

CONNELL & ANDERSEN LLP
545 FIFTH AVENUE
NEW YORK, NEW YORK 10017

WILLIAM F. CONNELL
ROY C. ANDERSEN

TELEPHONE: (212) 687-6900
FACSIMILE: (212) 687-6999
randersen@connellandersen.com

OF COUNSEL
GEORGE A. SCHNEIDER
LUCA CANTELLI

December 18, 2012

How does the Fed's New Foreign Bank Rule Affect the Small Foreign Banks?

With the Fed's new proposed regulation of foreign banks, much of the focus, deservedly so, has been on the requirements applicable to the big foreign banks. The big banks will have to set up U.S. holding companies and abide by new capital and other rules. The Fed is giving the smaller banks somewhat of a pass, but there are still new rules in the offing for the smaller foreign banks.

This memorandum discusses those requirements and for this purpose, smaller foreign banks are those banks that have over \$10 billion in total consolidated assets but less than \$50 billion in total consolidated assets and less than \$50 billion in U.S. assets.

Of course, this whole exercise should be tempered by the fact that this rule does not become effective until 2015; although it is almost 2013, it is not yet time to panic over the new rule. There is still two and half years left to think about how this applies to your bank.

What do these smaller foreign banks have to do?

Establish a Risk Committee

The Fed is requiring a FBO with over \$10 billion in total consolidated assets and which is publicly traded to establish a risk committee.

The proposal would require a foreign banking organization with publicly traded stock and total consolidated assets of \$10 billion or more [...] to certify to the Board, on an annual basis, that it maintains a committee that (1) oversees the U.S. risk management practices of the combined U.S. operations of the company, and (2) has at least one member with risk management expertise. This certification must be filed with the Board concurrently with the foreign banking organization's Form FR Y-7. See pages 118-119 of the Fed's Release dated December 14, 2012, and section 252.251 of the proposed rules.

At least one member of a U.S. risk committee would be required to have risk management expertise that is commensurate with the capital structure, risk profile, complexity, activities, and size of the foreign banking organization's combined U.S. operations. See page 119 of the Fed's Release dated December 14, 2012.

Under the proposal, foreign banking organization with publicly traded stock and total consolidated assets of \$10 billion or more as of July 1, 2014, would be required to comply with the proposed risk committee certification requirement on July 1, 2015, unless that time is extended by the Board in writing. This must mean when the foreign bank has to file its FR Y-7. See page 120 of the Fed's Release dated December 14, 2012.

A foreign banking organization that does not have to set up an intermediate holding company may maintain its U.S. risk committee either: (i) As a committee of the global board of directors (or equivalent thereof), on a standalone basis or (ii) as part of its enterprise-wide risk committee (or equivalent thereof). See section 252.251(b) of the proposed rules. I suspect forming this committee as a stand alone committee of the global board will be a nonstarter for many foreign banks so it leave this as a part of the existing risk committee.

Engage in Stress Testing

Unless otherwise determined in writing by the Board, a foreign banking organization with total consolidated assets of more than \$10 billion, must (1) be subject to a stress testing regime by its home country supervisor that includes: (i) an annual supervisory capital stress test conducted by the company's home country supervisor or an annual evaluation and review by the home country supervisor of an internal capital adequacy stress test conducted by the company; and (ii) requirements for governance and controls of the stress testing practices by relevant management and the board of directors (or equivalent thereof) of the foreign banking organization; and (2) conduct such stress tests and meet the minimum standards set by its home country supervisor with respect to the stress tests. See section 252.264(a) of the proposed rules.

The Fed's background information about the new regulation states: "these companies would *not* be subject to separate information requirements imposed by the Board related to the results of their stress tests." This is not in the regulation so it is not clear what it means although it sound like the Fed would not be requesting additional information on the stress tests so long as the standards are met. See page 140 of the Fed's Release dated December 14, 2012.

The proposal would require any foreign banking organization or foreign savings and loan holding company that meets the \$10 billion asset threshold as of July 1, 2014 to comply with the proposed stress testing requirements beginning in October 2015, unless that time is extended by the Board in writing. . See page 141 of the Fed's Release dated December 14, 2012.

If a foreign banking organization described above does not meet the proposed stress test requirements, the Board would require its U.S. branch and agency network, as applicable, to maintain eligible assets equal to 105 percent of third-party liabilities (asset maintenance requirement). The 105 percent asset maintenance requirement reflects the more limited risks that these companies pose to U.S. financial stability.

R.C.A.