Foreign Banks Increase Stake In Texas

"...Texas foreign agencies have managed to capture a sizable portion of the banking commercial loan market in the state..."

Despite their relatively short history and limited presence in Texas, foreign banking organizations have evolved into a major source of financing for corporations in the Southwest. Initially attracted to Texas by the region's energy industry, foreign banking organizations now provide financial services to a variety of regional corporate customers. Increases in wholesale commercial lending at the state's foreign banking offices have led to remarkably strong asset growth in recent years. Moreover, in addition to extending traditional commercial loans, foreign banking organizations in Texas are active providers of both credit lines and standby letters of credit. This expansion of foreign banking activity is particularly striking since it began when the regional domestic banking market was experiencing a downturn. The recent strides of foreign banking organizations, coupled with slow growth among domestic banks, have boosted the foreign share of all commercial and industrial loans booked at Texas banking organizations to 28 percent. These trends suggest that foreign banking organizations have successfully established a significant and permanent position within the Texas financial landscape.

The Structure of Foreign Banking Organizations

Prior to 1985, state law limited foreign banking offices in Texas to representative offices, Edge Act corporations and agreement corporations. A representative office is not a licensed or chartered branch and cannot accept deposits or book loans. Such offices typically are set up to establish correspondent banking relationships and offer support services between a parent bank and its customers. Similarly, the activities of Edge Act and agreement corporations also are limited. Specifically, Edge Act and agreement corporations can only conduct activities that are incidental to international or foreign business activity, primarily international trade.

Despite these severe restrictions, foreign banking organizations entered the Texas market in the 1960s by establishing representative offices in Dallas and Houston. In addition, a few Edge Act and agreement corporations were established in the early 1980s. At first, international banks were attracted to the region by the possibility of financing large natural gas and oil projects launched by the region's oil companies.

Much of the more recent increase in foreign banking activity in Texas was precipitated by a state legislative change in August 1985, that permitted foreign banks to establish agencies in counties with populations of 1.5 million or more. Activities of foreign agencies generally include purchasing, selling and making loans; foreign exchange transactions; activities associated with letters of credit, bills of exchange, drafts, notes and acceptances; maintaining credit balances; and the transfer of funds. However, the state's foreign agencies are not allowed to exercise fiduciary powers or receive deposits. Moreover, the Texas State Banking Code still does not permit...
the establishment of branches of foreign banks in the state.

In response to the partial liberalization that occurred in 1985, the number of foreign agencies in Texas grew from three in 1985 to 23 by 1991, as shown in Chart 1. As of year-end 1993, 21 foreign agencies operated in Texas. Also, Texas was home to 23 representative offices at the end of last year. All these representative offices and foreign agencies were located in either Dallas or Houston.

Performance of Foreign Banking Organizations

Asset Growth. Foreign agencies in Texas, while few in number, represent a significant presence in the region’s financial markets. When the financial-sector distress associated with the regional economic downturn of the latter half of 1980s led many domestic banks to restrict loan growth, foreign agencies successfully pursued growth strategies to increase their market share. Assets at foreign agencies in Texas have increased every year since 1986, with the most growth occurring between 1990 and 1992. Although asset growth slowed slightly last year, total assets increased 88 percent between year-end 1990 and year-end 1993.

Asset and Liability Composition. Asset growth at the state’s foreign agencies has been a direct result of steady loan growth. As Chart 2 shows, loans make up the bulk of assets at foreign agencies in Texas. At the end of 1993, loans accounted for 98 percent of total assets at foreign agencies. The prominence of lending activity at Texas foreign agencies reflects their focus on loan production, as opposed to full-service banking. Other banking services typically are consolidated at related foreign branches located in New York.

As Chart 3 shows, the aggregated balance sheet of all foreign branches in New York reveals a relatively diverse asset base. The New York foreign branches are more active in the fed funds market, securities trading and cash management. In addition, the foreign branches in New York often act as regional managers for related foreign banking organizations located elsewhere in the country (such as the Texas foreign agencies). For example, activities such as liability management, reserve management, data processing, treasury operations and accounting are consolidated at the New York foreign branches. While most foreign banks consolidate these activities at their New York branches, some have established head office branches in Chicago, Los Angeles or San Francisco.

In addition to conducting a relatively wide array of banking services, foreign branches in New York often help fund the activities of related foreign offices located elsewhere. Because foreign agencies in Texas are not allowed to accept deposits, their funding requirements are met by borrowings from their head offices or other related depository institutions (DIs) located in the United States. As Chart 4 shows, the liabilities of the state’s foreign agencies consist almost exclusively of balances due to related depository institutions. In contrast, the foreign branches in New York meet most of their funding requirements from wholesale deposits in denominations of $100,000 or more.

Lending Activity. As shown in Chart 5, the aggregate loan portfolio of
foreign agencies in Texas consists almost entirely of commercial and industrial loans, reflecting the focus on wholesale lending by the state’s foreign banking organizations. Commercial loans at foreign agencies in Texas grew from $45 million in 1985 to $6.6 billion at year-end 1993, with 97 percent of the loans made to customers residing in the United States. The other loan categories—real estate loans, loans to depository institutions and other loans—accounted for only 11 percent of the agencies’ total loans as of year-end 1993.

Much of the growth in commercial loans at Texas foreign agencies occurred during a period of retrenchment among the state’s domestic banks. The increase in commercial lending activity at foreign agencies contrasts sharply with the reductions and slow growth that occurred at the domestic banks, as shown in Chart 6. These trends are consistent with the view that increased lending activity at foreign banking organizations helped offset reductions in the domestic supply of bank credit brought on by the financial-sector difficulties of the late 1980s. In addition to providing loans to large corporations headquartered in the Southwest, foreign agencies in Texas also have acquired significant amounts of commercial loans through loan participations and syndications with U.S. banks.

As a result of this dramatic growth in commercial lending, the state’s agencies have increased their market share of the Texas commercial loan market. The foreign share of total commercial loans booked at Texas banking organizations grew from less than 1 percent in 1985 to 19.5 percent in 1993. Moreover, foreign banking organizations in the United States began reporting assets and liabilities booked at their offshore branches for the first time last year. These new data reveal an additional $4 billion in commercial loans booked at the offshore branches of Texas agencies at year-end 1993, giving the foreign agencies a market share of 28 percent. While Texas foreign agencies have managed to capture a sizable portion of the banking commercial loan market in the state, foreign banking organizations located elsewhere in the nation held 35 percent of the U.S. market at year-end 1993.

Asset Quality. The profitability of the foreign agencies in Texas is difficult to track because income is consolidated at the parent–bank level. Trends in asset quality, however, provide some indication of profitability. At year-end 1993, asset quality difficulties at Texas foreign agencies—measured by the ratio of noncurrent loans to total loans—was 0.24 percent, down from 1.78 percent at year-end 1992. The primary source of improvement occurred in the real estate sector. Noncurrent real estate loans dropped from 3 percent of total real estate loans in 1992 to 0.93 percent in 1993. In the commercial and industrial loan category, the noncurrent ratio fell from 1.73 percent in 1992 to 0.11 percent in 1993.

In terms of asset quality, Texas foreign agencies compared favorably at year-end 1993 with foreign branches and agencies located elsewhere in the country. Noncurrent loans as a percentage of total loans was highest at foreign branches and agencies in Georgia and Washington. Problem real estate loans were a primary contributor to the asset quality difficulties of foreign agencies in Georgia, while problem commercial and commercial

Chart 6
Commercial and Industrial Loan Growth at Foreign Agencies and Insured Commercial Banks in Texas

Billions of U.S. dollars at Foreign Agencies in Texas

Off-Balance Sheet Activities

Chart 7

Off-Balance Sheet Activities at Foreign Agencies in Texas

Billions of U.S. dollars

- Other
- Notional value of interest rate swaps
- Standby letters of credit
- Loan commitments


Off-Balance Sheet Activities. Because Texas foreign agencies operate primarily as loan production offices serving regional corporations, off-balance sheet activities also are geared toward serving these loan customers. At the state's foreign agencies, off-balance sheet activities are predominately loan commitments and standby letters of credit. Other off-balance sheet activities, such as futures and forward contracts, foreign exchange trading, commercial letters of credit, interest rate swaps and participations in acceptances are concentrated at the branches of foreign banks in New York.

Since 1985, loan commitments and standby letters of credit at Texas foreign agencies have grown dramatically. Loan commitments are used for construction progress payments, loan draws, seasonal or living advances, rotating or revolving credit arrangements and similar transactions. A standby letter of credit guarantees payment to a beneficiary by the issuing foreign agency in the event of default or nonperformance by the agency's customer. Loan commitments climbed from $13 million in 1985 to $9 billion at the end of 1993, as shown in Chart 7. Standby letters of credit rose from $61 million in 1985 to over $5 billion at year-end 1993. Such off-balance sheet activities give the region's corporations access to funds on a contingent basis, thereby providing them the flexibility needed to conduct day-to-day activities.

Conclusion

Foreign banking activity in Texas is surprisingly significant. Although the state's agencies are few in number, they have become a major source of financing for regional corporations. Recent increases in commercial lending at the foreign agencies coincided with declines in commercial lending at the state's domestic banks, suggesting that foreign banking organizations helped preserve credit flows during the economic and financial turbulence of the late 1980s. Moreover, in addition to extending commercial loans, the foreign agencies also engage in significant off-balance sheet activities, such as the provision of loan commitments and standby letters of credit.

The successful expansion of foreign banking organizations in Texas suggests that these institutions are enhancing competitiveness and efficiency in the provision of credit. In addition, foreign banking organizations provide an important link between Texas and the global community and help the state keep pace with the global integration of financial markets. Given the benefits associated with the 1985 liberalization of restrictions on the establishment of foreign agencies, Texas policymakers would do well to consider a liberalization of remaining restrictions contained in the Texas State Banking Code that prevent foreign banks from establishing branches within the state.

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