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Perspectives on Foreign Banking in the United States

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PERSPECTIVES

Perspectives on Foreign Banking in the United States

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I. THE GROWTH OF FOREIGN BANKING

Foreign banking has had a great expansion in the United States. This evolution has been accompanied by a variety of questions and concerns on the part of the public, American legislators and regulators, and American bankers. Many of these concerns have been allayed by the passage of the International Banking Act.[1] Some nevertheless remain. To evaluate them, I will begin by setting forth the benefits that foreign banks have brought to the United States. Then I will take a look at the principles that have guided and, I believe, should continue to guide United States' policy in this regard.

Foreign banks have made major contributions to the American financial scene. Over the last nine years, the number of foreign banking offices in the United States has grown from about 120 to just over 500. The volume of their assets has grown from about $30 billion to about $290 billion.[2] This means a rise from less than four percent of total

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† The original manuscript was submitted for publication in 1983.

1 International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1979) (codified in scattered sections of 12 U.S.C. (1982)).

2 The author obtained these figures from unpublished tabulations. For comparable data cover-

banking assets to about fifteen percent over these nine years. If we apply these ratios to the foreign banks' share in the assets of all depositary institutions, the increase has been from about 2.5% to about 10%. Given the prospect for increasing "homogenization" of depositary institutions in the United States, the more broadly based ratios are perhaps the more meaningful ones.

In evaluating growth of a market share, one should bear in mind that growth, after overcoming some initial obstacle, tends to accelerate to a maximum and then to slow down. Growth rates are highest when they

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ing the period from 1972 to 1980, see Houpt, *Foreign Ownership of U.S. Banks: Trends and Effects*, 14 J. BANK RESEARCH 144, 145 (1983):

Figure 1. Total Assets of Foreign Controlled U.S. Banking Offices.
(Amounts in billion $)

	1972		1980		Increase 1972-80	
Office	Assets	Number	Assets	Number	Assets	Number
Branches and agencies	$22.2	76	$148.0	322	$125.8	246
Subsidiary U.S. banks	4.7	34	65.4	104	60.7	70
Total	26.9	110	213.4	426	186.5	316
Percent of domestic banking industry[1]	3.6	.8	12.5	2.8	8.9	2.0

[1] The denominator is total domestic assets of all U.S. insured commercial banks, plus those of U.S. branches and agencies of foreign banks.

Figure 2. Domestic Assets of U.S. Banks Controlled by Foreign Parties, 1972-80.
(Dollar amounts in millions)

	Method of acquisition[1]						Foreign-owned banks as a percent of all insured commercial banks	
	De Novo		Purchase or Merger		Total			
Year	Domestic assets	Number of banks	Domestic assets	Number of banks	Domestic assets	Number of banks	Domestic assets	Number of banks
Foreign-owned banks at December 1972	4,364	28	290	6	4,654	34	0.62	0.23
Annual increases								
1973	...	1	40	1	...	2	...	...
1974	...	8	5,450	4[2]	...	12[2]	...	...
1975	...	0	932	3	...	3	...	...
1976	...	1	3,300	11	...	12	...	...
1977	...	4	1,490	10	...	14	...	...
1978	...	3	1,014	14	...	17	...	...
1979	...	0	9,889	12	...	12	...	...
1980	...	0	12,565	8[5]	...	8	...	...
Foreign-owned banks at December 1980	[3]	[3]	[3]	[3]	65,419	104[4]	4.26	0.71
Pro forma with Crocker and Financial General					83,403	118	5.44	0.82

[1] For banks merged or acquired, assets shown are as of year-end preceding foreign acquisition. Because *de novo* banks are, by definition, newly formed, they have no assets to show for that date.

[2] Includes Franklin National Bank ($3.8 billion).

[3] Cannot be determined because of mergers of *de novo* banks with banks previously owned by U.S. parties.

[4] The number of banks does not equal the sum for the individual years because of mergers.

[5] Includes Marine Midland ($11.1 billion—domestic assets only).

are measured from a small base. For example, penetration of foreign markets by American banks abroad, which, of course, began long before foreign banks started to expand intensively in the United States, now has slowed. I expect that the progress of foreign banking activity in the United States will follow a similar pattern.

Foreign banks, and their home countries, have benefited from entry into the United States in ways as varied as their reasons for entering. Foreign banks have been better able to serve their home-country customers as the latter expanded their international operations. They have gained direct access to the largest economy in the world. In some cases, they have made attractive acquisitions by being able to buy the stocks of American banks at depressed prices. And, before the passage of the International Banking Act, and in a small degree even thereafter, foreign banks have enjoyed competitive advantages with respect to American banks regarding interstate banking. Through grandfathering—the practice of allowing the continuance of already existing institutions and arrangements that otherwise would violate new law and regulation—some of these earlier advantages have been preserved.

II. The Benefits Brought By Foreign Banking

Foreign banks have brought many important benefits to the United States. In the domestic sphere, they have brought innovation and increased competition. For example, they have introduced new pricing techniques. At a time when prime-rate pricing of loans had become increasingly less consonant with the realities of the marketplace and, unfortunately, with the realities of inflation, foreign banks helped to bring about alternative pricing techniques, such as pricing on the London Interbank Offer Rate (LIBOR) and other money-market rates. Also, at a time when the capital position of many large American banks was becoming increasingly strained, foreign banks contributed to the capitalization of several United States banks through acquisition. Even when foreign banks entered as branches and agencies rather than through acquisition, they nevertheless contributed, by virtue of their home-office capital, to the total capital base underlying the structure of bank deposits in the United States. In some cases, foreign banks also have played a significant role in meeting banking needs of particular ethnic groups in the United States.

Before the passage of the International Banking Act, it was sometimes thought that foreign banks, by taking advantage of the opportunity for multi-state operations, might spearhead a relaxation of restraints on the geographic expansion of American banks. While the International

Banking Act took the opposite approach, by limiting multi-state activities of foreign banks rather than easing restraints on American banks, the continuing wide-ranging discussion of the McFadden Act may have gained impetus from the earlier example of foreign bank multi-state expansion.

In addition, foreign banks have on occasion helped to resolve problems created by American law with respect to the acquisition of problem banks. Large problem banks in some cases could not have been acquired by American banks because of the prohibition on interstate mergers and acquisitions, or because of the limitation on anti-competitive mergers and acquisitions within individual states. I must add that this represents only a relative benefit for the United States, given that it provided a solution to a problem that was clearly of American making.

Foreign banks have also brought advantages to the United States in the international sphere. In trying to create a stronger dollar base for their own international operations, foreign banks have helped to solidify the international role of the dollar. The strengthening of the commercial role of the dollar and the enhancement of American banking markets as world financial centers, together with the implied expression of confidence in the dollar and in the United States' economy generally, are heartening, even though under a regime of floating exchange rates the United States no longer has a strong interest in the reserve currency role as such of the dollar. Together with the expansion of American banking abroad, the growth of foreign banking in the United States has helped to round out the process of integration of the United States into the world's financial system.

III. A Dollar Base

Since creation of a dollar base is so often mentioned as an important motive for entry into the United States by a foreign bank, I will digress for a moment on this topic. It is, of course, understandable and, indeed, desirable for a nondollar bank that makes dollar loans and issues dollar liabilities in international markets to seek reliable access to dollar funding. A presence in United States financial markets can be helpful in this regard. Whether that presence is in the form of a subsidiary, a branch, or an agency, the entity can have access to a very large and flexible market. The flow of funds into this market comes from many sources and provides very elastic accommodation to a reputable borrower.

United States subsidiaries of foreign banks have access to the discount window of the Federal Reserve like other American banks. Since the passage of the International Banking Act, United States branches and agencies of foreign banks also have had access to the discount window. Access of agencies and branches is governed by the principle of "national treatment" which means that foreign banks' access will be on the same terms as access of a domestic bank. These entities, like their United States counterparts, can use the discount window to meet short-term liquidity needs after reasonable alternative sources of funds have been fully used. As a practical matter, foreign-related institutions have rarely had the need to turn to the discount window. They cannot expect to draw on this source, for instance, to meet obligations of a foreign parent or head office. Indeed, where United States-chartered subsidiaries of foreign banks are concerned, as is the case of domestic bank holding company subsidiaries, the regulatory authorities expect the parent to be a source of strength to its subsidiary bank in the United States. United States regulatory authorities seek to maintain information adequate to demonstrate that this is the case. Flows of funds between the foreign parent and its United States subsidiary are monitored through the confidential Y-8F report while a similar confidential schedule in the quarterly condition report is maintained for branches and agencies.

IV. National Treatment

The openness of the American economy to foreign banks is exemplified by the principle of national treatment underlying the International Banking Act. Foreign banks are allowed to do in the United States what American banks are allowed to do. The United States does not place greater limitations on foreign banks than on domestic banks, as some countries do, sometimes to the extent of totally excluding foreign banks from the local market.

National treatment, nevertheless, cannot cross every T and dot every I. The practice of grandfathering has given some foreign banks competitive advantages with respect to American banks and foreign banks entering after the date of the International Banking Act. More liberal bank legislation and regulation abroad, moreover, can carry over to the benefit of foreign bank operation in the United States. Differences in capital ratios, in reserve requirements, and in the scope of permissible activities may affect funding costs and competitive relationships of their foreign subsidiaries and branches. Perfection must not be looked for in this field.

The United States treats foreign banks in the way it does because it is beneficial to the United States. The benefits that I have listed do not depend on reciprocity. It is sometimes thought that "concessions" made to foreigners are beneficial only if matched by reciprocal concessions from the other side. This may be a concept carried over from reciprocal trade negotiations, in which concessions of hopefully equal value are exchanged. But while reciprocity may be an effective technique for extracting benefits for American exporters and for the American economy, it is not a proper rationale for either United States trade policy or banking policy. The benefits to the United States of buying foreign goods and foreign banking services are the same, whether or not there is reciprocity. The American consumer receives cheaper and better goods and services. American producers and bankers are led to concentrate on activities in which they are more productive. A foreign country refusing to offer reciprocity in the treatment of foreign goods and services injures primarily itself. In principle, absence of reciprocity is not an economically valid reason to provide less than national treatment to foreign goods and foreign banking services.

Nevertheless, the absence of reciprocity in offering national treatment is not optimal. The country denying such reciprocity to the United States damages not only itself but also American exporters and American banks. Such a country fails to make its fair contribution to the achievement of an integrated world economy. Its action creates disappointment and frustration because a constructive policy on the part of the United States did not encounter a response in kind.

V. Supervision of Foreign Bank Holding Companies

Under the law, responsibility for the supervision of bank holding companies has been assigned to the Federal Reserve Board.[3] That responsibility runs to all bank holding companies whether domestically or foreign owned.

The Board outlined its approach to the supervision of foreign bank holding companies in a policy statement issued in February 1979.[4] The central theme of that statement is that the Board's primary concerns are with the operations and activities conducted in the United States and that its supervisory efforts would be so directed. The Board's interest in the foreign parent organization or the foreign owners lies principally in their capability to serve as a continuing source of strength to the banking operations in the United States.

Since that statement appeared three and one-half years ago, the Board has implemented it in several ways.[5] First, before approving the

[3] 12 U.S.C. § 1841 *et seq.* (1982).

[4] Press Release of the Board of Governors of the Federal Reserve System (Feb. 23, 1979), *reprinted in* 1 Fed. Reserve Reg. Service ¶ 4-835.

[5] 12 C.F.R. § 255.5(b) (1983) as authorized by the Bank Holding Company Act of 1982, 12

establishment of a foreign bank holding company, the Board assures itself of the financial and managerial resources of the foreign organization. Second, the Board has established annual reporting requirements through which foreign bank holding companies submit information that permits the Board to appraise the financial condition of the foreign organization on a continuing basis. Third, a reporting system has been put in place that monitors transactions between the United States bank and the foreign parent organization on a quarterly basis. Fourth, foreign bank holding companies are required to report any nonbank activities commenced in the United States and the authority under which they are undertaken.

A primary supervisory tool in the case of domestic bank holding companies is the examination or inspection process. It is also an important supervisory tool in the case of foreign bank holding companies, although there are some differences in the ways it is employed.

For the most part, foreign bank holding companies are foreign banking organizations. As such, they are usually the major banks in their home countries, they are supervised by foreign banking authorities, and they have a recognized reputation in the international market place. These banks acknowledge that they are guests in this country and are anxious to remain in good standing by adhering to the rules and regulations to which they are subject. For these reasons, the Board has not been confronted with serious problems in supervising the United States activities of these companies.

By contrast, where United States banks are controlled by foreign individuals, certain supervisory problems do arise. One relates to the initial entry of the foreign investors in seeking to acquire or establish a bank. Another problem relates to the supervision of the continuing operations of those banks, once they have been acquired. It should be noted that these problems also exist when domestic individuals acquire banks.

On the whole, the banks owned by foreign individuals have been managed well and have posed few supervisory problems; however, there have been exceptions.

VI. CONCERNS ABOUT FOREIGN BANKING

Occasional disappointment and frustration about foreign reaction to United States entry policies would be less serious if other circumstances that cast a shadow upon the very open policy of the United States in the

U.S.C. § 1844(c) (1982) and the International Banking Act of 1978, 12 U.S.C. §§ 3106, 3108(a) (1982).

banking area did not exist. Banking, whether we like it or not, is a sensitive business. That is documented by the heavy regulation imposed in the United States and elsewhere, to a degree. Foreign ownership touches particularly sensitive nerves in many places. Some in Congress and various elements in industry and the general public are concerned that, despite the International Banking Act, foreign banks may continue to enjoy legal advantages over American banks. These groups fear that in some cases a foreign owner may abuse his bank for the benefit of his other business interests. They believe that some foreign banks may be less responsive to the needs of local communities and other customers that were served by the bank before it came under foreign control. With the advent of control over banks by foreign governments that may employ these banks in pursuit of political objectives, new concerns could arise.

The available evidence goes far to allay many of these concerns. Such attentions are mainly directed toward that portion of foreign banking activity in the United States that is conducted through United States-chartered subsidiaries. This amounts to about one-quarter of the total, whereas the remaining three-quarters is conducted through agencies and branches. The United States-chartered subsidiaries in many instances do a retail business, which serves to focus most of the existing uneasiness on them. By contrast, agencies and branches deal principally at a wholesale level. Nonetheless, the evidence concerning foreign owned or controlled banks seems to show that the concerns I have mentioned generally have not materialized. On the contrary, foreign banks appear to be very sensitive to the need to be good financial citizens.

The findings show that banks taken over by foreign interests generally have become stronger banks, although on average they are less strong than American-owned banks because many of them were problem institutions when acquired. The evidence shows further that profitability improved after foreign takeover, although for the same reason it averaged below the profitability of domestically owned banks. Lending activity as a whole was approximately in line with that of their domestic competitors. Moreover, there was no evidence that the acquired banks are less responsive to consumer needs. Purchases of state and municipal securities declined relative to those of domestically owned banks, but this may reflect a lesser need for tax-exempt income because of low earnings.[6]

VII. LARGE ACQUISITIONS

Nevertheless, recent acquisitions of large American banks by foreign

[6] Houpt, *supra* note 2, at 149-56.

bank holding companies have caused concern at the regulatory and supervisory and also at the congressional level. In approving the acquisition of Crocker National Corporation by Midland Bank Limited, the Federal Reserve Board noted that " . . . there is no statutory authority in the Bank Holding Company Act for taking into account the nationality of the acquiring company and that the Community Reinvestment Act[7] does not apply to a transaction where the acquiring banking organization has no presence in the U.S."[8] Therefore, the Board looked only at the merits of the case and did not consider nationality as a material factor in arriving at its decision.

For three months during 1980, a congressionally imposed moratorium on foreign acquisitions was in effect. Legislative interest in the banking field currently focuses primarily on domestic matters because of the rapid evolution that is under way in the field of financial services. But an underlying concern about large acquisitions undoubtedly exists, and not only in Congress. It is nourished not only by past and possibly prospective developments, but also by the evidence that some countries are less open to foreign banks than the United States. Only a few countries, to be sure, close themselves altogether to foreign banking. On the other hand, it is doubtful whether many foreign countries, or indeed any, would permit the acquisition of one of their largest banks by an American bank. Of course, in many countries the majority of the banking business is conducted by a very small number of banks. Foreign acquisition of one such bank is not the same thing as acquisition of a bank of equal size in the United States. Smaller countries may have regulatory concerns, or concerns involving monetary and foreign-exchange policy, that would apply in the United States only to a lesser degree if at all. But there can be no doubt that such attitudes abroad can create pressures toward imposing restrictions on acquisitions of large United States banks by foreigners.

Various suggestions to restrict foreign acquisitions of American banks have been made. A limit might be placed on the size of the bank to be acquired or on the proportion of foreign penetration in particular markets, or a public benefits test might be imposed. A reciprocity test also might be applied, based on the ability of American banks to make equivalent acquisitions in the foreign country. To my mind, none of these proposals are persuasive in themselves. But I cannot deny that

7 Community Reinvestment Act of 1977, Pub. L. No. 95-128, 91 Stat. 1147 (1978) (12 U.S.C. §§ 2901-2905 (1982)).

8 67 Fed. Reserve Bull. 729, 731 (1981).

they seem to become more persuasive in the absence of reciprocal national treatment of American banks in foreign markets.

The United States Treasury prepared a study of the treatment of American banks abroad, in response to a provision of the International Banking Act requiring that the matter be studied. This provision was the very moderate reaction of American legislators to the issue of reciprocity. The overall finding of the study regarding treatment of American banks abroad was generally favorable although it was noted that some variation exists among countries in the treatment of American and foreign banks. I should think that particular instances of discriminatory treatment as between domestic and foreign banks, in general, or domestic and American banks only, could more appropriately be dealt with in bilateral negotiations rather than by some form of unilateral action by the United States.

VIII. Foreign Government Ownership

Still another cloud on the horizon has developed in the form of the potential growth of foreign-government-owned banking entities in the United States. In 1982, the French government nationalized all banks of some size in addition to the "big three" that previously had been nationalized. In 1982, the government of Mexico nationalized its entire banking system. Early in 1983, Spain nationalized a number of banks owned by a group that was encountering difficulties.

The Federal Reserve Board faced the issue of foreign-government-owned banking entities—by no means for the first time—in connection with the acquisition of Long Island Trust Company by *Banca Commerciale Italiana*. That bank is owned, in major part, by *Istituto per la Ricostruzione Industriale (IRI)*, an Italian-government-controlled holding company which owns two other commercial banks each of which has a banking presence in the United States, as well as over 100 subsidiaries engaged in nonbanking activities. As in some earlier cases, the Board did not apply the Bank Holding Company Act to the applicant's government owners and approved the acquisition.

The Board, however, noted several significant and complex problems. Where the applicant is owned by a government agency, or by a government directly, that is engaged in a wide range of banking and commercial-industrial activities, there may be problems of compatibility of these cross-industry links with one of the stated purposes of the Bank Holding Company Act—that of maintaining a separation between commerce and banking in the United States. Similarly, common ownership by a government or its agencies of multiple banking organizations, even though organized under separate corporate and management structures, but operating in the United States in different states, could raise issues of compatibility with the interstate banking limitations of the Bank Holding Company Act and the International Banking Act.

The Board examined whether a government or governmental corporation should be regarded a a bank holding company under the Bank Holding Company Act. It defined two key issues: (1) whether a foreign-government-owned bank is in fact operated independently from other banks and commercial enterprises that are subject to common government ownership, and (2) the conditions under which the Act's focus on prohibiting the potential for conflicts of interest and concentration of resources would require application of the Bank Holding Company Act because of the fact of common ownership. The Board noted the possibility that applying the Bank Holding Company Act could have a restrictive impact on the ability of foreign-government-owned banks to operate in the United States if the nonbank prohibitions of the Act were to be rigidly applied, and noted the international economic policy issues that would be raised in this context.

In approving the applications, the Board concluded that the complex issues raised by applying the Bank Holding Company Act would best be resolved in a Congressional framework which would allow broader international economic policy considerations to bear on examination and, hopefully, resolution of these problems.

While major unresolved issues of the kind here discussed were coming into clearer focus, it nevertheless can be said that in an economic sense the spread of international banking has moved in a constructive direction.

Greater integration of national economies into the world economy helps to increase productivity and promotes economic growth all around. National banking systems have been in the vanguard of this integrating movement at a time when in other fields there are rumblings of protectionism. It is important that these gains not be undermined by the irruption of protectionism into financial fields.