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Testimony by

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Federal Reserve System

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Committee on Banking, Finance and Urban Affairs

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Introduction

I am pleased to appear before you this morning to present the views of the Federal Reserve Board on Title II of H.R. 4803, the Non-Proliferation of Weapons of Mass Destruction and Regulatory Improvements Act of 1992. We recognize the broad policy objectives of this legislation which will be addressed by the other witnesses before the Committee. As requested, I will focus my remarks on Title II which concerns the activities in the United States of foreign banks owned or controlled by foreign governments. If enacted, this legislation would severely curtail the U.S. activities of such banks. It also would impose reporting requirements on all foreign banks and would provide for new sanctions on financial institutions for violations of export control provisions.

I will begin by providing you with an overview of the existing U.S. operations of foreign government-owned banks and the manner in which current law and regulation apply to them. I will identify the issues that have been associated with government ownership of foreign banks and the reasons why the Federal Reserve believes such issues do not require a prohibition on participation by foreign government-owned banks in the U.S. market. Then I will discuss the specific issues raised by the proposed legislation.

At the outset, I would like to say that the Federal Reserve appreciates the new authority to regulate foreign banks in the United States granted to us last year. As enacted by the Congress, the Foreign Bank Supervision Enhancement Act improves substantially the regulatory authority available to the Federal Reserve to monitor and examine the participation of all foreign banks in the U.S. market. We are now implementing this legislation; in April, the Federal Reserve adopted a regulation governing the entry by foreign banks into the U.S. market and we are hiring 200-250 new examiners to conduct frequent examinations of U.S. offices of foreign banks, including, for the first time, representative offices of such banks. We intend to use our authority to enforce vigorously both the statutory and supervisory standards applicable to foreign bank operations in the United States, whether conducted by government or privately owned banks.

Existing U.S. Operations of Foreign Government-Owned Banks

A foreign government is deemed to own or control a bank if it directly or indirectly owns 25 percent or more of the bank's voting shares or otherwise controls the bank. While the absolute number of banks owned by foreign governments is large, such banks hold only a small percentage of the total U.S. assets of foreign banks. As of December 31, 1991, there were 275 foreign banks operating in the United States and their U.S.

offices had total assets of $888 billion. Of these foreign banks, 85 are owned by foreign governments; the assets of their U.S. operations amount to $120 billion or about 13 percent of the total assets of U.S. offices of foreign banks or 3 percent of the total assets of all banking offices in the United States. A regional and country-by-country breakdown of these amounts is set forth in Exhibit I to my testimony.

As shown in Exhibit II, banks owned by foreign governments, like privately owned foreign banks, do business in the United States primarily through branches and agencies. Foreign government-owned banks operated 162 offices in the United States as of year-end 1991. Of those offices, 10 were bank subsidiaries, 147 were branches and agencies, 2 were Edge corporations, and 3 were New York state-chartered Article XII investment companies. The branches and agencies accounted for 87 percent ($105 billion) of the assets of foreign government-owned banks in the United States, while the assets of bank subsidiaries represented only 11 percent ($13 billion) of the U.S. assets of foreign government-owned banks. The remaining 2 percent is accounted for by Edge Act corporations and Article XII companies.

Government-owned banks from 37 countries currently operate in the United States. In terms of total assets of the U.S. operations, government-owned banks from countries in Europe clearly dominate. The European banks had U.S. assets of $83

billion as of December 31, 1991, representing 70 percent of the total assets of foreign government-owned banks, compared with $28 billion for Asian and Middle Eastern government-owned banks and $5 billion for Latin American banks. Italy, France, Israel and Germany have the most significant U.S. presence of foreign government-controlled banks. For foreign banks overall, it is the Japanese banks that have the largest share of U.S. assets; however, all but one of the Japanese banks operating in the United States are privately owned. The one Japanese government-owned bank, Shoko Chukin Bank, accounts for only 0.3 percent of the assets of Japanese banks in this country.

Government ownership of foreign banks may be either direct or indirect. That is, a foreign government, at the national, regional or local level, or an agency of the government, may own the foreign bank directly or a foreign government may own or control a corporation that, in turn, owns a bank with U.S. operations. Most foreign government ownership is direct; however, there are currently 10 foreign banks operating in the United States that are indirectly owned by foreign governments. As of December 31, 1991, the U.S. operations of these 10 banks, which consisted of 26 branches and agencies and 1 Edge corporation, had total assets of approximately $24 billion. Exhibit III shows the ownership and U.S. operations of banks indirectly controlled by foreign governments.

The Federal Reserve has considered the three types of issues that have been associated with foreign government ownership of banks operating in this country. First, foreign government-owned banks may have competitive advantages under U.S. law with respect to interstate banking and nonbanking activities. Second, foreign government-owned banks may make biased credit decisions based on priorities dictated by the government owner that could unduly favor foreign nationals and, if such nationals were not creditworthy, could weaken the condition of their U.S. operations. Finally, foreign government-owned banks may attempt to exploit competitive advantages to gain market share in the United States. Banks owned by foreign governments may have more advantageous access to funding than private banks to the extent that they can benefit from implicit government guarantees. They also may have more flexibility in pricing of services because government owners may be willing to accept lower levels of profitability.

The Federal Reserve monitors the participation of foreign government-owned banks in the U.S. market in light of these three issues. We have found no evidence suggesting that government-owned banks as a class operate in the United States differently from other foreign banks. Indeed, our information suggests that these banks have operated and continue to operate competitively on market terms. In our view, current law and regulation, including the increased regulatory authority granted

in the Foreign Bank Supervision Enhancement Act enacted last year, provide the Federal Reserve with the ability to regulate the activities of all foreign banks, including those that are owned by foreign governments.

The major competitive advantages potentially available to a foreign government-owned bank that have been identified thus far derive from the fact that the restrictions on interstate banking and nonbanking activities in the Bank Holding Company Act ("BHC Act") do not apply to a foreign government that owns one or more foreign banks with U.S. operations because a foreign government is not a "company." One concern in this regard was that several government-owned banks from a single country might act in a coordinated fashion to select different states as their home states for purposes of avoiding the limitations on multistate expansion of domestic deposit-taking activities under the BHC Act and the International Banking Act. By contrast, a foreign privately owned company with several foreign banks would be permitted only one home state. This concern has diminished significantly as interstate restrictions have become less of a constraint on domestic banking organizations. In any case, there has been no indication that foreign banks owned by the same foreign government behave in such a coordinated fashion to take advantage of interstate opportunities. From all available evidence, these banks operate independently of one another and follow separate business plans. For example, all 7 Italian

government-owed banks operating in the United States have selected New York as their home state.

Another concern arose in connection with the BHC Act's restrictions on nonbanking activities. Some foreign governments, in addition to owning banks that operate in the United States, also own companies that engage in extensive nonbanking activities. For example, both France and Italy, among others, own several banks with U.S. operations and also own national airlines. Such cross industry links may be incompatible with one of the stated purposes of the BHC Act -- maintaining a separation between commerce and banking in the United States. The operation of both banks and nonbanks in the United States controlled by the same government owner could be viewed as inconsistent with the purposes of the BHC Act. However, a strict application of the Act's nonbanking restrictions in these circumstances would have serious ramifications beyond the regulatory realm and might preclude certain foreign government-owned banks from engaging in any banking activities in the United States, even where there is no evidence that the banks and nonbanks act together or in any way derive advantages in the United States from their common ownership.

Although the BHC Act nonbanking restrictions do not apply to a foreign government that owns a foreign bank, there are several ways in which the bank regulatory agencies address the

potential for abuse. If a foreign government-owned bank owns a subsidiary bank in the United States, the restrictions of Section 23A of the Federal Reserve Act apply to transactions between the U.S. bank and any company owned by the foreign government. This provision imposes limits on loans by banks to affiliates and establishes strict collateral requirements. The application of Section 23A is designed to curtail practices that conflict with the purposes of the BHC Act; that is, it helps insure the safety of the U.S. bank by prohibiting unsound transactions with affiliated government-owned companies and also insures that such companies do not have greater access to credit from the bank than non-affiliated companies. In addition, the U.S. branches and agencies of foreign banks are monitored to insure that they do not engage in preferential lending to affiliates, including government-owned affiliates. In sum, our experience has been that government-owned banks do not enjoy competitive advantages in the U.S. market by virtue of the nonbanking companies owned by the same government nor do the nonbanking companies obtain access to preferential credit. Similarly, we see no evidence that domestic banks are disadvantaged by such foreign organizations.

We have also been concerned about the potential negative impact of government policies on the U.S. operations of banks owned by foreign governments. Such banks might not operate in a fully market-oriented way through their U.S. branches and subsidiaries. In particular, government-owned banks might make

biased credit judgments, discriminating in favor of companies headquartered in their home country. Such biased credit judgments could give competitive advantages to the companies so favored; these biased judgments could also weaken the balance sheet of the U.S. branch or subsidiary of the foreign bank. Although this concern is greatest with respect to companies owned by a government that also owns a bank, it could in principle apply to private borrowers of the same nationality.

Another dimension of this concern is that a foreign government-owned bank might be operated in such a way as to support the general political-economic agenda of the home country (as distinct from a particular enterprise) by, for example, lending to support marketing agreements, cartels, or the government's foreign policy objectives. The result of these types of lending policies could be that the U.S. bank would become overexposed to the home country, to certain industries, or to groups of related borrowers.

However, as I stated earlier, foreign government-owned banks, as a class, operate on market terms. Indeed, the ratio of home country exposure to total assets for banks owned by foreign governments is lower than the comparable ratio for privately owned foreign banks. Similarly, the ratio of nonperforming loans to total assets is lower for foreign government-owned banks than

for privately owned banks. These ratios are set forth in more detail in Exhibit IV.

Another possibility is that a foreign government-owned bank may have funding advantages over other banks. In contrast to private owners, governments may be willing to provide funding at below market cost to their banking entities and to accept lower levels of profitability. In theory, this would allow such entities to grow at unusually high rates. Actual data on the growth of U.S. branches and agencies of foreign government-owned banks, however, indicate that these entities have grown at a slower rate than branches and agencies of privately owned foreign banks.

Furthermore, any potential advantage to foreign government-owned banks in terms of capital -- that is, the ability to operate with very low levels of capital -- has been eroded substantially by the adoption of the Basle capital standards and the emphasis placed by market participants on capital strength. The Basle standards themselves apply to all internationally active banks of the G-10 countries and Luxembourg, regardless of the ownership of such banks. Many other governments have adopted these standards and there is increasing pressure on banks from all countries to meet the internationally agreed capital rules.

It must be kept in mind that there are a number of different ways, other than direct provision of funding, that a government can subsidize its banks. These include tax policies, cheap discount window credits, controlled interest rates in domestic markets, and toleration of non-competitive domestic markets that favor local banks or provide a safety net. A government may provide these sorts of subsidies to any of its banks, regardless of whether such banks are government-owned.

The Federal Reserve plans to continue its monitoring of the activities of government-owned foreign banks in the United States in light of the issues I have outlined. To date, the Federal Reserve has not found a pattern of abuse by government-owned banks or any measurable competitive disadvantage to domestic banks. Current law and regulations provide the Federal Reserve with adequate tools to supervise and regulate the U.S. activities of foreign government-owned banks.

Issues Raised by H.R. 4803

I would now like to turn to the specific proposals set forth in Title II of H.R. 4803. The most troublesome is Section 202, which effectively denies access to the U.S. market by foreign government-owned banks.

The bill would preclude foreign government-owned banks from engaging in any financial transactions in the United States, either through any type of subsidiary, whether a bank or a nonbanking company, or through branches and agencies, except for extensions of credit for trade financing. Even trade financing would be difficult given the limitations on funding for such activities that would be imposed by the legislation. In the Federal Reserve's view, this proposal virtually to eliminate the activities in the United States of all foreign government-owned banks cannot be justified and would have serious negative ramifications. The issues that I discussed earlier do not justify effectively closing the U.S. market to foreign government-owned banks. This bill would preclude participation in the U.S. market by some of the world's largest and soundest institutions. Implementation of these restrictions on the activities of foreign government-owned banks also may well have implications for the most favored nation obligations set forth in treaties of the United States with foreign countries. Such restrictions would also make negotiation of additional international agreements in financial services, which could provide substantial benefits to U.S. banks, much more difficult because access to the U.S. market by banks from our trading partners would be curtailed.

These provisions raise questions of consistency with the principle of national treatment and may also raise the

possibility that retaliatory action of some sort could be taken against U.S. commercial banks operating overseas. As the Federal Reserve has testified before, the traditional U.S. policy of national treatment seeks to insure that foreign and domestic banks have a fair and equal opportunity to participate in our markets. The motivation is not merely a commitment to equity and nondiscrimination, although such a commitment in itself is worthy. More fundamentally, the motivation also is to provide U.S. consumers of financial services with access to a deep, varied, competitive, and efficient banking market in which they can satisfy their financial needs on the best possible terms.

Current law applies the policy of national treatment to all foreign banks alike, whether they are privately owned or government-owned. In our view, the existing legal and regulatory framework, including the particular regulatory attention that has been paid to the U.S. operations of foreign government-owned banks, is adequate to deal with abuses by government-owned banks on a case-by-case basis. The Federal Reserve advocates a case-by-case approach in this area because we have not observed a pattern of abuse. Most government-owned banks operating in the United States behave in a manner fully consistent with market practices and in compliance with law. While we recognize abuses have occurred, such abuses have been limited in number and cannot be attributed to the mere fact of government ownership.

Section 201 of the bill would require each branch, agency or representative office of a foreign bank and each affiliate of a foreign bank that is organized under the laws of any state or maintains an office in any state to report to the Federal Reserve annually the names of the depository institutions at which it retains deposit accounts. In the Federal Reserve's view, this type of reporting does not appear to serve any meaningful purpose because, to the extent it is needed, it can be obtained in the examination process.

The Federal Reserve already requires substantial reporting by foreign banks. Branches, agencies and subsidiary banks of a foreign bank must file periodic call and country exposure reports. These reports provide regulators with information to judge the behavior and performance of foreign banks. Information in these reports also permits the Federal Reserve and the other regulatory agencies to compare foreign banks with their domestic counterparts. Moreover, under the recently enacted Foreign Bank Supervision Enhancement Act, each branch, agency and subsidiary bank of a foreign bank is examined at least annually and more frequently if necessary. In contrast, the information required to be reported by this bill could become quickly outdated, since deposits may be created and liquidated very quickly.

The requirement also would not appear to be consistent with the principle of national treatment in that comparable reporting is not required of domestic banks and bank holding companies. Finally, we are concerned about the extraterritorial reach of the provision -- as drafted, it may require reporting of deposits held by a foreign affiliate of a foreign bank whether or not such deposits are related to U.S. operations.

The final section of Title II would require revocation of the charter or impose other comparable sanctions on any bank that is found to have violated export control laws and regulations. Unlike the provisions applicable to government-owned banks, these provisions are applied on a national treatment basis. I would note, however, that current law permits regulatory authorities to terminate the U.S. activities of a foreign bank that violates U.S. law, including any violation of export control provisions.

Conclusion

In summary, the Federal Reserve believes existing regulatory tools, bolstered by the recently passed Foreign Bank Supervision Enhancement Act, are sufficient to deal with the issues presented by the activities of foreign banks that are owned by foreign governments. Accordingly, we oppose the bill's attempt to close the U.S. market to foreign government-owned

banks. If such a provision were enacted, the ultimate losers would be U.S. consumers of financial services. The incidence of improper activities does not appear any greater for government-owned banks than for other banks, whether foreign or domestic. We recognize the need to monitor the activities of government-owned banks and we fully intend to take appropriate enforcement action on a case-by-case basis. We also believe, however, that the problems encountered do not justify the result called for in this legislation.

EXHIBIT I

U.S. PRESENCE OF FOREIGN BANKS AS OF DECEMBER 31, 1991

(dollar amounts in billions)

	TOTAL U.S. ASSETS		NUMBER OF BANKS		NUMBER OF OFFICES	
	Gov't	*Private*	*Gov't*	*Private*	*Gov't*	*Private*
WESTERN EUROPE						
France	$33	$29	5	10	18	16
Italy	$32	$14	7	7	18	8
Germany	$7	$17	4	9	4	17
Austria	$6	$2	2	1	3	1
Portugal	$1	$1	3	1	4	1
Spain	$1	$13	1	5	3	19
Switzerland	$0	$39	0	6	0	16
Sweden	$0	$11	0	4	0	4
United Kingdom	$0	$48	0	9	0	31
Netherlands	$0	$30	0	3	0	22
Others	$3	$8	6	7	11	10
TOTAL	$83	$212	28	62	61	145
ASIA AND MIDDLE EAST						
Israel	$12	$0	4	0	21	0
Korea	$3	$6	2	6	9	21
China	$2	$0	2	0	3	0
Indonesia	$2	$0	5	3	6	3
Taiwan	$2	$4	6	2	8	7
Japan	$1	$432	1	54	1	146
India	$1	$0	3	0	8	0
Malaysia	$1	$0	2	0	3	0
Thailand	$1	$1	2	3	5	6
Pakistan	$1	$0	3	0	6	0
Singapore	$0	$1	1	4	2	7
Hong Kong	$0	$22	1	9	2	22
Others	$3	$8	7	12	1	20
TOTAL	$28	$474	39	93	75	232
LATIN AMERICA						
Brazil	$2	$2	5	11	10	15
Mexico *	$1	$10	1	5	1	12
Argentina	$1	$0	2	1	3	1
Colombia	$1	$0	3	1	5	1
Venezuela	$0	$2	1	5	2	9
Others	$0	$3	2	7	0	10
TOTAL	$5	$17	14	30	21	48
OTHER						
New Zealand	$2	$0	1	0	1	0
Australia	$2	$6	3	3	4	11
Canada	$0	$60	0	7	0	46
TOTAL	$3	$66	4	10	5	57
GRAND TOTAL	$120	$768	85	195	162	482

* Five of the six Mexican banks with U.S operations were privatized between August 1991 and March 1992. Source: Call reports.

EXHIBIT II

U.S. PRESENCE OF FOREIGN BANKS AS OF DECEMBER 31, 1991

(dollar amounts in billions)

	Government		Private		Total	
	Offices	Assets	Offices	Assets	Offices	Assets
Branches & Agencies	147	$105	383	$601	530	$706
Bank Subsidiaries	10	$13 1/	84	$164	94	$177
Other	5	$2 2/	15	$3	20	$5
Total	162	$120	482	$768	644	$888

Notes:

1/ The ten U.S. bank subsidiaries of foreign government owned banks are: Banco de Bogota Trust Co. (Banco de Bogota), State Bank of India California (State Bank of India), Bank Leumi Trust Co. of NY (Bank Leumi-le Israel), Israel Discount Bank of NY (Israel Discount Bank), UMB Bank and Trust Co. (United Mizrahi Bank), California Korea Bank (Korea Exchange Bank), Century Bank California (Philippine National Bank), Bank of the West (Banque Nationale de Paris), Extebank (Banco Exterior-de Espana), and Atlantic Bank of NY (National Bank of Greece).

2/ Includes two Edge Corporation subsidiaries and three Article XII New York Investment Companies.

Source: Call reports.

EXHIBIT III

U.S. OPERATIONS OF FOREIGN BANKS WITH INDIRECT GOVERNMENT OWNERSHIP

COUNTRY/ CORPORATE PARENT	FOREIGN BANK	U.S. OPERATIONS	12/31/91 U.S. ASSETS $ MM
ITALY			
Istituto per la Ricostruzione Industriale (IRI)	Banco di Roma	2 branches, 2 agencies	$ 10,639
	Banca Commerciale Italiana	2 branches, 1 agency	4,617
	Credito Italiano	1 branch, 1 agency	2,163
Fondazione Cassa di Risparmio di Roma and IRI	Banco di Santo Spirito	1 branch	1,825
ISRAEL			
Histradut (Government controlled labor org.)	Bank Hapoalim	7 branches, 1 agency	2,830
COLOMBIA			
National Coffee Fund	Banco Cafetero	1 Edge corp.	186
AUSTRALIA			
Commonwealth Banking Corporation	Commonwealth Bank of Australia	1 branch, 1 agency	303
MALAYSIA			
Petrolian Nasional (National Oil Co.)	Bank Bumiputra	1 branch, 1 agency	498
SINGAPORE			
Tamasek Holdings (Govt. holding co.)	Development Bank of Singapore	2 agencies	371
HONG KONG			
China International Trust & Investment Corp. (PRC)	Ka Wah Bank Ltd	2 branches	154
TOTAL U.S. ASSETS			$23,586

EXHIBIT IV

U.S. BRANCHES AND AGENCIES OF FOREIGN GOVERNMENT OWNED BANKS
(AS OF DECEMBER 31, 1991)

	Type of Government Ownership			
	DIRECT	INDIRECT	TOTAL	PRIVATE OWNERSHIP
ASSETS 1/ ($ in billions)	$66	$21	$87	$585
GROWTH RATE FOR U.S. OFFICES				
Average annual rate of growth in assets for individual offices from 1980-91	11.4%	8.7%	10.1%	16%
LENDING TO HOME COUNTRY				
Home country exposure/assets	26%	21%	25%	30%
NONPERFORMING LOANS				
Nonperforming loans/assets:				
Foreign and domestic nonperforming	2.15%	2.39%	2.21%	2.91%
Domestic nonperforming only	1.37%	1.28%	1.35%	2.09%

Notes: 1/ "Assets" include only claims on third parties-- this amount is net of any claims on the parent bank or its other affiliates.

- Mexican banks privatized in 1991 are included in "Government Ownership" calculations above since affects of privatization will not be represented in 1991 financial statements.
- SOURCE: U.S. branch and agency call reports and U.S. branch and agency country exposure reports.