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Foreign Bank Participation in U.S. Financial Services Reform

An Address by

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I am pleased to be here today to discuss the opportunities and challenges facing foreign banks in the United States today. Foreign banks are significant participants in the U.S. economy. Banks from 68 countries currently operate over 800 offices in the United States, accounting for over $900 billion in assets at year end 1994. Approximately a third of the business lending in the United States is by foreign banks.

I believe this is a particularly opportune time to discuss foreign bank participation in U.S. markets. Progress toward structural reform of the U.S. financial system and the trend toward reduction of regulatory burden present compelling opportunities not only for U.S. banking organizations but also for the foreign banking community. The enactment of the interstate banking reform legislation last year was a positive step. If enacted, both Glass Steagall reform and regulatory burden reduction would represent additional real progress. I will focus my remarks on these three areas.

Interstate

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 authorizes phased removal of barriers to nationwide banking and branching for both domestic and foreign banks. The Act's provisions are consistent with the policy of national treatment. In fact, a provision that would have required a foreign bank to own a U.S. subsidiary bank in order to operate nationwide was rejected.

Under this new law, a foreign bank may acquire subsidiary banks nationwide on the same basis as a U.S. bank holding company. In addition, any U.S. bank subsidiary controlled by a foreign bank may establish branches outside its home state to the same extent as other U.S. banks. A foreign bank also will be allowed to establish and operate federal or state-licensed branches in any state outside its home state to the same extent as a domestic bank. This can occur in two ways: first, if a state opts in to permit branching on a de novo basis, the foreign bank may set up direct de novo branches. Second, a foreign bank would also have the ability to merge with a domestic bank and convert the domestic bank's offices to branches of the foreign bank. Foreign banks also retain their current ability under the International Banking Act to establish agencies and limited branches outside their home states.

De novo branching would be the preferred alternative for both U.S. and foreign banks. It appears, however, that many states may choose not to "opt in" for de novo branching. Consequently, the route to interstate banking likely will require merger for both foreign and domestic banking organizations.

It will be interesting to watch the development of interstate banking over the next two years, as banks continue to expand and as more states adapt their own statutes in response to the new federal law. When the provisions of Riegle-Neal are fully effective in 1997, foreign banks will have a number of interstate expansion options.

Glass Steagall

The Federal Reserve has long recognized the need and strongly supports efforts to modernize U.S. financial laws. The time has come to dismantle Glass Steagall which mandates separation of commercial and investment banking. Specifically, the Board supports the approach contained in the Leach bill -- which would authorize the affiliation of banks and securities firms, as well as permit banks to have affiliates engaged in most other financial activities.

Like the interstate legislation, the Leach bill would remove outdated restrictions and rationalize the system for delivering financial services in the United States. It would bring the United States more into line with other industrialized countries, virtually all of which currently permit banking organizations to affiliate with securities firms.

Consistent with the policy of national treatment, this expansion of permissible activities for banking organizations would be available to foreign banks as well. The bill recognizes that foreign banks operate in this country as both banks and bank holding companies and establishes a structure that accommodates these organizational forms. For example, foreign banks would not be required to establish U.S. banking subsidiaries in order to take advantage of the new rules. In addition, in determining whether a foreign bank is well capitalized -- one of the prerequisites for engaging in broader powers -- the Board is directed by the statute to apply capital standards comparable to those applied to domestic banking organizations, giving due regard to national treatment and equality of competitive opportunity.

The bill as reported out of Committee also addresses a major concern identified earlier this year by the foreign banking community. Specifically, the bill would permit foreign banks that operate in the United States only through wholesale branches and agencies to choose to be treated as investment bank holding companies, rather than as financial services holding companies. Consistent with national treatment, investment bank holding company status is available only if the foreign bank meets comparable capital and other standards applicable to domestic wholesale financial institutions. The bill also requires that the home country of a foreign bank provide national treatment to U.S. banks before treatment as an investment bank holding company is available to the foreign bank.

Of course, the Leach version of Glass Steagall reform would not achieve European-style universal banking in the United States. In addition, while the Leach bill would currently allow banks to affiliate with insurance companies, the outcome of this issue is unclear. This is a very important issue for foreign banks that affiliate with foreign insurance companies. Under current law, such firms must choose between banking and insurance operations in the United States which can have the undesirable result of the bank being forced to "de-bank" in this country. However this debate is settled, I hope that some form of Glass

Steagall reform can be passed to break down the long outmoded barriers between commercial and investment banking for foreign and domestic banks.

Reduction of Regulatory Burden

The Board supports relieving costs imposed on our nation's banking system by governmental regulation when those costs are not offset by corresponding benefits to the safety and soundness of financial institutions, the protection of bank customers, or the availability of credit. We are acting on our own to reduce the cost of regulation where we can. But we believe that legislation is necessary to continue these efforts.

Reduction of regulatory burden is as much an issue for foreign banks as it is for domestic counterparts, particularly since the enactment of the Foreign Bank Supervision Enhancement Act in 1991. The Board has now had over three years of experience under this Act. Although the processing of most FBSEA applications has been very time consuming, we are working to reduce those delays. I am pleased to report that the pace of applications processing has accelerated in 1995.

On the basis of our experience, the Board believes that some provisions of the FBSEA should be reevaluated -- notably the inflexible requirement that the Board may not approve an application unless a foreign bank is subject to comprehensive consolidated supervision by home country authorities. This standard has proved a significant barrier to entry for banks from jurisdictions, especially developing countries, that have not yet implemented a policy of consolidated supervision. The Board supports the provision recently adopted by the House Banking Committee in the regulatory burden relief bill that would allow a foreign bank meeting all other requirements to open an office in the United States, subject to appropriate safeguards, if the Bank's home country is working to establish arrangements for consolidated supervision. This approach would be consistent with the Basle minimum standards on consolidated supervision and would give well-run foreign banks from developing countries an opportunity to establish a limited presence in the United States. The revised provision would also encourage foreign supervisors to continue their efforts to improve their systems of supervision.

In two other respects, the bill addresses concerns of foreign banks. As you are no doubt aware, the International Banking Act requires that the Board assess foreign banks for the costs of examination, subject to a moratorium that expires in 1997. The regulatory relief bill provides that the Board must charge foreign banks but only to the same extent it charges State member banks for the costs of examinations.

Second, the bill as revised in Committee would require the Board to take all reasonable measures to reduce burden and avoid unnecessary duplication in bank examinations. With respect to foreign banks, the Board and other banking authorities are well on the way to meeting this requirement with the implementation of the Foreign Banking Organization Program.

In closing, I wish to emphasize that the Federal Reserve remains committed to open markets that provide the opportunity for all competitors to offer their services. The legislation discussed today demonstrates a willingness to accommodate the interests of foreign banks within a context of true national treatment. It will be a lost opportunity to U.S. and foreign banks alike if some forms of Glass Steagall reform and burden reduction are allowed to wither in this legislative session.