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Highlights

Highlights of GAO-12-235, a report to congressional committees

January 2012

BANK CAPITAL REQUIREMENTS

Potential Effects of New Changes on Foreign Holding Companies and U.S. Banks Abroad

Why GAO Did This Study

During the 2007-2009 financial crisis, many U.S. and international financial institutions lacked capital of sufficient quality and quantity to absorb substantial losses. In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) introduced new minimum capital requirements for bank and savings and loan (thrift) holding companies—including intermediate holding companies of foreign banks. Intermediate holding companies are the entities located between foreign parent banks and their U.S. subsidiary banks. These companies held about 9 percent of total U.S. bank holding companies' assets as of September 2011. The Dodd-Frank Act also required GAO to examine (1) regulation of foreign-owned intermediate holding companies in the United States, (2) potential effects of changes in U.S. capital requirements on foreign-owned intermediate holding companies, and (3) banks' views on the potential effects of changes in U.S. capital requirements on U.S. banks operating abroad. To conduct this work, GAO reviewed legal, regulatory, and academic documents; analyzed bank financial data; and interviewed regulatory and banking officials and market participants.

GAO makes no recommendations in this report. GAO provided a draft to the federal banking regulators (Federal Reserve, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency) for their review and comment. They provided technical comments that were incorporated, as appropriate.

View GAO-12-235. For more information, contact Thomas J. McCool at (202) 512-2642 or mccoolt@gao.gov.

What GAO Found

Foreign-owned intermediate holding companies can engage in the same activities as and generally are regulated similarly to their U.S. counterparts. The Board of Governors of the Federal Reserve System (Federal Reserve) oversees the regulation, supervision, and examination of foreign and U.S. bank and thrift holding companies. As of the end of 2010, four qualifying foreign-owned intermediate holding companies (exempt holding companies) were relying on a capital exemption, which allowed them to operate with significantly lower capital than U.S. peers. Federal Reserve officials noted that allowing capital to be held at the foreign parent bank (consolidated) level was consistent with its supervision for U.S. bank holding companies and met international standards for home-host supervision. The Dodd-Frank Act eliminated the capital exemption in order to enhance equal treatment of U.S.- and foreign-owned holding companies by requiring both types of companies to hold similar capital levels in the United States. As a result, these exempt holding companies must meet minimum capital standards that are not less than those applicable to Federal Deposit Insurance Corporation-insured depository institutions by July 2015.

The four exempt holding companies have been considering various actions to comply with new capital requirements, and the effects of eliminating the capital exemption on competition and credit cost and availability likely would be small. Specifically, these companies are considering raising capital, decreasing their holdings of risky assets, restructuring, or adopting a combination of these actions. GAO's analysis of loan markets suggests that the elimination of the capital exemption likely would have a limited effect on the price and quantity of credit available because the affected banks have relatively small shares of U.S. loan markets, which are competitive. These four companies accounted for about 3.1 percent of the loans on the balance sheets of all bank holding companies in the United States as of year end 2010. In addition, GAO's review of the academic literature and econometric analysis both suggest that changes in capital rules that affect the exempt companies would have a limited effect on loan volumes and the cost of credit and add minimally to the cumulative cost of new financial regulations. Although the impact on the price and quantity of credit available may vary across regions, modeling limitations restricted GAO's ability to identify regional differences.

Market participants expressed uncertainty about how changes in capital requirements might affect the competitiveness of U.S. banks operating abroad, partly because international regulatory capital requirements have yet to be implemented. The largest internationally active U.S. banks derived about one-third of their 2010 revenues from operations abroad. They face a variety of domestic and foreign competitors and are subject to multiple regulatory regimes. Bank officials expressed uncertainty about how changes in capital requirements will affect their cost of capital, lending ability, and competitiveness. Furthermore, they were concerned that fragmented or conflicting regulations across national jurisdictions might restrict banks' ability to use capital efficiently. Many U.S. banks GAO interviewed expressed concerns about the added costs of compliance with multiple regulatory regimes and the impact of the Act on the global competitiveness of U.S. banks, but these concerns would need to be considered against the potential benefits of a safer and sounder financial system.