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MULTINATIONAL BANKING IN THE UNITED STATES
SOME REGULATORY ISSUES

Remarks of

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It is a pleasure to be here today and to have this opportunity to discuss with you some problems of multinational banking in the United States. In recent years, contacts between the Bankers' Association for Foreign Trade and the Federal Reserve System have been steadily increasing because of our mutual interest in international banking issues. It is only a month or so ago that several of us met with your President and one of your committees and benefited from an exchange of views.

Because of this, I thought it would be appropriate this morning to share with you some of the thinking that has been going on in the Federal Reserve System's Steering Committee on International Banking Regulation. As you know, it is a little over a year ago that the Federal Reserve announced the establishment of this Steering Committee to bring before the Board of Governors the regulatory policy issues that had emerged in the field of international banking. The assignment of the Steering Committee, drawing on the findings of an extended body of staff work, was twofold: First, to examine Board regulatory policies and supervisory practices concerned with the international activities of U. S. banks; second, to assess the operations of foreign banks in the United States in the light of their recently enlarged activity in this country and in view of changes in banking activities and banking structure growing out of the 1970 amendments to the Bank Holding Company Act.

Today, I would like to speak mainly about the second half of the Steering Committee's assignment--the position of foreign banks in the U.S. banking system. Any consideration of this subject can easily lead to misunderstandings. Hopefully, my comments here on Federal Reserve attitudes, objectives and approaches to several questions will allay some fears and reduce some of the misunderstandings that have already occurred. However, it needs to be emphasized at the outset that resolution of issues relating to foreign banking in the United States is primarily a matter of Congressional determination under our system. Any conclusions by the Federal Reserve thus will take the form of recommendations to the Congress.

Before turning to particular aspects of the Steering Committee's work, I should like to make a few general observations about the present state of international banking, the consequences of its development, and the Federal Reserve interest in multinational banking issues. That background may serve to place specific issues in a better perspective.

International Banking Today and the Public Interest

Banking has had an international cast to it since its very beginnings. But the transformation of banking into truly a multinational business and of banking institutions into multinational enterprises is the product of the last decade or so.

A clear manifestation of this is found in the international business of American banks. Since the late 1950's the major American banks, at first gradually and then with growing momentum, have been extending the frontiers of their business into the corners of the earth. The extension of that business has taken the form of traditional commercial banking operations through branches and subsidiary banks overseas; but, increasingly, various types of affiliates have been used to engage in such bank-related activities as are identified with leasing and finance companies, various money market institutions, securities companies, development banks, long-term credit institutions and the like. In many instances these banking affiliates have come into being in markets where straightforward banking operations have not been permitted or have been subject to discriminatory treatment.

The dimensions of the internationalization of the major American banks are nowadays widely recognized. It is not too many years ago when there were only eleven U.S. banks operating full-scale branches abroad. Today, nearly 50 banks carry on full-scale foreign branch operations and the total number of foreign branches of American banks now exceeds 700. The assets of these branch networks alone are now in excess of $125 billion. Earnings from international operations constitute a major source of income for the largest American banks; for a number of them, as nearly as can be determined, between one-quarter and one-half of their income is generated in their international business.

Banks in the principal industrial countries outside the United States have also undergone this process of internationalization during the past decade. Some, of course, have long records of overseas operations but these usually were of a somewhat specialized nature arising for historical reasons. They, too, have been recasting their operations into a more generalized international business involving an enlargement of their overseas facilities. One observes this development among the British clearing and overseas banks, a number of continental European banks and most recently the Japanese banks.

One aspect of the growing international orientation of banks outside the United States is their interest in the United States. The number of foreign banks represented or operating in this country has grown steadily in recent years and very recently has accelerated.

The forces behind the internationalization of banking are well known to all of you: rapid and continuous expansion in world income and output, the growth in world trade and payments accompanying the increasing interdependence of national economies, the development of the multinational corporation--to cite a few. These forces are still in an expansive phase and the transformation of banking into a multinational business is by no means complete. The financing of prospective growth in world trade and investment will involve huge sums and will call for effective and efficient mechanisms for collecting and allocating funds throughout the world.

Thus, there is every likelihood that in the near future governments generally will be concerned with the institutional framework and the means by which international banking is conducted. It seems to me, that, for our part, only by providing reasonable certainty in the environment and ground rules, can we expect that needed changes will take place which involve further enlargement and adaptation of American bank operations abroad and of foreign bank operations in the U.S.

Several consequences have flowed out of the growth of multinational banking. First of all, that development has resulted in a wider range of financial services being available. That variety of services has acted as an underpinning to the growth of world trade and investment. It has also led to more vigorous competition in national and international banking markets to the benefit of consumers and business. Money and capital markets the world over are now closely linked with the result that the allocation of savings and credit to productive uses is now more efficient.

These advantages have not been achieved without some drawbacks appearing. The integration of money and capital markets has accelerated the transmission of changing money and credit conditions among national economies, and has probably reduced the scope for independent national financial policies. At the very least, it has, at times, complicated the task of monetary and fiscal authorities. Also, in some countries, the increased penetration of local banking and money markets by foreign

institutions has provoked nationalistic reactions of a restrictive character. In any event, there is a greater concern on the part of governments nowadays as to the implications of multinational banking for the financial structures of their countries and for the formulation and conduct of their own financial policies.

The Federal Reserve shares this concern. Accordingly, it may be helpful to elaborate on the nature of the Federal Reserve's interest in multinational banking issues. The Federal Reserve's primary responsibility as a central bank is to conduct monetary policy. The effective conduct of monetary policy presupposes strong, well-functioning institutions and markets through which policy actions can be effected. A related prerequisite is a knowledge of the likely and actual consequences of different policy actions in financial markets and in the real sectors of the economy. The Federal Reserve has therefore a vital interest in the condition of the banking institutions participating in domestic financial markets. Equally vital is the access to knowledge of changing conditions in banking and credit markets in response to monetary policy actions, a matter of particular importance when those conditions are significantly affected by international capital flows channeled through major banking institutions. It is, therefore, essential that the Federal Reserve have a close working relationship with the major banking institutions and that they are subject to such rules as the Federal Reserve may devise to implement monetary policy.

Besides these interests growing out of its monetary policy function, the Federal Reserve has specific responsibilities for banking structure and soundness as a bank supervisory agency. Over the years, Congress has consistently granted the Board a large measure of discretionary authority to regulate and supervise the overseas activities of member banks. Thus, Board approval must be obtained for the establishment of foreign branches, the chartering of Edge Corporation subsidiaries, and investments in foreign subsidiaries and affiliates and the Board is empowered to set rules governing the activities of these entities. The public interest with which the Board is concerned here is that of helping to assure the soundness of banks in this country and their continued ability to provide banking services in their communities. From this general objective derives the Board's concern with bank capital and bank management and the nature of banking activity overseas and the risks associated with it.

Also, Congress has given the Board very large responsibilities for banking structure in this country under the 1970 amendments to the Bank Holding Company Act. In keeping with the legislative mandate, the Board has sought to carry out those responsibilities in a way that would promote competition in an enlarged and more rational framework of banking activity. One of the questions encountered in devising rules that would apply throughout the banking industry and in implementing those rules in specific cases, has concerned the status of foreign banks in this country and their position vis-a-vis indigenous banks.

Foreign Banks in the United States

Foreign banks have a long history in this country but until recently their activities here have been of a limited and specialized nature. Their representation here had its beginnings in facilitating and financing trade between the United States and their countries of origin. Consequently their representation here was largely confined to the principal port cities. Some others, such as the Canadian banks, employed offices in this country to avail themselves of U.S. financial markets in managing their external liquidity.

Today, foreign banks are conducting a much wider range of activities and are having a much more significant impact on both wholesale and retail loan markets and in the various markets for funds. At the end of last year some 60 foreign banks were engaged in banking operations in the United States and the total assets of their offices here amounted to $38 billion, more than a six-fold increase since 1965. Moreover, the number of foreign banks operating here and the number of their banking offices are growing rapidly. Witness the recent purchase of the billion-dollar First Western banking organization by Lloyds Bank and the numerous banks seeking to enter the newly opened Chicago market.

Rather than survey the range and character of these operations, I propose to offer a few general observations on their role and position in the United States. First of all, it is my opinion that the growth and activities of foreign banks in this country have been, on balance, salutary. Among other things, they have provided additional competition

in loan and money markets; and they have increased the range of international financial services available to U.S. trading and investment interests. The continued growth of the operations of reputable foreign banks is therefore to be welcomed, a view which I believe is shared throughout the Federal Reserve.

The United States has been generally hospitable to the entry and activities of foreign banks. But that hospitality has depended on the workings of State law. And State laws have operated to limit the location of foreign bank operations and to circumscribe the form of their banking organization. Until recently, foreign banks were effectively confined to the States of New York and California as locales for banking operations. While some others have since been added, most of the States do not now permit foreign banks to establish offices within their borders. As to form of organization, New York law for many years only permitted foreign banks to have agencies in the State--that is, banking offices that could not engage in a general deposit business with the public; only in 1962 was that changed to permit foreign banks to operate full-service branches. In California, State law has operated to require the establishment of subsidiaries if foreign banks sought to conduct both domestic and international banking operations.

The uneven incidence of State laws has provided foreign banks with certain advantages over domestic banks. By careful choice of organizational form, foreign banks have been able to establish banking operations in more than one State, a privilege not presently

available to domestic banks. Several foreign banks have taken advantage of this ability and are established in the form of agencies, branches and subsidiaries in as many as five States. At the same time, some of the limitations attached to the form of organization have reduced operational flexibility and lessened the ability of foreign banks to benefit from the developed money markets in this country. For example, agencies of foreign banks do not have access to the CD market and consequently must rely on the inter-bank or Federal Funds market or on foreign sources of funds to finance their operations.

Foreign banks have thus far confined their activities in this country largely to traditional commercial banking operations. This can be contrasted to the behavior of American banks: in foreign markets they have extended their activities, where permitted, into a broad range of near-banking activities; and even at home domestic banks have been expanding under the holding company umbrella through finance companies, factoring companies, mortgage banking and other financial services as permitted under the bank holding company regulations. To the best of our knowledge, the "nonbanking" interests of foreign banks in the United States are thus far insignificant; it would seem that foreign banks have not yet become aware of the enlarged opportunities available to banks to conduct numerous operations in the United States, without geographical limitation, under the Bank Holding Company Act.

One area of activity in which some foreign banks have been interested is the securities business. Several banks, principally from

Europe, have securities subsidiaries or interests in securities companies. Some of these affiliates engage in a certain amount of underwriting and dealing, an activity not permitted to domestic banks under the Glass-Steagall Act. Their principal activities, however, appear to be brokerage of securities for their foreign customers and the provision of investment advisory services related to the U.S. market for their foreign customers. In general, these latter activities are of a type that domestic banks perform through their trust and other departments.

One final point concerns the size of foreign banks operating in this market. With few exceptions, the foreign banks here are the principal banks in their home countries and are among the largest on a worldwide basis. Of the 60 or so foreign banking organizations operating in the U.S. today, no less than 10 have worldwide resources in excess of $15 billion, no less than 25 have resources in excess of $5 billion. Of the remainder, about one-third have resources in excess of between $1 and $5 billion.

In my view these banks should be regarded in terms of their worldwide status, not just by the scale of their operations in the United States. Similarly it is appropriate to judge U.S. banks overseas not by their particular position in an individual country but by their worldwide operations.

Even in the United States the operations of most foreign banks are of a very respectable size--a number of them now have footings in excess of $1 billion. This point has importance in assessing the

standing and competitive impact of foreign banks in the domestic banking market. Regardless of their size here, they are fundamentally the competitors of the large money market banks in this country.

Several public policy problems are posed by the enlarged and growing scale of foreign bank activity in this country. In the area of monetary policy, the Federal Reserve could, until recently, afford largely to ignore the operations of foreign banks. Overlooking the impact of their present scale of operations in money, loan, and deposit markets is no longer a prudent course.

The Federal Reserve has faced a growing problem in its monetary operations in assessing the effects of those operations on the liabilities of the entire banking system because of the existence of nonmember banks. Foreign banks form an important part of the nonmember bank sector because of their role as conduits for international money flows and their heavy reliance on foreign sources of funds, their liabilities are subject to variations of considerable significance. Though important money market operators, foreign banks have not generally been subject to the reserve requirements that apply to the major U.S. banks. This situation has given them a cost advantage compared to the other money market banks and has introduced other discontinuities into the functioning of money markets. It was partly for this reason that last June, when the Board 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. It is very much to the credit of the foreign banking community that it recognized the importance of the Board's objectives and voluntarily has cooperated fully with this request.

In the regulatory area, too, certain issues have surfaced. These seem to be more important prospectively than currently. Nonetheless, a certain tension does exist where a different set of rules applies to foreign institutions than to their major domestic competitors. This fact is being brought to our attention with increasing frequency, the latest instance concerning Regulation M.

Tension also will arise where the rules applicable to one set of foreign institutions differ from those to which others are subject, just by virtue of the organization of their operations in this country and the way in which those operations are subject to different provisions of law and regulation. Although the nonbanking activities of foreign banks are minimal today, looking ahead, unless they are subject to essentially the same rules as domestic banks and bank holding companies, the banking environment will be politically unstable. And it seems to me that the nationality of banks has little bearing on the questions of competition, concentration of banking power, conflict of interest, and soundness of banking operations with which regulatory policy is basically concerned.

Finally, there are potential problems of international amity. I have already mentioned that in some countries the entry of foreign banks and their penetration of local banking markets have provoked nationalistic and restrictive reactions. While U.S. attitudes toward foreign banks have not been hostile, there have been exceptions. Last year, as many of you know, two bills were introduced into the California State Legislature which by their terms would have severely restricted foreign bank operations in California and which would have had adverse repercussions extending well beyond the State's borders. Those bills were vigorously opposed by the major banks in California, an opposition in which the Federal Reserve joined, and the bills were defeated. The information we receive is that the issue may be revived through the reintroduction of these bills, or something like them. That experience does serve to point up the need for a national policy that would minimize the chances of discriminatory treatment here.

Then, too, late last year two bills were introduced in Congress to control foreign banks in the United States. In the opinion of the Board, these virtually identical bills adopt an overly restrictive attitude toward foreign banks in this country; not only would they remove the advantages now possessed by foreign banks, they would actively discriminate against foreign bank operations in this country. The Board's views in opposition to these bills are matters of public record.

The Approach of the Federal Reserve Steering Committee

I have outlined some of the problems we perceive with the present status of foreign banks in the United States. To recapitulate: The entry and activities of foreign banks are almost exclusively under the jurisdiction of the several States, and consequently are subject to the variation of State laws and regulations. This condition provides both advantages and disadvantages, as compared to domestic banks, with regard to where they may establish banking operations and to the nature of their activities and the terms on which they may be conducted. In the absence of any Federal presence, foreign bank operations are exposed to changes in State laws and regulations which are determined by local interests that may not have a common national viewpoint. Foreign bank operations in this country are significant to the workings of monetary policy and to external financial policy, but foreign banks do not now have an established relationship with the central bank.

In the Steering Committee, we have concluded that the existence of these problems warrants an effort to regularize the status and position of foreign banks in this country. The objective would be to bring those operations here into conformity with those of domestic banks, with the same opportunities and subject to the same disciplines. Achievement of that objective would, importantly, remove uncertainties as to the future for foreign banks in this country and would help to assure that as a matter of national policy, their presence here would continue to be welcomed and fostered on a fair basis.

In arguing this position, the question is frequently raised: Why now? The concerns mentioned seem more prospective than actual, complaints from domestic competitors are few, and the scale of foreign bank operations is still relatively small.

As I have tried to indicate, the structure of banking and the banking environment is rapidly changing the world over, and this is especially true in the United States. The monetary and financial problems that we will have to face in the coming years are very unclear, as is how we shall cope with them and the tools we may seek to employ. It seems to me that if we are to meet those problems successfully it behooves us at all times and as best we can, to promote a strong and sound banking structure in which institutions may compete vigorously and equitably in furnishing financial services to the public. The time to deal with recognizable problems is before they become acute and while remedial actions can be taken without large dislocations.

In approaching the question of the appropriate treatment for foreign banks in this country, the first issue encountered was that of reciprocity. We soon discovered that that term is very loosely used indeed. Implicit definitions ranged from "when we are in your country we should be treated as your domestic banks," to "when we are in your country we should be able to do what your banks are permitted in our country"; and there were several gradations in between. It became quickly apparent that the logical and sensible guiding principle to be followed was what we have called mutual nondiscrimination. That is

to say, a policy of national treatment should be followed where foreign and indigenous institutions would have the same privileges and be subject to the same rules so that equitable treatment would be afforded to comparable institutions competing in the same national market. This approach also preserves for each national government the right to determine the rules applicable to banks operating in its territory. A few moments reflection is sufficient to be convinced of the impracticality of the opposite approach of permitting a foreign bank to operate in accordance with the rules of its home country. In the United States, that could mean more than a dozen sets of institutions, each coming from different banking traditions and environments and operating under different sets of rules, the consequences of which would be unsatisfactory, both economically and politically.

Mutual nondiscrimination then seems to us the only sensible and workable approach to problems of multinational banking regulation and a worthwhile example for us to set. Moreover, adoption of that principle by the principal industrial countries of the world seems to us the best means of achieving true reciprocity in international banking. One can appreciate the sensitivities in some countries lest their banking systems be dominated by external influences. But such a possibility seems more or less remote so far as the larger and industrialized countries with highly developed banking systems are concerned. We have been discussing this approach of mutual nondiscrimination with the central banks and banking authorities of the major industrial

countries. I think it fair to say that among those we have contacted, there is a wide measure of agreement with this general principle. There are, of course, differences of view about the possible implementation of such a principle, particularly as it may affect existing interests which in some cases are those of government-owned banks.

Several conclusions flow from acceptance of that principle. Any implementing measures would have to (1) include bringing all foreign-owned institutions conducting the essence of a banking business in the United States under the same set of rules as domestic banks, (2) opening up to foreign banks entry alternatives available to domestic institutions, including the possibility of entry into areas previously closed to them, and (3) bringing foreign bank operations within the purview of the central bank. As I said at the outset, to consider changes of this sort is to contemplate Federal legislation, both because it would be necessary and because it would be desirable as a means of establishing a national policy toward foreign banks.

Some of the problems in devising a legislative solution include (1) entry alternatives, (2) the question of Federal Reserve membership, (3) multi-State operations, and (4) the status of existing activities and locations (the so-called grandfathering problem). The first of these problems concerns both ease and form of entry. The apparent solution to this problem is to provide a Federal alternative to State chartering and licensing of foreign bank operations. In this way, opportunities for entry would be made possible in areas hitherto

closed to foreign banks by reason of State law, and the conditions of entry would be formulated on the basis of national policy rather than on individual State interests. On the form of entry, we believe that it should be a matter of indifference whether a foreign bank operates here as a subsidiary or a branch. Regardless of the form of organization, those operations rest in the last analysis on the capital and management capabilities of the home office. Thus, in our view, any Federal alternative should permit foreign banks to establish banking subsidiaries with national charters, and it would be helpful if foreign banks could operate branches under a national license.

The question of requiring Federal Reserve membership on the part of foreign banks has evoked a surprising amount of talk. The United States must be the only country in the world where the foreign banks do not have an established relationship with the central bank. There are no "nonmember" banks abroad!

The principal argument raised against requiring Federal Reserve membership is that it would be discriminatory, since not all banks in the United States have to be members. That argument confuses the operations of foreign banks here with those of our many small community and neighborhood banks. Without exception, all domestic banks with deposits in excess of $1 billion are members of the Federal Reserve. And as I have emphasized, almost all of the foreign banks operating in the United States are very large banks that even in their U.S. operations do not wish to be mistaken for small local banks and, in fact, hold themselves out as competitors with the large American money market banks.

It has seemed to me that there has been an insufficient assessment among foreign banks of the benefits as well as the costs of System membership. Among the benefits, I would include access to the discount window, check clearing and wire transfer privileges, and the recognition within the American banking community that System membership brings. From the Federal Reserve's point of view, of course, foreign banking membership in the System would bring within the purview of the central bank the remaining money market banks and would promote the efficiency of the instruments of monetary policy.

The establishment of general equality of treatment for foreign banks would have the consequence of foreclosing, under present rules, multi-State deposit banking. An argument one hears is that foreign banks can break down existing barriers to inter-State banking. I see no practical force in this argument.

In the meantime, domestic banks are availing themselves of other means of conducting certain types of national and international banking business throughout the country. One form of doing so, which should be of interest to foreign banks, is the Edge Corporation subsidiary. A number of the major domestic banks are employing these subsidiaries in as many as five different cities to conduct an international deposit and lending business. Other usable means available to banks wishing to conduct business in more than one State include loan production offices and the facilities available under the Bank Holding Company Act to which I have already referred. It should be emphasized, too,

that operating in the United States means access to a highly developed money market, a condition that does not exist in many other countries. In such a money market, banks of good national and international reputation can raise funds quickly and efficiently no matter in what part of the country they are located.

The final problem I would mention is the endemic one encountered whenever changes in rules are contemplated--namely, the problem of what to do about existing operations. In the case of foreign banks operating in the United States this grandfathering problem can only get worse if resolution of their status is delayed. As already mentioned, that is one of the major reasons it is important to come to some public policy decisions in this area. As of now, all foreign bank locations and activities could probably be granted grandfather rights without significant adverse effects. The grandfathering decision, however, is one for Congress.

A number of alternatives are available in dealing with this problem. None are perfectly satisfactory. Neither we in the Steering Committee nor the Board have come to firm conclusions in the matter. It may be useful in the circumstances to review the attitudes of Congress in past situations where this question has arisen. Congressional solutions have ranged widely, from near-immediate disposition of non-permissible activities to permanent grandfathering of existing activities as of the date of enactment of legislation.

In the McFadden Act, for example, which was concerned with branch banking, Congress took the position that all existing branches in lawful operation on the date of the Act would be grandfathered. Similarly, in enacting the Bank Holding Company Act in 1956, Congress concluded that the impact of the Act on multi-State expansion would be only prospective in nature and that existing multi-State operations of bank holding companies would be grandfathered permanently.

In the area of nonbanking activities, Congressional decisions have been more varied. In seeking to separate commercial and investment banking under the Banking Act of 1933, Congress gave member banks only one year to disaffiliate themselves from securities companies. The Bank Holding Company Act of 1956 gave bank holding companies only two years from the date of enactment in which to divest themselves of nonpermissible investments, though the Board was given limited authority to extend the divestiture period. In the 1970 amendments to the Bank Holding Company Act, Congress granted permanent grandfather rights to nonpermissible nonbanking companies held as of mid-1968 and 10-year grandfather rights to all other nonpermissible nonbanking companies acquired between mid-1968 and the enactment of the Act.

Conclusion

The problem of regularizing the status of foreign banks in the United States is complex. The approach I have outlined is to my mind a reasonable one. Nevertheless, there remain a number of details to be explored in seeking to implement that approach. Discussions are

continuing with foreign authorities and, to some degree, with interested parties to ascertain that all aspects of the problem have been considered and fairly treated. Once that is completed, the Board will be in a position to reach conclusions and to make specific proposals. I hope this can be accomplished in the near future.

In conclusion, I would ask each of you--whether American or foreign bankers--in considering the question under discussion today to think seriously about the advantages of creating a stable yet flexible framework for multinational banking operations. If you do, I think that you will conclude, as I have, that in such an endeavor the public interest and the private interests of banking organizations and their customers are better served by nondiscriminatory rules and guidelines and by certainty in their application.

Thank you very much.

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