



# INTERNATIONAL BANKING FOCUS

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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 FILES COMMENT LETTER SUPPORTING  
PROPOSED CHANGES TO NEW YORK'S ASSET PLEDGE REQUIREMENT**

The Institute submitted a comment letter dated December 15th to the New York State Banking Department expressing support for proposed changes to New York's asset pledge requirement that reflect many of the recommendations made by the Institute in our September 22, 2005 submission. The proposed change will result in significant additional savings for our members. (The proposal is available on the Banking Department's web site at <http://www.banking.state.ny.us/legal/propregu.htm>; the Institute's December 15th letter and other submissions and related documents are available on the Institute's web site at <http://www.iib.org/member/AssetPledge/>).

The Banking Department proposes to modify its asset pledge regulation by (i) calibrating the amount of assets required to be pledged by well rated institutions on the basis of a sliding scale, whereby the percentage of third party liabilities required to be covered by the pledge decreases from 1% to 0.25% as such liabilities increase from \$1 billion or less to more than \$10 billion; (ii) reducing the maximum amount of the asset pledge for well rated institutions from \$400 million to \$100 million; and (iii) permitting all institutions, and not just well rated institutions, to use investment grade assets which are not rated at the highest level to satisfy up to one half of their asset pledge requirement. However, as is the case under the current regulation, "same country obligor" assets generally would be ineligible, and all institutions would remain subject to a \$2 million minimum pledge.

The Institute's comment letter states that qualification as a financial holding company (FHC) under the Bank Holding Company Act should be a sufficient but not necessary condition for qualification as a "well rated" institution for asset pledge purposes. The letter emphasizes that an institution may be treated as "well rated" even if it is not an FHC (for example, because its tier 1 and total risk-based capital ratios are less than the minimum required for FHC status (6% and 10%, respectively)) and urges the Banking Department to take a flexible approach in applying the "well rated" criteria.

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.

**FEDERAL RESERVE AND FDIC APPROVE ISSUANCE OF BASEL I-A PROPOSAL;  
OCC AND OTS TO FOLLOW SUIT UPON COMPLETION OF OMB REVIEW**

On December 5th, the Federal Reserve and FDIC released a draft interagency notice of proposed rulemaking (NPR) on the so-called Basel I-A proposal (the text is at [www.federalreserve.gov/BoardDocs/press/bcreg/2006/20061205/attachment1.pdf](http://www.federalreserve.gov/BoardDocs/press/bcreg/2006/20061205/attachment1.pdf) and [www.fdic.gov/news/board/5dec06n3reg.pdf](http://www.fdic.gov/news/board/5dec06n3reg.pdf)). Formal publication of the NPR in the Federal Register is subject to approval by the OCC and OTS, which in turn must await review of the proposal by the Office of Management and Budget. Once published, the Basel I-A proposal will be open for comment for a 90-day period. It is expected that the period for comments on the Basel II NPR, which was published on September 25, 2006 for a 120-day comment period, will be extended to coincide with the comment period on the Basel I-A proposal.

As discussed in prior Institute meetings and seminars, as a general matter the U.S. Basel II and Basel I-A initiatives are of primary interest to member institutions with U.S. bank subsidiaries. U.S. branches and agencies of international banks will continue to operate in accordance with their home country Basel requirements, and international banks that are, or seek qualification as, a financial holding company under the Gramm-Leach-Bliley Act will continue to compute their capital on the basis of applicable home country Basel standards.

The draft NPR makes several changes to the Basel I-A advanced notice of proposed rulemaking (ANPR) published in October 2005. In addition, the draft NPR contemplates that non-Basel II banks would have the option to choose between Basel I or Basel I-A, an approach favored by the Institute in its comment letter on the ANPR. In addition, the draft NPR requests comments on whether Basel II banks should be given the option to calculate their risk-based capital requirements using approaches other than the most advanced internal ratings based approaches called for under Basel II. Further, the draft NPR specifically asks whether “advanced” Basel II banks should be given the option to apply either the Basel II “standardized” approach or the Basel I-A approach for credit risk and, if so, how operational risk should be handled.

Of note, in announcing the draft NPR, the Federal Reserve stated that “as proposed, Basel IA would not be available to large, complex international banking organizations subject to the proposed Basel II advanced capital framework,” whereas the FDIC Chairman Bair stated that “I am particularly interested in comments on whether [the Basel I-A] approach or a variation of it should be available to any U.S. bank.”

As described in the draft NPR, the Basel I-A proposal would, among other things:

- add three new risk weights to the existing framework, 35%, 75% and 150%;
- expand the use of external credit ratings for certain exposures;
- expand the range of eligible collateral and guarantors used to mitigate credit risk;
- use loan-to-value ratios to determine risk weights for most residential mortgages;
- increase the credit conversion factors for certain commitments with an original maturity of less than one year;
- assess a risk-based capital charge to reflect the risks in securitizations with early amortization provisions that are backed by revolving exposures; and
- remove the 50 percent limit on the risk weight that applies to certain derivative contracts.

Once the Basel I-A NPR is formally approved by the OCC and OTS, the Institute will schedule a conference call to review the Basel I-A proposal and solicit input from member institutions regarding comments the Institute should consider making on the proposal, as well as additional comments the Institute should make on the Basel II proposal in light of the Basel I-A NPR.

### **INSTITUTE CONTINUES EFFORTS TO ADDRESS INTRADAY LIQUIDITY ISSUES**

The Institute held a conference call on December 5th with interested member institutions to solicit additional input regarding the Federal Reserve’s Consultation Paper on intraday liquidity issues. The Institute plans to submit a comment letter on the Paper by March 15, 2007 (the Federal Reserve extended the comment period from the earlier deadline of December 15th). In addition to continuing discussion on the Consultation Paper, the December 5th call provided an opportunity to discuss further the Institute’s parallel effort to obtain expedited resolution of the disparity in treatment of international banks with respect to daylight overdraft caps and deductibles.

As previously reported, the Institute submitted a letter dated October 4, 2006 to Chairman Bernanke requesting that the Federal Reserve address the disparity in treatment of international banks vis-à-vis U.S. domestic banks under the Federal Reserve’s existing overdraft policy on a separate and expedited track from the comment period for its draft Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy. (The letter and other documents on this issue are available on the Institute’s web site at <http://www.iib.org/member/Other-Regs>.) As the Institute continues to pursue this effort, support from home country authorities would be very helpful, including conferring with the Federal Reserve on the question as may be appropriate.

**SEC AND FEDERAL RESERVE TO ISSUE PROPOSED JOINT RULES IMPLEMENTING THE BROKER “PUSHOUT” PROVISIONS OF THE GRAMM-LEACH-BLILEY ACT**

On December 13th, the SEC unanimously voted to issue new rules to implement the Gramm-Leach-Bliley Act’s broker “pushout” provisions. As required by the recently enacted regulatory relief legislation, the SEC will issue these rules jointly with the Federal Reserve and in consultation with the other federal banking regulators. The Federal Reserve Board is scheduled to consider the proposal at its meeting on Monday, December 18th.

The SEC announced it will publish the full text of the proposed rules for a 90-day comment period once the Federal Reserve Board has acted, but in the meantime it has provided a summary of the proposal (see [www.sec.gov/news/press/2006/2006-205.htm](http://www.sec.gov/news/press/2006/2006-205.htm)). In addition, the SEC stated that it plans to provide a transitional 18-month exemption until the first day of their first fiscal year commencing after June 30, 2008 in order to give institutions affected by the “pushout” time to modify their compliance programs in light of the final rules.

As described in the SEC summary, the proposed rules include an exemption for agency and riskless principal transactions by “Banks” (including U.S. branches and agencies of non-U.S. banks) in Regulation S securities with non-U.S. persons. This “Regulation S Exemption” is based on the exemption that was included in the SEC’s proposed Regulation B in 2004 at the urging of the Institute and member institutions. It appears the SEC has taken into account some, but not all, of the comments made by the Institute on that original proposal with respect in particular to its applicability to secondary market transactions in Regulation S securities.

The proposed rules respond favorably to concerns previously raised by the Institute, its member institutions and U.S. domestic banks and their trade associations with respect to other aspects of the broker “pushout” provisions, including implementation of the “chiefly compensated” standard under the trust and fiduciary exception, the ability to effect securities transactions on an accommodation basis as part of the safekeeping and custody exception and the payment of referral fees under the networking exception. Briefly, it appears that Banks will be given the option to measure the “chiefly compensated” standard on either an account-by-account basis or a “bank wide” basis, in either case by applying less stringent criteria than those the SEC proposed in 2004; “accommodation” trades will be permissible under the safekeeping and custody exception, subject to certain limitations; and the referral fee provisions will not restrict Banks’ customary bonus plans.

Careful review of the text of the proposed rules will be necessary to form a more definitive judgement on the proposal. Once the full proposal is published, the Institute will schedule a conference call to discuss its implications and solicit additional input from interested member institutions regarding comments the Institute should consider submitting on the proposal. In addition, consideration will be given to the implications of the changes proposed with respect to the safekeeping and custody exception for the Institute’s continuing effort to obtain “no action” relief from the SEC for international banks acting through their non-U.S. offices or branches as securities custodians for U.S. investors.

**INSTITUTE SUBMITS COMMENT LETTER ON PROPOSED CHANGES TO FORMS FR Y-7 AND FR Y-10F**

The Institute submitted a comment letter dated November 13, 2006 regarding the Federal Reserve’s proposed changes to Form FR Y-7 and the proposed adoption of a combined Form FR Y-10. Reflecting discussions with interested member institutions, the letter seeks clarification of the requirement to report entities that are wholly owned (as opposed to being 80%-or-greater owned) and urges revisions to the definition of “control” used for reporting purposes. (The comment letter is available on the Institute’s web site at <http://www.iib.org/member/FRY-7>.) In addition, the Institute is organizing a one-day seminar on January 24th on Federal Reserve reporting requirements applicable to internationally headquartered banking institutions that

will include presentations by Ken Lamar and his colleagues at the Federal Reserve Bank of New York (see related article in *Institute News*). The quality of an institution's reporting is relevant to the supervisory assessment of its condition, and all member institutions are urged to attend the seminar.

### **INSTITUTE COMMENTS ON NEW INTEREST ALLOCATION REGULATIONS INCREASING "FIXED RATIO" TO 95 PERCENT**

In October, the Institute submitted a letter to the U.S. Treasury Department and the Internal Revenue Service commenting on the new regulations under section 1.882-5, dealing with the calculation of an international bank's deductible interest expense. The letter expressed our appreciation regarding the increase of the "fixed ratio" to 95% and other favorable aspects of the new regulations.

As previously reported, the persistent, multi-year efforts of the Institute have finally been rewarded, as the new regulations increase the "fixed ratio" for computing the leverage ratio of the U.S. branch for tax purposes from 93% to 95% (thereby reducing the imputed equity-to-assets ratio from 7% to 5%).

For a U.S. branch with \$20 billion of assets, the reduction in the imputed capital from 7% to 5% translates into an allowance of interest expense on an additional \$400 million of debt. This change will benefit not only banks that are on the fixed ratio, but also banks that have been on the actual ratio and wish to ease their administrative burdens and audit exposures by shifting to a more secure and reasonable 95% fixed ratio. Most calendar year taxpayers will be able to elect to apply the 95% fixed ratio for their 2005 tax year.

The regulations also make a number of other changes, including allowing banks to elect on an annual basis to use a 30-day LIBOR rate to compute their excess interest under the adjusted U.S. booked liabilities method, instead of having to determine the actual dollar borrowing rate of their non-U.S. branches and offices. The Institute had been advocating this simplification measure.

The Institute's letter makes three substantive comments: (i) requesting an extension of the 95% fixed ratio to the 2005 fiscal year of Australian and Canadian banks, (ii) expressing concerns about the failure to provide branch profits tax relief in respect of the increase in the fixed ratio, and (iii) requesting that taxpayers be allowed to elect to identify an integrated non-ECI position consisting of a third party borrowing, inter-branch loan and related foreign currency exposures.

The Institute has reason to believe that the IRS will respond favorably to the request to modify the effective date of the 95% fixed ratio with respect to Australian and Canadian banks, and we are continuing to pursue the other two matters.

### **INSTITUTE WRITES SECRETARY PAULSON ON NEED FOR PARITY OF TREATMENT OF IFRS WITH U.S. GAAP UNDER PROPOSED 'MARK-TO-MARKET' TAX REGULATIONS**

In connection with his initiative to enhance the competitiveness of the U.S. capital markets, the Institute sent a letter to Treasury Secretary Paulson on November 16th urging the elimination of the disparate treatment of U.S. and internationally headquartered financial institutions under 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. Secretary Paulson's competitiveness initiative was outlined in his address before the Economic Club of New York on November 20th (see [www.ustreas.gov/press/releases/hp174.htm](http://www.ustreas.gov/press/releases/hp174.htm)).

As previously reported, the Institute has been engaged in an ongoing effort to persuade Treasury and IRS officials who are responsible for this regulation project to eliminate the disparate treatment of U.S. and internationally headquartered financial institutions by accepting the mark-to-market valuations under International Financial Reporting Standards ("IFRS") and other non-U.S. GAAP financial reporting standards that

have been reconciled to U.S. GAAP in SEC filings. We believe that this approach is appropriate because the fair value of mark-to-market securities under these non-U.S. financial reporting standards is almost invariably the same as the fair value of those securities under U.S. GAAP, given that the definition of, and methodology for determining, fair value for these purposes are substantially equivalent to those under U.S. GAAP. (Institute memoranda, submissions and related documents on this issue are available at <http://iib.org/member/Other-Matters/>.)