Remarks before the
International Monetary Conference
London, England, on
Tuesday, June 12, 1979

Treatment of Foreign Banks in the United States: Dilemmas and Opportunities

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I have been asked to concentrate today on the treatment of foreign banks in the United States. Our recent Federal legislation on the subject has settled some old issues. But it has also revealed more clearly some policy dilemmas where there is, as yet, no evident consensus.

In approaching the subject, it seems to me obvious that any consistent, stable policy toward foreign banking must be rooted in more general attitudes.

In broad principle, the United States accepts the market system. We like to see more, not fewer competitors. In general, we are content to see economic policy work its way through relatively impersonal market incentives. And we have long supported the free movement of capital internationally, alongside trade, as being in the national, as well as in the international, interest.

Consequently, when the United States in the 1970's finally got around to considering in a conscious way what national policy should be toward foreign banks, a law was adopted, the International Banking Act, that embedded "national treatment" as the guiding light—that is, foreign banks would be permitted to operate in the United States on substantially the same basis as United States banks. The new legislation for the first time brought banking by foreigners in all its forms—agencies and branches as well as subsidiaries—fully within the ambit of Federal law. But, in doing so, it seems to me indisputable that it maintained an open, nondiscriminatory attitude. In fact, to this observer, one of the more significant aspects of the long debate that led to the International Banking Act was the care of the Congress in responding to the expressed concerns of foreign banks—even in a situation in which those banks were defending some important competitive advantages inherited from the days prior to Federal legislation.

To be sure, part of the motivation for the Federal legislation was the restiveness of some domestic banks feeling the pressure of foreign competition. But the intent and result of the legislation was to deal with that restiveness by removing most of the legitimate concerns that foreign banks were peculiarly *favored* by the absence of Federal law relating to foreign branches or agencies, not by discriminating against them.[1]

If this all seems simple and straightforward in broad

These remarks are personal, and do not purport to reflect the views of the Federal Reserve generally

[1] In fact, even apart from "grandfathered" securities operations and branching privileges, foreign banks operating in the United States retain some elements of flexibility, particularly in branching, denied United States banks

philosophical terms, the process of moving from broad philosophy to practical policy always raises difficult and crucial questions. One set of policies and philosophies—national treatment and the free flow of capital—has to be reconciled to others, including the desire of any country to be able to conduct effective national economic policies. We have to deal with the peculiarities of the dual system of state-Federal regulation in the United States and the related restrictions on interstate banking. More concretely, supervisory approaches and practices in the United States, including those primarily aimed at safety and soundness of individual banks, were shaped with domestic, not international, institutions in mind.

The need to resolve these practical issues is apparent, for foreign banking in the United States can no longer be considered a minor appendage on the domestic system. Since the early 1970's, few weeks have passed without a foreign bank establishing an office in the United States or expanding the number of existing locations. Taking account of recent acquisitions, the total number of foreign banks has reached over three hundred, and their United States-domiciled assets have passed the $140 billion mark, about 10 percent of the assets booked at all banking offices in the United States. In the area of commercial lending, their portion of the market is more than 13 percent nationwide, roughly doubling in the past seven years.

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Reflecting both state regulatory patterns and the concentration of business opportunities, the penetration of certain major money centers has been much larger than these national figures imply. More than two thirds of the total assets are in New York City, and almost 95 percent in New York, Los Angeles, and San Francisco, combined. In those three cities, foreign-owned institutions hold 32 percent or more of the commercial banking assets booked by banks operating in those areas and do 38 percent of the commercial lending.

Those data exaggerate the penetration of purely domestic markets, because foreign-owned banks no doubt rely on both foreign funding and foreign lending to a greater extent than the average United States bank. Moreover, it could be noted that the figures are still smaller than those for foreign banks here in London. But I think it can also be said that the typical foreign bank in the United States, operating almost wholly in the domestic currency and free of exchange control or any regulatory restraint on domestic business, is more fully integrated into the United States banking system than is the Eurocurrency institution that accounts for the bulk of the foreign presence in European countries.

This growth—against the background of the new legislation—has brought at least four key issues to the forefront:

(1) What kind of information should be obtained, and what supervisory control maintained, by United States authorities with respect to foreign owners of United States banking offices, paralleling requirements routinely placed on all United States banking organizations?

(2) Is there some degree of penetration of the United States banking system, or of particular markets within that system, by foreign-owned institutions that should be a matter of legitimate concern, and what is the nature of that concern? In particular, do takeovers of large United States institutions raise a different question than *de novo* or foothold approaches to the market?

(3) Are there implications in the growth of foreign banking in the United States for the way United States banking itself is structured, and particularly for the limitations on interstate banking?

(4) Finally, should some concept of reciprocity in national treatment play a larger role in United States policy? More broadly, how should national banking and supervisory systems mesh together in an integrated financial world?

The first of these questions has already been dealt with in fairly specific terms earlier this year by the Federal Reserve as it was called upon to consider several applications by large foreign banks proposing to acquire substantial United States banks. As with purely domestic acquisitions, our basic supervisory considerations are that the United States subsidiary be operated safely and that the foreign parent be a source of strength and support to the subsidiary. The position naturally followed that the foreign owner of a United States institution should, in concept, be subject to information and reporting requirements comparable to those of a United Sates owner to the extent required to judge its financial soundness, including its capitalization, and its ability to support its United States operation over time.

At the same time, in recognition of the practicalities of a situation in which jurisdiction over the foreign

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owner is removed, the Federal Reserve indicated that it intends to exercise particularly close surveillance over transactions involving a major United States subsidiary with its foreign owner to assure the independent soundness of the United States institution. To that end, it has insisted that the United States subsidiary be plainly capitalized adequately.[2]

I know these requirements can raise difficult practical questions in the minds of bankers contemplating an acquisition in the United States. But we have ample experience, with United States or foreign owners, to know how difficult it is to insulate the fortunes of a subsidiary from that of its owner. In the last analysis, when an important United States banking institution is foreign owned, I see no alternative to seeking a modus vivendi for satisfying those informational requirements that we feel essential to evaluating an acquisition or to our continuing surveillance responsibilities.

My second question about limits to the degree or manner of penetration of domestic markets by foreign banks is nowhere addressed specifically in the International Banking Act or other Federal legislation. But it would be too much for me to say that it is not an issue at all in the United States, as suggested by the apparent hesitancy of New York State authorities to approve the voting of the stock that would be acquired by the Hong Kong Shanghai Bank in the Marine Midland Bank, a major state-chartered institution. These concerns have, in fact, led to the calling of Congressional hearings later this summer. That process seems to me potentially constructive in more clearly settling, from a national perspective, a potentially troublesome and emotional issue. In practice, if the Congress wishes to develop new legislative criteria, it would appear to have the opportunity to do so before the Federal Reserve, in the normal course of events, would be called upon to act on any new proposals for a sizable acquisition.

My own thinking at this stage is that concerns about the extent or manner of foreign penetration—to the degree they have substance—can be dealt with by means other than setting arbitrary limits or a blanket prohibition on major acquisitions. The points I just made about adequate information about the parent, and surveillance and control of relations between parent and subsidiary, are relevant in that connection. The extension of reserve requirements to foreign branches and agencies, the fact that their United States operations will be subject to laws and policies affecting United States banks generally (including, for retail operations, laws specifically directing attention to the needs of the local community), the requirements of state or Federal law for heavy United States representation on boards of directors of subsidiaries—all of these help deal with broader concerns of possible lack of responsiveness to United States policies and needs. I might add, in my own observation institutions owned by reputable foreign banks have in general displayed a sensitivity to the policies and requirements of United States authorities in their United States operations as close (and as appropriate!) as that of purely United States institutions. Perhaps most importantly,

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banks in the United States are operating in a competitive market that provides disciplines as well as opportunities for domestic and foreign-owned institutions alike. In this environment, neglect of service or credit needs of an area should rather quickly provide openings for other institutions.

There are some special areas that deserve exploration and debate. Should we be equally hospitable to institutions that may not be subject to usual market

[2] The reporting and surveillance requirements are reflected in a *Statement of Policy on Supervision and Regulation of Foreign Bank Holding Companies* by the Board of Governors issued on February 23, 1979

disciplines such as foreign government-owned banks, particularly if there is a pattern of state direction? Is it desirable, in the interests of supervisory control and the ability of the United States operation to stand on its own feet, to encourage major banking operations in the United States heavily directed toward our domestic market to be operated as subsidiaries rather than branches? Should foreign nonbanking institutions be able to operate banks in the United States, a possibility not permitted United States companies? What are the competitive implications of funding of United States banking offices from a home abroad subject to lower capital requirements or lower (or even no) reserve requirements?

These questions are not easily separable from those of the United States banking structure itself. Indeed, much of the concern expressed recently about foreign takeovers of large United States institutions in New York has turned upon the point that United States institutions do not have equivalent opportunities. Under United States law, takeovers, domestic or foreign, must be judged on competitive grounds. In practice, large domestic institutions that wish to acquire another sizable bank within their home state must assume a heavy burden of proof that any significant adverse competitive consequences in relevant markets are outweighed by substantial public benefits. Such domestic banks cannot, by law, acquire a bank out of their own state. As a result, a major bank in, say, New York or California is practically forbidden the opportunity to expand either by acquisition of another major viable institution in its home state or by acquiring an institution in another state. But, ironically, the laws of both the United States and of a number of major states permit entry of banks domiciled abroad, while excluding banks of sister states as "foreign". Among other things, the implication is that a sizable domestic bank seeking sale or merger (or perhaps a large injection of capital in a depressed stock market) may be almost forced to look abroad for a partner.

We have here a clash between the idea of open entry for foreign banks and the traditional geographic insularity of the United States domestic banking system. That insularity is breaking down, particularly for international or wholesale banking, under economic and technological pressures. The fact that it is happening is in part due to the penetration of foreign banks themselves. But we are still a long way from freedom of entry for retail banking nationwide.

The resistance to interstate banking, and in some areas to large metropolitan banks expanding offices elsewhere within a state, is rooted in part in some of the same instincts that fear foreign takeovers draining local funds for use elsewhere. I have not seen convincing evidence to support that instinct. Indeed, much of the force behind the resistance appears to lie in the natural inclination of some banks to resist a new source of competition.

In such circumstances, prohibiting foreign acquisitions simply because of the interstate restrictions of the MacFadden and the Bank Holding Company Acts would seem backward looking. As a simple forecast, sweeping elimination of those domestic restrictions at any time soon appears unlikely. But there are practicable means for easing the dilemma. For instance, Federal legislation has been urged by the Federal Reserve and others to permit out-of-state institutions to acquire a failing bank. More broadly, there seems to me a strong case on domestic grounds for the provision of reciprocal branching or holding company privileges between major states.

Even in the absence of progress in those directions, *de novo* entry or foothold acquisitions by foreign banks normally suggest competitive benefits that we as a nation should encourage. The pro-competitive presumption is not self-evident in the case of a really major takeover by a foreign bank—such as acquisition of a large money center institution. I believe a proposal for such a takeover, in practice forbidden to another United States bank and involving ownership removed from United States regulatory control, should reasonably be required to pass a test of identifiable positive benefits to the United States. Those benefits might take such forms as increased capital, stronger management, together with a full commitment to support of local banking and the local economy. As I emphasized earlier, a fundamental prerequisite should

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be a wholehearted commitment to compliance with United States law, regulations, and policy in its United States operations, a suitable degree of insulation of the operation of the United States subsidiary so that in event of need it could stand on its own feet, and responsiveness to informational requirements.

Finally, a brief word about reciprocity. National legislation, unlike that of some states, makes no such requirement for approval of foreign entry, although it does call for a report by the Secretary of the Treasury on treatment afforded United States banks abroad. I personally question whether open entry on a basis of national treatment in instances where the home country does not provide reasonably equivalent access to American and other foreign banks is equitable to United States banking interests or fully responsive to the national policy of open markets. I recognize that many foreign banking systems are much more concentrated than in the United States, and they are much smaller markets in the aggregate. Takeover of one of a handful of leading banks in those countries would have quantitatively and qualitatively different implication than a takeover in the United States—but the differences might not be so great if analysis were directed toward regional sectors of the United States markets.

In the long run, I suspect the continued hospitality of the United States to foreign banks will be dependent on a sense that United States and foreign banks alike are operating under comparable ground rules and that cooperation among national supervisory authorities is adequate to maintain a sense of both competitive equity and soundness. The policies of the United States toward foreign banking seem to me broadly consistent with those needs.

I won't try to tread my way through the labyrinth this afternoon by suggesting more specific standards. But I would leave you with the thought that, as banking systems become more integrated across national borders, inconsistency among major nations in the ways they approach banking regulation and supervision is bound to pose more and more awkward problems.

I would quickly concede we have too much regulation in our national system. But, the answer cannot be found in retreat to no regulation at all, or even to the lowest common denominator. The national authorities of all leading countries should have a common interest in assuring that their banks operating abroad, or foreign banks operating in their jurisdiction, do their business with appropriate prudential surveillance of their worldwide operations. Useful work in developing complementary and integrated approaches by the leading national authorities has been going forward mainly under the auspices of Peter Cooke's Committee in the Bank for International Settlements.

There should also be a common interest in assuring equitable competitive conditions, with implications for reserve requirements and capital ratios, among other things. I know the subject is bound to be difficult and controversial, but in that connection I welcome the studies under way in the Bank for International Settlements and elsewhere to look afresh at approaches to the Euromarkets.

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