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Diagram 1: Structural Application of Proposed Dodd-Frank Enhanced Prudential Standards to Large FBOs[1]

IHC Requirement

A Large FBO must generally establish a separately capitalized top-tier U.S. intermediate holding company (**IHC**) that would hold **all** U.S. bank and nonbank subsidiaries other than Section 2(h)(2) subsidiaries. **Exception:** The IHC requirement would **not** apply to a Large FBO that has less than $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies).

Large Foreign Banking Organization (FBO)

Primary Regulator:
Home Country Regulator

Applicable U.S. Requirements

In addition to currently applicable U.S. regulations, U.S. branches and agencies of a Large FBO would be subject to liquidity standards, single counterparty credit limits and, in certain circumstances, asset maintenance requirements.

U.S. Branch or Agency*

Primary Regulator:
U.S. Federal Reserve, OCC / State Banking Regulator (depending on license), **and Home Country Regulator**

* A U.S. branch or agency of the Large FBO would **not** be part of the IHC.

Applicable U.S. Requirements

The IHC would be subject to the following U.S. requirements on a consolidated basis:

- U.S. capital rules for BHCs[2]
- Liquidity rules
- Stress testing
- Single counterparty credit limits
- Risk management standards
- Debt-to-equity limits
- Early remediation requirements

Top-Tier U.S. Intermediate Holding Company (IHC)

Primary Regulator:
U.S. Federal Reserve

Other lower-tier U.S. holding companies are omitted from the chart for purposes of simplification

U.S. Broker-Dealer
Primary Regulator: **U.S. SEC**

U.S. Bank
Primary Regulator: **U.S. Federal and/or State Banking Regulators** (depending on charter)

U.S. Insurance Company
Primary Regulator: **U.S. State Regulator**

U.S. Nonbank Lender
Primary Regulator: **U.S. State Regulator**

U.S. Investment Adviser / Commodity Trading Advisor
Primary Regulator: **U.S. SEC / CFTC**

U.S. Swap Dealer / Security-based Swap Dealer
Primary Regulator: **U.S. CFTC / SEC**

U.S. Futures Commission Merchant
Primary Regulator: **U.S. CFTC**

1. Large FBO refers to a foreign banking organization with total **global** consolidated assets of $50 billion or more. Under the Federal Reserve's proposal, the U.S. operations of a Large FBO with combined **U.S.** assets of $50 billion or more must generally meet more stringent enhanced prudential standards.
2. A Davis Polk memorandum on the U.S. banking regulators' proposals to implement Basel III in the United States is available **here**.

Diagram 2: Possible Structure for a Tiered FBO under the Federal Reserve's Proposal

Multiple IHCs

Upon written request by an FBO, the Federal Reserve would consider whether to permit an FBO to establish multiple IHCs or use an alternative organizational structure to hold its combined U.S. operations, if the FBO controls another FBO that has separate U.S. operations.

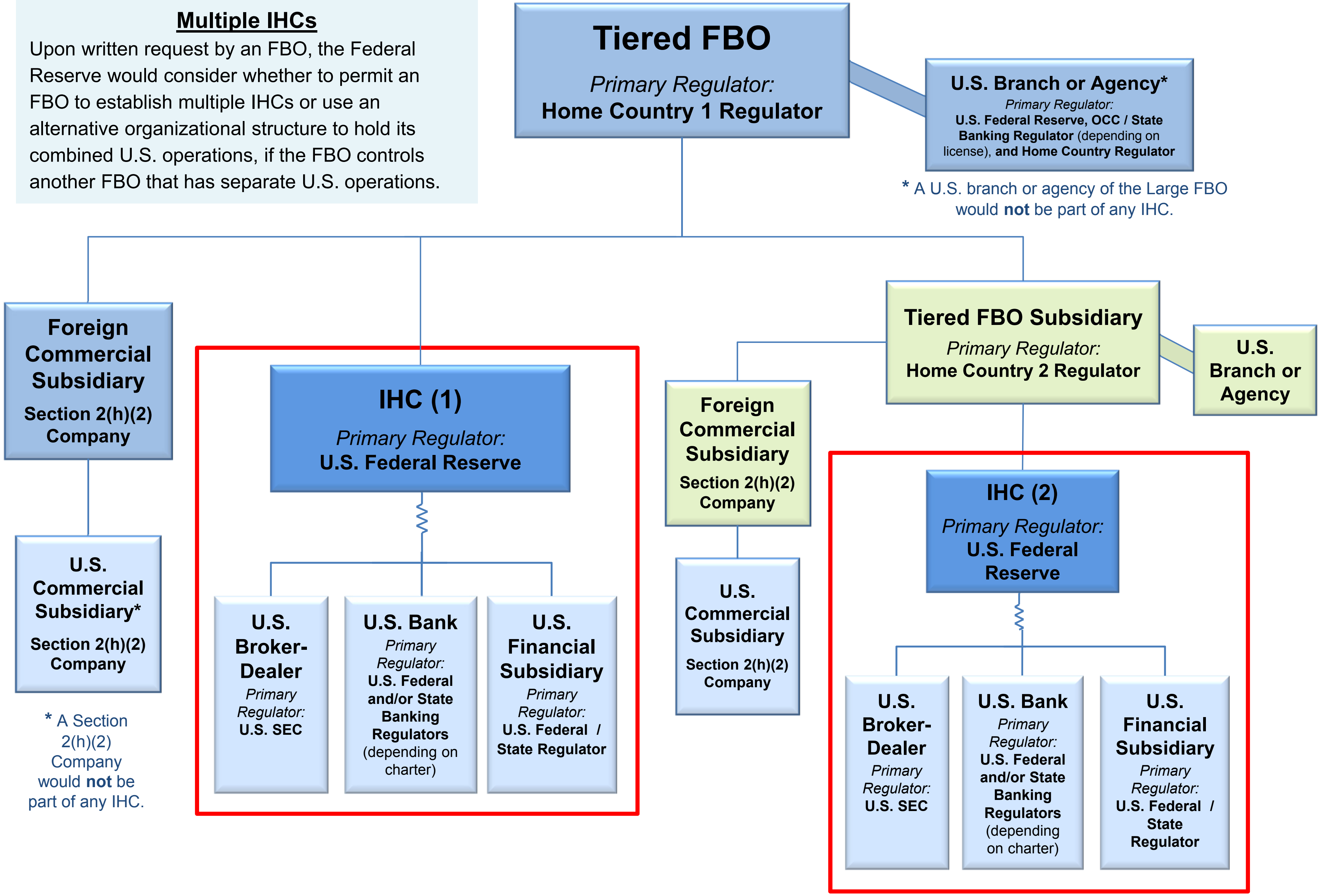

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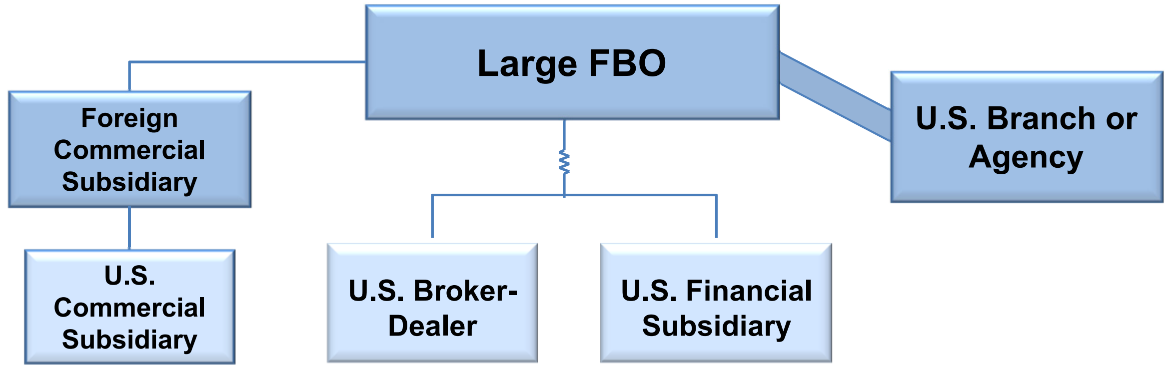
Diagram 3: New Requirements for a Large FBO with a Limited U.S. Footprint

Key FBO Facts

- ≥ $50 billion in global assets
- < $50 billion in combined U.S. assets
- < $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)



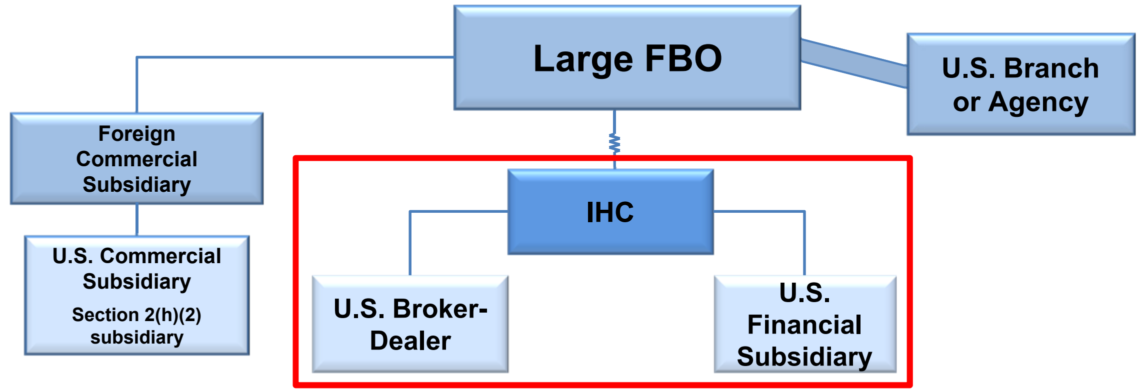
Impact of Federal Reserve's Proposal: No IHC Requirement But Other New Requirements Apply

- **Capital:** FBO must certify that it meets home country capital standards that are broadly consistent with Basel capital standards, including **Basel III**.
  - Non-compliance = Federal Reserve may impose restrictions on FBO's U.S. operations.
- **Capital Stress Tests:** FBO must be subject to and pass annual home country stress tests that are comparable to U.S. standards.
  - Non-compliance = **105% U.S. asset maintenance** requirement for U.S. branches and agencies and FBO must conduct annual stress test of U.S. subsidiaries.
- **Liquidity Stress Tests:** FBO must report to results of internal liquidity stress test that meets Basel Committee's principles for liquidity risk management.
  - Non-compliance = U.S. operations must maintain **net due from** funding position with non-U.S. affiliates of no more than **25%** of third-party liabilities of U.S. operations on a daily basis.
- **Risk Management:** FBO must maintain a board level U.S. risk committee meeting certain requirements. The U.S. risk committee can be part of the overall risk committee of the board.
- **Single Counterparty Credit Limits:** Aggregate net credit exposure of U.S. operations to any **unaffiliated counterparty**, together with its subsidiaries, must be limited to **25%** of the FBO's consolidated total regulatory capital. Stricter limit applies to exposures between major counterparties.
- **Early Remediation:** Only if triggered. **Debt-to-Equity Limits:** Only if FSOC makes determinations about FBO's grave threat to U.S. financial stability.

Diagram 4: New Requirements for a Large FBO with a Major U.S. Footprint

Key FBO Facts

- ≥ $50 billion in global assets
- ≥ $50 billion in combined U.S. assets
- ≥ $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)



Impact of Federal Reserve's Proposal: IHC Requirement and Other New Requirements Apply

- **Top-Tier U.S. IHC** subject to:
  - **U.S. capital requirements** for U.S. bank holding companies, regardless of whether the IHC controls a U.S. bank.
  - **30-day U.S. liquidity buffer** and other liquidity risk management requirements, including internal liquidity stress tests.
  - **Single counterparty credit limits:** Aggregate net credit exposure of the IHC, together with its subsidiaries, to any **unaffiliated counterparty**, together with its subsidiaries, must be limited to **25%** of the IHC's capital stock and surplus. Stricter limit applies to exposures between major counterparties.
  - **Dodd-Frank capital stress test rules**
- **FBO Capital:** FBO must certify that it meets home country capital standards that are broadly consistent with Basel capital standards, including **Basel III**. Non-compliance = Federal Reserve may impose restrictions on U.S. operations.
- **FBO Capital Stress Tests:** FBO must be subject to and pass annual home country stress tests that are comparable to U.S. standards and must provide certain information to the Federal Reserve regarding its home country stress tests.
  - Non-compliance = **108% U.S. asset maintenance** requirement for U.S. branches and agencies, and Federal Reserve may impose intragroup funding restrictions or additional liquidity requirements.
- **Liquidity:** U.S. branches and agencies must maintain a U.S. liquidity buffer that is separate from the IHC's buffer.
- **Risk Management:** FBO must maintain a board level U.S. risk committee meeting certain requirements. The U.S. risk committee can be part of the overall risk committee of the board. Must appoint a U.S. chief risk officer meeting certain requirements.
- **Single Counterparty Credit Limits:** Aggregate net credit exposure of U.S. operations to any **unaffiliated counterparty**, together with its subsidiaries, must be limited to **25%** of the FBO's consolidated total regulatory capital. Stricter limit applies to exposures between major counterparties.
- **Early Remediation:** Only if triggered. **Debt-to-Equity Limits:** Only if FSOC makes determinations about FBO's grave threat to U.S. financial stability.

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Table 1: Applicability of Proposed Dodd-Frank Enhanced Prudential Standards to Foreign Banking Organizations

Type of FBO	U.S. Enhanced Prudential Standards Proposed by Federal Reserve							
	U.S. IHC Requirement	Capital	Stress Testing	Liquidity	Single Counterparty Credit Limits	Risk Management	Debt-to-Equity Limits	Early Remediation
FBO with > $10 billion *but* < $50 billion in global assets (approx. 29 such FBOs)	**No**	**No**	**Yes.** FBO must meet home country stress test requirements in order to avoid U.S. asset maintenance and other requirements	**No**	**No**	**Yes** ▪ If FBO is publicly traded, it must annually certify that it maintains a board level U.S. risk committee meeting certain requirement ▪ The U.S. risk committee can be part of the overall risk committee of the board.	**No**	**No**
FBO with ≥ $50 billion in global assets *but* < $50 billion in combined U.S. assets (approx. 84 such FBOs)	**Yes**, unless FBO has < $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)	**Yes** ▪ IHC is subject to U.S. capital requirements for BHCs ▪ FBO must certify that it meets home country capital standards that are broadly consistent with Basel capital standards, including Basel III	**All of the above, plus:** IHC is subject to Federal Reserve's Dodd-Frank stress testing rules as if it were a U.S. BHC	**Yes** FBO must report results of annual internal liquidity stress test to Federal Reserve	**Yes** ▪ Limits apply to IHC and combined U.S. operations of FBO ▪ Stricter limits apply to exposures between major counterparties	**Same as above**, regardless of whether its stock is publicly traded	**Yes** if FSOC makes certain determinations about FBO's grave threat to U.S. financial stability	**Yes**, but *not* automatically subject to remediation actions upon exceeding an early remediation trigger
FBO with ≥ $50 billion in combined U.S. assets (approx. 23 such FBOs)	**Yes**, unless FBO has < $10 billion in combined U.S. assets (**excluding** assets of U.S. branches and U.S. agencies)	**All of the above, plus:** ▪ IHC is subject to U.S. advanced approaches capital rules or market risk capital rules if it crosses applicability thresholds, or if it elects, with Federal Reserve approval, to use the advanced approaches ▪ IHC must submit annual capital plan to Federal Reserve if it has ≥ $50 billion in total consolidated assets	**All of the above plus:** FBO must meet additional conditions regarding home country stress tests in order to avoid U.S. asset maintenance and other requirements	**Yes** ▪ Various liquidity risk management and stress testing requirements ▪ U.S. Branch and Agency Network and IHC must maintain separate U.S. liquidity buffers	**Same as above**	**All of the above, plus:** ▪ Additional requirements for U.S. risk committee, at least one member of which must be independent ▪ Must appoint a U.S. chief risk officer meeting certain requirements	**Same as above**	**Yes** Subject to non-discretionary early remediation actions upon exceeding an early remediation trigger

Table 2: Methods for Calculating Asset Thresholds Used in the Proposal

Type of Asset	Calculation Method	Where Calculation is Relevant
FBO's "Total Consolidated Assets"	Determined based on the average of the total assets: ▪ For the four most recent consecutive quarters as reported by the FBO on its FR Y-7Q; ▪ If the FBO has not filed the FR Y-7Q for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on FR Y-7Q; **or** ▪ If the FBO has not yet filed an FR Y-7Q, as determined under applicable accounting standards*.	The $10/$50/$500 billion asset thresholds for the following requirements: capital; liquidity; single counterparty credit limits; risk management; stress testing; and early remediation.
IHC's "Total Consolidated Assets"	Determined based on the average of the total assets: ▪ For the four most recent consecutive quarters as reported by the IHC on its FR Y-9C; ▪ If the IHC has not filed the FR Y-9C for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on FR Y-9C; **or** ▪ If the IHC has not yet filed an FR Y-9C, as determined under applicable accounting standards*.	The $10/$50/$500 billion asset thresholds for the following requirements: capital; single counterparty credit limits; and stress testing.
"Combined U.S. Assets (<u>excluding</u> assets of U.S. branches and U.S. agencies)"	Equal to the average of the total consolidated assets of each top-tier U.S. subsidiary of the FBO (**excluding any Section 2(h)(2) company**): ▪ For the four most recent consecutive quarters as reported by the FBO on its FR Y-7Q; ▪ If the FBO has not filed the FR Y-7Q for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on FR Y-7Q; **or** ▪ If the FBO has not filed an FR Y-7Q, as determined under applicable accounting standards*. The FBO may **reduce** its "combined U.S. assets (excluding assets of U.S. branches and U.S. agencies)" calculated above by the amount corresponding to any balances and transactions between any U.S. subsidiaries that would be eliminated in consolidation were an IHC already formed. Balances and transactions between any U.S. subsidiary, on the one hand, and the FBO's head office or other non-U.S. affiliate, on the other hand, would be **included.**	For determining whether an FBO must establish a top-tier U.S. IHC.

"Combined U.S. Assets"	Equal to the sum of:
	▪ The average of the total assets of each U.S. branch and U.S. agency of the FBO:
	    ▪ For the four most recent consecutive quarters as reported to the Federal Reserve on the FFIEC 002; or
	    ▪ If the FBO has not filed the FFIEC 002 for a U.S. branch or U.S. agency for each of the four most recent consecutive quarters, for the most recent quarter or consecutive quarters as reported on the FFIEC 002; or
	    ▪ If the FBO has not yet filed a FFIEC 002 for a U.S. branch or U.S. agency, as determined under applicable accounting standards*.
	▪ If an IHC has been established, the average of the "**total consolidated assets**" of the IHC, calculated as described above in this table.
	▪ If an IHC has not been established, the average of the total consolidated assets of each top-tier U.S. subsidiary of the FBO (**excluding any section 2(h)(2) company**), calculated as described above in this table.
	The FBO may **reduce** its "combined U.S. assets" calculated above by the amount corresponding to balances and transactions between the U.S. subsidiary or U.S. branch or U.S. agency and any other top-tier U.S. subsidiary or U.S. branch or U.S. agency to the extent such items are not already eliminated in consolidation. Balances and transactions between any U.S. subsidiary, U.S. branch or U.S. agency, on the one hand, and the FBO's head office or other non-U.S. affiliate, on the other hand, would be **included.**
		The $10/$50/$500 billion asset thresholds for the following requirements: liquidity; risk management; stress testing; and early remediation.

* Applicable accounting standards" means U.S. GAAP, IFRS or such other accounting standards that a company uses in the ordinary course of its business in preparing its consolidated financial statements.

Table 3: Proposed Dodd-Frank Early Remediation Triggers for Large FBOs

	Capital Adequacy of FBO	Capital Adequacy of IHC	Stress Tests of IHC	Risk Management	Liquidity Risk Management	Market Indicators
Level 1 ***(Heightened Supervisory Review)***	Federal Reserve determines the FBO's capital position is **not** commensurate with the level and nature of risks to which it is exposed, even though: ▪ The risk-based capital ratios of the FBO exceed the minimum applicable requirements by [200-250]* basis points or more; and ▪ The leverage ratios of the FBO exceed the minimum applicable requirements by **[**75-125**]** basis points or more. * The Federal Reserve is considering a range of numbers for the capital triggers in the proposed early remediation framework. The final rule will include specific levels that will be within, or near to, the proposed range.	Federal Reserve determines the IHC is **not** in compliance with rules regarding capital plans or the IHC's capital position is **not** commensurate with the level and nature of risks to which it is exposed, even though: ▪ The risk-based capital ratios of the IHC exceed the minimum applicable requirements by **[**200-250**]** basis points or more; and ▪ The leverage ratios of the IHC exceed the minimum applicable requirements by **[**75-125**]** basis points or more.	The IHC fails to comply with the Federal Reserve's capital plan or stress testing rules.	Any part of the combined U.S. operations has manifested **signs of weakness** in meeting the enhanced risk management requirements.	Any part of the combined U.S. operations has manifested **signs of weakness** in meeting the enhanced liquidity risk management requirements.	Receipt of a notice indicating that the Federal Reserve has found that, with respect to the FBO or IHC, any market indicator has exceeded the market indicator threshold for the breach period.
Level 2 ***(Initial Remediation)***	▪ Any risk-based capital ratio of the FBO is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the FBO is **less** than **[**75-125**]** basis points above the minimum applicable requirements.	▪ Any risk-based capital ratio of the IHC is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the IHC is **less** than **[**75-125**]** basis points above the minimum applicable requirements.	Under the supervisory stress test severely adverse scenario, the IHC's Tier 1 Common risk-based capital ratio falls below **5%** during any quarter of the planning horizon.	Any part of the combined U.S. operations has demonstrated **multiple deficiencies** in meeting the enhanced risk management requirements.	Any part of the combined U.S. operations has demonstrated **multiple deficiencies** in meeting the enhanced liquidity risk management requirements.	Not applicable.
Level 3 ***(Recovery)***	▪ Any risk-based capital ratio or leverage ratio of the FBO is **less** than the minimum applicable requirements; **Or, for two consecutive quarters:** ▪ Any risk-based capital ratio of the FBO is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the FBO is **less** than **[**75-125**]** basis points above the minimum applicable requirements.	▪ Any risk-based capital ratio or leverage ratio of the IHC is **less** than the minimum applicable requirements; **Or, for two consecutive quarters:** ▪ Any risk-based capital ratio of the IHC is **less** than **[**200-250**]** basis points above the minimum applicable requirements; **or** ▪ Any leverage ratio of the IHC is **less** than **[**75-125**]** basis points above the minimum applicable requirements.	Under the supervisory stress test severely adverse scenario, the IHC's Tier 1 Common risk-based capital ratio falls below **3%** during any quarter of the planning horizon.	Any part of the combined U.S. operations is in **substantial noncompliance** with the enhanced risk management requirements.	Any part of the combined U.S. operations is in **substantial noncompliance** with the enhanced liquidity risk management requirements.	Not applicable.
Level 4 ***(Recommended Resolution)***	▪ Any risk-based capital ratio of the FBO is **more** than **[**100-250**]** basis points **below** the minimum applicable requirements; **or** ▪ Any leverage ratio of the FBO is **more** than **[**50-150**]** basis points **below** the minimum applicable requirements.	▪ Any risk-based capital ratio of the IHC is **more** than **[**100-250**]** basis points **below** the minimum applicable requirements; **or** ▪ Any leverage ratio of the IHC is **more** than **[**50-150**]** basis points **below** the minimum applicable requirements.	Not applicable.	Not applicable.	Not applicable.	Not applicable.

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Table 4: Proposed Dodd-Frank Early Remediation Actions for Large FBOs

Level 1 (Heightened Supervisory Review)	▪ The Federal Reserve will conduct a targeted supervisory review of the FBO's combined U.S. operations to evaluate whether these are experiencing financial distress or material risk management weaknesses, including with respect to exposures that the combined U.S. operations have to the FBO, such that further decline of the combined U.S. operations is probable. ▪ If the Federal Reserve determines that such further decline is probable, it may subject the FBO to level 2 remediation.
Level 2 (Initial Remediation)	**Large FBOs with ≥ \$50 billion in combined U.S. assets:** ▪ **IHC** capital distributions (e.g., dividends and buybacks) are restricted to no more than 50% of the average of the IHC's net income in the previous two quarters. ▪ **U.S. Branch and Agency Network** must remain in a net due to position to the FBO's head office and non-U.S. affiliates. ▪ **U.S. Branch and Agency Network** must hold 30-day liquidity buffer in the United States (not required in level 3). ▪ **Combined U.S. operations (IHC and U.S. Branch and Agency Network)** face restrictions on growth (no more than 5% growth in total assets or total risk-weighted assets per quarter or per year). ▪ **FBO** may not directly or indirectly acquire any controlling interest in any U.S. company, establish or acquire any U.S. branch, U.S. agency or U.S. representative office, or engage in any new line of business in the United States, without the prior approval of the Federal Reserve. ▪ **FBO** must enter into a non-public memorandum of understanding to improve its financial and managerial condition in the United States. ▪ **Combined U.S. operations** may be subject to other limitations and conditions on their conduct or activities as the Federal Reserve deems appropriate. **Large FBOs with < \$50 billion in combined U.S. assets:** Federal Reserve may take some or all of the actions outlined above on a case-by-case basis.
Level 3 (Recovery)	**Large FBOs with ≥ \$50 billion in combined U.S. assets:** ▪ **FBO and IHC** must enter into a written agreement specifying that the IHC must take appropriate actions to restore its capital to or above the applicable minimum capital requirements and take such other remedial actions as prescribed by the Federal Reserve. If it fails to satisfy the requirements of such a written agreement, the IHC may be required to divest assets identified by the Federal Reserve. ▪ **IHC and any other U.S. subsidiary** are prohibited from making capital distributions. ▪ **U.S. Branch and Agency Network** must remain in a net due to position to the FBO's head office and non-U.S. affiliates. ▪ **U.S. Branch and Agency Network** subject to a 108% asset maintenance requirement. ▪ **Combined U.S. operations** are subject to a prohibition on growth (no quarterly or annual increase in total assets or total risk-weighted assets). ▪ **FBO** may not directly or indirectly acquire any controlling interest in any U.S. company, establish or acquire any U.S. branch, U.S. agency or office, or other place of business in the United States, or engage in any new line of business in the United States, without the prior approval of the Federal Reserve. ▪ **FBO and IHC** are prohibited from increasing the compensation of or paying any bonus to U.S. senior management or any IHC board member. ▪ **IHC** may be required to replace its board of directors or dismiss any executive primarily responsible for any US. operations or any board member. ▪ **Combined U.S. operations** may be subject to other limitations and conditions on their conduct or activities as the Federal Reserve deems appropriate, including restrictions on transactions with affiliates. **Large FBOs with < \$50 billion in combined U.S. assets:** Federal Reserve may take some or all of the actions outlined above on a case-by-case basis.
Level 4 (Recommended Resolution)	▪ Federal Reserve will consider whether the FBO's combined U.S. operations warrant termination or resolution based on their financial decline, the factors contained in Section 203 of the Dodd-Frank Act as applicable or any other relevant factor. ▪ If such a determination is made, the Federal Reserve will take actions that include recommending to the appropriate financial regulatory agencies that an entity within the FBO's U.S. Branch and Agency Network be terminated or that a U.S. subsidiary be resolved.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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