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LEGISLATIVE & REGULATORY

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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 SUBMITS COMMENT LETTER TO U.S. BANKING AGENCIES
ON SO-CALLED BASEL I-A**

The Institute submitted a comment letter on January 18th to the federal banking agencies addressing their Advance Notice of Proposed Rulemaking (ANPR) with respect to so-called Basel I-A. The comment letter requests that U.S. bank subsidiaries of international banks be permitted to elect to continue to utilize existing Basel I standards for U.S. capital compliance, if they so choose, rather than being required to implement new Basel I-A systems at the same time as they are undertaking extensive changes necessary to implement home country Basel II standards at the U.S. subsidiary as part of their global consolidated capital requirement. The comment also recommends that the Basel I-A methodology be sufficiently flexible to permit use of existing data systems to reduce the burden that would result from its implementation by those institutions electing to do so.

In addition, the comment letter renews the request made in the Institute's November 3, 2003 comment letter that the U.S. banking regulators defer to home country Basel II standards, noting that guidance on similar deference was recently issued by the U.K.'s Financial Services Authority. The comment letter also urges that there be no requirement to implement Basel I-A system changes on a temporary basis for purposes of calculating capital floors during the transition period for those international banks that may elect to utilize Basel II methodology for capital compliance at their U.S. bank subsidiary. These and other Basel capital concerns for international banks with U.S. operations were recently discussed by the Institute in the first of an expected ongoing series of conference calls with Nicholas Le Pan, Chairman of the Basel Committee's Accord Implementation Group and Canada's Superintendent of Financial Institutions. (Institute submissions and related documents on Basel II are available on our web site at <http://www.iib.org/member/Basel-Capital/>.)

**INSTITUTE MEETS WITH FEDERAL RESERVE BOARD GOVERNOR BIES
ON MINORITY INVESTMENTS BY INTERNATIONAL BANKS**

As part of our ongoing efforts in this area, the Institute met with Federal Reserve Board Governor Bies and key staff in Washington on January 19th regarding the application of "well-capitalized" and "well-managed" standards to foreign banking organizations (FBOs) in which financial holding companies (FHCs) hold a minority interest. (See also separate article below relating to the minority investment issue in connection with an application by Banco Santander to acquire up to 24.99% of the common stock of Sovereign Bancorp.)

We understand that our concerns regarding FHC minority investments outside the United States were to be discussed during the recent EU-U.S. Financial Markets Dialogue meeting. We view this as an important development and one that should create an impetus for interested banks and banking associations to generate additional expressions of interest by their home-country regulators. As we have emphasized in our prior communications, the success of this effort will depend on strong support from home-country governmental authorities. We therefore continue to urge member institutions to contact their home country regulators and suggest that they raise these concerns as part of their regular dialogue with their U.S. regulatory counterparts. We also request that member banks keep the Institute informed of their communications with their home country regulators on this issue so that we can most effectively coordinate our efforts. The Institute's September 19, 2005 submission on this issue and related documents are available at <http://www.iib.org/member/GLB-FHC>.

As previously indicated, the Institute is working to expand the syndicate of banks providing financial support for our efforts on this issue. If your institution is interested in joining this syndicate and participating in the Institute's ongoing efforts on this issue, please contact the Institute to discuss your participation.

INSTITUTE FILES LETTER WITH FEDERAL RESERVE REGARDING POLICY ISSUES OF CONCERN TO INTERNATIONAL BANKS

In connection with an application by Banco Santander to acquire up to 24.99% of the common stock of Sovereign Bancorp, Relational Investors has submitted a protest to the Federal Reserve which makes several arguments that are inconsistent with positions that the Institute has long advocated to the Federal Reserve Board on behalf of international banks. The issues involved relate to the application of a leverage ratio test and other U.S. capital rules to international bank applicants (as opposed to deference to home-country Basel standards) and the application of financial holding company (FHC) requirements to minority investments in foreign banking organizations. Because of the importance of these issues to international banks, the Institute submitted a letter to the Board on February 7th expressing our concerns and reiterating our longstanding positions on the Board policies at issue. Our letter does not take a position on the merits of Santander's application itself. The Institute's letter and related documents are available on our web site at <http://www.iib.org/>

INSTITUTE RECOMMENDATIONS REFLECTED IN NEW YORK BANKING DEPARTMENT'S PROPOSED CHANGES IN ASSET PLEDGE REQUIREMENT

At a luncheon meeting on February 7th with the Institute's Board of Trustees, New York State Superintendent of Banks Diana Taylor outlined the Department's proposed modifications to New York's asset pledge requirement. The Department's proposal, which is expected to be released soon for public comment, reflects recommendations made by the Institute in our September 22, 2005 submission and will result in significant additional savings for our members. Accordingly, the Institute plans to comment favorably on the Department's proposal once it is officially released and we urge our member institutions to indicate their individual support. (The Institute's September 22nd submission and related documents are available at <http://www.iib.org/member/AssetPledge/>.)

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.

NEW GUIDANCE ON SHARING SARs WITH HEAD OFFICES REFLECTS POSITION ADVOCATED BY THE INSTITUTE

The Financial Crimes Enforcement Network (FinCEN) and federal banking regulators issued inter-agency guidance on January 20th clarifying, among other things, that U.S. branches and agencies of international banks may share Suspicious Activity Reports (SARs) with their head offices, and that U.S. bank subsidiaries may share SARs with their international bank parents.

The guidance reflects a position that the Institute has advocated in the Bank Secrecy Act Advisory Group (BSAAG) and elsewhere and memorializes informal guidance that the Institute received from FinCEN Director William Fox late last year. The guidance confirms that (1) U.S. branches or agencies of an international bank, (2) U.S. banks or savings associations, and (3) U.S. broker-dealers, futures commission merchants and introducing brokers in commodities may share SARs with their head offices/controlling companies, whether in or outside the United States. The guidance and related documents are available on the Institute's web site at <http://www.iib.org/member/Anti-Money/>.

INSTITUTE PLANS TO FILE SUBMISSION ON PROPOSED REGULATIONS UNDER SECTION 312 OF THE USA PATRIOT ACT

The Institute participated in a briefing in late December for members of FinCEN's Bank Secrecy Act Advisory Group regarding the issuance of final and proposed regulations under Section 312 of the USA Patriot Act. The proposed regulations contain an important change that would require "enhanced due diligence" (although on a risk-assessed basis) with regard to correspondent accounts for offshore booking centers (so-called "shell" branches). Under FinCEN's 2002 proposed regulations implementing Section 312, enhanced due diligence would not have been required to the extent the international bank that maintained the booking center or shell branch was subject to comprehensive consolidated supervision. The Institute is continuing to review the proposed and final regulations for other issues and plans to comment on the proposed regulations. In addition, the Institute expects to participate in a broader industry comment letter relating to issues affecting all covered financial institutions, including U.S. banks and broker-dealers. (For background, see Institute memoranda and related documents in the member area of the Institute's web site at www.iib.org/member/Anti-Money/.)

INSTITUTE SEEKS RESOLUTION OF DAYLIGHT OVERDRAFT DISCUSSIONS WITH FEDERAL RESERVE

As a follow-up to the November 28th meeting of the Institute's Board of Trustees with Chairman Greenspan at which the daylight overdraft deductible standard was discussed, the Institute sent a letter to Federal Reserve staff urging completion of the planned on-site meetings by Fed staff with individual member institutions to advance our ongoing daylight overdraft discussions toward a resolution. As previously reported, in connection with the Institute's ongoing efforts to resolve concerns with the differential in intraday overdraft limits and deductibles for domestic versus international banks, 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. (Institute submissions and related documents regarding this issue are available at <http://www.iib.org/member/Other-Regs/>.)

INSTITUTE FORMS WORKING GROUP OF MEMBER BANKS ON POTENTIAL REPORTING REQUIREMENTS FOR CROSS-BORDER WIRE TRANSFERS

The Institute is forming a working group of member bank representatives to develop a collective response that the Institute and our members can provide to the Treasury Department's Financial Crimes Enforcement Network (FinCEN) with respect to the feasibility and problems associated with potential reporting requirements for cross-border wire transfers. The proposal under serious consideration is to require banks to electronically file relevant information on all international wire transfers.

As previously reported, the Institute has participated in meetings of a subcommittee of the Bank Secrecy Act Advisory Group (BSAAG) formed to consider issues relating to cross-border wire transfer reporting. FinCEN 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 MEET WITH TREASURY AND IRS CONCERNING THE IRS' PROPOSAL TO INCREASE THE 93% FIXED RATIO AND TO MAKE OTHER FAVORABLE CHANGES TO REGULATION SECTION 1.882-5

The Institute will be meeting on February 9th with U.S. Treasury International Tax Counsel Hal Hicks and other Treasury and IRS representatives to discuss the proposed changes to Treasury regulation section 1.882-5 that were announced in Notice 2005-53, dealing with the determination of the deductible interest expense of a U.S. branch of an internationally headquartered bank (a report on the meeting will follow). 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. A principal focus of the meeting will be a discussion of data and other information that would support an increase of the fixed ratio to somewhere between 94 - 96% (and hopefully at the high end of this range). The Institute's October 31, 2005 comment letter on the proposed changes is available at www.iib.org/member/Interest-Expense/.

INSTITUTE TO MEET WITH TREASURY AND IRS REGARDING PROPOSED SAFE HARBOR FOR MARK-TO-MARKET SECURITIES VALUATIONS

The Institute will also be meeting on February 9th with Treasury Associate Tax Legislative Counsel Michael Novoy, IRS Associate Chief Counsel (Financial Institutions & Products) Lon Smith and their staffs to discuss our concerns regarding 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 (a report on the meeting will follow). 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.

To date, the IRS has indicated that it is reluctant to rely on fair values as determined under IFRS and other non-U.S. GAAP financial statements. Unless the IRS can be persuaded to modify its position, most internationally headquartered banks and securities firms will not be able to rely on the book/tax conformity safe harbor in respect of their cross-border and other global dealing operations.

In response to an IRS request, the Institute submitted a proposal in December, whereby a senior officer of the financial institution would certify that the mark-to-market values shown on the books of the institution are the same as 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 support this project. Other member institutions that wish to join the syndicate and participate in this effort should contact the Institute.

NEW YORK STATE BUDGET PROPOSALS REGARDING BANK TAXATION

Governor Pataki's budget proposes to make permanent the New York State franchise tax on banking institutions (Article 32). Until now, the bank tax rules have been extended periodically on an interim basis (usually 2 years at a time). As previously reported, for the past several years, the New York State Finance Department's Financial Modernization Task Force has been exploring a major overhaul of the bank tax rules, which would involve combining the bank tax rules and the general corporate tax provisions. Apparently, these ambitious reform efforts are being abandoned for now.

The budget also contains a potentially significant benefit for internationally headquartered banks in proposing to repeal the asset-based alternative tax for banks. In addition, the budget proposal would (i) extend the Gramm-Leach-Bliley financial modernization provisions of Article 32 for only two years, rather than making them permanent, and (ii) repeal the dividends received deduction under Article 32 for dividends from REITs and RICs.