FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7593
March 24, 1975]

Proposed Legislation To Regulate Foreign Banking Organizations Operating in the United States

To Branches and Agencies of Foreign Banking Corporations, and Others Concerned, in the Second Federal Reserve District:

On March 4, 1975, the Board of Governors of the Federal Reserve System resubmitted to Congress proposed legislation to regulate foreign banking in the United States. As announced in our Circular No. 7516, dated December 3, 1974, the legislation was first introduced in Congress late last year, and is designed to standardize the status of foreign banks in the United States by placing them under the same basic rules and procedures that must be observed by domestic banks.

Copies of a 6-page *Summary of Principal Technical Changes Made in Proposed Foreign Bank Act of 1974 by Proposed Foreign Bank Act of 1975*, and a 12-page *Summary of Principal Features of the Foreign Bank Act of 1975*, issued by the Board of Governors on March 4, may be obtained from our Foreign Banking Applications Department. In addition, that Department has available for public inspection copies of the draft bill, and a section-by-section analysis of the bill.

ALFRED HAYES,
President.

Board of Governors of the Federal Reserve System

Foreign Bank Act of 1975

Summary of Principal Features

The proposed legislation, entitled the Foreign Bank Act of 1975, would establish a national policy on foreign banks entering and operating in the United States and a system of Federal regulation and supervision of those operations.

Foreign banks have in recent years been coming to the United States in increasing numbers and operating through branches, agencies, and subsidiary banks. The scale and nature of foreign bank activities through these facilities is now significant in terms of competition within the banking industry and of the functioning of money and credit markets. This movement by foreign banks into the United States is part of the broader development of multinational banking in which United States banks are deeply involved through their extensive operations overseas. The multinational banking system that has evolved as a result of the establishment by the world's leading commercial banks of banking and financing facilities on a global basis is now a key element in the world's financial system. Its functioning has far-reaching ramifications for international financial policy and for the economic and financial policies of individual nations.

At the present time, foreign banks entering and operating in this country do so on terms and conditions almost exclusively determined

by the laws and regulations of the various States. The uneven incidence of these laws and regulations has the result that in some States foreign banks are precluded from entry; in others, the form of organization and the nature of their activities are restricted in various ways. On the other hand, by careful choice of organizational form, foreign banks are able to engage in deposit banking activities in several States, an opportunity presently not available to domestic banks. Also, in contrast to the large United States banks, a number of foreign banks conducting sizable banking operations through branches and agencies are not subject to the constraints imposed by the Bank Holding Company Act on nonbank activities. Few foreign banks are members of the Federal Reserve System; as a consequence, a growing and increasingly important sector of money market and credit operations is not directly subject to the monetary disciplines of the central bank. Finally, existing arrangements provide only a limited role for the Federal Government in regulating and supervising the entry and operations of foreign banks in this country despite the fact that foreign bank operations in this country and their treatment here have important implications for our external financial policy and for our relations with foreign governments.

The proposed legislation seeks to regularize the status of foreign banks in the United States on the basis of the principle of national treatment, or nondiscrimination. Its provisions are aimed at providing foreign banks with the same opportunities to conduct activities in this country as are available to domestic banking institutions and

subjecting them to the same rules and regulations. In this way, equitable treatment would be afforded to comparable institutions competing in the same national market. The legislation also provides for a Federal Government role in licensing and supervising foreign bank operations because of the national policy considerations involved and would bring most of those operations directly within the purview of the Federal Reserve as the nation's central bank. The ways in which the legislation seeks to implement these general objectives are described in the following sections.

Coverage

At the present time, foreign banks operating in the United States exclusively through branches and agencies are not subject to the Bank Holding Company Act. Moreover, the branches and agencies of foreign banks that are subject to that Act because of their ownership of a subsidiary bank are not considered as additional "banks" for purposes of the Act. This situation is remedied by Section 2 of the bill which amends the Bank Holding Company Act to redefine "bank" to include branches and agencies of foreign banks established or operating under the laws of the United States, any State of the United States, or the District of Columbia, at which deposits are received, credit balances are maintained incident to or arising out of the exercise of commercial banking powers, checks are paid, money is lent, or other commercial banking activities are performed. As a result, the

Bank Holding Company Act would apply to virtually all foreign banks conducting depository and bank lending functions in the United States.

These amendments to the Bank Holding Company Act would not extend to New York State Investment Companies nor to certain banking organizations that are joint ventures or consortia of foreign banks. New York State Investment Companies are organized under Article XII of the New York banking law and are empowered to transact virtually all the usual activities of a commercial bank, except that they may not engage in the general business of accepting deposits. Instead, they are limited to accepting credit balances from their customers that are incident to or arise from the exercise of their lawful powers. There are currently three of these Companies that are foreign-owned and conduct the essence of a commercial banking business in this manner. Two of these Companies are wholly-owned subsidiaries of foreign banking organizations, the other being a joint-venture or consortium formed by six foreign banks. At the same time, there are about nine domestically-owned Investment Companies that are active but which conduct essentially a domestic finance company business. The foreign-owned Investment Companies are excluded from coverage under these amendments because of the limited number involved and because of the difficulty of distinguishing those Companies on a nondiscriminatory basis from the domestically-owned companies that are not essentially engaged in a commercial banking function.

Some banking organizations that are joint ventures or consortia of foreign banks will be excluded from coverage by retaining the existing standards of control in the Bank Holding Company Act. Under those standards, a company must become a bank holding company if it controls 25 per cent or more of the voting stock of a bank. Thus, a bank owned by several companies, none of which owns 25 per cent of the bank, is excluded. Currently, there is only one institution of significance that falls in this category, the European-American Bank and Trust Company. That institution, which is owned by six European banks, recently became a member of the Federal Reserve System. The singularity of such joint ventures to date, together with the potential domestic repercussions of changing the existing control standards of the Bank Holding Company Act, are the principal reasons for excluding these joint ventures or consortia from coverage of the Act.

Equality of Treatment

This objective is achieved by subjecting all foreign banks to the Bank Holding Company Act through the redefinition of "bank" (Section 2 of the bill as just described), by enlarging entry alternatives through facilitating ownership of national banks (Section 12) and enabling the establishment of a Federally-licensed branch (Section 18), by permitting foreign banks and subsidiary U.S. banks thereof to own Edge Corporations (Section 10), by requiring Federal Reserve membership in most instances (Sections 3 and 5-8), and through enabling FDIC insurance on deposits in branches and agencies (Section 17).

Entry alternatives

The provisions of Sections 12 and 18 would provide an alternative to State chartering and licensing, comparable to that available to domestic banks. At present, foreign ownership of national banks is inhibited by the requirement that all directors of national banks shall be citizens of the United States. The proposed amendment to the National Bank Act would allow the Comptroller of the Currency to permit not more than one-third of the directors of a national bank to be non-citizens of the United States.

The Comptroller is also authorized to license branches of a foreign bank in any State to conduct a banking business on the same basis as a national bank. This would enable foreign banks to establish branches in States where such branches are prohibited or not permitted by State law. Establishment of such branches would, however, be subject to the provisions fo the Bank Holding Company Act with respect to multi-State banking operations.

Edge Corporations

Domestic banks are presently authorized to own Edge Corporations at various locations in the United States to conduct international lending and deposit activities. Under Section 25(a) of the Federal Reserve Act, however, a majority of the shares of an Edge Corporation must be owned or controlled by citizens of the United States. Moreover, all of the directors of an Edge Corporation must be citizens of the United States. The proposed amendments to this Section would give the Board of Governors the authority to waive these provisions and, consequently,

to allow foreign banks to conduct international business throughout the country on the same basis as domestic banks.

Federal Reserve membership

The foreign banks operating in the United States are with few exceptions very large banks when their activities are viewed on a world-wide basis. As such, they are direct competitors, both in this country and abroad, of the large U.S. money market banks, all of which are members of the Federal Reserve System. The legislation would require Federal Reserve membership for all foreign banking operations in the United States where the foreign bank involved had world-wide assets in excess of $500 million. Such foreign banks would have to maintain reserve requirements and conform to other provisions of the Federal Reserve Act with respect to their operations in the United States, and would have access the discount and lending facilities of the Federal Reserve. The exception made for foreign banks with less than $500 million in world-wide assets is on the grounds that banks of that size are likely to come to the United States for specialized purposes and that such treatment is comparable to that given domestic banks. Only a handful of domestic banks with assets larger than $500 million are nonmember banks.

FDIC insurance.

Subsidiary banks of foreign banks are now required by the Bank Holding Company Act to carry Federal Deposit Insurance. The legislation would extend that requirement to branches and agencies of foreign banks, thus assuring that depositors in virtually all banking institutions in the United States are covered by insurance. Because of the possible technical problems in implementing this requirement with respect to institutions that are not incorporated in the United States, the bill directs the Federal Deposit Insurance Corporation to submit within 90 days of its enactment proposals to extend insurance coverage to deposits in branches and agencies.

Federal Government Presence

To assure a consistent national policy toward foreign banks and to enable consideration of international financial relations in the entry of foreign banks, the legislation provides in section 25 that a Federal banking license shall be obtained for all banking facilities of foreign banks, whether organized or operating under State or Federal law. The Comptroller of the Currency is designated as the Federal licensing agent for this purpose. However, the Secretary of the Treasury must approve the issuance of any such license and before granting approval he is required to consult with the Secretary of State and the Board of Governors of the Federal Reserve System. Similarly, the Board of Governors is required to consult with the Secretary of State and

Secretary of the Treasury before chartering an Edge Corporation to be owned by a foreign bank.

To facilitate discussions and agreements with foreign authorities on multinational banking issues, section 24 of the bill authorizes the Federal supervisory authorities--the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation--to enter into mutual arrangements with foreign bank supervisory authorities for the interchange of information on banking institutions. At present, the Federal supervisory agencies are strictly limited by law on the disclosure of information arising from bank examinations or other sources in the course of exercise of their supervisory functions.

Grandfathering Provisions

Foreign banks presently conducting banking operations in the United States have in a number of instances commercial banking facilities in more than one State. In a few cases, they have ownership interests in companies engaged in a securities business in the United States and in other nonbanking activities that are not permissible to domestic banks. Under the provisions of the bill, future multi-State banking operations and ownership interests in securities and other nonbanking companies would be limited to the same extent as domestic banks.

The proposed legislation in sections 3 and 4 gives permanent grandfather status to existing banking and nonbanking operations. Such a grant recognizes the vested interest of foreign banks in these facilities, conforms broadly to this country's obligations under its treaties of friendship, commerce and navigation, and is generally consistent with past Congressional precedent. The grandfathering date is set at the date of the original introduction of the legislation in Congress i.e., December 3, 1974. Nonconforming banking facilities established after the grandfathering date would have to be divested within two years, unless extended for up to an additional three years by the Board of Governors. Nonconforming nonbanking interests acquired after the grandfathering date would have to be divested within a period of 10 years.

The grandfathering provisions with respect to multi-State banking operations would work as follows: foreign banks would be allowed to retain banking facilities in the States in which presently located. The principal State of operations for foreign banks that become bank holding companies as a result of the enactment of this legislation would be defined to be the State in which the foreign bank's operations are the largest, as determined by a total assets test. For foreign banks that became subject to the Bank Holding Company Act prior to the date of enactment of the legislation, their principal State of operations would remain the same as when they became a bank holding company. In its principal State, a foreign bank would

be able to expand its operations through any form of organization as permitted by State law: additional branching, mergers, and acquisitions. Outside the principal State of operations, a foreign bank would be able to expand through the form in which its present operations in that State are conducted--i.e., additional branches if it had branches, additional agencies if it had agencies, or if it had a subsidiary bank, that bank could expand by branching or mergers. However, the foreign bank would be able to convert its operations in that secondary State to another form of organization provided that all of its operations in that State were so converted. In essence, a foreign bank would be able to retain its operations in the States in which it is located and to expand within those States in accordance with State law.

The securities affiliates of foreign banks are few in number and small in size with little competitive impact within the securities or banking industries. For the most part, these securities affiliates engage in brokerage activities for the foreign customers of the foreign bank and in corporate financial services such as advice on mergers and acquisitions. The underwriting and dealing activities of these securities affiliates are relatively small. The permanent grandfathering of these affiliates reflects the Board's judgment that no public purpose would be served by requiring divestiture. However, the foreign banks with grandfathered securities affiliates would not be allowed to acquire or to establish de novo additional securities affiliates.

The other nonbanking affiliates of foreign banks that are of a nonconforming nature are limited in number and significance. Providing permanent grandfather status to these activities again reflects a judgment that no public purpose would be served by forcing divestiture of these interests or providing a limited grandfathering period.

March 4, 1975