INTERNATIONAL FINANCE SPRING 2014
ISSUES IN CROSS BORDER FINANCIAL REGULATION

Caroline Bradley[1]

OBJECTIVES OF BANKING REGULATION AND SECURITIES REGULATION

As we have seen, different transnational standard-setters, which comprise networks of domestic regulators, focus on different aspects of financial regulation (IOSCO for securities regulation and the Basel Committee for bank regulation).[2] This separation between different regimes for harmonizing standards for the regulation of different types of financial activity reflects a separation in many countries between the regulators responsible for different types of financial activity. However, whereas the US has many separate regulators for different types of financial activity, other countries have organized financial regulation differently so that a single domestic regulators supervises many different types of financial activity. In both types of system

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[1] Professor of Law, University of Miami School of Law, PO Box 248087, Coral Gables, FL, 33124, cbradley@law.miami.edu ; http://blenderlaw.umlaw.net/ .

[2] Note that there are efforts to look at issues which cross these functional and regulatory boundaries. For example, the Financial Stability Board is concerned with financial stability generally and not just with respect to banks, the Joint Forum deals with cross-disciplinary issues, and the FSAP process looks at implementation of the various standards.

(multi-function and single-function regulatory systems) there are regulatory distinctions between banks and non-banks. Traditionally banks took in deposits and made loans.[3] Depositors in deposit-taking banks benefit from deposit insurance, which means that they do not need to monitor their bank. Banks are at the core of the financial system and deposit insurance reflects this. Different regulatory systems have taken different approaches to the range of activities firms regulated as banks have been allowed to engage in. In some jurisdictions, such as Germany, universal banks have been able to carry on a broad range of financial activity (including insurance) for some time. In the US after the 1929 market crash commercial banks were not allowed to underwrite issues of securities (they could not engage in investment banking) (under the Glass-Steagall Act). These restrictions were reduced over time, and eliminated by the Gramm-Leach-Bliley Act of 1999 which allowed US banks to engage in "broad banking".The restriction eroded at least in part due to a perceived need for US banks to be able to compete with universal banks. Since the financial crisis, regulators have focused on requiring banks which benefit from deposit insurance to limit their involvement in proprietary trading. In the US the relevant rules are known as the "Volcker Rule, "[4] whereas similar proposals in the EU were denominated the Liikanen Rule.[5] Both sets of rules reflect a concern to prevent banks, which benefit from deposit insurance and have during the financial crisis benefitted from bailouts, from engaging in "proprietary trading" because of the risks this type of trading is perceived to involve for bank safety and soundness. Episodes such as JP Morgan's London Whale problem, where Bruno Iksil, a trader, lost more than $6.2 billion for the bank,

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[3] The Allen & Overy document on the Greek debt reorganization continues to characterize banks in this way. Allen & Overy, How the Greek Debt Reorganisation of 2012 changed the Rules of Sovereign Insolvency (2012) at 18 ("If we strip aside all the veils of incorporation, all the fictions of legal imagination, the real creditors of sovereign debtors are not the nominal banks and insurance companies. They are the depositors who put their money in the banks....").

[4] The final version of the Volcker Rule (at 272 pages) was published in the Federal Register in January 2014. Final Rule: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds; 79 Fed. Reg. 5535 (Jan. 31, 2014) http://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf. The American Bankers Association challenged parts of the rules which would have required community banks to divest holdings in some collateralized debt obligations. The regulators agreed to review this issue. Interagency Statement Regarding the Treatment of Certain Collateralized Debt Obligations Backed by Trust Preferred Securities under the Volcker Rule (Dec. 27, 2013) at http://www.federalreserve.gov/bankinforeg/srletters/sr1325.pdf;Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities With Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, Interim Final Rule, 79 Fed. Reg. 5223 (Jan. 31, 2014).

[5] See http://ec.europa.eu/internal_market/bank/structural-reform/index_en.htm and Proposal for a Regulation on Structural Measures Improving the Resilience of EU Credit Institutions, COM(2014) 43 final (Jan. 29, 2014) at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2014:0043:FIN:EN:PDF.

illustrate the problem the rules are trying to address. A US Senate Committee wrote in 2013 that:

JPMorgan Chase has consistently portrayed itself as an expert in risk management with a "fortress balance sheet" that ensures taxpayers have nothing to fear from its banking activities, including its extensive dealing in derivatives. But in early 2012, the bank's Chief Investment Office (CIO), which is charged with managing $350 billion in excess deposits, placed a massive bet on a complex set of synthetic credit derivatives that, in 2012, lost at least $6.2 billion.

The CIO's losses were the result of the so-called "London Whale" trades executed by traders in its London office – trades so large in size that they roiled world credit markets. Initially dismissed by the bank's chief executive as a "tempest in a teapot," the trading losses quickly doubled and then tripled despite a relatively benign credit environment. The magnitude of the losses shocked the investing public and drew attention to the CIO which was found, in addition to its conservative investments, to be bankrolling high stakes, high risk credit derivative trades that were unknown to its regulators.

The JPMorgan Chase whale trades provide a startling and instructive case history of how synthetic credit derivatives have become a multi-billion dollar source of risk within the U.S. banking system. They also demonstrate how inadequate derivative valuation practices enabled traders to hide substantial losses for months at a time; lax hedging practices obscured whether derivatives were being used to offset risk or take risk; risk limit breaches were routinely disregarded; risk evaluation models were manipulated to downplay risk; inadequate regulatory oversight was too easily dodged or stonewalled; and derivative trading and financial results were misrepresented to investors, regulators, policymakers, and the taxpaying public who, when banks lose big, may be required to finance multi-billion-dollar bailouts.

The JPMorgan Chase whale trades provide another warning signal about the ongoing need to tighten oversight of banks' derivative trading activities, including through better valuation techniques, more effective hedging documentation, stronger enforcement of risk limits, more accurate risk models, and improved regulatory oversight. The derivatives overhaul required by the Dodd-Frank Wall Street Reform and Consumer Protection Act is intended to provide the regulatory tools needed to tackle those problems and reduce derivatives-related risk, including through the Merkley-Levin provisions that seek to implement the Volcker Rule's prohibition on high risk proprietary trading by federally insured banks, even if portrayed by banks as hedging activity designed to lower risk.[6]

Some banks pose particular risks to financial stability, and the financial crisis prompted

[6] United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, JP Morgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses, p. 1 (Mar. 15, 2013) at http://www.hsgac.senate.gov/download/report-jpmorgan-chase-whale-trades-a-case-history-of-derivatives-risks-and-abuses-march-15-2013.

domestic regulators and transnational standards bodies to identify systemically important banks at the domestic and international levels. The Financial Stability Board has identified a group of banks which are considered to be Global Systemically Important Banks (GSIGs),[7] banks which are particularly likely to have an impact on financial stability because of "size, interconnectedness, lack of readily available substitutes or financial institution infrastructure, global (cross-jurisdictional) activity and complexity."[8] These banks should be subjected to higher levels of scrutiny than banks whose activities do not have the same systemic implications, and they should be required to hold additional capital and to be a particular focus of bank resolution regimes designed to avoid the need for bail-outs.

Identifying systemically important banks, however, does not completely address concerns about financial stability. Although financial regulation has tended to draw distinctions between banking and other types of financial activity, firms which are not regulated as banks may behave very much like banks. For example, consider Elliott's purchases of distressed sovereign debt: Elliott takes the place of the bank lenders (and incurs the credit risk relating to the debt) by purchasing the debt. Insurance companies which take on credit risk through credit default swaps are also behaving like banks. These hedge funds and insurance companies do not benefit from deposit insurance, but if they take on excessive amounts of risk they may have a negative impact on financial stability (think, for example about the AIG bailout). Shadow banking raises issues about how firms which perform functions like those of banks should be regulated. and the G20 and domestic regulators have focused on the need to identify Systemically Important Financial Institutions (SIFIs): non-bank financial institutions whose activities may have an impact on financial stability. As of the beginning of 2014 the Financial Stability Board has focused on how to identify non-bank non-insurer global systemically important financial institutions.[9]

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[7] *See* Financial Stability Board, 2013 Update of Group of Global Systemically Important Banks (G-SIBs) (Nov. 11, 2013); Basel Committee, Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement (Jul. 2013) at http://www.bis.org/publ/bcbs255.pdf .

[8] Basel Committee Press Release, Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement (Jul. 2013) at http://www.bis.org/publ/bcbs255.htm .

[9] Financial Stability Board, Consultative Document: Assessment Methodologies for Identifying Non-bank Non-insurer Global Systemically Important Financial Institutions (NBNI G-SIFIs) (Jan. 8, 2014) at http://www.financialstabilityboard.org/publications/r_140108.pdf .

In 2011, **Daniel Tarullo, a Governor of the Federal Reserve** addressed shadow banking:

... it is noteworthy that while the term "shadow banking system" has taken its place in the lexicon of policymakers alongside "systemic risk" and "financial stability," comparatively little has been done to regulate the channels of capital flows in which one or both transacting parties lie outside the perimeter of prudentially supervised institutions. This despite the often considerable degree of leverage and maturity transformation associated with many of these channels. In part, the relative lack of reform directed at the shadow banking system is a result of the fact that it was substantially disrupted by the financial crisis, and that some of its more unstable parts have fortunately disappeared. Yet there are certainly significant pieces that have survived and that serve important purposes in financial markets.... money market funds [are] one example. Although many broker-dealers are parts of bank holding companies, the breadth and significance of the repo market suggest that it may be another.

Just as important as dealing with systemic risks that might be posed by vestiges of the pre-crisis shadow banking system is the ability to monitor and, where necessary provide oversight for, the new conduits that are almost surely to develop in the future. In fact, it may be useful to require some systematic and standardized reporting by some classes of nonbank-affiliated firms, even without a designation under section 113.

With respect to both old and new channels, there is an important and growing academic literature on various aspects of the shadow banking system. There is now a formal exercise sponsored by the Financial Stability Board to identify policy approaches and options for ensuring that the shadow banking system does not again grow so as to pose a threat to financial stability. My hope is that these sources will serve as a catalyst for more active policy discussion and, eventually, action. In the absence of appropriate regulatory, and possibly legislative, action, the section 113 designation tool will inevitably bear more of the weight in policies crafted to contain systemic risk. [10]

Section 113 of the Dodd-Frank Act:

Sec. 113. Authority to Require Supervision and Regulation Of Certain Nonbank Financial Companies. (A) US Nonbank Financial Companies Supervised by the Board of Governors.. (1) Determination..The Council,[11] on a nondelegable basis and by a vote of not fewer than 2/3 of the voting members then serving, including an affirmative vote by the Chairperson, may determine that a U.S. nonbank financial

[10] Governor Daniel K. Tarullo, Regulating Systemic Risk, Speech at the 2011 Credit Markets Symposium, Charlotte, North Carolina (Mar. 31, 2011) at http://www.federalreserve.gov/newsevents/speech/tarullo20110331a.htm.

[11] This is the Financial Stability Oversight Council (a interagency council) : http://www.treasury.gov/initiatives/Pages/FSOC-index.aspx . See FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21637 (Apr. 11, 2012).

company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States.
(2) Considerations..In making a determination under paragraph (1), the Council shall consider. (A) the extent of the leverage of the company; (B) the extent and nature of the off-balance-sheet exposures of the company; (C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies; (D) the importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system; (E) the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities; (F) the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse; (G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company; (H) the degree to which the company is already regulated by 1 or more primary financial regulatory agencies; (I) the amount and nature of the financial assets of the company; (J) the amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and (K) any other risk-related factors that the Council deems appropriate
(b) Foreign Nonbank Financial Companies Supervised by The Board of Governors..
(1) Determination..The Council... may determine that a foreign nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the foreign nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the foreign nonbank financial company, could pose a threat to the financial stability of the United States.
(2) Considerations.—In making a determination under paragraph (1), the Council shall consider— (A) the extent of the leverage of the company; (B) the extent and nature of the United States related off-balance-sheet exposures of the company; (C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies; (D) the importance of the company as a source of credit for United States households, businesses, and State and local governments and as a source of liquidity for the United States financial system; (E) the importance of the company as a source of credit for low-income, minority, or underserved communities in the United States, and the impact that the failure of such company would have on the availability of credit in such communities; (F) the extent to which assets are managed rather than owned by the company and the extent to which ownership of assets under management is diffuse; (G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company; (H) the extent to which the company is subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority; (I) the amount and nature of the United States financial assets of the company; (J)

the amount and nature of the liabilities of the company used to fund activities and operations in the United States, including the degree of reliance on short term funding; and (K) any other risk-related factors that the Council deems appropriate.
(c) Antievasion.. (1) Determinations..In order to avoid evasion of this title, the Council, on its own initiative or at the request of the Board of Governors, may determine... that.
(A) material financial distress related to, or the nature, scope, size, scale, concentration, interconnectedness, or mix of, the financial activities conducted directly or indirectly by a company incorporated or organized under the laws of the United States or any State or the financial activities in the United States of a company incorporated or organized in a country other than the United States would pose a threat to the financial stability of the United States, based on consideration of the factors in subsection (a)(2) or (b)(2), as applicable;
(B) the company is organized or operates in such a manner as to evade the application of this title; and
(C) such financial activities of the company shall be supervised by the Board of Governors and subject to prudential standards in accordance with this title, consistent with paragraph (3).
(2) Report.—Upon making a determination under paragraph (1), the Council shall submit a report to the appropriate committees of Congress detailing the reasons for making such determination.
(3) Consolidated Supervision of Only Financial Activities; Establishment of an Intermediate Holding Company.—
(A) Establishment of an Intermediate Holding Company.—Upon a determination under paragraph (1), the company that is the subject of the determination may establish an intermediate holding company in which the financial activities of such company and its subsidiaries shall be conducted (other than the activities described in section 167(b)(2)) in compliance with any regulations or guidance provided by the Board of Governors. Such intermediate holding company shall be subject to the supervision of the Board of Governors and to prudential standards under this title as if the intermediate holding company were a nonbank financial company supervised by the Board of Governors.
(B) Action of the Board of Governors.—To facilitate the supervision of the financial activities subject to the determination in paragraph (1), the Board of Governors may require a company to establish an intermediate holding company, as provided for in section 167, which would be subject to the supervision of the Board of Governors and to prudential standards under this title, as if the intermediate holding company were a nonbank financial company supervised by the Board of Governors.
(4) Notice and Opportunity for Hearing and Final Determination; Judicial Review.—Subsections (d) through (h) shall apply to determinations made by the Council pursuant to paragraph (1) in the same manner as such subsections apply to nonbank financial companies.
(5) Covered Financial Activities.—For purposes of this subsection, the term ''financial activities''—
(A) means activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956);
(B) includes the ownership or control of one or more insured depository institutions; and
(C) does not include internal financial activities conducted for the company or any affiliate thereof, including internal treasury, investment, and employee benefit functions.

(6) Only Financial Activities Subject to Prudential Supervision.—Nonfinancial activities of the company shall not be subject to supervision by the Board of Governors and prudential standards of the Board. For purposes of this Act, the financial activities that are the subject of the determination in paragraph (1) shall be subject to the same requirements as a nonbank financial company supervised by the Board of Governors. Nothing in this paragraph shall prohibit or limit the authority of the Board of Governors to apply prudential standards under this title to the financial activities that are subject to the determination in paragraph (1).

(d) Reevaluation and Rescission..The Council shall. (1) not less frequently than annually, reevaluate each determination made under subsections (a) and (b) with respect to such nonbank financial company supervised by the Board of Governors; and (2) rescind any such determination, if the Council, by a vote of not fewer than 2.3 of the voting members then serving, including an affirmative vote by the Chairperson, determines that the nonbank financial company no longer meets the standards under subsection (a) or (b), as applicable.

(E) Notice and Opportunity for Hearing and Final Determination..

(1) in General..The Council shall provide to a nonbank financial company written notice of a proposed determination of the Council, including an explanation of the basis of the proposed determination of the Council, that a nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards in accordance with this title.

(2) Hearing..Not later than 30 days after the date of receipt of any notice of a proposed determination under paragraph (1), the nonbank financial company may request, in writing, an opportunity for a written or oral hearing before the Council to contest the proposed determination. Upon receipt of a timely request, the Council shall fix a time (not later than 30 days after the date of receipt of the request) and place at which such company may appear, personally or through counsel, to submit written materials (or, at the sole discretion of the Council, oral testimony and oral argument).

(3) Final Determination..Not later than 60 days after the date of a hearing under paragraph (2), the Council shall notify the nonbank financial company of the final determination of the Council, which shall contain a statement of the basis for the decision of the Council.

(4) No Hearing Requested..If a nonbank financial company does not make a timely request for a hearing, the Council shall notify the nonbank financial company, in writing, of the final determination of the Council under subsection (a) or (b), as applicable, not later than 10 days after the date by which the company may request a hearing under paragraph (2).

(F) Emergency Exception..

(1) in General..The Council may waive or modify the requirements of subsection (e) with respect to a nonbank financial company, if the Council determines,... that such waiver or modification is necessary or appropriate to prevent or mitigate threats posed by the nonbank financial company to the financial stability of the United States.

(2) Notice.—The Council shall provide notice of a waiver or modification under this subsection to the nonbank financial company concerned as soon as practicable, but not later than 24 hours after the waiver or modification is granted.

(3) International Coordination.—In making a determination under paragraph (1), the Council shall consult with the appropriate home country supervisor, if any, of the foreign nonbank financial company that is being considered for such a determination.
(4) Opportunity for Hearing.—The Council shall allow a nonbank financial company to request, in writing, an opportunity for a written or oral hearing before the Council to contest a waiver or modification under this subsection, not later than 10 days after the date of receipt of notice of the waiver or modification by the company. Upon receipt of a timely request, the Council shall fix a time (not later than 15 days after the date of receipt of the request) and place at which the nonbank financial company may appear, personally or through counsel, to submit written materials (or, at the sole discretion of the Council, oral testimony and oral argument).
(5) Notice of Final Determination.—Not later than 30 days after the date of any hearing under paragraph (4), the Council shall notify the subject nonbank financial company of the final determination of the Council under this subsection, which shall contain a statement of the basis for the decision of the Council.
(g) Consultation.—The Council shall consult with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company that is being considered for supervision by the Board of Governors under this section before the Council makes any final determination with respect to such nonbank financial company under subsection (a), (b), or (c).
(h) Judicial Review.—If the Council makes a final determination under this section with respect to a nonbank financial company, such nonbank financial company may, not later than 30 days after the date of receipt of the notice of final determination under subsection (d)(2), (e)(3), or (f)(5), bring an action in the United States district court for the judicial district in which the home office of such nonbank financial company is located, or in the United States District Court for the District of Columbia, for an order requiring that the final determination be rescinded, and the court shall, upon review, dismiss such action or direct the final determination to be rescinded. Review of such an action shall be limited to whether the final determination made under this section was arbitrary and capricious.
(i) International Coordination.—In exercising its duties under this title with respect to foreign nonbank financial companies, foreign-based bank holding companies, and cross-border activities and markets, the Council shall consult with appropriate foreign regulatory authorities, to the extent appropriate.

Question: What do you think are likely to be the advantages and disadvantages of the Section 113 designation process?

Securities regulation is designed to protect the interests of purchasers of securities (by regulating issuers and the disclosures they make about the securities they issue, and by regulating participants in the securities issuance and trading process (underwriters, broker-dealers) and the integrity of the securities markets (for example, by controlling fraud). By protecting investors and ensuring the integrity of the markets, securities regulation should protect confidence in the securities markets.

Banking regulation, like securities regulation, is in part about the maintenance of confidence in aspects of the financial markets. Banking regulators want to avoid bank runs. They want to protect depositors (note that we assume that bank depositors are likely to be more risk averse than investors in securities - they want a safe place for their money rather than just an opportunity to make a profit). Banking regulators also want to ensure the safety and soundness of banks as key elements in the payments system. Securities regulators have not traditionally seen their role as involving the protection of the payments system, therefore ensuring the safety and soundness of securities firms has been a less visible, and less significant feature of securities regulation.

IOSCO's Objectives and Principles of Securities Regulation [12] are based on protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk:

A. Principles Relating to the Regulator

1 The responsibilities of the Regulator should be clear and objectively stated.

2 The Regulator should be operationally independent and accountable in the exercise of its functions and powers.

3 The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

4 The Regulator should adopt clear and consistent regulatory processes.

5 The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.

6 The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.

7 The Regulator should have or contribute to a process to review the perimeter of regulation regularly.

8 The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.

B. Principles for Self-Regulation

9 Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

[12] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf (Jun. 2010).

C. Principles for the Enforcement of Securities Regulation
10 The Regulator should have comprehensive inspection, investigation and surveillance powers.
11 The Regulator should have comprehensive enforcement powers.
12 The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

D. Principles for Cooperation in Regulation
13 The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
14 Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
15 The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

E. Principles for Issuers
16 There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors' decisions.
17 Holders of securities in a company should be treated in a fair and equitable manner.
18 Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.

F. Principles for Auditors, Credit Ratings Agencies, and other information service providers
19 Auditors should be subject to adequate levels of oversight.
20 Auditors should be independent of the issuing entity that they audit.
21 Audit standards should be of a high and internationally acceptable quality.
22 Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.
23 Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.

G. Principles for Collective Investment Schemes
24 The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.
25 The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
26 Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the

investor's interest in the scheme.
27 Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
28 Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.

H. Principles for Market Intermediaries
29 Regulation should provide for minimum entry standards for market intermediaries.
30 There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
31 Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.
32 There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.

I. Principles for Secondary Markets
33 The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
34 There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
35 Regulation should promote transparency of trading.
36 Regulation should be designed to detect and deter manipulation and other unfair trading practices.
37 Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
38 Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

The **Basel Committee's Core Principles for Effective Banking Supervision**, revised in 2012, are set out below:[13]

Supervisory powers, responsibilities and functions

[13] Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision (Sep. 2012) at http://www.bis.org/publ/bcbs230.pdf .

Principle 1 – Responsibilities, objectives and powers:
An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorise banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.

• Principle 2 – Independence, accountability, resourcing and legal protection for supervisors:
The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.

• Principle 3 – Cooperation and collaboration:
Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information.

• Principle 4 – Permissible activities:
The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled.

• Principle 5 – Licensing criteria:
The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition (including capital base). Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home supervisor is obtained.

• Principle 6 – Transfer of significant ownership:
The supervisor has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.

• Principle 7 – Major acquisitions:
The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

• Principle 8 – Supervisory approach:
An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking

system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.

• Principle 9 – Supervisory techniques and tools:

The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.

• Principle 10 – Supervisory reporting:

The supervisor collects, reviews and analyses prudential reports and statistical returns from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.

• Principle 11 – Corrective and sanctioning powers of supervisors:

The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking licence or to recommend its revocation.

• Principle 12 – Consolidated supervision:

An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.

• Principle 13 – Home-host relationships:

Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.

Prudential regulations and requirements

• Principle 14 – Corporate governance:

The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organisational structure, control environment, responsibilities of the banks' Boards and senior management, and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.

• Principle 15 – Risk management process:

The supervisor determines that banks have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (incuding robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management

process is commensurate with the risk profile and systemic importance of the bank.
• Principle 16 – Capital adequacy:
The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
• Principle 17 – Credit risk:
The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk (including counterparty credit risk) on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
• Principle 18 – Problem assets, provisions and reserves:
The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.
• Principle 19 – Concentration risk and large exposure limits:
The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.
• Principle 20 – Transactions with related parties:
In order to prevent abuses arising in transactions with related parties and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
• Principle 21 – Country and transfer risks:
The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk and transfer risk in their international lending and investment activities on a timely basis.
• Principle 22 – Market risks:
The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
• Principle 23 – Interest rate risk in the banking book:
The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk in the banking book on a timely basis. These systems

take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.

• Principle 24 – Liquidity risk:

The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.

• Principle 25 – Operational risk:

The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk on a timely basis.

• Principle 26 – Internal control and audit:

The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

• Principle 27: Financial reporting and external audit:

The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.

• Principle 28 – Disclosure and transparency:

The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.

• Principle 29 – Abuse of financial services:

The supervisor determines that banks have adequate policies and processes, including strict customer due diligence rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.

These two sets of principles are among the standards the IMF focuses on in its Reports on the Observance of Standards and Codes,[14] and that the World Bank considers as part of its Financial Sector Assessment Program. How useful do you think the standards are?

In January 2010 the **Joint Forum** wrote:[15]

International financial regulation is sector specific as evidenced by the independent development of core principles or standards in each financial sector. A sector-specific approach to supervision comes with the potential for increasing regulatory gaps, which causes supervisory challenges and presents opportunities for regulatory arbitrage. Differences exist in the nature of financial regulation among the banking, insurance, and securities sectors. These differences are warranted in some cases due to specific attributes of each financial sector, but, in others, these differences may contribute to gaps in the regulation of the financial system as a whole. One way to understand the differences and identify the gaps is to compare the core principles for financial supervision across each sector. The core principles reflect characteristics of the respective sector and the nature of the supervised financial institutions. They represent the key components and features of the supervisory and regulatory framework of each financial sector. These principles, issued independently by the BCBS, IAIS, and IOSCO, correspond to the minimum requirements for sound supervision.

Applying the Basel and IOSCO principles can be complex due to the intricacies of domestic regulatory systems. As well as the issues of how responsibilities for different areas of financial regulation (securities, banking, insurance etc) may be split between different regulators within different national systems, different countries allocate responsibilities for banking supervision differently. In the US a number of different federal agencies currently have responsibilities in relation to banking regulation. The **Office of the Comptroller of the Currency** (OCC)[16] is the primary federal regulator for national banks.[17] The **Federal Reserve**

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[14] List of Standards, Codes and Principles Useful for Bank and Fund Operational Work and for which Reports on the Observance of Standards and Codes Are Produced at http://www.imf.org/external/standards/scnew.htm .

[15] Joint Forum, Review of the Differentiated Nature and Scope of Financial Regulation - Key Issues and Recommendations, 3 (Jan. 2010) at http://www.bis.org/publ/joint24.htm

[16] http://www.occ.treas.gov . The Dodd-Frank Act integrated the Office of Thrift Supervision into the OCC.

[17] In the US, banks may be chartered at the federal level as national banks or at the state level. This is the dual banking system (see below).

Board (Fed)[18] is the main federal regulator for state-chartered banks which are members of the Federal Reserve System, and the **FDIC** (Federal Deposit Insurance Corporation)[19] is the main federal regulator for state chartered banks which are not members of the Federal Reserve System. Often the federal banking regulators act together in proposing new federal banking regulations, and they have been required to report to Congress on differences in their capital standards and accounting standards.[20]

Under the **International Banking Act**, a foreign bank which wants to do business in the US is required to obtain authorization to do so. If it wishes to establish a federal branch or agency it requires the approval of the OCC, if it wishes to establish a state branch, agency or representative office it requires the approval of the Federal Reserve. In practice, foreign banks doing business in the US have tended to establish state branches or agencies.[21]

12 USC § 3105

...**(d) Establishment of foreign bank offices in United States**

(1) Prior approval required

No foreign bank may establish a branch or an agency, or acquire ownership or control of a commercial lending company, without the prior approval of the Board.

(2) Required standards for approval

Except as provided in paragraph (6), the Board may not approve an application under paragraph (1) unless it determines that-- (A) the foreign bank engages directly in the business of banking outside of the United States and is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country; and (B) the foreign bank has furnished to the Board the information it needs to adequately assess the application.

(3) Standards for approval

In acting on any application under paragraph (1), the Board may take into account--

(A) whether the appropriate authorities in the home country of the foreign bank have consented to the proposed establishment of a branch, agency or commercial lending company in the United States by the foreign bank;

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[18] http://www.federalreserve.gov/ .

[19] http://www.fdic.gov/ .

[20] *See, e.g.* Joint Report on Differences in Accounting and Capital Standards Among the Federal Banking Agencies 77 Fed. Reg. 75259 (Dec. 19, 2012) (noting some differences).

[21] *See generally* Foreign Banks and the Federal Reserve at http://www.newyorkfed.org/aboutthefed/fedpoint/fed26.html .

(B) the financial and managerial resources of the foreign bank, including the bank's experience and capacity to engage in international banking;

(C) whether the foreign bank has provided the Board with adequate assurances that the bank will make available to the Board such information on the operations or activities of the foreign bank and any affiliate of the bank that the Board deems necessary to determine and enforce compliance with this chapter, the Bank Holding Company Act of 1956 [12 U.S.C. 1841 et seq.], and other applicable Federal law; and

(D) whether the foreign bank and the United States affiliates of the bank are in compliance with applicable United States law.

(4) Factor

In acting on an application under paragraph (1), the Board shall not make the size of the foreign bank the sole determinant factor, and may take into account the needs of the community as well as the length of operation of the foreign bank and its relative size in its home country. Nothing in this paragraph shall affect the ability of the Board to order a State branch, agency, or commercial lending company subsidiary to terminate its activities in the United States pursuant to any standard set forth in this chapter.

(5) Establishment of conditions

The Board may impose such conditions on its approval under this subsection as it deems necessary.

(6) Exception

(A) In general

If the Board is unable to find, under paragraph (2), that a foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country, the Board may nevertheless approve an application by such foreign bank under paragraph (1) if--

(i) the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank; and (ii) all other factors are consistent with approval.

(B) Other considerations

In deciding whether to use its discretion under subparagraph (A), the Board shall also consider whether the foreign bank has adopted and implements procedures to combat money laundering. The Board may also take into account whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering.

(C) Additional conditions

In approving an application under this paragraph, the Board, after requesting and taking into consideration the views of the appropriate State bank supervisor or the Comptroller of the Currency, as the case may be, may impose such conditions or restrictions relating to the activities or business operations of the proposed branch, agency, or commercial lending company subsidiary, including restrictions on sources of funding, as are considered appropriate. The Board shall coordinate with the appropriate State bank supervisor or the Comptroller of the Currency, as appropriate, in the implementation of such conditions or restrictions.

(D) Modification of conditions

Any condition or restriction imposed by the Board in connection with the approval of an application under authority of this paragraph may be modified or withdrawn.

(7) Time period for Board action

(A) Final action

The Board shall take final action on any application under paragraph (1) not later than 180 days after receipt of the application, except that the Board may extend for an additional 180 days the period within which to take final action on such application after providing notice of, and the reasons for, the extension to the applicant foreign bank and any appropriate State bank supervisor or the Comptroller of the Currency, as appropriate.

(B) Failure to submit information

The Board may deny any application if it does not receive information requested from the applicant foreign bank or appropriate authorities in the home country of the foreign bank in sufficient time to permit the Board to evaluate such information adequately within the time periods for final action set forth in subparagraph (A).

(C) Waiver

A foreign bank may waive the applicability of this paragraph with respect to any application under paragraph (1).

(e) Termination of foreign bank offices in United States

(1) Standards for termination

The Board, after notice and opportunity for hearing and notice to any appropriate State bank supervisor, may order a foreign bank that operates a State branch or agency or commercial lending company subsidiary in the United States to terminate the activities of such branch, agency, or subsidiary if the Board finds that--

(A)(i) the foreign bank is not subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country; and

(ii) the appropriate authorities in the home country of the foreign bank are not making demonstrable progress in establishing arrangements for the comprehensive supervision or regulation of such foreign bank on a consolidated basis; or

(B)(i) there is reasonable cause to believe that such foreign bank, or any affiliate of such foreign bank, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States; and

(ii) as a result of such violation or practice, the continued operation of the foreign bank's branch, agency or commercial lending company subsidiary in the United States would not be consistent with the public interest or with the purposes of this chapter, the Bank Holding Company Act of 1956 [12 U.S.C. 1841 et seq.], or the Federal Deposit Insurance Act [12 U.S.C. 1811 et seq.].

However, in making findings under this paragraph, the Board shall not make size the sole determinant factor, and may take into account the needs of the community as well as the length of operation of the foreign bank and its relative size in its home country. Nothing in this paragraph shall affect the ability of the Board to order a State branch, agency, or commercial lending company subsidiary to terminate its activities in the United States pursuant to any standard set forth in this chapter.

(2) Discretion to deny hearing

The Board may issue an order under paragraph (1) without providing for an opportunity for a hearing if the Board determines that expeditious action is necessary in order to protect the public interest.

(3) Effective date of termination order

An order issued under paragraph (1) shall take effect before the end of the 120-day period beginning on the date such order is issued unless the Board extends such period.

(4) Compliance with State and Federal law

Any foreign bank required to terminate activities conducted at offices or subsidiaries in the United States pursuant to this subsection shall comply with the requirements of applicable Federal and State law with respect to procedures for the closure or dissolution of such offices or subsidiaries....

(6) Enforcement of orders

(A) In general

In the case of contumacy of any office or subsidiary of the foreign bank against which– (i) the Board has issued an order under paragraph (1); or(ii) the Comptroller of the Currency has issued an order under section 3102(i) of this title,or a refusal by such office or subsidiary to comply with such order, the Board or the Comptroller of the Currency may invoke the aid of the district court of the United States within the jurisdiction of which the office or subsidiary is located.

(B) Court order

Any court referred to in subparagraph (A) may issue an order requiring compliance with an order referred to in subparagraph (A).

(7) Criteria relating to foreign supervision

Not later than 1 year after December 19, 1991, the Board, in consultation with the Secretary of the Treasury, shall develop and publish criteria to be used in evaluating the operation of any foreign bank in the United States that the Board has determined is not subject to comprehensive supervision or regulation on a consolidated basis. In developing such criteria, the Board shall allow reasonable opportunity for public review and comment.

(f) Judicial review

(1) Jurisdiction of United States courts of appeals

Any foreign bank--

(A) whose application under subsection (d) of this section or section 3107(a) of this title has been disapproved by the Board;

(B) against which the Board has issued an order under subsection (e) of this section or section 3107(b) of this title; or

(C) against which the Comptroller of the Currency has issued an order under section 3102(i) of this title, may obtain a review of such order in the United States court of appeals for any circuit in which such foreign bank operates a branch, agency, or commercial lending company that has been required by such order to terminate its activities, or in the United States Court of Appeals for the District of Columbia

Circuit, by filing a petition for review in the court before the end of the 30-day period beginning on the date the order was issued.

(2) Scope of judicial review

Section 706 of title 5 (other than paragraph (2)(F) of such section) shall apply with respect to any review under paragraph (1).

(g) Consultation with State bank supervisor

The Board shall request and consider any views of the appropriate State bank supervisor with respect to any application or action under subsection (d) or (e) of this section.

(h) Limitations on powers of State branches and agencies

(1) In general

After the end of the 1-year period beginning on December 19, 1991, a State branch or State agency may not engage in any type of activity that is not permissible for a Federal branch unless--(A) the Board has determined that such activity is consistent with sound banking practice; and(B) in the case of an insured branch, the Federal Deposit Insurance Corporation has determined that the activity would pose no significant risk to the deposit insurance fund.

(2) Single borrower lending limit

A State branch or State agency shall be subject to the same limitations with respect to loans made to a single borrower as are applicable to a Federal branch or Federal agency under section 3102(b) of this title.

(3) Other authority not affected

This section does not limit the authority of the Board or any State supervisory authority to impose more stringent restrictions.

(i) Proceedings related to conviction for money laundering offenses

(1) Notice of intention to issue order

If the Board finds or receives written notice from the Attorney General that--

(A) any foreign bank which operates a State agency, a State branch which is not an insured branch, or a State commercial lending company subsidiary; (B) any State agency; (C) any State branch which is not an insured branch; or (D) any State commercial lending subsidiary,

has been found guilty of any money laundering offense, the Board shall issue a notice to the agency, branch, or subsidiary of the Board's intention to commence a termination proceeding under subsection (e) of this section.

(2) Definitions

For purposes of this subsection--

(A) Insured branch

The term ``insured branch'' has the meaning given such term in section 3(s) of the Federal Deposit Insurance Act [12 U.S.C. 1813(s)].

(B) Money laundering offense defined

The term ``money laundering offense'' means any criminal offense under section 1956 or 1957 of title 18 or under section 5322 of title 31....

(k) Management of shell branches

(1) Transactions prohibited

A branch or agency of a foreign bank shall not manage, through an office of the foreign bank which is located outside the United States and is managed or controlled by such branch or agency, any type of activity that a bank organized under the laws of the United States, any State, or the District of Columbia is not permitted to manage at any branch or subsidiary of such bank which is located outside the United States.

(2) Regulations

Any regulations promulgated to carry out this section--(A) shall be promulgated in accordance with section 3108 of this title; and

(B) shall be uniform, to the extent practicable.

The Federal Reserve's Regulation K deals with foreign operations of US banks and US operations of foreign banks.[22]

At the end of 2012 the Federal Reserve issued a notice of proposed rulemaking with respect to **Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (2012 Proposal)**[23]

The recent financial crisis demonstrated that certain U.S. financial companies had grown so large, leveraged, and interconnected that their failure could pose a threat to overall financial stability in the United States and globally. The financial crisis also demonstrated that large foreign banking organizations operating in the United States could pose similar financial stability risks. Further, the crisis revealed weaknesses in the existing framework for supervising, regulating, and resolving significant U.S. financial companies, including the U.S. operations of large foreign banking organizations.

The Board recognizes the important role that foreign banking organizations play in the U.S. financial sector. The presence of foreign banking organizations in the United States has brought competitive and countercyclical benefits to U.S. markets. This preamble describes a set of proposed adjustments to the Board's regulation of the U.S. operations of foreign banking organizations to address risks posed by those entities and to implement the enhanced prudential standards and early remediation requirements in sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act). The proposed adjustments are consistent with the Board's long-standing policy of national treatment and equality of competitive opportunity between the U.S. operations of foreign banking organizations and U.S. banking firms.

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[22] You can access Regulation K at http://www.federalreserve.gov/bankinforeg/reglisting.htm .

[23] 77 Fed. Reg. 76627 (Dec. 28, 2012)

The Board is responsible for the overall supervision and regulation of the U.S. operations of all foreign banking organizations. Other federal and state regulators are responsible for supervising and regulating certain parts of the U.S. operations of foreign banking organizations, such as branches, agencies, or bank and nonbank subsidiaries.

Under the current U.S. supervision framework for foreign banking organizations, supervisors monitor the individual legal entities of the U.S. operations of these companies, and the Federal Reserve aggregates information it receives through its own supervisory process and from other U.S. supervisors to form a view of the financial condition of the combined U.S. operations of the company. The Federal Reserve and other U.S. regulators also work with regulators in other national jurisdictions to help ensure that all internationally active banks operating in the United States are supervised in accordance with a consistent set of core capital and other prudential requirements. International standards are intended to address the risks posed by the consolidated organization and to help achieve global competitive equity. Under this approach, the Federal Reserve oversees operations in the United States, but also relies on the home country supervisor to supervise a foreign banking organization on a global basis consistent with international standards and relies on the foreign banking organization to support its U.S. operations under both normal and stressed conditions.

Under this regulatory and supervisory framework, foreign banking organizations have structured their U.S. operations in ways that promote maximum efficiency of capital and liquidity management at the consolidated level. Permissible U.S. structures for foreign banking organizations have included cross-border branching and holding direct and indirect bank and nonbank subsidiaries. U.S. banking law and regulation also allow well-managed and well-capitalized foreign banking organizations to conduct a wide range of bank and nonbank activities in the United States on conditions comparable to those applied to U.S. banking organizations. Further, as a general matter, a top-tier U.S. bank holding company subsidiary of a foreign banking organization that qualifies as a financial holding company has not been required to comply with the Board's capital standards since 2001 pursuant to Supervision and Regulation (SR) Letter 01-01.

As a result of this flexibility granted to foreign banking organizations in the United States, the current population of foreign banking organizations is structurally diverse. Some foreign banking organizations conduct U.S. banking activities directly through a branch or agency; others own U.S. depository institutions through a U.S.-based bank holding company; and still others own a U.S. depository institution directly. Most large foreign banking organizations also conduct a range of nonbank activities through separate nonbank subsidiaries. Similar to the largest, most complex U.S. banking organizations, some of the largest foreign banking organizations with operations in the United States maintain dozens of separate U.S. legal entities, many of which are engaged in nonbank activities.

The structural diversity and consolidated management of capital and liquidity permitted under the current approach has facilitated cross-border banking and increased global flows of capital and liquidity. However, the increase in concentration, complexity, and interconnectedness of the U.S. operations of foreign banking organizations and the financial stability lessons learned during the crisis have raised questions about the continued suitability of this approach. Additionally, the Congressional mandate included in the Dodd-Frank Act requires the Board to impose enhanced prudential standards on large foreign banking organizations. Congress also directed the Board to strengthen the capital standards applied to U.S. bank holding company subsidiaries of foreign banking organizations by adopting the so-called “Collins Amendment” to the Dodd-Frank Act. Specifically, section 171 of the Dodd-Frank Act requires a top-tier U.S. bank holding company subsidiary of a foreign banking organization that had relied on SR Letter 01-01 to meet the minimum capital requirements established for U.S. bank holding companies by July 21, 2015.

The following sections provide a description of changes in the U.S. activities of large foreign banking organizations during the period that preceded the financial crisis and the financial stability risks posed by the U.S. operations of these companies that motivate certain elements of this proposal.

Shifts in the U.S. Activities of Foreign Banking Organizations

Many of the core elements of the Federal Reserve's current approach to the supervision of foreign banking organizations were designed more than a decade ago, when the U.S. presence of foreign banking organizations was significantly less complex. Although foreign banking organizations expanded steadily in the United States during the 1970s, 1980s, and 1990s, their activities here posed limited risks to overall U.S. financial stability. Throughout this period, the U.S. operations of foreign banking organizations were largely net recipients of funding from their parent institutions and their activities were generally limited to traditional lending to home-country and U.S. clients.

The profile of foreign bank operations in the United States changed substantially in the period preceding the financial crisis. U.S. branches and agencies of foreign banking organizations as a group moved from a position of receiving funding from their parent organizations on a net basis in 1999 to providing significant funding to non-U.S. affiliates by the mid-2000s. In 2008, U.S. branches and agencies provided more than $700 billion on a net basis to non-U.S. affiliates. As U.S. operations of foreign banking organizations received less funding, on net, from their parent companies over the past decade, they became more reliant on less stable, short-term U.S. dollar wholesale funding, contributing in some cases to a buildup in maturity mismatches. Trends in the global balance sheets of foreign banking organizations from this period reveal that short-term U.S. dollar funding raised in the United States was used to provide long-term U.S. dollar-denominated project and trade finance around the world as well as to finance non-U.S. affiliates' investments in U.S. dollar-denominated asset-backed securities. Because U.S. supervisors, as host authorities, have more limited access to timely information on the global operations of foreign banking organizations than to similar information on U.S.-based banking organizations, the totality of the risk profile of the U.S. operations of a foreign banking organization can be obscured when these U.S. entities fund activities outside the United States, such as occurred in recent years.

In addition to funding vulnerabilities, the U.S. operations of foreign banking organizations have become increasingly concentrated, interconnected, and complex since the mid-1990s. Ten foreign banking organizations now account for roughly two-thirds of foreign banking organizations' third-party U.S. assets, up from 40 percent in 1995. Moreover, U.S. broker-dealer assets of large foreign banking organizations as a share of their third-party U.S. assets have grown rapidly since the mid-1990s. Five of the top-ten U.S. broker-dealers are currently owned by foreign banking organizations. In contrast, commercial and industrial lending originated by U.S. branches and agencies of foreign banking organizations as a share of their third-party U.S. liabilities dropped after 2003.

Financial Stability Risks Posed by U.S. Operations of Foreign Banking Organizations

The financial stability risks associated with the increased capital market activity and shift in funding practices of the U.S. operations of foreign banking organizations in the period preceding the financial crisis became apparent during and after the crisis. The large intra-firm cross-border flows that grew rapidly in the period leading up to the crisis created vulnerabilities for the U.S. operations of foreign banking organizations. While some foreign banking organizations were aided by their ability to move liquidity freely during the crisis, this model also created a degree of cross-currency funding risk and heavy reliance on swap markets that proved destabilizing. In many cases, foreign banking organizations that relied heavily on short-term U.S. dollar liabilities were forced to sell U.S. dollar assets and reduce lending rapidly when that funding source evaporated. This deleveraging imposed further stress on financial market participants, thereby compounding the risks to U.S. financial stability.

Although the United States did not experience a destabilizing failure of a foreign banking organization during the crisis, some foreign banking organizations required extraordinary support from home- and host-country central banks and governments. For example, the Federal Reserve provided considerable amounts of liquidity to both the U.S. branches and U.S. broker-dealer subsidiaries of foreign banking organizations during the financial crisis. While foreign banking organizations recently have reduced the scope and risk profile of their U.S. operations and have shown more stable funding patterns in response to these events, some have continued to face periodic funding and other stresses since the crisis. For example, as concerns about the euro zone rose in 2011, U.S. money market funds dramatically pulled back their lending to large euro-area banks, reducing lending to these firms by roughly $200 billion over a four-month period.

Risks to Host Countries

Beyond the United States, events in the global financial community underscore the risks posed by the operations of large multinational banking organizations to host country financial sectors. The failure of several internationally active financial firms during the crisis revealed that the location of capital and liquidity is critical in a resolution. In some cases, capital and liquidity related to operations abroad were trapped at the home entity. For example, the Icelandic banks held significant deposits belonging to citizens and residents of other countries, who could not access their funds once those banks came under pressure. Actions by government authorities during the crisis period highlighted the fact that, while a foreign bank regulatory regime designed to accommodate centralized management of capital and liquidity can promote efficiency during good times, it can also increase the chances of home and host jurisdictions placing restrictions on the cross-border movement of assets at the moment of a crisis, as local operations come under severe strain and repayment of local creditors is called into question. Resolution regimes and powers remain nationally based, complicating the resolution of firms with large cross-border operations.

In response to financial stability risks highlighted during the crisis and ongoing challenges associated with the resolution of large cross-border firms, several other national authorities have adopted modifications to or have considered proposals to modify their regulation of internationally active banks within their geographic boundaries. Modifications adopted or under consideration include increased requirements for liquidity to cover local operations of domestic and foreign banks and nonbanks, limits on intragroup exposures of domestic banks to foreign subsidiaries, and requirements to prioritize or segregate home country retail operations.

Actions by a home country to constrain a banking organization's ability to provide support to its foreign operations, as well as the diminished likelihood that home-country governments of large banking organizations would provide a backstop to their banks' foreign operations, have called into question one of the fundamental elements of the Board's current approach to supervising foreign banking organizations—the ability of the Board, as a host supervisor, to rely on a foreign banking organization to act as a source of strength to its U.S. operations when the foreign banking organization is under stress.

The issues described above-growth over time in U.S. financial stability risks posed by foreign banking organizations individually and as a group, the need to minimize destabilizing pro-cyclical ring-fencing in a crisis, persistent impediments to effective cross-border resolution, and limitations on parent support-together underscore the need for enhancements to foreign bank regulation in the United States.

Overview of Statutory Requirements

Sections 165 and 166 of the Dodd-Frank Act direct the Board to impose a package of enhanced prudential standards on bank holding companies, including foreign banking organizations, with total consolidated assets of $50 billion or more and nonbank financial companies the Financial Stability Oversight Council (Council) has designated for supervision by the Board (nonbank financial companies supervised by the Board). These stricter prudential standards for large U.S. bank holding companies, foreign banking organizations, and nonbank financial companies supervised by the Board required under section 165 of the Dodd-Frank Act must include enhanced risk-based capital and leverage requirements, enhanced liquidity requirements, enhanced risk management and risk committee requirements, resolution planning requirements, single-counterparty credit limits, stress test requirements, and a debt-to-equity limit for companies that the Council has determined pose a grave threat to financial stability.

Section 166 of the Dodd-Frank Act requires the Board to establish a regulatory framework for the early remediation of financial weaknesses for the same set of companies in order to minimize the probability that such companies will become insolvent and the potential harm of such insolvencies to the financial stability of the United States. Further, the Dodd-Frank Act authorizes, but does not require, the Board to establish additional enhanced prudential standards relating to contingent capital, public disclosures, short-term debt limits, and such other prudential standards as the Board determines appropriate.

The Dodd-Frank Act requires the enhanced prudential standards established by the Board under section 165 to be more stringent than those standards applicable to other bank holding companies and nonbank financial companies that do not present similar risks to U.S. financial stability. The standards must also increase in stringency based on the systemic footprint and risk characteristics of companies subject to section 165. Generally, the Board has authority under section 165 to tailor the application of the standards, including differentiating among companies subject to section 165 on an individual basis or by category. In applying section 165 to foreign banking organizations, the Act also directs the Board to give due regard to the principle of national treatment and equality of competitive opportunity and to take into account the extent to which the foreign banking organization is subject, on a consolidated basis, to home country standards that are comparable to those applied to financial companies in the United States.

The Board has already issued proposed and final rules implementing certain elements of sections 165 and 166 of the Dodd-Frank Act. The Board and the FDIC jointly issued a final rule to implement the resolution plan requirement in section 165(d) of the Dodd-Frank Act for foreign and U.S. companies that became effective on November 30, 2011, and expect to implement periodic reporting of credit exposures at a later date. Section 165(d) establishes requirements that large foreign banking organizations, large U.S. bank holding companies, and nonbank companies supervised by the Board submit periodically to the Board and the FDIC a plan for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure.

In December 2011, the Board proposed a set of enhanced prudential standards and early remediation requirements for U.S. bank holding companies with total consolidated assets of $50 billion or more and U.S. nonbank financial companies supervised by the Board that included risk-based capital and leverage requirements, liquidity requirements, single-counterparty credit limits, overall risk management and risk committee requirements, stress test requirements, a debt-to-equity limit, and early remediation requirements (December 2011 proposal). On October 9, 2012, the Board issued a final rule implementing the supervisory and company-run stress testing requirements included in the December 2011 proposal for U.S. bank holding companies with total consolidated assets of $50 billion or more and U.S. nonbank financial companies supervised by the Board. Concurrently, the Board issued a final rule implementing the company-run stress testing requirements for U.S. bank holding companies with total consolidated assets of more than $10 billion but less than $50 billion as well as state member banks and savings and loan holding companies with total consolidated assets of more than $10 billion.

The proposed standards for foreign banking organizations are broadly consistent with the standards proposed for large U.S. bank holding companies and nonbank financial companies supervised by the Board in the December 2011 proposal. In general, differences between this proposal and the December 2011 proposal reflect the different regulatory framework and structure under which foreign banking organizations operate, and do not reflect potential modifications that may be made to the December 2011 proposal for U.S. bank holding companies. The Board is currently in the process of reviewing comments on the remaining standards in the December 2011 proposal and is considering modifications to the proposal in response to those comments. Comments on this proposal will help inform how the enhanced prudential standards should be applied differently to foreign banking organizations.

The Board is requesting comment on proposed rules to implement the provisions of sections 165 and 166 of the Dodd-Frank Act for foreign banking organizations with total consolidated assets of $50 billion or more and foreign nonbank financial companies supervised by the Board. The proposal includes: risk-based capital and leverage requirements, liquidity requirements, single-counterparty credit limits, overall risk management and risk committee requirements, stress test requirements, a debt-to-equity limit for companies that the Council has determined pose a grave threat to financial stability, and early remediation requirements. As described below, the Board is also proposing a supplemental enhanced standard: a requirement for certain foreign banking organizations to form a U.S. intermediate holding company, which would generally serve as a U.S. top-tier holding company for the U.S. subsidiaries of the company. The Board is not proposing any other enhanced prudential standards at this time, but continues to consider whether adopting any additional standards would be appropriate.

By setting forth comprehensive enhanced prudential standards and an early remediation framework for large foreign banking organizations, the proposal would create an integrated set of requirements that are intended to increase the resiliency of the U.S. operations of large foreign banking organizations and minimize damage to the U.S. financial system and the U.S. economy in the event such a company fails. The proposed rules, which increase in stringency with the level of systemic risk posed by and the risk characteristics of the U.S. operations of the company, would provide incentives for large foreign banking organizations to reduce the riskiness of their U.S. operations and to consider the costs that their failure or distress would impose on the U.S. financial system.

In applying section 165 to foreign banking organizations, the Act directs the Board to give due regard to the principle of national treatment and equality of competitive opportunity. As discussed above, the proposal broadly adopts the standards set forth in the December 2011 proposal to ensure equality of competitive opportunity, as modified appropriately for foreign banking organizations. Modifications address the fact that foreign banking organizations may operate in the United States through direct branches and agencies. The proposal also recognizes that not all foreign banking organizations that meet the statutory asset size thresholds, particularly those with a small U.S. presence, present the same level of risk to U.S. financial stability. As a result, the proposal would apply a reduced set of requirements to foreign banking organizations with combined U.S. assets of less than $50 billion in light of the reduced risk that these companies pose to U.S. financial stability.

The Act also directs the Board in implementing section 165 to take into account the extent to which a foreign banking organization is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States. In developing the proposal, the Board has taken into account home country standards in balance with financial stability considerations and concerns about extraterritorial application of U.S. enhanced prudential standards. The proposed capital and stress testing standards rely on home country standards to a significant extent with respect to a foreign banking organization's U.S. branches and agencies because branches and agencies are not separate legal entities and are not required to hold capital separately from their parent organizations. In addition, the proposed risk management standards would provide flexibility for foreign banking organizations to rely on home country governance structures to implement certain proposed risk management requirements.

The Dodd-Frank Act requires the Board to apply enhanced prudential standards to any foreign nonbank financial company supervised by the Board. Consistent with this statutory requirement, the proposal would also apply the enhanced prudential standards, other than the intermediate holding company requirement, to a foreign nonbank financial company supervised by the Board. In addition, the proposal would set forth the criteria that the Board would consider to determine whether a U.S. intermediate holding company should be established by a foreign nonbank financial company. The Board would expect to tailor the enhanced prudential standards to individual foreign nonbank financial companies, as necessary, upon designation by the Council.

A group of trade associations asked for more time to react to the proposals (referring to "Proposed Rules of extraordinary complexity, with 306 pages of text and 103 questions."[24]

The Proposed Rules are wide-ranging in scope, touching upon virtually every major area of prudential regulation, including risk-based capital and leverage requirements, liquidity standards, risk management, single-counterparty credit limits and stress-test requirements. They also are in important ways novel in their application, calling for far-reaching and unprecedented structural changes and introducing a totally new early remediation regime. Further, they have a very significant cross-border dimension and present potentially very profound implications for home-host country supervisory relationships. Their breadth and complexity call for both extensive analysis of the various individual requirements and the interrelationships among them and careful assessment of the extent to which they create an effective and cohesive framework for enhanced prudential supervision that is consistent with the Dodd-Frank Act and avoids unintended consequences. Moreover, due consideration must be given to the interaction of the Proposed Rules with other international financial reform initiatives, including in particular implementation of the Basel III Accord, as well as tax laws of close to 10 different jurisdictions. Finally, we anticipate that the evaluation of certain areas of the Proposed Rules (for example, the proposed liquidity and single-counterparty credit limit requirements) will constitute a very significant analytical exercise. This entire process is requiring an extensive commitment of time and personnel at a time when our members are also actively dealing with other significant implementation challenges under the Dodd-Frank Act...

The Federal Reserve did extend the comment period,[25] and in February 2014 published a final rule:

Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking

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[24] *See* http://www.federalreserve.gov/SECRS/2013/February/20130204/R-1438/R-1438_013113_110956_528140603839_1.pdf

[25] Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, Extension of Comment Period, 78 Fed. Reg. 13294 (Feb. 27, 2013).

Organizations (Final Rule 2014)[26] (please note that in this excerpt there are discussions of capital adequacy requirements, leverage requirements, stress-tests etc that we have not yet discussed and which are not self-explanatory - for now the point is that the US is imposing stricter requirements on larger domestic and foreign banks that address the risks those organizations pose, and we will initially focus mostly on the treatment of foreign banks) :

The Board received ... over 60 public comments on the foreign proposal, from U.S. and foreign firms, public officials (including members of Congress), public interest groups, private individuals, and other interested parties. While many commenters expressed support for the broad goals of the proposed rules, some commenters criticized specific aspects of the proposals.... the final rule makes adjustments to the proposed rules that respond to commenters' concerns...

The final rule implements elements of both the domestic and foreign proposals. For a bank holding company with total consolidated assets of $50 billion or more, it incorporates as an enhanced prudential standard the previously - issued capital planning and stress testing requirements and imposes enhanced liquidity requirements, enhanced risk-management requirements, and the debt -to - equity limit for those companies that the Council has determined pose a grave threat to the financial stability of the United States. It also establishes risk -committee requirements for a publicly traded bank holding company with total consolidated assets of $10 billion or more. For a foreign banking organization with total consolidated assets of $50 billion or more, the final rule implements enhanced risk - based and leverage capital requirements, liquidity requirements, risk - management requirements, stress testing requirements, and the debt - to -equity limit for those companies that the Council has determined pose a grave threat to the financial stability of the United States. In addition, it requires foreign banking organizations with U.S. non -branch assets, as defined in the final rule, of $ 50 billion or more to form a U.S. intermediate holding company and imposes enhanced risk -based and leverage capital requirements, liquidity requirements, risk - management requirements, and stress - testing requirements on the U.S. intermediate holding company. The final rule also establishes a risk - committee requirement for publicly traded foreign banking organizations with total consolidated assets of $10 billion or more and implements stress-testing requirements for foreign banking organizations and foreign savings and loan holding companies with total consolidated assets of more than $10 billion.

The prudential standards established for bank holding companies and foreign banking organizations with total consolidated assets of $50 billion or more and nonbank financial companies supervised by the Board (covered companies) must be more stringent than the standards and requirements applicable to bank holding companies and nonbank financial companies that do not present similar risks to the financial stability of the United States.

The Board is developing an integrated set of prudential standards for covered companies through a

[26] See http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140218a1.pdf (amendments to Regulation YY).

series of rulemakings, including the resolution plan rule, the capital plan rule, the stress test rules, and this final rule.... the Board will continue to develop these standards through future rules and orders. The integrated set of standards will result in a more stringent regulatory regime to mitigate risks to U.S. financial stability, and include measures that increase the resiliency of covered companies and reduce the impact on U.S. financial stability were these firms to fail. These rules are applicable only to covered companies, and do not apply to smaller firms that present less risk to U.S . financial stability.... the final rules result in enhanced supervision and regulation of covered companies that is more stringent based on the systemic footprint and risk characteristics of the company than the provisions applicable to firms that are not covered companies and that take into account differences among covered companies based on these factors.

For instance, bank holding companies and U.S. intermediate holding companies of foreign banking organizations are subject to the capital plan rule, which requires a company to project its regulatory capital ratios under stressed conditions and demonstrate the ability to meet the Board's minimum regulatory capital requirements. These minimum regulatory capital requirements include leverage and risk -based capital requirements. By requiring firms to demonstrate the ability to meet these capital requirements under stressed conditions, the capital plan rule subjects a company to more stringent standards as the leverage, off-balance sheet exposures, and interconnectedness of a covered company increase. For example, with respect to leverage, the Board's minimum leverage capital requirements require a U.S. company subject to the requirements to hold capital based on its total consolidated assets. The more on-balance sheet assets that a company holds, the more capital the company must hold to comply with the minimum leverage capital requirement. Companies that have $250 billion or more in total consolidated assets or $10 billion or more in total foreign exposure based on year -end financial reports will become subject to a supplementary leverage ratio, which requires the companies to hold leverage capital for both their on-and off -balance sheet assets. For a company subject to the supplementary leverage ratio, the more on -and off -balance sheet assets that the company holds, the more capital the company must hold to comply with the minimum leverage capital requirement. The Board's risk -based capital rules require a company subject to the rules to deduct an investment in an unconsolidated financial institution above certain thresholds. The more investments in such unconsolidated financial institutions that a company has above these thresholds, the more deductions that a company must take from its regulatory capital. Covered bank holding companies and foreign banking organizations are subject to the enhanced liquidity standards included in this final rule, which will result in a more stringent set of standards as the liquidity risk of a company's liabilities increases. For instance, the enhanced liquidity standards require covered bank holding companies and foreign banking organizations to maintain a liquidity buffer sufficient to cover net cash outflows based on a 30 -day stress test. In general, the more a company relies on short- term funding, the larger the required buffer will be. The set of enhanced prudential standards for bank holding companies and foreign banking organizations increases in stringency based on the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company. For example, the resolution plan rule applies a tailored resolution plan regime for smaller, less complex bank holding companies and foreign banking organizations that is materially less stringent than what is required of larger organizations. Similarly, the Board has tailored the application of and its supervisory expectations regarding stress testing and capital planning based on the size and complexity of covered companies. For instance, the Board applies the global market shock to the trading and private equity positions of the largest bank holding companies subject to the market risk requirements, and requires bank holding companies with substantial trading and custodial operations to include a counterparty default scenario component in their stress tests. In addition, the capital, liquidity, risk -management, and stress testing requirements applicable to foreign banking organizations with combined U.S. assets of less than $50 billion are substantially reduced as compared to the requirements applicable to foreign banking organizations with a larger U.S. presence....

The enhanced prudential standards for bank holding companies and foreign banking organizations take into account the extent to which the company is subject to existing regulatory scrutiny... In recognition of the home -country supervisory regime applicable to foreign banking organizations, the final rule relies on the home country capital and stress testing regimes applicable to the foreign banking organization. However, to the extent that a foreign banking organization's home country capital or stress test standards do not meet the standards set forth in the final rule, the Board will impose requirements, conditions or restrictions relating to the activities or business operations of the combined U.S. operations of the foreign banking organization....

Foreign banking organizations have a banking presence in the United States through either control of an insured depository institution or through U.S. branches or agencies. Foreign banking organizations that have branches and agencies are treated as if they were bank holding companies for purposes of the Bank Holding Company Act and the Dodd -Frank Act . By statute, both uninsured and insured U.S. branches and agencies of foreign banks may receive Federal Reserve advances on the same terms and conditions that apply to domestic insured state member banks. The risks to financial stability presented by foreign banking organizations with U.S. branches and agencies generally are not dependent on whether the foreign banking organization has a U.S. insured depository institution. In many cases, insured depository institution subsidiaries of foreign banks form a small percentage of their U.S. assets...

Major Changes from the Proposals

1. Threshold for Forming a U.S. Intermediate Holding Company

The foreign proposal would have required a foreign banking organization with U.S. non-branch assets of $10 billion or more to establish a U.S. intermediate holding company. Many commenters argued that the proposed threshold was too low, asserting that the U.S. operations of entities with $10 billion of U.S. non-branch assets do not present risks to U.S. financial stability. These commenters suggested that a minimum of $ 50 billion in U.S. non-branch assets is a more appropriate threshold for the U.S. intermediate holding company requirement. After considering these comments and the other statutory considerations in section 165 of the Dodd -Frank Act , the Board is raising the final rule's threshold for the U.S. intermediate holding company requirement from $10 billion to $50 billion of U.S. non-branch assets.

2 .Implementation Timing for Foreign Banking Organizations

The proposed rule would have required a foreign banking organization with U.S. non-branch assets of $50 billion or more as of July 1, 2014, to establish a U.S. intermediate holding company by July 1, 2015, unless that time were extended by the Board in writing A foreign banking organization with U.S. non-branch assets equal to or exceeding the asset threshold after July 1, 2014 would have been required to establish a U.S. intermediate holding company within 12 months after it met or exceeded the asset threshold, unless that time were accelerated or extended by the Board in writing. A number of commenters requested a longer transition period for the proposed requirements, citing the need to reorganize their U.S. operations and address attendant restructuring costs and tax costs, as well as the costs of compliance with other regulatory initiatives

In response to comments, the final rule would extend the initial compliance date for foreign banking organizations by one year to July 1, 2016. The extended transition period would provide foreign banking organizations that exceed the asset threshold on the effective date of the rule with a reasonable transition period during which to prepare for the structural reorganization required by the final rule and for compliance with the enhanced prudential standards.

In order to ensure that foreign banking organizations are taking the necessary steps toward meeting the requirements of the final rule, the final rule requires a foreign banking organization that has U.S. non -branch assets of $50 billion or more as of June 30, 2014, to submit an implementation plan by January 1, 2015 outlining its proposed process to come into compliance with the rule's requirements

In addition, to address commenters' concerns about the cost of compliance with leverage capital requirements proposed for the U.S. intermediate holding company, the final rule generally delays application of leverage capital requirements to the U.S. intermediate holding company until January 1, 2018. Finally, a foreign banking organization that has U.S. non- branch assets that equal or exceed $50 billion after July 1, 2015 has two years to come into compliance with the final rule, instead of 12 months under the proposal.

These modifications to the transition period will enable a foreign banking organization to plan the transactions necessary to bring its U.S. subsidiaries under the U.S. intermediate holding company and mitigate costs.

3. Nonbank Financial Companies Supervised by the Board

The proposals would have provided that the standards applicable to bank holding companies and foreign banking organizations would serve as the baseline for enhanced prudential standards applicable to U.S. and foreign nonbank financial companies, respectively. Many commenters representing nonbank financial companies asserted that the proposed enhanced prudential standards were inappropriate for nonbank financial companies because of their business models and activities, as well as the existing regulatory regime applicable to certain nonbank financial companies. These commenters also expressed concern that the proposals as applied to nonbank financial companies supervised by the Board were too broad, and the proposals did not provide sufficient information for nonbank financial companies supervised by the Board to understand application of the proposed standards. The Board recognizes that the companies designated by the Council may have a range of businesses, structures, and activiti es, that the types of risks to financial stability posed by nonbank financial companies will likely vary, and that the enhanced prudential standards applicable to bank holding companies and foreign banking organizations may not be appropriate, in whole or in part, for all nonbank financial companies. Accordingly, the Board is not applying enhanced prudential standards to nonbank financial companies supervised by the Board through this rulemaking. Instead, following designation of a nonbank financial company for supervision by the Board, the Board intends thoroughly to assess the business model, capital structure, and risk profile of the designated company to determine how the proposed enhanced prudential standards should apply, and if appropriate, would tailor application of the standards by order or regulation to that nonbank financial company or to a category of nonbank financial companies.

In applying the standards to a nonbank financial company, the Board will take into account differences among nonbank financial companies supervised by the Board and bank holding companies with total consolidated assets of $ 50 billion or more. For those nonbank financial companies that are similar in activities and risk profile to bank holding companies, the Board expects to apply enhanced prudential standards that are similar to those that apply to bank holding companies. For those that differ from bank holding companies in their activities, balance sheet structure, risk profile, and functional regulation, the Board expects to apply more tailored standards. The Board will ensure that nonbank financial companies receive notice and opportunity to comment prior to determination of their enhanced prudential standards....

IV. Enhanced Prudential Standards for Foreign Banking Organizations

A. Background

1.Considerations in Developing the Proposal

The Board is responsible for the overall supervision and regulation of the U.S. operations of all foreign banking organizations. Other federal and state regulators are responsible for supervising and regulating certain parts of the U.S. operations of foreign banking organizations, such as branches, agencies, or bank and nonbank subsidiaries. Under the Board’s historic framework for foreign banking organizations, supervisors have monitored the individual legal entities of the U.S. operations of these companies, and the Federal Reserve has aggregated information it receives through its own supervisory process and from other U.S. supervisors to form a view of the financial condition of the combined U.S. operations of the company. In addition, the Federal Reserve has relied on the home country supervisor to supervise a foreign banking organization on a global basis consistent with international standards, and has relied on the foreign banking organization to support its U.S. operations under both normal and stressed conditions.

As discussed in the proposal, the profile of foreign bank operations in the United States changed substantially in the period preceding the financial crisis. U.S. branches and agencies of foreign banking organizations as a group moved from a position of receiving funding from their parent organizations on a net basis in 1999 to providing significant funding to non- U.S. affiliates by the mid - 2000s. In 2008, U.S. branches and agencies provided more than $ 600 billion on a net basis to non-U.S. affiliates. As U.S. operations of foreign banking organizations received less funding, on net, from their parent companies over the past decade, they became more reliant on less stable, short -term U.S. dollar wholesale funding, contributing in some cases to a buildup in maturity mismatches. Trends in the global balance sheets of foreign banking organizations from this period reveal that short - term U.S. dollar funding raised in the United States was used to provide long- term U.S. dollar -denominated project and trade finance around the world as well as to finance non -U.S. affiliates' investments in U.S. dollar - denominated asset -backed securities. Because U.S. supervisors, as host authorities, have more limited access to timely information on the global operations of foreign banking organizations than to similar information on U.S. -based banking organizations, the totality of the risk profile of the U.S. operations of a foreign banking organization can be obscured when these U.S. entities fund activities outside the United States.

In addition to funding vulnerabilities, the U.S. operations of foreign banking organizations became increasingly concentrated, interconnected, and complex after the mid-1990s. By 2007, the top ten foreign banking organizations accounted for over 60 percent of foreign banking organizations' U.S. assets, up from 40 percent in 1995. Moreover, U.S. broker - dealer assets of large foreign banking organizations as a share of their U.S. assets grew rapidly after the mid - 1990s. In 2012, five of the top-ten U.S. broker-dealers were owned by foreign banking organizations. In contrast, commercial and industrial lending originated by U.S. branches and agencies of foreign banking organizations as a share of their third-party U.S. liabilities dropped after 2003...

In December 2012, the Board sought comment on the foreign proposal. The proposal presented a set of targeted adjustments to the Board's regulation of the U.S. operations of foreign banking organizations to address risks posed by those entities and to implement the enhanced prudential standards in section 165 of the Dodd -Frank Act. In the proposal, the Board sought to implement section 165 in a manner that enhanced the Board's current regulatory framework for foreign banking organizations in order to mitigate the risks posed to U.S. financial stability by the U.S. activities of foreign banking organizations....

... the Federal Reserve traditionally has relied on the home -country supervisor to supervise a foreign banking organization on a global basis, consistent with international standards, which are intended to address the risks posed by the consolidated organization and to help achieve global competitive equity. The Federal Reserve has relied on the parent foreign banking organization to support its U.S. operations under both normal and stressed conditions. The proposal would have adjusted this traditional approach by requiring a foreign banking organization to organize its U.S. subsidiaries under a single U.S intermediate holding company and applying enhanced prudential standards to the U.S. intermediate holding company. Some commenters supported the proposal as an enhancement of U.S. financial stability and expressed the view that the proposal would reduce reliance on a foreign banking organization to keep its U.S. entities solvent, particularly where both the home - country parent and the U.S. operations come under simultaneous stress. However, other commenters questioned the need for such adjustment and asserted that the Board already has adequate tools and information for supervising the U.S. operations of foreign banking organizations. Commenters asserted that the goals of the proposal could be achieved without, for example, the U.S. intermediate holding company requirement . For example, as an alternative to the proposal, some commenters suggested that the

Board supplement its existing regulatory approach by requiring more information from home -country supervisors. Another commenter suggested that, instead of finalizing the proposed rules, the Board condition exemptions to regulatory requirements on the receipt of appropriate information and use its strength -of-support assessment process as a framework for evaluating home -country regulation.

Congress directed the Board to adopt enhanced prudential standards for foreign banking organizations in order to mitigate risks to U.S. financial stability posed by foreign banking organizations. As discussed above, the concentration, complexity, and interconnectedness of the U.S. operations of foreign banking organizations present risks to U.S. financial stability that are not addressed by the traditional framework. The modifications to the Board's current supervisory approach suggested by commenters — such as providing the Federal Reserve with additional information, or building upon the existing strength-of-support framework — would not provide a consistent platform for regulating and supervising the U.S. operations of foreign banking organizations or facilitate the application of enhanced prudential standards to the U.S. non-branch operations of a foreign banking organization.

Many commenters suggested that the Board did not adequately tailor the enhanced prudential standards set forth in the proposal to the systemic risk posed by foreign banking organizations. According to these commenters, the proposal did not reflect consideration of either the meaningful differences among foreign banking organizations in their systemic risk characteristics or whether actual threats to U.S. financial stability would justify the requirement for a given foreign banking organization. One commenter expressed the view that only a very small subset of foreign banking organizations has the potential to present risks to U.S. financial stability. Others asserted that a global consolidated assets measure would overstate the U.S. systemic risk posed by many foreign banking organizations. Similarly, other commenters observed that many foreign banking organizations do not rely on their U.S. branches as a net source of U.S. dollar funding for their non - U.S. operations.

The Dodd -Frank Act requires the Board to impose enhanced prudential standards on all foreign banking organizations with global consolidated assets of $50 billion or more, and contemplates that the Board will tailor the requirements depending on the risk presented to U.S. financial stability by these institutions. The Board believes that the measures included in the final rule are appropriate for managing the risks to U.S. financial stability that may be posed by such firms. The standards that the Board has developed are tailored such that a foreign banking organization with U.S. operations that pose less risk will generally make fewer changes to their U.S. operations to come into compliance with the new standards.

For instance, the standards applicable to foreign banking organizations with total consolidated assets of $ 50 billion or more but combined U.S. assets of less than $ 50 billion are substantially less as compared to those applicable to foreign banking organizations with combined U.S. assets of $50 billion or more. In addition.. a foreign banking organization with less than $ 50 billion in U.S. non-branch assets will not be required to form a U.S. intermediate holding company. The liquidity requirements applicable to a foreign banking organization with combined U.S. operations of $50 billion or more are calibrated such that a foreign banking organization whose U.S. operations have maturity-matched cash inflows and outflows is unlikely to be substantially affected by these requirements. The risk-based capital rules applicable to U.S. intermediate holding companies also calibrate capital requirements to the level of risk posed by the assets and off-balance sheet exposures of the U.S. intermediate holding company, including the degree of interconnectivity. Foreign banking organizations that already maintain sufficient risk-based or leverage capital at their U.S. operations will not have to reallocate to or raise capital for those operations.

The proposal also described recent modifications to the regulation of internationally active banks adopted or contemplated by other national authorities. These modifications include increased local liquidity and capital requirements, limits on intragroup exposures of domestic banks to foreign subsidiaries, and requirements to prioritize or segregate home country retail operations. Commenters argued that it would be premature for the Board to modify its regulatory approach before these adjustments are complete. Commenters also argued that the Board should consider home-country legal or political developments that could potentially limit a foreign bank parent's ability to support its U.S. operations in the overall context of factors that would determine a foreign banking organization's practical ability to support its U.S. operations.

While the Board considered these modifications and legal and political developments as factors in its assessment of the likelihood that a foreign bank parent will be willing and able to support its U.S. operations in the future, the proposal and the final rule respond to a broader set of considerations that are intended to address the financial stability risks posed by the U.S. operations of foreign banking organizations. While the Board recognizes the important initiatives under development in other countries, the Board does not believe it is appropriate to await the outcomes of such initiatives before adopting enhanced prudential standards to address risks to U.S. financial stability

.... the Board will monitor supervisory approaches that are implemented throughout the world and may take further action in the future as appropriate Some commenters asserted that the proposal's narrative describing the period leading up to and during the financial crisis omitted the role that foreign banking organizations played in supporting financial stability, such as through acquisitions of failed bank and nonbank operations of U.S. financial companies. One commenter stated that foreign banking organizations undertook such acquisitions with an expectation that cross-border supervisory and regulatory standards would not be significantly disrupted.

The Board recognizes the important role that foreign banking organizations play in the U.S. financial sector. The presence of foreign banking organizations in the United States has brought competitive and countercyclical benefits to U.S. markets. The Board acknowledges that there have been significant developments, both in the United States and overseas, to strengthen capital positions since the crisis. However, these changes in the international regulatory landscape, and the likelihood of changes still to come, are not a substitute for enhancing regulation of the foreign banking organizations that have large U.S. operations and pose risks to U.S. financial stability.

While the Board acknowledges that some foreign banking organizations undertook cross-border acquisitions during the financial crisis, the crisis also highlighted weaknesses in the existing framework for supervising, regulating, and otherwise constraining the risks of major financial companies, including the U.S. operations of foreign banking organizations.

The Board believes the requirements contained in the final rule are appropriate in light of the statutory directive to impose enhanced prudential standards on domestic and foreign firms that address these risks, and by the Board's mandate to minimize risks to U.S. financial stability. Some commenters argued that the proposal would prevent foreign banking organizations from managing capital and liquidity on a centralized basis. These commenters asserted that the proposal would inhibit diversification of risk and could reduce a foreign banking organization's flexibility to respond to stress in other parts of the organization on a continual basis. These commenters also indicated that they expected the proposed requirements to increase the need for foreign banking organizations to take advantage of "lender of last resort" government facilities, because banks that currently manage capital and liquidity on a centralized basis would lose the ability efficiently to move those resources to the branches or operations that need it the most. While the proposed requirements could incrementally increase costs and reduce flexibility of internationally active banks that primarily manage their capital and liquidity on a centralized basis, they would increase the resiliency of the U.S. operations of a foreign banking organization, the ability of the U.S. operations to respond to stresses in the United States, and the stability of the U.S. financial system. A firm that relies significantly oncentralized resources may not be able to provide support to all parts of its organization. The Board believes that the final rule reduces the need for a foreign banking organization to contribute additional capital and liquidity to its U.S. operations during times of home-country or other international stresses, thereby reducing the likelihood that a banking organization that comes under stress in multiple jurisdictions will be required to choose which of its operations to support. Finally, the Board notes that req uiring foreign banking organizations to maintain financial resources in the jurisdictions in which they operate subsidiaries is consistent with existing Basel Committee agreements and international regulatory practice. U.S. banking organizations operate in overseas markets that apply local regulatory requirements to commercial and investment banking activities conducted in locally incorporated subsidiaries of foreign banks. In the Board's view, the final rule establishes a regulatory approach to foreign banking organizations that is similar in substance to that in other jurisdictions.

b. Taking into Account Home- country Standards

In applying section 165 to a foreign -based bank holding company, the Dodd -Frank Act directs the Board to take into account the extent to which the foreign banking organization is subject, on a consolidated basis, to home country standards that are comparable to those applied to financial companies in the United States. This direction requires the Board to consider the regulatory regimes applicable to foreign banking organizations abroad when designing the enhanced prudential standards for foreign banking organizations. Commenters argued that the Board did not adequately take into account home country standards when developing the proposal. For instance, commenters urged the Board to rely on home country standards in applying the enhanced prudential standards, absent a material inconsistency that could be addressed through targeted U.S. regulation. Other commenters suggested that the Board incorporate a "substituted compliance" framework into the rule, which would defer to home -country standards where the home country has adopted standards similar to those included in the proposal.

The Board has taken into account home country standards as required by section 165 in the development of the proposed and final rules. In recognition of the home -country standards and the home-country supervisory regime applicable to foreign banks, the final rule continues to permit foreign banks to operate through branches and agencies in the United States on the basis of their home-country capital. Accordingly, the final rule does not apply risk -based or leverage capital standards or stress testing standards to U.S. branches and agencies of foreign banking organizations . In addition, the proposed and final risk management standards provide flexibility or foreign banking organizations to rely on home-country governance structures to implement certain elements of the final rule's risk-management requirements by generally permitting a foreign banking organization to establish its U.S. risk committee as a committee of its global board of directors. While taking home country standards into account, the final rule recognizes that foreign jurisdictions do not calibrate or construct their home country standards to address U.S. exposures or the potential impact of those exposures on the U.S. financial system. The consideration of the home country standards applicable to foreign banking organizations must be done in light of the general purpose of section 165, which 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 these firms. The final rule, with the requirement that large foreign banking organizations establish a U.S. intermediate holding company and look to home country standards in operating branches in the United States, attempts to balance these two considerations Commenters argued that the Board is required to engage in an institution- specific analysis of comparable consolidated home -country standards because of the statute's use of the singular term "foreign financial company." Commenters further argued that that directive requires the Board to consider the home -country regime applicable to a foreign banking organization and the effect of that regime on the U.S. operations of the specific foreign banking organization. The Board observes that the statute permits it to promulgate standards by regulation and permits the Board to tailor standards by category of institution, suggesting that Congress did not require an institution-specific analysis in establishing the standards. Furthermore, the final rule applies an institution -specific analysis in evaluating comparable consolidated home - country standards in determining whether the home-country capital and stress test standards meet the requirements of the final rule... With respect to all standards, the Board's supervisory approach will be tailored to the size and complexity of the company....

... The principles of national treatment and equality of competitive opportunity were central considerations in the design of the enhanced prudential standards for foreign banking organizations. The standards applied to the U.S. operations of foreign banking organizations are broadly consistent with the standards applicable to U.S. bank holding companies. In particular, a U.S. firm that proposes to conduct both banking operations and nonbank financial operations must (with a few limited exceptions) form a bank holding company or savings and loan holding company subject to supervision and regulation by the Board. The U.S. intermediate holding company requirement subjects foreign banking organizations with large U.S. banking operations to comparable organizational and prudential standards. Foreign banking organizations operating in the United States generally are treated no less favorably, and are subject to similar restrictions and obligations, as similarly-situated U.S. banking organizations.

To the extent that there are differences in the application of the standards for U.S. bank holding companies and foreign banks, the differences generally reflect the structural differences between foreign

banking organizations' operations in the United States and U.S. bank holding companies. For instance, because the final rule permits U.S. branches and agencies of foreign banks to continue to operate on the basis of the foreign bank's capital, the final rule does not impose capital or stress testing requirements on U.S. branches and agencies of foreign banks ..
..Many commenters asserted that the proposal represented a retreat from the Board's past practice of international regulatory coordination and cooperation. These commenters stated that the Board's international commitments place a strong emphasis on cooperation, sharing of information, and coordination for internationally active banks. Many of these commenters urged the Board to follow the G-20's call for regulatory cooperation, and asserted that the Board should work within the international fora to address its concerns about systemic stability. Several commenters requested that the Board conduct a quantitative impact study on the effect of the proposal or on particular aspects of the proposal before adopting a final rule. One commenter suggested that the Board should recommend steps that banking organizations and regulators could take to foster international cooperation and asserted that the Board should work through international agreements by, for example, obtaining pledges among regulators to maintain intra - group services and support, requiring home country consultation before host country supervisors may make managerial changes, and providing a sunset date for any provision of the final rule that is addressed by an international agreement in the future.
The Board has long worked to foster cooperation among international regulators, and actively participates in international efforts to improve cooperation among supervisors around the world. As a general matter, these supervisors have responded to the lessons learned during the recent financial crisis by enhancing the supervisory and regulatory standards that apply to their banking organizations. The Board has been working closely with its international counterparts and through international fora, such as the Basel Committee and the FSB, to develop common approaches that strengthen financial stability as well as the regulation of financial organizations. While these efforts often lead to unified approaches, such as the Basel III capital and liquidity frameworks, in some cases countries move at different paces and develop supplemental solutions that are tailored to the legal framework, regulatory system, and industry structure in each jurisdiction. For example, the United States has required U.S. banking organizations to meet a minimum leverage ratio since the 1980s, and the United States has long had strict activity restrictions on companies that control banks. The Board will continue to work with its international counterparts to strengthen the global financial system and financial stability. As regulatory and supervisory standards are implemented throughout the world, the Board and its international supervisory colleagues will gain further insight into which approaches are most effective in improving the resilience of banking organizations and in protecting financial stability, and the Board will take further action as appropriate....
Several commenters focused on the potential effect of the proposal on cross-border resolution. One commenter approved of the proposal on the grounds that requiring a U.S. intermediate holding company for large foreign banking organizations would create a consolidated U.S. legal entity that can be spun off from a troubled parent or placed into receivership under Title II of the Dodd - Frank Act. However, most commenters asserted that the proposal would present impediments to effective cross - border resolution.

Commenters argued that the Board was signaling that it lacks confidence in cross -border resolution, which could reduce other regulators' incentives to cooperate, both in advance of and during a crisis. The Board notes, however, that multiple jurisdictions apply prudential requirements to commercial and investment banking activities conducted in locally incorporated subsidiaries of foreign banks. In the Board's view, and as noted above, the final rule will result in a regulatory approach that is substantively similar to that which now exists in some other jurisdictions, and is therefore not inconsistent with coordinated resolution. Further, a U.S. intermediate holding company would facilitate an orderly cross-border resolution of a foreign banking organization with large U.S. subsidiaries by providing one top-tier U.S. holding company to interface with the parent foreign banking organization in a single -point-of-entry resolution conducted by its home country resolution authority (which is the preferred resolution strategy of many foreign banking organizations) or to serve as the focal point of a separate resolution of the U.S. operations of a oreign banking organization in a multiple-point-of-entry resolution (which is the preferred resolution strategy of other foreign banking organizations).

Commenters also asserted that the Board had not shown that it adequately considered the risks to financial stability that could result from measures taken by other jurisdictions in response to the final rule. Most of these commenters asserted that the proposal could invite retaliatory measures from other jurisdictions, and argued that fragmented, nationalized financial regulation would make the United States less financially stable. The Board has considered the possibility that the proposal may affect the environment for U.S. banking organizations operating overseas. As noted above, U.S. banking organizations already operate in a number of overseas markets that apply local regulatory requirements to their local commercial banking and investment banking subsidiaries. In addition, the United Kingdom, which is host to substantial operations of U.S. banking organizations, applies local liquidity standards to commercial banking and broker -dealer subsidiaries of non - U.K. banks operating in their market that are similar to the requirements included in the Board's proposal. While most other jurisdictions have not imposed similar liquidity requirements on branches and agencies, the Board took into account the particular role of U.S. branches and agencies in funding markets, especially in U.S. -dollar denominated short-term wholesale funding markets, in its evaluation of measures for protecting U.S. financial stability, and has determined that the requirements imposed upon branches and agencies that operate in the United States are appropriate. With respect to requests for quantitative impact studies on the proposal as a whole or on aspects of the proposal in particular...the Board and its international supervisory colleagues will gain further insight into which regulatory approaches are most effective in improving the resilience of banking organizations and in protecting financial stability over time, and the Board will take further action as appropriate.

Some commenters expressed concern that the proposal could jeopardize transatlantic trade agreement negotiations, or that the proposal was protectionist and antithetical to fair, free and open markets. The final rule, however, provides no barriers to entry or operation in the United States that contravene national treatment. The final rule imposes requirements on foreign banking organizations that are comparable to those required of U.S. organizations and are based in prudential regulation.

Do you think that the commentators that objected to aspects of the original proposal are likely to be pacified by the Federal Reserve's explanation of the reasons for its decisions and modifications to the proposals? Does this Rule suggest that harmonization of financial regulation is achievable?

ARE BANKS DIFFERENT FROM OTHER FINANCIAL INSTITUTIONS ?

Banks rely on other financial institutions to acquire credit risk from them by means of loan sales, loan participations and credit default swaps, and this type of activity has some implications for financial stability. Banks are subject to different regulatory regimes from other financial institutions. But there is some blurring between the functions banks and other financial institutions perform.

In 2006, Mark Olson, then a Governor of the Federal Reserve Board,[27] argued that banks are special:[28]

Significant increases in international capital flows among bank and nonbank entities, in addition to a broad range of specialized financial instruments mean banks can no longer be considered the only source of transaction accounts. Except for their access to the Federal Reserve discount window, banks are no longer the dominant provider of liquidity for other financial industries. But banks remain the key access point to the dominant wholesale payments network, and they still provide federally insured checking and savings deposits. With the rise of new financial services, products, and techniques, moreover, banks have expanded their role in providing liquidity in more indirect ways, for example, through securitization of loans and backup commitments to securitization vehicles and other capital-markets instruments. Even when banks may not be "special" or unique providers in a particular market, banks have proven themselves to be formidable competitors and innovators--which only reinforces banks' importance in the proper functioning of our financial system. In short, the public's trust and confidence in banking continue to be vital to our financial well-being.
Banks provided considerable credit in the aftermath of the September 11 attacks, when financial flows were slowed by operational problems. To be sure, banks were able to provide this credit in part because of the huge injection of liquidity provided by the Federal Reserve. But that is a key role for banks in a crisis: to obtain funds--through the discount window or from open market operations, if necessary--and to channel them to those needing funds, based on an assessment of their creditworthiness. Banks' access to the discount window and the payments system, as well as their ongoing relationships with customers and their credit-evaluation skills, allow them to play this role. During a crisis, those banks that play critical

[27] Mark Olson was Chairman of the Public Company Accounting Oversight Board from 2006-9.

[28] See http://www.bis.org/review/r060322c.pdf .

roles in the payments system are especially important. As a result, these banks are expected to be very resilient. Though banks now have a smaller role in transmitting monetary policy, they still help to transmit policy actions by arbitraging between the federal funds market and other money markets.

US: DUAL BANKING REGULATION

In the US, banks may be chartered by the states or by the Office of the Comptroller of the Currency (OCC). Banks chartered by the OCC are known as national banks. The OCC also regulates federal branches and agencies of foreign banks. This separation of functions between the states and the federal authorities is sometimes problematic as states may want to impose rules on banks carrying on business on their territory and the federal authorities may be sensitive about issues of pre-emption in relation to national banks. The following **excerpt from a speech[29] by Mark W. Olson** discusses whether dual banking regulation is a good thing or not:

Importance of the Dual Banking System...

... the significance of the uniquely American dual banking system. Our country's founders established a federal system of government, dividing power and responsibilities between the state governments and the central government. Perhaps less well known to the public is that, since the Civil War, our banking system has developed along similar lines. State banks were, of course, first. But the dynamic tension between centralization and decentralization in U.S. banking is as old as the debate between Thomas Jefferson and Alexander Hamilton over the First Bank of the United States. For a time, after the demise of the Second Bank of the United States in 1836, the forces of state banking were in ascendance. Then, with the passage of the National Bank Act of 1863, nationally chartered banks arrived on the scene. At the time, with the tax on state bank notes, some thought state banks would fade away. Instead, they innovated--by emphasizing demand deposits--and prospered. In typically American fashion, the compromise that has been worked out over time is to have it both ways. We have nationally chartered banks supervised by the federal government and state-chartered banks supervised by both state and federal regulators. The Federal Reserve System itself also reflects this American preference for dispersal of authority. In 1913 the Congress, fearful of central authority, attempted to create a set of regional central banks. Today the twelve Reserve Banks, with the Board of Governors in Washington, provide the regional representation and authority so dear to the American psyche.

Over the years, the dual banking system has provided many innovations. Forced to find a substitute for the issuance of state bank notes that were taxed out of the market by the National Bank Act of 1863, state banks pioneered demand deposits. Much more recently, a state-chartered bank invented the NOW account, which was the opening shot in the long campaign to remove national

[29] http://www.federalreserve.gov/boarddocs/speeches/2002/20020531/default.htm

controls from interest rates on deposits. And the 1994 interstate branching statute was essentially the epilogue to the interstate banking movement, which had begun a decade before then through the establishment of regional interstate compacts. If memory serves, forty-nine of the fifty states had passed some form of interstate banking legislation before the federal government acted on this issue. After the 1994 Reigle-Neal Act, the state banking commissioners combined their efforts to provide for the orderly and consistent supervision of state banks with a multistate presence. I believe the results are a tribute both to the resilience of state banking and, not incidentally, to the leadership of the Conference of State Bank Supervisors.

Now that interstate banking is a reality, I submit that the dual banking system remains an important factor underlying the strength and flexibility of our financial system. As Chairman Greenspan has reminded us in the past, the freedom of banks to choose their regulator is the key to the protection of banks from the potential for unreasonable regulatory behavior. Some are concerned, of course, that the freedom to choose could lead to a "competition in laxity" among regulatory agencies. To be sure, we must guard against that possibility by ensuring the highest standards of supervision as well as the availability of resources and staffing to implement those standards. But I believe that the ability of banks to choose their regulator has fostered both the continued competitiveness of the industry and vitality of the economic activity it finances.

As an aside, let me add that the Federal Reserve, as a central bank responsible for the nation's monetary policy and financial stability, benefits enormously from the insight gleaned from hands-on responsibility for supervising, in partnership with state supervisors, a portion of the banking industry. That is one reason why the Federal Reserve should remain in the bank regulatory business.

See also the following **speech by John Hawke, (then) the Comptroller of the Currency**:[30]

...Even during our colonial period, Americans recognized that banks were necessary to meet the financial needs of the modern state and a developing economy. At the same time, banks were viewed with deep suspicion, if not hostility. Thomas Jefferson, the primary author of our Declaration of Independence, believed that banks were "more dangerous than standing armies." Yet even Jefferson did not believe that the country could afford to dispense with banks altogether. Indeed, America needed banks even more than Britain did, for ours was a young, undeveloped, and far-flung country noticeably lacking in the great private accumulations of liquid wealth with which England was blessed. In order to mobilize capital in such a place, banks were essential. In fact, Americans concluded that if we were to have any banks at all, we should have many of them – not only to serve potential customers for bank services, but also to discourage the rise of a small number of large and powerful institutions capable of

[30] John D. Hawke, Jr., Comptroller of the Currency, Remarks at a Session on Banking Supervision with the People's Bank of China Beijing, China (Oct. 14, 2002) at http://www.occ.gov/static/news-issuances/speeches/2002/pub-speech-2002-80.pdf.

exercising dangerous dominance over local economies.

From this reasoning flowed one of the most distinctive characteristics of the U.S. banking system. At its high water mark, in 1921, there were no fewer than 29,000 independent commercial banks in America. Even today, after decades of industry contraction, there are more than 8000 U.S. banking companies, a number not equaled anywhere else in the world...Viewed purely as an economic arrangement, this banking structure has probably never made much sense. Any system based on thousands of independent, mostly small, institutions might be viewed as a system inevitably lacking in stability and efficiency. But Americans were willing to sacrifice those qualities in a conscious trade off to preserve other values they cherished even more: competition, individual initiative, local responsiveness, and opportunity. Branch banking, despite its real economic benefits, was seen as a threat to those values – and as a step toward financial concentration and monopoly. That's why branching and bank consolidation were systematically suppressed by state and federal laws – some of which remained in effect until just a few years ago.

Americans did not depend entirely on the structure of their banking system to curb potential abuses of banking power. Government oversight and enforcement were also viewed as essential. But here too there have been inhibitions. Americans have always been uneasy with the idea of government intervention in the economy. Our experience as a colony left our people with deep suspicions of government authority -- suspicions that linger to this day. The arrangements formalized in the U.S. Constitution, with its provisions for checks and balances and power sharing between the national government and the states, reflected these suspicions. Thus, in the same way – and for many of the same political reasons -- that U.S. banks were encouraged to proliferate, a system of multiple bank chartering and regulatory authorities arose. During the first half of the 19th century, the states dominated the field of banking. Each carried out its own program of bank chartering and supervision, reflecting wide variances in rigor and competence. The federal government's involvement was sporadic -- and generally unwelcome. Not until the American Civil War, which redefined the relationship between the central government and the states, did a federal presence become a permanent part of the U.S. banking system in the form of the Office of the Comptroller of the Currency and the national banking system, which our office supervises. I am proud to be the 28th person to hold the Office of the Comptroller of the Currency since our founding in 1863.

It is significant that when the U.S. Congress created the national banking system, it did not choose to abolish state-chartered banking at the same time. Given the advantages they built into the national charter, some lawmakers felt that such an outcome -- a system consisting exclusively of national banks -- was assured. But the state banks proved equal to the competitive challenge, and, as your slide shows, the U.S. has ever since had a dual system of state and national banks, under which national banks operate under the primary supervision of the OCC and state banks under the primary supervision of the 50 state banking departments.

Dual banking made for a complicated regulatory system that would soon grow more complicated still. But Americans didn't necessarily see regulatory complexity as a bad thing. It was viewed instead as a safeguard against the dangers of regulatory hegemony and abuse – and as an incentive to regulatory responsiveness and efficiency. Dividing regulatory authority between the federal government and the states – and then dividing it again, over a period of years, among three separate federal agencies – ensured that no single agency would be able to gain meaningful dominance. And because regulatory authority was checked and balanced in this way, Congress felt safe in endowing the OCC with considerable independence, both from its own control as well as from that of the executive branch within which the OCC was positioned.

The decision to create the OCC as an independent agency was quite an extraordinary step, and it was one that reflected Congress's understanding of the importance of supervision in the nation's overall banking scheme. Although formally a "bureau" of the Treasury Department – indeed, until the 1970s, the Comptroller's offices were actually housed within the main Treasury building in Washington -- the OCC has always enjoyed considerable operational autonomy. Although appointed by the President with Senate confirmation, the president cannot remove the Comptroller before the expiration of the statutory five-year term without providing to the Senate in writing a statement of his reasons for doing so.

Just within the past decade, Congress passed additional legislation reaffirming the OCC's ability to submit legislative recommendations and testimony to Congress without prior approval or review in the Executive Branch. Moreover, Congress has forbidden the Treasury Department from intervening in any matter or proceeding before us, or from delaying or preventing the issuance of any rule or regulation by the OCC. I
speak from personal experience – as Under Secretary of the Treasury for Domestic Finance before moving to the OCC – when I say that these rules have been scrupulously respected.

These structural firewalls have made it possible to successfully insulate the OCC
from occasional pressures to support particular fiscal or monetary policies or to appoint politically connected individuals to supervisory positions. One measure of that success lies in the fact that my staff in Washington consists of civil servants who work under the merit system; while national bank examiners, of which there are currently more than 1500, have been recruited from the nation's universities and financial institutions, and commissioned after passing through a rigorous program of classroom instruction, on-the-job training, and continuing education. I hope you will not accuse me of being immodest when I say that our peers at home and abroad regard the OCC as the premier bank regulatory agency. But it's true.

So far, I have just spoken of one phase of OCC independence – independence from the executive branch of the federal government. Our relationship with Congress is somewhat different. Of course, the OCC is subject to all laws that Congress may make, and the Comptroller is regularly called upon to provide testimony on subjects of interest to legislators. But a crucial element of this relationship is the fact that we – unlike virtually all other agencies of our government -- do not depend upon Congress to provide the funds we depend upon to finance our activities.

That is in accordance with Congress's own plan. In creating the OCC and the national banking system, it chose to remove the OCC from the normal budget and appropriations process – to remove it, that is, from its own direct control. It recognized that the power to approve a budget may confer an ability to direct policy, and that subjecting bank supervisors to the give-and-take of budget negotiations would inevitably lead to pressures for supervisory compromises. Thus, in a historic act of self-denial, Congress chose to restrict its own influence and authority rather than compromising the ability of the OCC to conduct its operations objectively and with independence. Instead, in a system that has continued to operate without interruption since the 1860s, banks are subject to annual fee assessments by the OCC, which since 1914 have been asset-based. They also pay fees to cover the cost of processing corporate applications. Those two sources together account for nearly 97 percent of the OCC's $413 million annual budget.

Our ability to deliver independent and professional bank supervision owes in large measure to the wisdom and selflessness of those who created the national banking system as a self-supported, self-financing entity.

Our longstanding belief that independence is crucial to effective bank supervision has received repeated confirmation elsewhere in the world. Indeed, the absence of supervisory independence has been implicated in almost every national financial crisis the world has recently seen. In Argentina, South Korea, Thailand, Japan, Turkey, and Indonesia, bank supervisors were unable to operate with the independence their responsibilities demanded. In each case, supervisors became instruments of government or central bank policies that subordinated the safety and soundness of financial institutions to other goals. In each case, banks were permitted -- or even encouraged -- to make loans in defiance of good credit practices in order to promote certain policy objectives, such as protecting inefficient industries. Moreover, in each case, the result was the same: supervision was discredited; the condition of the banking system deteriorated; the national economy suffered; and the process of recovery was seriously impeded by a crippled banking system. Some countries are still struggling with the consequences of such ill-advised supervisory policies.

These experiences help explain why, when the Basel Committee on Banking Supervision adopted its core principles for effective supervision in 1997, "operational independence and adequate resources" headed the list. And the experiences of other countries remind us of the importance of vigilance in defending supervisory independence here at home.

On another crucial issue of supervisory structure, however, global practice is less conclusive. That is the role of central banks – and, to a lesser degree, the deposit insurance agencies – in the supervisory arena. In this area there have been a wide variety of experiences and results. Many of the world's countries have opted to separate monetary policy from bank supervision. Austria, Canada, Germany, Japan, Norway, Mexico, and, recently, the United Kingdom, among others, have taken the step of removing the central bank from the supervisory function. The rationale is that there are inherent conflicts of interest between the two roles – that the goals of monetary policy – and a solvent deposit insurance fund – may not coincide with the demands of a safe, sound, and competitive banking system. For example, a central bank may decide that its overall monetary and macroeconomic objectives are better served by infusing capital into an insolvent institution, whereas the pure supervisor might have opted to close the bank. Similarly, the deposit insurer, if also endowed with supervisory responsibilities, may take a supervisory position that is highly adverse to risk-taking – good for the loss-ratios of the insurance fund, but perhaps not so good for the competitiveness of banks and their customers.

In the United States, nonetheless, we entrust the Federal Reserve and the Federal Deposit Insurance Corporation with significant responsibilities for bank supervision... state-chartered banks in America, in addition to their state supervisors, each have one primary federal bank supervisor: the FDIC if it's a state-chartered bank that is not a member of the Federal Reserve system (membership is optional for all state banks and mandatory for OCC-supervised national banks), and the Federal Reserve if the state bank is a Fed member.

We are often asked to explain why this complicated regulatory structure arose – and why we have not attempted systematically to simplify it. The question of origins has a relatively straightforward answer. I have already spoken of Americans' enduring suspicion of concentrated political authority and their belief that establishing multiple and competing government bureaucracies would serve to check their ambitions and excesses. Thus, when the Federal Reserve System was created in 1914 – becoming the second federal agency with a bank supervisory mission – Congress simply layered it on top of the existing supervisory structure and parceled supervisory authority between the new Fed and the OCC. The same pattern held in 1933, when the FDIC – the third of the federal banking agencies -- was created.

So it was not political cowardice, as some have suggested, that led Congress to avoid trying to abolish one agency when creating another to perform essentially the same, or a complimentary, function -- although as you well know, abolishing government bureaucracies is never an easy task. There is a positive rationale for multiple agencies: that competition can be as productive in the public sector as in the private. In the case of bank supervision, the assumption has been that the agencies would each do their jobs better with bureaucratic competitors in the mix, challenging them to excel. Whether or not this was Congress's rationale, most agree that it has been the happy result.

In the case of U.S. banking, regulatory competition can take on a particular edge, because U.S. banks have the extraordinary ability not only to choose their chartering agency, but also to switch charters if they grow dissatisfied with the manner in which they're supervised. It's in the direct self-interest of the primary supervisors that depend upon assessment funding – the states and the OCC –to provide high quality, cost-effective supervision. And by most accounts, we do just that.

The other main reason why this somewhat unwieldy structure arose was because both the Federal Reserve and the FDIC made compelling cases in favor of their receiving significant supervisory responsibilities. The Fed has argued that it needs a "window" into the banking system to assist it in carrying out monetary policy, and the FDIC has made a plausible argument that the insurer's interests – and the health of the deposit insurance funds -- must be taken into account in supervisory decisions that are likely to affect them. Thus, in addition to their routine responsibilities for state-chartered banks – responsibilities that, as already noted, are shared with state authorities -- both the Fed and the FDIC have back-up supervisory authority for national banks that can be exercised in problem bank situations.

Once the Federal Reserve and the FDIC became permanent parts of our supervisory structure, the complexion of the U.S. dual banking system changed. Laws passed by Congress that were meant to apply to state as well as national banks were increasingly entrusted for administration to the federal supervisors of state banks, whose compliance with Congress's wishes could be better monitored. Thus, as your chart shows, most of the supervisory activities concerning state-chartered banks are carried out not by the states, but by the Federal Reserve and the FDIC. So there is probably less "duality" today than there has ever been in the 140-year history of the U.S. dual banking system.

As to why our system has persisted despite its unwieldiness, there are a couple of points to consider. The first is that there has never been a clear and compelling consensus for change. The U.S. banking industry and other interest groups have learned to live with – and take advantage of – our existing system. For them, change would be unwelcome. But even those groups that might be expected to support supervisory rationalization – consumer and public interest groups, for example -- have been not expressed that support in any consistent or unified way. And the regulatory agencies themselves have never been enthusiastic about proposals to simplify supervision – especially when simplification would occur at their expense.

A second reason why our structure has remained in place is that the U.S. regulatory agencies, through trial and error, have learned to work effectively within it. We have created formal mechanisms for coordinating our efforts and avoiding duplication and unnecessary burden on U.S. financial institutions, as well as informal avenues for information sharing and consultation. I believe that the relationships that exist among U.S. supervisors validate the concept that lies at the heart of our structure – that competition among regulatory agencies can enhance the quality of supervision and help prevent it from becoming unduly burdensome for financial institutions.

The final and perhaps most important reason why our regulatory structure works is that it is an authentic reflection of our country's habits of mind and practice. While international experience suggests certain core principles of effective bank supervision – independence being chief among them -- every country must find its own way of implementing those principles, in a manner consistent with its own culture and institutions. That is what the United States has successfully done over a period of many years. And that is one of the great challenges that confront the People's Republic of China. We at the OCC are delighted to assist in any way in that effort.

Do you think it is possible to reconcile Hawke's concern for cultural differences with regulatory harmonization?

States make it clear they are competing to attract banks to charter with them. They say that the state banking officials will be accessible, that the charges they impose are lower than the OCC's charges, and that the regulators and rules are local.[31] In addition states often have parity statutes which allow state banks to have many of the benefits they would derive from a national charter.

[31] *See, e.g.*, Advantages of a State Bank Charter http://www.flofr.com/PDFs/state_charter.pdf .

Here is the Florida statute (**Section 655.061, Florida Statutes**):

> Subject to the prior approval of OFR pursuant to rule or order of general application, state financial institutions subject to the financial institutions codes may make any loan or investment or exercise any power which they could make or exercise if incorporated or operating in this state as a federally chartered or regulated financial institution of the same type and are entitled to all privileges and protections granted federally chartered or regulated financial institutions of the same type under federal statutes and regulations. The provisions of this section take precedence over, and must be given effect over, any other general or specific provisions of the financial institution's codes to the contrary. In issuing an order under this section, OFR shall consider the importance of maintaining a competitive dual system of financial institutions and whether such order is in the public interest.

Do you think that the competition for bank charters is likely to produce better bank regulation overall? Better banks? Do you think that depositors are likely to know whether their bank is a national bank or a state chartered bank? How would you go about finding out? Is your bank a state bank or a national bank?

This question may matter. States sometimes try to regulate what banks do within their territory. In particular, states enacted statutes to control predatory lending.[32] Predatory lenders impose unfair terms on their customers. Where predatory loans are mortgage loans borrowers may lose their homes.[33] The statutes tend to be drafted to cover lending within the state rather than lending by state chartered banks. This makes some sense if borrowers cannot easily distinguish between state chartered and national banks and therefore cannot easily work out what rules

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[32] Sometimes described as “abusive lending”. *See*, *e.g.*, OCC notice for Request of Pre-emption Determination or Order relating to the Georgia Fair Lending Act, 68 Fed. Reg.8959 (Feb. 26, 2003).

[33] Opponents of predatory lending referred to “asset stripping” or “equity stripping” which can happen because of large fees charged in relation to the loans. *See*, *e.g.*, Center for Responsible Lending, Comments on OCC Working Paper (Oct. 6, 2003) (“The primary abuse the North Carolina law, and other subsequent state laws, is aimed at is preventing equity stripping, which occurs when lenders charge excessive fees. The problem of excessive fees for the subprime refinancing borrower is two-fold: the fees seem painless at closing and they are forever. They are *deceptively costless* to many borrowers because when the borrower “pays” them, with a stroke of a pen at closing, he or she does not feel the pain of counting out thousands of dollars in cash. The borrower parts with the money only later, when the loan is paid off and the equity value remaining in his or her home is reduced by the amount of fees owed. And *fees are forever* because, even if a responsible lender refinances a family a week later, the borrowers’ wealth is still permanently stripped away.”)

would regulate predatory lending. However, national banks objected to being subjected to these state laws on the basis that they are pre-empted. A major concern underlying the objection was the impact of state predatory lending laws on securitizations. Rating agencies addressed these issues. For example, Standard & Poor's stated in 2003 that it considered whether predatory lending statutes provide for assignee liability, whether the loan categories affected are clearly defined, what penalties apply and how clear the statute is (including safe harbors). Rating agencies and lenders suggested that if state statutes made it hard for lenders to securitize loans the legislation would be counter-productive and cut off access to credit for borrowers:

> GAFLA, with its complicated structure, ambiguous provisions and undefined terms, has created uncertainty, and the secondary market has reacted strongly and negatively. The reaction was to be expected on 'high cost' loans, as the large, national buyers of home loans such as Fannie Mae and Freddie Mac do not buy those loans. However, the market has also reacted negatively to 'covered' loans primarily due to the uncertainty created by the wording of the Act. No other state or federal anti-predatory lending laws include a category of mid-priced loans in their statutes, and loans made in Georgia will continue to be treated with suspicion by the secondary market. The national buyers of mortgage loans have changed their underwriting standards and now require lenders to agree to take back any loans made under GAFLA if a compliance failure is found – even years after the loan was closed, sold or even paid off.[34]

In January 2004 the OCC issued two rules: one on Bank Activities and Operations; Real Estate Lending and Appraisals[35] and the other on Bank Activities and Operations.[36] These rules attempt to delineate when state rules may impact national banks and when they may not.

In **Watters v. Wachovia Bank**[37] the Supreme Court held that the National Banking Act operated to pre-empt state rules with respect to a subsidiary of a national bank:

Business activities of national banks are controlled by the National Bank Act and regulations

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[34] The Georgia Bankers Association White Paper, Georgia Fair Lending Act. The Unintended Consequences 5 (Jan. 2003).

[35] 69 Fed. Reg. 1904 (Jan 13, 2004).

[36] 69 Fed. Reg 1895 (Jan 13, 2004).

[37] 550 U.S. 1 (2007).

promulgated thereunder by the Office of the Comptroller of the Currency (OCC). As the agency charged by Congress with supervision of the NBA, OCC oversees the operations of national banks and their interactions with customers. The agency exercises visitorial powers, including the authority to audit the bank's books and records, largely to the exclusion of other governmental entities, state or federal.

The NBA specifically authorizes federally chartered banks to engage in real estate lending. It also provides that banks shall have power "[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking." Among incidental powers, national banks may conduct certain activities through "operating subsidiaries," discrete entities authorized to engage solely in activities the bank itself could undertake, and subject to the same terms and conditions as those applicable to the bank.

Respondent Wachovia Bank, a national bank, conducts its real estate lending business through Wachovia Mortgage Corporation, a wholly owned, state-chartered entity, licensed as an operating subsidiary by OCC. It is uncontested in this suit that Wachovia's real estate business, if conducted by the national bank itself, would be subject to OCC's superintendence, to the exclusion of state registration requirements and visitorial authority. The question in dispute is whether the bank's mortgage lending activities remain outside the governance of state licensing and auditing agencies when those activities are conducted, not by a division or department of the bank, but by the bank's operating subsidiary. In accord with the Courts of Appeals that have addressed the issue, we hold that Wachovia's mortgage business, whether conducted by the bank itself or through the bank's operating subsidiary, is subject to OCC's superintendence, and not to the licensing, reporting, and visitorial regimes of the several States in which the subsidiary operates.

Wachovia Bank is a national banking association chartered by OCC. Respondent Wachovia Mortgage is a North Carolina corporation that engages in the business of real estate lending in the State of Michigan and elsewhere. Michigan's statutory regime exempts banks, both national and state, from state mortgage lending regulation, but requires mortgage brokers, lenders, and servicers that are subsidiaries of national banks to register with the State's Office of Financial and Insurance Services (OFIS) and submit to state supervision. From 1997 until 2003, Wachovia Mortgage was registered with OFIS to engage in mortgage lending. As a registrant, Wachovia Mortgage was required, inter alia, to pay an annual operating fee, file an annual report, and open its books and records to inspection by OFIS examiners.

Petitioner Linda Watters, the commissioner of OFIS, administers the State's lending laws. She exercises "general supervision and control" over registered lenders, and has authority to conduct examinations and investigations and to enforce requirements against registrants. She also has authority to investigate consumer complaints and take enforcement action if she finds that a complaint is not "being adequately pursued by the appropriate federal regulatory authority."

On January 1, 2003, Wachovia Mortgage became a wholly owned operating subsidiary of Wachovia Bank. Three months later, Wachovia Mortgage advised the State of Michigan that it was surrendering its mortgage lending registration. Because it had become an operating subsidiary of a national bank, Wachovia Mortgage maintained, Michigan's registration and inspection requirements were preempted.

Watters responded with a letter advising Wachovia Mortgage that it would no longer be authorized to conduct mortgage lending activities in Michigan.

Wachovia Mortgage and Wachovia Bank filed suit against Watters, in her official capacity as commissioner, in the United States District Court for the Western District of Michigan. They sought declaratory and injunctive relief prohibiting Watters from enforcing Michigan's registration prescriptions against Wachovia Mortgage, and from interfering with OCC's exclusive visitorial authority. The NBA and regulations promulgated thereunder, they urged, vest supervisory authority in OCC and preempt the application of the state-law controls at issue. Specifically, Wachovia Mortgage and Wachovia Bank challenged as preempted certain provisions of two Michigan statutes--the Mortgage Brokers, Lenders, and Services Licensing Act and the Secondary Mortgage Loan Act. The challenged provisions (1) require mortgage lenders--including national bank operating subsidiaries but not national banks themselves--to register and pay fees to the State before they may conduct banking activities in Michigan, and authorize the commissioner to deny or revoke registrations, (2) require submission of annual financial statements to the commissioner and retention of certain documents in a particular format, (3) grant the commissioner inspection and enforcement authority over registrants, and (4) authorize the commissioner to take regulatory or enforcement actions against covered lenders.

In response, Watters argued that, because Wachovia Mortgage was not itself a national bank, the challenged Michigan controls were applicable and were not preempted. She also contended that the Tenth Amendment to the Constitution of the United States prohibits OCC's exclusive superintendence of national bank lending activities conducted through operating subsidiaries.....

Nearly 200 years ago, in McCulloch v. Maryland this Court held.federal law supreme over state law with respect to national banking. Though the bank at issue in McCulloch was short-lived, a federal banking system reemerged in the Civil War era. In 1864, Congress enacted the NBA, establishing the system of national banking still in place today. The Act vested in nationally chartered banks enumerated powers and "all such incidental powers as shall be necessary to carry on the business of banking." To prevent inconsistent or intrusive state regulation from impairing the national system, Congress provided: "No national bank shall be subject to any visitorial powers except as authorized by Federal law . . . ."

In the years since the NBA's enactment, we have repeatedly made clear that .federal control shields national banking from unduly burdensome and duplicative state regulation...Federally chartered banks are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or the general purposes of the NBA. For example, state usury laws govern the maximum rate of interest national banks can charge on loans, contracts made by national banks "are governed and construed by State laws," and national banks'"acquisition and transfer of property [are] based on State law,"..However, "the States can exercise no control over [national banks], nor in any wise affect their operation, except in so far as Congress may see proper to permit. Any thing beyond this is an abuse, because it is the usurpation of power which a single State cannot give."

We have "interpret[ed] grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law." States are permitted to regulate the activities of national banks where doing so does not prevent or significantly

interfere with the national bank's or the national bank regulator's exercise of its powers. But when state prescriptions significantly impair the exercise of authority, enumerated or incidental under the NBA, the State's regulations must give way.
The NBA authorizes national banks to engage in mortgage lending, subject to OCC regulation. The Act provides:
"Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order."
Beyond genuine dispute, state law may not significantly burden a national bank's own exercise of its real estate lending power, just as it may not curtail or hinder a national bank's efficient exercise of any other power, incidental or enumerated under the NBA. In particular, real estate lending, when conducted by a national bank, is immune from state visitorial control: The NBA specifically vests exclusive authority to examine and inspect in OCC..("No national bank shall be subject to any visitorial powers except as authorized by Federal law.").
Harmoniously, the Michigan provisions at issue exempt national banks from coverage. This is not simply a matter of the Michigan Legislature's grace. For, as the parties recognize, the NBA would have preemptive force, i.e., it would spare a national bank from state controls of the kind here involved. State laws that conditioned national banks' real estate lending on registration with the State, and subjected such lending to the State's investigative and enforcement machinery would surely interfere with the banks' federally authorized business: National banks would be subject to registration, inspection, and enforcement regimes imposed not just by Michigan, but by all States in which the banks operate. Diverse and duplicative superintendence of national banks' engagement in the business of banking, we observed over a century ago, is precisely what the NBA was designed to prevent: "Th[e] legislation has in view the erection of a system extending throughout the country, and independent, so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the States." Congress did not intend, we explained, "to leave the field open for the States to attempt to promote the welfare and stability of national banks by direct legislation. . . . [C]onfusion would necessarily result from control possessed and exercised by two independent authorities."
Recognizing the burdens and undue duplication state controls could produce, Congress included in the NBA an express command: "No national bank shall be subject to any visitorial powers except as authorized by Federal law. . . ." "Visitation," we have explained "is the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting business, and enforce an observance of its laws and regulations." ..Michigan, therefore, cannot confer on its commissioner examination and enforcement authority over mortgage lending, or any other banking business done by national banks.
While conceding that Michigan's licensing, registration, and inspection requirements cannot be applied to national banks, ..Watters argues that the State's regulatory regime survives preemption with respect to national banks' operating subsidiaries. Because such subsidiaries are separately chartered under some

State's law, Watters characterizes them simply as "affiliates" of national banks, and contends that even though they are subject to OCC's superintendence, they are also subject to multistate control. We disagree.

Since 1966, OCC has recognized the "incidental" authority of national banks .. to do business through operating subsidiaries. That authority is uncontested by Michigan's commissioner. ..OCC licenses and oversees national bank operating subsidiaries just as it does national banks.

In 1999, Congress defined and regulated "financial" subsidiaries; simultaneously, Congress distinguished those national bank affiliates from subsidiaries--typed "operating subsidiaries" by OCC--which may engage only in activities national banks may engage in directly, "subject to the same terms and conditions that govern the conduct of such activities by national banks." Gramm-Leach-Bliley Act (GLBA).. For supervisory purposes, OCC treats national banks and their operating subsidiaries as a single economic enterprise. OCC oversees both entities by reference to "business line," applying the same controls whether banking "activities are conducted directly or through an operating subsidiary."

As earlier noted, Watters does not contest the authority of national banks to do business through operating subsidiaries. Nor does she dispute OCC's authority to supervise and regulate operating subsidiaries in the same manner as national banks. Still, Watters seeks to impose state regulation on operating subsidiaries over and above regulation undertaken by OCC. But just as duplicative state examination, supervision, and regulation would significantly burden mortgage lending when engaged in by national banks, so too would those state controls interfere with that same activity when engaged in by an operating subsidiary.

We have never held that the preemptive reach of the NBA extends only to a national bank itself. Rather, in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank's powers, not on its corporate structure. And we have treated operating subsidiaries as equivalent to national banks with respect to powers exercised under federal law (except where federal law provides otherwise). In NationsBank of N. C., for example, we upheld OCC's determination that national banks had "incidental" authority to act as agents in the sale of annuities. It was not material that the function qualifying as within "the business of banking," was to be carried out not by the bank itself, but by an operating subsidiary, i.e., an entity "subject to the same terms and conditions that govern the conduct of [the activity] by national banks [themselves],"

Security against significant interference by state regulators is a characteristic condition of the "business of banking" conducted by national banks, and mortgage lending is one aspect of that business. That security should adhere whether the business is conducted by the bank itself or is assigned to an operating subsidiary licensed by OCC whose authority to carry on the business coincides completely with that of the bank...

Watters contends that if Congress meant to deny States visitorial powers over operating subsidiaries, it would have written § 484(A)'s ban on state inspection to apply not only to national banks but also to their affiliates. She points out that § 481, which authorizes OCC to examine "affiliates" of national banks, does not speak to state visitorial powers. This argument fails for two reasons. First, one cannot ascribe any intention regarding operating subsidiaries to the 1864 Congress that enacted §§ 481 and 484, or the

1933 Congress that added the provisions on examining affiliates to § 481 and the definition of "affiliate" to § 221a. That is so because operating subsidiaries were not authorized until 1966. Over the past four decades, during which operating subsidiaries have emerged as important instrumentalities of national banks, Congress and OCC have indicated no doubt that such subsidiaries are "subject to the same terms and conditions" as national banks themselves.

Second, Watters ignores the distinctions Congress recognized among "affiliates." The NBA broadly defines the term "affiliate" to include "any corporation" controlled by a national bank, including a subsidiary. An operating subsidiary is therefore one type of "affiliate." But unlike affiliates that may engage in functions not authorized by the NBA, e.g., financial subsidiaries, an operating subsidiary is tightly tied to its parent by the specification that it may engage only in "the business of banking" as authorized by the Act. Notably, when Congress amended the NBA confirming that operating subsidiaries may "engag[e] solely in activities that national banks are permitted to engage in directly," it did so in an Act, the GLBA, providing that other affiliates, authorized to engage in nonbanking financial activities, e.g., securities and insurance, are subject to state regulation in connection with those activities. Recognizing the necessary consequence of national banks' authority to engage in mortgage lending through an operating subsidiary "subject to the same terms and conditions that govern the conduct of such activities by national banks," OCC promulgated 12 CFR § 7.4006 (2006): "Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank." Watters disputes the authority of OCC to promulgate this regulation and contends that, because preemption is a legal question for determination by courts, § 7.4006 should attract no deference. This argument is beside the point, for under our interpretation of the statute, the level of deference owed to the regulation is an academic question. Section 7.4006 merely clarifies and confirms what the NBA already conveys: A national bank has the power to engage in real estate lending through an operating subsidiary, subject to the same terms and conditions that govern the national bank itself; that power cannot be significantly impaired or impeded by state law.

The NBA is thus properly read by OCC to protect from state hindrance a national bank's engagement in the "business of banking" whether conducted by the bank itself or by an operating subsidiary, empowered to do only what the bank itself could do. The authority to engage in the business of mortgage lending comes from the NBA, § 371, as does the authority to conduct business through an operating subsidiary. That Act vests visitorial oversight in OCC, not state regulators. State law (in this case, North Carolina law), all agree, governs incorporation-related issues, such as the formation, dissolution, and internal governance of operating subsidiaries. And the laws of the States in which national banks or their affiliates are located govern matters the NBA does not address. But state regulators cannot interfere with the "business of banking" by subjecting national banks or their OCC-licensed operating subsidiaries to multiple audits and surveillance under rival oversight regimes.

In **Cuomo v. Clearing House Association** [38] the Supreme Court distinguished between the exercise of visitorial powers (which was pre-empted by the NBA) and judicial enforcement actions brought by the Attorney General. Justice Scalia wrote:

Historically, the sovereign's right of visitation over corporations paralleled the right of the church to supervise its institutions and the right of the founder of a charitable institution "to see that [his] property [was] rightly employed," .. By extension of this principle, "[t]he king [was] by law the visitor of all civil corporations," A visitor could inspect and control the visited institution at will.
When the National Bank Act was enacted in 1864, "visitation" was accordingly understood as "[t]he act of examining into the affairs of a corporation" by "the government itself." .. Lower courts understood "visitation" to mean "the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting business, and enforce an observance of its laws and regulations."... A State was the "visitor" of all companies incorporated in the State, simply by virtue of the State's role as sovereign: The "legislature is the visitor of all corporations founded by it."..
This relationship between sovereign and corporation was understood to allow the States to use prerogative writs--such as mandamus and quo warranto--to exercise control "whenever a corporation [wa]s abusing the power given it, or, . . . or acting adversely to the public, or creating a nuisance."... State visitorial commissions were authorized to "exercise a general supervision" over companies in the State...
Our cases have always understood "visitation" as this right to oversee corporate affairs, quite separate from the power to enforce the law In the famous Dartmouth College case, Justice Story, describing visitation of a charitable corporation, wrote that Dartmouth was "subject to the controlling authority of its legal visitor, who . . . may amend and repeal its statutes, remove its officers, correct abuses, and generally superintend the management of [its] trusts," and who are "liable to no supervision or control." .. This power of "genera[l] superintend[ence]" stood in contrast to action by the court of chancery, which acted "not as itself possessing a visitorial power . . . but as possessing a general jurisdiction . . . to redress grievances, and frauds."
In Guthrie, supra, we held that a shareholder acting in his role as a private individual was not exercising a "visitorial power" under the National Bank Act when he petitioned a court to force the production of corporate records,.. "[C]ontrol in the courts of justice," we said, is not visitorial, and we drew a contrast between the nonvisitorial act of "su[ing] in the courts of the State" and the visitorial "supervision of the Comptroller of the Currency,"..
In First Nat. Bank in St. Louis v. Missouri .. we upheld the right of the Attorney General of Missouri to bring suit to enforce a state anti-bank-branching law against a national bank. We said that only the United States may perform visitorial administrative oversight such as "inquir[ing] by quo warranto whether a national bank is acting in excess of its charter powers." But if a state statute of general

[38] 129 S. Ct. 2710 (2009).

applicability is not substantively pre-empted, then "the power of enforcement must rest with the [State] and not with" the National Government..

Our most recent decision, Watters v. Wachovia Bank does not, as the dissent contends "suppor[t] OCC's construction of the statute." To the contrary, it is fully in accord with the well established distinction between supervision and law enforcement. Watters held that a State may not exercise "'general supervision and control'" over a subsidiary of a national bank because "multiple audits and surveillance under rival oversight regimes" would cause uncertainty " [G]eneral supervision and control" and "oversight" are worlds apart from law enforcement. All parties to the case agreed that Michigan's general oversight could not be imposed on national banks; the sole question was whether operating subsidiaries of national banks enjoyed the same immunity from state visitation. The opinion addresses and answers no other question.

The foregoing cases all involve enforcement of state law. But if the Comptroller's exclusive exercise of visitorial powers precluded law enforcement by the States, it would also preclude law enforcement by federal agencies. Of course it does not.

In sum, the unmistakable and utterly consistent teaching of our jurisprudence, both before and after enactment of the National Bank Act, is that a sovereign's "visitorial powers" and its power to enforce the law are two different things. There is not a credible argument to the contrary. And contrary to what the Comptroller's regulation says, the National Bank Act pre-empts only the former...

The consequences of the regulation also cast doubt upon its validity. No one denies that the National Bank Act leaves in place some state substantive laws affecting banks. .. But the Comptroller's rule says that the State may not enforce its valid, non-pre-empted laws against national banks. . The bark remains, but the bite does not.

The dissent admits, with considerable understatement, that such a result is "unusual," "Bizarre" would be more apt. As the Court said in St. Louis:

"To demonstrate the binding quality of a statute but deny the power of enforcement involves a fallacy made apparent by the mere statement of the proposition, for such power is essentially inherent in the very conception of law."

In sharp contrast to the "unusual" reading propounded by the Comptroller's regulation, reading "visitorial powers" as limiting only sovereign oversight and supervision would produce an entirely commonplace result--the precise result contemplated by our opinion in St. Louis, which said that if a state statute is valid as to national banks, "the corollary that it is obligatory and enforceable necessarily results."...

Channeling state attorneys general into judicial law-enforcement proceedings (rather than allowing them to exercise "visitorial" oversight) would preserve a regime of exclusive administrative oversight by the Comptroller while honoring in fact rather than merely in theory Congress's decision not to pre-empt substantive state law. This system echoes many other mixed state/federal regimes in which the Federal Government exercises general oversight while leaving state substantive law in place.

This reading is also suggested by § 484(a)'s otherwise inexplicable reservation of state powers "vested in the courts of justice." As described earlier, visitation was normally conducted through use of the prerogative writs of mandamus and quo warranto. The exception could not possibly exempt that manner of exercising visitation, or else the exception would swallow the rule. Its only conceivable purpose is to preserve normal civil and criminal lawsuits. To be sure, the reservation of powers "vested in the courts of justice" is phrased as an exception from the prohibition of visitorial powers. But as we have just discussed, it cannot possibly be that, and it is explicable only as an attempt to make clear that the courts' ordinary powers of enforcing the law are not affected.

On a pragmatic level, the difference between visitation and law enforcement is clear. If a State chooses to pursue enforcement of its laws in court, then it is not exercising its power of visitation and will be treated like a litigant. An attorney general acting as a civil litigant must file a lawsuit, survive a motion to dismiss, endure the rules of procedure and discovery, and risk sanctions if his claim is frivolous or his discovery tactics abusive. Judges are trusted to prevent "fishing expeditions" or an undirected rummaging through bank books and records for evidence of some unknown wrongdoing. In New York, civil discovery is far more limited than the full range of "visitorial powers" that may be exercised by a sovereign. Courts may enter protective orders to prevent "unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice," A visitor, by contrast, may inspect books and records at any time for any or no reason.

The Comptroller's regulation, therefore, does not comport with the statute. Neither does the Comptroller's interpretation of its regulation, which differs from the text and must be discussed separately.

Evidently realizing that exclusion of state enforcement of all state laws against national banks is too extreme to be contemplated, the Comptroller sought to limit the sweep of its regulation by the following passage set forth in the agency's statement of basis and purpose in the Federal Register:

"What the case law does recognize is that 'states retain some power to regulate national banks in areas such as contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law.' [citing a Ninth Circuit case.] Application of these laws to national banks and their implementation by state authorities typically does not affect the content or extent of the Federally-authorized business of banking . . . but rather establishes the legal infrastructure that surrounds and supports the ability of national banks . . . to do business." 69 Fed. Reg. 1896 (2004) (footnote omitted).

This cannot be reconciled with the regulation's almost categorical prohibition in 12 CFR § 7.4000(a)(1) of "prosecuting enforcement actions." Nor can it be justified by the provision in subsection (a)(2)(iv) which defines visitorial powers to include "[e]nforcing compliance with any applicable . . . state laws concerning" "activities authorized or permitted pursuant to federal banking law," § 7.4000(a)(2)(iii). The latter phrase cannot be interpreted to include only distinctively banking activities (leaving the States free to enforce nonbanking state laws), because if it were so interpreted subsection (a)(2)(iii), which uses the same terminology, would limit the Comptroller's exclusive visitorial power of "regulation and supervision" to distinctively banking activities--which no one thinks is the case. Anyway, the National Bank Act does specifically authorize and permit activities that fall within what the statement of basis and purpose calls "the legal infrastructure that surrounds and supports the ability of national banks . . . to do business." See, e.g., 12 U.S.C. § 24 Third (power to make contracts); § 24 Seventh ("all such incidental powers as shall be necessary to carry on the business of banking"). And of course a distinction between "implementation" of "infrastructure" and judicial enforcement of other laws can be found nowhere within the text of the statute. This passage in the statement of basis and purpose, resting upon neither the text of the regulation nor the text of the statute, attempts to do what Congress declined to do: exempt national banks from all state banking laws, or at least state enforcement of those laws.

The dissent fails to persuade us. Its fundamental contention--that the exclusive grant of visitorial powers can be interpreted to preclude state enforcement of state laws--rests upon a logical fallacy. The dissent establishes,.. (and we do not at all contest), that in the course of exercising visitation powers the sovereign can compel compliance with the law. But it concludes from that that any sovereign attempt to compel compliance with the law can be deemed an exercise of the visitation power. That conclusion obviously does not follow. For example, in the course of exercising its visitation powers, the sovereign can assuredly compel a bank to honor obligations that are in default. Does that mean that the sovereign's taking the same action in executing a civil judgment for payment of those obligations can be considered an exercise of the visitation power? Of course not. Many things can be compelled through the visitation power that can be compelled through the exercise of other sovereign power as well. The critical question is not what is being compelled, but what sovereign power has been invoked to compel it. And the power to enforce the law exists separate and apart from the power of visitation.

The dissent argues that the Comptroller's expansive reading of "visitorial powers" does not intrude upon the, "'the historic police powers of the States,'".. because, like federal maritime law, federal involvement in this field dates to "'the earliest days of the Republic,'" ..For that reason, the dissent concludes, this case does not raise the sort of federalism concerns that prompt a presumption against pre-emption. We have not invoked the presumption against pre-emption, and think it unnecessary to do so in giving force to the plain terms of the National Bank Act. Neither, however, should the incursion that the Comptroller's regulation makes upon traditional state powers be minimized. Although the sovereign visitorial power of assuring national-bank compliance with all laws inhered in the Federal Government from the time of its creation of national banks, the Comptroller was not given authority to enforce non pre-empted state laws until 1966. .. A power first exercised during the lifetime of every current Justice is hardly involvement "from the earliest days of the Republic."

States, on the other hand, have always enforced their general laws against national banks--and have enforced their banking-related laws against national banks for at least 85 years, as evidenced by St. Louis, in which we upheld enforcement of a state anti-bank-branching law,

The dissent seeks to minimize the regulation's incursion upon state powers by claiming that the regulation does not "declare the pre-emptive scope of the [National Bank Act]" but merely "interpret[s] the term 'visitorial powers.'"... That is much too kind. It is not without reason that the regulation is contained within a subpart of the Comptroller's regulations on Bank Activities and Operations that is entitled "Preemption." The purpose and function of the statutory term "visitorial powers" is to define and thereby limit the category of action reserved to the Federal Government and forbidden to the States. Any interpretation of "visitorial powers" necessarily "declares the pre-emptive scope of the NBA," What is clear from logic is also clear in application: The regulation declares that "[s]tate officials may not . . .

prosecut[e] enforcement actions." If that is not pre-emption, nothing is.

Applying the foregoing principles to this case is not difficult. "Visitorial powers" in the National Bank Act refers to a sovereign's supervisory powers over corporations. They include any form of administrative oversight that allows a sovereign to inspect books and records on demand, even if the process is mediated by a court through prerogative writs or similar means. The Comptroller reasonably interpreted this statutory term to include "conducting examinations [and] inspecting or requiring the production of books or records of national banks,"..when the State conducts those activities in its capacity as supervisor of corporations.

When, however, a state attorney general brings suit to enforce state law against a national bank, he is not acting in the role of sovereign-as-supervisor, but rather in the role of sovereign-as-law-enforcer. Such a lawsuit is not an exercise of "visitorial powers" and thus the Comptroller erred by extending the definition of "visitorial powers" to include "prosecuting enforcement actions" in state courts ..

The request for information in the present case was stated to be "in lieu of" other action; implicit was the threat that if the request was not voluntarily honored, that other action would be taken. All parties have assumed, and we agree, that if the threatened action would have been unlawful the request-cum-threat could be enjoined. Here the threatened action was not the bringing of a civil suit, or the obtaining of a judicial search warrant based on probable cause, but rather the Attorney General's issuance of subpoena on his own authority under New York Executive Law, which permits such subpoenas in connection with his investigation of "repeated fraudulent or illegal acts . . . in the carrying on, conducting or transaction of business." See N. Y. Exec. Law Ann. § 63(12) (West 2002). That is not the exercise of the power of law enforcement "vested in the courts of justice" which 12 U.S.C. § 484(a) exempts from the ban on exercise of supervisory power.

Accordingly, the injunction below is affirmed as applied to the threatened issuance of executive subpoenas by the Attorney General for the State of New York, but vacated insofar as it prohibits the Attorney General from bringing judicial enforcement actions.

Do you think it is easy to distinguish between ways in which states can regulate national banks and ways in which they are pre-empted from regulating national banks?

Julie Williams of the OCC stated in a speech in 2004:[39]

Our jurisdiction over national banks and their subsidiaries also does not deprive state regulators of a role in protecting consumers in their states, and we welcome the opportunity to work cooperatively with them to further that goal. We have invited state authorities to refer consumer complaints concerning national banks to the OCC, and to bring to our attention concerns that any national bank is engaged in unfair, deceptive, abusive or predatory practices. We have set up special procedures to handle and track

[39] Julie Williams left the OCC in 2012.

referrals from state authorities.

The OCC and the states already cooperate extensively in many respects, referring consumer complaints to the appropriate regulator of the entity generating the complaint, and we welcome additional opportunities to collaborate. We issued a new Advisory Letter to national banks just last week clarifying our expectations about how they should handle consumer complaints that are forwarded to them from state agencies and departments. Personally, I hope that we can move beyond the rhetoric of the current controversy and leverage off existing cooperative processes to put our collective resources to work to maximize their coverage.... Preemption provides benefits to banks and thrifts in the form of efficiencies that flow from uniform, consistent, and predictable standards that apply wherever in the nation an institution does business. In other words, you know you can run a better railroad if the track gauge doesn't change with every state and county line that you cross. But with preemption also comes responsibility, and this is a timely opportunity for all bankers to recommit to the highest standards of customer service, integrity, and fair play in their business. The *very best* way to counter the controversies that I have just discussed and preserve the benefits of preemption is for bankers to be leaders in responsible corporate behavior and exemplary customer treatment. That way, both bankers and their customers come out winners. [40]

[40] Julie L. Williams, Chief Counsel and First Senior Deputy Comptroller, Office of the Comptroller of the Currency, *National Banks and Uniform Standards*, Remarks to America's Community Bankers Government Affairs Conference (Mar.9, 2004) *available at* http://www.occ.gov/static/news-issuances/news-releases/2004/nr-occ-2004-18a.pdf.