NOT RELEASED

Remarks by

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While it is always a pleasure to hobnob with a rich assortment of influential international bankers, I am somewhat chagrined that the Congress of the United States and the Administration seem to be headed down a path toward making U.S. financial markets somewhat less open to foreign organizations. I refer to the provisions of the Federal Deposit Insurance Corporation Improvement Act which impose additional hurdles for new entrants and new fees on those already here; and the Fair Trade in Financial Services Bill which seems to have a good chance of becoming law.

At the same time, neither the Congress nor the Administration seem to have any interest in basic structural reform of the United States financial system to make it more competitive with Europe and the rest of the developed world. European banks have enjoyed broad securities powers, in the bank, for years without serious mishap, but a few key men in the

Congress refuse to dismantle the archaic Glass-Steagall law which essentially excludes U.S. banks from the non-Treasury securities markets. And now insurance and banking alliances in Europe and Canada particularly have spotlighted another handicap for U.S. firms. Integration of the financial system is an accepted policy in our fellow industrial nations. It is a growing tragedy that it cannot be a reality here.

The disparities created by these legal differences force U.S. authorities to severely limit activities of foreign banks in the U.S. in order to protect the competitive position of U.S. banks in domestic markets. This creates delicate supervisory problems to be sure, but, more important, it denies U.S. financial markets the advantage of competition by completely integrated financial enterprises.

Growing international trade and investment continue to be the principal underlying factors in the expansion of banks outside their home countries. As with u.S. banks and those of the major industrialized nations a generation ago, banks from the Pacific Rim countries, Latin America, and Eastern Europe are expanding abroad in order to service the international needs of their domestic customers and perhaps attract indigenous business in the host country as well. The United States has been a targeted host country for many of these new "international" banks. Some of these banks are already here, and some also present current supervisory challenges, even though their presence in the long run is likely to benefit the U.S. and global economy. For those banks that do not yet have a U.S. presence, one might question the extent to which their entry can or should be accommodated under the Foreign Bank Supervisory Enhancement Act.

For those countries whose markets are already well integrated into the global economy and whose banks established international branch systems in the 1970s, "international banking" today has acquired a new dimension, and taken on a somewhat different meaning. In the United States, international banking has become more concentrated in a few institutions and different in terms of activities. The U.S. banks which are most active internationally are readily recognized by the scope of their off-balance-sheet trading activities. These banks generally have a volume of off-balance-sheet activity that is a sizable multiple of their balance sheet assets. In addition, there are certain U.S. banks which are not particularly "international" in the geographic sense. They may not have a significant foreign office network. But they are significantly engaged in international banking activities, such as, foreign exchange trading and other derivative trading activities. While among U.S. banks a market-making role in these trading activities is currently limited to a few institutions, there is some indication of increased interest in more active trading among the newer "superregional" banks. It is not clear at present that the international ambitions of these superregionals include a significant foreign presence. Many of the institutions which come under this definition had branches or consortia banks abroad and have since abandoned that approach. My guess would be that geographic expansion among this group in the future will be limited.

International supervision today is challenged on two fronts. There is a need to monitor effectively the cross-border expansion of traditional deposit-taking/lending institutions from countries which are beginning to become integrated into the global economy. We must also be able to identify accurately the potential risks to international financial markets from high volume trading of new, and sometimes exotic, instruments. A great deal of analytical activity in pursuit of that goal is underway here in the United States as well as internationally.

Certainly one of the most important lessons of the recent past is that international supervision is only as strong as its weakest link. It was agreed in principle in the Basle Concordat of 1974 that no bank operating internationally should be able to escape supervision. Most recently the Basle Committee proposed "minimum standards" for the supervision of international banking groups. Greater effort still needs to be made, however, to put this principle into practice. Reluctance in certain jurisdictions to this cession of authority to an international organization should not be allowed to block adoption of standards designed to protect the interest of all of the players. The United States has adopted the principle of consolidated comprehensive supervision in the Foreign Bank Supervision Enhancement Act. In judging the fitness of a foreign bank to enter the U.S. market, the Federal Reserve must conclude that it is subject to effective consolidated supervision. One might argue with some justification that the terms are too vague and leave too much to subjective judgment. But the intent of Congress, in the aftermath of well publicized scandals, is very clear. This statute has not been easily implemented because banking structure and the techniques of bank supervision vary greatly among countries. In putting into practice the principle that all foreign banks seeking to operate in the United States should be subject to effective consolidated supervision, the Federal Reserve is trying not to inhibit the efficient working of other banking markets or to impede their development. We are finding that most bank supervisory systems provide at least some of the elements of consolidated, comprehensive supervision. But it is clear that some new entrants cannot meet this standards without further development, and we are actively assisting those who seek our help. On another front, the Federal Reserve, in coordination with the other federal banking regulators, has been in the process of developing a program for improving the supervision of the U.S. operations of foreign banking organizations. This approach will explicitly take into account the financial condition of the foreign banking organization as a whole, as well as the level and quality of its home country supervision. Branches and agencies are by far the predominant organizational form of foreign bank operations in this country. The new program is designed to provide a targeted supervisory plan based on the U.S. role as host country in the home/host country system of responsibilities adopted by the Basle group. It will also focus on the specific concerns for our markets and laws presented by the specific operations of foreign banks.

Over the longer term, it is clear that additional bilateral and multilateral initiatives are needed to strengthen supervision over the full range of global trading and derivative activities.

We must devise a reliable system to measure the exposure of banks to the market risks of trading and derivatives activities, and that system should be incorporated into the Basle risk-based capital framework.

The increasing disparity between U.S. and European banks in terms of permissible activities has become a matter of real concern in the past few years, in particular in the area of insurance. While all the evidence is not yet in on the projected economies of scale and "synergies" to be derived from the banking-insurance link-up, the fact remains that European banks have this option and U.S. banks do not. In my opinion, that is a distinct advantage for European banks. The U.S. banking situation is probably not going to change in this respect in the near term. In order to maintain competitive equity between U.S. and foreign banks, as required by law, foreign banks which have both banking and insurance activities in the United States must divest one or the other. We are currently looking closely at what constitutes adequate "de-banking" and what kinds of financial activities foreign institutions may continue to pursue in the United States if conventional banking is foreclosed.

Fair trade in financial services legislation continues to move forward. if the legislation ultimately passes, the United States' policy of unconditional national treatment in financial services will be changed to one of essentially reciprocal national treatment. This is consistent with a more demanding stance by the Administration on trade. Although the Board has continued to oppose the legislation, the present House bill has a number of safety valves which somewhat reduce the original severity of the proposal. The current bill requires consultation with the appropriate federal banking agency prior to the imposition of sanctions and includes significant grandfathering provisions. It also narrows the targets for possible sanctions to include only those matters that now require application to or authorization from a regulator to expand operations in the United States.

Let me turn now, briefly, to the issue of regulatory reform in the United States which has become a serious matter of disagreement.

The Treasury proposal to combine all of the federal bank regulatory functions in a single new Federal Banking Commission is seriously flawed in my opinion.

The idea of a monopoly regulator for the entire banking system almost assures a too restrictive regulatory environment -- one which would be likely to stifle innovation and so limit risk taking that there could be serious negative impact on the economy. A single regulator, with no other responsibilities, would tend to want to eliminate bank failures and consequently limit risk taking in the industry to the point that it would shut off the flow of credit to support commerce.

A single regulator which would have state-chartered banks as well as national banks under its rule-making authority would inevitably have the tendency to blur the distinction between a national bank charter and a state bank charter, spelling the eventual demise of the dual banking system which has served the country well for 131 years. In any case, banks would no longer have a choice of federal regulators and no way to escape from over-restrictive regulatory policies by changing charters.

The Treasury proposal removes all rule making and most supervisory and examination functions from the Fed. I believe that hands-on involvement in supervision, rule making and examinations over a broad spectrum of banking organizations is essential to enable the Federal Reserve to discharge its responsibility for the integrity of the payments system, the operation of the window, as lender of last resort, and the central player in crisis management when there is an accident in the financial system which might destabilize the system.

Putting the entire banking system under one agency that is at least potentially more vulnerable to political manipulation does not appear to me to be good public policy.

A better approach would be to have two regulators at the federal level. This could most directly be accomplished by merging the OTS and the OCC, thus combining the two agencies presently responsible for federally chartered institutions. The second step would be to transfer responsibility for state-chartered nonmember banks to the Federal Reserve which already has oversight of state member banks. This would reduce the number of federal regulators from four to two and strongly underscore the importance of the dual banking system by having one federal regulator for federally chartered banks and a separate one for state-chartered banks.

Because there is a small group of 30 to 40 banking organizations which are so large and have such reach to their operations that they are special, both agencies should have some degree of oversight. This could be accomplished by joint examination of the parent holding companies and the lead banks. In all other cases, duplicative examination and overlapping supervision could be eliminated by giving top-to-bottom supervision and examination authority to the regulator of the lead bank. Our proposal has the following advantages.

-- It avoids over-restrictive and stultifying rule making by a monopoly regulator.
-- It provides strong support for the dual banking system at the federal level.
-- It maintains the role in bank supervision critical to the Federal Reserve's needs.
-- It provides choice of federal regulator to banks.
-- It reduces federal regulators from four to two.
-- With the exception of a small special group of banks, it assures one examiner per banking organization.
-- It maintains a healthy dynamic tension between two agencies in rule making.

The outlook then is cloudy. While financial markets globally are becoming more integrated and there is real movement toward homogeneity in rules and operating procedures, the trend in the United States is in many ways defensive, paranoid and protective. These measures may discourage the free entry of foreign banks to our markets. Free entry and national treatment have served the United States well, and to retreat from these principles just at a time when the leadership position of the United States economy has been reconfirmed, seems to me to be counterintuitive and certainly counterproductive.

Thank you for listening.

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