The Two Greatest Threats to the Banking Industry
Part II: Tax Reformation and Offshore Banks

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NET(net), Inc. + 1 (6 1 6) 5 4 6 - 3100

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Ahead of the Market, Behind the Deal.

NET(net), Inc. 217 East 24th Street - Suite 010 Holland, Michigan 49423

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To say the political landscape in the United States is tumultuous right now might be the understatement of the year. Even with one party controlling both the Executive and Legislative branches of the government, the party in power has shown little ability to get anything done on their own stated agenda. However, there is one glaring opportunity that most politicians will not be able to resist, and that's the chance to overhaul or at least impact the U.S. tax system. Lowering taxes is typically a very popular measure for most politicians, and both major U.S. political parties will want in on the action. Beyond the obvious lowering of taxes across the board, there is a 'Golden Parachute' of sorts being dangled out to U.S. Corporations – which is a onetime exemption to bring cash and profits back the United States with minimal tax exposure. When that happens (which we predict it will), the implications for Banking and Financial institutions with offshore presence will go far beyond the Panama Papers.

If the tax implications weren't enough, traditional banks already face a fight for their life from non-banks performing the same services (re: Fidelity), security issues and breaches (e.g., Equifax), and their desire to become 'Digital Banks' (a challenge we discussed in Part I of this series - click here to view).

The competition is stiff, and only going to get stiffer, so the time is now for Banks to prepare for what is coming with tax changes, especially to those that are either operating wholly offshore, or even those that just have an offshore presence. On the day the U.S. President signs tax reform into law, bankers around the world will hear a whirring sound start to originate from North America which will be a giant vacuum cleaner sucking Trillions in US Dollars back home.

How Bad is It?

Let's just start with the raw numbers. Most estimates put the number of US Dollars being hoarded overseas by U.S. based companies at over $2.5 TRILLION. Let's write that out for impact: **$2,500,000,000,000.00**. In terms of GDP, this would basically tie the United Kingdom as the world's 5th largest economy (USA, China, Japan, and Germany as 1-4). This number should also be a huge clue as to why the politicians will want to get this done. The revenue windfall to the government coffers will be enormous – which is why we stated previously – both political parties will want in on the action. While not the entire amount will likely go back the U.S., even if we do the rough calculation based on that assumption: 5% of $2.5T would be **$125B in new tax revenue**. According the U.S. CBO (Congressional Budget Office) historical tables, that $125B would be almost half of all the $300B Corporate taxes collected by the US Government in 2016. This represents the third largest revenue line item to the US Government:

Revenues	Dollars (Billions)				Share (% Total Revenue or Spend)			% GDP		
	FY2015	FY2016	$ Change	% Change	FY2015	FY2016	Change	FY2015	FY2016	Change
Individual Income Taxes	1,541	1,546	5	0%	47.4%	47.3%	-0.1%	8.6	8.4	-0.2
Payroll Taxes	1,065	1,115	50	5%	32.8%	34.1%	1.3%	6.0	6.1	0.1
Corporate Income Taxes	344	300	-44	-13%	10.6%	9.2%	-1.4%	1.9	1.6	-0.3
Excise Taxes	98	95	-3	-3%	3.0%	2.9%	-0.1%	0.5	0.5	0.0
Estate and Gift Taxes	19	21	2	11%	0.6%	0.7%	0.1%	0.1	0.1	0.0
Customs Duties	35	35	0	-1%	1.1%	1.1%	0.0%	0.2	0.2	0.0
Miscellaneous Receipts	147	156	9	6%	4.5%	4.8%	0.2%	0.8	0.8	0.0
Total Revenues	**3,250**	**3,268**	**18**	**1%**	**100.0%**	**100.0%**		**18.2**	**17.8**	**-0.4**

Who Is Doing It?

Basically…..everyone. We estimate that a full 75% of the U.S. Fortune 500 is hoarding cash in offshore banks and financial institutions. According to Bloomberg, the top 5 US companies are tech related, and gives you a great example of how far reaching offshore tax avoidance really is:

1. Apple: $239B
2. Microsoft: $122B
3. Cisco: $65B
4. Alphabet: $55B
5. Oracle: $52B

And of these top 5 – all increased their offshore holdings by double digits YoY from 2015 to 2016. Interesting that while the US leads the world in Technology Spend, the very companies that we spend it with are the leading the world in offshoring revenue, and deferring tax liability until such time as those monies are repatriated (if ever). Not Exxon-Mobile, not Walmart, or even Berkshire Hathaway which lead the F500 in size – but American Tech Companies. But they are not alone – many other stalwart brands show up on the list including Coca-Cola, Amazon, Visa, P&G, and even Facebook who have increased their overseas cash by 238% YoY.

The Banking Challenges

The challenges are many, and are only going to be compounded in the near term. Our own research shows that the ***banking sector already ranks number 2 out of 29 on our list of industries that overpay for technology***. There is a myriad of reasons for this:

- Banks tend to be highly insular and seek advice and examples within their own industry. For example, a bank that thinks they may be overpaying – seeks the advice or ‘Benchmark’ of another bank and thinks they are paying what the market does. In reality, they are simply overpaying like the others, and not looking at the entire IT Market for guidance.
- Large ‘legacy’ foot print. There are institutions out there that have a technology mindset that started in the 1960’s and still exists today. In other words – it’s the old “that’s how we do it here” and unfortunately that means it may not have changed since 1965.
- Highly Operational. Staying with incumbent suppliers creates (for a time) operational stability, but is quite ‘unstable’ for the business when it’s time to cut costs or transform.
- Centralized Procurement teams in place that may be overly cautious on preserving the status quo and operational stability, over innovation and cost reduction.

- Linear 'Think'. We view these types of buyers who equate scale with purchasing power, which we have found to be wrong, and in the end, a very costly approach
- Regulations. There are many, and this does in fact often hamper innovation and restrict ways in which companies can operate. That said, there is NO industry that should pay a premium for services that others pay just a fraction of for the same technology.

On top of these numerous hurdles, now comes government change that will add to this already large list of reasons why many offshore banks, or those with offshore entities will hemorrhage technology budget, and whose performance will hamper any plans banks must continue climbing that 'Digital Bank' mountain:

1. Regulatory Changes
    - With any tax changes, are surely going to come changes in US regulations, that will have a ripple effect and be emulated on the International Bank stage. Given that banks play a central role in not just their own business, but that of all its clients, it can change the very way in which banks manage their own Profit and Loss statements. Changes to liquidity requirements, corporate tax withholding, loan management, and various Ratio requirements all contribute additional costs in capital, cash, and people. All of which will require existing technology be updated, and new technology (software) introduced to deal with and comply with these regulations.
2. Closure of Tax Loopholes
    - A condition of any 'Tax Holiday' or a onetime opportunity to repatriate cash from overseas, will no doubt include the closure of certain loopholes that enabled the movement of money to begin with. It can be argued that over time, new loopholes will be made into law, but any of these changes immediately make offshore tax havens less appealing.
3. Increase in Cross Border Costs
    - New rules may be put into effect that will cause changes to cross border business processes and cost that banks incur, which will be another dis-incentive to move money around internationally.
4. Loss of Cash and Capital
    - As the balance sheets of offshore banks and entities vaporize, so too will their ability to operate and do business – especially at current levels of spend.
5. Localized Economic Impact
    - As Offshore Banks lose assets, the impact on local economies could also be significant. When banks shutter, pull out of a country, or significantly downsize, there are human consideration as well as business. There are fewer jobs, less money to loan to local businesses, and overall fewer depositors to keep the economy moving. After the banking collapses of 2008, several offshore havens became severely depressed in the aftermath as their entire economy was built around catering to the financial sector.
6. Competition and Risk from Shadow Banking Industry
    - Its estimated that the Shadow Banking Industry now claims $18 Trillion in assets versus regulated Commercial Banks at approximately $16 Trillion. This industry is only growing and serves as competition to Commercial Banks who have comply with regulators and other entities to continue doing business. Not so with Shadow Banks – so while

commercial banks may benefit short term with some lifting of regulations, they will still have to complete with one arm tied behind their back.

7. EU and US Banks Using Tax Havens
    - Let's not forget as well that banks are also a business beholden to the 'tax man', and they too have been hoarding cash overseas. According to an Oxfam report, in 2015 European Banks stashed as much as 26% of their profits overseas. This will be a risk as some of these banks become untenable and tax havens become less available with more regulations, and less inventive to use them. According the Citizens for Tax Justice, as of 2016, the following banks and financial institutions are invested heavily 'offshore' tax havens (name and number of offshore entities located in tax havens):
        - Goldman Sachs 987
        - Morgan Stanley 669
        - JP Morgan Chase 385
        - Bank of NY Mellon 188
        - Citigroup 140
        - Bank of America 109
        - PNC Financial Services 92

Of the companies with tax haven subsidiaries, **banks and financial first own 4 of the top 5.**

Optimizing Your Technology Supply Chain in These Market Conditions

Now more than ever, international banks with operations in foreign markets (tax havens) must take steps that plan for a major loss of investment and revenue. Nowhere is there better opportunity to cut immediate cost than the technology supply chain of these institutions. As we've stated previously, banks more than any other industry (healthcare is close) overpay for technology by a factor of 10 over other commercial enterprises. With one global bank, with one supplier alone, NET(net) mitigated over $40m USD in spend within 60 days of being introduced. The fact of the matter is, that situation is not an anomaly – but the reality for banks.

Let's take a quick look at the numbers this savings opportunity represents. For the sake of this conversation, we'll say that the average Financial Institution spends 7.5% of its revenue on IT - depending on the source, it can be anywhere from 6% to 8%. It was reported by Bloomberg in April that JP Morgan will spend **$9.5B** or roughly 8.76% of revenue on IT.

Bank	Country	Revenue
ICBC	China	$134.8B
BNP Paribas	France	$126.2B
China Construction Bank	China	$113.1B
Banco Santandar	Spain	$108.8B
JP Morgan Chase	USA	$108.2B
Societe Generale	France	$107.8B
HSBC Bank	UK	$104.9B
Agricultural Bank of China	China	$103.0B
Bank of America	USA	$100.1B
Bank of China	China	$ 98.1B
		$1.4 Trillion
	Average IT Spend at 7.5%	**$105.3 Billion**

We see an average of 30%+ of overspend, but even if we go conservative and say it's less than that, the numbers are still staggering:

15% Overspend: $21B

20% Overspend: $15.8B

30% Overspend: $31.6B

Remember, these numbers only look at the top 10 global banks by revenue. When we look at the entire industry, we are talking about numbers that could fund many *countries* for years. This same principle certainly applies to Banks that will be impacted by tax reforms and legislation both in the US and around the world.

While the world's focus on tax reform shines a light on how much cash corporations and people are hoarding in overseas banks and tax havens, not enough CEOs are looking at how much cash their own organizations are helping technology suppliers to hoard. It's not a coincidence that we earlier pointed out that some of the largest offenders of hoarding profit in tax havens are TECHNOLOGY SUPPLIERS! Do you ever wonder where they got all that cash to stash? From you.

To say there is uncertainty in what's to come for the Banking and Finance industry, is an understatement. In Part I of this series we discussed the challenges facing the move to becoming a true Digital Bank:

- People and Culture
- Innovation
- Technology Investments
- Legislation and Regulation

Those alone should be a sufficient amount of challenge for any industry, but now we can layer on US Tax Reform and the impact to Offshore Banking entities around the globe. Leadership will have some tough decisions to make in the coming months that will have an impact for years to come. The question is, will those decisions enable the enterprise, or disable it.

There is no question that within the Technology Supply Chain, opportunity exists wherein companies can empower the changes that are coming, rather than hinder it. Technology Suppliers are not in the business of helping organizations through change with charitable contributions and write downs of business without getting something in return.

This is where NET(net) will make the difference. We can assess and structure any environment and agreement that will not only future proof the enterprise, but also yield both short and long-term savings out of the current spend. On average, most Banking and Financial Institutions are paying a 40% to 50% premium for technology which in and of itself is bad enough. However, when you factor in the potential for massive change as articulated in this Whitepaper series, continuing to overpay is not an option. Call or write us to engage in an assessment of your immediate challenges, and let's roadmap how we'll find overspend and accelerate your transformation immediately.

About NET(net)

Celebrating 15 years, NET(net) is the world's leading IT Investment Optimization firm, helping clients find, get and keep more economic and strategic value. With over 2,500 clients around the world in nearly all industries and geographies, and with the experience of over 25,000 field engagements with over 250 technology suppliers in XaaS, Cloud, Hardware, Software, Services, Healthcare, Outsourcing, Infrastructure, Telecommunications, and other areas of IT spend, resulting in incremental client captured value in excess of $250 billion since 2002. NET(net) has the expertise you need, the experience you want, and the performance you demand. Contact us today at info@netnetweb.com, visit us online at http://www.netnetweb,com, or call us at +1-866-2-NET-net to see if we can help you capture more value in your IT investments, agreements, and relationships.