



New levies threaten overseas bank offices

Added 30 June 2010 by Bob Lyddon, Managing Director, IBOS



The IMF has made proposals for new taxes on banks' activities; the US and UK governments have floated ideas for Stability and Activity Taxes; the EU, through Commissioner Michel Barnier, has called for the creation of a series of stabilisation funds.

In whichever form these extra levies on the banks emerge, there is a consistent logic: to make banks operate on a high-scale/low-risk model i.e. to concentrate on domestic banking in the countries that bailed them out.

These proposed measures threaten to kick away the legs on which stand many of the overseas offices of international banks. This is because these overseas offices often rely on a contribution from “risky” activities like venture capital and proprietary trading to cover local costs, including increasing compliance costs. Such activities will be heavily penalized by the new taxes. Banks are instead being encouraged to concentrate on their “home markets”.

The increasing desire for direct insight into “offshore” locations is another aspect of governments' response to the credit crisis, to capture tax revenues that might be concealed in “blacklist” and “grey list” locations. By the same token the operations of foreign banks in such locations cannot fail but to come under scrutiny from their own head offices in terms of financial and reputational risk

The Hiring Incentives to Restore Employment bill, signed by Barack Obama on 18th March 2010, requires international financial institutions to divulge the details of any US citizen that holds \$50,000 or more with them, on pain of a 30% withholding tax on all payments made to that bank in the US.

Non-US banks are already starting to close bank accounts of US citizens in response. Banks who continue to hold accounts for US expats will need to adapt IT systems and reporting processes to ensure compliance, the costs for which will be passed on to the customer.

This is at a time when banks are generally reviewing their overseas operations:

- In response to EU or national government demands to refocus activities and make divestments, as the quid-pro-quo for receiving government support. RBS' divestment of Churchill and Direct Line was dictated by the UK government and falls into this category
- To refocus onto activities or markets where the bank has a chance of sustainable and profitable growth, thus allowing the bank to tap the international markets for new capital on "open market" terms, as opposed to going to a government. HSBC's policy of concentrating on emerging markets is an example: HSBC could obtain new capital because it could show how it will generate a return.

Contrast that with a small operation of a bank in an offshore centre, possibly "grey list", seen by Head Office as peripheral, a source of increasing risk, and a source of reputational embarrassment, if its customers are principally residents of the country that owns the bank: an easy decision in the current environment is to close down.

The potential outcome is fewer foreign banks in offshore locations. How would the location then attract business from the residents of "onshore" countries, in the absence of the marketing channels through the home networks of the foreign banks? And even then, would the proposition of banking with a local bank – or an operation of foreign bank of another base nationality – be trusted by the customer? If not, then the offshore location might see a drop-off of business.

By the same token, the range of locations and services that were available for advisers to recommend – and which the customers were willing to trust in - could reduce as the cost of service increases.

This is bad news for service providers in offshore banking and advisers alike: a more expensive marketplace to operate in with fewer options, and a higher compliance and risk management burden. Similarly, the number of customers is unlikely to rise for whom offshore solutions are a more attractive risk/return proposition than onshore solutions.