Statement on

# FOREIGN BANK OPERATIONS AND ACQUISITIONS IN THE UNITED STATES

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FEDERAL DEPOSIT INSURANCE CORPORATION

Presented to

Subcommittee on Financial Institutions Supervision, Regulation and Insurance

of the

Committee on Banking, Finance and Urban Affairs
United States House of Representatives

by

Irvine H. Sprague, Chairman
Federal Deposit Insurance Corporation

10:00 a.m.
Thursday, September 25, 1980

2128 Rayburn House Office Building

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Mr. Chairman, I appreciate this opportunity to present our views during your hearings on bank operations and acquisitions in the United States by foreigners.

You have asked for a report on our activities under the International Banking Act of 1978 and under the Change in Bank Control Act, Title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

Both of these laws have expanded FDIC jurisdiction concerning foreign banks operating in the United States. We have become insurers of deposits in certain branches of foreign banks, and we are required to review certain proposed bank acquisitions, including those which involve a foreign acquirer. In addition, we retain the responsibility of dealing with potential foreign acquirers in our capacity as receiver of failed banks.

You have also asked for our comment on the Comptroller General's report of August 26, 1980, which recommends enactment of a limited moratorium on acquisitions by foreign banks or bank holding companies of domestic banks with $100 million or more in assets, unless necessary to prevent bankruptcy or insolvency.

Finally, you have asked us for recommendations for changes in the laws concerning U. S. operations of foreign banks.

I would like to address each of these aspects separately.

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ACTIVITIES AS RECEIVER

As receiver of failed banks, we have participated in six purchase and assumption agreements, the earliest in 1974, which have resulted in full or partial foreign acquisition of failed United States banks:

| Failed Bank | Acquired by |
|---|---|
| Banco de Ahorro Puerto Rico<br>San Juan, Puerto Rico<br>Failed September 5, 1978 | Banco Commercial de Mayaquez<br>Mayaquez, Puerto Rico, the<br>the majority of this bank is<br>owned by Banco Occidental<br>de Madrid, Spain |
| Banco Credito y Ahorro Ponceno<br>Ponce, Puerto Rico<br>Failed March 31, 1978 | Approximately one-third of<br>this bank was acquired by<br>Banco de Santander-Puerto<br>Rico, San Juan, Puerto Rico,<br>a subsidiary of Banco de<br>Santander, Spain |
| Banco Economias<br>San German, Puerto Rico<br>Failed September 2, 1977 | Banco Central y Economias<br>San Juan, Puerto Rico, a<br>newly formed subsidiary of<br>Banco Central, Spain |
| American Bank & Trust Company<br>New York City, New York<br>Failed September 15, 1976 | Bank Leumi Trust Company of<br>New York, a subsidiary of<br>Bank Leumi Le Israel, B. M.<br>Tel Aviv, Israel |
| First State Bank of Northern<br>California<br>San Leandro, California<br>Failed May 21, 1976 | Lloyds Bank of California,<br>Owned by Lloyds Bank, Ltd.,<br>London, United Kingdom |
| Franklin National Bank<br>New York City, New York<br>Failed October 8, 1974 | European American Bank &<br>Trust Co., owned by a<br>consortium of European<br>banks |

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In these cases, as in all other failed bank situations, our guiding considerations were the needs of the communities served by the failed banks and our statutory mandate to avert a loss to the insurance fund. In the case of Banco Economias, the foreign acquirer submitted the only bid; it was the only alternative to a statutory payoff of depositors and a reduction of banking services in the community. In the other four cases, foreign acquirers submitted the highest bid.

In a number of instances, foreign acquisition has infused new strength into financially troubled banks -- including some of substantial size -- and may well have prevented the failure of many of them.

In any troubled bank or failed bank situation, a number of factors can come into play that inhibit prospects for acquisition by a domestic purchaser. These factors include antitrust considerations, lack of interest on the part of domestic parties, and laws which may restrict bidding eligibility to purchasers within a given state.

In brief, foreign acquisition has had beneficial effects in a number of specific instances. It has served to revive troubled institutions, and it has provided us with an option in failed bank cases which we believe is necessary to the FDIC in carrying out its statutory responsibilites.

## BACKGROUND

Foreign banks operate in the United States through agencies, branches, subsidiaries, and commercial lending companies. The U. S. branches of foreign banks are concentrated in New York and Illinois. The U. S. agency offices of foreign banks are concentrated in New York and California, and, like the branches, are engaged primarily in wholesale banking. A small number of U. S. branches of foreign banks is engaged in domestic retail deposit activity -- that is, acceptance of deposits of less than $100,000

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from the general public — and they are required by the International Banking Act to have Federal deposit insurance.

INSURANCE

To carry out the mandate of the Congress in the International Banking Act, the FDIC issued regulations effective July 9, 1979, and amendments effective September 10, 1979, providing for the insurance of deposits in U. S. branches of foreign banks. Since then, the FDIC Board has approved deposit insurance applications for 17 branches of nine foreign banks from five countries and has granted appproval contingent upon the fulfillment of certain conditions for nine branches of five additional foreign banks from three countries.

| NAME OF BANK | | LOCATION OF BRANCH |
| --- | --- | --- |
| Allied Irish Banks Ltd.<br>Ireland | | 405 Park Avenue<br>New York, N. Y. |
| Bank of Baroda<br>India | * | One Park Avenue<br>New York, N. Y. |
| Bank Hapoalim B. M.<br>Israel | | 70 Federal Street<br>Boston, Mass. |
| | | 10 Rockefeller Plaza<br>New York, N. Y. |
| | | 97-77 Queens Blvd.<br>Rego Park, Queens, N. Y. |
| | | 445 Brood Hollow Rd.<br>Melville, Suffolk, N. Y. |
| | | 174 N. Michigan<br>Ave., Chicago, Ill. |
| | | 3 Penn Center Plaza<br>Philadelphia, Pa. |
| Bank Leumi Le-Israel<br>Israel | | 100 N. LaSalle St.<br>Chicago, Ill. |
| | | 1511 Walnut St.<br>Philadelphia, Pa. |

* Indicates approval contingent upon fulfilling certain conditions.

(Time extensions have been made to January 23, 1981, to meet the conditions, basically access to information. Serious negotiations are currently underway in an effort to meet the deadline.)

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| NAME OF BANK | | LOCATION OF BRANCH |
|---|---|---|
| Bank of Ireland<br>Ireland | | 640 Fifth Avenue<br>New York, N. Y. |
| Bank of India<br>India | * | 277 Park Avenue<br>New York, N. Y. |
| The Hongkong and Shanghai<br>Banking Corporation<br>Hong Kong | * | 5 World Trade<br>New York, N. Y. |
| | * | 50 Bowery<br>New York, N. Y. |
| Israel Discount Bank Ltd.<br>Israel | | 511 Fifth Ave.<br>New York, N. Y. |
| | | 1350 Broadway<br>New York, N. Y. |
| Korea Exchange Bank<br>Korea | | 33 N. Dearborn St.<br>Chicago, Ill. |
| Korea First Bank<br>Korea | | 11 East Adams St.<br>Chicago, Ill. |
| National Bank of Greece S. A.<br>Greece | | 33 State St.<br>Boston, Mass. |
| | | 168 N. Michigan Ave.<br>Chicago, Ill. |
| National Bank of Pakistan<br>Pakistan | * | 39 LaSalle St.<br>Chicago, Ill. |
| | * | One UN Plaza<br>New York, N. Y. |
| Standard Chartered Bank Ltd.<br>United Kingdom | | Sears Tower<br>92nd Floor<br>Chicago, Ill. |
| State Bank of India<br>India | * | 460 Park Avenue<br>New York, N. Y. |
| | * | 42-08 Main Street<br>Flushing, N. Y. |
| | * | 110 South LaSalle St.<br>Chicago, Ill. |

* Indicates approval contingent upon fulfilling certain conditions.

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Additionally, the FDIC insures deposits of more than 40 U. S. subsidiary banks of foreign banks or foreign bank holding companies, and of approximately 50 U. S. banks controlled by foreign individuals. These institutions are supervised and examined by the Federal and State banking authorities in the same manner as domestic banking institutions.

With the advent of the International Banking Act, the FDIC has been expanding its working relationships with overseas banks and foreign bank supervisors. Members of the Board of Directors and FDIC staff have met with senior bank supervisory officials of many countries and we intend to continue to do so.

The FDIC is required to consider seven statutory factors in acting upon applications for insurance of U. S. branches of foreign banks:

(1) the financial history and condition of the bank,

(2) the adequacy of its capital structure,

(3) its future earnings prospects,

(4) the general character of its management, including but not limited to the management of the branch proposed to be insured,

(5) the convenience and needs of the community to be served by the branch,

(6) whether or not its corporate powers, insofar as they will be exercised through the proposed branch, are consistent with the purposes of the FDI Act, and

(7) the probable adequacy and reliability of information supplied and to be supplied by the bank to the Corporation to enable the FDIC to carry out its functions under the FDI Act.

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The Corporation reviews the history and financial data of the parent bank. The FDIC requires foreign banks to submit financial data on a worldwide consolidated basis. We obtain and review the three prior annual reports to evaluate the financial strength and earnings record of the parent and its major subsidiaries. We often request supplemental information concerning the bank's management policies, the composition and quality of assets, and the differences between local and U. S. bank accounting practices.

Corporation field personnel also conduct examinations of existing branches. These examinations include an analysis of asset quality, liquidity position and investment policies, internal controls, compliance with applicable laws and regulations, foreign exchange activities, if any, intercompany lending and transfer of assets among offices of the bank and its affiliates, country risk exposure, the quality of management, and support from the parent bank. The FDIC in concert with the other Federal banking agencies has issued examination guidelines to field personnel. We will continue to review these guidelines. We expect them to evolve as international banking evolves and as the agencies gain more experience with U. S. branches of foreign banks.

The review of the parent bank and the examination of existing branches are necessary to evaluate the foreign bank as a whole. We seek to measure the entire bank organization, as an entity, against the seven statutory factors in the FDI Act. Our purpose is to ensure to the extent possible that deposit insurance is granted only to banks in sound financial condition with capable management. We seek to assess whether the foreign

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bank will be a source of strength to its U. S. branch and whether the branch is likely to be a viable, well managed operation.

To ameliorate potential risks in insuring deposits of foreign bank branches, the Corporation's regulations require insured foreign branches to pledge assets of not less than 10 percent of average branch liabilities. Pledges to State authorities (or to the Comptroller of the Currency) up to five percent of branch liabilities may be deducted from FDIC's requirements. The International Banking Act permits the FDIC to increase the amount of pledged assets required of an individual branch when deemed necessary to protect the deposit insurance fund. Pledged assets become the property of the FDIC in the event of a bank failure, and serve to minimize losses to the deposit insurance fund that might result from the liquidation of a domestic branch of a foreign bank. The Corporation has also imposed an asset maintenance rule to discourage the foreign bank from directly funding 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 are identifiable and available to satisfy claims against any potential receivership estate. Branches must maintain eligible assets in U. S. dollars (or a currency freely convertible into U. S. dollars) in an amount equal to the branch's liabilities. Eligible assets of the branch exclude any funds due from the parent bank or a wholly-owned subsidiary, 50 percent of assets classified "doubtful" and 100 percent of assets classified "loss", any deposit in a bank that is not subject to a valid waiver of offset agreement, and any asset not supported by sufficient credit information to facilitate the review of the asset's credit quality.

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Also, assets not in the branch's possession are not eligible unless the branch holds title to the asset and the branch maintains records sufficient to enable independent verification of the branch's ownership. Finally, if a State authority or the Comptroller of the Currency requires a higher ratio of eligible assets to liabilities, compliance with the State or Comptroller of the Currency's requirements is deemed compliance with the requirements of the FDIC.

The Corporation's regulations also require the head office of the foreign bank to furnish an agreement 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.

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 relationship between the insured branch and the bank and its affiliates, and to assess the financial condition of the bank as a whole. 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 presents an unacceptable risk to the insurance fund, the FDIC Board of Directors reserves the right to deny the application for deposit insurance.

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SUPERVISION

U. S. financial regulators have jointly developed policies and procedures for regulating on an ongoing basis the branches of foreign banks, including those that have been granted FDIC insurance.

As set forth in the "Statement of Policy on Supervision of U. S. Branches and Agencies of Foreign Banks" issued by the Federal Financial Institutions Examination Council (FFIEC), the FDIC and other regulators place primary emphasis on assessing the financial well-being of the U. S. offices of foreign banks as well as the compliance of those offices with U. S. laws and regulations. To this end, the FDIC, the Office of the Comptroller of the Currency, the Federal Reserve System, and several State banking authorities have developed a uniform examination report to be used in examinations of U. S. branches and agencies of foreign banks. We have also designed a uniform call report for the branches and agencies of foreign banks.

Recognizing that U. S. branches of foreign banks depend on their parent institutions for strength, the FFIEC recommended that its member regulators develop mechanisms for acquiring and analyzing financial information on the consolidated bank, and to expand working relationships with senior management of the banks. The reporting requirements imposed on the parent foreign bank are similar to those for foreign bank holding companies, and require specific information on earnings, reserves, and capital, as well as an explanation of the differences between U. S. and foreign accounting practices.

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## CHANGE IN BANK CONTROL ACT

The FDIC has reviewed six proposed bank control changes involving foreign interests since March 10, 1979 -- the effective date of the Change in Bank Control Act, Title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978. Domestic acquirers have submitted approximately 200 proposed changes to the FDIC in the same period.

The proposals from foreign interests relate to banks with less than $50 million in assets. The FDIC evaluated the proposed acquisitions and notified three acquiring parties that the Corporation did not intend to disapprove the acquisitions. One of these cases involved a bank in near failing condition, and the change brought new management and a significant addition to the bank's capital accounts. Of the remaining three proposals, one was rejected as incomplete and the other two were withdrawn until the proposed acquirers could produce evidence of compliance with home country laws regarding exportation of capital.

The Change in Bank Control Act applies broadly to an individual or other entity -- domestic or foreign -- proposing to acquire control of an insured bank in the United States. The acquirer is required to give 60 days prior written notice to the appropriate Federal banking agency. Within that period, subject to a 30-day extension, the agency may disapprove the acquisition on grounds specified in the Act. The waiting period may be further extended if the agency determines that the acquiring party has not furnished all the information required by the Act

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or that furnished information is substantially inaccurate. An acquisition may be made prior to the expiration of the disapproval period if the agency issues written notice of its intent not to disapprove the acquisition. An acquiring party receiving notice of disapproval may ask for a hearing under the Administrative Procedure Act. The agency then must approve or disapprove the acquisition on the basis of the hearing record, and the decision is subject to review in the U. S. Courts of Appeals.

Acquiring parties, foreign and domestic, are required to furnish personal, business background, financial and other information to the Federal regulatory agency. As part of its implementation of the Change in Bank Control Act, the FDIC has expanded its procedures for checking the backgrounds of individuals. Names of proposed foreign acquiring parties are checked through the FBI in the same manner as names of proposed acquirers who are United States citizens or residents. However, FBI files usually yield information about a non-citizen only if the person has been charged, convicted or investigated or has had criminal associations in the United States. In appropriate cases, we also check with the Drug Enforcement Administration, Interpol, the U. S. Customs Service and the Department of State. We are exploring the possibility of making background inquiries through the Central Intelligence Agency.

Our experience has been that when the proposed acquirer is a foreign bank, as opposed to an individual or other entity, information is usually more accessible and reliable. In the case of foreign individuals or groups, we have had difficulties in obtaining and verifying information or in conducting an independent assessment of a proposed acquirer's background

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and experience. Nevertheless, in these cases too, we will continue to make every effort to determine whether the transaction involves responsible and capable acquirers and otherwise meets the requirements of the Act.

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

The bases for disapproval under the Change in Bank Control Act (Section 7(j)(7)(A)-(E) of the Federal Deposit Insurance Act) are 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. Neither nationality nor citizenship is listed as a basis for disapproval, and it does not appear that the fact that a proposed acquirer is foreign in and of itself could serve as a basis for disapproval under the statute.

## REPORT BY THE COMPTROLLER GENERAL

The Comptroller General of the United States in his August 26, 1980, report to your Committee discusses the supervision of U. S. bank activities outside the United States, the U. S. supervision of foreign banking in the United States, the status of implementation of the International Banking Act of 1978, and the impact foreign control has had on acquired U. S. banks. Recommendations in the Report include --

(1) The enactment of a limited moratorium on acquisition of domestic banks with total assets of $100 million or more by foreign banks or bank

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holding companies unless such acquisitions are necessary to prevent bankruptcy or insolvency;

(2) The setting of a policy that would require U. S. regulatory agencies to contact their counterparts in the home country of a foreign individual acquirer to ascertain the acquirer's financial strength and reputation;

(3) denial of those applicants given unfavorable referrals from their home-country regulator; and

(4) The establishment of a requirement that foreign banks and other foreign businesses acquiring U. S. banks submit certified consolidated financial statements prepared in accordance with U. S. "generally accepted accounting principles."

In our prepared responses which are incorporated in the GAO report, the Federal Deposit Insurance Corporation has indicated its opposition to the proposed moratorium. We reaffirm our opposition to that proposal.

We recognize that acquisitions of U. S. banks, particularly the larger ones, raise issues which require further exploration. Accounting practices differ from country to country, making it more difficult to evaluate the performance of some foreign banks. Variations in supervisory techniques, laws, customs and regulatory standards present challenges in terms of parallel treatment of U. S. and foreign banks, both in this country and abroad. Moreover, although the International Banking Act has alleviated many perceived inequities in this country, U. S. banks and bank holding companies are subject to restraints on their banking and nonbanking acquisitions and activities to which foreign banks are not subject. We believe that these and other important issues relating to foreign bank expansion in the U. S. deserve attention.

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However, we do not believe that present circumstances warrant the imposition of the proposed moratorium. The moratorium would contradict our national policy of promoting open international capital markets. Further, we believe the moratorium would be inconsistent with the fundamental principle of national treatment and mutual nondiscrimination of domestic and foreign banks. This precept underlies the International Banking Act.

We support the Comptroller General's conclusion that foreign acquisitions necessitated by the insolvency of a domestic bank should be exempt from any moratorium. In fact, we would go further and say that such powers should be further defined along the lines of H. R. 7080, extraordinary acquisition legislation which we proposed earlier this year.

We do not share the Comptroller General's view that foreign acquisitions should be rejected solely on the basis of an unfavorable recommendation by the home-country banking regulator. It should be noted that foreign acquirers who are individuals may not be known to the home-country banking regulator. In any acquisition, a whole array of factors must be weighed. We believe that it would be inappropriate to permit the recommendation of a foreign government agency to override the independent judgment of the FDIC.

Finally, we prefer the discretionary authority we now have to require foreign acquirers to submit consolidated financial statements conforming to the U. S. generally accepted accounting principles. We believe that it

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would not be practical, as the report suggests, to make such a submission mandatory in every instance. The problems of achieving consistency among 150 nations with different laws, customs and cultures are formidable.

RECOMMENDATIONS

Both the International Banking Act and the Change in Bank Control Act are still new. We are still gaining experience with them. We are making careful observations as we progress, and we expect in the future to be ready to recommend technical changes and other amendments to the law.

One issue already is making itself felt -- that of confidentiality of certain information submitted by foreign banks to U. S. regulators. In the case of the FDIC, that usually means information associated with applications for deposit insurance for U. S. branches or information necessary for supervisory or Change of Bank Control purposes.

The information requirements, in most cases, are the same for foreign banks as for domestic institutions. In many countries some of this information may not be customarily disclosed to stockholders or the public. One substantial impediment in our dealings with foreign banks is their concern that such information might be disclosed in the United States through a Freedom of Information Act request.

We join with the Board of Governors of the Federal Reserve System and the Office of the Comptroller in recommending that the law be amended to provide for confidentiality of information submitted by a foreign bank to a United States bank regulator if such information is not ordinarily disclosed in the bank's home country.

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