Statement by

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Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Commerce, Consumer & Monetary Affairs
Committee on Government Operations
House of Representatives

September 30, 1982
Thank you, Mr. Chairman.

This is the third time I have been privileged to appear before this Subcommittee to present the views of the Board of Governors on the subject of foreign investment in U.S. banks. On those previous occasions, in 1979 and 1980, some especially large acquisitions had drawn public attention to the growing tide of foreign interest in investing in our banking system. That interest, as I mentioned then, reflected the growing internationalization of banking, which had been manifested earlier by the movement abroad by U.S. banks. In the last two years, foreign investment has continued at significant levels, though perhaps not so intensely. By the middle of this year, there were 134 banks controlled by foreign banking organizations and other foreign investors, or about 35 more than when I last testified here. These 134 banks account for approximately 5-1/2 percent of domestic banking assets.

The invitation for the Board to be represented at these hearings asked that the testimony treat several specific points: first, the performance of foreign-owned banking institutions; second, Federal Reserve policy on the supervision of foreign bank holding companies; third, the procedures followed by the Board in processing applications by foreigners to invest in U.S. banks; and finally, the issues that were present in recent specific applications.

The performance of foreign-owned banking institutions

In the last two years, there have been further foreign acquisitions of large U.S. banking organizations such as Crocker National Corporation, Financial General Bankshares, and LITCO
Bancorporation. I shall revert to these acquisitions later on. There has also been significant interest in smaller institutions, notably in Florida and California.

These acquisitions and investments have been very recent and, indeed, some are currently in process. It is yet too soon, therefore, to attempt to draw any firm conclusions about the performance of these banking organizations under their new owners. As the Subcommittee is aware, the Board and the other bank regulatory agencies have been monitoring on a continuous basis the behavior and performance of foreign-owned banking organizations. The most recent overall review by Board staff was completed last year and I have attached it to this statement for the Subcommittee's information.

The principal conclusions of the review may be summarized as follows:

(1) Before their acquisition, the banks generally had lower earnings and lower equity ratios than other banks in their peer group.

(2) Following acquisition, earnings generally improved, though not fully to peer group levels, while equity ratios were raised to peer levels as a result of infusions of capital by their new owners.

(3) The business orientation of the acquired banks did not change materially. Somewhat less emphasis on retail lending as a proportion of the total was evident as a result of greater diversification of the lending portfolio.
(4) Within the total group, the greatest improvement in earnings and the largest increases in capital took place at banks acquired by foreign individuals; however, the earnings base of these banks was low before acquisition.

These generalizations are based on a review of banks acquired by foreign interests and not those established de novo by foreigners. They are also based on information through 1980. However, partial data for 1981 are supportive of these findings.

Supervisory experience forms another aspect of the performance of foreign-owned banking organizations. As you know, direct supervisory responsibility is shared at the Federal level among the Office of the Comptroller of the Currency with responsibility for national banks, the Federal Reserve with responsibility for state member banks and bank holding companies, and the Federal Deposit Insurance Corporation with responsibility for all other insured banks. There are 12 state member banks owned by foreigners for which the Federal Reserve has supervisory responsibility, and 67 foreign-owned bank holding companies. We have direct knowledge of and experience with only these institutions. However, we do keep in close touch with the other banking agencies about their supervisory experience with foreign-owned banks under their jurisdictions. Specific material on the supervisory experience has been filed by the three agencies with the Subcommittee. Here, I should like to confine my remarks to some general observations about that experience.
Supervisory experience may be judged in several ways. One way is according to the condition of the banking institution, since the ultimate objective of bank supervision is the promotion of sound and healthy banks. Another way is the record of compliance by the banking institution with the laws and regulations to which it is subject.

On the first measure, there is the evidence that has already been cited that the equity ratios and earnings of banks acquired by foreigners generally showed improvement. Further evidence is available from the ratings assigned by the supervisory agencies on the basis of examination reports. In response to your request, the three banking agencies prepared and transmitted to the Subcommittee a summary table of the ratings of a sample of banks. Out of the 52 banks in the sample, 40 had strong composite ratings for financial soundness of 1 or 2. Only five of them were rated unsatisfactory, and some of these were weak when acquired by foreign investors.

The record of compliance is more difficult to measure. There is probably not a bank in the United States whose examination report does not cite violations of law and regulations. Most of these violations are technical and most are immediately corrected, usually during the examination itself. Foreign-owned banks have proved no different in this regard. It is only when serious violations occur or there is a recurring pattern of violations that a supervisory problem exists. This may be cause for a cease and desist order or some other supervisory action. On this basis, it has been our experience -- and I believe this is shared by the other agencies --
that the compliance record of foreign-owned banks equals that of similar domestically-owned banks.

**Supervision of foreign bank holding companies**

Under the law, responsibility for the supervision of bank holding companies has been assigned to the Board. That responsibility runs to all bank holding companies whether domestically or foreign owned.

Out of the 134 U.S. banks controlled by foreign interests, 84 are held through corporations. These corporations are required to become bank holding companies, and fall under the direct supervisory jurisdiction of the Board. Within this group of 84 banks, 60 are owned by foreign banking organizations and the remainder by individual investors.

The Board outlined its approach to the supervision of foreign bank holding companies in a policy statement issued in February 1979. The central theme of that statement is that the Board's primary concerns are with the operations and activities conducted in the United States and that our supervisory efforts would be so directed. The Board's interest in the foreign parent organization or in the foreign owners lies principally in their capability to be a continuing source of strength to the banking operations in the United States.

Since that statement appeared three and one-half years ago, the Board has implemented it in several ways. First of all, before approving the establishment of a foreign bank holding company, the Board assures itself about the financial and managerial resources of
the foreign organization. Applicants are required to furnish extensive information so as to enable the Board to render a judgment that those resources are sufficient to provide support to the U.S. subsidiary bank. The same requirements apply to domestic applicants. In addition, foreign supervisory authorities are contacted about the financial condition and the reputation of the applicant.

Secondly, the Board has established annual reporting requirements through which foreign bank holding companies submit information permitting an appraisal of the financial condition of the foreign organization on a continuing basis. The requirements also serve for assessing compliance with regulations governing their U.S. operations.

Third, a reporting system has been put in place that monitors transactions between the U.S. bank and the foreign parent organization on a quarterly basis.

Fourth, foreign bank holding companies are required to report any nonbank activities commenced in the United States, and the authority under which they are undertaken. Committee staff has seen copies of the reports that have been filed with the Board.

A primary supervisory tool in the case of domestic bank holding companies is the examination or inspection process. It is also an important supervisory tool in the case of foreign bank holding companies, although there necessarily are some differences in the ways it is employed. There is no inspection of the foreign organization itself, since it is located outside the jurisdiction of the United States. For information about the foreign organization, reliance is placed on the reports just mentioned and on relationships with foreign
supervisory authorities. Neither is there a system of regular inspections of nonfinancial subsidiaries in the United States. As you know, under the law, foreign banking organizations may have indirect subsidiaries in the U.S. that engage in nonfinancial activities of kinds not permitted domestic bank holding companies, provided certain conditions are met. Since the Board is not responsible for the condition of the foreign banking organization and its activities, financial and nonfinancial, outside the United States, interest in any indirect nonfinancial activities in the United States is limited to their compliance with regulation. Where the U.S. bank is held by an intermediate U.S. holding company, that company and its nonbank subsidiaries will be inspected, as necessary, on the same terms as a domestic bank holding company. The subsidiary banks are, of course, examined by the relevant bank supervisory agency and the Board relies on the examination reports prepared by those agencies to monitor the condition of those institutions.

For the most part, foreign bank holding companies are foreign banking organizations. As such, they are usually the major banks in their home countries, they are supervised by foreign banking authorities, and they have a recognized reputation in the international marketplace. These banks acknowledge that they are guests in this country and are anxious to remain in good standing by adherence to the rules and regulations to which they are subject. For these reasons, the Board has not been confronted with serious problems in supervising the U.S. activities of these companies.
By contrast, where U.S. banks are controlled by foreign individuals, certain supervisory problems do arise. One relates to the initial entry of the foreign investors in seeking to acquire or establish a bank. Another relates to the supervision of the continuing operations of those banks, once they have been acquired. It should be noted that these problems also exist with domestic individuals acquiring banks.

On the question of entry, the principal problem is ascertaining the financial strength and reputation of the would-be foreign owners. This is a problem faced by the Office of the Comptroller of the Currency when foreign investors seek to charter a national bank and by the various state authorities when a state banking charter is sought. The problem is also encountered in all three Federal banking agencies under the Change in Bank Control Act when a foreign investor seeks approval to acquire more than 10 percent of an existing bank and becomes the largest single shareholder. The relevant banking agency has to determine the investor's condition and status. The ability to make such a determination is necessarily complicated by distance and differences in foreign conditions and standards.

On the question of continuing supervision, there is the problem of assuring that the bank is managed well and that it is not used for the benefit of the foreign owners to the detriment of the condition of the bank. Individual investors, by comparison with banking organizations, may not have the same interest in preserving their banking reputations. The first line of defense on this point is to limit entry to persons of undoubted integrity and banking
experience. On the whole, as described earlier, the banks owned by foreign individuals have been managed well and have posed few supervisory problems. However, there have been exceptions, one being the American Bank and Trust Company situation in New York several years ago where a foreign investor abused the bank to his own benefit. The Subcommittee is familiar with that unfortunate experience, which illustrates the need for vigilance in the examination process when dealing with banks owned by individuals, domestic or foreign.

Federal Reserve procedures on application acquisitions

I should now like to turn to a description of how the Board handles applications by foreigners to acquire U.S. banking organizations.

The Bank Holding Company Act provides several criteria which the Board is required to consider in judging applications to form bank holding companies. These are: (1) the financial and managerial resources of the acquiring company and the bank to be acquired; (2) the future prospects of each; (3) the convenience and needs of the community to be served; and (4) the effects of the proposal on competition. Similar criteria are to be considered by the banking agencies under the Change in Bank Control Act. These criteria apply to both foreign and domestic acquirers.

When an application is received by the Federal Reserve from foreign banking organizations or foreign individuals to form a bank holding company, the same general procedures are followed and the same general information is required as if domestic organizations or domestic individuals were involved. Also, a concerted effort is made
to obtain additional information that will enable an evaluation of
the applying foreign banking organization viewed against the environ­
ment in which it operates in its home country. In the case of foreign
individuals, they are required to submit financial statements and
other information sufficient to assess their ability to manage a
banking organization and to stand behind the acquired bank. Contact
is usually made with the appropriate foreign supervisory authority
about the condition and reputation of the foreign applicant. When a
foreign banking organization is involved, this procedure is in keeping
with the broad agreement reached among the central banks and bank
supervisory authorities of the G-10 countries and Switzerland that
foreign banks operating within their territories should be adequately
supervised institutions in their home countries and that the home
country supervisors shall supervise the activities of their banks on
a consolidated basis.

Some major recent acquisitions

I propose now to comment on three recent major acquisitions
as requested in your letter to testify. The cases are: first, the
acquisition of Crocker National Corporation by Midland Bank Limited;
second, the acquisition of Financial General Bankshares by a group of
Middle Eastern Investors; and third, the acquisition of LITCO
Bancorporation by Banca Commerciale Italiana. My remarks will be
confined to the highlights of each case. More details are contained
in the Board's orders approving the acquisitions which I should like
to submit for inclusion in the record.
Crocker National Corporation. In early 1981, Midland Bank Limited, one of the major London clearing banks, applied to acquire a majority interest in Crocker National Corporation, whose principal subsidiary bank and principal asset is Crocker National Bank. At the time, Midland Bank had total deposits of $55 billion and was the third largest bank in the United Kingdom. Crocker National Bank had total assets of $19 billion and was the fourth largest bank in California and the twelfth largest in the United States.

Under the proposal, Midland Bank would immediately acquire 51 percent of the stock of Crocker National Corporation with the intention of ultimately acquiring 57 percent. The end result of the acquisition would be an infusion of $495 million in new capital into the Crocker National Corporation. At the time of the application, Midland Bank had no operating banking presence in the United States. Its only representation was as a part owner of European American Bank and Trust Company, a consortium bank in New York owned by six banks from different European countries.

Although the acquisition of a large U.S. bank was involved, there were virtually no issues presented by the application under the criteria specified in the Bank Holding Company Act. There were no adverse competitive factors in the application since Midland Bank had no direct banking operations in California or elsewhere in the United States. Midland Bank was in strong financial condition and its reputation as an international bank was undoubted. The proposed capital infusion was regarded as a factor weighing in favor of approval.
In approving the bank acquisition, the Board had also to consider the other activities of the Midland Bank organization in the United States and their consistency with the requirements of the Bank Holding Company Act. As a result, the Board order approving the bank holding company formation required that Midland divest its 20 percent interest in European American Bank on the grounds that retention would be inconsistent with the policy underlying Section 3(d) of the Act. Under that section, bank holding companies are effectively barred from acquiring more than 5 percent of the shares of a bank in another state. The Board also denied an exemption from the prohibitions of Section 4 of the Act for the activities of the U.S. subsidiary of Thomas Cook Ltd. That company provides retail and wholesale travel services in the United States, an activity which the Board has found as not closely related to banking.

Financial General Bankshares. Financial General Bankshares is a multi-state bank holding company with 12 banks located in the District of Columbia and the states of Maryland, New York, Tennessee, and Virginia. In November 1978, the first applications to acquire this holding company were made by Credit and Commerce American Holdings of the Netherlands Antilles and Credit and Commerce American Investment of the Netherlands. The two applicant companies were formed by a group of individual investors from several Middle Eastern countries for the purpose of the acquisition. A protracted process ensued. The proposed acquisition was at first opposed by existing management of Financial General and its subsidiary banks. Moreover, two of the
state banking supervisors involved (Virginia and Tennessee) recommended
denial on the grounds that the acquisition would be detrimental to
the convenience and needs of the communities served. In addition,
the Attorney General of the State of Maryland issued an opinion that
Maryland state law precluded a Maryland banking institution from
being subject to an "unfriendly" affiliation. In these circumstances,
the Board dismissed the first applications on the grounds that it was
prohibited from approving a proposal that would violate state law.

These complications were subsequently resolved and a new
application was filed in November 1980. While a number of technical
issues remained, the principal issue for the Board then became the
identity of the purchasers, their reputation and their financial
strength, and what those attributes meant for the future operations
of the bank holding company.

The Middle Eastern investor group consisted of 14 individuals
and companies from Saudi Arabia, the United Arab Emirates, and Kuwait.
The group included eight individuals, three personal holding companies,
two government-owned companies, and one private company. In the
course of processing the application, a meeting was held at the
Board's offices which was attended by representatives of the
investor group, counsel for the applicants, and representatives of
the state banking departments involved and the Comptroller of the
Currency. The information developed at this meeting became part of
the record on which the Board based its decision. In making that
decision, the Board took special care to review the financial resources
of all the investors. The information submitted demonstrated that all the investors possessed sufficient financial resources to make the acquisition and to provide future support if needed.

The financial factors relating to the acquisition of Financial General were considered to be consistent with approval. So far as management was concerned, the investors did not propose to take an active role themselves. Rather, they proposed to have all the director and top management positions filled by qualified Americans. The Board carefully reviewed the composition of the proposed board of directors of Financial General and the proposed senior management and satisfied itself about their qualifications.

The Board approved the acquisition on August 25, 1981. The transaction was consummated in April 1982 and the name of the organization was subsequently changed to First American Bankshares.

LITCO Bancorporation. In December 1981, Banca Commerciale Italiana (BCI) applied to the Board to acquire LITCO Bancorporation of New York, a bank holding company owning all of the shares of Long Island Trust Company. Long Island Trust Company had about $1.1 billion in assets and its business orientation was primarily directed to domestic business in the Metropolitan New York area. BCI was the second largest bank in Italy and had consolidated assets of about $34.5 billion. BCI conducted a wholesale banking business in the United States through branches in New York and Chicago and an agency in Los Angeles. BCI is indirectly owned by the Italian Government through a government holding company, Istituto per la Ricostruzione Industriale (IRI).
In this case, as with the Midland/Crocker acquisition, there were few issues under the statutory factors prescribed in the Bank Holding Company Act. The Board found that the acquisition would have no significantly adverse effects on the concentration of banking resources or on existing or potential competition. BCI had committed to inject $20 million of foreign capital into LITCO and to maintain LITCO among the more strongly capitalized institutions in the United States. As for BCI itself, the Board made its evaluation on the basis of its policy statement on supervision of foreign bank holding companies that takes a number of factors into account in judging the financial and managerial resources of a foreign banking organization. In addition to its financial condition, these included the record and integrity of management, the bank's standing and role in its home country, and the opinion of the home country regulators. Having considered these factors, the Board concluded that the financial and managerial resources of BCI were satisfactory.

During the Board's consideration of this case, several issues emerged that stemmed from the fact that BCI is indirectly owned by the Government of Italy. The four largest banks in Italy are nationalized institutions. All conduct banking operations in several states in the United States. The Italian Government also operates a number of nationalized industries and commercial enterprises, many of which have subsidiaries in the United States.

The specific question that arose in these circumstances was how foreign governments or governmental entities should be treated under the Bank Holding Company Act. Should they be subject to the
same provisions as a private company or is a different treatment warranted?

The principle of national treatment is the basic government policy toward foreign banks and is embodied in the International Banking Act of 1978. The essence of that principle is that foreign banking organizations and their owners be treated the same as their domestic counterparts. The Bank Holding Company Act, which governs the activities of domestic banking organizations, has among its purposes the prevention of conflicts of interest and undue concentration of resources. These objectives are intended to help ensure that banks in the United States serve as effective and impartial credit intermediaries. To this end, the Act provides that a private company cannot own a U.S. bank and also own companies in the United States that engage in industrial and commercial activities. Also, a private company cannot, as a general rule, own and operate banks in more than one state. These rules apply to all private companies, domestic or foreign, although for foreign private companies exceptions are allowed for indirect interests in the U.S. operations of foreign commercial and industrial companies. Application of these rules to a foreign government would mean that it could not indirectly own banks in more than one state. Similarly, a foreign government that indirectly owned a bank in the United States would have to conform its nonbanking activities in the United States to those permissible to a privately owned foreign banking organization. Failure to apply these rules to foreign government-owned banks, it can be argued, would give those organizations advantages over their privately-owned counterparts and
thus would be inconsistent with the principle of national treatment.

Distinctions can be drawn between private and government ownership and they may form a basis for differences in treatment. The Bank Holding Company Act presumes that all banks and nonbank companies under common ownership and control are operated as an integrated whole. That presumption stems from the Act's objectives of avoiding conflicts of interest and undue concentration of resources when banking and nonbanking activities are combined under common control and management. This presumption also reflects experience, especially in the United States, that private companies do operate in this way.

Foreign countries that have nationalized banks and other enterprises have done so for a variety of historical and policy reasons. Some foreign governments do operate, and in fact have good policy reasons for so operating, the nationalized banks and nationalized businesses as separate entities. However, conditions vary from country to country and may change over time within a country with changes in political philosophy or in other circumstances. This diversity highlights the difficulty of establishing a policy suitable to all situations that avoids making arbitrary distinctions among countries.

Little guidance on these questions is provided in the Act. It expressly exempts from its application organizations owned by the Federal Government or state governments. However, it is silent on the status of foreign governments.
The question of applying the Act to foreign governments is not concerned with the activities they conduct within their own territories or outside the United States. It is solely concerned with those activities that extend into the United States. Applying the Act to foreign governments even in that more limited sense has broad implications that extend beyond the purely regulatory issues. For example, strict application of the limitation on nonbanking activities could preclude foreign government owned banks from engaging in banking activities in the United States. This could raise important questions in the fields of U.S. foreign relations and U.S. foreign investment and economic policy.

Prior to the BCI case, the Board had approved a number of applications to form bank holding companies by foreign banks that were government owned and where the foreign government indirectly had commercial and industrial activities in the United States. In those cases, the Board did not apply the Act to the applicant's government owners. After careful consideration, and pending further examination of the issues outlined here, the Board decided to continue the previous practice in the BCI case.

In approving the application, the Board recognized that the Act is concerned not only with problems of actual conflicts of interest or concentration of resources but also with the potential for those problems. For this reason, the Board in its order highlighted its belief that the issues associated with foreign government ownership should be brought to the attention of the public for further discussion and debate. Because of the complexity and far-reaching implications
of these issues, some of which I have tried to convey, the Board stated in its order that they should be resolved in a Congressional framework where all of the relevant considerations could be examined and weighed.

In recognition of the potential conflicts in the BCI case, the Board decided that Italian government owned banking and nonbanking organizations were affiliates of LITCO. As a consequence, the amount limitations and collateral requirements of Section 23A of the Federal Reserve Act would apply to extensions of credit by LITCO to these affiliates. The Board believed that the application of Section 23A to this situation would help limit the potential for practices conflicting with the purposes of the Bank Holding Company Act.

Conclusion

To sum up, foreign interest in establishing and expanding banking operations in the United States continues unabated. Most of those operations will continue to be conducted through branches and agencies, but it is reasonable to expect that foreigners will also seek to acquire or establish subsidiary banks. The involvement of foreign banks in our banking system and foreign investment in U.S. banks have benefitted the United States and I believe that they will continue to do so.

There are problems associated with foreign investments in U.S. banks, and in this statement I have tried to identify them and to place them in perspective. On the whole, the performance of foreign-owned banks has been satisfactory and supervisory problems
have not been serious. As foreign involvement in the banking system increases, new problems and new issues will surely emerge. This calls for continuous monitoring of developments and the adaptation of supervisory requirements to them.

In discussing the BCI case, I devoted a large amount of time to the issue of the treatment of foreign governments and foreign government owned entities under the Bank Holding Company Act. This issue is extremely complex and the questions that arise in evaluating the issue are themselves very difficult. The Board itself has not reached any firm conclusions on these issues and is not prepared to make legislative recommendations at this time. For this reason, the Board welcomes these hearings as contributing to the public discussion of these issues that it believes desirable. We hope that the discussion will evoke thoughtful and constructive consideration by the Congress, other government agencies, foreign banking authorities, and the banking community both here and abroad.
FOREIGN OWNERSHIP OF U.S. BANKS: TRENDS AND EFFECTS*
by James V. Houpt

Foreign ownership of U.S. banks has increased dramatically in recent years and has attracted substantial interest from the Congress, the bank regulatory agencies, the banking industry, and the general public. Prior to the mid-1970s the pace of acquisitions was slow, and the owners were usually large banks that established new banks or acquired banks of small or moderate size. Since then, however, the pattern has changed. Foreign parties have more often bought existing banks, rather than establish new ones; individual investors have expanded their role; and the size of the acquired banks has increased tremendously. Since 1978, foreign banks have acquired the 12th and 13th largest U.S. banks, as well as two others that rank among the top fifty.

Because of the key role banks perform in any society, it is important to examine this trend. The Federal Reserve Board staff, the Office of the Comptroller of the Currency, and the General Accounting Office have all addressed the issue to determine what impact these acquisitions may have on the public. 1/ No study to date, however, has identified any systematic problems or abuses that can be traced to foreign owners. In its report in 1980, the General Accounting Office also conceded that the level of foreign ownership was not (then) "too high." It did, however, recommend a moratorium on large foreign acquisitions until the laws prohibiting domestic interstate banking were fully reviewed. At present, no moratorium exists.


The analyses and conclusions set forth are those of the author and do not necessarily indicate concurrence by the Board of Governors, by the Federal Reserve Banks, or by the member of their staffs.

* This study has been accepted for publication by the Journal of Bank Research.
This study updates an earlier empirical study that examined the effects of foreign ownership on U.S. banks. When the earlier study was done, the most recent data available were as of year-end 1978, and there were relatively few banks with an adequate time period under foreign ownership to analyze. This study uses year-end 1980 data and includes almost twice as many banks as before. It also tells more about the influence of the two types of foreign owners: large foreign banks and foreign individual investors.

Therefore, this study has important advantages over the previous work: more recent data, a larger sample, and a longer time period under foreign ownership for differences to appear. It is important to stress, however, that neither of the two largest foreign acquisitions is included. Hong Kong Shanghai Banking Corporation did not consummate its purchase of Marine Midland Bank (New York) until mid-1980, and the Federal Reserve Board did not approve the acquisition of Crocker National Bank (San Francisco) by Midland Bank (United Kingdom) until August 1981. The largest banks that were included were Union Bank, (Los Angeles) and the National Bank of North America (New York), with year-end 1980 consolidated assets of $7 billion and $5.7 billion, respectively. The reader should also recognize that the findings describe the "typical" (and historical) performance of the banks acquired. The performance of individual banks may differ from the general pattern.

The study is in three parts. Part I reviews the size and growth trends of foreign-owned or controlled U.S. banks. Part II describes the methodology used and presents the findings. Part III presents a summary and some conclusions.

1/ Foreign Ownership and the Performance of U.S. Banks, Board Staff Study #109, July 1980, by James V. Houpt.
FOREIGN PRESENCE IN U.S. BANKING

During the past decade, foreign banks and foreign investors established a significant presence in U.S. banking markets. At December 1972, foreign-owned or controlled banking offices accounted for $26.9 billion and 3.6 percent of total U.S. domestic banking assets (Table 1). By year-end 1980, these figures had climbed to $213.4 billion and 12.5 percent. Most of this increase was due to the growth of U.S. branch and agency offices of foreign banks, but the increase in foreign-owned U.S. banks was also substantial.

Branch and agency offices are integral parts of foreign banks and rely almost entirely on internal growth. Therefore, while their impact on various markets might be substantial, their de novo expansion has generally been pro-competitive and has led to broader and more efficient financial markets. Few commentators have questioned the privilege of foreign banks to operate branches or agencies in this country.

The second method of expansion, and the focus of this study, is growth by acquiring or merging with established U.S. banks. The acquired banks, their shareholders, and the U.S. public in general might benefit from foreign acquisitions, but the positive benefits to society are often less clear than with de novo growth. Some critics have expressed concern that by acquiring existing banks, foreign owners will change the operations of the banks to the detriment of the local communities. Foreign owners might lack the commitment to the community that a U.S. owner would have; they might introduce conflicting

1/ This is not to say the lawmakers and banking authorities have been disinterested in the activities and growth of these offices. Indeed, Congress passed the International Banking Act of 1978 to eliminate inequities in U.S. laws that favored foreign banks over their domestic competitors. Among other things, the IBA prevented further interstate expansion of deposit-taking offices of foreign banks, subjected the deposits of their U.S. branches to federal reserve requirements, and in some cases required the U.S. deposits of foreign bank branches to be insured by the FDIC.
Table 1

Total Assets of Foreign Controlled U.S. Banking Offices
(Amounts in billion $)

<table>
<thead>
<tr>
<th>Office</th>
<th>1972 Assets</th>
<th>Number</th>
<th>1980 Assets</th>
<th>Number</th>
<th>Increase Assets</th>
<th>1972-80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branches and agencies</td>
<td>$22.2</td>
<td>76</td>
<td>$148.0</td>
<td>322</td>
<td>$125.8</td>
<td>246</td>
</tr>
<tr>
<td>Subsidiary U.S. banks</td>
<td>4.7</td>
<td>34</td>
<td>65.4</td>
<td>104</td>
<td>60.7</td>
<td>70</td>
</tr>
<tr>
<td>Total</td>
<td>26.9</td>
<td>110</td>
<td>213.4</td>
<td>426</td>
<td>186.5</td>
<td>316</td>
</tr>
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Percent of domestic banking industry /1/ 3.6 .8 12.5 2.8 8.9 2.0

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/1/ The denominator is total domestic assets of all U.S. insured commercial banks, plus those of U.S. branches and agencies of foreign banks.
(foreign) interests; and they might be outside the reach of U.S. authorities and domestic controls.

Table 2 shows that during the period from year-end 1972-1980, the number of foreign-owned U.S. banks tripled and their assets increased 1,300 percent. The domestic assets of Crocker and Financial General Bankshares (Washington, D.C.) would increase the year-end 1980 figures by 27 percent. When these acquisitions are consummated, foreign parties will control about 5.4 percent of the domestic banking assets of U.S. banks, compared with only 0.6 percent in 1972.

Table 2 also highlights the shift from establishing subsidiary U.S. banks to acquiring existing banks. At year-end 1972, 28 of the 34 foreign-owned banks had been established de novo, mostly by large foreign banks. During 1976-80, by contrast, over 50 existing U.S. banks were purchased by foreign parties while only 8 were established new. Because of mergers between de novo and previously U.S.-owned banks, the precise split between newly established and acquired foreign-owned banks cannot be known, but the acquired banks clearly dominate both the assets and the number of U.S. banks owned by foreign parties.

Another important trend that sometimes goes unnoticed is the increased interest of foreign investors other than large banks to acquire U.S. banks. Prior to the mid-1970s, virtually all foreign owners were, themselves, banks. While they still dominate the assets of foreign-owned U.S. banks, purchases by other parties (mostly individual investors) have risen

1/ At the same time the Federal Reserve Board approved Midland Bank's request to acquire Crocker National Corporation, it also granted its consent to a group of Middle East investors to acquire Financial General Bankshares, which has assets exceeding $2 billion.
### Table 2
Domestic Assets of U.S. Banks Controlled by Foreign Parties, 1972-80
(Dollar amounts in millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign-owned banks at December 1972</th>
<th>Domestic assets</th>
<th>Number of banks</th>
<th>Foreign-owned banks at December 1980</th>
<th>Domestic assets</th>
<th>Number of banks</th>
<th>Pro forma with Crocker and Financial General</th>
<th>Domestic assets</th>
<th>Number of banks</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>4,364</td>
<td>28</td>
<td>290</td>
<td>4,654</td>
<td>34</td>
<td>0.62</td>
<td>0.23</td>
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<tr>
<td><strong>Annual increases</strong></td>
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<td>1973</td>
<td></td>
<td>...</td>
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<td></td>
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<td>2</td>
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<tr>
<td>1974</td>
<td></td>
<td>...</td>
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<td></td>
<td>...</td>
<td>12</td>
<td>2/</td>
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</tr>
<tr>
<td>1975</td>
<td></td>
<td>...</td>
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<td>1977</td>
<td></td>
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<td></td>
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<td>1978</td>
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<td>3</td>
<td></td>
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<td>17</td>
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<tr>
<td>1979</td>
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<td>...</td>
<td>0</td>
<td></td>
<td>...</td>
<td>12</td>
<td>...</td>
<td></td>
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</tr>
<tr>
<td>1980</td>
<td></td>
<td>...</td>
<td>0</td>
<td></td>
<td>...</td>
<td>8</td>
<td>...</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3/</td>
<td>3/</td>
<td>3/</td>
<td>3/</td>
<td>65,419</td>
<td>104</td>
<td>4/</td>
<td>5.44</td>
<td>0.71</td>
</tr>
</tbody>
</table>

1/ For banks merged or acquired, assets shown are as of year-end preceding foreign acquisition. Because de novo banks are, by definition, newly-formed, they have no assets to show for that date.

2/ Includes Franklin National Bank ($3.8 billion).

3/ Cannot be determined because of mergers of de novo banks with banks previously owned by U.S. parties.

4/ The number of banks does not equal the sum for the individual years because of mergers.

5/ Includes Marine Midland ($11.1 billion--domestic assets only).
sharply. This second group accounts for 38 of the 104 U.S. banks owned by foreign parties at year-end 1980, or more than one-third of the total. All but three of these 38 banks have been acquired since 1975.

Most public attention and policy issues have focussed on the acquisition of major U.S. banks by large foreign banks. Some commentators point to the lack of reciprocity of most foreign governments in permitting similar-sized bank purchases in their countries and also question the prudence of allowing major U.S. banks to become foreign-owned. Large U.S. banks usually have sizeable shares of local markets, and changes to their lending policies may significantly affect their communities. Such concerns do not generally arise with banks acquired by foreign individual investors because they tend to be smaller and less visible, with relatively less market impact. Another distinction is that banks acquired by large foreign banks become part of an international banking network. Consequently, foreign banks might have different objectives for U.S. banks than would individual investors and might tend to operate their banks differently.

EMPIRICAL STUDY

The study attempts to answer three questions:

(1) Did the acquired banks differ from their U.S.-owned peers prior to their change in ownership?

(2) What are the present differences between the acquired banks and their peers?

(3) How have foreign owners influenced the operations of the acquired banks?

For each question, the study also distinguishes between the performance of U.S. banks acquired by large foreign banks and those acquired by other foreign parties, virtually all of whom are individual investors.
Methodology

The study is based on a review of call report data for all U.S. banks known to be owned by foreign parties prior to year-end 1979. This procedure omits the most recently acquired banks because of their brief experience under foreign owners and produced an average period under foreign ownership of over 3.5 years. Other banks were excluded from the study because they had merged into existing foreign-owned U.S. banks and represented only insignificant parts of the resulting institutions. In cases where the merged bank was not insignificant, it was used in the study by combining its data with that of the already foreign-owned bank and creating a "pro-forma" bank for the year preceding the merger. The banks reviewed were placed into two categories based on the type of foreign owner: (1) a foreign private investor or "small" foreign bank (referred to as "small parents"), and (2) large foreign banks ("large" parents).

Each foreign-owned bank was paired with a "peer bank," which was constructed as an average of all banks that (1) were domiciled in the same standard metropolitan statistical area as the foreign-owned bank; (2) existed both at the year-end preceding acquisition of the foreign-owned bank and at year-end 1980; and (3) only mergers in which the previously U.S.-owned bank represented at least 40 percent of the assets of the "acquiring" foreign-owned bank were used. In most cases, the percentage was actually much larger than that.

A large foreign bank is one that (a) has total asset exceeding $5 billion, or (b) is among the three largest banks in its home country and is at least ten times the size of its U.S. bank subsidiary (or subsidiaries). These criteria ensure that the parent is large even by international standards or is at least very important in its home country and clearly dominant to the U.S. bank.

The earlier study (see footnote on p. 1) also checked for differences between acquired and newly established foreign-owned banks. This analysis has been omitted here. The comparison did reveal significant differences between these two bank groups relating mostly to their customer orientation, funding practices, and capitalization ratios. For a full discussion of these differences, see the earlier study.
and (3) were in the same size class as the foreign-owned bank at the earlier period. Financial ratios for each merged or acquired bank were then compared with the mean of the corresponding ratios of its peer bank.  

Comparison of a ratio for each foreign-owned bank with the mean ratio of its peers avoids the problems and possible errors inherent in attempting to select a particular bank as a peer and relies on the more numerous "representative" peers to offset any distortion caused by an outlier. While not expressly shown in the table below, most acquired banks were compared with over 20 "peer" banks. This approach may produce findings slightly different from an approach based on pairings with individual banks. In addition, using composite data reduces the variance within the peer group, and consequently is more likely than the other technique to identify differences between foreign-owned U.S. banks and their peers. The size classes used in the study are shown below:

1/ The terms used in this study are defined as follows: consumer loans are real estate loans on one- to four-family and multifamily properties plus loans to individuals; purchased funds are time deposits greater than $100,000 plus federal funds purchases and securities repurchase agreements plus other liabilities for borrowed money; income is net income before extraordinary items; and equity is the total equity capital account, which excludes subordinated debt and loan-loss reserves. Risk assets are total assets less cash, claims on domestic offices of commercial banks, and debt of or guaranteed by the U.S. federal government. Adjusted equity is equal to total equity capital plus the reserve for loan losses. Except for ratios involving equity or income figures, all amounts relate to domestic offices only.

To address the first question, on the pre-existing characteristics of the acquired banks, selected financial ratios for all foreign-acquired banks included in the study were compared with those of their peer banks for the year-end immediately preceding the change in ownership. A similar comparison was made using year-end 1980 data for both groups of banks to address the second question, about current differences.

Finally, to evaluate the significance of differences in changes in characteristics between the acquired banks and their peers, the percentage change in the ratios from the earlier period until year-end 1980 was calculated for each bank and its peer. These percentages were then converted into annual rates of change to facilitate aggregation of banks acquired in different years. Tests were then performed to determine if the changes in those banks acquired by foreign parties were significantly different from the changes for their peers.

Measurement of Statistical Significance

The standard mean test was used to answer most of the questions regarding differences between the two groups of banks. This test evaluates the hypothesis that

---

1/ The peer group for banks located in California in these size classes includes all banks in the United States in the same size class. This adjustment was necessary because most (if not all) of the banks' peers in the SMSA were also foreign-owned. For example, only five of the eighteen banks located in Los Angeles and San Francisco areas and having year-end 1980 assets between $200 million and $8,000 million were U.S.-owned banks.

2/ The peer group for both banks in this size class includes all U.S. banks in the same size class.
the ratio or rates of change for the two groups are the same \((H_0: \bar{x}_f = \bar{x}_p)\) against the two-sided alternative that they are not equal \((H_1: \bar{x}_f \neq \bar{x}_p)\) and reflects a comparison of t-value using this formula:

\[
t = \frac{(\bar{x}_f - \bar{x}_p)}{\sqrt{\frac{\text{Var}(x_f - x_p)}{n-1}}}
\]

where

- \(\bar{x}_f\) = mean of foreign-owned banks
- \(\bar{x}_p\) = mean of peer-group banks
- \(x_f - x_p\) = difference between individual paired observations
- \(n\) = number of paired observations.

This approach produces an unbiased statistic and takes into consideration the covariance between the paired data. The results of these tests for the acquired banks and their peers are shown in tables 3-5 for the pre-acquisition period and in tables 6-8 for year-end 1980.

The nature of the data and the possibility of tremendous percentage changes made the t-test impractical when evaluating certain ratios. Consequently, to measure the difference in changes to three ratios, the "sign-test" was used.

---

1/ For example, a decrease in the ratio of state and municipal securities to total assets from 0.001 (virtually zero) to zero (a 100 percent drop) would not present a representative comparison with a peer whose ratio fell from 0.11 to 0.05. Similarly, many foreign-owned banks had very low or negative earnings bases on which to show increases.

2/ In this study, the sign test considers whether the percentage change for the foreign-owned banks was greater than the change recorded for the bank's peer group. The number of instances in which the change was greater for the foreign-owned bank is shown along with the corresponding likelihood (when it is significant) of getting these results if indeed foreign-owned banks were no different from U.S. banks. These calculations are based on the binomial distribution formula, which in this instance gives the probability that, out of a sample of \(n\) banks, \(x\) banks will exceed the peer group:

\[
P(x|n) = \binom{n}{x} \theta^x (1-\theta)^{n-x}
\]

where \(\theta\) is the probability that the foreign bank will exceed the peer group (placed at 50 percent to correspond with the hypothesis that there is no difference between the two groups).
Findings

This section presents the answers to the three questions about foreign-owned banks and their domestically-owned peers. Since acquisitions by large foreign banks may be viewed differently than acquisitions by other types of foreign owners (mostly individuals), the findings are also shown by type of owner. Tables 3 through 11 show the mean of selected financial ratios for both the foreign-owned and U.S.-peer banks, give the degree of dispersion of the differences, and indicate the confidence level for the differences that are statistically significant.

The general characteristics of the foreign-owned banks prior to their acquisitions are discussed next. Of special note, however, is the fact that a substantial portion had poor profitability. Indeed, 20 of the 47 acquired banks included in the study reported losses or earnings below 0.2 percent of total assets in the year prior to their acquisition. This condition probably influenced the change in ownership in many cases, as well as the subsequent performance of the banks.

What were the pre-acquisition differences? Tables 3-5 show the characteristics of the banks prior to the period of foreign ownership. Most of the differences found in the earlier study appeared again. The acquired banks held much smaller amounts of state and municipal securities than their peers, had relatively larger loan portfolios (because of more commercial and industrial loans), and had much lower earnings.

Neither this study nor the earlier one revealed a difference in equity to asset ratios. Since most of the acquired banks in both studies had poor or negative pre-acquisition earnings, and poor profits and low equity are often related, this lack of difference seemed surprising. Consequently, this study also checked the adjusted equity to risk asset ratio and did find a
Table 3
Financial data for all U.S. banks acquired by foreign parties and for their domestically owned peers, for year-end preceding acquisition

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean ratio</th>
<th>Foreign-owned banks</th>
<th>Peer banks</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ratios to total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks plus U.S. government securities</td>
<td>27.1</td>
<td>28.4</td>
<td>1.02</td>
<td>-1.27</td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>6.5</td>
<td>10.2</td>
<td>.80</td>
<td>-4.61</td>
<td>.005</td>
<td></td>
</tr>
<tr>
<td>Total loans</td>
<td>55.4</td>
<td>52.0</td>
<td>1.31</td>
<td>2.59</td>
<td>.020</td>
<td></td>
</tr>
<tr>
<td>Consumer</td>
<td>24.1</td>
<td>23.6</td>
<td>1.57</td>
<td>.32</td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>20.0</td>
<td>16.5</td>
<td>1.34</td>
<td>2.61</td>
<td>.020</td>
<td></td>
</tr>
<tr>
<td>Total deposits</td>
<td>87.1</td>
<td>86.0</td>
<td>.68</td>
<td>1.61</td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>Savings deposits</td>
<td>22.8</td>
<td>22.6</td>
<td>1.18</td>
<td>.17</td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>Purchased funds</td>
<td>15.1</td>
<td>13.7</td>
<td>1.17</td>
<td>1.20</td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>Equity capital</td>
<td>7.3</td>
<td>7.9</td>
<td>.57</td>
<td>-1.06</td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td>.3</td>
<td>.7</td>
<td>.12</td>
<td>-3.43</td>
<td>.005</td>
<td></td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>11.7</td>
<td>14.6</td>
<td>1.12</td>
<td>-2.58</td>
<td>.020</td>
<td></td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>2.9</td>
<td>9.6</td>
<td>2.61</td>
<td>-2.57</td>
<td>.020</td>
<td></td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.

2/ Not significant at the 0.10 level.
Table 4

Financial data for U.S. banks acquired by "small" foreign parents and for their domestically owned peers, for year-end preceding acquisition

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean ratio %</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ratio to total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks plus U.S.</td>
<td>27.6</td>
<td>29.2</td>
<td>1.38</td>
<td>-1.16</td>
</tr>
<tr>
<td>government securities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>5.3</td>
<td>9.7</td>
<td>.99</td>
<td>-4.43</td>
</tr>
<tr>
<td>Total loans</td>
<td>55.9</td>
<td>52.6</td>
<td>1.59</td>
<td>2.08</td>
</tr>
<tr>
<td>Consumer</td>
<td>27.5</td>
<td>24.8</td>
<td>1.93</td>
<td>1.40</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>18.2</td>
<td>15.9</td>
<td>1.45</td>
<td>1.59</td>
</tr>
<tr>
<td>Total deposits</td>
<td>88.3</td>
<td>88.1</td>
<td>.83</td>
<td>.24</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>24.8</td>
<td>24.0</td>
<td>1.54</td>
<td>.52</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>12.3</td>
<td>12.5</td>
<td>1.33</td>
<td>-.15</td>
</tr>
<tr>
<td>Equity capital</td>
<td>7.7</td>
<td>8.2</td>
<td>.75</td>
<td>-.67</td>
</tr>
<tr>
<td>Income</td>
<td>.2</td>
<td>.7</td>
<td>.17</td>
<td>-2.77</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>12.4</td>
<td>15.7</td>
<td>1.51</td>
<td>-2.18</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>1.1</td>
<td>8.8</td>
<td>3.70</td>
<td>-2.08</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.
2/ Not significant at the 0.10 level.
Table 5

Financial data for U.S. banks acquired by large foreign banks and for their domestically owned peers, for year-end preceding acquisition

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean ratio</th>
<th>Standard deviation</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>t-value</td>
</tr>
<tr>
<td>Ratio to total assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks plus U.S.</td>
<td>25.9</td>
<td>26.5</td>
<td>1.18</td>
</tr>
<tr>
<td>government securities</td>
<td>9.2</td>
<td>11.5</td>
<td>1.36</td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>54.2</td>
<td>50.7</td>
<td>2.03</td>
</tr>
<tr>
<td>Total loans</td>
<td>16.1</td>
<td>20.7</td>
<td>2.29</td>
</tr>
<tr>
<td>Consumer</td>
<td>24.3</td>
<td>17.8</td>
<td>2.94</td>
</tr>
<tr>
<td>Total deposits</td>
<td>84.2</td>
<td>81.1</td>
<td>1.04</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>18.0</td>
<td>19.3</td>
<td>1.83</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>21.8</td>
<td>16.5</td>
<td>2.09</td>
</tr>
<tr>
<td>Equity capital</td>
<td>6.5</td>
<td>7.3</td>
<td>.82</td>
</tr>
<tr>
<td>Income</td>
<td>0.5</td>
<td>0.8</td>
<td>.11</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>10.2</td>
<td>11.9</td>
<td>1.26</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>7.5</td>
<td>11.4</td>
<td>1.26</td>
</tr>
</tbody>
</table>

1/ Foreign-owned minus peer value.
2/ Not significant at the 0.10 level.
difference; the mean ratio for the acquired banks was significantly lower than for the U.S.-owned peer group. Weak or troubled banks often reduce their most liquid assets as a first-line defense to combat problems. Since this tends to produce higher concentrations of risk assets, the equity to risk-asset ratio is usually best for measuring "capital adequacy."

While the acquired banks as a group held less state and municipal government securities than their peers, the difference was not statistically significant for the subsidiaries of large foreign banks. The significant difference occurred only with banks having small parents. Exactly the reverse held with the commercial and industrial loan ratio, where only the banks acquired by the large foreign banks had higher ratios than their peers. Both sub-groups had low profitability, compared with their peers.

What were the most recent differences? As shown in Tables 6-8, most of the differences identified in the period preceding acquisition continued to exist at year-end 1980. Earnings of the acquired banks stayed low (although the gap narrowed slightly), their loan portfolios remained large, and their holdings of tax-sheltered state and local government securities also remained small.

Overall, the only notable differences from the pre-acquisition period related to the equity and funding ratios. For the earlier period, the equity to risk asset ratios of the acquired banks were lower than those of the banks' peers; by 1980, this difference had disappeared. On the other hand, at year-end 1980, the foreign-acquired banks made greater use of purchased funds than did their peers, whereas before they had not.

1/ Risk assets are total assets less cash, claims on domestic banks, and U.S. government guaranteed securities. Adjusted equity equals total equity capital plus the reserve for loan losses.
### Table 6

Financial data for all U.S. banks acquired by foreign parties and for their domestically owned peers, year-end 1980

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean ratio %</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>( \bar{X}_f - \bar{X}_p )</td>
<td>t-value</td>
</tr>
<tr>
<td>Ratio to total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>plus U.S. government securities</td>
<td>26.2</td>
<td>27.9</td>
<td>1.70</td>
<td>-1.00</td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>5.4</td>
<td>11.0</td>
<td>.88</td>
<td>-6.40</td>
</tr>
<tr>
<td>Total loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer</td>
<td>54.5</td>
<td>51.5</td>
<td>1.65</td>
<td>1.82</td>
</tr>
<tr>
<td>Commercial</td>
<td>21.4</td>
<td>23.3</td>
<td>1.73</td>
<td>-1.10</td>
</tr>
<tr>
<td>Total deposits</td>
<td>19.5</td>
<td>15.8</td>
<td>1.40</td>
<td>2.64</td>
</tr>
<tr>
<td>Total deposits</td>
<td>83.1</td>
<td>83.7</td>
<td>1.02</td>
<td>-0.59</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>15.4</td>
<td>16.8</td>
<td>1.06</td>
<td>-1.32</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>25.4</td>
<td>9.7</td>
<td>1.87</td>
<td>8.41</td>
</tr>
<tr>
<td>Equity capital</td>
<td>8.6</td>
<td>7.9</td>
<td>.74</td>
<td>.94</td>
</tr>
<tr>
<td>Income</td>
<td>.8</td>
<td>1.0</td>
<td>.09</td>
<td>-2.29</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>14.2</td>
<td>13.6</td>
<td>1.46</td>
<td>.41</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>10.0</td>
<td>12.7</td>
<td>.87</td>
<td>-3.09</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.
2/ Not significant at the 0.10 level.
### Table 7

Financial data for U.S. banks acquired by "small" foreign parents and for their domestically owned peers, year-end 1980

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean ratio</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>$\bar{x}_f - \bar{x}_p$</td>
<td>$t$-value</td>
</tr>
<tr>
<td><strong>Ratio to total assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks plus U.S. government securities</td>
<td>28.2</td>
<td>28.5</td>
<td>2.14</td>
<td>-.14</td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>5.5</td>
<td>11.1</td>
<td>.99</td>
<td>-5.64</td>
</tr>
<tr>
<td>Total loans</td>
<td>52.6</td>
<td>51.8</td>
<td>2.00</td>
<td>.40</td>
</tr>
<tr>
<td>Consumer</td>
<td>21.5</td>
<td>24.2</td>
<td>2.06</td>
<td>-1.31</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>18.6</td>
<td>15.2</td>
<td>1.89</td>
<td>1.80</td>
</tr>
<tr>
<td>Total deposits</td>
<td>84.1</td>
<td>85.8</td>
<td>1.27</td>
<td>-1.34</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>16.2</td>
<td>17.4</td>
<td>1.30</td>
<td>-.92</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>21.9</td>
<td>8.8</td>
<td>3.66</td>
<td>3.58</td>
</tr>
<tr>
<td>Equity capital</td>
<td>9.4</td>
<td>8.4</td>
<td>1.03</td>
<td>.97</td>
</tr>
<tr>
<td>Income</td>
<td>.9</td>
<td>1.1</td>
<td>.12</td>
<td>-1.64</td>
</tr>
<tr>
<td><strong>Other ratios</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>16.0</td>
<td>14.8</td>
<td>2.07</td>
<td>.58</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>10.7</td>
<td>13.4</td>
<td>1.15</td>
<td>-2.35</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.

2/ Not significant at the 0.10 level.
Table 8

Financial data for U.S. banks acquired by large foreign banks and for their domestically owned peers, year-end 1980

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean ratio</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>$\overline{x}_f - \overline{x}_p1/</td>
<td></td>
</tr>
<tr>
<td>Ratio to total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks</td>
<td>21.5</td>
<td>26.5</td>
<td>2.11</td>
<td>-2.37</td>
</tr>
<tr>
<td>plus U.S. government securities</td>
<td>21.5</td>
<td>26.5</td>
<td>2.11</td>
<td>-2.37</td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>5.3</td>
<td>10.6</td>
<td>1.18</td>
<td>-4.51</td>
</tr>
<tr>
<td>Total loans</td>
<td>58.9</td>
<td>50.8</td>
<td>2.62</td>
<td>3.09</td>
</tr>
<tr>
<td>Consumer</td>
<td>21.3</td>
<td>21.2</td>
<td>3.33</td>
<td>.03</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>21.6</td>
<td>17.3</td>
<td>1.44</td>
<td>2.98</td>
</tr>
<tr>
<td>Total deposits</td>
<td>80.4</td>
<td>78.8</td>
<td>1.60</td>
<td>1.00</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>13.6</td>
<td>15.4</td>
<td>1.89</td>
<td>-.95</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>33.5</td>
<td>11.9</td>
<td>3.42</td>
<td>6.31</td>
</tr>
<tr>
<td>Equity capital</td>
<td>6.8</td>
<td>6.8</td>
<td>.67</td>
<td>0</td>
</tr>
<tr>
<td>Income</td>
<td>.5</td>
<td>.8</td>
<td>.11</td>
<td>-2.81</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>10.0</td>
<td>10.9</td>
<td>1.05</td>
<td>-.86</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>8.4</td>
<td>11.0</td>
<td>1.49</td>
<td>-1.74</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.

2/ Not significant at the 0.10 level.
These overall findings generally apply to both subgroups, although there were some differences. Surprisingly, at year-end 1980 the profitability of banks acquired by "small" foreign parents was similar to that of their peers, while the profitability of banks acquired by large foreign banks remained relatively low. This difference might be explained by the relative size of the acquired banks. It often takes longer to substantially improve a large institution than a small one, and the large foreign banks generally acquire larger U.S. banks.

An indicator of liquidity—loans to total assets—was also different for the two subgroups. Banks with "small" foreign parents had ratios similar to those of their peers, while the banks that were acquired by large foreign banks had ratios significantly higher than their peers. This difference might reflect the need for the former to stand alone, while the latter can be more "loaned-up" and rely on the financial backing of a large foreign bank should the need arise. The ratio of "cash" and U.S. government securities to total assets further supports this finding.

Have the banks changed in different ways? The third and perhaps the most important question relates to the way foreign owners have changed the operations of the acquired banks. In evaluating these changes and the differences between the groups, one must also keep in mind the differences discussed earlier. In terms of size and location, the selected peers are, indeed, comparable to the acquired banks. However, in terms of earnings—a key factor—many are not.

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1/ Banks in the study that were acquired by large foreign banks averaged $1.1 billion in assets prior to their change in ownership, compared with average assets of $180 million for those banks acquired by "small" foreign parents. If Crocker and Marine Midland were included, the difference would be much greater.
In many cases, the shift in ownership was probably caused by the banks' low earnings, and one should expect the new owners to make changes. Therefore, one should look at the different rates of changes in tandem with the previous and present financial ratios of both groups. The earlier problems of the acquired banks might relate to their earlier differences from their peers that were "corrected" by bringing their ratios closer to industry standards. This shift might produce statistically significant differences in the rates of change between the two groups, but not produce differences in the way each group now performs.

The earlier study identified a rapid drop in holdings of state and municipal government securities of the acquired banks as the only change different from the U.S.-owned banks. This study revealed more. Tables 9-11 show that, when compared with their peers, the acquired banks:

(a) reduced holdings of state and municipal government securities;
(b) reduced consumer loans and sustained a decline in savings deposits;
(c) increased the use of purchased funds;
(d) improved equity capital ratios; and
(e) improved earnings.

The drop in state and municipal securities probably relates directly to the prior low earnings record of the acquired banks and to their federal
tax position, rather than to their foreign ownership. Many banks had tax losses to carry forward and did not need to sacrifice higher yields for tax-sheltered income.

By itself, the drop in consumer loans and savings deposits suggests that the foreign owners are retreating from small customers. While this is a potentially damaging claim, it should be tempered with the analysis of present differences. At year-end 1980, the level of consumer loans at the acquired banks was not different from that at the U.S.-owned banks. Many acquired banks started with moderately large consumer portfolios and reduced them to average or moderately low (but not statistically different) levels compared with levels for their peer banks.

This condition is illustrated by the data for the banks acquired by small parents. For the pre-acquisition period, these banks had a mean ratio of consumer loans to total assets of 27.5 percent compared with 24.8 percent for the peer group. The acquired banks were somewhat higher than their peers, but, given the degree of dispersion, the difference was not statistically significant. By year-end 1980, the relation had reversed; the ratio for the acquired banks was 21.5 percent, while that of the peer banks remained almost constant at 24.2 percent. At neither period was the difference between the two ratios statistically significant.

1/ Note in tables 6-8 that at year-end 1980, the acquired banks remained significantly less profitable than their peers. Low-earning ("problem") banks and their investment and lending were addressed in an analysis by Joseph F. Sinkey, Jr., "A Multivariate Statistical Analysis of the Characteristics of Problem Banks," Journal of Finance, vol. 30 (March 1975), p. 21. That analysis indicated that problem banks had significantly higher percentages of assets in loans (presumably offset by lower amounts of investment securities) and derived significantly lower percentages of revenues from state and municipal government securities than did the control group. Both findings support the statement that the clear tendency for foreign-acquired banks to invest less in these securities than do their peers is linked more closely to the banks' financial conditions than to the citizenship of their owners.
Table 9

Comparison of performance of all U.S. banks acquired by foreign parties and of their domestically owned peers, from period preceding acquisition to year-end 1980

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean annual percentage rate of change</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>$\bar{x}_f - \bar{x}_p$ 1/</td>
<td></td>
</tr>
<tr>
<td>Ratio to total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks</td>
<td>-2.4</td>
<td>-1.1</td>
<td>1.94</td>
<td>-.67</td>
</tr>
<tr>
<td>plus U.S. government securities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>15 of 47 3/</td>
</tr>
<tr>
<td>Total loans</td>
<td>-1.4</td>
<td>-.4</td>
<td>1.20</td>
<td>-.83</td>
</tr>
<tr>
<td>Consumer</td>
<td>-5.4</td>
<td>-.8</td>
<td>2.14</td>
<td>-2.14</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>.7</td>
<td>-.6</td>
<td>2.24</td>
<td>.58</td>
</tr>
<tr>
<td>Total deposits</td>
<td>-1.5</td>
<td>-.8</td>
<td>.42</td>
<td>-1.67</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>-12.4</td>
<td>-9.2</td>
<td>1.62</td>
<td>-1.98</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>30.0</td>
<td>-8.3</td>
<td>5.29</td>
<td>7.24</td>
</tr>
<tr>
<td>Equity capital</td>
<td>6.8</td>
<td>.5</td>
<td>3.42</td>
<td>1.84</td>
</tr>
<tr>
<td>Income</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>30 of 47 3/</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>9.0</td>
<td>-.8</td>
<td>4.02</td>
<td>2.44</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>29 of 47 3/</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.

2/ Not significant at the 0.10 level.

3/ The "sign test," rather than the "t-test," was used for this ratio because of peculiarities of the data. The figures shown identify the number of foreign owned banks (out of the total number of such banks in the study) whose ratios increased faster than, or decreased more slowly than, those of their domestically owned peers. The probability of getting a result this far from the expected value, if there were no differences between the bank groups, is shown in the last column when the differences were statistically significant.

NC = Not calculated.
Table 10
Comparison of performance of U.S. banks acquired by "small" foreign parents and of their domestically owned peers, from period preceding acquisition to year-end 1980

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean annual percentage rate of change</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>$\bar{x} - \bar{x}_p$ 1/</td>
<td>t-value</td>
</tr>
<tr>
<td>Ratio of total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks plus U.S. government securities</td>
<td>-1.1</td>
<td>-1.3</td>
<td>2.50</td>
<td>.08</td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>12 of 33 3/</td>
</tr>
<tr>
<td>Total loans</td>
<td>-2.5</td>
<td>-.7</td>
<td>1.61</td>
<td>-1.12</td>
</tr>
<tr>
<td>Consumer</td>
<td>-9.3</td>
<td>-1.4</td>
<td>2.43</td>
<td>-3.25</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>1.7</td>
<td>-.7</td>
<td>2.93</td>
<td>.82</td>
</tr>
<tr>
<td>Total deposits</td>
<td>-1.5</td>
<td>-.8</td>
<td>.49</td>
<td>-1.43</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>-14.5</td>
<td>-10.8</td>
<td>2.22</td>
<td>-1.67</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>36.6</td>
<td>-8.4</td>
<td>7.09</td>
<td>6.35</td>
</tr>
<tr>
<td>Equity capital</td>
<td>7.8</td>
<td>1.3</td>
<td>3.61</td>
<td>1.80</td>
</tr>
<tr>
<td>Income</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>23 of 33 3/</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>10.8</td>
<td>-.4</td>
<td>4.71</td>
<td>2.38</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>21 of 33 3/</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.
2/ Not significant at the 0.10 level.
3/ The "sign test," rather than the "t-test," was used for this ratio because of peculiarities of the data. The figures shown identify the number of foreign owned banks (out of the total number of such banks in the study) whose ratio increased faster than, or decreased more slowly than, those of their domestically owned peers. The probability of getting a result this far from the expected value, if there were no differences between the bank groups, is shown in the last column when the differences were statistically significant.

NC = Not calculated.
Comparison of performance of U.S. banks acquired by large foreign banks and for their domestically owned peers, from period preceding acquisition to year-end 1980

<table>
<thead>
<tr>
<th>Item</th>
<th>Mean annual percentage rate of change</th>
<th>Standard deviation</th>
<th>t-value</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign-owned banks</td>
<td>Peer banks</td>
<td>$\bar{x}_f - \bar{x}_p$</td>
<td></td>
</tr>
<tr>
<td>Ratios to total assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and due from banks plus U.S. government securities</td>
<td>-5.5</td>
<td>-7.7</td>
<td>1.87</td>
<td>-2.57</td>
</tr>
<tr>
<td>State and municipal securities</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>3 of 14 $\frac{3}{2}$</td>
</tr>
<tr>
<td>Total loans</td>
<td>1.2</td>
<td>.3</td>
<td>1.41</td>
<td>.64</td>
</tr>
<tr>
<td>Consumer</td>
<td>4.1</td>
<td>.7</td>
<td>3.66</td>
<td>.92</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>-1.7</td>
<td>-.3</td>
<td>2.26</td>
<td>-.62</td>
</tr>
<tr>
<td>Total deposits</td>
<td>-1.4</td>
<td>-.8</td>
<td>.69</td>
<td>-.87</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>-7.6</td>
<td>-5.3</td>
<td>2.25</td>
<td>-1.02</td>
</tr>
<tr>
<td>Purchased funds</td>
<td>15.3</td>
<td>-8.1</td>
<td>5.68</td>
<td>4.12</td>
</tr>
<tr>
<td>Equity capital</td>
<td>4.6</td>
<td>-1.2</td>
<td>7.84</td>
<td>.74</td>
</tr>
<tr>
<td>Income</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>7 of 14 $\frac{3}{2}$</td>
</tr>
<tr>
<td>Other ratios</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted equity to risk assets</td>
<td>4.8</td>
<td>-1.8</td>
<td>8.05</td>
<td>.82</td>
</tr>
<tr>
<td>Income to equity capital</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>8 of 14 $\frac{3}{2}$</td>
</tr>
</tbody>
</table>

1/ Foreign-owned value minus peer value.

2/ Not significant at the 0.10 level.

3/ The "sign test," rather than the "t-test," was used for this ratio because of peculiarities of the data. The figures shown identify the number of foreign owned banks (out of the total number of such banks in the study) whose ratio increased faster than, or decreased more slowly than, those of their domestically owned peers. The probability of getting a result this far from the expected value, if there were no differences between the bank groups, is shown in the last column when the differences were statistically significant.

NC = Not calculated.
Regarding changes by type of owner, the U.S. banks acquired by "small" parents accounted for the drop in the consumer loan ratio and for the improvement in the income and equity to risk asset ratios. Banks acquired by large foreign banks did not differ in these areas from their peer groups. They did, however, show a meaningful decrease in holdings of state and municipal government securities. Both groups of acquired banks increased their use of purchased funds much faster than their respective peers.

SUMMARY AND CONCLUSION

The trend in foreign-ownership of U.S. banks gathered substantial momentum in the mid-70s and shows no signs of slowing. Several foreign banks have recently purchased large U.S. banks, and other major purchases may occur. The Bank Holding Company Act, which governs these purchases, directs the Federal Reserve Board to base its decision on the effect of an acquisition on three factors: (1) competition, (2) the financial and managerial resources and future prospects of the organizations involved, and (3) the convenience and needs of the communities to be served. It provides no authority to deny a request on the basis of the nationality of the applicant. Moreover, under present laws and regulations, a foreign bank can acquire any U.S. bank, provided the acquirer's banking activity remains predominantly abroad. Given the large size of many foreign banks, any but the very largest U.S. banks could potentially become foreign-owned.

1/ In order to qualify for exemptions on nonbanking activities, a majority of the foreign bank's business must be banking and more than half its banking business must be conducted outside the United States. If this test is not met, the foreign bank (worldwide) becomes subject to prohibitions on nonbank activities contained in Section 4 of the BHC Act. This result would be unacceptable to virtually any sizeable foreign bank, and would be an effective deterrent to its acquiring a larger U.S. bank.
Foreign individual investors have also increased their activity. The United States has over 14,000 commercial banks, relatively few barriers preventing entry or changes in ownership, a stable government, and no banking laws that discriminate against foreign parties. In the past, these investors came mostly from Canada and the Western European countries. More recently, however, they have been joined by individuals from Middle Eastern, Latin American, and Asian countries who seek to diversify their holdings. Given the political uncertainty in many countries, the structure of the U.S. banking system, and the absence of barriers to foreign investment, foreign investors will probably continue to buy U.S. banks.

In view of these developments, it is important to know how foreign ownership has affected the acquired banks. This study revealed three major areas where the performance of the acquired banks changed relative to their peers. The acquired banks:

1. reduced their holdings of state and municipal securities;
2. became much more dependent on purchased funds; and
3. improved in their earnings and equity capital ratios.

The decline in holdings of state and municipal government securities could be viewed as indicative of less bank support for local governments. However, it is probably more related to the (still) relatively lower profitability of the acquired banks than to their foreign ownership; the acquired banks probably continue to have less need for tax-sheltered income than their peers.

The remaining factors have supervisory implications. Other things equal, a bank increases its funding risks when it relies heavily on "purchased funds." However, with high interest rates, increased consumer awareness, and deposit deregulation, the concept of a bank having stable and low-cost "core" deposits carries less weight than before.
Finally, the improved earnings and equity capital ratios must be viewed as favorable. While there was certainly much room for improvement, especially regarding earnings, at least the change was in the right direction. The foreign owners do not appear to have abused the acquired banks.

Banks acquired by foreign individual investors performed differently in certain respects than those that were acquired by large foreign banks, but neither group showed disturbing trends. The former produced statistically significantly increases in their earnings and equity ratios, while the latter gained potentially important strength and liquidity from their new foreign bank parents. This potential improvement is not yet apparent in the financial ratios of the acquired banks, but is, nevertheless, a positive factor. Neither group showed a meaningful movement away from consumer lending, which is a concern that is often voiced.

Foreign ownership does raise potential supervisory concerns relating to legal jurisdiction and to transactions between the U.S. bank and its foreign affiliates. It may also raise policy questions about the level of foreign ownership of U.S. banks in general or about acquisitions of especially large U.S. banks in particular. In the author’s opinion, however, this study gives no suggestion that foreign ownership of U.S. banks to-date, by either foreign individuals or banks, has been harmful to the acquired institutions or to the communities they serve.
For immediate release June 9, 1982

The Federal Reserve Board today announced its approval of an application by Banca Commerciale Italiana, Milan, Italy, to become a bank holding company by acquiring LITCO Bancorporation of New York, Inc., Garden City, New York.

Attached is the Board's Order relating to this action.

Attachment
Banca Commerciale Italiana ("BCI"), Milan, Italy, has applied for the Board's approval under section 3(a)(1) of the Bank Holding Company Act (12 U.S.C. § 1842(a)(1)) to become a bank holding company by acquiring 100 per cent of the voting shares of LITCO Bancorporation of New York, Inc. ("LITCO"), Garden City, New York. LITCO, a registered bank holding company, owns 100 per cent of the voting shares of Long Island Trust Company, N.A. ("Bank"), Garden City, New York.

Notice of the application, affording opportunity for interested persons to submit comments and views, has been given in accordance with section 3(b) of the Act. The time for filing comments and views has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3(c) of the Act (12 U.S.C. § 1842(c)).

BCI, with consolidated assets of approximately $34.5 billion, is the second largest commercial bank in Italy and the 36th largest banking organization in the world. BCI operates primarily as a short-term credit institution and generally makes loans and accepts deposits with a maximum maturity of 18 months. Domestic banking is conducted through a network of over 350 branches throughout Italy. In addition, BCI operates worldwide through branches, agencies, and subsidiary and affiliated organizations. BCI is majority-owned by Istituto per la

1/ Unless otherwise noted, all financial data are as of December 31, 1981.
Ricostruzione Industriale ("IRI"), a holding company that is controlled by the government of the Republic of Italy. IRI also holds two other major Italian banks and numerous commercial and industrial companies.

BCI operates in the United States through branches in New York City and Chicago and an agency in Los Angeles. These offices are grandfathered under section 5 of the International Banking Act of 1978 (the "IBA") (12 U.S.C. § 3102) and BCI has selected New York as its home State under the Board's Regulation K (12 C.F.R. § 211.22).

LITCO, with consolidated assets of $1.1 billion, is the 22nd largest commercial banking organization in New York State. Bank, with consolidated deposits of $870.0 million, has 46 branch offices in the Metropolitan New York banking market and two branch offices in the Eastern Long Island banking market. Bank ranks as the 17th largest commercial banking organization in the New York banking market, holding 0.5 per cent of total commercial bank deposits in the market. BCI's New York office is a wholesale, uninsured branch with total deposits and credit balances of $328.5 million as of June 30, 1981. In light of the small presence that BCI and LITCO have in the New York banking market, the Board finds that consummation of the proposal would have no significantly adverse effects on the concentration of banking resources or on existing competition in any relevant area. Moreover, consummation of the transaction would have no adverse effect on potential competition

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2/ The Metropolitan New York banking market is defined to include southwestern Fairfield County in Connecticut; northeastern Bergen County and eastern Hudson County in New Jersey; New York City; and all of Nassau, Putnam, Westchester and Rockland Counties and western Suffolk County, New York.

3/ The Eastern Long Island banking market is approximated by the eastern portion of Suffolk County.
in the Eastern Long Island market. LITCO is the eleventh largest of 28 commercial banking organizations operating in that market and holds 3.7 per cent of market deposits in commercial banks. The market is not highly concentrated and there are numerous potential entrants into the market. Thus, the Board concludes that consummation of the proposal would have no significantly adverse effects with respect to potential competition.

Section 3(c) of the Act requires in every case that the Board consider the financial resources of the applicant organization and the bank or bank holding company to be acquired. The Board has considered this application in the context of the Board's guidelines for capital adequacy and its policy statement on the supervision of foreign bank holding companies. In that policy statement the Board indicated that, in reaching a judgment on the strength of a foreign bank, the Board would consider several factors: the bank's financial condition; the record and integrity of management; its role and standing in its home country; and the opinion of the home country regulators.

The Board evaluated the financial and managerial resources of BCI and, applying the Board's capital adequacy guidelines within a solely U. S. context, had some concern that the stated capital of BCI may not warrant an investment of the size of LITCO. At the same time, evaluating BCI in the context of the policy statement on supervision of foreign bank holding companies, the Board noted that BCI is primarily


5/ 1 Federal Reserve Regulatory Service ¶ 4-835 (1981).
a short-term credit institution with a relatively stable deposit base characteristic of Italian banks. BCI has an established record of operating successfully both in its local market and as an international bank and the Board understands that the board of directors of BCI has embarked on a program designed to improve its capital position. Moreover, BCI has committed to inject capital of $20 million into LITCO within six months of consummation and the Board considered it particularly important that BCI has committed to maintain LITCO as among the more strongly capitalized banking organizations of comparable size in the United States. Having considered these and other related factors, the Board finds that BCI would serve as a source of strength to LITCO and Bank, and concluded that the financial and managerial resources of BCI, LITCO and Bank are generally satisfactory and the future prospects for each appear favorable.

As noted, BCI, through common government ownership, is affiliated with a number of banking and nonbanking organizations, some of which operate locally in Italy and others internationally. Upon acquisition of LITCO by BCI, Bank will become affiliated with these organizations. Section 23A of the Federal Reserve Act (12 U.S.C. § 371c) applies to extensions of credit to and investments in affiliates by member banks. Generally, section 23A sets limits on the amounts that may be loaned by a member bank to affiliates and strict collateral requirements for any loans to an affiliate. Thus, Bank's extensions of credit to any majority-owned subsidiaries of the Italian government, including IRI and its majority-owned subsidiaries, will be subject to the requirements of section 23A.
In light of all the facts of record, the Board concludes that banking factors and considerations relating to the convenience and needs of the communities to be served are consistent with approval of the application.

BCI currently has interests in two firms that engage in certain activities in the United States, BSI Securities, and Lehman Brothers Kuhn Loeb Holding, Inc., both in New York, New York. BCI owns indirectly 100 per cent of the shares of BSI Securities, which engages solely in providing information to its direct parent, Banca della Svizzera Italiana, a Swiss bank subsidiary of BCI. Lehman Brothers engages in investment banking, securities trading and brokerage activities.

While both holdings appear to meet the requirements for the grandfather privileges under section 8(c) of the International Banking Act of 1978 ("IBA") (12 U.S.C. 3106(c)), the Board has previously determined that an otherwise grandfathered foreign banking organization loses that status upon the acquisition of a U.S. subsidiary bank. Midland Bank Limited, 67 Federal Reserve Bulletin 729, 733 n. 9 (1981). Under section 4(a)(2) of the Act and section 8(e) of the IBA, a company may not retain, two years after becoming a bank holding company, more than 5 per cent of the shares of a company that engages in the business of underwriting, selling or distributing securities in the United States. Consistent with this requirement, BCI will reduce its interest in Lehman Brothers to 5 per cent or less within two years of consummation of the proposed transaction. BSI Securities does not actively engage in the securities business in the United States, and its New York office, which acts merely as a representative office, does not appear to engage in any prohibited
activities. Accordingly, the Board finds that BCI's proposed retention of certain interests in these two organizations is consistent with the Act and the Board's regulations.

In acting on this application, the Board noted, as discussed above, that BCI is owned, in major part, by a government-owned holding company, IRI, which owns two other commercial banks, Banco di Roma, S.p.A., and Credito Italiano, each of which has a banking presence in the United States, as well as over 100 subsidiaries engaged in nonbanking activities.

In several cases since the 1970 Amendments to the Act, the Board has approved applications in which foreign government ownership of the applicant was noted but the Board did not apply the Act to the applicant's government owners, and the Board recognizes that the banking community understands, without dissent, that this is the Board's practice in handling such applications. The Board has decided that it is appropriate to continue this practice in the present case and to confirm it with respect to currently conducted activities of foreign government-owned entities with a banking presence in the United States.

However, as more foreign government-owned banking entities become established here, making additional acquisitions of existing banking institutions, the Board believes that further attention should be given to the policy issues involved in government ownership of multiple

banks and commercial-industrial enterprises. Several significant and complex problems were considered by the Board. Where the applicant is owned by a government agency, or by a government directly, that is engaged in a wide range of banking and commercial-industrial activities, there may be problems of compatibility of these cross-industry links with one of the stated purposes of the Act—maintaining a separation between commerce and banking in the United States. Similarly, common ownership by a government or its agencies of multiple banking organizations, even though organized under separate corporate and management structures, but operating in this country in different states, could raise issues of compatibility with the interstate banking limitations of the Act and the IBA.

The Act prohibits domestic companies under common ownership from engaging in these types of nonbanking and interstate banking activities, and Congress, in applying the concept of national treatment in the IBA, placed similar limitations upon foreign privately-owned enterprises under common ownership. Thus, consistency with national treatment does not prevent application of the Act to foreign government-owned institutions in similar circumstances.

The Board examined the issues involved in interpreting the Act. It considered whether a foreign government or agency meets the jurisdictional test for application of the Act—the entity must be a "company" for the purposes of the Act. In focusing on whether the Act was intended to reach governments or governmental corporations, the Board discussed two key issues: (a) whether a foreign government-owned
bank is in fact operated independently from other banks and commercial enterprises that are subject to common government ownership and, therefore, as an independently organized and operated entity, should not be considered commonly owned, thus avoiding application of the Act to its parent; and (b) the conditions under which the Act's focus on prohibiting the potential for conflicts of interests and concentration of resources requires application of the Act because of the fact of common ownership. Moreover, the Board noted the possibility that applying the Act could have a restrictive impact on the ability of foreign government-owned banks to operate in this country if the nonbanking prohibitions of the Act were to be rigidly applied, and noted the international economic policy issues that would be raised in this context.

The Board believes that more extensive analysis and broader participation in the decisionmaking process are necessary before these public policy issues are resolved. The issues and policy considerations outlined in this Order should facilitate the necessary full public discussion. Moreover, the Board believes that the complex issues raised by applying the Act are best resolved in a Congressional framework which allows for the bringing to bear of broader international economic policy considerations, and the present Board action would allow an opportunity for Congressional review.

Within the framework and under the authority of existing law, however, the Board wishes to avoid a situation of competitive inequality and to apply as a general matter the policy that foreign governmental entities should be entitled only to the benefits of national treatment.
The Board would be particularly concerned should a circumstance arise where a government-owned entity is established for the principal purpose of evading the interstate banking prohibitions of section 3(d) of the Act, or where the activities of commonly owned banking and nonbanking entities were conducted in a manner that clearly frustrates the purposes of the Act. Moreover, the Board believes that the application of section 23A of the Federal Reserve Act, as described above, will make a contribution towards limiting the potential for actions inconsistent with the policies of the Act.

Based on the foregoing and other facts of record, the Board has determined that consummation of the transaction would be consistent with the public interest and that the application should be and hereby is approved. The transaction shall not be made before the thirtieth calendar day following the effective date of this Order, or later than three months after the effective date of this Order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of New York pursuant to delegated authority.

By order of the Board of Governors, effective June 9, 1982.

(signed) James McAfee

James McAfee
Associate Secretary of the Board

[SEAL]

\[\text{Voting for this action: Chairman Volcker and Governors Martin, Wallich, Partee, Teeters, Rice and Gramley.}\]
For immediate release

The Federal Reserve Board today announced its approval of
the applications of Credit and Commerce American Holdings, N.V., Willemstad,
Netherlands Antilles; Credit and Commerce American Investment, B.V.,
Amsterdam, The Netherlands; and PGB Bolding Corporation, Washington,
D.C., to become bank holding companies by acquiring Financial General
Bankshares, Inc., Washington, D.C.

Attached is the Board's Order relating to this action.

Attachment
Credit and Commerce American Holdings, N.V. ("CCAH"), Willemstad, Netherlands Antilles; Credit and Commerce American Investment, B.V. ("CCAI"), Amsterdam, The Netherlands; and FGB Holding Corporation ("FGB"), Washington, D.C., have applied for the Board's approval under section 3(a)(1) of the Bank Holding Company Act (12 U.S.C. § 1842(a)(1)) to become bank holding companies through the acquisition by FGB of up to 100 per cent of the voting shares of Financial General Bankshares, Inc. ("FG"), Washington, D.C. FG is a grandfathered multi-state bank holding company with subsidiary banks in Maryland, New York, Tennessee, Virginia and the District of Columbia.1/

Applicants have also applied under section 4(c)(8) of the Act (12 U.S.C. § 1843(c)(8)) and section 225.4(b)(2) of the Board's Regulation Y (12 C.F.R. § 225.4(b)(2)) for permission to acquire indirectly, as an incident to their acquisition of FG, shares of National Mortgage Corporation and Money Exchange Services, Inc., both of Washington, D.C.

These companies are existing nonbanking subsidiaries of FG. National Mortgage Corporation, is a small, presently inactive, mortgage banking company, and Money Exchange Service Corporation provides electronic data processing services for certain affiliated banks. Such activities have been determined by the Board to be closely related to banking (12 C.F.R. § 225.4(a)(1) and (8)).

Notice of the applications, affording opportunity for interested persons to submit comments and views, has been given in accordance with sections 3 and 4 of the Act (45 Fed. Reg. 85,521 (1980)), and the time for filing views and comments has expired. The Board has considered the applications and all comments received, including those of the Commissioner of Financial Institutions for the State of Virginia and several shareholders of FG, in light of the factors set forth in section 3(c) of the Act (12 U.S.C. § 1842(c)) and the considerations set forth in section 4 of the Act.

CCAH and CCAI first applied to acquire FG in November 1978. The applications grew out of Securities and Exchange Commission ("SEC") allegations that certain individuals, some of whom are principals of CCAH and CCAI, had violated section 13(d) of the Securities and Exchange Act of 1934 by acquiring, as a group, more than 5 per cent of the equity securities of FG without making appropriate filings with the SEC. Without admitting or denying these allegations, the defendants entered into a consent agreement with the SEC; according to the terms of that agreement,

2/ The Board has determined that the shareholder protests do not raise issues that would warrant denial of the applications.
certain of the defendants represented that they intended to make a tender offer for any and all shares of FG at the previously highest offered price, subject to obtaining appropriate regulatory approvals. CCAH and CCAI were created as the vehicles for making the tender offer.

When these applications were first filed in 1978, the Commissioner of Financial Institutions of the State of Virginia, the Commissioner of Banking of the State of Tennessee, and the Bank Commissioner of the State of Maryland, as well as the management of FG, objected to the applications. In addition, the Attorney General for the State of Maryland issued an opinion interpreting a section of Maryland State law to preclude unfriendly affiliations. Since the Maryland State bank affiliate of FG was objecting to the proposal, the Attorney General found that the proposed acquisition of FG would violate Maryland law. The Board decided to address this legal issue before acting on the merits of the applications, and by Order dated February 16, 1979 (65 Federal Reserve Bulletin 254 (1979)), determined that it was precluded by law from approving the applications.3/

3/ In that Order the Board also determined that section 3(d) of the Act (12 U.S.C. § 1842(d)), which generally prohibits the Board from approving an application by a bank holding company to acquire voting shares of banks in more than one state, was not applicable to the proposed transaction. While the Board determined that section 3(d) applies to the formation of a multi-state bank holding company as well as the expansion of an existing multi-state bank holding company, the Board held that the Congressional intent of prohibiting the formation and limiting the expansion of such holding companies would be preserved even if the Board approved those applications. The Board reached this determination since the acquisition of FG by these two shell corporations would increase neither the number of multi-state bank holding companies nor the number of out-of-home state banks owned or controlled by FG (65 Federal Reserve Bulletin at 255-56).
In July 1980, CCAH and CCAI and their principals, and FG entered into a definitive agreement for the sale of FG's voting shares to CCAH and CCAI. This agreement concluded the struggle over control of FG between FG's management and CCAH and CCAI and their principals, and led to the filing of the subject applications.

Applicants are non-operating corporations organized for the purpose of becoming bank holding companies by acquiring FG. CCAH, a corporation organized under the laws of the Netherlands Antilles, owns all of the outstanding shares of CCAI, which is organized under the laws of The Netherlands. CCAI, in turn, owns all of the outstanding shares of FGB, a corporation chartered under the laws of the State of Virginia. Upon acquisition of FG (total deposits of $2.1 billion), Applicants would control 10.2 per cent of total deposits in commercial banks in the District of Columbia, 4.7 per cent of such deposits in Virginia, 2.2 per cent in Maryland, and negligible percentages of such deposits in New York and Tennessee. Inasmuch as Applicants and their principals control no other banks and engage in no nonbanking business in the United States, consummation of the transaction would have no adverse effects on either existing or potential competition in any relevant market and would not increase the concentration of resources in any relevant area. Therefore, competitive considerations are consistent with approval of the applications.

The financial and managerial resources of Applicants, FG, and its subsidiary banks are considered generally satisfactory and the future prospects of each appear favorable. The proposed transaction would

4/ Banking data are as of March 31, 1980.
provide FG with $12 million in new capital. Moreover, the Board expects Applicants to serve as a continuing source of strength to FG and its subsidiary banks, and Applicants recognize their responsibility to do so. Although Applicants will incur $50 million in debt in connection with this proposal, Applicants have made certain commitments that ensure that they will be able to service the debt without adversely affecting the financial position of FG or its subsidiary banks. Also, as part of the proposal, Applicants have stated they will not be paying any dividends to their principals in the near future. In the Board's judgment, banking factors are consistent with approval.

Convenience and needs considerations relating to this proposal are favorable. The additional capital to be injected into FG's subsidiary banks is expected to strengthen the organization and allow it to provide new services to the public. Applicants plan to increase the competitive posture of FG by expanding the branch networks of its subsidiary banks, increasing commercial lending and services, and establishing an international department at the New York City subsidiary bank. The Board finds that considerations relating to the convenience and needs of the communities to be served lend some weight toward approval of these applications. It is the Board's judgment that, with respect to the applications filed under section 3 of the Act, consummation of the proposal would be in the public interest and these applications should be approved.

In reaching these conclusions, the Board considered the public comments received on these applications, and has given particular attention to the submissions made by the Commissioner of Financial Institutions for the State of Virginia (the "Commissioner"). The Commissioner made
a timely recommendation of denial of these applications, which would ordinarily require the Board, in accordance with section 3(b) of the Act (12 U.S.C. § 1842(b)), to order a formal hearing on the applications. However, the Commissioner subsequently concurred in a decision by the Virginia State Corporation Commission to withdraw the request for a formal hearing.

The Board determined it would be useful for Board and Reserve Bank staff to conduct an informal meeting, on the record, to be attended by representatives of CCAH and CCAI. The bank supervisors for the States of Maryland, New York, Tennessee and Virginia, and the Comptroller of the Currency were invited to participate. Only the Commissioner decided to participate in this proceeding held at the Board on April 23, 1981, while all the other invited parties, except for the Banking Department of the State of Tennessee, sent representatives as observers.

The Commissioner was given an opportunity to submit written question to the Applicants, make an oral presentation at the meeting, and submit a closing statement in response to issues and questions raised by representatives of CCAH and CCAI at the meeting. The Board has examined carefully all of these comments, and Applicants' responses thereto, and determined that while the Commissioner has raised issues regarding foreign acquisitions of U.S. banks and supervisory and regulatory issues related to such acquisitions, these matters were addressed responsively by Applicants, and, in certain instances, have previously been addressed
by the Board itself. Accordingly, the Board finds that the objections of the Commissioner do not warrant denial of these applications.

With respect to the applications to acquire FG's nonbank subsidiaries, the Board has determined that the balance of public interest factors prescribed by section 4(c)(8) of the Act favor approval of FG's retention of National Mortgage Corporation (65 Federal Reserve Bulletin 72 (1979)). Nothing in the record suggests that Applicants' acquisition of FG would alter that balance. Money Exchange Services, Inc., provides data processing services to FG's subsidiary banks. It does not appear that the acquisition of this company would have any adverse effect on competition in any relevant area. There is no evidence in the record that consummation of the proposal would, with respect to these applications, result in undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices or other adverse effects on the public interest. Accordingly, the Board has determined that the balance of public interest factors it must consider under section 4(c)(8) of the Act favors approval of the applications filed under that section, and that these applications should be approved.

On the basis of the record, the applications are approved for the reasons summarized above. The acquisition of FG shall not be made before the thirtieth calendar day following the effective date of this Order, or later than three months after the effective date of this Order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Richmond pursuant to delegated authority.

5/ In its February 23, 1979 "Statement of Policy on Supervision and Regulation of Foreign Bank Holding Companies," the Board endorsed the principle of national treatment, or nondiscrimination, as a basis for the rules governing the entry and subsequent operations of foreign banks in this country. The Board noted that the International Banking Act of 1978 generally incorporates that principle in its provisions.
The determination as to Applicant's acquisition of FG's nonbank subsidiaries under section 4(c)(8) of the Act is subject to the conditions set forth in section 225.4(c) of Regulation Y, and to the Board's authority to require such modification or termination of the activities of a holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder, or to prevent evasion thereof.

By Order of the Board of Governors, effective August 25, 1981.

(Signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]

6/ Voting for these actions: Chairman Volcker and Governors Schultz, Wallich, Partee and Gramley. Absent and not voting: Governors Teeters and Rice.
For immediate release


Attached is the Board's Order relating to these actions.

Attachment

Midland has also applied to do business under section 25(a) of the Federal Reserve Act (the "Edge Act") (12 U.S.C. §§ 611-631) by acquiring indirectly the shares of three Edge Corporation subsidiaries owned by Crocker National Bank: Crocker Bank International (Chicago), Chicago, Illinois; Crocker Bank International (New York), New York, New York; and Crocker International Investment Corporation, San Francisco, California. The factors that are considered in acting on these applications include those set forth in section 211.4(a) of the Board's Regulation K (12 C.F.R. § 211.4(a)).

Midland has also applied, pursuant to section 4(c)(8) of the BHCA (12 U.S.C. § 1843(c)(8)) and section 225.4(b)(2) of the Board's Regulation Y (12 C.F.R. § 225.4(b)(2)), for permission to acquire indirectly voting shares of the following subsidiaries of Crocker: (1) Bishop Building Co., Inc., Honolulu, Hawaii, which owns and operates the Bishop Trust Building in Honolulu and leases it to subsidiaries of Crocker.
and other tenants; (2) Bishop Trust Company, Ltd., Honolulu, Hawaii, which conducts a full-service trust business and provides limited data processing services to other Crocker subsidiaries; (3) Hawaii Finance Company Ltd., Honolulu, Hawaii, which operates as an industrial loan company making secured and unsecured loans to individuals; (4) Miles Crossing Ltd., Honolulu, Hawaii, which owns real estate mortgages and other real estate receivables; (5) CNC Insurance Agency Inc., San Francisco, California, which engages in the activity of acting as agent for credit life and credit accident and health insurance directly related to extensions of credit by Crocker's subsidiaries; (6) Crocker Investment Management Corp., San Francisco, California, which engages in the activity of providing portfolio investment advice and general economic and financial information and advice; (7) Crocker Mortgage Investment Company Inc., Los Angeles, California, which engages in the activities of originating, purchasing and servicing loans secured by real estate and servicing loans and other extensions of credit; (8) Western Bradford Trust Company, San Francisco, California, a trust company which furnishes services to security holders, brokers, dealers and issuers, provides data processing services to Crocker and its subsidiaries, and provides computer software services to Crocker and its subsidiaries; and (9) Crocker Holdings Inc., Germantown, Tennessee, which holds real estate related assets of Crocker that are in the process of liquidation.

In addition, Midland has applied, pursuant to section 4(c)(8) of the BHCA and section 225.4(b)(2) of the Board's Regulation Y, for permission to retain the following indirect subsidiaries: (1) Samuel Montagu (Metals), Inc., New York, New York, which engages in the activity
of dealing in precious metals by buying and selling gold and silver on the spot and futures market for its own account, and deals with other precious metals dealers; (2) Thomas Cook, Inc., New York, New York, a company that engages in the issuance and sale of travelers checks; and (3) London American Finance Corporation, New York, New York, a commercial finance company specializing in overseas trade financing of products manufactured in the United States; (4) LAFCO (Western Hemisphere), Ltd., New York, New York, which markets in the western hemisphere the services of certain financing affiliates and extends credit to Latin American importers of United States products; and (5) Export Credit Corporation, a commercial finance company specializing in overseas trade financing of products manufactured in the U.S.

The activities applied for have either been specified by the Board in section 225.4(a) of Regulation Y as permissible for bank holding companies, subject to Board approval of individual proposals in accordance with the procedures of section 225.4(b), or have been authorized by Order under section 4(c)(8) in particular cases.

Midland has also applied, pursuant to section 4(c)(9) of the BHCA (12 U.S.C. § 1843(c)(9)) and section 211.23(f)(5) of the Board's Regulation K (12 C.F.R. § 211.23(f)(5)), to retain Midland's interest in The Thomas Cook Group Ltd. ("TCG"), Peterborough, England. TCG provides retail and wholesale travel arrangements and issues and sells travelers checks on a worldwide basis through its subsidiaries.¹/

¹/ As noted above, Midland applied pursuant to section 4(c)(8) to retain TCG's U.S. travelers check business.
Notice of receipt of these applications has been given in accordance with sections 3 and 4 of the BHCA (42 Fed. Reg. 16,066 (1981)), and the time for filing views and comments has expired. The Board has considered the applications and all comments received in light of the factors set forth in section 3(c) of the BHCA (12 U.S.C. § 1842(c)), the considerations specified in sections 4(c)(8) and (9) of the BHCA, and the purposes of the Edge Act.

Midland is the third largest of the major London clearing banks and the lead bank of the 15th largest banking organization in the world, with total deposits of approximately $55.1 billion.2/ Midland's business consists of the provision of a wide range of banking, financial and related services through its various subsidiaries and affiliated companies. Domestic banking is conducted through a network of more than 3,000 branches by Midland itself in England and Wales, and by subsidiaries in Scotland, Northern Ireland, and the Republic of Ireland. In addition to commercial banking and trust services, Midland engages in merchant banking, equity financing, mortgage banking, consumer financing, equipment leasing, factoring, and providing travel services and issuing and selling travelers checks on a worldwide basis. Approximately 60 per cent of Midland's profits derive from domestic banking; 25 per cent from its international activities; and 15 per cent from related services.

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2/ Banking data for Midland are as of December 31, 1980.
Crocker does not engage directly in any activity except holding shares of its subsidiaries. Its banking subsidiary, Crocker National Bank ("Bank"), San Francisco, California, holds domestic deposits of approximately $11.4 billion, is the fourth largest banking organization in California, with 385 branches, and the 12th largest banking organization in the United States. Upon consummation of this proposal, Midland would be the 10th largest banking organization in the world.

Midland does not operate any banking offices in the United States. Accordingly, the Board finds that approval of the proposal would have no significant effect on the concentration of banking resources or existing competition in any relevant area. Furthermore, while Midland has demonstrated that it is a likely entrant into the United States banking market, and has the financial resources to establish de novo offices in Bank's major market areas, most of the metropolitan California markets in which Bank competes are competitive markets; therefore, the elimination of probable future competition would not be significant. Accordingly, the Board finds consummation of the proposal would have no significant effect on probable future competition.

The financial and managerial resources and future prospects of Midland appear generally satisfactory. Under the proposed transaction, Crocker would receive capital injections totalling $495 million. In the first stage of the proposal, Midland would acquire 51 per cent of

3/ Banking data for Crocker and market data are as of December 31, 1980.

4/ Midland does have, as discussed below, a 20.125 per cent interest in European American Bancorp, New York, New York, which has a wholly-owned subsidiary bank, European American Bank and Trust Company, New York, New York. In addition, Thomas Cook Travellers Cheques, Ltd. is licensed as a banking agency under New York State Banking Law.
Crocker for $595 million, of which $270 million would be added to Crocker's capital funds through the purchase of newly issued shares. In the second stage of the proposal, Midland, at its option or upon call by Crocker, would purchase over four years new common shares from Crocker for a total of $225 million. The additional purchase would increase Midland's ownership of Crocker from 51 per cent to 57 per cent.

The Board regards the additional capital being provided to Crocker as a result of the transaction as a positive factor in that it provides the opportunity to achieve a permanent enhancement of Crocker's capital position. Moreover, the Board expects that both Midland and Crocker will be mindful of this opportunity in the employment of the new capital funds.

The Board notes that Crocker's capital ratios are comparable to the ratios of other large U.S. banks at the present time. The Board, however, is aware that the capital ratios of the largest U.S. banks have generally declined over the past few years while, at the same time, the risks to which they are exposed have increased. The Board believes, therefore, that banks in this position should avail themselves of every opportunity to strengthen their capital positions. The injection of capital by Midland provides such an opportunity consistent with a reasonable rate of growth in Crocker's assets. In exercising its responsibility under the Bank Holding Company Act, the Board will monitor closely the capital position of large banking organizations in connection with their future expansion plans.
In light of all the facts of record, the Board concludes that banking factors and considerations relating to the convenience and needs of the communities to be served are consistent with approval of the applications. It is the Board's judgment that, with respect to the application filed under section 3 of the BHCA, consummation of the proposal would be in the public interest and should be approved.

In reaching these conclusions, the Board has given due consideration to the public comments received on these applications, and the views expressed at the public meeting ordered by the Board on the proposal and held in San Francisco, California, on June 22, 1981. The Board had ordered this meeting because of the importance of Crocker in the communities in which it operates and the interest of the public in the proposal. The objections expressed in the written submissions and at the public meeting were based primarily upon issues related to the foreign acquisition of U.S. banks in general and Community Reinvestment Act ("CRA") considerations. The Board has determined that these objections do not warrant denial of the application. The Board notes that there is no statutory authority in the BHCA for taking into account the nationality of the acquiring company, and that CRA does not apply to a transaction where the acquiring banking organization has no banking presence in the U.S. The Board also considered the written submissions and oral presentations at the June 22 meeting in regard to their bearing on the convenience and needs factors that the Board must consider under the BHCA and found that these factors are positive and consistent with
approval as discussed above. Accordingly, the Board has determined that the public comments on the applications do not raise issues that would warrant denial, or conditioning the approval of this application.

As discussed above, Midland currently has a 20.125 per cent ownership interest in European-American Bancorp ("EAB"), New York, New York, a bank holding company with respect to European-American Bank and Trust Company ("EABTC"), New York, New York. At the time the Board approved EAB's application to become a bank holding company in 1977 (63 Federal Reserve Bulletin 595), the Board concluded that neither Midland nor any of the other five foreign banks having interests in EAB should be considered bank holding companies, individually or collectively.\(^5\)

Section 3(d) of the BHCA (12 U.S.C. \$ 1842(d)) generally prohibits the Board from approving an application that would permit a bank holding company to acquire more than 5 per cent of the voting shares of a bank located outside of the bank holding company's principal State of banking operations, unless such acquisition is specifically authorized by State law. Although Midland is not currently a bank holding company, the effect of Midland's acquisition of Crocker while maintaining its present interest in EAB would be inconsistent with the legislative direction contained in section 3(d).

\(^5\) The other shareholders of EAB are Societe Generale de Banque, S.A., Brussels, Belgium (20.125%); Deutsche Bank A.G., Frankfurt, Germany (20.125%); Amsterdam-Rotterdam Bank, N.V., Amsterdam, The Netherlands (17.0%); Societe Generale, Paris, France (20.125%); and Creditanstalt Bankverein, Vienna, Austria (2.5%).
Therefore, in order to prevent any evasion of the provisions and purposes of section 3(d), the Board has determined that Midland should be required to divest its interest in EAB. In light of the unique structure of EAB as a consortium organization, and taking into consideration EABTC's acquisition in 1974 of the assets of Franklin National Bank, the Board believes that it would be appropriate to allow Midland a longer period of time than is usual in order to complete the divestiture. The additional time will provide EAB and its owners flexibility to assure that the capital strength of the institution will be adequately maintained. Therefore, the Board has determined that Midland should reduce its interest in EAB to five per cent or less of EAB's shares within three years of consummation of the transaction, provided that such period may be extended for good cause by the Board or by the Federal Reserve Bank of San Francisco under delegated authority.

With respect to the applications to acquire Crocker's nonbank subsidiaries, it was previously determined that the balance of public interest factors prescribed by section 4(c)(8) of the BHCA favored approval of the acquisition of these companies when they were acquired originally by Crocker. Nothing in the record suggests that Midland's acquisition of Crocker would alter that balance. Furthermore, the Board has determined that retention by Midland of Samuel Montagu (Metals), Inc., Thomas Cook, Inc. (issuance and sale of travelers checks), London American Finance Corporation, LAFCO (Western Hemisphere), Ltd., and Export Credit Corporation would produce benefits to the public and would be in the public interest. There is no evidence in the record that consummation of the proposal would, with respect to these section 4(c)(8) applications, result in
undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or other adverse effects on the public interest. Accordingly, the Board has determined that the balance of public interest factors it must consider under section 4(c)(8) of the BHCA favors approval of the applications filed under that section, and that those applications should be approved.6/

Similarly, with respect to Crocker's three Edge corporations, the public interest in the uninterrupted continuation of their service to customers favors approval of their retention after Crocker is acquired by Midland. The financial and managerial resources of Midland are regarded as consistent with approval of the affiliation of these three corporations with Midland, an organization broadly represented in foreign markets, and their acquisition by Midland would enable these Edge corporations to continue the international services Crocker's Edge Corporations are able to provide to their customers, consistent with the purposes of the Edge Act to afford at all times a means of financing international trade, to stimulate competition for international banking and financing services, and to facilitate and stimulate United States exports. Accordingly, the Board finds that the applications filed under the Edge Act for the retention of Crocker Bank International (Chicago), Crocker Bank International (New York), and Crocker International Investment Corporation should be approved.

6/ In light of the Board's action requiring Midland's divestiture of EAB, the applications filed under section 4(c)(8) to retain EAB's nonbank subsidiaries are rendered moot.
Midland has also applied, pursuant to section 4(c)(9) of the BHCA and section 211.23 of the Board's Regulation K, to retain its wholly-owned subsidiary, Thomas Cook Group Ltd. ("TOG"), a worldwide travel agency whose U.S. subsidiary is Thomas Cook, Inc. ("TCI"). Midland, through its indirect subsidiary, TCI, engages in providing travel services in the U.S. as part of the worldwide travel services provided by its parent company, TOG. Section 211.23(f)(5)(iii)(B) of the Board's Regulation K specifically states that a foreign banking organization may engage in the activity of arrangement of passenger transportation (Standard Industrial Code 4722) in the United States only with the approval of the Board pursuant to section 4(c)(9) of the BHCA.

TOG, a British company controlled by Midland since 1972 and wholly owned by Midland since 1977, provides retail and wholesale travel arrangements and sells travelers checks on a worldwide basis through its subsidiaries. TOG currently engages in the wholesale and retail travel business through the Travel Division of its wholly-owned U.S. subsidiary, TCI, a New York Corporation. TCI serves customers in both the business (70 per cent of its revenues) and pleasure (30 per cent of its revenues) travel segments through a nationwide retail network of 66 travel outlets in 53 cities in the U.S. Several of the outlets in New York engage in both wholesale (i.e., packaging of tours) and retail travel business. All other U.S. outlets engage only in retail business.
In support of its application to retain TCI, Midland has made a number of commitments and presented evidence to demonstrate that an exemption under section 4(c)(9) would not be at variance with the purposes of the BHCA and would be in the public interest. In the past, Midland and TCI have not sought public recognition of their connection and there is little public identification in the U.S. of one with the other. Midland has committed to preserve the complete separation of its banking operations in the U.S., whether conducted through Crocker or otherwise, from the travel business conducted in the U.S. by TCI. Midland also contends that retention of TCI would be in the public interest because of the fragmentation of the U.S. travel agency industry and because TCI brings foreign revenues to the U.S. by virtue of its relationship with TCG.

Section 4(c)(9) of the BHCA provides that the nonbanking prohibitions of section 4 shall not apply to the investments or activities of a foreign company that conducts the greater part of its business outside the U.S. if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of the BHCA and would be in the public interest.

In determining whether to grant an exemption under section 4(c)(9), the Board has generally considered among other things whether such exemption would give the foreign institution a competitive advantage over domestic banking organizations.7/

With respect to this application, the Board notes that not only are the travel agency activities of TCI impermissible for domestic banking organizations but TCI, in addition to providing travel services to its customers, provides nationwide outlets for the sale of Thomas Cook travelers checks and the conducting of foreign currency transactions. Thus, Midland would be able, through TCI, to combine under common ownership and operation permissible section 4(c)(8) activities with the impermissible activity of operating a travel agency. No U.S. banking organization is able to market section 4(c)(8) services throughout the U.S. in the same manner.\footnote{By Order dated January 26, 1976, the Board found that the operation of a travel agency is not closely related to banking and therefore determined not to add the operation of a travel agency to the list of permissible activities in Regulation Y (62 \textit{Federal Reserve Bulletin} 148 (1976)).} Midland's commitments regarding the separation of its U.S. travel and banking business do not reduce the competitive advantage Midland would gain over domestic organizations in the conduct of its permissible nonbanking activities. Thus, based on all the facts of record, the Board concludes that Midland's retention of the travel services of TCI would be substantially at variance with the purposes of the BHCA and that the application to retain TCI under section 4(c)(9) should be and is denied. Accordingly, under section 4(a)(2) of the BHCA, Midland
must divest the travel agency operations of TCI within two years of acquiring Crocker, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco pursuant to delegated authority.9/

Midland has also indicated that it intends to retain certain indirect investments in the United States through foreign nonbanking companies on the basis of section 2(h) of the BHCA (12 U.S.C. § 1841(h)). In each instance, Midland has provided information on the size and amount of assets and revenues of the foreign company abroad and of its U.S. operations, and information on whether the activity of the U.S. operations is in the same general line of business as that of the foreign nonbanking company. From the information provided, it appears that retention of these investments is permissible under section 2(h).

Based on the foregoing and other considerations reflected in the record, the Board has determined that the applications under sections 3(a)(1) and 4(c)(8) of the BHCA and under the Edge Act should be and hereby approved subject to the following conditions:

(1) that Midland reduce its interest in EAB to five per cent or less of EAB's shares within three years of consummation of the transaction; and

9/ As noted above, a subsidiary of Midland is licensed by the New York State Banking Department to maintain an agency in New York City and has operated the agency since prior to July 26, 1978. Although Midland has not asserted grandfather rights under the International Banking Act of 1978 to retain TCI, the Board has examined the question of Midland's grandfathered status. In light of previous Board determinations that an otherwise grandfathered foreign bank loses that status upon the acquisition of a U.S. subsidiary bank, the Board has determined that Midland may not retain the travel agency operation of TCI pursuant to 12 U.S.C. § 3106(c). National Westminster Bank Limited, 65 Federal Reserve Bulletin 357 (1979); Algemene Bank Nederland, N.V., 65 Federal Reserve Bulletin 658 (1979).
(2) that Midland divest the travel agency operations of TCI or reduce its interest in TCI to five per cent or less of TCI's shares within 2 years of consummation of the transaction.

The periods referred to above may be extended for good cause by the Board or by the Federal Reserve Bank of San Francisco under delegated authority. The acquisition of Crocker shall not be made before the thirtieth calendar day following the effective date of this Order, or later than three months after the effective date of this Order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco pursuant to delegated authority. The determination as to Midland's acquisition of Crocker's nonbank subsidiaries and retention of its own nonbank subsidiaries under section 4(c)(8) of the Act is subject to the conditions set forth in section 225.4(c) of Regulation Y, and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's Orders and regulations issued thereunder, or to prevent evasion thereof.

By Order of the Board of Governors,\(^{10/}\) effective August 25, 1981.

(Signed) William W. Wiles

William W. Wiles
Secretary of the Board

\(^{10/}\) Voting for these actions: Chairman Volcker and Governors Schultz, Wallich, Partee and Gramley. Absent and not voting: Governors Teeters and Rice. Not voting on the insurance activities: Governors Schultz and Wallich.