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The Fed's new prudential standards for foreign banks

Yesterday, the Fed released its final rule on prudential supervision of larger foreign banks.

The Fed termed the rule as presenting a set of "targeted adjustments" to the Fed's regulation of foreign banks. The Fed noted that Section 165 of the Dodd-Frank Act drove these changes and the goal was to increase the resiliency of foreign banks during stressed times.

A major change for foreign banks was to raise the bar for when a foreign bank had to establish an intermediate holding company—now only the largest foreign banks will have to do so.

The following summarizes how the new rule affects foreign banks.

What is required of a foreign bank with total consolidated assets of $10 billion but less than $50 billion?

Stress Tests

The FBO must be subject on a consolidated basis to a capital stress testing regime by its home country supervisor—on an annual basis by the supervisor or an annual review by the supervisor of an internal capital stress test done by the FBO—and the supervisor must require governance and controls for the stress testing by the FBO's management and Board of Directors. In addition, the FBO must conduct such stress tests or the supervisor must and the FBO has to meet any minimum standards set by the supervisor for such tests.[1]

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1 252.122(a)

If the FBO cannot meet the standards in the prior paragraph then it must:

1. Maintain eligible assets (as defined) in the US branches that are at least 105% of the average daily liabilities of all U.S. branches.

2. Conduct an annual capital stress test of its U.S. subsidiaries, and

3. Report the results of the stress test to the Fed—with the information the Fed wants

A company wide stress test can be submitted to the Fed to determine if it will meet the requirements of the Fed for items 2 and 3 above.[2]

What is required of a foreign bank with total consolidated assets of $10 billion but less than $50 billion and is also publicly traded?

Risk Committee

Starting July 1, 2016, such a FBO must annually certify as part of its FR Y-7 that it maintains a committee of its Board of Directors that:

1. Oversees the risk management policies of the U.S. operations of the FBO; and

2. Has at least one member with experience in managing risk at a large firm.[3]

The FBO must take measures to implement the risk policies overseen by the committee and that the committee receives enough information from the U.S. operations to do its job.[4]

If the FBO does not comply with these requirements, the Fed may impose requirements, conditions, or restrictions relating to the activities or business operations of the combined U.S. operations of the FBO.[5]

What new Prudential Standards are required of a foreign bank with total consolidated assets of over $50 billion but with combined U.S assets of less than $50 billion?

Risk-Based and Leverage Capital Requirements

Starting July 1, 2016, such a FBO must certify to the Fed that it meets capital adequacy standards on a consolidated basis established by its home-country supervisor that are consistent with the

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2 252.122(b)
3 252.132(a)
4 252.132(c)
5 252.132(d)

regulatory capital framework in Basel III.6 If the home-country supervisor has not adopted Basel III, the FBO must convince the Fed that it would meet Basel III assuming it applied.7

The FBO must report to the Fed on its compliance with the capital standards as part of the FR Y-7Q.8

If the FBO does not comply with these requirements, the Fed may impose requirements, conditions, or restrictions (including capital or leverage requirements) relating to the activities or business operations of the combined U.S. operations of the FBO.9

Risk-management and Risk Committee Requirements

Starting July 1, 2016, such a FBO <u>must</u> annually certify as part of its FR Y-7 that it maintains a committee of its Board of Directors that:

1. Oversees the risk management policies of the U.S. operations of the FBO; and

2. Has at least one member with experience in managing risk at a large firm.10

The FBO must take measures to implement the risk policies overseen by the committee and that the committee receives enough information from the U.S. operations to do its job.11

If the FBO does not comply with these requirements, the Fed may impose requirements, conditions, or restrictions relating to the activities or business operations of the combined U.S. operations of the FBO.12

Liquidity Risk-management Requirements

Starting July 1, 2016, such a FBO <u>must</u> annually report to the Fed the results of an internal liquidity stress test for either the consolidated operations or the combined U.S. operations of the FBO using the Basel principles.13 If the FBO does not conduct the liquidity stress test and report to the Fed, the FBO must limit the amount owed by the FBO's non-U.S. offices to the combined U.S. operations to 25 percent or less of the third party liabilities of its combined U.S. operations, on a daily basis.14

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6 252.143(a)
7 252.143(a)(2)
8 252.143(b)
9 252.143(c)
10 252.144(a)
11 252.144(c)
12 252.144(d)
13 252.145(a)
14 252.145(b)

Capital Stress Testing Requirements

The FBO must be subject on a consolidated basis to a capital stress testing regime by its home country supervisor—on an annual basis by the supervisor or an annual review by the supervisor of an internal capital stress test done by the FBO—and the supervisor must require governance and controls for the stress testing by the FBO's management and Board of Directors. In addition, the FBO must conduct such stress tests or the supervisor must and the FBO has to meet any minimum standards set by the supervisor for such tests.15

If the FBO cannot meet the standards in the prior paragraph then it must:

1. Maintain eligible assets (as defined) in the US branches that are at least 105% of the average daily liabilities of all U.S. branches.

2. Conduct an annual capital stress test of its U.S. subsidiaries, and

3. Report the results of the stress test to the Fed—with the information the Fed wants.

A company wide stress test can be submitted to the Fed to determine if it will meet the requirements of the Fed for items 2 and 3 above.16

What new Prudential Standards are required of a foreign bank with total consolidated assets of over $50 billion and with combined U.S assets of more than $50 billion?

Intermediate holding company

Foreign banking organizations with combined U.S. assets of $50 billion or more and U.S. non-branch assets of $50 billion or more are also subject to the U.S. intermediate holding company requirement contained in § 252.153.17 The intermediate holding company is subject to direct regulation by the Fed in the same manner as a domestic bank holding company.

Risk-based and Leverage Capital Requirements

A foreign banking organization with combined U.S. assets of $50 billion or more must certify to the Fed that it meets its home country capital adequacy standards under Basel III. 18

Risk-Management and Risk-Committee Requirements

15 252.145(b)
16 252.145(c)
17 252.150

18 252.154(a)

The FBO must maintain a U.S. risk committee that approves and periodically reviews the risk management policies of the combined U.S. operations of the FBO.[19] The U.S. risk committee's responsibilities include the liquidity risk-management responsibilities.[20]

The FBO must have a framework for risk management that reflects its business and includes policies and procedures and systems to implement and monitor the policies, such as processes to identify and report risks and ensure timely implementation, establishing management responsibilities, maintaining independence and integrating risk and controls with compensation[21]

The U.S. risk committee may be a committee of the Board of Directors of the intermediate holding company or of the FBO's Board.[22]

The FBO must appoint a U.S. Chief Risk Officer to oversee monitoring or risks, compliance with risk policies and the management of risks and risk controls and report any risks and deficiencies. The Fed has requirements for the U.S. Chief Risk Officer's compensation, employment, reporting lines and access to the Board of Directors.[23]

Liquidity Risk-management Requirements

The U.S. risk committee must: approve annually the acceptable level of liquidity risk for the FBO with the concurrence of the FBO's board; review data to insure that the U.S. operations are within liquidity risk tolerances and approve a contingency funding plan.[24]

The U.S. Chief Risk Officer must review the policies for managing risks, review management data to insure that the FBO is operating within established risk parameters, approve new products and businesses and assess the liquidity impacts of such ventures, review all cash flow projections, establish liquidity risk limits, approve the liquidity stress testing practices.[25]

The FBO must establish an independent review function to review the liquidity risk management processes, assess compliance with law and report any issues.[26]

The FBO must produce cash flow projections across a variety of scenarios.

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19 252.155(a)
20 252.155(a)
21 252.155(a)(2)
22 252.155(a)(3)
23 252.155(b)
24 252.156(a)
25 252.156(b)
26 252.156(c)

The FBO must have a contingency funding plan for the U.S. operations.

The FBO must have specific liquidity risk limits and focus on concentrations and liabilities.

Liquidity Stress Testing and Buffer Requirements

The FBO must conduct monthly liquidity stress tests separately for its U.S. intermediate holding company and its U.S. branches and agencies. Stress testing must be conducted for the combined U.S. operations (including the U.S. intermediate holding company, if any, or the foreign banking organization's U.S. subsidiaries, if there is no U.S. intermediate holding company, and any U.S. branches and agencies) and separately for each of the U.S. intermediate holding company, if any, and the U.S. branches and agencies of the foreign bank.

Capital Stress Testing Requirements

The FBO must be subject on a consolidated basis to a capital stress testing regime by its home country supervisor—on an annual basis by the supervisor or an annual review by the supervisor of an internal capital stress test done by the FBO—and the supervisor must require governance and controls for the stress testing by the FBO's management and Board of Directors. In addition, the FBO must conduct such stress tests or the supervisor must and the FBO has to meet any minimum standards set by the supervisor for such tests.27

The FBO must report various items of information to the Fed each year on the stress testing activities. In addition if U.S. branches are in a net due from position with the head office, the FBO must provide additional information.28

If the FBO cannot meet the standards in the prior paragraphs then it must:

1. Maintain eligible assets (as defined) in the US branches that are at least 108% of the average daily liabilities of all U.S. branches.

2. Conduct an annual capital stress test of its U.S. subsidiaries, and

3. Report the results of the stress test to the Fed—with the information the Fed wants.

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27 252.158(b)
28 252.158(c)