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# Regulatory Review Initiatives at the Federal Reserve

An Address by

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at

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I am pleased to be here today to talk with you about important regulatory initiatives currently underway at the Federal Reserve which I believe may be of interest to the foreign bank community.

Before turning to regulatory issues, I would like to put the role that foreign banks play in this country into context. Simply put, foreign bank participation is of major significance to the U.S. economy, especially in the wholesale banking market. Banks from 61 countries currently operate over 800 offices in the United States, accounting for over $1 trillion in assets at the end of 1995. Approximately one third of the business lending in the United States is by foreign banks. I believe foreign bank participation in the U.S. has helped create the strongest, deepest and most varied banking and capital market in the world.

A report issued last month by the General Accounting Office highlighted significant growth during the past two decades in the share of U.S. banking assets held by foreign banks and confirmed the importance of foreign banks in the wholesale market. The report also noted that U.S. branches and agencies of foreign banks helped to maintain access to credit for U.S. businesses a few years ago when U.S. banks were restricting lending in order to rebuild their own capital.

Foreign banks are indeed welcome to operate in the United States. Because of the significant contribution made to the U.S. market by foreign banks, we are concerned about the growing trend by foreign banks to "debank" in the United States.

This "debanking" phenomenon is a result of the fact that our laws on bank affiliation prevent foreign financial groups from offering in the United States the same range of financial services they offer in their home countries. A foreign bank must choose how to expand its operations in the United States: if it conducts banking, it cannot conduct insurance activities and only limited securities operations. If the foreign bank chooses insurance or securities, it must close its U.S. banking operations. Should "debanking" become a well-used route out of the United States by foreign banks, it would be a serious and unfortunate consequence of our failure to maintain a legal environment that helps to assure that the United States remains a pre-eminent financial services market. I believe this provides one of many compelling reasons for reform of our financial services laws.

Section 303 Regulatory Review

Turning now to the major topic of my remarks, I would like to give a progress report on the Board's comprehensive review of all of its regulations and written policies. This review is mandated by Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994. The Board has assigned the section 303 review a high priority. I am directly involved in overseeing the efforts of Board staff to analyze all regulations and supervisory policies. These rules and policies will be revised or, if appropriate, eliminated to assure that they reflect recent changes in our financial system

and do not hinder the operation of our banking markets. We hope that the result will be a reduction in burden, improved efficiency, and lower cost to the industry. As part of the review, we are working with the other banking agencies to make uniform any regulations and guidelines that implement common statutory policies. Where our review demonstrates the need for statutory changes, we will recommend such changes to the Congress.

The Board published a schedule for our section 303 review last fall -- our timetable is ambitious. The banking agencies are required to submit a joint report to the Congress detailing our efforts by September 1996. We have already made substantial progress. For example, in the tying area the Board has removed restrictions that inhibited nonbank affiliates of bank holding companies from packaging their products. We believe this has been a major benefit to the industry in seeking to compete with nonbank competitors.

Among the Board's regulations of particular interest to foreign banks that are currently under review are Regulation Y (dealing with bank holding companies), Regulation H (dealing with member banks), and Regulation K (a significant portion of which contains the rules governing foreign banking organizations). Regulation Y is currently being evaluated to determine if further changes can be made to streamline application processes by reducing or eliminating notices and applications. We also will be looking at the list of permissible activities with a view

toward expanding the list. Regulation H, which has never before been reviewed as a whole, is being modernized and reorganized. We hope to make it easier to understand and apply by eliminating many unnecessary provisions and updating those provisions that remain pertinent.

Turning now to Regulation K, the Board recently published four amendments of interest to foreign banks. These amendments further implement various sections of the Foreign Bank Supervision Enhancement Act (FBSEA) and the 1994 interstate banking legislation. We are trying to implement these additions to Regulation K consistent with the underlying principles of the section 303 review; that is, in a manner that minimizes, wherever possible, burden and cost to the regulated institutions. Briefly, here is what we have done so far.

Interstate Banking Issues

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 is a complex piece of legislation that authorizes phased removal of barriers to nationwide banking and branching for both domestic and foreign banks in a manner consistent with the policy of national treatment.

In December, the Board requested comment on proposed changes to implement the new statutory requirement that every foreign bank that operates a branch, agency, commercial lending company subsidiary or bank in the United States have a home state. The proposal also would remove outdated restrictions on certain mergers by U.S. bank subsidiaries of foreign banks

outside the home state. The amendments retain the provisions permitting a foreign bank to change its home state once.

In its proposal the Board requested comment on all aspects of the Interstate Act of interest to foreign banks. We intend this year to review the issues raised by the commenters.

Offshore Shell Branches

Last month, the Board issued a proposed rule regarding the management of shell branches of foreign banks by their U.S. offices. The new rule implements a provision in the Interstate Act that prohibits foreign banks from using their U.S. branches or agencies to manage activities through offshore offices that could not be managed by a U.S. bank at its foreign branches or subsidiaries. A substantially similar provision was published for comment by the OCC.

Historically, both foreign banks and U.S. banks have been permitted to manage offshore operations from the United States. The Board has and will continue to monitor relationships between the U.S. and offshore offices of foreign banks as part of the supervisory process to determine whether such activities are consistent with safety and soundness of the U.S. operation. Moreover, an internal study is underway to consider the use currently being made of offshore shell branches by U.S. and foreign banks and what, if any, supervisory challenges they might pose.

Representative Offices

In January of this year, the Board adopted a final rule that reduces the burden associated with the establishment of representative offices by those foreign banks that the Board has already determined to be subject to comprehensive consolidated supervision or for which the Board has previously approved the establishment of a representative office. Such foreign banks need only file a prior notice rather than an application for the Board's specific approval.

Criteria Applicable to Banks Found Not Subject to Consolidated Supervision

Also last month, the Board published a final rule setting forth criteria that it would apply to a foreign bank that the Board has found not to be subject to consolidated comprehensive supervision. These criteria were developed in consultation with the Treasury Department and the OCC and will be used in evaluating whether a foreign bank's U.S. operations, in the absence of consolidated comprehensive supervision, should be terminated or permitted to continue and, if continued, whether any supervisory constraints should be placed upon the foreign bank.

Comprehensive Review of Regulation K

I would now like to turn to additional aspects of Regulation K affecting foreign banks that will be reviewed this year.

As you know, the Bank Holding Company Act contains certain exemptions for foreign banks from the nonbanking

restrictions of the Act. One of these exemptions is available only to foreign banks that are principally engaged in banking. Regulation K implements these exemptions and provides that they are available to foreign banks that meet the standards for "qualified foreign banking organizations" or "QFBOs." To meet the requirements, a QFBO generally must derive more than half of its non-U.S. business from banking and more than half of its banking business from outside of the United States. In determining whether the foreign bank has more than half its business in banking, it may consider virtually any financial services performed under the foreign bank itself.

In the last comprehensive review of Regulation K in 1991, the Board considered, but chose not to eliminate the requirement that financial activities be conducted in the bank ownership chain for purposes of determining compliance with the QFBO standard. The Board instead retained the existing standard and permitted case-by-case exemptions in order to gain more experience with ongoing consolidations of financial organizations in Europe and elsewhere. In the intervening years, the Board has considered a number of exemption requests. In light of this experience, proposals may be made to address the QFBO standard and I encourage your institutions to comment on any such proposals.

Applications for Approval of New U.S. Offices

Another area that will be examined closely will be the application process for approval of new branches, agencies and

representative offices of foreign banks. In our view, the simultaneous processing of such applications by Reserve Banks and the Board's staff initiated in March 1993 has been successful in eliminating certain delays and has allowed an increasing number of applications to be processed in a timely manner. Although we are pleased with the progress that has been made in this area, we also recognize that there is room for improvement. Consequently, we plan to look at other ways in which the applications process can be made less burdensome while still meeting the Board's statutory responsibilities. In this connection, the Board may consider whether any types of applications can be delegated or replaced with prior notices. We are also working on developing a standard application form for FBSEA applications. Any form that is developed would continue to permit, as we do today, incorporation of applicable portions of state or OCC applications. I invite any foreign bank that is interested in these issues to make your views known to the Board in connection with the review of Regulation K, in order that we can all achieve a satisfactory process.

Representative Offices

Defining the proper role and permissible activities of a representative office has proven to be a more difficult task than we had anticipated when the Board first received approval and examination authority over these offices in 1991. Examinations have revealed substantial variation in the size of representative offices and in the scope of their activities. For

example, many smaller representative offices conduct only "traditional" functions such as market research and promotion of the foreign bank, while larger offices perform the full range of loan production services or serve as regional administrative offices for the foreign bank's U.S. banking operations.

As part of the section 303 process, the Board plans to reexamine the portions of Regulation K dealing with representative office activities in order to be assured that the range of permissible activities is consistent with the level of oversight.

Legislative Changes

As we are all aware, there are limits to the amount of burden reduction that can be accomplished without statutory change. The Board, therefore, is hopeful that the regulatory burden reduction legislation currently pending in the Congress will be enacted. We have estimated that if the legislation is enacted, the number of applications and notices required to be filed with the Federal Reserve can be reduced by 50 percent.

An important aspect of that legislation for foreign banks is the provision related to comprehensive consolidated supervision. On the basis of our experience, the Board believes that 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 should be changed. 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 in the bills pending in both the House and the Senate that would allow a foreign bank meeting all other requirements to open a banking 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 at least two other respects, the regulatory relief burden bills address 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 bills provide 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 bills as revised 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.

The regulatory burden reduction legislation is significant and would be beneficial to the banking industry in general. I hope that, despite the difficulties presented by the legislative calendar and the ongoing negotiations over the budget, we do not lose the opportunity to pass legislation which would reduce the regulatory burden for U.S. and foreign banks alike and eliminate barriers to competition in the market for U.S. financial services.

In closing, I encourage you and your institutions to participate fully in the section 303 review process by making your views and suggestions known to the Board's staff. The Board is committed to making the review substantive, comprehensive and timely. We welcome your involvement in that effort.