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INTERNATIONAL BANKING FOCUS

A Bimonthly Publication of the
INSTITUTE OF INTERNATIONAL BANKERS

Volume XXX, Number 5
December 23, 2009

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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 EFFORTS REGARDING FINANCIAL REGULATORY REFORM LEGISLATION PASSED BY THE HOUSE FOCUS IN PARTICULAR ON APPLICATION OF STRICTER PRUDENTIAL STANDARDS TO INTERNATIONAL BANKS AND THE EXTRATERRITORIAL SCOPE OF THE LEGISLATION'S OTC DERIVATIVES PROVISIONS

On December 11th, the House of Representatives passed sweeping financial regulatory reform legislation that, among other things, (i) subjects institutions that are designated as posing a significant threat to financial stability or the economy to stricter capital and other prudential limits and (ii) establishes a new regulatory regime over the OTC derivatives market.

The stricter standards applicable to systemically significant institutions generally include the following:

- enhanced capital requirements (risk-based and leverage limits);
- liquidity and concentration requirements;
- maintaining a debt-equity ratio of not more than 15:1;
- conducting periodic stress tests; and
- such contingent capital requirements, limits on short-term debt and restrictions on proprietary trading activities as the Federal Reserve may determine appropriate.

Under the legislation, an international bank could be designated as systemically significant. Such designation would be made with respect to the global bank and not its U.S. operations. Reflecting efforts by the Institute, the final bill includes a provision that leaves determination of how the stricter standards apply to a “systemically significant” international bank to the Federal Reserve, which is directed to prescribe implementing regulations “giving due regard to the principles of national treatment and equality of competitive opportunity and taking into account the extent to which [a systemically significant international bank] is subject on a consolidated basis to home country standards comparable to those applied to financial holding companies in the United States.”

The Institute’s efforts regarding the OTC derivatives legislation focused on limiting its extraterritorial application. Reflecting these efforts, the final bill provides as follows:

- **Harmonization.** The CFTC, SEC and federal banking agencies are directed to consult and coordinate with their foreign counterparts to establish “consistent international standards” with respect to the regulation of swaps and security-based swaps and are authorized to enter into information-sharing agreements.
- **Extraterritorial Limits.** Non-U.S. transactions in swaps and security-based swaps are excluded from the bill’s requirements unless they are found to be evasive, or, in the case of transactions subject to the CFTC’s oversight, “have a direct and significant connection with activities in or effect on United States commerce.”

- **Exemption from Swap Dealer/Major Market Participant Registration and Regulatory Requirements.** The CFTC/SEC are authorized to provide “conditional or unconditional exemptions from some or all” of the registration and regulatory requirements applicable to swap/security-based swap dealers and major market participants. This exemptive authority is not dependent on the CFTC or SEC making any type of comparability determination. However, it is limited to the specific swap dealer/major market participant registration and regulatory requirements prescribed in Sections 3107 and 3204 of the bill. Some of the notable provisions not included within these sections are the bill’s mandatory clearing and exchange-trading requirements and requirements for swap dealers to segregate margin for non-cleared swaps.

The legislation strengthens the regulation and oversight of financial institutions generally and not only those designated as being systemically significant. Key provisions for international banks in this regard include those (i) requiring financial companies with more than \$10 billion in assets to conduct semi-annual stress tests; (ii) imposing on financial companies with at least \$50 billion of assets assessments to support the fund established to cover the costs of resolving systemically significant institutions; and (iii) applying “well capitalized” and “well managed” requirements to parent companies of international banks that are financial holding companies. (Institute memoranda and related documents on the legislation are available on the Institute’s web site at www.iib.org.)

With the approval of the bill in the House, the Institute is now focusing its efforts on the Senate, which is expected to take up financial regulatory reform legislation early in the new year. All interested member institutions that have not already done so are encouraged to contact the Institute about joining the IIB Working Group on financial regulatory reform.

RESPONDING TO THE INSTITUTE’S CONCERNS, THE FDIC PROVIDES GRACE PERIOD ON ENFORCEMENT OF AMENDMENTS AFFECTING UNINSURED BRANCHES OF INTERNATIONAL BANKS

In response to the Institute’s letter dated September 25th to Federal Deposit Insurance Corporation Chairman Bair (see link below), the FDIC on October 30th informed the Institute of its decision to provide a 90-day grace period (until January 14, 2010), during which FDIC staff will not recommend that the recently adopted amendments to Part 347 of the FDIC’s regulations be enforced. As previously reported, the amendments were adopted in response to the temporary increase in the standard maximum deposit insurance amount (SMDIA) from \$100,000 to \$250,000, which the FDIC viewed as automatically requiring a corresponding increase from \$100,000 to \$250,000 in the threshold for determining whether an uninsured branch of an international bank is engaged in “domestic retail deposit activities requiring deposit insurance protection” under Section 6 of the International Banking Act (the “Minimum Wholesale Requirement”).

In the October 30th letter, the FDIC’s General Counsel explained that the 90-day grace period is intended to permit the Institute the opportunity to provide information for the FDIC to consider whether the Minimum Wholesale Requirement should remain at \$100,000 and to explain further its views regarding the scope of the FDIC’s regulatory authority under Section 6.

In a submission dated December 14th (see link below), the Institute provided further support for its conclusions that (i) an increase in the SMDIA does not automatically require a corresponding (or any) increase in the Minimum Wholesale Requirement; (ii) the FDIC has ample statutory authority to set the Minimum Wholesale Requirement at an amount less than the SMDIA and to maintain it at \$100,000; and (iii) as a policy matter, there is no need to increase, and there would be no benefit to increasing, the Minimum Wholesale Requirement to \$250,000 (or to any amount greater than \$100,000).

Link to Institute's September 25th letter to Chairman Bair:

<http://www.iib.org/associations/6316/files/20090925FinalFDICLetter.pdf>

Link to Institute's December 14th letter to FDIC General Counsel Michael Bradfield:

<http://www.iib.org/associations/6316/files/20091214FDICLetter.pdf>

INSTITUTE TO ADDRESS ISSUES RAISED IN KOEHLER CASE

The Institute is organizing a Working Group of interested member banks to address the recent New York Court of Appeals decision in the Koehler case (see link below) which held that New York courts can order a bank with operations in New York to turn over to a person who has obtained a judgment against a third party, in satisfaction of that judgment, property of the third party that is held or controlled by the bank outside New York (including property outside the United States) regardless of whether the person enforcing the judgment, the third party or the underlying dispute between the two has any connection to New York.

This issue is especially serious for international banks that operate in New York through branches or agencies, or even only through representative offices. Koehler in effect potentially makes these New York operations a collection agent through which a judgment creditor can seek to recover against property of a judgment debtor held by a bank anywhere in the world. Several international banks currently are defending against Koehler-based collection efforts and it is likely that judgment creditors will seek to take advantage of Koehler's principles by initiating similar actions against other international banks in New York.

The Institute plans to prepare an *amicus* brief focusing on the comity, potential constitutional and other policy considerations raised by the Koehler decision for use in cases brought under Koehler. In addition, we plan to undertake an effort to amend the relevant provisions of New York law that underlie Koehler.

Institute member banks interested in participating in the Working Group and providing funding for the Institute's outside legal /lobbying expenses are asked to contribute \$5,000 each, with medium and small-size banks contributing half that amount. All interested member institutions are encouraged to contact the Institute about joining the IIB Working Group.

Link to the New York Court of Appeals' Koehler decision:

<http://www.iib.org/associations/6316/files/20090604KoehlerOpinion.pdf>

INSTITUTE FILES COMMENT LETTER ON FEDERAL RESERVE'S PROPOSED GUIDANCE ON INCENTIVE COMPENSATION POLICIES

The Institute submitted a comment letter dated December 8th (see link below) on the Federal Reserve's proposed guidance on sound incentive compensation policies. Reflecting input from member institutions, the letter seeks clarification of the relationship between a foreign bank's board of directors and its senior management in the United States that is contemplated by the guidance with respect to the exercise of active and effective oversight of incentive compensation arrangements involving the foreign bank's U.S. operations. The letter states that such clarification will strengthen the efficacy of the guidance by providing helpful direction to banks and examiners alike in assessing a foreign bank's U.S. incentive compensation program.

Link to December 8th comment letter:

http://www.iib.org/associations/6316/files/20091208IncentiveComp_FinalComment.pdf

**INSTITUTE, EUROPEAN BANKING FEDERATION RECOMMEND CHANGES
IN "FATCA" REPORTING AND WITHHOLDING TAX PROPOSAL**

In joint submissions to the Congressional tax writing committees, the Institute and the European Banking Federation (EBF) recommended key statutory changes to mitigate the significant adverse affects of the proposed Foreign Account Tax Compliance Act (FATCA). Links to the November 25th submission to the House Ways & Means Committee and the December 15th letter to the Senate Finance Committee are provided below.

Introduced in late October, FATCA calls for dramatic changes in the structure of the U.S. withholding tax and reporting regime that, as originally drafted, would have raised serious and costly operational/systems problems for internationally headquartered financial institutions trying to comply with the proposed legislation.

The joint IIB/EBF submission to Ways & Means on November 25th made eight key recommended changes in the statutory language and legislative history of the bill that were intended to further the bill's goal of tackling offshore tax evasion by U.S. persons in a manner that takes account of the structure and operations of financial intermediaries and the markets that they serve, as well as compliance costs and burdens. While the revised proposal, passed by the House of Representatives on December 9th as part of the Tax Extenders Act of 2009, incorporated many of the changes that had been requested by the Institute and the EBF, several of our requests were not included. Accordingly, the joint IIB/EBF submission to the Senate Finance Committee on December 15th requested that they be incorporated in the Senate version of the bill.

FATCA would affect all banks and other financial and investment-type entities by requiring them to sign agreements with the IRS in order to avoid a 30% withholding tax on their investments into the U.S. The proposed legislation would affect not just those institutions that have chosen to be Qualified Intermediaries (QIs), but all banks and other financial/investment entities worldwide that have any kind of U.S. investments, either directly or on behalf of their customers. The agreements with the IRS would require them to check their global depositor base for possible U.S. customers as well as a number of other things that QIs are normally required to do.

In addition to the written submissions, the Institute and the EBF have held constructive discussions with senior staff of the Congressional tax writing committees and Treasury/IRS officials. We expect that if this legislation is enacted, the Institute will need to engage in extensive discussions with Treasury and the IRS in connection with the development of the detailed guidance that will be necessary before these new rules go into effect.

In order to ensure that we have sufficient funds to cover our outside legal/lobbying expenses to see this effort through to a successful completion, we continue to urge as many member institutions that have not already done so to join the Institute's Working Group and provide the needed financial support.

As of this date, 23 institutions have joined the Working Group. Larger member banks have contributed \$5,000 each and medium to smaller-sized institutions have contributed half that amount, with several banking associations also contributing either \$5,000 or \$2,500 each. The Working Group has been playing a key role in formulating our strategy and coordinating our efforts on the legislation. We plan to schedule another conference call with the Working Group to discuss developments in the Senate.

Link to IIB/EBF Nov. 25 submission to Ways & Means:

http://www.iib.org/associations/6316/files/20091125IIB_EBFSubmission.pdf

Link to IIB/EBF Dec. 15 submission to Senate Finance:

http://www.iib.org/associations/6316/files/20091215IIB_EBFSubmission_SFC.pdf

INSTITUTE CONTINUES ITS EFFORTS ON NEW YORK CORPORATE TAX REFORM PROPOSALS

As previously reported, an Institute working group of member institutions met in mid-September with the New York State Tax Department in connection with the Department's corporate tax reform proposals contained in a July 13th Department "white paper". Following the meeting, the Institute submitted a letter to the Tax Department providing additional information on three items raised during the September meeting: applicability of U.S. tax treaties to the computation of entire net income; computation of interest expense under section 1.882-5 when a branch is included in a New York combined return; and the definition of includable corporations for purpose of the proposed water's edge group election. We are grateful for the assistance of Jeff Gotlinger of Ernst & Young in preparing the letter. (A link to the IIB's October 8th letter is provided below.) The Tax Department subsequently released a revised proposal that responded favorably to the issues raised in our letter.

Legislation is now being drafted in Albany which differs in part from what had been contemplated by the Tax Department's November 6th Outline. In particular, effectively connected income (as computed pursuant to Section 882 of the Internal Revenue Code) will generally be used for purposes of determining entire net income of an alien corporation and taxpayers reporting their federal taxable income pursuant to a treaty would be subject to a modification provision.

The Institute has expressed its concerns with this approach, emphasizing that it is important for tax administration reasons that New York State follow the applicable federal income tax return calculation of taxable income, including under applicable tax treaties, and that doing so would be consistent with and further enhance New York's role as a preeminent international financial center. The Institute working group will continue to focus on resolving this question in further discussions with the Tax Department and other officials in Albany.

Link to IIB Letter:

<http://www.iib.org/associations/6316/files/20091008NYTaxLetter.pdf>