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Chairman Baucus, Ranking Member Grassley, and Members of the Finance Committee, I am Nancy McLernon, President & CEO of the Organization for International Investment (OFII). Thank you for the invitation to testify on the Administration's proposed "Financial Crisis Responsibility Fee."

The Organization for International Investment (OFII) is the only business association exclusively representing the U.S. subsidiaries of many of the world's largest international companies – or "insourcing" companies. Insourcing companies directly employ over 5 million Americans and support an annual U.S. payroll of over $400 billion. These American businesses generate 6 percent of GDP, produce almost 20 percent of total U.S. exports, and pay 12 percent of total corporate taxes.

Many of our member companies are household names with historic and substantial U.S. operations. The vast majority hail from European Union countries, such as the United Kingdom, France, Germany, Denmark and The Netherlands, as well as from Japan, Canada, and Australia. A full membership list can be found at the end of my testimony.

On behalf of these companies, OFII advocates for the fair, non-discriminatory treatment of U.S. subsidiaries in the United States. We undertake these efforts with the goal of making the United States an increasingly attractive market for foreign investment, which will ultimately encourage insourcing companies to conduct more business and employ more Americans within our borders.

While OFII member companies include a number of bank and non-bank financial institutions such as Barclays, HSBC, Credit Suisse, Swiss Re, Zurich, Allianz and others, *all* OFII members care deeply about the principle of national treatment. It is the United States' adherence to this principle that has made this country the largest host of foreign direct investment in the world. The United States has a long history of according national treatment to insouring companies, not merely because of its obligations to other countries, but because it is in the best interest of the U.S. economy and its workers.

The global coordination of financial regulatory reform efforts is particularly important to OFII member companies because they operate across borders. To that end, ensuring that any "Financial Crisis Responsibility Fee" is properly structured and coordinated with other developed nations that are contemplating similar actions in the wake of the recent financial crisis is of great importance to OFII and will be the focus of my testimony.

Unilateral U.S. Action Could Have Negative Effects

Were the United States to act alone, or differently than other major financial centers, on a financial institution tax or other measure such as the proposed Fee, it could jeopardize not only global businesses such as the ones OFII represents, but also the broader U.S. economic recovery efforts.

At three separate summits in the past two years, the leaders of the G20 reaffirmed their commitment to coordinate financial regulatory reform efforts, avoid protectionism, and prevent regulatory arbitrage. Coordination will be key on any sort of targeted tax or Fee. Uncoordinated and unilateral action would encourage regulatory arbitrage. It would create incentives for the off-shoring of high risk activities to markets that do not impose a tax on such activities. These dynamics would undermine the effectiveness of any tax that the United States or any other country might impose unilaterally.

Moreover, if agreement on imposing such a tax is reached, there also must be coordination on the scope of a tax in order to prevent multiple taxation on global financial institutions. If this were not to happen, it would remove significant amounts of capital from the system, which would materially diminish the needed lending and could slow worldwide and U.S. economic recovery. While recovery efforts have been effective to date, we are not yet clear of the crisis. Introducing a new, uncoordinated tax would create a headwind in the face of our economic recovery.

Given that financial markets are global, if the United States moves alone on a tax it would also tilt the competitive playing field against institutions and investors located in the United States, including U.S. subsidiaries of companies headquartered abroad. This could discourage investment in the United States and thus further slow our economic recovery efforts.

Absence of G20 Consensus on Purpose of Financial Institution Tax

Although the G20 has agreed on underlying principles for financial reform, it has not yet achieved consensus on the form, purpose, or use of a tax such as the proposed "Financial Crisis Responsibility Fee". Indeed, the G20 has not yet achieved consensus on whether a financial institution tax is an appropriate element of regulatory reform in the first place.

Last month in Washington, the G20 Finance Ministers discussed developing a global tax. Clear divisions emerged at the Finance Ministers' meeting, and G20 countries' disagreement on the issue continues to be aired in the press. A number of G20 members, including Canada, Australia, Japan, and the BRIC countries (Brazil, Russia, India, China), have expressed strong reservations about the wisdom of a tax. Singapore and Switzerland, two non-G20 countries with major, attractive global financial centers, have also voiced concerns.

Even among those countries that support a financial institution tax or fee, there is no consensus about the type of such a levy. A report sent to the G20 last month from the International Monetary Fund (IMF) highlighted these differences, and various approaches were debated at the April G20 meeting in Washington.

While the competing approaches have yet to be fully spelled out, it is clear that a number of points of disagreement are emerging. For example, there is significant disagreement about the appropriate use of any targeted tax revenues. The United States and others have supported the creation of a "work-out" or "resolution" fund for winding up failing institutions. On the other hand, the United Kingdom and France, among others, have voiced strong opposition to a dedicated fund, fearing that it would exacerbate the threat of moral hazard by insuring the financial markets against their own excessive risk-taking. Not only is there disagreement about the purposes of or uses for any tax, there is also disagreement about which entities should be taxed – whether all banks, large diversified financial institutions, or insurance companies should be included.

Further, this lack of consensus is not limited to G20 discussions. At a recent meeting of the Economic and Financial Affairs Council (ECOFIN) of the European Union, the United Kingdom, France and Austria all opposed efforts by the European Commission to establish a crisis management fund that could be used for the orderly resolution and winding up of failed financial institutions. In fact, only Sweden and Germany supported the Commission's proposal. At the same meeting, the United Kingdom and France expressed support for a tax on financial transactions, while Finland, Sweden, and European Central Bank President Jean-Claude Trichet all opposed such a levy.

As you can see from these examples, there is no consensus even among those countries or institutions that favor some kind of a tax. It is also noteworthy that Canada, Australia, Japan and other major developed countries do not support imposition of a targeted tax at all, and do not intend to adopt one. Likewise, major emerging markets like China, India and Brazil are firmly opposed to burdening their financial institutions with a new systemic tax.

In the face of this lack of agreement, the G20 Finance Ministers decided to defer action until the IMF and other international organizations have time to study more fully the potential effects of such a tax.

Interaction of Any Tax with Other Financial Reform Efforts

It is also questionable whether imposing a new tax is the appropriate next step in financial reform. The leaders of the key institutions charged by the G20 with formulating the new financial reform rules—Mario Draghi, Chairman of the Financial Stability Board (FSB), and Nout Wellink, Chairman of the Basel Committee on Banking Supervision (BCBS)—have encouraged the G20 to undertake further study and to finalize new capital and liquidity rules *before* tackling a tax.

Before the G20 meetings, FSB Chairman Draghi warned that "[t]he cumulative impact on the system of the . . . proposed reforms will need to be carefully considered, in order to lessen the risk of unintended consequences and to counter financial industry claims that the reforms could derail the economic and financial recovery."

Following the G20 meetings, BCBS Chairman Wellink suggested that "[w]hat we should do first is finalize the [Basel] process . . . [T]hen we can ask ourselves if national proposals are still necessary and useful."

Before adopting a tax, the United States and its G20 counterparts need to understand better how the tax would interact with the other financial reform initiatives, such as new capital and liquidity rules that are also being considered.

Scope of U.S. Financial Institution Tax

If the United States nevertheless decides to impose a bank tax unilaterally, despite the known and unknown adverse consequences of uncoordinated action, it is important that the tax be structured carefully. In particular, a tax on insourcing financial groups should be based only on their U.S. operations. If a U.S. tax were to be imposed on the worldwide operations of insourcing financial companies, its negative effect on the competitive and diplomatic position of the United States could be dramatic.

In particular, because other countries such as the U.K. and Germany are considering their own versions of a targeted tax, there is a critical risk of double (or triple or more) taxation if each country were to tax worldwide operations. A failure by the United States to adopt a "water's-edge" limitation on the application of such a tax to insourcing financial groups would inevitably lead to multiple taxation as soon as any other country imposes a tax of its own, even if that country limits itself to taxing activity in that country alone. The problem grows far worse if the other country also imposes the tax on a worldwide basis, and multiplies with every additional country that decides to get into the financial institution taxing game.

Historically, the United States has limited the taxation of all insourcing companies to income derived from, and proportional to, activities that have a nexus to the United States. It has done so for many reasons, including (i) Constitutional

considerations, (ii) the principles of international law, (iii) political and diplomatic imperatives, and (iv) economic theory. For example, U.S. law limits the federal income taxation of insourcing companies to U.S.-sourced income that is effectively connected with the conduct of a U.S. trade or business—all items that have an obvious nexus to the United States. Even the occasional proposals to replace this system with a worldwide unitary approach have recognized the need to prevent double taxation by apportioning the tax based on an insourcing companies' actual connections to the United States.

Because taxes or fees of the type under discussion do not appear to qualify as income taxes, neither the U.S. foreign tax credit system nor the double tax mitigation provisions of U.S. tax treaties would provide any relief from such double or multiple taxation. Importantly, the resulting disproportionate burden on insourcing financial companies would tend to discourage overseas financial institutions from participating in the U.S. lending and capital markets—at a time when both Congress and the Administration are justifiably concerned about a dearth of liquidity. In addition, such disparately burdensome treatment might give rise to plausible claims of prohibited discrimination under the many tax treaties and friendship, commerce and navigation treaties to which the United States is a party.

An insourcing financial group only benefits from access to the U.S. market, and, in the case of banks, is only subject to U.S. banking regulation, to the extent of its activities within the United States. Its liability for a tax should be similarly limited in order not to fail a standard of fundamental fairness. Thus, it is imperative that if the United States were to adopt some sort of targeted tax, its application should not be based on the worldwide operations of insourcing financial groups.

Next Steps

At this stage, further study by the IMF, FSB and BCBS is needed before the G20 countries consider adopting a global tax. In particular, these institutions need to closely examine the inter-linkages between a tax and other proposed regulatory reforms. Rather than unnecessarily add to the complexity of current reform efforts, the U.S. and the G20 should prioritize and complete the immediate – and difficult – task of establishing new capital and liquidity rules before developing a global tax on financial institutions.

But even if countries decide to proceed with a targeted tax before these other reforms are complete, any tax must be coordinated among them. G20 countries need to come to agreement on the form, purpose, and use of any tax—and that consensus needs to be reached before any individual G20 country adopts such a tax. There can still be room for variation across countries as appropriate, but agreement on the fundamental principles underlying a such a tax is necessary to ensure its effectiveness.

Given the possibilities of regulatory arbitrage, duplicative and contradictory regulations, and adverse competitive impacts, OFII believes that the United States should implement any tax or other fundamental changes only when other major financial centers are prepared also to adopt comparable measures on a coordinated basis. Going it alone is not in the United States' interests in this globally interconnected economy.

OFII is the only business association in Washington D.C. that exclusively represents U.S. subsidiaries of foreign companies and advocates for their non-discriminatory treatment under state and federal law.

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