Statement for the Record
by the
Institute of International Bankers
for the hearing before the
Committee on Financial Services
of the
United States House of Representatives

***"Financial Regulatory Reform:
The International Context"***

June 16, 2011

Chairman Bachus, Ranking Member Frank and members of the Committee, the Institute of International Bankers (IIB) appreciates the opportunity to submit this statement for the record for the June 16, 2011 House Financial Services hearing entitled "Financial Regulatory Reform: The International Context". The IIB represents internationally headquartered financial institutions from over 35 countries around the world; our members include international banks that operate branches and agencies, bank subsidiaries and broker-dealer subsidiaries in the United States. International banks provide an important source of credit for U.S. borrowers and enhance the depth and liquidity of U.S. financial markets. Their U.S. operations contribute billions of dollars each year to the economies of major cities across the country through the employment of over 250,000 U.S. citizens and permanent residents and through other operating and capital expenditures.

The IIB and its members support the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) objectives of reducing systemic risk and increasing transparency in the financial markets. We also support the commitments of the G-20 leaders to setting high, internationally consistent requirements for OTC derivatives and avoiding overlapping regulations.

Background

As a general matter, the international framework for the supervision of cross-border banking activities is based on considerations of comity and appropriate allocation of supervisory responsibilities across home and host country supervisors. As applied in the United States, this framework is reflected in the longstanding policy of national treatment, *i.e.*, there should be parity of treatment between U.S. banks and international banking firms that operate in the United States, and the understanding that international banking firms are subject to primary supervision by their home country authorities with U.S. authorities, primarily the Federal Reserve Board (FRB), as host country supervisors, exercising appropriate oversight of international banking firms' U.S. operations. Accordingly, the U.S. banking and nonbanking operations of our members, like their U.S. counterparts, are subject to extensive U.S. regulation and supervision by the federal banking agencies, the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), as appropriate.

Swap Dealer Registration and Regulation

As noted above, our members support Title VII's objectives of reducing systemic risk and increasing transparency. Together, we have developed a proposal on the cross-border application of Title VII that we hope will assist global regulators to develop a workable regime for supervising U.S. and foreign firms that operate global swap businesses.

Before turning to a discussion of that proposal, it is important to note that Title VII's effective date of July 16th is just a few short weeks away. The possibility that many of that Title's provisions may be deemed self-effectuating and, thus, may become effective on July 16th

without rulemaking or further action on the part of the SEC or CFTC has led to great uncertainty among global swap dealers and other market participants. We appreciate the CFTC's proposal on Tuesday to alleviate this uncertainty, which we are currently reviewing, as well as the recent announcement made by the SEC that it also intends to clarify the requirements that will apply on July 16th.

However, even if the agencies clarify that compliance with Title VII largely is not required on July 16th, there will still be considerable uncertainty surrounding basic elements of Title VII which make preparing for compliance extremely difficult. In particular, until the agencies provide guidance about the extraterritorial application of Title VII, internationally active firms, regardless of where they are headquartered, will be unable to complete the analysis that is needed to determine how to structure their cross-border derivatives activities. Specifically, many firms do not yet have the guidance necessary to determine through which entities activities may continue to be conducted under the new regime.

Our proposal was developed in the spirit of addressing that uncertainty. Before describing the proposal's details, it is important to note that foreign banks and U.S. banks alike seek to minimize the number of legal entities through which they conduct swap dealing activities and, where possible, to use a single legal entity to transact with swap counterparties globally. This increases efficiency and decreases risk by permitting the bank and its counterparties to net and offset their exposures. It also allows counterparties to transact with a more creditworthy entity, which for foreign banks is usually located and supervised outside the U.S. The personnel who have relationships with U.S. customers or manage U.S.-related portfolios on behalf of their head office are often, however, located inside the U.S.

Our proposal, which would apply Title VII to this and other common ways in which international derivatives dealers operate, has been guided by the following considerations:

(1) We have sought to be faithful to the statute; we are not asking for an exemption from swap dealer registration. Any time that swap dealing activities occur directly with U.S. customers or from within the U.S., a U.S.-registered swap dealer would be involved. Additionally, the personnel interacting with U.S. customers would be employed by a U.S. registrant subject to supervision and examination by the CFTC and the SEC.

(2) We have sought to protect U.S. customers. We believe that U.S. regulations that apply to particular transactions, such as U.S. clearing, trading, reporting and business conduct and similar requirements should apply to transactions entered into with a U.S. counterparty or from within the U.S. Transactions entered into with foreign counterparties from abroad should, of course, be subject to the rules of the relevant foreign jurisdictions, rather than U.S. rules.

(3) We have sought to be sensitive to the resource constraints of U.S. regulators. One of the key ways for U.S. regulators to address these constraints is to leverage effective foreign supervision while retaining their full enforcement authority. So, we believe that, if U.S. regulators determine that home country capital and other similar entity-wide regulations are sufficiently comparable to U.S. regulations, then compliance with those regulations should constitute compliance with U.S. requirements, and failure to comply should be treated as noncompliance with U.S. requirements, enforceable by U.S. regulators. This is consistent with the FRB's current proposal for swap dealer capital requirements.[1]

[1] We believe a similar approach is warranted for foreign non-bank swap dealers subject to comparable home country capital requirements, with comparability determined based on well-established benchmarks (such as pre-existing evaluations of the home country regulator's supervisory framework by the FRB or whether the home country

(4) We have sought to support and encourage international harmonization. We believe that our proposal would encourage foreign regulators to adopt regulations comparable to the U.S and to open access further to U.S. banks. In particular, we believe it would be consistent with the approach of recognizing equivalent third country regimes that is currently under consideration by the European Union (EU).[2]

(5) Further to this last consideration, under our proposal, if a branch of a U.S.-headquartered bank were engaged in off-shore derivatives activities, that country's regulators would allow the branch to comply with U.S. capital and other entity-wide rules so long as they were deemed comparable to those applied by the regulators to firms headquartered in that country. Assuming the branch entered into a swap transaction with a foreign counterparty, the foreign regulators' transaction rules, *e.g.*, business conduct, clearing, etc., would apply, and U.S. rules would not. Also, a foreign affiliate of a U.S.-headquartered bank would be treated just like a foreign bank, *i.e.*, U.S.

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regulator administers a capital regime consistent with the Basel Accord). This is necessary to level the playing field between non-bank subsidiaries of U.S. bank holding companies, which could use a risk-based approach to capital under the CFTC's current swap dealer capital proposal, and non-bank subsidiaries of foreign bank and financial holding companies, which under that proposal would be subject to rules-based capital requirements that are inconsistent with requirements applied by home country supervisors.

[2] Since the EU has not historically had exemptions for OTC derivatives similar to what were in place in the United States prior to enactment of Dodd-Frank, most EU derivatives dealers are already subject to comprehensive prudential supervision and prohibitions against abusive market conduct. Consistent with the G-20 commitments, the EU is working to adopt mandatory clearing requirements (under the proposed European Market Infrastructure Regulation (EMIR)) and trading and reporting requirements (under proposed revisions to the Markets in Financial Instruments Directive (MiFID)) in the December 2012 timeframe, with mandatory clearing on track to be implemented first. As part of the MiFID reform, the European Commission has proposed to allow third country firms subject to equivalent regulation to access the EU common market. If adopted, this proposal would allow U.S.-headquartered banks to access the entire EU directly without registering in the EU or using an EU subsidiary. We believe that the EU is unlikely to adopt this aspect of the proposal unless the United States also takes a similar approach with respect to institutions headquartered in the EU.

We note further that there are also some areas, such as business conduct standards for advice to pension plans and the timing for public trade reporting, where the rules under Dodd-Frank may diverge from the approach taken in the EU. Accordingly, we believe that U.S. requirements under Dodd-Frank should apply to U.S.-related transactions, and EU requirements under the applicable regulations and directives should apply to EU-related transactions.

regulations that apply to particular transactions would apply to transactions with U.S. counterparties, but transactions by the foreign affiliate with foreign counterparties from outside the U.S. would be subject to relevant foreign rules.[3] U.S. regulators would also defer to comparable foreign entity-wide rules for the foreign affiliate.

We believe that this proposal will help maintain the preeminence of the U.S. as a leading international financial center by maintaining the liquidity of the U.S. derivatives market. By contrast, if Title VII were to effectively require foreign banks to conduct their derivatives dealing activities in the U.S. through separately incorporated subsidiaries, U.S. customers and foreign banks would face inefficiencies and additional costs of transacting in derivatives through multiple legal entities. The significant negative impacts on capital, netting and risk management resulting from conducting derivatives trading through multiple U.S. and non-U.S. legal entities could also reduce the liquidity available to U.S. market participants.

Moreover, in our view, the best way to guard against offshoring of derivatives activities is to make sure that Title VII is applied sensibly and in a manner that does not require U.S. regulators to supervise swap activity across the entire world. Consistent with this objective, our proposal calls for application of Title VII's requirements to common ways that cross-border swap activity is currently conducted. The proposal has been carefully crafted to ensure that U.S. customers are protected by dealing with a U.S.-registered swap dealer that is responsible for compliance with U.S. clearing, trading, reporting and business conduct standards. As described

[3] We note that the banking agencies' margin proposal would treat both U.S. and foreign banks the same if they are entering into transactions from the U.S. or with U.S. persons – in such cases, U.S. rules under Title VII would apply. The one area where there would be different treatment is for swaps entered into from abroad with a foreign counterparty. While the banking agencies would distinguish between a U.S. and foreign-controlled entities – with U.S. entities' non-U.S. operations subject to U.S. margin rules and foreign controlled entities subject to rules of the applicable foreign jurisdiction – we believe that all transactions entered into between foreign counterparties, regardless of whether conducted by a U.S. entity's non-U.S. operation or by a foreign-controlled entity, should be subject to primary supervision by foreign regulators, not U.S. regulators.

above, the registered swap dealer would also be subject to comparable home country prudential supervision.

In contrast, the real danger lies in applying inconsistent or duplicative U.S. rules and supervision to every institution whose swap-related activities has a connection to the U.S. Offshoring is more likely if foreign banks are forced to set up separate trading operations in the United States and abroad, since that would encourage trading to move to the more liquid offshore market rather than staying in the United States where it is now conducted.

Thus, we believe that, under our proposal, Title VII can be applied fairly to all derivatives dealers in a way that does not cause undue disruption and increased costs to customers and the overall financial system.

Swaps Push-Out and Swap Dealer Definition

The IIB would also like to raise two other provisions of Title VII, specifically Section 716 of Dodd-Frank, also known as the swaps "push-out" provision, and the definition of "swap dealer" under Section 1(a)(49) of the Commodity Exchange Act. While we are concerned about the adverse impacts on capital, netting and risk management that will result from the swaps push-out provision, we are most concerned with the unequal treatment accorded to foreign banks under this provision.

Section 716 contains exceptions from the push-out provision for FDIC-insured banks; those exceptions do not extend to uninsured U.S. branches or agencies of foreign banks. When Dodd-Frank was enacted, members of Congress recognized that this oversight was unintentional Left uncorrected, it will, contrary to U.S. policy, prevent foreign banks from conducting bank-permissible businesses and managing risks through their U.S. branches. It also will cause serious market and business disruptions as foreign banks are not included within the provision's grandfather and, thus, will be forced to assign and re-document entire portfolios booked in their U.S. branches. We strongly support extending Section 716's exception and grandfather provisions to U.S. branches and agencies of foreign banks.

Finally, the IIB would support revisions to the definition of "swap dealer" that would allow uninsured U.S. branches and agencies of international banks, like FDIC-insured depository institutions, to enter into swaps with customers as an adjunct to their loan origination activities without having to register as a swap dealer. Branches and agencies of international banks are significant credit providers in this country and account for approximately 18% of all U.S. commercial and industrial loans. To permit these institutions to enter into swaps with their customers only as a registered dealer puts them at a competitive disadvantage to U.S. firms and, more importantly, could discourage further lending in this country by foreign banking institutions.

Systemic Risk, Capital and Other Prudential Standards

The global legislative and regulatory environment is moving towards heightened prudential standards and supervision for all systemically important financial institutions, with increased capital and liquidity requirements, stress tests, "living wills", risk management and disclosure requirements, and corporate governance and incentive compensation standards. The application of these requirements to foreign banking institutions with U.S. banking operations raises complex issues that require a deliberative, cross-jurisdictional approach. Coordination and cooperation among international regulators and deference to home country regulation wherever comparable standards exist is key.

Congress made a determination that these enhanced supervision and prudential standards should apply to those bank holding companies with $50 billion or more in consolidated assets

($50 Billion Asset Threshold) and to certain nonbank financial companies in order to prevent or mitigate risk to the financial stability of the U.S. Congress did not prescribe a specific means for measuring the $50 Billion Asset Threshold and, instead, left this determination to the FRB's discretion.

Unfortunately, the recent proposal on living wills issued jointly by the FRB and the Federal Deposit Insurance Corporation (FDIC) under authority of Section 165(d) of Dodd-Frank takes a fairly expansive view and proposes to define the $50 Billion Asset Threshold by reference to a foreign banking institution's worldwide assets, rather than on the basis of the assets of their U.S. operations. The IIB believes that the Agencies' view is contrary to Congressional intent.

Specifically, as expressed in the plain language of Section 165, the Congressional intent underlying the resolution plan requirement and the other enhanced prudential standards prescribed under Section 165 is to "prevent or mitigate risks to the *financial stability of the United* States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions" (emphasis added). Of the estimated 124 banking institutions subject to the Agencies' living wills proposal, 98 of them are foreign banking institutions. Of those 98, the IIB estimates that approximately 20 institutions have U.S. operations with total consolidated assets of $50 billion or more. Of the remaining 78 foreign banking institutions, the IIB estimates that almost all have U.S. operations whose total consolidated assets are less than $25 billion (and of these approximately 20 have less than $1 billion in assets).

Implementing Section 165 in a manner such that nearly 80% of the banking organizations subject to its enhanced prudential requirements would be institutions headquartered outside the

United States cannot be what Congress intended. It is also difficult to imagine that Congress intended the regulators to devote their precious supervisory resources in this way. Rather, it would be more consistent with Congressional intent, as well as principles of national treatment and equality of competitive opportunity, if the prudential standards were to apply to those foreign banking organizations with $50 billion or more in U.S. assets.

With respect to capital and liquidity generally, we take comfort in the FRB's recent statement that it, together with the other Federal banking agencies, expects to issue in 2011 proposed rules outlining how Basel III-based requirements will be implemented for all institutions with a view towards finalizing Basel III-based capital requirements in 2012 and implementation in 2013.[4] It is important that the global regulators coordinate and work closely to ensure that the Basel III agreement is implemented globally in a consistent and comprehensive manner.

However, the Basel III capital and liquidity rules raise a host of complexities, not the least of which is the interconnectedness of these reforms with those under contemplation by global regulators for systemically important financial institutions. It is important that the global regulators address these issues carefully and with a complete understanding of their impact on the ability of banks as financial intermediaries to continue to serve their clients and the global economy as a whole.

Volcker Rule

The Volcker Rule generally prohibits banking entities, including international banks, from engaging in proprietary trading or sponsoring, acquiring or retaining an interest in a hedge or private equity fund. Congress deliberately limited the extraterritorial effects of the Volcker

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[4] Board of Governors of the Federal Reserve System, Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, 76 Fed. Reg. 22662, 22665 (April 22, 2011).

Rule by permitting international banks to engage in these activities outside of the U.S. Permitting international banks to so engage in these activities is consistent with the policy objectives of the Volcker Rule, which generally focus on protecting U.S. banks, the stability of the U.S. financial system and U.S. taxpayer funds from what Congress deemed to be inappropriate risks. It is also consistent with longstanding principles of international bank supervision, reflected in U.S. federal banking laws, which limit unwarranted extraterritorial application of U.S. banking laws and accord appropriate deference to home country bank supervision.

Governments and supervisors in other countries are actively debating these issues and may make different judgments about bank proprietary trading and fund activities. If the Volcker Rule were applied in such a manner as to reach international banks' non-U.S. proprietary trading and fund activities, it could result in the imposition of overlapping and inconsistent regulatory regimes on foreign banking institutions' non-U.S. operations.

Conclusion

The international bank supervisory framework has long recognized that host country supervisors are inherently limited in their ability to effectively oversee activities in a bank's home country and other jurisdictions, and the legitimate interests of home country regulatory authorities in discharging their responsibilities, as primary supervisors of foreign banking institutions, should be not be dismissed lightly. Nor should the global implications of overreaching by U.S. authorities be ignored. International regulators may well be forced to take a similar stand with respect to U.S.-headquartered financial institutions. Finally, it is imperative from a risk and reward perspective that the U.S. and other countries work together to develop a rational and workable supervisory regime for both U.S. and foreign banking institutions that operate on a global basis. Without such an approach, foreign banking institutions may determine to pare back their U.S. operations, which may well have a significant impact on credit availability, employment and the continued preeminence of the U.S. as a leading financial center.