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HIGHLIGHTS

LEGISLATIVE & REGULATORY

	<u>Page</u>
Institute Submits Comment Letter on Federal Reserve Board's Proposed Changes to Form FR Y-7.....	2
Institute to Meet with Federal Reserve Staff for Further Discussions on the Competitive Disadvantages to International Banks from Differential Fedwire Daylight Overdraft Caps.....	2
Institute Plans Further Communications to Senior U.S. and European Officials Regarding SEC's Consolidated Supervised Entity (CSE) Rule.....	2
Fixed Income Clearing Corporation Amends Proposed Rule Change, Following Concerns Expressed By Institute.....	3
Institute Files Brief in Support of Appeal by New York State Superintendent of Banks in Bankruptcy Court Case.....	3
Institute Submission Supports Proposed "Large Customer" Safe-Harbor Exemption From Anti-Tying Prohibitions.....	3
Institute Continues Efforts to Improve the OECD's Draft Report on Taxation of Bank Branches and Other Permanent Establishments ("PEs").....	4
Institute to Discuss Treasury Department's Earning Stripping Study.....	4
New IRS Pre-Filing Agreement ("PFA") Procedure Available to Resolve Interest Expense and Other Issues.....	5

TAX

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

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INSTITUTE SUBMITS COMMENT LETTER ON FEDERAL RESERVE BOARD'S PROPOSED CHANGES TO FORM FR Y-7

On January 28th, the Institute submitted a comment letter on the Federal Reserve Board's proposed changes to the "Annual Report of Foreign Banking Organizations" on Form FR Y-7. The comment letter and related Institute background documents are available on our web site at www.iib.org/member/FRY-7/. The Federal Reserve Board's proposal, together with drafts of the revised form and instructions and related materials, are available at <http://www.federalreserve.gov/boarddocs/reportforms/review.cfm>. In its comment letter, the Institute argued against proposed requirements that only top-tier foreign banking organizations (FBOs) file a consolidated FR Y-7 and that all filings be signed by a managing board member. In addition, the Institute said the FR Y-7 should not be revised to elevate the standard for requesting confidential treatment of information regarding shareholders of an FBO, nor should it be revised to expand the information required for companies held under authority of Section 211.23(f)(5) of the Federal Reserve Board's Regulation K. In its submission, the Institute also urged the Board to defer the proposal's effective date by one year to December 31, 2005.

INSTITUTE TO MEET WITH FEDERAL RESERVE STAFF FOR FURTHER DISCUSSIONS ON THE COMPETITIVE DISADVANTAGES TO INTERNATIONAL BANKS FROM DIFFERENTIAL FEDWIRE DAYLIGHT OVERDRAFT CAPS

The Institute has arranged a follow-up meeting in early March with senior Federal Reserve staff in Washington to discuss the significant systemic inefficiencies and operational risks arising from current Board policy on Fedwire daylight overdrafts and the resulting competitive disadvantages to international banks, including decreased liquidity. At present, only 35% of the capital of an international bank is credited under the Board's formula as compared with 100% for a domestic bank, with the result that access to liquidity is limited and fees begin to be assessed and caps imposed at overdraft levels that are only 35% of those of comparable domestic bank competitors. The upcoming meeting is part of the Institute's ongoing efforts in this area and follows our October 26, 2004 submission to the Fed (available at www.iib.org/10-26-04IntradayLetterToFed.pdf).

INSTITUTE PLANS FURTHER COMMUNICATIONS TO SENIOR U.S. AND EUROPEAN OFFICIALS REGARDING SEC'S CONSOLIDATED SUPERVISED ENTITY (CSE) RULE

As a follow-up to our November 19, 2004 letter to representatives of the EU-U.S. Financial Markets Regulatory Dialogue, the Institute is preparing new communications to senior U.S. and European officials to express ongoing concerns with the duplicative and burdensome consolidated supervision requirements imposed on international banks under the SEC's consolidated supervised entity (CSE) rule and the resulting disparity when compared to the full deference accorded by the EU to the SEC's supervision of U.S. securities firm financial groups. The Institute will also address the competitive inequity resulting from restricting the economic benefit of the CSE rule to only those banks with the largest U.S. broker dealer capital even when other international banks have larger broker dealer capital and operations globally. The Institute's November 19, 2004 letter is available at www.iib.org/member/11-19-04CSE_letter_Sobel.pdf, and our earlier submission to the SEC is available at www.iib.org/02-04-04SECCommentLetter.pdf.

**FIXED INCOME CLEARING CORPORATION AMENDS PROPOSED
RULE CHANGE, FOLLOWING CONCERNS EXPRESSED BY INSTITUTE**

In response to concerns raised by the Institute, Fixed Income Clearing Corporation (FICC) amended its proposed rule change to eliminate the automatic clearing fund premium for branches of non-U.S. members. Instead, FICC's latest proposal would require legal opinions from non-U.S. members. As previously reported, through the Institute's efforts, the collateral premium called for in the FICC's original proposal was reduced from 30% to 10%. Although an improvement, the revised proposal would still have established the precedent of penalizing international banks participating in clearance and settlement systems through their branches. In our November 17, 2004 meeting with the SEC on the FICC proposal, the Institute emphasized the importance of this issue to the international banking community, both on its own and as a precedential matter with respect to the treatment of U.S. branches, and presented to the senior SEC staff our substantive arguments as to why the FICC proposal is unfairly discriminatory by imposing a collateral surcharge on non-U.S. bank members of FICC. (See the Institute's October 26, 2004 submission to the SEC at www.iib.org/member/FICC/10-26-04NazarethLetter.pdf.)

**INSTITUTE FILES BRIEF IN SUPPORT OF APPEAL BY
NEW YORK STATE SUPERINTENDENT OF BANKS
IN BANKRUPTCY COURT CASE**

On December 16, 2004, the Institute filed an *amicus curiae* brief in the United States Court of Appeals for the Second Circuit in support of an appeal by the New York State Superintendent of Banks. The issue raised by the Superintendent's appeal is whether the liquidator of a foreign bank can commence a case in United States Bankruptcy Court ancillary to the foreign liquidation proceeding and obtain an order compelling the Superintendent to turn over assets of the New York agencies or branches of the foreign bank. Although the Bankruptcy Court dismissed the cases filed by the foreign liquidators on the Superintendent's motion, finding that the foreign liquidators were not eligible to obtain relief under § 304 of the Bankruptcy Code, the District Court reversed this ruling. In the brief, the Institute argued that if the District Court's decision stands, it could result in more onerous regulation of U.S. branches in the future, and may require U.S. regulators to preemptively close U.S. branches of potentially troubled foreign banks, and foreign banks from countries experiencing difficulties, that would not be required to be closed under the existing regulatory regime as it functioned prior to the District Court's orders. The brief is available on the Institute's web site at www.iib.org/member/AmicusBrief_Declaration.pdf.

**INSTITUTE SUBMISSION SUPPORTS PROPOSED "LARGE CUSTOMER"
SAFE-HARBOR EXEMPTION FROM ANTI-TYING PROHIBITIONS**

The Institute submitted a letter to the Federal Reserve Board on December 13, 2004 expressing support for the creation of a "large customer" safe harbor exemption from the coverage of the anti-tying prohibitions of Section 106 of the Bank Holding Company Act Amendments of 1970 and for the adoption of a coercion interpretation of Section 106, as outlined in a submission by a group of large domestic and international banking organizations. The December 13th letter reiterates the Institute's support for these measures, as previously expressed in the Institute's October 3, 2003 comment letter on the Federal Reserve Board's proposed interpretation of Section 106 and related supervisory guidance. (The Institute's letters and related documents are available on our web site at www.iib.org/member/Anti-Tying/.)

INSTITUTE CONTINUES EFFORTS TO IMPROVE THE OECD'S DRAFT REPORT ON TAXATION OF BANK BRANCHES AND OTHER PERMANENT ESTABLISHMENTS ("PEs")

The OECD's Committee on Fiscal Affairs decided at its meeting on January 25-26 to delay finalizing its report on the taxation of branches and other PEs, including especially so-called "dependent agent" PEs of securities and derivatives dealers, until January 2007. In the interim, the OECD will revise Parts I (general principles), II (banking) and III (global trading in securities and derivatives) to reflect industry comments, will issue Part IV (insurance), and will prepare a revised Commentary to the OECD model income tax treaty to reflect the report.

Recognizing the limited opportunity for influencing the final report, the Institute has been discussing the principal industry concerns with OECD representatives as well as other banking associations. In this connection, the Institute hosted a seminar on the OECD's report on January 11th featuring as its keynote speaker John Neighbour, the head of the tax treaty, transfer pricing and financial transactions division of the OECD Secretariat and the person who is responsible for actually drafting the report. That seminar, as well as other informal discussions with OECD representatives, are part of a continuing effort by the Institute and other banking associations to try to persuade the OECD to address the principal concerns that the financial industry has regarding the report: (1) the approved OECD method for allocating capital to branches and other PEs is likely to lead to double taxation and protracted controversy, (2) the report's insistence that the ownership of assets be fragmented and allocated to multiple locations based on an expanded notion of the "key entrepreneurial risk-taking" ("KERT") functions that are performed in each location is unnecessarily complex and unworkable in practice, and (3) the report has failed to provide a practical solution to the difficult problems that will be created if the "dependent agent PE" concept is applied literally and expansively to global trading activities of dealers in securities and derivatives.

The Institute is working with the European Banking Federation to prepare a follow-up letter to the OECD and to organize meetings with the OECD representatives from the various countries' tax authorities.

INSTITUTE TO DISCUSS TREASURY DEPARTMENT'S EARNINGS STRIPPING STUDY

As previously reported, Congress has directed the Treasury Department to prepare a study concerning the so-called "earnings stripping" rules, which limit the amount of interest expense that foreign-owned businesses can deduct under certain circumstances. The study is supposed to examine (1) the effectiveness of the existing rules in preventing the shifting of income outside the U.S., (2) whether any deficiencies in these rules place U.S.-based businesses at a competitive disadvantage, (3) the impact of earnings stripping activities on the U.S. tax base, (4) whether laws of foreign countries facilitate stripping of earnings out of the U.S., and (5) whether changes to the earnings stripping rules would affect jobs in the U.S. While our lobbying efforts over the past two-and-a-half years were successful in preventing the enactment of adverse changes to the "earnings stripping" rules, we are concerned that the report could serve as the basis for legislative changes that will adversely impact internationally headquartered banks and their securities subsidiaries. The Institute and a working group of member banks are preparing materials to support our previously articulated positions on the earnings stripping question, and expect to meet with representatives of the Treasury Department and Congress.

NEW IRS PRE-FILING AGREEMENT (“PFA”) PROCEDURE AVAILABLE TO RESOLVE INTEREST EXPENSE AND OTHER ISSUES

The IRS has released a new revenue procedure (Revenue Procedure 2005-12) that greatly expands the Pre-Filing Agreement program, under which taxpayers and the IRS can resolve specific issues through an examination that is conducted before, rather than after, a tax return is filed. In general, the IRS will consider entering into a PFA on any issue that requires either a determination of facts or the application of well-established legal principles to known facts. A PFA is available for issues raised in the current tax year, any prior taxable year for which a return is not yet due and has not been filed, and up to four taxable years after the current year.

Significantly, the areas that are eligible for PFAs have been expanded to include many international issues relating to branches and other permanent establishments of non-U.S. entities. Among the issues that the IRS has indicated may be suitable for a PFA are questions regarding the computation of (i) the home office administration and overhead expense of an international bank and (ii) the interest expense deduction of an international bank under Treasury regulation section 1.882-5, including practical issues concerning the application of the “actual ratio.”

As a result, banks that have felt compelled to utilize the less favorable 93% “fixed ratio” under section 1.882-5 now have a process available to them by which they may be able to obtain the requisite level of certainty as to how the IRS would apply the actual ratio in their circumstances, which may enable them to switch to the actual ratio.

This favorable development is the culmination of many years’ effort by the Institute to try to resolve the predicament faced by the many banks that were penalized under the fixed ratio but could not accept the uncertainties and potential exposures of the actual ratio. It is hoped that banks will avail themselves of the PFA process to resolve these and other issues that they face.

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