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**Statement by**

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**Vice Chairman, Board of Governors of the Federal Reserve System**

**before the**

**Subcommittee on International Finance**

**of the**

**Committee on Banking, Housing and Urban Affairs**

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## Foreign Banking in the United States

### Introduction

Mr. Chairman, I appreciate your invitation to appear before the Subcommittee in its hearings on direct foreign investment in the United States. Too often, direct foreign investment is thought of as involving only industrial and commercial institutions. The Subcommittee's recognition that such investment also involves banks and other financial institutions is certainly appropriate.

The amount of direct investment by foreign banks in U.S. banking facilities is small--less than \$1 billion. But in the case of banking, the size of that direct capital investment does not measure the importance of the activity. Banks traditionally operate on a smaller capital base than is typical in industry and commerce. The principal business of banks is to assemble funds from a variety of sources--deposits or borrowings in domestic or foreign money markets--and to relend those funds to others. It is the effects of these banking transactions--the money flows and the business transactions they accommodate--that should be used to assess the implications of foreign investment in U. S. banking offices. Judged by these activities, and by their total assets of close to \$35 billion, the U. S. banking offices of foreign banks are still not large compared to insured U. S. banks, which have \$762 billion in total assets and \$59 billion in equity capital and reserves. But their activities are growing and becoming increasingly important in certain U. S. financial markets. For example, commercial and industrial loans at these institutions have now grown to 8 per cent of all such loans in the United States.

Sources and uses of funds by foreign-owned banks

Banks traditionally rely on deposits of their regular customers for the bulk of their resources. A second source of funds, and one that is growing in importance, is the domestic money market, which includes the market for interbank loans and deposits. A third source of funds is the international money market (including borrowing from affiliates abroad). Eurodollar borrowings and deposits are the pre-eminent instruments in this market. Participants in both the domestic and international money markets are sophisticated, and funds invested in these markets are highly interest-sensitive and predominantly very short in maturity.

Banks engaged in international banking, operating offices in a foreign country, generally have difficulty in establishing a large stable deposit base in the currency of the host country. This is true both for U. S. banks operating abroad and for foreign banks operating in the United States. Therefore, when operating outside their home country, banks are inclined to rely in some considerable measure on funds supplied from their home office. Frequently, however, they encounter difficulties in bringing funds from outside the host country. Many countries impose limits on such capital inflows through banks, both for balance of payments reasons and because capital inflows can have an unwanted effect on domestic credit flows. Accordingly, banks in foreign countries seek to supplement their resources from their home country by drawing on various parts of the

money market in the host country. Usually the most important source of money market funds for foreign banks is borrowing from the host country's domestic banks. Other money market sources of funds in the foreign country tend to be very short term and in most countries quite limited in amount.

The operations of foreign-owned banks in the United States reflect these general characteristics of international banking. They have to look to foreign sources for about 40 per cent of their resources of about \$35 billion (as seen in the table). Foreign funds of about \$14 billion, are drawn primarily from the home offices or other affiliates of the parent. Funds obtained in the United States consist mainly of deposits of nonbank customers, about \$5 billion, and borrowings from nonaffiliated U.S. banks, almost \$7 billion.

U. S. offices of foreign-owned banks lend and otherwise invest about \$5 billion more in the United States than they obtain here-- that is, they are channeling that amount of foreign funds into the U. S. economy. This figure changes, of course, with shifts in relative money market conditions here and abroad.

These foreign-owned offices use a large share of their resources to make commercial and industrial loans in the United States. Commercial and industrial loans account for about 40 per cent of their assets--a substantially higher proportion than is the case for domestically owned banks that are members of the Federal Reserve. The foreign banks' commercial and industrial loans are in good part related

Assets and Liabilities of Foreign-Owned  
U. S. Banking Institutions as of October 31, 1973  
(billions of dollars)

<u>Assets</u>		<u>Liabilities</u>
<u>Commercial and industrial credits</u>		<u>Deposits and other liabilities</u>
		<u>Nonbank</u>
To U. S.	11.8	5.5 From U. S.
To foreign	3.6	3.6 From foreign
<u>Money market assets</u>		
<u>Interbank loans and securities</u>		<u>Bank (non-affiliated)</u>
Loans to U. S. banks <sup>a/</sup>	4.4	6.8 From U. S.
Loans to foreign banks	1.1	0.5 From foreign
U. S. Government, agency securities	1.5	
<u>Due from parent bank and other affiliated institutions</u>		<u>Due to parent bank and other affiliated institutions</u>
In U. S.	2.9	3.4 In U. S.
Foreign	4.2	10.1 Foreign
<u>Clearing balances</u>	3.0	2.0 <u>Clearing balances</u>
<u>Other assets</u>	2.5	2.3 <u>Other liabilities</u>
	35.1	0.9 <u>Capital and reserves</u>
		35.1

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<sup>a/</sup> Includes loans to security dealers

Detail may not add to total due to rounding.

Source: FR 886a form, "Monthly Report of Condition of U. S. Agencies, Branches and Domestic Banking Subsidiaries of Foreign Banks."

to international business and reflect the international orientation of these banks. One-fourth of these loans are to foreign customers.

Types of operations of foreign banking offices

The U. S. activities of foreign-owned banks depend in some degree on how and where they are established in the United States. There are also differences reflecting historical or ethnic characteristics of the country of domicile of the parent bank.

Apart from the representative office, which is essentially nothing more than a sales or service office and does not perform any banking functions, there are three corporate alternatives used by foreign banks conducting a banking business in this country: subsidiary corporations, branches, and agencies. Subsidiaries may be chartered under laws of some States; three States have in fact issued such charters. They can also be chartered under Federal law but the requirement that the directors must be U. S. nationals has limited the use of this alternative. Branches of foreign banks are presently authorized to conduct a full-scale lending and deposit business in five States. Agencies of foreign banks are authorized in New York and California. Agencies and branches are similar to each other in some respects, but agencies do a wholesale banking business whereas branches engage in wholesale banking, retail banking, or both.

Agencies account for more than half the assets of all foreign banking offices. Because they cannot sell certificates of deposit, they rely heavily on interbank (Federal funds) borrowing and borrowings from directly related institutions abroad (Eurodollars).

These sources account for a total of about three-fourths of their funds. They typically employ their funds in money market loans and commercial and industrial loans, frequently related to international transactions.

Branches and subsidiary banks, on the other hand, rely to a substantial degree on deposits: for branches deposits account for about one-half of total liabilities, whereas in the case of subsidiary banks the share is about three-fourths. Some of these deposits are obtained from local business and consumers, while others are obtained by offering large-denomination certificates of deposit to money market investors. Branches, like agencies, also obtain funds from directly related institutions abroad as well as in the interbank market. Subsidiary banks (particularly in California) and some branches endeavor to conduct a retail banking business similar to that of most U. S. banks; other branches concentrate primarily in wholesale international banking.

There are 60 foreign banks with offices in the United States. Most of these institutions are very large banks; in the aggregate their worldwide deposits are over \$450 billion. At recent count, they had 115 offices in the United States--68 in New York, 39 in California, and 8 in four other States. Relative to worldwide deposits, Canadian and Japanese banks have larger interests in U.S. offices than banks based in Great Britain, Western Europe, and elsewhere. In total U.S. assets, Japanese banks ranked first followed by Western Europe, Canada and Great Britain.

The modes of operations of foreign-owned banking offices in this country tend to vary according to the country of the parent bank.

1. Canada. Canadian banks operate both agencies and subsidiary banks in California, and agencies in New York.

The Canadian agencies in New York draw the funds they use to operate in the United States largely from the head offices and foreign branches of the Canadian chartered banks although those funds may originally have been acquired, in part, from U. S. or other non-Canadian sources.

In recent years, the Canadian agencies have been using those funds increasingly in commercial loans and in arbitrage between the Eurodollar market and the domestic market for interbank loans. Their commercial loans are largely to U. S. corporations to meet domestic needs. Some of that loan business has been related to the growth of direct investment by U. S. corporations in Canada. Although maintaining a long-standing role as specialists in lending to U. S. securities dealers and brokers, these agencies have recently been reducing their emphasis on this type of activity.

2. Japan. Japanese banks, like the Canadian banks, operate agencies and subsidiary banks in California and agencies in New York.

The Japanese agencies have the same powers as Canadian agencies, but in their lending operations they have emphasized the financing of U. S.-Japanese trade, and in some cases also financing of Latin American exports to Japan.

The agencies obtain funds from their parent banks' head offices in Japan and raise funds in the U. S. market by selling their own acceptances and borrowing from U. S. banks.



Some of the Japanese subsidiary banks in California have been successful in developing a retail banking business.

3. Europe. European banks have placed greater emphasis historically on branch operations in New York City. Additionally, however, they have established some agencies and subsidiaries in New York, including a few investment companies chartered under New York State laws. European banks also have banking subsidiaries in California, the largest being First Western, which has just been acquired by Lloyd's Bank.

Many European banks, in important but varying degrees, use their New York branches to channel payments that the parent banks generate through their worldwide financial operations. These foreign banks find it essential to have offices in this country to handle efficiently transactions that have grown to enormous dollar totals. Many of the European branches serve their head offices not only for payments business in the United States but also for administering their payments activities worldwide.

Handling payments gives rise to other banking business. The huge volume of foreign exchange orders and the sharp swings in transaction balances that occur from day to day sometimes place substantial demands on these U. S. offices for funds and on other days produce large excess balances. To dispose of such excess funds the U. S. offices of European banks lend large amounts of money to U. S. corporations and also furnish substantial funds to their foreign head offices.

Most of the European banks that have offices in this country are engaged here principally in wholesale banking activities. However, some British banks have been expanding into the retail banking market as well.

Growth of foreign banks' activities

Growth of foreign banks' activities in the United States since the mid-1960's has been one aspect of the broad internationalization of banking which has occurred during this period. This is the counterpart in the banking area of the flourishing growth of multinational business.

Measured from 1965, foreign banks' assets in the United States have grown by about six-fold. It should be noted, however, that this striking rate of increase has been roughly matched by the six-fold expansion in the foreign assets of a group of seven large U. S. banks that were already actively engaged in international banking in the mid-1960's. And much the same reasons that account for the expansion of U. S. banks abroad also account for the growth of foreign banks in this country.

Foreign banks have followed their own foreign customers who have come to the United States to set up industrial and commercial operations. Once here, they have assisted other industrial concerns in investing in this country. They have helped to finance the growing volume of trade and have provided information on economic activity and trade opportunities both in the United States and abroad.

Foreign banks have found that banking offices in the United States afforded valuable access to the U. S. money market, and banking offices in New York have strengthened the ability of foreign banks to handle the daily settlements that arise from their own or their customers' transactions in dollars.

In sum, for any foreign bank, as for any U. S. bank, an office in each major international money market is viewed as a key ingredient in an effective worldwide banking operation.

In addition to these broad financial considerations that have led to the expansion of international banking generally, the growth of foreign banks in the United States has reflected changes in legislation in several States. The decision of New York State about a dozen years ago to permit foreign banks to establish branches was one of the principal legislative changes improving the opportunities for foreign expansion in the United States. A few other States have also liberalized laws regarding foreign banks. Notably, several months ago Illinois amended its laws to permit a foreign bank to establish a single branch within the Loop area of Chicago. Several foreign banks are in the process of opening such branches in Illinois.

Nonbanking activities

To this point, I have spoken about banking activities of foreign-owned institutions in this country. They also conduct some other activities on the periphery of banking, but it should be noted that these are not very large. Certainly their nonbanking activities are insignificant compared with domestic bank holding companies.

Several foreign banks have affiliates in the United States engaged in the securities business--in some cases both as underwriters for new issues and as brokers and dealers for domestic or foreign issues. Several of these affiliates have become members of regional stock exchanges in this country.

The Canadian banks do some financial business in this country through trust subsidiaries, in addition to their U. S. banking offices. These trust units act mainly as custodian, paying agent, and transfer

agent for Canadian entities that have issued securities in the United States.

British banks have few nonbanking direct investments here. One of them is continuing its interests in real estate development projects, and its investment banking interest in some small U. S. companies, which it held before passage of the Bank Holding Company Act Amendments of 1970.

Japanese banks have small investments in some Japanese companies that do business in this country--notably the trading companies. In Japan, banks traditionally have taken equity interests of less than 10 per cent in nonfinancial firms that are their important customers.

Several foreign banks (Italian, French, and Greek banks) operating in the United States are owned directly or indirectly by their respective governments, which also own nonfinancial companies doing business in the United States.

Concluding remarks

Mr. Chairman, my assignment today has been to provide a factual presentation on the activities of foreign banks in the United States, and I welcome the opportunity to assist in this way in your inquiry. I should like to conclude my remarks with a general comment or two.

In my view, the growing and substantial investment and operational activity of foreign banking interests in this country has stimulated competition in banking and financial markets here. In addition, the access to U. S. markets that foreign banks have enjoyed has facilitated the activities of U. S. banks in markets abroad.

At the same time, it should be noted that these institutional developments have abetted the greater movement of funds internationally and in so doing have posed some problems in implementing monetary policy in the United States. In recent years, the Board has taken several actions to modify the effect of international monetary flows on domestic monetary and credit conditions. However, foreign-owned banking institutions, which are an important channel for these flows, are not subject directly to Federal Reserve legislation. Last June, therefore, when the Board as part of its anti-inflationary program introduced a marginal reserve requirement for large certificates of deposit issued by member banks and asked nonmember banks similarly to hold reserves, it requested foreign-owned banking institutions to maintain reserve deposits against increases in large CD's and in net Eurodollar borrowings above base-period levels. I am happy to say that foreign banks acceded to this request.

Recognizing the growing importance of foreign banking in the United States, the Board established a Federal Reserve System Steering Committee a year ago to review the status of international banking regulations and to consider the public policy issues. The Committee, of which I am Chairman, has made good progress and hopes soon to submit recommendations to the Board.

Mr. Chairman, thank you very much.