Navigating uncertainty: Corporate governance for foreign banks in the US

With the regulatory agenda for the US operations of foreign banks in a state of flux, **Kevin Petrasic, Paul Saltzman, Glen Cuccinello, Will Giles** and **Alexander Abedine** of global law firm White & Case provide a map to help boards navigate an uncertain terrain.

Non-US banks operating in the US (Foreign Banking Organizations or FBOs) have unique corporate governance issues regarding the role of boards and branch leadership for their combined US operations (CUSO). US regulators expect the CUSO to be governed and resolved in the same general manner as comparable US institutions. However, the operating structure and management reporting framework of the CUSOs are different than those of US institutions due to differing home-country regulatory regimes and highly integrated operating models that rely on the global scale of parent operations. As a result, FBOs may find it difficult to readily adapt to a corporate governance model that is more segregated and legal entity-based or some other US-based approach.

The general policy of the Federal Reserve Board (FRB) regarding the treatment of US banks and FBOs is parity. That said, the operating structures, the competitive need for scale, and the active involvement of home office management greatly complicate matters for CUSOs and can often inhibit efficient and effective corporate governance. There is additional complexity for FBOs with large US operations given the requirement to form US Intermediate Holding Companies (IHCs) and the enhanced prudential standards prescribed by FRB Regulation YY.

Regulation YY requires not only that the IHC Board oversee the IHC, but that the US Risk Committee—which in most FBOs will be the same group of directors as the IHC Board Risk Committee—oversee the CUSO, even though branch operations may be outside of the legal entity for which the IHC board is responsible.

Furthermore, the presence of state or other federal regulators, such as the New York State Department of Financial Services or the Office of the Comptroller of the Currency, adds an additional layer of complexity for FBOs with US branches.

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Signs of progress

Since US regulators are committed to holding FBOs to prudential standards similar to those of their US peers, they have not made significant adjustments to cater to these different operating models.

As a result, much more remains to be done to address these differences and variations in application across the spectrum of affected CUSOs. But industry efforts, combined with open-minded FRB leadership, have raised hopes that regulators will embrace a more tailored approach to FBO oversight.

The FRB recognizes the complexity of these corporate governance issues, and is in the process of revising expectations regarding the responsibilities of both bank boards and executive management. For example, the FRB has finalized a new

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rating system for IHCs and other large financial institutions and is expected to propose tailoring the enhanced prudential requirements applicable to FBOs in the near future.

The FRB has also proposed supervisory guidance regarding board effectiveness, the supervisory expectations of boards and management, and the communication between boards and management. Thus, the regulatory agenda for FBOs, which includes guidance regarding the proper oversight roles of board and branch managers, remains in flux.

A path through uncertainty

Given the uncertainty of the existing regulatory framework, there are questions regarding what boards and branch chiefs should do when confronted with supervisory criticism. With this in mind, there are some basic guiding principles that FBO boards or branch executives should consider following regardless of—or despite—regulatory uncertainty.

- **Ensure a holistic approach to CUSO governance**. US regulators view the CUSO as a single, unified entity; thus, it is important to understand the relationship and dependencies among various operating entities in the US in order to ensure efficient and effective regulatory compliance. Equally important is the ability to explain and demonstrate to US regulators the holistic approach employed by the CUSO with a view toward underscoring the rationality of the CUSO governance structure.
- **Develop familiarity with the legal standard of care and accountable persons regime in the relevant jurisdictions**. In most cases, the boards of depository institutions confront heightened fiduciary expectations imposed by regulators to ensure board accountability and oversight of management and, perhaps more relevant, regulatory and supervisory responsiveness. It is therefore important for FBO boards and branch managers to understand all applicable US federal and, where applicable, state banking laws, regulations and agency guidance, including examination guidance, particularly in the context of subsidiary boards.
- **Double down on risk identification and internal controls**. Regulatory developments, such as the Dodd-Frank Act's mandatory supervisory stress testing and the Comprehensive Capital Analysis and Review (CCAR), underline the importance to policymakers, regulators and examiners of identifying, measuring and mitigating material risks. These developments also highlight that these practices are a founding principal of good governance for all financial institutions, whether or not subject to CCAR, and, thus, should be considered, incorporated and/or amplified where prudent to do so.
- **Insist on extensive, targeted training**. Management should maintain up-to-date proficiencies in identifying and managing emerging and other risks that are particularly acute for FBOs. These include, for example, cybersecurity, sanctions, anti-money laundering and Bank Secrecy Act issues, and cross-jurisdictional regulatory issues in areas such as intragroup funding, privacy, data governance, and the scope of permissible activities and in-country operations. Training should be idiosyncratic and tailored to the operating circumstances of an institution and not be on a one-size-fits-all basis.
- **Ensure planning of executive sessions and encourage a culture of candor and compliance**. As a general principle of good governance, management and the board should foster an environment of cooperation and transparency in order to maintain the highest levels of quality and integrity. Equally important, of course, is fostering and maintaining a culture of compliance that promotes strong regulatory and supervisory relations.
- **Audit data and Management Information System (MIS) integrity**. Effective board oversight and supervision requires boards to monitor the activities of management and the company as a whole based on granular and reliable data at the legal entity level (or other relevant category). Relatedly, boards should ensure that MIS monitors understand and adhere to applicable

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risk limits, and remain apprised of and alert to specific issues under current supervision.

- **Quarterly meetings with regulators and coordinated regulatory outreach**. Boards should cultivate positive working relationships with regulators and coordinate their message across multiple regulators. The ability to communicate regularly, effectively and with integrity with one voice to all regulators enhances firm-wide credibility and operational efficiency. It also establishes a culture of trust that not only may help during times of stress, it is a powerful and effective approach when regulatory support or sign-off is required to facilitate a transaction, operational changes or an application approval. The unique challenges posed by FBO governance are due, in part, to unique and varied corporate structures and operating models that are distinct from those of US counterparts. While the regulatory regime for FBOs with large US operations is evolving, FBO boards and branch managers should consider implementing the points referenced above into their US operations to help better integrate the FBO and its CUSO in the US regulatory framework.

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