

# Client Alert

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January 24, 2018

## Federal Reserve Board Revises FR Y-7 and Provides Guidance on Enhanced Prudential Standards for Foreign Banking Organizations

On January 18, 2018, the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) announced the approval of proposed revisions<sup>1</sup> to the Annual Report of Foreign Banking Organizations (“FR Y-7”).<sup>2</sup> The revisions were proposed and adopted to enable foreign banking organizations (“FBOs”) to comply with certain certification requirements contained in Regulation YY. Regulation YY imposes enhanced prudential standards on FBOs that meet certain asset thresholds.<sup>3</sup> In addition, the announcement of the revised FR Y-7 (the “Adopting Release”) contains important guidance regarding how an FBO may be permitted to comply with Regulation YY.

The revisions to the FR Y-7 are effective beginning with FR Y-7 reports submitted for fiscal year-ends that end on or after March 1, 2018. The revisions are generally being adopted as proposed on December 2, 2015.<sup>4</sup>

### AMENDMENTS TO FR Y-7

The amendments to the FR Y-7 and its accompanying instructions create a new Report Item 5. The new Report Item 5 has five subparts that ask reporters to check “Yes,” “No,” or “N/A” to report compliance with applicable capital stress testing and risk committee requirements.

Below is a chart showing the new Report Items, the type of entity to which the Report Item applies, and the relevant standard that may be certified on the revised form:

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<sup>1</sup> The adopting release is available here: <https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-6%20FR%20Y-7%20FR%20Y-10%20FR%20Y-10E%20FFRN01182018.pdf>.

<sup>2</sup> FBOs that are qualifying FBOs (“QFBOs”) are required to file the FR Y-7 on an annual basis. The form gathers financial, organizational, shareholder, and managerial information about the FBO. A QFBO is an FBO that meets certain requirements as set forth in 12 C.F.R. § 211.21(o).

<sup>3</sup> The proposed revisions to the FR Y-7 are available here: [https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-7\\_Draft%20Form\\_01032018.pdf](https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-7_Draft%20Form_01032018.pdf). The proposed revisions to the instructions to Form FR Y-7 are available here: [https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-7\\_Draft%20Instructions\\_01032018.pdf](https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-7_Draft%20Instructions_01032018.pdf).

<sup>4</sup> See 80 Fed. Reg. 75457 (Dec. 2, 2015).

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Item	Entity	Standard
5(a)	FBOs with total consolidated assets more than \$10 billion but less than \$50 billion and foreign savings and loan holding companies with total consolidated assets more than \$10 billion <sup>5</sup>	Must (1) be subject on a consolidated basis to a capital stress testing regime by their home country supervisor that meets certain standards; and (2) conduct such stress tests or be subject to a supervisory stress test and meet any minimum standards set by their home-country supervisor with respect to the stress tests.
5(d)	FBOs with total consolidated assets of \$50 billion or more but less than \$50 billion in combined U.S. assets <sup>6</sup>	
5(e)	FBOs with \$50 billion or more in combined U.S. assets that have a U.S. branch or U.S. agency <sup>7</sup>	
5(b)	Publicly traded <sup>8</sup> FBOs with total consolidated assets of at least \$10 billion but less than \$50 billion <sup>9</sup>	Must annually certify to the Federal Reserve Board that they maintain a committee of its global board of directors (or equivalent) on a standalone basis or as part of their enterprise-wide risk committee (or equivalent) that: (1) oversees the risk-management policies of the combined U.S. operations; and (2) includes at least one member having experience identifying, assessing, and managing risk exposures of large, complex firms (a "U.S. Risk Committee").
5(c)	FBOs with total consolidated assets of \$50 billion or more but less than \$50 billion in combined U.S. assets <sup>10</sup>	

## GUIDANCE FROM ADOPTING RELEASE

The Federal Reserve Board received a comment letter in response to the December 2, 2015 proposed revision to the FR Y-7 that poses a number of questions regarding the requirements of Regulation YY. As further discussed below, the Adopting Release addresses a number of these questions.

### ***Risk Committee Composition***

The commenter asked whether the U.S. Risk Committee required by Regulation YY "must be composed entirely of members of the FBO's global board or can be configured in other ways which appropriately take into account

<sup>5</sup> 12 C.F.R. § 252.122(a).

<sup>6</sup> 12 C.F.R. § 252.146(b).

<sup>7</sup> 12 C.F.R. § 252.158(b). Additional reporting obligations also apply, namely, summary information about the FBO's stress testing must be provided to the Federal Reserve Board under 12 C.F.R. § 252.158(c)(1) and certain additional reporting obligations apply if the FBO is in a net due from position under 12 C.F.R. shares listed on a U.S. or non-U.S. securities exchange. § 252.158(c)(2).

<sup>8</sup> Publicly traded FBOs include FBOs with shares listed on a U.S. securities exchange and those with shares listed on a non-U.S. securities exchange.

<sup>9</sup> 12 C.F.R. § 252.132(a).

<sup>10</sup> 12 C.F.R. § 252.144(a).

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the size, scale and complexity of an FBO's combined U.S. operations, most effectively utilize the expertise of those most familiar with the risks of these operations and provide the [Federal Reserve] Board assurance that the FBO's board of directors is devoting appropriate attention to and exercising proper oversight over these risks."

In response to this question, the Adopting Release states:

"[T]o certify compliance with sections 252.132(a) and 252.144(a), the FBO is not required to form a special U.S. risk committee comprised of members of the FBO's board of directors. Rather, the FBO must ensure that the FBO's board of directors or a committee comprised of members of the FBO's board of directors has primary responsibility for oversight of the risks of the combined U.S. operations. The committee that oversees U.S. risk for an FBO subject to Regulation YY is not required to (though it may) directly administer the FBO's U.S. risk management policies; rather, the FBO may designate specific senior management officials from the FBO's U.S. operations to be responsible for administering the U.S. risk management policies and for providing regular reports directly to the FBO's board of directors or risk committee."

This response indicates that an FBO's board of directors (or a committee thereof) is ultimately responsible for overseeing the risk management policies of U.S. operations. The board of directors need not be responsible for administering such policies and may delegate responsibility to senior management officials. The response further clarifies that the board committee need not be a "special" committee created specifically for the purpose of overseeing the risk management policies of U.S. operations.

The Adopting Release further explains that an FBO has "flexibility in establishing its oversight function so long as the FBO's board of directors is informed about and provides the appropriate level of guidance about the risks of the combined U.S. operations of the FBO," and that no matter how the FBO constructs its oversight function, the FBO must "take appropriate measures to ensure that the risk management policies for its combined U.S. operations are implemented and that the risk committee is provided sufficient information on the combined U.S. operations to allow it to carry out its responsibilities."

### ***Two-Tier Board Structures***

The commenter requested clarification regarding how the U.S. Risk Committee requirement could be satisfied in the context of a two-tier board structure. The Adopting Release remarks that a two-tier board structure is "a common feature of FBOs in European countries, and generally consists of a supervisory board independent from management that sets the direction of the company and oversees the company's senior management, and a management/executive board that implements the company's strategies and risk management."

In the Adopting Release, the Federal Reserve Board states that "in a two-tier board structure, a committee of either the supervisory board or the management/executive board (or a combination thereof) could be considered a committee of the FBO board of directors for purposes of complying with the requirement under Regulation YY for an FBO to maintain a committee that oversees U.S. risk."

The purpose of the U.S. Risk Committee requirement, the Federal Reserve Board states, is "to ensure that the FBO parent is aware of and takes responsibility for the oversight of the risks of its combined U.S. operations."

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## ***Home Country Capital Adequacy Standards***

Regulation YY requires certain FBOs to certify to the Federal Reserve Board that they meet home-country capital adequacy standards on a consolidated basis, and that such capital adequacy standards are “consistent with” the Basel Capital Framework.

The commenter raised questions regarding this “consistency” determination, suggesting “that a finding by the most recently-completed peer review that a home country’s standards overall are compliant with the Basel Committee Framework should be sufficient (but not necessary) to enable an FBO from that country to certify its compliance with the applicable requirements of Regulation YY that are within the scope of the review.” The commenter further stated that it supported the Federal Reserve Board’s current approach to this issue, which they interpreted to allow an FBO to “exercise their reasonable discretion in making the required certification.” The Adopting Release does not address this suggestion regarding the sufficiency of a peer review.

The commenter requested clarification as to whether the filing of the FR Y-7Q could satisfy the requirement to report and certify compliance with home country capital adequacy standards, and also asked the Federal Reserve Board to clarify the frequency of such certification, its as-of date, and the means by which certification should be made. In response to these points, the Adopting Release confirms that “Regulation YY does not specify the frequency or the as-of date for an FBO’s certification of compliance with its home country capital requirements,” but that “completion of the FR Y-7Q on a quarterly basis would satisfy both the requirement to report and the requirement to certify to the [Federal Reserve] Board its compliance with capital adequacy measures that are consistent with the Basel Capital Framework.”

## ***Home Country Capital Stress Testing Requirement***

The Adopting Release notes generally that “an FBO is expected to evaluate the stress testing regime to which it is subject and make a reasonable conclusion about whether this regime meets the home country stress testing criteria in Regulation YY.” The commenter asked whether “satisfactory completion” of an Internal Capital Adequacy Assessment Process (“ICAAP”) review could satisfy the home country capital stress test requirements of Regulation YY. In response, the Adopting Release clarifies that, “if an ICAAP satisfies the underlying requirements for a capital stress test, including all applicable information requirements in Regulation YY, satisfactory completion of the ICAAP would be sufficient to satisfy these requirements.”

The commenter noted that certain jurisdictions may require capital stress testing, but not on an annual basis, and asked what the Federal Reserve Board’s expectations would be where “an FBO would simply be unable to comply with Regulation YY as the result of circumstances entirely outside its control.” The Adopting Release clarifies that Regulation YY “requires an FBO to be subject to a stress testing regime that includes an annual supervisory stress test or annual supervisory evaluation of the FBO’s internal stress test.” Thus, as an example, a biennial stress test would not satisfy this requirement.

## ***Internal Liquidity Stress Requirements***

Regulation YY requires certain FBOs to report the results of an internal liquidity stress test on an annual basis. The rule sets forth three time horizons which must be included in this test (30-day, 60-day, and one-year). The commenter remarked that not all jurisdictions may require these specific time horizons. The commenter asked the Federal Reserve Board to clarify “whether these highly prescriptive provisions of the regulation are intended to

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apply equally regardless of whether stress testing applies to an FBO's consolidated operations or only its combined U.S. operations.”

In response, the Federal Reserve Board notes that “[i]n the event that an FBO is not required to conduct an internal liquidity stress test for its consolidated operations using the three specified planning horizons in Regulation YY or chooses not to do so, the FBO may instead choose to provide an internal liquidity stress test for just the combined U.S. operations.” The Adopting Release also mentions that “if an FBO does not comply with the internal liquidity stress testing reporting requirements, it must limit the net aggregate amount owed by the parent or other non-U.S. affiliates to the U.S. operations to 25 percent or less of the third party liabilities of the combined U.S. operations.”

The commenter requested clarification regarding what information an FBO is required to provide to the Federal Reserve Board on an annual basis in order to comply with Regulation YY. The Adopting Release states that “although Regulation YY does not prescribe the information that must be reported to the [Federal Reserve] Board regarding the internal liquidity stress tests, given the diversity in liquidity reporting requirements across jurisdictions, FBOs are expected to provide sufficient information in the internal liquidity stress test to allow the [Federal Reserve] Board to assess the liquidity position of the FBO.”

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