FedFin Client Report

Tuesday, June 20, 2017

FedFin Assessment: Treasury Contemplates a New Day for FBOs

Client Report: **FBO6**

Executive Summary

In this report, we build on our overall assessment of Treasury's financial-reform report (see Client Report **REFORM136**) with a focus here on actions affecting foreign banking organizations (FBOs) doing business in the U.S. Although Treasury's approach to global rulemaking is an "America First" one (see Client Report **REFORM138**), the America-First approach taken also to FBO regulation would not only fragment the U.S. from the global framework but also provide considerable competitive advantage to many FBOs. The new focus on the U.S. footprint – not parent-bank size – creates significant opportunities for FBO expansion, including through M&A structured to optimize regulatory requirements. Treasury recommendations are in part aimed expressly at ensuring a level playing field for FBOs and U.S. banks abroad, reflecting that the FRB's FBO rule (see FSM Report **FBO3**) is leading to host-country subsidiarization demands on U.S. banks. These demands will grow still stronger if Treasury's OLA-repeal action plan advances, perhaps leading Treasury to give ground now on a little-noticed policy to save the politically-potent proposals on TBTF. The paper includes no discussion of applying regulatory capital at the branch level as proposed earlier by former FRB Gov. Tarullo. Much of the report suggests that even large branches might be left as is were FRB officials and staff to concur with the new Treasury "U.S.-footprint" approach.

Analysis

Treasury recommends that:

- U.S. internal TLAC standards be revisited so that capital and liquidity are not "unnecessarily" trapped in IHCs or other subsidiaries. The FRB's TLAC rule (see FSM Report **TLAC6**) has no internal TLAC standard for

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U.S. GSIBs but demands this for IHCs that are subsidiaries of designated GSIBs, doing so in a manner different than the FSB is working out in the global TLAC standards (see FSM Report **TLAC7**). Treasury emphasizes that consideration should be given to a parent bank's ability to support its U.S. operations when arrangements are in place to do so with home-country supervisors. Treasury otherwise endorses the FRB's TLAC rule as it pertains to IHCs, thus extending to them the same relief proposed for U.S. GSIBs from the FRB's approach to long-term debt;

- requirements applicable to FBOs not required now to form IHCs should be relaxed so that these are based on the U.S. profile, not parent-company size; and
- changes should be made to living-will, stress-test, liquidity, and risk-management requirements for FBOs so that only those with U.S. assets above a new systemic threshold, rather than those with assets greater than $50 billion are covered. Prudential regulation should also be tied to the U.S. risk profile, not the current parent-based threshold, and also defer when home-country standards are equivalent. U.S. resolution-planning requirements should, Treasury says, reflect only U.S. concerns, not parent-company size.

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