
THE BANKING REGULATION REVIEW

FOURTH EDITION

EDITOR
JAN PUTNIS

LAW BUSINESS RESEARCH

THE BANKING REGULATION REVIEW

Reproduced with permission from Law Business Research Ltd.

This article was first published in The Banking Regulation Review, 4th edition
(published in April 2013 – editor Jan Putnis).

For further information please email
Adam.Sargent@lbresearch.com

THE BANKING REGULATION REVIEW

Fourth Edition

Editor
JAN PUTNIS

LAW BUSINESS RESEARCH LTD

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW
THE RESTRUCTURING REVIEW
THE PRIVATE COMPETITION ENFORCEMENT REVIEW
THE DISPUTE RESOLUTION REVIEW
THE EMPLOYMENT LAW REVIEW
THE PUBLIC COMPETITION ENFORCEMENT REVIEW
THE BANKING REGULATION REVIEW
THE INTERNATIONAL ARBITRATION REVIEW
THE MERGER CONTROL REVIEW
THE TECHNOLOGY, MEDIA AND
TELECOMMUNICATIONS REVIEW
THE INWARD INVESTMENT AND
INTERNATIONAL TAXATION REVIEW
THE CORPORATE GOVERNANCE REVIEW
THE CORPORATE IMMIGRATION REVIEW
THE INTERNATIONAL INVESTIGATIONS REVIEW
THE PROJECTS AND CONSTRUCTION REVIEW
THE INTERNATIONAL CAPITAL MARKETS REVIEW
THE REAL ESTATE LAW REVIEW
THE PRIVATE EQUITY REVIEW
THE ENERGY REGULATION AND MARKETS REVIEW
THE INTELLECTUAL PROPERTY REVIEW
THE ASSET MANAGEMENT REVIEW
THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW
THE MINING LAW REVIEW
THE EXECUTIVE REMUNERATION REVIEW
THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW
THE CARTELS AND LENIENCY REVIEW
THE TAX DISPUTES AND LITIGATION REVIEW

www.TheLawReviews.co.uk

PUBLISHER
Gideon Roberton

BUSINESS DEVELOPMENT MANAGERS
Adam Sargent, Nick Barette

MARKETING MANAGERS
Katherine Jablonowska, Thomas Lee, James Spearing

PUBLISHING ASSISTANT
Lucy Brewer

PRODUCTION COORDINATOR
Lydia Gerges

HEAD OF EDITORIAL PRODUCTION
Adam Myers

CHIEF SUBEDITOR
Jonathan Allen

SUBEDITORS
Caroline Rawson, Anna Andreoli

EDITOR-IN-CHIEF
Callum Campbell

MANAGING DIRECTOR
Richard Davey

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2013 Law Business Research Ltd
www.TheLawReviews.co.uk

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation. Legal advice should always be sought before taking any legal action based on the information provided. The publishers and the editor accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of March 2013, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – gideon.roberton@lbresearch.com

ISBN 978-1-907606-59-5

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ADVOKATFIRMAET BA-HR DA

AFRIDI & ANGELL

ALI BUDIARDJO, NUGROHO, REKSODIPUTRO

ANDERSON MŌRI & TOMOTSUNE

ARTHUR COX

BONELLI EREDE PAPPALARDO

BREDIN PRAT

BUN & ASSOCIATES

CHANCERY CHAMBERS

CLAYTON UTZ

CONSORTIUM – TABOADA & ASOCIADOS

CONSORTIUM CENTRO AMÉRICA ABOGADOS

DAVID GRISCTI & ASSOCIATES

DAVIES WARD PHILLIPS & VINEBERG LLP

DAVIS POLK & WARDWELL LLP

DE BRAUW BLACKSTONE WESTBROEK

DLA PIPER WEISS-TESSBACH RECHTSANWÄLTE GMBH

ELVINGER, HOSS & PRUSSEN

F.O. AKINRELE & CO

FERRERE ABOGADOS

GERNANDT & DANIELSSON

GIDE LOYRETTE NOUEL AARPI

HANNES SNELLMAN

HENGELER MUELLER

KADIR, ANDRI & PARTNERS

KBH KAAUUUN

KIM & CHANG

LENZ & STAEHELIN

LS HORIZON LIMITED

MATTOS FILHO ADVOGADOS

MAYORA & MAYORA, SC

MIRANDA CORREIA AMENDOEIRA & ASSOCIADOS

MKONO & CO ADVOCATES

MORATIS PASSAS LAW FIRM

MOURANT OZANNES

MULLA & MULLA & CRAIGIE BLUNT & CAROE

NAGY ÉS TRÓCSÁNYI ÜGYVÉDI IRODA

NAUTADUTILH

PAKSOY

PELIFILIP SCA
PIMENTA DIONISIO E ASSOCIADOS
RUSSELL McVEAGH
SHALAKANY LAW OFFICE
SKUDRA & UDRIS
SLAUGHTER AND MAY
SYCIP SALAZAR HERNANDEZ & GATMAITAN
T STUDNICKI, K PŁESZKA, Z ĆWIAKALSKI, J GÓRSKI SPK
URÍA MENÉNDEZ
VASIL KISIL & PARTNERS
VIEIRA DE ALMEIDA & ASSOCIADOS
WASELIUS & WIST
WEBBER WENTZEL
ZHONG LUN LAW FIRM

CONTENTS

Editor's Prefacexi
	<i>Jan Putnis</i>
Chapter 1	INTERNATIONAL INITIATIVES 1
	<i>Jan Putnis and Tolek Petch</i>
Chapter 2	ANGOLA 34
	<i>Mafalda Oliveira Monteiro and Bruno Sampaio Santos</i>
Chapter 3	AUSTRALIA..... 45
	<i>Louise McCoach and David Landy</i>
Chapter 4	AUSTRIA 85
	<i>Wolfgang Freund</i>
Chapter 5	BARBADOS 95
	<i>Trevor A Carmichael QC</i>
Chapter 6	BELGIUM..... 104
	<i>Anne Fontaine</i>
Chapter 7	BOLIVIA..... 115
	<i>Carlos Pinto-Meyer and Cristian Bustos</i>
Chapter 8	BRAZIL 123
	<i>José Eduardo Carneiro Queiroz</i>
Chapter 9	CAMBODIA 129
	<i>Bun Youdy</i>
Chapter 10	CANADA 145
	<i>Scott Hyman, Carol Pennycook, Derek Vesey and Nicholas Williams</i>
Chapter 11	CAYMAN ISLANDS..... 161
	<i>Richard de Basto</i>

Chapter 12	CHINA.....	172
	<i>Wantao Yang and Borong Liu</i>	
Chapter 13	DENMARK.....	193
	<i>Mikkel Fritsch and Tanja Lind Melskens</i>	
Chapter 14	EGYPT	205
	<i>Aly El Shalakany</i>	
Chapter 15	EL SALVADOR.....	215
	<i>Oscar Samour and Aquiles Delgado</i>	
Chapter 16	EUROPEAN UNION.....	226
	<i>Jan Putnis and Michael Sholem</i>	
Chapter 17	FINLAND	250
	<i>Tarja Wist and Jussi Salo</i>	
Chapter 18	FRANCE	262
	<i>Olivier Saba, Samuel Pariente, Jennifer Downing, Jessica Chartier and Hubert Yu Zhang</i>	
Chapter 19	GERMANY	295
	<i>Thomas Paul and Sven H Schneider</i>	
Chapter 20	GREECE	309
	<i>Dimitris Passas and Vassilis Saliaris</i>	
Chapter 21	GUATEMALA.....	332
	<i>María Fernanda Morales Pellecer</i>	
Chapter 22	GUERNSEY	346
	<i>John Lewis and Helen Wyatt</i>	
Chapter 23	HONG KONG	358
	<i>Laurence Rudge and Peter Lake</i>	
Chapter 24	HUNGARY	376
	<i>Zoltán Varga and Tamás Pásztor</i>	
Chapter 25	INDIA	389
	<i>Shardul Thacker</i>	

Chapter 26	INDONESIA.....	403
	<i>Ferry P Madian and Yanny Meuthia S</i>	
Chapter 27	IRELAND.....	426
	<i>William Johnston, Robert Cain, Eoin O'Connor and Niall Esler</i>	
Chapter 28	ITALY	440
	<i>Giuseppe Rumi and Andrea Savigliano</i>	
Chapter 29	JAPAN	452
	<i>Hirohito Akagami and Wataru Ishii</i>	
Chapter 30	JERSEY	464
	<i>Simon Gould and Sarah Huelin</i>	
Chapter 31	KOREA.....	476
	<i>Sang Hwan Lee, Chan Moon Park and Hoin Lee</i>	
Chapter 32	KUWAIT	489
	<i>Haifa Khunji and Basem Al Muthafer</i>	
Chapter 33	LATVIA	503
	<i>Armands Skudra</i>	
Chapter 34	LUXEMBOURG	514
	<i>Franz Fayot</i>	
Chapter 35	MALAYSIA	534
	<i>Andri Aidham bin Dato' Ahmad Badri, Julian Mahmud Hashim and Tan Kong Yam</i>	
Chapter 36	MALTA	544
	<i>David Griscti and Clint Bennetti</i>	
Chapter 37	MOZAMBIQUE.....	555
	<i>Paulo Pimenta and João Leite</i>	
Chapter 38	NETHERLANDS	565
	<i>Joost Schutte, Annick Houben and Mariken van Loopik</i>	
Chapter 39	NEW ZEALAND	579
	<i>Guy Lethbridge and Debbie Booth</i>	

Chapter 40	NICARAGUA	592
	<i>Rodrigo Taboada R</i>	
Chapter 41	NIGERIA.....	605
	<i>Adamu M Usman and Jumoke Onigbogi</i>	
Chapter 42	NORWAY	620
	<i>Terje Sommer, Richard Sjøqvist and Markus Nilssen</i>	
Chapter 43	PHILIPPINES	632
	<i>Rafael A Morales</i>	
Chapter 44	POLAND	648
	<i>Tomasz Gizbert-Studnicki, Tomasz Spyra and Michał Bobrzyński</i>	
Chapter 45	PORTUGAL.....	662
	<i>Pedro Cassiano Santos</i>	
Chapter 46	ROMANIA	679
	<i>Alexandru Birsan, Carmen Peli and Alexandra Manciulea</i>	
Chapter 47	SOUTH AFRICA.....	692
	<i>Johan de Lange and Matthew Gibson</i>	
Chapter 48	SPAIN	704
	<i>Juan Carlos Machuca</i>	
Chapter 49	SWEDEN	732
	<i>Niclas Rockborn and Nils Unckel</i>	
Chapter 50	SWITZERLAND	750
	<i>Shelby R du Pasquier, Patrick Hünerwadel, Marcel Tranchet and Valérie Menoud</i>	
Chapter 51	TANZANIA.....	773
	<i>Wilbert B Kapinga, Rehema A Khalid and Kamanga W Kapinga</i>	
Chapter 52	THAILAND	783
	<i>Montien Bunjarnondha and Rahat Alikhan</i>	
Chapter 53	TURKEY	798
	<i>Serdar Paksoy and Nazlı Bezirci</i>	

Chapter 54	UKRAINE	810
	<i>Denis Lysenko and Yulia Kyrpa</i>	
Chapter 55	UNITED ARAB EMIRATES.....	822
	<i>Amjad Ali Khan and Stuart Walker</i>	
Chapter 56	UNITED KINGDOM.....	830
	<i>Jan Putnis, Benjamin Hammond and Nick Bonsall</i>	
Chapter 57	UNITED STATES	868
	<i>Luigi L De Ghenghi and Reena Agrawal Sahni</i>	
Chapter 58	VIETNAM	948
	<i>Samantha Campbell, Pham Bach Duong and Nguyen Thi Tinh Tam</i>	
Appendix 1	ABOUT THE AUTHORS.....	969
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS..	1007

EDITOR'S PREFACE

2012 may be remembered as the year when practical reality caught up with those who thought that the financial crisis that emerged in Western economies in 2007 would result in more effective cooperation between financial regulators across the world. By one measure – the number of new initiatives and proposals for reform – the amount of cross-border financial regulatory activism has never been higher. But by more useful measures – moves towards solutions to the ‘too big to fail’ problem through the development of effective cross-border resolution mechanisms for banking groups and international cooperation on reform of OTC derivatives regulation – the optimism of the past has faded a little.

Questions are increasingly asked about whether the obstacles to truly productive cross-border regulatory cooperation – political imperatives, different incentives and straightforward differences of view – will ever be surmounted in ways that make international banking groups fundamentally safer. Media speculation in January 2013 that US regulators might not allow banks to assume cross-border regulatory cooperation in the resolution plans that they prepare in 2013 would, if substantiated, highlight this trend.

These apparently negative developments have not made the period since the publication of the last edition of this book in April 2012 any less interesting. It is also worth noting that most of the challenges that we have seen – new law and regulation that creates difficult questions of cross-border consistency and extraterritoriality, differing regulatory philosophies between major financial jurisdictions and the sheer slowness and unpredictability of developments – have rational, if depressing, explanations. For example, fundamental differences between the insolvency law of major jurisdictions, coupled with cross-border recognition issues and disagreements over how to pay for resolution, are nothing if not formidable barriers to the development of workable group-wide resolution plans for banking groups.

However, the past 12 months have not been a period of complete failure of regulatory reform either. Progress has been made, for example, in the enactment of legislation regarding OTC derivatives, most notably the European Market Infrastructure

Regulation (EMIR) in the European Union. But, as noted above, cross-border cooperation in this area remains an issue: it seems that hardly a month goes by without the discovery of a previously unremarked-upon anomaly between the rules in this area in different countries.

Bank liquidity regulation has continued to be the subject of intense debate in 2012, culminating in the Basel Committee's announcement in January 2013 of its decision to relax and to recommend the gradual phasing in of the liquidity coverage ratio ('LCR') for banks. Taking into account the fundamental influence that the LCR will have on many banks' business models, this was a welcome sign of pragmatism and also a sign of the Basel Committee's willingness to move the debate on liquidity forward.

Despite the challenges that have arisen in bank resolution initiatives, legislation and rules are developing in this area in multiple jurisdictions, with, for example, the publication of the draft European Union Recovery and Resolution Directive ('the RRD') in June 2012.

The European Union is, at the time of writing, enjoying a period of respite from the problems that it faced from the eurozone crisis in 2012, but it would be very optimistic to say that those problems have been brought under control. The European Commission is placing much emphasis on finalising the legislation implementing Basel III (CRD IV) and the RRD as soon as possible in 2013, notwithstanding that each of these initiatives may ultimately be affected profoundly by the parallel 'banking union' proposals for the eurozone.

In the United States, the main rules implementing Basel III are also expected to be substantially finalised in 2013. The significance of the restructuring of the financial regulatory regime in the United States, principally under the rules that are emerging from the framework established by the Dodd-Frank Act, continues to unfold and looks set to dominate the careers of a generation of regulators, bankers and their advisers.

The realisation dawned on many banks in 2012 that regulatory reform will be a longer and more drawn-out process than had been anticipated. For this reason, 2012 may also be remembered as the year when the banking sector in Europe, the United States and some other parts of the world began to think seriously about structural change in the long term, accepting that restructuring will have to take place against a backdrop of continuing regulatory reform. We have begun to see more group reorganisations, disposals, and the severe downsizing or closure of some businesses in banking groups, as well as opportunistic acquisitions. Four principal factors have contributed to these developments:

- a* A little more certainty, or at least the perception of a little more certainty, about rule-making (or, at least, the direction of rule-making) when compared to the past.
- b* The continuing urgent need that many banking groups have for capital and liquidity, and the related need to ensure that capital is deployed in the most efficient and profitable ways.
- c* Some specific legal and regulatory initiatives driving structural change, such as the US Volcker Rule (although this rule has not yet been fully defined at the time of writing) and some emerging (though not yet in force) 'ring-fencing' proposals in parts of Europe (so far principally in the United Kingdom and France).

- d* Continuing regulatory attacks on complexity and actual or perceived barriers to resolution of banking groups.

Accordingly, many banks are refocusing their businesses (or are currently planning how to do so) on what they consider to be the areas that will yield the highest returns relative to cost in regulatory capital and liquidity terms. Consistent with that objective, we are seeing intense competition for capital allocation between different businesses within banking groups and a more widespread appreciation of the relative capital cost (or capital efficiency) of different activities.

2012 was of course also marked by further recrimination about past practices in parts of the banking sector. Allegations that LIBOR and other benchmarks have been manipulated (or subject to attempted manipulation), continuing losses from mis-selling and other past misconduct continue to affect the sector. Attention has turned more recently to the ways in which banking groups quantify and present these problems in their financial statements.

An increasingly orthodox view among senior management of banking groups in Europe and the United States is to conclude that the only way through these difficulties is to adopt a 'whiter than white' approach to compliance. This involves banks taking the initiative to present a new way forward on compliance matters and breaking away from the more reactive stance that some of them held in the past. Some commentators have asked where this will lead. Will it result in banking groups that are so hobbled and diminished by internal policies and rules that innovation, efficiency and, ultimately, service to the 'real' economy, is put at risk? Observation would suggest that this is a concern unless banks keep in mind four critical objectives when developing their compliance strategy and relationships with financial regulators:

Compliance

The first and most obvious objective is to ensure that banking groups are and remain compliant with their legal and regulatory obligations. In many countries this involves developing a good understanding of the purpose and spirit of those obligations in addition to (or, in some cases, instead of) their literal meaning.

Predictability

It is desirable to maximise the predictability of relationships with financial regulators. Good and constructive relationships with regulators generally make it more likely that banks will see what is coming around the corner sooner and will be better able to find positive ways to plan ahead.

Influence

Constructive influence of regulatory policy development in areas affecting banks is also desirable, even if a bank achieves no more than a small proportion of the change that it would like to see. For this purpose I would include within the meaning of 'influence' the conveying of cogent arguments even where regulators do not act in response to them. This is simply because the route to influence for a bank includes convincing regulators that it has thoughtful and coherent ideas, even where political or other imperatives have the result that the regulator does not address the bank's concerns.

Flexibility and pragmatism

Flexibility and pragmatism in the relationships between banks and their regulators is critical. Inflexibility can lead to inappropriate or overly formulaic regulatory approaches to unexpected developments. Flexibility is often difficult to achieve but is worth pursuing in the interests of both banks and regulators, through regular informal contacts and exchanges of views with senior staff at regulators in addition to formal interactions.

Obvious-looking these objectives may be, but serious problems in relationships between banks and their regulators can usually be traced back to a failure to achieve at least one of them.

This updated edition contains submissions by authors provided for the most part between mid-January and mid-February 2013, covering 56 countries (in addition to the chapters on International Initiatives and the European Union). As ever, comments on this book from banks, regulators and governments are welcome.

My thanks go to the contributors to this book, who have once again taken time out from advising on important matters affecting the banking sector to update their chapters – ‘update’ meaning a fundamental revision in many cases.

Thanks are also due to Adam Myers, Lydia Gerges and Gideon Robertson at Law Business Research Ltd, for their continuing support in the preparation of this book.

Finally, the list of credits would not be complete without mention of the partners and staff of Slaughter and May, in particular Ruth Fox, Ben Kingsley, Peter Lake, Laurence Rudge, Nick Bonsall, Ben Hammond, Tolek Petch and Michael Sholem. Once again, they helped not only to make this book possible but also to keep it as painless a project as is currently possible in the field of banking regulation.

Jan Putnis

Slaughter and May

London

March 2013

Chapter 57

UNITED STATES

*Luigi L De Ghenghi and Reena Agrawal Sahni*¹

I INTRODUCTION

The US and global financial crisis in 2008 precipitated an avalanche of activity and changes in US banking regulation. In that year, the US Congress, the President and the regulators exerted their power and influence to help turn back the tide of the financial crisis by using long-dormant tools and promulgating new programmes. Once the crisis was contained, these authorities began to propose changes with the avowed purpose of attempting to prevent a future financial crisis.

On 21 July 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ('the Dodd-Frank Act' or 'the Act') into law.² The Dodd-Frank Act is the most drastic overhaul of US financial regulation since the 1930s. The Act is resulting in fundamental changes to the shape and scope of regulation, as well as adding new regulation, in a wide range of areas, including systemic risk oversight, derivatives, hedge funds, investor protection, credit rating agencies, consumer financial protection, and securitisation, to name a few. For the most part, the legislation creates only a general framework, leaving the key issues to be resolved by implementing regulations. The Act contains 400 new federal rule-making requirements,³ many of which are now underway,

1 Luigi L De Ghenghi is a partner and Reena Agrawal Sahni is counsel at Davis Polk & Wardwell LLP. The authors would like to express their gratitude to Priya Bindra, Andrew S Fei, Colleen Hobson, Lena Kiely, Jeanine P McGuinness, Zain Ur Rehman and Alexander Young-Anglim, all of Davis Polk & Wardwell LLP, for their contributions and whose efforts in preparing this chapter were invaluable.

2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. (2010).

3 Davis Polk, Dodd-Frank Progress Report (1 February 2013), www.davispolk.com/files/Publication/6c236def-3542-46d5-bc09-03fb57f26799/Presentation/PublicationAttachment/

but most of which, particularly in the area of bank regulation, will take some time to implement. The changes in bank regulation brought on by the Dodd-Frank Act, and some of the issues to be resolved, are discussed in this chapter.

II THE REGULATORY FRAMEWORK APPLICABLE TO BANKS

i Dual banking system

The United States has a dual banking system, whereby banks, or depository institutions, may be chartered by either federal or state authorities. The Office of the Comptroller of the Currency ('OCC') is the federal bank regulator with the power to charter national banks⁴ and, as of 2011, thrifts, or federal savings associations.⁵ The OCC is part of the US Treasury Department. Separately, each state also has either a banking department or division of financial institutions that may charter either banks or thrifts. An institution must apply for and obtain a bank or thrift charter from either a federal or state regulator in order to accept deposits.

Pursuant to the Dodd-Frank Act, the Office of Thrift Supervision ('OTS'), which had previously chartered and supervised thrifts and thrift holding companies, was abolished in 2011.⁶ Supervisory and rule-making authority previously vested in the OTS was divided among existing bank regulators as described in Section III, *infra*.⁷ The

d4df574e-3b7f-4693-aec9-050e869f9134/Feb2013_Dodd.Frank.Progress.Report.pdf. This total counts rule-makings to be completed by multiple agencies separately, which we believe most accurately reflects the staff burden on regulatory agencies. If joint rule-makings are counted only once, the total number of required rule-makings is closer to 243.

4 National Bank Act Section 2, 12 USC Section 26.

5 OCC, Interim Final Rule: Office of Thrift Supervision Integration Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 48950 (9 August 2011), www.gpo.gov/fdsys/pkg/FR-2011-08-09/pdf/2011-17581.pdf; OCC, Final Rule: Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg. 43549 (21 July 2011), www.gpo.gov/fdsys/pkg/FR-2011-07-21/pdf/2011-18231.pdf. This chapter will largely focus on bank and bank holding company regulation, and will not cover the entire scope of thrift and thrift holding company regulation.

6 OCC, Final Rule: Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg. 43549 (21 July 2011), www.gpo.gov/fdsys/pkg/FR-2011-07-21/pdf/2011-18231.pdf; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 313 (2010).

7 The transfer of powers from the OTS to the Federal Reserve, OCC and FDIC, respectively, occurred on 21 July 2011. Federal Reserve, Interim Final Rule: Availability of Information, Public Observation of Meetings, Procedure, Practice for Hearings, and Post-Employment Restrictions for Senior Examiners; Savings and Loan Holding Companies, 76 Fed. Reg. 56508 (13 September 2011), www.gpo.gov/fdsys/pkg/FR-2011-09-13/pdf/2011-22854.pdf; OCC, Final Rule: Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg. 43549 (21 July 2011), www.gpo.gov/fdsys/pkg/FR-2011-07-21/pdf/2011-18231.pdf; FDIC, Interim Rule: Transfer and Redesignation of Certain Regulations Involving State Savings Associations Pursuant

Dodd-Frank Act maintains the federal thrift charter. However, since it eliminates the most important regulatory advantages of the charter, it is likely that most thrift charter holders will convert into bank charters to avoid certain asset restrictions applicable to thrifts. It is unlikely that the OCC will grant any federal thrift charters in the future, and none were issued in 2012.

The Federal Deposit Insurance Corporation ('FDIC') is also a federal bank regulator.⁸ The FDIC does not charter banking institutions, but it administers the federal deposit insurance programme that insures certain bank deposits, including supervising any bank failures, and regulates certain bank activities and operations in order to protect and preserve the federal deposit insurance fund.

ii Bank holding companies

Any legal entity with a controlling ownership interest in a bank or thrift is regulated as a bank or thrift holding company by the Board of Governors of the Federal Reserve System ('the Federal Reserve').⁹ In connection with the abolition of the OTS, the power to regulate thrift holding companies transferred to the Federal Reserve in 2011.¹⁰

The Federal Reserve also regulates state banks that choose to become Federal Reserve member banks, in addition to the respective state or federal banking regulators that charter the banks. All nationally chartered banks are required to hold stock in one of the Federal Reserve banks, while state-chartered banks may choose to be members and hold stock in a regional Federal Reserve bank, upon meeting certain standards. Benefits of Federal Reserve membership include eligibility to serve as a director, which affords member banks the opportunity to participate in monetary policy formulation.¹¹

to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 76 Fed. Reg. 47652 (5 August 2011), www.gpo.gov/fdsys/pkg/FR-2011-08-05/pdf/2011-18276.pdf.

8 Federal Deposit Insurance Act, Section 1, 12 USC Section 1811(a).

9 The Bank Holding Company Act of 1956 ('the BHC Act') defines a 'bank holding company' as any company that has control over any bank or over any company that is or becomes a bank holding company by virtue of the Act. A company has control over a bank or over any company if: (1) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per cent or more of any class of voting securities of the bank or company; (2) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or (3) the board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company (12 USC Section 1841(a)).

10 Federal Reserve, Interim Final Rule: Availability of Information, Public Observation of Meetings, Procedure, Practice for Hearings, and Post-Employment Restrictions for Senior Examiners; Savings and Loan Holding Companies, 76 Fed. Reg. 56508 (13 September 2011), www.gpo.gov/fdsys/pkg/FR-2011-09-13/pdf/2011-22854.pdf; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Sections 311, 312 (2010).

11 See Federal Reserve Bank of Boston, Federal Reserve Membership, www.bostonfed.org/bankinfo/members; Federal Reserve Bank of Dallas, Becoming a Member Bank of the Federal Reserve System: Questions and Answers, www.dallasfed.org/banking/apps/faq.html.

While state banking regulators normally focus their supervisory attention on depository institutions, there are also some state regulations that may apply to bank holding companies.

iii Foreign banks

Foreign bank activities in the United States are supervised by the Federal Reserve, as well as any other regulator implicated by the type of charter or entity that a foreign bank uses to conduct its banking business in the United States. The foreign activities of US banks are also regulated by the Federal Reserve.

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

Overview

Most banks are first regulated by their chartering entities, or their primary regulators. Primary regulators are generally responsible for conducting bank examinations, initiating supervisory and enforcement actions, and approving branch, change of control, merger and other applications. State-chartered institutions are regulated at the federal level by the Federal Reserve in the case of state member banks or by the FDIC in the case of state non-member banks. The following chart illustrates these relationships:

<i>Institution type</i>	<i>Chartering agency</i>	<i>Primary federal regulator</i>	<i>Secondary federal regulator</i>
Federal charter			
National bank	OCC	OCC	Federal Reserve, FDIC
Federal savings association	OCC	OCC	FDIC
Federal savings bank	OCC	OCC	FDIC
State charter			
State non-member bank	State agency	FDIC	N/A
State member bank	State agency	Federal Reserve	FDIC
State savings bank	State agency	FDIC	N/A
State savings association	State agency	FDIC	N/A
Foreign banks			
Foreign bank uninsured state branches and agencies	State agency	Federal Reserve	N/A
Foreign bank uninsured federal branches and agencies	OCC	OCC	Federal Reserve
Foreign bank commercial state chartered lending companies	State agency	Federal Reserve	N/A
Foreign bank edge corporations	Federal Reserve	Federal Reserve	N/A
Foreign bank agreement corporations	Federal Reserve	Federal Reserve	N/A
Foreign bank representative offices	State agency	Federal Reserve	N/A

Banks and bank holding companies may also be subject to functional regulation by other regulatory agencies, depending on the types of activities in which they engage. For instance, a bank holding company's securities underwriting and dealing activities are also regulated by the US Securities and Exchange Commission ("SEC"), the functional regulator of any SEC-registered broker-dealer, and any insurance activities would be supervised by the relevant state insurance regulator.

Regulatory reporting requirements and bank examinations

In order to supervise bank holding companies and banks, regulators have two primary tools – regulatory reporting requirements and on-site banking examinations. Bank holding companies and banks are subject to extensive financial, structural and other periodic reporting requirements. Financial reporting requirements for banks include capital, asset and liability data reported quarterly on call reports, and requirements for bank holding companies include financial statements for the bank holding company and certain non-bank subsidiaries. Bank holding companies are also required to provide annual reports to the Federal Reserve that detail their shareholders and their organisational structure. Banking institutions that are experiencing financial difficulties or are not in compliance with regulatory requirements face more frequent and additional reporting obligations.

Bank regulators also conduct on-site examinations of bank holding companies and banks. Regulators generally conduct three principal types of formal examinations: (1) safety and soundness, or 'full scope', examinations that determine the fundamental financial health of a bank and generally take place every 12 or 18 months; (2) compliance examinations that cover consumer compliance and fair lending issues; and (3) specialty examinations that cover areas such as trust activities and information technology infrastructure.

In the aftermath of the financial crisis, regulators came under intense public scrutiny by congressional committees, the Financial Crisis Inquiry Commission, the Government Accountability Office, and several other investigative or oversight bodies that questioned the quality of regulatory supervision in the years leading up to the financial crisis. Since the financial crisis, bank regulators appear to have increased their scrutiny of all regulatory reports, expanded the range of their full scope and specialty examinations, and also sharpened their supervisory focus on such areas as regulatory capital, corporate governance (boards and management) and liquidity and funding risk management.¹² The Dodd-Frank Act also expanded regulatory reporting requirements, notably in the area of stress testing; bank holding companies with \$50 billion or more in total assets are now subject to annual stress tests conducted by the Federal Reserve and must also conduct semi-annual internal stress tests, while all bank holding companies,

12 See, e.g., Rachel Witkowski, 'Regulators Ramp Up Bank Enforcement Actions', *American Banker*, 13 August 2010, www.americanbanker.com/issues/175_155/bank-enforcement-actions-1024026-1.html; Eugene A Ludwig, 'Relationships are Hard, Especially with Regulators', *American Banker*, 15 June 2011, www.americanbanker.com/issues/176_115/relationships-hard-especially-with-regulators-1039002-1.html; Barbara A Rehm, 'Big Banks Flunk OCC Risk Tests', *American Banker*, 13 December 2012, www.americanbanker.com/issues/177_238/big-banks-flunk-occ-risk-tests-1055128-1.html.

savings and loan holding companies, and state member banks with \$10 billion or more in total assets are required to conduct annual internal stress tests. Regulators have issued final rules implementing these requirements.¹³

Congress also expanded bank regulators' authority to examine entities beyond bank holding companies and banks in the Dodd-Frank Act. For instance, the Federal Reserve was granted the authority to examine functionally regulated subsidiaries (i.e., subsidiaries whose activities are regulated by another US regulatory authority, such as the SEC) and all insured depository institutions (including those for which the Federal Reserve is not currently the primary federal banking regulator).¹⁴ Previously, the Federal Reserve only had the authority to examine functionally regulated subsidiaries in narrow circumstances, such as when it had reasonable cause to believe that the functionally regulated subsidiary was engaged in activities that posed a material risk to an affiliated depository institution.¹⁵

The Dodd-Frank Act also requires the Federal Reserve to examine the permissible activities of bank holding companies' non-depository institution subsidiaries that are not functionally regulated or are not subsidiaries of a depository institution.¹⁶ The Federal Reserve is required to examine these entities subject to the same standards and with the same frequency as would be required if such activities were conducted in the lead insured depository institution. These expanded examination authorities are subject to the new Consumer Financial Protection Bureau in respect of federal consumer financial law, discussed in Section IV, *infra*.

Aside from transactions such as mergers and acquisitions or other matters that require formal approvals,¹⁷ bank regulators are also routinely informed or involved on a more informal basis with certain key decisions contemplated by a bank or bank holding company, including capital-raising activities, dividend policies and changes in business plans or strategies.

13 Fed. Reserve, Final Rule: Supervisory and Company-Run Stress Test Requirements for Covered Companies, 77 Fed. Reg. 62378 (12 October 2012), www.gpo.gov/fdsys/pkg/FR-2012-10-12/pdf/2012-24987.pdf; Fed. Reserve, Final Rule: Annual Company-Run Stress Test Requirements for Banking Organizations With Total Consolidated Assets Over \$10 Billion Other Than Covered Companies, 77 Fed. Reg. 62396 (12 October 2012), www.gpo.gov/fdsys/pkg/FR-2012-10-12/pdf/2012-24988.pdf; OCC, Final Rule: Annual Stress Test, 77 Fed. Reg. 61238 (9 October 2012), www.gpo.gov/fdsys/pkg/FR-2012-10-09/pdf/2012-24608.pdf; FDIC, Final Rule: Annual Stress Test, 77 Fed. Reg. 62417 (15 October 2012), www.gpo.gov/fdsys/pkg/FR-2012-10-15/pdf/2012-25194.pdf. See also FHFA, Proposed Rule: Stress Testing of Regulated Entities, 77 Fed. Reg. 60948 (5 October 2012), www.gpo.gov/fdsys/pkg/FR-2012-10-05/pdf/2012-24637.pdf.

14 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 604 (2010).

15 12 USC 1844(c)(2), as amended by Section 111 of the GLB Act.

16 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 604 (2010).

17 For a further discussion, see Section VI, *infra*.

Dodd-Frank Act deposit insurance reforms

The FDIC is the regulator responsible for administering the deposit insurance system and managing the Deposit Insurance Fund ('DIF') and is also involved in the supervision of depository institutions with insured deposits. Congress took statutory action in the Dodd-Frank Act to change the deposit insurance system in many important respects.

The Dodd-Frank Act permanently increases the Standard Maximum Deposit Insurance Amount ('SMDIA') to \$250,000, with retroactive effect for insured depository institutions ('IDIs') for which the FDIC was appointed receiver or conservator between 1 January 2008 and 3 October 2008.¹⁸ In order for a foreign bank to establish or operate a state branch without federal deposit insurance, the branch, in addition to meeting other requirements, may now only accept initial deposits in an amount equal to the SMDIA or greater.¹⁹

The Dodd-Frank Act also temporarily provided for unlimited FDIC deposit insurance coverage of non-interest-bearing transaction accounts,²⁰ regardless of the balance of the account.²¹ This unlimited coverage began on 31 December, 2010, and ended on 31 December, 2012. Legislative efforts to extend the unlimited coverage beyond the end of 2012 or to gradually phase out such coverage were unsuccessful.

In addition, the Dodd-Frank Act changes how the FDIC assesses deposit insurance premiums against IDIs. An IDI's quarterly deposit insurance assessment is determined by multiplying its assessment rate by its assessment base.²² An IDI's assessment base has historically been its domestic deposits, with some adjustments.²³ The Dodd-Frank Act, however, requires the FDIC to redefine the assessment base as total consolidated liabilities or average consolidated total assets minus average tangible equity during the assessment period.²⁴ This revision to assessment calculations shifts the distribution of assessments,

18 Pub. L. No. 111-203, Section 335, 124 Stat. 1,540. The retroactivity will benefit creditors of a number of financial institutions, such as IndyMac, that failed before the temporary increase in deposit insurance coverage was enacted at the height of the financial crisis.

19 12 CFR Section 347.213, www.gpo.gov/fdsys/pkg/CFR-2011-title12-vol4/pdf/CFR-2011-title12-vol4-sec347-213.pdf; FDIC, Final Rule: Deposit Insurance Regulations; Temporary Increase in Standard Coverage Amount; Mortgage Servicing Accounts; Revocable Trust Accounts; International Banking; Foreign Banks, 74 Fed. Reg. 47711, (17 September 2009), www.fdic.gov/regulations/laws/federal/2009/09Final917.pdf.

20 A non-interest-bearing transaction account is a deposit account where interest is neither accrued nor paid; depositors are permitted to make an unlimited number of transfers and withdrawals; and the IDI does not reserve the right to require advance notice of an intended withdrawal. 12 CFR 330.1(s).

21 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 343 (2010).

22 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 331(b) (2010).

23 FDIC, Final Rule: Assessments, Large Bank Pricing, 76 Fed. Reg. 10672, 10673 (25 February 2011), www.gpo.gov/fdsys/pkg/FR-2011-02-25/pdf/2011-3086.pdf.

24 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 331(b) (2010).

and the cost of federal deposit insurance, to larger banks, which fund a greater percentage of their balance sheet through non-deposit liabilities.²⁵ Because the new assessment base is larger than the existing assessment base, the FDIC generally lowered assessment rates going forward so that the new deposit insurance assessments are revenue neutral from the DIF's perspective.²⁶ The FDIC also established a new assessment system for large IDIs and highly complex IDIs²⁷ that combines supervisory ratings and certain financial measures into two scorecards, one for most large IDIs and another for highly complex IDIs, and modifies and introduces new assessment rate adjustments.²⁸

The Dodd-Frank Act also modifies the management of the DIF. Among other things, the Act requires that the DIF's reserve ratio²⁹ reach 1.35 per cent by 30 September 2020 (rather than 1.15 per cent by the end of 2016, as previously required);³⁰ stipulates that, in setting assessments, the FDIC offset the effect of requiring that the reserve ratio reach 1.35 per cent by 30 September 2020 on IDIs with total assets of less than \$10 billion;³¹ eliminated the requirement that the FDIC provide dividends from the DIF

25 FDIC, Final Rule: Assessments, Large Bank Pricing, 76 Fed. Reg. 10672 (25 February 2011), www.gpo.gov/fdsys/pkg/FR-2011-02-25/pdf/2011-3086.pdf.

26 Id.

27 A 'large IDI' would continue to be defined as an IDI with at least \$10 billion in total assets for at least four consecutive quarters while a 'highly complex IDI' would be an IDI (other than a credit card bank) with \$50 billion or more in total assets for at least four consecutive quarters controlled by a parent or intermediate parent company with more than \$500 billion in total assets or a processing bank or trust company with at least \$10 billion in total assets for at least four consecutive quarters. FDIC, Final Rule: Assessments, Large Bank Pricing, 76 Fed. Reg. 10672, 10688 (25 February 2011), www.gpo.gov/fdsys/pkg/FR-2011-02-25/pdf/2011-3086.pdf.

28 Each scorecard assesses certain risk measures to produce two scores that would be combined and converted into an initial assessment rate. The performance score measures an IDI's financial performance and its ability to withstand stress. The loss severity score quantifies the relative magnitude of potential losses to the FDIC in the event of the IDI's failure. According to the FDIC, the scorecard method better captures risk at the time it is assumed by a large or highly complex IDI, better differentiates risk among such institutions during periods of good economic and banking conditions based upon how they would fare during periods of stress or economic downturns, and better takes into account the losses that the FDIC may incur if such an institution fails.

29 The reserve ratio of the DIF means the ratio of the net worth of the DIF to the value of the total estimated insured deposits covered by FDIC deposit insurance. Federal Deposit Insurance Act Section 3(y)(3), 12 USC 1813(y)(3).

30 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 334(d) (2010).

31 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 334(e) (2010).

when the reserve ratio is between 1.35 per cent and 1.5 per cent;³² and granted the FDIC sole discretion in determining whether to suspend or limit the declaration or payment of dividends.³³

ii Management of banks

The two traditional areas of regulatory focus on the management of banks have been the responsibilities and duties of bank holding companies and bank boards, directors and senior management and the regulation of insider loans.

Bank and bank holding company boards of directors are different from corporate boards in that they normally have more competing interests to balance, such as shareholder, depositor, parent holding company (in the case of a bank), creditor and regulatory interests. Bank and bank holding company boards are generally responsible for overseeing management plans and ensuring that there are adequate controls and systems in place to identify and manage risk, while management is responsible for the implementation, integrity and maintenance of risk-management systems. Bank examiners normally review bank and bank holding company board performance and make recommendations for improvement if they find weaknesses.³⁴

During the financial crisis, regulators actively used their authority to review board performance and, in some cases, they encouraged banks to include directors with more banking experience and fewer ties to management on their boards.

The Federal Reserve Act of 1913 and implementing regulations also govern extensions of credit by a bank to an executive officer, director or principal shareholder of that bank, of a bank holding company of which the member bank is a subsidiary, or of any other subsidiary of that bank holding company. In general, a bank may not extend credit to any such 'insider' unless the extension of credit (1) is made on substantially all the same terms, and subject to no less stringent credit underwriting procedures, as those for comparable transactions by the bank with persons who are not insiders and not employed by the bank; and (2) does not involve more than the normal risk of

32 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 332 (2010).

33 In February 2011, the FDIC ruled that it will suspend dividends indefinitely whenever the DIF's reserve ratio exceeds 1.5 per cent to increase the probability that the fund's reserve ratio will reach a level sufficient to withstand a future crisis. In lieu of dividends, the FDIC will progressively lower deposit insurance assessment rates against IDIs when the reserve ratio exceeds 2 per cent and 2.5 per cent. FDIC, Final Rule: Assessments, Large Bank Pricing, 12 CFR Section 327.50 (effective 1 April 2011), 76 Fed. Reg. 10672 (25 February 2011), www.gpo.gov/fdsys/pkg/FR-2011-02-25/pdf/2011-3086.pdf.

34 OCC, Detecting Red Flags in Board Reports – a Guide for Directors (2004), www.occ.gov/publications/publications-by-type/other-publications-reports/rf_book.pdf; OCC, Internal Controls – a Guide for Directors (2000), www.occ.gov/publications/publications-by-type/other-publications-reports/IntCtrl.pdf; OCC, The Director's Book – the Role of National Bank Director (2010), www.occ.gov/publications/publications-by-type/other-publications-reports/director.pdf.

repayment or present other unfavourable features. The Dodd-Frank Act strengthened insider loan restrictions by expanding the types of transactions subject to insider lending limits to include derivative transactions, repurchase agreements and securities lending or borrowing transactions. It also imposed limitations on the sale of assets to, or the purchase of assets from, insiders by requiring that such transactions be on market terms and, in the case of significant transactions, have the approval of the majority of disinterested board members.³⁵

New areas of regulatory focus – executive remuneration

Since 2008, bank and bank holding company management remuneration has become an area that has received widespread media, political and regulatory attention. Congress and regulators have both formally and informally become more involved in reviewing remuneration packages and providing input on the appropriateness of remuneration at both the bank and bank holding company level.

In 2010, the Federal Reserve, the OCC, the FDIC and the OTS jointly issued final guidance intended to ensure that incentive remuneration paid by banking organisations does not encourage imprudent risk taking that threatens an organisation's safety and soundness.³⁶

In 2011, the Federal Reserve, in consultation with the other federal banking agencies, published a report on the trends and developments in remuneration practices at large banking organisations that have been observed as a part of a 'horizontal review' or a coordinated examination of practices across multiple firms.³⁷ The report found that large banking organisations have made significant progress in adjusting incentive remuneration arrangements to provide appropriately balanced incentives to take risk, but significant work remains to achieve full compliance with regulatory guidance. In addition to the work with the large, complex banking organisations, the banking agencies are also working to incorporate oversight of incentive remuneration arrangements into the regular examination process for smaller firms.³⁸

Further, as required by the Dodd-Frank Act, on 30 March 2011, seven federal agencies – the OCC, the Federal Reserve, the FDIC, the OTS, the National Credit Union Association ('NCUA'), the SEC and the Federal Housing Finance Agency ('FHFA') – jointly proposed a draft rule to mandate that each covered financial institution with assets of at least \$1 billion prohibit incentive-based remuneration that is excessive or

35 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Sections 614, 615 (2010).

36 Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (25 June 2010), <http://edocket.access.gpo.gov/2010/pdf/2010-15435.pdf>.

37 Fed. Reserve, Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations (2011), www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf.

38 Fed. Reserve press release, 'Federal Reserve, OCC, OTS, FDIC Issue Final Guidance on Incentive Compensation' (21 June 2010), www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm.

that could lead to material financial loss to the institution and disclose incentive-based remuneration arrangements to its appropriate regulator.³⁹

The proposed rule would subject financial institutions to the following requirements:

- a* all covered financial institutions with \$1 billion of assets would be subject to principles-based prohibitions on providing incentive-based remuneration that is excessive or that could lead to material financial loss to the institution and would be required to submit annual reports to their appropriate regulators and to establish and maintain policies and procedures governing the award of incentive-based remuneration; and
- b* larger covered financial institutions with \$50 billion of assets would be required to defer 50 per cent of incentive-based remuneration paid to executive officers and to review and approve incentive-based remuneration paid to non-executive officers who individually have the ability to expose the institution to a substantial amount of risk.

These requirements would apply to a wide array of financial institutions, including bank holding companies, banks, broker-dealers, investment advisers and, possibly, other institutions, such as insurance companies, if they are subsidiaries of certain covered financial institutions. As of 1 February 2013, a final rule has not yet been issued.

New areas of regulatory focus – risk management

The Dodd-Frank Act also imposes a new focus on risk management, requiring the establishment of risk committees by publicly traded bank holding companies with \$10 billion or more in total assets, and allowing the Federal Reserve to prescribe public disclosure to support market evaluation of a company's risk profile, capital adequacy and risk-management capabilities. On 5 January 2012, the Federal Reserve published proposed rules to implement the risk committee requirements. See Section VII, *infra*.

iii Regulatory capital

Regulatory capital emerged from the financial crisis as one of bank regulators' primary areas of supervisory focus. This section will cover existing capital requirements and changes to capital requirements that will occur over time as the Dodd-Frank Act and the Basel Committee on Banking Supervision's ('Basel Committee') new accord on regulatory capital, known as Basel III, are implemented.

39 Department of the Treasury, Federal Reserve, FDIC, National Credit Union Administration, SEC, Federal Housing Finance Agency, Proposed Rule Regarding Incentive-based Compensation Arrangements, 76 Fed. Reg. 21170 (14 April 2011), www.gpo.gov/fdsys/pkg/FR-2011-04-14/pdf/2011-7937.pdf.

Capital rules applied to US banks

Current capital requirements

Under current US bank regulations, to be considered ‘adequately capitalised’, a bank must have a Tier I capital ratio of at least 4 per cent of risk-weighted assets (‘RWAs’), a total capital ratio of at least 8 per cent of RWAs and a leverage ratio (Tier I capital to average total on-balance sheet assets) of at least 4 per cent. To be ‘well capitalised’, a bank must have a Tier I capital ratio of at least 6 per cent, a total capital ratio of at least 10 per cent and a leverage ratio of at least 5 per cent. In addition, all bank holding companies are currently subject to the following minimum capital requirements: a Tier I capital ratio of at least 4 per cent of RWAs; a total capital ratio of at least 8 per cent of RWAs; and a leverage ratio (Tier I capital to average total on-balance sheet assets) of at least 4 per cent (a 3 per cent minimum currently applies to bank holding companies with strong supervisory ratings).⁴⁰ Approximately 475 top-tier bank holding companies in the US are required to ensure that all banks they control remain ‘well capitalised’ as a result of electing to be financial holding companies.⁴¹

Basel II implementation

In 2004, the Basel Committee published capital guidelines, known as Basel II, reflecting a new international consensus among bank regulators on appropriate capital requirements and monitoring tools developed since publication of the Basel I Accord in 1988. The United States has, thus far, issued final rules to implement Basel II only in part. In December 2007, the US banking agencies issued final rules establishing a new risk-based capital framework, known as the advanced approaches, which implemented Basel II’s advanced internal ratings-based approach to calculating risk-based capital requirements for credit risk and advanced measurement approaches to calculating risk-based capital requirements for operational risk. The advanced approaches capital framework became effective 1 April 2008 but required a phase-in period of several years.

The US banking agencies made the Basel II advanced approaches mandatory only for internationally active US banking organisations with at least \$250 billion in consolidated total assets or at least \$10 billion of on-balance sheet foreign exposures (known as ‘core’ banking organisations), of which there are at least 17 in the United States.⁴² The US banking agencies also permitted other US banking organisations to adopt the Basel II advanced approaches if they meet the applicable qualification requirements (known as ‘opt-in’ banking organisations). ‘Core’ and ‘opt-in’ banking organisations

40 12 CFR Part 225, Appendix A (Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure) and Appendix E (Capital Adequacy Guidelines for Bank Holding Companies: Tier 1 Leverage Measure).

41 According to data from the Federal Reserve’s website, as of 21 December 2012, there were 475 top-tier financial holding companies in the United States. See Board of Governors of the Federal Reserve System, ‘Financial Holding Companies’, www.federalreserve.gov/bankinforeg/fhc.htm.

42 As of the end of 2011, there were 17 ‘core’ banking organisations and one ‘opt-in’ banking organisation. Basel Committee, Basel III regulatory consistency assessment (Level 2) Preliminary report: United States of America (October 2012) at 8 n. 12.

are collectively referred to as advanced approaches banking organisations. All other US banking organisations are required to calculate their risk-based capital ratios using only the ‘general risk-based capital rules,’ which as of 1 February 2013 were based on Basel I.

An advanced approaches banking organisation is required to undergo a parallel run period of at least four consecutive quarters during which it remains subject to the general risk-based capital rules (currently based on Basel I) but also must calculate its capital ratios using the advanced approaches and report them to its primary federal supervisor.⁴³ The advanced approaches generally rely on a banking organisation’s internal models to calculate RWAs (the denominator of a banking organisation’s risk-based capital ratios). Reliance on internal models could, in some instances, result in lower RWA values compared with ‘standardised’ non-models based approaches, thereby lowering such banking organisations’ regulatory capital requirements. To avoid abrupt decreases in regulatory capital requirements, the advanced approaches, similar to Basel II implementation in many jurisdictions outside the United States, originally provided for RWA transitional floors over the course of three years. The transitional floors required that banking organisations’ RWAs be at least equal to 95, 90 and 85 per cent of the value of their RWAs, as calculated under the general risk-based capital rules, in the first, second and third years of the transition period, respectively.

As discussed in greater detail below, as a result of the Dodd-Frank Act, the US banking agencies have modified the advanced approaches by eliminating the transitional floors and replacing them with a permanent capital floor that is based on the generally applicable risk-based capital rules that apply to US banks. Accordingly, an advanced approaches banking organisation must calculate its risk-based capital ratios under both the generally applicable risk-based capital rules (currently based on Basel I) and the advanced approaches. The banking organisation must then use the lower of the two sets of risk-based capital ratios to determine whether it meets the minimum risk-based capital requirements.⁴⁴ This has the practical effect of denying advanced approaches banking organisations any potential capital-saving benefits of using the more risk-sensitive advanced approaches to calculate their minimum capital requirements.

Current capital elements

Currently, there are two types of capital components that banking regulators use in monitoring the financial health of banks: ‘core capital elements’ (Tier I capital elements) and ‘supplementary capital elements’ (Tier II capital elements). As discussed in greater detail below, Basel III introduces a new tier of capital, common equity Tier I, and generally narrows the eligibility criteria for Tier I and Tier II capital elements.

43 As of 1 February 2013, none of the advanced approaches banking organisations had exited their parallel run and begun formally calculating and reporting their regulatory capital requirements in accordance with the Basel II advanced approaches.

44 Office of the Comptroller of the Currency, Federal Reserve, Federal Deposit Insurance Corporation, ‘Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor’, 76 Fed. Reg. 37620 (28 June 2011), www.gpo.gov/fdsys/pkg/FR-2011-06-28/pdf/2011-15669.pdf.

In the case of bank holding companies, Tier I capital is currently composed of common stock, non-cumulative perpetual preferred stock, certain restricted core capital elements,⁴⁵ disclosed reserves and minority interests in the equity accounts of consolidated subsidiaries. In the case of banks, trust preferred securities and hybrid securities are not considered Tier I capital elements and may be included only in Tier II capital. Tier II capital is composed of capital items that are considered to be important parts of a bank's capital base, but may not have the same loss-absorbing properties as Tier I capital. Tier II capital, for bank holding companies, includes hybrid capital instruments (e.g., mandatory convertible debt, cumulative perpetual preferred stock), term subordinated debt, intermediate-term preferred stock and certain types of reserves.⁴⁶ Basel III and provisions of the Dodd-Frank Act related to regulatory capital have the effect of narrowing the class of instruments that qualify as regulatory capital, as described in greater detail below.

Adequacy of capital standards challenged by the financial crisis

The collapse, and near collapse, of several financial institutions challenged the notion that the existing Basel capital standards, as applied, were accurate indicators of the appropriate amount of capital that institutions needed in order to remain solvent during unexpected and severe market shocks, such as the severe downturn in the US housing market, the first domino to fall during the financial crisis.

Unable to change capital requirements quickly in response to the crisis, bank regulators instead used their existing regulatory authority to informally encourage or formally require bank holding companies and their subsidiary banks to increase their capital. The number of supervisory actions against financial institutions and institution-affiliated parties reached unprecedented levels during the financial crisis and continued to rise in 2010, well after the lowest point of the crisis. Bank regulators took 1,011 formal and informal actions against banking organisations in 2008, followed by 2,242 such actions in 2009, and 2,724 in 2010. As demonstrated by the table below, however, the number of informal actions has grown much more quickly than formal actions, and formal actions actually dropped between 2009 and 2010.

Formal and informal supervisory actions taken by US banking agencies 2008–2010

	2008	2009	2010
Formal	506	1,143	1,056
Informal	505	1,099	1,668
Total	1,011	2,242	2,724

45 Restricted core capital elements include: qualifying cumulative perpetual preferred stock and qualifying trust preferred securities (must be issued by a trust or similar entity sponsored, but generally not consolidated, by a banking organisation that is the sole common equity holder of the trust).

46 See, e.g., undisclosed reserves, asset revaluation reserves, general provisions or general loan-loss reserves.

Federal Reserve Board policy requires a bank holding company to act as a source of financial and managerial strength to each of its subsidiary banks and to commit resources to their support. This policy became a statutory requirement pursuant to the Dodd-Frank Act. Section 616(d) requires all companies that directly or indirectly control an insured depository institution to serve as a source of strength for the institution.⁴⁷ US banking agencies were required to issue regulations implementing this requirement not later than 21 July 2012, but, as of 1 February 2013, had not proposed any such regulations.

Similarly, under the cross-guarantee provisions of the Federal Deposit Insurance Act, the FDIC can hold any FDIC-insured depository institution liable for any loss suffered or anticipated by the FDIC in connection with ‘the default’ of a commonly controlled FDIC-insured depository institution or any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution ‘in danger of default’.

The result of the bank regulators’ efforts was the beginning of a sustained period of increased bank capital offerings and minority investments in banks.⁴⁸ In the case of bank holding companies or banks that were dangerously close to becoming or that were not adequately capitalised, regulators used more formal mechanisms, such as enforcement actions, pursuant to the statutory authority provided in the Federal Deposit Insurance Corporation Improvement Act of 1991⁴⁹ to compel such institutions to increase their capital.

When it was clear that market confidence in bank holding companies’ ability to remain solvent was not restored as a result of this initial capital raising activity and other government efforts discussed in Section V, *infra*, the government took further action by implementing the Supervisory Capital Adequacy Program (‘SCAP’) in 2009. The Federal Reserve, supervisors, economists and analysts led and conducted SCAP and assessed the amount of capital needed by the 19 largest US bank holding companies to withstand

47 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 616(d) (2010).

48 Alejandro Lazo, ‘Washington Mutual Gets \$7 Billion Boost’; ‘Bank to Close Home-Loan Offices, Eliminate 3,000 Jobs’, Washington Post, 9 April 2008, www.washingtonpost.com/wp-dyn/content/article/2008/04/08/AR2008040803339.html; Morgan Stanley press release, ‘Morgan Stanley Announces Plan to Pursue Global Strategic Alliance with Mitsubishi UFJ Financial Group’ (22 September 2008), www.morganstanley.com/about/press/articles/6934.html; Goldman Sachs press release, ‘Berkshire Hathaway to Invest \$5 Billion in Goldman Sachs’ (23 September 2008); David Enrich & Damian Paletta, ‘Regulators Push the Banks – Seek Outside Capital, Market Officials Urge, and WaMu Is Doing So’, Wall Street Journal, 7 March 2008, <http://online.wsj.com/article/SB120486529923119143.html>; Tomoeh Murakami Tse, ‘After Losses, Banks Do Damage Control’; ‘Citigroup, Others Shoring Up Capital’, Washington Post, 30 April 2008, www.washingtonpost.com/wp-dyn/content/article/2008/04/29/AR2008042902700.html.

49 The Federal Deposit Insurance Corporation Improvement Act of 1991 requires the relevant federal banking regulator to take ‘prompt corrective action’ with respect to a depository institution if that institution does not meet certain capital adequacy standards. Federal Deposit Insurance Corporation Improvement Act Section 131(a), 105 Stat. 2253 (codified at 12 USC Section 1831o).

greater than expected losses and still remain sufficiently capitalised through 2010 to be able to meet the needs of their creditworthy borrowers. SCAP consisted of a series of stress tests under a baseline economic scenario and a variety of more adverse scenarios.⁵⁰

Following SCAP, the Federal Reserve announced that it would require the same 19 bank holding companies ('SCAP bank holding companies') to submit a comprehensive capital plan to the Federal Reserve by January 2011. The Federal Reserve also announced guidelines that it would use for evaluating the capital plans, including plans to undertake capital actions in 2011, such as increasing dividends or redeeming stock.⁵¹ The guidelines simulated stress conditions and placed particular emphasis on the banking organisation's ability to absorb losses over a two-year period under three scenarios – baseline, adverse and severely adverse – and take into account the impact of the Dodd-Frank Act and Basel III on the organisation's capital position and its plans to repay US government investments, if applicable.

After the 2011 SCAP stress tests, the Federal Reserve adopted a final rule, in November 2011, making capital plans and related stress tests part of the annual supervisory process for large bank holding companies.⁵² Unlike the earlier stress tests, which only applied to the 19 largest banking organisations in the United States, the capital plan final rule applies to US bank holding companies with consolidated assets of \$50 billion or more ('large bank holding companies'). Effective from December 2011, large bank holding companies must submit annual capital plans to the Federal Reserve for non-objection incorporating projected capital distributions over a planning horizon of at least nine quarters. *Inter alia*, the capital plan must demonstrate a large bank holding company's ability to maintain capital above each minimum regulatory capital ratio and a Tier I common ratio of at least 5 per cent on a *pro forma* basis under expected and stressful conditions throughout the planning horizon.

In the absence of a non-objection regarding the capital plan, large bank holding companies generally may not pay dividends or make other capital distributions.⁵³ Large bank holding companies are required to submit their capital plans to the Federal Reserve in early January each year, and the Federal Reserve must take action by March.

The Dodd-Frank Act codified capital stress tests into its enhanced prudential standards framework. Section 165 of the Dodd-Frank Act requires large bank holding companies and systemically important non-bank financial companies designated by the FSOC for supervision by the Federal Reserve (collectively, 'covered companies') to

50 Federal Reserve, The Supervisory Capital Assessment Program: Overview of Results (7 May 2009), www.federalreserve.gov/bankinforeg/bcreg20090507a1.pdf.

51 Federal Reserve press release, 'Press Release' (17 November 2010), www.federalreserve.gov/newsevents/press/bcreg/20101117b.htm.

52 Federal Reserve, 'Capital Plans,' 76 Fed. Reg. 74631 (1 December 2011), www.gpo.gov/fdsys/pkg/FR-2011-12-01/pdf/2011-30665.pdf.

53 Even if a large bank holding company receives a non-objection, it may not pay a dividend or make other capital distributions without Federal Reserve approval under specified circumstances, such as if the distribution would result in the bank holding company not meeting a minimum regulatory capital ratio or a Tier I common ratio of at least 5 per cent on a *pro forma* basis under expected and stressful conditions throughout a planning horizon.

conduct semi-annual company-run stress tests and requires all other financial companies that have total consolidated assets of more than \$10 billion and are regulated by a primary federal financial regulatory agency to conduct annual company-run stress tests. Section 165 also requires the Federal Reserve to conduct annual supervisory stress tests of covered companies. In addition, companies subject to stress test requirements must publish summaries of their company-run stress test results and the Federal Reserve must publish summaries of its supervisory stress test results. In October 2012, the Federal Reserve, OCC and FDIC issued broadly consistent final rules to implement the Dodd-Frank Act's stress test requirements for banking organisations subject to their primary supervision.⁵⁴ Most banking organisations subject to the final rules will perform their first stress tests under the rules in the autumn of 2013.

In November 2012, the Federal Reserve launched the 2013 capital planning and stress testing process for large bank holding companies with the publication of two sets of instructions: one set for the 19 SCAP bank holding companies and another set for 11 other US-domiciled, top-tier bank holding companies with total consolidated assets of \$50 billion or more ('non-SCAP bank holding companies'). The 2013 instructions to the 19 SCAP bank holding companies reveal how the Dodd-Frank Act's stress test rules will be integrated into the Federal Reserve's capital planning process.⁵⁵ Non-SCAP bank holding companies will become subject to Dodd-Frank Act stress test rules beginning in the 2014 stress test cycle (i.e., the autumn of 2013).

Phase-in of new regulatory capital requirements and practical implications

An international consensus has emerged that bank holding companies and banks must hold more capital and that common equity should comprise a larger portion of banks' capital. When fully implemented, the Dodd-Frank Act and Basel III will require banking organisations to raise significant amounts of new capital to meet enhanced capital standards. In addition, as discussed further below, the G20 in November 2011 agreed to impose a capital surcharge on the world's largest and most systemically important banking organisations. While aiming to reduce the frequency and severity of financial crises, the new rules, when fully implemented, are expected to reduce economic growth: A Basel Committee working paper released in February 2011 estimated that each percentage point increase in the capital ratio under the Basel rules will result in a median 0.09 per cent decline in the level of steady state output, relative to the baseline.⁵⁶

54 As of 1 February 2013, non-banking regulators, such as the SEC and CFTC, have yet to issue rules implementing the Dodd-Frank Act's stress test requirements for entities subject to their federal supervision.

55 For a detailed discussion of the 2013 capital planning and stress-testing process for large bank holding companies, please see Davis Polk & Wardwell LLP, 2013 CCAR Process Begins and US Basel III Rules Are Delayed (14 November, 2012), www.davispolk.com/files/Publication/a531f098-49f8-4d38-a462-37ba2a1805d2/Presentation/PublicationAttachment/78874f7c-8fe8-40c2-a6fe-39335c0f6835/111412_CCAR.pdf.

56 P Angelini, L Clerc, V Cúrdia, L Gambacorta, A Gerali, A Locarno, R Motto, W Roeger, S Van den Heuvel, J Vlček, 'Basel III: Long-term economic performance and fluctuations', BIS Working Papers, No. 338 (February 2011).

As discussed further below, in June 2012, the US banking agencies issued proposals that would implement many aspects of the Basel III capital framework in the United States ('US Basel III proposals'). The proposals would apply to virtually all US banking organisations and, if adopted, would represent the most comprehensive revision to US bank capital standards in over two decades.

Dodd-Frank Act – the Collins Amendment

Section 171 of the Dodd-Frank Act, commonly referred to as the Collins Amendment, imposes, over time, the risk-based and leverage capital standards currently applicable to US insured depository institutions on US bank holding companies, including US intermediate holding companies of foreign banking organisations, as well as thrift holding companies and systemically important non-bank financial companies. The Collins Amendment also limits the class of equity and debt instruments that qualify as regulatory capital by eliminating, for certain banking organisations, the ability to use trust preferred securities as an element of Tier I capital.

The minimum leverage and risk-based capital requirements applicable under the Collins Amendment are subject to two floors:

- a* the requirements must not be 'less than' the 'generally applicable risk-based capital requirements' and the 'generally applicable leverage capital requirements'; and
- b* they must also not be 'quantitatively lower than' the risk-based capital and leverage requirements that were in effect for insured depository institutions as of 21 July 2010.

The US banking agencies adopted a final rule in June 2011 to implement the capital floor requirement of the Collins Amendment.⁵⁷ The final rule amended the advanced approaches to impose a permanent capital floor based on the generally applicable risk-based capital rules that apply to US banks. Currently the generally applicable risk-based capital rules are based on Basel I. The June 2012 US Basel III proposals, however, would replace the existing generally applicable risk-based capital rules with two sets of rules. The first set of rules, embodied in the Basel III Numerator Proposal,⁵⁸ would implement many of Basel III's revisions to minimum capital requirements and to regulatory capital, the numerator of a banking organisation's risk-based capital ratios. The second set of rules proposal, embodied in the Standardised Approach Proposal,⁵⁹ would implement a modified, US version of the standardised approach for credit risk under Basel II. If adopted as final rules, the Basel III Numerator Proposal and Standardised Approach

57 Office of the Comptroller of the Currency, Federal Reserve, Federal Deposit Insurance Corporation, 'Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor,' 76 Fed. Reg. 37620 (28 June 2011), www.gpo.gov/fdsys/pkg/FR-2011-06-28/pdf/2011-15669.pdf.

58 Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (30 August, 2012).

59 Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (30 August, 2012).

Proposal would together constitute the new Collins Amendment capital floor for advanced approaches banking organisations.

The Collins Amendment does not require any ‘capital deductions’ for debt or equity instruments issued before 19 May 2010 by a depository institution holding company with total consolidated assets of less than \$15 billion as of 31 December 2009. The Collins Amendment permanently grandfathers the qualifying hybrid capital of these institutions for regulatory capital purposes, although they must comply with the Collins Amendment when issuing new regulatory capital instruments. Likewise, debt or equity instruments issued to the federal government or any agency before 4 October 2010 – the last date of the Treasury’s authority to invest in banking organisations through the Troubled Asset Relief Program (‘TARP’) – are exempt from the Collins Amendment. Further, the Amendment does not require any ‘capital deductions’ for debt or equity instruments issued before 19 May 2010 by an organisation that was a mutual holding company on 19 May 2010.

The requirements of the Collins Amendment will be phased in over a number of years. For depository holding companies with consolidated assets of \$15 billion or more and systemically important non-bank financial companies, the phase-out of hybrid debt or equity instruments from Tier I capital would take place over a three-year period beginning on 1 January 2013. This statutorily mandated phase-out schedule is more accelerated than the one under Basel III, which generally provides for a nine-year phase-out of existing instruments that no longer meet Basel III’s new eligibility criteria for regulatory capital instruments. Under the US Basel III proposals, which would implement the Collins Amendment’s phase-out schedule, capital instruments issued before 19 May 2010 by a depository institution holding company with \$15 billion or more in total consolidated assets as of 31 December 2009 that do not meet the proposed eligibility criteria for additional Tier I or Tier II capital, but that were included in Tier I or Tier II capital as of 19 May 2010, would be phased out over a linear three-year schedule beginning in 2013. As of 1 January 2013, up to 75 per cent of Tier I capital and up to 75 per cent of Tier II capital could consist of capital instruments issued before 19 May 2010 that would no longer be considered Tier I or Tier II capital under the Basel III Numerator Proposal. The proportion of allowable non-qualifying instruments would decline annually on a linear basis until 1 January 2016, at which point all Tier I and Tier II capital would have to meet the new standards. In contrast, depository institution holding companies with less than \$15 billion in total consolidated assets and depository institutions would be allowed to benefit from Basel III’s more gradual phase-out schedule that would extend until 1 January 2022 with respect to capital instruments that were issued before 12 September 2010 and were outstanding as of 1 January 2013.

Bank holding companies with consolidated assets of less than \$500 million are exempt from the risk-based capital and leverage capital requirements of the Collins Amendment and will not be forced to exclude hybrid debt or equity instruments issued before 19 May 2010 from regulatory capital. While the Collins Amendment does not apply to foreign parents of banks operating in the US, its requirements do apply to intermediate US holding companies of foreign banks. For domestic bank holding company subsidiaries of foreign banking organisations that have relied on the exemption from the Federal Reserve’s capital adequacy guidelines under Supervision and Regulation Letter SR-01-1, the US risk-based capital and leverage capital requirements and the other

requirements of the Collins Amendment for debt or equity issued before 19 May 2010 will take effect on 21 July 2015.

Basel III

At the end of 2010, the Basel Committee reached agreement on Basel III: A global regulatory framework for more resilient banks and banking systems ('Basel III'), a comprehensive set of reforms to the Basel capital framework, which represented the Basel Committee's response to the recent financial crisis and was intended to raise the resilience of the banking sector by, *inter alia*, increasing both the quality and quantity of regulatory capital.

Among other significant revisions to the Basel capital framework, Basel III introduces a new tier of capital – common equity Tier I capital – and requires banks to maintain a minimum ratio of common equity Tier I capital to RWAs of 4.5 per cent. It requires banks to maintain a minimum ratio of Tier I capital (the sum of common equity Tier I and additional Tier I capital) to risk-weighted assets of 6 per cent (increased from the current 4 per cent) and a minimum ratio of total capital (the sum of Tier I and Tier II capital) to risk-weighted assets of 8 per cent (unchanged from the current requirement). In addition, Basel III introduces regulatory capital buffers – consisting of the capital conservation buffer and, if deployed, the countercyclical buffer – that banks must maintain above these minimum requirements in order to avoid restrictions on capital distributions and discretionary bonus payments.

In terms of the numerator of the risk-based capital ratio, Basel III narrows the eligibility criteria for regulatory capital instruments within each tier of capital and introduces new regulatory deductions from and adjustments to capital, the vast majority of which apply to common equity Tier I capital instead of Tier I or total capital. As for the denominator of the risk-based capital ratio, Basel III makes a number of changes to the way banks calculate risk-weighted asset amounts for over-the-counter as well as centrally cleared derivative and repo-style transactions. Basel III also introduces a non-risk based Tier I leverage ratio, which takes into account both on- and off-balance sheet exposures in its denominator. In general, the Basel III capital standards will be phased in over a multi-year period.

The Basel III reform package also includes an international liquidity framework that centers around two quantitative measures of liquidity: the liquidity coverage ratio ('LCR') and the net stable funding ratio ('NSFR'). This framework, aspects of which are still being debated and calibrated at the Basel Committee level,⁶⁰ was introduced

60 In January 2013, the Basel Committee made some significant revisions to the LCR. The revised LCR allows banks to use a broader range of liquid assets to meet its liquidity buffer and relaxes some of the run-off assumptions that banks must make in calculating their net cash outflows. The Basel Committee also clarified that banks may dip below the minimum LCR requirement during periods of stress. The Basel Committee expects national regulators to implement the LCR on a phased-in basis beginning on 1 January 2015. The Basel Committee stated that it will press ahead with its review of the NSFR. See Basel Committee, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013), www.bis.org/publ/bcbs238.pdf.

to address some of the liquidity problems faced by certain banking organisations at the height of the recent financial crisis.

US Basel III Proposals

The US Basel III proposals consist of three proposed rules and a final rule, which, taken together, would implement Basel III for virtually all US banking organisations. The first of the three proposed rules ('Basel III Numerator Proposal')⁶¹ would implement many of Basel III's revisions to minimum capital requirements and to regulatory capital, the numerator of a bank's risk-based capital ratios. The second proposed rule ('Standardised Approach Proposal')⁶² would implement a modified, US version of the standardised approach for credit risk under Basel II. If adopted as final rules, the Basel III Numerator Proposal and Standardised Approach Proposal together would constitute the new permanent capital floor for advanced approaches banks. The Basel III Numerator Proposal and the Standardised Approach Proposal would apply to all US national banks, all state member and non-member banks, all state and federal savings associations, all US bank holding companies except those with less than \$500 million in total consolidated assets, and all US savings and loan holding companies (collectively, 'US banking organisations'). The third proposed rule ('Advanced Approaches Proposal')⁶³ would revise the existing Basel II-based advanced approaches capital rules to implement the revisions in Basel III. The Advanced Approaches Proposal would apply to advanced approaches banking organisations.

The US Basel III proposals diverge from the international Basel capital standards in a number of ways. For example, the international Basel capital standards, particularly the standardised approach for credit risk, rely extensively on external credit ratings in determining the risk weight for many types of exposures. However, Section 939A of the Dodd-Frank Act requires federal agencies, including the US banking agencies, to remove all references to external credit ratings in their regulations and replace them with alternative standards of creditworthiness. As a result of Section 939A, the US Basel III proposals do not contain references to external credit ratings. *Inter alia*, this means that the US Basel III proposals would not permit US banking organisations to use the ratings-based approach to calculate capital requirements for securitisation exposures. It also means that under the Standardised Approach Proposal, a banking organisation would be required to assign risk weights to exposures to foreign sovereigns, foreign public sector entities and foreign banks that are generally based on the relevant sovereign's OECD country risk classification.

The Federal Reserve has indicated that it intends to implement a provision under Basel III, agreed to by the G20 in November 2011, that would require global systemically

61 Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (30 August 2012).

62 Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 (30 August 2012).

63 Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule, 77 Fed. Reg. 52,978 (30 August 2012).

important banks ('G-SIBs') to hold an additional common equity Tier I capital buffer of between 1 and 2.5 per cent of a G-SIB's RWAs, depending on the size of the G-SIB's systemic footprint.⁶⁴ The G-SIB capital surcharge is intended to function as an extension of the Basel III capital conservation buffer.⁶⁵ As of 1 February 2013, the Federal Reserve has not yet issued a proposed rule to implement the G-SIB surcharge in the United States.

Using the Basel Committee's G-SIB methodology and 2009 data, the Financial Stability Board ('FSB') in November 2011 issued an initial list of 29 G-SIBs.⁶⁶ The FSB stated that the list of G-SIBs will be updated annually in November and the G-SIB surcharge would initially apply to those banks identified in the November 2014 list. In November 2012, the FSB issued an updated list of 28 G-SIBs using year-end 2011 data and provisionally assigned to each G-SIB a common equity Tier I capital surcharge ranging from 1 to 2.5 per cent of RWAs.⁶⁷

New bank capital instruments

One likely result of these capital reform proposals is that a new set of bank capital instruments will need to be developed and negotiated with regulators. The capital instruments that have attracted the most interest, thus far, are contingent convertible bonds, or bonds that convert into loss-absorbing equity once a certain trigger is breached, such as a bank's Tier I ratio falling below a certain level.

Contingent capital has already been issued in the UK, first by Lloyds Banking Group, with Lord Turner, the chairman of the FSA, urging banks, 'to create a role for contingent capital'.⁶⁸ More recently, contingent capital has also been issued by Barclays,

64 Federal Reserve, 'Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,' 77 Fed. Reg. 594, 599 (5 January 2012), www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf. See generally Basel Committee, 'Global systemically important banks: assessment methodology and the additional loss absorbency requirement,' November 2011, www.bis.org/publ/bcbs207.pdf.

65 Basel Committee, Global systemically important banks: assessment methodology and the additional loss absorbency requirement, Rules text (November 2011) at paragraph 91.

66 Financial Stability Board, Policy Measures to Address Systemically Important Financial Institutions (4 November 2011). The initial list of G-SIBs included the following: Bank of America; Bank of China; Bank of New York Mellon; Banque Populaire Cde; Barclays; BNP Paribas; Citigroup; Commerzbank; Credit Suisse; Deutsche Bank; Dexia; Goldman Sachs; Group Crédit Agricole; HSBC; ING Bank; JPMorgan Chase; Lloyds Banking Group; Mitsubishi UFJ FG; Mizuho FG; Morgan Stanley; Nordea; Royal Bank of Scotland; Santander; Société Générale; State Street; Sumitomo Mitsui FG; UBS; Unicredit Group; and Wells Fargo.

67 Financial Stability Board, Update of group of global systemically important banks (G-SIBs) (1 November 2012). The November 2012 list adds two banks (BBVA and Standard Chartered) to and removes three banks (Commerzbank, Dexia and Lloyds Banking Group) from the November 2011 list.

68 Anousha Sakoui & Patrick Jenkins, 'Stability Concerns over CoCo Bonds', *Financial Times*, 5 November 2009, www.ft.com/cms/s/0/833b6f8e-ca34-11de-a3a3-00144feabdc0.html.

Rabobank and Credit Suisse.⁶⁹ Proponents of contingent capital say that benefits include allowing financial firms to raise capital when they most need it. They also argue that, by exposing bondholders to more risk, it could improve incentives for bank management not to take on excessive risk.⁷⁰

In the United States, pursuant to the Dodd-Frank Act, the Federal Reserve is permitted to require systemically important firms to hold contingent capital, but only after a study and subsequent report are issued to Congress. In July 2012, the FSOC published its report to Congress on contingent capital, which identified a number of potential benefits and drawbacks associated with such instruments and discussed structural considerations, regulatory, accounting, tax and ratings agency issues.⁷¹ The report noted that the United States' experience with contingent capital instruments is 'quite limited' and that there are a range of potential issues that could be associated with contingent capital instruments, depending on their structure and, in particular, the structure and timing of conversion triggers. The FSOC recommended that contingent capital instruments 'remain an area for continued private sector innovation, and encourage[d] the Federal Reserve and other financial regulators to continue to study the advantages and disadvantages of including contingent capital and bail-in instruments in their regulatory capital frameworks'.

Internationally, the Basel Committee similarly determined that in view of the advantages and disadvantages of contingent capital instruments, the G-SIB surcharge for systemically important banks can only be met with common equity Tier I capital, and not with contingent capital instruments.⁷² The Basel Committee, however, stated that it will continue to review contingent capital, and support the use of contingent capital to meet higher national loss absorbency requirements than the G-SIB surcharge.⁷³

iv Resolution planning

Section 165(d) under Title I of the Dodd-Frank Act requires all bank holding companies and foreign banking organisations with assets of \$50 billion or more, as well as any

69 Harry Wilson, 'Barclays Swamped with Demand for 'CoCos'', *The Telegraph*, 14 November 2012, www.telegraph.co.uk/finance/newsbysector/banksandfinance/9678874/Barclays-swamped-with-demand-for-CoCo.html; Katy Burne, 'US Appetite For 'CoCo' Bonds Could Be Tested Soon – Bankers', *Dow Jones*, 15 February 2011.

70 Steven K Beckner, 'Fed Board Staffers Mull 'Contingent Capital' for Banks', *iMarketNews*, 4 January 2010.

71 FSOC, Report to Congress on Study of a Contingent Capital Requirement for Certain Nonbank Financial Companies and Bank Holding Companies, Completed pursuant to Section 115(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (July 2012), www.treasury.gov/initiatives/fsoc/Documents/Co%20co%20study%5b2%5d.pdf.

72 Basel Committee, Global systemically important banks: assessment methodology and the additional loss absorbency requirement, Rules text (November 2011) at paragraph 87.

73 Basel Committee, Global systemically important banks: assessment methodology and the additional loss absorbency requirement, Rules text (November 2011) at paragraph 88.

non-bank financial institution that has been designated as systemically important,⁷⁴ to prepare and regularly update a resolution plan ('Title I resolution plan').⁷⁵ Under the final rules implementing this provision, such entities would have to periodically submit a report regarding the plan of the company for rapid and orderly resolution under the US Bankruptcy Code or other applicable insolvency law in the event of material financial distress at, or failure of, the company.⁷⁶ Such plans would be submitted to, and evaluated by, the Federal Reserve and the FDIC. If the plan were deficient, or deemed to be not credible, the Federal Reserve and the FDIC could jointly agree to impose increasingly onerous restrictions on the company until such plan was determined to be credible.⁷⁷ The FDIC separately requires all US insured depository institutions with assets of \$50 billion or more to also submit and regularly update a resolution plan ('IDI resolution plan').⁷⁸

Nine institutions filed initial Title I resolution plans and five filed initial IDI resolution plans on 1 July 2012 ('Round 1 Filers').⁷⁹ Two additional institutions filed initial Title I and IDI resolution plans on 1 October 2012 ('Round 1.5 Filers').⁸⁰ All of

74 See Dodd-Frank Act, US Public Law No. 111-203, Section 113, 124 US Statutes at Large 1375, 1398 (2010); 77 US Federal Register 21637 (11 April 2012). See also Davis Polk & Wardwell LLP, FSOC Issues Final Rule on Designation of Systemically Important Nonbank Financial Companies (4 April 2012), available at www.davispolk.com/files/Publication/bd4d269c-ecc1-4757-a5ae-007f26f378e1/Presentation/PublicationAttachment/c6a028ce-271b-4aef-b140-02f4b9094236/040412_FSOC.Final.Rules.pdf.

75 Dodd-Frank Act, US Public Law No. 111-203, Section 165(d), 124 US Statutes at Large 1375, 1426 (2010).

76 Federal Reserve System, FDIC, Final Rule, Resolution Plans Required, 76 Federal Register 67323 (1 November 2011).

77 Dodd-Frank Act Section 165(d)(3)–(4).

78 FDIC, Final Rule, Resolution Plans Required for Insured Depository Institutions with \$50 Billion or More in Total Assets, 77 Federal Register 3075 (23 January 2012).

79 Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan Chase, Morgan Stanley and UBS filed Title I resolution plans. The public sections of their Title I resolution plans are available at www.federalreserve.gov/bankinforeg/resolution-plans.htm. Five of these institutions – Bank of America, Citigroup, Goldman Sachs, JP Morgan Chase and Morgan Stanley – were required to file IDI resolution plans because they all have IDI subsidiaries with \$50 billion or more in assets. See FDIC, Bank Data and Statistics, www.fdic.gov/bank/statistical/ (searchable database with IDI asset size and other information). The public sections of their IDI resolution plans are available at www.fdic.gov/regulations/reform/resplans/index.html.

80 Bank of New York Mellon and State Street filed Title I and IDI resolution plans. The public sections of their Title I resolution plans are available at www.federalreserve.gov/bankinforeg/resolution-plans.htm. Both have IDI subsidiaries with \$50 billion or more in total assets. See FDIC, Bank Data and Statistics, www.fdic.gov/bank/statistical/ (searchable database with IDI asset size and other information). The public sections of their IDI resolution plans are available at www.fdic.gov/regulations/reform/resplans/index.html.

the Round 1 and Round 1.5 Filers have previously been designated by the FSB as global SIFIs ('G-SIFIs').⁸¹ The Round 1 Filers will be required to file their first annual updates on 1 July 2013 or such other date as the regulators may specify,⁸² and the Round 1.5 Filers will be required to file their first annual updates either on 1 October 2013⁸³ or such other date as the regulators may specify.⁸⁴ Four additional institutions are expected to file their initial plans on 1 July 2013 ('Round 2 Filers').⁸⁵ All the rest of the firms required to file plans are currently required to file their initial plans by the end of 2013 ('Round 3 Filers').⁸⁶ The total number of firms required to submit Title I resolution plans was initially estimated to be 124.⁸⁷ The vast majority of this number are foreign banking organisations with worldwide assets of \$50 billion or more, but with relatively small US footprints.⁸⁸

The regulators also advised the initial filers that they did not intend to conduct a credibility review of any of the initial plans, but instead would reserve their credibility reviews for future updates.⁸⁹

81 See Financial Stability Board, Update of group of globally systemically important banks (G-SIBs) (1 November 2012), available at www.financialstabilityboard.org/publications/r_121031ac.pdf (list of G-SIFIs consisting of 28 G-SIBs).

82 12 US Code of Federal Regulations Section 243.3(a)(3)–(4).

83 *Id.*

84 *Id.* Section 243.3(a)(4) (giving the agencies the authority to accelerate or delay any filing dates).

85 *Id.* Section 243.3(a)(1)(ii). FDIC presentation slides from the 10 December 2012 meeting of the FDIC's Systemic Resolution Advisory Committee indicate that four covered companies are expected to file their initial resolution plans by 1 July 2013. The presentation slides from the meeting are available at www.fdic.gov/about/srac/2012/2012-12-10_title-i_resolution-plans.pdf.

86 12 US Code of Federal Regulations Section 243.3(a)(1)(iii).

87 See 76 US Federal Register 67323, 67333 (1 November 2011) (124 estimated respondents in Paperwork Reduction Act analysis consisting of 20 full resolution plan filers and 104 tailored resolution plan filers).

88 See Victoria McGrane and Alan Zibel, FDIC Drafts Rule on 'Living Wills' for Banks, WALL ST. J., 29 March 2011 (quoting FDIC officials as saying that 26 of the 124 institutions required to file Title I resolution plans would be US bank holding companies and the remaining 98 would be subsidiaries of foreign-owned banks); Institute of International Bankers, Comment Letter to the Federal Reserve and the FDIC on the Joint Notice of Proposed Rulemaking Implementing the Resolution Plan and Credit Exposure Requirements of Section 165(d) of the Dodd-Frank Act (10 June 2011), available at www.iib.org/associations/6316/files/20110610ResPlanNPR_IIB_final.pdf (estimating that of the approximately 98 foreign banking organisations required to file US resolution plans, only approximately 20 have US consolidated assets of \$50 billion or more).

89 76 US Federal Register 67323, 67331 (1 November 2011). ("There is no expectation by the [Federal Reserve] and the [FDIC] that the initial resolution plan iterations submitted after this rule takes effect will be found to be deficient, but rather the initial resolution plans will provide

v **Proposed regulation of foreign banking organisations**

The Federal Reserve has proposed a tiered approach for applying US capital, liquidity and other Dodd-Frank enhanced prudential standards, including single counterparty credit limits, risk management, stress testing and early remediation requirements, to the US operations of foreign banking organisations ('FBOs') with total global consolidated assets of \$50 billion or more. Most such FBOs would have to create a separately capitalised top-tier US intermediate holding company ('IHC') that would hold all US bank and non-bank subsidiaries. The IHC requirement would not apply to an FBO with combined US assets of less than \$10 billion, excluding its US branch and agency assets. The IHC would be subject to US capital, liquidity and other enhanced prudential standards on a consolidated basis. In addition, the Federal Reserve would have the authority to examine any IHC and any subsidiary of an IHC. Although the US branches and agencies of a large FBO's foreign bank would not be required to be held beneath the IHC, they too would be subject to liquidity, single counterparty credit limits and, in certain circumstances, asset maintenance requirements. Large FBOs not required to form an IHC would also be subject to many of the new enhanced prudential standards.⁹⁰

The proposed rules would become effective on 1 July 2015. As of 1 February 2013, the proposed rules are open for comment and the comment period ends on 30 April 2013.

IV CONDUCT OF BUSINESS

The activities of bank holding companies and banks are subject to a number of overlapping legal requirements. Some of the most important are summarised below.

The BHC Act generally prohibits a bank holding company from owning or controlling any company other than a US bank or from engaging in, or directly or indirectly owning or controlling any company engaged in, any activities that are not 'so closely related to banking as to be a proper incident thereto'.⁹¹ These restrictions on the

the foundation for developing more robust annual resolution plans over the next few years following that initial period.')

90 Federal Reserve System, Proposed Rule, Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 12 CFR Part 252, available at www.federalreserve.gov/newsevents/press/bcreg/bcreg20121214a.pdf; see also Davis Polk, Dodd-Frank Enhanced Prudential Standards for Foreign Banking Organizations (17 December 2012), www.davispolk.com/files/Publication/c891fe48-d955-4c0f-af87-bf845002fa4b/Presentation/PublicationAttachment/7cacd6fa-f6e6-4c4b-8a2c-38b13fd7eabf/121712_Prudential.pdf.

91 See 12 USC Section 1843(a), (c)(8). The BHC Act also contains various narrow exemptions from this general prohibition, including exemptions that allow a bank holding company to (1) make non-controlling investments for its own account or an investment fund controlled by it in up to 4.9 per cent of any class of voting securities and up to 24.9 per cent of the total equity (including voting, non-voting securities and subordinated debt) of any non-banking company; (2) invest in a subsidiary that does not have any office or direct or indirect subsidiary or otherwise engage in

non-banking activities and investments of a bank holding company reflect the traditional US policy of maintaining an appropriate separation between banking and commerce.⁹²

The BHC Act was amended by the Gramm-Leach-Bliley Act of 1999 ('the GLB Act') to permit bank holding companies to exercise certain expanded powers if they qualify for and elect to be treated as financial holding companies ('FHCs').⁹³ In contrast to ordinary bank holding companies, FHCs are not limited to owning and controlling banks and engaging in, or owning or controlling companies engaged in, activities that are 'closely related to banking'. FHCs may also engage in, or own or control any companies engaged, in any activity that is financial in nature, incidental to a financial activity or complementary to a financial activity.⁹⁴ This category of financial and financial-related activities includes everything deemed to be 'closely related to banking' and much more.⁹⁵ In particular, FHCs are permitted to make controlling and non-controlling investments in companies engaged exclusively in financial activities or activities that are incidental or complementary to financial activities, including securities underwriting and dealing beyond that permitted for banks, insurance underwriting, merchant banking, insurance company portfolio investments and certain commodities trading.⁹⁶ Under the merchant banking authority, FHCs are permitted to make controlling and non-controlling investments in non-financial and mixed financial/non-financial companies, including companies engaged in owning and managing real estate, subject to certain conditions.⁹⁷

any activities directly or indirectly in the United States, other than those that are incidental to its foreign or international business; (3) hold investments as a fiduciary; or (4) furnish services to its subsidiaries (12 USC Sections 1843(c)(1)(C), (c)(4), (c)(6), (c)(7), (c)(13)).

92 This traditional policy is justified mainly on the grounds that the mixing of banking and commerce would lead to (1) conflicts of interest in the allocation of credit; (2) potential increased risks to insured depository institutions and expansion of the federal deposit insurance safety net; (3) undue concentration of economic power and therefore anti-competitive behaviour; and (4) the creation of conglomerates that would be too complex to manage or supervise because of the different skills needed to manage or supervise both financial and commercial businesses in the same group. See, e.g., Leach, 'The Mixing of Commerce and Banking', in Proceedings of the 43rd Annual Conference on Banking Structure and Competition, Federal Reserve Bank of Chicago, 13 (May 2007).

93 Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 106th Cong., 1st Sess. (12 November 1999), 113 Stat. 1338-1481 (1999). Although the GLB Act softens the US policy of maintaining an appropriate separation between banking and commerce, it did not eliminate that separation.

94 12 USC Section 1843(k)(1).

95 12 USC Section 1843(k)(4), especially (k)(4)(F).

96 12 USC Sections 1843(k)(4)(B) (insurance underwriting); (k)(4)(E) (securities underwriting and dealing); (k)(4)(H) (merchant banking); (k)(4)(I) (insurance company portfolio investments). See, e.g., The Royal Bank of Scotland, 94 Federal Reserve Bulletin C60 (2008) (certain energy commodities trading as a complement to energy derivatives trading).

97 12 USC Section (k)(4)(H) (merchant banking).

i Proposed changes in permitted activities

The Volcker Rule

In the wake of the financial crisis, the GLB Act's expansion of financial activities for FHCs came under new scrutiny. In early 2010, as the bills that would become the Dodd-Frank Act were under consideration by Congress, the President announced support for a proposal advocated by former Federal Reserve Chairman Paul Volcker to prohibit insured depository institutions, their holding companies and their affiliates from engaging in proprietary trading and sponsoring or investing in hedge funds and private equity funds.⁹⁸ A form of this proposal, popularly known as the 'Volcker Rule,' ultimately became new Section 13 of the Bank Holding Company Act upon the signing into law of the Dodd-Frank Act.⁹⁹

The Volcker Rule prohibits any 'banking entity,' that is, any insured depository institution, any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978 (any non-US bank with a US banking presence), and any affiliate of the foregoing,¹⁰⁰ from engaging in proprietary trading or sponsoring or investing in hedge funds or private equity funds, except pursuant to a 'permitted activity' exception.¹⁰¹ The permitted activity exceptions include:

- a* trading in certain US government obligations;¹⁰²
- b* underwriting and market making-related activities;¹⁰³
- c* risk-mitigating hedging activities;¹⁰⁴
- d* trading on behalf of customers;¹⁰⁵
- e* investing in small business investment companies and certain public welfare investments, and making investments that are qualified rehabilitation expenditures;¹⁰⁶

98 'President Obama Calls for New Restrictions on Size and Scope of Financial Institutions to Rein in Excesses and Protect Taxpayers' (21 January 2010), [www.whitehouse.gov/the-press-office/president-obama-calls-new-restrictions-size-and-scope-financial-institutions-rein-e](http://www.whitehouse.gov/the-press-office/2010/01/21/president-obama-calls-new-restrictions-size-and-scope-financial-institutions-rein-e).

99 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 619 (2010) (to be codified at 12 USC Section 1851).

100 12 USC Section 1851(h)(5). The statutory definition of 'banking entity' excludes any insured depository institution that functions solely in a trust or fiduciary capacity.

101 12 USC Section 1851(a)(1). The Volcker Rule also prohibits a banking entity or any of its affiliates from entering into a 'covered transaction,' as defined in Section 23A of the Federal Reserve Act, with any hedge fund or private equity fund for which the banking entity serves as investment adviser, investment manager or sponsor, or which the banking entity organises and offers under the Volcker Rule's asset management exception, or any hedge fund or private equity fund controlled by such fund. 12 USC Section 1851(f).

102 12 USC Section 1851(d)(1)(A).

103 12 USC Section 1851(d)(1)(B).

104 12 USC Section 1851(d)(1)(C).

105 12 USC Section 1851(d)(1)(D).

106 12 USC Section 1851(d)(1)(E).

- f* trading in securities and other instruments by a regulated insurance company for its general account;¹⁰⁷
- g* organising and offering or sponsoring, and co-investing in, a hedge fund or private equity fund if certain conditions are met, including compliance with *de minimis* investment limits of 3 per cent per fund and (aggregating all investments permitted under this exception) 3 per cent of the banking entity's Tier I capital;¹⁰⁸
- h* proprietary trading or sponsoring or investing in hedge funds or private equity funds 'solely outside of the United States';¹⁰⁹ and
- i* such other permitted activities as the agencies charged with implementing the Volcker Rule¹¹⁰ may provide for, by rule, subject to certain findings.¹¹¹

The precise scope of these exceptions will be clarified when the agencies adopt final implementing regulations.

As required by the Volcker Rule, the Financial Stability Oversight Council ('FSOC') conducted a study on implementation of the Volcker Rule's provisions and, on 18 January 2011, issued recommendations relating thereto.¹¹² Although the statute required that the agencies issue final implementing regulations for the Volcker Rule within nine months of completion of the FSOC study¹¹³ (i.e., by 18 October 2011), the agencies missed this deadline. The Federal Reserve, SEC, FDIC and OCC issued common proposed regulations in October 2011,¹¹⁴ and the US Commodity Futures Trading Commission ('CFTC') proposed substantively identical regulations in January 2012.¹¹⁵ The comment period for these proposed regulations closed on 13 February 2012 and 16 April 2012, respectively. In response to the agencies' inclusion of over 1,000 specific requests for comments in the proposed implementing regulations, various stakeholders submitted thousands of comment letters. Commenters included US and non-US banking entities, industry groups, foreign governments, pension funds, legislators, academics, and others. The scope and substance of the final implementing regulations remains unknown as of 1 February 2013.

107 12 USC Section 1851(d)(1)(F).

108 12 USC Section 1851(d)(1)(G).

109 12 USC Section 1851(d)(1)(H), (I).

110 The Federal Reserve, the SEC, the US Commodity Futures Trading Commission ('CFTC'), the FDIC and the OCC. 12 USC Section 1851(b)(2).

111 12 USC Section 1851(d)(1)(J).

112 FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (2011), www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf.

113 12 USC Section 1851(b)(2).

114 See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (7 November 2011).

115 See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds, 76 Fed. Reg. 8332 (14 February 2012).

The Volcker Rule became effective on 21 July 2012,¹¹⁶ despite the fact that the agencies had not adopted final regulations by that date. Following the effectiveness of the Volcker Rule, banking entities will have two years to conform their activities and investments to the requirements of the Volcker Rule, and can apply to the Federal Reserve for up to three one-year extensions.¹¹⁷ The Federal Reserve may also, upon application by a banking entity, extend the conformance period for up to a maximum of five additional years in order to permit a banking entity to take or retain an interest in, or otherwise provide additional capital to, an ‘illiquid fund’, ‘to the extent necessary to fulfil a contractual obligation that was in effect on 1 May 2010’.¹¹⁸ On 9 February 2011, pursuant to statutory mandate, the Federal Reserve adopted final conformance regulations,¹¹⁹ and subsequently issued a statement of policy clarifying certain aspects of the conformance period.¹²⁰

Derivatives

Title VII of the Dodd-Frank Act created a new, comprehensive regulatory system for the previously mostly unregulated over-the-counter derivatives market. The most significant aspects of Title VII for bank holding companies and banks are those provisions that:

116 12 USC Section 1851(c).

117 12 USC Section 1851(c)(2).

118 12 USC Section 1851(c)(3)-(6).

119 Fed. Reserve, Final Rule: Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 Fed. Reg. 8265 (14 February 2011), <http://edocket.access.gpo.gov/2011/pdf/2011-3199.pdf>.

120 See Press Release, Federal Reserve (9 April 2012), 77 Fed.Reg. 33,949 (8 June 2012).

a require most swaps¹²¹ and security-based swaps¹²² (collectively referred to as swaps) to be cleared through central clearing houses and executed on regulated

121 The definition of swap is comprehensive and includes a wide range of agreements, contracts, and transactions. In general, a swap, subject to enumerated exceptions, is any agreement, contract, or transaction that: (1) is a put, call, cap, floor, collar or similar option of any kind that is for the purchase or sale, or based on the value, of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind; (2) provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, non-occurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence; (3) provides on an executory basis for the exchange, on a fixed or contingent basis, of one or more payments based on the value or level of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level including any agreement, contract, or transaction commonly known as – (i) an interest rate swap; (ii) a rate floor; (iii) a rate cap; (iv) a rate collar; (v) a cross-currency rate swap; (vi) a basis swap; (vii) a currency swap; (viii) a foreign exchange ('FX') swap; (ix) a total return swap; (x) an equity index swap; (xi) an equity swap; (xii) a debt index swap; (xiii) a debt swap; (xiv) a credit spread; (xv) a credit default swap; (xvi) a credit swap; (xvii) a weather swap; (xviii) an energy swap; (xix) a metal swap; (xx) an agricultural swap; (xxi) an emissions swap; and (xxii) a commodity swap; (4) is an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap; or (5) is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of the foregoing clauses. See Commodity Exchange Act ('CEA') Section 1a(47).

In August 2012, the CFTC and SEC jointly issued a final regulation to further define the terms 'swap' and 'security-based swap.' CFTC and SEC, Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208 (13 August 2012), www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf.

In November 2012, the Secretary of the US Department of the Treasury issued, pursuant to Title VII, a determination that FX swaps and FX forwards, as such terms are defined in the statute, are not to be regulated as swaps and are to be exempt from many, but not all, Title VII requirements. Department of the Treasury, Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694 (20 November 2012), www.gpo.gov/fdsys/pkg/FR-2012-11-20/pdf/2012-28319.pdf.

122 Security-based swaps ('SBS') are defined as swaps with certain specified characteristics. Specifically, SBS are swaps that are based on certain underlying assets, including a single security, a loan, a narrow-based group or index of securities, or events relating to a single issuer or issuers of securities in a narrow-based security index. SBS are excluded from the swap definition to avoid regulatory overlap. Securities Exchange Act of 1934 ('Exchange Act') Section 3(a)(68). In August 2012, the CFTC and SEC jointly issued a final regulation to further define the terms 'swap' and 'security-based swap.' CFTC and SEC, Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement

- trade execution platforms;
- b* require data concerning all swaps to be reported to trade repositories or regulators and require certain data, including price and volume, to be publicly disseminated as soon as technologically practicable after a swap transaction is executed;
- c* provide for the registration and comprehensive regulation (including capital, margin, collateral, business conduct, documentation, risk management, corporate governance and record-keeping requirements) of swap dealers, security-based swap dealers, major swap participants and major security-based swap participants (collectively referred to as 'swaps entities') by the CFTC and the SEC;¹²³ and
- d* require IDIs and US branches and agencies of non-US banks to push their swap dealing activities out of their banking institutions and into separately capitalised affiliates (such requirement is referred to as 'the Swaps Pushout Rule').

Title VII of the Dodd-Frank Act requires swaps that the CFTC or SEC determines are required to be cleared¹²⁴ to be submitted for central clearing to a regulated clearinghouse.¹²⁵ The mandatory clearing requirement applies to all persons engaging in such swaps, but

Recordkeeping, 77 Fed. Reg. 48208 (Aug. 13, 2012), www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf.

- 123 In general, Title VII of the Dodd-Frank Act requires the CFTC to regulate swaps, including the clearing, trade platform execution and reporting of swaps as well as swap dealers, major swap participants, clearing houses that clear swaps, trade platforms that trade swaps and trade repositories to which swap information must be reported. Title VII requires the SEC to regulate SBS, including the clearing, trade platform execution and reporting of SBS as well as SBS dealers, major SBS participants, clearing houses that clear SBS, trade platforms that trade SBS and trade repositories to which SBS information must be reported.
- 124 Dodd-Frank Act Sections 723(a)(3) and 763(a), which added CEA Section 2(h) and Exchange Act Section 3C, respectively, each provide for two approaches for determining which swaps are to be cleared: (1) the CFTC or SEC may determine upon its own initiative whether a swap or a group, category, type, or class of swaps should be required to be cleared; or (2) a clearing house initiates such a determination by the CFTC or SEC if it plans to accept for clearing a swap or a group, category, type, or class of swaps. CEA Section 2(h)(2)(D) and Exchange Act Section 3C(b)(4) enumerate five factors that must be taken into account in making the mandatory clearing determination: (1) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (2) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded; (3) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing house available to clear the contract; (4) the effect on competition, including appropriate fees and charges applied to clearing; and (5) the existence of reasonable legal certainty in the event of the insolvency of the relevant clearinghouse or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.
- 125 CEA Section 2(h)(1) mandates that swaps that are required to be cleared must be submitted to a registered or exempt derivatives clearing organisation ('DCO'), and Exchange Act Section

certain end users that use these swaps to hedge or mitigate commercial risk are exempted from this requirement.¹²⁶ Title VII sets forth comprehensive requirements with which clearing houses must comply.¹²⁷ It also requires the execution of those swaps that are required to be cleared to occur on regulated trade execution platforms, unless no such platforms make these swaps available to trade.¹²⁸ In addition, the statute sets forth comprehensive registration, operational, and self-regulatory requirements with which trade execution platforms must comply.

Title VII of the Dodd-Frank Act requires all swaps to be reported to a registered data repository or, if no such repository will accept the swap, to the CFTC or SEC. Title VII also requires public dissemination of certain data relating to a swap transaction, including price and volume, as soon as technologically practicable after the transaction has been executed. In addition, Title VII sets forth comprehensive requirements with which data repositories must comply.

Title VII of the Dodd-Frank Act authorises the CFTC to regulate entities that are swap dealers or major swap participants and authorises the SEC to regulate entities that are security-based swap dealers or major security-based swap participants. The statute defines swap dealer and security-based swap dealer in terms of whether an entity engages in certain types of activities: (1) holding oneself out as a dealer in swaps; (2) making a market in swaps; (3) regularly entering into swaps with counterparties as an ordinary course of business for one's own account; or (4) engaging in activity causing oneself to be commonly known in the trade as a dealer or market maker in swaps.¹²⁹ In addition, the swap dealer definition (but not the definition of security-based swap dealer) provides that an IDI is not to be considered a swap dealer to the extent it offers to enter

3C(a)(1) mandates that SBS that are required to be cleared must be submitted for clearing to a registered or exempt clearing agency.

126 CEA Section 2(h)(7) and Exchange Act Section 3C(g) provide an exception from the mandatory clearing requirement for swaps if one of the swap counterparties: (1) is not a financial entity; (2) is using swaps to hedge or mitigate commercial risk; and (3) notifies the CFTC (for swaps) or the SEC (for SBS) how the counterparty generally meets its financial obligations associated with entering into non-cleared swaps.

127 An entity acting as a central clearing house for swaps must be registered with the CFTC as a DCO, and an entity acting as a central clearing house for SBS must be registered with the SEC as a clearing agency (unless the entity is operating under an exemption granted by either Commission). An entity may register in both capacities.

128 Specifically, Title VII requires the execution of swaps that are required to be cleared to occur on a designated contract market or a registered or exempt swap execution facility and requires the execution of SBS that are required to be cleared to occur on an exchange or a registered or exempt security-based swap execution facility, unless no such entities make these swaps or SBS, as the case may be, available to trade.

129 Entities that enter into swaps or security-based swaps for their own accounts, either individually or in a fiduciary capacity but not as part of a regular business, are not included within the definitions. The definitions allow the CFTC and SEC to exempt an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers.

into a swap with a customer in connection with originating a loan with that customer. The statute also provides for a *de minimis* exception that permits entities to engage in a minimal amount of swap dealing activity (to be set by the CFTC and SEC, as the case may be) without being deemed a swap dealer. The statutory definitions of major swap participant and major security-based swap participant focus on the market impacts and risks associated with an entity's swap positions.¹³⁰ The statute requires the CFTC and the SEC to jointly further define the terms 'swap dealer,' 'security-based swap dealer,' 'major swap participant' and 'major security-based swap participant'.¹³¹

In May 2012, the CFTC and SEC issued final regulations further defining the terms 'swap dealer,' 'security-based swap dealer,' 'major swap participant' and 'major security-based swap participant'.¹³² *Inter alia*, the final regulations provide guidance on what constitutes swap dealing activity, specify the quantitative parameters around the *de minimis* exception and specify the conditions for meeting the exception for IDIs that enter into a swap with a customer in connection with originating a loan with that customer.

Entities that act as swap dealers or security-based swap dealers, or that are major swap participants or major security-based swap participants must register as such with the CFTC or SEC, as applicable. In addition, an entity required to be registered as a swap dealer or major swap participant shall register with the CFTC regardless of whether it also is registered with the SEC as a security-based swap dealer or major security-based swap participant, and *vice versa*.¹³³ The registration process for CFTC-regulated swap dealers and major swap participants began at the end of 2012.¹³⁴ As of 1 February 2013, the SEC had not yet finalised its regulation on the registration of security-based swap

130 Specifically, the statute defines major swap participants and major security-based swap participants as: (1) entities that maintain a substantial position in any of the major categories of swaps, as those categories are determined by the CFTC or the SEC; (2) entities whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets; or (3) any financial entity that is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate US banking agency and that maintains a substantial position in swaps for any of the major categories of swaps.

131 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 712(d)(1) (2010).

132 CFTC and SEC, Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant,' 77 Fed. Reg. 30596 (23 May 2012), www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-10562.pdf.

133 CEA Sections 4s(c), (k) and Exchange Act Sections 15F(c), (k).

134 According to the CFTC, as of 31 December 2012, approximately 65 legal entities have provisionally registered with the CFTC as swap dealers. Many of these entities are US or foreign banks and their affiliates. Press Release, CFTC Announces Real-Time Public Reporting of Swap Transactions and Swap Dealer Registration Began December 31, 2012, www.cftc.gov/PressRoom/PressReleases/pr6489-13.

dealers and major security-based swap participants. Accordingly, the registration process for these SEC-regulated swap entities has not yet begun.

Title VII requires comprehensive regulation of registered swaps entities. Specifically, swaps entities are required to comply with minimum capital and minimum initial and variation margin requirements with respect to non-cleared swaps.¹³⁵ In addition, they must establish comprehensive risk-management systems adequate for managing their businesses and must designate a chief compliance officer to carry out certain enumerated duties and prepare annual compliance reports.¹³⁶ Registered swaps entities must also comply with business conduct requirements under Title VII. Such requirements address, *inter alia*, interaction with counterparties, disclosure, supervision, reporting, record keeping, documentation, confirmation, valuation, conflicts of interest, and avoidance of fraud and other abusive practices. Heightened business conduct requirements apply to dealings with 'special entities', including US federal or state agencies, municipalities, pension plans and endowments. Swaps entities must also comply with documentation standards established by the CFTC or SEC, as applicable, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps.

The Swaps Pushout Rule effectively requires IDIs and US branches and agencies of non-US banks to push out their swap dealing activities to their affiliates.¹³⁷ The Swaps Pushout Rule contains an exemption that permits IDIs to engage in hedging and similar risk-management activities and to enter into swaps (other than non-cleared credit default swaps) that reference rates or assets that national banks are permitted to own such as investment grade debt securities and US government and agency securities.¹³⁸ The Swaps Pushout Rule also authorises the appropriate US banking agency, after consulting with

135 CEA Section 4s(e)(1)(B) provides that the CFTC shall prescribe capital and margin requirements for swap dealers and major swap participants for which there is not a prudential regulator and Exchange Act Section 15F(e)(1)(B) provides that the SEC shall prescribe capital and margin requirements for security-based swap dealers and major security-based swap participants for which there is not a prudential regulator. CEA Section 4s(e)(1)(A) and Exchange Act Section 15F(e)(1)(A) provide that the prudential regulators shall prescribe capital and margin requirements for swaps entities for which there is a prudential regulator. The term 'prudential regulator' includes the Federal Reserve, OCC, FDIC, Farm Credit Administration, and FHFA. In the case of the Federal Reserve, it is the prudential regulator for certain banks, as well as for bank holding companies and any foreign banks treated as bank holding companies. It is also the prudential regulator for subsidiaries of these bank holding companies and foreign banks, but not their non-bank subsidiaries that are required to be registered with the CFTC or SEC as swaps entities. See CEA Section 1a(39).

136 CEA Section 4s(j)(2) and Exchange Act Section 15F(j)(2).

137 The Swaps Push-out Rule permits an IDI to have a swaps entity affiliate as long as Sections 23A and 23B of the Federal Reserve Act (discussed below), as well as any additional requirements that the CFTC or SEC, as applicable, and the Federal Reserve determine to be necessary and appropriate, are complied with.

138 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Pub. L. No. 111-203, HR 4173, 111th Cong. Section 716 (2010).

the CFTC and the SEC, to provide an IDI a transition period of up to two years, which can be extended by one additional year, to cease any non-exempt swap activities.

On its face, the statute would not permit the uninsured branches of non-US banks to benefit from this exemption (because they are not IDIs),¹³⁹ but it may be possible that the exemption will be extended to these uninsured branches through implementing regulations or interpretative guidance provided by the US banking agencies, particularly in light of related congressional commentary. In a Senate colloquy, Senator Blanche Lincoln (D-AR), the author of the original Swaps Pushout Rule, called the omission of uninsured branches of non-US banks 'unfortunate and clearly unintended'.¹⁴⁰ Senator Christopher Dodd (D-CT), chairman of the Senate Banking Committee at the time and a co-sponsor of the Act, agreed and cited a need to 'ensure that uninsured US branches and agencies of foreign banks are treated the same as insured depository institutions under the provisions of [the Pushout provision], including the safe harbor language'.¹⁴¹ The Swaps Pushout Rule remains controversial and contains a number of ambiguities, contradictions and technical errors that will need to be clarified during the regulatory implementation process, or through the congressional technical amendments process. The Swaps Pushout Rule becomes effective on 16 July 2013, with up to an additional two-year transition period for IDIs, plus the possibility of a discretionary one-year extension.¹⁴²

In general, the effective date of Title VII provisions that regulate swaps and security-based swaps is the later of 360 days after the enactment of the Dodd-Frank Act (i.e., 16 July 2011) and to the extent rule-making is required with respect to a provision, not less than 60 days after publication of the final regulation. The CFTC and SEC are continuing to implement Title VII and have taken certain actions to minimise undue disruption and uncertainty for markets and participants during the transition period, especially with respect to those Title VII provisions that do not require rule-making and thus became effective on 16 July 2011.

As of 1 February 2013, the CFTC, which is in charge of regulating the 'swaps' market and its participants, is generally further ahead in implementing Title VII than the SEC, which is in charge of the smaller 'security-based swaps' market and its participants. The CFTC has proposed guidance, granted temporary exemptive relief and issued no-action letters regarding the cross-border application of its Title VII rules. Very generally,

139 As of 30 September 2012, there were approximately 182 uninsured state and federally licensed branches of foreign banks with aggregate assets of \$1,936 billion; 46 uninsured state and federally licensed agencies of foreign banks with aggregate assets of \$164 billion; and 10 grandfathered insured state and federally licensed branches of foreign banks with aggregate assets of \$68 billion. Federal Reserve, Structure and Share Data for US Banking Offices of Foreign Entities (September 2012), www.federalreserve.gov/releases/iba/201209/bytype.htm.

140 156 Congressional Record S5904 (2010) (statement of Senator Lincoln), http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=2010_record&page=S5797&position=all.

141 156 Congressional Record S5904 (2010) (statement of Senator Dodd), http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=2010_record &page=S5797&position=all.

142 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Pub. L. No. 111-203, HR 4173, 111th Cong. Sections 712, 716 (2010).

the CFTC's proposed cross-border guidance has the effect of minimising the application of the CFTC's Title VII regulations to swaps entered into between a non-US person counterparty (such as a non-US swap dealer) and another non-US person counterparty. The SEC also intends to provide guidance on the cross-border application of its Title VII rules, but has not done so as of 1 February 2013.

Transactions with affiliates

Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve's Regulation W impose quantitative and qualitative limits on a variety of transactions, including loans and other extensions of credit (collectively referred to as covered transactions), between a bank and an affiliate. Section 23A of the Federal Reserve Act limits a bank's covered transactions¹⁴³ with any single affiliate to no more than 10 per cent of the bank's capital stock and surplus, and limits its covered transactions with all affiliates combined to no more than 20 per cent of the bank's capital stock and surplus.¹⁴⁴ In addition, certain covered transactions must be secured at all times¹⁴⁵ by a statutorily defined amount of collateral.¹⁴⁶ Section 23B of the Federal Reserve Act requires that covered transactions¹⁴⁷

143 For purposes of Section 23A of the Federal Reserve Act, covered transactions include: (1) a loan or extension of credit to the affiliate, including a purchase of assets subject to an agreement to repurchase; (2) a purchase of or an investment in securities issued by the affiliate; (3) a purchase of assets from the affiliate; (4) the acceptance of securities or other debt obligations issued by the affiliate as collateral security for a loan or extension of credit to any person or company; (5) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate; (6) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a bank or subsidiary to have credit exposure to the affiliate; or (7) a derivative transaction with an affiliate, to the extent that the transaction causes a bank or a subsidiary to have credit exposure to the affiliate. Parts (6) and (7) of the 'covered transaction' definition are added by the Dodd-Frank Act and have an effective date of 21 July 2012. Section 23A of the Federal Reserve Act also contains an 'attribution rule' whereby a transaction with any person is considered to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, the affiliate.

144 Capital stock and surplus is essentially the sum of a bank's Tier I capital and Tier II capital and the balance of the bank's allowance for loan and lease losses not included in its Tier II capital.

145 The Dodd-Frank Act added the 'at all times' requirement, effective 21 July 2012. Previously, such transactions had to be secured by a statutorily defined amount of collateral 'at the time of the transaction'.

146 Transactions that are subject to the collateral requirement in Section 23A include a loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate by a bank or its subsidiary, and, after 21 July 2012, any credit exposure of a bank or a subsidiary to an affiliate resulting from a securities borrowing or lending transaction or a derivative transaction.

147 Covered transactions for purposes of Section 23B of the Federal Reserve Act include all Section 23A covered transactions (identified above) as well as: (1) sale of assets by a bank to an affiliate; (2) any payment of money or furnishing of services by a bank to an affiliate; (3) any transaction

between a bank and its affiliates be on market terms and at arm's length. These restrictions are designed to protect a depository institution from suffering losses in its transactions with affiliates and to limit the ability of a depository institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net.¹⁴⁸ The Federal Reserve implements Sections 23A and 23B of the Federal Reserve Act for all depository institutions and has the power to grant exemptions from these provisions in addition to the exemptions contained in the statute itself.¹⁴⁹

The Dodd-Frank Act further constrains the ability of banks to engage in derivatives and securities financing transactions with affiliates and imposes more stringent collateral requirements on transactions with affiliates, all of which may require changes to banking organisations' risk-management systems and practices related to inter-company derivatives.¹⁵⁰ Sections 23A and 23B of the Federal Reserve Act are modified by the Dodd-Frank Act to cover derivatives and securities lending and financing transactions with affiliates to the extent they create bank credit exposure¹⁵¹ to the affiliate, and, as a result, such transactions are subject to quantitative limits and collateral requirements under these sections from 21 July 2012. The Dodd-Frank Act further requires that collateral must be maintained at all times on a mark-to-market basis for credit transactions, rather than only at the time the transactions are entered into, and debt obligations issued by an affiliate cannot be used to satisfy Section 23A collateral requirements. The Dodd-Frank Act also limits the Federal Reserve's discretion to provide exemptions from the restrictions on transactions with affiliates. Under the Act, the Federal Reserve may grant such an exemption by regulation (and not by order) only if: (1) the Federal Reserve finds the exemption to be in the public interest and consistent with the purposes of the

in which an affiliate acts as an agent or broker for a bank or for any other person if the bank is a participant in the transaction; and (4) any transaction by a bank with a third party if an affiliate has a financial interest in the third party or if an affiliate is a participant in the transaction. Section 23B of the Federal Reserve Act contains the same 'attribution rule' as Section 23A.

148 The federal safety net refers to the benefits that banks receive through their access to FDIC deposit insurance as well as the Federal Reserve's discount window and payments system.

149 The statutory and regulatory exemptions from Section 23A of the Federal Reserve Act include, *inter alia*: (1) entering into certain covered transactions that are fully secured by obligations of the United States or its agencies; (2) intraday extensions of credit to an affiliate (if certain risk-management and monitoring systems are in place) and (3) giving immediate credit to an affiliate for uncollected items received in the ordinary course of business.

150 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Pub. L. No. 111-203, HR 4173, 111th Cong. Section 608 (2010).

151 The Dodd-Frank Act does not define 'credit exposure', and this and other aspects of the Dodd-Frank Act's amendments to Sections 23A and 23B will most likely need to be addressed through amendments to Regulation W. The Dodd-Frank Act explicitly authorises the Federal Reserve to issue regulations or interpretations with respect to the manner in which a bank may take netting agreements into account under Section 23A in determining the amount of a covered transaction with an affiliate, including whether a covered transaction is fully secured. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 608(a) (2010).

statute and notifies the FDIC of such finding; and (2) the FDIC does not object to the exemption during a 60-day notice period on the basis that the exemption presents an unacceptable risk to the Deposit Insurance Fund. The Dodd-Frank Act also permits the OCC to exempt, by order, a transaction of a national bank from the restrictions in Section 23A provided that: (1) the OCC and the Federal Reserve jointly find the exemption to be in the public interest and consistent with the purposes of the statute and notifies the FDIC of such finding; and (2) the FDIC does not object to the exemption during a 60-day notice period on the basis that the exemption presents an unacceptable risk to the Deposit Insurance Fund. Subject to similar conditions, the Act also permits the FDIC and Federal Reserve to jointly exempt a transaction of a state non-member bank from the restrictions in Section 23A. The Federal Reserve has indicated that it will issue regulations to implement the Dodd-Frank Act's revisions to Sections 23A and 23B. As of 1 February 2013, the Federal Reserve has not issued such regulations. In other Dodd-Frank rule-makings, the Federal Reserve and other US banking agencies have looked to methodologies set forth in their bank capital framework, including the current exposure method and the internal models methodologies, as a means of quantifying a bank's credit exposure arising from derivatives.

In addition, the Volcker Rule prohibits a bank or any of its affiliates (collectively referred to as a banking entity) from entering into covered transactions as defined in Section 23A of the Federal Reserve Act with a hedge fund or private equity fund, or any hedge fund or private equity fund controlled by such a fund, if the banking entity or any of its affiliates serves as the investment manager, investment adviser, or sponsor to the fund.¹⁵² This aspect of the Volcker Rule is commonly referred to as Super 23A because rather than simply restricting the amount of covered transactions a banking entity may engage in with a hedge fund or private equity fund that it advises, manages or sponsors, Super 23A appears to wholly prohibit such transactions.¹⁵³ Moreover, Super 23A does not, on its face, incorporate any of the exemptions contained in Section 23A of the Federal Reserve Act or in the Federal Reserve's Regulation W. Super 23A is intended to establish strict limits on the lending and asset purchase relationships that certain banking entities have used to facilitate 'bailouts' of private funds.

ii Securitisation

In the Dodd-Frank Act, Congress adopted the view that securitisation abuses were a major contributing factor to the financial crisis. In an attempt to better align market participants' incentives, the Dodd-Frank Act imposes credit risk retention requirements under which securitisers, and in certain circumstances, originators of asset-based securities must retain not less than 5 per cent of the credit risk for any asset unless the asset is a 'qualified residential mortgage', or the originator of the assets meets underwriting standards that

152 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Pub. L. No. 111-203, HR 4173, 111th Cong. Section 619 (2010).

153 The statute contains a narrow exception to Super 23A for prime brokerage transactions between a banking entity and any hedge fund or private equity fund in which a hedge fund or private equity fund that is managed, sponsored, or advised by such banking entity has taken an equity, partnership, or other ownership interest.

the federal regulators will jointly prescribe.¹⁵⁴ On 29 April 2011, six federal agencies¹⁵⁵ published a proposed rule to implement these requirements that provided more clarity on the definition of ‘qualified residential mortgage’ and the methods of risk retention that sponsors of covered securitisations may employ.¹⁵⁶ The public comment period on the proposed rule closed on 1 August 2011, but as of 1 February 2013 no final rule has been adopted. Many aspects of the proposed rule, including the definition of ‘qualified residential mortgage’ proposed by the regulators, were met with a great deal of criticism, including from members of US Congress, who expressed concern that the proposed rule would increase consumer costs and reduce access to affordable credit. Moreover, the new risk-retention rules will need to be crafted in a way that takes into account securitisation accounting developments such as FASB Statements 166 and 167 and Basel and other international securitisation rules. It is anticipated that further action on the proposed rule will be taken by the regulators later in 2013.

iii Consumer protection regulation

Traditional bank activities such as lending and deposit taking are subject to a broad range of consumer protection statutes at both the federal and state level. Consumer protection statutes can generally be grouped into three categories: disclosure laws, civil rights laws and privacy laws. The Dodd-Frank Act significantly changes the consumer protection regulatory landscape and is discussed further below.

Overview

Disclosure laws include the Truth in Lending Act,¹⁵⁷ which establishes standard disclosures for consumer creditors nationwide. Important loan terms must be disclosed in uniform terminology, with rules for each type of credit. The Truth in Savings Act¹⁵⁸ requires that consumers receive written information about the terms of their deposit accounts and it also governs the advertising of deposits and interest computations.

154 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 941 (2010).

155 The federal agencies tasked with the implementation of the Dodd-Frank Act’s credit risk retention requirements are the OCC, the Federal Reserve, the FDIC, the FHFA, the SEC and the US Department of Housing and Urban Development.

156 Department of the Treasury, Federal Reserve, FDIC, et al., Proposed Rule: Credit Risk Retention, 76 Fed. Reg. 24090 (29 April 2011), www.gpo.gov/fdsys/pkg/FR-2011-04-29/pdf/2011-8364.pdf.

157 Truth in Lending Act of 1968, Pub. L. No. 90-321, 90th Cong., 2nd Sess., (29 May 1968) 82 Stat. 146 (1968).

158 Truth in Savings Act of 1991, Pub. L. No. 102-242, 102nd Cong., 1st Sess., (19 December 1991) 105 Stat. 2236 (1991).

Civil rights laws include the Equal Credit Opportunity Act,¹⁵⁹ which prohibits certain types of discrimination in personal and commercial transactions¹⁶⁰ and the Community Reinvestment Act ('CRA'),¹⁶¹ intended to encourage depository institutions to help meet the credit and development needs of their communities, especially the needs of low and moderate-income neighbourhoods.¹⁶²

Banks are also subject to certain consumer privacy laws. Title V of the GLB Act¹⁶³ governs the protection and disclosure of consumer financial information by institutions. The GLB Act contains three basic requirements. A financial institution must provide:

- a* an initial notice to consumers that describes the institution's privacy policies and its practices regarding the disclosure of non-public personal information to affiliates and non-affiliated third parties;
- b* an annual notice of its privacy policies to any consumer with whom the institution continues to maintain a customer relationship; and
- c* an opportunity for customers to 'opt out' of having non-public personal information about them disclosed to non-affiliated third parties.

Bank regulatory guidelines require each financial institution to create, implement and maintain a comprehensive written information security programme designed to ensure the security and confidentiality of customer information, and protect against unauthorised access to or use of such information that could result in substantial harm or inconvenience to any customer.¹⁶⁴

As discussed in more detail below, the newly created Consumer Financial Protection Bureau ('the Bureau')¹⁶⁵ is responsible for ensuring compliance with federal

159 Equal Credit Opportunity Act of 1974, Pub. L. No. 93-495, 93rd Cong., 1st Sess., (28 October 1974) 88 Stat. 1521 (1974).

160 Creditors may not discriminate against an applicant, or discourage a potential applicant, on the basis of race, colour, religion, national origin, sex, marital status, age, receipt of income from public assistance programmes, or good faith exercise of rights under the Consumer Credit Protection Act.

161 Community Reinvestment Act of 1977, Pub. L. No. 95-128, 95th Cong., 1st Sess. (12 October 1977), 91 Stat. 1111 (1977).

162 If a depository institution does not receive at least a satisfactory rating for its CRA compliance, it could prevent such an institution or its holding company from engaging in certain permissible activities for financial holding companies and acquisitions of other financial institutions.

163 Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 106th Cong., 1st Sess. (12 November 1999), 113 Stat. 1338-1481 (1999). The GLB Act and its regulations apply to individuals who acquire financial products or services primarily for personal, family or household purposes.

164 Interagency Guidelines Establishing Standards for Safeguarding Customer Information and Rescission of Year 2000 Standards for Safety and Soundness; Final Rule, 66 Fed. Reg. 8616, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2001_register&docid=01-1114-filed.pdf.

165 Title X of the Dodd-Frank Act established the Bureau, marking a significant change to the federal consumer financial protection framework by largely centralising rule-making, supervisory and enforcement powers in a single agency. The Bureau formally is an 'independent bureau' within

consumer protection laws through examinations and investigations of consumer complaints. For non-depository lenders, enforcement authority is shared between the Bureau and the Federal Trade Commission.

Depository institutions normally correct consumer protection law violations voluntarily during the course of regulators' examinations. However, if institutions do not voluntarily comply or the violations are particularly severe, civil money penalties may be applied by bank regulators. Most of the federal consumer credit laws can also be enforced by consumers through civil lawsuits, which may entitle consumers to an award of actual damages as well as punitive damages in some cases.

New developments

Although Congress and bank regulators have tried to improve consumer protection regulation through use of existing statutory and regulatory tools, many have argued that a complete overhaul of the framework for consumer protection laws is required. The Dodd-Frank Act implements a new regulatory regime for consumer protection legislation.¹⁶⁶

Bureau of Consumer Financial Protection

On 21 July 2011, the Bureau assumed enforcement authority over, and began the examination of, large depository institutions under many federal consumer protection laws.¹⁶⁷ In January 2012, with the appointment of its first director, Richard Cordray, the Bureau assumed its full range of authorities, including enforcement authority over certain non-bank participants in the consumer financial markets, and rule-making authority over smaller depository institutions.¹⁶⁸ Carved out from the Bureau's authority are a number of entities and activities, including persons regulated by the SEC and the CFTC and the business of insurance.¹⁶⁹

the Federal Reserve, but is treated as an executive agency and effectively shielded from oversight by the Federal Reserve. See Title X, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. (2010).

166 Connie Prater, 'Obama Signs Credit Card Reforms into Law', Credit Card News, 22 May 2009, www.creditcards.com/credit-card-news/obama-signs-credit-card-law-1282.php.

167 Large depository institutions in this context are those with \$10 billion or more in assets. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 1025 (2010).

168 See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Sections 1024 and 1026 (2010). Controversy has dogged the establishment of the Bureau and its formation, as well as the appointment of its first director. Whether the ongoing political wrangling over the structure of the Bureau, the legitimacy of its director, and its appropriate role in the regulatory framework will result in material changes to the Bureau's authority and mission as defined in Title X remains to be seen.

169 For a discussion of excluded entities and activities, see Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 1027 (2010).

In June 2012, the Bureau issued regulations setting forth its procedures and practices for enforcement of federal consumer protection laws.¹⁷⁰ Shortly thereafter, the Bureau announced its first public enforcement action, relating to deceptive tactics in the marketing of credit card products.¹⁷¹ Notably, this was also the Bureau's first exercise of its authority to interpret and enforce the Dodd-Frank Act's prohibition on any 'unfair, deceptive, or abusive act or practice' in connection with consumer financial products.¹⁷²

The Bureau's initial rule-making activity has focused primarily on mortgage standards, international remittance transfers and credit reporting. Pending the development of comprehensive final regulations, the Bureau currently operates under a number of interim regulations transferred from other federal agencies. Continuous development of Bureau regulations should be anticipated as the Bureau continues its assessment of transferred regulations and its development of new regulations mandated under Titles X and XIV of the Dodd-Frank Act.

Pre-emption

'Pre-emption' in this context refers to the degree to which the activities of a federally chartered insured depository institution, such as a national bank or thrift, are regulated by federal law rather than by the laws of any individual state in which it may have a branch or otherwise conduct activities. Title X revises the pre-emption standards for state consumer financial laws applicable to national banks and thrifts, introducing obstacles to pre-emption determinations by the OCC and creating uncertainty about the continuing pre-emptive effect of certain OCC regulations.¹⁷³ Under Title X, the OCC may make pre-emption determinations with respect to state consumer financial laws only on a case-by-case basis, on the basis of 'substantial evidence' and 'in accordance with the holding of the Supreme Court in *Barnett Bank v. Nelson*'.¹⁷⁴ Title X also expands the authority of state attorneys general and state regulators by first, declaring that state consumer

170 Consumer Fin. Prot. Bureau, Final Rule: Rules of Practice for Adjudication Proceedings, 77 Fed. Reg. 39,058 (29 June 2012), www.gpo.gov/fdsys/pkg/FR-2012-06-29/pdf/2012-14061.pdf; Consumer Fin. Prot. Bureau, Final Rule: Rules Relating to Investigations, 77 Fed. Reg. 39,101 (29 June 2012), www.gpo.gov/fdsys/pkg/FR-2012-06-29/pdf/2012-14047.pdf.

171 See Consumer Fin. Prot. Bureau, Stipulation and Consent Order: Capital One Bank, (USA) N.A., http://files.consumerfinance.gov/f/201209_cfpb_0001_001_Consent_Order_and_Stipulation.pdf. The Bureau announced several additional enforcement actions in 2012, all addressing practices relating to consumer credit card products.

172 See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 1031 (2010).

173 The OCC has adopted a final rule revising its pre-emption regulations in accordance with Title X. In its final rule, the OCC takes the position that its pre-emption regulations already applied the *Barnett* standard and that no substantive change to the regulations is needed. In addition, while the OCC indicates it will revisit any pre-emption determination not properly based on the *Barnett* standard, it states that it has not identified any determination that would require such a re-examination. See Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg. 43,549 (21 July 2011).

174 517 US 25 (1996).

financial laws are applicable to operating subsidiaries and affiliates of national banks and thrifts, contrary to the Supreme Court's holding in *Watters v. Wachovia Bank*,¹⁷⁵ and second, by citing the Supreme Court's holding in *Cuomo v. Clearing House Association*¹⁷⁶ to clarify that no provision of the National Bank Act relating to state visitorial authority may be construed so as to limit the authority of state attorneys general to bring actions to enforce any applicable law against a national bank.

iv BSA/AML

The Bank Secrecy Act ('BSA'),¹⁷⁷ as amended by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ('the USA PATRIOT Act')¹⁷⁸ requires all financial institutions, including banks, to, *inter alia*, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. The BSA includes a variety of record-keeping and reporting requirements (such as cash and suspicious activity reporting) as well as due diligence/know-your-customer documentation requirements. Bank regulators and the Financial Crimes Enforcement Network ('FinCEN'), a division of the United States Treasury Department, issue and enforce BSA implementing regulations. Criminal anti-money laundering violations may also be prosecuted by the Department of Justice ('DoJ').

Developments of interest to banks

Beneficial ownership

FinCEN continues to focus attention on enhancing access to beneficial ownership information in order to combat the abuse of legal entities by those engaging in financial crimes.¹⁷⁹ As James Freis, former director of FinCEN, testified before the US Senate Committee on Homeland Security and Government Affairs in February 2010, 'Heightened risks can arise with respect to beneficial owners of accounts because nominal account holders can enable individuals and business entities to conceal the identity of the true owner of assets or property derived from or associated with criminal activity.'¹⁸⁰

On 5 March 2010, FinCEN, the SEC and the bank regulators, in consultation with staff of the CFTC, issued intra-agency guidance on obtaining and retaining beneficial ownership information. The guidance, which was intended to clarify and consolidate existing US regulatory expectations relating to beneficial ownership information, reiterates that financial institutions are required to establish and maintain customer due

175 550 US 1 (2007).

176 129 S.Ct. 2710 (2009).

177 Currency and Foreign Transactions Reporting Act, Pub. L. No. 91-508, Title II (1970).

178 The United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

179 Keeping Foreign Corruption Out of the United States: Hearing before the S. Comm. on Homeland Security and Governmental Affairs, Subcomm. on Investigations, 111th Cong. (4 February 2010) (statement of James Freis, former Director of FinCEN).

180 *Id.* FinCEN's 2010 guidance regarding beneficial ownership, discussed below, repeats this statement.

diligence procedures that are reasonably designed to identify and verify the identity of beneficial owners of an account based upon the institution's evaluation of risk pertaining to that account. The guidance notes that certain trusts, corporate entities, shell entities and private investment companies are examples of customers that may pose heightened risk.¹⁸¹

On 16 February 2012, the Financial Action Task Force ('FATF') released its revised FATF Recommendations, which were the result of a review of the prior Recommendations commenced in October 2010.¹⁸² The revised FATF Recommendations integrate the formerly separate 'Special Recommendations on Terrorist Financing' into the body of the 40 Recommendations. New Recommendation 10 (formerly Recommendation 5) addresses customer due diligence ('CDD') measures with respect to, *inter alia*, the identification and verification of customers and beneficial owners, calling for a risk-based approach. On 27 November 2012, FATF Vice-President Vladimir Nechaev affirmed that the revised Recommendations had been endorsed by most FATF members and FATF-style regional bodies, and he noted that one of the important changes in the FATF Recommendations has been 'to strengthen implementation of the most difficult requirements – for example to ensure transparency about the beneficial ownership of legal persons and legal arrangements'.¹⁸³ He stated, 'The first priority for the FATF in the coming year will [...] be to promote and facilitate an effective implementation of these revised Recommendations.'¹⁸⁴ Mr Bjorn S Aamo, new FATF President as of July 2012, explained in early December 2012 that an upcoming cycle of mutual evaluations would emphasise in particular the 'practical availability of information on legal persons and beneficial ownership' and that FATF's evaluation process will look closely at the availability of such information.¹⁸⁵

181 FinCEN, Fed. Reserve, FDIC, OCC, OTS, SEC and NCUA joint release, Guidance on Obtaining and Retaining Beneficial Ownership Information (5 March 2010), www.FinCEN.gov/statutes_regs/guidance/pdf/fin-2010-g001.pdf.

182 International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations, Financial Action Task Force (February 2012), [www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%20\(approved%20February%202012\)%20reprint%20May%202012%20web%20version.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%20(approved%20February%202012)%20reprint%20May%202012%20web%20version.pdf).

183 Speech by Vladimir Nechaev, FATF Vice-President, at the 16th MENAFATF Plenary: 'Recent developments in the fight against money laundering and terrorist financing, and MENAFATF's vital contribution to these efforts' (27 November 2012), www.fatf-gafi.org/documents/documents/recentdevelopmentsinthefightagainstmoneylaunderingandterroristfinancingandmenafatfsvitalcontributiontotheseefforts.html.

184 Id.

185 Speech by Bjorn S Aamo, FATF President, at the 40th Plenary Meeting of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL): 'Development of the Global Network and other key elements of FATF work under the Norwegian Presidency' (3 December 2012), www.fatf-gafi.org/documents/news/developmentoftheglobalnetworkandotherkeyelementsoffatfworkunderthenorwegianpresidency.html.

On 29 February 2012, FinCEN issued an advance notice of proposed rule-making ('ANPRM') on CDD requirements for financial institutions in order 'to solicit public comment on a wide range of questions pertaining to the development of a [...] CDD regulation that would (1) codify, clarify, consolidate, and strengthen existing CDD regulatory requirements and supervisory expectations; and (2) establish a categorical requirement of financial institutions to identify beneficial ownership of their accountholders, subject to risk-based verification.'¹⁸⁶ The ANPRM covers all industries that currently have anti-money laundering programme requirements under FinCEN regulations. According to the ANPRM, FinCEN is considering developing a CDD rule to cover banks, brokers or dealers in securities, mutual funds, futures commission merchants, and introducing brokers in commodities, although it may consider extending a CDD rule to other financial institutions subject to FinCEN regulations in the future.¹⁸⁷ In the ANPRM, FinCEN discusses possible new, more specific definitions of the term 'beneficial owner' for the purposes of the CDD programme requirements.¹⁸⁸ FinCEN states that it 'believes that one fundamental element necessary for an effective CDD programme is obtaining beneficial ownership information for all account holders, possibly subject to limited exceptions based on lower risk'.¹⁸⁹

During the summer and autumn of 2012, FinCEN held roundtable meetings in Washington, DC, Los Angeles, New York and Chicago to continue gathering information and feedback on the ANPRM, and subsequently released summaries of

186 Financial Crimes Enforcement Network, Advance Notice of Proposed Rule-making: Request for Comments: Customer Due Diligence Requirements for Financial Institutions, (29 February 2012), www.fincen.gov/statutes_regs/frn/pdf/1506-AB15_CDD%20ANPRM.pdf at 1.

187 *Id.* at 2.

188 *Id.* at 23–24. FinCEN's current definition of 'beneficial owner' can be found at 31 CFR Section 1010.605(a). The obligation to obtain beneficial ownership information applies expressly in only two limited situations under current FinCEN regulations: covered financial institutions that offer private banking accounts and those that offer correspondent accounts for certain foreign financial institutions must take reasonable steps to obtain certain beneficial ownership information. See 31 CFR Sections 1010.620(b)(1) and 1010.610(b)(1)(iii)(A). In the ANPRM, FinCEN proposes an additional definition for CDD programme requirements that would include, in the case of legal entities:

(1) either:

- (a) each of the individuals who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity, or otherwise, owns more than 25 per cent of the equity interests in the entity; or
- (b) if there is no individual who satisfies (a), then the individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, intermediary, tiered entity, or otherwise, has at least as great an equity interest in the entity as any other individual' and

(2) the individual with greater responsibility than any other individual for managing or directing the regular affairs of the entity.

189 *Id.* at 9.

those meetings.¹⁹⁰ Discussion topics included, *inter alia*, clarifying that the ANPRM definition of ‘beneficial owner’ with respect to a legal entity customer includes both concepts of ownership and control; concern from attendees that the ANPRM’s proposed definition of ‘beneficial owner’ is unclear; support from commenters for legislation that would require disclosure of beneficial ownership information at the time of company formation to provide an independent source of verification; support from commenters for being able to rely on customer self-certification to reduce the burden on financial institutions (although there was some question of whether such self-certifications are reliable); the potential for exceptions, such as for customers currently exempt from customer identification programme rules or low-risk customers; the significant burden of implementing the proposed requirements, particularly of verifying a party’s status as a beneficial owner, and the possible inability to do so in certain circumstances; and the challenge of due diligence with regard to intermediated relationships.

At the Washington, DC roundtable meeting held on 31 July 2012, David Cohen, Under Secretary for Terrorism and Financial Intelligence, US Department of the Treasury, stated that the:

Financial transparency [...] has long been recognized as paramount to protecting the US and global financial systems from all manner of illicit financial activity, from proliferation financing to terrorism financing to more traditional forms of financial crime like money laundering, tax evasion, and securities fraud. Key to financial transparency, we believe, is understanding beneficial ownership [...]. We believe the solution lies in an approach that includes the revised international standards, issued earlier this year by [FATF], that clarify the global standards related to [CDD] and the transparency of legal entities and trusts; legislation that would enhance law enforcement’s access to meaningful beneficial ownership information for legal entities formed in the United States; and a clearer [CDD] regulatory requirement, including the possibility of an express obligation to collect beneficial ownership information.¹⁹¹

SAR confidentiality and information sharing

On 3 December 2010, FinCEN published a final rule that clarifies the circumstances under which suspicious activity report (‘SAR’) filings are confidential.¹⁹² The final rule

190 FinCEN, Summary of Roundtable Meetings: Advance Notice of Proposed Rulemaking on Customer Due Diligence: Chicago, IL (28 September 2012): www.fincen.gov/whatsnew/html/20121130CHI.html, New York, NY (5 October 2012): www.fincen.gov/whatsnew/html/20121130NYC.html, Los Angeles, CA (29 October 2012): www.fincen.gov/whatsnew/html/20121130LA.html.

191 FinCEN, Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence, Washington, DC (31 July 2012), www.regulations.gov/#!documentDetail;D=FINCEN-2012-0001-0094; See also International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations, Financial Action Task Force (February 2012), www.fatf-gafi.org/media/fatf/documents/reports/Specific%20Risk%20Factors%20in%20the%20Laundering%20of%20Proceeds%20of%20Corruption.pdf.

192 FinCEN, Final Rule: Confidentiality of Suspicious Activity Reports, 75 Fed. Reg. 75593 (3 December 2010), <http://edocket.access.gpo.gov/2010/pdf/2010-29869.pdf>.

prohibits, with certain exceptions, financial institutions from disclosing SARs to any person, not only the persons involved in the transaction to which the SAR relates, as the prior regulation provided. The final rule also clarifies that SARs and any information that would reveal the existence of a SAR are confidential;¹⁹³ however, the underlying facts, transactions and documents upon which a SAR is based are not confidential and may be disclosed in civil litigation or any other proceedings.

FinCEN issued guidance, effective 3 January 2011, on the sharing of SARs by depository institutions with certain affiliates.¹⁹⁴ Prior FinCEN guidance permitted sharing of SARs upward in an organisational structure to entities that are deemed to control the financial institution. For example, depository institutions could share SARs with their US or non-US head offices or controlling companies. The guidance clarifies that the final rule discussed above permits financial institutions to share SARs more broadly, with all affiliates that have SAR filing requirements.

FinCEN has identified information sharing among governmental agencies and among financial institutions regarding potential money laundering and terrorist activities as an important tool in combating financial crimes and a strategic focus area for the agency.¹⁹⁵

FinCEN regulations require financial institutions, upon FinCEN's request, to search their records to determine whether they have maintained accounts for or conducted transactions with a person that a federal law enforcement agency has certified is suspected, based upon credible evidence, of engaging in terrorist activity or money laundering.¹⁹⁶ On 10 February 2010, FinCEN adopted a final rule that expands this requirement to allow certain foreign, state and local law enforcement agencies to initiate 314(a) inquiries as well, generally following the same procedures currently applicable to federal agencies.¹⁹⁷

193 Prior regulations confused financial institutions because they contained less precise language that protected the confidentiality of SARs and any information that would disclose that a SAR has been prepared or filed.

194 FinCEN, *Guidance on Sharing Suspicious Activity Reports by Depository Institutions with Certain US Affiliates* (23 November 2010), www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-g006.pdf.

195 *Keeping Foreign Corruption Out of the United States: Hearing before the S. Comm. on Homeland Security and Governmental Affairs, Subcomm. on Investigations, 111th Cong.* (2010) (statement of James Freis, then-Director of FinCEN).

196 31 CFR Section 1010.520 (known as the '314(a) Rule' after Section 314(a) of the USA PATRIOT Act, which directs the secretary of the Treasury to adopt such regulations). In the case of money laundering, FinCEN also requires the requesting agency to certify that the matter is significant, and that the requesting agency has been unable to locate the information sought through traditional methods of investigation before attempting to use this authority. See FinCEN, *Final Rule: Expansion of Special Information Sharing Procedures to Deter Money Laundering and Terrorist Activity*, 75 Fed. Reg. 6560 (10 February 2010), www.fincen.gov/statutes_regs/frn/pdf/20100204.pdf.

197 See FinCEN, *Final Rule: Expansion of Special Information Sharing Procedures to Deter Money Laundering and Terrorist Activity*, 75 Fed. Reg. 6560 (10 February 2010), www.fincen.gov.

The USA PATRIOT Act also allows two or more financial institutions to 'share information with one another regarding individuals, entities, organizations, and countries suspected of possible terrorist or money laundering activities'.¹⁹⁸ Section 314(b) establishes a safe harbour from liability for a financial institution or a group of financial institutions that voluntarily chooses to share information with other financial institutions for the purpose of identifying and reporting possible money laundering or terrorist activities. Financial institutions had been hesitant to share information pursuant to this authority particularly in cases of fraud, since it is often unclear at the outset of a fraud investigation whether money laundering or terrorist activities are implicated.

In order to encourage more information sharing, on 16 June 2009, FinCEN issued guidance that included several types of suspected fraud as permissible information-sharing categories covered by the Section 314(b) Safe Harbor.¹⁹⁹ Then-FinCEN Director Freis noted in February 2010 that FinCEN had 'already begun to see SARs being filed which indicate fraud-related information sharing involving suspected check fraud, wire transfer fraud, insurance fraud, mortgage fraud, new account fraud, and consumer loan fraud'.²⁰⁰ In remarks given in October 2011 to the Nebraska Bankers Association, Mr Freis stated, 'Section 314(b) of the USA PATRIOT Act allows regulated financial institutions to share information with each other for the purpose of identifying and, where appropriate, reporting possible money laundering or terrorist activity. In speaking with many of the largest banks in 2008, FinCEN found use of the 314(b) process to be quite extensive, with several banks noting that they often use the 314(b) process throughout the course of a SAR investigation, before filing a SAR or making a decision to close an account. In our discussions with institutions with assets under \$5 billion, however, FinCEN found there was rather limited use of the 314(b) programme.'²⁰¹

A November 2011 media report noted that financial institutions can be reluctant to share information through this channel. Even though FinCEN spokesman Bill Grassano estimated that over 4,000 institutions were registered to share information

gov/statutes_regs/frn/pdf/20100204.pdf. Members of the European Union that have signed the Agreement on Mutual Legal Assistance between the US and the European Union are able to initiate 314(a) inquiries. Agencies from foreign jurisdictions are required to first contact a federal law enforcement officer that will be appointed as a 314(a) liaison between foreign jurisdictions and FinCEN. This federal law enforcement officer will confirm that the inquiry relates to a significant matter before referring the inquiry to a financial institution.

198 Pub. L. No. 107-56, Section 314(b). See also the implementing regulation at 31 CFR Section 1010.540.

199 FinCEN, Guidance on the Scope of Permissible Information Sharing Covered by Section 314(b) Safe Harbor of the USA PATRIOT Act (16 June 2009), www.fincen.gov/statutes_regs/guidance/pdf/fin-2009-g002.pdf.

200 James H Freis Jr, then-Director of FinCEN, Remarks at the Florida International Bankers Association 2010 AML Conference (18 February 2010), www.fincen.gov/news_room/speech/pdf/20100218.pdf.

201 James H Freis Jr, then-Director of FinCEN, Remarks at the Nebraska Bankers Association Summit on Regulatory Issues (28 October 2011), www.fincen.gov/news_room/testimony/pdf/20111028.pdf.

under 314(b), a former federal prosecutor and regulatory policy official at FinCEN said: 'I have heard recently that some institutions are reticent about sharing information under 314(b). Some contend the standards for sharing are vague or that reliance on the civil safe harbor is risky.'²⁰²

As of 1 July 2012, FinCEN no longer accepts most paper filings and instead requires forms, including SARs, to be filed electronically.²⁰³ By 1 April 2013, financial institutions will be required to use new SARs that FinCEN has designed to work more efficiently within its electronic system.²⁰⁴

At an anti-money laundering conference in Washington, DC in November 2012, FinCEN Director Jennifer Shasky Calvery emphasised the significance and utility of BSA reports like SARs in combating security threats such as drug trafficking, terrorist organisations, foreign corrupt officials, and multibillion-dollar frauds.²⁰⁵ She noted that FinCEN's new IT Modernization Program, which includes the E-Filing mandate, would create a more streamlined database for the information financial institutions provide and would allow data to be shared more readily with various law enforcement agencies and regulatory partners. In her remarks, Shasky Calvery also stated that she had proposed the creation of a team that would compare compliance risk to illicit financing risk in order to help financial institutions reduce the difference between the two.

Foreign embassy accounts

In November 2010, it was widely reported that US banks, including JPMorgan Chase, Citigroup and Bank of America, were scaling back their services for foreign embassies and missions in the US, as a result of the burden of complying with BSA/AML regulations.²⁰⁶ According to the US Department of State, approximately 40 countries were affected, 16 of which were African nations. This situation strained diplomatic relations between the affected countries and the US.²⁰⁷

On 24 March 2011, the US federal bank regulators issued inter-agency guidance on accepting accounts from foreign embassies, consulates and missions. The guidance stated that, 'the Agencies are confirming that financial institutions have the flexibility to

202 Brett Wolf, 'Some US financial institutions wary of sharing suspicious information under Patriot Act shield', Thomson Reuters News & Insight, 14 November 2011, http://newsandinsight.thomsonreuters.com/Securities/Insight/2011/11_-_November/Some_U_S__financial_institutions_wary_of_sharing_suspicious_information_under_Patriot_Act_shield/.

203 FinCEN press release, 'FinCEN Marks the End of Paper SARs and CTRs' (29 June 2012), www.fincen.gov/news_room/nr/pdf/20120629.pdf.

204 Jennifer Shasky Calvery, Director of FinCEN, Remarks at the American Bankers Association/American Bar Association Money Laundering Enforcement Conference (13 November 2012), www.fincen.gov/news_room/speech/pdf/20121113.pdf.

205 Id.

206 Matthias Rieker, Joseph Palazzolo and Victoria McGrane, 'Banks Exit From Embassy Business,' *Wall Street Journal*, 20 November 2010, <http://online.wsj.com/article/SB10001424052748703531504575625060985983720.html>.

207 Id.

provide services to foreign missions while also remaining in compliance with the BSA.²⁰⁸ The guidance suggested that one approach to mitigating such accounts' risk was to offer limited purpose accounts, such as those used to facilitate operational expense payments, including payroll, rent and utilities and routine maintenance.²⁰⁹

By early 2012, the State Department had reportedly begun encouraging large banks to resume their business with foreign embassies whose accounts they had closed in 2010 and 2011.²¹⁰ The American Banking Association, however, reportedly replied to a letter from Treasury Secretary Timothy Geithner and Secretary of State Hillary Clinton by stating that current regulations made resuming business with certain embassies 'almost an impossible task.'²¹¹

BSA/anti-money laundering ('AML') enforcement activity

BSA/AML compliance was one of the top enforcement priorities for FinCEN and bank regulators from 2005 to 2007. BSA/AML enforcement increased dramatically during these years. There were six BSA/AML enforcement actions brought against financial institutions in 2005, while there were 32 in 2007.²¹² By 2009, BSA/AML enforcement actions against financial institutions had decreased to 11 and remained steady at 12 in 2010, evidencing shifting priorities as regulators turned their focus to bank capital, liquidity and funding and managing bank failures.²¹³ There were seven BSA/AML enforcement actions in 2011 against financial institutions, and five in 2012.²¹⁴ The number of enforcement cases may be set to rise again. In September 2012, just before leaving the DoJ, Shasky Calvery stated, 'I think you are going to see more complex BSA cases against banks, I think you are going to see enforcement across the broader spectrum of financial institutions [...]. The way we [protect the US financial system] is by aggressively enforcing the Bank Secrecy Act.'²¹⁵

208 Fed. Reserve, FDIC, FinCEN, NCUA, OCC, and OTS joint release, Guidance on Accepting Accounts from Foreign Embassies, Consulates and Missions (24 March 2011), www.occ.treas.gov/news-issuances/bulletins/2011/bulletin-2011-9a.pdf.

209 Id.

210 Joe Palazzolo and Matthias Rieker, 'Lenders Pressed on Embassy Banking,' *Wall Street Journal*, 17 April 2012, <http://online.wsj.com/article/SB10001424052702304818404577350171935104982.html>.

211 Id.

212 See Bankers Online, 'BSA/AML Penalties List', www.bankersonline.com/security/bsapenaltylist.html.

213 Id.

214 Id.; In the Matter of HSBC Bank USA N.A, FinCEN Assessment of Civil Money Penalty (10 December 2012), www.fincen.gov/whatsnew/pdf/20121211.pdf; New York State Department of Financial Services, 'In the Matter of Standard Chartered Bank, New York Branch, New York, New York: Order Pursuant to Banking Law 39' (6 August 2012), www.dfs.ny.gov/banking/ea120806.pdf.

215 Aruna Viswanatha and Brett Wolf, 'US Justice Department eyes compliance lapses in next era of money laundering cases,' Reuters Blog, (4 September 2012), <http://blogs.reuters.com/>

On 25 January 2013, TCF National Bank, Sioux Falls, South Dakota entered into a consent order with the OCC to pay a \$10 million civil monetary penalty for BSA violations.²¹⁶ The OCC identified BSA deficiencies at the bank that included cash transactions that indicated structuring, wire transfers with unknown source and purpose, and occasions when the bank submitted inadequate SARs regarding potential terrorist financing. The civil penalty follows a 2010 consent order in which the OCC instructed TCF National Bank to fix its BSA/AML programme and to have independent testing conducted on certain BSA reports.²¹⁷

On 14 January 2013, the Federal Reserve and the OCC each issued a cease-and-desist order against JPMorgan Chase & Co related to BSA/AML compliance. The Federal Reserve and the OCC also issued cease-and-desist orders unrelated to AML issues.²¹⁸ The OCC's AML-related order identifies deficiencies in the BSA/AML programmes at three JPMorgan Chase & Co subsidiaries, specifically in regard to SARs, monitoring transactions, conducting CDD and risk assessment, and implementing adequate systems of internal controls and independent testing.²¹⁹ The Federal Reserve's AML-related order requires JPMorgan Chase & Co to take corrective action to enhance the BSA/AML compliance programmes at various of its subsidiaries. It also requires the bank to implement a comprehensive BSA/AML action plan to improve compliance.

On 12 December 2012, HSBC Holdings plc and its affiliates (collectively, 'HSBC') agreed to pay \$1.9 billion in fines and forfeitures in a joint settlement with the

financial-regulatory-forum/2012/09/04/u-s-justice-department-eyes-compliance-lapses-in-next-era-of-money-laundering-cases/.

216 'OCC Assesses \$10 Million Civil Money Penalty against TCF National Bank, Bank Secrecy Act Violations Cited' (25 January 2013), www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-18.html; In the Matter of TCF National Bank, Sioux Falls, South Dakota, Consent Order for the Assessment of a Civil Money Penalty (25 January 2013), www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-18a.pdf.

217 In the Matter of TCF National Bank, Sioux Falls, South Dakota, Consent Order (20 July 2010), www.occ.gov/static/enforcement-actions/ea2010-164.pdf.

218 In the Matter of JPMorgan Chase & Co, Federal Reserve Consent Orders (14 January 2013,) www.federalreserve.gov/newsevents/press/enforcement/enf20130114a1.pdf, www.federalreserve.gov/newsevents/press/enforcement/enf20130114a2.pdf; In the Matter of JPMorgan Chase Bank, N.A. et al, OCC Consent Orders (14 January 2013), www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-7a.pdf; www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-8a.pdf. The Federal Reserve's other cease and desist order required JPMorgan Chase & Co. to continue to take corrective action to enhance its risk-management program and its finance and internal audit system, particularly in light of the bank's multi-billion dollar trading loss in spring 2012. Similarly, the OCC's other cease-and-desist order identified at JPMorgan Chase Bank, N.A. unsafe and unsound practices and violations of laws or regulations related to derivatives trading activities conducted by the bank's Chief Investment Officer.

219 'OCC Issues Cease and Desist Order Against JPMorgan Chase, N.A., Related to Bank Secrecy Act/Anti-Money Laundering' (14 January 2013), www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-8.html.

US Department of the Treasury's Office of Foreign Assets Control ('OFAC'), FinCEN, the OCC, the DoJ, and the New York County District Attorney's Office, and orders involving the Federal Reserve, regarding alleged violations of both US sanctions and AML laws and regulations. HSBC allegedly violated the BSA by failing to develop, implement and maintain an effective AML programme and failing to conduct due diligence on correspondent bank accounts for non-United States persons.²²⁰ According to the Treasury Department and the DoJ, HSBC's prolonged systemic failures to comply with suspicious activity reporting requirements resulted in its failure to detect and adequately report evidence of money laundering and other illegal activity, and the bank's egregious breakdowns in AML compliance allowed over \$881 million in Mexican and Colombian drug proceeds to flow through accounts in the United States.²²¹ The Treasury Department noted that HSBC's inadequate AML program 'exposed the US financial system to severe criminal abuse'.²²²

HSBC's December 2012 settlement arrived five months after the US Senate's Permanent Subcommittee on Investigations published a report entitled 'US Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History,' which examined at length the failure of HSBC's AML controls and subsequent repercussions in the realm of US national security.²²³

In November 2012, First Bank of Delaware consented to the assessment of concurrent civil monetary penalties with FinCEN and the FDIC and settled related civil charges with the DoJ.²²⁴ All penalties were satisfied with the payment of \$15 million to the United States Treasury. FinCEN and the FDIC found that the bank's internal controls failed to oversee third-party payment processor relationships and related products and services. The civil monetary penalty was aggravated by the bank's history of non-compliance and BSA violations. After the settlement, a trust company purchased certain assets and assumed deposit liabilities from the bank. Additionally, the

220 In the Matter of HSBC Bank USA N.A., FinCEN Assessment of Civil Money Penalty (10 December 2012), www.fincen.gov/whatsnew/pdf/20121211.pdf.

221 DoJ press release, 'HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement' (11 December 2012), www.justice.gov/opa/pr/2012/December/12-crm-1478.html; OFAC press release, 'Treasury Department Reaches Landmark Settlement with HSBC' (11 December 2012), www.treasury.gov/press-center/press-releases/Pages/tg1799.aspx.

222 Id.

223 US Senate's Permanent Subcommittee on Investigations press release, 'HSBC Exposed US Financial System to Money Laundering, Drug, Terrorist Financing Risks' (16 July 2012), www.hsgac.senate.gov/subcommittees/investigations/media/hsbc-exposed-us-finacial-system-to-money-laundering-drug-terrorist-financing-risks; US Senate's Permanent Subcommittee on Investigations public hearing, 'US Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History' (17 July 2012), www.hsgac.senate.gov/subcommittees/investigations/hearings/us-vulnerabilities-to-money-laundering-drugs-and-terrorist-financing-hsbc-case-history.

224 FDIC press release, 'FDIC and FinCEN Assess Civil Money Penalty Against First Bank of Delaware' (19 November 2012), www.fdic.gov/news/news/press/2012/pr12135.html.

Delaware Office of State Bank Commissioner terminated the bank's charter, and the FDIC terminated its deposit insurance.

Earlier in November 2012, Moneygram International ('Moneygram') agreed to forfeit \$100 million and enter into a deferred prosecution agreement ('DPA') with the DoJ.²²⁵ In the DPA, Moneygram admitted to aiding and abetting wire fraud and violating the BSA by failing to maintain an adequate AML program. The DoJ noted among Moneygram's AML violations its failure to submit SARs when customers reported fraud or when Moneygram believed its agents had been involved in fraud. Moneygram agreed in its DPA to retain a compliance monitor for five years and to adopt significant structural changes to its compliance programme.

In September 2012, Standard Chartered Bank agreed to pay \$340 million to the New York State Department of Financial Services ('NYSDFS') to settle allegations that the bank had violated US AML and sanctions laws by hiding from regulators thousands of transactions with both the government of Iran and privately owned Iranian banks, corporations, and individuals.²²⁶ The NYSDFS alleged that Standard Chartered Bank had been using a practice called 'repair' by which it removed Iranian information from US dollar wire payment messages. In December 2012, Standard Chartered Bank agreed to pay \$327 million as part of a joint settlement among the bank, OFAC, the DoJ, the New York County District Attorney's Office, and the Federal Reserve regarding related violations of US sanctions on Iran, as well as Burma, Libya, Sudan, and foreign narcotics traffickers²²⁷ (see *OFAC enforcement*).

In April 2012, the OCC issued a cease and desist order against Citibank N.A., Sioux Falls, South Dakota, for BSA/AML violations. Citibank agreed to take comprehensive corrective action to improve its BSA compliance programme.²²⁸ The OCC determined that Citibank N.A.'s BSA compliance programme had deficiencies in its internal controls,

225 DoJ press release, 'Moneygram International Inc. Admits Anti-Money Laundering and Wire Fraud Violations, Forfeits \$100 Million in Deferred Prosecution' (9 November 2012), www.justice.gov/opa/pr/2012/November/12-crm-1336.html.

226 New York State Department of Financial Services, 'In the Matter of Standard Chartered Bank, New York Branch, New York, New York: Consent Order Under New York Banking Law 44' (21 September 2012), www.dfs.ny.gov/banking/ea120921.pdf.

227 OFAC Civil Penalties Enforcement Notice: Standard Chartered Bank (10 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/12102012_scb.pdf; OFAC Settlement Agreement (10 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/121210_SCB_Settlement.pdf. Dep't of Justice press release, 'Standard Chartered Bank Agrees to Forfeit \$227 Million for Illegal Transactions with Iran, Sudan, Libya, and Burma' (10 December 2012), www.justice.gov/opa/pr/2012/December/12-crm-1467.html; Federal Reserve Release (10 December 2012), www.federalreserve.gov/newsevents/press/enforcement/20121210a.htm; The New York County District Attorney's Office press release, 'Standard Chartered Bank Reaches \$327 Million Settlement for Illegal Transactions,' (10 December 2012), manhattanda.org/press-release/standard-chartered-bank-reaches-327-million-settlement-illegal-transactions.

228 OCC press release, 'OCC Issues Cease and Desist Order Against Citibank, N.A.' (5 April 2012), www.occ.gov/news-issuances/news-releases/2012/nr-occ-2012-57.html; In the Matter

CDD, the independent BSA and AML audit function, monitoring of its remote deposit capture and international cash letter instrument processing in connection with foreign correspondent banking, and SARs related to such monitoring. As a result, the OCC found that the bank had violated statutory and regulatory requirements to maintain an adequate BSA compliance programme, file SARs, and conduct appropriate due diligence on foreign correspondent accounts.²²⁹

The most significant BSA/AML enforcement actions in 2011 included Zions First National Bank's consent order with the OCC resulting in \$8 million in fines; Pacific National Bank of Miami, Florida's consent order with FinCEN and the OCC resulting in \$7 million in fines; and Ocean Bank of Miami, Florida's consent order with FinCEN and DPA with the DoJ resulting in almost \$11 million in fines.

In August 2011, Ocean Bank of Miami, Florida ('Ocean') consented to the assessment of a civil monetary penalty by FinCEN in the amount of \$10.9 million and entered into a DPA with the DoJ.²³⁰ Ocean, the largest state chartered bank in Florida, is regulated by the FDIC. FinCEN found Ocean's AML programme to be deficient in three of the four core elements required by the BSA and its implementing regulations, related to internal controls, designation of compliance personnel and independent testing. It noted that as a result, Ocean failed to timely file SARs with respect to the receipt and transfer by its customers of tens of millions of dollars in wire transactions. FinCEN characterised Ocean's account base as high-risk and found that Ocean failed to structure its BSA/AML compliance programme to adequately address the risks of its customer base. FinCEN specifically noted Ocean's failure to recognise, address and mitigate the risks associated with transactions with Venezuela's parallel foreign exchange market or *permuta*, and noted that Ocean had received wire transfers from Mexican *casas de cambio* that exhibited patterns commonly associated with potential money laundering and Black Market Peso Exchange. Ocean's violations reportedly allowed account holders to launder millions of dollars of narcotics proceeds through Ocean accounts over an extended period of time while such accounts were being criminally investigated by the DoJ. Ocean also failed to respond to a number of 314(a) requests from FinCEN and to file currency transaction reports.

of Citbank, N.A., OCC Consent Order (5 April 2012), www.occ.gov/news-issuances/news-releases/2012/nr-occ-2012-57a.pdf.

229 Id.

230 The FinCEN penalty assessment was issued concurrently with a Deferred Prosecution Agreement and accompanying \$10,988,136 forfeiture assessed by the US government and \$10.9 million civil money penalty assessed by the FDIC and the Florida Office of Financial Regulation against Ocean, and was deemed satisfied in full by the \$10,988,136 payment to the US government. In the Matter of Ocean Bank, Miami, Florida, FinCEN Assessment of Civil Money Penalty (22 August 2011), www.fincen.gov/news_room/ea/files/08222011_OceanBank_ASSESSMENT.pdf; Southern District Court of Florida. United States of America vs. Ocean Bank, Defendant: Deferred Prosecution Agreement (16 August 2011), www.justice.gov/usao/fls/PressReleases/Attachments/110822-01.DPA.pdf.

In March 2011, Pacific National Bank of Miami, Florida ('Pacific') consented to the assessment of a civil monetary penalty by FinCEN in the amount of \$7 million.²³¹ Pacific is a subsidiary of Banco del Pacifico SA ('BPE'), which is owned by the Central Bank of Ecuador. FinCEN noted that approximately 85 per cent of Pacific's customers reside in Ecuador, which FATF has identified as having strategic anti-money laundering and combating the financing of terrorism deficiencies. FinCEN determined that Pacific violated the requirement to establish and implement an effective anti-money laundering programme, resulting in violations of BSA SAR requirements. According to the assessment, Pacific had received notices from its federal functional regulator, the OCC (including a BSA-based consent order in 2005), and FinCEN, yet it repeatedly failed to adequately carry out its duties under the BSA necessary to assure detection and reporting of suspicious activity. FinCEN noted that Pacific's dollar amount threshold for monitoring two correspondent bank accounts of BPE was arbitrarily high. In addition, Pacific filed many delinquent and incomplete SARs.

In February 2011, Zions First National Bank entered into a consent order with the OCC and agreed to pay regulators \$8 million in fines. This enforcement action is notable because it marks regulators' increased interest in investigating and prosecuting BSA/AML violations at regional/super-community banks.²³² The consent order focused on activity of Zions' former foreign correspondent business, which was terminated in 2008. During 2006 and 2007, according to the OCC's findings, Zions failed to adequately monitor over \$5.4 billion of activity in 2006 and 2007 for a new product initiative, specifically remote deposit capture offered to former foreign correspondent customers, including *casas de cambio*; failed to adequately monitor wire activity of its former foreign correspondent customers, including \$7.9 billion of wire activity with *casas de cambio* customers in 2006 and 2007, before the bank exited the line of business in early 2008; had inadequate SAR processes for its former *casas de cambio* and foreign correspondent customers and failed to file SARs on a timely basis with respect to those customers.

US economic sanctions

General

OFAC administers US economic sanctions against foreign countries, entities and individuals to counter threats to the US national security, foreign policy or economy. The goal of these programmes is to deny, wholly or partly, the benefits of the US economy to targets of sanctions, by denying access to the financial system, capital markets, and import and export markets for goods, services and technology. There are approximately 30 separately imposed OFAC sanctions programmes. While OFAC is responsible for promulgating and administering the sanctions, all of the bank regulatory agencies

231 In the Matter of Pacific National Bank, FinCEN Assessment of Civil Money Penalty (23 March 2011), www.fincen.gov/news_room/ea/files/PacificNationalBankASSESSMENT.pdf. The FinCEN \$7 million civil monetary penalty was issued concurrently with a consent order for a civil monetary penalty of \$7 million assessed by the OCC, and was deemed satisfied by Pacific making one payment of \$7 million to the US government.

232 Tracy Kitten, 'AML Case Study: New Way to Fight Fraud', Bank Information Security, 25 March 2011, www.bankinfosecurity.com/articles.php?art_id=3471&cop=1.

cooperate in ensuring that financial institutions comply with the sanctions. OFAC sanctions may also carry criminal penalties and may be enforced by the DoJ.

Penalties for OFAC violations

One of the most important developments in OFAC regulations and enforcement has been the implementation of increased civil penalties for the violation of most OFAC sanctions. Pursuant to the International Emergency Economic Powers Enhancement Act passed in 2007, civil penalties for the violation of most OFAC sanctions increased from \$50,000 to the greater of twice the transaction value or \$250,000 per violation.²³³ The severity of the potential penalties for violations prompted OFAC to issue final enforcement guidelines on 9 November 2009, in order to make its enforcement approach to apparent OFAC violations more transparent.²³⁴

OFAC's enforcement guidelines note that OFAC will consider certain 'general factors' in determining the appropriate enforcement response to an apparent violation and, if a civil monetary penalty is warranted, in establishing the amount of that penalty. If it is determined that a civil penalty is appropriate, OFAC will generally mitigate the penalty based upon certain factors such as voluntary self disclosure, cooperation with OFAC, and whether the case involved is a first-time violation.

*Developments of interest to banks*²³⁵

Iran sanctions

On 1 July 2010, President Obama signed into law the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (Public Law 111-195 – 'CISADA'), imposing significant new sanctions on Iran and firms and individuals doing business with Iran.²³⁶ CISADA's aim is to create a secondary boycott against Iran, restricting access to the US economy to foreign firms that conduct targeted business activities with Iran. CISADA has increased the compliance burden on both US and foreign companies. It requires foreign firms to implement controls to ensure that they limit their exposure to Iran if they wish to continue to do business with the United States.

Section 104(c) of CISADA required that the Treasury issue regulations prohibiting or restricting foreign financial institutions' correspondent or payable-through accounts with US financial institutions if the foreign institution is determined to have engaged in specified activities relating to Iran. Section 104(d) required the Treasury to issue regulations prohibiting entities owned or controlled by a US financial institution from knowingly transacting with, or benefiting, the Islamic Revolutionary Guard Corps ('IRGC') or its agents or affiliates whose property is blocked under the International

233 International Emergency Economic Powers Enhancement Act of 2007, Pub. L. No. 110-96, 50 USC Section 1701 note, 121 Stat. 1011–1012 (2007).

234 OFAC, Economic Sanctions Enforcement Guidelines, 74 Fed. Reg. 215, 57,593 (9 November 2009), <http://edocket.access.gpo.gov/2009/pdf/E9-26754.pdf>.

235 This discussion is limited to recent OFAC regulatory actions of interest to banks. There have been a number of other actions taken by OFAC that are beyond the scope of this chapter.

236 Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. No. 111-195 (2010).

Emergency Economic Powers Act ('IEEPA').²³⁷ These requirements were implemented in the Iranian Financial Sanctions Regulations ('IFSR') issued and immediately effective as of 16 August 2010.²³⁸

Section 104(e) of CISADA also required that the Treasury issue regulations requiring US financial institutions to police the activities of foreign institutions that maintain correspondent or payable-through accounts with US financial institutions.²³⁹ In October 2011, FinCEN issued a final rule to implement CISADA Section 104(e), which imposes a reporting requirement on US banks that FinCEN can invoke, as necessary, to elicit information valuable in the implementation of CISADA regarding non-US banks for which US banks maintain correspondent or payable-through accounts.²⁴⁰ The final rule requires a US bank, upon FinCEN's written request, to request any of its non-US correspondent banks to certify as to whether such bank (1) maintains a correspondent account for an Iranian-linked financial institution designated under IEEPA (Iranian-linked FI); (2) has processed one or more transfers of funds within the preceding 90 calendar days for or on behalf of, directly or indirectly, an Iranian-linked FI, other than through a correspondent account; or (3) has processed one or more transfers of funds within the preceding 90 calendar days for or on behalf of, directly or indirectly, the IRGC or any of its agents or affiliates designated under IEEPA. The US bank will be required to report certain information about the non-US bank to FinCEN.

On 31 December 2011, President Obama signed into law the National Defense Authorization Act for Fiscal Year 2012 ('the 2012 NDAA'), which imposed new sanctions with respect to the financial sector of Iran.²⁴¹ The 2012 NDAA designated the financial sector of Iran, including the Central Bank of Iran, as being of primary money laundering concern, which is simply a duplication, in statutory form, of the FinCEN finding already in effect. The 2012 NDAA also required the president to block all property and interests in property of Iranian financial institutions (including the Central Bank of Iran) that are within the United States or within the possession or control of a US person.²⁴² In

237 Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. No. 111-195 Sections 104(c) and (d) (2010).

238 OFAC, Final Rule: Iranian Financial Sanctions Regulations, 75 Fed. Reg. 157, 49,836 (16 August 2010), <http://edocket.access.gpo.gov/2010/pdf/2010-20238.pdf>. The IFSR were amended on 27 February 2012. See footnote 203.

239 Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. No. 111-195 Section 104(e) (2010).

240 See 76 Fed. Reg. 196, 62,607 (11 October 2011), www.gpo.gov/fdsys/pkg/FR-2011-10-11/pdf/2011-26204.pdf.

241 Pub. L. No. 112-81 (2011), www.gpo.gov/fdsys/pkg/BILLS-112hr1540enr/pdf/BILLS-112hr1540enr.pdf. See Section 1245.

242 A 'financial institution' is broadly defined in Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. No. 111-195 Section 104(i)(C) (2010). On 5 February 2012, the president issued Executive Order 13599 to implement Section 1245 of the NDAA. The Executive Order blocks all property and interests of the government of Iran, any political subdivision, agency or instrumentality thereof (including the Central Bank of Iran), and any person owned or controlled by or acting for or on behalf of the government of Iran, all Iranian

addition, a provision of the 2012 NDAA, as well as the IFSR (as noted above) and proposed FinCEN regulations,²⁴³ are intended to restrict the opening or maintaining in the US of correspondent or payable-through accounts by non-US financial institutions that knowingly engage in certain transactions involving Iran, including with the Central Bank of Iran and certain other Iranian financial institutions. There are a number of exceptions and possible waivers in the 2012 NDAA with respect to the imposition of correspondent and payable-through account sanctions, including an exception for certain transactions by financial institutions in countries that the Secretary of State has determined to have significantly reduced their purchases of Iranian crude oil. Effective 6 February 2013, the exception was narrowed to (1) exempt from sanctions only transactions that conduct or facilitate bilateral trade in goods or services between the country granted the exception and Iran; and (2) require that funds owed to Iran as a result of the bilateral trade be credited to an account located in the country granted the exception and not be repatriated to Iran.²⁴⁴

On 27 February 2012, OFAC amended and reissued the IFSR in their entirety, in order to implement Section 1245(d) of the 2012 NDAA.²⁴⁵

On 30 July 2012, the President issued Executive Order ('EO') 13622 to authorise additional sanctions with respect to Iran's energy and petrochemical sectors.²⁴⁶ EO 13622 authorised the Secretary of the Treasury, in consultation with the Secretary of State, to impose sanctions on foreign financial institutions found to have knowingly conducted or facilitated any significant financial transaction with the National Iranian Oil Company or Naftiran Intertrade Company, with limited exceptions. It also provided authority to impose sanctions on foreign financial institutions found to have knowingly conducted or facilitated (or any persons who engage in) significant transactions for the purchase or acquisition of petroleum or petroleum products from Iran, with certain exceptions, including the exception described above for persons or jurisdictions that have significantly reduced their purchases of crude oil. Finally, EO 13622 provided authority for the Secretary of the Treasury to block the property and interests in property of any person to have materially assisted, sponsored, or provided financial, material,

financial institutions, and all persons determined by the secretary of the Treasury, in consultation with the secretary of State, to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to the Executive Order. See www.treasury.gov/resource-center/sanctions/Programs/Documents/iran_eo_02062012.pdf.

243 See 76 Fed. Reg. 228, 72,878 (28 November 2011), www.gpo.gov/fdsys/pkg/FR-2011-11-28/pdf/2011-30331.pdf.

244 See OFAC's frequently asked questions relating to these provisions, www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#254.

245 See 77 Fed. Reg. 38, 11,724 (27 February 2012), www.treasury.gov/resource-center/sanctions/Programs/Documents/fr77_11724.pdf.

246 Executive Order 13622, 'Authorizing Additional Sanctions With Respect to Iran' (30 July 2012), www.gpo.gov/fdsys/pkg/DCPD-201200607/pdf/DCPD-201200607.pdf; OFAC's Frequently Asked Questions, 'What does E.O. 13622 'Authorizing Additional Sanctions With Respect to Iran' do?', www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#216.

or technological support for, or goods or services in support of, National Iranian Oil Company, Naftiran Intertrade Company, or the Central Bank of Iran, or the purchase or acquisition of US bank notes or precious metals by the government of Iran.

On 10 August 2012, the President signed into law the Iran Threat Reduction and Syria Human Rights Act of 2012 ('TRA'), which strengthens existing sanctions on Iran, especially those aimed at third-country nationals engaging in business with Iran, and includes measures relating to human rights abuses in Iran and Syria. The TRA focuses on Iran's petroleum and petrochemical industries as the principal sources of Iran's foreign exchange and thus its ability to finance weapons proliferation, terrorism and human rights abuses.²⁴⁷ *Inter alia*, it expands the list of Iran-related activities that expose a person to sanctions, including participation in certain petroleum-related joint ventures outside of Iran, the supply to Iran of goods or other support for the development of domestic Iranian petroleum or petrochemical production, transportation of crude oil from Iran, transactions related to Iran's acquisition or development of WMD or other military capabilities, and participation in joint ventures with the government of Iran relating to uranium. OFAC further revised the IFSR on 8 November 2012 to implement certain sections of the TRA that amend the financial institutions provisions of CISADA.²⁴⁸

On 2 January 2013, the President signed into law the National Defense Authorization Act for Fiscal Year 2013 ('the 2013 NDAA'). Title XII D, the Iran Freedom and Counter-Proliferation Act of 2012 ('IFCA'), imposes new sanctions with respect to (1) the energy, shipping and shipbuilding sectors of Iran; (2) the sale, supply or transfer to or from Iran of certain precious and other metals and materials; (3) the provision of underwriting services, insurance or reinsurance with respect to certain activities relating to Iran; (4) foreign financial institutions that facilitate significant transactions involving (1) or (2) or Iranian persons identified on the SDN list (except for Iranian financial institutions not designated for WMD proliferation, terrorism or human rights abuses); (5) transactions with respect to the Islamic Republic of Iran Broadcasting and its President; and (6) the diversion of goods intended for the Iranian people. The IFCA further expands the scope of secondary boycotts requiring third country persons to terminate their dealings with Iran in order to maintain economic ties with the United States.²⁴⁹

As a result of the recent measures taken by the US with respect to Iran, if non-US banks knowingly engage in or facilitate certain significant transactions related to Iran, they are at risk of having sanctions imposed by the US government.

Syria sanctions

The US and the European Union have also imposed additional sanctions on Syria in the wake of the violent crackdown by the Syrian government on protesters there,

247 Pub. L. No. 112-158 (2012), www.gpo.gov/fdsys/pkg/BILLS-112hr1905eah/pdf/BILLS-112hr1905eah.pdf.

248 See 77 Fed. Reg. 217, 66918 (8 November 2012), www.treasury.gov/resource-center/sanctions/Programs/Documents/fr77_66918.pdf.

249 Pub. L. No. 112-239 (2013), www.gpo.gov/fdsys/pkg/BILLS-112hr4310enr/pdf/BILLS-112hr4310enr.pdf.

including prohibiting the importation of crude oil and petroleum products from Syria. In addition, the US has prohibited the exportation by US persons or from the United States of financial services to Syria.

Burma sanctions

With the election of Nobel Prize winner Aung San Suu Kyi and her National League for Democracy in Burma's April 2012 by-election, the US and the EU began to recognise the Burmese government's efforts toward reform by waiving a number of long-standing sanctions. The EU announced in April 2012 that it would suspend for one year all sanctions against Burma, except for an arms embargo.²⁵⁰ In July 2012, the US relaxed its prohibitions on the exportation of financial services to, and new investment in, Burma, although transactions remain subject to certain conditions relating to the Ministry of Defense, armed groups, and persons blocked under the BSR and related Executive Orders.²⁵¹ US persons engaging in new investment in Burma are subject to significant reporting requirements, which were published in the Federal Register in August 2012, but are not yet in effect.²⁵² In September 2012, the US removed Burmese President Thein Sein and Lower House of Parliament Speaker Thura Shwe Mann from the SDN List, allowing them access to once-blocked property and assets and permitting them to conduct transactions involving US persons or in the United States.²⁵³ President Obama became the first US President to visit Burma in November 2012. Ahead of the President's trip, the US waived its ban on the importation of Burmese products, subject to certain limitations.²⁵⁴

OFAC enforcement

From 2006 to 2008, OFAC enforcement activity against financial institutions steadily increased. In 2006, there were 21 OFAC enforcement actions brought against financial institutions, while in 2008 there were 61.²⁵⁵ The total number of OFAC enforcement actions brought from 2009 to 2012 decreased, but very significant OFAC cases have been brought and settled within the past several years.

250 Council of the European Union: Council conclusions on Burma/Myanmar (23 April 2012), www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/129703.pdf.

251 OFAC, Burma General Licenses No. 16 and 17 (11 July 2012), www.treasury.gov/resource-center/sanctions/Programs/Documents/burmagl16.pdf; www.treasury.gov/resource-center/sanctions/Programs/Documents/burmagl17.pdf.

252 See 77 FR 46786 (6 August 2012), www.gpo.gov/fdsys/pkg/FR-2012-08-06/pdf/2012-19283.pdf.

253 OFAC press release, 'Treasury Department Lifts Sanctions Against Burma's President and Lower House Speaker,' (19 September 2012), www.treasury.gov/press-center/press-releases/Pages/tg1715.aspx.

254 OFAC, Burma General License No. 18 (16 November 2012), www.treasury.gov/resource-center/sanctions/Programs/Documents/burmagl18.pdf.

255 See OFAC, Civil Penalties and Enforcement Information, www.treasury.gov/resource-center/sanctions/CivPen/Pages/civpen-index2.aspx (provides a year-by-year listing of all enforcement actions, including enforcement actions brought against financial institutions).

For instance, Lloyds TSB Bank plc ('Lloyds') entered into a DPA with the DoJ on 9 January 2009.²⁵⁶ According to the DPA, Lloyds, in the United Kingdom and through other non-US branches, removed or omitted identifying information, such as client names and addresses, from US-dollar payment instructions that it received from Iranian and Sudanese clients, and forwarded them to non-affiliated US banks for processing. According to the DPA, this resulted in transactions being processed through US banks on behalf of sanctioned clients that OFAC would otherwise have required US banks to block or reject.

This prosecution marked the first time in recent history that US law enforcement authorities asserted jurisdiction over a non-US person whose conduct occurred outside the United States, but which caused OFAC violations by a non-affiliated US person. Pursuant to the DPA, Lloyds agreed to forfeit \$350 million to federal enforcement authorities and New York State. ABN AMRO,²⁵⁷ Credit Suisse AG,²⁵⁸ and Barclays²⁵⁹ settled similar charges for \$500 million, \$536 million and \$176 million respectively, and other non-US banks have been reported to be under investigation for similar matters.

On 25 August 2011, JPMorgan Chase Bank N.A. agreed with OFAC to pay \$88.3 million to settle potential civil liability for apparent violations of multiple US sanctions programmes, including the Cuba, Iran, Sudan, and weapons of mass destruction proliferators sanctions.²⁶⁰

On 12 June 2012, OFAC announced a settlement with ING Bank N.V., which agreed to pay \$619 million to settle potential civil liability for apparent violations of US sanctions programmes, including Cuba, Burma, Sudan, Libya, and Iran sanctions.²⁶¹ The settlement was part of a global settlement among the bank, OFAC, the DoJ, and the New York County District Attorney's Office.

Standard Chartered Bank's \$327 million joint settlement agreement of 10 December 2012 (see *BSA/AML enforcement activity* above) noted that Standard Chartered

256 DoJ press release, 'Lloyds TSB Bank Plc Agrees to Forfeit \$350 Million in Connection with Violations of the International Emergency Economic Powers Act' (9 January 2009), www.justice.gov/opa/pr/2009/January/09-crm-023.html.

257 DoJ press release, 'Former ABN AMRO Bank NV Agrees to Forfeit \$500 Million in Connection with Conspiracy to Defraud the United States and with Violation of the Bank Secrecy Act' (10 May 2010), www.justice.gov/opa/pr/2010/May/10-crm-548.html. The \$500 million ABN AMRO settlement included the AML charges discussed above.

258 DoJ press release, 'Credit Suisse Agrees to Forfeit \$536 Million in Connection with Violations of the International Emergency Economic Powers Act and New York State Law' (16 December 2009), www.justice.gov/opa/pr/2009/December/09-ag-1358.html.

259 DoJ press release, 'Barclays Bank PLC Agrees to Forfeit \$298 Million in Connection with Violations of the International Emergency Economic Powers Act and the Trading with the Enemy Act' (18 August 2010), www.justice.gov/opa/pr/2010/August/10-crm-933.html.

260 OFAC press release, 'JPMorgan Chase Bank N.A. Settles Apparent Violations of Multiple Sanctions Programs' (25 August 2011), www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20110825.aspx.

261 OFAC press release, 'US Treasury Department Announces \$619 Million Settlement with ING Bank, N.V.' (12 June 2012), www.treasury.gov/press-center/press-releases/Pages/tg1612.aspx.

Bank and a number of Iranian banks had developed operating procedures intended to circumvent US sanctions screening systems.²⁶² The following day, on 11 December 2012, HSBC's \$1.9 billion joint settlement was announced (see *BSA/ AML enforcement activity* above) regarding apparent violations of both US sanctions and anti-money laundering laws and regulations, including Iran, Burma, Sudan, Cuba, and Libya sanctions.²⁶³ In its settlement agreement with HSBC, OFAC stated that HSBC had helped sanctioned clients evade bank sanctions filters.

OFAC announced on 12 December 2012, shortly after its joint settlements with Standard Chartered Bank and HSBC, that the Bank of Tokyo-Mitsubishi UFJ, Ltd had agreed to pay OFAC approximately \$8.6 million to settle potential civil liability for apparent violations of multiple US sanctions programmes, including Burma, Iran, Sudan, Cuba, and weapons of mass destruction proliferators sanctions.²⁶⁴ OFAC's settlement stated that the Bank of Tokyo-Mitsubishi UFJ, Ltd had used similar 'stripping' practices as Standard Chartered Bank and HSBC by systematically deleting or omitting from payment messages any information referencing US sanctions targets that would have caused the funds to be blocked or rejected.

262 OFAC Civil Penalties Enforcement Notice: Standard Chartered Bank (10 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/12102012_scb.pdf; OFAC Settlement Agreement (10 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/121210_SCB_Settlement.pdf. Dep't of Justice press release, 'Standard Chartered Bank Agrees to Forfeit \$227 Million for Illegal Transactions with Iran, Sudan, Libya, and Burma' (10 December 2012), www.justice.gov/opa/pr/2012/December/12-crm-1467.html; Federal Reserve Release (10 December 2012), www.federalreserve.gov/newsevents/press/enforcement/20121210a.htm; The New York County District Attorney's Office press release, 'Standard Chartered Bank Reaches \$327 Million Settlement for Illegal Transactions,' (10 December 2012), manhattanda.org/press-release/standard-chartered-bank-reaches-327-million-settlement-illegal-transactions.

263 OFAC Civil Penalties Enforcement Notice: HSBC Holdings plc (11 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/121211_HSBC_posting.pdf; OFAC Settlement Agreement (11 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/121211_HSBC_Settlement.pdf. DoJ press release, 'HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement' (11 December 2012), www.justice.gov/opa/pr/2012/December/12-crm-1478.html; Federal Reserve Release (11 December 2012), www.federalreserve.gov/newsevents/press/enforcement/20121211b.htm; The New York County District Attorney's Office press release, 'District Attorney Vance Announces \$325 Million Settlement with HSBC Bank,' (11 December 2012), manhattanda.org/press-release/district-attorney-vance-announces-375-million-settlement-hsbc-bank.

264 OFAC Civil Penalties Enforcement Notice: Bank of Tokyo-Mitsubishi UFJ, Ltd. (10 December 2012), www.treasury.gov/resource-center/sanctions/CivPen/Documents/20121212_btmu.pdf.

V FUNDING

i Traditional funding sources

Bank holding companies and banks have a number of different funding sources, including: (1) consumer-driven bank products and services such as demand deposit accounts, certificates of deposit and deposit sweeps; (2) interbank borrowing through agreements such as repurchase agreements; and (3) capital markets activities including commercial paper, subordinated debt, preferred securities and equity issuances and offerings.

Bank holding companies and banks also have access to additional funding and liquidity sources during strained credit markets when traditional funding sources may either be prohibitively expensive or unavailable. The Federal Reserve's discount window, available only to member banks and other depository institutions, which has existed since the Federal Reserve System was created in 1913, has long served the banking industry 'as a safety valve in relieving pressures in reserve markets'.²⁶⁵ Its typical overnight extensions of credit to depository institutions can 'relieve liquidity strains in a depository institution and in the banking system as a whole',²⁶⁶ as well as ensuring 'the basic stability of the payment system more generally by supplying liquidity during times of systemic stress'.²⁶⁷ Almost all discount window credit has been extended as secured advances for many years.²⁶⁸

ii Funding sources and the financial crisis of 2008

In the first quarter of 2008, the credit markets had become frozen for certain highly leveraged, largely unregulated market participants. As the value of their securities portfolios decreased, they were increasingly viewed by the credit markets as higher credit risks. As rumours swirled that some large financial institutions might collapse, interest spreads widened dramatically for all market participants and creditors refused to lend to certain borrowers. The problems reverberated throughout the global credit markets as market participants were unaware as to which of their counterparties might have significant exposure to troubled financial institutions, inhibiting lending even to financially strong borrowers.

Federal reserve funding

By the time credit markets had practically frozen in March 2008, it became clear that neither traditional funding sources nor the Federal Reserve's discount window would be enough to restore credit, funding and liquidity to the markets. In response to these unprecedented credit needs, the Federal Reserve created several additional funding programmes pursuant to its emergency financial stabilisation powers under Section 13(3)

265 Fed. Reserve, The Federal Reserve Discount Window 1 (2008), www.frbdiscountwindow.org/discountwindowbook.cfm?hdrID=14&dtlID=43.

266 Id.

267 Id.

268 See James Clouse, Recent Developments in Discount Window Policy, 80 Fed. Reserve Bull. 966 (November 1994).

of the Federal Reserve Act, including the Primary Dealer Credit Facility, an overnight facility that provided secured loans to some of the United States' largest investment banks and the Commercial Paper Funding Facility, which created a Federal Reserve special purpose vehicle to purchase commercial paper directly from issuers, including non-depository institutions and even non-financial institutions. At the height of the financial crisis, just these two programmes alone had approximately \$365 billion in outstanding loans or advances, while all funding programmes totalled approximately \$2 trillion, providing much-needed credit, funding and liquidity to the markets.²⁶⁹ These, and most similar Federal Reserve programmes, were terminated on 1 February 2010 once credit and funding markets had significantly improved.²⁷⁰

The Dodd-Frank Act enacted a variety of changes to the Federal Reserve's emergency financial stabilisation powers. The Act limits emergency assistance to a 'program or facility with broad-based eligibility' rather than to any single and specific individual, partnership or corporation that is not part of such a broad-based programme. In addition, the Federal Reserve must establish by regulation, in consultation with the Treasury secretary, policies and procedures designed to ensure that any emergency lending is to provide liquidity to the financial system and not to aid a single and specific failing financial company; that collateral for emergency loans is sufficient to protect taxpayers from losses; and that any such programme is terminated in a timely and orderly fashion.

269 See Fed. Reserve, Periodic Report Pursuant To Section 129(B) of the Emergency Economic Stabilization Act of 2008: Update On Outstanding Lending Facilities Authorized by the Board Under Section 13(3) of the Federal Reserve Act 4-6 (29 December 2008).

270 Fed. Reserve Press Release, Federal Reserve Announces Extensions of and Modifications to a Number of its Liquidity Programs (25 June 2009), www.federalreserve.gov/newsevents/press/monetary/20090625a.htm. Federal Reserve funding programmes also included the Term Auction Facility, the Term Securities Lending Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and the Term Asset-Backed Securities Loan Facility. These programmes, except for the Term Asset-Backed Securities Loan Facility which terminated on 30 June 2010, terminated on 1 February 2010. In addition to these funding programmes the Federal Reserve also provided certain institutions with individually tailored funding programmes including American International Group, Inc. These individual extensions of credit are beyond the scope of this chapter.

These new programmes were notable because they represented a departure from traditional Federal Reserve discount window lending practice and policy. The new programmes were open to unregulated non-depository institutions that normally did not have access to the Federal Reserve's discount window. This allowed investment banks to borrow directly from the Federal Reserve, increasing overall funding in the markets. Prior to 2008, the Federal Reserve had not used its legal authority to lend to non-depository institutions since the Great Depression.

An analysis of the legal basis for the Federal Reserve's establishment of such funding programmes and expanding the parameters of its lending are beyond the scope of this chapter; however, it has been the subject of much legal, academic and political analysis. For more information, see Davis Polk, Financial Crisis Manual (2009), 18–40, www.davispolk.com/files/Publication/d1ab7627-e45d-4d35-b6f1-ef356ba686f2/Presentation/PublicationAttachment/2a31cab4-3682-420e-926f-054c72e3149d/fcm.pdf.

In addition, the Federal Reserve is required to obtain the Treasury Secretary's approval before establishing a programme or facility under Section 13(3).

US government funding

Although the Federal Reserve's programmes during the financial crisis provided critical immediate funding for financial institutions, it was clear that the magnitude of the financial crisis required a more comprehensive solution. Congress passed the Emergency Economic Stabilisation Act ('EESA'), which authorised the Treasury to spend up to \$700 billion to purchase troubled assets and make capital injections, to provide financial institutions, and certain other entities, with much-needed funding. The EESA was signed into law on 3 October 2008.

One of the US Treasury's most important capital injection programmes was the Capital Purchase Program, which provided capital to financial institutions determined to be viable through the purchase of up to \$250 billion of senior preferred shares in such financial institutions, which included warrants for future Treasury purchases of common stock.²⁷¹ As of 31 December 2009, the date on which the programme was closed, Treasury had invested \$204.9 billion in 707 financial institutions.²⁷² As of 30 September 2012, the programme had outstanding investments of \$8.7 billion, and had received approximately \$219.5 billion in repayments and income, exceeding the amount originally disbursed by \$14.6 billion.²⁷³

FDIC funding

Also in October 2008, the FDIC Board approved the Temporary Liquidity Guaranty Program ('TLGP') as part of the broader effort by the Treasury and the Federal Reserve to stabilise the nation's financial system. The purpose of the TLGP was to provide funding and liquidity to the interbank lending market. The Debt Guarantee Program, a part of the TLGP, allowed participating entities to issue FDIC-guaranteed senior unsecured debt. The Debt Guarantee Program was highly attractive to participating entities, particularly the larger bank holding companies, because it provided access to funding at a relatively low cost and accordingly, the programme was largely considered a success. For most institutions, the programme concluded on 31 October 2009, while the FDIC's guarantee expired no later than 31 December 2012.²⁷⁴

271 US Dep't of the Treasury Press Release, Treasury Announces TARP Capital Purchase Program Description (14 October 2008), www.treasury.gov/press-center/press-releases/Pages/hp1207.aspx.

272 Office of the Special Inspector Gen. for the Troubled Asset Relief Program, Quarterly Report to Congress (20 April 2010), www.sigtar.gov/reports/congress/2010/April2010_Quarterly_Report_to_Congress.pdf.

273 United States Government Accountability Office, Troubled Asset Relief Program: Treasury Sees Some Returns and it Exits Programs and Continues to Fund Mortgage Programs (January 2013), www.gao.gov/assets/660/651179.pdf.

274 FDIC, Amendment of the Temporary Liquidity Guarantee Program to Extend the Debt Guarantee Program and to Impose Surcharges on Assessments for Certain Debt Issued on

The Dodd-Frank Act also changes the FDIC's emergency financial stabilisation powers, and imposes new substantive and procedural requirements over the FDIC's ability to establish programmes like the TLGP. The Act limits the FDIC's authority to provide assistance to individual banks upon a systemic risk finding to only those banks that have been placed in receivership and only for the purpose of winding up the institution.

In the case of future guarantee programmes, the Act provides that upon a written determination of the FDIC and the Federal Reserve that a liquidity event exists, the FDIC would create a widely available programme to guarantee obligations of solvent depository institutions, depository institution holding companies and affiliates during times of severe economic distress. Such a determination requires a vote of two-thirds of the members of the boards of the Federal Reserve and the FDIC and the written consent of the Treasury Secretary. The Treasury Secretary, in consultation with the President, would determine the maximum amount of debt that the FDIC may guarantee. The Treasury Secretary must provide notice to Congress and the FDIC could exercise its authority only upon passage of a joint congressional resolution of approval.

Aside from the Federal Reserve and US government funding programmes set forth above, there were a number of other government funding programmes instituted during the financial crisis, including programmes to provide funding to certain systemically important entities, including the American International Group and Citigroup, which served to stabilise funding markets broadly.²⁷⁵

iii Post-financial crisis funding developments

In 2010, bank regulators issued two significant policy statements on their expectations regarding how bank holding companies and banks manage their funding and liquidity risks.

On 22 March 2010, federal bank regulators issued an inter-agency policy statement on funding and liquidity risk management.²⁷⁶ In the preamble to the guidance, regulators noted that they have observed deficiencies in liquidity risk management including, 'funding risky or illiquid asset portfolios with potentially volatile short-term liabilities and a lack of meaningful [...] liquidity contingency plans'. The guidance clarifies the processes that institutions should implement to identify, measure, monitor and control their funding and liquidity risk, such as having cash-flow projections, diversified funding sources, stress testing, a cushion of liquid assets and a formal well-developed contingency funding plan. Aside from overall funding needs, the guidance was specific in highlighting the importance of monitoring and managing intraday liquidity positions.

or After 1 April 2009, 74 Fed. Reg. 26521 (3 June 2009), www.fdic.gov/regulations/laws/federal/2009/09FinalAD37.pdf.

275 For a more detailed discussion of these programmes, see Davis Polk, *Financial Crisis Manual* (2009), www.davispolk.com/files/Publication/d1ab7627-e45d-4d35-b6f1-ef356ba686f2/Presentation/PublicationAttachment/2a31cab4-3682-420e-926f-054c72e3149d/fcm.pdf.

276 Fed. Reserve, FDIC, US Dep't of the Treasury, OCC, OTS, *Final Guidance on Correspondent Concentration Risks*, 75 Fed. Reg. 23764 (4 May 2010), www.fdic.gov/regulations/laws/federal/2010/10noticeMay4.pdf.

On 30 April 2010, the federal regulatory agencies issued final guidance addressing the risks associated with funding and credit concentrations arising from correspondent interbank relationships.²⁷⁷ The guidance highlights the need for institutions to identify, monitor, and manage correspondent concentration risk on a stand-alone and organisation-wide basis. Notably, the guidance states that a financial institution should consider credit exposures²⁷⁸ of over 25 per cent of total capital and funding exposures as low as 5 per cent of total liabilities indicative of correspondent concentration risk.

Pursuant to the guidance, financial institutions are to establish written policies and procedures to monitor and prevent such correspondent concentration risk. The guidance also highlights regulators' concern with financial institutions conducting proper due diligence on all credit and funding relationships, including confirmation that terms for all credit and funding transactions are on an arm's-length basis and that they avoid potential conflicts of interest.²⁷⁹

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESSES

In the United States, investing in banks or bank holding companies has long been a strictly regulated process. There are three federal statutes that may potentially govern the acquisition of a bank or bank holding company, depending on the structure of the acquisition and the type of bank or holding company to be acquired:²⁸⁰

a The BHC Act: Section 3(a) of the BHC Act requires the prior approval of the Federal Reserve Board for transactions that result in the formation of a bank holding company or cause a bank to become a subsidiary of a bank holding company; acquisitions by a bank holding company of more than 5 per cent of any class of voting shares of a bank or another bank holding company; acquisitions of all or substantially all of a bank's assets (except by merger into another bank); and mergers of bank holding companies.²⁸¹ Under the BHC Act, a controlling

277 Fed. Reserve press release, Interagency Guidance on Correspondent Concentration Risk (30 April 2010), www.federalreserve.gov/boarddocs/srletters/2010/sr1010.pdf.

278 Credit exposures include, due from bank accounts, federal funds sold on a principal basis, the over-collateralised amount on repurchase agreements, the under-collateralised portion of reverse repurchase agreements, net current credit exposure on derivatives contracts, unrealised gains on unsettled securities transactions, direct or indirect loans to or for the benefit of the correspondent, and investments, such as trust preferred securities, subordinated debt and stock purchases in the correspondent.

279 The guidance does not elaborate on exactly what 'conflicts of interests' means within this context.

280 This chapter does not address the requirements for the acquisition of thrifts or thrift holding companies. In connection with the abolition of the OTS, the power to regulate thrifts was transferred to the OCC, and the power to regulate thrift holding companies was transferred to the Federal Reserve in 2011. For a further discussion of the current state of thrift and thrift holding company regulation, see Section II, *supra*.

281 12 USC Section 1842(a).

investment in a bank or bank holding company will generally cause the investor (and any controlling person of that investor) to become a bank holding company and subject it to Federal Reserve regulation.²⁸² Control is presumed if a person or entity, acting alone or in concert with others, controls or has the power to vote 25 per cent or more of the outstanding shares of any class of voting stock of a bank or company; has the power to control the election of a majority of the board of directors of a bank or company; or has the power to exercise a controlling influence over the management or policies of a bank or company.²⁸³

- b* The Bank Merger Act: the Bank Merger Act requires the approval of the appropriate federal bank regulator for any merger involving two or more insured depository institutions, transfers of assets by an insured depository institution to an uninsured bank (or uninsured branch of a non-US bank) in consideration for the assumption of deposits, an insured bank's acquisition of assets of another insured bank, and assumptions of liabilities of any depository institution (insured or uninsured) by an insured depository institution.²⁸⁴ The appropriate federal bank regulator is that of the surviving entity in a merger.²⁸⁵
- c* The Change in Bank Control Act: the Change in Bank Control Act ('the CIBC Act') applies primarily to the acquisition of control of a US bank or bank holding company and requires prior written notice be given to the bank regulator of the target bank or bank holding company.²⁸⁶ Control (defined as the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25 per cent or more of any class of voting securities of an insured depository institution)²⁸⁷ is presumed, but may be rebutted, and a filing under the CIBC Act is required, if a person (including a bank or company) will, immediately after the transaction, own or control 10 per cent or more of any class of voting securities of a US bank and either (1) no other person owns or controls a greater percentage of the same class of voting securities; or (2) the shares of the bank or its holding company are registered with the SEC.²⁸⁸ The CIBC Act does not apply to transactions requiring approval under the BHC Act or the Bank Merger Act.²⁸⁹

On 22 September 2008, the Federal Reserve Board issued a 'Policy Statement on Equity Investments in Banks and Bank Holding Companies',²⁹⁰ clarifying the Federal Reserve Board's views with respect to how a minority equity investment can be structured to prevent an investor from being deemed to exercise a controlling influence over a bank

282 12 USC Section 1841(a)(1).

283 12 USC Section 1841(a)(2).

284 12 USC Section 1828(c)(1).

285 12 USC Section 1828(c)(2).

286 12 USC Section 1817(j).

287 12 USC Section 1817(j)(8)(B).

288 See, e.g., 12 CFR Section 225.41(c)(2).

289 12 USC Section 1817(j)(17).

290 12 CFR Section 225.144.

or bank holding company for purposes of the BHC Act, including with respect to the following issues:

- a* Director representation: a minority investor may generally have one representative on the board of directors of a bank or bank holding company, provided the representative is not the chairman of the board or any committee of the board, and does not represent more than 25 per cent of the seats on any board committee. A minority investor may have up to two representatives on the board if (1) its aggregate director representation is proportionate to its total equity interest in the bank or bank holding company but does not exceed 25 per cent of the membership of the board; and (2) another shareholder is a bank holding company that controls the bank or bank holding company under the BHC Act.
- b* Total equity interest: a minority investor may generally own up to 24.9 per cent of any class of voting securities of a bank or bank holding company, or a combination of voting and non-voting securities that, in the aggregate, represents less than one-third of the total equity and less than 15 per cent of any class of voting securities of the bank or bank holding company.
- c* Consultations with management: although a minority investor may generally communicate with management of a bank or bank holding company about the organisation's policies and operations, just like any other shareholder, the decision whether or not to adopt a particular position or take a particular action must remain with the organisation's shareholders as a group, board of directors or management, as applicable. A minority investor may not accompany its communications with explicit or implicit threats to dispose of its shares or to sponsor a proxy solicitation if the organisation or its management does not follow the minority investor's recommendations. This and other limitations on a minority investor's actions are generally reflected in written 'passivity commitments' the Federal Reserve Board requires the minority investor to make as a condition for determining that the investor does not control the bank or bank holding company.
- d* Business relationships: a minority investor is generally required to limit its business relationships with the bank or bank holding company in which it holds its investment, particularly when its voting stake is above 10 (and typically 5) per cent, and to ensure that those relationships are on market terms, non-exclusive and terminable without penalty by the banking organisation. A minority investor's written 'passivity commitments' will frequently contain a quantitative limit to business relationships (whether a fixed dollar amount or a percentage of revenues), above which prior approval of the Federal Reserve Board would be required for any transaction.
- e* Covenants: a minority investor is generally not able to impose covenants or contractual terms on a bank or bank holding company that substantially limit management's discretion over major policies and decisions, such as: (1) the hiring, firing and remuneration of executive officers; (2) engaging in new business lines or making substantial changes to a bank's or bank holding company's operations; (3) raising additional debt or equity capital; (4) merging or consolidating; (5) selling, leasing, transferring or disposing of material subsidiaries or major assets; or (6) acquiring significant assets or control of another firm.

The wave of bank failures in 2008 to 2010, together with a rapid rise in the number of banks included on the FDIC's 'troubled bank' list (as of 31 December 2012 the list contained 651 banks representing approximately \$233 billion in assets), led to interest in private investments in both troubled and failing banks. In the case of failed banks, the FDIC acts as their receiver and coordinates their sale to banks and private investors or their liquidation.

In addition to the requirements discussed above for acquiring banks or bank holding companies, on 26 August 2009, the FDIC released a Statement of Policy on the Acquisition of Failed Depository Institutions ('the Policy Statement').²⁹¹ Together with two sets of FDIC questions and answers ('Q&As') intended to help explain the requirements,²⁹² the Policy Statement imposes additional standards and requirements on potential private investors in failed banks.²⁹³

The Policy Statement reflects the FDIC's desire that private investors serve as 'responsible custodians' for a failed institution and try to ensure that the institution does not fail again. If a private investor covered by the Policy Statement makes an investment in a failed bank, the post-acquisition financial institution must maintain at least a 10 per cent Tier I common equity ratio throughout the first three years, generally remain well capitalised thereafter and be subject to firewalls with respect to any investment funds controlled by the private investor. In addition, the private investor will be subject to a three-year lock-up on the shares it acquires in the absence of FDIC approval, whether in the bank itself or a holding company formed for the purposes of making failed bank investments.

The Policy Statement exempts two types of investors from its requirements.

First, an investor with less than 5 per cent of the total voting power when there is no evidence of 'concerted action'. The FDIC presumes 'concerted action' among less-than-5 per cent investors where, in the aggregate, such investors have over two-thirds of total voting power. Therefore, other private investors who have an ownership percentage of one-third or more, together with the depository institution itself, must be bound by the Policy Statement in order for the less-than-5 per cent investors outside this anchor group to be exempted. The Q&As clarify that the less-than-5 per cent investors not subject to the Policy Statement may, however, elect to be part of the anchor group subject

291 FDIC, Final Statement of Policy on Qualifications for Failed Bank Acquisitions, 74 Fed. Reg. 45440 (2 September 2009), <http://edocket.access.gpo.gov/2009/pdf/E9-21146.pdf>.

292 FDIC, Q&As: Statement of Policy on Qualifications for Failed Bank Acquisitions, issued on 6 January 2010 and updated on 23 April 2010, www.fdic.gov/regulations/laws/faqfbqual.html.

293 Davis Polk client memorandum, 'A Nice Step Forward: New Q&As on the FDIC's Policy Statement for Failed Bank Acquisitions' (29 April 2010), www.davispolk.com/files/Publication/d5fbeddd-77da-4e82-ac8a-f1968d8e8447/Presentation/PublicationAttachment/abb2f530-d1d0-4e44-950d-32ecb5120f14/042910_fdic_failed_banks.pdf; Davis Polk client memorandum, 'Structuring Private Equity Investments in FDIC 'Problem' Institutions' (29 March 2009), www.davispolk.com/files/Publication/c816ca5d-f74b-450e-bde1-b1528a80135e/Presentation/PublicationAttachment/ab42637d-8c08-4c5f-803c-02fbb56c1292/032910_PE_NL.pdf.

to the Policy Statement in order to meet the one-third test, and note that the one-third test may be satisfied through both voting and non-voting shares.

Second, an investor that enters into a partnership with or invests directly in an existing bank holding company, where the holding company has a 'strong majority interest' in the failed bank and an established record for successful operation of insured banks or thrifts, is also exempt. The FDIC presumes that such an established bank holding company does not have a 'strong majority interest' if new private investors own more than one-third of the voting or total equity of the company on a *pro forma* basis. However, the Q&As clarify that there is no minimum holding period applicable to shares held by investors that were shareholders in the existing holding company prior to the injection of new private capital, and create an exemption from the Policy Statement for 'recapitalisations' of existing institutions subject to a limit on the amount of total assets the recapitalised institution may acquire from failed insured depository institutions.

i Dodd-Frank Act

The Dodd-Frank Act introduced significant changes to the regulation of investments in banks or bank holding companies in the United States.

New capital and management requirements

The Federal Reserve may approve a Section 3 application by a bank holding company to acquire control, or substantially all of the assets, of a bank only if the bank holding company is 'well capitalised' and 'well managed.'²⁹⁴ The federal banking agencies may approve interstate merger transactions only if the resulting bank will be 'well capitalised' and 'well managed' after the transaction. This requirement became effective on 21 July 2011.

New financial stability factor

The Federal Reserve must consider the extent to which a proposed acquisition would result in greater or more concentrated risks to the stability of the US banking or financial system.²⁹⁵ This requirement became effective on 21 July 2011.

The Federal Reserve Board has considered the financial stability factor in its review of several recent applications. It uses the following non-exhaustive criteria, both individually and in combination, in evaluating an acquisition's risk to the broader economy: (1) the size of the resulting firm; (2) the availability of substitute providers for any critical products and services offered by the resulting firm; (3) the interconnectedness of the resulting firm with the financial system; (4) the extent to which the resulting firm contributes to the complexity of the financial system; and (5) the extent of the cross-border activities of the resulting firm.²⁹⁶ In addition, the Federal Reserve Board has

294 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Sections 606-607 (2010).

295 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 604(d) (2010).

296 Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., and UnionBanCal Corp., Fed. Res. Bd. Order. No. 2012-12 at 25 (14 November 2012); Capital

considered qualitative factors indicative of the difficulty of resolving the resulting firm, such as the opaqueness and complexity of the institution's internal organisation.²⁹⁷

In considering the financial stability factor in its order approving the acquisition by Capital One of ING Direct, the Federal Reserve Board further explained that certain types of transactions would likely have only a *de minimis* impact on the 'systemic footprint' of the institution, thereby not likely raising concerns regarding financial stability.²⁹⁸ According to the Federal Reserve Board, 'a proposal that involves an acquisition of less than \$2 billion in assets, results in a firm with less than \$25 billion in total assets, or represents a corporate reorganization may be presumed not to raise financial stability concerns' unless there is 'evidence that the transaction would result in a significant increase in interconnectedness, complexity, cross-border activities, or other risk factor'.²⁹⁹

Limitations on non-bank acquisitions by systemically important companies

Systemically important companies, including systemically important bank holding companies, must provide prior notice to the Federal Reserve before acquiring control of voting shares of a company engaged in activities that are financial in nature or incidental thereto that has \$10 billion or more of consolidated assets.³⁰⁰ Such acquisitions also may not rely on the statutory exemption from Hart-Scott-Rodino Act filing requirements for transactions that require prior approval of the Federal Reserve.

The Dodd-Frank Act states that the prior notice requirement does not apply to (1) an acquisition permitted under Section 4(c) of the BHC Act, thus exempting among certain other types of investments, less-than-5 per cent investments and investments in companies the activities of which are 'closely related to banking;' and (2) an acquisition made in the course of a systemically important company's underwriting, dealing, or market-making activities.³⁰¹ This provision is already in effect; as of 1 February 2013 no implementing regulations had been issued.

Expansion of nationwide deposit cap

The Dodd-Frank Act prohibits acquisitions by insured depository institutions and their holding companies of additional depository institutions that would result in the applicant

One Financial Corp., 98(5) Fed. Res. Bull. 7, 23 (2012); The PNC Financial Services Group, Inc. and PNC Bancorp, Inc., 98(3) Fed. Res. Bull. 16, 21 (2012); Capital One Financial Corporation, 98(5) Fed. Res. Bull. 7, 24-27 (2012).

297 Mitsubishi UFJ Financial Group, Inc., The Bank of Tokyo-Mitsubishi UFJ, Ltd., and UnionBanCal Corp., Fed. Res. Bd. Order No. 2012-12 at 25 (14 November 2012); Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 24 (2012).

298 Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 24 (2012).

299 Capital One Financial Corp., 98(5) Fed. Res. Bull. 7, 24 (2012). See also Industrial and Commercial Bank of China Ltd., China Investment Corp., and Central Huijin Investment Ltd., Fed. Res. Bd. Order No. 2012-4 at 29 (9 May 2012).

300 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 163.

301 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 163(b) (2010).

controlling more than 10 per cent of the total amount of deposits of US insured depository institutions.³⁰² Current law imposes a deposit cap on bank holding companies, but not other insured depository institution holding companies. An exemption is provided for insured depository institutions in default or in danger of default. This requirement became effective on 21 July 2011.³⁰³

Concentration limits

A ‘financial company’ is prohibited from merging with or acquiring substantially all of the assets or control of another company if the resulting company’s total consolidated liabilities would exceed 10 per cent of the aggregate consolidated liabilities of all financial companies at the end of the prior calendar year.³⁰⁴ There are exceptions for acquisitions of a bank in default or in danger of default; FDIC-assisted transactions; and acquisitions that would result in only a *de minimis* increase in the liabilities of the financial company. The term ‘financial company’ is defined as an insured depository institution, a bank holding company, a savings and loan holding company, a company that controls an insured depository institution, a systemically important non-bank financial company and a foreign bank or company treated as a bank holding company for purposes of the Bank Holding Company Act. While a majority of merger and acquisition deals will likely not trigger this provision, the concentration limits imposed by the Act may affect the prospects of much larger mergers between financial institutions.

The Act required the FSOC to complete a study of concentration limits by 21 January 2011 and to make recommendations regarding their implementation, including any ‘modifications’ to the concentration limit that would ‘more effectively implement’ the concentration limits. Concentration limits may be largely inevitable despite this requirement. The FSOC issued its study and recommendations on concentration limits on 18 January 2011.³⁰⁵ In its report, the FSOC generally takes a positive view of the concentration limit and its effect on financial stability, moral hazard, the efficiency and competitiveness of US financial firms and financial markets, and the cost and availability of credit and other financial services in the United States. The study identifies several implementation issues posed by this provision of the Dodd-Frank Act, and makes three specific recommendations. The FSOC recommends that the statutory definition of ‘liabilities’ be modified for those companies that do not currently calculate or report consolidated risk-based capital figures, in favour of a hybrid approach that allows such companies to calculate ‘liabilities’ pursuant to Generally Accepted Accounting Principles (‘GAAP’) or other accounting standards. The study further suggests that the calculation of aggregate financial sector liabilities use a two-year rolling average instead of a single year.

302 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 623 (2010).

303 Id.

304 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 622 (2010).

305 FSOC, Study & Recommendations Regarding Concentration Limits on Large Financial Companies (2011), www.treasury.gov/initiatives/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf.

The FSOC also recommends that the statutory exception for acquisitions of failing banks be extended to acquisitions of other failing insured depository institutions. Although the Federal Reserve is required to issue final rules implementing the concentration limits in light of the FSOC's recommendations by 18 October 2011, as of 1 February 2013 implementing regulations had yet to be issued.³⁰⁶

VII SYSTEMIC RISK REGULATION, RESOLUTION AUTHORITY AND THE PROBLEM OF 'TOO BIG TO FAIL'

Post-financial crisis, there has been a movement towards expanding the principles and application of bank holding company and bank regulation to other parts of the financial system. The administration has argued that this is necessary because, 'over time there has been a gradual but pronounced decline in the share of financial assets originated and held by banks, and a corresponding increase in the share of financial assets held across a variety of non-bank financial institutions, funds and complex financial structures'.³⁰⁷

The Dodd-Frank Act created the the FSOC to oversee and identify risks in the financial system. The duties of the FSOC include collecting information to assess risks to the US financial system through the new Office of Financial Research; monitoring the financial services marketplace; designating as 'systemically important' any non-bank financial company if the failure of such company would threaten US financial stability, identifying gaps in regulation; recommending supervisory priorities; and facilitating information sharing and coordination among financial regulatory agencies.

i Designation of non-bank financial companies as systemically important

The FSOC has issued a rule as well as some additional guidance regarding the designation of non-bank financial companies as systemically important (and therefore subject to enhanced supervision and prudential standards).³⁰⁸ Under the final rules and guidance, the FSOC has adopted a three-stage approach to the designations: in the first stage, the FSOC will use certain metrics, such as total consolidated assets and leverage ratios, to determine whether a non-bank financial company warrants closer attention for designation; in the second stage, the FSOC will use a six-category framework to measure an institution's vulnerability and impact on the broader US economy; and in the third

306 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, HR 4173, 111th Cong. Section 622 (2010).

307 Financial Market Regulatory Restructuring: Hearing before the House Committee on Financial Services, 110th Cong. (2008) (statement of Treasury Secretary Timothy F Geithner).

308 Financial Stability Oversight Council, Final Rule and Interpretive Guidance, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Federal Register 21,637 (11 April 2012); see also Davis Polk & Wardwell LLP, FSOC Issues Final Rule on Designation of Systemically Important Nonbank Financial Companies (4 April 2012), available at www.davispolk.com/files/Publication/bd4d269c-ecc1-4757-a5ae-007f26f378e1/Presentation/PublicationAttachment/c6a028ce-271b-4aef-b140-02f4b9094236/040412_FSOC.Final.Rules.pdf.

stage of review, the FSOC will evaluate whether the company's material financial distress would pose a threat to US financial stability, focusing on the transmission channels through which the company's distress would affect the broader economy. Nonetheless, the FSOC retains broad discretion in making such designations and may designate any non-bank financial company it deems to pose a threat to US financial stability, even where such company does not meet any of the thresholds set out in the guidance. As of 1 February 2013, the FSOC had not designated any non-bank financial company as systemically important.

ii Heightened prudential standards

The Dodd-Frank Act also subjects bank holding companies with total consolidated assets of \$50 billion or more and systemically important non-bank financial companies to heightened prudential and other standards and enhanced reporting and disclosure requirements. The heightened standards include increased capital and liquidity requirements, leverage limits, contingent capital, resolution plans, credit exposure reporting, concentration limits, public disclosures and short-term debt limits. The FSOC is authorised to make recommendations to the Federal Reserve concerning the establishment and refinement of prudential standards, and the Federal Reserve must consider those recommendations in prescribing standards.

On 5 January 2012, the Federal Reserve published proposed rules to implement the enhanced prudential standards required by Section 165 of the Dodd-Frank Act and the early remediation regime required by Section 166 of the Dodd-Frank Act. The rules, if adopted as proposed, would generally apply to US bank holding companies with consolidated assets of \$50 billion or more and non-bank financial companies designated by the FSOC for supervision by the Federal Reserve, with some provisions also applicable to smaller bank holding companies and other depository institution holding companies. The Section 165 enhanced prudential standards relate to: (1) risk-based capital and leverage; (2) liquidity; (3) single-counterparty credit limits; (4) overall risk management and risk committees; (5) stress tests; and (6) debt-to-equity limits. The early remediation regime creates a framework to address material financial distress or management weaknesses at companies covered by the proposed rules.

All companies covered by the proposed rules must comply with, and hold capital commensurate with, the requirements of any regulations adopted by the Federal Reserve related to capital plans and stress tests, including the Federal Reserve's capital planning final rule. The capital planning final rule, effective from 31 December 2011, described in greater detail above, requires firms to demonstrate a *pro forma* Tier I common ratio above 5 per cent under baseline, adverse and severely adverse conditions. Non-bank financial companies designated for supervision by the Federal Reserve will also have to comply with the Federal Reserve's capital and leverage requirements generally applicable to bank holding companies.

The liquidity provisions of the proposed rules require companies to maintain a sufficient quantity of highly liquid assets to survive a projected 30-day liquidity stress event, to conduct regular liquidity stress tests, and to implement various liquidity risk-management requirements, including periodic reviews of business lines for liquidity risks. The board of directors of the company is required to be ultimately responsible for liquidity risk management, including periodic review and approval of a contingency

funding plan to address potential liquidity stress events. The liquidity requirements of the proposal rule are similar, but not identical, to Basel III's Liquidity Coverage Ratio, which the Federal Reserve and other banking agencies will presumably implement as part of their forthcoming regulations implementing Basel III.

The proposed rules also implement a statutory requirement to create new single-counterparty credit exposure limits. The proposed rules would limit the aggregate exposure of each of the largest systemically important US financial institutions, defined to include US bank holding companies with consolidated assets of \$500 billion or more, and any non-bank financial company designated by the FSOC, to each other such institution to 10 per cent of the aggregate capital and surplus of each institution. Bank holding companies with consolidated assets of \$50 billion or greater would be subject to a 25 per cent capital/surplus exposure limit with respect to any counterparty.

Companies covered by the proposed rules, as well as bank holding companies with consolidated assets of \$10 billion or more, must also comply with a range of corporate governance requirements, such as establishment of a risk committee of the board of directors and appointment of a chief risk officer with defined responsibilities.

The proposed rules would also subject covered companies to annual supervisory stress tests and company-run stress tests. The stress tests, which are designed to assess firms' capital adequacy, involve nine-quarter planning horizons under baseline, adverse and severely adverse scenarios. The Federal Reserve intends to publish public summaries of companies' stress test results, with more detailed information to remain confidential. The stress tests are designed to work in tandem with the capital planning final rule, which requires large US bank holding companies to submit annual capital plans to the Federal Reserve for approval while demonstrating capital adequacy under baseline, adverse and severely adverse scenarios.

The proposed rule also implements a provision of Section 165 that would allow the FSOC to impose a 15:1 debt-to-equity limit on a company covered by the proposed rule upon a determination that the company represents a 'grave threat' to US financial stability.

The early remediation regime would address material financial distress or management weaknesses at any company covered by the proposed rules. A company would be placed into one of the regime's four early remediation levels based on triggers related to capital and leverage, forward-looking stress tests, risk management or liquidity. In addition, under the proposed rules, a company may be considered for placement into the lowest early remediation category in response to volatility in certain market indicators tied to the company's financial strength. The four levels of early remediation under the proposed rules are heightened supervisory review, initial remediation, recovery, and resolution assessment, with the specific limitations and requirements increasing in severity with each level.

It is uncertain when final rules will be adopted.

iii Resolution plan requirements

On 1 November 2011, the Federal Reserve and the FDIC jointly issued a final rule-making to implement the resolution plan requirement for systemically important non-bank financial institutions and bank holding companies with consolidated assets of \$50 billion or more. The purpose of resolution planning is to develop, in advance of any crisis,

strategies for resolving SIFIs and G-SIFIs that are credible alternatives to the Hobson's choice between taxpayer-funded bailouts and 'disorderly' liquidations or other strategies that risk destabilising the financial system.³⁰⁹ The 'too big to fail' problem arises when the only options available for resolving a particular SIFI are taxpayer-funded bailouts or 'disorderly' liquidations or other destabilising resolution strategies. Faced with such a choice, policymakers inevitably choose bailout as the lesser of two evils.³¹⁰ Resolution planning is an important component of the toolkit necessary to solve the 'too big to fail' problem.

iv Orderly liquidation authority

The Dodd-Frank Act includes an orderly liquidation authority, modelled on the US bank resolution authority in the Federal Deposit Insurance Act, which gives the government the authority, under certain circumstances, to resolve a US financial company outside the bankruptcy process. This is thought to retain the discipline that the possibility of liquidation imposes, while providing the government the flexibility to curtail the potential domino effect of the failure of a systemically important financial institution during a period of severe economic and financial stress.

Specifically, provided a determination to place a financial company under the resolution regime has been made, the FDIC would step in as receiver of the company, with the authority to sell all or any assets and liabilities to a third party, or to establish one or more bridge financial companies to hold the part of the business worth preserving until it can be recapitalised, sold or liquidated in an orderly fashion. The Act provides for an orderly liquidation fund to be used to provide liquidity to the covered financial company or bridge financial company in a financial crisis. That fund would not be pre-funded, but rather would be funded initially through borrowing from the Treasury. Any loss in the fund would be paid back over time either through a clawback of creditors who received additional benefits or through assessments on eligible financial companies.

On 15 July 2011, the FDIC issued its final rule implementing certain provisions of orderly liquidation authority. The final rule covers a wide range of topics previously covered in an interim final rule and in a proposed rule, including:

- a* how the preferential transfer and fraudulent transfer provisions of orderly liquidation authority will be harmonised with the Bankruptcy Code;
- b* the priorities of administrative expenses and unsecured claims;
- c* the obligations of bridge financial companies with respect to assumed claims and the use of any proceeds realised from the sale or other disposition of the bridge;
- d* certain details of the FDIC's administrative claims process;
- e* special rules for secured claims;

309 See Randall D Guynn, *Are Bailouts Inevitable?*, 29 *Yale Journal on Regulation* 121, 123–24 (2012).

310 *Id.* at 127–29. See also Hal S Scott, *Interconnectedness and Contagion* (20 November 2012), available at www.capmktreg.org/pdfs/2012.11.20_Interconnectedness_and_Contagion.pdf.

- f* proposals for determining whether senior executives or directors of a covered financial company were ‘substantially responsible’ for its failure and may therefore be ordered to return up to two years of their remuneration; and
- g* the treatment of claimants whose set-off rights are destroyed by the FDIC.³¹¹

It is expected that these are the first in a series of rule-makings that will be necessary to provide the market guidance on how the FDIC would exercise its authority under orderly liquidation authority.

The chairman of the FDIC has said that the FDIC’s preferred method for resolving the largest and most complex banking groups under Title II is called the single-point-of-entry (‘SPOE’) recapitalisation model.³¹² Under the SPOE model, only the parent bank holding company of a banking group would be put into a resolution proceeding. All of the parent’s assets, including its ownership interests in operating subsidiaries, would be transferred to a bridge financial company. The transferred business would be recapitalised by leaving the failed company’s equity capital and a sufficient amount of its unsecured long-term debt behind in a receivership. The operating subsidiaries would be recapitalised and kept out of insolvency proceedings by converting loans or other extensions of credit from the parent into new equity in the operating subsidiaries or otherwise downstreaming available parent assets to the subsidiaries. If the bridge financial holding company or any of its operating subsidiaries were unable to obtain sufficient liquidity from the market, the Federal Reserve’s discount window,³¹³ or Section 13(3) of the Federal Reserve Act,³¹⁴ the FDIC could provide such liquidity by borrowing from the US Treasury subject to certain limits contained in Title II of Dodd-Frank.³¹⁵

The FDIC and the Bank of England have issued a joint paper endorsing the SPOE model for resolving banking organisations with cross-border operations.³¹⁶ The FDIC has also indicated that it intends to propose a policy statement or regulation describing

311 FDIC, Final Rule: Certain Orderly Liquidation Authority Provisions under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 July 2011), www.gpo.gov/fdsys/pkg/FR-2011-07-15/pdf/2011-17397.pdf.

312 Martin J Gruenberg, acting chairman, FDIC, Remarks to the Federal Reserve Bank of Chicago Bank Structure Conference (10 May 2012), available at www.fdic.gov/news/news/speeches/chairman/spmay1012.html.

313 See, for example, 12 US Code of Federal Regulations Part 201; The Federal Reserve Discount Window (21 July 2010), available at www.frbdiscountwindow.org/discountwindowbook.cfm?hdrID=14&dtlID=43#eligibilitytps.

314 12 USC Section 343.

315 See Dodd-Frank Act, US Public Law No. 111-203, Section 210(n), 124 US Statutes at Large 1375, 1506-09 (2010).

316 Resolving Globally Active, Systemically Important, Financial Institutions: A joint paper by the Federal Insurance Deposit Corporation and the Bank of England (10 December 2012), available at www.fdic.gov/about/srac/2012/gsif.pdf; Martin Gruenberg & Paul Tucker, Op-Ed., Global Banks Need Global Solutions When They Fail, *Financial Times*, 10 December 2012.

in more detail how it would use its authority under Title II to resolve a covered financial company under the SPOE model.³¹⁷

VIII OUTLOOK AND CONCLUSIONS

The significance of the restructuring of the US financial regulatory framework cannot be understated. It is the most extensive overhaul of the US financial regulatory system since the 1930s. Notably, the Dodd-Frank Act extends the principles of bank holding company and bank regulation to many other players in the financial markets, including investment banks, non-depository lenders, hedge funds, insurance companies and any others deemed to be systemically important. Regulatory implementation of the requirements has mostly proceeded through notice and comment rule-making. While the final outcome of the implementation phase remains unknown, the new financial regulatory rules will structure, constrain and channel the behaviour of institutions, markets and individuals, and inspire creative behavioural responses, for the foreseeable future.

317 See, for example, Statement of James Wigand, Director of the FDIC's Office of Complex Financial Institutions, in Video: Banking Law Institute 2012, Panel on Systemic Risk – the Challenge of Systemically Important Financial Institutions (SIFIs), Living Wills and Orderly Liquidation Issues (Practicing Law Institute programme 19 December 2012), available at www.pli.edu/Content/OnDemand/Banking_Law_Institute_2012/_/N-4nZ1z12whl?fromsearch=false&ID=144553.

Appendix 1

ABOUT THE AUTHORS

LUIGI L DE GHENGI

Davis Polk & Wardwell LLP

Luigi L De Ghengi is a partner in Davis Polk's financial institutions group. His practice focuses on bank regulatory advice, and mergers and acquisitions and capital markets transactions for US and non-US banks and other financial institutions, including transactions involving the acquisition of failed banks or their assets and liabilities. He is also experienced in advising banks and other financial institutions on corporate governance and compliance matters, bank insolvency issues, government investigations and enforcement actions, cross-border collateral transactions, and clearance and settlement systems. Mr De Ghengi has advised a number of financial institutions on capital raising transactions ranging from Tier I and Tier II capital securities offerings to initial public offerings.

Mr De Ghengi received his BA, *magna cum laude*, from McGill University in 1980 and in 1982 received his BA in law from Oxford University. In 1985, he received his JD, *cum laude*, from Northwestern University School of Law, where he was an articles editor of the *Northwestern University Law Review*.

REENA AGRAWAL SAHNI

Davis Polk & Wardwell LLP

Reena Agrawal Sahni is a counsel in Davis Polk's financial institutions group. Her practice focuses on bank regulatory advice, and mergers and acquisitions and capital markets transactions for US and non-US banks, private equity firms and other financial institutions. She is also experienced in advising banks and other financial institutions on corporate governance, OFAC and anti-money laundering compliance matters, internal investigations and enforcement actions. Ms Sahni has been actively involved in Davis Polk's Dodd-Frank Act implementation, and advises SIFMA and other organisations on regulatory reform issues. Ms Sahni was a senior attorney at the SEC, in the Division of Enforcement, from 2007 through 2009.

Ms Sahni graduated, *magna cum laude*, from Harvard College in 1996 and in 2001 received her JD from Columbia Law School, where she was a James Kent Scholar and managing editor of the *Columbia Law Review*. She clerked for the Honourable Jon O Newman, US Court of Appeals, Second Circuit, from 2001 to 2002.

DAVIS POLK & WARDWELL LLP

450 Lexington Avenue

New York

NY 10017

United States

Tel: +1 212 450 4000

Fax: +1 212 701 5800

reena.sahni@davispolk.com

www.davispolk.com