

Research Department Federal Reserve Bank of San Francisco

December 14, 1973

Foreign Banks

In a world of multinational corporations, multinational banks have a growing role to play, as is seen from the expanded scope of foreign-bank operations inside this country in recent years. Between 1965 and 1972, assets of foreign-bank agencies and branches in the U.S. increased three-fold to about \$13 billion. This growth does not compare with the eight-fold expansion of American banks' branches overseas (to \$75 billion), but it has created an important new force in the leading American financial centers.

About 150 foreign banks now operate in the U.S., with their activities ranging in size from one-man representative offices, through agencies and subsidiaries with regular banking charters. (In fact, some subsidiaries now rank among the 100 or 200 largest **American** banks.) These institutions have come to the United States because they realize that they must operate inside the world's largest market if they are to offer a competitive range of international-banking services to their customers.

The U.S. is a major trading nation and, despite the turmoil of the past several years, the dollar is still the principal currency used in international finance. A New York, San Francisco, or Los Angeles office, for example, permits direct participation in U.S. financial markets with resulting benefits in lower costs and saving of time. In dealing with their corporate customers, moreover,

foreign banks are at a competitive disadvantage if they cannot offer those firms banking services in overseas as well as home markets. This consideration becomes increasingly important as foreign manufacturing and trading firms expand their beachhead in the continent-sized American market.

New York is the most important center of foreign banking, because it is the leading financial center for both domestic and international trade, and because it has obvious locational advantages for financing trade with Europe. California is next in importance, because of its advantages for financing Pacific trade as well as the large size of the state's economy. (Foreign-bank affiliates in California accounted for almost 6 percent of the state's \$43 billion total business loans at mid-year.) With the easing of banking laws in other states, centers such as Chicago, Boston and Seattle can be expected to attract more foreign banks in the future.

Types of activities

The most common type of operation for a foreign bank is the representative office, but it also has the most limited functions. It cannot make loans or accept deposits. Basically, the representative office attempts to develop business which will be handled by the parent bank abroad. About 80 foreign banks have representatives in New York City, and another 20 have representatives in either San Francisco or Los Angeles. A few offices also are

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located in Chicago, Dallas and Houston.

To make loans in the U.S., a foreign bank must establish an agency or a branch—or a domestically-chartered commercial-bank subsidiary. The actual powers of an agency or branch vary from state to state, but the principal difference is that a branch can accept—and an agency cannot accept—domestically-owned deposits.

Under New York banking law, a branch of a foreign bank not only can accept deposits, both domestic and foreign-owned, but it also can make the same types of loans permitted to domestic banks. Loan limits are determined by the size of the foreign head office, rather than by the size of the domestic branch or agency. Most loans are associated with the financing of foreign-trade, but many agencies and branches also seek domestic business in making loans and accepting deposits. Some New York City branches of foreign banks actively solicit consumer-type deposits and make instalment loans, while under California banking law, foreign-bank offices are permitted only to accept foreign-owned deposits. Thus California offices operate like agencies in New York, and work primarily in foreign-trade financing.

Subsidiaries of foreign banks are able to conduct a full domestic-banking business in the states where they are chartered. (All

foreign-controlled banks presently have state charters, because Federal law requires that all directors of Federally chartered banks be U.S. citizens.) At present, subsidiaries are chartered in New York, California and Illinois. In California, where state-wide branch banking is permitted, five of the eleven foreign-controlled subsidiaries have developed branch networks and compete actively for consumer business, whereas the other six conduct a wholesale banking business with a strong international emphasis. In Illinois, where branching is forbidden to all banks, each subsidiary is permitted only a single office which these institutions generally choose to locate in the financial district of Chicago.

Regulatory differences

Where foreign banks maintain only branches or agencies, they are subject only to state law. Foreign banks thus can operate branches or agencies in more than one state, which means that they have a form of interstate banking open to them which is unavailable to domestic banks. (States can stop entry, of course, and at the moment, nine states forbid all foreign-bank offices.) In addition, they are not covered by the Glass-Steagall Act, which prevents domestic banks from engaging in investment banking. Thus, foreign banks can participate in both commercial- and investment-banking functions.

When foreign banks maintain subsidiaries, they are subject to reg-

ulation by the Federal Reserve System under the Bank Holding Company Act. This act prohibits the acquisition or formation of subsidiaries in more than one state. Subsidiaries consequently do not have the interstate branching powers available to foreign branches and agencies, and because of this limitation, they tend to concentrate in the largest financial centers. The Bank Holding Company Act brings both the banking and nonbanking subsidiaries of foreign banks under regulation. For example, the Federal Reserve Board, applying the principles of the Glass-Steagall Act, recently required an Italian bank to divest itself of a one-third interest in a U.S. investment-banking operation before being permitted to buy into a Chicago commercial bank.

The Federal government does not possess statutory authority to govern all aspects of foreign-bank activities in this country. As a result, Federal efforts to negotiate with foreign governments to reduce barriers against U.S. banks sometimes are impeded because the Federal government can not guarantee uniform regulations in all states. Many state banking superintendents are aware of this problem, and therefore attempt to keep national objectives in view when processing applications from foreign banking institutions.

Last month, Congressman Patman introduced legislation to authorize Federal regulation in this area,

which would require foreign banks to apply to the Treasury Department for permission to establish new offices or continue present operations. Under the provisions of the Patman bill all foreign banking operations in the U.S. would be conducted through subsidiaries, rather than through a combination of branches, agencies and subsidiaries—in a sense, paralleling the type of system under which U.S. banks operate in most foreign countries. Only two types of subsidiaries would be permitted any foreign bank under the Patman proposal: up to five federally-chartered international-banking subsidiaries, and one state-chartered domestic bank. Bank holding companies could also be formed.

The Federal Reserve System has been conducting its own study of the foreign-banking situation, in an attempt to develop a coordinated policy which would reconcile national and international needs with the interests of the individual states. The System became involved in this study partly because of its responsibilities under the Bank Holding Company Act, but also because of the growing importance of foreign banking for domestic financial activity and monetary policy. While further efforts are made to develop a national policy in this very complex field, multinational banking will continue to exert a growing influence on the domestic economy.

Robert Johnston

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 11/28/73	Change from 11/21/73	Change from year ago	
			Dollar	Percent
Loans adjusted and investments*	76,117	+ 223	+9,156	+ 13.67
Loans adjusted—total*	57,977	+ 236	+9,164	+ 18.77
Securities loans	1,337	+ 66	- 14	- 1.04
Commercial and industrial	20,001	+ 24	+2,698	+ 15.59
Real estate	18,004	+ 32	+3,195	+ 21.52
Consumer instalment	8,878	+ 5	+1,299	+ 17.14
U.S. Treasury securities	5,934	- 157	- 965	- 13.99
Other securities	12,206	+ 154	+ 957	+ 8.51
Deposits (less cash items)—total*	71,684	- 151	+6,015	+ 9.16
Demand deposits adjusted	21,805	+ 35	+ 934	+ 4.48
U.S. Government deposits	474	- 51	- 856	- 64.36
Time deposits—total*	48,224	- 100	+5,813	+ 13.71
Savings	17,479	- 42	- 760	- 4.17
Other time I.P.C.	22,053	- 114	+5,115	+ 30.20
State and political subdivisions	5,579	+ 47	+ 570	+ 11.38
(Large negotiable CD's)	10,461	- 197	+3,812	+ 57.33
Weekly Averages of Daily Figures		Week ended 11/28/73	Week ended 11/21/73	Comparable year-ago period
Member Bank Reserve Position				
Excess reserves		12	89	- 10
Borrowings		19	88	64
Net free (+) / Net borrowed (-)		- 7	+ 1	- 74
Federal Funds—Seven Large Banks				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (-)		+933	+686	-218
Transactions: U.S. securities dealers				
Net loans (-) / Net borrowings (+)		- 21	-219	+172

*Includes items not shown separately.

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