States or the scope of activities conducted in the United States.[8] The Proposal, however, adopts a less extraterritorial approach by reserving its most stringent requirements for those FBOs with a large US branch or agency and/or subsidiary bank presence. The most stringent, and potentially most cumbersome, requirement for a US holding company or IHC is reserved for those FBOs with a systemically-important US bank, broker-dealer or other nonbank subsidiary.

Our discussion divides FBOs into two broad categories: FBOs with US$50 billion or more in global consolidated assets ("50B-FBOs") and FBOs with at least US$10 billion, but less than US$50 billion, in global consolidated assets ("10B-FBOs"). For each, we outline the proposed standards that would apply based on the size and scope of US activities conducted.

In general, the standards for each group of FBOs would apply as of July 1, 2015 to those FBOs that meet the required asset-size threshold as of July 1, 2014 and to other FBOs beginning 12 months after meeting the threshold requirement.

FBOs With US$50 Billion or More in Global Consolidated Assets

While all 50B-FBOs are treated as systemically important under the Dodd-Frank Act, the Proposal takes into account the size and nature of a 50B-FBO's US activities. The result is to create a series of increasingly stringent prudential standards that would apply based on the type of activities conducted in the United States and the asset size of those operations. Of those, the most stringent would be reserved for those 50B-FBOs that conduct significant activities through US subsidiaries, including a bank, broker-dealer or other nonbank subsidiary. Those 50B-FBOs would be required to create a US IHC to hold all US subsidiaries. Each of the IHCs, and the 50B-FBOs would be subject to its own set of prudential standards under the Proposal. The applicability of these stringent requirements is triggered by the size of those US subsidiaries, including a US bank, broker-dealer, leasing, lending or other subsidiary organized under the laws of the United States or any of its states, territories or possessions. The requirement to ring-fence assets into an IHC applies based only on the asset size of the US subsidiaries and would apply only to those subsidiaries.

Certain of the Proposal's capital and other proposed standards for 50B-FBOs, however, would apply to the FBO based solely on the total size of its US assets, even if limited solely to US branches and agencies. A base set of prudential standards would be applicable to any 50B-FBO irrespective of the size of its US branch, agency and/or subsidiary operations.

The following discussion organizes the proposed standards based on the size and type of US operations conducted by a 50B-FBO. A 50B-FBO would be required, directly or through its IHC, to meet the prudential standards in each of the following classes that apply:

- All 50B-FBOs, regardless of the size of their US operations
- 50B-FBOs with total combined US assets, including branches, agencies and subsidiaries, of US$50 billion or more
- IHCs of 50B-FBOs where the IHC has
  - US$10 billion or more, but less than US$50 billion, in total assets or
  - US$50 billion or more in total assets

For ease of reference, the charts on the following pages offer a summary of the proposed standards for each category of FBO and IHC. The discussion following the charts offers more detail on each proposed standard.

Proposed Standards for Foreign Banking Organizations With US$50 Billion or More in Global Consolidated Assets (50B-FBOs)

	Proposed Standards for All 50B-FBOs	Additional Proposed Standards for 50B-FBOs with Combined US Branch, Agency and Subsidiary Assets of US$50 Billion or more
Risk-Based Capital and Leverage		
	Reporting and certification of compliance with home country standards comparable to Basel Accords, including Basel III which, as of January 1, 2019, will require minimum ratios of: ■ Common equity tier 1 capital ratio of 4.5 percent ■ Tier 1 capital ratio of 6.0 percent ■ Total capital ratio of 8.0 percent ■ Conservation buffer (common) of 2.5 percent, including restrictions on capital distributions, if breached Board would impose restrictions on FBO's US activities for noncompliance.	
Liquidity Requirements		
Buffer		Maintenance of a liquidity buffer as follows: ■ Equal to at least 30 days of projected net stressed cash flow of all US branches and agencies and any US subsidiaries not in an IHC ■ Consisting only of cash, US government, agency or special entity securities or other liquid assets approved by the Board ■ Maintained in the United States, except that an FBO that demonstrates to Board satisfaction that it is prepared to provide highly liquid assets to its US branches or agencies, may maintain at its head office outside the United States the portion of the required buffer for days 15 through 30.
Stress Testing	Required conduct and annual reporting to Board of periodic internal stress testing of liquidity of combined US operations over 30-day, 90-day and one-year horizons or, in the absence of such testing, to limit net aggregate amount due from head office and non-US operations to no more than 25 percent of total amounts due to US operations from non-affiliated third parties.	Required conduct and reporting to Board of monthly internal stress tests of cash flow projections of combined US branches, agencies and IHC under market, idiosyncratic and combined stress over at least overnight, 30-day, 90-day and one year horizons.
Cash Flow Projections		Detailed short and long-term cash flow projections for combined US operations.
Contingency Funding Plan		Plan for projected liquidity needs and sources of liquidity for combined US operations.
Collateral Monitoring		Monitoring at least weekly of the value of pledged and unencumbered assets of its combined US operations.
Independent Review		Annual independent review of liquidity risk management and compliance with legal and supervisory requirements and best practices.

	Proposed Standards for All 50B-FBOs	Additional Proposed Standards for 50B-FBOs with Combined US Branch, Agency and Subsidiary Assets of US$50 Billion or more
Single Counterparty Credit Limits		
	Maximum daily average net credit exposure to any single non-affiliated counterparty limited to either: ■ 25 percent of FBO consolidated capital stock and surplus ■ [X] percent of FBO consolidated capital stock and surplus, if the FBO and the counterparty each have US$500 billion or more in consolidated assets, where [X] is to be the same limit applicable to US bank holding companies (10 percent as proposed)	
Risk Management		
Board of Directors' Committee	Board of directors-level committee to oversee risk management of combined US operations and to include at least one member with risk management expertise. Annual certification to Board required. Board-imposed limitations on US activities absent certification.	Annual approval of liquidity risk tolerance of combined US operations by board of directors' committee.
US Chief Risk Officer		Required chief risk officer reporting directly to board risk committee and charged with monitoring, review and approval of liquidity risk tolerance, contingency funding, liquidity buffer and cash flow projections of combined US operations.
Stress Testing		
	If not subject to at least annual home country supervisory stress testing, required to conduct and report annual internal stress testing of any US subsidiary not included in an IHC.	If not subject to at least annual home country supervisory stress testing, required to: ■ Maintain assets in US branches and agencies equal to at least 108 percent of average liabilities ■ Restrict intragroup funding
Debt-to-Equity Limits		
	If found to pose a grave threat to US financial stability, required to: ■ Maintain assets in US branches and agencies equal to at least 108 percent of average liabilities ■ Limit the debt-to-equity ratio of any US subsidiary, including an IHC, to no more than 15 to 1	
IHC Requirement		
	Required to hold interests in all US bank and nonbank subsidiaries in a US intermediate holding company (IHC) if the combined total assets of all US subsidiaries equal US$10 billion or more. *See* chart entitled ***Proposed Standards for Intermediate Holding Companies***.	

Proposed Standards for Intermediate Holding Companies (IHCs)

	Proposed Standards for All IHCs	Additional Proposed Standards for IHCs with Total Assets of US$50 Billion or More
Risk-Based Capital and Leverage		
Basel Accords	Compliance with risk-based capital and leverage requirements for US bank holding companies. Current US capital rules require: ■ Tier 1 capital of 4.0 percent ■ Total capital of 8.0 percent US banking supervisors have not yet finalized rules to implement Basel III.	
Capital Plan Rule		Subject to capital plan rule for US bank holding companies, including: ■ Required annual submission of capital plan for prior Board approval ■ Required internal and Board stress testing ■ Restrictions on dividends or other capital distributions if unable to maintain a common equity tier 1 capital ratio of at least 5 percent through a two-year period of severe sustained stress
Liquidity Requirements		
Buffer	Maintenance of a liquidity buffer as follows: ■ Equal to at least 30 days of projected net internal and external cash flow needs under stressed conditions ■ Consisting only of cash, US government, agency or special entity securities or other liquid assets approved by the Board ■ Held in safekeeping in US by unaffiliated institutions	
Stress Testing		Required to be conducted at parent FBO level.
Cash Flow Projections		Required to be conducted at parent FBO level.
Contingency Funding Plan		Required to be conducted at parent FBO level.
Collateral Monitoring		Required to be conducted at parent FBO level.
Independent Review		Required to be conducted at parent FBO level.
Single Counterparty Credit Limits		
	Maximum daily average net credit exposure to any single non-affiliated counterparty limited to either: ■ 25 percent of IHC capital stock and surplus ■ [X] percent of IHC capital stock and surplus, if the IHC and the counterparty each have US$500 billion or more in consolidated assets, where [X] is to be the same limit applicable to US bank holding companies (10 percent as proposed)	

	Proposed Standards for All IHCs	Additional Proposed Standards for IHCs with Total Assets of US$50 Billion or More
Risk Management		
Board of Directors' Committee		Board committee required.
US Chief Risk Officer		Required chief risk officer reporting directly to board risk committee and charged with monitoring, review and approval of liquidity risk tolerance, contingency funding, liquidity buffer and cash flow projections of combined US operations.
Stress Testing		
	Annual internal testing and reporting of results under rules applicable to a US bank holding company.	Annual internal and supervisory stress testing under capital plan rule applicable to US bank holding companies.

Prudential Standards for All 50B-FBOs

All 50B-FBOs would be subject to capital and certain other enhanced standards that recognize systemic importance based solely on global consolidated assets. The Board staff estimates that 107 existing FBOs would fall within the 50B-FBO category. The following set of standards would apply to those 50B-FBOs irrespective of the size of their respective US branches, agencies and subsidiaries and whether or not required to establish an IHC:

Risk-Based Capital and Leverage

Every 50B-FBO would be required to meet Basel III minimum risk-based capital ratios, leverage ratios and capital buffer requirements in accordance with the phase-in schedule established by the Basel Committee on Banking Supervision ("Basel Committee") and, during the phase-in period, to meet capital adequacy standards that are consistent with the Basel capital framework then in place.[9] That presumably would be either Basel I or Basel II, though the Proposal refers only to any framework published by the Basel Committee from time to time. A 50B-FBO would be required to report its common equity tier 1, tier 1, tier 2 and total capital, risk-weighted assets and corresponding risk-based capital and leverage ratios in its FR Y-7Q quarterly filings with the Board. The Proposal specifies that the restriction on dividends or other capital distributions and discretionary bonus payments would apply if a capital conservation buffer of at least 2.5 percent is not maintained.

A 50B-FBO would be required to certify to the Board that its capital position either is calculated in accordance with home country standards or is otherwise consistent with Basel III or the applicable Basel framework during the Basel III phase-in period. The Board could restrict or impose conditions on a 50B-FBO's US operations, including those conducted through US subsidiaries of an IHC, if the 50B-FBO failed to meet either the required Basel capital and leverage requirements or the Board's reporting and certification requirements.[10]

The proposed capital and leverage requirement for 50B-FBOs makes no reference to comparable US standards. It is unclear if a 50B-FBO would be found to meet the standard if it is not in compliance with US capital and leverage minimums then in place for US bank holding companies with US$50 billion or more in total consolidated assets but is in compliance with home country standards. The Board and the other US banking supervisors have proposed rules to implement the Basel III framework, but in November announced that, while they continued to work expeditiously, a final rulemaking would not be in place by the January 1, 2013 phase-in start date set by the Basel Committee.

Liquidity Requirements

Every 50B-FBO would be required to conduct periodic internal liquidity stress testing and submit the results annually to the Board or else limit the net amount due to any US branches, agencies or subsidiaries from the head office or any non-US affiliates.[11] The stress tests could cover either total US operations or the consolidated worldwide operations of the FBO. The tests would have to be consistent with liquidity risk management principles established by the Basel Committee and cover at least 30-day, 90-day and one-year testing horizons. In the absence of such stress tests, a 50B-FBO would be required to limit funding of the head office and the FBO's other non-US operations by its US branches, agencies and subsidiaries. The net aggregate amount due to its combined US branch, agencies and subsidiaries from the head office or any other non-US operations of the FBO would be limited to no more than 25 percent of total third-party amounts due to its combined US operations. The limit would be applied to total US operations and not at the individual branch, agency or subsidiary level.[12]

Single Counterparty Credit Limits

Every 50B-FBO would be required on a daily basis to limit the aggregate net credit exposure of its combined US operations to any single unaffiliated counterparty to no more than 25 percent of the FBO's consolidated capital stock and surplus.[13] In addition, if the 50B-FBO is considered a major FBO—that is, one with total consolidated assets of US$500 billion or more—it would be required to restrict its net credit exposure to any major counterparty according to the same limits that apply to US bank holding companies with US$500 billion or more in total consolidated assets. A major counterparty is defined as a bank holding company, including an FBO, that has total consolidated assets of US$500 million or more and any nonbank financial company designated for Board supervision.[14] The US BHC Proposal includes a proposed major counterparty credit limit of no more than 10 percent of the bank holding company's consolidated capital stock and surplus.

US Risk Committee

Every 50B-FBO would be required to establish a board-level risk management committee to oversee its combined US operations, including any branch, agency, subsidiary and/or IHC, and to certify in its annual report filing with the Board that such committee is in place.[15] If the Board finds any 50B-FBO not to be in compliance with the risk committee requirement, it could impose conditions or restrictions on the activities or business operations of the 50B-FBO's US branches, agencies or subsidiaries, including those activities and operations conducted by subsidiaries held by an IHC.

The risk committee could either be a committee of the 50B-FBO's board of directors or of the board of its IHC, if applicable. The committee would be responsible for developing a risk management framework for the 50B-FBO's combined US operations and overseeing ongoing compliance with such framework. The committee would have to include at least one member with risk management expertise commensurate with the capital structure, risk profile, complexity, size and activities of the 50B-FBO's combined US operations. The 50B-FBO would be responsible for ensuring that the committee has access to adequate information to oversee the risk management practices of its US operations.[16]

Stress Testing

Any 50B-FBO that has any US subsidiaries, whether or not included in an IHC, would be required to conduct an annual stress testing of its US subsidiaries and to report the results of such testing to the Board, unless it is subject to a home country stress testing regime that requires at least annual supervisory testing, provides for periodic internal testing and establishes corporate governance and internal control requirements for such stress testing.[17]

Asset Maintenance and Debt-to-Equity Limits

In addition to any notional capital requirement imposed by the Office of the Comptroller of the Currency on federal branches and agencies and state bank supervisors on state-licensed branches and agencies, any 50B-FBO that is found by the FSOC to pose a grave threat to the financial stability of the United States would have to:

- Maintain in the United States assets equal to at least 108 percent of the average liabilities of all of its US branches and agencies in the preceding quarter. For this purpose, assets would exclude intercompany receivables, prepaid expenses, equity securities, impaired assets or any other assets excluded by the Board
- Limit the debt-to-equity ratio of its IHC and any other US subsidiary to no more than 15 to 1[18]

Proposed Standards for 50B-FBOs With Total US Branch and Subsidiary Assets of US$50 Billion or More

A second set of standards would apply to any 50B-FBO that has combined total assets of at least US$50 billion in the United States, whether those assets are in US subsidiaries or direct US branches or agencies. The Board staff estimates that there are 23 50B-FBOs that have total combined US branch, agency and subsidiary assets of US$50 billion or more. These standards would apply in addition to those applicable to all 50B-FBOs. A 50B-FBO with only US branches or agencies would be subject to these standards if the combined total assets of those branches and agencies equal at least US$50 billion. Similarly, a 50B-FBO with a combination of US branches and agencies, and US subsidiaries that together have combined total assets of at least US$50 billion would be subject to these standards. Such a 50B-FBO might also be required to form an IHC to ring-fence its US subsidiaries if the combined assets of those subsidiaries total at least US$10 billion. An additional set of proposed standards would apply directly to that IHC. A 50B-FBO, however, would be required to comply with the following set of standards, even if the bulk of its US$50 billion in US assets consists of US subsidiaries placed in an IHC:

Liquidity Requirements

Liquidity requirements substantially similar to those proposed for US systemically-important bank holding companies would apply to any 50B-FBO with US$50 billion or more in combined total US assets. In addition to liquidity requirements applicable to any IHC, a 50B-FBO would be required to meet certain liquidity standards for its US branches and agencies, regardless of their combined asset size.

Liquidity Buffer
A 50B-FBO with at least US$50 billion in combined total US assets would be required to maintain a liquidity buffer sufficient to meet at least 30 days of the net stressed cash flow needs for its US branches and agencies, and any subsidiaries not included in an IHC, as would be the case in respect of these subsidiaries if the assets of those subsidiaries equal less than US$10 billion.[19] This buffer would be in addition to any liquidity buffer required for its IHC, as outlined below. The amount of the buffer would be as determined by the periodic stress testing outlined below. The buffer would be required to consist of highly liquid unencumbered assets—in general, cash or securities issued by the US government, a US government agency or a US government-sponsored entity, and other assets allowed with Board approval. Such other assets would have to be of low credit and market risk, have an active two-way market and be of a type normally used to provide liquidity during periods of market stress. Other assets would be allowed only to the extent they are diversified by collateral, counterparty, borrowing capacity or other factors the Board deems to be associated with liquidity risk. The Proposal does not specify whether non-US sovereign debt would qualify and, if so, to what extent. The equivalent of at least the first 14 days of the required liquidity buffer for any US branches and agencies would have to be retained in the United States. The portion of the buffer for days 15 to 30 could be held outside the United States at the FBO's head office if the FBO demonstrates to the satisfaction of the Board that it is prepared to provide highly liquid assets to its US branches or agencies sufficient to meet its liquidity needs for that 15-day period. The entire liquidity buffer for any US subsidiary not included in an IHC structure would have to be held by the US subsidiary in the United States.

Liquidity Risk Limits
A 50B-FBO with combined total US assets of US$50 billion or more would be required to control its liquidity risk by placing limits on (a) funding concentrations by type of instrument, counterparty, security features or other indicia of liquidity risk, (b) the amount of each type of liability maturing within a specified time horizon, and (c) off-balance and other exposures that could create funding shortfalls during liquidity stress events.[20]

Liquidity Stress Testing
A 50B-FBO with combined total US assets of at least US$50 billion would be required to conduct monthly stress tests on the combined cash flow projections of its US branches and agencies and its IHC.[21] The stress testing requirement would apply notwithstanding any home country liquidity stress testing requirement. The stress testing is to be used to inform the amount of the liquidity buffer required to be maintained by the FBO for its US branches and agencies and by the IHC itself to support the operations of its bank and nonbank subsidiaries. The stress tests would have to cover a range of scenarios that at a minimum include market stress, idiosyncratic stress and a combination of the two tested over a range of horizons including at least overnight, 30-day, 90-day and one-year timeframes. The scenarios tested would be required to include general market disruptions as well as those caused by the liquidity stress of another market participant and would be required to be tailored to the 50B-FBO's legal and capital structure, risk profile and other relevant characteristics. Results of stress tests would have to be reported to the Board within 14 days and specify the amount of the liquidity buffers in place for the 50B-FBO's US branches and agencies and its IHC. The results of any consolidated or other liquidity stress testing dictated by home country supervisors would also have to be reported to the Board. The Board did not state the extent to which stress test reports would be made public, as is required of US bank holding companies.

Liquidity Cash Flow Projections
A 50B-FBO with total combined US assets of at least US$50 billion would be required to prepare detailed and tailored short-term and long-term cash flow projections for its US operations that take into account asset, liability and off-balance exposures, cumulative cash flow mismatches, the liquidity impact of contractual maturities, intercompany transactions, new business, funding renewals, customer options and any other events that could impact liquidity.[22]

Monitoring of Collateral
A 50B-FBO with US assets of US$50 billion or more is required to have in place procedures to monitor the collateral positions of its combined US operations on at least a weekly basis to identify the value of pledged assets and the availability of unencumbered assets.[23] This proposed rule is intended both to take into account combined exposures, and their breakdown across specific significant legal entities, business lines and currencies.

Contingency Funding Plan
A 50B-FBO with total combined US assets of at least US$50 billion would be required to maintain a contingency funding plan covering its combined US operations, including all US branches and agencies and its IHC.[24] The contingency funding plan must include a quantitative assessment of future liquidity needs, the projected source of that liquidity, procedures to identify and address liquidity stress events, and periodic testing of the plan's reliability.

Oversight of Liquidity Risk Management Plan
A 50B-FBO with total combined US assets of at least US$50 billion would be required to have a liquidity risk tolerance in place for its US operations that is approved annually by the US risk committee of its board of directors.[25]

US Chief Risk Officer
A 50B-FBO with total combined US assets of at least US$50 billion would be required to have a US chief risk officer that is responsible for (a) approval of the liquidity costs, benefits and risks of any new product or business lines that the 50B-FBO plans to conduct in the United States, (b) a review at least annually of whether

existing US significant business lines and products are consistent with the 50B-FBO's liquidity risk tolerance, (c) approval of the annual contingency funding plan for the 50B-FBO's combined US operations, and (d) a quarterly review and approval of the liquidity buffer, liquidity cash flow projections and internal stress testing.[26] The US chief risk officer would be responsible for reviewing any liquidity risk policies and procedures for US operations put in place by the 50B-FBO's management and for reporting directly to the US risk committee of the board of directors at least twice a year on the liquidity risk profile of the 50B-FBO's combined US operations.[27]

Annual Independent Review

A 50B-FBO with combined total US assets of at least US$50 billion would be required to conduct at least annually an independent review to evaluate the adequacy and effectiveness of liquidity risk management processes for its US operations, to assess compliance with applicable laws, regulations, supervisory guidance and business practices.[28] Any findings of material deficiencies or weakness in liquidity risk management would have to be reported to the US risk committee along with recommended corrective action.

Stress Testing

A 50B-FBO that has US branches, agencies and subsidiaries with consolidated assets of US$50 billion or more would be required to comply with an asset maintenance requirement for its US branches and agencies and to maintain intragroup funding limits, as well as to undergo Board-dictated stress testing unless it is subject to a home country stress testing regime.[29] A home country stress testing regime will be deemed adequate to meet this requirement if it includes at least annual stress testing on a consolidated basis by home country supervisors, periodic internal stress testing, and corporate governance and internal control requirements relating to internal stress testing. In addition, if the 50B-FBO's US branches and agencies are in a net due from parent position, the 50B-FBO would have to demonstrate to the Board's satisfaction that it has in place adequate capital to withstand stress.

A 50B-FBO not found to have adequate capital or a sufficient home country stress testing regime would be required to:

- Maintain in the United States assets equal to at least 108 percent of the average liabilities of all of its US branches and agencies in the preceding quarter. For this purpose, assets would exclude intercompany receivables, prepaid expenses, equity securities, impaired assets or any other assets excluded by the Board
- Comply with restrictions on intragroup funding by its US branches, agencies and any subsidiaries not included in an IHC, including requirements to establish a liquidity buffer
- Conduct annual stress testing of all US subsidiaries not included in an IHC and report test results to the Board

Proposed IHC Standards for 50B-FBOs With US Subsidiaries With Total Assets of US$10 Billion or More

The IHC Requirement

The centerpiece of the Proposal is the requirement for a 50B-FBO to ring-fence all controlling interests in any US bank, broker-dealer, leasing, lending or other US subsidiary under a single IHC, if the combined total assets of those subsidiaries, on a consolidated basis, equal at least US$10 billion.[30] Every IHC would be subject to compliance with prudential standards that would apply directly to the IHC, with more stringent capital, liquidity and other standards reserved for those IHCs with at least US$50 billion in consolidated assets.

The IHC requirement applies to US subsidiaries, not to US branches or agencies, or other business conducted directly by the 50B-FBO in the United States. The IHC, in effect, is the equivalent of a US bank holding company, whether or not it is the direct parent of a US subsidiary bank. The Proposal notes that an IHC, however, would be subject to prudential requirements applicable to a bank holding company only to the extent expressly mandated by the Board. The requirement to establish an IHC and compliance by the IHC with applicable capital, liquidity and other prudential standards is based solely on the combined asset size of a 50B-FBO's US subsidiaries, not the business conducted by those subsidiaries. A 50B-FBO whose US subsidiaries have assets totaling at least US$10 billion would be required to hold them under a single IHC even if each of the subsidiaries is engaged solely in nonbanking activities. A 50B-FBO that has only one or more US bank subsidiaries also would be required to ring-fence those subsidiaries under an IHC if their combined assets equal at least US$10 billion. In this latter case, an existing US holding company for the FBO's interests in the US bank subsidiaries would qualify to become the IHC. In this case, it would seem that the holding company would meet the definition of both a bank holding company and an IHC. A 50B-FBO would continue to be treated as a bank holding company of any US bank held in an IHC and presumably would be required to seek the appropriate Board approvals for the IHC to engage in any banking activities or other activities closely related to banking. The parent FBO also would continue to be eligible to elect to become a financial holding company. A financial holding company election would cover the activities of the IHC.

An IHC would be treated as systemically important and therefore subject to the same type of enhanced standards that apply to systemically-important US bank holding companies based solely on having at least US$50 billion in consolidated assets, regardless of the portion of the assets, if any, used in its banking activities. By contrast, a foreign or US nonbank financial company with at least US$50 billion in consolidated assets would only be considered for designation as systemically important if it had at least US$3.0 billion or more in gross notional value of outstanding credit default swaps, US$3.5 billion or more in derivatives liabilities, US$20 billion or more in total debt outstanding, a minimum 15-to-1 leverage ratio (total consolidated assets-to-total equity), or a minimum 10 percent short-term debt ratio.

A US subsidiary required to be held by an IHC would include any US company that is directly or indirectly controlled by the 50B-FBO.[31] Control, for this purpose, includes the power to vote 25 percent or more of any outstanding class of voting securities, to elect a majority of the board of directors of the company or to exercise a controlling influence over the company's management or policies, if the Board so determines. Any US subsidiary formed to facilitate the business of the 50B-FBO or one or more of its non-US subsidiaries outside the United States would not be counted towards the US$10 billion threshold or required to be included in any IHC if the US subsidiary engaged in the same general line of business or a related business to the business conducted outside the United States by the 50B-FBO or any non-US subsidiary of the 50B-FBO that is its direct or indirect parent (a "section (2)(h)(2) company").[32] In addition, any intercompany balances that would be eliminated in a consolidation of US subsidiaries are not counted towards the US$10 billion threshold.[33]

A 50B-FBO could seek Board approval to establish multiple IHCs, rather than the single one required by the Proposal.[34] That might be done to accommodate a 50B-FBO that itself controls one or more 50B-FBOs, home country limitations on control through a single entity or such other circumstances as the Board deems to warrant an exception to the single IHC requirement.

The IHC would have to be organized as a company under the laws of the United States or any of its states or the District of Columbia.[35] It could take the form of a corporation, partnership, limited liability company or other structure typically included within the BHC Act definition of company.[36] The IHC would be subject to the laws of its place of incorporation that, among other things, would dictate its corporate governance structure and requirements relating to shareholders, directors and management.

A 50B-FBO would have up to one year after meeting the US$10 billion subsidiary asset threshold to establish an IHC for its US subsidiaries. No Board approval would be required unless the IHC were to hold a subsidiary bank, in which case an expedited procedure should apply. 50B-FBOs that meet the asset test as of July 1, 2014 would be expected to have an IHC in place no later than July 1, 2015. A 50B-FBO would be required to provide the Board with notice of having established an IHC and to certify that the IHC meets the requirements of the Board's rule.[37] Prior Board approval to establish the IHC is not required.

While the benefit of this new structure inures to the benefit of the Board, the cost will be borne by the FBO. FBOs will need to consider the expense and cost of setting up and maintaining this corporate structure and weigh those costs against potentially less costly alternatives that might be available.

The IHC would supplant the 50B-FBO as the entity that in effect is treated as a bank holding company in respect of the 50B-FBO's US non-branch operations. Under the principle of national treatment, an FBO itself is treated as a bank holding company in respect of all banking and nonbanking activities it conducts in the United States, whether directly through a branch or agency or through a separately incorporated US subsidiary. An FBO, like a US bank holding company, is subject to comprehensive supervision on a consolidated basis by its home country banking supervisor. As Board Governor Tarullo notes in his speech that foreshadowed the IHC requirement, an FBO would not be allowed to establish a US branch or agency or acquire or open a US bank unless found by the Board to be subject to such comprehensive consolidated supervision by home country authorities.[38]

While reliance on home country supervision was sufficient to protect the safety and soundness of the US banking system, it appears to have been found inadequate to assess a potential threat to the financial stability of the United States. The Dodd-Frank Act does not define financial stability, but merely establishes it as the standard of systemic importance for US and foreign bank and nonbank financial companies. It is not defined by the Board in any of its proposed rulemakings, including the Proposal or by the FSOC, the new uber-financial agency tasked with its oversight. For the purposes of analyzing bank holding company bank acquisitions, the Board has detailed its view of financial stability and the factors that the Board will assess in making a financial stability finding.[39]

Governor Tarullo noted that, to assess whether an FBO poses a threat to US financial stability, the Board would need at a minimum to conduct "regular and detailed assessments of each firm's home country regulatory and resolution regimes, the financial stability risk posed by each firm in the United States, and the financial condition of the consolidated banking organization." He called this a "worst of both worlds" approach that would be intrusive on home country regulators and still not allow US supervisors to require the FBO to change its practices or to meet requirements to address the risks to US financial stability. This seems to discount the value of existing Board supervisory tools requiring periodic FBO reporting and examination. It also seems to find lacking global financial reform efforts that for the first time include formalized mechanisms for peer monitoring of implementation of agreed-upon capital and other reforms by home country authorities and that reinforced home-host country cooperation in the supervision and resolution of global systemically-important banking organizations. It may be, as Governor Tarullo makes clear, that the uniqueness of FBO involvement in the US financial and banking markets justifies a uniquely US approach to FBO supervision. That uniqueness may arise in part out of the role of the US dollar as the principal medium of international exchange in the global financial markets.

Interestingly, the Dodd-Frank Act itself does contemplate the use of an IHC as the entity that would be subject to the Board's enhanced prudential standards for US and foreign nonbank financial companies designated as systemically important by the FSOC. It does not, however, provide for the use of an IHC for FBOs. In the case of designated foreign nonbank financial companies, the Proposal provides for the Board to retain the discretion to require the designated nonbank to establish an IHC to hold its US subsidiaries. Among other things, the Board will base its decision on the extent to which the foreign nonbank financial company is subject to prudential standards on a consolidated basis imposed by a home country supervisory authority. Oddly enough, the same consideration is not extended to 50B-FBOs. 50B-FBOs that meet the US asset threshold will be required to ring-fence their US subsidiaries in a US IHC irrespective of the level of home country comprehensive consolidated supervision. The Proposal also contemplates that the Board can waive application of any enhanced standards to a systemic nonbank if it deems the requirement would "not be appropriate." The Proposal does not specify any criteria for determining what would constitute an inappropriate determination.

Prudential Standards for All IHCs

The Proposal creates two sets of capital, liquidity and other prudential standards that would apply directly to an IHC. The first set would apply to any IHC required to be established based on having US subsidiaries with combined assets of least US$10 billion. The second set of standards would apply only to those IHCs that have total combined assets of US$50 billion or more on a consolidated basis ("50B-IHC"). The following provides an overview of each:

Though the Proposal specifies that an IHC that does not have a US bank subsidiary is not a bank holding company for purposes of application of Board rules, the proposed prudential standards that do apply to an IHC are substantially similar or in some cases identical to the requirements applicable to US bank holding companies. The Proposal creates a set of standards for any IHC required to be formed. The standards applicable to any required IHC include each of the following:

Risk-Based Capital and Leverage

All IHCs, including those with less than US$50 billion in total assets, would be required to meet all minimum risk-based capital and leverage ratios, and capital buffer requirements in place for US bank holding companies.[40] The Proposal expressly provides that the IHC would be subject to such minimum capital and leverage requirements even if its subsidiaries consist wholly of nonbank entities rather than including a US bank subsidiary.

Based on current capital rules in place for a US bank holding company, an IHC would be required to have minimum tier 1 capital of 4.0 percent and total capital of 8.0 percent.[41] If the US banking supervisors adopt rules proposed to implement Basel III, an IHC would be required to have in place common equity equal to at least 7.0 percent of risk-based capital and perhaps more if a surcharge for a domestic systemically-important bank is implemented by US supervisors and applies to the IHC.[42] The Proposal indicates that the Board may apply such a surcharge to any 50B-IHC it found to be systemically important.

US bank holding companies would be allowed to meet proposed enhanced standards on a consolidated basis without any specified requirement for the amount of capital and liquid assets to be maintained in the United States. In theory, at least, a US bank holding company could meet the US capital and liquidity requirements applicable to its US securities brokerage and other nonbank activities with capital held in a non-US subsidiary. An IHC would not be able to do the same. Presumably a US subsidiary required to be held by an IHC could maintain assets outside the United States either through foreign offices or through its own non-US subsidiaries. That would to some extent allow for the use of IHC capital to support non-US activities. The Proposal's intent, however, is clear. Capital and liquid assets are to be ring-fenced for the sole benefit of US subsidiary operations, making it difficult for those assets to be used for the benefit of any non-US activities or the activities conducted directly by the FBO through branches and agencies in the United States. Capital allocation will become more important in respect of an FBO's US operations.

Liquidity Buffer

In general, an IHC would not be subject to its own set of liquidity requirements, but the IHC's assets would be counted towards determining the level of liquidity standards applicable to the combined US operations of a 50B-FBO as detailed above.

A 50B-FBO, however, would be required to maintain at the IHC level a required liquidity buffer. As in the case of the liquidity buffer at the FBO level for a 50B-FBO with at least US$50 billion in combined total US assets, a liquidity buffer would be required for any IHC that is controlled by an FBO with combined US branch, agency and bank and/or nonbank subsidiary assets of at least US$50 billion. The IHC liquidity buffer requirement would apply regardless of the asset size of the IHC itself. The IHC liquidity buffer would have to equal at least 30 days worth of the projected net external and internal cash flow needs of the IHC under stressed conditions.[43] The liquidity buffer would have to consist of unencumbered, highly liquid assets—cash or securities issued by the US government, a US government agency or a US government sponsored entity and such other assets deemed by the Board to be of low credit and market risk, to have an active two-way market and to be of a type normally used to provide liquidity during periods of market stress. The Proposal does not specify whether non-US sovereign debt would qualify and, if so, to what extent. The IHC's liquidity buffer would have to be held in safekeeping with US institutions not affiliated with the 50B-FBO.

Single Counterparty Credit Limits

Every IHC would be subject to the same counterparty credit limits applicable to its 50B-FBO parent. In specific, aggregate net credit exposure of the IHC, including its subsidiaries, to any single unaffiliated counterparty could not exceed 25 percent of the IHC's consolidated capital stock and surplus. If the IHC has US$500 billion or more in total consolidated assets, aggregate net credit exposure to a major counterparty would be limited to a more stringent limit that would be aligned with the limit imposed on US bank holding companies with US$500 billion or more in total consolidated assets.[44]

Risk Management

The Proposal creates risk management requirements for a 50B-FBO, including one that is required to form an IHC, but does not include specific risk management requirements applicable to the IHC.

Stress Testing

An IHC with US$10 billion, but less than US$50 billion, in total assets would be required to conduct an annual stress test following the same rules that apply to a US bank holding company of similar size.[45] The IHC also would be required to report the results of its testing to the Board and to disclose a summary of the test results to the public.

Additional Prudential Standards for a 50B-IHC

The Proposal treats a 50B-IHC as being systemically important and imposes on these larger IHCs the same type of requirements applicable to systemically-important US bank holding companies. Those include:

Capital Planning

While the Proposal does not expressly include an "enhanced" capital requirement for a 50B-IHC comparable to that proposed for a US bank holding company with US$50 billion or more in total assets, it does seem to arrive at the same place by making a 50B-IHC subject to the capital planning rule the Board has in place. Under the US BHC Proposal, a systemically-important US bank holding company would be required not only to meet risk-based capital ratios then in effect, but to maintain capital at levels sufficient to maintain common equity tier 1 capital of at least 5.0 percent throughout a period of severe sustained stress. That is the same standard required to pass Board stress testing of capital plans submitted under the Board's existing capital plan rule applicable to US bank holding companies with US$50 billion or more in total consolidated assets.

A 50B-IHC would be required to submit an annual capital plan to the Board under that same existing capital plan rule. The rule requires the Board's prior approval for dividends and distributions by a bank holding company that would include distributions by a 50B-IHC to its shareholders, including its 50B-FBO parent.[47] A 50B-IHC that, in internal and Board stress testing, failed to maintain required minimum capital and leverage levels over a two-year period of projected stress would not be allowed to make dividend and other distributions. In particular, a 50B-IHC would be required to maintain common equity tier 1 capital of at least 5 percent throughout a period of severe stress, as well as to meet the tier 1 and total risk-based capital minimums in place. The practical effect is that a 50B-IHC will be required to maintain common equity tier 1 capital equal to at least 5 percent of risk-weighted assets on a forward-looking stressed basis.

The Proposal contemplates an initial filing of capital plans by 50B-IHCs based on stress testing of actual results for the 12 months ending September 30, 2015. Dividends and distributions in 2016 would be limited to those approved by the Board based on the results of its stress testing.

Single Counterparty Credit Limits

An IHC with at least US$500 billion in total consolidated assets would be considered a major IHC and would be required on a daily basis to limit aggregate net credit exposure to any single unaffiliated counterparty with US$500 billion or more in total consolidated assets to no more than the major counterparty credit limit that would apply to US bank holding companies treated as major counterparties.[48] Under the US BHC Proposal, a major US bank holding company would have to limit its aggregate net credit exposure to any unaffiliated major counterparty to no more than 10 percent of the bank holding company's consolidated capital stock and surplus.

Risk Management

A 50B-IHC would be overseen by a board of directors or board of managers that has substantially the same rights, powers, privileges, duties and responsibilities of a company organized under relevant state law.[49] A 50B-FBO with at least US$50 billion in combined US assets could choose to have its required US chief risk officer be an employee of its IHC.[50]

Stress Testing

A 50B-IHC would be subject to the same stress testing requirements applicable to a US bank holding company with US$50 billion or more in total consolidated assets.[51] The Board in October 2012 adopted final rules governing the supervisory and company-run stress test requirements.[52] The rules would require, among other things, that the IHC conduct semi-annual internal stress testing and submit the results of such testing to the Board. That internal stress testing would be integrated with the Board's rules requiring the annual submission of a capital plan for prior Board approval and would be supplemented by annual stress tests performed by the Board to determine the adequacy of the capital plan submitted by a systemically-important bank holding company or IHC.

FBOs With at Least US$10 Billion, But Less Than US$50 Billion in Global Consolidated Assets

The Proposal is focused on 50B-FBOs defined by the Dodd-Frank Act as systemically important. It does, however, include several requirements that would apply to FBOs with less than US$50 billion, but at least US$10 billion, in global consolidated assets ("10B-FBOs"). Those requirements are meant to correspond to requirements that have been proposed for similar-sized US bank holding companies, and savings and loan holding companies.

The Proposal expressly treats a foreign savings and loan holding company with at least US$10 billion, but less than US$50 billion, in global consolidated assets as a 10B-FBO, though it recognizes that none exist at present. A foreign savings and loan holding company is defined as a foreign company that controls a US savings bank or a cooperative bank or a company that controls such a company, but excludes any company that is, or that controls, a bank holding company under the BHC Act.[53] A foreign bank that acquires an interest in a US savings bank or cooperative bank would be treated as a foreign savings and loan holding company if it does not have an existing US branch, agency or bank subsidiary.

IHC Requirement

A 10B-FBO would not be required to establish an IHC even if it has more than US$10 billion of assets in US subsidiaries as it does not meet the US$50 billion global consolidated asset threshold.

Other Prudential Standards

The prudential standards proposed for a 10B-FBO would apply regardless of the size or form of its US presence. A 10B-FBO with a single branch or agency would be required to comply with the standards proposed despite the branch or agency having only nominal assets. A foreign bank with only a US representative office would not be considered an FBO.

Asset Maintenance

A 10B-FBO would be required to maintain in the United States assets equal to at least 105 percent of average liabilities of its US branches and agencies over the preceding quarter, unless it is subject to a prescribed level of stress testing under its home country supervision. Home country stress testing requirements would have to include at a minimum (a) annual consolidated stress testing or similar review of capital adequacy by its home country supervisor, (b) at least annual internal stress testing, and (c) corporate governance and internal control requirements relating to such stress testing. In addition, a 10B-FBO that failed to demonstrate to the Board that its internal stress tests met or exceeded minimum standards set by home country supervisors would be subject to the asset maintenance requirement.[55]

Stress Testing of US Subsidiaries

A 10B-FBO would be required to conduct an annual stress testing of its US subsidiaries and to report the results of such testing to the Board, unless it is subject to a home country stress testing regime that includes the components outlined in the asset maintenance requirement above.[56]

US Risk Committee

A 10B-FBO that has publicly traded securities in the United States or elsewhere would be required to certify to the board each year that it maintains a risk committee to oversee the risk management of its combined US operations. Its risk management oversight would have to be at the board of director level and would have to be conducted either by the global risk committee of the 10B-FBO's board of directors or by a separate board committee established to focus on US operations. In either case, the risk committee would have to include at least one member with expertise commensurate to the capital structure, risk profile, complexity, size and activities of the 10B-FBO's US operations. The management of the 10B-FBO would be responsible for ensuring that the risk committee receives sufficient information about its US operations to assess their risk and that any risk management framework dictated by the risk committee for its US operations is implemented. The Board would have the express authority to impose conditions or restrictions on the 10B-FBO's US activities and operations if it failed to satisfy the risk committee requirement.

The Proposed Early Remediation Framework

As proposed for US bank holding companies, 50B-FBOs would be subject to early remediation if their US branch, agency and subsidiary operations were deemed to pose a risk to the financial stability of the United States. The US operations of any 50B-FBO with at least US$50 billion in combined total US branch, agency and subsidiary assets automatically would be subject to early remediation. In some cases, separate remedial actions would apply to the FBO's US branches and agencies, its IHC and the FBO itself. The early remediation requirements, however, could be applied to 50B-FBOs with less than US$50 billion in combined total US assets on a case-by-case basis as deemed appropriate by the Board.

The proposed early remediation framework would create four levels of required remediation based on a 50B-FBO breaching certain specified triggers. The triggers follow those proposed for systemically-important US bank holding companies, but include as well triggers based on market indicators to be established by the Board, but not defined in the Proposal.

Early levels of remediation would begin based on the breach of forward-looking triggers, such as failure to maintain capital necessary to sustain a severe period of stress. That follows the approach proposed for systemically-important US bank holding companies, but seems to include more detailed limitations on funding, growth and compensation than those originally proposed for US bank holding companies. The proposed remediation actions are summarized in the chart attached to this Alert.

Remediation Action Required for Specified Trigger Events

Level 1	
Risk-Based Capital & Leverage	Applied to the US operations of a 50B-FBO or an IHC whose risk-based capital ratios exceed required minimums by at least 200 to 250 basis points and whose leverage ratio exceeds required minimums by at least 75 to 125 basis points, if: ■ The 50B-FBO's capital position is not commensurate with its risk level or ■ The IHC is not in compliance with the capital plan rules
Stress Test Results	Applied to the US operations of an FBO that is not in compliance with applicable stress testing requirements.
Risk Management	Applied to the US operations of an FBO if any part of its US operations manifest weakness in meeting required risk management standards.
Liquidity	Applied to the US operations of an FBO if any part of its US operations manifest weakness in meeting required liquidity standards.
Market Indicators	Applied to the US operations of an FBO that has any market indicator exceeding acceptable thresholds for that indicator as published annually by the Board.
Remediation Action	Targeted supervisory review by the Board and required level 2 remediation upon any finding of financial distress or material weaknesses in risk management.
Level 2	
Risk-Based Capital & Leverage	Applied to a 50B-FBO or an IHC with: ■ Risk-based capital ratios less than 200 to 250 basis points above applicable minimum requirements, or ■ A leverage ratio less than 75 to 125 basis points above applicable minimum requirements
Stress Test Results	Applied to the US operations of an FBO that does not maintain at a common ratio of at least 5.0 percent in supervisory stress testing
Risk Management	Applied to the US operations of an FBO if any part of its US operations demonstrates multiple deficiencies in meeting required risk management standards.
Liquidity	Applied to the US operations of an FBO if any part of its US operations demonstrates multiple deficiencies in meeting required liquidity standards.
Market Indicators	
Remediation Action	For the IHC, required suspension of any capital distributions in excess of 50% of current net income. For any US branches or agencies: ■ No net funding to the head office or non-US affiliates, and ■ Required full 30-day (rather than 14-day) liquidity buffer to be maintained in the United States ■ For the combined US operations of the 50B-FBO: – Limits on average daily combined assets and risk-weighted assets that do not exceed prior quarter or calendar year levels by more than 5 percent, – A prohibition on establishing or acquiring a controlling interest in any US company, branch or agency or new line of business without prior Board approval – Required agreement to a memorandum or other enforcement action by the Board

Level 3	
Risk-Based Capital & Leverage	Applied to a 50B-FBO or an IHC that for at least two consecutive quarters has: ■ Risk-based capital ratios less than 200 to 250 basis points above applicable minimum requirements or ■ A leverage ratio less than 75 to 125 basis points above applicable minimum requirements
Stress Test Results	Applied to the US operations of an FBO that does not maintain at a common ratio of at least 3.0 percent in supervisory stress testing
Risk Management	Applied to the US operations of an FBO if any part of its US operations demonstrates substantial noncompliance with required risk management standards.
Liquidity	Applied to the US operations of an FBO if any part of its US operations demonstrates substantial noncompliance with required liquidity standards.
Market Indicators	
Remediation Action	For all US branches and agencies: ■ Required asset maintenance of 108 percent of average liabilities and ■ A prohibition on any funding to the head office or any non-US affiliates For an IHC: ■ A prohibition on any capital distributions and ■ Required replacement of its board of directors and/or executive officers if required by the Board For the 50B-FBO itself: ■ No acquisitions or openings of any US branch, agency or subsidiaries or new lines of business and ■ No permitted bonuses or increased compensation to any executive officer primarily responsible for its US operations For the US operations of the 50B-FBO, limits on average daily combined assets and risk-weighted assets to no more than prior quarter or calendar year levels. For both the 50B-FBO and its IHC, required agreement to formal enforcement action, including a written agreement or other action deemed appropriate by the Board.
Level 4	
Risk-Based Capital & Leverage	Applied to a 50B-FBO or an IHC that has: ■ Risk-based capital ratios at least 100 to 250 basis points below applicable minimum requirements or ■ A leverage ratio at least 50 to 150 basis points below applicable minimum requirements
Stress Test Results	
Risk Management	
Liquidity	
Market Indicators	
Remediation Action	Termination of resolution of the combined US operations of the FBO if deemed warranted by the Board.

Endnotes

1 Board, *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies* (December 14, 2012) available at http://www.federalreserve.gov/aboutthefed/boardmeetings/FBO_FR_notice_20121214.pdf.

2 Dodd-Frank Act § 165.

3 Dodd-Frank Act §112. The Proposal adopts the Board's existing Regulation K definition of an FBO as a foreign bank that operates a branch, agency or commercial lending company in the United States or controls a US bank or Edge corporation and includes a company that controls such a foreign bank. 12 C.F.R. §211.21(o).

4 The Dodd-Frank Act requires more stringent standards for risk-based capital and leverage, liquidity, risk management, resolution planning, counterparty credit exposure and internal and supervisory stress testing. A contingent capital requirement, short-term debt limits, public disclosure requirements and any other standard the Board deems appropriate may also be imposed, as well as a 15-to-1 debt-to-equity limit for any bank holding company deemed to pose a grave threat to US financial stability. Dodd-Frank Act §165(b).

5 Dodd-Frank Act §165(b)(2).

6 The FSOC is considering initial designations of systemically-important nonbank financial companies, but has not announced any final designations to date. Several US nonbank financial companies have indicated that they have been advised that they are under FSOC consideration for a systemic designation. No similar public disclosures have been made by any foreign nonbank financial company.

7 For a discussion of the financial stability standard to be applied by the FSOC in designating a nonbank financial company, see the recent article by Ernie Patrikis entitled "Nonbank SIFIs: A Mythical Beast," published in the January 1, 2013 issue of BNA Banking Reporter, a reprint of which is available on our website at http://www.whitecase.com/articles-01012013/.

8 Asset size, in general, would be determined based on the average assets as reported by the FBO in its filings with the Board or as determined under either international financial reporting standards, US generally applicable accounting principles or such other accounting standards used by the FBO in the ordinary course of its business.

9 Proposed Rule §252.212(c). The Basel III framework provides for the phase-in over a five-year period beginning on January 1, 2013 of common tier 1, tier 1 and total risk-based capital minimum ratios of 4.5 percent, 6.0 percent and 8.0 percent and a capital conservation buffer of 3.5 percent, as well as a parallel run of a 3.0 percent leverage ratio.

10 The Proposal contains a number of certification requirements. The filing of a certification that is not accurate presents the potential for both civil and criminal enforcement by federal authorities.

11 Proposed Rule §252.231.

12 An FBO might consider determining whether it would want to recommend that the Board permit a deduction from this affiliate exposure if secured with certain liquid US assets.

13 Proposed Rule §252.242(a)(2). Each of these certification requirements imposes serious compliance enforcement risk on the FBO beyond mere imposition of conditions by the Board.

14 Proposed Rule §252.240.

15 Proposed Rule §252.251.

16 Examiners can be expected to review the minutes of the risk committee. If the risk committee is a committee of the IHC board, examiners could sit in on a committee meeting. One question is whether an IHC board could combine its audit and risk committees into a single committee.

17 Proposed Rule §252.264(b)(2).

18 Proposed Rule §252.271.

19 Proposed Rule §252.227(a).

20 Projected Rule §252.229. Unlike the other liquidity requirements, this proposed rule does not specify that it is limited to FBOs with a certain global or US asset size. It is unclear if the intent is to extend this requirement to all FBOs or not.

21 Projected Rule §252.226(a).

22 Projected Rule §252.225.

23 Proposed Rule §252.230(a).

24 Projected Rule §252.228(a).

25 Proposed Rule §252.222(a).

26 Proposed Rule §§252.222 and 252.253.

27 Proposed Rule §252.223.

28 Proposed Rule §252.224.

29 Proposed Rule §252.263.

30 Proposed Rule §252.201(a).

31 Proposed Rule §252.3 (definition of subsidiary by reference to Board Regulation Y 12 C.F.R. §225.2(o)).

32 Proposed Rule §252.201(a)(2) (relating to exclusion of companies excluded under section 2(h)(2) of the BHC Act).

33 Proposed Rule §252.201(a)(3).

34 Proposed Rule § 252.202. Puerto Rico and territories and possessions of the US are apparently regarded as foreign for this purpose.

35 Proposed Rule 252.203(a).

36 Proposed Rule 252.3. The proposed definition of company tracks the BHC Act and Regulation Y definitions, but expressly adds a limited liability company or special-purpose entity. 12 USC. §1841(b) and Board Regulation Y 12 C.F.R. §211.2(d).

37 Proposed Rule §252.203(b).

38 Our Client Alert entitled "A Proposal for Rebalancing US Supervision of Foreign Banking Organizations" offers a detailed analysis of and link to Governor Tarullo's speech.

39 The overall financial stability standard applied by the Board involves a metrics-based analysis of risk-indicating factors set out in the Dodd-Frank Act to determine whether the post-acquisition "failure of the acquirer or its inability to conduct regular-course-of-business transactions, would likely impair financial intermediation or financial market functioning so as to inflict material damage on the broader economy." Board Order Approving the Acquisition of ING Bank by Capital One Financial Corporation, FRB Order No. 2012-2 (February 14, 2012) (approving the acquisition of a savings association and its nonbank subsidiaries that would result in the acquiring US bank holding company becoming the 20th and 5th largest US depository institutions in terms of assets and deposits, respectively). *See also* Board Order Approving the Acquisition of The Bank of East Asia (USA.) National Association by the Industrial and Commercial Bank of China Limited, FRB Order No. 2012-4 (May 9, 2012) (approving the direct acquisition by an FBO of an 80 percent interest in a US national bank, based on, among other things, a financial stability analysis involving the size of the transaction, the expansion of the products and services offered by the FBO as a result of the acquisition, the potential for the acquisition to add significant complexity to the FBO's structure and operations, and the involvement of the post-acquisition FBO as a major provider of a product or service deemed critical to the functioning of the US financial system).

40 Proposed Rule §252.212(a).

41 12 C.F.R. Part 225, Appendix A.

42 *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action*, 77 Fed. Reg. 52792 (August 30, 2012).

43 Proposed Rule §252.227(b).

44 Proposed Rule §252.242(a).

45 *Annual Company-Run Stress Test Requirements for Banking Organizations With Total Consolidated Assets Over US$10 Billion Other Than Covered Companies*, 77 Fed. Reg. 62396 (October 12, 2012).

46 Proposed Rule §252.212(b).

47 Board Regulation Y, 12 C.F.R. §225.8.

48 Proposed Rule §252.242(c).

49 Proposed Rule §252.254. This would seem self-evident as an IHC is required to be formed under US law.

50 Proposed Rule §252.253(a).

51 Proposed Rule §252.262(a).

52 *Supervisory and Company-Run Stress Test Requirements for Covered Companies*, 77 Fed. Reg. 62378 (October 12, 2012).

53 Proposed Rule § 252.260.

54 Proposed Rule § 252.264(b)(1).

55 Proposed Rule §252.264(a).

56 Proposed Rule §252.264(b)(2).

57 Proposed Rule §252.251.