

Client Alert

Latham & Watkins
Corporate Department

Federal Reserve Releases Proposed Rules for Enhanced Prudential Standards for Foreign Banking Organizations

"The proposed rules reflect a significant and controversial shift by the Federal Reserve away from tolerance of diverse organizational structures with deference to comparable home-country standards and towards a more uniform structure for US operations of large foreign banking organizations."

This *Client Alert* provides an overview and summary of key requirements of the proposed rules issued on December 14, 2012 by the Board of Governors of the Federal Reserve System (Federal Reserve) to implement the enhanced prudential standards and early remediation requirements of Section 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for foreign banking organizations¹ and foreign nonbank financial companies designated for supervision by the Federal Reserve (FBO Proposal). The FBO Proposal follows from the December 2011 proposed rules to implement the Section 165 and 166 requirements applicable to US bank holding companies with consolidated assets of \$50 billion or more and certain nonbank financial firms (Domestic 165/166 Proposal) and the recent speech by Federal Reserve Governor Daniel Tarullo outlining the anticipated approach to supervision of the US operations of large foreign banking organizations.

Summary

The FBO Proposal reflects a significant and controversial shift by the Federal Reserve away from tolerance of diverse organizational structures with deference to comparable home-country standards and towards a more uniform structure for US operations of large foreign banking organizations. Stopping short of a full subsidiarization approach, the FBO Proposal adopts a tiered approach to enhanced prudential standards, with the expressed intent of imposing the most stringent requirements on foreign banking organizations perceived to pose the greatest risk to the financial stability of the United States.²

In a deliberate move away from its case-by-case supervisory approach towards foreign banking organizations, under the FBO Proposal the Federal Reserve would require all FBOs with global consolidated assets of \$50 billion or more and combined US assets of \$10 billion or more (excluding any assets held by US agencies or branches) to create a United States intermediate holding company (US IHC) and organize all of its US subsidiaries³ under the US IHC. The US IHC would be the parent entity for businesses such as SEC registered broker-dealers, state regulated insurance subsidiaries and national and state bank subsidiaries. Branches and agencies of the foreign banking organization would remain outside the IHC, but certain enhanced prudential standards will apply to the FBO branch and agency network in the United States as well.

In addition to the US IHC requirement and consistent with the Domestic 165/166 Proposal, the FBO Proposal would apply enhanced prudential standards to large foreign banking organizations in the following areas:

- **Risk-based Capital Requirements and Leverage Limits:** US IHCs would be subject to the same risk-based and leverage capital standards applicable to US bank holding companies. US IHCs with \$50 billion or more in consolidated assets would also be subject to the Federal Reserve's capital plan rule. US branch and agency networks of FBOs with \$50 billion or more in consolidated assets would be allowed to continue to meet US capital equivalency requirements at the consolidated level by virtue of the parent bank meeting home country capital adequacy standards that are consistent with the Basel capital framework.
- **Liquidity Requirements:** The US operations of FBOs with combined US assets of \$50 billion or more would be required to meet enhanced liquidity risk-management standards, conduct liquidity stress tests, and hold a 30-day buffer of highly liquid assets. The 30-day liquidity buffer applies separately to each of the US IHC and the US branch and agency network.
- **Single Counterparty Credit Limits:** FBOs with \$50 billion or more in total global consolidated assets would be required to limit their net credit exposure to a single unaffiliated counterparty to 25 percent of the covered company's capital stock and surplus. The 25 percent limit would apply to the US IHC as well as the combined US operations of the FBO.
- **Risk Management and Risk Committee Requirements:** A publicly traded FBO with total global consolidated assets of \$10 billion or more would be required to maintain a US risk committee. Regardless of whether its stock is publicly traded, an FBO with combined US assets of \$50 billion or more would, in addition, be required to appoint a US chief risk officer and implement enhanced risk management requirements.
- **Stress Test Requirements:** US IHCs would be subject to the Federal Reserve's stress testing rules as if it were a US bank holding company. Depending on the size of the US IHC, different stress test requirements would apply. Certain stress testing requirements would also apply to the US branch and agency network of FBOs.
- **Debt-to-Equity Limits for Certain Covered Companies:** If an FBO with \$50 billion or more in total global consolidated assets is determined to pose a grave threat to the financial stability of the United States, the US IHC may be required to maintain a debt to equity ratio of no more than 15-to-1.
- **Early Remediation Framework:** The combined US operations of an FBO would be subject to early remediation triggers based on capital ratios, stress test results, market indicators, and liquidity and risk management weaknesses. Early remediation actions automatically apply to an FBO with combined US assets of \$50 billion or more that breaches a stated trigger.

The FBO Proposal includes more than 100 specific questions inviting comment on a wide range of issues, including threshold questions such as whether the FBO Proposal should (i) be further tailored to accommodate the structural and regulatory idiosyncrasies of foreign banking organizations, (ii) draw further distinctions among foreign banking organizations depending on the size, scope and complexity of the organization, (iii) adopt different liquidity frameworks for the IHC as compared

to the US branch and agency network, including with respect to the location and currency of the buffer amount, and (iv) provide further guidance on the liquidity buffer, including any limitations on its use. Comments on the Domestic 165/166 Proposal are currently under consideration and the Federal Reserve expects to conform the FBO Proposal to the Domestic 165/166 Proposal where appropriate in response to comments already received. The Federal Reserve is also conducting a review of existing supervisory guidance to identify guidance that may be relevant to the operations and activities of a US IHC and intends to revise and reissue or publish notifications that reference applicable guidance. Comments on the FBO Proposal are due by March 31, 2013.

Scope of Applicability and Effective Date

The FBO Proposal generally applies to FBOs with total global assets of \$50 billion or more, as well as to any foreign non-bank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve (no such designations have been made to date); although, as described below, some aspects of the FBO Proposal would apply at lower thresholds.

The FBO Proposal provides for an extended phase-in period to allow FBOs time to implement the proposed requirements. Most of the enhanced prudential standards required under the FBO Proposal would become effective July 1, 2015 for organizations that meet the thresholds as of July 14, 2014. Stress test requirements and the capital plan rule would be applied in October of the year following the year in which the FBO is required to establish a US IHC. The proposed debt-to-equity ratio limitation would apply beginning on the effective date of the final rule.

Once subject to the requirements set forth in the FBO Proposal, a foreign banking organization will remain subject to them unless and until the FBO's assets remain below the relevant asset threshold for four consecutive calendar quarters.

See Chart 1 ("Scope of Application for FBOs" from the FBO Proposal) for a summary of the applicability of the proposed enhanced prudential requirements based on relevant asset size thresholds.

Intermediate Holding Company Requirement

FBOs with global consolidated assets of \$50 billion or more and combined US assets of \$10 billion or more (excluding any assets held by US agencies or branches) would be required to create a US intermediate holding company and organize all of its US subsidiaries⁴ under the US IHC. The US IHC would be subject to the FBO Proposal's enhanced prudential standards and remediation requirements on a consolidated basis. In addition, the US IHC would be subject to comparable regulatory reporting requirements and inspection requirements to those that apply to a US bank holding company. US branches and agencies of FBOs would not be part of the US IHC as they are not separate corporate entities from the foreign bank.

A foreign banking organization required to form a US IHC would be required to hold its interest in any US subsidiary through the US IHC. There is a limited exception for interests held in foreign commercial firms that conduct some business in the United States (the section 2(h)(2) company exception). The Proposed Rule also contemplates that the Federal Reserve may permit an FBO to establish multiple US IHCs or use an alternative organizational structure to hold its US subsidiaries.

Risk-Based Capital Requirements and Leverage Limits

US IHCs would be subject to the same risk-based capital and leverage standards applicable to US bank holding companies. An FBO with total global consolidated assets of \$50 billion or more would be required to certify that it meets capital adequacy standards established by its home country supervisor on a consolidated basis and that those standards are consistent with the Basel Capital Framework.⁵ If the Federal Reserve determined that an FBO required to make such a certification does not meet capital adequacy standards, the Federal Reserve may impose conditions or restrictions on the US operations of the FBO.

The Board may also, through a separate, future rulemaking, apply a quantitative risk-based capital surcharge in the United States to a US IHC that is determined to be a domestic systemically important banking organization (D-SIB), consistent with the Basel Committee on Banking Supervision (BCBS) regime or similar framework. In addition, through another separate rulemaking process, the Federal Reserve may introduce a consolidated capital surcharge certification requirement for an FBO that maintains US operations and that has been designated by the BCBS as a global systemically important banking organization (G-SIB).

Under the FBO Proposal, a US IHC with total consolidated assets of \$50 billion or more would be subject to the Federal Reserve's capital plan rule governing capital distributions.⁶ The capital plan rule would require US IHCs to submit annual capital plans to the Federal Reserve which demonstrates an ability to maintain capital above the Federal Reserve's minimum risk-based capital and leverage ratios under both baseline and stressed conditions. Capital distributions would be prohibited until a satisfactory capital plan is submitted to and accepted by the Federal Reserve.

The FBO Proposal would not impose capital requirements on the US branch and agency networks of foreign banking organizations, but instead would allow them to continue to meet US capital equivalency requirements at the consolidated level. The proposal would require an FBO with a branch or agency in the United States to certify that it meets on an ongoing basis home country capital adequacy standards that are consistent with the Basel Capital Framework.

Liquidity Requirements

An FBO with combined US assets of \$50 billion or more must meet liquidity requirements that are largely similar to the requirements for domestic institutions under the Domestic 165/166 Proposal. The US operations of such an FBO would be required to meet liquidity risk management standards, conduct liquidity stress tests, and maintain a 30-day buffer of highly liquid assets.

Liquidity risk management rules would require an FBO to adopt specific corporate governance practices regarding liquidity risk management, project cash flow needs over various time horizons, develop specific limits related to liquidity metrics, and maintain a contingency funding plan, all with respect to its combined US operations.

The FBO Proposal would require subject FBOs with combined US assets of \$50 billion or more to conduct internal liquidity stress tests and maintain separate 30-day liquidity buffers consisting of "highly liquid assets" for the US branch and agency network and for the US IHC. The US branches and agencies of affected FBOs would be required to maintain the first 14 days of such buffer in the United States, with the remainder of the 30-day buffer permitted to be held at the parent consolidated level, subject to satisfying certain conditions. The full amount of the 30-day buffer for a US IHC would be required to be held in the United States.

For FBOs subject to liquidity stress test requirements but with combined US assets of less than \$50 billion, the results of the internal liquidity stress test (performed either on a consolidated basis or for combined US operations) would be required to be reported to the Federal Reserve on an annual basis. Failure to meet this requirement would subject the FBO to intragroup funding restrictions.

The Federal Reserve anticipates future rulemakings to implement the Basel III quantitative liquidity standards for the US operations of FBOs with \$50 billion or more in combined US assets.

Single Counterparty Credit Limits

The FBO Proposal establishes a two-tier single counterparty credit limit for the US operations of FBOs with \$50 billion or more in total global consolidated assets. The FBO Proposal sets a general limit of 25 percent of the covered company's capital stock and surplus for the aggregate net credit exposure to a single unaffiliated counterparty and would apply to the US IHC as well as the combined US operations of the FBO. A more stringent limit would be established for US IHCs with total consolidated assets of \$500 billion or more and foreign banking organizations with total global consolidated assets of \$500 billion or more with exposures to "major counterparties" (defined to include any bank holding company or foreign banking organization that is or is treated as a bank holding company with total consolidated assets of \$500 billion or more and any nonbank company designated for supervision by the Federal Reserve). These limits are expected to be consistent with the limits established for major US bank holding companies and major US nonbanking financial companies in the Domestic 165/166 Proposal.

The credit exposure limit is calculated under the FBO Proposal based on the capital stock and surplus of the US IHC and the foreign banking organization, respectively. Under the proposed rule, capital stock and surplus of a US IHC is the sum of the company's total regulatory capital as calculated under the risk-based capital adequacy guidelines applicable to that US IHC and the balance of the allowance for loan and lease losses of the US IHC not included in Tier 2 capital under the capital adequacy guidelines of the FBO Proposal. In light of differences in international accounting standards, the capital stock and surplus of a foreign banking organization would not reflect the balance of the allowance for loan and lease losses not included in Tier 2 capital. Instead, the term would be defined to include the total regulatory capital of such company on a consolidated basis, as determined in accordance with the FBO Proposal.

The FBO Proposal sets forth the types of transactions that are subject to the single counterparty credit limits and prescribes methods for measuring gross credit exposure and net credit exposure resulting from such transactions. It should be noted that the methods for calculating credit exposures from various types of transactions for purposes of the single counterparty credit limit is not completely consistent with the methods for calculating credit exposures arising from such transactions for other regulatory purposes, such as the OCC lending limit regulations.

All limits include exposures to foreign sovereign governments and US state and local governments, except that exposures to the US federal government (including US federal agencies and Fannie Mae and Freddie Mac while in conservatorship) or an FBO's home country sovereign would be exempt from the single counterparty limits.

Risk Management and Risk Committee Requirements

A publicly-traded FBO with total global consolidated assets of \$10 billion or more would be required to certify that it maintains a US risk committee that has at least one member with appropriate risk expertise. An FBO with combined US assets of \$50 billion or more would be subject to these requirements regardless of whether its stock is publicly traded, and such larger FBOs would also be subject to additional US risk committee requirements, including that at least one member of the committee be independent. Such FBOs would also be required to appoint a US chief risk officer employed by a US subsidiary or US office of the FBO. Among other requirements, the US chief risk officer would be required to meet certain standards for risk management expertise.

Stress Test Requirements

US IHCs would be subject to the Federal Reserve's stress testing rules as if it were a US bank holding company. A US IHC with total consolidated assets of greater than \$10 billion, but less than \$50 billion, would be required to perform annual company-run stress tests in accordance with standards established in the Dodd-Frank Act (as set forth in subpart H of the Federal Reserve's Regulation YY). US IHCs with total consolidated assets of \$50 billion or more would be subject to the Dodd-Frank Act requirement for both annual supervisory stress tests and semi-annual company-run stress tests (as implemented in subparts F and G of Regulation YY).

The FBO Proposal takes a different approach with respect to US branches and agencies since they are not separate legal entities. Accordingly, FBOs with total consolidated assets of more than \$10 billion but combined US assets of less than \$50 billion would be required to be subject to a home country stress testing regime that is broadly consistent with the Federal Reserve's stress testing regime for US bank holding companies. For FBOs with combined US assets of \$50 billion or more, the FBO must submit a summary of the annual home country stress test results for the consolidated company. If the US branch and agency network of an FBO with combined US assets of \$50 billion or more is in a net due from position to the FBO parent or its non-US affiliates, the FBO would be required to provide additional, more detailed information regarding its annual consolidated stress test. If there is not an adequate home country stress testing regime or the FBO does not otherwise meet the stress testing requirements, the FBO would be subject to additional requirements, such as asset maintenance requirements applied to its US branches and agencies.

Debt-to-Equity Limits

The FBO Proposal would implement Section 165(j) of the Dodd-Frank Act, which directs the Federal Reserve to require FBOs with \$50 billion or more in total global consolidated assets to maintain a debt-to-equity ratio of no more than 15-to-1 upon the determination by the Financial Stability Oversight Council that the FBO poses a grave threat to the financial stability of the United States and the imposition of such limits is necessary to mitigate that risk. Under the FBO Proposal, in such circumstances the 15-to-1 debt-to-equity limitation would be applied to the US IHC. In addition, the FBO Proposal would impose a 108 percent asset maintenance requirement on an FBO's US branch and agency network, if applicable.

Early Remediation Framework

The combined US operations of an FBO would be subject to early remediation triggers based on capital ratios, stress test results, market indicators, and liquidity and risk management weaknesses. An FBO with combined US assets of \$50 billion or more that exceeds an early remediation trigger would be subject to a set of remediation actions on its US operations. FBOs with combined US assets of less than \$50 billion would not be automatically subject to remediation actions, but instead would be subject to a more tailored approach.

See Chart 2 (“Early Remediation Triggers for FBOs” from the FBO Proposal) for a summary of the early remediation triggers for each level of remediation. See Chart 3 (“Early Remediation Actions for FBOs” also from the FBO proposal) for a summary of the early remediation actions for each level of remediation.

The FBO Proposal establishes four levels of remediation:

- *Level 1: Heightened supervisory review* in which there is a review of the FBO’s US operations to determine if it should be moved to the next level of remediation.

The US operations of a foreign banking organization would be subject to Level 1 remediation if the Federal Reserve determined that the capital position of the foreign banking organization or the US IHC were not commensurate with the level and nature of the risks to which it is exposed in the United States. In addition, Level 1 remediation would be triggered if the US IHC of a foreign banking organization fell out of compliance with the capital plan rule or if the US IHC is not in compliance with the proposed rules regarding stress testing. If the Federal Reserve determines that the US operations of a foreign banking organization have failed to comply with applicable enhanced risk management requirements, the US operations of the foreign banking organization would be subject to Level 1, Level 2 or Level 3 remediation, depending on the severity of the compliance failure. Market indicators may also be used to trigger Level 1 remediation.

The first level of remediation for the US operations of FBOs with combined US assets of \$50 billion or more would consist of heightened supervisory review of the US operations, including whether the US operations are experiencing financial distress or material risk management weaknesses.

- *Level 2: Initial remediation*, in which an FBO’s US operations are subject to initial remediation, such as restrictions on growth and capital distributions.

The US operations of a foreign banking organization would be subject to Level 2 remediation when (i) any risk-based capital ratio of the foreign banking organization or the US IHC fell below a specified threshold above the minimum applicable risk-based capital requirements⁷, (ii) any applicable leverage ratio of the foreign banking organization or the US IHC fell below a specified threshold above the minimum applicable leverage requirements or (iii) if the results of a supervisory stress test of its US IHC reflect a Tier 1 common risk-based capital ratio of less than 5 percent under the severely adverse scenario during any quarter of the nine-quarter planning horizon.

The Dodd-Frank Act provides that remedial actions of companies in the initial stages of financial decline must include limits on capital distributions, acquisitions, and asset growth. The FBO Proposal would implement these remedial actions for the US operations of foreign banking organizations with combined US assets of \$50 billion or more that have breached a Level 2 trigger by imposing limitations on its US IHC, its US branch and agency network, and its combined US operations.

Upon a Level 2 trigger event, the US IHC would be prohibited from making capital distributions in any calendar quarter in an amount that exceeded 50 percent of the average of its net income for the preceding two calendar quarters. While in Level 2 remediation, the US branch and agency network would be required to remain in a net due to position to the foreign banking organization's non-US offices and to non-US affiliates. The US branch and agency network would also be required to maintain a liquid asset buffer in the United States sufficient to cover 30 days of stressed outflows. In addition, the US operations of the foreign banking organization in Level 2 remediation would be subject to growth limitations. The FBO would also be prohibited, without prior Federal Reserve approval, from establishing a new branch, agency, or representative office in the United States; engaging in any new line of business in the United States; or directly or indirectly acquiring a controlling interest in any company that would be required to be a subsidiary of a US IHC.

- *Level 3: Recovery*, in which an FBO's US operations are subject to a prohibition on growth and capital distributions, restrictions on executive compensation, requirements to raise additional capital, and additional requirements as necessary.

The US operations of a foreign banking organization would be subject to Level 3 remediation where (i) for two complete consecutive quarters, any risk-based capital ratio or leverage ratio of the foreign banking organization or the US IHC fell below a specified threshold above the minimum applicable risk-based capital ratios or any minimum applicable leverage ratio, as the case may be (ii) any risk-based capital ratio or leverage ratio of the foreign banking organization or the US IHC fell below the minimum applicable risk-based capital ratio or leverage ratio or (iii) if the results of a supervisory stress test of its US IHC reflect a Tier 1 common risk-based capital ratio of less than 3 percent, under the severely adverse scenario during any quarter of the nine-quarter planning horizon.

The Dodd-Frank Act provides that remediation actions for companies in later stages of financial decline must include a capital restoration plan and capital raising requirements, limits on transactions with affiliates, management changes and asset sales. In Level 3 remediation, the FBO and its US IHC would be required to enter into a written agreement or other formal enforcement action with the Federal Reserve. If the company fails to satisfy the requirements of the written agreement, the company may be required to divest assets. The US IHC and other US subsidiaries of a foreign banking organization also would be prohibited from making capital distributions. An FBO in Level 3 remediation would also be subject to growth and new business limitations with respect to its combined US operations. In addition, the FBO and its US IHC would not be able to increase the compensation of, or pay any bonus to, an executive officer whose primary responsibility pertains to any part of the combined US operations or any member of the board of directors (or its equivalent) of the US IHC and may also be required to replace the US IHC's board of directors, or dismiss or replace US senior executive officers. Furthermore, the foreign banking organization would be required to cause its US branch and agency network to remain in a net due to position with respect to the FBO's non-US offices and non-US affiliates and would be subject to asset maintenance requirements.

- *Level 4: Recommended resolution*, in which case the Federal Reserve would consider whether the US operations of the FBO warrant termination or resolution.

For the US operations of a foreign banking organization, the Level 4 trigger would be breached where the FBO or US IHC's risk-based capital ratios or leverage ratios fell below a specified threshold of the applicable minimum risk-based capital ratios or leverage requirements, as the case may be.

Under the FBO Proposal, if Level 4 remediation is triggered, the Federal Reserve would consider whether the combined US operations of the FBO warrant termination

or resolution based on the financial decline of the combined US operations, the considerations relevant to systemic risk determinations under the Dodd-Frank Act, or any other relevant factor. If such a determination is made, the Federal Reserve will take actions that include recommending to the appropriate financial regulatory agencies that an entity within the US branch and agency network be terminated or that a US subsidiary be resolved.

Conclusion

While stopping short of a full subsidiarization approach, the FBO Proposal reflects a significant and controversial shift by the Federal Reserve away from its traditional approach of structural flexibility and deference to comparable home-country standards. The FBO Proposal is in many respects consistent with the Domestic 165/166 Proposal, but it reflects a significant change in the Federal Reserve's approach to regulating foreign banking organizations. Foreign banking organizations should consider whether the requirements under the FBO Proposal can be satisfied under their current organizational structure and whether their home-country supervisor will accommodate changes that need to be made to comply with the FBO Proposal. The requirements imposed by the FBO proposal are likely to increase costs and create capital inefficiencies for FBOs that may have a significant impact on the scope and appeal of cross-border banking. FBOs and other interested parties are encouraged to comment on the FBO Proposal so that the Federal Reserve is aware of the practical and legal challenges that FBOs will face in implementing and operating under the requirements in the proposed regulations.

Endnotes

- ¹ For purposes of the FBO Proposal, a foreign banking organization, or FBO, is a foreign bank that has a banking presence in the United States by virtue of operating a branch, agency, or commercial lending company subsidiary in the United States or controlling a bank in the United States, or any company of which the foreign bank is a subsidiary.
- ² The Institute of International Bankers recently estimated that the FBO Proposal would apply to approximately 107 foreign banking organizations (each with \$50 billion or more of total *global consolidated assets*) and more stringent standards would apply to approximately 23 foreign banking organizations (each with combined *US assets* of \$50 billion or more).
- ³ "Subsidiary" is defined using the Bank Holding Company Act (BHC Act) definition of "control." Under the BHC Act, "control" of a company means: (i) directly or indirectly owning, controlling, or having the power to vote 25 percent or more of any class of voting securities of the company; (ii) controlling the election of a majority of the directors or trustees of a company; or (iii) directly or indirectly exercising a controlling influence over the management or policies of the company, as determined by the Federal Reserve.
- ⁴ As described in note 1 above, "subsidiary" is defined using the BHC Act definition of "control".
- ⁵ The FBO Proposal notes that the US leverage ratio would not apply to an FBO at the consolidated level. However, once the international leverage ratio as set forth in Basel III is implemented (currently expected in 2018), FBOs with \$50 billion or more in total global consolidated assets would be required to comply with the international leverage ratio as implemented by their home country supervisor consistent with the Basel Capital Framework.
- ⁶ 12 CFR 225.8
- ⁷ For a foreign banking organization, the applicable level of risk-based capital ratios and minimum leverage ratio would be those established by the Basel III Accord, including relevant transition provisions, calculated in accordance with home country standards that are consistent with the Basel Capital Framework. As proposed, a US IHC's minimum risk-based capital ratios and leverage ratios would be the same as those that apply to US bank holding companies.
- ⁸ Foreign banking organizations with assets of \$500 billion or more and US IHCs with assets of \$500 billion or more would be subject to stricter limits.

Chart 1: Scope of Application for FBOs

Global Assets	US Assets	Summary of Requirements That Apply
> \$10 billion and < \$50 billion	N/A	<ul style="list-style-type: none"> • Have a US risk committee • Meet home country stress test requirements that are broadly consistent with US requirements
> \$50 billion	< \$50 billion	<p>All of the above, plus:</p> <ul style="list-style-type: none"> • Meet home country capital standards that are broadly consistent with Basel standards • Single-counterparty credit limits⁸ • Subject to an annual liquidity stress test requirement • Subject to Dodd-Frank Act section 166 early remediation requirements • Subject to US IHC requirements: <ul style="list-style-type: none"> ○ Required to form US IHC if non-branch US assets exceed \$10 billion. All US IHCs are subject to US bank holding company capital requirements ○ US IHC with assets between \$10 and \$50 billion subject to Dodd-Frank Act Stress Testing Rule (company-run stress test)
> \$50 billion	> \$50 billion	<p>All of the above, plus:</p> <ul style="list-style-type: none"> • US IHC with assets > \$50 billion subject to capital plan rule and all Dodd-Frank Act stress test requirements (CCAR) • US IHC and branch/agency network subject to monthly liquidity stress tests and in-country liquidity requirements • Must have a US risk committee and US Chief Risk Officer • Subject to nondiscretionary Dodd-Frank Act section 166 early remediation requirements

Source: FBO Proposal

Chart 2: Early Remediation Triggers for Foreign Banking Organizations

	Risk-Based Capital/Leverage (US IHC)	Risk-Based Capital/Leverage (Parent)	Stress Tests (US IHC)	Enhanced Risk Management and Risk Committee Standards (US combined operations)	Enhanced Liquidity Risk Management Standards (US combined operations)	Market Indicators (Parent or US IHC as applicable)
Level 1 (Heightened Supervisory Review [HSR])	<p>The firm has demonstrated capital structure or capital planning weaknesses, even though the firm:</p> <ul style="list-style-type: none"> • Maintains risk-based capital ratios that exceed all minimum risk-based and requirements established under subpart L by [200-250] basis points or more; or • Maintains applicable leverage ratio(s) that exceed all minimum leverage requirements established under subpart L by [75-100] basis points or more. 	<p>The firm has demonstrated capital structure or capital planning weaknesses, even though the firm:</p> <ul style="list-style-type: none"> • Maintains risk-based capital ratios that exceed all minimum risk-based and requirements established under subpart L by [200-250] basis points or more; or • Maintains an applicable leverage ratio that exceed all minimum leverage requirements established under subpart L by [75-100] basis points or more. 	<p>The firm does not comply with the Board's capital plan or stress testing rules, even though regulatory capital ratios exceed minimum requirements under the supervisory stress test severely adverse scenario.</p>	<p>Firm has manifested signs of weakness in meeting enhanced risk management or risk committee requirements.</p>	<p>Firm has manifested signs of weakness in meeting the enhanced liquidity risk management standards.</p>	<p>The median value of any market indicator over the breach period crosses the trigger threshold.</p>
Level 2 (Initial remediation)	<ul style="list-style-type: none"> • Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or • Any leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L. 	<ul style="list-style-type: none"> • Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or • Any applicable leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L. 	<p>Under the supervisory stress test severely adverse scenario, the firm's <u>Tier 1 common risk-based capital ratio falls below 5%</u> during any quarter of the nine quarter planning horizon.</p>	<p>Firm has demonstrated multiple deficiencies in meeting the enhanced risk management and risk committee requirements.</p>	<p>Firm has demonstrated multiple deficiencies in meeting the enhanced liquidity risk management standards.</p>	N/A
Level 3 (Recovery)	<ul style="list-style-type: none"> • Any risk-based capital ratio is less than a minimum applicable risk-based capital requirement established under subpart L; or • Any applicable leverage ratio is less than a minimum applicable leverage requirement established under subpart L. <p>Or for two complete consecutive calendar quarters:</p> <ul style="list-style-type: none"> • Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or • Any leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L. 	<ul style="list-style-type: none"> • Any risk-based capital ratio is less than a minimum applicable risk-based capital requirement established under subpart L; or • Any applicable leverage ratio is less than a minimum applicable leverage requirement established under subpart L. <p>Or for two complete consecutive calendar quarters:</p> <ul style="list-style-type: none"> • Any risk-based capital ratio is less than [200-250] basis points above a minimum applicable risk-based capital requirement established under subpart L; or • Any leverage ratio is less than [75-125] basis points above a minimum applicable leverage requirement established under subpart L. 	<p>Under the severely adverse scenario, the firm's <u>Tier 1 common risk-based capital ratio falls below 3%</u> during any quarter of the nine quarter planning horizon.</p>	<p>Firm is in substantial noncompliance with enhanced risk management and risk committee requirements.</p>	<p>Firm is in substantial noncompliance with enhanced liquidity risk management standards.</p>	N/A
Level 4 (Recommended resolution)	<ul style="list-style-type: none"> • Any risk-based capital ratio is more than [100-250] basis points below a minimum applicable risk-based capital requirement established under subpart L; or • Any applicable leverage ratio is more than [50-150] basis points below a minimum applicable leverage requirement established under subpart L. 	<ul style="list-style-type: none"> • Any risk-based capital ratio is more than [100-250] basis points below a minimum applicable risk-based capital requirement established under subpart L; or • Any applicable leverage ratio is more than [50-150] basis points below a minimum applicable leverage requirement established under subpart L. 	N/A	N/A	N/A	N/A

Chart 3: Early Remediation Actions for Foreign Banking Organizations

	Risk-Based Capital/Leverage (US IHC or Parent Level)	Stress Tests (US IHC)	Enhanced Risk Management and Risk Committee Standards (US combined operations)	Enhanced Liquidity Risk Management Standards (US combined operations)	Market Indicators (Parent or US IHC as applicable)
Level 1 (Heightened supervisory review)	For foreign banking organizations with \$50 billion or more of global consolidated assets: The Board will conduct a targeted supervisory review of the combined US operations to evaluate whether the combined US operations are experiencing financial distress or material risk management weaknesses, including with respect to exposures to the foreign banking organization, such that further decline of the combined US operations is probable.				
Level 2 (Initial remediation)	<p>For foreign banking organizations with \$50 billion or more in US assets:</p> <ul style="list-style-type: none"> o US IHC capital distributions (e.g., dividends and buybacks) are restricted to no more than 50% of the average of the firm's net income in the previous two quarters. o US branches and agency network must remain in a net due to position to head office and non-US affiliates. o US branch and agency network must hold 30-day liquidity buffer in the United States (not required in Level 3). o US IHC and US branch and agency network face restrictions on growth (no more than 5% growth in total assets or total risk-weighted assets per quarter or per annum), and must obtain prior approval before directly or indirectly acquiring controlling interest in any company. o Foreign banking organization must enter into non-public MOU to improve US condition. o US IHC and US branch and agency network may be subject to other limitations and conditions on their conduct or activities as the Board deems appropriate. <p>For foreign banking organizations with less than \$50 billion in US assets: Supervisors may undertake some or all of the actions outlined above on a case-by-case basis.</p>				N/A
Level 3 (Recovery)	<p>For foreign banking organizations with \$50 billion or more in US assets:</p> <ul style="list-style-type: none"> o Foreign banking organization must enter into written agreement that specifying that the US IHC must take appropriate actions to restore its capital to or above the applicable minimum capital requirements and take such other remedial actions as prescribed by the Board. o US IHC is prohibited from making capital distributions. o US branch and agency network must remain in a net due to position to office and non-US affiliates o US branch and agency network is subject to a 108% asset maintenance requirement. o US IHC and US branch and agency network will be subject to a prohibition on growth, and must obtain prior approval before directly or indirectly acquiring controlling interest in any company. o Foreign banking organization and US IHC are prohibited from increasing pay or paying bonus to US senior management o US IHC may be required to remove culpable senior management. o US IHC and US branch and agency network may be subject to other limitations and conditions on their conduct or activities as the Board deems appropriate. <p>For foreign banking organizations with less than \$50 billion in US assets: Supervisors may undertake some or all of the actions outlined above on a case-by-case basis.</p>				N/A
Level 4 (Recommended resolution)	The Board will consider whether the combined US operations of the foreign banking organization warrant termination or resolution based on the financial decline of the US combined operations, the factors contained in section 203 of the Dodd-Frank Act as applicable, or any other relevant factor. If such a determination is made, the Board will take actions that include recommending to the appropriate financial regulatory agencies that an entity within the US branch or agency network be terminated or that a US subsidiary be resolved.	N/A			N/A

Source: FBO Proposal

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