SwissBanking

ASA | SVV Schweizerischer Versicherungsverband
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Discussion draft on Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Recommendations for Domestic Laws)

Dear Mr. Pross,

The Swiss Bankers Association and the Swiss Insurance Association, two leading professional organizations of the Swiss financial center, would like to take the opportunity to comment on Action 2 of the BEPS action plan.

First of all we emphasize that hybrid instruments play an important role for the highly regulated financial sector. Hybrid regulatory capital for banks subject to Basel III and for insurances subject to solvency will be addressed in more detail below, but it is important to recall at this stage some general facts illustrated by an example: most European insurance groups, especially life insurance groups, issue long-term debt instruments containing some hybrid features. The rationale behind it is that such instruments allow raising long-term capital in a form which is more flexible and cheaper than equity, while fulfilling regulatory capital requirements. Such instruments are subordinated to any claim policyholders may have in the case of bankruptcy of the insurance company. Frequently there will be one single issuer of such instruments within an insurance group: this is mainly due to the fact that one is seeking both to achieve the lowest interest rate and to simplify the issuance process to the financial markets. Often such instruments are then lent on a back to back basis to underlying subsidiaries requiring funds.

For the financial sector, operations containing hybrid elements are fundamental to achieve a capital structure in line with regulatory requirements and therefore great care must be taken not to disturb useful mechanisms allowing compliance with regulatory obligations.

We would like to make more specific comments on a number of issues addressed in the discussion draft.

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1. General anti-avoidance rules vs. Rules specifically addressing hybrid mismatch arrangements (page 5)

General anti-avoidance rules are considered to be less effective to fight against hybrid mismatches than rules specifically addressing such arrangements. We doubt it: according to our experience, rules which are difficult to implement are actually less effective than rules that can be more easily implemented. The specific rules addressing mismatch arrangements are complicated and might therefore be difficult to implement. We recognize, however, that any general anti-avoidance rule should be clear in prescribing the exact circumstances when it can be used in order to provide certainty; official guidance might play an important role in this context.

2. Double Taxation (page 12)

We think that through the introduction of an automatism but also because of the complexity of the rules designed to prevent mismatches, there is a risk that taxation might occur twice and that double taxation will not be corrected automatically: according to us, the co-ordination of rules proposed does not represent a well defined process. We do not think that increasing the risk of double taxation is appropriate in a context where globalization takes place to the benefit of all, including of the emerging economies: double taxation might prevent economic development.

Many instruments issued by banks and insurance companies have similar if not identical terms, due to the commercial and regulatory requirements that drive the structure of such instruments. The risk of mismatch or double taxation could be materially reduced if OECD members and treaty partners could set out clearly their tax treatment of particular instruments, e.g. Tier 2 debt instrument issued under Solvency 1, so both taxpayers and tax authorities can directly identify the appropriate tax treatment for both lender and borrower (see also our point on hybrid regulatory capital).

3. Related Parties (page 34)

The 10% threshold for considering a person a related person is too low. We should rather have a 50% threshold, which allows full consolidation according to IFRS. With a participation representing less than 50%, there is no full control and hence no actual possibility to influence. For that reason also, any instrument issued and traded on a recognized stock exchange, as many such instruments are, should be exempt from the hybrid mismatch regulations.

4. Acting in concert (page 35)

We strongly disagree that the simple fact of acting in concert (as well as being related parties) are sufficient to apply the financial instrument rule (§ 125.). This would mean that from the outset related parties or acting in concert are considered as being suspicious and abusive, which implies to take automatic correcting measures, without any further consideration.

5. Definition of structured arrangements (§ 131., page 35)

Concerning the indicator of structured arrangement described at point (a):

"(a) an arrangement which was developed to exploit differences in the tax treatment; marketed as a tax-advantaged product or marketed to investors that would benefit from the tax arbitrage;"

as it is worded, this indicator might be overly broad since it prevents any tax competition, including on the level of tax rates. We consider that tax competition has positive effects and BEPS should not prevent it. The qualification of the tax treatment should be more specific in order to address actual mismatches.

6. Exclusion of certain categories of instruments (§ 145., page 39)

Hybrid regulatory capital should be excluded. As a principle all the instruments implying third parties should be excluded. In all cases, the loans to individuals should be excluded (see also our point on hybrid regulatory capital).

7. "Widely Held" Instruments (page 39 ff.)

It is difficult to find a good definition of "widely held". For that reason we think that it is better to stick to the "third party" concept and as a consequence any instruments issued and actively traded on a recognized stock exchange should be excluded.

8. Hybrid Regulatory Capital (pages 41-42)

Regardless of whether a "bottom-up" or a "top-down" approach is eventually adopted, it is important to note that hybrid regulatory capital deserves to be addressed separately, because it imposed to the business and does not reflect a business choice.

To deal with the issue arising from the fact that "countries have chosen to adopt different positions with respect to its taxation" (§ 159.) guidelines (of the OECD) should be developed or reference to accepted accounting standards (e.g. IFRS, US-GAAP for the definition of interest and the respective interest bearing instruments) should be made. A harmonization of the definitions qualifying the revenues would be the most appropriate way to address mismatches. We understand that for the time being, some banks issue regulatory capital domestically in order both to avoid any mismatch that could occur because of the different positions of countries with respect to taxation (as described in § 159.) and to take due consideration of the own pace of each country for introducing regulatory capital requirements. This represents a pragmatic approach; we do not think however that BEPS, in a globalized economy, should lead to a situation, where the financial sector adopts exclusively domestic solutions.

Banks and insurances should not be restricted in their use of hybrid capital which they need to fulfill their regulatory obligations. They should in particular be able to fiscally deduct a payment regardless of the fiscal treatment of this payment in the country of residence of the investors. Otherwise, in some cases payments made by banks and

insurances are fiscally deductible, whereas the same payment, only because it is made to a different person would not be fiscally deductible: such an approach leads to a non acceptable uncertainty for the business.

Banks have to comply with regulatory requirements with respect to equity such as Basel III, as mentioned in the document. Before having to comply with Basel III they had to comply with Basel II and they might in the future comply with other requirements including those of the Financial Stability Board. In that context new instruments are examined (e.g. bail-in bonds; see the Swiss Financial Market Supervisory Authority FINMA position paper). Insurances have to comply with regulatory requirements with respect to equity such as solvency.

For these regulated instruments, no mismatches are intended, these instruments are meant to fulfill regulatory obligations, they should therefore not fall under the scope of BEPS, a reference to (accounting) standards would however be necessary. We understand that this might take time; we do think however that it is advisable to address the issue properly, which is a challenge in a complex and fast moving environment, rather than trying to adopt rules that might eventually prove to be inadequate.

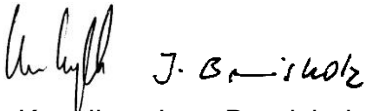
In addition, we would like to mention that regulatory hybrid capital for banks and insurances should not be regarded as constituting harmful tax practices because:

- The debt is issued to the capital markets with no connection between the issuer and the investor.
- Issuers are unlikely to know the identity of the investors in externally issued debt and will not be in a position to enquire about their tax position.
- The interest on such debt is a genuine cost born by the issuer.

To sum up, we are of the opinion that hybrid instruments issued to fulfill regulatory requirements, involving third parties, should not fall under the scope of BEPS. Potential mismatches stemming from the fact that countries have chosen to adopt different positions with respect to the taxation instruments should be addressed through a harmonization of tax qualifications at the level of tax administrations.

We thank you to take due consideration of our submission.

Swiss Bankers Association



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