

Timothy D. Adams  
President and CEO, Institute of International Finance



June 2, 2017

Mr. Olivier Guersent  
Director General  
Directorate-General Financial Stability, Services and Capital Markets Union  
European Commission  
Rue de Spa 2  
1000 Brussels  
Belgium

### Re: European Commission's Intermediate Parent Undertaking Proposals

Dear Mr. Guersent:

The Institute of International Finance (IIF) would like to take the opportunity to comment on the European Commission's (EC) proposed requirement for certain non-EU banking firms to establish an intermediate parent undertaking in the EU (the IPU Proposal)<sup>1</sup>. As a global association of financial institutions, the IIF has particularly focused on the international implications of the IPU Proposal and the likely effects it will have on the development of the international regulatory agenda, effective resolution, cross-border cooperation, international finance and economic growth.

The IPU Proposal comes at a time at which the international regulatory environment displays signs of a trend away from global, cooperative regulation and towards greater localization<sup>2</sup>. Since the time of the US Federal Reserve (Fed) proposals requiring certain foreign banking organizations to establish intermediate holding companies (IHCs) over their US subsidiaries (FBO Rule)<sup>3</sup>, the IIF has signaled its concern about regulatory and supervisory approaches that could result in global regulatory fragmentation. The IIF is concerned that the IPU Proposal may turn out to be a further example of fragmentation of the international regulatory framework, implicitly signaling a shift in policy within the EU which goes against the long-standing approach of relying on consolidated supervision by home-country authorities.

The IIF recognizes the importance of prudential goals such as simplifying and strengthening the resolution process for financial groups and facilitating the implementation of internationally agreed standards on internal loss absorbing capacity of non-EU G-SIIs, which the EC has stated

---

<sup>1</sup> See: 2016/0364 (COD). *Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures*. See Article 21b. November 2016.

<sup>2</sup> Concerns about international cooperation are not only, or even primarily, European issues. The IIF has recently published a significant statement on the topic, reflecting the industry view that international regulatory coordination, cooperation and standard-setting remain essential to effective credit provision and economic growth in a global economy. See IIF, *International Regulatory Standards: Vital for Economic Growth*. March 2017. <https://www.iif.com/publication/regulatory-report/international-regulatory-standards-vital-economic-growth>

<sup>3</sup> 79 Fed Reg. 17239, Mar. 27, 2014. *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies*

as the driving objectives for introducing the IPU proposals. It may also be considered that an intermediate holding company structure can provide supervisory benefits to local regulators and could also provide a means of facilitating regulators' understanding of a financial group's operations, thus supporting more effective supervisory engagement under some circumstances.

While such objectives are worthy and while acknowledging the importance of ensuring credible resolvability of financial groups operating in the EU, the IIF believes that the current IPU Proposal is potentially counterproductive for the EC's and the FSB's prudential, and the G20's broader macroeconomic, objectives for the following reasons:

- The IPU Proposal appears to lack consistency with the internationally agreed framework for cross border resolution (as set out in the Key Attributes), including the internal TLAC proposals of the FSB;
- The proposal does not account for legal structural requirements of some third-country groups, which, if not corrected, would lead to constraints that would likely have negative implications for financial stability and limit the ability of third-country banks to fund the EU economy;
- The IPU Proposal would result in trapped capital and liquidity, restricting the flexibility of third-country groups, with potentially negative financial stability implications;
- Many of the perceived regulatory benefits of intermediate holding company structures can also be achieved, more efficiently and proportionately, by other means, principally via effective cooperation between home and host regulators through colleges of supervisors and crisis management groups (CMGs).

There have also been suggestions from some authorities, including the European Central Bank, to formally include branches within the scope of the IPU. This would not only represent a further example of fragmentation, but would have negative implications for counterparty risk for EU customers, operational efficiency and enterprise wide risk management.

This letter highlights our main views regarding the IPU Proposal, through the lens of the international regulatory framework. The IIF recommends that the EC, as part of its effort to improve conditions for finance and investment in the EU markets, reconsider the efficacy of the current IPU Proposal in meeting its stated objectives.

Should the EC determine to proceed with the IPU Proposal, then this letter offers recommendations for amending the proposal to ensure that it is proportionate and to mitigate to some degree the negative effects that could result from its implementation.

### **The holding company trend and regulatory and economic implications – dangers of fragmentation**

When the FBO rule was first proposed, the IIF submitted detailed comments to the Fed stressing that the proposed rule would have negative implications for global cooperation and

financial efficiency, leading to reduced global liquidity, increased borrowing costs for end users and a more fragile financial system<sup>4</sup>.

The IIF continues to believe that arguments about the negative effects of the FBO Rule are valid and, in parallel with this letter, we are writing to the US authorities (copy attached) to reiterate our concerns and to encourage them to reconsider the Rule both independently and as part of the comprehensive review of financial regulation currently being undertaken by the US Treasury.

It has always been the position of the IIF that a global approach to these issues is essential. In this regard, we continue to encourage global policy makers, including both the EC and the US authorities, to work through the FSB to determine whether any additions or revisions to the existing FSB *Key Attributes*<sup>5</sup> would be helpful to make the cross-border resolution framework more cooperative, efficient, internationally consistent and proportionate, and therefore obviate any argument for overlapping measures such as the FBO Rule or the IPU Proposal. This would have the benefit of not only alleviating the unnecessary burdens on the international financial system that these local approaches impose, but would also further the goal of consistent, cooperative resolution that is well-coordinated across the major markets.

In addition to the implications for the global regulatory agenda, the IIF is concerned with the potential economic impact of any fragmenting regulatory trend. The Chairman of the FSB, Mark Carney, recently spoke about the negative consequences of diminished trust and cooperation among regulatory authorities and increasing regulatory fragmentation, warning about the detrimental economic impacts of such a trend: *"If that happens, domestic authorities could impose local requirements on domestic entities of foreign firms. In a world where many banks and FMI's are highly interconnected that would generate significant inefficiencies, frustrating the benefits that flow from open trade and investment. Taking this low road would be sub-optimal for all, with fewer jobs, lower growth and higher domestic risks."*<sup>6</sup> We believe such risks of fragmentation are real and should be avoided through greater emphasis on cooperation and coordination among regulatory authorities. With this in mind, the IIF is also writing to the FSB to encourage active engagement with US and EU authorities to ensure that the agreed global regulatory and resolution framework is respected and maintained (copy attached).

### **Importance of maintaining integrity of branches**

There has been commentary from some EU bodies suggesting that the IPU Proposal should be widened to include branches in the formal structural requirements. While this is not part of the original proposal, moving in this direction would have important negative consequences.

---

<sup>4</sup> The IIF letter also stated: *"In all likelihood, the proposed rule would, if finalized, open a window for change in the general tenor of policymaking at the national and international levels, with the focus of regulatory change shifting toward regulatory protectionism, ring-fencing and obligatory subsidiarization"* See: Letter from the IIF to US Federal Reserve, April, 2013. Re: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies.

<sup>5</sup> See: Key Attributes of Effective Resolution Regimes for Financial Institutions. 15 October 2014.

<sup>6</sup> See: Mark Carney, Chair of the Financial Stability Board, *What a Difference a Decade Makes*. Remarks at the Institute or International Finance's Washington Policy Summit. 20 April, 2017.

Foreign branches are beneficial in the corporate and investment banking business, because clients are exposed to the credit and business risk of the bank parent, which is usually much stronger than a local subsidiary. Clients can transact under the same legal documentation, providing significant operational benefits and reduced transaction costs, and trading books are managed globally facilitating efficient risk management of the consolidated positions. Breaking up this longstanding and fully tested business model would entail significant inefficiencies for banks and clients, while creating unnecessary obstacles to enterprise wide risk management. Other avenues for bank oversight are available to authorities, including where appropriate, the 'combined US operations' approach followed in the US.

Any proposal to include branches within the requirement would significantly increase international regulatory fragmentation, which would further hamper the ability of third-country groups to contribute to the EU economy. The inclusion of branches would also be inconsistent with the legal concept of a branch as an integral part of the same legal entity and, among other things, would disrupt the leading role of the home regulator in regulating an entity including its branches. Furthermore, it could make resolution more difficult, by impeding the flow of resources within the group at a crucial time. Also, the Bank Recovery and Resolution Directive (BRRD) already provides resolution authorities in the EU with the power under certain circumstances to take independent resolution actions with respect to third-country branches where this is deemed necessary<sup>7</sup>. Importantly, it should be noted that the FBO Rule does not require inclusion of branches under the US intermediate holding company and we would urge the EU authorities not to move in such a direction.

### **Cross-border resolution**

The IPU Proposal may have the effect of ensuring that the resolution of a third-country bank's EU operations would be undertaken exclusively within the EU. This would be in conflict with the globally coordinated resolution approach developed over several years by the FSB and expressed in the *Key Attributes* and related statements. Similarly, it would create friction with the recovery and resolution plans major banking groups have developed over many years of detailed discussions with their home-country supervisors (or developed by the supervisors themselves, depending on the jurisdiction). This is especially true for groups that use Single Point of Entry (SPE) strategies, which are designed on the premise that failure would occur at the top-level institution, allowing subsidiary operating companies to continue to function while the top company is in resolution, but other, group-specific strategies may be affected as well. Because of these conflicts with carefully worked-out and approved strategies, and because of the unnecessary rigidities and inefficiencies it would create, the IIF shares the doubts already expressed in the official sector about whether the IPU Proposal would in fact enhance the potential resolvability of third-country banking groups operating in the EU<sup>8</sup>.

---

<sup>7</sup> See: Directive 2014/59/EU of the European Parliament and of the Council. Title VI, Article 96.

<sup>8</sup> Deputy Governor of the Prudential Regulation Authority of the UK Sam Woods wrote about the IPU Proposal: "However, it is not immediately clear to us that the proposals would enhance the effectiveness of resolution as intended. We consider that the creation of an EU sub-group would not increase the feasibility of the Single-Point-of-Entry ("SPE") resolution strategies used by many non-EU banking groups; and placing EU subsidiaries under a common EU parent would in our view not be likely to provide host authorities with greater assurance that the SPE strategy will be carried through" See Letter from Sam Woods, Deputy Governor for Prudential Regulation, PRA, dated 19 January 2017.

Many banking groups have aligned their legal structures with their business lines, in keeping with the objectives of the FSB to facilitate robust resolution planning. Requiring such groups to aggregate diverse EU business operations under an IPU would reintroduce complexity that may interfere with the careful business-as-usual restructuring and resolution planning already done, and could impede internationally consistent recovery and resolution efforts. In some circumstances, such a lack of consistency between EU and international structural and resolution approaches could exacerbate a crisis that might otherwise have been managed effectively by the relevant authorities.

The Information Memorandum which accompanies the IPU Proposal states that the intent of the Proposal is to “... facilitate implementation of the internationally agreed standards on internal loss-absorbing capacity for non-EU G-SIBs”. While the IIF endorses these international measures, it observes that the IPU Proposal could be considered as inconsistent with the FSB Internal TLAC proposals<sup>9</sup>.

The FSB has developed a carefully balanced resolution approach under the *Key Attributes*, including provision for Total Loss Absorbing Capacity (TLAC), with requirements for Internal TLAC within groups that, if properly implemented, should ensure that cross-border groups are robustly prepared for the risks of resolution. The main outlines of the *Key Attributes* and TLAC have been supported by the IIF since their original proposal because they are well-designed to eliminate “too big to fail” and meet the G20’s post-crisis goals. However, these existing measures have substantial costs and already reflect a rigorous balancing of resolution, stability and going-concern goals. In the IIF view, it would not be proportionate or effective to alter this balance by measures such as the IPU Proposal (or, equally, the US FBO rules), which add further costs, rigidities, and interference with efficient and rational organization of groups. Furthermore, we are concerned about the potential negative effects of the IPU proposal in the context of the necessary balancing of stability and growth under the post-crisis reforms.

While not explicit in the proposal, there appears to be an assumption that cross-border cooperation cannot be relied upon, in particular during a period of stress, which is reinforced by the EC proposal to require internal TLAC pre-positioning within material EU subsidiaries of non-EU G-SIBs at the upper end of the 75-90% range, which, the IIF notes, mirrors the US requirement for FBOs. In the Institute’s view, greater emphasis should be placed on improving regulatory and supervisory cooperation across borders, rather than establishing structural requirements that are likely to further financial fragmentation.

## Structural Implications

Careful consideration and review is required of the way in which the IPU Proposal would interact with the structural requirements of certain foreign jurisdictions, if unintended impacts are to be avoided. For example, US banking groups are subject to statutory requirements that in effect require separation of a group’s banking and non-banking activities and the IPU

---

<sup>9</sup> See Financial Stability Board. *Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs (‘Internal TLAC’)* Dec 2016

Proposal for a *single* IHC would conflict with those requirements, requiring US groups to restrict activities in ways that would significantly limit their ability to contribute to financing growth in the EU<sup>10</sup>.

Similarly, the major Japanese banks are organised in structurally separated "pillars", in accordance with domestic legal requirements regarding the separation of banking and securities activities. Requiring the aggregation of the equivalent EU operations of these banks under a single IPU would not only be extremely cumbersome in terms of established business, governance and reporting structures, but it in many cases would also conflict with established resolution plans. Post-Brexit, compliance with the IPU Proposal appears likely, in many cases, to be onerous for a bank that is also subject to the ring-fencing requirements in the UK.

### **Funding efficiency and trapped capital and liquidity**

The IPU Proposal would effectively require third-country banking groups to ring-fence liquidity and capital within their European groups under single IPUs. Lack of flexibility to deploy available resources where needed within a group gives rise to misallocation risk, with negative implications for funding efficiency and group-wide resilience, and potentially for system stability. The FSB recognizes this and states in its recent Consultation Paper on Internal TLAC: "... *there must be sufficient flexibility to use loss-absorbing capacity within a G-SIB where needed and credible mechanisms in place to allow losses and recapitalisation needs to be passed with legal certainty to the resolution entity or entities.*"<sup>11</sup> This is of value to economies and to global stability and should not be discounted. Such restrictions could also eliminate the lower funding and lending cost benefits that integrated, wholesale global finance can provide.

Furthermore, the IPU Proposal could contribute to de-facto (and un-necessary) increases in capital requirements, which could be substantial for some groups that contribute significantly to European finance and markets, and who are already fully in compliance with international prudential requirements. This is not only because of the inherent inefficiency of separated sub-groups, but when one considers the cumulative effects of capital requirements plus Internal Total Loss Absorbing Capacity (TLAC), plus possible local Pillar 2 top-ups, the impact of the Proposal is likely to add up to more than would be necessary from a global perspective.

Overall, the requirement would make the European market a less attractive business location for global banks. The US experience provides insight into the negative impact of an

---

<sup>10</sup> In the US, banking groups are subject to complex statutory requirements under the Federal Reserve Act, the Bank Holding Company Act and the Dodd Frank Act. Due to these requirements, and the restrictions on activities and transactions, US banking groups are effectively separated into a "bank chain," comprised of the US-organized depository institution and its subsidiaries, and a "non-bank chain," comprised of other affiliates of the US banking group, with prescribed limitations on transactions between the two sub-groups. The subsidiaries which would need to be consolidated under the IPU would become subject to materially different U.S. regulatory requirements that could impact how, and in some cases whether, various products and services are offered in the EU market. These structural changes would also generally require the prior approval of the Federal Reserve Board and/or the Federal Deposit Insurance Corporation, and there is no certainty that such approvals would be forthcoming. For additional information on the relevant U.S. regulatory requirements, and the implications for compliance with the IPU Proposal, we refer you to a white paper prepared by The Clearing House: *An Assessment of the European Commission's Proposal to Require EU Intermediate Holding Companies*, March 2017. Pp. 11-17.

<sup>11</sup> See Financial Stability Board. *Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')* Dec 2016.

intermediate holding company requirement. The assets of large broker/dealer operations of FBOs have declined sharply, by some 30% (approx. \$0.5trn), following the Fed's proposal of the FBO Rule<sup>12</sup>. The total assets of US broker-dealers have remained relatively flat over the same period, suggesting a differential impact from the FBO Rule. This result also means that overall credit provision has been negatively affected along with reduced liquidity in capital markets, resulting in a less competitive marketplace for financial services in the US.

### **Sufficiency of powers and authority already in place**

In the view of the IIF, the current IPU Proposal for mandatory structural solutions would appear to go further than is required, not only in light of the international resolution framework already implemented by most major jurisdictions under the *Key Attributes*, but also given the fact that the BRRD already incorporates a discretionary power to require structural measures including potentially an IPU by the relevant EU authority if an objective analysis shows that it is necessary, given the facts and circumstances of a given group<sup>13</sup>.

In the light of the existing authority to require structural changes, if necessary, given the circumstances and condition of a given group, and the fact that Internal TLAC and other resolvability measures are already in place, the likely costs of the IPU Proposal seem to be disproportionate to its stated goals.

Given the potential significant implications of the proposal, we believe it would be of great value to conduct a robust impact assessment process, balancing the potential benefits with the associated costs in the form of loss of efficiency of the system and negative implications for financing of the economy, among other unintended consequences. This process would be in line with the EC's Better Regulation<sup>14</sup> guidelines and the overall global policy consensus on the importance of such processes.

### **Mitigation alternatives**

While the IIF believes that the EC should reconsider the current IPU Proposal for the reasons set out above, we offer the following recommendations to reduce potential adverse impacts should the EC decide to maintain its proposed approach:

#### ***Scope and application***

The current EU prudential and resolution framework under the BRRD empowers the competent EU supervisory and resolution authorities to require an IPU or other structure in appropriate cases to improve resolvability<sup>15</sup>. The IIF recommends that, instead of a mandated obligation, any proposed structural requirement, such as an IPU or IHC, should be left to the judgement of

---

<sup>12</sup> See FSOC Annual Report, 2016. Page 77.

<sup>13</sup> See: Directive 2014/59/EU of the European Parliament and of the Council. Title II, Articles 15 - 18.

<sup>14</sup> The EC guidelines on impact assessment state: "An Impact Assessment (IA) is required when the expected economic, environmental or social impacts of EU action are likely to be significant. The benchmark criterion of "significant impacts" applies both to the macro- and the micro-level. This implies that IA is not only required for proposals expected to have far reaching impacts on the economy or society as a whole, but also for initiatives likely to have a significant impact on a particular sector, societal group or geographical area." See Tool #5. Page 1.

<sup>15</sup> See: Directive 2014/59/EU of the European Parliament and of the Council. Title II, Articles 15-18.

the supervisory and resolution authorities, based on and subject to a specific assessment, which would most appropriately be conducted in cooperation with the home supervisor. The assessing authorities should be required to formally document that any such structural requirement is necessary in order to ensure a group's resolvability, given its size, the essential services that it provides in the EU, and its systemic importance.

If a mandated IPU approach is maintained, the size threshold for the IPU Proposal of €30bn is too low, especially as this threshold includes branch assets. While the IIF assumes that the threshold may have been determined by reference to the EU's single supervisory mechanism threshold, a group of this size is highly unlikely to be systemic in the context of the EU financial system or real economy, which comprises over €16 trillion of GDP. We note that the US FBO Rule does not include branch assets and has a higher threshold at \$US50bn (which threshold is currently subject to review for possible upward adjustment). Also, the IPU Proposal does not take into account the relative systemic importance of a given third-country banking group or the nature or riskiness of its operations. The IIF recommends that the threshold be reconsidered and the Proposal should also include consideration of systemic risk and not automatically mandate an IPU for a GSII's EU operations.

Also, the IIF wishes to reiterate our recommendation that the IPU Proposal should not be widened to include branches in the formal structural requirements, as has been suggested by some other authorities.

### ***Structure***

In order to accommodate the home legal requirements of some third-country banking groups (and in some cases to facilitate important business structure efficiency objectives that will also benefit the host economy), the IIF recommends that the IPU Proposal be amended to allow flexibility for groups to have more than one IPU in the EU, or to meet the essential goals of the proposal by other structural measures with the agreement of the relevant authorities. This would allow such groups to comply with home country requirements, and would still provide the EU with the structural outcome which it is seeking to meet its stated objectives. As already noted, it would be preferable for any question of structural requirements for resolution purposes to be left to the relevant EU authorities in consultation with the home authorities, but even if a per-se IPU requirement is maintained, there is no evident reason why the authorities should be constrained from approving more than one IPU (or some other structural solution, such as excluding particular entities from the scope of the IPU) if appropriate to the group and its resolution strategy.

### ***Timing***

The length of time that may be required to comply with any final IPU requirement should not be underestimated, including the internal restructuring process (which may lead to a reconsideration of a group's entire resolution strategy), home authority approvals and then EU supervisor authorization.



The timing of Brexit is also potentially a significantly complicating issue. For example, a non-EU banking group may have operations currently located only in the UK. If the Effective Date for the IPU Proposal is pre-Brexit, this may impose a costly and complicated restructuring requirement on the group for what may in effect be only a period of months.

In addition, UK banks, which currently would not be subject to the requirement, will need appropriate time to consider the implications and implement the required structural adjustments, after the UK exits the EU, depending among other things on the form of the final agreement between the EU and the UK. Crucial to these considerations will be the numerous regulatory and commercial determinations which are yet to be finalized.

However, the currently proposed timetable for the IPU Proposal appears to allow approximately one year, from expected finalization of the requirement, for groups to achieve implementation. By way of comparison, large UK banks were given five years to prepare for the ring-fencing of their retail businesses following the adoption of primary legislation and a clear two years following the publication of the final detailed Prudential Regulation Authority rules, while the Fed allowed almost 2.5 years for implementation following the adoption of its final FBO rules.

The IIF recommends that the Effective Date should allow for an appropriate implementation period for compliance with the final IPU Proposal including due consideration of Brexit.

## Conclusion

The IIF is hopeful that its analysis and recommendations can be of help to the Commission and other EU authorities as they reconsider the efficacy of the current IPU Proposal in meeting its stated objectives. While the Institute fully shares the goal of ensuring credible resolvability of financial groups operating in the EU, in our view the Proposal is potentially counterproductive for the EC's prudential goals. For the reasons outlined in this document, we would encourage the EU authorities to reconsider the proposed policy; should the EC determine to proceed with the IPU Proposal, the IIF encourages consideration of the specific recommendations to amend the Proposal in a way that would be more proportionate and effective, while mitigating to some extent the negative effects that could result from its implementation in the original terms in which it was proposed.

We remain at your disposal for further elaboration on and discussion of our analysis and recommendations on this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy D. Adams". The signature is fluid and cursive, with a long horizontal stroke at the end.

Timothy D. Adams

Timothy D. Adams  
President and CEO, Institute of International Finance



June 2, 2017

Governor Jerome Powell  
Board of Governors of the Federal Reserve System  
Constitution Avenue NW & 20<sup>th</sup> Street  
Washington, D.C.

### Re: European Commission's Intermediate Parent Undertaking Proposals

Dear Governor Powell:

As you are aware, a key element of the mandate of the Institute of International Finance (IIF) is to advocate efficient and consistent global regulation on behalf of members, which consist of internationally active financial institutions from the US and 70 countries. In this regard, the IIF considers it essential at this point in time to write again to regulatory authorities to reiterate industry's concerns over a disconcerting regulatory trend in the introduction of a requirement for intermediate holding companies (IHCs) by regional regulatory authorities. This trend has negative implications for the internationally agreed bank resolution framework as well as for the provision of competitive financial services in funding global and regional economies.

Specifically, this letter is to call the attention of the Federal Reserve (the Fed) to the *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations (the FBO Rule)*, in light of current concerns and the evolving nature of global regulation. As you know, the FBO Rule now requires certain foreign banking organizations to establish intermediate holding companies over subsidiaries and which subjects such organizations to increased prudential and supervisory requirements. In April, 2013 the IIF wrote to the Fed detailing the concerns of the industry over this proposal. We highlighted that the FBO Rule would have negative implications for global regulatory consistency, international cooperation and financial efficiency, leading to reduced global liquidity, increased borrowing costs for end users and a more fragile financial system<sup>1</sup>.

In pointing out the concerns for increased fragmentation in the future, should the FBO Rule be implemented, the IIF letter stated: "*In all likelihood, the proposed rule would, if finalized, open a window for change in the general tenor of policymaking at the national and international*

---

<sup>1</sup> See: Letter from the IIF to US Federal Reserve, April, 2013. *Re: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies*

levels, with the focus of regulatory change shifting toward regulatory protectionism, ring-fencing and obligatory subsidiarization”<sup>2</sup>.

As you are aware, in November, 2016 the European Commission (EC) published proposals for revisions to the EU prudential regulatory framework, as part of the CRD IV revision, including a proposal for certain non-EU financial institutions to establish an intermediate parent undertaking for their operations in the EU (the IPU Proposal)<sup>3</sup>.

The IIF has recently written to the EC about the IPU Proposal and raising similar concerns to the Commission to those expressed to the Fed about the FBO Rule. In particular, the letter to the EC (copy attached) highlights that the IPU Proposal is not easily reconciled with other regulatory requirements including TLAC<sup>4</sup> and the successful implementation of a global resolution framework, with particular implications for financial institutions, such as most of the large US firms, which use single point of entry resolution strategies. Further, the IPU Proposal would raise significant challenges for the structures and business models of many global banking groups because it may not accommodate long-standing home-country regulatory requirements. This is particularly relevant to US banking groups operating in the EU, given the US statutory requirements for separation of banking and non-banking operations. The proposed requirement could lead to trapped capital and liquidity, with negative implications for global financial stability, and could significantly constrain the business activities in the EU of foreign banking organizations. The operations of internationally active US banking organizations, as the largest foreign participants in the EU, could be profoundly affected.

As you are aware, the US Treasury is currently undertaking a review of the regulation of the US financial system in response to the President’s Executive Order: *Core Principles for Regulating the United States Financial System*<sup>5</sup>. The IIF has written to the Treasury to reinforce the importance of the US supporting consistent international regulatory standards and furthermore to highlight areas of regulation which we believe should be considered as part of that review, notably the FBO Rule. In this regard, the IIF would like to respectfully urge the Fed to reconsider the current form of the FBO Rule within the context of the Treasury review, but also as a part of its own review of the post-crisis regulatory regime.

The IIF believes that it is timely for there to be an updated review of the US FBO IHC requirements to take into account both the extensive cross-border resolution measures implemented since the FBO Rule was first proposed, and also the important role foreign banking organizations play in the US financial system. The FBO Rule has arguably contributed to cuts in the size and operations of FBOs in the US. The Annual Report of the FSOC showed that the assets of large broker/dealer operations of FBOs declined by some 30% following the

---

<sup>2</sup> Ibid: p.2

<sup>3</sup> See: 2016/0364 (COD). *Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures*. See Article 21b. November 2016.

<sup>4</sup> See: Financial Stability Board. *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution; Total Loss-absorbing Capacity (TLAC) Term Sheet*. November, 2015.

<sup>5</sup> See: Presidential Executive Order 13772, Feb 3, 2017: *Core Principles for Regulating the United States Financial System*

Fed's proposal of the Rule<sup>6</sup>. This decline can negatively impact credit provision in the economy and further reduce the depth of liquidity provision in the capital markets.

FBOs operating in the US also have specializations and capacities which can be very beneficial to the US economy. By way of example, many such banks are experienced in the provision of long-term bank financing of infrastructure. Increasing investment in infrastructure is widely recognized to be necessary, would advance the Fed's mandated goals and, of course, has been part of the platform of the new US Administration. Any review of the FBO Rule should consider how to facilitate more efficient and cost-effective participation in the US by FBOs to increase the capacity of these groups to contribute to financing the desired growth in infrastructure investment and development.

The IIF has separately written to the FSB (copy attached) expressing industry's concerns over the trend towards measures that fragment the international financial system - contrary to the aims of the G20 since 2009 - including requirements for IHCs. The FSB has developed a carefully balanced resolution approach under the *Key Attributes for Effective Resolution of Financial Institutions*<sup>7</sup>, including provision for Total Loss Absorbing Capacity (TLAC), with requirements for Internal TLAC within groups that, if properly implemented, should ensure that cross-border groups are robustly prepared for the risks of resolution. The IIF is encouraging the FSB to continue to work to ensure that this cross-border regulatory framework, which has been developed and internationally agreed over many years of painstaking effort, is respected and maintained.

The IIF encourages the Fed to consider engaging directly with the EC in discussing cross-border resolution, including the implications of the FBO Rule and the IPU Proposal with the aim of developing more flexible approaches that, while achieving the objectives of ensuring resolvability of foreign banking groups, would be more proportionate and consistent with the international cross-border resolution framework. Such bilateral discussions should of course be broadened out to achieve global consistency through the FSB.

## Conclusion

The IIF believes that the FBO Rule can be reviewed and adjusted in a manner which ensures that it continues to meet the resolvability and financial stability objectives of the Fed, but which is also more proportionate and appropriate in the international regulatory context. We respectfully urge such a review of the FBO Rule to determine whether it is possible to define a requirement that would be more consistent with the global resolution framework and would facilitate more efficient provision of financial services by FBOs for the benefit of the US economy, and would reinforce a more efficient approach that would avoid fragmenting the global financial regulatory framework, as the FBO rule and the IPU Proposal unfortunately tend to do. Direct discussion with the EC and with the FSB could be helpful in achieving

---

<sup>6</sup> See FSOC Annual Report, 2016. Page 77.

<sup>7</sup> See: *Key Attributes of Effective Resolution Regimes for Financial Institutions*. 15 October 2014.

appropriate, globally consistent, pro-growth results without sacrificing any of the goals of the Key Attributes.

We welcome your consideration of this matter and we remain at your disposal for further elaboration and discussion of the issues we have raised.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy D. Adams". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Timothy D. Adams

Timothy D. Adams  
President and CEO, Institute of International Finance



June 2, 2017

Mr. Mark Carney  
Chairman  
Financial Stability Board  
Centralbahnplatz 2  
Basel, Switzerland

### Re: European Commission's Intermediate Parent Undertaking Proposals

Dear Chairman Carney:

A key element of the Institute of International Finance's (IIF) mandate is to advocate efficient and consistent global regulation on behalf of its members, which consist of internationally active financial institutions from over 70 countries.

At this point in time, the IIF considers it essential to write again to the global policy-making community and to regulatory authorities to express the industry's concerns over an increasing trend by local authorities to introduce intermediate holding companies (IHCs) for foreign banks. This trend has negative implications for the internationally agreed bank resolution framework as well as for the provision of competitive financial services to global and regional economies.

Under the mandate from the G20, the FSB has developed a balanced resolution approach under the *Key Attributes for Effective Resolution of Financial Institutions*<sup>1</sup>, including provision for Total Loss Absorbing Capacity (TLAC), with requirements for Internal TLAC within groups. If properly implemented, this should ensure that cross-border groups are robustly prepared for the risks of resolution. The IIF has long supported full implementation of the *Key Attributes* in the major jurisdictions and encourages the FSB to continue to work to ensure that this cross-border regulatory framework is respected and maintained.

#### Actions in the US

In February 2014, the US Federal Reserve finalized a rule (FBO Rule)<sup>2</sup> which required certain foreign banking organizations to establish intermediate holding companies over their subsidiaries and which subjects these organizations to increased prudential and supervisory requirements. At the time that the FBO Rule was first proposed, the IIF submitted a detailed

---

<sup>1</sup> See: *Key Attributes of Effective Resolution Regimes for Financial Institutions*. 15 October 2014.

<sup>2</sup> 79 Fed Reg. 17239, Mar. 27, 2014. *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies*

comment letter highlighting the industry's concerns that the proposed rule would have negative implications for global cooperation and financial efficiency, leading to reduced global liquidity, increased borrowing costs and a more fragile financial system.

In pointing out the concerns for increased fragmentation, the IIF letter stated: *"In all likelihood, the proposed rule would, if finalized, open a window for change in the general tenor of policymaking at the national and international levels, with the focus of regulatory change shifting toward regulatory protectionism, ring-fencing and obligatory subsidiarization"*<sup>3</sup>.

The IIF has recently again written to the Fed to reiterate our concerns over the FBO Rule and to encourage the US authorities to reconsider the Rule independently and as part of the comprehensive review of financial regulation currently being undertaken by the US Treasury.

### **Actions in the EU**

In November, 2016 the European Commission (EC) published proposals for revisions to the EU prudential regulatory framework, as part of the CRD IV revision, including a proposal for certain non-EU financial institutions to establish an intermediate parent undertaking for their operations in the EU (the IPU Proposal)<sup>4</sup>.

The IIF has recently written to the EC about the IPU Proposal, raising similar concerns to the Commission to those expressed to the Fed about the FBO Rule when it was proposed. In particular, the letter to the EC highlights the fact that the IPU Proposal is not easily reconciled with other regulatory requirements, including TLAC,<sup>5</sup> and the successful implementation of a global resolution framework, with particular implications for financial institutions which use single point of entry resolution strategies. Further, the IPU Proposal would raise significant challenges for the structures and business models of many global banking groups because it may not accommodate long-standing home-country regulatory requirements. The proposed requirement could lead to trapped capital and liquidity, with negative implications for global financial stability, and could significantly constrain the business activities in the EU of foreign banking organizations.

The recent letters by the IIF to the Fed and the EC are attached.

### **Concerns of the IIF**

The IIF believes that it is crucial that the actions of regional authorities not undermine the efficacy and coherence of the internationally agreed cross border resolution framework. Of equal concern is the potential economic impact of any fragmenting regulatory trend. In particular, the IIF endorses your comments at the recent IIF Policy Summit, where you spoke

---

<sup>3</sup> See: Letter from the IIF to US Federal Reserve, April, 2013. *Re: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies.*

<sup>4</sup> See: 2016/0364 (COD). *Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures.* See Article 21b. November 2016.

<sup>5</sup> See: Financial Stability Board. *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution; Total Loss-absorbing Capacity (TLAC) Term Sheet.* November, 2015.

about the negative consequences of diminished trust and cooperation among regulatory authorities and increasing regulatory fragmentation, warning about the detrimental economic impacts of such a trend: “*If that happens, domestic authorities could impose local requirements on domestic entities of foreign firms. In a world where many banks and FMI are highly interconnected that would generate significant inefficiencies, frustrating the benefits that flow from open trade and investment. Taking this low road would be sub-optimal for all, with fewer jobs, lower growth and higher domestic risks.*”<sup>6</sup>

There has also been commentary from some authorities that consideration should be given to widening the IPU Proposal to include branches in the formal structural requirements. While the IIF acknowledges that this is not part of the original proposal, we believe moving in this direction would have important negative consequences. Any proposal to include branches within the holding company requirement would significantly increase international regulatory fragmentation. The inclusion of branches would also be inconsistent with the legal concept of a branch as an integral part of the same legal entity and, among other things, would disrupt the leading role of the home regulator in regulating an entity including its branches.

### **Potential Actions by the FSB**

The IIF asks the FSB to consider engaging directly with the Fed and the EC on the issue of intermediate holding companies, encouraging these authorities to reconsider the FBO Rule and the EU IPU Proposal. This process should stress that countries do not need to take measures that duplicate the agreed international requirements, contribute to regulatory fragmentation rather than coherence, and act as brakes on international finance and ultimately economic growth, contrary to both the 2009 and the 2017 statements of the G20. While such review can and should be incorporated into the FSB’s current *Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*<sup>7</sup>, the Institute considers that it is urgent for the FSB to catalyze a policy discussion around such proposals. Such discussions should also reinforce the importance of maintaining the current structural recognition and integrity of branches.

As importantly, if the FSB determines that this continuing trend to fragmentation will not abate, it should then give urgent priority to due and careful consideration of other policy measures to mitigate some of its effects and ensure that financing can continue to flow across borders. Cross-border financing provided by major banks can have important economic and social impacts, depending on whether they are trapped or can be invested. An open financial system in accordance with the G20 mandate should remain the goal but there needs to be an honest evaluation of how this can be achieved, given that policy implementation and mandates for supervisors and resolution authorities remain national. If it becomes clear that the original

---

<sup>6</sup> See: Mark Carney, Chair of the Financial Stability Board, *What a Difference a Decade Makes*. Remarks at the Institute or International Finance’s Washington Policy Summit. 20 April, 2017.

<sup>7</sup> See: *Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*



framework cannot be maintained, it is crucial that alternative measures to maintain cross-border investment flows be considered and adopted by the FSB.

We welcome your consideration of this matter and we remain at your disposal for further elaboration and discussion of the issues we have raised.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy D. Adams", with a stylized flourish extending to the right.

Timothy D. Adams