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

by Vice Chair for Supervision Randal K. Quarles

Good morning, and thank you for joining us today as we consider the very important topics of tailoring prudential requirements for foreign banks and resolution plan requirements for domestic and foreign banks. Let me begin, first, by thanking our staff and the staffs of the other banking agencies for coordinating and executing these thoughtful proposals.

Like the domestic tailoring proposal that the Board and the other banking agencies considered several months ago, today's proposals were formulated with a basic objective in mind: to match the character of regulation to the character of the firm. But in approaching this objective for foreign banks, we had two additional objectives that we sought to achieve: creating a level playing field between foreign banks operating in the United States and domestic firms of similar size and business models, and giving due regard to the principle of national treatment. The contributions of foreign banks domestically, to both lending markets as well as capital markets, are significant to the U.S. economy and should continue.

This proposal should look familiar because it shares the same basic framework as the domestic proposal--firms are assigned to a category of regulatory stringency based on their size, business model, and risk profile--but it is not a direct transposition of it. We have given serious thought to how to account for the important differences between domestic firms and foreign banks operating in the United States. In addition, the differences in business models between domestic firms and foreign banks in the United States may also mean that the distribution of firms into categories of stringency could vary significantly.

Let me turn to the unique feature of the U.S. operations of foreign banks--their membership in a larger organization. The U.S. operations of foreign banks have a parent and affiliates outside of the United States that can both provide and require support in varying circumstances. That dynamic is central to two key design choices in today's proposal.

The first is the proposal's solicitation of comment on whether the Board should impose a standardized liquidity requirement on the U.S. branches of a foreign bank. Unlike the rest of today's proposal, this aspect does not include a proposal of any concrete requirements, but rather seeks broad input on the advisability and possible approaches of doing so. Introducing this concept is novel in the realm of international regulation (in contrast to supervision, where there is precedent), and I believe that we need robust public discourse--domestically and internationally--on its advantages and disadvantages.

Let me say a few words about the intellectual underpinnings of this concept. The United States finds itself as a host to large foreign branches that engage in short-term wholesale U.S. dollar sourcing. That dynamic has created severe liquidity strain in the U.S. banking system in times of stress, even after the financial crisis. I think now is a good time to give serious consideration to the optimal balance of certainty for host supervisors and local operations in a time of crisis and freely available liquidity for home supervisors and consolidated firms in good times. Some degree of certainty about available local resources would form a basis for trust among regulators that might mitigate the human tendency to freeze all available resources in a stress. Given these considerations, and the possibility that with shifting global dynamics, jurisdictions outside of the United States might also find themselves with similar risks, we should engage in much more dialogue on this subject.

The second feature is the measurement of a firm's cross-border exposure. The domestic proposal from last fall, and the foreign bank proposal we review today, use cross-border exposures as a risk indicator for assigning firms to a category of regulatory stringency. The key risks that this indicator seeks to capture are complexity and complications to resolvability. For a domestic firm, cross-border exposures are comprised of exclusively third-party relationships.

The challenging question for us in today's foreign bank proposal is whether the connections between a foreign bank's U.S. operations and its non-U.S. affiliates create similar complexity and resolvability concerns as a firm's cross-border exposures to third parties. The proposal seeks to strike a middle ground between complete inclusion and exclusion of such inter-affiliate exposures. We look forward to robust input on that approach.

Finally, in addition to the foreign bank tailoring proposal, we are also considering a proposal to tailor the requirements for resolution plans. In the seven or so years of resolution plan submissions, we have seen substantial gains in both the resiliency and resolvability of large banking organizations and the broader financial system. Congress recognized this progress when it passed the Economic Growth, Regulatory Relief, and Consumer Protection Act last year. Consistent with the law, the proposal seeks to tailor the both the frequency and content of resolution plans according to the business model and risk profile of firms.

Let me conclude by reiterating our overarching objective: The proposals seek to increase the efficiency of the firms without compromising the strong resiliency of the financial sector. These proposals are a good first step toward that goal, and I look forward to the input we will receive.