Is the Force with FBOs?
The Future of U.S. Operations

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January 28, 2016

In this brief, we update the prospects for profitable foreign banking organization (FBO) U.S. operations under current and prospective market and policy conditions. As several very large FBOs shrink in the U.S. to conserve capital for troubled parents, FBOs are eyeing not just these divested operations, but also other market openings for expanded U.S. activity to leverage overall bank operations and, in some cases, substitute for diminished home-country opportunity. Here, we outline principles for considering these U.S. options based on the forward-looking analytics Federal Financial Analytics maintains on U.S. and global legislative, regulatory, and policy drivers with strategic impact. Additional information on how business-line analytics are based on these guiding principles for FBOs may be found at http://www.fedfin.com/images/stories/press_center/speeches/How%20FBOs%20Can%20Still%20Do%20Well%20In%20the%20U%20S%20%20-%20IIB%20Remarks_speech.pdf

Guiding Principles

1) **Don't let legal and reputational risk fears drive U.S. strategy**
   - FBOs should now have effective risk-management/governance frameworks in place or under final construction satisfactory to U.S. regulators. Those failing to do so should re-evaluate not just U.S. expansion, but also any continued presence of size or strategic value.
   - Like it or not, the U.S. risk-management and governance framework is an *a priori* condition for substantive U.S. banking activity. It should be considered in this light, as well as in the broader context of global standards that increasingly demand adherence to similar requirements.

- FBOs will remain favored enforcement targets for the foreseeable future, reinforcing the need for effective risk-management, governance, and compliance infrastructure.
- Where an FBO has implemented needed reforms for ongoing operations, investments in risk management and resulting reductions in legal/reputational-risk will lower material binding constraints except in specific activities where these risks are elevated and/or management depends on specialized skills not housed at the FBO or acquired in concert with the operation.

2) Expect ring-fencing

- Despite intra-group efficiencies and leverage for branch structures, planning should assume subsidiarization for all but *de minimis* activities or "concierge" operations.
- Although more costly in many cases, subsidiarization facilitates compliance and ensures viability under applicable stress-test, resolution, and capital requirements if the FBO parent or U.S. operation has significant scale or complexity.
- Subsidiarization often provides cultural, compliance structures appropriate for non-traditional or novel activities (e.g., consumer finance).
- Depending on parent-company structure/regulation and existing U.S. activities, subsidiarization may also allow non-banking activities to be housed in SEC, CFTC, or state-regulated entities at lower cost to capital and liquidity in both the U.S. and parent operations.
- The cost of ready transfer of capital and liquidity from subsidiaries to the parent must be measured against this advantage.

3) Identify RAROC-advantaged opportunities

- Advisory services
- Liquidity backstops for asset management
- FICC for Treasury, agency paper
- Regional banking operations
- Special-purpose credit enhancement
- Broker-dealer operations
- Wealth/asset management despite diminished opportunity, volatility challenges, pending capital requirements

4) Consider an "export" and/or "import" strategy

- Use home-country capacity/structures for U.S. covered bonds
- Use U.S. expertise for home-country securitization, credit-enhancement, analytical operations
- Vertically integrate advisory/agency services in U.S. with principal activities in home jurisdiction or vice-versa based on capital, liquidity drivers

- Transfer technology (e.g., P2P, payment products) through targeted U.S. operations/acquisitions to home-country operations and/or import remittance, P2P back to the U.S.

How Federal Financial Analytics can help:

- Ongoing services that provide forward-looking policy analytics used by large banks, central banks, and regulators around the globe
- Transaction-specific, proprietary analytics for potential U.S. operational changes and acquisitions in several precedent-setting transactions
- Line-of-business analytics determining competitive advantage or challenges based on policy drivers that differentiate U.S.-regulated banking organizations from other providers of comparable products and services undertaken for major financial-services institutions, private-equity investors

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Federal Financial Analytics is a proprietary think tank providing analytical and advisory services on legislative, regulatory, and public-policy issues affecting global financial services companies. The firm's practice is a unique blend of strategic advice and policy analysis serving as a thought leadership resource for boards of directors and senior management seeking a forward looking assessment of risks, opportunities, governance and other matters critical to success.

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