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# Fed Rule May Prompt Asset Sell-Offs by Foreign Banks

It's been nearly two weeks since the Federal Reserve Board issued a new capital rule for foreign-owned banks, and just how far they'll have to go to comply is only getting murkier.

Some foreign banks will seek to sell assets to sidestep the potentially costly rule, thus creating a buying opportunity for rivals, many observers predict. At least one institution, Royal Bank of Scotland's $98 billion-asset RBS Citizens Financial Group, appears to already be taking such steps.

Yet some companies seem confident they're already compliant with the rule, or that corporate restructuring will bring them in line and that they won't have to add further capital. That could be a mistaken interpretation, some experts say.

A bank "needs to be concerned with capital adequacy and leverage requirements," says Ernie Patrikis, an attorney at White & Case and a former chief operating officer of the Federal Reserve Bank of New York.

The Fed rule would require foreign banks to hold more capital in the U.S., for the purpose of providing extra protections in the event of another financial crisis, and—in the eyes of some—to even up the regulatory playing field with American banks.

But some foreign banks may attempt to argue they don't need to make many changes. BMO Harris Bank, for example, says it won't need to form an intermediate holding company, one of the Fed rule's main requirements, because it already has one.

Observers expect the issue will be hashed out over the coming months. The rule will apply to foreign-owned banks in the U.S. that have assets of $50 billion or more as of July 2016. They will then get two years, until July 2018, to ensure they have Tier 1 leverage ratios of at least 5%.

The issue may be most pressing to those institutions that hover near the $50 billion asset threshold, says Douglas Landy, an attorney at Milbank, Tweed, Hadley & McCloy who has represented international banks before the Fed and the Office of the Comptroller of the Currency. Those banks are the most likely to sell assets to slim down.

"If you are right around $50 billion and you don't want to grow your business significantly, it makes huge sense to manage it down to $50 billion," Landy says.

To reach the smaller size, these banks may put some assets on the auction block, including branches and loan portfolios, says David Olson, the chairman and chief executive of River Branch Holdings, a Chicago investment bank that represents financial services companies.

"I see a very measured, bank-by-bank approach to this," Olson says. "Some will sell networks of assets. Some will sell particular asset classes."

There are 17 foreign-owned banks that could be subject to the new rule, based on current financial measurements, according to a Fed document released in February.

Among the 17 foreign banks that hold federally insured deposits, British-owned HSBC Bank USA is the largest of the group, with about $290 billion of U.S. assets. Spain's BBVA Compass is the smallest, with about $72 billion of assets.

The rule could impose huge new expenses on these banks. Some bankers have suggested that the initial regulatory costs could reach into the hundreds of millions of dollars, Patrikis says. That's based on the hours required to set up the recordkeeping and compliance for a new intermediate holding company.

There would also be yearly compliance costs, which could reach as high as $50 million, Patrikis says.

Additionally, foreign-owned banks will need to maintain Tier 1 capital of about $2.5 billion for every $50 billion of U.S. assets, Patrikis says. That, too, adds a new layer to the banks' cost of doing business, he says.

BMO Harris says it won't need to form an intermediate company, although the Fed included the $111 billion-asset bank on the list of those that would be subject to the rule.

BMO Harris's parent company, Bank of Montreal, is classified as a foreign financial holding company by the Federal Financial Institutions Examination Council. Below Bank of Montreal on the corporate flow chart sits BMO Financial Corp., which is classified as a domestic financial holding company.

Because it already has a domestic financial holding company, BMO Harris will not need to form an intermediate holding company, nor sell off assets, says Jim Kappel, a BMO spokesman.

"We are not considering the sale of any assets in connection with the Federal Reserve rule," Kappel says.

Even so, BMO and other companies may still need to examine potential asset sales or other means to improve its capital standing, Patrikis says.

"You still might be concerned with liquidity requirements and funding the portfolio," Patrikis says.

The Dodd-Frank Act required regulators to write the rule in order to provide extra protections against potential failures of foreign banks, and to ensure that overseas banks operating in the U.S. are subjected to the same rules as U.S. institutions.

"We…retain the responsibility to maintain the stability of the U.S. financial system," Fed Gov. Daniel Tarullo said at a Feb. 18 board meeting.

Foreign banks were among the institutions that accessed the Fed's emergency lending facilities at the onset of the financial crisis in 2008.

*– Andy Peters*