INSTITUTE OF INTERNATIONAL BANKERS

299 PARK AVENUE, 17TH FLOOR, NEW YORK, N.Y. 10171
TELEPHONE: (212) 421-1611 FACSIMILE: (212) 421-1119
HTTP://WWW.IIB.ORG

LAWRENCE R. UHLICK
EXECUTIVE DIRECTOR AND GENERAL COUNSEL
DIRECT E-MAIL: LUHLICK@IIB.ORG

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Annette L. Nazareth,
Director, Division of Market Regulation,
Securities and Exchange Commission,
450 5th Street, N.W.,
Washington, D.C. 20549

Dear Ms. Nazareth:

The Institute of International Bankers (the "IIB") is writing to express its serious concern with a proposed rule change (the "Proposal") submitted to the Securities and Exchange Commission (the "Commission") by Fixed Income Clearing Corporation ("FICC").[1] The Proposal would discriminate against foreign bank members of FICC ("Bank Members") in two ways. First, it would require higher capital levels for foreign members that report financial statements in accordance with non-U.S. GAAP standards, such as IAS. Second, it would require foreign members to maintain collateral equal to 110 percent of what other members must post, the increment to be in the form of a letter of credit. As originally proposed, the penalty was 130 percent, rather than 110 percent. Although the IIB recognizes the improvement in the modified proposal, for the reasons discussed below, a blanket penalty for foreign members is simply unjustified.

The IIB and its members recognize the critical importance of ensuring a safe clearance and settlement system. The IIB, however, respectfully submits that the

[1] Proposed Rule Change by Fixed Income Clearing Corporation, File No. SR-FICC-2004-14.

Proposal is unwarranted. The Proposal raises serious issues under Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, which requires inter alia that clearing corporation rules "are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency."[2] It also runs afoul of the long-standing Federal policy of affording national treatment to non-U.S. banks operating in the United States, as articulated in the International Banking Act of 1978.

The imposition of a capital penalty for the use of non-U.S. GAAP financial statements is extremely troubling and invites a similar approach by non-U.S. authorities with respect to firms using U.S. GAAP, given the concern many abroad have about U.S. GAAP in light of recent events in the United States.[3] As a practical matter, however, the Bank Members are all major regulated banking institutions from major industrial countries[4] with capital many times the $100 million minimum required by FICC. Therefore, although we find the capital penalty objectionable in principle, it is the collateral surcharge that poses the greatest practical burden and precedential concern. For example, one Bank Member believes that the Proposal's collateral requirement would cost it between $100,000 and $200,000 annually, depending on a number of variables. If the Proposal's approach was more broadly adopted by other systems, the cost would be a

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2 15 U.S.C.S. § 78q-1(b)(3)(F) (2004).

3 Events such as the collapse of Enron have led many to question the adequacy as well as the potential for improper implementation of U.S. GAAP. See Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: International Accounting Standards and Necessary Reforms to Improve Financial Reporting, 107th Cong. (2002) (statement of Sir David Tweedie, Chairman, International Accounting Standards Board) (attached as Annex A).

4 The home countries of the Bank Members are Australia, Canada, France, Germany, Japan and the Netherlands.

multiple of that number. Thus, the precedential impact of the Proposal, even as revised, is of grave concern.

According to FICC's filing with the Commission, the collateral surcharge is to address "increased risk as compared to domestic members," which include "legal risk, country risk and regulatory risk."[5] The IIB does not purport to address the risks posed by all current and potential foreign members of FICC, but it does submit that FICC has made no showing to justify its blanket imposition of any collateral surcharge on highly regulated banks from major industrial countries.

We propose to examine each of the three areas of risk raised by FICC to justify the collateral surcharge. With respect to country risk, given the home countries of the Bank Members, the IIB does not believe that this is a meaningful risk as to any Bank Member. With respect to regulatory risk, each of the Bank Members holds its membership through a U.S. branch which is either a Federal branch licensed and supervised by the Office of the Comptroller of the Currency (the "OCC") or through a New York State branch which is licensed by the New York State Banking Department (the "NYSBD") and supervised by the NYSBD and the Federal Reserve System (the "FRS"). Moreover, the U.S. operations of each of the Bank Members is subject to overall FRS supervision, and each is subject to a home country regulatory regime as to which the FRS has made a finding as to comprehensive consolidated supervision.[6] In

5 Proposed Rule Change by Fixed Income Clearing Corporation, File No. SR-FICC-2004-14.

6 In most cases, the FRS has made a determination of comprehensive consolidated supervision with respect to the specific Bank Member. See ABN Amro Bank, 80 Fed. Res. Bull. 662 (July 1994); Bank of Montreal, 80 Fed. Res. Bull. 925 (Oct. 1994); Commerzbank, 85 Fed. Res. Bull. 336 (May 1999); National Australia Bank, 81 Fed. Res. Bull. 1154 (Dec. 1995); Rabobank, 89 Fed. Res. Bull. 81 (Feb. 2003); Société Générale, 87 Fed. Res. Bull. 353 (May

fact, the Commission itself, in determining that U.S. branches of non-U.S. banks could be eligible to rely on the bank exemption from registration found in Section 3(a)(2) of the Securities Act of 1933, relied on the comparability between the regulation of such U.S. branches and the regulation of domestic U.S. banks.[7]

The IIB also submits that the FICC's collateral surcharge is not justified by legal risk posed by the Bank Members' status as non-U.S. banks. To understand the issue of legal risk, it is necessary to consider three areas of analysis – (i) the U.S. substantive insolvency law governing Federal and New York State branches, (ii) Section 304 of the Bankruptcy Code and (iii) the substantive insolvency law of the home country. This tripartite analysis is not unique to FICC; it is the same analysis every clearing and payment system must employ to manage foreign participant risk. Indeed, it is the very fact that FICC is not unique that concerns our members as a precedential matter.

Turning first to the applicable substantive U.S. insolvency law, in the case of a non-U.S. bank with a Federal branch, the insolvency of its U.S. branches and agencies will be handled by the OCC under Federal law provisions applicable to national

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2001); WestLB AG, 89 Fed. Res. Bull. 344 (July 2003). In the case of Calyon, it was formed as a result of the 2004 merger of Crédit Lyonnais' Corporate and Investment Banking division into Crédit Agricole Indosuez. The Board of Governors of the Federal Reserve System previously determined that Crédit Agricole Indosuez was subject to comprehensive supervision on a consolidated basis by its home country supervisor. 83 Fed. Res. Bull. 1025 (Dec. 1997). We are not aware of specific determinations of comprehensive consolidated supervision that have been made for The Bank of Nova Scotia or The Norinchukin Bank. However, the regulatory regimes in Canada and Japan have been the subject of such determinations. See Bank of Montreal, 80 Fed. Res. Bull. 925 (Oct. 1994) and Mitsubishi-Tokyo Financial Group, Inc., 87 Fed. Res. Bull. 349 (May 2001). Referenced FRS determinations of comprehensive consolidated supervision are attached as Annex B.

[7] Interpretation of Section 3(a)(2) of the Securities Act of 1933, Securities Act Release Nos. 33-6661; 39-2038, 51 Fed. Reg. 34,460 (Sept. 29, 1986).

banks,[8] as supplemented by netting provisions established for all financial institutions by FDICIA.[9] In the case of a New York State branch, an insolvency will be handled by the NYSBD under the New York Banking Law,[10] as supplemented by the FDICIA netting provisions. As explained at the recent meeting with the FICC, which Commission staff attended via telephone, the substantive insolvency schemes for New York State and Federal branches, coupled with the FDICIA netting provisions, provide legal certainty which we believe is at least equivalent to that provided for domestic U.S. institutions, be they banks, broker-dealers or other domestic entities.

The second area of analysis is Section 304 of the Bankruptcy Code. Section 304 allows a foreign receiver to commence a proceeding in a U.S. Bankruptcy Court in aid of a foreign insolvency proceeding. The IIB believes that the better view is that Section 304 should not be available to allow a home-country receiver to prevent the application of U.S. branch assets in accordance with U.S. substantive insolvency law. We must acknowledge, however, that this question is unclear, especially in light of a recent decision by the U.S. District Court in the Southern District of New York.[11]

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8 12 U.S.C.S. § 3102(j) (2004).

9 12 U.S.C.S. § 4403 (2004).

10 N.Y. BANKING LAW § 606 (Consol. 2004).

11 Agency for Deposit Ins., Rehab., Bankr. & Liquidation of Banks v. Superintendent of Banks, Case No. 03-CV-9320 (JSR), Case No. 03-CV-9321 (JSR), 2004 U.S. Dist. LEXIS 10848 (S.D.N.Y. June 2004) (attached as Annex C). The case does not hold that a foreign receiver would gain access to U.S. branch assets, only that he would have the ability to seek to have a bankruptcy court in its discretion consider whether he should have such access. This case involved a branch that had been closed for some time before the Section 304 proceeding was brought, and does not even present the case of whether a court would actually interfere with a U.S. bank insolvency proceeding in which an active business would be wound-up. Indeed, often the settlement system issues would in practice be resolved before a foreign liquidator could bring a Section 304 proceeding.

Although we believe that this decision will ultimately be overturned either on appeal or by legislation, for purposes of our analysis, we will assume that Section 304 can be used by a foreign receiver to reach U.S. branch assets. All that this means is that one gets referred to the home country's substantive insolvency law in order to determine FICC's rights. Thus, it means that one needs to go through the third part of the analysis – what is the substantive law of the relevant bank's home country. In other words, all Section 304 would do is invoke home country law and, if that law protects FICC's rights, there is ultimately no issue.

Thus, at worst Section 304 simply requires an examination of the home country law. Clearing and payment systems, including FICC, routinely get home country insolvency law opinions. The IIB agrees that until the Section 304 issue is satisfactorily resolved, FICC should get such home country opinions and, if the law in any country is unfavorable or unclear, impose additional collateral requirements on a case-by-case basis. This is what FICC has historically done, and this is what it should keep doing.

Moreover, the IIB believes that the home-country legal issues have in general become clearer in recent years in response to global regulatory efforts to create legal certainty.[12] In view of this trend, we believe it is especially unfair and discriminatory to impose a collateral surcharge on all foreign members instead of determining which, if any, members raise a real legal risk.

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[12] For example, the European Parliament and the Council of the European Union adopted Council Directive 98/26/EC in part to help reduce "legal risks associated with participation in real time gross settlement systems" and to determine "which insolvency law is applicable to the rights and obligations of [a] participant in connection with its participation in a system. . . ." Council Directive 98/26/EC, 1998 O.J. (L 166) 45.

FICC has indicated that the reasoned nature of the opinions it has received is a factor leading to the Proposal. We recognize that insolvency opinions are complex and reasoned. This is true of opinions on U.S. insolvency law as well as foreign law. But the burden of engaging in a thoughtful review of the opinions is not a reason to simplify the process by arbitrarily disadvantaging all the Bank Members. Significantly, we note that the regulatory community has in fact insisted on obtaining reasoned opinions, rather than conclusory opinions, even when the law is clear enough to permit a conclusory opinion.[13] A major object of the opinion exercise is to expose the legal issues and allow an evaluation of the conclusions expressed. In that sense, the reasoned nature of the opinions is in fact a positive, not a negative.

In short, as we stated above, we believe this Proposal is of critical importance to the international financial and regulatory community because of its departure from industry practice and the precedential implications of its arbitrary approach. If that approach were adopted broadly in the United States or abroad, it could severely increase the costs associated with, or even disrupt, international clearance and payment systems.

[13] See, e.g., Capital; Capital Adequacy Guidelines, 59 Fed. Reg. 62,987, 62,989-90 (Fed. Reserve Sys. Dec. 7, 1994) (attached as Annex D); see also Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries, 1990 (attached as Annex E).

We appreciate your consideration of our concerns and hope to be afforded the opportunity to meet with you to discuss them.

Sincerely yours,

Lawrence R. Uhlick

Lawrence R. Uhlick
Executive Director and
General Counsel

(Attachments)

cc: Jerry Carpenter
David Karasik
(Securities and Exchange Commission)