

Historical

Survey of Recent Developments in  
International Bank Regulation

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INTERNATIONAL BANK REGULATION

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## A SURVEY OF RECENT DEVELOPMENTS IN INTERNATIONAL BANK REGULATION

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A SURVEY OF RECENT DEVELOPMENTS IN  
INTERNATIONAL BANK REGULATION

I. INTRODUCTION

International banking has grown very rapidly since 1960. Many forces have spurred the dramatic expansion of multinational banking over the last decade and a half. By 1974, world exports of \$880 billion were almost six times greater than in 1960. As businesses expanded overseas and developed into multinational corporations, their banks followed them abroad and became multinational banks.

World liquidity has exploded in the last several years. World holdings of gold and official foreign exchange reserves have nearly quadrupled in the 15 years since 1960 to \$800 billion by the end of 1974. In addition, the development of the Eurocurrency<sup>1/</sup> market, has been a major source of increased world liquidity over the last ten years. The Eurocurrency market, which began in 1958, grew slowly to about \$20 billion in 1966. In the last ten years, the net volume of transactions in the Eurocurrency market has risen ten-fold, to almost \$200 billion by the end of 1974. Today the Eurocurrency market links together the domestic money markets of all of the major industrial countries.

As the international financial system grew in size and complexity, commercial banks here and abroad met the challenge by growing in numbers, size of operation and types of services provided.<sup>2/</sup> The ten largest

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<sup>1/</sup> Eurocurrencies refers to any currency deposited outside its country of origin, i.e., a Eurodollar is a U.S. dollar deposited outside the United States. The Eurodollar is the principal currency, and London is the major market for Eurocurrencies.

<sup>2/</sup> For an excellent discussion of the causes of the worldwide expansion in banking, see Fred Kopstock's article, "Foreign Banks in The United States."

banks in the world had combined assets of over \$300 billion--more than the entire gross national product of all but a handful of countries. Table 1 lists the 50 largest banks in the world as of 1973, their total assets and growth from 1972 to 1973.

Three giant American banks top this list as the three biggest banking organizations in the world. And together with the other ten U.S. American banks included on the list, over one-quarter of the 50 largest banks in the world are American. There are 13 Japanese banks on the list, another fourth of the total. The other banks on the list--the rest of the world's big banks--originate in the other industrial countries of Europe and Canada, with the single exception of the Banco do Brasil, which ranks 32nd on the list.

The vast financial resources of these multinational banks are employed throughout the world. To a large degree, the banks became a focal point for the increasing international interdependence of the world's economy and this development has in turn created problems for bank regulators in many countries. George Mitchell, Vice Chairman of the Board of Governors of the Federal Reserve System summarized the situation very nicely: "The integration of money and capital markets has accelerated the transmission of changing money and credit conditions among national economies, and has probably reduced the scope for independent national financial policies....there is greater concern on the part of governments nowadays as to the implications of multinational banking for the financial structure of their countries and for the formulation and conduct of their own financial policies."<sup>2a/</sup>

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<sup>2a/</sup> Mitchell, George W., "Multinational Banking the United States: Some Regulatory Issues," BAFT Speech, April 8-11, 1974, pp. 5-6.

In many ways, the pressures on international banking (and its regulations) come to a head in 1974. The risks inherent in a system of floating exchange rates became apparent as several major banks around the world suffered massive foreign exchange losses: a few banks closed, partially as a result of losses in their foreign exchange transactions, but primarily because of more general management problems.<sup>3/</sup> The massive flows of foreign exchange, primarily dollars, accumulated by the Organization

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<sup>3/</sup>A near crisis occurred in international banking markets when Bankhaus Herstatt of Germany closed on June 26, 1974. For a chronology of foreign exchange losses and bank insolvencies in the summer of 1974, see Appendix A.

of Petroleum Exporting Countries (OPEC)<sup>4/</sup> severely strained the ability of banks to absorb these funds as short-term deposits, find acceptable longer-run investment opportunities and at the same time maintain appropriate capital bases. Many factors--foreign ownership of banks, large losses due to foreign exchange transactions, international linkage of banks through the Eurocurrency markets, and large foreign deposits of short-term funds which threatened the liquidity of banks--all caused bank regulators to question the appropriateness of their banking supervision and regulations.

In the United States, bank regulators and legislators have been considering proposals to regulate the activities of U.S. banks and foreign banks operating in the United States for several years. One product of this effort was the introduction in December 1974 of the Foreign Bank Act of 1974 by the Federal Reserve System.

During 1974, the U.S. Treasury and foreign bank supervisory agencies around the world issued new and more stringent foreign exchange regulations and reporting requirements. The Bank of England requested (and received) assurances of support from the parents of foreign owned subsidiary banks operating in London. Central bankers again discussed the question of who should act as lender of last resort for multiowned subsidiaries, and the problems surrounding the Eurocurrency market.

This paper outlines the many changes affecting international banking in 1974. The background, purposes and contents of the Federal

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<sup>4/</sup> The members of OPEC are Abu Dhabi, Algeria, Ecuador, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia and Venezuela; Gabon is an associate member.

Reserve's proposed Foreign Bank legislation are discussed in detail. Other regulatory changes applicable to international banking are also described.

## II. FOREIGN BANKING IN THE UNITED STATES CURRENTLY

### A. Expansion of Foreign Banking

The dramatic expansion of international banking during the 1960s affected American banks in two ways. In the first place, American banks opened offices abroad in record numbers, and simultaneously increased the scope and variety of their overseas operations. The activities of American banks abroad are discussed in Section IV of this paper.

Secondly, the growing number of foreign banks in the United States attracted great attention. Little data is available on foreign banking in the United States until 1966, when foreign agencies, branches and subsidiaries<sup>5/</sup> had total U.S. assets of \$6.5 billion. By the end of 1974, the U.S. assets of foreign banks' branches, agencies and subsidiaries were \$56 billion.

At the end of 1974, 180 foreign banks were represented in the U.S. Foreign banks had 62 subsidiaries or affiliates, 77 branches and 72 agencies, most of them concentrated in New York, California and Illinois. There were 26 foreign bank holding companies registered under the Bank Holding Company Act of 1956 (as amended in 1970) which operated 25 subsidiaries in New York, California and Illinois, and 24 agencies and branches throughout the United States. More than 20 foreign banks owned or had some share in securities companies. In addition, foreign banks had about 141 representative offices.

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<sup>5/</sup> There are five organizational forms available to foreign banks desiring to establish an American presence: (1) a representative office; (2) an affiliate; (3) a subsidiary; (4) a branch; and (5) an agency. Some of these five types are jointly owned by a group of foreign banks, and are called consortium banks. It is also possible for foreign individuals or corporations to buy an existing U.S. bank in some states. The differences between these types of organizations are described in Appendix B.

B. State Regulation of Foreign Banking

At present there is no federal legislation regulating the activities of foreign banks in the United States. Foreign banking organizations are chartered by the individual states and they can therefore engage in any form of banking operation which is permitted (or not prohibited) by state laws.

Of the ten states<sup>6/</sup> in the United States which expressly authorize foreign banks to conduct banking operations in some manner within their states, New York and California<sup>and New Illinois</sup> have the most liberal laws and therefore the greatest number of foreign banking offices.

1. New York

Traditionally, most foreign banks have tended to gravitate to New York. New York has many attractions--the financial center of the United States, the biggest money market in the world, the focal point for much of the world's trade finance--and by no means least, liberal New York state laws regulating foreign banking. There are more foreign banking operations in New York than in any other state. At the end of 1974, these consisted of 35 agencies, 25 branches, 14 subsidiaries and 3 New York state investment companies.<sup>7/</sup> In recent years, however, foreign banks have been moving into other large financial centers across the United States.

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<sup>6/</sup>The ten states authorizing foreign banking are Alaska, California, Georgia, Hawaii, Illinois, Massachusetts, Missouri, New York, Oregon and Washington, Robert Huff, "Entry of Foreign Banks Into the United States," EB/IFD/OMA, unpublished staff paper, September 4, 1973.

<sup>7/</sup>Klopstock, op. cit. contains a comprehensive review of the activities of foreign banks in New York.

## 2. California

Nowhere has the expansion of foreign banks been more remarkable than in California. In 1965, only nine foreign banks had branches in California; by the end of 1974, there were 40 foreign banks with branches and/or agencies in the state. Subsidiaries of foreign banks have grown even more rapidly and have had an even larger impact on the banking community in California. Table 2 lists the foreign banking subsidiaries operating in California as of December 31, 1974 and gives some indication of their importance. *It will be noted that eight of these subsidiaries, or over half of the total, had percent banks headquartered in the Far East.*

Taken individually, none of the subsidiaries appears very large: only two of them held as much as 1 percent of the state's total deposits at the end of 1974. However, these two banks, Lloyds Bank of California (British) and Bank of Tokyo of California (Japan) ranked as the eighth and ninth largest banks in the state.

Out of the total of 186 banks in California, there were only 15 foreign subsidiary banks with less than 5 percent of the state's total deposits. However, California permits statewide branching, and the branching systems of some of these subsidiaries and their competition for deposits with indigenous California banks attracted considerable attention, much of it unfavorable.

In the spring of 1973, a bill was introduced into the California Legislature which would have restricted the expansion of foreign banking operations. The bill was obviously discriminatory, and was primarily aimed at restricting the growth of Japanese banks which, due to their attraction to the Nisei population, were making strong inroads into the deposit base of the small California banks. Interestingly, this is one of the few examples of foreign banks securing an indigenous deposit base

in the United States:<sup>8/</sup> most foreign banks rely on their parent organization, customers from their own country and the money market for funds. The strong support of the small independent banks of California made passage of the legislation appear likely for a time. Possible enactment of this legislation was a major factor stimulating the Federal Reserve System to concentrate on drafting legislation to regulate the activities of foreign banks in the United States. (This legislation is discussed in Section III.) The San Francisco Federal Reserve Bank was instrumental in the defeat of this bill in the California Legislature.

### 3. Illinois

In the early 1970s, Illinois granted state charters to two subsidiaries of foreign banks. The First Pacific Bank is a subsidiary of the Dai-Ichi Kangyo Bank of Japan, and Banco di Roma (Chicago) is a subsidiary of the Banco di Roma of Italy. The large Illinois commercial banks, however, wanted to make it easier for foreign banks to enter the Chicago market for two reasons.

In the first place, they felt that easier entry for foreign banks would stimulate Chicago's growth as an international financial center. And, secondly, it was hoped that offering reciprocity to foreign banks would facilitate the expansion of Illinois banks overseas. Largely

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<sup>8/</sup>The few other foreign banks with a domestic U.S. deposit base have usually acquired the deposits with the purchase of an existing bank. For instance, Lloyds Bank acquired a domestic deposit base along with 95 branches when it bought First Western Bank of California in 1973, as did European American Trust when it bought Franklin National and acquired its 104 New York branches in 1974. On the other hand, the Barclays Group (British) has been quite aggressive in attempting to secure a domestic deposit base in its operations in New York, California, and Massachusetts.

due to their efforts, in August 1973 the Illinois Legislature passed the "Foreign Banking Act" which permits foreign banks to establish one branch office in the Chicago "loop" area. By the end of 1974, 22 foreign banks, including many of the world's largest multinational banks, had filed applications for branches under the terms of this Act, and 18 licenses had been approved.<sup>9/</sup>

4. Other States

There are ten states<sup>10/</sup> which expressly prohibit foreign banking within their borders, prominently among them, Florida, Texas and Minnesota. Florida has a long standing prohibition on branching, which applies to both domestic and foreign institutions. But in 1972, after a Canadian bank had acquired a small trust company in the state and other foreign banks had shown an interest in engaging in banking, Florida passed a law prohibiting "any foreign bank from maintaining an office within the state."<sup>11/</sup> In Texas, the prohibition of foreign banking is part of the state constitution.<sup>12/</sup>

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<sup>9/</sup>The 18 banks for which branch licenses have been granted are: Banque Nationale de Paris, Banque de l'Indochine (a part of the Suez group) and the Credit Lyonnais of France; Commerzbank and Dresdner Bank of Germany; the National Bank of Greece; Bank Leumi le Israel; Banca Commerciale Italiana; the Sanwa Bank and the Sumitomo Bank of Japan; Algemene Bank Nederland; Swiss Bank Corporation; Barclays Bank International, The Chartered Bank, Lloyds Bank International, and the National Westminster Bank of the United Kingdom; the European Banking Company, a branch of a U.K. merchant bank owned by seven major European banks; the Hongkong and Shanghai Bank of Hong Kong.

<sup>10/</sup>The other nine states prohibiting foreign banking are: Maine, Maryland, New Jersey, Ohio, Rhode Island, Texas, Virginia, West Virginia, and Florida. Huff, op. cit.

<sup>11/</sup>Florida Banking Code, Section 659.57. Huff, op. cit.

<sup>12/</sup>Texas Constitution; Article 16, Section 16. Ibid.

The relevant portion of the Minnesota law states that: "No foreign corporation shall transact in this state the business which only a bank, trust company, or savings, building and loan association may transact in this state.<sup>13/</sup> Although the law may have been written originally to prevent out-of-state banking, it effectively prevents non-U.S. entities from entering banking in Minnesota. Holding company legislation proposed during 1974 by the Minnesota Independent Bankers' Association would, however, expressly bar the entry of holding company banks from abroad as well as from other states. "No bank holding company organized or based in any other state or country shall be allowed to operate any business of any kind in this state, directly or indirectly. . ."<sup>14/</sup> The remaining Ninth District states are among the thirty states which make no mention at all of foreign banking in their statutes. However, foreign banking is implicitly prohibited in at least ten of these 30 states.

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<sup>13/</sup> Statutes Annotated, Section 303.02 and 303.04.

<sup>14/</sup> American Banker, August 30, 1974.

### III. PROPOSED FEDERAL REGULATION OF FOREIGN BANKING

#### A. The Stimulus for Regulation

By the mid-1960s, foreign banking had become an important part of the U.S. banking scene. From the point of view of the monetary authority, this presented problems, because foreign banks constituted a significant proportion of nonmember banks, i.e., those banks which are not members of the Federal Reserve System and are therefore not subject to the Fed's reserve requirements.<sup>14a/</sup> Particularly during periods of tight monetary policy, the ability of foreign banks in the U.S. to attract funds from abroad interfered with the Fed's ability to control the money supply. Loans by foreign banks have become an important source of credit for domestic concerns--in 1974, foreign banking organizations extended about 10 percent of the total commercial and industrial loans made by commercial banks in the United States. Foreign banks are also not subject to Regulation Q limitations on interest payments.

Advocates of federal regulation for foreign banks in the United States frequently point out that in no other country in the world is a significant portion of the banking community outside the scope of the monetary authority. From time to time, the Federal Reserve has brought some activities of foreign banks under its regulation. In 1973,

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<sup>14a/</sup>The Federal Reserve System has tried (unsuccessfully to date) to convince Congress that the growing number of nonmember banks places a serious handicap on the Fed's ability to control the money supply. Since foreign banks are an important part of nonmember banks, the activities of these banks may have played an important role in the Fed's inability to control the money supply in certain periods. For a further discussion of this point see Irving Auerbach's article, "International Banking Institutions and the Understatement of the Money Supply," Monthly Review of the Federal Reserve Bank of New York, May 1971, pp. 109-118.

foreign branches and agencies were subject to the now-expired Voluntary Foreign Credit Restraint (VFCR) program and were requested to maintain the same reserve requirements as domestic banks on Eurodollar borrowings. But inequities in the regulation of domestic and foreign bank operations still exist.

At about the same time, both the foreign and domestic commercial banking communities began complaining about the inequities that existed because of differing laws governing entry and regulation of foreign banking in the various states. Both the domestic and the foreign banks seemed to feel that the existing situation made them the injured party! On the one hand, foreign banks--and their diplomatic representatives--protested the injustice of American banks operating in their countries, while they were not allowed to engage in banking in the home state of those same American banks. Illinois was often cited as a case in point, prior to the passage of the Illinois Foreign Banking Act in 1973.

On the other hand, many U.S. banks complained that foreign banks had an unfair advantage over domestic banks. The American banking community cited three specific areas in which foreign banks had a competitive edge: (1) freedom from Federal Reserve Regulations; (2) ability to engage in multistate banking, and (3) contravention of the Glass Steagall Act's prohibition against combining investment and commercial banking.

The multistate operation of foreign banks has probably elicited the most vocal criticism by U.S. banks. Table 3 outlines the multistate operations of foreign banks in this country as of December 31, 1974. Banks of four countries--Canada, Hong Kong, Japan and the United Kingdom--were engaging in banking in four states of the United States. Indeed, the Barclays Group had full-service banking operations in four states plus a U.S. territory. In addition, 11 foreign banks from seven countries were conducting banking operations in at least three states, and banks from a total of 13 countries were engaged in at least some form of multistate banking operation. The Federal Reserve Bank of San Francisco has estimated that 38 of the foreign banks located in California have banking offices in at least one other state.<sup>15/</sup>

About a dozen or so foreign banks have acquired broker-dealer security affiliates in New York in recent years. Some of these institutions have become members of regional U.S. stock exchanges. These affiliates trade and distribute securities, underwrite issues, and offer management and investment services to their customers. They can engage in many activities which are proscribed for U.S. banks by the Glass-Steagall Act of 1933.

B. Proposed Federal Legislation

As early as 1967, four bills were introduced in Congress to regulate foreign banking in the United States but all of them died in

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<sup>15/</sup> Balles, John J., "The Proposed Foreign Bank Act and its Probable Effect on California Banking," speech at the President's Seminar, California Banker's Association, January 10, 1975, p. 3. The 38 banks cited in this speech do not correspond to the numbers in Table 3 because of classification differences.

committee.<sup>16/</sup> In November, 1973, Representatives Patman of Texas and Rees of California each introduced legislation aimed at the regulation of foreign banks in this country. Both of these bills were very restrictive in nature.

Both bills would have reduced the scope of foreign bank operations to fully capitalized subsidiaries of the foreign parent bank. Under the terms of these bills, foreign subsidiaries would have needed approval of the Secretary of the Treasury for all activities. Foreign banks would have been required to obtain FDIC insurance and to meet Federal Reserve requirements, but not to become members of the Federal Reserve System. Foreign banks would have been prohibited from expanding through acquisitions and mergers and they would have been required to divest themselves of securities affiliates and multistate operations within a limited number of years. The Rees bill contained additional special provisions to accommodate Japanese banks where such banks were in violation of U.S. antitrust law, and to permit interstate banking in the event states passed enabling legislation. Little progress was made in moving either the Rees or Patman bill through Congress.

On December 3, 1974, the Board of Governors of the Federal Reserve System submitted to Congress legislation entitled "The Foreign Bank Act of 1974." A number of revisions and technical changes were made to the original legislation and it was resubmitted to the new Congress on March 4, 1975. The December 1974, cut-off date was retained

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<sup>16/</sup>The bills were based on the so called Zwick Report on foreign banking, by Dr. Jack A. Zwick of Columbia University for the Joint Economic Committee of Congress.

for purposes of "grandfathering"<sup>17/</sup> existing institutions, but the bill was retitled, "The Foreign Bank Act of 1975." The legislation was the work of the Committee on International Bank Regulation SSCIBR,<sup>18/</sup> which the Federal Reserve System established in early 1973 to study foreign banking in the United States and the overseas activities of U.S. banks.

Initially, the SSCIBR focused its attention on the activities of foreign banks in the United States. Among the forces which spurred the Committee to first consider foreign banking in the U.S. were:

(1) complaints about foreign competition by the U.S. domestic banking system; (2) the Congress's interest in foreign banking as evidenced by the introduction of the Rees and Patman bills; and (3) the proposed California legislation to restrict the activities of foreign banks in that state (see Section II).

One of the early conclusions of the Committee was that regulations governing foreign banking should be based on the principle of reciprocal nondiscrimination. Under this principle, all nations would be expected to cooperate in applying the same rules to both foreign and indigenous institutions. In this way, all institutions operating within one national market would be afforded equitable treatment. At the same time, the rule of nondiscrimination would preserve the right of every country to establish the rules governing the activities of banks within its jurisdiction.

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<sup>17/</sup>"Grandfathering" is a common term in U.S. banking laws, and refers to the practice of permitting existing institutions to continue to exist, even though new institutions or associations of this type may be prohibited from being formed in the future.

<sup>18/</sup>Present members of the SSCIBR are Governors Mitchell, Bucher, Holland and Wallich, and Presidents Hayes (New York), Balles (San Francisco), and MacLaury (Minneapolis).

The principle of nondiscrimination was basic to the framework of legislation on foreign banking in the United States which was drafted by the staff of the SSCIBR. The draft legislation was the result of detailed study by the staff on problem areas; consultation with officials of other government agencies (including the Executive Office, Treasury, State Department, Comptroller and state banking authorities); discussion and resolution of many issues by the members of the Committee, and consultation with central bank authorities in all major industrial countries on their views with respect to such legislation.

The general purposes of the Act are: to achieve equality in the treatment of domestic and foreign banks in both their banking and nonbanking operations, to provide a federal presence in licensing and supervision of foreign banks, and to bring foreign bank operations within the scope of the Federal Reserve System. The bill would amend the Bank Holding Company Act to include branches and agencies of foreign banks as "banks." Currently, branches and agencies do not fall under the purview of federal bank regulations, because they are considered to be an integral part of the parent foreign bank's operations. On the other hand, subsidiaries of foreign banks in this country are chartered as separate entities by the state and because they are U.S. chartered institutions the provisions of the Bank Holding Company Act of 1956 (as amended in 1970) do apply to foreign subsidiaries just as they do to domestic banks that are part of a bank holding company organization. Moreover, as U.S. chartered institutions, foreign subsidiaries are

eligible for insurance by the Federal Deposit Insurance Corporation, while deposits in branches are not.<sup>19/</sup>

Additionally, the legislation would require Federal Reserve membership for all foreign banks conducting banking operations through branches, agencies, and subsidiaries, and would enable branches and agencies of foreign banks to obtain FDIC insurance. The proposed Act would enable the establishment of a federally licensed branch in any state, which could then operate on the same terms as a national bank. By relaxing citizenship requirements, foreign banks would be allowed to own Edge Act corporations<sup>20/</sup> and national banks.

In mid-1975, Representative Rees of California circulated for comment a draft law to regulate foreign banking in the United States which differed substantially from both his own earlier proposal and the Federal Reserve's draft bill.<sup>21/</sup> Among the key areas of difference were the following provisions of Representative Rees' new proposal:

- (1) Require divestiture of interests in security affiliates.
- (2) Eliminate the differences between foreign agencies and branches, and limit the deposits of these institutions to foreigners with only credit balances allowed for U.S. citizens.

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<sup>19/</sup>For additional information on the differences between agencies, branches and subsidiaries, see Appendix B.

<sup>20/</sup>See footnote 29 and Appendix C for a definition of Edge Act Corporations.

<sup>21/</sup>In circulating his proposal, Representative Rees noted that he did not expect Congress to consider any legislation on foreign banking (his own, the Federal Reserve's, or others) before 1976, when the House of Representatives' study on Financial Institutions and the Nation's Economy (FINE) is completed. International banking is a part of the FINE study.

- (3) Permitting foreign chartered national banks only in those states which would grant state charters to such banks.

As the proposal by Representative Rees makes clear, there are several major issues left unresolved in the area of foreign banking in the United States. The three issues which are likely to prove most contentious are (1) grandfathering, (2) compulsory Federal Reserve membership, and (3) compulsory FDIC membership.

The Federal Reserve's draft legislation provides for permanent grandfathering of all presently existing multistate banking operations, securities affiliates and other nonbank activities; the Rees proposal grandfathers only the multistate banking operations. The provision for permanent grandfathering helped to defuse a substantial amount of adverse reaction from foreign central and commercial banks to the proposed legislation. Many large American banks favor this proposal because they feel it is a wedge which will promote interstate banking for U.S. banks. However, U.S. officials appear to feel this argument has little merit.<sup>22/</sup>

From time to time, attempts have been made to provide for interstate banking between a few states. In the early 1970s, Governor Rockefeller of New York State proposed that the states of Illinois, California, Massachusetts, Texas, and New York permit reciprocal interstate commercial banking in the major money market centers of the other states. This proposal was greeted with little enthusiasm in the other states. However, in the spring of 1973, legislation was introduced in both the New York and California legislatures which would have provided for reciprocal

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<sup>22/</sup> See Mitchell, George C., "Multinational Banking in the United States: Some Regulatory Issues," BAFT Convention, April 8-11, 1975, p. 20, and Balles, op. cit., pp. 15-16.

interstate banking. The bill moved as far as the floor of the assembly in New York before it died. In California, the bill was tabled in the senate committee on banking. Proponents expect the bills to be revised in future legislative sessions.

The requirements for compulsory Federal Reserve membership and FDIC insurance are issues on which all members of the SSCIBR were not in agreement. They have also stimulated considerable adverse reaction abroad and generated heated debate at home. There are aspects of the proposed legislation which are de jure discriminatory, since all domestic banks are not required to be members of the Federal Reserve System nor to obtain FDIC insurance. Indeed, Representative Henry S. Ruess of Wisconsin has argued that "since compulsory membership is not required for domestic banks, this would be asking foreign banks to be more Catholic than the Pope."<sup>23/</sup>

On the other hand, proponents of requiring Federal Reserve membership argue that de facto the requirement for Federal Reserve membership is not as discriminatory as it appears, since the branches, agencies and subsidiaries of foreign banks which would be required to become Federal Reserve System members under this legislation compete almost exclusively with U.S. domestic banks which are already System members. Governor Mitchell of the Federal Reserve has remarked, "The question of requiring Federal Reserve membership on the part of foreign banks has evoked a surprising amount of talk. The United States must be the only country in the world where the foreign banks do not have an

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<sup>23/</sup> Ruess, Henry S., "The Legislative Outlook for Foreign Banks Operating in the United States," speech at the 9th Annual Banking Law Institute, May 3, 1974.

established relationship with the central bank. There are no 'nonmember' banks abroad!"<sup>24/</sup>

Foreign banks oppose mandatory FDIC insurance for two reasons. Firstly, they feel the requirement is discriminatory. And, secondly they argue that such insurance is not as necessary for the wholesale banking in which they primarily engage as it is in retail banking.

Some foreign banks and many large U.S. banks oppose any restrictions on the activities of foreign banks in this country chiefly because they fear retaliation abroad. The New York Clearing House<sup>25/</sup> is one of the most vocal spokesmen of this faction. Harry W. Albright, Jr., New York State Superintendent of Banks raised the specter of foreign retaliation against U.S. banks abroad if the United States imposed any restrictions on the activities of foreign banks in this country. He said that restrictions on foreign banks "would invite foreign nations to correspondingly limit U.S. banks to a single province or city or to take other retaliatory measures. Or the European Common Market might well limit U.S. banks to a single country within the Market, thus forcing U.S. banks to divest their assets in other countries."<sup>26/</sup> Because U.S. banking assets abroad are much greater than foreign assets in the United States, the threat of retaliation is very forceful in some quarters.

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<sup>24/</sup>Mitchell, op. cit., p. 19.

<sup>25/</sup>Members of the New York Clearing House are The Bank of New York, The Chase Manhattan Bank, First National City Bank, Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank-New York, United States Trust Company of New York, European American Bank and Trust, and National Bank of North America.

<sup>26/</sup>Albright, Harry W., Jr., speech to the New York State Bankers' Association, January 21, 1975.

#### IV. U.S. BANKS ABROAD

##### A. Expansion of Branches, Subsidiaries and Affiliates

While foreign banks were vigorously expanding their operations in this country, American banks were engaged in simultaneously expanding their activities overseas. In the United States at the end of 1960, there were eight U.S. parent banks operating 131 overseas branches with \$3.5 billion in assets. As late as 1967, there were only 15 U.S. banks operating 295 branches with \$15.7 billion in assets. But, six years later, at the end of 1974, 125 U.S. banks had 730 overseas branches in 76 countries with total assets of over \$150 billion.

Table 4 lists the foreign branches of U.S. banks abroad as of December 31, 1974, ranked by country of greatest concentration. The table points up clearly the large number of so-called "shell branches" operated in the Bahama and Caymen Islands. These branches are called "shells" because transfers of funds appear on the branches' books to avoid reserve requirements and other federal bank regulations, although all decisions are made by the U.S. domiciled parent bank.

Not surprisingly, 37 U.S. banks maintained more than 50 branches in London, the center of the Eurodollar market as well as a leading international financial center. There was a great deal of concern about the viability of some of the London branches of U.S. banks in the early 1970s. Fierce competition among the many U.S. branches and other banks headquartered in London (both British and those of other national origins) led to very small interest rate margins on loans. A comparison of relative rates of return on assets of U.S. banks with London branches and the rate of return on assets of total U.S. commercial banks led one observer

to conclude that "profit margins in the London-based banking business are remarkably narrow."<sup>27/</sup> Because of low profit margins and the extreme caution which followed the 1974 bank failures (see Appendix A), there were many rumors that several American banks were considering closing their London branches. It was often said that no American bank wanted to be the first bank out of London, but that several U.S. banks wanted to be second. In the event, no significant contraction of U.S. branches in London had taken place through the spring of 1975.

U.S. banks are extremely well represented in the European Community (EC) Common Market countries. In addition to the 55 banks in the United Kingdom, there are a total of 82 branches of U.S. banks in the other member countries: 30 in Germany, 17 in France, 9 in Belgium, 10 in Italy, 6 each in the Netherlands and Luxembourg, and 5 in Ireland. Denmark is the only EC member country in which U.S. banks do not have branches. U.S. banking is also well represented in other industrial developed countries, such as Japan (29), Switzerland (9) and Austria (1). Among the industrialized nations, Canada, Australia and the Scandanavian countries are notably absent from the list.

The developing countries of Latin America and Asia also host a number of U.S. banks, and the Middle East (including Israel) boast a number of U.S. bank branches. The non-oil producing countries of Africa have apparently had little attraction for U.S. banks.

In addition to the foreign branches of U.S. banks, banking has also expanded its overseas network through subsidiaries and affiliates.

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<sup>27/</sup> Brimmer, Andrew F., "American International Banking: Trends and Prospects," April 2, 1973.

Restrictions in both U.S. banking regulations and foreign bank laws prohibiting the foreign ownership of branches, encouraged the growth of subsidiaries and affiliates as the most practical, and sometimes the only vehicle through which U.S. banks could conduct a banking business overseas. At the end of 1973, American banks were engaged in foreign banking through 78 foreign subsidiaries, 31 of which were in Europe.<sup>28/</sup> A number of these subsidiaries were engaged in merchant banking, underwriting, and other types of financial activity prohibited to U.S. domestic banks.

B. Edge Act Corporations

In addition, U.S. banks have increasingly taken advantage of the provisions of the Edge Act to engage in foreign banking and investment.<sup>29/</sup> In 1960, there were only 15 Edge Act and "agreement" corporations with assets of \$550 million. By the end of 1973, there were 104 such corporations with assets of nearly \$7 billion, and the number of Edge Act corporations had further expanded to 117 by <sup>the end of</sup> 1974.

One of the most unique features of this law is that it is the only vehicle through which U.S. banks can establish subsidiaries, i.e., Edge Act corporations, for the purpose of engaging in banking operations

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<sup>28/</sup> For a fuller discussion of the activities and growth of U.S. banks abroad, see Brimmer, Andrew R. and Frederick R. Dahl, "Growth of American International Banking: Implications for Public Policy," AEA Meetings, December 28, 1974.

<sup>29/</sup> The so-called Edge Act is Section 25(a) of the Federal Reserve Act (12 U.S.C. 611-631). The Edge Act provides for the establishment of "corporations. . . for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations. . . ." Agreement corporations may be formed under Section 25 of the Federal Reserve Act for very similar purposes. Appendix C contains a more detailed description of Edge Act and agreements corporations.

related to international trade and finance in various domestic locations outside their home state of operation. As such, the Edge Act provides a major exception to the general prohibition on interstate banking in the U.S.

The growth in these out-of-state banking corporations has been dramatic over the last 10 years, as shown in Table 5. From less than \$1 billion in 1964, the assets of these subsidiaries has grown to nearly \$9 billion by the end of last year. Although most of the Edge Act corporations are still located in New York, as they all were in 1964, a significant number of them are now established in <sup>Culverton, Cal.</sup> Miami. The remainder are reasonably well distributed in other major financial and trade centers throughout the United States.

Allowing foreign banks to charter Edge Act subsidiaries on the same terms as domestic banks is among the more important provisions of both the Federal Reserve and Rees proposals to regulate foreign banks. The Federal Reserve legislation even proposes some liberalization in lending powers for both domestic and foreign owned Edge Act corporations. It has been pointed out to foreign bankers concerned about future U.S. restrictions on interstate banking that this vehicle for expanding outside the state of initial chartering would then be available.

C. Issues Raised By U.S. Foreign Banking Operations

Until quite recently, concern about the activities of foreign banks in this country has usurped most of the attention of bank regulators. However, the Federal Reserve System has long been aware of the many problems surrounding the activities of U.S. banks abroad. In April 1971, the Board of Governors commissioned a report on the foreign operations of U.S. banks: a two volume report consisting of study papers, analysis

of issues and recommendations by the Board's staff was issued in August 1972.<sup>30/</sup>

The System Steering Committee on International Bank Regulation was established in February 1973, to look at issues related to both foreign banks in the U.S. and U.S. banks overseas. However, as mentioned in Section II, the pressure of events forced the committee to devote most of the ensuing two years to proposals for regulating foreign banks in the U.S.

Since the introduction of the Foreign Bank Act of 1975, the Board had been able to renew its interest in the activities of U.S. banks overseas. The problems and questions raised by the expansion of U.S. banking abroad have been discussed in two recent papers by Federal Reserve personnel.<sup>31/</sup>

There appear to be four major issues to be resolved in the area of American banking in foreign countries:

- (1) Entry into foreign countries by U.S. banks and limitations on permissible activities abroad;
- (2) capital adequacy of the foreign operation and the degree of involvement of the parent bank's capital;
- (3) the treatment of joint venture and consortium banks; and
- (4) the impact of multinational banking on domestic monetary

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<sup>30/</sup> Federal Reserve System, "Report of Task Force on Foreign Operations of U.S. Banks," submitted to the Board of Governors, August, 1972 (confidential).

<sup>31/</sup> Brimmer and Dahl, op. cit., and Holland, Robert C., "Public Policy Issues in U.S. Banking Abroad," BAFT Convention, April 8, 1975.

policy, the lender of last resort role of central banks, and questions of bank reporting, examination, and surveillance.

The issues are extremely complex and their resolution may well prove time consuming. Some of them will undoubtedly be part of the <sup>(Study of Financial Institutions and the National Economy)</sup> FINE committee's study currently in progress in the House of Representatives.

V. OTHER DEVELOPMENTS AFFECTING INTERNATIONAL BANKING

The monetary authorities in other major industrial countries have neither proposed nor implemented the kind of extensive revisions in their international banking regulation which is being considered in the United States. In the wake of the collapse of Herstatt and several other small banks in Germany, the authorities there, however, substantially revised domestic bank supervision and regulation.<sup>32/</sup>

A. Foreign Exchange Regulation and Supervision

The foreign exchange losses sustained by large commercial banks in many industrial countries in the summer and fall of 1974 caused authorities in several countries to increase their monitoring of foreign exchange and lending operations. In some cases, more stringent foreign exchange regulations were imposed.

Both the U.S. Treasury and the Comptroller of the Currency have taken actions affecting the international transactions of domestic banks. The Treasury began requiring a new foreign exchange reporting form as of October 30, 1974. The new form requires U.S. banks to list their net position on both spot and forward foreign exchange transactions. The Comptroller's office also initiated a program of more stringent evaluation of U.S. banks' lending to foreign countries or companies in countries that were experiencing financial difficulties. At one time

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<sup>32/</sup> Among the changes were an increase in the powers of the bank supervisory agency, the Credit Supervisory Board, to permit it to conduct regular audits at its discretion; specific limitations on the banks' lending activities; and a set of management standards. In addition, the responsibilities of the "liquidity consortium" formed by the German Banker's Association were greatly expanded.

during 1974, the Comptroller's office reportedly had a list of about 20 countries in which financial conditions were considered weak, and evaluations of U.S. banks' loans in these countries were being evaluated and shared among the 14 regional bank administrators.

The United Kingdom, Germany and Switzerland have all tightened their regulations on foreign exchange transactions. The Swiss Central Bank required commercial banks to report monthly on all forward foreign exchange transactions beginning July 15, 1974. Germany's Bundesbank and the Bank of England have also announced more stringent reporting requirements on foreign exchange transactions. In addition, Germany has instituted limitations on foreign exchange transactions, effective October 1, 1974. German banks are required to limit total foreign liabilities to the value of their foreign assets plus 30 percent of a bank's nominal capital and paid-in reserves. Within this overall limitation, open forward foreign exchange positions are limited to 40 percent of the bank's capital.

B. Supervision of Multinational Banking

Authorities in the industrial countries have very different policies with regard to supervising the foreign activities of their domestic banks. For example, in the United Kingdom and Canada, bank regulators are not held responsible for the foreign activities of domestic banks. The amount and degree of banking supervision also varies substantially from country to country. Table 6 shows the differing policies on supervision/regulation of a few key banking variables in several important industrial countries. The table can be misleading, in that it implies that the U.S. has minimal bank regulation. Domestic U.S. banks would almost certainly dispute that proposition.

Views also differ with respect to which central bank has responsibility for banks which are located in one country, but are owned or controlled by banks from another country. Central banks apparently have agreed on the question of which central bank should act as lender-of-last-resort when a foreign branch of a domestic bank has difficulties. Because the assets and liabilities of the parent domestic bank and its foreign branch are so intermingled, it is generally felt that the parent bank has the first line of responsibility followed by the central bank of the parent bank.

However, the United States disagrees with several of the other industrial countries, notably the United Kingdom and Germany, on the question of which central bank has final responsibility for subsidiaries of multiple-owned banks. It is agreed that first responsibility rests with the parent bank--for example, the American bank which has a wholly owned subsidiary incorporated in London. In fact, the Bank of England requested formal assurances from the foreign parents of London-based subsidiaries of their willingness to come to the assistance of their offspring in case of need. However, this still leaves open the question of which central bank is ultimately responsible if support by parent banks should prove inadequate. The United States' position is that the central bank of the country where the subsidiary (or multiple-owned bank) is located should act as lender-of-last-resort--in the case of the London subsidiary, the Bank of England. European monetary authorities feel that this is the responsibility of the central bank in the country of the parent bank--in this example, the Federal Reserve System. The European point of view would make it very difficult technically to assign lender-of-last-resort responsibility in the case of consortium banks.

C. Eurocurrency Markets

The problems surrounding the Eurocurrency markets prompted several proposals for regulation of this market and the multinational banks that are its major institutional base. The huge size of the market, and the accelerating rate at which it is growing--particularly due to deposits from the oil surplus nations--drew the attention of world financial and political leaders to this problem. The failure of several large western banks solidified the issue of which central bank should act as lender-of-last-resort for multinational banks involved in these markets.

In mid-1974, Guido Carli,<sup>then</sup> Governor of the Bank of Italy, recommended that the Federal Reserve System should become the regulator of the Eurodollar market and the lender-of-last-resort in the Euromarkets. Later, Chancellor Helmut Schmidt (West Germany) requested new international cooperation and agreement on the issues revolving around the Eurocurrency markets. He noted that the volume of transactions in the Eurocurrency markets at the end of the year might be almost as large as the GNP of Germany, and that in the last two years the market was growing by about \$50 billion annually, as fast as the total money supply of Germany. Despite repeated expressions of the need for greater consultation and cooperation in regard to multinational banking, no concrete plan of action by the central banks has been announced to date. Suggestions that reserve requirements similar to reserve requirements on domestic funds should be imposed on Eurodollar deposits have been rejected by a number of central banks. The prospects for resolving the issues surrounding the Eurocurrency markets appear dim, at least as long as the solution for a new international monetary order cannot be found.

APPENDIX A  
CHRONOLOGY OF 1974 BANK FAILURES

Although substantial foreign exchange losses had previously been announced by Franklin National Bank of New York (reported at \$46 million) and Union Bank of Switzerland (\$150 million), near panic prevailed in the foreign exchange markets when Bankhaus I.D. Herstatt of Cologne, West Germany was closed June 26, 1974, after sustaining \$150-200 million in foreign exchange losses. Subsequently, Bankhaus Wolf and Co., K.G. Dortmund closed at the end of June. In August, three small private banks went under: August 12, Bankhaus Bass & Herz (assets \$46.1 million); August 23, Bankhaus Wolf K.G. of Hamburg (and not related to the Dortmund bank), assets \$21 million; and August 27, Frankfurter Handelsbank, assets, \$5.3 million. Fifty percent of the shares of Bankhaus Wolf of Hamburg were owned by Italian financier Michele Sindona's holding company, which was also the largest shareholder in Franklin National Bank of New York.

This was followed by the closing of banks in Austria, Switzerland, Italy and The Caymen Islands. Lloyds Bank International lost about \$75 million through its Swiss branch in September, and Banque de Brussels (Belgium) lost about \$50 million in foreign exchange transactions in October. In October, Franklin National Bank in New York was declared insolvent by U.S. regulatory authorities and its viable assets were acquired by European-American Bank and Trust, a consortium owned by six large European banks. During September, First National City Bank of New York, took over two European banks that were experiencing liquidity problems: Trinkhaus & Burkhardt of Dusseldorf, West Germany and the British Bank of Commerce in Glasgow, Scotland.

## APPENDIX B

### ORGANIZATIONAL FORMS OF FOREIGN BANKS IN THE UNITED STATES

Representative Offices. Numerically, representative offices are the most common type of foreign banking organization in the United States. Banks from almost every country in the world maintain at least a representative office somewhere in the United States. A representative office is not permitted to engage in any actual banking operations. Rather, representative offices serve as a convenient facility through which a foreign bank's employees can attract customers for the parent bank and can also provide U.S. services for their parent's customers. In many instances, representative offices are an inexpensive first step by which a foreign bank can gain a foothold in American banking. Since representative offices do not engage in actual banking operations, they are not usually supervised by American banking authorities.

Affiliates. Another way for a foreign bank to gain entry to U.S. banking is through affiliation with an American bank. When a foreign bank becomes an affiliate of a U.S. bank, it usually purchases a minority share of the American bank's voting stock. Affiliation frequently arises out of correspondent banking relationships between American and foreign banks. Affiliation has not generally proven attractive to foreign banks, however, mainly because of the problems arising from divided leadership of the bank. On the other hand, affiliation has been the common form of foreign entry into the U.S. securities business, an activity prohibited for U.S. banks under the Glass-Steagall Act of 1933. Several foreign banks own or share in the ownership of securities affiliates in this country.

Subsidiary. The three types of foreign banking in the United States which have grown most rapidly in the past decade are the subsidiary, the branch, and the agency. The critical distinction between a subsidiary, on the one hand, and branches and agencies on the other hand, is a legal one. A subsidiary has a separate legal identity from its parent bank, while branches and agencies do not.

A subsidiary is a new corporate entity chartered by the state<sup>33/</sup> which is subject to the same state corporation and banking laws as a domestic bank chartered by that state. The foreign parent bank owns at least a majority or controlling interest in the subsidiary, and usually a subsidiary is wholly owned by its foreign parent bank or banks. For instance, the European-American Bank and Trust Company that acquired Franklin National Bank is a wholly-owned subsidiary of six large European banks. Branches and agencies do not have a separate legal identity, however, but rather are considered to be integral parts of their foreign parent bank's operations. This legal distinction is the primary basis for the differences in banking operations between subsidiaries, and branches and agencies.

The subsidiary of a foreign bank requires the same capitalization as that of a domestic bank applying for a state charter. For this reason, the subsidiary form of entrance to U.S. banking may prove expensive for the foreign parent bank. Moreover, the loans of the

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<sup>33/</sup> Although a subsidiary can apply for a national charter, the requirement of the National Bank Act (Title 12, Sec. 72) that "every director must during his whole term of service, be a citizen of the United States" has meant that in practice, this is not a reasonable option for foreign banks.

subsidiary are limited, as are those of domestic banks, by its own capital; a subsidiary may not loan more than 10 percent of its own capital to any one borrower. The capital of the parent bank has no bearing on the loan limits of the subsidiary, and this may prove a drawback to this form of organization for some foreign banks.

On the other hand, the subsidiary form of organization offers several advantages over that of branches and agencies to the foreign bank considering a U.S. presence. Because a subsidiary is a U.S. chartered institution, it can provide the same banking service as a domestic bank. Subsidiaries of foreign banks can accept deposits from U.S. citizens as well as foreign customers, and they can offer checking accounts. A subsidiary is eligible for insurance by the Federal Deposit Insurance Corporation (FDIC) and membership in the Federal Reserve System, although only four subsidiaries of foreign banks have opted to become members.

The Bank Holding Company Act (BHCA) applies to certain activities of foreign subsidiary banks just as it does to domestically owned banks.<sup>34/</sup> The Board of Governors' list of permissible nonbanking activities for bank holding companies applies to both foreign and domestically owned bank holding companies. The prohibition on multistate operations of bank holding companies also applies to foreign banks: the five foreign banks which have subsidiaries in both California and New York were grandfathered, just as the multistate banking operations

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<sup>34/</sup>Section 225.4 (G) of the BHCA deals specifically with Foreign Bank Holding Companies.

of several domestic banks were grandfathered. However, since the Board does not have any jurisdiction over branches or agencies, there is nothing to prohibit a foreign bank from having a subsidiary in one state and branches and agencies in several other states--state laws permitting. Moreover, state laws allow subsidiaries of foreign banks to engage in activities that are not on the Board's list of approved activities, and the same foreign bank may still have branches or agencies conducting a banking business. Subsidiaries are supervised by the state banking authorities, and usually by one or more federal banking authorities (the FDIC, Fed, etc.).

Branch. A branch is an office of a foreign bank to which the state issues a license thus permitting the branch to operate in that state on the basis of the parent bank's charter in the foreign country. The branch is regarded as an integral part of the parent foreign bank's operations. A branch bank license permits the branch to accept deposits and provide checking accounts. However, since the branch is not a U.S. chartered institution, a branch is not eligible for FDIC insurance, and, in practice, this has severely limited the ability of branches to acquire a domestic deposit base.<sup>35/</sup> Branches can borrow in the U.S. money market through CDs or similar instruments, however, and this provides branches with a source of funds not available to agencies.

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<sup>35/</sup> California requires any banking institution accepting domestic deposits to have FDIC insurance; since branches are ineligible for FDIC insurance, they are effectively limited to the same sources of funds as agencies in California.

A branch obviously is much less expensive for a foreign bank initially than a subsidiary because it does not have to be separately capitalized. A second big advantage the branch has over the subsidiary is that the branch's loan limit is based on the parent's capital, and not on the assets of the branch alone.<sup>36/</sup> Branches are required to keep a separate set of books from that of the parent bank for supervisory and tax purposes. Branches are supervised only by the state banking authorities. As was mentioned above, since branches are not subject to federal laws, there are no restrictions on foreign banks' multistate banking operations through branches and subsidiaries' nonbanking activities prohibited by the Board under the BHCA.

Agencies. Agencies, like branches, are issued state licenses allowing them to operate on the basis of the parent bank's charter from the foreign home country and the agency, too, is regarded as an integral part of the foreign parent bank's operations. Agencies, however, are much more circumscribed in their sources of funds. Agencies cannot accept domestic deposits nor borrow funds in the U.S. money market. As a result, agencies are limited to acquiring funds from their parent banks, non-U.S. customers, the Eurodollar, and federal funds markets. Agencies, like branches, are ineligible for FDIC insurance. The loan limit of the agency is based on the parent's capitalization, not on the agencies' assets.

Agencies are the most unrestricted of all forms of foreign banking in the United States. Agencies have no capital or asset

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<sup>36/</sup> Loan limits may be imposed on branches by state law. New York state limits branch loans to 10 percent of the parent bank's capital. This limitation does not apply to agencies.

requirements and no liability ratios which must be maintained, and are subject to no reserve requirements and no lending limits. Like branches, there are no restrictions on the multistate activities of agencies, and the BHCA does not apply to the nonbanking activities of subsidiaries of their parent banks.

Some of the most important distinguishing features of foreign banks in this country are presented in Table 7. In the legislation regulating foreign banking, which the Board of Governors submitted to Congress as the Foreign Bank Act of 1975, the Board proposes defining branches and agencies of foreign banks as "banks" within the meaning of the Bank Holding Company Act. This proposal would eliminate many of the distinctions which currently exist between subsidiaries, and branches and agencies.

APPENDIX C

EDGE ACT AND AGREEMENT CORPORATIONS

Although both Edge Act and agreement corporations engage in international finance, there are several distinctions between the two types of organizations. Agreement corporations were the first organizational form through which American banks were allowed to engage in international finance. Agreement corporations were permitted by a 1916 amendment to Section 25 of the Federal Reserve Act. Under the terms of this amendment, national banks with capital and surplus of \$1 million or more were permitted to invest up to 10 percent of their capital and surplus in the stock of banks or corporations "principally engaged in international or foreign banking." Only state chartered corporations could be formed for this purpose, however, since the amendment did not provide federal chartering authority.

Before a national bank could purchase the stock of these state chartered corporations:

the said corporation shall enter into an agreement or undertaking with the Board of Governors of the Federal Reserve System to restrict its operations or conduct its business . . . as the said Board may prescribe . . . <sup>1/</sup>

Because of this requirement, such corporations became known as "agreement" corporations. At the end of 1974, there were five agreement corporations in operation.

In 1919, Senator Walter E. Edge of New Jersey sponsored the amendment to the Federal Reserve Act that became Section 25(a) and

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<sup>1/</sup> Author's underscoring. 12 U.S.C. 603.

bequeathed the name Edge Act corporations to organizations chartered under its provisions. The Edge Act provides for the federal chartering of:

Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations . . . either directly or through the agency, ownership, or control of local institutions in foreign countries, . . . <sup>2/</sup>

At the end of 1974, there were 112 Edge Act corporations in operation.

There are several major differences between Edge Act and agreement corporations. In the first place, as the preceding discussion indicates, Edge Acts are federally chartered and are not subject to state corporation or banking laws. Agreement corporations, on the other hand, are chartered by states and are subject to state laws.

A second difference is that it costs less to charter an agreement corporation. An agreement corporation can be chartered by any bank having \$1 million in capital and surplus and there is no minimum capital requirement for the agreement corporation. An Edge Act corporation must have a minimum capitalization of \$2 million, and since the parent bank is limited to an investment of 10 percent of its own capital and surplus, only a bank with at least \$20 million capitalization can establish an Edge Act corporation.

There is also some difference in the scope of activity permitted, with Edge Act corporations having more leeway, since they can engage in "foreign financial operations" as well as banking. The terms of Section 25 quoted above would appear to limit agreement

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<sup>2/</sup>12 U.S.C. 611.

corporations to banking. Edge Act corporations may be owned by more than one bank or company. Additionally, there are a few other technical differences between the two types of organizations.

Regulation K, "Corporations Engaged in Foreign Banking and Financing Under the Federal Reserve Act" sets forth the Board of Governors' guidelines for the operations of Edge Act and agreement corporations. In 1963, Regulation K was amended to permit a corporation to engage in both banking and investment activities; until that date, Edge Act corporations had been limited to either one or the other activity.

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