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Transcript of May 18, 2011, IRS Hearing on Guidance (REG-146097–09) on Reporting Interest Paid to Nonresident Aliens

THOMAS CARDWELL: Thank you, lady and gentlemen. I'm Tom Cardwell. I am the commissioner of financial regulation for the state of Florida, and I appear before you today as a public official who has the responsibility for the safety and soundness of the institutions that are chartered in our state.

This proposed rule causes me some serious safety and soundness concerns. The United States has long been, as we've heard, the recipient of substantial deposits from our foreign residents. And this is because of the long connection that the state has with Central and South America historically and geographically.

Many of these countries have a history of economic and political instability. There have been regimes that don't follow the rule of law. They're oppressive. The government does not control law and order. Bribery and corruption are common. Individuals have been subjected, as we've heard, from kidnapping, paying ransom, extortion, disappearance, even murder.

Local banking, frankly, is very risky. And it's not to say that these conditions exist at all times in all places, but the issue is that the possibility and the consciousness of the people who live down there, it's always there. And as a result, many of them have established U.S. bank accounts. And it's a competitive advantage, frankly, the U.S. has over other banking systems.

Most of the deposits in Florida, as I've talked to the bankers about it, are longstanding and they're stable. They're not associated with money laundering. They're not associated with other illegal activity. And these are deposits by law-abiding individuals with personal funds and business assets. And they put their money here, frankly, to protect themselves from the economic and political issues that they face, just as I am sure each of us in this room would do if we were subjected to the same considerations.

In Florida, you need to note that the effect of this rule is particularly concentrated, because the institutions in our part of the state have cultivated relationships in that area.

Now, we have done a survey. There are 32 state-chartered banks and 22 foreign banks or banking corporations in the South Florida area over which I have regulatory responsibility. We've gotten data from 16 of the state-chartered banks and 22 of the...21 of the 22 foreign entities. They have about $14.2 billion in deposits in Florida-regulated institutions. And remember, this is only a segment of it, because it doesn't cover the deposits that are either in national banks, that are in state-chartered institutions doing business there, or in federally regulated foreign banks. So the $14.2 billion is, I would suggest, probably less than half of the total that's down there.

The survey shows that, with respect to chartered commercial banks, 41 percent of their total deposits in the commercial banks are NRA deposits. That's 41 percent. With respect to the 21 foreign institutions we regulate, 90. Nine-zero percent of their total deposits are NRA deposits.

Now, I recognize that all NRA deposits are not subject to reporting requirements, that we have made a supplemental inquiry as to the breakdown between individual and non-individual NRA accounts. And while the list is not complete, it shows that something in the neighborhood of about 26 percent of the NRA deposits in commercial banks are individual, and about 31 percent in the foreign banks.

But there's a lot more to the story than just those numbers. Much of this NRA money is a set of interrelated accounts controlled by a single person. So it's common for a person to have a personal account, to have an investment... what they call a PIC account in the business, a private investment company account...to have a corporate account, to have family accounts. These are interrelated.

So what happens is, if you lose the individual account, you lose the whole relationship. In addition to that, there's a large amount of money that these people have in brokerage accounts, not...I don't believe, covered by the reporting rule...but nevertheless, money that's likely to be exported as these relationships move themselves abroad, which they will do.

So what needs to be understood is that the unwillingness to have a reportable individual account often means a loss of the entire relationships in there. Why do we believe the money is going to be run off? Well, that's because the customers of banks, as they talk to me, say that's what their customers tell them they're going to do. We believe it because the rationale behind the accounts is to protect the assets against political, criminal and economic predation.

And if there is the possibility... it's fear that's the issue...if there's a possibility that the account information will be made available, then, to those who would take it...the depositor and their families and their business assets at risk. If your money is at risk, your incentive is to protect it. And that's what they have said they'll do, and I, frankly, believe they will.

All right, let me move on. The effects of the outflow: They are short-term and long-term. First is a liquidity crisis issue. Now, as you all know, when a bank gets deposits, they are not kept as cash in the vault. They loan the money out. Usual ratio is about 85 percent of the deposits are loaned out at any given time. And then they're put in loans, and the loans are illiquid.

So if you can get a deposit runoff of about 15 percent, you can put an economic... an institution into jeopardy. Why? There's not enough money in the vault to pay the... (inaudible)...as it comes out. And what happens to that? As a regulator, I can tell you: The bank fails. It might otherwise be sound, but if it can't pay the people when they ask

for the money, it fails. The FDIC gets to take it over, in the case of the domestic banks, and take the loss.

A run on the banks is one of the regulators' greatest concerns. And even...and this is... this rule causes me a genuine concern that there are...that this will happen. Numbers: If a bank with only 30 percent NRA deposits lost only half those deposits, you'd have a bank at risk. A bank with 60 percent NRA deposits would only have to lose 25 percent. Sixty percent NRA deposits only have to lose 25 percent to be at risk.

And frankly, we have a substantial number of institutions that fit that profile. We've provided you with that information in a supplemental letter. There is a real liquidity risk. This does not make me sleep easily at night.

A runoff on NRA deposits also has long-term effects on safety and soundness. Banks earn money by loaning out at a higher interest rate than they pay for the deposits. The NRA deposits are generally low account...are low-cost funding for the banks, much more so than other sides. If they have to be replaced, even if you could replace them, it would be at a higher level or a cost.

Well, what does this mean? Number one, the bank could make fewer loans. And secondly, it's going to be more difficult for a bank to be profitable, because the spread...the interest margin spread... is going to squeeze. So how does that affect in Florida?

Look, I have personally closed 28 banks in Florida in the last 2 years. Last year, 66 percent of the banks that we regulated were unprofitable. Sixty-five percent of them are under regulatory supervision, as I stand here today. In other words, the banking system in Florida, and particularly in South Florida, is in a fragile state. It is extremely important that the banks be able to have this income to be able to work their way out of the problems that they're in. This rule is quite counterproductive to their being able to do that, because good deposits are going to go away.

There is one other effect on safety and soundness I want to mention briefly, and that is the cost of implementation. Grisel spoke to it earlier. The cost of implementation doesn't fall equally over the industry. It falls on individual banks.

And a lot of these small banks that I regulate don't have the systems in place to do this. It costs them a ton of money to try to comply with this rule. And maybe Bank of America can do it. But the ones that I regulate, which are largely community banks...not going to be able to do that.

Before my time runs out, there's another very important point I want to make, which is the impact on Florida's economy of this rule. As I say, I regulate community banks. Community banks are the guys who go out and make the lending to the small businesses, which is really what we need... a lot of government initiatives to do that, to get it started.

The economic textbooks will tell you that for every dollar in deposits that you have, it generates $9 in lending, so that the shrinking deposit base that this causes magnifies a loss of lending capacity. So let's say there's $14.2 billion in NRA deposits: A 20-percent shrinkage, which is frankly on the low end, would reduce lending by about 25-and-a-half billion dollars. A 30-percent shrinkage would reduce lending by 38.3 billion (dollars).

If as much as half ran off, which is a real possibility, you'd reduce your lending capacity in here by about $63.9 billion, right at a time and a place when, as was pointed out, unemployment's between 11 and 12 percent; 20.4 percent of the residential mortgages in Florida are 90 days more...are due...past due. And 47 percent of all of them are underwater. I mean, we got problems down there.

And this rule is, as it turns out to be focused, is going to cause some real genuine damage in Florida. And I see that as a regulator to these institutions. Now, if I am right, the damage...and I hope I am not...but if I am, the damage will be irreversible, principally because the money, once it flows out, isn't going to come back. Once these things go out, it isn't going to come back.

So I think, before we act on this, we really need a clear vetting and understanding of what is, in the real world, actually going to happen to institutions and people if we put this in place.

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I understand the goal of international tax transparency. And it is something that is very, very, very important. But this rule, as it is drafted, which is not a nuanced rule at all, which does not provide any guidance to the terms, conditions and basis on which information will be disclosed, is something that is simply... how it's going to be shared is a problem.

There is no transparency in this rule. And therefore, a person who is sitting on the other side trying to analyze whether their information is really going to be given out has no way to know, with any degree of assuredness, when, whether and under what circumstances it will be given out. And therefore, the fear alone is going to drive the economic determination.

So at a minimum, this rule could be hugely improved if we understood what it was, when it was, how it was, what the...if a customer and a bank could understand what the risk is, as this rule is applied.

But to this date... and I have personally inquired with some of the people in this agency...what are these terms and conditions that we could look at? And as of yet, I haven't gotten a clear answer. Again, I understand this is a difficult rule. It's...you know, anything that's helpful to some person is often difficult to others. I appreciate your time in listening to us in this and me running over. Thank you.