Banking and Finance Law Daily Wrap Up, TOP STORY—Fed proposes to ease regulatory standards for many international banks, (Apr. 8, 2019)

Banking and Finance Law Daily Wrap Up

Click to open document in a browser

By Richard A. Roth, J.D.

The Fed is proposing regulation amendments that it says would better match the rules on large foreign banks to the risks they pose to the U.S. financial system in a way that parallels proposed rules for large domestic banks. A second proposal would consider liquidity requirements on foreign banks' U.S. branches and agencies.

A regulation amendment proposed by the Federal Reserve Board would ease the prudential standards that apply to all but the largest international banking organizations and create risk categories that would apply to foreign banks with $100 billion or more in U.S. assets. According to the Fed, the result would be to set comparable standards for U.S. and international banking organizations. The Fed also is proposing standardized liquidity requirements for foreign banks' intermediate holding companies and asking for public comment on whether branches of foreign banks should be subject to such requirements.

Comments on both proposals are due by June 21, 2019. The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency are expected to propose comparable rules for the institutions they supervise.

Prudential standards. Under the enhanced prudential standards proposal, foreign banking organizations with $100 billion or more in U.S. assets would be assigned to one of three categories based on the size of their U.S. operations and a set of risk-based indicators: cross-jurisdictional activity, nonbank assets, off-balance sheet exposure, and weighted short-term wholesale funding. The most stringent prudential standards would apply to Category II institutions, and the least stringent would apply to Category IV institutions. (The categories are the for U.S. global systemically important bank holding companies, and only U.S. GSIBs would be in Category I.) A chart summarizing the regime is included in the Fed's presentation materials.

Currently, enhanced prudential standards can be applied to foreign banking organizations with $50 billion in total assets. The proposal would double that threshold and also require the institution have "a significant U.S. presence"—combined U.S. assets of $100 billion or more.

Similarly, three categories would be created for intermediate U.S. holding companies of foreign BHCs that meet the same $100 billion threshold.

The proposal predicts that the changes, including related reporting changes, would reduce affected banks' compliance costs with only "minimal effects" on safety and soundness or financial stability. However, some foreign banks rely more on short-term wholesale funding than do U.S. banks, the notice points out. These banks could be required to increase their liquid assets, although they also could slightly reduce their required capital.

This notice includes clarifications and technical changes to an earlier Fed proposal affecting U.S. BHCs and savings and loan holding companies.

Regulatory capital. The second proposal would amend the Fed's rules on regulatory capital requirements for foreign banks' IHCs and their depository institution subsidiaries by imposing liquidity coverage ratio and net stable funding ratio requirements. It also asks for comments on whether standardized liquidity requirements should be imposed on U.S. branches of foreign banks, but does not propose these requirements.

This proposal also would have a threshold of $100 billion in combined U.S. assets. The risk-based categories used for enhanced prudential standards would be used to determine the liquidity requirement for a specific institution.

This proposal includes one amendment that would apply to U.S. BHCs and SLHCs. If the holding company is in risk Category IV and relies significantly on short-term wholesale funding, it would be subject to a new standardized liquidity requirement.

Governors' comments. In preliminary statements, both Fed Chairman Jerome H. Powell and Vice Chairman for Supervision Randal K. Quarles praised the proposals. They noted that the proposals achieved two objectives: they tailored supervisory requirements to risk, and they treated U.S. and foreign institutions the same.

However, Governor Lael Brainard was less complimentary. She complained that the proposals went too far and would "weaken important regulatory requirements for banking institutions with total assets above $250 billion." Also, they did not adequately address the liquidity risks posed by foreign bank U.S. branches and agencies that rely heavily on short-term wholesale funding. This practice presents a risk of runs during times of stress, Brainard said.

MainStory: TopStory BankHolding BankingFinance CapitalBaselAccords FederalReserveSystem FedTracker FinancialStability PrudentialRegulation