

COMMENTS RECEIVED FROM NETHERLANDS BANKING ASSOCIATION (NVB)

OECD REVISED DISCUSSION DRAFT ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS – PART II (BANKS) AND PART III (ENTERPRISES CARRYING ON GLOBAL TRADING OF FINANCIAL INSTRUMENTS)

Part II (Banks)

Referring to § 3 this Part II is apparently making the distinction between the basic activity of the banking business of borrowing and on-lending of money on the one hand and other financial activities on the other hand. It follows that there is the impression that there is a link between specific funds borrowed and specific loans granted. In the practice of a multinational operating bank it is usually impossible to find a direct link between one fund within a pool of funds and one loan within a pool or portfolio of loans. Most banks are not only active in assessing credit risk related to granted loans but are also active in *managing credit risk* during the life time of the loans granted as mentioned in §9. This activity is not merely performed on an individual loan basis but usually *on a portfolio basis* (per region or per industry etc). The portfolio risk management is also reigned by the solvency requirements of the home regulator.

Above mentioned portfolio management activity is often performed in centres of excellence (hereafter: CE), in locations, where the market in selling or buying credit risk is most developed (e.g. in London, New York and Hong Kong) in the field of Credit Default Swaps (CDS), Credit Linked Notes (CLN) or Floating Rate Notes (FRN), Letters of Credit (LC) and Risk Allocation Letters (RAL), which instruments are all used to lay off credit risk to third parties. You will find some examples in attachment II.

These credit management activities will often be performed in relation to banking assets of other branches, which could also be located in other countries. In these cases the CE operates in its capacity of protection provider for the group.

During the process of creating the new asset (as mentioned in §8) a branch has to cope with lending limits, collateral constraints, regulatory obligations and internal instructions and therefore it is inevitable that the branch will contact the relevant CE. This could result in a decision that the branch could only take a part of the risk of the loan and should lay off the rest of the risk to one or more branches. CE could decide to lay off a part of the risk of the asset to third parties.

Three different scenarios to lay off credit risks from a branch can be considered:

- CE enters into CDS's with third parties and enters into intergroup (back to back) mirror swap's (compare Part III, § 246 - § 248), guarantees or RAL's in such a way that no residual risk remains in CE, nor in the relevant branch(es). In case of any default CE should pay out to the relevant branch any payments received.

If structured in this way, any (partial) transfer of an asset by the branch to CE would be unnecessary and the related TP issues of such a transfer would be avoided.

If CE finds it necessary to buy credit risk for its own account, it can do so in the market but could also buy extra risk by issuing guaranties (in the form of a RAL) to other branches.

Note:

We can not understand that before mentioned intra-branch guarantees should be denied for fiscal purposes, if they are supported by internal documents like RAL's and the like and are based on a price which is obtained in the market.

- CE enters into partial or mismatched hedge transactions with third parties in the market, with no back to back transactions with the relevant local branch(es) due to lending limits or collateral constraints or regulatory obligations.
If structured in this way, any (partial) transfer of an asset by the branch to CE would be unnecessary as these hedge transactions are not related to any branch in another country for fiscal purposes.
- CE enters into an inter-branch CDS, an inter-branch guarantee or an inter-branch RAL with no external link to the market based on a decision influenced by lending limits or collateral constraints or regulatory obligations.

We are of the opinion that, if an external price is in place or can be obtained (benchmark in the market), the costs of the protection bought should be charged by CE to the branch where the relevant asset is created and booked, leaving CE with a commission or broker fee or part of the interest spread (a credit derivative price), related to the level of transferred risks. Any partial or mismatched hedging should be for the account of CE as part of its own book / position.

Before mentioned contacts between the originating branch and CE should in our opinion not lead to a situation where the asset should be split for tax purposes between two or more branches according to their assumed risk position, as was suggested in in the first draft Part II (§ 140) and reconfirmed in Annex 2 (§ 10) of the latest draft Part II.

Part III (Enterprises carrying on global trading of financial instruments)

With respect to § 250 we would like to refer to above-mentioned comments. We also like to note that risk management techniques can reduce the capital requirements of a branch for its specific assets.