Testimony of Gerry Schwebel

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before the

House Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

regarding

Tax Reporting on Interest Paid to Nonresident Aliens

October 27, 2011

Madame Chairwoman and Members of the Subcommittee:

Thank you for holding this important hearing on the Treasury Department's proposed regulation to require U.S. banks to report interest paid on deposits to nonresident alien individuals (REG-146097-09) and the damaging effect this regulation would have on our economy and U.S. employment.

My name is Gerald Schwebel, and I am Executive Vice President of IBC Bank, Laredo, Texas. I oversee our international banking operations. I am also speaking today on behalf of a coalition of depository institutions and industry trade associations including the Texas Bankers Association, the New York Bankers Association and the California Bankers Association.

By way of background on IBC, the bank was founded in 1966 to meet the needs of small businesses in Laredo and serve cross border trade. Today, it serves as the flagship bank of International Bancshares Corporation. Since its opening, IBC has grown from less than $1

million in assets to approximately $12 billion, making it one of Texas' largest banks. IBC now serves 107 communities throughout Texas and Oklahoma with 275 branches.

In 2010, Hispanic Business Magazine ranked IBC as the number one Hispanic-owned financial institution in the nation. We are also the number one Hispanic-owned business in Texas and fourth nationally.

I want to state at the outset that we strongly oppose this Treasury initiative which is actually the resuscitation of a plan proposed by the IRS a decade ago, but eventually withdrawn in the face of substantial Congressional opposition. Because of the extraordinary negative effect it will have on our economy and on job creation, we hope the same result will occur in 2011.

OVERVIEW

One of the great strengths of the American banking system is its openness to *bona fide* depositors from nations all over the world. U.S. based depository institutions are the repository of literally trillions of dollars of foreign deposits throughout the nation. These deposit flows are particularly important in states such as Texas, Florida and California which have international borders, large immigrant populations, and significant volumes of international trade and travel, as well as other states which meet one or more of these characteristics.

American banks and other financial institutions benefit greatly from this international deposit flow. The communities in which they do business benefit immensely from loan generation, job creation and related economic growth which stem from this form of capital investment.

For as long as the federal personal income tax code has existed, the United States has never taxed the interest earned on these accounts or required their reporting except with respect to Canadian residents. Now, even though the interest earned on such accounts has never been

taxed, the IRS is proposing an extensive reporting regimen on U.S. banks. This will risk the loss of these foreign deposits. Realistically, many of these depositors would fear for their personal safety. Kidnapping is not just a theoretical concern for these depositors. Having their deposit information potentially leaked is a real threat to them.

In addition to the massive capital flight which would result from the adoption of such a regulation, there would be serious impairment to the oversight of international financial transactions since U.S. depository institutions operate under comprehensive rules both as to the establishment and ongoing maintenance of deposit accounts. These laws include "know-your-customer" and anti-money laundering procedures as well as other aspects of the Bank Secrecy and USA PATRIOT Acts.

As noted, only nonresident Canadians are currently subject to reporting on their interest earned on deposit accounts held in the U.S. This experience cannot, of course, be realistically compared with the prospect of sharing specific, individualized asset data with countries which do not possess the same level of public safety and political stability as Canada.

STATUS OF PROPOSED REGULATION

On January 17, 2011, the IRS published this proposed rule for public comment due by April 7, 2011 (76 Fed. Reg. 1105). Hundreds of comments were submitted, most of which were overwhelmingly negative. Among the entities submitting comments in opposition to the proposal were the American Bankers Association, California Bankers Association, Credit Union National Association, Conference of State Bank Supervisors, Florida Bankers Association, Florida International Bankers Association, Independent Community Bankers Association, Institute of International Bankers, New York Bankers Association, and the Texas Bankers Association.

I would also like to point out that the FDIC weighed in against the earlier incarnation of this proposal in a 2003 letter suggesting that no action be taken without a careful study of the potential impact on the U.S. banking system as well as a separate evaluation of the proposal's regulatory impact cost.

When the IRS also held a public hearing on the proposed regulation on May 18, 2011, over 80 percent of the witnesses were against the plan; the volume of written submissions had an even higher ratio of opponents to proponents. The unified message of the public commentary was that the adoption of the proposed rule was marginal, at best, to the effective enforcement of cross-border tax evasion, but highly likely to result in tens of billions of dollars in deposit outflow from the United States.

Notwithstanding the overwhelming level of public opposition, there is no reason to believe, on the basis of Treasury Department actions to date, that there is any intent to back off this highly controversial initiative. It is for this reason that we are asking the Congress to oppose this proposal as it successfully did ten years ago.

SERIOUS ADVERSE EFFECTS ON U.S. ECONOMY AND JOBS

It is essential first to appreciate the sheer size of the market which this proposal would fundamentally alter. While these are difficult times in the U.S. economy, circumstances elsewhere make our country an even greater repository for individuals seeking safety and security. According to data recently released by the Bureau of Economic Analysis (BEA), the value of foreign investments in the United States continued to vastly exceed the value of U.S. investments abroad reflecting an additional $75 billion increase from year-end 2009 to year-end 2010 (www.bea.gov/newsreleases/international/intinv/intinvnewsrelease.htm). The BEA further reports that this change "primarily reflected net foreign acquisitions of financial assets in the

United States that exceeded net U.S. acquisitions of financial assets abroad." (*Id.*) In the aggregate, foreign-owned assets in the United States increased by $1.9 trillion in 2009 and now amount to $22.7 trillion.

As would be expected, the bank segment of these foreign investments is very significant, and, again according to the most recent BEA report "liabilities to private foreign residents reported by U.S. banks, increased $166.6 billion and now total $3.7 trillion." Our experience as bankers indicates that a substantial portion of the $3.7 trillion represents individual NRA deposits or business accounts connected to such individual depositors. This is because customers often place their individual and business accounts at the same bank for a number of reasons, including convenience.

The Treasury Department concedes the vast scope of the U.S. based investments, but argues that "deposits held by nonresident alien individuals are a *very small* percentage of the [total] deposits held by U.S. financial institutions." (*Emphasis added*). No matter how it is subdivided among public, corporate and invidual segments, the $3.7 trillion figure should give everyone pause before proceeding any further on this proposed regulation.

There should also be no confusion about the fact that the imposition of a reporting requirement will be a clear and present threat to the retention of these deposits in the United States. I can tell you from personal experience that the mere announcement of the proposed regulation and its widespread publicity has already generated major concerns on the part of our nonresident depositors. Mexican newspaper accounts are stating that interest earned on banking accounts in the U.S. is already being sent to the government of Mexico and up to 30 percent of current customer calls are inquiries related to this matter. This is also a concern in Latin America and many other parts of the world.

The reasons for these calls and the high level of concern being expressed has little or nothing to do with tax compliance, but are occuring for reasons related to the security of the institutions involved, the physical safe-keeping of the funds, and, depending upon the depositors' domicile, the security of the depositors and their families. Indeed, the personal security implications to individuals and families due to the potential leakage of financial information from tax authorities in certain countries cannot be underestimated. As noted, there is no comparison between Canada and the other countries which could come within the scope of this proposed regulation, e.g., Venezuela.

Although, as the IRS and Treasury officials frequently point out, this proposed rule is directed toward individual deposits, these accounts are often interrelated with business and investment accounts, which, as a practical matter, would also be at risk of leaving the U.S. banking system: a massive multiplier effect. The data is clear as to the large amount of investment accounts that are tied to nonresident alien deposits. So, the risk is not only the outflow of deposits; there is also the potential threat of outflow of other types of investment.

Even if the Treasury Department were correct in the estimates of modest deposit outflows in terms of the total banking system, that overlooks the data showing very high concentration levels in individual banks as well as international branches and agencies located in border areas and other areas with high immigration populations. In some cases, NRA accounts can amount to 30-50 percent of an individual bank's total deposits. At these levels, of course, the liquidity impact could be enormous. The concentration of these deposits in Border States and cities with high immigrant populations is very significant.

While IBC is a profitable and highly capitalized institution, there is also the problem that many institutions in affected locations are under supervisory oversight where added liquidity

pressure could lead to even more serious financial strain. Liquidity destruction is nearly as important as asset destruction. As each of you are aware, liquidity crises have engulfed the world and are presently of serious concern in Europe, especially in European domiciled banks. This is no time to add to already difficult liquidity problems facing banks. Given the breadth of supervisory problems already prevalent in the banking system, not to mention the growing level of political instability throughout the world, this proposed regulation makes even less sense in 2011 than it did ten years ago.

It goes without saying that in all situations, the outflow of substantial deposit accounts can only reduce the ability of local banking institutions to recycle these funds into job-creating loans. Deposit losses would result in even larger losses in funds available for mortgage loans, small business loans and other credit availability. Economic texts routinely state for every dollar of deposits lost, there is a loss of nine dollars in credit. Regardless of whether one holds the view that the U.S. economy is near-recession or near-recovery, there is no reason to take any steps which would affirmatively curtail lending activity, reduce economic growth and kill job creation.

LEGISLATIVE ACTIVITY TO DATE

We appreciate the degree to which Congress has once again stepped forward on this issue in a broad and bipartisan manner, beginning with the March 2, 2011 letter of opposition from every Member of the Florida House delegation. The Texas House delegation is likewise broadly on record in opposition to this proposal through the leadership of Representatives Canseco and Hinojosa. It is certainly no coincidence that every Hispanic Member of Congress from these two States has communicated to Secretary Geithner or directly to the President in opposition to this proposal.

In addition to holding this hearing, we appreciate the April 15, 2011 letter which the House Financial Services Committee, through the efforts of Representatives Posey and Meeks sent to the President. The House Ways & Means and Appropriations Committees have also weighed in against this Treasury-IRS initiative for reasons related to both the flight of foreign capital from U.S. banks and the jeopardy posed to foreign nationals.

It is our view, however, that only legislation that blocks the proposed information reporting regulation from taking effect will return confidence to the community of NRA depositors. Thus, we stand in strong support of H.R. 2568 which would specifically prevent the Secretary of the Treasury from expanding the interest reporting requirements to U.S. banks, credit unions and securities firms regarding nonresident aliens. The Senate companion bill to this legislation has been introduced by Senator Rubio (S. 1506) and currently has the support of 16 cosponsors.

We appreciate that H.R. 2568 lies outside the jurisdiction of the House Financial Services Committee, but the liquidity and safety and soundness of depository institutions reside here as do, of course, economic issues in general. For this reason, we thank you again for bringing attention to this issue through today's hearing and look forward to working with you and your colleagues on the Ways and Means Committee to achieve passage of H.R. 2568.

United States House of Representatives

Committee on Financial Services

"Truth in Testimony" Disclosure Form

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Gerald (Gerry) Schwebel	IBC Bank, Laredo, Texas and other banks

3. Business Address and telephone number:
[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No

6. If you answered yes to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

7. Signature:

Please attach a copy of this form to your written testimony.