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Statement by

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before the

Commerce, Consumer, and Monetary Affairs Subcommittee

of the

Committee on Government Operations

United States House of Representatives

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I am pleased to testify before this committee on the subject of foreign acquisitions of U.S. banks.

Foreign interest in the U.S. banking market has been strong. While the bulk of foreign bank activity has taken the form of operating branches and agencies, the last two years have seen an important increase in the acquisition of U.S. banks by foreign parties. However, I believe it important to keep in mind that foreigners still own only about 80 of our more than 14,000 banks and, even including pending acquisitions, assets of the banks acquired by foreign interests would amount to only about 3 per cent of total commercial bank assets. Most of these acquisitions have been by foreign banking institutions.

The factors that have prompted foreign interest in U.S. banks have been many and varied. The internationalization of world business has led foreign banks to follow their customers to this country in the same way that U.S. banks followed U.S. companies abroad. In coming to this country, many large foreign banks have sought to establish substantial roots here that would provide access to dollar funds to support their business in this country and abroad. This has often entailed development of both wholesale and retail banking business. For some of these banks, acquisition of a local, established banking institution provided a means of accomplishing this objective.

Some of our national policies have facilitated these acquisitions. Perhaps most important in this regard have been those policies that have led to inflation and that have made U.S. banks relatively cheap internationally. The factors that have attracted foreign banks to the United States are still present, and one must expect continuing acquisition of U.S. banks or investments in them by foreign interests. Whether large acquisitions of the kind that have recently been the subject of so much attention will continue to occur over the next few years is more problematical, and I would hesitate to make any

estimates. Clearly, the foreign banks that already operate subsidiary banks in this country will seek to acquire and merge other banks in their markets, just as domestic banks do. As I have already indicated, the part of the U.S. banking system controlled in this way by foreign banks is small.

There can be important potential benefits from foreign investment in individual banks. One of the principal benefits of a foreign acquisition can be an addition of capital to the bank. This would strengthen both the bank invested in and the U.S. banking system as a whole--at a time when U.S. bank capital has been eroded by inflation and (historically) is costly. Foreign purchases of U.S. bank stock reduce the available market supply of that stock, and tend to raise the price-earnings ratio of stock of that bank and ratios of U.S. bank stocks generally. Higher price-earnings ratios may enable banks to raise capital through stock issues without substantially diluting the equity of existing stockholders. Actions that restrict the flow of foreign capital to the American banking industry would also reduce the attractiveness of that industry to domestic investors. If we are to have a healthy, flourishing banking industry, we cannot afford to discourage investment in U.S. banks.

Foreign investment may also bring innovation and improved efficiency to U.S. banks; traditional bank pricing and lending techniques may be shaken up by innovative foreign management--with benefits both for the bank and for its customers. It is, of course, essential that a foreign bank seeking to acquire a U.S. bank be soundly managed.

Foreign investment can contribute to financial stability when the bank invested in is a "problem" bank, or is in danger of failing. Under existing rules, acquisition of a failing bank by a bank from another State is not

permitted and sometimes local alternatives are not desirable. In these circumstances, of which the Franklin National Bank case is a prime example, acquisition by a foreign bank may be the only solution. In this connection, I should note that the Federal Reserve has recommended that the Bank Holding Company Act be amended to permit a domestic bank to acquire a failing bank in another State; such an amendment would broaden the range of alternatives that might be open to bank supervisors in cases of failing banks.

These macroeconomic benefits can extend to all levels of the economy and all classes of bank customers, including households and small business. While it is not possible to furnish any precise measurements, experience with banks acquired by foreign investors suggests a strong interest on their part in retail banking. European-American Bank in acquiring Franklin National took on a substantial retail banking business. Bankers Trust sold its retail branches in New York to three foreign banks. And it is of interest to note that when it acquired Union Bank in Los Angeles, the Standard Chartered Bank undertook to broaden Union Bank's retail base, including a major expansion of its consumer mortgage lending and adoption of an active branching policy. This commitment was an important consideration in the judgment of how the acquisition would serve the convenience and needs of customers in California. Data that have been submitted to this committee demonstrate that the retail orientation of banks acquired by foreign interests has on the whole been maintained at its previous level or increased.

Federal Reserve policy on foreign acquisitions of American banks is in accord with U.S. policy of welcoming foreign investment in general. We believe that our economy and our financial system benefit from foreign competition, and from foreign capital so long as the investment is subject to the same rules

and regulations that apply to domestic companies. This principle of national treatment is embodied in the letter and spirit of the International Banking Act, and it underlies the exercise of the Federal Reserve's responsibilities regarding foreign banking in the United States.

It needs to be emphasized that there is a framework of law covering foreign acquisitions of U.S. banks and that recent acquisitions have been made in accordance with law. I refer to Section 3 of the Bank Holding Company Act. The Federal Reserve evaluates proposed acquisitions according to standards set forth in the Act; the financial and managerial capabilities of the acquiring company, the convenience and needs of the community to be served, and the effect on competition and concentration of resources in the United States. In my view, these are appropriate standards for assessing individual applications.

When the foreign investor is an individual, rather than a bank or bank holding company, the standards are those of the Change in Bank Control Act of 1978, which took effect this past March. That Act requires individuals seeking to acquire control of a bank to give the relevant Federal bank regulatory agency 60 days' prior notification. The proposed acquisition may be disapproved if it would substantially lessen competition, result in a banking monopoly in any part of the United States, jeopardize the financial stability of the bank or otherwise be contrary to the interests of the bank to be acquired.

As to the impact of foreign acquisitions on the supply of banking services to meet the needs of U.S. industry and consumers, probably the best protection in this regard is the competitiveness of U.S. banking. All owners of banks are free to change the character of the bank's business--for example, from retail to wholesale. However, banks that do not meet the needs of their community quickly lose business to those that do. As businessmen,

foreign bankers can be expected to recognize that fact and act accordingly. Moreover, the Bank Holding Company Act requires the Board in acting on any proposed acquisition to consider the convenience and needs of the community being served. In this connection, the Board reviews the effects of an acquisition on the services offered by the bank being acquired and generally expects some showing of improved services. Further, foreign-owned banks--like domestic banks--are subject to the Community Reinvestment Act, which requires the Federal bank regulatory authorities to evaluate the extent to which a bank is servicing all elements of its community, and also the Equal Credit Opportunity Act which prohibits discrimination in lending.

It has been suggested that a limit be placed on the share of a particular banking market that may be controlled by foreign interests as a group. Existing statutory authority does not explicitly provide for the denial of an acquisition for that reason. In the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act, Congress has identified specific factors on which the Board is to base its decisions. A ceiling on foreign bank ownership in a particular market is not one of those factors. Nor would I favor an arbitrary ceiling of that sort. Such a limit would be contrary to the principle of national treatment. Moreover, the Bank Holding Company Act contains protection against domination of a market by one or more large banks--foreign as well as domestic. In most cases involving a foreign bank acquisition, the foreign bank is not a substantial competitor in the market in question, although it could be considered a potential competitor.

Foreign ownership does pose some special supervisory problems that are not present in cases of domestic ownership. These relate to the fact that the foreign bank owner is located outside the United States and outside the jurisdiction of the U.S. banking authorities. We do not therefore have the same kinds of knowledge and insights into the workings and management of the foreign bank as we do with domestic banking organizations. Nevertheless, the Board believes these problems to be manageable and is addressing them in a number of ways.

On February 23, the Board issued a policy statement on foreign bank holding companies which makes clear that the foreign bank is expected to be a source of strength--both financial and managerial--to its U.S. subsidiary. That policy statement also indicated that at the time of a proposed acquisition the Board will seek to obtain sufficiently comprehensive information to make such a determination. Subsequently, the Board will evaluate on an ongoing basis the condition of the foreign parent bank through improved reporting requirements and will monitor carefully transactions between the U.S. subsidiary and the foreign parent. Revised or new reports for this purpose (Y-7 and Y-8f) are now in an advanced stage of development. In addition, the Board is continuing to strengthen its relationships and cooperative efforts with foreign bank supervisory agencies.

Finally, I wish to speak about how the Federal Reserve monitors foreign ownership in U.S. banks. The Board has not had a legislative mandate to collect comprehensive foreign ownership information for all banks. However, citizenship information has been obtained on investments representing more than 5 per cent of any bank holding company. Moreover, we have sought to collect information on foreign ownership interests in banks not affiliated with bank holding companies where that ownership is substantial. The Board

believes that any significant foreign ownership interests have been identified under these procedures. Moreover, under the recently enacted Financial Institutions Regulatory and Interest Rate Control Act, the Federal Reserve will now collect information on changes of ownership where the investment exceeds 10 per cent of a bank's outstanding voting shares. These data will be tabulated in a more systematic fashion than heretofore, and we believe that information on foreign ownership will be sufficient to meet our policy objectives.

Thank you, Mr. Chairman. I appreciate the opportunity to make these comments.

Q. 1. In response to the subcommittee's request of February 12, 1979, the Federal Reserve provided to this subcommittee, on March 15, 1979, a list of U.S. banks determined to be owned or controlled by foreign bank holding companies or domestic bank holding companies with significant or controlling ownership held by foreigners according to the bank holding company annual reports for 1977. This list identified as, in effect, foreign owned or controlled two banks that do not appear on the Federal Reserve's computerized and publicly available listing of "Foreign-Owned/-Controlled Banks/Branches as of 78/12/31", even as updated by hand through 79/05/31.

The two banks to which I refer are the Security National Bank of New Jersey (Newark) and Totalbank (Miami, Florida). Since the foreign ownership of these two banks is immediately available in Federal Reserve bank holding company annual report files, why do they not appear on the list of foreign owned or controlled banks?

A. 1. The computerized listing titled "Foreign-Owned/-Controlled Banks/Branches . . ." represents an attempt to automate information on foreign ownership or control of various types of U.S. banking offices. This listing includes U.S. banks owned by both foreign BHC's and foreign individuals that have come to the attention of Board staff. The listing has been believed to be substantially complete and accurate but it has never been purported that the list includes all foreign-controlled U.S. banks. The two banks identified as missing from the list are both relatively small (with assets of \$40 and \$80 million, respectively) and owned by domestic BHC's that in turn are controlled by foreign citizens. BHC's identify their important shareholders in their annual reports to the Board; and the District Federal Reserve Banks were aware of the nationality of the owners of these foreign institutions. However, given the domestic nature of these BHC's, their foreign ownership did not come to the attention of Board staff until a special survey was made of each Reserve Bank. These foreign-owned banks, as well as any others that come to the attention of Board staff, whether through BHC Annual Reports, through Change of Bank Control Reports, or through verified press reports, will be reflected on such lists in the future.

2. Will the Board gather and make available on request information on (a) citizenship or nationality of the foreign owners of individual U.S. banks and/or (b) the citizenship or nationality distribution of aggregate foreign investment in U.S. banking?

The Federal Reserve Board currently collects information on shareholders owning more than 5 percent of a bank holding company. The information collected includes the citizenship of the shareholder. Data from these reports are available to the public. In addition, the Board recently collated the information and has provided the General Accounting Office and other parties with an ownership list which included this information.

Under the Change in Bank Control Act (Title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978), the Federal bank regulatory agencies will collect information on the citizenship of individuals that acquire 10 percent or more of a insured bank. This information will be made available to the public upon request.

3. Where present reports and information required under the implementing regulations of the Change in Bank Control Act are not sufficient for determining the citizenship or nationality of foreign owners, does the authority conveyed to the President under the International Investment Survey Act of 1976 (PL 94-472) provide sufficient residual authority for the banking regulatory agencies to obtain citizenship or nationality information?

The powers granted the Board under the Change in Bank Control Act and the Bank Holding Company Act together with normal bank examination powers are sufficient to enable the Board and the other bank regulatory agencies to monitor foreign ownership of U.S. banks. While all shareholdings of foreigners in U.S. banking concerns will not be reported, significant ownership interests that have an impact on the structure of U.S. banking will be detected and the information received will be sufficient to monitor substantive developments.

The President has not granted the bank regulatory agencies any authority under the International Investment Survey Act of 1976. However, under the Act, the President would appear to have sufficient authority to collect necessary information on the identity of foreign investors.

4. By what means can the banking agencies determine the identity of the beneficial owner or owners of a bank if the owner or owners, through various nominees or agents, wish to conceal their identity?

The Federal Reserve Board in this area generally relies on respondents to report truthfully. It is possible that some shareholders, whether domestic or foreign, will file false information concerning beneficial ownership or, in cases where a banking organization is filing the information, that the banking organization itself will not know the true identity of beneficial owners. In cases where the beneficial owner has little relationship with the bank in which there is an ownership interest, the ownership, if concealed, might well go undetected. However, if the owner becomes involved in the policies of the bank, or there is some other indication of hidden ownership, the banking agencies could use the broad investigatory powers available through examination process to trace ownership. The Change in Bank Control Act and the Bank Holding Company Act both provide for penalties against violations, including the filing of false information.

5. Are any regulatory loopholes suggested by the alleged concealed foreign control of the Diplomat National Bank in Washington, D. C.?

In approving the formation of Diplomat National Bank, the Office of the Comptroller of the Currency stipulated that no shareholder should beneficially own more than 5 per cent of the stock of the bank. This bank was purportedly established to service the Washington, D. C. area's Asian-American community and the restriction was intended to obtain a wide distribution of ownership. It appears, however, that through the use of nominees, control of more than 5 per cent of the shares of the bank may actually have been acquired by a single group and that fact was not reported either to the Comptroller or the Securities and Exchange Commission. Federal agencies, through their investigative powers, nevertheless uncovered the true nature of the ownership interests in the bank.

Of course, no reporting or monitoring system can detect all potential abuses, especially if efforts are made to conceal the true facts.