As prepared for delivery
For release at 9:40 a.m. EDT
April 8, 2019

Statement on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks

by Governor Lael Brainard

I appreciate the work that has gone into the two proposals we are considering today. I have consulted closely with my colleagues in the hope that I could support the proposals. Unfortunately, the proposals go beyond the requirements of S. 2155 and weaken important regulatory requirements for banking institutions with total assets above $250 billion--at a time when large banks have comfortably achieved the post-crisis requirements and are providing ample credit to the economy and enjoying robust profitability.

Proposal to Modify Prudential Standards for Foreign Banking Organizations

With regard to foreign banking organizations, these banks decreased the risk of their operations in the United States and strengthened capital, liquidity, and risk-management at their U.S. holding companies in response to the enhanced prudential standards that we put into place following the financial crisis. This represented important progress.

The crisis demonstrated clearly that the combined U.S. operations of foreign banks can pose important risks to U.S. financial stability because of their reliance on dollar-denominated short-term wholesale funding from the United States to fund the banks' global activities. In recognition of those risks, in the final liquidity coverage ratio (LCR) rule for domestic banking organizations in 2014, the Board stated its intention to implement an LCR standard for the combined U.S. operations of foreign banks. Today's proposal does not achieve that objective. While I am encouraged that it would apply the LCR and net stable funding ratio requirements to

the intermediate holding companies (IHCs) of foreign banks, today's proposal does not address the important liquidity risks associated with the U.S. branch and agency networks of these firms.

As we saw in the crisis, the U.S. branches of foreign banks can face important run risk during periods of stress. This is because most U.S. branches, which often serve as important sources of dollar funding for activities at their parent banks, rely heavily on runnable short-term wholesale funding. The U.S. branches and agencies of foreign banks rely roughly twice as much on short-term wholesale funding as the U.S. IHCs. In the decade leading up to the crisis, dollar lending from U.S. branches to foreign parents grew to very high levels, and during the crisis some foreign branches were among the most active users of discount window borrowing when wholesale funding markets became stressed.[1] This risk is relatively unique to our financial markets due to the special role of the dollar in the global financial system. We have long discussed addressing this vulnerability by proposing the application of standardized liquidity requirements to the branches and agencies of foreign banks. This would reduce the incentive to shift assets to branches from IHCs, which is important in light of the fact that branch assets have grown as a percentage of foreign bank activities in the United States since the IHC requirements were put in place. I am disappointed the proposal today does not address this important outstanding vulnerability and therefore does not represent a balanced package.

Proposal to Reduce Resolution Planning Requirements

Turning to resolution, we saw clearly in the crisis that the failure of one or more large banking organizations may lead to severe stress in the financial system as fire sales and run

---

[1] Linda Goldberg and David Skeie, "Why Did U.S. Branches of Foreign Banks Borrow at the Discount Window during the Crisis?" April 13, 2011. Liberty Street Economics, Federal Reserve Bank of New York. https://libertystreeteconomics.newyorkfed.org/2011/04/why-did-us-branches-of-foreign-banks-borrow-at-the-discount-window-during-the-crisis.html

dynamics spread contagion. The Dodd-Frank Act requires firms to develop resolution plans that provide a credible path to orderly resolution in bankruptcy to ensure taxpayers will not again be on the hook.

I support some reduction in the frequency of plan submissions to temper the substantial work entailed. However, today's proposal goes beyond the requirements of S. 2155 in ways that may weaken the resolution planning process for very large banking firms and leave the system less safe. Under the proposal, most domestic banking organizations in the range of $100 to $250 billion in assets are no longer required to file a resolution plan at all. For banks with $250 billion to $700 billion in assets, the proposal would require a full resolution plan only once every 6 years. Beyond that, the proposal would allow even the largest and most systemic firms to obtain a waiver for many elements of their resolution plan if only one agency fails to proactively disapprove the waiver request.

It is important to remind ourselves that it is not only the failure of the largest and most systemic firms that poses a risk to the financial system. During the crisis, the failures of large banks in the $100 to $250 billion asset size range necessitated distress acquisitions, and the failure of a large banking organization with roughly $300 billion in assets triggered substantial spillovers. These episodes would have led to rapid depletion of the deposit insurance fund had the institutions not been acquired in distress--an avenue that is less likely to be available today than in the crisis.

For these reasons, I am concerned the proposals we are voting on today go beyond the requirements of S. 2155 and would weaken the important safeguards put in place to address vulnerabilities that proved extremely damaging in the crisis. I see no change in the financial

environment that would require us to weaken protections that are vital to a safe and sound financial system and ensure large banks--and not taxpayers--are on the hook.