

THE TREACHEROUS LANDSCAPE FOR FOREIGN G-SIBS: THE IHC FRAMEWORK AND FINANCIAL STABILITY

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In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act restructured the regulatory regime for financial institutions in the United States by mandating corporate governance reforms and requiring that firms maintain high levels of high-quality capital reserves in their U.S. legal entities. Likely the most consequential of the statute's provisions was that which authorized Regulation YY, a landmark regulation that transformed capital planning and risk management processes among financial institutions in the United States. Along with implementing enhanced prudential standards for the U.S. operations of large, complex financial institutions, Regulation YY altered the corporate structure of foreign banking organizations ("FBOs") by requiring large foreign banking institutions to establish a new legal entity, called an intermediate holding company ("IHC"). Put simply, IHCs were created to reorganize and capture, in one umbrella legal entity, all non-branch U.S. operations of FBOs. Further, to ensure robust, localized oversight of U.S. operations, each IHC is required to establish their own board of directors and risk committee, separate and apart from the board and committees of the broader organization. IHCs are also required to comply with both the capital and leverage ratio requirements applied to similarly large domestic financial institutions, and the programmatic requirements associated with firms of that size (resolution planning, CCAR, CLAR).

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There is another regulation, though, that when coupled with the far-reaching implications of Regulation YY has disparately impacted foreign banking organizations. That regulation is Regulation W, a longstanding regulation that limits the amount of intracompany transactions banking organizations can engage in. Following the enactment of Dodd-Frank, Regulation W was amended in several ways which limited specifically the types of transactions that FBOs often engage in with their affiliates to manage their liquidity risk and to absorb liquidity shocks. The post-crisis changes made to Regulation W have already begun to be rolled back by U.S. regulators, however there has not yet been a detailed analysis of how specifically the interaction between Regulation YY and Regulation W undermines global financial stability.

The specific aim of this Note is to evaluate whether Regulation YY and Regulation W have destabilized the global financial system. Institutions' 2018 and 2019 CCAR results will be the lens through which the impact of the regulations is evaluated. Specifically, we look at both institutions' Tier 1 capital ratios and Tier 1 leverage ratios to assess how specifically the IHCs have positioned their liquid capital and adjusted their business model in response to Regulation YY reorganization. Ultimately, we conclude that the interaction between Regulation YY and the revised Regulation W has dramatically fragmented the global flow of capital among FBOs. Regulation YY's IHC reorganization mandate largely cabins foreign banks' ability to absorb liquidity shocks through their organizations—a result that may pose a serious threat to global financial stability. That is, the fundamental disruption of institutions' ability to funnel liquidity to their network of legal entities around the world raises a significant concern regarding their resiliency during periods of stress, particularly for those systemically important firms who experienced pervasive liquidity issues in the most recent crisis.

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I. INTRODUCTION

In the ten years since the close of the 2007–2009 financial crisis (“the crisis” or “the Great Recession”), much of the conversation among economists, policymakers, and legal academics has revolved around the regulatory and economic impact of the crisis within the United States. These discussions have been held for good reason; the congressional legislation passed in response to the crisis has now forced many financial institutions to fundamentally alter their risk profiles and business models. More specifically, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) transformed the way banking organizations price, oversee, and structure their own investment activities by introducing new prudential risk management standards and financial measures of soundness that financial institutions must now meet to maintain their bank charter.¹ These qualitative and quantitative expectations are not static for all financial institutions; indeed, a central piece of Dodd-Frank’s statutory scheme is tailoring regulators’ qualitative risk management expectations and

¹ See generally Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

quantitative financial benchmarks to financial institutions' size.² Tailoring regulatory expectations to institutions' relative asset size³ in this way was meant to offer a risk-weighted regulatory framework for all financial institutions to operate within, acknowledging specifically the unique role of community banks and their higher cost of capital when compared to the largest financial institutions in the world.⁴ This approach

² See Dodd-Frank Act §§ 116, 121, 163–65, 171, 210, 622. See also Daniel K. Tarullo, Governor, Fed. Reserve Bd., Speech at the Community Bankers Symposium: A Tiered Approach to Regulation and Supervision of Community Banks 2 (Nov. 7, 2014), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20141107a.pdf> [<https://perma.cc/TKC2-RJNL>]; DAVID W. PERKINS, CONG. RESEARCH SERV., R45051, TAILORING BANK REGULATIONS: DIFFERENCES IN BANK SIZE, ACTIVITIES, AND CAPITAL LEVELS 1–2 (2017).

³ For purposes of establishing most enhanced prudential risk management standards, a FBO's size is to be measured by its combined U.S. assets (also commonly referred to as its "CUSO"). See Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 Fed. Reg. 59,032, 59,033 (Nov. 1, 2019) (to be codified at 12 C.F.R. pts 217, 225, 238, 242 and 252). Importantly, though, apart from the enhanced prudential standards of Dodd-Frank, for intermediate holding company ("IHC") reorganization institutions' size is measured by their non-branch U.S. assets. See 12 C.F.R. § 252.153 (2020). Thus, while the dollar threshold for each of these two standards is the same, their measurement of an institution's "size" is different. See Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Harvard Law School Symposium: Regulating Large Foreign Banking Associations 13–14 (Mar. 27, 2014), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20140327a.pdf> [<https://perma.cc/Q9AN-HLFL>]. However, note that for some select enhanced prudential standards a FBO's size is measured by its non-branch U.S. assets. See Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 Fed. Reg. at 59,034.

⁴ See, e.g., *Strengthening and Streamlining Prudential Bank Supervision: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 111th Cong. 3–4 (2009) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation); Tarullo, *supra* note 2, at 2–3. *But see* Rep. Jeb Hensarling, Address at the American Enterprise Institute (July 21, 2015), <https://republicans-financialservices.house.gov/news/document-single.aspx?DocumentID=399392> [<https://perma.cc/GN6D-FRYG>] (describing the challenges faced by community banks as "an intended consequence of the [Dodd-Frank] Act. Dodd-Frank concentrates greater assets in fewer institutions").

has been largely accepted as appropriate across the political spectrum, and in the years since the law's enactment bipartisan political blocs have continued to lobby for increased stratification in financial regulatory thresholds.⁵

To apply these quantitative and qualitative standards to the largest financial institutions in the United States, Dodd-Frank introduced an entirely new concept in banking supervision—the annual, uniform, publicly-filed stress test.⁶ Known as the Comprehensive Capital Annual Review (“CCAR”), this program, initially the brainchild of regulators’ improvisation during the financial crisis,⁷ emerged as the foundation of large, complex financial institution supervision in the post-recession era. Although intensely nuanced and complicated, at a high-level CCAR offers a point in time snapshot of the financial condition and risk management practices of the largest financial institutions in the United States, and ultimately determines if they meet both the qualitative and quantitative capital planning benchmarks otherwise established by section 165 of Dodd-Frank.⁸ It is important to note at the outset that these programs have been extraordinarily controversial and costly for affected financial institutions,⁹

⁵ See Scott Heitkamp, *Political Foes Agree: Banks Pounded by Dodd-Frank*, HILL (June 27, 2017), <https://thehill.com/blogs/pundits-blog/finance/339693-helping-small-banks-is-something-we-can-all-agree-on> [<https://perma.cc/ZB3C-FLET>]. See also Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018).

⁶ See Dodd-Frank Act § 165(i).

⁷ See Beverly Hirtle, Exec. Vice President, Fed. Reserve Bank of N.Y., Remarks at the Effects of Post Crisis Banking Reforms Conference: Structural and Cyclical Macroprudential Objectives in Supervisory Stress Testing (June 22, 2018), <https://www.bis.org/review/r180718d.pdf> [<https://perma.cc/T3R3-HJ7V>]; Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Stress Test Modeling Symposium: Stress Testing After Five Years 2–8 (June 25, 2014), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20140625a.pdf> [<https://perma.cc/7MTK-PZD6>].

⁸ See Capital Planning, 12 C.F.R. § 225.8 (2020).

⁹ See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-17-48, FEDERAL RESERVE: ADDITIONAL ACTIONS COULD HELP ENSURE THE ACHIEVEMENT OF STRESS TEST GOALS 30 (2016) (surveying large financial institutions and finding that fifty percent of firms estimated their CCAR compliance costs

although key regulators have responded by pointing to the significant increase in affected institutions' capital and liquidity buffers since CCAR began in 2010.¹⁰ Still, the push against these regulatory programs has recently achieved a large victory with the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("the EGRRCPA") in 2018.¹¹ With this new law, the number of institutions required to participate in CCAR and comply with the most stringent enhanced prudential standards allowed by Dodd-Frank was reduced by increasing the qualifying asset threshold from \$50 billion to \$250 billion.¹² This threshold shift was completed in two stages. First, immediately following the EGRRCPA's enactment, financial institutions with consolidated assets of less than \$100 billion were exempt from section 165 of Dodd-Frank.¹³ Eighteen months after the date of the EGRRCPA's

to be between \$15 million and \$30 million annually); Letter from Jamie Dimon, Chief Exec. Officer & Chairman, J.P. Morgan Chase & Co., to J.P. Morgan Chase & Co. Shareholders (Apr. 4, 2019), <https://reports.jpmorganchase.com/investor-relations/2018/ar-ceo-letters.htm?a=1> [<https://perma.cc/C76N-DRR7>]; Matthew C. Turk, *Stress Testing the Banking Agencies*, 105 IOWA L. REV. (forthcoming May 2020) (manuscript at 20–23), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3367546 [<https://perma.cc/M356-QGVB>].

¹⁰ See Tarullo, *supra* note 7, at 6; Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Clearing House 2014 Annual Conference: Liquidity Regulation 17 (Nov. 20, 2014), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20141120a.pdf> [<https://perma.cc/A52E-7YS5>].

¹¹ Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115–174, 132 Stat. 1296 (2018).

¹² *Id.* § 401(a).

¹³ *Id.* § 401(d). Although they are exempt from participating in the annual CCAR exercise, under the EGRRCPA the Federal Reserve retains the discretion to require institutions with over \$100 billion in assets to comply with the enhanced prudential standards that only institutions with over \$250 billion in consolidated assets are required to comply with. See *id.* § 401(a)(1)(B)(iii). The Federal Reserve does not retain this discretion for institutions with between \$50 billion and \$100 billion in assets; the only "enhanced standard" those institutions may be required to comply with is the risk committee requirement of section 165(h) of Dodd-Frank. See *id.* § 401(a)(4). See also Risk Committee Requirement for Bank Holding Companies with Total Consolidated Assets of \$50 billion or More, 12 C.F.R. §

enactment, the exemption threshold was raised to \$250 billion.¹⁴ This move was the first significant blow to Dodd-Frank's regulatory paradigm, and was intended to "simplify and improve the regulatory regime for . . . midsize banks and regional banks to promote economic growth."¹⁵

Despite all the paradigm-shifting developments that took place in the United States following the crisis, the economic and regulatory consequences of the Great Recession reached much farther than just the financial markets in the U.S. Indeed, the economic consequences and market impact of the crisis in European and South American countries have been acknowledged by economists as being the most severe.¹⁶ In

252.22 (2019). Importantly, the Federal Reserve has publicly stated that although endowed with this discretion under the EGRRCPA,

the Board will not take action to require bank holding companies with less than \$100 billion in total consolidated assets to comply with certain existing regulatory requirements. These requirements include the enhanced prudential standards in the Board's Regulation YY, the liquidity coverage ratio requirements in the Board's Regulation WW, and the capital planning requirements in the Board's Regulation Y. . . . [Additionally,] the Board will not take action to require [b]ank holding companies with total consolidated assets of less than \$50 billion to comply with . . . Regulation YY, [or] subpart C ([the] risk committee [requirement]) . . .

Press Release, Bd. of Governors of the Fed. Reserve Sys., Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) (July 6, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf> [<https://perma.cc/7TEC-3CCA>].

¹⁴ Economic Growth, Regulatory Relief, and Consumer Protection Act § 401(d).

¹⁵ *Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 115th Cong. 1 (2018) (statement of Sen. Mike Crapo). As of June 2017, twenty-seven institutions had between \$50 billion and \$250 billion in consolidated assets. Fifteen institutions had above \$250 billion in consolidated assets. See PERKINS, *supra* note 2, at 9 tbl.1.

¹⁶ See, e.g., Maria A. Arias & Yi Wen, *Recovery from the Great Recession Has Varied Around the World*, REGIONAL ECONOMIST, Oct. 2015, at 10, 11; Shimelse Ali et al., *Financial Transmission of the Crisis: What's the Lesson?*, CARNEGIE ENDOWMENT FOR INT'L PEACE (June 17, 2009),

response, just as policymakers in the United States restructured the regulatory paradigm for financial institutions within their borders, global regulators have reformed their systems of financial regulation.

Globally, the most dramatic of these regulatory redirections was that adopted in the European Union. The most meaningful regulation adopted in the EU following the crisis was that which created the European System of Financial Supervisors (“the ESFS”),¹⁷ a body that provided an entirely new framework for financial supervision in the European Union. There are numerous regulatory agencies that operate under the ESFS framework, however two supervisory authorities are especially relevant for our purposes here: the European Banking Authority, which executes microprudential supervisory tasks for Europe’s financial institutions,¹⁸ and the European Systemic Risk Board, which is tasked with preventing and mitigating systemic risk in the Eurozone.¹⁹

Parallel to the operations and responsibilities of the ESFS, in November 2012 the European Parliament adopted a resolution recommending that the European Commission establish a Banking Union.²⁰ The European Parliament has followed this recommendation, and has, in its own words, “contributed significantly to establishing a real Banking Union.”²¹ The first large step Parliament took toward achieving a Banking Union occurred in 2013, when it established what is commonly known as “the first pillar of the Banking Union,”

<https://carnegieendowment.org/2009/06/17/financial-transmission-of-crisis-what-s-lesson-pub-23284> [<https://perma.cc/EER2-J5SS>].

¹⁷ See Council Regulation 1092/2010, art. 1, 2010 O.J. (L 331) 1.

¹⁸ See Council Regulation 1093/2010, art. 2, 2010 O.J. (L 331) 12. The European Banking Authority maintains the authority to compel national regulators to take the regulatory actions it deems necessary in emergency situations. See Council Regulation 1093/2010, *supra* note 18, art. 18.

¹⁹ See Council Regulation 1092/2010, *supra* note 17, arts. 1, 3. Included on the European Systemic Risk Board are ECB representatives along with representatives from the national central banks of EU member states. See Council Regulation 1092/2010, *supra* note 17, art. 6.

²⁰ See EUR. PARL. DOC. T7-0430 (2012).

²¹ See *Fact Sheets on the European Union: Banking Union*, EUROPEAN PARLIAMENT (Dec. 1, 2019), <https://www.europarl.europa.eu/factsheets/en/sheet/88/banking-union> [<https://perma.cc/CSM7-3USH>].

the Single Supervisory Mechanism (“the SSM”).²² The SSM removed primary responsibility for “significant” financial institution regulation from the institutions’ home country regulatory agency (“the Member State Regulator”), instead effectively centralizing the decisive regulatory authority for such institutions within the European Central Bank (“the ECB”).²³ Under this framework, although Member State Regulators maintain a regulatory role in supervising the financial institutions operating within their borders, direct supervision for significant institutions is delegated to the centralized SSM.²⁴ The criteria for determining whether a financial institution is considered significant—and therefore falls under the ECB’s direct supervision—is set out in two separate regulations, and relates to a bank’s size, economic importance, cross-border activities and reliance on public “bailout funds.”²⁵

Outside the scope of the Eurozone and purview of the ESFS and Banking Union, financial institutions in the United Kingdom were also confronted with unique and unprecedentedly aggressive regulations in the wake of the financial crisis. In enacting the Financial Services (Banking Reform) Act, the English Parliament imposed new funding regulations and enhanced risk management standards on large banking institutions,²⁶ and, critically, also mandated that banks with more than £25 billion in core deposits be ring-fenced.²⁷ Although

²² See Council Regulation 1024/2013, art. 6, 2013 O.J. (L 287) 63.

²³ See *id.*

²⁴ See *id.*; European Central Bank Regulation 468/2014, art. 5, 2014 O.J. (L 141) 1 (EU).

²⁵ See Council Regulation 1024/2013, *supra* note 22, art. 6; European Central Bank Regulation 468/2014, *supra* note 24, arts. 39–44.

²⁶ Financial Services (Banking Reform) Act 2013, c. 33, §§ 4, 18–35 (Eng.).

²⁷ See *id.* § 4; Financial Services and Markets Act 2000, SI 2014/1960, art. 3, ¶ 12 (Eng.). Following the enactment of the Banking Reform Act, the HM Treasury issued an order which clarified the definition of “core deposit.” Specifically, that order noted that “[a] deposit is a core deposit if it is held with the UK deposit-taker in an [European Economic Area] account except where one or more of the account holders is—(a) a relevant financial institution; (b) a qualifying organisation; (c) a qualifying group member; or (d) an eligible individual.” Financial Services and Markets Act 2000, SI 2014/1960, *supra* note 27, art. 2, ¶ 2. As of 2019, seven institutions exceeded

notably ill-defined,²⁸ the operative definition of ring-fencing relevant to the Banking Reform Act is the requirement that financial institutions separate their holding company that offers core deposits from those entities that provide other services, such as investment and international banking services.²⁹ In other words, banking institutions in the U.K. with over £25 billion in core retail deposits are now required to establish a distinct holding company encapsulating all core retail deposits collected in the Eurozone.³⁰ The purpose of imposing such a regulation, as explained by the Bank of England, is to:

reduce the potential for risks which originate elsewhere in a banking group . . . ensure [affected banking institutions] are able to take decisions independently of the rest of their banking groups . . . reduce [affected banking institutions'] dependency on financial or other resources provided [] from other members of the banking group . . . and ensure [affected banking institutions] are able to carry on their business even if other group members fail.³¹

the £25 billion threshold. See James Proudman, Exec. Dir., UK Deposit Takers Supervision, *From Construction to Maintenance: Patrolling the Ring-Fence 3* (Nov. 26, 2018), <https://www.bis.org/review/r181127g.pdf> [<https://perma.cc/J6ER-JK9T>].

²⁸ See Steven L. Schwarcz, *Ring-Fencing*, 87 S. CAL. L. REV. 69, 71–72 (2013) (“Because it is proposed in different contexts as a solution to ostensibly different problems, ring-fencing is inconsistently defined . . .”).

²⁹ See Financial Services (Banking Reform) Act 2013 § 4. Cf. Katie Britton et al., *Ring-Fencing: What is It and How Will it Affect Banks and Their Customers?*, 2016 BANK ENG. Q. BULL. 164, 165 (2016) (“But ring-fencing does not prevent RFBs being owned by a parent company that also owns a bank that undertakes prohibited or excluded activities; such entities can sit within the same banking group . . .”).

³⁰ See Financial Services (Banking Reform) Act 2013, § 4; Financial Services and Markets Act 2000, SI 2014/1960, *supra* note 27, art. 2, ¶ 2. Note, however, that the Banking Reform Act “does not mandate what sort of entity may carry out activities such as mortgage lending or taking deposits from large corporates. Some banking groups will place such activities in their RFBs, alongside their retail deposit-taking operations, but others may not.” Katie Britton et al., *supra* note 29, at 166.

³¹ Katie Britton et al., *supra* note 29, at 168.

Thus, it should be gathered that the global regulatory overhaul following the financial crisis was dramatic, but fragmented, around the world. This fragmentation has imposed a dynamic and complicated regulatory environment for international banking organizations with large-scale operations in many countries, ultimately resulting in extraordinarily high compliance costs.³²

The central focus of this Note is to analyze the position of foreign banking organizations (“FBOs”) with consolidated U.S. assets over \$50 billion,³³ and their response to the regulatory overhaul implemented by Dodd-Frank. Specifically, Part II will begin by offering a brief history of FBOs in the United States and will then describe how FBOs generally organize their U.S. activities. Part II also introduces and describes the regulatory rules promulgated out of Dodd-Frank that will be the anchor guiding our discussion. Part III will present and discuss the results of the 2018 and 2019 CCAR exercises, comparing the IHCs’ results to those of similarly sized institutions headquartered in the United States. Finally, given the findings of Part III’s analysis, Part IV will argue for the reinstatement of a limited exception to Regulation

³² See Matthias Lehmann, *Legal Fragmentation, Extraterritoriality and Uncertainty in Global Financial Regulation*, 37 OXFORD J. LEGAL STUD. 406, 419–21 (2017). See also INT’L FED’N OF ACCOUNTANTS & BUS. AT THE OECD, *REGULATORY DIVERGENCE: COSTS, RISKS, IMPACTS* 4 (2018), <https://www.ifac.org/system/files/publications/files/IFAC-OECD-Regulatory-Divergence.pdf> [<https://perma.cc/QL66-NKT9>] (finding that the current system of piecemeal global financial regulation costs the global economy more than \$780 billion each year).

³³ Despite the EGRRCPA’s change of CCAR’s consolidated U.S. asset threshold from \$50 billion to \$250 billion, in the interest of leveraging as much relevant data as possible to determine the impact of Regulation YY, all institutional data above \$50 billion will be included in the empirical analysis of Part IV. Because the EGRRCPA was not signed into law until May 2018, institutions with consolidated assets of more than \$50 billion were required to participate in the exercise in 2018. See Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018). Although the role of the EGRRCPA’s threshold increase will no doubt be a ripe topic for further academic debate, it will only be a peripheral point in this Note.

W that existed prior to Dodd-Frank's enactment. Part V concludes.

II. THE REGULATORY ENVIRONMENT FOR LARGE, COMPLEX, FINANCIAL INSTITUTIONS

To assess the efficacy of the United States' financial regulatory regime in supervising foreign banking organizations and reducing global systemic risk, this Note will center its discussion around the regulatory rules promulgated out of Dodd-Frank. Specifically with respect to foreign banking organizations, the crucial regulatory changes that emerged out of Dodd-Frank were promulgated under Regulation YY and Regulation W.³⁴ Together, these rules require that foreign banking organizations fundamentally restructure their global legal entity framework and, as a result, their funding strategy.

Given that the IHCs submitted their first public stress test results in the summer of 2018,³⁵ the impact of the IHC paradigm has yet to be assessed comprehensively. However, before reaching our evaluation of Regulation YY and Regulation W, it is first necessary to explain the history of foreign banking organizations in the United States and how that historical context informs current FBO regulation.

A. Brief History of Foreign Banking Organizations in the United States

The global financial system is largely an advent of the past thirty years. Indeed, while there was certainly cross-border banking activity before the 1980s, "the scale of international banking changed dramatically between 1985 and 2009."³⁶

³⁴ See Enhanced Prudential Standards (Regulation YY), 12 C.F.R. § 252 (2020); Transactions Between Member Banks and Their Affiliates (Regulation W), 12 C.F.R. § 223 (2020).

³⁵ See Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Releases Results of Comprehensive Capital Analysis and Review (CCAR) (June 28, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180628a.htm> [<https://perma.cc/9GLR-R8NW>].

³⁶ COMM. ON THE GLOB. FIN. SYS., LONG-TERM ISSUES IN INTERNATIONAL BANKING 6 (2010), <https://www.bis.org/publ/cgfs41.pdf>

That is, in the years leading up to the financial crisis global banks' cross-border and foreign currency claims increased precipitously.³⁷ One driver of this growth in international banking was the globalization of the world's economy generally, however international banking activity has significantly outpaced international trade³⁸ in the twenty-first century.³⁹ The commonly accepted explanation among financial economists as to what has driven the rise of international banking, particularly over the past twenty years, is the emergence of FBOs as "market intermediaries."⁴⁰

Briefly, the market intermediary function of foreign banking organizations refers to the active role FBOs have recently taken in global capital markets.⁴¹ Specifically, the evolution of

[<https://perma.cc/HS7N-HHZB>]. See also Mitchell Berlin, *New Rules for Foreign Banks: What's at Stake?*, BUS. REV., First Quarter 2015, at 1, 1–2; John C. Dugan et al., *Forms of Entry and Operation in the United States*, in REGULATION OF FOREIGN BANKS & AFFILIATES 1, 4–6 (Randall D. Guynn ed., 9th ed. 2016).

³⁷ See Patrick McGuire et al., *Highlights of International Banking and Financial Market Activity*, 2008 BIS Q. REV. 17, 24 (2008).

³⁸ International trade activity is generally accepted as a proxy to measure the globalization of the world's economy. See, e.g., OECD, MEASURING GLOBALISATION: OECD ECONOMIC GLOBALISATION INDICATORS 40 (2010), <https://unstats.un.org/unsd/EconStatKB/KnowledgebaseArticle10422.aspx> [<https://perma.cc/PA6X-37WS>]; Petra Vujakovic, *How to Measure Globalization? A New Globalization Index (NGI)*, 38 ATLANTIC ECON. J. 237 (2010).

³⁹ See COMM. ON THE GLOB. FIN. SYS., *supra* note 36, at 6–7. Growth in international banking activity largely mirrored international trade growth from 1986 to 2000. See COMM. ON THE GLOB. FIN. SYS., *supra* note 36, at 7 tbl.2. It can thus be presumed that, up until 2000, the observed rise in international banking activity was at least in part attributable to the globalization of the world's economy generally.

⁴⁰ See, e.g., COMM. ON THE GLOB. FIN. SYS., *supra* note 36, at 7, 18; Berlin, *supra* note 36, at 2–3; KATIE KOLCHIN, SIFMA INSIGHTS: THE IMPORTANCE OF FBOs TO US CAPITAL MARKETS 4 (2019), <https://www.sifma.org/wp-content/uploads/2019/04/SIFMA-Insights-The-Importance-of-FBOs-to-US-Capital-Markets.pdf> [<https://perma.cc/R4VB-VJ68>].

⁴¹ See, e.g., COMM. ON THE GLOB. FIN. SYS., *supra* note 36, at 18; Semyon Malamud & Andreas Schrimpf, *An Intermediation-Based Model of Exchange Rates* 2 n.1 (Bank for Int'l Settlements, Working Paper No. 743, 2018), <https://www.bis.org/publ/work743.pdf> [<https://perma.cc/6LAV-ABAA>].

FBOs into market intermediaries has largely been driven by their expansion into derivatives and interbank lending markets.⁴² To illustrate the impact this change has had on the funding strategy of FBOs, it is helpful to describe one type of fee-generating transaction that FBOs routinely engage in: asset-backed securitizations.

By way of background, asset-backed securitizations are financial products that allow banks to sell their loans by bundling them together into a tradeable bond and selling them to other financial institutions.⁴³ In the lifecycle of a securitization large global banks serve as middlemen, buying loans from commercial banks and packaging them into securitized tranches to be sold to investors.⁴⁴ That is, by design middlemen banks are not intended to retain exposure to the securitized products they create, they are meant to transfer credit risk from one party (the original lending commercial bank) to another (the securitization investor).⁴⁵ Initially, when securitizations became popularized in the 1970s, they were thought to be a force for stability given that they offered liquidity to commercial banks, whose balance sheets were otherwise inflexible, and diversified risk around the financial system.⁴⁶ At face value this understanding of securitizations is true, and indeed, there is nothing inherently unstable about securitized products. Practically, however, the transfer of credit risk associated with securitized transactions is often “not complete for various reasons, either because banks provided explicit or

⁴² See COMM. ON THE GLOB. FIN. SYS., *supra* note 36, at 13–14, 17 tbl.6. See also KOLCHIN, *supra* note 40, at 11; McGuire et al., *supra* note 37, at 17–19.

⁴³ See SULEMAN BAIG & MOORAD CHOUDHRY, *THE MECHANICS OF SECURITIZATION: A PRACTICAL GUIDE TO STRUCTURING AND CLOSING ASSET-BACKED SECURITY TRANSACTIONS* 3 (2013).

⁴⁴ See, e.g., Nicola Cetorelli & Stavros Peristiani, *The Role of Banks in Asset Securitization*, FRBNY ECON. POL'Y REV., July 2012, at 47, 48–50; Gary Gorton & Andrew Metrick, *Securitized Banking and the Run on Repo*, 104 J. FIN. ECON. 425, 426–28 (2012).

⁴⁵ See Viral V. Acharya et al., *Securitization Without Risk Transfer*, 107 J. FIN. ECON. 515, 515 (2013).

⁴⁶ See S.L. Schwarcz, *Securitization and Structured Finance*, in *HANDBOOK OF KEY GLOBAL FINANCIAL MARKETS, INSTITUTIONS, AND INFRASTRUCTURES* 565, 566 (Gerard Caprio et al. eds., 2013).

implicit support to special purpose vehicles, or because banks retained on [their] balance sheet some tranches of their structured issuances.”⁴⁷

In the years leading up to the crisis many large foreign⁴⁸ banks retained remnants of their previously structured issuances on their balance sheet.⁴⁹ Commentators have offered several strategic explanations as to why foreign banking organizations retained these exposures leading up to the financial crisis,⁵⁰ however the structural explanation lies in the presence of “credit enhancements” in pre-crisis securitizations.⁵¹ Credit enhancements are defined as “contractual arrangements in which a bank retains or assumes [securitized] exposure and, in substance, provides some degree of added protection to other parties in the transaction.”⁵² In effect, the

⁴⁷ Alessandro Diego Scopelliti, *Securitisation, Bank Capital and Financial Regulation: Evidence from European Banks 2* (Mar. 1, 2016) (unpublished manuscript) (citations omitted), https://www.ecb.europa.eu/pub/conferences/ecbforum/shared/pdf/2016/scopelliti_paper.pdf [<https://perma.cc/MA9V-8VU2>].

⁴⁸ Although there is some evidence that foreign banking organizations outside Europe retained their securitized exposures in the pre-crisis period, European banks did so in much greater quantities. See Robert McCauley, *The 2008 Crisis: Transpacific or Transatlantic?*, 2018 BIS Q. REV. 39, 41–42 (2018). Additionally, because eight out of the twelve IHCs are headquartered in Europe, European banks generally are afforded the most attention in academic studies. See *infra* Table 1.

⁴⁹ See Scopelliti, *supra* note 47, at 38; COMM. ON THE GLOB. FIN. SYS., *supra* note 36, at 21 fig.11.

⁵⁰ See *id.* at 30, 38 (arguing that European banks retained securitized exposures on their balance sheets as a means of regulatory arbitrage); Santiago Carbó-Valverde et al., *Securitization, Risk Transferring and Financial Instability: The Case of Spain*, 31 J. INT’L MONEY & FIN. 80, 93 (2012) (arguing that foreign banks retained portions of their securitized issuances to leverage as collateral in their transactions with central banks).

⁵¹ See Anna Sarkisyan & Barbara Casu, *Retained Interests in Securitizations and Implications for Bank Solvency 2* (European Cent. Bank, Working Paper No. 1538, 2013), <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1538.pdf> [<https://perma.cc/LWE5-E65R>].

⁵² See *id.* at 4. Credit enhancements are often used to achieve a specific credit rating for securitizations and to signal the strength of securitizations to investors. See *id.* at 4; Benjamin H. Mandel et al., *The Role of Bank Credit*

kind of internal credit enhancements that were leveraged by FBOs leading up to the crisis required them to retain junior interests in the securitized products they issued.⁵³ Although there is nothing inherently wrong with banks retaining exposure to securitized products,⁵⁴ the credit enhancements employed in the pre-crisis period were particularly problematic because of the “first-loss” position they put issuers in.⁵⁵

It is all important to note that, in addition to retaining junior tranches in the years leading up to the crisis, FBOs financed their securitization activities almost exclusively with dollar denominated, short-term wholesale funding.⁵⁶ That is, FBOs, while retaining long-term, illiquid assets on their balance sheets in the form of securitized products, were funding their operations with short-term, market-based funding.⁵⁷ This funding strategy is a classic “maturity mismatch,” and ultimately led to disaster.⁵⁸ As junior tranches began to

Enhancements in Securitization, FRBNY ECON. POL'Y REV., July 2012, at 35, 36.

⁵³ See Sarkisyan & Casu, *supra* note 51, at 17–18.

⁵⁴ In fact, following the crisis U.S. regulators promulgated a rule which now requires securitized issuers to retain five percent of the credit risk of the assets collateralizing their issuances. See Standard Risk Retention, 17 C.F.R. § 246.4 (2020).

⁵⁵ See Sarkisyan & Casu, *supra* note 51, at 2–3.

⁵⁶ See, e.g., Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Yale School of Management Leaders Forum: Regulation of Foreign Banking Organizations 5–6 (Nov. 28, 2012), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20121128a.pdf> [<https://perma.cc/9Z5E-LV79>]; Rita Babihuga & Marco Spaltro, *Bank Funding Costs for International Banks* 3 (Int'l Monetary Fund, Working Paper No. 14/71, 2014), <https://www.imf.org/external/pubs/ft/wp/2014/wp1471.pdf> [<https://perma.cc/6CSY-BT75>]; Eric S. Rosengren, President, Fed. Reserve Bank of Bos., Short-Term Wholesale Funding Risks 5–6 (Nov. 5, 2014), <https://www.bostonfed.org/news-and-events/speeches/short-term-wholesale-funding-risks.aspx> [<https://perma.cc/2Z6A-2B22>].

⁵⁷ See Babihuga & Spaltro, *supra* note 56, at 3.

⁵⁸ See William C. Dudley, President, Fed. Reserve Bank of N.Y., Remarks at the New York Bankers Association Annual Meeting: Fixing Wholesale Funding to Build a More Stable Financial System 2 (Feb. 1, 2013), <https://www.newyork-fed.org/newsevents/speeches/2013/dud130201.html> [<https://perma.cc/AFZ6-AWJ>].

default in 2008, FBOs were left with a shortfall; they did not have a “natural base” of dollar deposits like their U.S. counterparts, and desperately needed dollar funding to support their dollar-denominated securitized assets.⁵⁹ As a result of the growing insecurities of all banking organizations, both domestic and foreign banks largely stopped lending dollars in the interbank market after the collapse of Lehman Brothers.⁶⁰ Additionally, short-term dollar funding (largely provided by money market funds in the U.S.) dried up following Lehman’s failure.⁶¹ The stress in dollar funding markets forced FBOs to sell their dollar-denominated assets and reduce lending rapidly—actions that further aggravated the stress in global credit markets.⁶²

The Federal Reserve responded to the widespread disruption in funding markets by introducing the Term Auction Facility (“TAF”), which allowed institutions experiencing liquidity pressures to borrow from the Federal Reserve at depressed interest rates.⁶³ For their part, “foreign banks in the United States loaned relatively less in overnight interbank markets [and] borrowed more from the Federal Reserve’s Term Auction

⁵⁹ See Niall Coffey et. al, *The Global Financial Crisis and Offshore Dollar Markets*, CURRENT ISSUES IN ECON. & FIN., Oct. 2009, at 1, 1. Banking organizations finance their assets with the currency they are denominated in to maintain a “currency-matched book” and reduce their currency risk. See COMM. ON THE GLOB. FIN. SYS., US DOLLAR FUNDING: AN INTERNATIONAL PERSPECTIVE 61 (2020), <https://www.bis.org/publ/cgfs65.pdf> [<https://perma.cc/NS54-NQMU>].

⁶⁰ See, e.g., Niall Coffey et al., *supra* note 59, at 1; Naohiko Baba et al., *US Dollar Money Market Funds and Non-US Banks*, 2009 BIS Q. REV. 65, 66 (2009).

⁶¹ See Niall Coffey et al., *supra* note 59, at 2.

⁶² See, e.g., Dudley, *supra* note 58, at 2–3; Governor Jeremy C. Stein, Address at the Meeting of the Board of Governors of the Federal Reserve System (Dec. 14, 2012), <https://www.federalreserve.gov/newsevents/press/bcreg/stein20121214a.htm>. [<https://perma.cc/2ZAU-XX89>].

⁶³ See Press Release, Bd. of Governors of the Fed. Reserve Sys., Monetary Policy Release (Dec. 12, 2007), <https://www.federalreserve.gov/monetarypolicy/20071212a.htm> [<https://perma.cc/Q6GV-Z85H>]. The Federal Reserve also established swap lines with foreign central banks during the crisis to offer dollar liquidity throughout global capital markets. See *id.*

Facility.”⁶⁴ Although the assistance the United States offered foreign banks during the financial crisis sparked outrage among some industry commentators,⁶⁵ others have noted that without U.S. rescue programs, “a fair number of foreign banks operating in the U.S. likely would have failed, triggering a cascading crisis that would have been disastrous.”⁶⁶

Thus, largely as a result of their role in U.S. capital markets, it is safe to say that FBOs now pose a significant risk to the stability of the U.S. financial system. The risks posed by FBOs are often spoken on by policymakers, with Governor Brainard recently noting that “[t]he crisis demonstrated clearly that the combined U.S. operations of foreign banks can pose important risks to U.S. financial stability because of their reliance on dollar-denominated short-term wholesale funding from the United States to fund the banks’ global activities.”⁶⁷ Thus, beyond the poor optics of the Federal Reserve providing financial assistance to foreign-owned financial institutions, it is clear that, should another crisis hit, U.S. regulators will have little choice but to rescue FBOs again.

⁶⁴ Nicola Cetorelli & Linda S. Goldberg, *Foreign Banks in the Great Recession: Diversity in Internal and External Lending 2–3* (Dec. 26, 2011) (unpublished manuscript), <https://www.aeaweb.org/conference/2012/retrieve.php?pdfid=513> [<https://perma.cc/ZGF5-BDLL>]. See also Efraim Benmelech, *An Empirical Analysis of the Fed’s Term Auction Facility*, 2 CATO PAPERS ON PUB. POL’Y 57, 60 (2012) (finding that foreign banks accounted for fifty-eight percent of TAF lending during the financial crisis).

⁶⁵ See Robin Harding & Tom Braithwaite, *European Banks Took Big Slice of Fed Aid*, FIN. TIMES (Dec. 1, 2010), <https://www.ft.com/content/4dd95e42-fd6d-11df-a049-00144feab49a> [<https://perma.cc/9DX8-V8TF>].

⁶⁶ Better Markets, *Comment Letter on Proposed Prudential Standards for Large Foreign Banking Organizations* (June 21, 2019), <https://bettermarkets.com/sites/default/files/Better%20Markets%20CL%20Fed%20FBOs%20Enhanced%20Prudential%20Standards%206-21-2019.pdf> [<https://perma.cc/SH4B-EN6U>].

⁶⁷ Press Release, Bd. of Governors of the Fed. Reserve Sys., *Statement by Governor Lael Brainard* (Oct. 10, 2019), <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191010.htm> [<https://perma.cc/M4CN-6N6A>].

B. Modern Regulatory Paradigm for International Banking Organizations

Before delving into the enhanced regulatory standards certain foreign banking organizations are now tasked with complying with, it is first necessary to outline the relevant regulatory actors in the United States and how they are each assigned responsibility under the Dodd-Frank paradigm. The U.S. financial regulatory framework has been heralded by outsiders as being extraordinarily complicated,⁶⁸ and thus for our purposes here the discussion will be greatly simplified, with an intention to only discuss those regulators who have some insight into and peripheral responsibility under Regulation YY and Regulation W.

There are three leading regulators of banking organizations in the United States: the Federal Reserve System (“the FRS”), the Federal Deposit Insurance Corporation (“the FDIC”), and the Office of the Comptroller of the Currency (“the OCC”).⁶⁹ Although each is tasked with a broad mandate, the relevant responsibilities of each changed significantly with the passage of Dodd-Frank and the advent of a new regulatory paradigm for financial institutions in the United States.

First, the Federal Reserve System is the relevant “owner” of Regulation YY. That is, the Federal Reserve is the agency tasked with implementing the stress tests and enhanced prudential standards of Regulation YY and ensuring that the mechanical transformations of the regulation (including IHC

⁶⁸ See, e.g., Chester S. Spatt, *Complexity of Regulation*, 3 HARV. BUS. L. REV. ONLINE 1–9 (2012); Andrew G. Haldane & Vasileios Madouros, Address at the Federal Reserve Bank of Kansas City’s Economic Policy Symposium: The Dog and the Frisbee 24 (Aug. 31, 2012), <https://www.bankofengland.co.uk/-/media/boe/files/paper/2012/the-dog-and-the-frisbee.pdf?la=en&hash=4DEAA2E6D1698A1A0891153A6B4CE70F308351D7> [https://perma.cc/U2K2-Q7R6].

⁶⁹ See MARC LABONTE, CONG. RESEARCH SERV., R44918, WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 8 tbl.1 (2020).

reorganization) are completed in a timely manner.⁷⁰ Although the Federal Reserve has played a role in financial institution supervision since the passage of the Federal Reserve Act in 1913,⁷¹ Dodd-Frank fundamentally changed the supervisory role of the central bank, and as result, the tone of financial institution regulation in the United States.⁷² In the Regulation W context, the Federal Reserve maintains its primary ownership status in ensuring institutions' ongoing compliance with internal transaction limits and collateral requirements,⁷³ however the Federal Reserve's Regulation W authority has been substantially diluted under Dodd-Frank. That dilution of FRS authority is a result of section 608 of Dodd-Frank,⁷⁴ which vests the OCC and FDIC with the "statutory power to grant exemptions from the requirements of Section 23A to institutions under their respective supervision."⁷⁵ Even in articulating official interpretations of the regulation "the [Federal Reserve] Board [now] must act jointly with the federal banking agency, either the OCC or the FDIC, which directly regulates and supervises such entities [affected by the interpretation]."⁷⁶

Generally speaking, the FDIC plays a smaller role in the Dodd-Frank regulatory regime, however in several contexts the FDIC has an outsized influence as a result of the agency's chief responsibility of overseeing the federal deposit insurance

⁷⁰ See Enhanced Prudential Standards (Regulation YY), 12 C.F.R. § 252.1 (2020).

⁷¹ Federal Reserve Act, Pub. L. No. 63-43, § 21, 38 Stat. 251, 271 (1913) (codified as amended in scattered sections of 12 U.S.C.).

⁷² It is important to note, for those not familiar with the framework of banking supervision in the United States, that the supervisory responsibility of the Federal Reserve is in addition to, and separate from, its well-known role in executing monetary policy.

⁷³ Transactions Between Member Banks and Their Affiliates (Regulation W), 12 C.F.R. § 223.1 (2020).

⁷⁴ Dodd-Frank Act, Pub. L. No. 111-203, § 608, 124 Stat. 1376, 1608 (2010) (codified at 12 U.S.C. § 371c (2018)).

⁷⁵ Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23a of the Federal Reserve Act*, 89 N.C. L. REV. 1683, 1766 (2011).

⁷⁶ *Id.* at 1767.

fund.⁷⁷ As was previously alluded to, the FDIC plays a secondary role in executing on the supervisory responsibilities introduced by Regulation YY. That is, although the FDIC acts as an independent actor in Regulation YY analyses, the Federal Reserve maintains its role as the final decisionmaker, and may overrule the input of FDIC examiners.⁷⁸ With respect to Regulation W, however, the FDIC plays a much more active role. Largely as a result of the use of Regulation W during the financial crisis,⁷⁹ Dodd-Frank for the first time gave the FDIC absolute authority to prevent exemptions under Section 23A “if the FDIC determines that such exemption presents an unacceptable risk to the federal deposit insurance fund.”⁸⁰ In other words, under Dodd-Frank the FDIC holds final decision making authority on Regulation W exceptions, although is not considered the regulation’s primary owner given that it is not held responsible for its implementation or ensuring compliance with its provisions.

The FDIC was delegated primary authority as to one crucial provision of Dodd-Frank, that which mandates bank holding companies with over \$50 billion in non-branch U.S. assets submit resolution plans for their orderly liquidation, an exercise popularly known as “resolution planning.”⁸¹ Under Dodd-

⁷⁷ Federal Deposit Insurance Act, Pub. L. No. 81-797, § 1, 64 Stat. 873, 873 (1950) (codified as amended at 12 U.S.C. § 1811 (2018)).

⁷⁸ See LABONTE, *supra* note 69, at 12. See also Enhanced Prudential Standards (Regulation YY), 12 C.F.R. § 252.1 (2020).

⁷⁹ See Omarova, *supra* note 75, at 1690 (“[D]uring the crisis, the Board effectively rendered section 23A irrelevant by repeatedly allowing depository institutions to provide financing to their affiliated securities firms, derivatives dealers, money market funds, and even automotive companies . . .”).

⁸⁰ *Id.* at 1766 (describing Dodd-Frank Act, Pub. L. No. 111-203, § 608(a)(4)(A), 124 Stat. 1376, 1609 (2010) (codified at 12 U.S.C. § 371c(f) (2018))).

⁸¹ See Resolution Plans (Regulation QQ), 12 C.F.R. § 243.1 (2020). Again, this threshold was altered with the passage of the EGRRCPA. Immediately following the EGRRCPA’s enactment, financial institutions with consolidated assets of less than \$100 billion were exempt from the resolution planning requirements of section 165(d) of Dodd-Frank. Eighteen months after the EGRRCPA’s enactment, the exemption threshold was raised to \$250 billion. See Economic Growth, Regulatory Relief, and

Frank, the FDIC and the FRS are jointly primarily responsible for implementing Regulation QQ, the regulation that mandates that institutions submit resolution plans, and making final decisions as to a resolution plan's adequacy.⁸² This delegation of responsibility to the FDIC, although perhaps seemingly out of sync with the rest of the FRS-centric paradigm of Dodd-Frank, is likely a result of the resolution planning process being derived from the FDIC's existing mandate of "orderly and efficiently managing and disposing of the assets of failed depository institutions."⁸³

Although delegated less authority under Dodd-Frank, the OCC "assumes responsibility for the ongoing examination, supervision, and regulation of federal savings associations"⁸⁴ under Title III of the statute.⁸⁵ Beyond its role in supervising savings associations, the OCC also maintains primary responsibility for federally chartered and licensed banks.⁸⁶ This primary regulatory authority gives the OCC unique insight into the operations of FBOs, as U.S. branches of foreign banking organizations are federally licensed.⁸⁷ U.S. branches are crucial tools in FBOs' global operations; they allow international banking organizations to participate in and clear dollar-denominated transactions in the United States while not requiring high levels of capital or liquidity to be held within the legal

Consumer Protection Act, Pub. L. No. 115–174, § 401(a), 132 Stat. 1296, 1356 (2018). *See also* Resolution Plans Required, 84 Fed. Reg. 59,194 (Nov. 1, 2019) (to be codified at 12 C.F.R. pts. 243, 381).

⁸² *See* 12 C.F.R. §§ 243.1, 243.8.

⁸³ OFFICE OF INSPECTOR GEN., OFFICE OF AUDITS & EVALUATIONS, EVAL-13-004, THE FDIC'S RESOLUTION PLANNING PROCESS i (2013).

⁸⁴ Press Release, Office of the Comptroller of the Currency, OCC Issues Final Rule to Implement Provisions of the Dodd-Frank Act (July 20, 2011), <https://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-95.html> [<https://perma.cc/FST8-6RGN>].

⁸⁵ *See* Dodd-Frank Act § 312(b)(2)(B).

⁸⁶ *See* 12 U.S.C. §§ 21, 27 (2018).

⁸⁷ *See* 12 U.S.C. § 3102. *See also* International Banking Activities, 12 C.F.R. § 28.12(a)(2) (2020) ("A foreign bank must receive a license from the OCC to open and operate its initial Federal branch or agency in the United States.").

entity.⁸⁸ The centrality of branches to FBOs' funding flows and broader business strategies has resulted in the OCC working closely with the Federal Reserve in regulating FBOs, and now, the IHCs.⁸⁹ Interestingly, in imposing its own heightened risk management standards in its capacity as a primary and secondary regulator, the OCC has mirrored many of the enhanced prudential standards adopted by the Federal Reserve.⁹⁰ This effort by the OCC illustrates a broader point that, even beyond the collaboration required by Dodd-Frank, the three main financial regulators in the United States have made a concerted effort towards uniformity in promulgating their risk management and corporate governance standards to ease the cost and complexity associated with compliance for affected institutions.⁹¹

⁸⁸ See William Goulding & Daniel E. Nolle, *Foreign Banks in the U.S.: A Primer* 21–22, 64 (Bd. of Governors of the Fed. Reserve Sys., International Finance Discussion Paper No. 1064r, 2012), <https://www.federalreserve.gov/Pubs/ifdp/2012/1064/revision/ifdp1064r.htm#foot106> [<https://perma.cc/U2TP-C38C>]. For an illustration of the legal entity relationship between IHCs and their U.S. branches, see Figure 2, *infra*.

⁸⁹ See OFFICE OF THE COMPTROLLER OF THE CURRENCY, APPROACH TO FEDERAL BRANCH AND AGENCY SUPERVISION 6 (2017), <https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-approach-fed-branch-agency-sup.pdf> [<https://perma.cc/L7LE-458P>].

⁹⁰ See OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations, 70 Fed. Reg. 54,518 (Sept. 11, 2014) (to be codified at 12 C.F.R. pts 30, 168, and 170). See also IRENA GECAS-MCCARTHY ET AL., DELOITTE CTR. FOR REGULATORY STRATEGIES, STRONGER: OCC'S HEIGHTENED EXPECTATIONS 2 (2014), <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-aers-occ-heightened-expectations-11-26-02-12042014.pdf> [<https://perma.cc/T6KV-93VP>] (“The OCC has formalized its ‘heightened expectations’ for risk management and governance . . . These proposed standards apply to large national banks and are consistent with the principles embedded in the Federal Reserve’s expectations for large bank holding companies.”).

⁹¹ See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-14-67, DODD-FRANK REGULATIONS: AGENCIES CONDUCTED REGULATORY ANALYSES AND COORDINATED BUT COULD BENEFIT FROM ADDITIONAL GUIDANCE ON MAJOR RULES 23 (2013) (“For 10 of the 49 rules, there was no Dodd-Frank requirement to

Although not directly relevant for our purposes here, it is pertinent to note in passing the existence of the Financial Stability Oversight Council (“FSOC”). FSOC was created by Title I of Dodd-Frank⁹² and, in addition to monitoring the aggregate risk and stability of the U.S. financial system, is most importantly tasked with designating institutions as “systemically important financial institutions” (“SIFIs”).⁹³ The SIFI title is incredibly consequential, as it gives FSOC the authority to require nonbanks to comply with Regulation YY standards and thus be treated, for regulatory purposes, as banking organizations with more than \$50 billion in consolidated assets.⁹⁴ It is not an over-exaggeration to note that this process has been the source of extreme outrage in the insurance and asset management communities,⁹⁵ with several large insurers obtaining the designation in the early days of FSOC’s existence.⁹⁶ However, following successful litigation on the part of

coordinate, but we found evidence that the agencies voluntarily coordinated on the rulemakings.”).

⁹² Dodd-Frank Act, Pub. L. No. 111-203, § 111, 124 Stat. 1376, 1392 (2010) (codified as amended at 12 U.S.C. § 5321 (2018)).

⁹³ See *id.* §§ 112–13.

⁹⁴ See *id.* § 113. Again, this threshold has shifted with the EGRRCPA, but for consistency (and because we are analyzing the 2018 CCAR filings, where institutions with \$50 billion in consolidated assets were required to participate), throughout this Note the \$50 billion threshold will be referenced. See *supra* notes 12–15 and accompanying text for an explanation of the modification of this asset threshold under the EGRRCPA.

⁹⁵ See, e.g., Press Release, MetLife, Inc., MetLife Statement on Final SIFI Designation (Dec. 18, 2014), <https://investor.metlife.com/news-and-events/financial-press-releases/news-details/2014/MetLife-Statement-on-Final-SIFI-Designation/default.aspx> [<https://perma.cc/LWT9-Z6WZ>]; Paul Kupiec, Opinion, *Our Worst Fears About Dodd-Frank’s FSOC Are Being Confirmed*, FORBES (Nov. 26, 2013), <https://www.forbes.com/sites/realspin/2013/11/26/our-worst-fears-about-dodd-franks-fsoc-are-being-confirmed/#40183eba3c86> [<https://perma.cc/8HFE-JKHZ>].

⁹⁶ See, e.g., James O’Toole, *AIG, GE Capital Tagged “Systemically Important,” Will Face Greater Regulation*, CNN (July 9, 2013), <https://money.cnn.com/2013/07/09/news/economy/ge-capital-aig/index.html> [<https://perma.cc/REC4-5TW2>]; Jim Puzzanghera, *MetLife Designated Too Big to Fail*, L.A. TIMES (Dec. 19, 2014), <https://www.latimes.com/business/la-fi-metlife-financial-stability-oversight-federal-reserve-20141219-story.html> [<https://perma.cc/6SW4-L7ZT>].

one designated nonbank,⁹⁷ and a new policy direction on the part of the Trump administration,⁹⁸ FSOC's use of the SIFI label has now been removed from all nonbanks.⁹⁹ Given this trend, it is increasingly unlikely, although not impossible, that a foreign-headquartered nonbank will be designated as a SIFI and thus brought into Regulation YY's purview in the near future.

C. Regulation YY, Regulation W, And IHC Reorganization

Now, before delving into subpart O of Regulation YY and its implications for foreign banking organizations, it is first necessary to outlay the other prudential risk management provisions of Regulation YY. Beyond providing helpful context for our analysis, these regulations are applicable to both IHCs and domestic banking organizations with U.S. non-branch assets over \$50 billion.¹⁰⁰ As will become clear later in this analysis, the holistic cost of compliance with Regulation YY looms large still today over the business decisions made by the IHCs in restructuring their U.S. operations.

Undoubtedly, the most well-documented regulatory exercise introduced by Regulation YY is the capital stress test commonly known as "CCAR."¹⁰¹ Broadly, the CCAR exercise requires that affected financial institutions stress their balance sheets annually in accordance with stress scenarios created by the Federal Reserve while maintaining capital levels

⁹⁷ See *Metlife, Inc. v. Fin. Stability Oversight Council*, 865 F.3d 661 (D.C. Cir. 2017).

⁹⁸ See Memorandum from President Donald J. Trump to Secretary Steven Mnuchin (Apr. 21, 2017), <https://www.whitehouse.gov/presidential-actions/presidential-memorandum-secretary-treasury/> [<https://perma.cc/RA8N-PHAK>].

⁹⁹ See John Heltman, *Prudential, the Last Nonbank SIFI, Sheds the Label*, AM. BANKER (Oct. 17, 2018), <https://www.american-banker.com/news/prudential-the-last-nonbank-sifi-sheds-the-label> [<https://perma.cc/JN3M-5NBH>].

¹⁰⁰ See Enhanced Prudential Standards (Regulation YY), 12 C.F.R. § 252 (2020).

¹⁰¹ See *id.* §§ 252.41–47, 225.8.

above the regulatory minima.¹⁰² Additionally, the exercise requires that institutions demonstrate that they maintain appropriate contingency plans to obtain emergency funding in the event of a capital shortfall.¹⁰³ Perhaps the most consequential component of the CCAR exercise is that its results are made publicly available.¹⁰⁴ By the Federal Reserve's own statements, the rationale behind publicly disclosing the results of CCAR is to "help the public understand and interpret the results of the supervisory stress test, particularly with respect to the condition and capital adequacy of participating firms . . . [and] allow[] the public to make an evaluation of the quality of the Board's assessment."¹⁰⁵ Beyond public pressure, however, compliance with CCAR's risk management requirements has become extremely costly, with the approximate aggregate annual cost to filers being in the hundreds of millions of dollars.¹⁰⁶

As noted in section 165 of Dodd-Frank, in designing the enhanced risk management standards of Regulation YY the Federal Reserve has the authority to "differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate."¹⁰⁷ As it relates to corporate governance, this flexible grant of authority to the Federal Reserve has resulted in institutions with over \$50 billion

¹⁰² See *id.* § 252.44.

¹⁰³ See *id.* § 225.8.

¹⁰⁴ See *id.* § 252.46.

¹⁰⁵ Stress Testing Policy Statement, 84 Fed. Reg. 6,664, 6,669 (Feb. 28, 2019) (to be codified at 12 C.F.R. pt 252). See also Beverly Hirtle & Andreas Lehnert, *Supervisory Stress Tests 3* (Fed. Reserve Bank of N.Y., Paper No. 696, 2014), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr696.pdf [<https://perma.cc/2W79-GVNU>] ("A commitment by regulators to publish the results of supervisory stress tests and to tie certain actions to firms' quantitative results on those stress tests offers a potential mechanism to increase the credibility of the regulatory regime and improve communication with market participants.").

¹⁰⁶ See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 9, at 30.

¹⁰⁷ Dodd-Frank Act, Pub. L. No. 111-203, § 165(a)(2)(A), 124 Stat. 1376, 1423–24 (2010) (codified as amended at 12 U.S.C. § 5365(a) (2018)).

in consolidated U.S. assets being expected to have a well-qualified Chief Risk Officer in the United States and retain a local board risk committee to maintain a consolidated view of the institution's risk across portfolios.¹⁰⁸ Regulatory expectations as to the management of each individual risk stripe are largely institution-specific, however there are several broad themes consistent across institutions that regulators emphasize when identifying satisfactory risk management regimes. Namely, regulators expect that internal capital and liquidity stress tests are performed separate and apart from the CCAR exercise,¹⁰⁹ appropriate and timely management reports are produced with key summary statistics as to the aggregate risk in each division,¹¹⁰ risk limits are established and complied with,¹¹¹ and institutions' internal controls and escalation processes are followed.¹¹²

1. Regulation YY Subpart O and the Structure of International Banking Organizations

Certainly, as was previously alluded to, the frictions associated with coming into compliance with the enhanced prudential standards of Regulation YY are similarly experienced by both large foreign banking organizations and domestic banking organizations. However, foreign banking organizations face an additional requirement under Regulation YY: in accordance with subpart O, FBOs with over \$50 billion in consolidated U.S. assets were required to reorganize their legal entity structure to establish an IHC by the compliance date of July 1, 2016.¹¹³ This process of reorganization was extremely complex and resulted in affected institutions fundamentally restructuring their investment activities in the U.S. and globally, which will be succinctly described below.

¹⁰⁸ See 12 C.F.R. § 252.33.

¹⁰⁹ See *id.* §§ 252.51–58.

¹¹⁰ See *id.* § 252.155(a)(2)(ii).

¹¹¹ See *id.* §§ 252.70–78, 252.33(b)(2)(i)(A), 252.34(a)(1).

¹¹² See *id.* § 252.33(a)(2).

¹¹³ See Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240, 17,271 (Mar. 27, 2014) (codified as amended at 12 C.F.R. pt 252).

Prior to IHC reorganization, large foreign financial institutions were only required to hold capital in the United States to the extent that they maintained a chartered U.S. banking entity.¹¹⁴ Before Dodd-Frank was enacted, a foreign banking organization was required to establish a chartered banking entity in the United States only if the institution intended to accept retail deposits.¹¹⁵ Thus, because most FBOs were not involved in retail banking activity in the U.S. prior to Regulation YY's promulgation, most did not have a chartered U.S. banking entity, operating instead through a "agency-branch" network.¹¹⁶ As a result of this regulatory regime in the United States, all business done by foreign banking organizations in the U.S. served not only to accomplish the enterprise goals of the institution, but also offered liquidity to the broader organization, particularly for those business lines (retail banking, structured finance) that are relatively illiquid.¹¹⁷ That is, in the pre-crisis era funds could flow freely between FBOs' U.S. branches and their global network of legal entities, and there

¹¹⁴ See *Foreign Banks and the Federal Reserve*, FED. RES. BANK OF N.Y. (Apr. 1, 2007), <https://www.newyork-fed.org/aboutthefed/fedpoint/fed26.html> [<https://perma.cc/C3BD-T938>]. See also Tarullo, *supra* note 3, at 11 ("[T]he United States did not—prior to the financial crisis—require that all broker-dealers and investment banks meet Basel capital standards."). Note that although branches are not subject to U.S. capital adequacy requirements, under the International Banking Act they must maintain a capital equivalency deposit equal to five percent of their liabilities. See International Banking Act of 1978, Pub. L. No. 95-369, § 4(g), 92 Stat. 607, 611 (codified as amended at 12 U.S.C. § 3102(g) (2018)).

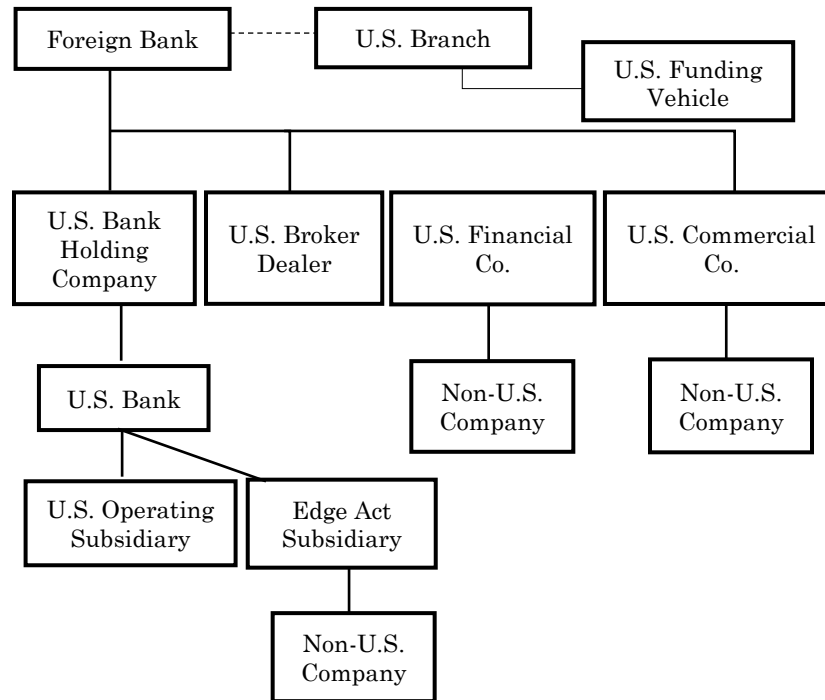
¹¹⁵ See 12 U.S.C. § 3102(d) (2018). Figure 1, *infra*, represents a case where an FBO chooses to establish a chartered banking entity under a bank holding company. Under that illustration, the FBO would be required to hold capital at both the holding company and bank level. See Capital Adequacy of Bank Holding Companies, Savings and Loan Holding Companies, and State Member Banks (Regulation Q), 12 C.F.R. § 217 (2020).

¹¹⁶ See Goulding & Nolle, *supra* note 88, at 3–4, 54 tbl.1. Recall that branches of FBOs are not chartered banking entities, they are only federally licensed. See *supra* note 87 and accompanying text.

¹¹⁷ See Nicola Cetorelli & Linda Goldberg, *Liquidity Management of U.S. Global Banks: Internal Capital Markets in the Great Recession 2* (Fed. Reserve Bank of N.Y., Paper No. 511, 2012), https://www.newyork-fed.org/medialibrary/media/research/staff_reports/sr511.pdf [<https://perma.cc/U3KZ-HN8L>]; Berlin, *supra* note 36, at 3.

is evidence to suggest that FBOs have responded to liquidity and capital shocks in the past by relying on their “internal capital markets.”¹¹⁸

Figure 1: Pre-Regulation YY International Bank Structure¹¹⁹



With the promulgation of subpart O, the organizational structure and funding strategy of FBOs has been dramatically

¹¹⁸ See Cetorelli & Goldberg, *supra* note 117. “Internal capital markets” refers to the funding banking organizations have access to through their network of parent companies/legal entities. See Berlin, *supra* note 36, at 3.

¹¹⁹ See DAVIS POLK & WARDWELL LLP, U.S. INTERMEDIATE HOLDING COMPANY: STRUCTURING AND REGULATORY CONSIDERATIONS FOR FOREIGN BANKS 6 (2014), https://www.davispolk.com/files/U.S.Intermediate.Holding.Company.Structuring.and.Regulatory.Considerations.for.Foreign.Banks_.pdf [https://perma.cc/YE4F-QS2W].

disrupted. First and most fundamentally, FBOs are required under subpart O to establish a chartered banking entity, the IHC itself, in the United States.¹²⁰ Under subpart O, there are several entities that must be organized under the IHC. First, any U.S. company¹²¹ controlled by a FBO with total consolidated U.S. assets over \$50 billion is required to be organized under the IHC.¹²² Any non-U.S. company controlled by the U.S. company also is mandated to be organized under the IHC.¹²³ The relevant statutory definition states that control can be achieved in three ways—(1) through owning, controlling, or having the power to vote more than twenty-five percent of any class of voting securities of the company; (2) by controlling in any manner the election of a majority of the directors or trustees of the company; or (3) by directly or indirectly exercising a controlling influence over the management or policies of the company.¹²⁴ Branches are to be considered outside this control determination, as they are explicitly named in subpart O as not being required to be organized under the IHC.¹²⁵ As a result of this exception, affected firms desperately attempted to reorganize their assets into their U.S. branch before the IHC reorganization compliance date.¹²⁶

¹²⁰ See U.S. Intermediate Holding Company Requirement for Foreign Banking Organizations with Combined U.S. Assets of \$100 Billion or More and U.S. Non-Branch Assets of \$50 Billion or More, 12 C.F.R. § 252.153(a)(1) (2020).

¹²¹ A “U.S. company” is defined as a “corporation, partnership, limited liability company, business trust, special purpose entity, association or similar organization” that is incorporated in or organized under the laws of the United States or in any U.S. state. 12 U.S.C. § 1841(b) (2018).

¹²² See 12 C.F.R. § 252.153(b)(1).

¹²³ See *id.*

¹²⁴ See 12 U.S.C. § 1841(a)(2). Recently, rules were finalized to clarify what exactly a “controlling influence” is under the Bank Holding Company Act. See Control and Divestiture Proceedings, 85 Fed. Reg. 12,398 (Mar. 2, 2020) (to be codified at 12 C.F.R. pts 225 and 238).

¹²⁵ See 12 C.F.R. § 252.153(b)(1).

¹²⁶ See James Disalvo, *How Foreign Banks Changed After Dodd-Frank*, BANKING TRENDS, Third Quarter 2019, at 1, 4, 5 fig.7 (showing that, through their U.S. branches, FBOs “increased their cash holdings dramatically following the financial crisis”); Lawrence L. Kreicher & Robert N. McCauley, *The New US Intermediate Holding Companies: Reducing or Shifting Assets?*, 2018 BIS Q. REV. 10, 11 (2018) (“From end-2015 to September 2017,

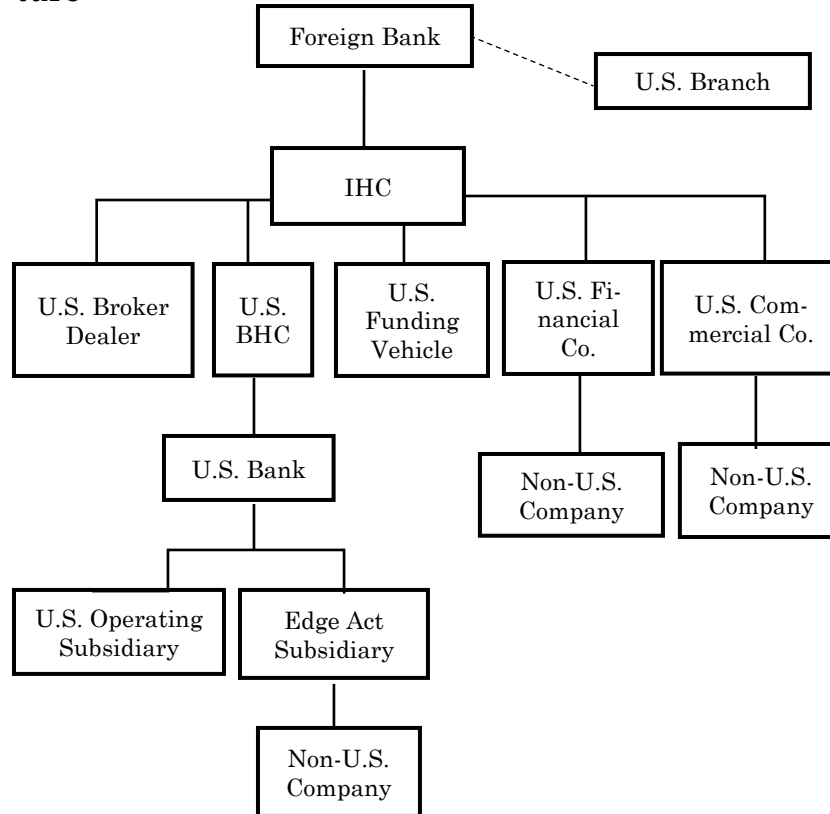
Beyond this reorganization strategy, every FBO subject to subpart O has sold off assets from their U.S. businesses,¹²⁷ a trend that has been the subject of recent congressional hearings.¹²⁸

US branch assets for FBOs with new IHCs increased by 16%.”); Laura Noonan, *European Banks Slash \$280bn From Main US Businesses*, FIN. TIMES (Nov. 24, 2019), <https://www.ft.com/content/ef651618-0b08-11ea-bb52-34c8d9dc6d84> [<https://perma.cc/7S9X-8C3F>].

¹²⁷ See Kreicher & McCauley, *supra* note 126, at 10.

¹²⁸ See *Fostering Economic Growth: Midsized, Regional, and Large Institution Perspective: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 115th Cong. 32–50 (2017) (statement of Greg Baer, President, Clearing House Association); *Semi-Annual Testimony on the Federal Reserve’s Supervision and Regulation of the Financial System: Hearing Before the H. Comm. on Fin. Servs.*, 115th Cong. 22–23 (2018) (statement of Rep. Andy Barr).

Figure 2: Post-Regulation YY International Bank Structure¹²⁹



2. Regulation W and Intrabank Funding

Importantly, Regulation YY and all its transformational provisions do not exist in a vacuum, and how they interact with the other regulations promulgated out of Dodd-Frank is important to describe to understand the unique challenges faced by the IHCs. Arguably the most important of these other regulations is Regulation W, which greatly impacts the IHCs and how they structure and fund their global businesses.¹³⁰

¹²⁹ See DAVIS POLK & WARDWELL LLP, *supra* note 119, at 7.

¹³⁰ Transactions Between Member Banks and Their Affiliates (Regulation W), 12 C.F.R. § 223 (2020).

The general concept propelling Regulation W has been debated for over eighty years,¹³¹ however the specific changes Dodd-Frank has made to the regulation illustrate how inapplicable regulations designed for domestic financial institutions can be to foreign financial institutions. While several major changes have been made to Regulation W since the financial crisis, we will specifically focus on Dodd-Frank's elimination of the financial subsidiary exemption¹³² and the derivatives exception.¹³³ Together, these amendments to Regulation W have drastically changed how financial institutions calculate their affiliate transactions, and, as a result, have changed the ways in which FBOs take on and distribute risk through their global organizations.

First, we begin with sections 23A¹³⁴ and 23B¹³⁵ of the Federal Reserve Act, which introduced the idea that intrabank transfers of assets should be curtailed "based on the amount of the bank's capital and surplus."¹³⁶ That is, sections 23A and 23B state that internal transactions within banking organizations should be limited and made on market terms to prevent banking organizations from engaging in excessive risk-taking through their subsidiaries.¹³⁷ Sections 23A and 23B were amended several times through the twentieth century,¹³⁸ and eventually, to consolidate all the rulemakings which resulted from these amendments, in 2002 the Federal Reserve issued Regulation W.¹³⁹ Regulation W's quantitative limits on

¹³¹ See Omarova, *supra* note 75, at 1692–1702.

¹³² Dodd-Frank Act, Pub. L. No. 111-203, § 609, 124 Stat. 1376, 1611 (2010) (codified at 12 U.S.C. § 371c(e) (2018)).

¹³³ *Id.* § 610.

¹³⁴ 12 U.S.C. § 371c-1 (2018).

¹³⁵ *Id.*

¹³⁶ Omarova, *supra* note 75, at 1692.

¹³⁷ 12 U.S.C. § 371c-1. See also S. REP. NO. 73-77, at 10 (1933) ("The greatest of such dangers is seen in the growth of 'bank affiliates' which devote themselves in many cases to perilous underwriting operations, stock speculation, and maintaining a market for the banks' own stock often largely with the resources of the parent bank.").

¹³⁸ See Omarova, *supra* note 75, at 1695–97.

¹³⁹ See Press Release, Fed. Reserve Bd. of Governors, Final Regulation W (Transactions Between Banks and Their Affiliates) (Nov. 27, 2002),

internal transactions, which were not altered by Dodd-Frank, are, as a percentage of an institution's capital and surplus, ten percent to a single affiliate, and an aggregate maximum of twenty percent to all affiliates.¹⁴⁰ Note that Regulation W is only concerned with the transfer of cash or value *from* a banking organization *to* its affiliates, not the other way around.¹⁴¹ So, while there are meaningful restrictions in how the IHCs may provide liquidity to their affiliates around the world, there are virtually no restrictions on how they can accept liquidity from their affiliates.

It is all important to note that not all transactions to affiliates are included in an institution's Regulation W calculation; only "covered transactions" are included in the computation.¹⁴² This term has been historically controversial,¹⁴³ and prior to the financial crisis, Regulation W was notable for including several important exceptions to what is to be considered a "covered transaction." Namely, before the financial crisis derivatives transactions were not considered "covered transactions," an exception that, according to some, ultimately had disastrous consequences.¹⁴⁴ Although the Federal Reserve initially justified the exception by pointing to the funding benefits that it would bring for large, complex, interconnected organizations,¹⁴⁵ many have argued that the

[https://www.federalreserve.gov/boarddocs/press/bcreg/2002/20021127/default.htm#:~:text=FRB%3A%20Press%20Release%20%2D%2D%20Finnal,Affiliates\)%20%2D%2D%20November%2027%2C%202002&text=The%20Federal%20Reserve%20Board%20on,of%20the%20Federal%20Reserve%20Act](https://www.federalreserve.gov/boarddocs/press/bcreg/2002/20021127/default.htm#:~:text=FRB%3A%20Press%20Release%20%2D%2D%20Finnal,Affiliates)%20%2D%2D%20November%2027%2C%202002&text=The%20Federal%20Reserve%20Board%20on,of%20the%20Federal%20Reserve%20Act) [https://perma.cc/3QZM-CGEM].

¹⁴⁰ See General Provisions of Section 23A, 12 C.F.R. § 223.11–12 (2020).

¹⁴¹ See MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW AND POLICY 226 (2016).

¹⁴² See 12 C.F.R. § 223.11–12.

¹⁴³ See Veryl Victoria Miles, *Banking Affiliate Regulation Under Section 23A of the Federal Reserve Act*, 105 BANKING L.J. 476, 490–93 (1988); Omarova, *supra* note 75, at 1692–1702.

¹⁴⁴ See Omarova, *supra* note 75, at 1698–1700.

¹⁴⁵ See Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. 76,560, 76,587 (Dec. 12, 2002) (codified as amended at 12 C.F.R. pt. 223).

exception contributed to the undercapitalization of large banks in the most recent financial crisis.¹⁴⁶ Indeed, because many Regulation W waivers were granted by regulators during the financial crisis to allow institutions to provide emergency liquidity to their global affiliates,¹⁴⁷ policymakers prioritized changes to the regulation in their drafting of Dodd-Frank.¹⁴⁸

The elimination of the derivatives exception¹⁴⁹ has resulted in a dramatic disruption of FBOs' funding strategies. Intra-company derivatives transactions are extremely important liquidity risk management tools for financial institutions, and have historically afforded large financial institutions, particularly those with complex legal entity structures, the ability to hedge risks and absorb liquidity shocks across their organizations.¹⁵⁰ Now that the exemption has been eliminated and intracompany derivatives transactions are limited by the ten percent and twenty percent limits of Regulation W, some commentators have noted that banks' ability to manage their risks is "totally change[d]."¹⁵¹ Further, others have shared concerns that the elimination of the exception undermines

¹⁴⁶ See Omarova, *supra* note 75, at 1727–28; Letter from Sen. Bob. Casey to Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve (Oct. 27, 2011), <https://www.casey.senate.gov/newsroom/releases/casey-to-federal-bank-regulators-must-ensure-risky-behavior-by-banks-does-not-threaten-taxpayers> [<https://perma.cc/Y5LE-KFMD>].

¹⁴⁷ See Omarova, *supra* note 75, at 1769–70; BARR ET AL., *supra* note 141, at 228.

¹⁴⁸ See BARR ET AL., *supra* note 141, at 228.

¹⁴⁹ Note that only derivative transactions that create a "credit exposure to the affiliate" are included as covered transactions. See 12 U.S.C. § 371c(b)(7)(G) (2018).

¹⁵⁰ See Patrick D. Morris, Comment, *Hedging with "Financial Weapons of Mass Destruction": Cleaning Up the Fallout of Treating All Derivative Transactions Between Bank Affiliates the Same*, 22 N.C. BANKING INST. 381, 383 (2018); *The Dodd-Frank Act's Impact on Affiliate Transactions*, CADWALADER (Apr. 21, 2011), <https://www.cadwalader.com/resources/clients-friends-memos/the-dodd-frank-acts-impact-on-affiliate-transactions> [<https://perma.cc/5QXX-GRFB>].

¹⁵¹ Stacey Kaper, *Obscure Provision in Reg Reform May Have Big Impact*, AM. BANKER (Mar. 5, 2010), <https://www.americanbanker.com/news/obscure-provision-in-reg-reform-may-have-big-impact-ab1015477> [<https://perma.cc/7VVW-EVV3>].

global financial stability as complex banking organizations, rather than relying on intracompany derivatives to hedge their risks, are now forced to rely on third parties, ultimately increasing the interconnectedness of the financial system.¹⁵²

Amending the definition of “covered transactions” was not the only impactful change Dodd-Frank made to Regulation W. Indeed, the statute also tackled the financial subsidiary exemption, a provision that was initially promulgated under the Gramm-Leach-Bliley Act.¹⁵³ Although financial subsidiaries have always been included as “affiliates” for purposes of Regulation W,¹⁵⁴ prior to Dodd-Frank’s enactment they were excluded from some of the regulation’s requirements.¹⁵⁵ Specifically, “the aggregate amount of covered transactions between a bank and any one financial subsidiary . . . was not limited to 10% of the bank’s capital and surplus, and the retained earnings of a financial subsidiary were excluded in calculating the bank’s investment in the financial subsidiary (which is a covered transaction).”¹⁵⁶ Section 609 of Dodd-Frank eliminated this exemption and brought financial subsidiaries fully within the boundaries of Regulation W,¹⁵⁷ a change that many have criticized as “limit[ing] the expansion of any financial subsidiary of a bank.”¹⁵⁸

¹⁵² See *id.* See also Morris, *supra* note 150, at 396–97.

¹⁵³ See Gramm-Leach-Bliley Act, Pub. L. No. 106-102, § 5136A(b), 113 Stat. 1338, 1373 (1999). See also Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. 76,560 (Dec. 12, 2002) (codified as amended at 12 C.F.R. pt. 223). “Financial subsidiary” is defined under Regulation W to mean “any subsidiary of a national or state bank that engage[s] in an activity that a national bank is not permitted to engage in directly or that is conducted under terms that differ from those that govern the conduct of the activity by national banks.” Robert E. Mannion & Tengfei (Harry) Wu, *Transactions Between Foreign Banks and Affiliated Entities*, in REGULATION OF FOREIGN BANKS & AFFILIATES 783, 804 (Randall D. Guynn ed., 9th ed. 2016).

¹⁵⁴ See Mannion & Wu, *supra* note 153, at 805.

¹⁵⁵ See *id.*

¹⁵⁶ *Id.*

¹⁵⁷ See Dodd-Frank Act, Pub. L. No. 111-203, § 609(a), 124 Stat. 1376, 1611 (2010) (codified at 12 U.S.C. § 371c(e) (2018)).

¹⁵⁸ Mannion & Wu, *supra* note 153, at 805. See also Douglas Landy et al., *Looking Back While Forging Ahead: What the History of Restrictions on*

It's worth describing, before discussing FBOs' CCAR results and their implications, the enormous impact the financial subsidiary exemption had on complex banking organizations' liquidity risk management. We begin with describing the basic funding strategy of FBOs prior to Dodd-Frank's enactment. In the pre-crisis period banking organizations were able to funnel liquidity in the form of retained earnings from a profitable financial subsidiary (like their U.S. broker-dealer, for example) to an entity that, because of the nature of its business, is relatively illiquid.¹⁵⁹ FBOs have made particular use of this funding strategy, which in the most recent financial crisis resulted in their relatively efficient absorption of liquidity shocks globally.¹⁶⁰ Further, FBOs' relatively efficient liquidity risk management in 2007–2008 allowed them to support their legal entities operating in struggling economic regions more effectively during the crisis.¹⁶¹ It is difficult to overstate how central this role of FBOs is for global financial

Bank Affiliate Transactions May Tell Us About the Impact of the Dodd-Frank Changes, 128 BANKING L.J. 588, 596 (2010).

¹⁵⁹ See BASEL COMM. ON BANKING SUPERVISION ET AL., THE MANAGEMENT OF LIQUIDITY RISK IN FINANCIAL GROUPS 3 (2006).

¹⁶⁰ See Daniel Belton et al., *Foreign Banks, Liquidity Shocks, and Credit Stability* (Bank for Int'l Settlements, Working Paper No. 845, 2020), <https://www.bis.org/publ/work845.pdf> [<https://perma.cc/SU64-4JNY>]. To be clear, emphasis should be put on the word “relatively” in this sentence. FBOs, like their domestic counterparts, struggled to manage liquidity shocks during the crisis; however there is a plethora of empirical evidence showing that their support of their global entities was more robust than that observed by similarly large U.S.-headquartered institutions. See Daniel E. Nolle, *Foreign-Owned Banks: (Way) Underestimated—and Volatile—Participants in the U.S. Banking Market*, 1 J. FIN. PERSP. 1, 7–14 (2013); Cornelia Düwel & Rainer Frey, *Competition for Internal Funds Within Multinational Banks: Foreign Affiliate Lending in the Crisis* 3 (Deutsche Bundesbank, Paper No. 19/2012, 2012), <https://www.bundesbank.de/resource/blob/618122/eb854427cb6625a2178a45ff5184d26b/mL/2012-08-28-dkp-19-data.pdf> [<https://perma.cc/3T9E-D2YU>].

¹⁶¹ See, e.g., Nicola Cetorelli & Linda S. Goldberg, *Banking Globalization and Monetary Transmission*, 67 J. FIN. 1811 (2012); Giorgia Barboni, *Foreign Banks as Shock Absorbers in the Financial Crisis?* (Nat'l Bank of Belg., Working Paper No. 322, 2017), <https://www.nbb.be/doc/oc/repec/reswpp/wp322en.pdf> [<https://perma.cc/Q67D-G5FA>]. See also *supra* note 118 and accompanying text.

stability. That is, large FBOs often serve as critical stabilizing forces in economies with less developed banking systems, which in many cases prevents a broadscale contraction of credit in vulnerable regions.¹⁶² Without their presence, developing economies around the world would be left significantly more vulnerable to economic crises, which, based on the interconnectedness of the global financial system, have historically proven capable of starting a global domino effect.¹⁶³

Now, with the elimination of the financial subsidiary exemption, complex banking organizations have lost control over how they manage their liquid assets. Including financial subsidiaries' retained earnings in the revised definition of "covered transactions" forces FBOs to either transmit a percentage of the earnings of its U.S. financial subsidiaries to the IHC parent, or to reduce its intracompany transactions in some other way. In other words, "[a]s the retained earnings of a financial subsidiary increases, the value of the parent bank's investment in the financial subsidiary increases."¹⁶⁴ To illustrate, consider an organization similar to that presented in Figure 2. In that case, the IHC's investment in its U.S. broker-dealer will increase to a level over ten percent "[u]nless the growth of the [IHC's] capital and surplus attributable to other business activities of the [IHC] outpaces that attributable to the financial subsidiary."¹⁶⁵ This outcome, that the growth of the IHC's banking business will outpace the growth of its financial subsidiaries, is extremely unlikely as virtually all of the business of the IHCs is conducted through their financial

¹⁶² See Barboni, *supra* note 161, at 7; B. Gerard Dages et al., *Foreign and Domestic Bank Participation in Emerging Markets: Lessons from Mexico and Argentina*, FRBNY ECON. POL'Y REV., Sept. 2000, at 17, 21.

¹⁶³ See Simon Romero, *The Markets: Market Place; An Argentine 'Domino Effect' on Brazilian Stocks*, N.Y. TIMES (May 25, 1999), <https://www.nytimes.com/1999/05/25/business/the-markets-market-place-an-argentine-domino-effect-on-brazilian-stocks.html> [<https://perma.cc/GCX3-B3FY>]; David Faber, *The Domino Effect of Greece*, CNBC (Apr. 22, 2010), <https://www.cnbc.com/2010/04/22/the-domino-effect-of-greece.html> [<https://perma.cc/5CZ4-ZR2W>].

¹⁶⁴ Mannion & Wu, *supra* note 153, at 805.

¹⁶⁵ *Id.*

subsidiaries.¹⁶⁶ Thus, because IHCs' banking businesses will likely not be able to keep pace with the growth of their financial subsidiaries, every subsidiary whose growth threatens to push an IHC over the ten percent single affiliate limit "will have to pay out at least some of its net income to the parent bank as dividends instead of reinvesting all of it in the expansion of the financial subsidiary."¹⁶⁷ Given the number of financial subsidiaries observed in Figure 2, and the fact that the retained earnings of *every one* will now count toward an IHC's twenty percent intracompany transaction limit, it is likely that liquid capital will be unnecessarily remitted back to the IHCs. Recall that any retained earnings that are not so remitted will be counted toward the ten percent and twenty percent limits of Regulation W. Additionally, any remittance the IHC attempts to make back to its U.S. financial subsidiaries (or any of its subsidiaries globally) will be subject to the ten percent single affiliate and twenty percent aggregate limits of Regulation W. As noted earlier, this outcome serves not only to deprive liquid capital from global affiliates of FBOs, but it also puts U.S. financial subsidiaries at risk. Thus, the interaction between Regulation W and Regulation YY results in capital being unnecessarily herded to one parent legal entity in the United States, however that parent's ability to support its subsidiaries, in the U.S. and around the world, is significantly cabined.

It is predictable, then, that the elimination of the financial subsidiary exemption has resulted in FBOs winding down a significant amount of the business they conduct in the United

¹⁶⁶ See, e.g., Barclays US LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) 2 (Feb. 28, 2019); Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) 2 (Mar. 31, 2020); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) 2 (Feb. 14, 2019); DB USA Corp., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) 2 (Feb. 14, 2019). Note that the extent of reliance on financial subsidiaries varies by IHC. See TD Group US Holdings LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) 2 (Feb. 12, 2019).

¹⁶⁷ Mannion & Wu, *supra* note 153, at 805.

States.¹⁶⁸ Beyond the economic implications of this trend in the U.S., FBOs now do not have the excess liquidity to spare to direct to targeted entities in times of stress. This reality, a problem of U.S. regulators' own creation, poses a significant and meaningful threat to global financial stability.¹⁶⁹

III. THE IMPACT OF REGULATION YY AND REGULATION W ON IHC CAPITAL

To evaluate the efficacy of Regulation YY, specifically when coupled with the recent changes to Regulation W, we now turn to the 2018 CCAR filings of the IHCs. As a level set, as of 2018 there were twelve IHCs, reflected along with their total U.S. consolidated asset size in Table 1.¹⁷⁰ Throughout this empirical analysis, we will largely consider the IHCs together as a means to categorically compare them to the domestic financial institutions subject to CCAR.¹⁷¹ However, it is important to keep in mind the intrinsic differences in the strategies and business models of the individual firms. To highlight this point, and also to specifically exemplify broader thematic takeaways, institution-specific data will be cited throughout this analysis.

¹⁶⁸ See Noonan, *supra* note 126.

¹⁶⁹ See *Examining Capital Regimes for Financial Institutions: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 115th Cong. 84–100 (statement of Keith A. Noreika, Partner, Simpson, Thacher, & Bartlett).

¹⁷⁰ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., COMPREHENSIVE CAPITAL ANALYSIS AND REVIEW 2018: ASSESSMENT FRAMEWORK AND RESULTS (2018), <https://www.federalreserve.gov/publications/files/2018-ccar-assessment-framework-results-20180628.pdf> [<https://perma.cc/JE9N-NW7T>].

¹⁷¹ As of the date of the CCAR 2018 filing, there were twenty-three domestic filers. *See id.*

Table 1: List of IHCs¹⁷²

Institution Name	U.S. Consolidated Assets Q417 (\$bn)	U.S. Consolidated Assets Q418 (\$bn)
Toronto Dominion	378	382
HSBC	273	272
Credit Suisse	228	134
Barclays	192	172
Deutsche Bank	159	137
UBS	147	137
BNP Paribas	145	127
MUFG	159	165
RBC	140	N/A ¹⁷³
Santander	130	135
BMO	132	158
BBVA	87	92

A. 2018 CCAR Results

First, to fully understand the CCAR results as they are reported, it is necessary to briefly describe the metrics this analysis will focus on: institutions' Tier 1 capital ratio and Tier 1 leverage ratio. An institution's Tier 1 capital ratio is defined as its Tier 1 capital divided by its total risk weighted assets ("RWAs").¹⁷⁴ The denominator of this equation, risk-weighted assets, is a sum of a bank's assets after they are multiplied by

¹⁷² The data is sourced through the public Consolidated Financial Statements for BHCs (Form FR Y-9C) for each IHC. See *Consolidated Financial Statements for BHCs (FR Y-9C)*, NAT'L INFO. CTR., <https://www.ffiec.gov/NPW> [<https://perma.cc/SM3M-6JGL>] (last visited Apr. 1, 2020).

¹⁷³ There is no data for Royal Bank of Canada's IHC past March of 2018, as RBC undertook a broad reorganization in 2018 and is now not considered to have an "active" IHC. See *RBC USA HoldCo Corporation: History*, NAT'L INFO. CTR., <https://www.ffiec.gov/npw/Institution/Profile/3226762?dt=20160701> [<https://perma.cc/FX86-MVA3>] (last visited Apr. 1, 2020).

¹⁷⁴ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., A USER'S GUIDE FOR THE BANK HOLDING COMPANY PERFORMANCE REPORT 3–66 (2013).

their “risk-weight,” a multiplier-system created to more accurately reflect the risk on an institution’s balance sheet.¹⁷⁵ Institutions’ Tier 1 capital ratios are widely used in the regulatory community to indicate the appropriateness of a firm’s capital planning, given that the measure reflects the size of a firm’s high quality capital stock as a percentage of the risk-adjusted size of its balance sheet.¹⁷⁶ An institution’s Tier 1 leverage ratio, on the other hand, is defined as its Tier 1 capital divided by its average total consolidated assets.¹⁷⁷ This measure, constructed to “measure the extent to which a bank has financed its assets with equity[,]”¹⁷⁸ reflects how reliant an institution is on external debt.¹⁷⁹ A certain degree of reliance on external debt is important to the healthy functioning of the financial system, however if banking organizations are too overleveraged liquidity and credit crises can result.¹⁸⁰

These two metrics have been heralded by both U.S. and global regulators as being the most accurate high-level

¹⁷⁵ See John Walter, *US Bank Capital Regulation: History and Changes Since the Financial Crisis*, 105 *ECON. Q.* 1, 10–11 (2019).

¹⁷⁶ See *Risk-Based Capital Ratios at US Banks*, FED. RES. BANK OF CLEVELAND (Dec. 9, 2013), <https://www.clevelandfed.org/en/newsroom-and-events/publications/economic-trends/2013-economic-trends/et-20131209-risk-based-capital-ratios-at-us-banks.aspx#:~:text=Tier%2D1%20risk%20based%20capital,to%20its%20risk%2Dweighted%20assets.&text=Regulators%20consider%20banks%20well%2Dcapitalized,at%202%20percent%20or%20below> [https://perma.cc/3749-SJ7M].

¹⁷⁷ See Minimum Capital Requirements, 12 C.F.R. § 217.10(b)(4) (2020).

¹⁷⁸ See Stefan Ingves, Chairman, Basel Comm. on Banking Supervision, Keynote Address at the Asia-Pacific High-Level Meeting on Banking Supervision: Banking on Leverage (Feb. 27, 2014), <https://www.bis.org/speeches/sp140226.pdf> [https://perma.cc/57UY-7D96].

¹⁷⁹ See Emiliós Avgouleas, *Bank Leverage Ratios and Financial Stability: A Micro- and Macprudential Perspective* (Levy Econ. Inst. of Bard Coll., Working Paper No. 849, 2015), <https://www.econstor.eu/bitstream/10419/146977/1/840973446.pdf> [https://perma.cc/A3WD-R5MK] (“Banks typically leverage themselves by borrowing to acquire more assets, with the aim of increasing their return on equity. Economic leverage means that a bank is exposed to a change in the value of a position by an amount that exceeds what the bank paid for it.”).

¹⁸⁰ See *id.* at 5–6.

summaries of complex financial institutions' safety and soundness.¹⁸¹ Although academics have a variety of conceptions as to what constitutes financial stability,¹⁸² it is universally agreed that high capital ratios are a prudent buffer against risk taking.¹⁸³

¹⁸¹ See, e.g., Martin J. Gruenberg, Member, Bd. of Dirs., Fed. Deposit Ins. Corp., Remarks at the Peterson Institute for International Economics: An Essential Post-Crisis Reform Should Not Be Weakened (Sept. 6, 2018), <https://www.fdic.gov/news/speeches/spsep0618.html> [<https://perma.cc/5XDM-FGFF>]; Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the 2016 Financial Stability Conference: Financial Regulation Since the Crisis 7–9 (Dec. 2, 2016), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20161202a.pdf> [<https://perma.cc/6D5G-FGM3>].

¹⁸² See Hilary J. Allen, *What is "Financial Stability"?* *The Need for Some Common Language in International Financial Regulation*, 45 GEO. J. INT'L L. 929, 941–51 (2015); William A. Allen & Geoffrey Wood, *Defining and Achieving Financial Stability*, 2 J. FIN. STABILITY 152–53 (2006).

¹⁸³ See *Examining Capital Regimes for Financial Institutions: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, *supra* note 169, at 2. However, there is some disagreement about how high is too high. See BPI Staff, *Former Fed Gov. Daniel Tarullo's Misplaced Calls for Higher Capital Requirements*, BANK POL'Y INST. (May 22, 2019), <https://bpi.com/former-fed-gov-daniel-tarulllos-misplaced-calls-for-higher-capital-requirements/> [<https://perma.cc/8ZVS-VMAQ>]; Jaime Caruana, Address at IESE Business School: How Much Capital is Enough? (Nov. 26, 2014), <https://www.bis.org/speeches/sp141216.pdf> [<https://perma.cc/4LLQ-7JZ5>].

Table 2: 2018 CCAR Summary Statistics¹⁸⁴

	Tier 1 Capital (Adverse)	Tier 1 Capital (Severely Adverse)	Tier 1 Leverage (Adverse)	Tier 1 Leverage (Severely Adverse)
Domes- tics	9.48%	7.12%	6.67%	5.08%
IHCs	14.83%	12.85%	7.84%	6.68%

Clearly, as illustrated by Table 2, the 2018 quantitative CCAR results are dramatic, with the IHCs holding capital at levels well above that required by regulators, and at significantly higher levels than their peer firms headquartered in the United States. However, the capital retained by the IHCs, while relatively high as a percentage of their risk-weighted assets, is not relatively high as a percentage of their total consolidated assets. These results suggest that, although the IHCs hold significantly more high-quality capital on their balance sheets as a percentage of the risk they take, they are just as reliant on external debt as the Domestics. This finding is consistent with the reports that FBOs have wound down much of their U.S. operations in preparing for IHC reorganization.¹⁸⁵ That is, based on the financial disclosures of the IHCs outside the CCAR exercise, we can conclude that their relatively high Tier 1 capital ratios likely result from a decrease in IHCs' RWAs. On one hand this may be viewed as a positive trend by regulators, as it implies that FBOs have undergone a significant de-risking in the United States.¹⁸⁶ On the other,

¹⁸⁴ See *CCAR Historical Data: CCAR 2018*, BOARD OF GOVERNORS OF FED. RES. SYS., <https://www.federalreserve.gov/supervisionreg/ccar-2020.htm> [<https://perma.cc/SE24-YTHJ>]. For reference, the Tier 1 Capital and Tier 1 Leverage regulatory minima as of the 2018 and 2019 CCAR filings was six and four percent, respectively. See Minimum Capital Requirements, 12 C.F.R. § 217.10(a)(1) (2020).

¹⁸⁵ See Noonan, *supra* note 126.

¹⁸⁶ See Randal K. Quarles, Vice Chair for Supervision, Bd. of Governors of the Fed. Reserve Sys., Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision 8 (Jan. 17, 2020),

however, this trend also signals that the IHCs are maintaining unduly large stocks of high-quality capital stagnantly on their balance sheets. In other words, we can conclude that FBOs are not using their stock of high-quality capital in the U.S. to fund their activities; the capital is instead left “trapped” at extremely high levels in their IHCs.¹⁸⁷ This development lends support to the analysis of Regulation W offered in Section II.C. However, there is another statistical point relevant to note from the 2018 CCAR exercise that further illustrates the impact of Regulation W on the IHCs’ capital ratios. That is the standard deviation of the IHCs’ results, depicted in Table 3 below.

<https://www.federalreserve.gov/newsevents/speech/files/quarles20200117a.pdf>
[<https://perma.cc/Z3CT-ASW9>].

¹⁸⁷ See, e.g., Lionel Laurent, Opinion, *Trapped Capital Ails Global Banks*, BLOOMBERG (Nov. 28, 2016), <https://www.bloomberg.com/opinion/articles/2016-11-28/global-banks-face-a-nasty-case-of-trapped-capital?sref=m42vRBnI> [<https://perma.cc/2WB7-MQDX>]; Lawrence White, *HSBC Walks U.S. Regulatory Tightrope Over \$10 Billion of ‘Trapped’ Capital*, REUTERS (Sept. 23, 2016), <https://uk.reuters.com/article/uk-hsbc-capital-idUKKCN11T0W7> [<https://perma.cc/NM75-P3Q2>] (“HSBC . . . has more than \$20 billion [] of capital in the United States earning a slim 1 percent return, of which up to half could be returned to the holding company via asset sales, analysts and investors say. The bank’s investors are currently missing out on higher profits and more secure dividends as a result of this hefty U.S. balance sheet. The bank earns a return on equity of just 1.4 percent on this, compared with 5 percent for HSBC globally and 13 percent for major U.S. commercial bank rivals . . .”).

Table 3: 2018 CCAR Standard Deviations¹⁸⁸

	σ Tier 1 Capital (Adverse)	σ Tier 1 Capital (Severely Adverse)	σ Tier 1 Leverage (Adverse)	σ Tier 1 Leverage (Severely Adverse)
Domes- tics	1.51	1.26	0.78	0.87
IHCs	4.26	4.63	1.91	1.83

The extremely high standard deviation observed in the IHCs' Tier 1 capital results is largely a function of three IHCs holding extremely high levels of capital: Credit Suisse, Deutsche Bank, and UBS.¹⁸⁹ Each of these institutions' Tier 1 capital ratio was above 22.8% under the adverse stress scenario created by the Federal Reserve, nearly eight percent higher than the IHC average,¹⁹⁰ and nearly seventeen percent higher than the regulatory minimum.¹⁹¹ These three institutions are widely considered to be three of the four most systemically important FBOs operating in the United States due to their involvement in U.S. capital markets.¹⁹² It is all the

¹⁸⁸ See *CCAR Historical Data: CCAR 2018*, *supra* note 184.

¹⁸⁹ See *id.*

¹⁹⁰ See *id.* As of the 2018 CCAR filing date each of these institutions was included in the Federal Reserve's Large Institution Supervision Coordinating Committee ("LISCC") portfolio. Just recently, following a reorganization that resulted in "the substantial and sustained decrease in risk from [] U.S. operations" UBS was taken out of the portfolio. See Press Release, Meghan Milloy, IIB Statement on the Federal Reserve's Announcement re: the LISCC Portfolio (Mar. 6, 2020), https://cdn.ymaws.com/www.iib.org/resource/resmgr/website_press/20200306Fed.LISCC.Statement.pdf [<https://perma.cc/GWV7-MC92>]. However, UBS remains as a "globally systemically important bank" ("G-SIB") as designated by the Financial Stability Board. FIN. STABILITY BD., 2019 LIST OF GLOBAL SYSTEMICALLY IMPORTANT BANKS (G-SIBS) 3 (2019), <https://www.fsb.org/wp-content/uploads/P221119-1.pdf> [<https://perma.cc/4SAF-GMTW>].

¹⁹¹ See Minimum Capital Requirements, 12 C.F.R. § 217.10(a)(1) (2020).

¹⁹² See Burke Speaker, *Fed Risk List: 15 Firms That Pose Risk to U.S. Financial Stability*, INV. PLACE (May 2, 2014),

more important, then, to explore these unusual results as they likely have had, and will continue to have, important economic implications in the United States.

B. 2019 CCAR Results

We now turn to 2019's CCAR exercise which, as a result of the threshold changes introduced by the EGRRCPA, had only eighteen filers.¹⁹³ As we would expect, the results from the 2019 exercise are similar, but even more stark, than those of the 2018 exercise.

Table 4: 2019 CCAR Summary Statistics¹⁹⁴

	Tier 1 Capital (Adverse)	Tier 1 Capital (Severely Adverse)	Tier 1 Leverage (Adverse)	Tier 1 Leverage (Severely Adverse)
Domes- tics	10.87%	8.55%	6.78%	5.25%
IHCs	18.23%	15.77%	7.9%	6.7%

<https://investorplace.com/2014/05/fed-risk-list-15-firms-risk-us-financial-stability/> [<https://perma.cc/X9KP-NQFM>]. The fourth is Barclays, whose 2018 Tier 1 capital and leverage ratios were in line with the IHC mean. See *CCAR Historical Data: CCAR 2018*, *supra* note 184.

¹⁹³ See BD. OF GOVERNORS OF FED. RESERVE SYS., COMPREHENSIVE CAPITAL ANALYSIS AND REVIEW 2019: ASSESSMENT FRAMEWORK AND RESULTS (2019), <https://www.federalreserve.gov/publications/files/2019-ccar-assessment-framework-results-20190627.pdf> [<https://perma.cc/X64F-TKEK>]. Of the eighteen filers, six were FBOs. They were Barclays, Credit Suisse, Deutsche Bank, HSBC, Toronto Dominion, and UBS. See *id.*

¹⁹⁴ See *CCAR Historical Data: CCAR 2019*, BOARD OF GOVERNORS OF FED. RES. SYS., <https://www.federalreserve.gov/supervisionreg/ccar-2020.htm> [<https://perma.cc/SE24-YTHJ>].

Table 5: 2019 CCAR Standard Deviations¹⁹⁵

	σ Tier 1 Capital (Adverse)	σ Tier 1 Capital (Severely Adverse)	σ Tier 1 Leverage (Adverse)	σ Tier 1 Leverage (Severely Adverse)
Domes- tics	1.43	1.77	1.51	0.85
IHCs	5.59	5.47	1.07	1.09

These results suggest that the same trends described above continue through to today. In 2019, again, the three FBOs previously discussed were those that held Tier 1 capital at levels well above their IHC peers, resulting in a very high IHC Tier 1 standard deviation.¹⁹⁶ Thus, despite the inefficiencies that result from holding high-quality capital at such levels,¹⁹⁷ it appears that those FBOs with large U.S. broker dealers *cannot* redirect their excess capital to their other global legal entities. This is the result we would expect following the elimination of Regulation W's financial subsidiary exemption. That is, because the ten percent single affiliate and twenty percent aggregate annual limits now apply to IHCs' investment in their financial subsidiaries (which includes the subsidiaries' retained earnings), it follows that the institutions are, with every passing year, building up more and more capital at the IHC level. This relationship between IHCs' financial subsidiaries and their stock of high-quality capital will continue to exist as long as the growth of their financial subsidiaries "outpaces that attributable to . . . the parent."¹⁹⁸ This clearly explains why the IHCs have dramatically reduced the size of their U.S. operations in recent years, and has been

¹⁹⁵ *See id.*

¹⁹⁶ *See CCAR Historical Data: CCAR 2019, supra* note 194.

¹⁹⁷ *See Noonan, supra* note 126.

¹⁹⁸ *See Mannion & Wu, supra* note 153, at 805.

reported by several journalists as being the driving force behind the IHCs' de-risking.¹⁹⁹

It seems as though these three firms themselves have also recognized Regulation W's role in trapping capital in their IHCs. Industry groups that represent Deutsche Bank, Credit Suisse, and UBS have made public statements addressing the high levels of Tier 1 capital maintained by the IHCs, noting that the requirements of Regulation W have "trap[ped] liquidity in the United States that could potentially be deployed more effectively elsewhere."²⁰⁰ Other industry trade associations have also weighed in on the development, with the Bank Policy Institute noting that FBOs' high capital ratios "undermine the resiliency of the global financial system."²⁰¹ The Bank Policy Institute went on to offer a more detailed analysis of the complications associated with misallocation risk, noting that:

Applying full requirements in the host jurisdiction . . . effectively increases consolidated requirements for the FBO because of the requisite high degree of pre-positioning in host jurisdictions and the lack of flexibility to deploy resources throughout the organization. If

¹⁹⁹ See Noonan, *supra* note 126; Yalman Onaran, *European Banks Spend Billions to Get U.S. Unites Fit for Fed*, BLOOMBERG (June 29, 2016), <https://www.bloomberg.com/news/articles/2016-06-29/european-banks-spend-billions-to-get-u-s-units-fit-for-the-fed?sref=m42vRBnI> [<https://perma.cc/RY8A-6UW3>]. See also Kreicher & McCauley, *supra* note 126, at 10.

²⁰⁰ See Institute of International Bankers, Comment Letter on Proposed Rule to Revise Prudential Standards for Large Foreign Banking Organizations 22 (June 21, 2019), https://cdn.ymaws.com/www.iib.org/resource/resmgr/2019_frb_tailoring_proposal/PDFFINALFBOTailoringLetter06.pdf [<https://perma.cc/Q3E5-UAP6>]. See also *Briget Polichene, CEO, Institute of International Bankers: View From IMF 2019*, BANKER (Oct. 19, 2019), <https://www.thebanker.com/video/v/6096039756001/briget-polichene-ceo-institute-of-international-bankers-view-from-imf-2019> [<https://perma.cc/N4F6-8G3U>].

²⁰¹ Bank Policy Institute & American Bankers Association, Comment Letter on Proposed Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations 32 (June 21, 2019), <https://www.fdic.gov/regulations/laws/federal/2019/2019-changes-to-applicability-thresholds-3064-ae96-c-018.pdf> [<https://perma.cc/6MRV-TUQG>].

many, much less all, host authorities were to act independently to require full pre-positioning in their own jurisdictions, this would exacerbate the problem of depleting available resources at the top of the group and would thereby limit the group's ability to allocate resources efficiently and, during stress, to deploy resources where actually needed.²⁰²

Global regulators have also chimed in on this point. In a recent report the Financial Stability Board (“the FSB”) noted that “[t]he domestic requirements that were adopted in some jurisdictions (e.g. subsidiarisation requirements, requirements to establish intermediate holding companies, high-levels of pre-positioning requirements) tend to favo[r] domestic activities and trap resources at local levels.”²⁰³ The statements of the FSB reflect a growing consensus among regulators that subpart O of Regulation YY and the revised Regulation W undermine one of the key pillars of the post-crisis global regulatory regime: improving the resolvability of complex financial institutions.²⁰⁴ Thus, the problems identified in the 2018 and 2019 CCAR results are consistent with the Regulation W analysis offered in Section II.C, the shrinking balance sheets of the IHCs, the statements of the FBOs themselves, and, increasingly, the perspective of both U.S. and global regulators. Indeed, regulators’ recognition of the complications associated with Regulation YY has already led to some changes in the IHC regulatory framework,²⁰⁵ however the most important provisions of the regulation have yet to be addressed.

²⁰² *Id.* at 11–12.

²⁰³ FIN. STABILITY BD., FSB REPORT ON MARKET FRAGMENTATION 48 (2019), <https://www.fsb.org/wp-content/uploads/P040619-2.pdf> [<https://perma.cc/P259-5JKV>].

²⁰⁴ See Randal K. Quarles, Vice Chairman for Supervision, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Harvard Law School Program on International Finance Symposium: Trust Everyone—But Brand Your Cattle (May 16, 2018), <https://www.bis.org/review/r180522a.pdf> [<https://perma.cc/4GV5-E9CQ>].

²⁰⁵ See Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59,230 (Nov. 1, 2019) (to be codified at 12 C.F.R. pts 3, 50, 217, 249, 324 and 329); Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59,970 (proposed Nov. 7, 2019) (to be codified at 12 C.F.R. pts 45, 237, 349, 624, and 1221).

IV. PROPOSED AMENDMENTS TO REGULATION W

It goes without saying that the money, time, and political capital spent to establish the IHC framework in the United States make its repeal implausible. However, there are small, meaningful changes that can be made to Regulation W to lighten the burden on FBOs and, more importantly, improve the stability of the global financial system.

We begin with the first provision of Regulation W discussed in Section II.C—the elimination of the derivatives exception. Recall that the elimination of that exception revised the definition of “covered transactions” under Regulation W to include derivatives transactions.²⁰⁶ This change was highly controversial, with some academics arguing that the change “was a mistake by Congress.”²⁰⁷ Critics of the exception’s elimination point to the liquidity risk management benefits associated with intracompany derivatives transactions²⁰⁸ and the systemic risk created by forcing complex financial institutions to rely on third parties to execute their hedging strategies.²⁰⁹ Indeed, one commentator went as far as to say that the elimination of the exception “had nothing to do with the crisis and [it] . . . diminish[es] the ability of affiliated companies to manage risk on a consolidated basis and . . . exacerbate[s] interconnectivity among unaffiliated financial institutions.”²¹⁰

However, while intracompany derivatives transactions do play an important role in complex financial institutions’ funding strategies, they also are associated with a significant degree of credit risk. That is, in the words of Professor Omarova, the derivatives exception, when in effect, “opened up a nearly unlimited channel for . . . extensions of credit.”²¹¹ The experience of U.S. regulators in the financial crisis exposed the significant risks these extensions of credit pose to the U.S.

²⁰⁶ See Dodd-Frank Act, Pub. L. No. 111-203, § 610, 124 Stat. 1376, 1611 (2010) (codified as amended at 12 U.S.C. § 84(b) (2018)).

²⁰⁷ Morris, *supra* note 150, at 393.

²⁰⁸ See *id.* at 393–96; Kaper, *supra* note 151.

²⁰⁹ See Morris, *supra* note 150, at 396–97; Kaper, *supra* note 151.

²¹⁰ Kaper, *supra* note 151.

²¹¹ Omarova, *supra* note 75, at 1690.

financial system. To illustrate these risks, we turn to the example of American Insurance Group, Inc. (“AIG”), a financial institution that nearly failed during the crisis.²¹² AIG is an insurance company that was a major player in the credit default swap (“CDS”) market leading up to the financial crisis.²¹³ As subprime bonds began to default in 2008 and CDS contracts became due, AIG was left with a shortfall.²¹⁴ Complicating this position, AIG executed most of its CDS contracts, not through its parent entity, but through a subsidiary, AIG Financial Products (“AIGFP”).²¹⁵ This organizational strategy is important for several reasons—first, because it allowed AIG to largely conceal its CDS activity from regulators,²¹⁶ and second, because it resulted in massive intracompany derivatives transactions emanating from the AIGFP entity.²¹⁷ This intracompany derivatives exposure led to what one government official called a “house of cards,”²¹⁸ and made AIGFP critical to the survival of AIG, and the U.S. financial system more

²¹² See David Goldman, *AIG Bailout: \$127.7B and Counting*, CNN (Dec. 30, 2008), <https://money.cnn.com/2008/12/29/news/companies/aig/index.htm> [<https://perma.cc/4NNF-FEWJ>].

²¹³ See Adam Davidson, *How AIG Fell Apart*, REUTERS (Sept. 18, 2008), <https://www.reuters.com/article/us-how-aig-fell-apart/how-aig-fell-apart-idUSMAR85972720080918> [<https://perma.cc/GPV6-S4X2>]. Credit default swaps are financial instruments that “insure” against the risk of a security issuer going bankrupt. Credit default swaps are derivative instruments, both in practical terms and for Regulation W purposes. See MOORAD CHOUDHRY, AN INTRODUCTION TO CREDIT DERIVATIVES 16 (2004).

²¹⁴ See Davidson, *supra* note 213.

²¹⁵ See *id.*

²¹⁶ See CONG. OVERSIGHT PANEL, THE AIG RESCUE, ITS IMPACT ON MARKETS, AND THE GOVERNMENT’S EXIT STRATEGY 17–18 (2010).

²¹⁷ See *id.* at 40. See also Gary Gensler, Chairman, Commodity Futures Trading Comm’n, Keynote Address at the FINRA Annual Conference: Cross-Border Application of Dodd-Frank Swaps Market Reforms (May 21, 2012), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-113> [<https://perma.cc/4PZ5-7YQA>] (describing the interconnectedness between derivatives affiliates and major banking organizations).

²¹⁸ *TARP and Other Government Assistance for AIG: Hearing Before the Cong. Oversight Panel*, 111th Cong. 221–22 (2010) (testimony of Jim Millstein, Chief Restructuring Officer, U.S. Department of the Treasury).

generally.²¹⁹ That is, the failure of AIGFP would not only leave its outside counterparties without the funding they had contracted for, but also would undermine many of its affiliate counterparties, almost certainly leading to the complete collapse of AIG.²²⁰ In the words of one regulator, “[w]hile the downfall of AIG was not caused by inter-affiliate swaps, the events surrounding AIG during the 2008 crisis demonstrate[d] how the risks of uncleared swaps at one affiliate can have significant ramifications for the entire affiliated business group.”²²¹

Thus, despite the protests of critics, there is little doubt that intracompany derivatives transactions post *some* risk to the global financial system, and if left unregulated, may seriously damage the resiliency of systemically important financial institutions. However, before moving on to a solution, we look to a proposal that was recently made by the OCC itself. In November 2019 the OCC issued a Notice of Proposed Rulemaking which, if adopted, would eliminate the initial margin requirements associated with intracompany derivative transactions.²²² By way of background, initial margin (“IM”) in derivatives transactions is a collateral tool that requires a counterparty to post a percentage of the derivative instrument’s value in cash or liquid assets prior to the performance of the contract.²²³ In the context of intracompany derivatives within

²¹⁹ See CONG. OVERSIGHT PANEL, *supra* note 216, at 40; *Economic and Budget Challenges for the Short and Long Term: Hearing Before the S. Comm. on the Budget*, 111th Cong. 27 (2009) (statement of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System).

²²⁰ See CONG. OVERSIGHT PANEL, *supra* note 216, at 40.

²²¹ Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21,750, 21,752 (Apr. 11, 2013) (codified as amended at 17 C.F.R. pt. 50).

²²² Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59,970 (proposed Nov. 7, 2019) (to be codified at 12 C.F.R. pts 45, 237, 349, 624, and 1221).

²²³ See Thomas Hoenig, *Why It’s So Difficult to Amend Inter-Affiliate Margin Rules*, MERCATUS CTR. (Aug. 12, 2019), <https://www.mercatus.org/bridge/commentary/why-so-difficult-amend-inter-affiliate-initial-margin-rules#:~:text=A%20proposal%20currently%20under%20consideration,the%20same%20corporate%20bank%20group> [https://perma.cc/ZF2R-TJC3].

banking organizations, IM resulted in high-quality capital being hoarded at whatever banking legal entity was participating in the intracompany transactions.²²⁴ Still, while the proposal to eliminate IM for intracompany derivatives has been politically controversial,²²⁵ it has largely been welcomed by banking organizations.²²⁶ Additionally, industry commentators have noted that the proposal would unlock \$40 billion in liquidity,²²⁷ a result that would seem to at least partially

²²⁴ See Press Release, Jelena McWilliams, Chairman, Fed. Deposit Ins. Corp., Statement by FDIC Chairman Jelena McWilliams on the Notice of Proposed Rulemaking 1 (Sept. 17, 2019), <https://www.fdic.gov/news/speeches/spsep1719b.pdf> [<https://perma.cc/6AVU-V4FJ>]. See also Letter from Am. Bankers Ass'n, to Jerome Powell, Chairman, Bd. of Governors of the Fed. Reserve Sys. (May 13, 2019), <https://www.sifma.org/wp-content/uploads/2019/05/Joint-Trades-Letter-to-Prudential-Regulators-on-IA-IM-Requirements-dated-May-13-2019.pdf> [<https://perma.cc/Z6PP-JNNX>].

²²⁵ See Press Release, Rep. Maxine Waters, Waters Statement on FDIC Proposal to Eliminate Inter-Affiliate Swaps Initial Margin (Sept. 17, 2019), <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=404339> [<https://perma.cc/6P9M-B5B5>]; Press Release, Sen. Thom Tillis, Tillis Statement on Inter-Affiliate Margin Requirements (Sept. 18, 2019), <https://www.tillis.senate.gov/2019/9/tillis-statement-on-inter-affiliate-margin-requirements> [<https://perma.cc/4CEE-KS2K>].

²²⁶ See American Bankers Association, Comment Letter on Proposed Rules on Margin and Capital Requirements for Covered Swap Entities (Dec. 9, 2019), <https://www.sifma.org/wp-content/uploads/2019/12/Joint-Trade-Associations-Comment-Letter-on-Proposed-Amendments-to-Margin-and-Capital-Requirements-for-Covered-Swap-Entities.pdf> [<https://perma.cc/EZ63-3782>]; International Swaps and Derivatives Association, Inc., Comment Letter on Proposed Rules on Margin and Capital Requirements for Covered Swap Entities (Dec. 9, 2019), https://www.isda.org/a/yUxTE/Final-ISDA_Margin-NPR-Comment-12.9.19.pdf [<https://perma.cc/N869-MQ3F>].

²²⁷ See Lalita Clozel, *Banks Set to Win \$40 Billion in Relief from Post-crisis Rule*, WALL ST. J. (Sept. 17, 2019), <https://www.wsj.com/articles/banks-set-to-win-40-billion-in-relief-from-postcrisis-rule-11568735719> [<https://perma.cc/Y6C7-VCSL>] (reporting that “[a]t the end of 2018, 20 of the largest financial firms had posted \$39.4 billion of initial margin for transactions between affiliates”). See also BASEL COMM. ON BANKING SUPERVISION & BD. OF INT’L ORG. OF SEC. COMM’NS, MARGIN REQUIREMENTS FOR NON-CENTRALLY CLEARED DERIVATIVES 21 (2019), <https://www.bis.org/bcbs/publ/d475.pdf> [<https://perma.cc/JW2M-SX6B>] (“Although current market practices on this point vary, the exchange of initial or variation margin by affiliated parties to a non-centrally cleared

relieve the amount of Tier 1 capital that FBOs are currently holding in their IHCs. Indeed, the Chair of the FDIC herself seemed to endorse this notion in remarking that the NPRM aims to address the presence of “locked up” and “frozen” capital maintained within banking legal entities.²²⁸

Assuming this NPRM is finalized in the coming months, the question still remains as to whether intracompany derivatives should be included as “covered transactions” at all under Regulation W. In considering this question we turn back to the experience of AIG during the financial crisis, and the emphasis regulators have placed on resolution and resolvability in the post-crisis era.²²⁹ Given the role AIG played in the financial crisis and the complications the firm’s intracompany derivatives introduced,²³⁰ it seems that a complete restatement of the derivatives exception would be unwise. The initial margin NPRM aims to address the major issue this Note identified, the excessive pre-positioning of high quality capital in IHC legal entities, and further regulatory rollback that potentially exposes investors to greater risk and undermines U.S. regulators’ goals of orderly resolution is unnecessary and could be counterproductive. Indeed, as the affiliate margin proposal was tailored, several prominent regulators acknowledged that a writ large reintroduction of the exception may introduce financial stability issues,²³¹ a sentiment that

derivative is not customary. Accordingly, extending the initial margin requirements to such transactions would likely create additional liquidity demands for firms engaging in such transactions.”)

²²⁸ See McWilliams, *supra* note 224, at 1.

²²⁹ See Dodd-Frank Act, Pub. L. No. 111-203, §§ 201–17, 124 Stat. 1376, 1442–1520 (2010). See also Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Federal Reserve Bank of Richmond: Toward Building a More Effective Resolution Regime: Progress and Challenges (Oct. 18, 2013), <https://www.federalreserve.gov/newsevents/speech/files/tarullo20131018a.pdf> [<https://perma.cc/84AX-WKP4>].

²³⁰ See CONG. OVERSIGHT PANEL, *supra* note 216, at 119.

²³¹ See Press Release, Bd. of Governors of the Fed. Reserve Sys., Statement by Governor Lael Brainard (Oct. 28, 2019), <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191028.htm> [<https://perma.cc/BUX8-ARRG>]; Press Release, Martin J. Gruenberg, Member, Bd. of Dirs., Fed. Deposit Ins. Corp., Notice of Proposed Rulemaking:

banking organizations themselves appeared to endorse in their collective comment letter on the point.²³² This agreement reflects how far we have come in the ten years since Dodd-Frank’s enactment—although still not agreeing on everything, it seems as though the process of regulatory “tailoring” has been more collaborative than adversarial.

There is still one more provision of Regulation W to address: the financial subsidiary exemption. Recall that when the exemption was in effect, intracompany transactions with financial subsidiaries did not count toward Regulation W’s single affiliate limitation, and, most importantly, “the retained earnings of [] financial subsidiar[ies] were excluded in calculating the bank’s investment in the financial subsidiar[ies] (which is a covered transaction).”²³³ The broader implications of the exemption’s elimination were discussed in Section II.C, however for our purposes here it is enough to note that many have remarked that the elimination will likely result in the forced upstreaming of high-quality capital away from U.S. financial subsidiaries (like U.S. broker-dealers, for example) to the parent IHC.

The financial subsidiary exemption’s elimination is more likely to be driving the 2018 and 2019 IHC CCAR results than the derivative exception’s elimination. That is, while commentators noted that initial margin posted on intracompany derivative transactions drained nearly \$40 billion of liquidity from affected institutions,²³⁴ a review of the IHCs’ FR Y-9LP disclosures reveals that the retained earnings of IHCs’ financial subsidiaries dwarfs that number.²³⁵ For illustrative

Swap Margin Requirements 2 (Sept. 17, 2019), <https://www.fdic.gov/news/speeches/spsep1719.pdf> [<https://perma.cc/AM93-SCBE>].

²³² See American Bankers Association, *supra* note 226, at 3–4.

²³³ See Mannion & Wu, *supra* note 153, at 805.

²³⁴ See Clozel, *supra* note 227.

²³⁵ See Barclays US LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 28, 2019); Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Mar. 31, 2020); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2019); DB USA Corp.,

purposes, again, we turn to the examples of Credit Suisse, Deutsche Bank, and UBS, the three IHCs that held the highest levels of Tier 1 capital in both the 2018 and 2019 CCAR exercises.²³⁶ Each of these institutions received over \$1.5 billion in remittances from their nonbank financial subsidiaries through 2018, with Credit Suisse and UBS receiving over \$2.4 billion each.²³⁷ These remittances amount to between one and two percent of these IHCs' total assets,²³⁸ and thus at least partially account for the elevated capital levels observed in the 2018 and 2019 CCAR results. Based on these disclosures, it appears that, rather than draining their financial subsidiaries of capital through remittances, IHCs are otherwise limiting their intracompany transactions to stay within the bounds of Regulation W's limitations.²³⁹ Further, a review of the IHCs'

Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2019).

²³⁶ See *CCAR Historical Data: CCAR 2018*, *supra* note 184; *CCAR Historical Data: CCAR 2019*, *supra* note 194.

²³⁷ See Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Mar. 31, 2020); Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Mar. 31, 2020); Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Mar. 31, 2020); Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Mar. 31, 2020); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2019); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Nov. 14, 2018); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Aug. 24, 2018); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (May 15, 2018); DB USA Corp., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2019); DB USA Corp., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Nov. 14, 2018); DB USA Corp., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Aug. 24, 2018); DB USA Corp., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (May 15, 2018).

²³⁸ See *supra* Table 1.

²³⁹ See *supra* notes 163–64 and accompanying text.

2019 FR Y-9LP disclosures shows that the IHCs have substantially reduced the amount of activity housed in their financial subsidiaries,²⁴⁰ supporting the reporting done by journalists²⁴¹ and the hypotheses several commentators posed before the exemption's elimination went into effect.²⁴²

It is worth noting, though, that the elimination of the financial subsidiary exemption does not only affect FBOs. However, the importance of the exemption specifically for FBOs relates to the traditional FBO funding model, discussed in Section II.C. That is, because IHCs have reached their Regulation W intracompany transaction limit through their "investment" in their nonbank subsidiaries, they are unable to direct liquidity to their global affiliates around the world.²⁴³ This development may have already proven to seriously undermine global financial stability, as global affiliates of FBOs have struggled significantly during the COVID-19 pandemic.²⁴⁴ Thus, beyond the economic damage trapped capital causes in U.S. capital markets, the elimination of the financial subsidiary exemption also fragments the flow of capital throughout the world, unnecessarily exposing certain regions' financial systems to liquidity stress and potential collapse. For this reason, too, it is crucial that U.S. regulators begin to reconsider the elimination of the exemption to improve the stability of the global financial system.

²⁴⁰ See Credit Suisse Holdings (USA), Inc., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2020); UBS Americas Holding LLC, Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2020); DB USA Corp., Parent Company Only Financial Statements for Large Holding Companies (Form FR Y-9LP) (Feb. 14, 2020).

²⁴¹ See Noonan, *supra* note 126.

²⁴² See Mannion & Wu, *supra* note 153, at 805.

²⁴³ See *supra* notes 158–67 and accompanying text.

²⁴⁴ See Tobias Adrian & Fabio Natalucci, *Covid-19 Worsens Pre-Existing Financial Vulnerabilities*, INT'L MONETARY FUND BLOG (May 22, 2020), <https://blogs.imf.org/2020/05/22/covid-19-worsens-pre-existing-financial-vulnerabilities/> [https://perma.cc/ZW4U-NVXP].

V. CONCLUSION

Ten years later, it is clear that the regulatory rules promulgated under Dodd-Frank have had some unanticipated and consequential effects. Large foreign banks have perhaps been hit the hardest by post-crisis regulations in the United States, collectively spending hundreds of millions of dollars in attempting to achieve compliance.²⁴⁵ Namely, the changes made to Regulation YY and Regulation W have had enormous implications for FBOs' funding models, which has resulted in the hoarding of capital at the IHC legal entity level in the United States. This development has been cited by many as unduly limiting the activity of FBOs and slowing down growth in U.S. capital markets, concerns which have led U.S. regulators to reconsider several post-crisis rules. However, the agencies tasked with overseeing IHC reorganization have maintained that the process has been largely successful, pointing to the performance of the IHCs in the Federal Reserve's CCAR exercise as evidence of their soundness.²⁴⁶

The COVID-19 pandemic is beginning to reveal the short-sightedness of many countries' conception of financial stability. That is, financial stability cannot be ring-fenced—as international banking has grown over the past thirty years so too has the interconnectedness of the financial system. This interconnectedness makes trapped capital and liquidity particularly problematic, as legal entities with less liquid business models often struggle to obtain funding from third party sources during times of crisis. It is safe to say, then, that the elevated levels of capital the IHCs are holding in the U.S. are not benign. As we observed in the AIG case during the last financial crisis, the success of affiliates may dictate the success of parent entities, and during times of crisis regulators

²⁴⁵ See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 9, at 30.

²⁴⁶ See Randal K. Quarles, Vice Chairman for Supervision, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Institute of International Bankers Annual Washington Conference: The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations 4 (Mar. 5, 2018), <https://www.federalreserve.gov/newsevents/speech/files/quarles20180305a.pdf> [<https://perma.cc/532J-YBH4>].

have in the past acknowledged the importance of supporting subsidiaries under stress for exactly this reason. This begs the question—why wait until a crisis hits to allow financial institutions to manage their capital freely across their global organizations? Binding the hands of large, systemically important foreign banking organizations makes all of us less prepared for the next major financial crisis, which indeed, may already be in its beginning stages.