



Summary of Final Rule Imposing Enhanced Prudential Standards on FBOs

Last week, the Federal Reserve Board (the “Board”) issued its long-awaited final enhanced prudential rule (Regulation YY) under Section 165 of the Dodd-Frank Act (the “Final Rule”) for bank holding companies and foreign banking organizations (“FBOs”) with global consolidated assets of \$50 billion or more (“covered FBOs”).¹ This brief overview focuses on the applicability of the Final Rule on FBOs. The Board expects that approximately 100 FBOs will be subject to enhanced prudential standards under the Final Rule. In addition, the Final Rule imposes stress testing on FBOs with total consolidated assets of \$10 billion or more, and requires U.S. risk committees for FBOs with total consolidated assets of \$10 billion that are publicly traded.

The Final Rule is responsive, in some respects, to objections raised by home-country regulators and foreign banking organizations to the rule proposed in December 2012 (the “Proposed Rule”). To some degree, consideration appears to have been given, as required by Section 165, to a more tailored application of the enhanced prudential requirements and differentiation among companies. In presenting the Final Rule to the Board for consideration, Governor Tarullo, a principal author of the Final Rule, characterized the Final Rule as taking the middle road between the vulnerabilities of the status quo and the subsidiarization of U.S. operations of foreign banks. Nonetheless, the overall approach of the Proposed Rule has been maintained, and the Board reserves its authority to impose additional prudential standards that it deems necessary to carry out its authority under Title I of the Dodd-Frank Act (and not just Section 165), and/or to take supervisory or enforcement action.

In addition to the imposition of enhanced prudential standards, which we summarize below, the Final Rule imposes an important structural requirement on the U.S. operations of certain covered FBOs. The Proposed Rule required that each covered FBO with \$10 billion or more in U.S. assets held outside of the FBO’s branches and agencies establish an intermediate holding company (“IHC”) for its U.S. affiliates. Under the Final Rule, the \$10 billion threshold has been raised to \$50 billion, thus removing this structural requirement for a number of covered FBOs. The Board anticipates that approximately 15-20 covered FBOs will be required to form IHCs. An IHC will be subject to enhanced prudential standards on a consolidated basis, and an IHC and each of its subsidiaries will be subject to examination and inspection by the Board. In addition, an IHC will be subject to risk-based and leverage ratio requirements applicable to BHCs (other than the advanced approaches capital rules, unless the IHC elects to be subject to them). Addressing in part concerns about the imposition of leverage ratio on IHCs, Board staff pointed out in comments to the Board during the meeting at which the Final Rule was adopted that the investment banking operations of the largest foreign banks are similar to those of Goldman Sachs and Morgan Stanley, and that once the leverage ratio goes “on line in 2018,” the expectation is that U.S. firms’ foreign

¹ The stated purpose of Section 165 is to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions, by establishing prudential standards more stringent than those that would otherwise apply to financial institutions that do not present similar risks to the financial stability of the United States. In applying such enhanced prudential standards to an FBO, the Federal Reserve Board is required to give due regard to the principle of national treatment for FBOs and equality of competitive opportunity, and to take into account the extent to which the FBO is subject on a consolidated basis to home-country standards that are comparable to those applied to financial companies in the United States.

operations would be subject to a leverage ratio in the jurisdiction of their operations, hence meeting competitive equality standards. IHCs will also be subject to the Board's capital plan rules, requiring capital plans and governing capital distributions.

U.S. branches and agencies of a covered FBO may continue to operate outside of the IHC environment. Failure to comply with applicable enhanced prudential standards raises the possibility of action by the Board.

Here's a quick overview of what else is covered in the Final Rule:

What's in:

- *Compliance Period for IHC Implementation.*
 - Covered FBOs with U.S. non-branch assets of \$50 billion or more have until July 1, 2016 (one year later than provided in the Proposed Rule), to set up or designate a U.S. company as an IHC and transfer their U.S. bank holding company and bank subsidiaries and substantially all their other U.S. nonbank subsidiary business to the IHC. Full compliance must be achieved by July 1, 2017. FBOs are required to submit an implementation plan for compliance with the IHC requirement by January 1, 2015, although this date may be accelerated or extended by the Board. The Board may make limited exceptions to the requirements to allow multiple IHCs, or to allow certain ownership interests to remain outside of the IHCs or other modifications.
- *Capital and Leverage Requirements.*
 - IHCs will be subject to the same risk-based capital (but not the advanced approach risk-based rules unless an IHC elects to do so) and leverage ratio requirements (which will not be effective until January 1, 2018) as the largest U.S. bank holding companies. Covered FBOs must certify to the Board that they meet consolidated capital adequacy standards established by their home-country supervisors that are consistent with the Basel Capital Framework.
- *Liquidity Risk-management Requirements.*
 - A covered FBO with combined U.S. assets of less than \$50 billion must report the results of an internal liquidity test on their consolidated operations or combined U.S. operations, consistent with the Basel Committee principles for liquidity risk management and other requirements, to the Board on an annual basis. Failure to meet this requirement will result in a daily cap on the net "due from" non-U.S. offices and non-U.S. affiliates position of the combined U.S. operations of the FBO.
 - A covered FBO with combined U.S. assets of \$50 billion or more is required to conduct internal liquidity stress tests on at least a monthly basis and must meet certain standards for liquidity risk management.
 - U.S. branches and agencies of a covered FBO with combined U.S. assets of \$50 billion must maintain a liquidity buffer in the United States of 14 days based on a 30-day liquidity stress test planning horizon. Any cash held pursuant to the liquidity buffer requirement may not be maintained in an account with a U.S. affiliate.
 - An IHC must maintain a liquidity buffer in the United States based on a 30-day liquidity stress test planning horizon. Any cash held pursuant to the liquidity buffer requirement may not be maintained in an account with a U.S. branch or agency or another U.S. affiliate of the IHC.

- *Capital Stress Testing.*
 - An FBO with \$10 billion or more in total consolidated assets is subject to and must comply with an annual home-country capital stress testing regime, which has governance and control requirements and is conducted by the home-country supervisor, or is a company-run test reviewed and evaluated by that supervisor. A covered FBO with combined U.S. assets of \$50 billion or more with a U.S. branch or agency must make certain annual reports to the Board regarding the capital stress testing regime. Failure to meet the home_country's minimum standards would subject U.S. branches and agencies of the FBO to an asset maintenance requirement, may require the FBO to conduct an annual stress test of its U.S. subsidiaries, and, where not already required, require the FBO to meet certain Board reporting requirements.
 - IHCs will be subject to supervisory and company-run stress tests to assess capital adequacy, with public reporting requirements comparable to BHCs.
- *Risk Management Requirements.*
 - An FBO with more than \$10 billion but less than \$50 billion in consolidated assets and any class of stock that is publicly traded, and a covered FBO with less than \$50 billion in combined U.S. assets, must annually certify to the Board that it maintains a home-country governance structure (which could include a U.S. risk committee of its board of directors) that oversees the U.S. risk-management policies of the combined U.S. operations of the company, and has at least one member with extensive experience relating to risk of large, complex firms.
 - Generally, an FBO subject to the preceding paragraph must take appropriate measures to ensure that its combined U.S. operations (i) provide the U.S. risk committee with sufficient information to allow it to carry out its responsibilities and (ii) implement the U.S. risk committee's risk management policies. The Board may impose requirements, conditions, or restrictions on the business operations of the FBO's combined U.S. operations if these requirements are not met.
 - A covered FBO with combined U.S. assets of \$50 billion or more is required to have a U.S. risk committee at either its IHC board of directors or its own board of directors that oversees the U.S. risk management policies of the combined U.S. operations and to appoint a chief risk officer who must be resident in the United States. The Final Rule sets forth responsibilities for each of the U.S. risk committee and the U.S. chief risk officer.
 - An IHC must establish and maintain a risk committee as a committee of its U.S. board of directors to oversee the IHC risk management framework and approve and periodically review the IHC's risk management policies. The risk committee is required to have members who fulfill certain experience and independence requirements.
- *Debt-to-Equity Limits*
 - If a covered FBO receives written notice from the Financial Stability Oversight Council, or from the Board on behalf of the Council that it poses a grave threat to the U.S. financial stability and that the imposition of a debt-to-equity requirement is necessary to mitigate such risk, (i) the FBO's IHC, or in absence of an IHC certain of the FBO's U.S. subsidiaries, must achieve and maintain debt-to-equity ratios of no more than 15:1 and (ii) the FBO's U.S. branches and agency will be subject to an asset maintenance requirement.

What's deferred:

- *Single Counterparty Credit Limits.*
 - The rulemaking on SCCLs will be deferred until the Basel Committee addresses the large exposure framework for G-SIFIs.
- *Early Remediation Standards.*
 - The adoption of final standards under Section 166 of the Dodd-Frank Act has been deferred while consideration is given to the impact of the new Basel capital and liquidity standards on the early remediation requirements under the Proposed Rule.
- *Foreign Nonbank Financial Companies Supervised by the Board.*
 - Rather than take a one-size-fits-all approach for nonbank financial companies, the Final Rule provides that the Board will apply enhanced prudential standards on a case-by-case basis.

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