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U.S. REGULATORY AND MONETARY POLICIES AND THE INTERNATIONAL OPERATIONS OF U.S. BANKS

Remarks of

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I am pleased to be with you today to discuss some current issues involving the regulation of the international activities of U.S. banks.

U.S. banks have long occupied a central position in the financing of world trade and investment and have played a key role in the development of multinational banking as we know it today. For nearly a decade, however, the growth of the international activities of U.S. banks was centered outside the United States because of the capital controls in effect in this country. That orientation may well be changed by the reopening of U.S. credit and capital markets to full participation in the international financial system. Because of the standing of U.S. banks in domestic financial markets, their contribution to the evolution of multinational banking should be enlarged by this altered situation. The nature of that contribution will, among other things, be conditioned by the regulatory climate in which U.S. banks operate both in this country and abroad.

In my remarks this morning, I should like to focus most of my attention on the multinational role of U.S. banks as it is affected by foreign and domestic regulatory policies with primary attention to those of the Federal Reserve. Before doing so, however, I think it would be useful to make some general observations about the role of banking regulation in a multinational banking world.

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Regulation In a Multinational Banking World

The rapid pace of expansion in international banking has transformed the world's principal commercial banks into truly multinational enterprises. U.S. banks currently operate more than 700 foreign branches with total assets in excess of $100 billion. In addition, the major U.S. banks have extensive operations abroad through various types of affiliates engaged in leasing, factoring, investment banking, money market operations, wholesale and retail financing and the like. For these banks, international activities now account for between one-third and one-half of their total business. One large bank currently derives more than one-half of its income from its international business.

I do not have comparable data for banks from other countries. But there can be no doubt that their international activities have also been expanding rapidly and have involved a substantial enlargement of their overseas facilities. One manifestation of this development is the enlarged role of foreign banks in the United States. More than 60 foreign banks now have banking facilities in the United States with total assets of some $40 billion. It is primarily the large foreign banks engaged in international business that have chosen to expand their operations in the United States. For example, 90 per cent of those foreign banks having total deposits of over $10 billion maintain banking offices in the United States. Using a lower size cutoff of $1 billion, the proportion of foreign banks with offices in the United States is 40 per cent.

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The multinationalization of banking has brought distinct advantages and benefits to the functioning of the world economy. A wider range of financial services is now available to underpin the growth of world trade and investment. More vigorous competition exists in national and international banking markets to the benefit of consumers and business. Money and capital markets are now closely linked providing a more efficient allocation of savings and credit to productive uses. With everyone operating in everyone else's backyard, so to speak, an increasingly effective institutional structure has been constructed for the financing of the world's work.

At the same time, this development has had profound implications for banking and financial structure in national markets and for the functioning of national money and credit markets. Central bankers and bank regulatory authorities cannot afford to ignore these widening horizons nor their implications for regulatory policy.

The role of regulation in banking has traditionally been to help assure the safety and soundness of banking institutions and their viability as going concerns in serving their communities and economies. The public interest in the basic safety and health of the banking system has in no way been diminished by the development of multinational banking; rather the added dimension has extended and probably complicated the task. There is now a trans-national public interest in regulatory practices that will promote a sound, efficient, and competitive banking and financing structure on a global basis.

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There are two aspects of the regulation of multinational banking that I would like to single out. The first is the role and responsibility of the host country. The second concerns the special responsibilities of the home country.

Every nation has a primary responsibility and concern for the safety of institutions providing deposit, loan and other banking services to the public within its borders. That responsibility and concern extend to both indigenous and foreign-owned institutions. When a foreign bank seeks to operate within a country, that host country and its governmental authorities have an obligation to satisfy themselves that the foreign bank is reputable, well-managed and in a sound financial condition. The host country has the further and continuing responsibility to insure that the bank's subsequent local operations are conducted in a responsible and prudent way.

At the same time, the home country, the country of domicile, has a unique interest and responsibility for the soundness of its multinational banking institutions. The home country cannot afford to overlook the potential repercussions of international activities on such bank's domestic operation and its ability to provide banking and financial services in the domestic economy. Nor can it afford to overlook the repercussions of domestic activities on such bank's repute and standing abroad. While it might be legally and theoretically possible to separate a bank's international activities from its domestic operations, I see no way in real life to do so. The business of handling the

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public's money and deposits demands a single standard of soundness, integrity and confidence. A default on an obligation in one country or by one affiliate can pose a threat of default wherever the bank is operating and runs the risk of destroying confidence in the institution and its management so essential to its existence as a going concern. Experience of recent years has clearly demonstrated that wherever a bank operates, and whatever organizational form it uses, all operations rest fundamentally on the capital, management capabilities, and reputation of the home office.

This poses a special problem and a special responsibility on the regulators in the home country. For it is only the home country that is in the position to provide the surveillance designed to help assure that those of its banks conducting multinational operations are adequately capitalized, sufficiently liquid, and possess management capable of conducting all of its activities, domestic and foreign. Host countries must in these circumstances look to the home countries for this breadth of supervision. Up to now, we cannot be sure that a fail-safe means of assuring this calibre of supervision exists. Accordingly, a problem confronting all central banks and bank regulatory authorities today is to devise improved means of accommodating their mutual interests in promoting safety and soundness in multinational banking enterprises.

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The Regulation of Foreign Activities of U.S. Banks by U.S. Authorities

I should now like to turn to the regulatory framework governing the foreign activities of U.S. banks and the current regulatory issues in that area, as I see them.

For some time now, as you know, there has been within the Federal Reserve System a Steering Committee on International Banking Regulation. That Committee, of which I am the Chairman, is composed of four members of the Board and three Presidents of Federal Reserve Banks. The purpose of establishing the Committee was to provide a means of exploring and bringing before the Board the regulatory policy issues that had emerged as a consequence of the rapid development of multinational banking.

The work of the Committee has fallen into two parts. One part has been concerned with issues relating to host country responsibilities--namely, the status and position of foreign banks in the United States. That topic has been widely discussed recently by myself and others. The other part of the Committee's work has been concerned with issues relating to home country responsibilities--that is, U.S. regulatory policies governing the activities of American banks abroad.

The Federal Reserve has long had specific statutory responsibilities for supervising the overseas activities of member banks. Board approval must be obtained for the establishment of foreign branches, the chartering of Edge Corporation subsidiaries, and for investments in foreign subsidiaries and affiliates. The Board is also empowered to set rules governing the activities of these entities.

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The public interest with which the Federal Reserve is concerned in regulating and supervising the overseas activities of U.S. banks is that of helping to assure their soundness in this country and their continued ability to provide banking services in their communities. Accordingly, the Board has, in approving member bank activities overseas, looked to the condition of the bank and has sought to satisfy itself that the bank was adequately capitalized and had sufficient management capabilities to support those activities. In devising rules governing banks' overseas activities, the Board has been concerned for the same reason with the nature of those activities and the risks associated with them.

In carrying out its responsibilities, the Board has consistently permitted U.S. banks to engage in a wider range of activities in foreign countries than is permissible at home. For example, they have been allowed to engage in investment banking activities of the sort not permissible under the Glass-Steagall Act. They have also been permitted to make limited equity investments in nonfinancial companies in connection with their financing activities.

A principal reason for allowing this greater latitude overseas has been to enhance their competitive effectiveness in foreign markets. The rules governing banks in foreign countries reflect quite different banking requirements, banking traditions and legal and social structures from those of the United States. Banks in many countries often have wider powers than have been granted to banking institutions within the

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United States. Absent compelling policy considerations to the contrary, it has seemed equitable to allow U.S. banks to take advantage of those additional powers so that they might fully and vigorously compete in those markets.

A second reason for not extending domestic banking constraints to the banks' international activities is that many of those constraints are basically concerned with the competitive environment in the United States and with concentration of financial resources in the United States. The banking and financial structure in foreign countries and the competitive environment in those countries are the responsibility of the foreign authorities. Thus, the Board has avoided extending the standards incorporated in the Bank Holding Company Act to the international activities of U.S. banks.

The regulations governing the international activities of U.S. banks have not been revised for many years. Under those regulations, the activities that American banks are permitted to engage in have been and are still largely decided on a case-by-case basis. This has resulted in a lack of certainty as to the activities American banks can conduct abroad and has created a large administrative burden on the industry and on the Federal Reserve System.

The Steering Committee has consequently been reexamining the System's regulatory posture with a view to clarifying and simplifying the regulations under which the foreign operations of U.S. banks are conducted. A principal objective is to furnish a regulatory framework

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in which U.S. banks can plan and conduct their international activities with greater certainty but which still retains sufficient flexibility to accommodate changing demands for banking and financial services. A second objective is to provide a regulatory scheme of sufficient generality that will reduce the burden of regulatory approvals.

Three problem areas encountered in this attempt to revise the regulatory framework are (1) the limits that should be placed on the types of activities American banks engage in abroad; (2) the overlap of activities conducted abroad with domestic activities; and (3) the treatment of joint ventures. Concerns in these areas relate to risk, the soundness of banking operations and the separation of banking and commerce in the United States.

As I have already noted, banks in foreign countries often have much wider powers than are possessed by banking institutions in the United States. In a number of countries, those wider powers extend to operating participations in commercial and industrial enterprises. One view on this problem, which is sometimes characterized by "When in Rome, do as the Romans do", is that for reasons of competitive equality U.S. banks should be allowed to engage in any activity permitted to local banks in foreign markets. The opposite view is that certain activities involve risks qualitatively different from those associated with banking and financial operations and those risks are unfamiliar to bank management. According to this view, those activities should not be permitted in the interest of bank soundness.

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The second problem area concerns the potential for activities engaged in overseas to intrude on domestic objectives for banking structure and competition. In an increasingly integrated world, it is becoming progressively difficult to maintain a separation between foreign and domestic activities. Thus, U.S. banks' investments in commercial and industrial enterprises abroad could by virtue of the worldwide operations of those enterprises conflict with the domestic objectives of maintaining a separation of banking and commerce in the United States. Similarly, the participation of U.S. banks in foreign financial institutions could by the nature of their activities lead to compromises of the standards imposed under the Bank Holding Company Act.

The third problem I would like to mention is one associated with joint ventures overseas. This is a problem for host countries and home countries alike. The problem may be illustrated as follows: In recent years, there have been numerous instances of two or more banks joining together to establish specialized banking and financing institutions. None of the partners in these enterprises has been in a position to exercise control. These institutions are operating on the strength and reputation of the participating banks. Yet for the host country, the question is where does the responsibility for this institution lie? For the home countries of the participating banks, the question is the extent of the liability of that bank toward the joint venture and the ensuing implications for its capital and for its domestic operations.

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I have mentioned these problems to indicate some of the difficulties and complexities of devising a suitable and rational regulatory framework in a multinational banking world.

Monetary Regulations Governing Foreign Operations of U.S. Banks

My remarks have turned out to have been mainly concerned with regulations relating to banking structure and banking soundness and safety. But monetary regulation may also be expected to affect the international operations of U.S. banks, particularly those regulations designed to influence international credit and capital flows.

World financial markets have become increasingly integrated and the transmission of changing money and credit conditions among national economies has been greatly accelerated. Views may differ on the extent to which this development has reduced the scope for independent national financial policies; but at the very least, the task of monetary and fiscal authorities in managing their economies has been complicated.

For the foreseeable future, it seems to me a fact of life that monetary authorities the world over will seek to be in a position to influence international money flows through the banking system when those flows conflict with domestic economic policy objectives. The form that regulations to that end might take cannot be fully specified in advance. But U.S. and other banks with international operations must, in my opinion, expect that those operations will be constrained or shaped from time to time by various types of monetary regulations aimed directly at international capital flows.

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Conclusion

A sound and efficient multinational banking system is becoming more and more vital to the functioning of the world economy and to the economic welfare of its inhabitants. The task of constructing a rational regulatory framework for such a banking system that will promote soundness and safety, encourage competition, and allow for flexibility and innovation, pose a challenge for all central bankers and bank regulatory authorities.

Banking markets the world over are far from homogeneous. Their variegated nature derives from differing banking requirements, differing banking traditions, and differing legal and social structures. In the circumstances, establishment of something approaching a uniform regulatory framework, even among the industrialized nations, can only be thought of as a very long-range objective. Current endeavors to harmonize banking regulations within the European Economic Community provide a topical illustration of the difficulties to be encountered and surmounted. We even have problems in harmonizing banking regulations within the U.S.

In the near term an appropriate regulatory framework, in my opinion, can be achieved by the adoption of the principle of nondiscrimination or national treatment. Under this approach, each country establishes the regulatory and monetary rules under which banking operations are conducted within its jurisdiction. Both foreign and indigenous banks are subject to the same opportunities and the same

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disciplines as to the nature of their activities. Mutual subscription to this principle would have the distinct advantage that within at least the major national markets, comparable institutions could operate and compete fully with one another under a uniform set of rules.

Here in the United States, we at the Federal Reserve are attempting to do our part in carrying out home and host country responsibilities by promoting a competitive, yet soundly based banking structure. In doing so we recognize that differences in banking practices and patterns from country to country should be accommodated so long as that accommodation does not frustrate our national policy nor weaken the ability of U.S. banks to meet their responsibilities in the United States.

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