

# COMMITTEE ON CAPITAL MARKETS REGULATION

January 6, 2017

Mr. Valdis Dombrovskis  
Vice-President for Financial Stability, Financial Services and Capital Markets Union  
European Commission  
Rue de la Loi / Wetstraat 200  
B-1049 Brussels, Belgium

The Honorable Daniel K. Tarullo, Governor  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551

Re: Proposal for a Directive of the European Parliament and the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (2016/0364)

Dear Vice-President Dombrovskis and Governor Tarullo:

The Committee on Capital Markets Regulation (the “**Committee**”) is grateful for the opportunity to comment on the proposed amendments to Directive 2013/36/EU (the “**Proposal**”).

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-four leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee is concerned by the provisions of the Proposal requiring third-country banking groups to establish an EU-based intermediate holding company (“**IHC**”) for subsidiaries located in the EU.

Specifically, the Committee believes that the Proposal’s IHC mandate will impose burdensome and unnecessary restructuring requirements without providing a commensurate benefit to bank resolvability. In general, the Committee is also concerned that any widespread adoption of IHC mandates by national authorities could undercut the stability of international banking organizations, as such mandates may restrict the ability to efficiently manage capital in a crisis.

The Committee therefore recommends that the European Commission withdraw its Proposal. The Committee further recommends that the Federal Reserve Board (“**Federal Reserve**”) reconsider its IHC requirement for foreign banking organizations. In particular, the Federal Reserve should evaluate whether its IHC requirement could *increase* risk to the U.S. financial system by reducing the ability of international banking organizations to respond to a crisis.

### ***The European Union’s IHC Proposal***

Under the Proposal a non-EU banking organization that has two or more subsidiaries in the EU and either (i) has been identified by the European Banking Authority as a “global systemically important institution” or (ii) has total consolidated assets of at least €30 billion in the EU must establish an “intermediate EU parent undertaking” to function as an EU-based holding company for such subsidiaries.<sup>1</sup>

The IHC would be subject to the EU Capital Requirements Regulation and Capital Requirements Directive.<sup>2</sup> According to the Proposal, the IHC requirement is intended to “strengthen the resolution process of third-country groups with significant activities in the EU.”<sup>3</sup>

### ***Problematic Aspects of IHC Mandates***

Although the Proposal would require third-country groups to undertake costly and burdensome restructuring efforts, it is not clear that there would be any benefit to the resolution of EU entities. Moreover, the Proposal may have the unintended effect of weakening the stability of the banking group as a whole. That is because mandating organization of subsidiaries under an EU IHC may make it more difficult for the banking group to manage capital and liquidity on a consolidated basis.<sup>4</sup> The Proposal would do so by subjecting the IHC’s regulatory capital to various country-specific restrictions on cross-border and inter-affiliate capital flows.<sup>5</sup>

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<sup>1</sup> Proposal for a Directive of the European Parliament and the Council Amending Directive 2013/36/EU (2016/0364), at 12, 23-24 (proposed Article 21b).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> See, e.g., Bank for International Settlements Committee on the Global Financial System, Paper No. 39, *Funding Patterns and Liquidity Management of Internationally Active Banks* 18, 33 (May 2010).

<sup>5</sup> Recent reports issued by the European Commission state that between 2008 and 2013 financial regulators in a number of EU Member States enacted “ring-fencing” measures to trap liquidity within the regulator’s home country, thereby precluding cross-border intra-bank capital transfers. Report from the Commission to the European Parliament and the Council: Legal Obstacles to the Free Movement of Funds Between Institutions Within a Single Liquidity Sub-Group 3-6 (June 5, 2014); Commission Staff Working Document on the Movement of Capital and Freedom of Payments (March 5, 2015) [hereinafter “Commission Staff Report”]; see also Jonathan Fiechter, İnci Ötker-Robe, Anna Ilyina, Michael Hsu, André Santos, & Jay Surti, IMF Staff Discussion Note SDN/11/04, *Subsidiaries or Branches: Does One Size Fit All?* 3-4, 8, 18 n. 17 (2011); Bank of England, Supervisory Statement No. SS10/14, *Supervising International Banks: the Prudential Regulation Authority’s Approach to Branch Supervision* 4 (Sept. 2014) (explaining that “a subsidiary structure puts [legal] limits on the bank’s ability to transfer funds across borders within the bank”).

Furthermore, the Proposal could set a precedent for further restrictions on the cross-border transfer of capital and liquidity that would significantly impede the ability of international banking organizations to efficiently manage a crisis.<sup>6</sup> Indeed, the Proposal was itself conceived as a means of “retaliation” for the Federal Reserve’s IHC rule.<sup>7</sup>

Such an outcome would frustrate the objectives and charters of global standard-setters in which the EU plays key roles, such as the Basel Committee on Banking Supervision and the Financial Stability Board. Both of these international standard setters emphasize a commitment to improving cross-border cooperation and establishing and promoting global regulatory standards.<sup>8</sup>

The Committee therefore believes that the European Union should abandon its endeavor to impose an IHC mandate and instead continue to work with other jurisdictions to develop international procedures for dealing with the failure of large banks with international operations. Unlike the Proposal, such efforts would be incrementally beneficial for the resolvability of an international bank.

Furthermore, under the new Trump Administration, the Federal Reserve should reconsider its imposition of a similar IHC requirement on foreign banking organizations with non-branch assets of at least \$50 billion in the United States.<sup>9</sup>

In particular, the Federal Reserve should conduct an empirical analysis of whether its own IHC requirement could *increase* risk to the U.S. financial system. The Federal Reserve’s rule could increase risk to the U.S. financial system by encouraging other countries to adopt similar IHC rules that would then weaken the ability of U.S. banks with international operations to efficiently manage capital in a crisis. This issue is addressed in detail in the Committee’s 2013 letter to the Fed on its IHC requirement.<sup>10</sup> For example, in that letter the Committee noted that, “As recently as the 2008 financial crisis, U.S. banks relied on their foreign affiliates for over \$500 billion in net funding.”<sup>11</sup>

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<sup>6</sup> Commission Staff Report at 27.

<sup>7</sup> See Letter from Michel Barnier, European Commissioner for Internal Market and Services, European Commission, to Ben Bernanke, Chairman, Federal Reserve Board (Apr. 18, 2013).

<sup>8</sup> Basel Committee on Banking Supervision Charter, <http://www.bis.org/bcbs/charter.htm>; Financial Stability Board Charter, [http://www.fsb.org/wp-content/uploads/r\\_090925d.pdf?page\\_moved=1](http://www.fsb.org/wp-content/uploads/r_090925d.pdf?page_moved=1).

<sup>9</sup> 12 C.F.R. § 252.153.

<sup>10</sup> Letter from the Committee on Capital Markets Regulation to the Board of Governors of the Federal Reserve System (April 24, 2013). Available at:

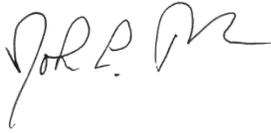
[http://www.capmksreg.org/wp-content/uploads/2013/04/FRB.IHC\\_.comment.ltr\\_.pdf](http://www.capmksreg.org/wp-content/uploads/2013/04/FRB.IHC_.comment.ltr_.pdf)

<sup>11</sup> *Id* at 6.

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Thank you very much for your consideration of the Committee's views. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott ([hscott@law.harvard.edu](mailto:hscott@law.harvard.edu)), or its Executive Director of Research, John Gulliver ([jgulliver@capmksreg.org](mailto:jgulliver@capmksreg.org)), at your convenience.

Respectfully submitted,



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