MEMORANDUM

TO: Comments on Other Initiatives to be Undertaken by the SEC in Response to the Dodd-Frank Wall Street Reform and Consumer Protection Act

FROM: Brian P. Murphy
Counsel to Commissioner Walter
Office of Commissioner Walter

DATE: April 13, 2011

RE: Meeting with Sally Miller, Institute of International Bankers, Bob Colby, Davis Polk & Wardwell LLP, Ed Rosen, Cleary Gottlieb Steen & Hamilton, LLP, and Colin Lloyd, Cleary Gottlieb Steen & Hamilton, LLP ("Meeting Participants")

On the above date, Commissioner Walter and Brian P. Murphy met with the Meeting Participants to discuss, among other things, the capital and margin requirements applicable to security-based swap dealers. The Meeting Participants produced the attached documents, entitled "Institute of International Bankers: Proposed Framework For Swap Dealer Registration and Regulation" and "Regulation and Supervision of U.S. Branches and Agencies of Foreign Banks by U.S. Banking Authorities and the Application of U.S. Regulatory Capital Requirements to Such Banks."

April 11, 2011

INSTITUTE OF INTERNATIONAL BANKERS:
PROPOSED FRAMEWORK FOR SWAP DEALER REGISTRATION AND REGULATION

In order to assist the agencies in structuring their swap dealer registration and regulatory frameworks for foreign banks, and to ensure that the agencies' frameworks do not give rise to market disruption by failing to accommodate the structuring alternatives that must be available to foreign firms, we have summarized below a registration and regulatory framework that we believe appropriately applies sound principles of home/host country regulation in the context of Title VII of the Dodd Frank Act.[1]

The paradigms outlined in this matrix represent the principal (although not the only) structuring paradigms that foreign firms employ to structure their cross-border swap and security-based swap (hereinafter, "swap") business with U.S.-domiciled counterparties. Individual banks often use different structural paradigms for swaps involving different asset categories, and individual variations on these pure paridigms are not uncommon. No single paradigm would suffice to meet the needs and circumstances of all foreign banks and we do not believe that it is necessary or desirable to impose any single paradigm on foreign banks—whether the bank is ultimately U.S. owned or non-U.S. owned. This matrix illustrates how supervision and oversight of swap dealers can be established under each of the paradigms in a manner that is compliant with the provisions and objectives of Title VII.

We also note that, as an integral part of this framework, it is critical that the relevant U.S. and home country regulators agree upon an appropriate framework for examination, direct supervisory responsibility and access to information that is consistent with the allocation of applicable host/home country law.

	Direct Contacts by Foreign Bank Personnel	**U.S. Branch Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank**	**U.S. FCM/Broker-Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank**	**U.S. Swap Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank**	**U.S. Affiliate Deals in Swaps as Principal**
Facts	Employees of the foreign bank resident outside the U.S. contact U.S. persons to deal in swaps that the foreign bank enters into as principal. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may be hedged through inter-branch	Employees of a U.S. branch, acting as agent for the foreign bank principal, solicit, negotiate and commit to swaps that are booked to the foreign bank. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may be	Employees of a U.S. futures commission merchant ("FCM")/broker-dealer affiliate, acting as agent for the foreign bank principal, solicit, negotiate and commit to swaps that are booked to the foreign bank. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or	Employees of a U.S. swap dealer affiliate, acting as agent for the foreign bank principal, solicit, negotiate and commit to swaps that are booked to the foreign bank. Certain market risks, such as risks relating to swaps involving U.S. underliers, may be risk managed on an agency basis (subject to specified parameters) by personnel of an affiliate or branch located in the U.S., or certain market risks may	Personnel employed by a U.S. affiliate contact U.S. persons to deal in swaps for the account of the U.S. affiliate. Some or all of the risk arising from this swap activity might be backed-to-back to the foreign bank.

[1] While this framework is, for convenience, described with reference to a foreign bank, the same framework would also apply to a foreign, non-bank financial institution, except that the Commodity Futures Trading Commission ("CFTC") and the Securities and the Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions"), rather than the Board of Governors of the Federal Reserve System (the "FRB"), would be responsible for capital and margin requirements.

	Direct Contacts by Foreign Bank Personnel	U.S. Branch Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. FCM/Broker-Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. Swap Dealer Affiliate Personnel, on an Agency Basis, Solicit, Negotiate and Commit to Swaps that are "Booked" to the Foreign Bank	U.S. Affiliate Deals in Swaps as Principal
	or inter-affiliate swaps.	hedged through inter-branch or inter-affiliate swaps.	branch located in the U.S., or certain market risks may be hedged through inter-branch or inter-affiliate swaps.	be hedged through inter-branch or inter-affiliate swaps.	
Registration (Commodity Exchange Act ("CEA") § 4s(a)(1) / Securities Exchange Act of 1934 ("SEA") § 15F(a)(1))	The foreign bank would register in the U.S. as a swap dealer, but registration and regulation (other than with respect to entity-wide prudential regulation requirements identified below) would be limited to the U.S.-facing activities of the branch/separately identifiable department or division that is involved in the execution of swaps with U.S. persons. Other branches/divisions would not be subject to U.S. regulation.	The foreign bank would register in the U.S. as a swap dealer, but registration and regulation (other than with respect to entity-wide prudential regulation requirements identified below) would be limited to the U.S. branch activities. Foreign branches would not be subject to U.S. regulation.	The U.S. affiliate, since it is engaged in soliciting and accepting orders for swaps on behalf of the foreign bank, would register as an introducing broker or securities broker (or, if it is registered as an FCM/broker-dealer, otherwise qualify). The foreign bank would register in the U.S. as a swap dealer, but registration and regulation (other than with respect to entity-wide prudential regulation requirements identified below) would be limited to the U.S.-facing activities.	The U.S. affiliate would register as a swap dealer. The foreign bank "booking entity" would either register in the U.S. as a swap dealer solely with respect to its role as the contractual counterparty on U.S. customer-facing swaps or, as a condition to not registering, be required to be subject to and comply with home country standards determined by the FRB and the Commissions, as applicable, to be comparable to U.S. capital, risk management, and other prudential requirements (in which case the foreign bank would undertake to notify the FRB and the Commissions of any violations of or material changes to those home country standards, which could constitute a basis for revoking the exception from registration).	The U.S. affiliate would register as a swap dealer. The foreign bank affiliated with the U.S. swap dealer would not be subject to U.S. regulation, including in cases where: (a) market risk is hedged back to the foreign bank by the U.S. swap dealer; and/or (b) the foreign bank guarantees the U.S. swap dealer's obligations.
Capital (CEA § 4s(e) / SEA § 15F(e))	The FRB would be responsible for the foreign bank's capital, but would defer to comparable home	The FRB would be responsible for the foreign bank's capital, but would defer to comparable home	The FRB would be responsible for the foreign bank's capital, but would defer to comparable home	The U.S. swap dealer affiliate would comply with U.S. capital requirements, as established by the Commissions. Under these	The U.S. swap dealer affiliate would comply with U.S. capital requirements, as established by the Commissions or the relevant

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	country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	country standards. Failure to comply with home country standards would constitute a violation of FRB requirements by the foreign bank.	requirements, the U.S. swap dealer affiliate would not be required to hold capital against the market and credit risk arising from positions booked in the foreign bank so long as either: (a) the foreign bank counterparty registers as a swap dealer, in which case the FRB would defer to comparable home country standards, and failure to comply with those standards would constitute a violation of FRB rules by the foreign bank; or (b) the U.S. swap dealer affiliate obtains a determination from the FRB that the foreign bank booking entity is subject to comparable home country capital standards and undertakes to notify the FRB and the Commissions of any violations of or material changes to those standards, which could constitute a basis for revoking the exception from registration.	prudential regulator.
Margin (CEA § 4s(e) / SEA § 15F(e))	The FRB would be responsible for the foreign bank's margin requirements, but would defer to comparable home country standards. Failure to comply with home	The FRB would be responsible for the foreign bank's margin requirements, but would defer to comparable home country standards. Failure to comply with home	The FRB would be responsible for the foreign bank's margin requirements, but would defer to comparable home country standards. Failure to comply with home	Foreign banks would agree to comply with U.S. requirements applicable to the affiliate for transactions intermediated by the affiliate.	The U.S. swap dealer affiliate would comply with U.S. margin requirements, as established by the Commissions or the relevant prudential regulator.

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	country standards would constitute a violation of FRB requirements by the foreign bank.	country standards would constitute a violation of FRB requirements by the foreign bank.	country standards would constitute a violation of FRB requirements by the foreign bank. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.		
Financial and Operational Records (CEA § 4s(f)(1) / SEA § 15F(f)(1))[2]	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	The U.S. swap dealer affiliate would comply with Commission requirements. For the limited registration foreign bank swap dealer, if any, the Commissions would defer to comparable home country standards, and failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	The U.S. swap dealer affiliate would comply with Commission requirements.
Risk Management Procedures (including Business Continuity / Disaster Recovery) (CEA § 4s(j)(2) / SEA § 15F(j)(2))	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards.	Since these requirements are integrally related to capital adequacy and overall safety and soundness, the Commissions would defer to comparable home country standards.	The U.S. swap dealer affiliate would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational

[2] U.S. regulators would, in consultation with home country regulators, establish an allocation for the exercise of examination authority and access to financial, operational, and other supervisory information.

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	Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	structures that comport with home country standards that are comparable in objective to U.S. standards. For the limited registration foreign bank swap dealer, if any, the Commissions would defer to comparable home country standards, and failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	structures that comport with home country standards that are comparable in objective to U.S. standards.
Conflicts of Interest (including Information Barriers) (CEA § 4s(j)(5) / SEA § 15F(j)(5))	Where comparable (i.e., reasonably designed to achieve the same objectives), the Commissions would defer to home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Where comparable (i.e., reasonably designed to achieve the same objectives), the Commissions would defer to home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	Where comparable (i.e., reasonably designed to achieve the same objectives), the Commissions would defer to home country standards. Failure to comply with home country standards would constitute a violation of Commission rules by the foreign bank.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.
Position Limits / Monitoring of Trading (CEA §§ 4s(h)(1)(C) and (j)(1) / SEA §§ 15F(h)(1)(C) and (j)(1))	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in	The foreign bank would comply with Commission requirements, but these should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are

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	objective to U.S. standards.	objective to U.S. standards.	objective to U.S. standards.	objective to U.S. standards.	comparable in objective to U.S. standards.
Diligent Supervision (CEA § 4s(h)(1)(B) / SEA § 15F(h)(1)(B)) / Chief Compliance Officer (CEA § 4s(k) / SEA § 15F(k))	The branch/division that is involved in the execution of swaps with U.S. persons would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with these requirements. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs.	The U.S. branch would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the U.S. branch as responsible for complying with these requirements. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	The foreign bank, in conjunction with the U.S. FCM/Broker-dealer affiliate, would establish an integrated system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel at the foreign bank, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would establish a system for supervision of compliance with applicable U.S. requirements, including designation of supervisory personnel, but requirements should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.
Business Conduct Standards with Counterparties (CEA §§ 4s(h)(3), (4) and (5) / SEA §§ 15F(h)(3), (4) and (5))	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by U.S. branch personnel, and would not apply to transactions	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons	The U.S. swap dealer affiliate would comply with, and be responsible for, U.S. requirements as though it were	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by the U.S. swap dealer affiliate.

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	domiciled abroad. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	executed with non-U.S. persons by foreign bank personnel located outside the U.S. The foreign bank would designate the U.S. branch as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	domiciled abroad. The foreign bank would outsource the performance, but <u>not</u> responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.	the counterparty. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.	
Back Office / Documentation Standards (CEA § 4s(i) / SEA § 15F(i))[3]	U.S. requirements that apply to particular transactions/ counterparties (e.g., acknowledgement, confirmation, trading relationship documentation) would apply to transactions with U.S. persons, but should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with	U.S. requirements that apply to particular transactions/ counterparties (e.g., acknowledgement, confirmation, trading relationship documentation) would apply to transactions with U.S. persons, but should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with	U.S. requirements that apply to particular transactions/ counterparties (e.g., acknowledgement, confirmation, trading relationship documentation) would apply to transactions with U.S. persons, but should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.	The U.S. swap dealer affiliate would comply with Commission requirements, which should be flexible enough to accommodate group-structured systems, policies and procedures and different organizational structures that comport with home country standards that are comparable in objective to U.S. standards.

[3] To the extent that the Commissions adopt portfolio compression requirements pursuant to these provisions, we would regard those requirements, like risk management requirements, as integrally related to capital adequacy and overall safety and soundness. Accordingly, under this framework, the Commissions would defer to comparable home country standards designed to address the same objectives as the Commissions' portfolio compression requirements, and failure to comply with home country standards would constitute a violation of Commission rules.

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	home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with these requirements. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	home country standards that are comparable in objective to U.S. standards. The foreign bank would designate the U.S. branch as responsible for complying with these requirements. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	home country standards that are comparable in objective to U.S. standards. The foreign bank would outsource the performance, but not responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.		
Trading Records (CEA § 4s(g) / SEA § 15F(g))	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by U.S. branch personnel, and would not apply to transactions executed with non-U.S. persons by foreign bank personnel located outside the U.S. The foreign bank would designate the U.S. branch as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the U.S. branch where the relevant	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would outsource the performance, but not responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs. Books and records relevant to compliance with respect to all	The U.S. swap dealer affiliate would comply with, and be responsible for, U.S. requirements as though it were the counterparty. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by the U.S. swap dealer affiliate.

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	or enforcement relating to conduct associated with non-U.S. transactions.	customer-facing activity occurs.	activities conducted by the U.S. affiliate on behalf of the foreign bank swap dealer would be accessible in the U.S. With respect to the FCM/broker-dealer, Commission rules for FCMs/broker-dealers would apply.		
Segregation Requirements (CEA § 4s(l) / SEA § 3E(f))	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would designate the branch/division involved in the execution of swaps with U.S. persons as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the branch/division where the relevant customer-facing activity occurs. No U.S. examination of or enforcement relating to conduct associated with non-U.S. transactions.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by U.S. branch personnel, and would not apply to transactions executed with non-U.S. persons by foreign bank personnel located outside the U.S. The foreign bank would designate the U.S. branch as responsible for complying with such U.S. regulations applicable to its transactions with U.S. persons. Examination for compliance would occur at the U.S. branch where the relevant customer-facing activity occurs.	U.S. requirements would apply directly to transactions with U.S. persons, but would not apply to transactions with persons domiciled abroad. The foreign bank would outsource the performance, but not responsibility for due performance, of those requirements to the U.S. FCM/broker-dealer affiliate. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.[4]	The U.S. swap dealer affiliate would comply with, and be responsible for, U.S. requirements as though it were the counterparty. Examination for compliance would occur at the U.S. affiliate where the relevant customer-facing activity occurs.	U.S. requirements would apply to all transactions (with U.S. and non-U.S. persons) executed by the U.S. swap dealer affiliate.

[4] As discussed above, books and records relevant to compliance with respect to all activities conducted by the U.S. affiliate on behalf of the foreign bank swap dealer would be accessible in the U.S.

INSTITUTE OF INTERNATIONAL BANKERS

April 11, 2011

REGULATION AND SUPERVISION OF U.S. BRANCHES AND AGENCIES OF FOREIGN BANKS BY U.S. BANKING AUTHORITIES AND THE APPLICATION OF U.S. REGULATORY CAPITAL REQUIREMENTS TO SUCH BANKS

Banking organizations headquartered outside the United States ("foreign banks") conduct a substantial portion of their banking activities in the United States through branch offices of the bank[1] pursuant to licenses granted either by New York or one of the other states or, if the foreign bank so chooses, by the Office of the Comptroller of the Currency ("OCC").[2] In the aggregate, U.S. branches of foreign banks hold over $2 trillion of assets, accounting for approximately 15% of total banking assets in the United States.[3]

The discussion below summarizes key aspects of how U.S. branches of foreign banks are regulated and supervised in the United States as separately licensed offices of the banks, focusing in particular on the key role the Federal Reserve plays in this process. This brief review is followed by a discussion of how the Federal Reserve, in applying U.S. capital requirements to foreign banks that maintain U.S. branches, gives appropriate deference to home country standards while providing sufficient flexibility to ensure compliance with U.S. regulatory capital requirements in a manner that is consistent with national treatment.

The U.S. Bank Regulatory Approach to U.S. Branches as Separately Licensed Offices of Foreign Banks

U.S. branches are not separately capitalized entities, but their operations are separately examined by U.S. banking authorities and assigned supervisory "ROCA" ratings.[4] In addition,

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[1] Strictly speaking, foreign banks may establish "branches" and "agencies" in the United States, the principal difference between the two types of offices being that a "branch" is authorized to accept deposits from U.S. persons but an "agency" is not. Foreign banks conduct principally wholesale banking activities through their branches and agencies. The deposits of branches are not insured by the FDIC (with the exception of 8 foreign banks that are permitted, pursuant to "grandfather" authority granted under federal banking law, to maintain FDIC-insured branches subject to the same limits on deposit insurance coverage applicable to all other FDIC-insured depository institutions (according to the Federal Reserve data referenced in note 2 below, these grandfathered insured branches have less than $30 billion total assets in the aggregate)).

[2] According to the information most recently published by the Federal Reserve (reported as of September 30, 2010), there are 199 state-licensed foreign bank branches and agencies, 106 of which are licensed by the New York State Banking Department. According to information most recently published by the OCC (reported as of February 28, 2011), there are 51 federal branches and agencies, 35 of which are located in New York.

[3] According to the Federal Reserve data, state-licensed branches and agencies in the aggregate have total assets of approximately $1.89 trillion (of which $1.81 trillion is held by branches), and federal branches and agencies have total assets of approximately $140 billion (almost all of which is held by branches).

[4] The "ROCA" rating system consists of separate assessments of a branch's risk management, operations, compliance and asset quality, as well as an overall composite assessment of the branch.

U.S. branches maintain separate books and records in accordance with U.S. regulatory requirements and file with U.S. regulators quarterly reports of their assets and liabilities ("Call Reports").

In general, U.S. branches are limited to the same types of activities as are permissible for their U.S. domestic bank counterparts. Inasmuch as foreign banks' U.S. branches do not have their own capital, restrictions on such activities that are based on capital (for example, lending limits) are applied to branches by reference to the foreign bank's capital, as calculated under its home country standards.

U.S. regulators have the authority to take over and oversee the liquidation of the operations of U.S. branches. These proceedings are undertaken pursuant to so-called "ring-fencing" provisions whereby the assets of the branch are distributed first to satisfy the claims of creditors that have done business with the branch, with the balance, if any, then distributed to the appropriate authority in the foreign bank's home country.

Federal Reserve Regulation and Oversight of U.S. Branches of Foreign Banks

The Federal Reserve plays an especially important role in the regulation and oversight of foreign banks and their U.S. branches. Foreign banks seeking to enter the U.S. market through a branch are required to obtain the Federal Reserve's prior approval (as well as approval from the appropriate federal or state licensing authority). In reviewing an application to establish a branch, the Federal Reserve takes into account, among other considerations, the financial and managerial resources of the foreign bank, and the Federal Reserve may impose such conditions on its approval as it deems necessary.[5]

A key consideration in acting on an application to establish a U.S. branch is whether the foreign bank is subject to "comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country."[6] In addition, in the case of an application by a foreign bank that "presents a risk to the stability of the United States financial system," the Federal Reserve may consider "whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk."[7]

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5 See generally, 12 U.S.C. 3105(d).

6 See 12 U.S.C. 3105(d)(2)(A).

7 This factor was added by Section 173(a) of the Dodd-Frank Act, *codified at* 12 U.S.C. 3105(d)(3)(E).

The Federal Reserve considers a variety of factors in determining whether a foreign bank satisfies the "comprehensive consolidated supervision" ("CCS") requirement.[8] In the event the Federal Reserve is unable to find that a foreign bank meets the CCS requirement, the Federal Reserve nevertheless may permit the bank to establish a U.S. branch if it determines that "the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank."[9]

The Federal Reserve has the authority to examine each foreign bank's U.S. branch. In exercising this authority the Federal Reserve seeks to coordinate with the appropriate state or federal authority to the extent possible to reduce burden and avoid unnecessary duplication of examinations, and it may request that its examination be conducted simultaneously with that of the other appropriate examining authority.[10]

The Federal Reserve also has the authority to order a foreign bank to terminate the activities of its state-licensed branch upon its determination, after notice and an opportunity for a hearing and notice to the appropriate state bank supervisor, that there is reasonable cause to believe that the foreign bank, or any of its affiliates, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States.[11]

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[8] The relevant provisions of the Federal Reserve's Regulation K (12 C.F.R. 211.24(c)(1)(ii)) provides that in making a CCS determination, the Federal Reserve shall assess, among other factors, the extent to which the foreign bank's home country supervisor:

(A) Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;

(B) Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;

(C) Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;

(D) Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis;

(E) Evaluates prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.

[9] See 12 U.S.C. 3105(d)(6)(A)(i)).

[10] See generally, 12 U.S.C. 3105(c)(1).

[11] See 12 U.S.C. 3105(e)(1)(B). In addition, in the case of a foreign bank that "presents a risk to the stability of the United States financial system," the Federal Reserve may order the bank to terminate the activities of its state-licensed branch if the Federal Reserve finds that "the home country of the foreign bank has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk." (This latter authority was added by Section 173(b) of the Dodd-Frank Act, *codified at* 12 U.S.C. 3105(e)(1)(C).) In the case of a federal branch, the Federal Reserve is authorized to recommend to the OCC that it terminate the license of the federal branch on the basis of the same types of concerns that can trigger termination of a state-licensed branch's activities.

Federal Reserve Regulation and Oversight of Foreign Banks' U.S. Operations – Application of Capital Requirements to Foreign Banks That Maintain U.S. Branches

The Federal Reserve exercises broad regulatory and oversight authority over not only the operations of foreign banks' U.S. branches, but also their overall U.S. operations, both banking and nonbanking.[12] Consistent with the international framework for the supervision of cross-border banking activities, this approach reflects the understanding that foreign banks are subject to primary supervision by their home country authorities, with the Federal Reserve, as a host country supervisor, exercising appropriate oversight of their U.S. operations.

A foreign bank that maintains a U.S. branch is treated as a bank holding company and as such is subject to the requirements of the Bank Holding Company Act ("BHC Act"), including its activity restrictions, "in the same manner and to the same extent that bank holding companies are subject to such provisions."[13] Dating to the International Banking Act of 1978, the policy of national treatment has been the guiding principle for implementing these requirements. This principle calls for "parity of treatment between [foreign and U.S. banks] in like circumstances,"[14] but it is recognized that parity of treatment does not mean identical treatment. Instead, national treatment is accomplished by applying the requirements applicable to U.S. banking organizations in a manner that appropriately takes into account the differences resulting from foreign banks' operating in the United States through U.S. branches.

The practical consequences of implementing the national treatment principle are well illustrated by the approach taken by the Federal Reserve when applying U.S. regulatory capital requirements to foreign banks that maintain U.S. branches. This approach recognizes that (i) a U.S. branch does not maintain its own capital and (ii) the foreign bank itself is subject to capital requirements prescribed by its home country authority. In the case of a foreign bank whose home country applies capital standards consistent with those adopted by the Basel Committee on Banking Supervision (the "Basel Committee"),[15] the bank's capital as calculated under those standards is accepted as the starting point for the U.S. regulatory assessment.[16] In the case of banks that are subject to Basel II's requirements, this assessment takes into account any

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12 See, e.g., "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations," Federal Reserve Supervision and Regulation Letter 08-9 (October 16, 2008).

13 See 12 U.S.C. 3106(a).

14 S. Rep. No. 1073, 95th Cong. 2d Sess. 2, reprinted in 1978 U.S. Code Cong. and Admin. News 1421, 1422.

15 In its 2010 survey of countries around the world to measure the progress that has been made with respect to implementation of the revised international capital accords adopted by the Basel Committee in 2006 ("Basel II") the Financial Stability Institute found that 112 of the 133 countries responding to the survey have implemented or are currently planning to implement Basel II. See "2010 FSI Survey on the Implementation of the New Capital Adequacy Framework," *Occasional Paper No. 9* (August 2010).

16 See, e.g., 12 C.F.R. 225.2(r)(3)(i)(A).

transitional provisions implemented by the home country. If a foreign bank's home country has not adopted capital standards consistent with the Basel Committee's standards, then the foreign bank, rather than being able simply to utilize the ratios calculated under the home country standard as the basis for the U.S. regulatory assessment, is subject to a finding by the Federal Reserve that its capital is equivalent to the capital that would be required of a U.S. banking organization.[17] That finding, however, is based on the assessment of the home country standards and does not call for the foreign bank to calculate its capital using U.S. standards.

Thus, the analysis of a foreign bank's capital properly takes as its starting point the standards of the bank's home country and then undertakes to assess how those standards compare to the standards applicable to U.S. banking organizations under U.S. requirements. This approach neither gives complete deference to home country capital requirements nor requires a foreign bank strictly to abide by each of the U.S. requirements or to calculate its capital pursuant to U.S. rules.

The purpose of the analysis is not to force the foreign bank to conform its capital to U.S. requirements, but instead to determine whether the foreign bank's capital as calculated under its home country requirements is sufficiently equivalent or comparable to that applicable to a similarly situated U.S. banking organization. Consistent with national treatment, this approach recognizes that for U.S. regulatory purposes there is no need to ascertain whether home country requirements are identical to those of the United States. This approach provides the Federal Reserve flexibility in making determinations regarding foreign banks' capital without imposing on foreign banks any requirement to apply U.S. standards in calculating their capital ratios.

For example, one of the requirements applicable to a U.S. bank holding company that elects to operate as a financial holding company ("FHC"), and thereby engage in the expanded securities underwriting and dealing, merchant banking, insurance and other nonbank financial activities that are permissible for FHCs under the BHC Act (as amended by the Gramm-Leach-Bliley Act), is that each of its insured depository institution subsidiaries be maintained in a "well capitalized" condition.[18] To be well capitalized, each such subsidiary must have risk-based tier 1 and total risk-based capital ratios equal to at least 6% and 10%, respectively. In the case of determining whether a foreign bank that maintains a U.S. branch is well capitalized for FHC purposes, Section 4(l)(3) of the BHC Act requires the Federal Reserve to apply "comparable" standards, "giving due regard to the principle of national treatment and equality of competitive opportunity."[19]

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[17] See, e.g., 12 C.F.R. 225.2(r)(3)(i)(B).

[18] See 12 U.S.C. 1843(l)(1)(A). Section 606(a) of the Dodd-Frank Act added the new requirement that the bank holding company itself also satisfy the FHC "well capitalized" requirement. As discussed in the text below, in the case of a foreign bank that is treated as a bank holding company because it maintains a U.S. branch the FHC well capitalized requirement already applies to the foreign bank itself.

[19] See 12 U.S.C. 1843(l)(3).

In implementing the provisions of Section 4(l)(3) with respect to a foreign bank whose home country has adopted risk-based capital standards consistent with those prescribed by the Basel Committee, the Federal Reserve requires the foreign bank to meet the 6%/10% minimum risk-based capital requirement applicable to domestic FHCs, but this determination is based on the bank's risk-based capital ratios as calculated under its home country standards.[20] In addition, the foreign bank's capital must be comparable to the capital required for a U.S. bank owned by an FHC.[21] If the foreign bank's home country has not adopted capital standards consistent with those of the Basel Committee, then the bank must obtain a determination from the Federal Reserve that its capital (as calculated under home country standards) is otherwise comparable to the capital that would be required of a U.S. bank owned by an FHC.[22] For purposes of assessing comparability, the Federal Reserve may consider additional factors, including the composition of the foreign bank's capital, the ratio of the foreign bank's tier 1 capital to total assets ("leverage ratio"), home country accounting standards, the foreign bank's long-term debt ratings, its reliance on government support to meet capital requirements and whether it is subject to comprehensive supervision or regulation on a consolidated basis.[23]

Thus, consistent with national treatment, the approach taken by the Federal Reserve with respect to assessing the capital of foreign bank FHCs that maintain U.S. branches gives appropriate deference to home country standards while providing sufficient flexibility to ensure compliance with the U.S. "well capitalized" regulatory requirement.

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20 See 12 C.F.R. 225.90(b)(1)(i) and (ii).

21 See 12 C.F.R. 225.90(b)(1)(iii). .

22 See 12 C.F.R. 225.90(b)(2)

23 See 12 C.F.R. 225.92(e).