Davis Polk

CLIENT MEMORANDUM

Dodd-Frank Enhanced Prudential Standards for Foreign Banking Organizations

December 17, 2012

Following closely on the heels of Federal Reserve Governor Daniel K. Tarullo's November 2012 speech, the Federal Reserve has **proposed** a tiered approach for applying U.S. capital, liquidity and other Dodd-Frank enhanced prudential standards, including single counterparty credit limits, risk management, stress testing and early remediation requirements, to the U.S. operations of foreign banking organizations[1] with total *global* consolidated assets of $50 billion or more ("**Large FBOs**"). Most Large FBOs would have to create a separately capitalized top-tier U.S. intermediate holding company ("**IHC**") that would hold **all** U.S. bank and nonbank subsidiaries. A Large FBO with combined U.S. assets of less than $10 billion, *excluding* its U.S. branch and agency assets, would not be required to form an IHC.

The IHC would be subject to U.S. capital, liquidity and other enhanced prudential standards on a consolidated basis. In addition, the Federal Reserve would have the authority to examine any IHC and any subsidiary of an IHC. Although the U.S. branches and agencies of a Large FBO's foreign bank would not be required to be held beneath the IHC, they too would be subject to liquidity, single counterparty credit limits and, in certain circumstances, asset maintenance requirements. Large FBOs not required to form an IHC would also be subject to many of the new enhanced prudential standards.

This memorandum provides an overview of key aspects of the Federal Reserve's proposal, which would become effective on July 1, 2015. We invite you to also read the accompanying diagrams and tables for a visual representation of these new requirements. The comment period for the proposal ends on **March 31, 2013**.

- **Diagram 1** illustrates the structural application of the proposed requirements to the U.S. operations of a Large FBO.
- **Diagram 2** illustrates a possible structure under the proposal for a tiered FBO that controls another Large FBO.
- **Diagram 3** illustrates new requirements that would apply to a Large FBO with a **limited** U.S. footprint.
- **Diagram 4** illustrates new requirements that would apply to a Large FBO with a **major** U.S. footprint.
- **Table 1** summarizes the applicability of the proposed requirements to FBOs of different sizes.
- **Table 2** sets forth the different methods for calculating various asset thresholds used in the proposal.
- **Tables 3 and 4** summarize the proposed early remediation framework.

Requirement to Establish a Top-Tier U.S. IHC

- This requirement would apply to any Large FBO with combined U.S. assets of $10 billion or more, *excluding* its U.S. branch and agency assets. The proposal would generally require a Large FBO to

[1] A foreign banking organization is a foreign bank that has a banking presence in the United States by virtue of operating a U.S. branch, agency or commercial lending company subsidiary or controlling a U.S. bank. If an FBO does not have a U.S. banking presence, e.g., it only has representative offices in the United States, it would not be subject to the proposal.

organize under a single top-tier U.S. IHC **all** its U.S. subsidiaries[2] other than its interests in foreign commercial subsidiaries with activities in the United States, known in U.S. banking law as Section 2(h)(2) subsidiaries.[3] A Large FBO with combined U.S. assets of less than $10 billion, *excluding* assets held by its U.S. branches and agencies, would **not** be required to form an IHC. The proposed method for calculating this asset threshold is set forth in **Table 2**.

- **U.S. Requirements, Supervision, Examinations and Reporting:** The IHC would be subject to U.S. capital, liquidity and other Dodd-Frank enhanced prudential standards on a consolidated basis, as further described below. The IHC would be subject to umbrella supervision by the Federal Reserve and would be subject to regulatory reporting and inspection requirements comparable to those that apply to a U.S. bank holding company ("**BHC**"). The Federal Reserve noted that it is conducting a review of existing supervisory guidance to identify guidance that may be relevant to the operations and activities of an IHC that does not have a U.S. bank subsidiary. It proposes to apply such guidance to IHCs on a rolling basis, either by revising and reissuing the guidance or by publishing a notification that refers to the applicable guidance.
- **Structural Tailoring:** Upon written request by an FBO, the Federal Reserve would consider whether the circumstances – including where an FBO controls another FBO that has separate U.S. operations or where applicable law prohibits an FBO from holding one or more of its U.S. subsidiaries through a single IHC – warrant permitting the FBO to establish multiple IHCs or use an alternative organizational structure to hold its U.S. subsidiaries. The proposal's general provisions further provide that if an FBO owns more than one foreign bank, the Federal Reserve may apply the requirements in the proposal in a manner that takes into account the separate operations of such foreign banks.

IHC Subject to U.S. BHC Capital Requirements

- **U.S. BHC Capital Requirements Apply to IHC:** An IHC, regardless of whether it controls a U.S. bank, would be subject to the **same** U.S. risk-based and leverage capital standards that apply to a U.S. BHC.[4] Accordingly, an IHC that crosses the applicability thresholds under the advanced approaches capital rules, currently based on Basel II's advanced internal ratings-based approach for credit risk and advanced measurement approaches for operational risk,[5] and the market risk capital rules, currently

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[2] The term "subsidiary" would be defined using the Bank Holding Company Act ("**BHC Act**") definition of control. Accordingly, an IHC must house any U.S. company for which the FBO: (1) directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25% or more of any class of voting securities of the company; (2) controls in any manner the election of a majority of the directors or trustees of the company; or (3) directly or indirectly exercised a controlling influence over the management or policies of the company.

The proposal would also require the Large FBO to transfer to its IHC any controlling interests in U.S. companies acquired pursuant to the merchant banking authority.

[3] Section 2(h)(2) is the BHC Act's acknowledgment that most other countries do not separate commerce and banking. Thus, it provides a mechanism by which an FBO's interest in foreign commercial firms that conduct business in the United States is not disturbed, subject to certain conditions.

[4] The Federal Reserve's current rules for calculating minimum capital requirements for U.S. BHCs are found at 12 C.F.R. part 225, Appendix A (general risk-based capital rules), 12 C.F.R. part 225, Appendix D (U.S. leverage capital rule), 12 C.F.R. part 225, Appendix E (market risk capital rules), and 12 C.F.R. part 225, Appendix G (advanced approaches capital rules).

[5] An IHC would be subject to the advanced approaches capital rules if its total consolidated assets are $250 billion or more, its consolidated total on-balance sheet foreign exposures are $10 billion or more, or if it elects, subject to Federal Reserve approval, to use the advanced approaches capital rules.

based on Basel 2.5,[6] would be required to use those rules to calculate its risk-based capital requirements, subject to the Collins Amendment capital floor.[7]

- **D-SIB Surcharge:** The Federal Reserve stated that it may also, through a future rulemaking, apply a capital surcharge in the United States to an IHC that is determined to be a domestic systemically important bank ("**D-SIB**"), consistent with the Basel Committee's D-SIB regime or a similar framework.[8]
- **U.S. Basel III Proposals:** U.S. banking regulators recently proposed comprehensive revisions to the U.S. bank capital framework that would implement many aspects of Basel III and move all U.S. banking organizations toward a modified, U.S. version of the standardized approach for credit risk under Basel II. A Davis Polk memorandum on the U.S. Basel III proposals is available **here**.
- **Multiple Capital Regimes:** Among other things, the permanent capital floor imposed by the Collins Amendment and Dodd-Frank's prohibition on reliance on external credit ratings has resulted in significant U.S. departures from the international Basel capital framework and the capital regulations in other major jurisdictions. Imposing uniquely U.S. capital standards on the IHC of a Large FBO that is subject to home country capital standards on a group-wide consolidated basis would likely give rise to challenging operational and compliance issues.
- **Federal Reserve's Capital Plan Rule:** An IHC with total consolidated assets of $50 billion or more would be subject to the Federal Reserve's capital plan rule. The proposed method for calculating this asset threshold is set forth in **Table 2**. The capital plan rule would require such an IHC to submit annual capital plans to the Federal Reserve demonstrating the IHC's ability to maintain capital above the Federal Reserve's minimum risk-based capital and leverage ratios under both baseline and stressed conditions over a minimum nine-quarter, forward-looking planning horizon. An IHC that is unable to satisfy the capital plan rule's requirements generally may not make any capital distributions until it provides a satisfactory capital plan to the Federal Reserve. As is the case with an FBO's U.S. BHC subsidiary that will be subject to the Federal Reserve's capital planning rules, this proposal may make it more difficult for a Large FBO to repatriate excess capital from an IHC.
- **Certify Capital Adequacy on a Consolidated Basis:** A Large FBO must 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, including Basel III and any future amendments to said framework.[9] A Large FBO must also report on a quarterly basis its risk-based capital ratios, risk-weighted assets and total assets to the Federal Reserve. If the Federal Reserve determines that these conditions are not met, it may impose conditions or restrictions on the Large FBO's U.S. operations. The proposal would *not* apply the U.S. leverage ratio to an FBO at the consolidated level. The Federal Reserve noted, however, that the leverage ratio under Basel III is

[6] An IHC would be subject to the market risk capital rules if it has aggregate trading assets and trading liabilities equal to $1 billion or more or 10% or more of total assets.

[7] As a result of the Collins Amendment capital floor, a firm that is subject to the advanced approaches capital rules must calculate its risk-based capital ratios under **both** the general risk-based capital rules, currently based on Basel I, and the advanced approaches capital rules, in each case supplemented by the market risk capital rules, if applicable. The firm must then use the **lower** of the two sets of capital ratios to determine whether it meets its minimum risk-based capital requirements. The U.S. Basel III proposals would significantly revise both the general risk-based capital rules and the advanced approaches capital rules.

[8] *See* Basel Committee, *A framework for dealing with domestic systemically important banks - final document* (Oct. 2012), available **here**.

[9] If a Large FBO's home country standards are not consistent with the Basel capital framework, the Large FBO may demonstrate to the Federal Reserve's satisfaction that it nevertheless meets standards consistent with the Basel capital framework.

expected to be implemented internationally in 2018. At that time, the proposal would require a Large BHC to certify or otherwise demonstrate that it complies with the Basel III leverage ratio.

- **G-SIB Surcharge Certification:** The Federal Reserve may, through a separate rulemaking, introduce a consolidated capital surcharge certification requirement for a Large FBO that is designated by the Basel Committee and the Financial Stability Board as a global systemically important bank ("**G-SIB**").[10]

Liquidity Requirements for U.S. Operations of a Large FBO

- **Liquidity Risk Management:** A Large FBO with combined U.S. assets[11] of $50 billion or more must meet liquidity risk management standards that are broadly similar to the Federal Reserve's December 2011 enhanced prudential standards proposal for domestic firms ("**Domestic Proposal**").[12] Specifically, the risk management standards would require the Large FBO, with respect to its "combined U.S. operations,"[13] to adopt specific corporate governance practices regarding liquidity risk management, produce comprehensive cash flow projections,[14] develop specific limits relating to liquidity metrics, establish procedures for monitoring collateral and its availability, liquidity risk exposures and funding needs, and intraday liquidity risk exposures, and maintain a contingency funding plan. The liquidity risk management standards would impose certain responsibilities on the Large FBO's U.S. risk committee and U.S. chief risk officer.
- **Liquidity Stress Testing:** A Large FBO with combined U.S. assets of $50 billion or more must conduct, at least monthly, stress tests of its cash flow projections separately for all its U.S. branches and agencies ("**U.S. Branch and Agency Network**") and for its IHC. The stress test results would be used to determine the size of the liquidity buffers, discussed below, and to inform the Large FBO's contingency funding plan. The proposal imposes general requirements for the stress scenarios, assumptions and time horizons that the Large FBO must incorporate into its liquidity stress tests. Unlike the current calibration of the Basel III liquidity coverage ratio, however, the proposal does not prescribe standardized, one-size-fits-all assumptions about the Large FBO's cash inflows and outflows under stressed conditions. Instead, similar to the Domestic Proposal, the proposal requires liquidity stress tests to be tailored to, and provide sufficient detail to reflect, the capital structure, risk profile, complexity, activities, size and other relevant characteristics of the combined U.S. operations of the Large FBO and, as appropriate, the Large FBO as a whole. The Large FBO would be required to report to the Federal Reserve the results of the stress tests for its combined U.S. operations and the amount of the liquidity buffer, discussed below, for its combined U.S. operations, as well as, on a quarterly basis, the results of any internal liquidity stress tests and establishment of liquidity buffers required by its home country regulators.
- **Local U.S. Liquidity Buffers:** A Large FBO with combined U.S. assets of $50 billion or more must maintain a liquidity buffer for its U.S. Branch and Agency Network and a separate buffer for its IHC. Each liquidity buffer must consist of "highly liquid assets"[15] that are unencumbered and that are sufficient

[10] *See* Financial Stability Board, *Update of Group of Global Systemically Important Banks* (Nov. 1, 2012), available **here**.

[11] The proposed method for calculating this asset threshold is set forth in **Table 2**.

[12] A Davis Polk memorandum on the proposed enhanced prudential standards for large domestic firms is available **here**.

[13] Combined U.S. operations means any IHC and its consolidated subsidiaries; any U.S. branch or U.S. agency of the FBO; and any other U.S. subsidiary of the FBO that is not a section 2(h)(2) subsidiary.

[14] Cash flow projections for the combined U.S. operations must be tailored to, and provide sufficient detail to reflect, the capital structure, risk profile, complexity, activities, size and any other relevant factors of the Large FBO and its combined U.S. operations, including, where appropriate, analyses by business line or legal entity.

[15] The proposal defines "highly liquid assets" in a manner similar to the Domestic Proposal to include cash; securities issued or guaranteed by the U.S. government, a U.S. government agency or a U.S. government-sponsored entity; and any other asset that the (*cont.*)

to meet the "net stressed cash flow need"[16] over the first 30 days of its stress test horizon. The Large FBO's U.S. Branch and Agency Network must maintain the first 14 days of its 30-day buffer in the United States,[17] but would generally be permitted to meet the remainder of the requirement at the parent consolidated level, provided that the Large FBO has demonstrated to the Federal Reserve that it or an affiliate could provide the residual liquid assets to its U.S. Branch and Agency Network if needed. In contrast, the IHC of the Large FBO must maintain the full 30-day buffer in the United States.[18]

- **Basel III's Quantitative Liquidity Ratios:** In future rulemakings, the Federal Reserve intends to implement Basel III's quantitative liquidity standards, including the liquidity coverage ratio and the net stable funding ratio, for the U.S. operations of "some or all" Large FBOs with combined U.S. assets of $50 billion or more, consistent with the international timeline. It remains to be seen how these U.S. liquidity requirements would interact with any consolidated liquidity requirements implemented by a Large FBO's home country regulator. As with the Domestic Proposal, the Federal Reserve also requested comments on whether it should, pursuant to its Dodd-Frank enhanced prudential standards authority, adopt a short-term debt limit in addition to, or in place of, the Basel III liquidity requirements.
- **Large FBOs with Limited U.S. Footprint:** A Large FBO with combined U.S. assets of **less** than $50 billion would be required to report the results of an internal liquidity stress test, either on a consolidated basis or for its combined U.S. operations, to the Federal Reserve on an annual basis. The internal stress test must be conducted in a manner consistent with the Basel Committee's principles for liquidity risk management.[19] If the Large FBO does not satisfy this requirement, it must limit the net aggregate amount owed by its head office and its non-U.S. affiliates to its combined U.S. operations to 25% or less of the third-party liabilities of its combined U.S. operations, on a daily basis.

Single Counterparty Credit Limits

- The proposed single counterparty credit limits would apply to an IHC and the combined U.S. operations of a Large FBO. A Large FBO would have to ensure compliance with these requirements by its IHC and combined U.S. operations on a daily basis and submit to the Federal Reserve monthly reports showing daily compliance.
- **25% Limits for IHC and Combined U.S. Operations:** An IHC, together with its subsidiaries,[20] would be prohibited from having an aggregate net credit exposure to any unaffiliated counterparty, together with its

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(*cont.*)

FBO demonstrates to the satisfaction of the Federal Reserve: (1) has low credit risk and low market risk; (2) is traded in an active secondary two-way market that has committed market makers and independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a reasonable time period conforming with trade custom; and (3) is a type of asset that investors historically have purchased in periods of financial market distress during which market liquidity is impaired. The fair market value of an asset included in any liquidity buffer must be discounted to reflect any credit risk and market price volatility of the asset.

[16] The proposal provides detailed rules for calculating the net stressed cash flow need for the Large FBO's IHC and for its U.S. Branch and Agency Network. At a high level, net stressed cash flow need is equal to the sum of (1) net external stressed cash flow need and (2) net internal stressed cash flow need.

[17] To the extent that the assets in the U.S. Branch and Agency Network's liquidity buffer consist of cash, the cash may not be held in an account located at the IHC or other affiliate.

[18] To the extent that the assets in the IHC's liquidity buffer consist of cash, the cash may not be held in an account located at a U.S. branch or U.S. agency of the affiliated foreign bank or other affiliate.

[19] *See* Basel Committee, *Principles for Sound Liquidity Risk Management and Supervision* (Sept. 2008), available **here**.

[20] Subsidiary of a specified company means a company that is directly or indirectly controlled by the specified company. Consistent with the Domestic Proposal, the proposed definition of control for purposes of single counterparty credit limits is more limited than under the BHC Act, and essentially excludes the controlling influence and other subjective elements. Specifically, a company controls another company if it: (1) owns, controls or holds with power to vote 25% or more of a class of voting securities of the company; (2) owns or controls 25% or more of the total equity of the company; or (3) consolidates the company for financial reporting purposes.

subsidiaries, in excess of 25% of the IHC's consolidated capital stock and surplus.[21] In addition, the combined U.S. operations of a Large FBO, together with any subsidiary of an entity within the combined U.S. operations, would be prohibited from having an aggregate net credit exposure to any unaffiliated counterparty, together with its subsidiaries, in excess of 25% of the consolidated total regulatory capital of the Large FBO.[22]

- **Stricter Limits for Exposures Between Major Counterparties:** The proposal would impose a more stringent credit exposure limit between a major IHC or the combined U.S. operations of a major FBO,[23] together with their respective subsidiaries, and any unaffiliated major counterparty, together with its subsidiaries.[24] This more stringent limit would be set to be consistent with the stricter limit established for major U.S. BHCs and for nonbank financial companies supervised by the Federal Reserve following a systemic designation by the Financial Stability Oversight Council ("**FSOC**").
- **Calculating Credit Exposure:** The types of credit transactions subject to single counterparty credit limits[25] and the methods for calculating gross and net credit exposure arising from these transactions are broadly similar to the Domestic Proposal.[26] Accordingly, the proposal would not permit Large FBOs to use risk-sensitive, supervisor-approved internal models to calculate their credit exposure arising from derivative transactions and would instead require them to use the current exposure method ("**CEM**"), a look-up table approach that was first introduced in Basel I nearly a quarter of a century ago.[27] Moreover,

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[21] An IHC's "capital stock and surplus" is defined as the sum of the IHC's total regulatory capital and its excess allowance for loan and lease losses not included in Tier 2 capital under the applicable capital rules.

[22] The Federal Reserve noted that, in light of differences in international accounting standards, the "capital stock and surplus" of a Large FBO would not reflect the balance of the allowance for loan and lease losses not included in Tier 2 capital and would simply be defined as the FBO's total regulatory capital on a consolidated basis.

[23] The compliance provisions for the proposed single counterparty credit limits state: "A foreign banking organization must ensure the compliance of its U.S. intermediate holding company and **combined U.S. operations** with the requirements of this section" (emphasis added). In addition, the Federal Reserve's staff memorandum summarizing the proposal states: "the proposal would impose a more stringent credit exposure limit between a major U.S. intermediate holding company or **the combined U.S. operations** of a major foreign banking organization and a major counterparty" (emphasis added). Confusion over the scope of application of the proposed single counterparty credit limits may arise from a provision in the proposed rule text released on December 14, 2012, which states: "No major **foreign banking organization**, together with its subsidiaries, may have an aggregate net credit exposure to an unaffiliated major counterparty in excess of [x] percent of the consolidated capital stock and surplus of the major foreign banking organization" (emphasis added). In light of the other text discussed above, it is likely that the Federal Reserve intended for the stricter single counterparty credit limit, like the 25% limit, to apply with respect to the major FBO's combined U.S. operations and not to the FBO as a whole. It is difficult to see on what basis the Federal Reserve could impose such a limit on the credit exposures of a Large FBO's non-U.S. operations.

[24] A major IHC is defined as an IHC with total consolidated assets of $500 billion or more. A major FBO is defined as an FBO with total global consolidated assets of $500 billion or more. A major counterparty is defined to include a BHC or FBO that has total consolidated assets of $500 billion or more and *any* nonbank financial company supervised by the Federal Reserve following a systemic designation by the Financial Stability Oversight Council ("**Nonbank SIFI**").

[25] Credit transactions subject to the single counterparty credit limits include: any extension of credit, including loans, deposits and lines of credit, but excluding advised or other uncommitted lines of credit; any repurchase or reverse repurchase agreement; any securities lending or securities borrowing transaction; any guarantee, acceptance or letter of credit (including any confirmed letter of credit or standby letter of credit) issued on behalf of a counterparty; any purchase of, or investment in, securities issued by a counterparty; in connection with a derivative transaction: (1) any credit exposure to a counterparty, and (2) any credit exposure to the reference entity, where the reference asset is an obligation or equity security of a reference entity; any transaction that is the functional equivalent of the above; and any similar transaction that the Federal Reserve determines to be a credit transaction for purposes of the single counterparty credit limits.

[26] Generally, net credit exposure is determined by adjusting gross credit exposure to take into account, where permissible, bilateral netting agreements, eligible collateral, eligible guarantees, eligible credit and equity derivatives and certain other eligible hedges.

[27] In contrast, the OCC's interim final rule to implement Dodd-Frank's amendments to lending limits generally permits national banks to use to supervisor-approved internal models to calculate credit exposures arising from derivative transactions and securities financing transactions. A Davis Polk memorandum on the OCC's interim final rule is available **here**.

notwithstanding the G20 commitments regarding the central clearing of standardized derivatives, the proposal would not exempt exposures to central counterparties from single counterparty credit limits.

- **Exposures to U.S. Federal Government and Home Country Sovereign Are Exempted:** The limits would apply to credit exposures to foreign sovereign governments and U.S. state and local governments. The limits would *not* apply, however, to exposures to the U.S. federal government, including U.S. federal government agencies as well as Fannie Mae and Freddie Mac, while in conservatorship. The limits also would *not* apply to exposures to a Large FBO's home country sovereign, including the central government, an agency, department, ministry or central bank.
- **Quantitative Study on Single Counterparty Credit Limits:** On the one hand, the Federal Reserve stated that any differences between the proposal and the Domestic Proposal generally reflect the different regulatory framework under which FBOs operate and do not signal how the Domestic Proposal would be finalized. On the other hand, the Federal Reserve acknowledged the large volume of comments it received on the single counterparty credit limit framework in the Domestic Proposal, including comments on the proposed calculation methodologies and the stricter 10% threshold for exposures between major counterparties. The Federal Reserve's staff stated that they are preparing a quantitative impact study on single counterparty credit limits to help inform the rulemaking process. Notably, the Federal Reserve chose not to quantify the stricter limit for major counterparties in this proposal, except to note that it would be consistent with the one applicable to domestic firms.
- **Future Rulemakings:** In future rulemakings, the Federal Reserve will propose credit exposure reporting requirements for Large FBOs. The Federal Reserve also noted that the Basel Committee is examining single counterparty credit limit regimes across jurisdictions and evaluating potential international standards. If an international agreement on this issue is reached, the Federal Reserve stated that it may amend this proposal, as necessary, to achieve consistency with the international approach.

Risk Management and Risk Committee Requirements

- **U.S. Risk Committee:** A publicly traded FBO with total **global** consolidated assets of **$10 billion** or more and a Large FBO, regardless of whether its stock is publicly traded, would each be required to annually certify to the Federal Reserve that it maintains a U.S. risk committee that oversees the risk management practices of the FBO's combined U.S. operations and has at least one member with appropriate risk management expertise.[28] In general, the FBO may maintain its U.S. risk committee either as:
    - A committee of its global board of directors, on a stand-alone basis or as part of its enterprise-wide risk committee; or
    - A committee of the board of directors of its IHC, if applicable.
- **Additional U.S. Risk Committee Requirements:** A Large FBO with combined U.S. assets of $50 billion or more would be subject to additional U.S. risk committee requirements. Among other things, the U.S. risk committee of such a Large FBO would have to review and approve the risk management practices of its combined U.S. operations, oversee the operation of an appropriate risk management framework for the combined U.S. operations, including the proposed liquidity risk management standards, and would have to include at least one independent member. The independence requirement would apply regardless of where the U.S. risk committee is located. The Federal Reserve requested comments on a number of alternative risk management structures to the proposed U.S. risk committee requirement.

[28] The Federal Reserve noted that the requisite level of risk management expertise for an FBO's U.S. risk committee should be commensurate with the capital structure, risk profile, complexity, activities and size of the FBO's combined U.S. operations.

- **U.S. Chief Risk Officer:** A Large FBO with combined U.S. assets of $50 billion or more would be required to appoint a U.S. chief risk officer responsible for implementing and maintaining the risk management framework and practices for the Large FBO's combined U.S. operations, including the proposed liquidity risk management standards.[29] Among other requirements, the U.S. chief risk officer would be required to have appropriate risk management expertise, and would have to report directly to the U.S. risk committee and to the Large FBO's global chief risk officer or equivalent management official(s), unless the Federal Reserve approves an alternative reporting structure.
- **Existing Supervisory Guidance:** The Federal Reserve emphasized that the risk management requirements contained in this proposal supplement its existing risk management guidance and supervisory expectations for FBOs.

Stress Testing Requirements

- **Dodd-Frank Stress Tests for IHCs:** An IHC would be subject to the Federal Reserve's Dodd-Frank stress testing rules as if it were a U.S. BHC. As a result, an IHC with total consolidated assets of more than $10 billion but less than $50 billion would be subject to annual company-run stress tests under the Federal Reserve's final stress testing rule for U.S. BHCs in that size range. Likewise, an IHC with total consolidated assets of $50 billion or more would be subject to annual supervisory stress tests and semi-annual company-run stress tests under the Federal Reserve's final stress testing rule for similarly sized U.S. BHCs. The Federal Reserve's stress testing rules require firms to publish summaries of their company-run stress test results. In addition, the Federal Reserve publishes summaries of supervisory stress test results. A Davis Polk memorandum on the Federal Reserve's instructions for the 2013 Dodd-Frank stress testing and capital planning cycle is available **here**.
- **Home Country Stress Tests for Certain Large FBOs:** The U.S. Branch and Agency Network of a Large FBO with combined U.S. assets of $50 billion or more would be subject to a 108% asset maintenance requirement[30] as well as any intragroup funding restrictions or additional liquidity requirements imposed by the Federal Reserve ***unless*** the Large FBO satisfies certain conditions related to stress testing. These conditions include:
    - The Large FBO is subject to and passes an annual stress test conducted by its home country regulator or conducted by the FBO and reviewed by its home country regulator;
    - The Large FBO provides certain information to the Federal Reserve regarding its stress tests; and
    - If, on a net basis, the Large FBO's U.S. Branch and Agency Network provides funding to its head office and non-U.S. affiliates, the Large FBO must provide more detailed information regarding its stress tests and demonstrate to the Federal Reserve that it has adequate capital to withstand stressed conditions.
- **Home Country Stress Tests for Smaller FBOs:** The U.S. Branch and Agency Network of an FBO with total consolidated assets of more than $10 billion but with combined U.S. assets of less than $50 billion would be subject to a 105% asset maintenance and certain other requirements *unless* the FBO is subject

[29] The U.S. chief risk officer would also be expected to oversee regularly scheduled meetings, as well as special meetings, with the Federal Reserve's supervisory staff to assess compliance with its risk management responsibilities. This would require the U.S. chief risk officer to be available to respond to supervisory inquiries from the Federal Reserve as needed.

[30] The Federal Reserve noted that the 108% asset maintenance requirement reflects the 8% minimum risk-based capital standard currently applied to U.S. banking organizations.

to and passes an annual stress test conducted by its home country regulator or conducted by the FBO and reviewed by its home country regulator.

Debt-to-Equity Limitation

- In the event that the FSOC determined that a Large FBO posed a grave threat to U.S. financial stability and that the imposition of a debt-to-equity requirement was necessary to mitigate such risk, within 180 days after such a determination, subject to any extension granted by the Federal Reserve[31]:
  - The Large FBO's IHC would be required to maintain a debt-to-equity ratio of no more than 15-to-1; and
  - The Large FBO's U.S. Branch and Agency Network would be required to maintain a 108% asset maintenance requirement.

Early Remediation Framework

- **Early Remediation Triggers:** The combined U.S. operations of a Large FBO would be subject to early remediation triggers based on the Large FBO's and IHC's capital ratios relative to applicable minimum requirements,[32] stress test results, liquidity and risk management weaknesses and market indicators.[33] The proposed early remediation triggers are summarized in **Table 3**. The Federal Reserve stated that it expects to notify the Large FBO's home country supervisor, the primary regulators of its U.S. offices and subsidiaries and the FDIC as the Large FBO's U.S. operations enter into or change remediation levels.
- **Early Remediation Actions:** A Large FBO with combined U.S. assets of $50 billion or more that exceeds an early remediation trigger would be subject to a set of nondiscretionary remediation actions imposed on its U.S. operations. These proposed remediation actions are summarized in **Table 4**. A Large FBO with combined U.S. assets of less than $50 billion would not be automatically subject to remediation actions.

Implementation Timing

- For FBOs with total global consolidated assets of $50 billion or more as of July 1, 2014, the proposal's enhanced prudential standards and the IHC requirement, if applicable, would apply beginning on **July 1, 2015**.
- FBOs that cross the $50 billion total global consolidated assets threshold after July 1, 2014, would be required to form an IHC beginning 12 months after they reach the $50 billion threshold, unless accelerated or extended by the Federal Reserve. These FBOs generally would be required to comply with the proposed enhanced prudential standards beginning on the same date they are required to establish an IHC.

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[31] A Large FBO subject to the debt-to-equity ratio requirement may request up to two extension periods of 90 days each to come into compliance. Requests for an extension must provide information sufficient to demonstrate good faith efforts to comply with the debt-to-equity ratio requirement and that each extension would be in the public interest.

[32] The Federal Reserve noted that if the FBO's home country regulator establishes higher minimum capital ratios, the Federal Reserve would consider the FBO's capital with reference to the minimum capital ratios set forth in Basel III rather than the home country supervisor's higher standards.

[33] The Federal Reserve acknowledged that some market indicators may not be available for FBOs and that market indicators for different FBOs are not traded with the same frequency and therefore may not contain the same level of informational content. The Federal Reserve stated that it would anticipate analyzing market indicators available for both U.S. subsidiaries of FBOs, if available, and for the consolidated FBO.

Application to Foreign Nonbank SIFIs

- The proposal also would apply to foreign nonbank financial companies supervised by the Federal Reserve following a systemic designation by the FSOC (“**Foreign Nonbank SIFIs**”). The Federal Reserve, however, will clarify how the proposal would apply to a Foreign Nonbank SIFI following its systemic designation. The proposal also includes criteria to be considered by the Federal Reserve in determining whether to impose the IHC requirement on a Foreign Nonbank SIFI. To date, no systemic designations have been made with respect to foreign nonbank financial companies.

Broader Implications of the Proposal

The proposal, if adopted, could have profound negative implications not only for the U.S. operations of FBOs, but also for U.S. banking organizations doing business outside the United States. It would likely contribute and add fuel to the growing trend towards regionalization of global banking, thereby complicating and increasing the cost of providing cross-border banking services. These broader implications are explored in a Davis Polk **memorandum** discussing Federal Reserve Governor Daniel K. Tarullo’s November 2012 speech, which previewed the basic elements of the proposal.

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Diagram 1: Structural Application of Proposed Dodd-Frank Enhanced Prudential Standards to Large FBOs[1]

IHC Requirement

A Large FBO must generally establish a separately capitalized top-tier U.S. intermediate holding company (**IHC**) that would hold **all** U.S. bank and nonbank subsidiaries other than Section 2(h)(2) subsidiaries. **Exception:** The IHC requirement would **not** apply to a Large FBO that has less than $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies).

Large Foreign Banking Organization (FBO)

Primary Regulator:
Home Country Regulator

Applicable U.S. Requirements

In addition to currently applicable U.S. regulations, U.S. branches and agencies of a Large FBO would be subject to liquidity standards, single counterparty credit limits and, in certain circumstances, asset maintenance requirements.

U.S. Branch or Agency*

Primary Regulator:
U.S. Federal Reserve, OCC / State Banking Regulator (depending on license), **and Home Country Regulator**

* A U.S. branch or agency of the Large FBO would **not** be part of the IHC.

Applicable U.S. Requirements

The IHC would be subject to the following U.S. requirements on a consolidated basis:

- U.S. capital rules for BHCs[2]
- Liquidity rules
- Stress testing
- Single counterparty credit limits
- Risk management standards
- Debt-to-equity limits
- Early remediation requirements

Top-Tier U.S. Intermediate Holding Company (IHC)

Primary Regulator:
U.S. Federal Reserve

Other lower-tier U.S. holding companies are omitted from the chart for purposes of simplification

U.S. Broker-Dealer	U.S. Bank	U.S. Insurance Company	U.S. Nonbank Lender	U.S. Investment Adviser / Commodity Trading Advisor	U.S. Swap Dealer / Security-based Swap Dealer	U.S. Futures Commission Merchant
Primary Regulator: **U.S. SEC**	*Primary Regulator:* **U.S. Federal and/or State Banking Regulators** (depending on charter)	*Primary Regulator:* **U.S. State Regulator**	*Primary Regulator:* **U.S. State Regulator**	*Primary Regulator:* **U.S. SEC / CFTC**	*Primary Regulator:* **U.S. CFTC / SEC**	*Primary Regulator:* **U.S. CFTC**

1. Large FBO refers to a foreign banking organization with total **global** consolidated assets of $50 billion or more. Under the Federal Reserve's proposal, the U.S. operations of a Large FBO with combined **U.S.** assets of $50 billion or more must generally meet more stringent enhanced prudential standards.
2. A Davis Polk memorandum on the U.S. banking regulators' proposals to implement Basel III in the United States is available **here**.

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Diagram 2: Possible Structure for a Tiered FBO under the Federal Reserve's Proposal

Multiple IHCs

Upon written request by an FBO, the Federal Reserve would consider whether to permit an FBO to establish multiple IHCs or use an alternative organizational structure to hold its combined U.S. operations, if the FBO controls another FBO that has separate U.S. operations.

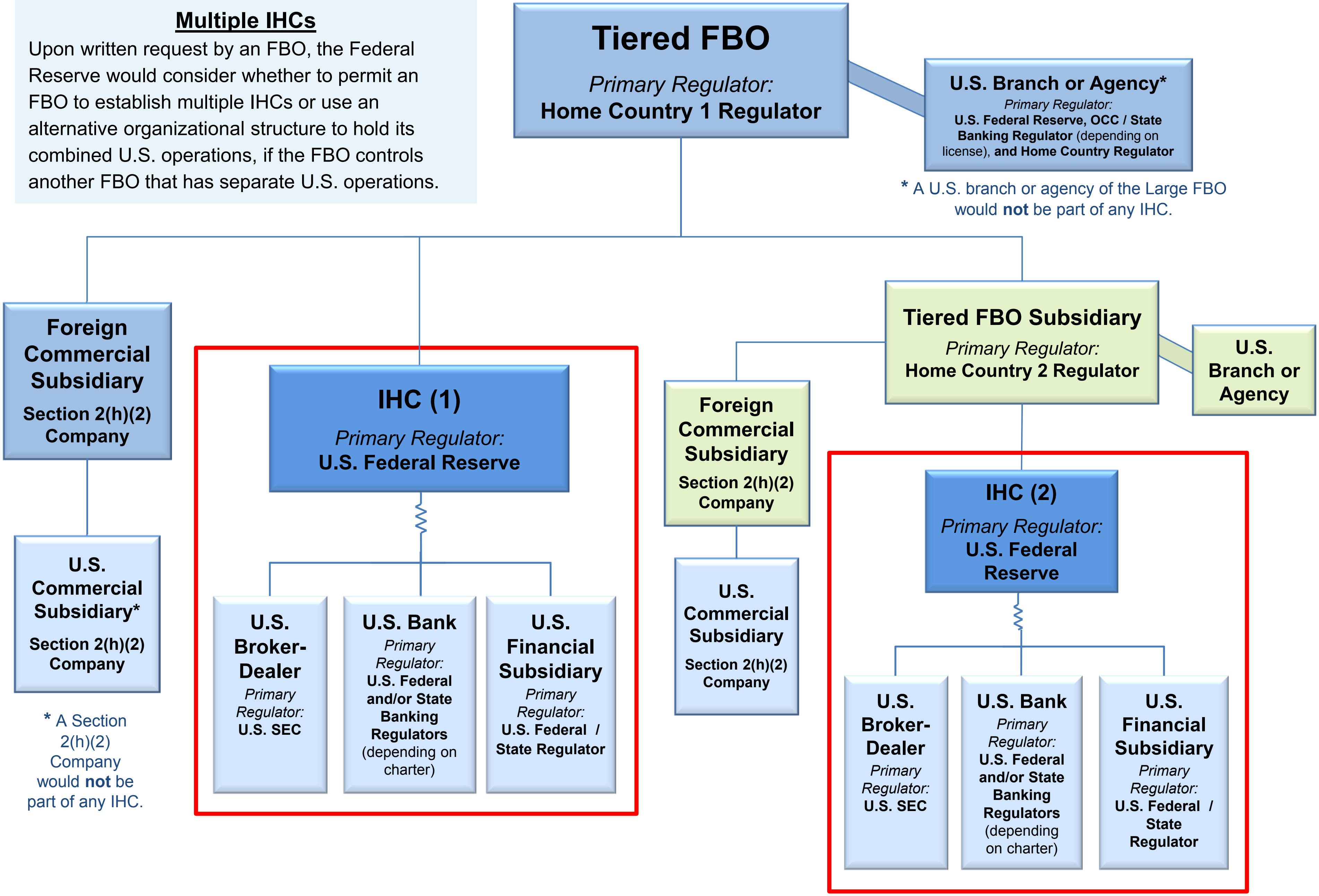
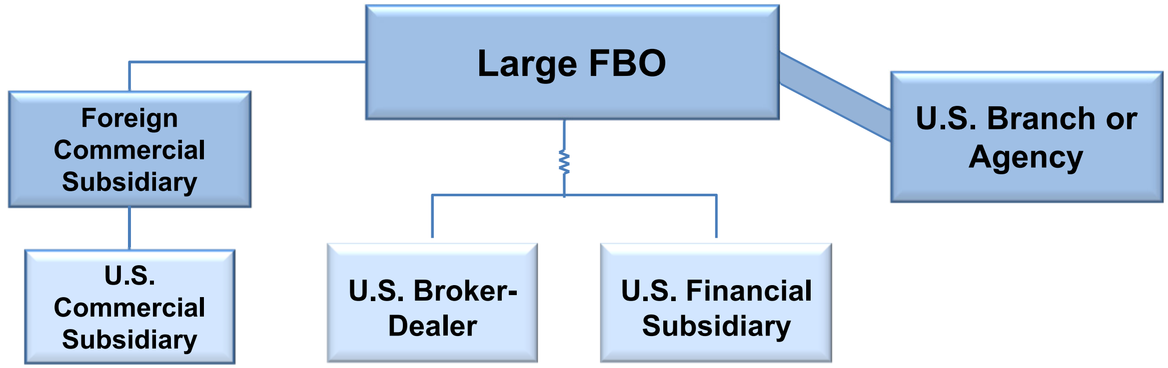


Diagram 3: New Requirements for a Large FBO with a Limited U.S. Footprint

Key FBO Facts

- ≥ $50 billion in global assets
- < $50 billion in combined U.S. assets
- < $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)



Impact of Federal Reserve's Proposal: No IHC Requirement But Other New Requirements Apply

- **Capital:** FBO must certify that it meets home country capital standards that are broadly consistent with Basel capital standards, including **Basel III**.
  - Non-compliance = Federal Reserve may impose restrictions on FBO's U.S. operations.
- **Capital Stress Tests:** FBO must be subject to and pass annual home country stress tests that are comparable to U.S. standards.
  - Non-compliance = **105% U.S. asset maintenance** requirement for U.S. branches and agencies and FBO must conduct annual stress test of U.S. subsidiaries.
- **Liquidity Stress Tests:** FBO must report to results of internal liquidity stress test that meets Basel Committee's principles for liquidity risk management.
  - Non-compliance = U.S. operations must maintain **net due from** funding position with non-U.S. affiliates of no more than **25%** of third-party liabilities of U.S. operations on a daily basis.
- **Risk Management:** FBO must maintain a board level U.S. risk committee meeting certain requirements. The U.S. risk committee can be part of the overall risk committee of the board.
- **Single Counterparty Credit Limits:** Aggregate net credit exposure of U.S. operations to any **unaffiliated counterparty**, together with its subsidiaries, must be limited to **25%** of the FBO's consolidated total regulatory capital. Stricter limit applies to exposures between major counterparties.
- **Early Remediation:** Only if triggered. **Debt-to-Equity Limits:** Only if FSOC makes determinations about FBO's grave threat to U.S. financial stability.

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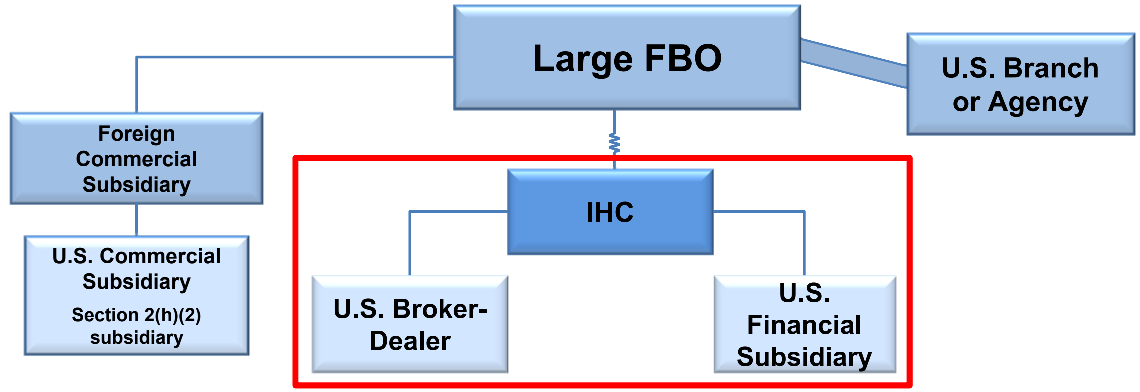
Diagram 4: New Requirements for a Large FBO with a Major U.S. Footprint

Key FBO Facts

- ≥ $50 billion in global assets
- ≥ $50 billion in combined U.S. assets
- ≥ $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)



Impact of Federal Reserve's Proposal: IHC Requirement and Other New Requirements Apply

- **Top-Tier U.S. IHC** subject to:
  - **U.S. capital requirements** for U.S. bank holding companies, regardless of whether the IHC controls a U.S. bank.
  - **30-day U.S. liquidity buffer** and other liquidity risk management requirements, including internal liquidity stress tests.
  - **Single counterparty credit limits:** Aggregate net credit exposure of the IHC, together with its subsidiaries, to any **unaffiliated counterparty**, together with its subsidiaries, must be limited to **25%** of the IHC's capital stock and surplus. Stricter limit applies to exposures between major counterparties.
  - **Dodd-Frank capital stress test rules**
- **FBO Capital:** FBO must certify that it meets home country capital standards that are broadly consistent with Basel capital standards, including **Basel III**. Non-compliance = Federal Reserve may impose restrictions on U.S. operations.
- **FBO Capital Stress Tests:** FBO must be subject to and pass annual home country stress tests that are comparable to U.S. standards and must provide certain information to the Federal Reserve regarding its home country stress tests.
  - Non-compliance = **108% U.S. asset maintenance** requirement for U.S. branches and agencies, and Federal Reserve may impose intragroup funding restrictions or additional liquidity requirements.
- **Liquidity:** U.S. branches and agencies must maintain a U.S. liquidity buffer that is separate from the IHC's buffer.
- **Risk Management:** FBO must maintain a board level U.S. risk committee meeting certain requirements. The U.S. risk committee can be part of the overall risk committee of the board. Must appoint a U.S. chief risk officer meeting certain requirements.
- **Single Counterparty Credit Limits:** Aggregate net credit exposure of U.S. operations to any **unaffiliated counterparty**, together with its subsidiaries, must be limited to **25%** of the FBO's consolidated total regulatory capital. Stricter limit applies to exposures between major counterparties.
- **Early Remediation:** Only if triggered. **Debt-to-Equity Limits:** Only if FSOC makes determinations about FBO's grave threat to U.S. financial stability.

Table 1: Applicability of Proposed Dodd-Frank Enhanced Prudential Standards to Foreign Banking Organizations

Type of FBO	U.S. Enhanced Prudential Standards Proposed by Federal Reserve							
	U.S. IHC Requirement	**Capital**	**Stress Testing**	**Liquidity**	**Single Counterparty Credit Limits**	**Risk Management**	**Debt-to-Equity Limits**	**Early Remediation**
FBO with > $10 billion *but* < $50 billion in global assets (approx. 29 such FBOs)	**No**	**No**	**Yes.** FBO must meet home country stress test requirements in order to avoid U.S. asset maintenance and other requirements	**No**	**No**	**Yes** ▪ If FBO is publicly traded, it must annually certify that it maintains a board level U.S. risk committee meeting certain requirement ▪ The U.S. risk committee can be part of the overall risk committee of the board.	**No**	**No**
FBO with ≥ $50 billion in global assets *but* < $50 billion in combined U.S. assets (approx. 84 such FBOs)	**Yes**, unless FBO has < $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)	**Yes** ▪ IHC is subject to U.S. capital requirements for BHCs ▪ FBO must certify that it meets home country capital standards that are broadly consistent with Basel capital standards, including Basel III	**All of the above, plus:** IHC is subject to Federal Reserve's Dodd-Frank stress testing rules as if it were a U.S. BHC	**Yes** FBO must report results of annual internal liquidity stress test to Federal Reserve	**Yes** ▪ Limits apply to IHC and combined U.S. operations of FBO ▪ Stricter limits apply to exposures between major counterparties	**Same as above**, regardless of whether its stock is publicly traded	**Yes** if FSOC makes certain determinations about FBO's grave threat to U.S. financial stability	**Yes**, but *not* automatically subject to remediation actions upon exceeding an early remediation trigger
FBO with ≥ $50 billion in combined U.S. assets (approx. 23 such FBOs)	**Yes**, unless FBO has < $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)	**All of the above, plus:** ▪ IHC is subject to U.S. advanced approaches capital rules or market risk capital rules if it crosses applicability thresholds, or if it elects, with Federal Reserve approval, to use the advanced approaches ▪ IHC must submit annual capital plan to Federal Reserve if it has ≥ $50 billion in total consolidated assets	**All of the above plus:** FBO must meet additional conditions regarding home country stress tests in order to avoid U.S. asset maintenance and other requirements	**Yes** ▪ Various liquidity risk management and stress testing requirements ▪ U.S. Branch and Agency Network and IHC must maintain separate U.S. liquidity buffers	**Same as above**	**All of the above, plus:** ▪ Additional requirements for U.S. risk committee, at least one member of which must be independent ▪ Must appoint a U.S. chief risk officer meeting certain requirements	**Same as above**	**Yes** Subject to non-discretionary early remediation actions upon exceeding an early remediation trigger

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Table 2: Methods for Calculating Asset Thresholds Used in the Proposal

Type of Asset	Calculation Method	Where Calculation is Relevant
FBO's "Total Consolidated Assets"	Determined based on the average of the total assets: ▪ For the four most recent consecutive quarters as reported by the FBO on its FR Y-7Q; ▪ If the FBO has not filed the FR Y-7Q for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on FR Y-7Q; **or** ▪ If the FBO has not yet filed an FR Y-7Q, as determined under applicable accounting standards*.	The $10/$50/$500 billion asset thresholds for the following requirements: capital; liquidity; single counterparty credit limits; risk management; stress testing; and early remediation.
IHC's "Total Consolidated Assets"	Determined based on the average of the total assets: ▪ For the four most recent consecutive quarters as reported by the IHC on its FR Y-9C; ▪ If the IHC has not filed the FR Y-9C for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on FR Y-9C; **or** ▪ If the IHC has not yet filed an FR Y-9C, as determined under applicable accounting standards*.	The $10/$50/$500 billion asset thresholds for the following requirements: capital; single counterparty credit limits; and stress testing.
"Combined U.S. Assets (<u>excluding</u> assets of U.S. branches and U.S. agencies)"	Equal to the average of the total consolidated assets of each top-tier U.S. subsidiary of the FBO (**excluding any Section 2(h)(2) company**): ▪ For the four most recent consecutive quarters as reported by the FBO on its FR Y-7Q; ▪ If the FBO has not filed the FR Y-7Q for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on FR Y-7Q; **or** ▪ If the FBO has not filed an FR Y-7Q, as determined under applicable accounting standards*. The FBO may **reduce** its "combined U.S. assets (excluding assets of U.S. branches and U.S. agencies)" calculated above by the amount corresponding to any balances and transactions between any U.S. subsidiaries that would be eliminated in consolidation were an IHC already formed. Balances and transactions between any U.S. subsidiary, on the one hand, and the FBO's head office or other non-U.S. affiliate, on the other hand, would be **included.**	For determining whether an FBO must establish a top-tier U.S. IHC.

"Combined U.S. Assets"	Equal to the sum of:
	▪ The average of the total assets of each U.S. branch and U.S. agency of the FBO:
	    ▪ For the four most recent consecutive quarters as reported to the Federal Reserve on the FFIEC 002; or
	    ▪ If the FBO has not filed the FFIEC 002 for a U.S. branch or U.S. agency for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on the FFIEC 002; or
	    ▪ If the FBO has not yet filed a FFIEC 002 for a U.S. branch or U.S. agency, as determined under applicable accounting standards*.
	▪ If an IHC has been established, the average of the "**total consolidated assets**" of the IHC, calculated as described above in this table.
	▪ If an IHC has not been established, the average of the total consolidated assets of each top-tier U.S. subsidiary of the FBO (**excluding any section 2(h)(2) company**), calculated as described above in this table.
	The FBO may **reduce** its "combined U.S. assets" calculated above by the amount corresponding to balances and transactions between the U.S. subsidiary or U.S. branch or U.S. agency and any other top-tier U.S. subsidiary or U.S. branch or U.S. agency to the extent such items are not already eliminated in consolidation. Balances and transactions between any U.S. subsidiary, U.S. branch or U.S. agency, on the one hand, and the FBO's head office or other non-U.S. affiliate, on the other hand, would be **included.**
		The $10/$50/$500 billion asset thresholds for the following requirements: liquidity; risk management; stress testing; and early remediation.

* Applicable accounting standards" means U.S. GAAP, IFRS or such other accounting standards that a company uses in the ordinary course of its business in preparing its consolidated financial statements.

Table 3: Proposed Dodd-Frank Early Remediation Triggers for Large FBOs

	Capital Adequacy of FBO	Capital Adequacy of IHC	Stress Tests of IHC	Risk Management	Liquidity Risk Management	Market Indicators
Level 1 ***(Heightened Supervisory Review)***	Federal Reserve determines the FBO's capital position is **not** commensurate with the level and nature of risks to which it is exposed, even though: ▪ The risk-based capital ratios of the FBO exceed the minimum applicable requirements by [200-250]* basis points or more; and ▪ The leverage ratios of the FBO exceed the minimum applicable requirements by **[**75-125**]** basis points or more. * The Federal Reserve is considering a range of numbers for the capital triggers in the proposed early remediation framework. The final rule will include specific levels that will be within, or near to, the proposed range.	Federal Reserve determines the IHC is **not** in compliance with rules regarding capital plans or the IHC's capital position is **not** commensurate with the level and nature of risks to which it is exposed, even though: ▪ The risk-based capital ratios of the IHC exceed the minimum applicable requirements by **[**200-250**]** basis points or more; and ▪ The leverage ratios of the IHC exceed the minimum applicable requirements by **[**75-125**]** basis points or more.	The IHC fails to comply with the Federal Reserve's capital plan or stress testing rules.	Any part of the combined U.S. operations has manifested **signs of weakness** in meeting the enhanced risk management requirements.	Any part of the combined U.S. operations has manifested **signs of weakness** in meeting the enhanced liquidity risk management requirements.	Receipt of a notice indicating that the Federal Reserve has found that, with respect to the FBO or IHC, any market indicator has exceeded the market indicator threshold for the breach period.
Level 2 ***(Initial Remediation)***	▪ Any risk-based capital ratio of the FBO is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the FBO is **less** than **[**75-125**]** basis points above the minimum applicable requirements.	▪ Any risk-based capital ratio of the IHC is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the IHC is **less** than [75-125] basis points above the minimum applicable requirements.	Under the supervisory stress test severely adverse scenario, the IHC's Tier 1 Common risk-based capital ratio falls below **5%** during any quarter of the planning horizon.	Any part of the combined U.S. operations has demonstrated **multiple deficiencies** in meeting the enhanced risk management requirements.	Any part of the combined U.S. operations has demonstrated **multiple deficiencies** in meeting the enhanced liquidity risk management requirements.	Not applicable.
Level 3 ***(Recovery)***	▪ Any risk-based capital ratio or leverage ratio of the FBO is **less** than the minimum applicable requirements; **Or, for two consecutive quarters:** ▪ Any risk-based capital ratio of the FBO is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the FBO is **less** than **[**75-125**]** basis points above the minimum applicable requirements.	▪ Any risk-based capital ratio or leverage ratio of the IHC is **less** than the minimum applicable requirements; **Or, for two consecutive quarters:** ▪ Any risk-based capital ratio of the IHC is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the IHC is **less** than [75-125] basis points above the minimum applicable requirements.	Under the supervisory stress test severely adverse scenario, the IHC's Tier 1 Common risk-based capital ratio falls below **3%** during any quarter of the planning horizon.	Any part of the combined U.S. operations is in **substantial noncompliance** with the enhanced risk management requirements.	Any part of the combined U.S. operations is in **substantial noncompliance** with the enhanced liquidity risk management requirements.	Not applicable.
Level 4 ***(Recommended Resolution)***	▪ Any risk-based capital ratio of the FBO is **more** than **[**100-250**]** basis points **below** the minimum applicable requirements; **or** ▪ Any leverage ratio of the FBO is **more** than **[**50-150**]** basis points **below** the minimum applicable requirements.	▪ Any risk-based capital ratio of the IHC is **more** than **[**100-250**]** basis points **below** the minimum applicable requirements; **or** ▪ Any leverage ratio of the IHC is **more** than **[**50-150**]** basis points **below** the minimum applicable requirements.	Not applicable.	Not applicable.	Not applicable.	Not applicable.

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Table 4: Proposed Dodd-Frank Early Remediation Actions for Large FBOs

Level 1 (Heightened Supervisory Review)	▪ The Federal Reserve will conduct a targeted supervisory review of the FBO's combined U.S. operations to evaluate whether these are experiencing financial distress or material risk management weaknesses, including with respect to exposures that the combined U.S. operations have to the FBO, such that further decline of the combined U.S. operations is probable. ▪ If the Federal Reserve determines that such further decline is probable, it may subject the FBO to level 2 remediation.
Level 2 (Initial Remediation)	**Large FBOs with ≥ $50 billion in combined U.S. assets:** ▪ **IHC** capital distributions (e.g., dividends and buybacks) are restricted to no more than 50% of the average of the IHC's net income in the previous two quarters. ▪ **U.S. Branch and Agency Network** must remain in a net due to position to the FBO's head office and non-U.S. affiliates. ▪ **U.S. Branch and Agency Network** must hold 30-day liquidity buffer in the United States (not required in level 3). ▪ **Combined U.S. operations (IHC and U.S. 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 year). ▪ **FBO** may not directly or indirectly acquire any controlling interest in any U.S. company, establish or acquire any U.S. branch, U.S. agency or U.S. representative office, or engage in any new line of business in the United States, without the prior approval of the Federal Reserve. ▪ **FBO** must enter into a non-public memorandum of understanding to improve its financial and managerial condition in the United States. ▪ **Combined U.S. operations** may be subject to other limitations and conditions on their conduct or activities as the Federal Reserve deems appropriate. **Large FBOs with < $50 billion in combined U.S. assets:** Federal Reserve may take some or all of the actions outlined above on a case-by-case basis.
Level 3 (Recovery)	**Large FBOs with ≥ $50 billion in combined U.S. assets:** ▪ **FBO and IHC** must enter into a written agreement specifying that the 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 Federal Reserve. If it fails to satisfy the requirements of such a written agreement, the IHC may be required to divest assets identified by the Federal Reserve. ▪ **IHC and any other U.S. subsidiary** are prohibited from making capital distributions. ▪ **U.S. Branch and Agency Network** must remain in a net due to position to the FBO's head office and non-U.S. affiliates. ▪ **U.S. Branch and Agency Network** subject to a 108% asset maintenance requirement. ▪ **Combined U.S. operations** are subject to a prohibition on growth (no quarterly or annual increase in total assets or total risk-weighted assets). ▪ **FBO** may not directly or indirectly acquire any controlling interest in any U.S. company, establish or acquire any U.S. branch, U.S. agency or office, or other place of business in the United States, or engage in any new line of business in the United States, without the prior approval of the Federal Reserve. ▪ **FBO and IHC** are prohibited from increasing the compensation of or paying any bonus to U.S. senior management or any IHC board member. ▪ **IHC** may be required to replace its board of directors or dismiss any executive primarily responsible for any US. operations or any board member. ▪ **Combined U.S. operations** may be subject to other limitations and conditions on their conduct or activities as the Federal Reserve deems appropriate, including restrictions on transactions with affiliates. **Large FBOs with < $50 billion in combined U.S. assets:** Federal Reserve may take some or all of the actions outlined above on a case-by-case basis.
Level 4 (Recommended Resolution)	▪ Federal Reserve will consider whether the FBO's combined U.S. operations warrant termination or resolution based on their financial decline, 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 Federal Reserve will take actions that include recommending to the appropriate financial regulatory agencies that an entity within the FBO's U.S. Branch and Agency Network be terminated or that a U.S. subsidiary be resolved.

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