UNITEHERE!

1630 SOUTH COMMERCE STREET, LAS VEGAS, NV 89102 • TEL (702) 385-2131 • FAX (702) 385-5205
WWW.UNITEHERE.ORG • FACEBOOK.COM/UNITEHERE • @UNITEHERE

April 29, 2013

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

RE: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (Docket No. R–1438 and RIN 7100 AD 86)

Dear Mr. Frierson,

This letter constitutes comments on the Notice of Proposed Rulemaking ("Proposed Rule") issued by the Board of Governors of the Federal Reserve on December 28, 2012, as required to be established under sections 165 and 166 of the Dodd-Frank Act. These comments are submitted on behalf of UNITE HERE.

UNITE HERE represents 250,000 workers throughout the U.S. and Canada who work in the hotel, gaming, food service, manufacturing, distribution, laundry, and airport industries. UNITE HERE supports the legislative intent of Dodd-Frank to reduce systemic risk and ensure the long term stability of the financial system. It is critical that rules adopted by the Federal Reserve effectively promote this aim.

The Proposed Rule would implement sections 165 and 166 of the Dodd-Frank Act for foreign banking organizations (FBOs) with total consolidated assets of $50 billion or more, including risk-based capital and leverage requirements, liquidity requirements, single-counterparty credit limits, and enhanced standards that would require certain FBOs to form a U.S. holding company. UNITE HERE strongly supports this rule. We believe such requirements are necessary given the increase in concentration, complexity, and interconnectedness of the U.S. operations of FBOs, and especially given the actions by two of the largest FBOs operating in the United States to deregister as bank holding companies in order to avoid a key provision of Dodd-Frank ("the Collins Amendment").

We commend the Board for proposing a rule that addresses many of the specific lessons learned from the recent financial crisis, in light of what we now know were extraordinary levels of central bank support for FBOs beginning in 2008. The Board is right to acknowledge the fact that FBOs have not been sources of strength to U.S. affiliates in the years leading up to the crisis and beyond, and in fact have required significant emergency funding and other forms of assistance from the Federal Reserve System.

The 'Anti-Deutsche Bank Rule' and Why We Need It

The largest of the FBOs that would be affected by this Proposed Rule is Deutsche Bank AG. In fact, according to a recent article in The Economist, the Proposed Rule is often referred to on Wall Street as 'the Anti-Deutsche Bank rule.'[1] Indeed, we believe the German lender's longstanding capital and liquidity issues pose a real and continuing risk to the global financial system, and that the Proposed Rule would significantly mitigate that risk while at the same time restoring competitive equality between Deutsche Bank, other FBOs and their domestic competitors.

Some opponents of the Proposed Rule have argued that it endangers the principle of 'national treatment' (by which they apparently mean the ability of FBOs to choose whatever structure for their U.S. operations that affords them the best opportunities to minimize regulatory capital and maximize leverage.) But this rule simply imposes upon FBOs the same requirements that U.S. domestic banks are held to under Dodd-Frank. In this sense, if the Proposed Rule is not made, the Board would be abandoning national treatment in favor of regulatory arbitrage for foreign banks.

Some have also argued that the Proposed Rule fails to adhere to the requirement in Section 165 that the Board take into account the adequacy of an FBO's home country capital and liquidity rules. We respectfully disagree. In fact, any serious examination of European capital rules and supervision, particularly as it relates to the German regulatory agencies, would have to conclude that it has been on the whole inadequate from a perspective of fostering transparency, uniformity and trustworthiness of reporting, or safety and soundness.

---

[1] "The Great Unraveling," *The Economist*, April 20, 2013.

German Regulatory Failures Have Necessitated Enhanced Prudential Standards in U.S.

German regulators in particular have helped create the conditions that have necessitated enhanced prudential standards in the U.S. through their resistance to higher capital and liquidity standards in the Basel discussions and in their inability or unwillingness to dissuade Deutsche Bank from dissipating its capital further via dividend distributions. While the United States, the United Kingdom, Canada, Switzerland, the Netherlands, Sweden and most other Basel Committee members were willing to support higher standards in Basel discussions, Germany consistently opposed these reforms.[2] As former FDIC Chairwoman Sheila Bair recalls in her book Bull by the Horns, "[The German regulators'] tactics were reminiscent of those used by segregationists on the Senate floor to try to block civil rights legislation."

The Board's Approach is Prudent: Past is Prologue When it Comes to Foreign Banks

Deutsche Bank was a major contributor to the financial crisis. At the peak of the mortgage bubble, between 2005 and 2008, its U.S. broker-dealer and investment banking arm, Deutsche Bank Securities Inc., issued over $85 billion in private label securitizations and $71 billion through whole loan sales.[3] It acquired two subprime mortgage originators with the expressed intention of funneling "a steady stream of product into the mortgage capital markets."[4] It was later revealed that the bank's top collateralized debt obligation (CDO) trader privately disparaged certain Deutsche-sponsored CDOs as "crap" or "pigs," that Deutsche often ignored ratings by its own due diligence firms on the quality of the underlying mortgages, and that Deutsche failed to disclose these risks to investors.[5]

When the mortgage market crashed, many Deutsche Bank investors and clients who had invested in CDOs faced heavy losses. In hindsight, it is easy to see that these products were unsuitable for many of the institutions to which they were sold. Deutsche Bank and its subsidiaries continue to face litigation related to losses in these securities.[6]

---

[2] Bair, Sheila. *Bull By The Horns.* Free Press, 2012.
[3] Deutsche Bank, *SEC Form 20-F*, March 15, 2011, F-134.
[4] Deutsche Bank Press Release, *Deutsche Bank Completes Acquisition of MortgageIT Holdings*, January 3, 2007. available at http://www.deutsche-bank.de/presse/en/content/press_releases_2007_3312.htm#print
[5] U.S. Senate Permanent Subcommittee on Investigations, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse*, April 13, 2011, p.331-332; Testimony of Vicki Beal, Senior Vice President, Clayton Holdings before the Financial Crisis Inquiry Commission, September 23, 2010. See, in particular: All Clayton Trending Reports, 1st Quarter 2006-2ndQuarter 2007, available at http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0923-Clayton-All-Trending-Report.pdf.
[6] Brinded, Lianna. "Deutsche Bank Ramps Up Litigation Provision by EU 600 million." *International Business Times*. March 20, 2013.

Deutsche Bank has been the recipient of billions in federal support since the crisis began: $11.8 billion[7] in TARP funds as one of the largest counterparties to AIG; $2 billion[8] as the second-heaviest user of the Fed's discount window; and $354 billion[9] as one of the largest users of low-cost emergency funding programs. During the same period it accessed this support, Deutsche Bank's U.S. bank holding company, Taunus Corporation, maintained negative Tier 1 capital levels, and in the last six years (2007-2012), the German bank has paid out over $9 billion in dividends while remaining the least well-capitalized (on a consolidated basis) of the systemically important global banks.

Why Foreign Banking Organizations Need Intermediate Holding Companies with National Treatment on Capital Standards

Rather than taking steps to raise the necessary capital to meet the requirements of rules for Bank Holding Companies (BHCs) operating in the U.S., in 2012 Deutsche Bank reorganized its U.S. operations and deregistered Taunus as a BHC. The bank's explicitly stated intent of this reorganization was to exempt Taunus from capital requirements (Basel II, Basel III and the Collins Amendment of the Dodd Frank Act).[10] This has rendered Deutsche's operations less transparent and more challenging for regulators and the public to monitor.[11] Without an Intermediate Holding Company (IHC) structure, the status quo with regard to capital and liquidity issues of FBO operations in the U.S. will continue to pose some of the same systemic risks that contributed to the financial crisis.

We find it amusing that the European Banking Federation (EBF) has submitted comments decrying the Proposed Rule's "obligatory Intermediate Holding Company" requirement, and

---

[7] "German and French banks got $36 billion from AIG bailout," *Business Week*, March 15, 2009.
[8] "Foreign Banks tapped Fed's Secret Lifeline Most at Crisis Peak," *Bloomberg*, April 1, 2011.
[9] U.S. Government Accountability Office. *Report to Congressional Addressees, Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes For Managing Emergency Assistance.* July 2011. Available at: http://info.publicintelligence.net/GAO-FedAudit.pdf
[10] Deutsche Bank AG and Deutsche Bank Financial LLC, *Joint Report of the Management Board of Deutsche Bank and the Board of Managers of Deutsche Bank Financial LLC on a Partial Profit and Loss Transfer Agreement between Deutsche Bank AG and Deutsche Bank Financial LLC in Accordance with Section 293a of the German Stock Corporation Act*, March 30, 2011.
[11] Federal Register, Vol. 77, No. 249. December 28, 2012. Proposed Rules, Introduction, p. 76630. On the issue of trends in balance sheets of foreign banking organizations "Because U.S. supervisors, as host authorities, have more limited access to timely information on the global operations of foreign banking organizations than to similar information on U.S.-based banking organizations, the totality of the risk profile of the U.S. operations of a foreign baking organization can be obscured when these U.S. entities fund activities outside the U.S., such as occurred in recent years."

arguing that IHCs would be at a competitive disadvantage compared to U.S. BHCs. The EBF fails to mention that two of its largest constituent banks, Deutsche Bank and Barclays, voluntarily gave up their BHC status in order to avoid capital and liquidity rules, and in so doing created a competitive advantage for themselves.

Restructuring in order to preserve tax benefits and avoid new capital requirements, undermined the purpose and the integrity of Section 165 of Dodd-Frank and made the need for the Proposed Rule that much more apparent. Requiring the establishment of IHCs, and holding those IHCs to the same capital and liquidity standards as domestic BHCs, is the appropriate regulatory response to the banks' ill-advised efforts to avoid Section 165.

In its comments to the Board last year, Deutsche Bank's rationale for a version of an IHC exempt from capital requirements was that such subsidiaries "do not create any potential for systemic risk to the financial system" given consolidation upward into the "ultimate parent company."[12] If we measure risk in quantifiable terms, such as, for example, the amount of emergency borrowing a bank did during the crisis or the sizeable losses to investors who bought its CDO products,[13] or its role as one of the largest counterparties to a failed underwriter that specialized in regulatory capital arbitrage,[14] it is hard to see how consolidation upward into Deutsche Bank made Taunus less risky since the crisis.

Deutsche Bank AG's reported capital is the lowest among its global peers, and it would be irresponsible to put too much faith in even those reported amounts, given that the bank has aggressively manipulated its reported capital ratios through the use of proprietary (that is, secret) asset risk-weighting models. If regulators in the EU were to standardize RWA models, Deutsche Bank would be affected more than any other European bank, with likely inflation in reported risk-weighted assets of 52 percent, according to research by Espirito Santo Investment Bank.[15] Especially given this level of manipulation-by-modeling, it is imperative that the Board establish methods of independently monitoring the balance sheets of FBOs' operations in the U.S.

Moreover, as the Proposed Rule primarily addresses foreign banks with a significant global footprint, the new risk management requirements at the IHC level should not lead to any

[12] Letter from Salvatore P. Palazzolo, Managing Director of Deutsche Bank AG, New York Branch, to Federal Reserve RE: *Enhanced Prudential Standards and Early Remediation Regulations under Dodd-Frank Sections 165 & 166.* Page 4. April 30, 2012.
[13] "Litigation Risks: Deutsche Bank Faces a Series of Damaging Lawsuits." *Spiegel Online*. January 30, 2012.
[14] Walsh, Mary Williams. "A.I.G. Lists Banks It Paid With U.S. Bailout Funds." *New York Times.* March 15, 2009.

[15] Elliott, Dominic. "Deutsche Bank's Capital Trick Will Be Hard to Repeat." *New York Times.* January 31, 2013.

additional compliance burden. Global banks that operate in diverse regional markets likely already have procedures in place for coordinated central and regional allocations of capital and liquidity. For example, at Deutsche Bank, "[r]egional capital plans covering the capital needs of our branches and subsidiaries are prepared on an annual basis and presented to the Group Investment Committee." Furthermore, at Deutsche Bank, regional governance committees already exist: "Local Asset and Liability Committees further safeguard compliance with requirements such as restrictions on dividends allowable for remittance to Deutsche Bank AG or on the ability of our subsidiaries to make loans or advances to the parent bank."[16]

<u>The Proposed Rule Addresses Foreign Banks' Over-Reliance on Short-Term Borrowing in the U.S.</u>

It is spurious for opponents of the Proposed Rule to argue that higher capital requirements at the IHC level would "trap" the capital of an FBO in the U.S.[17] Regulatory capital requirements are not the same as reserve requirements.[18] The Proposed Rule would in effect require FBOs to fund their U.S. operations with more parent-sourced equity rather than relying almost entirely on borrowings from U.S. sources. The Proposed Rule would ensure that the IHC of an FBO will have to have sufficient loss-absorbing equity in case there is a sudden decline in the value of its assets in the U.S. (which could otherwise render the IHC insolvent) or a freeze in the short-term funding market (which could create a liquidity crisis for the IHC). Both of these scenarios actually occurred and were contributing factors to the recent financial crisis, which necessitated unprecedented emergency interventions by the Federal Reserve. If the counterparties to an FBO in the U.S. are confident that it has sufficient U.S.-dollar-denominated equity to absorb losses in the value of its U.S. assets, they will be much less likely to cut off short-term funding and precipitate another crisis.

The Proposed Rule will not just require FBOs to fund their U.S. operations with sufficient equity capital, it will also subject these U.S. subsidiary IHCs (just as with domestic BHCs) to liquidity stress tests, designed to prevent (or at least detect) the kind of reliance on short-term funding that led to the failure of Bear Stearns.[19] Part I (Introduction) of the Proposed Rule points out the trend in the global balance sheets of foreign banks in the run up to the financial crisis: banks had been using short-term U.S. dollar funding raised in the U.S. to finance non-U.S. affiliates'

---

[16] Deutsche Bank website, https://www.db.com/ir/en/content/capital_management.htm
[17] See comment letter on this rule by European Banking Federation. 4/18/2013.
[18] See Admati, Anat and Martin Hellwig: *Bankers' New Clothes* (Princeton University Press, February 24, 2013) for clarification on the concept of regulatory capital requirements.
[19] SEC. "Answers to Frequently Asked Investor Questions Regarding The Bear Stearns Companies, Inc." 2008. http://www.sec.gov/news/press/2008/2008-46.htm

investments. As Goldman Sachs points out in their April 1, 2013 report on Deutsche Bank, the bank has had a substantial maturities mismatch between its short-term assets in the U.S. and its short-term U.S. funding.[20] Goldman Sachs estimates the mismatch was still around US $73 billion, as of end of 2011. (Because Taunus is no longer a BHC, these are the most recent data available to analysts.) Such a mismatch is exactly the kind of vulnerability the stress tests are supposed to detect.

As of December 31, 2012, there was virtually no equity in the aggregate balance sheet of the U.S. branches and agencies of FBOs, with $2,134 billion of total assets and $2,134 billion of total liabilities.[21] This means that, on the whole, FBOs operating in the U.S. have made virtually no direct investment in the U.S. market and any decline in their U.S. assets would render them insolvent. This is clearly an untenable and highly unstable situation, and one that invites prompt corrective action along the lines of the Proposed Rule.

The Board Should Clarify the Definition of "Subsidiary" to Exclude Nonbanking Assets From the Exemption of FBO Branch and Agency Holdings.

In response to Question 9 regarding the definition of "U.S. subsidiary", we urge the Board to require an FBO to transfer its interests in all U.S. companies that it controls to its IHC, even if such companies are currently assets associated with the FBO's U.S. branch or agency network. This is necessary in order to create greater transparency and better regulatory oversight in situations where a bank enters nonbanking and nonfinancial businesses. For example, Deutsche Bank AG New York Branch indirectly owns 100% of the economic interest of Nevada Property 1 LLC, which owns and operates the Cosmopolitan Resort and Casino of Las Vegas.[22] As the Cosmopolitan clearly is not a banking or financial institution, it should not be allowed to remain directly under the bank's New York Branch and should be consolidated under Deutsche Bank's new IHC.

In light of the above examples at Deutsche Bank, one of the largest and most systemically significant FBOs operating in the U.S., we fully support the Proposed Rule and we urge the Board to resist the entreaties from a handful of FBOs and their political allies to weaken or create overbroad exceptions or exemptions. We believe the Proposed Rule restores one of the most

[20] Matt Levin. "Goldman Analysts Hint That Deutsche Bank Should Consider Just Packing It Up and Going Back To Germany." *Wall Street Journal* Dealbreaker blog. March 1, 2013. http://dealbreaker.com/2013/03/goldman-analysts-hint-that-deutsche-bank-should-consider-just-packing-it-up-and-going-back-to-germany/taunus-3/
[21] Annual Report 2012 of the Federal Financial Institutions Examination Council. See p. 30.
[22] Licensing Hearing for Nevada Property 1. Nevada Gaming Control Board. October 21, 2010.

important reforms in the Dodd-Frank Act, namely, the Collins Amendment requirement that foreign banks operating in the US are held to the same capital and liquidity rules as domestic BHCs. Prudential regulators can no longer allow globally-interconnected banks that are systemically important to choose from an array of structures, or invent new ones, that allow for maximum regulatory capital arbitrage. The Board has a paramount responsibility to protect the safety and soundness of the financial system and to protect US taxpayers from the consequences of inadequately capitalized systemically important financial institutions. We believe the Proposed Rule is a critical step in that direction.

We appreciate the opportunity to provide comments to the Board regarding the Proposed Rule, and we would be pleased to discuss any questions the Board might have with respect to these comments.

Sincerely,

Marty R. Leary M. Schafer

Marty R. Leary Meredith L. Schafer