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PERSPECTIVES ON FOREIGN BANKING IN THE UNITED STATES

Remarks by

Henry C. Wallich
Member, Board of Governors of the Federal Reserve System

at a

"Conference on Foreign Banking in the United States
-- the Economic, Legal, and Regulatory Environment"

Washington, D.C.

March 1, 1982

S U M M A R Y

1. Foreign banking has brought the United States many benefits that are not dependent on international reciprocity. The lack of reciprocity, where it occurs, is nevertheless disappointing.

2. Many of the fears voiced about the impact of foreign banking have so far proved unfounded.

3. There remain, nevertheless, concerns at the political and regulatory level about large foreign acquisitions.

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At this conference on foreign banking in the United States, the task assigned to me is to provide some general perspectives on our topic. You have heard from other speakers concerning a variety of aspects. I would like to stress some general points that strike me as particularly important.

The Growth of Foreign Banking

Foreign banking has had a great expansion in the United States. This evolution has been accompanied by a great variety of questions and concerns on the part of the public, American legislators and regulators, and American bankers. Many of these concerns have been allayed by the passage of the International Banking Act. Some nevertheless remain. To evaluate them, let me begin by setting forth the benefits that foreign banks have brought to the United States, and then take a look at the

principles that have guided and, I believe, should continue to guide United States' policy in this regard.

Foreign banks have made major contributions to the American financial scene. Over the last eight years, the number of foreign banking offices in the United States has grown from about 120 to about 425. The volume of their assets has grown from about \$30 billion to about \$240 billion. This means a rise from less than 4 percent of total banking assets to about 14 percent over these eight years. If we apply these ratios to the foreign banks' share in the assets of all depository institutions, the increase has been from about 2-1/2 percent to about 9-1/2 percent. Given the prospect for increasing "homogenization" of depository institutions in the United States, the more broadly based ratios are perhaps the more meaningful ones.

In evaluating growth of a market share, it must be borne in mind that expansion, after overcoming some initial obstacle, tends to accelerate to a maximum and then to slow down. Growth rates are highest when they are measured from a small base. To take an example from the history of American banks abroad, their penetration of foreign markets, which, of course, began long before foreign banks started to expand intensively in the United States, has slowed down. I expect that the progress of foreign banking activity in the United States will follow a similar pattern.

Foreign banks, and their home countries, have had benefits from entry into the United States as varied as were their reasons for coming here. Foreign banks have been able better to serve their home-country customers as the latter expanded their international operations. They have gained direct access to the largest economy in the world. In some cases, they have made

attractive acquisitions by being able to buy the stocks of American banks at depressed prices. And, before the passage of the International Banking Act, and in a small degree even thereafter, foreign banks have enjoyed competitive advantages with respect to American banks as regards interstate banking. Through grandfathering, some of these earlier advantages have been preserved.

Foreign Banking Has Brought Benefits

Foreign banks have also brought many important benefits to the United States. In the domestic sphere, they have brought innovation and increased competition. For instance, they have brought new pricing techniques. At a time when prime-rate pricing of loans became increasingly less consonant with the realities of the marketplace and unfortunately with the realities of inflation, foreign banks helped to bring about alternative pricing techniques, such as pricing on LIBOR and other money-market rates. Also, at a time when the capital position of many large American banks was becoming increasingly strained, foreign banks contributed to the capitalization of several U.S. banks through acquisition. Even when foreign banks entered as branches and agencies rather than through acquisition, they nevertheless contributed, by virtue of their home-office capital, to the total capital base underlying the structure of bank deposits in the United States. In some cases, foreign banks also have contributed significantly to the meeting of banking needs of particular ethnic groups in the United States.

Before the passage of the International Banking Act, it was sometimes thought that foreign banks, by taking advantage of the opportunity for multi-state operations, might spearhead a relaxation of restraints on the

geographic expansion of American banks. While the International Banking Act took the opposite approach, by limiting multi-state activities of foreign banks rather than easing restraints on U.S. banks, the ferment in this area that we presently observe may have gained strength from the earlier example of foreign bank multi-state expansion.

In addition, foreign banks have on occasion helped to resolve problems created by American law with respect to the acquisition of problem banks. As you know, large problem banks in some cases could not have been acquired by American banks because of the prohibition on interstate mergers and acquisitions, or because of the limitation on anti-competitive mergers and acquisitions within individual states. I must add that I regard this as only a relative benefit for the United States, given that it provided a solution to a problem that was clearly of our own making.

In the international sphere, foreign banks have also brought advantages to the United States. In trying to create a stronger dollar base for their own international operations, foreign banks have helped to solidify the international role of the dollar. The strengthening of the commercial role of the dollar and the enhancement of American banking markets as world financial centers, together with the implied expression of confidence in the dollar and in the United States' economy generally, are heartening, even though the United States no longer has a strong interest in the reserve currency role as such of the dollar. Together with the expansion of American banking abroad, the growth of foreign banking in the United States has helped to round out the process of integration of the United States into the world's financial system.

A Dollar Base

Since creation of a dollar base is so often mentioned as an important motive for entry into the United States by a foreign bank, let me digress for a moment on this topic. It is, of course, very understandable and indeed desirable for a nondollar bank that makes dollar loans and issues dollar liabilities in international markets, to seek reliable access to dollar funding. A presence in the U.S. financial markets can be helpful in this regard. Whether that presence is in the form of a subsidiary, a branch, or an agency, the entity can have access to a very large and flexible market. The flow of funds into this market comes from many sources and provides very elastic accommodation to a reputable borrower.

U.S. subsidiaries of foreign banks have access to the discount window of the Federal Reserve like other U.S. banks. Since the passage of the International Banking Act, U.S. branches and agencies of foreign banks have had access to the discount window. Access of agencies and branches is governed by the principle of national treatment and therefore will be on the same terms as access by a domestic bank. These entities, like their U.S. counterparts, can use the discount window to meet short-term liquidity needs after reasonable alternative sources of funds have been fully used. As a practical matter, foreign-related institutions have rarely had the need to turn to the discount window. They cannot expect to draw on this source, for instance, to meet obligations of a foreign parent or head office. Indeed, where U.S.-chartered subsidiaries of foreign banks are concerned, as is the case of domestic bank holding company subsidiaries, the regulatory authorities expect the parent to be a source of strength to its subsidiary bank in the United States. U.S. regulatory authorities seek to maintain information adequate to demonstrate that this is the case. Flows of funds between foreign parent and the U.S. subsidiary are monitored through the confidential Y-8F report while for branches and agencies there is a similar confidential schedule in the quarterly condition report.

National Treatment

The openness of the American economy to foreign banks is documented by the principle of national treatment which underlies the International Banking Act. Foreign banks are allowed to do in the United States what American banks are allowed to do. The United States does not, as some countries do, place greater limitations on foreign banks than on domestic banks, in some cases going to the extent of total exclusion of foreign banks from the local market.

National treatment, nevertheless, cannot cross every T and dot every I. The practice of grandfathering has given some foreign banks competitive advantages with respect to American banks and with respect to foreign banks entering after the date of the International Banking Act. More liberal bank legislation and regulation abroad, moreover, can carry over to the benefit of foreign bank operations in the United States. Differences in capital ratios, in reserve requirements, and in the scope of permissible activities may affect funding costs and competitive relationships of their foreign subsidiaries and branches. Perfection must not be looked for in this field.

The United States treats foreign banks in the way it does because it is beneficial to the United States. The benefits that I have listed before do not depend on reciprocity. It is sometimes thought that "concessions" made to foreigners are beneficial only if matched by reciprocal concessions from the other side. This may be a concept carried over from reciprocal trade negotiations, in which concessions of hopefully equal value are exchanged. But while that may be an effective technique of extracting benefits for American exporters and for the American economy, it is not a proper rationale

for either U.S. trade policy or for U.S. banking policy. The benefits to the United States of buying foreign goods and foreign banking services are what they are, whether there is reciprocity or not. The American consumer receives cheaper and better goods and services. American producers and bankers are led to concentrate on activities in which they are more productive. A foreign country refusing to offer reciprocity in the treatment of foreign goods and services injures primarily itself. In principle, absence of reciprocity is not an economically valid reason to provide less than national treatment to foreign goods and foreign banking services.

Nevertheless, the absence of reciprocity in offering national treatment is not optimal. The country denying such reciprocity to the United States damages not only itself but also American exporters and American banks. Such a country fails to make its fair contribution to the achievement of an integrated world economy. Its action creates disappointment and frustration because a constructive policy on the part of the United States did not encounter a response in kind.

Concerns About Foreign Banking

This disappointment and frustration would be less serious if there did not exist other circumstances that cast a shadow upon the very open policy of the United States in the banking area. Banking, whether we like it or not, is a sensitive business. That is documented by the heavy regulation to which it is exposed in the United States but to a degree also elsewhere. Foreign ownership touches particularly sensitive nerves in many places. There is a concern that, despite the International Banking Act, foreign banks may still

enjoy legal advantages over American banks. There are concerns that in some cases a foreign owner may abuse his bank for the benefit of his other business interests. There are concerns that some foreign banks may be less responsive to the needs of local communities and other customers that were served by a bank before it came under foreign control. With the advent of control over banks by foreign governments that may employ these banks in pursuit of political objectives, new concerns could arise.

The available evidence goes far to allay many of these concerns. For one thing, such attentions are mainly directed toward that portion of foreign banking activity in the United States that is conducted through U.S.-chartered subsidiaries. This amounts to about one-quarter of the total, whereas the remaining three-quarters are conducted through agencies and branches. The U.S.-chartered subsidiaries in many instances do a retail business, which serves to focus most of the existing uneasiness on them. By contrast, agencies and branches deal principally at a wholesale level. However, the evidence concerning foreign owned or controlled banks seems to show that the concerns I have mentioned have in general not materialized. On the contrary, foreign banks seem to be very sensitive to the need to be good financial citizens.

Among the findings are that banks taken over by foreign interests became stronger banks, although on average they are less strong than U.S.-owned banks because many of them were problem institutions when acquired. The evidence shows further that profitability improved after foreign takeover, although for the same reason it averaged below the profitability of domestically owned banks. Lending activity as a whole was about in line with that of their

domestic competitors. Moreover, there was no evidence that the acquired banks are less responsive to consumer needs. Purchases of state and municipal securities declined relative to those of domestically owned banks, but this may reflect a lesser need for tax-exempt income because of low earnings.

As regards the danger of positive abuses, the U.S. bank supervisory mechanism is better equipped than that of other countries to catch untoward developments, although obviously a bank cannot be thoroughly examined every day. Moreover, the acquisition of banks, and even moderate changes in ownership well below the level of majority control, are closely monitored for both domestic and foreign acquirers of banks. Also, the supervisory system pays attention not only to the U.S. bank that is controlled by a foreign parent, but also to the parent itself. This reflects the principle, already noted, that the parent should be a source of strength to the subsidiary bank and its implementation in part by the monitoring of the flows of funds between the bank and its affiliates. Thus, despite a very favorable experience with foreign owners, considerable protection is provided against major abuses.

Large Acquisitions

Nevertheless, recent acquisitions of large American banks by foreign bank holding companies have caused concern at the regulatory and supervisory and also at the Congressional level. In approving the acquisition of Crocker National Corp. by Midland Bank Limited, the Federal Reserve Board noted: "There is no statutory authority in the Bank Holding Company Act for taking into account the nationality of the acquiring company and ... the Community Reinvestment Act

does not apply to transactions where the acquiring banking organization has no presence in the U.S." Therefore, the Board looked only at the merits of the case and did not consider nationality as a material factor in arriving at its decision.

For three months during 1980, a Congressionally imposed moratorium on foreign acquisitions was in effect. Legislative interest in the banking field currently focuses mostly on domestic matters because of the rapid evolution that is under way in the field of financial services. But an underlying concern undoubtedly exists, and not only in Congress. It is nourished not only by past and possibly prospective developments, but also by the evidence that some countries are less open to foreign banks than is the United States. It is only a few countries, to be sure, that close themselves altogether to foreign banking. On the other hand, it is doubtful whether many foreign countries, or indeed any, would permit the acquisition of one of their largest banks by an American bank. Of course, it must be remembered that in many countries the majority of the banking business is conducted by a very small number of banks. Foreign acquisition of one such bank is not the same thing as acquisition of a bank of equal size in the United States. Smaller countries may have regulatory concerns, or concerns involving monetary and foreign-exchange policy, that would apply in the United States only to a lesser degree if at all. But there can be no doubt that such attitudes abroad can create pressures toward imposing restrictions on acquisitions of large U.S. banks by foreigners.

Various suggestions to restrict foreign acquisitions of U.S. banks have been made, a limit might be placed on the size of the bank to be acquired, or on the proportion of foreign penetration in particular markets, or a public

benefits test might be imposed. There might also be a reciprocity test, based on the ability of U.S. banks to make equivalent acquisitions in the foreign country. To my mind, none of these proposals are persuasive in themselves. But I cannot deny that to me they gain in persuasiveness in the absence of reciprocal national treatment of U.S. banks in foreign markets.

The U.S. Treasury prepared a study of the treatment of U.S. banks abroad, in response to a provision of the International Banking Act requiring that the matter be studied. This was the very moderate reaction of the American legislator to the issue of reciprocity. The overall finding of the study as regards treatment of American banks abroad was generally favorable although it was noted that there was some variation among countries in the treatment of U.S. and foreign banks. I should think that particular instances of treatment that is discriminatory as between domestic and foreign banks, in general, or domestic and American banks only, could more appropriately be dealt with in bilateral negotiation rather than by unilateral U.S. action of one sort or another.

The spread of international banking has moved in an economically constructive direction. Greater integration of national economies into the world economy helps to increase productivity and promotes economic growth all around. National banking systems have been in the vanguard of this integrating movement at a time when in other fields there are rumblings of protectionism. It is important that these gains not be undermined by the irruption of protectionism into the financial fields.