Statement on

FOREIGN INVESTMENTS IN THE U.S. BANKING INDUSTRY

Presented to

Subcommittee on Commerce, Consumer, and Monetary Affairs
House Committee on Government Operations
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by

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Mr. Chairman, I appreciate this opportunity to present our views during your hearings on foreign investments in the U.S. banking industry.

In our capacity as receiver of failed banks, we have had direct experience with foreign acquisitions of United States banks. We have participated in purchase and assumption agreements which have resulted in full or partial foreign acquisition of failed United States banks in the following instances:

Failed Bank	Acquired by
Banco de Ahorro Puerto Rico San Juan, Puerto Rico Failed September 5, 1978	Banco Commercial de Mayaguez Mayaguez, Puerto Rico, the majority of this bank is owned by Banco Occidental de Madrid, Spain
Banco Credito y Ahorro Ponceno Ponce, Puerto Rico Failed March 31, 1978	Approximately one-third of this bank was acquired by Banco de Santander-Puerto Rico, San Juan, Puerto Rico, a subsidiary of Banco de Santander, Spain
Banco Economias San German, Puerto Rico Failed September 2, 1977	Banco Central y Economias San Juan, Puerto Rico, a newly formed subsidiary of Banco Central, Spain
American Bank & Trust Company New York City, New York Failed September 15, 1976	Bank Leumi Trust Company of New York, a subsidiary of Bank Leumi Le Israel, B. M. Tel Aviv, Israel
Franklin National Bank New York City, New York Failed October 8, 1974	European American Bank & Trust Co., owned by a consortium of European banks

As in any other purchase and assumption transaction, these have made it possible for the FDIC to avoid a statutory payoff of insured deposits in the failed banks. And, as in any such arrangement, the community has benefited from the continuation of banking services.

In a number of other cases, foreign acquisition has given a new chance to financially troubled banks in need of assistance. In both types of cases, foreign acquisitions may have been the only workable alternative. The inability to work out domestic solutions may be attributed to several causes: lack of interest, anticompetitive considerations, and inability to arrange an acceptable transaction when there are a limited number of buyers. In summary, foreign acquisition in given situations has provided us with a new option in carrying out our insurance function and in some cases has had the additional benefits of increasing net capital in the total United States banking system and having a positive effect on our balance of payments.

BACKGROUND

Mr. Chairman, perhaps some figures and background on the status of foreign banking in the United States would be useful.

According to statistics provided by the Federal Reserve, from November 1972 to the end of May 1979 the number of U.S. banking institutions owned by foreign banks increased from 104 to 325 and their total U.S. assets increased from $24 billion to $134 billion. Since 1965, there has been more than a seventeenfold increase in their assets.

Foreign banks presently operate in the United States through agencies, direct branches, subsidiaries, securities affiliates and commercial lending companies. Currently, these foreign banking organizations are located in eleven states plus Puerto Rico, Guam and the Virgin Islands. However, 86 percent of all foreign banking offices in the U.S. are concentrated in New York, California, and Illinois.

Until quite recently agencies have been the dominant form of foreign banking in the U.S. As of May 31, 1979, 146 agencies with approximately $40 billion in assets were operating in New York, California, Georgia, Florida, and Hawaii. Direct branches are the most rapidly growing form of foreign banking in the United States. There were 129 branches with assets totalling $68 billion in New York, Illinois, Pennsylvania, Washington, Oregon, Massachusetts, Puerto Rico, and the Virgin Islands on May 31, 1979.

At the end of May 1979, foreign banks owned 42 state-chartered subsidiaries in New York, California, Illinois, and Puerto Rico, with assets of $24 billion. Such subsidiaries are required to maintain FDIC insurance coverage and may choose to become members of the Federal Reserve System. Six have chosen to do so. Also, foreign banks may apply for national charters for bank subsidiaries. If a foreign bank chooses to operate in this country through a domestically incorporated banking subsidiary, its operations here are generally subject to the same rules under the Bank Holding Company Act that govern the U.S. activities of domestic bank holding companies, with limited exceptions involving nonbanking activities permitted by Federal Reserve regulations issued under Section 4(c)(9) and Section 2(h) of that Act.

ACTIVITIES OF FOREIGN BANKS IN THE UNITED STATES

Foreign banks operating in the United States are engaged primarily in wholesale banking which does not generally deal with the average household or small business. Benefits may have accrued to consumers, but that may be expected from increased competition, whatever its source.

Recent Federal Reserve Board studies have indicated that as U.S. branches of foreign banks have evolved, they have begun to enter into segments of the retail banking market. It is too early to draw conclusions because this foreign branch retail activity is still relatively new and limited in location. U.S. subsidiaries of foreign banks in California have acquired or established networks of branch offices which deal broadly with the general public. New York liberalized its branching laws a few years ago to permit statewide branching.

There are no precise data regarding the provision of retail banking services by foreign-owned institutions; however foreign banking in the United States is still evolving. The future course of economic events, recent changes in various nations' banking laws and other factors are all likely to have an impact on the future structure and activities in foreign banking. The FDIC was charged by law last year with the responsibility for insuring deposits in certain foreign branches. We are well underway with our new assignment, and we are watching developments on the foreign banking scene carefully.

Among other things we will be monitoring the effect of the International Banking Act itself to see whether or not foreign branches which seek deposit insurance will be able to compete in certain retail markets.

EXAMINATION PRACTICES

Recently, the Federal Reserve Board, in cooperation with the other Federal bank regulatory agencies, developed modifications in its supervisory approach to foreign bank holding companies.

Expanded supervisory oversight is a response to the recent trend toward increased involvement of foreign banks in domestic financial markets through acquisitions of existing American banks. The supervisory modifications include expanded reporting on transactions between the parent bank and its subsidiaries, consolidated financial information on the parent bank's worldwide operations with special emphasis on earnings, reserves and capital, and expanded dialogue with foreign bank supervisors concerning banks under their jurisdiction. In our opinion, these modifications should enhance our ability to evaluate both the financial condition of the parent bank and the relationship with its American bank subsidiary.

Some years ago, we encountered difficulty in evaluating credits extended by subsidiaries of foreign banks. It was not always possible to obtain adequate credit information about borrowers referred to the subsidiary by the parent organization. In each such instance, Corporation examiners reminded managers of the subsidiary bank of their responsibility to maintain current and complete information on all borrowers of the bank, including referrals from the parent bank. As a result, this deficiency has been largely rectified.

As you know, the Change In Bank Control Act of 1978, title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, gives the FDIC authority to disapprove changes in control in insured nonmember banks. The criteria for considering these transactions include the background and experience of the acquiring party. Where the acquirer is a foreign individual or group of individuals of foreign origin, our experience is that it has been

more difficult to obtain and verify information or to conduct an independent assessment of the acquirer's background and experience. In these instances, the Corporation will take a cautious stance and conduct a more extensive review of the transaction until we are satisfied that the individual(s) will act responsibly in controlling the institution. Generally, these same difficulties are not present where the acquirer is a foreign bank, largely because the information and data available in such instances are more reliable and accessible.

APPLICATIONS FOR FOREIGN ACQUISITIONS

Our consideration of foreign acquisitions of U.S. banks is generally similar to that for domestic acquisitions. Neither law nor precedent indicate that we should treat prospective foreign acquisitions differently from domestic.

In deciding applications of all types, including those for deposit insurance for newly organized banks, the FDIC applies criteria delineated in the operative statute. None of the statutory criteria includes nationality or citizenship as a basis for making a determination. The Change In Bank Control Act of 1978 lists certain bases for disapproval of a proposed acquisition, none of which include nationality or citizenship. The bases for disapproval are found at Section 7(j)(7)(A)-(E) of the Federal Deposit Insurance Act and are listed as follows: anticompetitive elements involved in the acquisition; the financial condition of the acquirer; the competence, experience, or integrity of the acquirer or of proposed management; or the failure to provide the FDIC with the information it requires to evaluate the proposed acquisition. As indicated

previously, neither nationality nor citizenship is listed as a basis for disapproval, and it does not appear that the fact that an acquisition is to be made by a foreign person could, under the statute, serve as a basis for disapproval in and of itself. If information in connection with a proposed acquisition of a U.S. bank by a foreigner is difficult to obtain or verify, the FDIC under the Act may hold up the acquisition until we are satisfied with the adequacy and accuracy of the information. If the required information were not supplied, the proposed acquistion could ultimately be denied.

INSURANCE OF FOREIGN BRANCHES

The International Banking Act expressly refers to possible increased risk to the insurance fund in providing insurance coverage for deposits in certain foreign branches. (12 U.S.C. 1815(c)(4)). The following are unique potential problems that the FDIC has identified:

(1) Directors and officers of the foreign bank are not usually subject to U.S. jurisdiction. Essential personnel or records needed to explain transactions may be located outside the United States or transferred there.

(2) Foreign banking laws or political decisions might have an unfavorable impact on the domestic operations of the U.S. based branch.

(3) Administrative enforcement proceedings initiated by regulatory authorities against branch personnel may be vitiated by lack of jurisdiction over senior management at the head office.

(4) Many foreign banks are legally permitted to engage in business activities abroad which are not permitted to U.S.

chartered banks, including those which may raise questions of conflicts of interest or other legal issues.

(5) In the event of insolvency, a foreign bank might seek to shift assets quickly out of the United States and liabilities into this country. The FDIC may find itself in conflict with other jurisdictions in obtaining the usual subrogation of claims and in the normal collection of these claims.

(6) Accounting practices, disclosure standards, and supervisory procedures vary from country to country.

The problems listed above have been addressed by both the Congress in the International Banking Act and by the FDIC in promulgating regulations thereunder. The Act enumerates seven statutory factors to be considered by the Corporation in acting upon applications for insurance by domestic branches of foreign banks. The thrust of these factors is to assure that only banks in sound financial condition with capable management obtain deposit insurance for their U.S. branches. Further, the Corporation must weigh the likelihood that the proposed branch will be a viable, well-managed operation. A selective process of granting deposit insurance materially lessens risk exposure to the deposit insurance fund.

To ameliorate potential risks in insuring deposits of foreign bank branches, the Corporation's regulations will require insured foreign branches to pledge assets of not less than 10 percent of liabilities. The foreign bank would be entitled to income on such assets and would have the right to withdraw an asset from pledge by substituting another for it, so long as the required minimum is

maintained. Assets on pledge would become available to the FDIC in the event of bank failure and would help minimize losses to the deposit insurance fund resulting from the liquidation of a domestic branch of a foreign bank. The asset pledge will, in a limited sense, serve as the capital buffer customarily found in domestic banks. By regulation, the Corporation has imposed an asset maintenance rule to discourage the foreign bank from funding operations of its operating entities outside the United States with deposits generated by the insured branch. The rule is also designed to ensure that assets of the insured branch can be identified to satisfy claims against any potential receivership estate.

The Corporation's regulations also require the Head Office of the foreign bank to furnish a commitment to permit an on-site examination, if necessary, of any office, agency, branch or affiliate of the foreign bank located in the United States and to agree to furnish such information on the affairs of such offices as the Corporation deems necessary. A foreign bank failing to agree to these terms will not be granted deposit insurance for its domestic branch.

With respect to operations of the foreign bank or its affiliates outside the United States, the foreign bank must agree to provide information deemed necessary by the FDIC to determine the relations between the insured branch and the bank and its affiliates and to assess the financial condition of the bank as it relates to the insured branch. If laws of certain foreign jurisdictions and/or policy of the central bank prohibit

or restrict the submission of such information, the agreement to provide information may be qualified appropriately. However, if the agreement is so limited that it may present an unacceptable risk to the insurance fund, the FDIC Board of Directors reserves the right to deny the application.

In cooperation with the other Federal bank regulatory agencies and various State banking departments, the Corporation is developing a uniform report to be used in examinations of branches and agencies of foreign banks. This report will assure a coordinated approach to the examination of all U.S. offices of a given foreign bank which potentially could be under the jurisdiction of two or more supervisory authorities. The Corporation's ability to analyze and evaluate the domestic operations of a foreign bank operating through branches and/or agencies will be enhanced.

The seven statutory factors set forth in the Act serve as guidance to the Corporation in acting upon applications of this nature. Procedural guidelines have been issued to examining personnel, but it is expected that procedures will continue to evolve as the Corporation gains more experience with these types of applications. A field investigation of de novo branches or an on-site examination of existing branches is required. With respect to the condition of the entire parent institution, it is anticipated that the Corporation will request detailed financial information on the foreign bank's worldwide operations, meet with management personnel of the bank, assess the reputation of the bank in the banking market and evaluate the support and supervision accorded by supervisory authorities in the home country.

MOTIVATION FOR FOREIGN INVESTMENT IN U.S. BANKS

Several factors may motivate foreign investors to invest in and acquire U.S. banks and holding companies. The general factors include:

(1) The internationalization of business and finance that has occurred since World War II which has stimulated major banks both in the U.S. and abroad to expand their operations beyond their national borders;

(2) Size and diversification of the U.S. financial markets;

(3) Political stability of the United States which provides a secure dollar liability base as a source of funding;

(4) Changes in state banking laws;

(5) The relaxation of capital controls in January 1974 which enable domestic banks and subsidiaries of foreign banks to extend credits to foreign borrowers free of restraint;

(6) Serving corporate clients of the foreign bank's home country;

(7) Developing closer contact with U.S. corporations;

(8) Defensive reaction based upon the fear that U.S. banks will take away foreign customers and home country business; and

(9) The dominant role of the dollar in the international payments system.

In addition, inflation, balance-of-payments considerations, undervaluing of bank stock and the position of the dollar abroad all have had a part in influencing foreign investment in U.S. banks.

It would be difficult to predict with accuracy the course of such investment during the next five years. That obviously would

be linked to economic developments and other factors in the United States and abroad.

CONCLUSION

Mr. Chairman, I have tried to give you a broad view of the FDIC's experience with foreign banking. I hope this has been of assistance to you.