



# INTERNATIONAL BANKING FOCUS

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

**Volume XXVI, Number 11**  
**December 9, 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.

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**INSTITUTE MEETS WITH FEDERAL RESERVE STAFF ON APPLICATION OF FINANCIAL HOLDING COMPANY REQUIREMENTS TO MINORITY INVESTMENTS BY INTERNATIONAL BANKS**

As a follow-up to our September 19th submission on this issue, the Institute met with senior Federal Reserve Board staff in Washington on November 22nd to discuss the Institute's proposal regarding the application of financial holding company (FHC) well-capitalized and well-managed standards to foreign banking organizations (FBOs) in which FHCs hold a minority interest. The Institute has also arranged a meeting on this issue with Governor Bies in January.

As described in the Institute's submission (available on the Institute's web site at <http://www.iib.org/member/GLB-FHC/>) the Board's current standards are seriously constraining the ability of international banks to make minority investments in other international banks outside of the United States. The Board's current FHC standards require that any non-U.S. bank with U.S. banking operations that is "controlled" by an FHC must be "well-capitalized" and "well-managed." Because the Board has traditionally looked to the definition of "control" in the U.S. Bank Holding Company Act when applying this requirement, an FHC can be deemed to "control" a non-U.S. bank in which it has a minority investment, even where the FHC lacks the actual power to ensure that the bank meets the well-capitalized and well-managed standards. As a result, an FHC or prospective FHC could be forced to choose between abandoning its minority investment or forsaking its FHC status, even where a minority investment by one non-U.S. bank in another is driven entirely by non-U.S. financial or strategic considerations.

In its meetings and submission to the Fed, the Institute emphasized the need for clarification of the Board's FHC standards in a manner that reduces unnecessary extraterritorial restrictions on the ability of international banks to make minority investments in other international banks.

The Institute will be working to expand the syndicate of banks providing financial support for our efforts on this issue. If your institution is interested in supporting this project, please contact the Institute to discuss your participation.

**INSTITUTE CONTINUES TO ADDRESS COMPETITIVE DISADVANTAGES TO INTERNATIONAL BANKS FROM THE DIFFERENTIAL IN DAYLIGHT OVERDRAFTS AND DEDUCTIBLES BETWEEN DOMESTIC AND INTERNATIONAL BANKS**

The Institute met in Washington with Federal Reserve staff on October 11th for further discussions regarding our concerns with the differential in intra-day overdraft limits and deductibles for domestic versus international banks. As part of our ongoing efforts in this area, several of the Institute's member banks have invited the Fed to visit their payment operations for a first-hand view of the delays in payments resulting from efforts to minimize overdrafts that exceed the deductible.

As previously reported, the Institute has provided a chart to the Fed illustrating the \$2 million of annual cost disadvantage that an international bank with \$30 billion in capital would experience in comparison to a comparably-sized domestic bank, assuming both institutions made full use of their deductibles. The cost disadvantage arises because an international bank's deductible is 65% lower than that of a U.S. domestic bank because the Fed recognizes only 35% of the capital for international banks compared with 100% for domestic banks. Artificially low deductibles resulting from the calculation cause postponement of payments as international banks try to minimize overdrafts that incur fees, with the result of increased operational risk for the payment system. (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/>.)

**U.S. HEADQUARTERED BANK HOLDING COMPANY'S APPLICATION UNDER SEC'S ALTERNATIVE NET CAPITAL RULE RAISES ISSUE OF SEC DEFERENCE TO EXISTING UMBRELLA SUPERVISION**

One of the largest U.S.-headquartered bank holding companies has applied to use the SEC's favorable risk-based capital rule for its broker-dealer subsidiary, raising anew the issue of SEC deference to existing umbrella supervision. If the SEC shows deference to the existing umbrella supervision of the domestic bank holding company – as the Institute hopes it will – then the same deference should apply to home-country consolidated supervision of internationally-headquartered banking/financial institutions under the new alternative net capital rule.

As previously reported, the Institute has raised two fundamental concerns with the rule – its failure to accord equivalent deference to home country consolidated supervision and its imposition of an unjustifiable \$5 billion “tentative net capital” threshold (a minimum capital requirement before adjustments for credit and market risk). The Institute continues to urge member institutions concerned with the SEC's implementation of its alternative net capital rule to communicate with their home country governmental authorities to ensure that the important principles at stake receive the ongoing attention they deserve. (Institute submissions and related documents on this issue are available on the Institute's web site at [http://www.iib.org/member/Other-Regs/.](http://www.iib.org/member/Other-Regs/))

**INSTITUTE SEEKS INPUT FROM MEMBERS REGARDING CONCERNS ABOUT POTENTIAL REPORTING REQUIREMENTS FOR CROSS-BORDER WIRE TRANSFERS**

The Institute has solicited input from our member institutions regarding concerns that we should convey to the Financial Crimes Enforcement Network (FinCEN) in connection with potential reporting requirements for cross-border wire transfers. The Institute has participated in meetings of a subcommittee of FinCEN's Bank Secrecy Act Advisory Group formed to consider issues relating to cross-border wire transfer reporting. FinCEN is continuing to study whether to impose reporting requirements on financial institutions concerning cross-border wire transfers and is in the process of preparing a report for the Treasury Secretary on this issue. Depending on the outcome of the study, and the Treasury Secretary's ensuing feasibility report to Congress, FinCEN would then potentially issue proposed regulations that would need to be finalized by December 2007.

**INSTITUTE TO PARTICIPATE IN OUTREACH SESSION WITH BANKING AGENCIES, FinCEN ON NEW BSA/AML EXAMINATION MANUAL**

The Institute has been invited to participate in an outreach session with representatives of the federal banking agencies and the Treasury Department's Financial Crimes Enforcement Network (FinCEN) to discuss the new BSA/AML Examination Manual on Tuesday, December 13th. The meeting is designed to serve as a forum for industry organizations to pose questions and offer feedback concerning the new Examination Manual. We believe this will be an important opportunity for the Institute to express some of the concerns we have previously raised informally with FinCEN regarding the Examination Manual and related matters, including language in the Examination Manual concerning monitoring of trade finance transactions.

**INSTITUTE SEEKS TO IMPROVE PROPOSED TAX RULES FOR MARK-TO-MARKET SECURITIES VALUATIONS**

The Institute has had several follow-up discussions with the Internal Revenue Service, subsequent to our extensive written comments and testimony at the September IRS hearing, on the recently issued proposed IRS regulations for valuing securities positions (including derivatives and currencies) for purposes of the “mark-to-market” rules of Internal Revenue Code section 475. The proposed regulations would allow dealers (and electing traders) in securities, commodities and derivatives to treat the values of positions reported on certain financial statements as the fair market value of those positions for purposes of the mark-to-market rules

of section 475 (the “book/tax conformity safe harbor”).

While the proposed book/tax conformity safe harbor is a welcome development, as currently proposed it will not be available to many U.S. branches of foreign banks and to foreign-based dealers in respect of their global dealing activities because it requires that those institutions have U.S. GAAP financial statements. This condition is NOT satisfied by those institutions that merely file with the SEC a reconciliation to U.S. GAAP, and therefore, nearly every major financial institution that books a portion of its global dealing positions outside its U.S. broker-dealer will face problems under the proposed regulations. The Institute has been urging the IRS to address these problems, and has expressed concern that failure to extend the benefits of the safe harbor to foreign-based institutions would be inconsistent with “national treatment” principles that are intended to prevent discriminatory treatment of foreign-based institutions.

In recent discussions, the IRS expressed a willingness to consider a procedure whereby a senior officer of the financial institution would certify that the mark-to-market values shown on the books of the institution are equivalent to what they would be under U.S. GAAP. Issues that will need to be worked out include (i) who signs the certification (the IRS’ preliminary view is that it should be a senior U.S.-based officer, who would need to sign under penalties of perjury); (ii) what the certification would say (the IRS’ opening position is that it wants the certification to say that the amounts are “the same” as under U.S. GAAP); and (iii) what if any adjustments can and should be made in the event the values shown on the financial statements differ in some respects from the mark-to-market values under U.S. GAAP. On the basis of these discussions, we believe that the certification procedure has some promise, although we still face considerable challenges in achieving our objectives.

The Institute is working with members of the syndicate of institutions that have agreed to provide financial support for this project to develop a certification procedure that might be proposed to the IRS. Other member institutions that wish to join the syndicate and participate in this effort should contact the Institute.

#### **INSTITUTE SUBMITS COMMENT LETTER CONCERNING THE IRS’ PROPOSAL TO INCREASE THE 93% FIXED RATIO AND TO MAKE OTHER FAVORABLE CHANGES TO REGULATION SECTION 1.882-5**

On October 31<sup>st</sup>, the Institute submitted a comment letter to the Treasury Department and the IRS expressing our strong support for the changes to Treasury regulation section 1.882-5, dealing with the determination of the deductible interest expense of a U.S. branch of an internationally headquartered bank, that were announced in Notice 2005-53, and to provide additional comments regarding this matter. (The Institute’s letter is available at <http://www.iib.org/member/Interest-Expense/>.) As previously reported, the Notice responds to a number of issues under regulation section 1.882-5 that the Institute has been pressing the IRS to address for some time.

Most welcome is the IRS’ indication that its review of recent data suggests that the 93% fixed ratio is too low. The notice requests internationally headquartered banks to submit data and other information to assist the IRS in determining whether the fixed ratio should be increased to 94 - 96%. The notice also states that the IRS is considering not allowing banks that elect the fixed ratio to also use the fair market value method (rather than tax basis) to determine the amount of their US assets.

In addition, the notice states that the regulation will be revised to allow banks to elect on an annual basis to use a 30-day LIBOR rate to compute their excess interest under the adjusted US booked liabilities method, instead of having to determine the actual dollar borrowing rate of their non-US branches and offices.

Finally, the notice provides some guidance for determining interest expense under the risk-weighted capital method that is sanctioned by the Japanese and UK treaties, and confirms that banks headquartered in those countries may continue to apply regulation section 1.882-5.