Remarks of

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As some of you know, I have advocated an early resolution of the question of the need for Federal regulation of foreign banks in the U.S. My reasons are not in the least obscure. In a still growing, dynamic, multinational financial system it is inconceivable that the U.S., almost alone among the developed nations, has no such national plan. There are parts, and pieces, of such a tapestry but no coherent finished design exists. We walk on the dark side here without the sure knowledge that what may come will be fair and equivalent to that which the Federal Government requires of its domestic banking enterprises. The principal argument in support of this state of affairs is simply that foreign banks in the U.S. are not important enough to require Federal oversight. That premise is not a valid basis for inaction, nor is it the way nations should view their responsibilities to international accord and commerce.

There are many other arguments advanced against the idea of a Federal law regulating foreign banks, of course. But these secondary reasons are principally related to prospective conditions that may be imposed by such a plan. Today I will try to deal mainly with the basic objection and selectively comment on some of the criticism of the proposed acts.

Multinational banking has predictably moved apace with expanding trade in the post World War II age. Banks which formerly dealt with correspondents in other nations more typically compete in each other's domestic markets today as well as in exotic offshore enclaves. The multinational industrial expansion phenomena undoubtedly reinforced or inspired some of this development. Conveniently, the Eurocurrency markets, responding to powerful demands for expediency in international payments, added further impetus. The extraordinary growth of international assets of U.S. banks only emphasizes the depth and breadth of this movement. The number of foreign banks in the U.S. and rapid growth of their assets is a fundamental strand of a vigorous economic force that shows no sign of abating.

I would suggest that for the vitality of the free world's economies, such developments have been in the main commendable. Some such system would have eventually evolved in any event. But the world-wide banking market we have today is characterized by competition, innovation (sometimes too much innovation), marketplace decision making, and private financial businesses. We all have learned something from each other in the process, and there is more vigor in, and less stratification of, financial markets than might have been the case if the development had taken other forms.

Most recently, severe tests of the international banking system have come with some rapidity. The massive redistribution of OPEC surpluses is an unfinished test, and there have been many other trials. Inflation, world-wide recession, and speculative booms and busts in real estate ventures are examples. More specifically, a dramatic failure or two of key institutions and some notable jolts to others from losses and inadequate controls on foreign exchange and other transactions have blooded the industry. Maturity grows from such experience and I believe the industry is maturing and has the capability and the resources to meet its coming challenges.

I cannot omit reference to the most talked about current challenge, that is, the extent of private lending to countries with rapidly growing external debt burdens. I want to cite it only because it emphasizes my contention that the international bankin system is an indispensable adjunct, vital to world commerce. By our estimates the world's private banking system in recent years has provided the majority of all credit from external sources, for trade, development, balance of payments and whatever, to non-oil lesser developed countries. I agree that new discipline and prudence are required of bankers while other solutions are sought, but that is exactly what I expect will occur among the leaders in your business.

I submit that there is enough substance to this new order to justify the premise that regulatory frameworks must be reviewed to see if they meet the needs of nations as well as the needs of multinational banking. This is not a unique view. In Belgium, the Netherlands, the U.K. and Canada, banking laws have been or are currently being revised. Other countries are reviewing their existing regulations and supervisory practices. The Bank for International Settlements is collecting information on the extent of bank loans to lesser developed countries through the cooperation of private international banks and central banks. International consultations are now occurring on a regular basis among bank supervisory authorities.

All of this is evidence of recognition of a need to rationalize the national regulatory structures with the emerging new world of international finance.

One of the most compelling reasons to regulate foreign banks is, of course, the influence of banks on domestic monetary policy. Most countries' regulatory schemes have not been designed with modern multinational banking operations in mind. As conduits for the international flow of funds have increased, no nation expecting to enjoy the benefits of this process can remain aloof from its impact on domestic policies.

There are other compelling reasons to review regulatory structures. I have mentioned the new order of competition that recent developments have brought to domestic banking markets. I have mentioned the value of exchanging knowledge on new types of lending and banking services. I have also mentioned that practical experience in the evolving system has exposed some weaknesses and a need for new controls. Obviously, the regulatory authorities should apply that same experience to improve their capacity to manage their oversight responsibilities.

The presumption should not be made that this work is or should be oriented towards new restrictions and controls. Quite to the contrary, the process could result in some relaxation of national constraints on foreign banks and some liberalization of regulatory systems which restrict the entry of foreign banks.

At the very least I expect far better and more regular flows of information aiding central bankers and private multinational organizations. A more economic process should result from these aids to a fuller understanding of exposure and risk. I also expect that there will be more informal cooperation among nations' banking authorities. You need no dramatic statement from me to persuade you that failures or difficulties in one international financial institution will cause widespread repercussion throughout similar institutions in freely trading nations. There may even be arguably a need for a formal international regulatory compact. I would resist this generally. In specific areas, such as the examination of overseas subsidiaries, affiliates and branches, the U.S. does need better working agreements and understandings with foreign authorities and, conversely, should be prepared to consider similar requests from our trading partners. On the whole, however, central bankers as a fraternity have a propensity to work together quite directly and quite effectively. My point is simply that there should be more understanding, cooperation and exchanges of information because we are increasingly dependent on such essential procedures to maintain a sound world economic order.

However, if a supernational regulatory framework is unnecessary, clearly some rationalization of the regulatory framework for foreign banks is a goal worth striving for. National treatment is the principle that should guide us, not retaliation. The Western world long ago rightfully disclaimed that latter concept for the conduct of international trade. I think we can be reasonably optimistic about the progress of rationalization of regulatory procedures such as entry into marketplaces, regulation within those marketplaces, and the application of domestic statutes and supervisory constraints on foreign banks. I think you will find these principles endorsed by the major central banks. The need for capital and technology is universal and the interdependence of nations, a fact. While it may take too long a time to harmonize banking rules among nations, the substantial benefits of a multinational banking order are strong enough incentives to ensure meaningful progress in this work.

Against this broad background of growth, change and complex interrelationships in the world of multinational banks, we can now turn to the U.S. position. A fragmentary, incomplete and still developing regulatory structure for foreign banking in the U.S. exists here. But there is no lack of interest. Congress is conducting an extensive study of the activities of U.S. multinational banks abroad. This could be a useful exercise. Concerns about how our banks operate overseas and how their operations affect U.S. interests and our economy need to be dispelled or recognized as valid. Both State and Federal regulators are improving and expanding their procedures in order to conduct their oversight function in a prudent and appropriate manner. National treatment and nondiscrimination, orderly entry and access to markets, protection and safeguards for a country's monetary system, its businesses, its depositors, are appropriate and essential subjects for the authorities in each nation to address.

It should be clear that in my mind there is no persuasive arguable base from which to assert that the Federal Reserve and the other Federal regulators and surely the Congress and the Administration should not have some Federal oversight of foreign banks here. Our domestic system has been too carefully ordered on the national level not to require some fairly comparable Federal regulation of non-domestic banking organizations operating here.

The premise that foreign banks are not important in the U.S. economy does not stand close inspection. The aggregate assets of foreign banks, which have grown at almost a 30 per cent rate in the last four years, now total $76 billion dollars. Credit extensions to domestic concerns aggregate $20 billion dollars and foreign banks now account for 13 per cent of U.S. commercial and industrial loans. I grant that we have a big vital domestic banking industry characterized by an unusual number of institutions in every size category. The giant U.S. banks are among the largest financial institutions in the world. They, in turn, compete, both within the United States and increasingly abroad, with half a hundred near-giant regional institutions. However, there are more than 13,500 other commercial banks just as critically important to the ebb and flow of consumer and commercial services to Americans, in many ways perhaps even more so, than the larger institutions. If I aggregate all of the domestic banks assets in U.S. banks up to approximately the 20 million size category, I could make the unprofessional comparison that 8,000 banks serving communities, farms, and businesses throughout America have aggregate assets that are only equal to the assets of the present number of foreign bank operations in the United States. This is not the right comparison, as you know, because it is everyone's conventional belief that the foreign banks serve larger concerns and compete only with our larger regionals and giants.

But this is not right either. The number of foreign banking offices has grown rapidly. More importantly, such banks are now competing with our smaller banks serving consumers and small businesses in some areas of our country. I have no criticism of this competition. It is good. But to allege that foreign banks are unimportant in our banking structure overlooks this trend and, more seriously, completely overlooks the attractiveness of U.S. domestic business to prospective entrants to our markets. I find it hard to understand why the rapid growth of such banks in the United States has not been extrapolated by the analysts. At the end of last year 88 foreign banks were operating some 200 banking facilities and more offices have been opened or announced since then. The widespread use of the dollar in international and financial transactions, the growing investment by foreigners in U.S. industry, the exceptional size of our capital markets and securities exchanges and the huge consumer markets for credits and goods in the United States support the conclusion that continued growth of foreign banks here is clearly more than a possibility. I haven't even mentioned our political stability and the convenience of dealing in the world's leading trading currency.

I think the usefulness of an international banking structure has been demonstrated and it follows that I have no uneasiness about the very large expansion that our banks have engaged in abroad. The corollary is that we should assure foreign banks an appropriate welcome here, a welcome that is accompanied by certainty of national treatment, fair and nonrestrictive provisions for entry, and nondiscrimination. These principles and goals will not be achieved and our own interests protected without a Federal foreign banking regulatory structure.

At the Federal Reserve two efforts have been made to develop an appropriate form for an International Banking Act. The Congress is willing to pursue this unfinished business and my colleagues and I intend to pursue the matter again in the new Congress.

What issues are left if we move beyond the basic question of whether the regulation of foreign banks is really necessary? I think that can be stated rather simply. The Federal Reserve, the national's Central Bank, should have more than a voluntary tentative program to ask large foreign banks to maintain reserves to ensure the integrity of monetary policy in the U.S. We have proposed and are continuing to propose that banking institutions similar to our giants and near giants should be required to maintain reserves in some form against their dollar liabilities. Secondly, but by no means second in importance, is the protection of Americans' deposits in these institutions. It seems extraordinarily curious to abandon the system of deposit insurance which has protected our domestic bank customers when that system is serving as a model for the development of similar systems abroad. For over 40 years, we have benefited from this safety net. The Federal Deposit Insurance Corporation has available a plan for foreign banks. To suggest a variety of less effective or suspect alternatives is to reject all that we have learned about minimizing the impact of bank failures and difficulties on jobs, business and our economy since the 1930's.

If we can realize fairly comparable treatment for foreign and domestic banks in these most important areas there are no insurmountable problems within the remaining issues. They have been debated extensively and perhaps the debate has obscured the more fundamental rationale for legislation.

Interstate banking for domestic banks exists only in specialized subsidiaries and affiliates and grandfathered installations in the U.S. Foreign banks should be treated similarly until our banking structure laws are changed, as they will be. We have enough experience to predict that this will be an agonizing and controversial process. The argument that we should wait until liberalizing legislation is passed before restricting foreign banks is a trap favoring those who reject a foreign bank bill or others who would use our foreign banking friends as a lever to change our laws covering U.S. banks.

Similarly, security affiliates should be grandfathered now for the same reasons and before the complex mix of commercial and investment banking becomes so tangled a web as to defy unravelling and fair treatment for existing affiliations.

Proceeding from the enactment of a bill similar to that which the Federal Reserve proposed in the last Congress, we can establish fairly comparable treatment for domestic and foreign bank affiliates engaged in nonbanking activities. I want to remind you that in commenting on that bill, the Federal Reserve made proposals that included a carefully ordered recommendation that would have prevented discrimination against foreign banks that engage in nonbanking activities in their own and other countries on a scale impermissible for domestic banks. We have no thought that foreign governments should adopt our concepts of domestic structure and regulation. We have no intention of denying entry to foreign banks because of their affiliations with nonbanking businesses elsewhere if the majority of such business is done outside the U.S.

State governments and Banking Commissioners have advanced seriously conflicting views in opposing Federal legislation to regulate foreign banks. Those States which have already attracted foreign banks want to keep that economic advantage. Some other States which hope to encourage branches of foreign banks argue for the status quo in which direct multistate banking privileges are available only to foreigners to the detriment of the domestic banking industry. There is some evidence that other States, abjuring these views, would be likely to bar foreign banks altogether. In the extreme there are fifty possible U.S. positions and thus fifty ways that U.S. banking policy towards our trading partners could be expressed, a clear prescription for chaos.

Let me drive this point a little further. U.S. banking regulation, State and Federal, while obviously not overly strict in the sense that our industry has flourished, is a very comprehensive compendium of law and regulation designed to insulate our huge economy from the vicissitudes of unsafe, unsound, speculative and fraudulent banking practices. It might be termed one of the first great consumer protection systems. We have enjoyed such benefits, however, for less than half of our country's history. It is a combined Federal and State process and responsibility, except for the increasingly important presence of the foreign banks. One would have to be naive to think the attractiveness of banking markets in the U.S. has gone unnoticed by the unscrupulous. The Federal bank regulatory defenses against such activities ought not to be allowed to remain only partially manned.

To conclude, I see, as you must, the prospects of accelerating change in financial technology everywhere, in domestic markets as well as overseas. Congress is earnestly considering improved supervisory powers and structural change proposals will soon appear in this session as they have in the last two Congresses. But private initiative does not await statutory action. Innovative developments needing no statutory blessing occur as the rule, not the exception. In the present case State legislative and State regulatory actions have created major regional differences in the U.S. banking industry. Some of this is anticompetitive, some of it is procompetitive. What I propose is that we get down to work and conform foreign bank regulation with domestic bank oversight including the standard Federal presence before we have multiple official positions on foreign banking, two commercial banking industries in this country and no fair and forthright way to recover from our neglect of the issue.

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