



# INTERNATIONAL BANKING FOCUS

*A Bimonthly Publication of the*  
**INSTITUTE OF INTERNATIONAL BANKERS**

**Volume XXVI, Number 7**  
**April 7, 2005**

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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.

**299 Park Avenue, 17<sup>th</sup> Floor, New York, N.Y. 10171**

**Telephone: (212) 421-1611 Facsimile: (212) 421-1119**

**E-Mail: [IIB@IIB.ORG](mailto:IIB@IIB.ORG) <http://www.iib.org>**

**Everett Schenk, Chairman Lawrence R. Uhlick, Executive Director**

## **INSTITUTE EXPRESSES ONGOING CONCERNS TO SENIOR U.S. AND EUROPEAN OFFICIALS REGARDING SEC'S UMBRELLA SUPERVISION/ 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 sent further communications to senior U.S. and European officials on February 9<sup>th</sup> and March 21<sup>st</sup> to express ongoing concerns with the duplicative and burdensome consolidated supervision requirements imposed on international banks seeking the favorable alternative net capital treatment 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 also addressed 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. Based on informal discussions with SEC staff, there is some indication that the SEC does not intend to exercise umbrella oversight over international banks, although its rules continue to call for an undertaking to permit that oversight. The Institute is seeking a favorable SEC clarification on this position and continues to urge that the benefits of the rule be extended to all international banks subject to umbrella supervision. (Institute submissions and related documents are available on the Institute's web site at <http://www.iib.org/member/Other-Regs/>.)

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

As part of the Institute's ongoing efforts on this critical issue, the Institute met again on March 2<sup>nd</sup> 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 increased costs and decreased liquidity. At present, only 35 percent 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 percent of those of comparable domestic bank competitors. (See Institute submissions to the Fed dated March 11, 2005, February 4, 2005 and October 26, 2004 at <http://www.iib.org/member/Other-Regs/>.)

## **INSTITUTE, MEMBER BANKS MEET WITH SUPERINTENDENT TAYLOR ON FURTHER IMPROVEMENTS IN NEW YORK'S ASSET PLEDGE REQUIREMENT**

Reflecting our ongoing dialogue in this area, New York State Superintendent of Banks Diana Taylor indicated in her remarks at the Institute's Annual Washington Conference on March 14<sup>th</sup> that the Banking Department will consider providing further relief under its asset pledge requirement. Superintendent Taylor specifically mentioned the existing \$400 million cap as well as the possibility of enabling all international banks to pledge investment grade assets as two areas under consideration for additional relief. (At present, only well-rated institutions are allowed to use an expanded list of eligible assets as collateral.) A helpful meeting on this matter was subsequently held at the Banking Department on April 4<sup>th</sup> at which a number of favorable revisions were discussed. As previously reported, the Banking Department in December 2002 significantly reduced its asset pledge requirement applicable to state-licensed branches and agencies of international banks, following a multi-year initiative in this area by the Institute and our member institutions. This initiative has resulted in considerable savings each year for our members. The Institute also continues to pursue further relief for members with OCC-licensed branches. (For background, see Institute memoranda and related documents at [www.iib.org/member/AssetPledge/](http://www.iib.org/member/AssetPledge/).)

## **INSTITUTE AND EUROPEAN BANKING FEDERATION SUBMIT COMMENTS ON THE OECD'S DRAFT REPORT ON TAXATION OF BANK BRANCHES AND OTHER PERMANENT ESTABLISHMENTS ("PEs")**

The Institute and the European Banking Federation (FBE) submitted a joint letter to the OECD in March (available at [www.iib.org/member/OECD-Initiatives/](http://www.iib.org/member/OECD-Initiatives/)), setting forth additional thoughts and suggestions regarding the principal concerns that the financial industry continues to have regarding the August 2004 version of the Discussion Draft. This submission was timed to coincide with the meeting of OECD Working Party No. 6 regarding the Discussion Draft. In addition, the Institute discussed its submission with the Treasury Department representatives to OECD Working Party No. 6.

The joint Institute-FBE submission made the following points:

1. The approved OECD method for allocating capital to branches and other PEs should be modified in certain limited respects to minimize double taxation and tax controversies;
2. The OECD should utilize a functional analysis to allocate profit or loss appropriately to each location in which "key entrepreneurial risk-taking" ("KERT") functions are performed, rather than also attributing ownership of the assets to those locations, because fragmenting the ownership of financial assets for tax purposes raises many practical problems and ancillary tax issues;
3. The OECD should carefully consider the problems raised by the financial industry – and more recently by non-financial industries as well – regarding the Discussion Draft's approach to "dependent agent" PEs, and should address these concerns through the development of a framework that better accommodates the realities of the global economy of the 21<sup>st</sup> century.
4. The OECD should further clarify the treatment of internal credit derivatives to conform with *bona fide* industry practices.

The Institute understands that the OECD continues to be resistant to modifying the Discussion Draft. We continue to believe that if the financial industry wishes to secure improvements in the manner in which PEs will be taxed under the OECD approach, it will be important for banking associations to discuss the industry's concerns with their respective country's tax representatives to the OECD. In addition, it will be desirable for the financial industry to coordinate with the non-financial industries, which are beginning to express their concerns to the OECD.

## **INSTITUTE SUBMITS LETTER AND SCHEDULES MEETING WITH THE TREASURY DEPARTMENT CONCERNING TREASURY'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

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the basis for legislative changes that will adversely impact internationally headquartered banks and their securities subsidiaries.

Accordingly, the Institute submitted to Treasury a letter setting forth the position of the financial industry concerning proposals to modify the “earnings stripping” rules (see [www.iib.org/member/Interest-Expense/](http://www.iib.org/member/Interest-Expense/)). The letter explains certain basic characteristics of the financial industry that distinguish this industry from industrial companies. The letter further explains why these distinguishing characteristics make it essential that careful consideration be given to the impact on the financial industry of potential changes to the “earnings stripping” rules before they are proposed or enacted. Next, the letter reviews the history of the various proposals that have been made in recent years to revise the “earnings stripping” rules from the perspective of their impact on the financial industry. Finally, the letter provides information pertaining to the financial industry in respect of three of the areas to be covered by the study (issues (2), (3) and (5)).

The Institute and the working group of member banks will be meeting with Treasury on April 13<sup>th</sup> to discuss this matter.

### **INSTITUTE TO COMMENCE EFFORT TO ALLOW BRANCHES TO FILE CONSOLIDATED RETURNS WITH SUBSIDIARIES**

Following a meeting with the Institute’s Tax Committee, interested member banks and professional liaison firms, the Institute has decided to commence an effort to persuade Congress to amend the tax law to enable branches to file consolidated returns with subsidiaries. A principal benefit of such a change in the law would be to allow losses of U.S. subsidiaries to offset income of the branch and *vice versa*. As currently drafted, the proposal would not modify other aspects of the taxation of branches, such as Treasury Regulation section 1.882-5 governing interest expense and the branch profits tax under section 884 of the Internal Revenue Code.

The proposal was initially suggested by Deutsche Bank and its advisers at Clark Consulting. Other member banks of varying sizes, as well as professional liaison firms, have endorsed this proposal, recognizing both the compelling equitable arguments in favor of its adoption and the benefits that would be derived by members of the international banking community.

The Institute is seeking to organize a working group of interested member banks that would participate in making decisions regarding this effort, would attend meetings in Washington and would help defray the costs of the Institute’s tax counsel.