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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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EC COMMISSIONER McCREEVY, EUROPEAN BANKING REGULATORS RESPOND TO INSTITUTE REGARDING TREATMENT OF INTERNATIONAL BANKS UNDER THE SEC'S ALTERNATIVE NET CAPITAL RULE

Commissioner Charlie McCreedy of the European Commission and a number of European banking regulators and other officials, including Jose Maria Roldan, Chairman of the Committee of European Banking Supervisors, Antonio Fazio, Governor of the Bank of Italy, and Daniele Nouy, Secretary General of the Commission Bancaire, responded positively to the Institute's July 20th letters to each of them regarding the treatment of international banks under the SEC's alternative net capital rule (these and related documents are available on the Institute's web site at <http://www.iib.org/member/Other-Regs/>.)

As previously reported, the Institute's July 20th letters addressed two fundamental concerns with the SEC's 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). We encourage our members that otherwise qualify to seek a waiver of the \$5 billion threshold. The Institute also urges institutions concerned with the SEC's implementation of its alternative net capital rule to communicate with your home country governmental authorities to ensure that the important principles at stake in these matters receive the ongoing attention they deserve.

INSTITUTE TO MEET WITH FEDERAL RESERVE STAFF IN WASHINGTON FOR FURTHER DISCUSSIONS ON THE COMPETITIVE DISADVANTAGES TO INTERNATIONAL BANKS FROM THE DIFFERENTIAL IN DAYLIGHT OVERDRAFTS AND DEDUCTIBLES BETWEEN DOMESTIC AND INTERNATIONAL BANKS

As part of our ongoing effort in this critical area, the Institute has arranged a follow-up meeting in October with senior Federal Reserve staff in Washington to discuss our concerns regarding the differential in intra-day overdraft limits and deductibles for domestic versus international banks.

As previously reported, the Institute met most recently on this issue in July with the Federal Reserve Bank of New York (following a meeting with Fed staff in Washington in March). At the July meeting, the Institute provided a chart 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. (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/>.) In our upcoming meeting with the Fed in Washington, the Institute will emphasize the serious delays in payments that result from efforts to limit overdraft charges.

INSTITUTE FILES SUBMISSION WITH FEDERAL RESERVE ON APPLICATION OF FINANCIAL HOLDING COMPANY REQUIREMENTS TO MINORITY INVESTMENTS BY INTERNATIONAL BANKS

The Institute filed a submission dated September 19, 2005 with the Federal Reserve Board regarding the Board's treatment of minority investments by international banks that are (or seek to be) financial holding companies (FHCs) in other international banks with U.S. banking operations. The submission followed an Institute conference call with interested member institutions in late July that confirmed the growing importance of this issue in view of cross-border merger and acquisition trends in Europe and elsewhere. The Institute's submission outlines the policy arguments supporting greater flexibility by the Federal Reserve in this area and makes a specific proposal for clarification of the Board's standards. (The submission and related documents are available on the Institute's web site at <http://www.iib.org/member/GLB-FHC/>.)

INSTITUTE SUBMITS LETTER TO SEC ON BROKER-DEALER REGISTRATION ISSUE FOR INTERNATIONAL BANKS ACTING AS SECURITIES CUSTODIANS FOR U.S. INVESTORS

The Institute submitted a letter to the Securities and Exchange Commission on September 12th requesting that the staff of the Division of Market Regulation confirm that it will not recommend that the SEC take enforcement action against internationally-headquartered financial institutions that provide, through their non-U.S. offices, custody services to U.S. investors without registering as broker-dealers under the U.S. Securities Exchange Act of 1934. The submission followed a conference call with representatives of interested member institutions on August 12th. The letter was submitted in draft form so that we can address any questions the SEC may have prior to responding to our request.

INSTITUTE PROPOSES MODIFICATIONS TO NEW YORK'S ASSET PLEDGE REQUIREMENT

In a letter dated September 22, 2005 to New York State Superintendent of Banks Diana Taylor, the Institute proposed further modifications to New York's asset pledge requirements. The Institute letter follows our recent conversations with Superintendent Taylor and her remarks earlier this year at the Institute's Annual Washington Conference that the Banking Department would consider providing further relief under its asset pledge requirement. In the letter, the Institute recommends that the existing asset pledge requirement of \$400 million for the largest branches of member institutions be reduced substantially to better conform with the intended purpose of the requirement – to pay initial expenses in the event of a liquidation. Specifically, the Institute letter proposes that the asset pledge be capped at \$50 million for the largest well-run international bank branches and reduced commensurately for smaller branches and agencies down to the floor for the smallest of \$2 million.

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 (to 1% of third-party liabilities from 5%), 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 (for background, please refer to Institute memoranda and related documents in the member area of our web site at www.iib.org/member/AssetPledge/). Our current proposal would build on this progress and better align the asset pledge requirement with its intended purpose of having funds readily available to defray the initial costs of liquidation.

INSTITUTE MEETS WITH FDIC TO DISCUSS REPEAL OF PROHIBITION AGAINST FDIC-INSURED BRANCHES OF INTERNATIONAL BANKS

The Institute met with the FDIC in Washington on September 27th to discuss the proposal by the Institute and the Conference of State Bank Supervisors (CSBS) to repeal the prohibition against FDIC-insured branches of international banks. The FDIC itself recognizes that branches are less costly to operate than a separately incorporated bank. For example, in FDIC Outlook, Summer 2005, the FDIC points out that American banks engaged in international activities “often accommodate the needs of their foreign banking customers through foreign branches or agencies, which are typically less costly to operate than foreign subsidiaries.” (emphasis added).

Moreover, in a December 22, 2003 letter to FDIC senior staff (see www.iib.org/member/12-22-03FDICLetter.pdf), the Institute noted that a 1992 joint study by the Federal Reserve and the Treasury (which was mandated by the same 1991 law that prohibited the establishment of new FDIC-insured branches) expressly opposed imposition of a requirement that international banks conduct U.S. operations only in subsidi-

ary form, concluding that operating in branch rather than subsidiary form is more efficient, allowing, among other things, more flexible deployment of capital and lower cost of funding. The Institute letter also pointed out that the Fed/Treasury study specifically concluded that “considerations relating to deposit insurance” do not provide support for a subsidiary requirement. Accordingly, the Institute letter said serious consideration should be given to repealing the 1991 statutory prohibition of FDIC-insured branches of international banks.

INSTITUTE OBTAINS CLARIFICATION ON SHARING OF SARs WITH HEAD OFFICE

In response to questions from member institutions regarding the ability of a U.S. branch of an international bank to share suspicious activity reports (SARs) with the bank's head office, the Institute obtained a clarification from FinCEN Director William Fox that U.S. branches may, consistent with U.S. legal restrictions protecting the confidentiality of SARs, share SARs with their head offices. The need for the clarification arose from earlier indications from FinCEN that such sharing would not be permitted. FinCEN is continuing to consider, together with the U.S. banking agencies, the extent to which U.S. financial institutions can share SARs with sister affiliates in a corporate group, an issue the Institute will monitor through its participation in the Bank Secrecy Act Advisory Group. It is the Institute's position that sharing of SARs within a corporate group for appropriate anti-money laundering risk management purposes should be freely permitted. We understand that FinCEN intends to issue written guidance with the U.S. banking agencies on these issues.

INSTITUTE PARTICIPATES IN BSA ADVISORY GROUP SUBCOMMITTEE MEETING ON CROSS-BORDER WIRE TRANSFERS

The Institute participated in a recent meeting of a subcommittee of the Bank Secrecy Act Advisory Group (of which the Institute is a member) formed to consider issues relating to cross-border wire transfer reporting. The Financial Crimes Enforcement Network (FinCEN) is studying whether to impose additional reporting requirements on financial institutions concerning cross-border wire transfers (a study mandated by the Intelligence Reform and Terrorist Prevention Act enacted in December 2004). FinCEN anticipates preparing a feasibility report for Congress on this issue and would then potentially issue proposed regulations.

INSTITUTE COMMENTS ON PROPOSED RULES FOR MARK-TO-MARKET SECURITIES VALUATIONS

The Institute submitted an extensive comment letter to the Internal Revenue Service (see www.iib.org/tax/) and testified at the September 15th 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. Unfortunately, as presently drafted, the safe harbor (as discussed below) would be available to almost no internationally headquartered financial institutions in respect of their cross-border and other global dealing operations -- and its application to U.S. branches is unclear -- because it requires the taxpayer to prepare U.S. GAAP financial statements.

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”).

In releasing this proposal, the IRS is seeking to avert the sort of audit controversies that have arisen regarding the application of the mark-to-market requirement, including in particular as to the valuation of derivatives and the adjustments that most financial institutions make to mid-market prices to account for credit risks and certain administrative costs. One such audit resulted in the Banc One case, in which the Institute joined in an amicus brief filed by a group of industry associations.

In our comment letter and testimony, the Institute urged the IRS to accept International Financial Reporting Standards (IFRS) and other non-U.S. GAAP as equivalent to U.S. GAAP for the purposes of meeting the requirements of the safe harbor. Thus far, the IRS has expressed skepticism about relying on fair values as determined under IFRS and other non-U.S. GAAP financial statements. The Institute expects to schedule a follow-up meeting with the IRS in the coming weeks to attempt to address this issue.

However, because the cost of our efforts to date have exceeded the amounts that we raised from an initial group of our interested member institutions, we will need to broaden our existing syndicate by at least 6 more members (contributing \$5,000 each) to cover the costs of additional submissions and meetings in Washington (as well as the extra costs to date).

As previously mentioned, we are grateful for the considerable assistance provided by Ernst & Young LLP in gathering information regarding many of the technical accounting and related issues discussed in the Institute's submission.

IRS SOLICITS INSTITUTE INPUT REGARDING THE IRS PROPOSAL TO INCREASE THE 93% FIXED RATIO AND TO MAKE OTHER FAVORABLE CHANGES TO REGULATION SECTION 1.882-5

As previously reported, in July the Internal Revenue Service issued a notice that 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 debt ratio (7% capital) 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.

The Institute has provided the Treasury and the IRS with a summary of the global leverage ratios and risk-weighted capital ratios of internationally headquartered financial institutions, based on data filed with the Federal Reserve. On a conference call with the Treasury Department and the IRS, we undertook (i) to provide them with Basel risk-weighting of the call reports of a representative sampling of our member banks, and (ii) to gather data supporting an interest rate on U.S. dollar borrowings outside the United States that is higher than the 30-day LIBOR rate proposed by the IRS. While a number of our members have come forward with helpful information, further participation would be helpful.

The Institute will be submitting further comments in response to this notice, including (at the invitation of the IRS) suggestions for additional guidance relating to the issues covered by the notice.