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REGULATION OF FOREIGN BANKING ACTIVITY IN THE UNITED STATES

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Although recent financial developments and technological innovations have generated intense public and legislative debate over the proper structure of domestic bank regulation,[1] relatively little attention has been focused on the increasing participation of foreign bank operatives in the United States market. This participation raises serious questions about both the ability of our present "dual banking system" to deal effectively with banking operations organized and primarily conducted beyond our border and the potentially disruptive consequences to international trade and comity of state-level decision-making in this area.

The Japanese and Canadian banks initiated the penetration of our domestic banking markets in the 1870's,[2] primarily in California, but there was little concerted foreign bank activity through the 1920's.[3] Large-scale foreign bank expansion into this country is a relatively recent phenomenon, dating no further back than the early 1960's. By 1972, however, the United States assets of foreign banks were estimated to be $35 billion, almost 4.5% of the total domestic banking assets, while commercial and industrial loans made in the United States by these institutions amounted to $7 billion, or eight percent of the total of similar loans by large domestic commercial banks.[4] By 1975, within one year after these statistics had been

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1. The President's Commission on Financial Structure and Regulation, known as the "Hunt Commission," dealt comprehensively with a broad spectrum of domestic bank regulatory objectives and formulated proposals calculated to avert future liquidity and disintermediation problems such as were encountered during the high interest periods of the late 1960's. *See* THE REPORT OF THE PRESIDENT'S COMMISSION ON FINANCIAL STRUCTURE AND REGULATION 1 (1971). S. 2591, 93d Cong., 1st Sess. (1973) and S.1267, 94th Cong., 1st Sess. (1975) were legislative adoptions of the Hunt Commission recommendations seeking to harmonize the functions of differing types of financial intermediaries. To date, however, there has been no enactment of the reform proposals. *See also* S. 2055, 95th Cong., 1st Sess. (1977) (dealing with N.O.W. accounts); BUS. WEEK, February 27, 1978, at 76 (discussing Merrill Lynch & Co.'s "cash management plan," a novel attempt to circumvent the Glass-Steagall Act).

2. Note, *Foreign Banking in the United States,* 6 VAND. J. TRANSNAT'L L. 595, 597 (1973).

3. *See* JOINT ECONOMIC COMMITTEE, 89TH CONG., 2D SESS., FOREIGN BANKING IN THE UNITED STATES 1 (1966).

4. *Hearings Before the Subcommittee on International Finance of the Senate Committee on Banking, Housing, and Urban Affairs*, 93d Cong., 2d Sess. 2 (1974).

explained to the Subcommittee on International Finance of the Senate Banking, Housing, and Urban Affairs Committee, foreign banks' aggregate share of domestic assets reached $61.9 billion (twelve percent of total), and their commercial and industrial loan portfolio was valued at $20 billion (16.8% of total) out of a total of $23.4 billion of loans and credits held by United States operatives of foreign banks.[5] By the middle of 1978, 122 foreign banks were operating in the United States with combined assets of $90 billion; and as of April 1978, foreign banks held more than $26 billion in commercial and industrial loans.[6] Presumably, this dramatic rate of expansion will continue at least over the short term as multinational banking becomes increasingly competitive. Furthermore, as entry requirements become liberalized and these banks become more adept at competing for lucrative retail banking business, their domestic market penetration should increase. Likewise, many of the Less Developed Country (LDC) markets, which have traditionally provided fertile avenues of expansion, have become less profitable in consequence of the higher risk presented by spiralling trade deficits and because they have become competitively saturated.

The tremendous growth of foreign banking can be attributed to several fundamental trends in international finance. It is axiomatic that the volume of foreign banking tends to follow the volume of foreign trade, along the pattern established in the early 1900's by the large New York banks in following our nascent multinational corporations abroad. By 1971, direct foreign investment in the United States had reached $11.3 billion, a 200% increase from 1965.[7] Although the growing proclivity of Middle Eastern petrodollar wealth to invest in the United States has received widespread publicity, there are numerous additional sources of foreign capital which look to the United States as the most stable situs for long term investment appreciation. Economic chaos in such countries as Canada, Jamaica, and Peru in the last five years, and the slow growth economies of Britain, France, and Germany, contribute significantly to the attractiveness of the United States as a long term capital haven.[8]

5. Terrell & Leimone, *The United States Activities of Foreign Owned Banking Organizations*, 10 COLUM. J. WORLD BUS. 87, 89-90 (1975).

6. S. REP. No. 1073, 95th Cong., 2d Sess. 2, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2827, 2828.

7. Klopstock, *Foreign Banks in the United States: Scope and Growth of Operations*, 55 FED. RES. BANK NEW YORK MONTHLY REV. 140, 143 (1973).

8. A detailed analysis of the source of foreign investment in the United States would be

The massive infusion of economic assistance to Europe and Japan after World War II and the development of a one world concept of international interdependence, guided by various homogenizing institutions such as the United Nations, the International Bank for Reconstruction and Development, and the Inter-American Development Bank, have stimulated international trade and, accordingly, generated a growing need for international banking capability. Particularly demonstrable of this need is the case of Japan with its highly leveraged export economy and de minimis reliance on equity financing. Likewise, the emergence of the United States dollar as the preeminent world currency has engendered a desire on the part of foreign banks to develop means by which dollar denominated assets and liabilities can be acquired and used effectively in international currency arbitrage. In fact, the Eurodollar market has become a primary financing tool for international corporate development as well as a major source of banking profits.[9]

Clearly, the question how to deal effectively with foreign bank participation in our regulatory system merits serious consideration. The volume of activity represented by foreign banks threatens frustration of several of the objectives toward which domestic bank regulation is directed and, potentially, portends significant international consequences in the areas of comity and commercial reciprocity. On September 17, 1978, President Carter signed into law the International Banking Act of 1978,[10] a comprehensive effort at adjusting the "dual banking system" to account for and rationally deal with the presence of foreign bank operations. This article will endeavor to examine the United States regulatory framework

far beyond the scope of this paper. Examples, however, of this trend are the purchase of real estate by Canadian syndicates in New York City and the ownership of a significant interest in Pennzoil Place, Houston, Texas, by a German group led by the Commerzbank of Duesseldorf, Germany. *See* BUS. WEEK, April 3, 1978, at 28 (discussing Olympia and York's purchase of eight Manhattan buildings and its plan to construct a new 1 million square foot complex); Wall St. J., Oct. 26, 1978, at 15, col. 2 (tentative agreement whereby Arlen Realty is to sell control of its Korvettes, Inc. retail merchandising subsidiary to a French concern, the Agache-Willot Group).

9. During periods of excessively high interest rates, both domestic banks and multinational corporations have turned to the Eurodollar market for financing. *See* F. LEES, INTERNATIONAL BANKING AND FINANCE 117-26 (1974); Giddy, *The Blossoming of the Eurobond Market*, 10 COLUM. J. WORLD BUS. 66, 66-76 (1975). This trend can be dangerous. *See generally* Neukomm, *Risk and Error Minimization in Foreign Exchange Trading*, 10 COLUM. J. WORLD BUS. 77, 77-85 (1975) (citing the failure of the Franklin National Bank (Pennsylvania) and I.D. Herstatt (Cologne, West Germany) as examples of over-speculation in the international money markets).

10. Pub. L. No. 95-369, 92 Stat. 607 (1978).

encountered by a potential foreign bank entrant and to synthesize the principles of domestic bank regulation.

THE DOMESTIC REGULATORY FRAMEWORK

Banking in the United States is carried on under a rather unusual system of dual regulation. Two separate regulatory schemes operate coincidently to supervise different areas of banking operations. Moreover, a particular bank can to a large extent choose which scheme, state or federal, it wishes to have supervise its primary functional operations. Since creation of the Federal Deposit Insurance Corporation[11] and enactment of the Bank Holding Company Act of 1956,[12] nearly all domestic banks have become subject to some form of direct federal regulation despite the option to have their primary operations governed by the laws of their respective state.[13] This bifurcated regulatory arrangement, generally referred to as the "dual banking system," has been alternately described as an "accident of history"[14] and a "great social compromise."[15] Although justifications for such a confusing and duplicative regulatory system may appear to be largely historical, the "dual banking system" continues to thrive as an integral element of the federalist system of government.[16] Appendix *A* contains a general outline of the jurisdictional bases from which this confusing and often overlap-

11. 12 U.S.C.A. §§ 1811-1831 (West 1969 & Supp. 1978).

12. 12 U.S.C.A. §§ 1841-1849 (West 1969 & Supp. 1978), *as amended by* International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1978). Section 1842(e) was added by amendment in 1970 which provides that every bank which is affiliated with a bank holding company "shall become and remain an insured bank" under the terms of section 1813(h). *See* 12 U.S.C. §§ 1842(e), 1813(h) (1970).

13. The only type of bank which, under current law, could escape all direct federal regulation would be a non-insured bank that was not a bank holding company. These banks, representing, as of December 31, 1976, only 1.9% of the total number of domestic banks and 2.6% of domestic banks assets, are virtually non-existent.

14. *See* Hackley, *Our Banking System*, 52 VA. L. REV. 565, 570-71 (1966). In an effort to abolish state banks and to herd all domestic banking into the framework established by the National Bank Act of 1864, a ten percent tax was levied on state bank notes in 1877. Displaying a remarkable instinct for self-preservation, the state banks merely turned to deposit banking instead of note circulation. *See id.* at 570-71.

15. *See* J. GALBRAITH, MONEY 84 (1975) (arguing that the "dual banking system" incorporates a series of compromises between the traditional "hard" money interests of the trade and finance centers and the "soft" money advocates from capital deficient, agrarian frontier areas). This historical approach tends to explain the continued adherence to the "dual banking system" in such recent legislation as the Bank Holding Company Act.

16. One can see the deference paid to state regulatory authority by 12 U.S.C. § 36(c), 321 (state law governs national and state member bank branching) and by 12 U.S.C. § 1846 (states can go beyond the terms of Bank Holding Company Act in prohibiting or circumscribing bank holding company activity).

ping admixture of regulatory bodies presently operates.

In order to deal comprehensively with the numerous regulatory complications presented by increased foreign bank activity within the United States, it is instructive to mention the basic objectives that the current system of domestic regulation is designed to achieve. Essentially, there are two fundamental premises or objectives around which all bank regulatory enactments are tailored: the necessity of instilling confidence in the banking system and the need for an effective system of monetary control. The former objective is essential to the sound functioning of deposit banking and the process of deposit creation by which it operates. Deposit creation is little more than a systematized, legitimized form of pyramiding wherein depositors' confidence in the safety of their assets becomes the primary determinant of the actual safety of those assets. Thus to the former premise a corollary attaches: the necessity of assuring depositor protection and the prevention of bank failure.[17] Since most of the principal bank legislation has been enacted in response to, rather than in anticipation of, fiscal crisis,[18] the resulting regulatory framework has an ad hoc character which can be rationalized only as an evolutionary effort to achieve the objectives of safety and control. While both the state and federal regulations contribute to depositor protection and bank soundness, monetary control has been confined to the province of the Federal Reserve Board operating through its various mechanisms for stimulating or retarding the availability of credit.[19]

From more than one hundred years of collective governmental wisdom directed toward fulfilling these dual premises, several guiding principles have emerged.[20] To foreign bankers, who generally

17. *See* 12 U.S.C. § 1816 (1970) (eumerating various safety factors relied upon by the FDIC in approving deposit insurance and by the Comptroller in granting national bank charters).

18. *See* J. GALBRAITH, MONEY 116-18 (1975). Civil War inflation and financing needs prompted enactment of the National Bank Act of 1864; the Panic of 1907 contributed to the creation of the Federal Reserve System in 1913; and the Great Depression produced the Federal Reserve Act of 1933, the Banking Acts of 1933 and 1934, and the Glass-Steagall Act of 1933. *See id.* at 116-18.

19. *See* BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTIONS iii (6th ed. 1974). The Federal Reserve Board controls the supply of credit in three ways. *See* 12 U.S.C. § 343 (1970)(discount window); *id.* § 263 (open market operations); 12 C.F.R. § 204.5 (1978) (reserve requirements place on member banks). The efficacy of reserves as a tool of control is a matter of controversy. *See* Robertson & Phillips, *Are Uniform Reserve Requirements Really Necessary?* 91 BANKING L.J. 403, 419 (1974). *See also* J. GALBRAITH, MONEY 116-18 (1975) (arguing that the F.R.B. has been unsuccessful both at controlling monetary expansion and at averting domestic financial crisis).

20. *See generally* Lichtenstein, *Foreign Participation in United States Banking: Regula-*

participate in all forms of financial intermediation and have relatively few limits on their permissible investments, these traditional limitations on banking activity may seem especially inconvenient.

The first, and most widely recognized, of these principles is the separation of investment banking from deposit-taking or retail banking contained in the Glass-Steagall Act.[21] Although an economic distinction exists between the two activities, based on the particular capital market in which financial intermediation is conducted, sections 20 and 20(a)(1) of the Glass-Steagall Act were aimed chiefly at the concentration of financial power and collusion which was perceived to have contributed greatly to over-speculation in the 1920's and the ensuring stock market crash of October 1929.[22] So strong is the belief that the combination of investment and depository banking is an evil to be avoided that a federal statute, authorizing foreign branches of national banks to "exercise such further powers as may be usual in connection with the transaction of the business of banking in the places where such foreign branch shall transact business," expressly prohibits such a branch from engaging "directly or indirectly, in the business of underwriting, selling, or distributing securities."[23] Likewise, other federal regulations prohibit an American "Edge Corporation"[24] that is "engaged in banking" from participating in the underwriting business.[25]

A second notion, that depository institutions should be restricted geographically, was accorded express legislative reaffirmation as recently as 1956 in section 3(d) of the Bank Holding Company Act,[26] which provides that:

> No application shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire . . . any additional bank located outside the State in which the operations of such bank holding company's banking subsidiaries were princi-

tory Myths and Realities, 15 B.C. INDUS. & COM. L. REV. 879, 886-912 (1974).

21. 12 U.S.C. §§ 377, 378(a)(1) (1970). *See also* Investment Co. Inst. v. Camp, 401 U.S. 617, 629 (1971).

22. *See* Investment Co. Inst. v. Camp, 401 U.S. 617, 629 (1971); S. REP. No. 77, 73d Cong., 1st Sess. 6 (1933).

23. 12 U.S.C. § 604(a) (1970).

24. *Id.* §§ 611-632 (1970), *as amended by* International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1978).

25. *See* 12 C.F.R. § 211.5(a)(1978). "Engaged in banking" is defined as whenever a corporation "has aggregate demand deposits and acceptance liabilities exceeding its capital and surplus." *Id.* § 211.2(d).

26. 12 U.S.C.A. § 1842 (West 1969 & Supp. 1978). The geographic limitation takes root in the deference to state law with respect to branching. See note 16 *supra.*

> pally conducted . . . unless the acquisition . . . is specifically authorized by . . . the State in which such bank is located.[27]

Unlike most other industries serving national, or at least potential national markets, domestic banking does not permit maintenance of physical locations coextensive with the scope of the business being conducted. The concept of viable, legally functioning boundaries between federated states is alien to most potential foreign bank entrants since the developed nations from which they hail generally have either unitary or highly centralized governments.

A third principle, which is also baffling to foreign bankers contemplating entry into the United States market is the idea that banking should be divorced from commerce. The National Bank Act of 1864 lent implicit recognition to this concept by limiting the nonbanking operations of national banks to "all such incidental powers as shall be necessary to carry on the business of banking."[28] This traditional notion concerning bank regulation was reaffirmed by the Bank Holding Company Act. Section 4 of that Act establishes a general prohibition on the holding, by a bank holding company, of "any voting shares" or "ownership or control" of any company that is not a bank unless authorized by certain specific exceptions contained therein.[29] The premise upon which this restriction is based, although perhaps odd to foreign bankers who are accustomed to functioning in a cartelized, interrelated business climate, comports squarely with an American concept of economic freedom: that concentration of both suppliers and users of credit in a single entity should be prohibited per se because of the inherent potential for unfair or discriminatory credit allocation and conflict of interest.[30]

The final broad regulatory concern that permeates the treatment of banks in the United States is antitrust. Nothwithstanding whatever logical inconsistencies may appear to exist between the principles of free competition and an industry as pervasively regulated as commercial banking, antitrust notions concerning the evils of industry concentration and structural movements have crept into several areas of United States bank regulation.[31] In light of the de-

27. 12 U.S.C. § 1842(d) (1970).

28. 12 U.S.C.A. § 24 (West 1969 & Supp. 1978).

29. *See id.* § 1843. 12 C.F.R. § 225.2 establishes conclusive and rebuttable presumptions of "control."

30. *See* S. Rep. No. 1084, 91st Cong., 2d Sess. 3-5, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5520-5522; S. Rep. No. 1179, 89th Cong., 2d Sess. 2, *reprinted in* [1966] U.S. Code Cong. & Ad. News 2385, 2386; S. Rep. No. 1095, 84th Cong., 2d Sess. 1-2, *reprinted in* [1956] U.S. Code Cong. & Ad. News 2482, 2482-83.

31. *See* United States v. Marine Bancorporation, Inc., 418 U.S. 602, 605 (1974); United

gree to which developed nations throughout the world have embraced antitrust as a practical and effective means of promoting sound business practices, this factor should not unduly threaten a foreign banker. Of course the foreign antitrust regimes are generally less rigorous than that of the United States or are aimed primarily at the market segmentation effects of industrial cartels and thus pose little direct threat to banking institutions.[32]

The case of *Barclays Bank International Ltd.*[33] vividly illustrates how application of American antitrust notions to a foreign bank entrant can engender tortured consequences. In *Barclays* the New York Superintendent of Banking denied Barclays Bank's application to acquire the Long Island Trust Company (LIT), not on grounds that Barclays' entry into the Long Island retail market would eliminate any existing or potential competition between Barclays and LIT nor that it would materially increase concentration in that market, but because a New York bank of Barclays' world size would similarily be prohibited from making the acquisition.[34] The decision illuminates a critical shortfall in the manner in which foreign bank entry has generally been treated. A single state banking official was able, without regard for the international repercussions of his actions and in a potentially disruptive manner, to effectuate a binding decision pertaining to a foreign organization. His decision rather flagrantly abused traditional merger analysis since he ignored the premise that some actual or potential danger to competition *in the relevant market* must be shown to exist.[35] The Superintendent's ruling was based simply on Barclays' aggregate

States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963); 12 U.S.C.A. § 1828 (c) (West 1969 & Supp. 1978) (1966 amendments to the Bank Merger Act); 12 U.S.C. § 1842(c)(1970) (1966 amendments to Bank Holding Company Act); *id.* §§ 1843(c)(8), 1971-78 (1970 amendments to Bank Holding Company Act).

32. *See* Treaty of Rome, March 25, 1957, arts. 85, 86, 298 U.N.T.S. 3 (regulating anticompetitive agreements and abuses of a dominant position in E.E.C. commerce). With respect to the industrial focus of the E.E.C. Commission, see Mok, *The Cartel Policy of the E.E.C. Commission*, 6 COMMON MARK. L. REV. 67 (1968).

33. *See* Recommendation of the Superintendent of Banking to the Banking Board with respect to the Application of Barclays Bank Limited and Barclays Bank International Limited pursuant to Section 142 of the Banking Law of the State of New York 1 (1972).

34. *Id.* at 19. *See generally* Lichtenstein, *Foreign Participation in United States Banking: Regulatory Myths and Realities*, 15 B.C. INDUS. & COM. L. REV. 879, 902-11 (1974).

35. *See, e.g.*, United States v. Von's Grocery Co., 384 U.S. 270, 278 (1966); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 360-61 (1963); Brown Shoe Co. v. United States, 370 U.S. 294, 301 (1962). In the context of international merger, see Crane Fruehauf Ltd. v. Fruehauf Corp., [1977] 2 TRADE REG. REP. (CCH) ¶ 61, 708 (S.D.N.Y. 1977); United States v. Joseph Schlitz Brewing Co., 253 F. Supp. 129, 144 (N.D. Cal.), *aff'd per curiam*, 385 U.S. 37 (1966).

size, irrespective of its position in the Long Island or greater New York City markets.[36] Such a basis is comparable to judging General Motors' share of the British automobile market by its size in the United States. The fact that a state official, under the "dual banking system," can become involved in international commercial decisions, adds insult to the injury of this tortured decision.

REGULATION OF FOREIGN BANKS PRIOR TO THE INTERNATIONAL BANKING ACT OF 1978

Until enactment of the International Banking Act of 1978[37] no comprehensive scheme existed for dealing rationally, or even consistently, at either state or federal level, with domestic operations of foreign banks.[38] Nonetheless foreign banks continue to undertake United States operations in dramatic proportions. Compared with many areas of the world, the United States has been quite receptive to foreign entrants.[39] Despite federal statutes requiring that all directors of national banks be U.S. citizens[40] and that a majority of the shares in an Edge Corporation be held by domestically controlled entities,[41] there was until recently no legislation that expressly discriminated against foreign entry, per se.[42] With passage of the new international banking act, it has been left to the states to facilitate or impede foreign competition in the domestic markets.

Although the United States has ratified bilateral Friendship, Commerce, and Navigation Treaties (FCN) with most of the devel-

36. *See* Recommendation of the Superintendent of Banking to the Banking Board with respect to the Application of Barclays Bank Limited and Barclays Bank International Limited pursuant to Section 142 of the Banking Law of the State of New York 20 (1972).

37. Pub. L. No. 95-369, 92 Stat. 607 (1978).

38. *Compare* Recommendation of the Superintendent of Banking to the Banking Board with respect to the Application of Barclays Bank Limited and Barclays Bank International Limited pursuant to Section 142 of the Banking Law of the State of New York 20 (1972) *with* Statement of the Board of Lloyds Bank Limited, 60 Fed. Res. Bull. 125, 125-26 (1974). Almost contemporaneously with *Barclays*, the Federal Reserve Board and California banking authorities approved the acquisition by merger of the First Western Bank and Trust Company, a much larger organization than LIT, by Lloyds Bank Limited, an entity which is comparable in size to Barclays.

39. *See Where Can a Bank Go?*, 123 THE BANKER, No. 568, at 623 (June 1973); S. REP. No. 1073, 95th Cong., 2d Sess. 2, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2827, 2835; 124 CONG. REC. H2555 (daily ed. Apr. 6, 1978) (discussing discrimination by foreign sovereigns against United States banking operations within their territories); 124 CONG. REC. S11611 (daily ed. Jul. 24, 1978) (United States banks in foreign countries).

40. 12 U.S.C. § 72 (1970).

41. *Id.* § 619.

42. As will be discussed hereafter, even these statutory obstacles have now been removed. *See* International Banking Act of 1978, Pub. L. No. 95-369, §§ 2-3, 92 Stat. 607 (1978).

oped, capitalist nations,[43] the United Kingdom FCN Treaty is one of the few agreements that does not qualify or restrict the right of each signatory to "national treatment" when banking is concerned.[44] A typical FCN banking provision, contained in the West Germany FCN Treaty, provides:

> Each Party reserves the right to limit the extent to which aliens may establish, acquire interests in, or carry an enterprise engaged within its territories in communications, air or water transport, taking on administrative trusts, banking involving depository functions . . . (but) neither Party shall deny to . . . banking companies of the other party the right to maintain branches and agencies . . . .[45]

Thus the United States is as vulnerable as West Germany in terms of restricting foreign bank activity, and questions of reciprocity may be particularly important in determining the degree to which domestic banks are allowed to compete abroad. As *Barclays* points out, under the prior regulatory system there was little the federal government could do to forestall embarassing restrictions on United State operations and thus avert the disturbing consequences that those restrictions invited.

Foreign Bank Entry

It has been previously mentioned that it was left to the states, by default, to facilitate or impede foreign bank penetration of domestic markets. Section 21(a)(2) of the Banking Act of 1933[46] imposes an entry condition on "deposit banking" as follows:

> It shall be unlawful . . .
> (2) For any person, firm, corporation, association, business trust, or other similar organization to engage . . . in the business of receiving deposits . . . unless such . . .
> (A) shall be incorporated under, and authorized to engage in such business by, the laws of the United States or any State . . . or
> (B) shall be permitted by any State . . . .[47]

43. *See, e.g.*, Treaty on Commerce and Navigation, Feb. 21, 1961, United States - Belguim, 14 U.S.T. 1284, T.I.A.S. No. 5432; Treaty on Commerce and Navigation, Oct. 29, 1954, United States - West Germany, 7 U.S.T. 1839, T.I.A.S. No. 3593; Treaty on Commerce and Navigation, Dec. 4, 1952, United States - Finland, 4 U.S.T. 2047, T.I.A.S. No. 2861.

44. *See* Treaty on Commerce and Navigation, July 3, 1815, United States-United Kingdom T.S. No. 110. The need to restrict "national treatment" of foreign banking enterprises is generally premised upon a strategic position which deposit banking holds in a country's economy.

45. Treaty on Commerce and Navigation, Oct. 29, 1954, United States - West Germany, art. VII, para. 2, 7 U.S.T. 1839, T.I.A.S. No. 3593.

46. 12 U.S.C. § 378(a)(2) (1970).

47. *Id.*

A potential entrant must either be chartered through incorporation of a state or national subsidiary[48] or must obtain a state license for its branch or agency operation.[49] The requirement that all directors of a nationally chartered banking institution be United States citizens[50] has effectively closed the national option contained in subsection (a) to foreign entrants.[51] Furthermore, the affirmative nature of the language of this section would seem to preclude state level entry in the absence of express statutory authorization. No foreign bank has, as of yet, attempted to challenge the validity of the silent veto.

Several states specifically prohibit foreign banking within their borders, and others, like Texas, allow only representative offices.[52] Currently, however, there are several states which, by specific language, permit a foreign bank to conduct banking operations to varying degrees within their borders: New York, California, Illinois, Massachusetts, Alaska, Georgia, and Missouri.[53] Only New York, Illinois, and Massachusetts, however, allow a foreign branch to conduct the types of "full scale" banking activities that would approximate the services of a separately incorporated subsidiary.[54] The

48. *Id.*

49. *Id.*

50. *Id.* § 72.

51. *Id.* § 378 (a)(2).

52. Texas authorizes representative offices by statute. *See* TEX. REV. CIV. STAT. ANN. arts. 342-901 to 951 (Vernon 1973 & Supp. 1978-1979). The Texas Constitution, however, provides that "[n]o foreign corporation, other than the national banks of the United States, shall be permitted to exercise banking on discounting privileges in this State." TEX. CONST. art. 16, § 16, cl. 3.

53. *See* ALASKA STAT. §§ 06.05.005-.545 (1978); CAL. FIN. CODE §§ 1750-1764 (Deering 1978); GA. CODE ANN. §§ 41A-3301 to 3312 (1974 & Supp. 1978); ILL. ANN. STAT. ch. 16 ½, §§ 101-182 (Smith-Hurd 1972 & Supp. 1978); MASS. ANN. LAWS ch. 167, §§ 37-45A (Michie/Law. Co-op 1977); MO. ANN. STAT. §§ 362.010-.900 (Vernon 1968 & Supp. 1979); N.Y. BANKING LAW §§ 200-206 (McKinney 1971 & Supp. 1978-1979). As an example of the various limitations placed upon foreign banks operating in the United States, Georgia allows only foreign agencies which may not accept deposits but may maintain credit balance accounts. *See* GA. CODE ANN. §§ 41A-3301 to 3312 (1974 & Supp. 1978). California allows branches in the sense that a foreign banking corporation can accept deposits under certain circumstances, but requires one of two things. The first is that the corporation be approved for FDIC deposit insurance. *See* CAL. FIN. CODE § 1756.1 (Deering 1978). This condition is one that an unincorporated branch cannot meet because 12 U.S.C. §§ 1813-1814 require that a bank be incorporated at either the state or federal level in order for its deposits to be insurable by the FDIC. The second requirement is that the deposits which are to be accepted be foreign-sourced. *See* CAL. FIN. CODE § 1756.2(b) (Deering 1978). This condition negates the very purpose of establishing a branch by foreclosing the opportunity to compete in the local retail deposit market. Accordingly, foreign banks operating in California generally use the subsidiary method of entry.

54. *See* ILL. ANN. STAT. ch. 16 ½, §§ 101-182 (Smith-Hurd 1972 & Supp. 1978); MASS. ANN. LAWS. ch. 167, §§ 37-45A (Michie/Law. Co-op 1977); N.Y. BANKING LAW §§ 200-206 (McKinney 1971 & Supp. 1978-1979).

remaining states limit the degree to which a foreign bank may conduct banking business within their borders.[55]

As a consequence of the deferral of control to the states over foreign bank entry, a foreign banking operation is subject to primary regulation of its operations at the state level. This regulation includes control over items such as capital requirements, lending limitations, reserves, periodic examination, and reporting obligations. Federal regulation of foreign bank operations by the Federal Reserve Board and the Federal Deposit Insurance Corporation accrues only in the event of the separate incorporation of a United States banking subsidiary.[56]

Arguable Competitive Advantages Accruing to Foreign Banks

Many ardent advocates of regulatory reform of foreign banking are quick to point out the competitive advantages that the United States operations of such foreign banks supposedly have vis-à-vis their domestic counterparts. These advantages derive from the ability of certain forms of foreign controlled operations to circumvent the regulatory principles of separation of investment from deposit banking activities and the geographical limitation on the physical range of depository institutions. Since foreign banks have very little incentive to subject themselves to the capital stock[57] and reserve requirements[58] of the Federal Reserve System, and the prohibitions on becoming affiliated with an underwriting organization[59] and on maintaining a management interlock with such an operation,[60] these restrictions can be avoided easily by refraining from becoming a member bank.

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55. *See, e.g.*, ALASKA STAT. §§ 06.05.005-.545 (1978); CAL. FIN. CODE §§ 1750-1764 (Deering 1978); GA. CODE ANN. §§ 41A-3301 to 3312 (1974 & Supp. 1978).

56. In the event of incorporation of a separate subsidiary, the Bank Holding Company Act will apply because there will exist "control over any bank" by "any company" within the purview of 12 U.S.C. § 1841(a) (1) (1970). Since the activities will be controlled by the Bank Holding Company Act, section 1842(e) provides that "[e]very bank that is a holding company and every bank that is a subsidiary of such a company shall become and remain an insured bank . . . ." 12 U.S.C. § 1842(e) (1970).

57. *See id.* § 321.

58. *See id.* § 461. The principal advantages of F.R.B. membership are the availability of the discount window and avenue for the national clearing of checks. *See id.* §§ 360, 342. Since only the largest and most well-capitalized of foreign banks have undertaken United States operations, they have little need for the former advantage. Concerning the latter, the limited degree to which foreign entrants have entered the local deposit markets thus far has not served to test their need for an efficient clearing mechanism. Furthermore, local clearing houses may provide an alternative to the F.R.B.'s clearing mechanism.

59. *See id.* § 377.

60. *Id.* § 378.

Another element in the "Glass-Steagall Wall" is section 21 (a)(1) of the Act.[61] This section makes it unlawful "for any person, firm, corporation, association . . . engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds . . . or other securities, to engage at the same time to any extent whatever in the business of receiving deposits . . . ."[62] Since this provision is limited to the combination of the two activities in a single entity, a foreign bank can conduct United States securities operations by ownership of a separately incorporated underwriting subsidiary while simultaneously participating in the deposit banking market through branch offices. Undoubtedly, this ability can be a significant advantage to foreign banks, who are accustomed to serving all aspects of their clients' financial affairs and to undertaking considerable equity investments in the companies they serve. Consequently, numerous foreign bank operatives have exercised this opportunity.[63] This advantage is muted, however, by the Bank Holding Company Act, which applies to a foreign bank controlling a United States subsidiary.[64] Federal regulations specifically foreclose bank holding companies from participating in or affiliating with an entity participating in the securities business.[65] Since only New York, Illinois, and Massachusetts allow full service branches, *a foreign banking organization* desirous of conducting both depository and underwriting activities has been limited to these areas in the conduct of retail banking.

Another ostensible competitive advantage accruing to foreign banks is the ability to conduct multistate banking operations. A foreign bank's branching powers are determined by the law of the place of its incorporation. Thus neither the McFadden Act[66] nor the various state law restrictions on multistate branching will restrict the areas into which a foreign incorporated bank may branch. Additionally, since only branches or agencies will be involved, the multistate prohibitions contained in section 3(d) of the Bank Holding

61. *Id.* § 378(a)(1).

62. *Id.* § 378(a)(1).

63. See Appendix B.

64. *See* 12 U.S.C. § 1841 (1970). Section 1841(a)(6) defines "bank" as "any institution organized under the laws of the United States, any state . . . which (1) accepts deposits . . . (2) engages in the business of making commercial loans." Section 1841(a)(1) defines a "bank holding company" as "any company . . . which has control over any bank." 12 C.F.R. § 225.2 (1978) interprets "control."

65. *See* 12 C.F.R. §§ 225.125, .4(g)(2)(v)(c) (1978).

66. 12 U.S.C. § 36 (1970).

Company Act will not apply.[67]

Although multistate branching may appear to give foreign bank entrants power to conduct a broadly based competitive attack on domestic deposit markets, several grounds exist for the argument that large domestic banks are placed at no competitive disadvantage by this power. The Senate Banking, Housing, and Urban Affairs Committee report on the International Banking Act of 1978 noted that the extent to which the multistate expansion privilege prejudices domestic banking institutions is "a matter of some earnest dispute."[68] Supporting this contention is the fact that many domestic banking institutions have established a multistate presence under two exemptions contained in the Bank Holding Company Act. The first exemption authorizes control of non-banking subsidiaries furnishing services to or performing services for a bank holding company's banking subsidiaries.[69] The second exemption provides a general escape hatch from the prohibition on non-banking activities for

> any company the activities of which the Board after due notice and opportunity for hearing has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto . . . the Board shall consider whether its performance . . . can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration . . . .[70]

Short of engaging in activities that would invite classification of a subsidiary as a "bank,"[71] a bank holding company is free to control transnational non-banking affiliates under this "closely related" test.[72] Regulation Y, interpreting this test, allows such disparate activities as loan production,[73] servicing, industrial banks,[74] engag-

67. See note 25 *supra* and accompanying text. The 1966 amendments to the Bank Holding Company Act, of July 1, 1966, Pub. L. No. 89-485, § 3, 80 Stat. 236 (1966), defined "bank" for purposes of the Act to mean "any institution which accepts deposits" in the United States and thus raised the spectre that foreign branches would be covered. The definition, however, was narrowed to exclude them in 1970. *See* 12 U.S.C. §§ 1843(c)(8), 1971-1978 (1970).

68. S. Rep. No. 1073, 95th Cong., 2d Sess. 8, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2827, 2834.

69. 12 U.S.C. § 1843(a)(2)(A) (1970).

70. *Id.* § 1843(c)(8).

71. *Id.* § 1843 (the acceptance of deposits and the making of commercial loans).

72. *See id.* § 378. The single state limitation of section 1842 (d) applies only to bank holding companies or their subsidiaries.

73. *See* 12 C.F.R. § 225.4(a)(1) (1978). *But see* 12 C.F.R. § 225.126 (1978) (outlining activities not "closely related to banking"). *See also* 12 C.F.R. § 225.122(f) (1978).

74. *Id.* § 225.4(a)(2).

ing in various leasing operations,[75] and furnishing investment advice.[76]

Thus domestic banks have been foreclosed only from the retail deposit markets beyond the state of their principal operation. It is questionable whether an exploitative advantage in this foreclosure inures to foreign operatives. To avoid classification as a bank holding company, foreign banks must operate branches or agencies, but in operating branches or agencies, they are not insurable by the FDIC. Furthermore, only a limited number of states allow these forms of entry, with Massachusetts, New York, and Illinois as the only states to allow full service branching. Lastly, the Edge Act[77] allows multistate expansion by domestic banks for purposes of performing international trade financing, thus providing an opportunity to compete on an even keel in the primarily foreign bank market.[78]

Forms of Foreign Bank Operation in the United States

As illustrated by the foregoing discussion of foreign bank entry and the supposed competitive advantages that these foreign institutions share over similarly situated domestic banks, the particular form in which a foreign operation is to be conducted is critical in assessing the nature of the regulation to which it becomes subjected. The simplest form of entry, a representative office, does not invoke the affirmative licensing requirement of the Banking Act of 1933 since it does not contemplate accepting deposits.[79] Several states, however, do require licensing of such offices, but there is no reason, absent express state legislation, why representative offices could not be established throughout the United States.

The antithesis of a representative office conducting de minimis activity is a separately incorporated subsidiary engaging in the full scale of banking services. Since separate incorporation will invite classification of the foreign bank organization as a "bank holding company,"[80] federal regulations will deny to that organization the opportunity to control a United States securities underwriting affili-

75. *Id.* § 225.4(a)(6).

76. *Id.* § 225.4(a)(5).

77. 12 U.S.C. §§ 611-631 (1970), *as amended by* International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1978).

78. *Id.* § 615(b).

79. *Id.* § 27. See note 39 *supra* and accompanying text.

80. *See* 12 U.S.C. § 1841(c) (1970).

ate,[81] restrict expansion of the group's banking affiliates to the state of their "principal" operations,[82] and require that every domestic banking affiliate become insured by the FDIC.[83] Thus, foreign banks pursuing the subsidiary route are treated generally as domestic bank holding companies. For foreign banks which were lawfully operating a plural state holding company prior to extension of the Bank Holding Company Act to one-bank holding companies,[84] however, the Federal Reserve Board has allowed retention of plural state interests but has required that future expansion be limited to the state of "principal" operations.[85] One salient disadvantage to the subsidiary option is that a separately incorporated entity must stand on its own in meeting the capital requirements and lending limitations imposed by the chartering state. Accordingly, the capital cost of investment in a subsidiary will be much greater than that necessary for a branch or agency operations.

Once classification as bank holding company attaches to a foreign banking organization, it must deal with additional regulations. Section 1841(h) of the Bank Holding Company Act provides that

> the prohibitions of section 1843 of this title shall not apply to shares of any company organized under the laws of a foreign country that does not do any business within the United States, if such shares are held or acquired by a bank holding company that is principally engaged in the banking business outside the United States.[86]

This language has been sufficient to avert the potentially embarrassing consequence of having the Federal Reserve Board require a foreign bank to divest, pursuant to section 4 of the Bank Holding Company Act, its holdings in various foreign subsidiaries that do no United States business. Such a broad assertion of extraterritorial jurisdiction would be difficult to justify under international law.[87]

81. *See* 12 C.F.R. § 225.4(g)(2)(v)(c) (1978).

82. *See* 12 U.S.C. § 1842(d) (1970).

83. *See id.* § 1842(e).

84. The Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, § 101(a), 84 Stat. 1760 (1970), amended section 1841(a), to include one-bank holding companies.

85. *See* Order Approving Action to Become a Bank Holding Company, Barclays Bank D.C.O., London, England, 57 Fed. Res. Bull. 45, 46-7 (1971); Order Approving Acquisition of Bank of London and South Africa, Limited, London, England, by Barclays Bank, Limited, London, England, 56 Fed. Res. Bull. 734, 734 (1970).

86. 12 U.S.C. § 1841(h) (1970), *as amended by* International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (1978).

87. *See, e.g.*, American Banana Co. v. United Fruit Co., 213 U.S. 347, 357 (1909); IIT v. Vencap, Ltd., 519 F.2d 1001, 1016 (2d Cir. 1975); United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945).

When a foreign bank holding company entertains an affiliation with a corporation that, regardless of its foreign incorporation, does some business in the United States, however, the nebulous test of section 4(c)(9) will apply.[88] This provision exempts from the general non-banking prohibition

> shares held or activities conducted by any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that . . . the exemption would not be substantially at variance with the purpose of this chapter and would be in the public interest.[89]

Since large foreign banking organizations, particularly the Japanese banks, generally maintain equity holdings in their multinational clients, in practice the exemption contained in this section may be more useful in averting international complications of extraterritoriality and comity than the general exemption of section 2 of the Bank Holding Company Act.

In Regulation Y the Federal Reserve Board has attempted to strike a delicate balance between domestic regulatory principles and the general commercial practices of foreign-based multinational banks.[90] The relevant provisions of this regulation explicitly exempt the more common forms of foreign bank affiliates under an "incidental test" which approximates the test employed in evaluating the non-banking activities of United States Edge Corporations under Regulation K,[91] and in ruling on the direct, foreign, non-banking investments of domestic bank holding companies under the Bank Holding Company Act.[92] These provisions provide that:

> (2) A foreign bank holding company may:
> (i) Engage in direct activities of any kind outside the United States;
> (ii) Engage in direct activities in the United States that are incidental to its activities outside the United States;
> (iii) Own or control voting shares of any company that is not engaged, directly or indirectly, in any activities in the United States except as shall be incidental to the international or foreign business of such company;

88. 12 U.S.C. § 1843(c)(9) (1970).

89. *Id.*

90. *See* 12 C.F.R. § 225 (1978) (dealing generally with bank holding company regulation); *id.* § 225.4(g) (specifically concerned with foreign bank holding companies).

91. *Compare id.* § 225.4(g) *with id.* § 211.7(d). *See also* 12 U.S.C. §§ 601-631 (1970).

92. *See* 12 U.S.C. § 1843(c)(13) (1970); 12 C.F.R. § 225.4(f) (1978).

> (iv) With the consent of the Board, own or control voting shares of any company principally engaged in the United States in financing or facilitating transactions in international or foreign commerce;
> (v) Own or control voting shares of any company, organized under the laws of a foreign country, that is engaged, directly or indirectly in any activities in the United States if (a) such company is not a subsidiary of such bank holding company, (b) more than half of such company's consolidated assets and revenues are located and derived outside the United States, and (c) such company does not engage, directly or indirectly, in the business of underwriting, selling or distributing securities in the United States . . . .[93]

The strictness with which the Board maintains the "Glass-Steagall Wall," under subsection (v)(c) above, is evidenced by *Banco Di Roma, S.P.A.*[94] After establishing a seventy percent "source of income" test for affiliates "principally engaged . . . in financing of facilitating transactions in international or foreign commerce," the Board required divestiture by Banco Di Roma, upon becoming a bank holding company, of an interest in Europartners Securities Corporation.[95] Less than fifteen percent of Europartners' underwriting business was with United States customers, and seventy-three percent of its gross income was derived from foreign sources, but these percentages could not save the affiliation. Thus, even though a foreign bank holding company may be able to continue its investment and underwriting practices throughout the world, *Banco Di Roma* holds that even a miniscule degree of United States contact in the securities business is prohibited.[96]

Most foreign bank entrants have chosen, by incorporating under state law, to forsake the opportunity of procuring FDIC deposit insurance in exchange for freedom from the rigors of Federal Reserve Board regulation and the Bank Holding Act.[97] When permitted, entry by means of branch or agency operations has served to achieve many foreign banking objectives without entanglement in extensive regulatory or capital investment necessities. Although a branch may become subject to state regulation of its primary banking operations, state mandated lending limits and capitalization requirements are a function of the home bank's capital. Neither the Glass-

93. 12 C.F.R. § 225.4(g)(2) (1978).

94. 37 Fed. Reg. 21,012 (1972).

95. *See* Banco Di Roma S.P.A., 37 Fed. Reg. 21,012, 21,013 (1972).

96. *See id.* at 21,013 (violative of 12 C.F.R. § 225.4(g)(2)(v)(c) (1978)).

97. See notes 57-60 *supra* and accompanying text. Banks desirous of competing in the California deposit market, however, have no such choice.

Steagall Act, the McFadden Act, nor the Federal Reserve Board's reserve requirements have applied to a foreign bank branch.[98]

A foreign banking agency requires even less regulatory supervision than a branch. Since these operatives do not accept deposits, they are generally subject to less stringent reporting and examination procedures than branches and are immune from lending limits, capital minimums, and reserve requirements. The prohibition against deposit-taking by agency operations can be effectively circumvented through the use of "credit balances." These balances function essentially like deposits, representing sums held by the agency on behalf of its home bank whether creditable to or due from the larger entity.

Although it is questionable whether a foreign bank representative office, in light of comity and reciprocity considerations, would be held to be doing business for purposes of state court jurisdiction, it seems clear that agency or branch operations would subject a foreign bank to suit by the United States.[99] The recently enacted Foreign Sovereign Immunities Act of 1976[100] ends the possibility that a foreign bank operative that has been nationalized by its home government, or in which the government holds a significant equity interest, could forstall legal proceedings against it on the basis of sovereign immunity.[101] Even in absence of this enactment, it would be unlikely that a United States court would feel compelled to decline to assert jurisdiction on the ground of sovereign immunity when the action arose out of commercial banking activity.[102]

Effect of Foreign Bank Activity in the United States

Foreign bank penetration of the United States banking market has not been accomplished without a significant impact upon the domestic economy. For the most part, foreign bank expansion has contributed positively to the domestic economic structure by improving the trade balance, stimulating international trade, and in-

98. See notes 57-76 *supra* and accompanying text.

99. *See* International Shoe Co. v. Washington, 326 U.S. 310, 320 (1945).

100. 28 U.S.C.A. § 1602-1611 (West Supp. 1978).

101. *See id.* § 1605(a)(2).

102. *See, e.g.*, Victory Transp. Inc. v. Comisaria Gen., 336 F.2d 354, 360 (2d Cir. 1964), *cert. denied*, 381 U.S. 934 (1965); Ocean Transp. Co. v. Government of Republic of Ivory Coast, 269 F. Supp. 703, 705-06 (E.D. La. 1967); American Hawaiian Ventures v. M.V.J. Latuharhary, 257 F. Supp. 622, 626 (D.N.J. 1966). *See generally* Letter from Jack B. Tate to Philip B. Perlman (May 19, 1952), *reprinted in* 26 DEP'T OF STATE BULL. 984, 984-85 (1952) (asserting the restrictive theory of sovereign immunity now expressed in 28 U.S.C.A. §§ 1602, 1605(a)(2) (West Supp. 1978)).

creasing competition in the retail banking area. Unfortunately, however, the presence of such a large bulk of banking assets and liabilities beyond the reach of the Federal Reserve Board's control mechanism can precipitate a dilution in domestic monetary control. Large, well-capitalized foreign banks have little incentive either to join the Federal Reserve System or to enter into the correspondent relationships through which credit policies are filtered through to non-member banks. In fact, by stimulating sizeable international investment flows in response to rising interest rates, foreign banks can engender a counter-productive effect on Federal Reserve Board credit tightening measures. The resulting surge in investment, under favorable interest rates, can serve to stimulate monetary growth. Accordingly, one of the primary goals of the International Banking Act of 1978 is to integrate foreign bank operations into the Federal Reserve's monetary police operations.[103]

Foreign banking organizations have exerted a more favorable impact by contributing positively to the United States trade balance. The degree to which foreign deposits held by United States affiliates of foreign banks exceed loans made by them to foreign debtors represents a net reduction in the balance of payments deficit. Because such foreign bank operatives have a major interest in providing a conduit for the channeling of funds from foreign depositors into the domestic lending markets serves both to maximize this "net excess" effect and to explain why these banks are not unduly concerned with their inability to obtain FDIC insurance and, thus, to compete for local deposits. Additionally, the initial capital investment made by foreign organizations in United States banking facilities represents a net capital in-flow, and once established, these facilities provide stimulus for the conversion of liquid foreign dollar holdings into longer term United States investment.

The International Banking Act of 1978 represents an effort to resolve the inconsistencies and shortcomings in the present treatment of foreign bank entrants and to establish a framework of equal treatment for all banking institutions doing business in the United States.[104] The generous hospitality extended to foreign operatives under this statute testifies to congressional desire to retain and perhaps amplify the positive attributes of increased foreign bank activity.

103. *See* International Banking Act of 1978, Pub. L. No. 95-369, § 3, 92 Stat. 607 (1978).

104. *See* S. REP. No. 1073, 95th Cong., 2d Sess. 2, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2827, 2828.

THE INTERNATIONAL BANKING ACT OF 1978

Despite the explosive growth of the foreign banking operations in this country, there have been few proposals to deal legislatively with the regulatory vacuum in which these operations have functioned. In 1966 Senator Javits introduced the Foreign Banking Control Act into the 89th Congress proposing exclusive federal regulation of the activities of foreign entrants.[105] This bill, however, as with subsequent similar proposals,[106] did little more than draw attention to the issue.[107] The International Banking Act of 1978 (IBA) represents a delicate political compromise which, while preserving the integrity of state licensing authorities, incorporates foreign banking affiliates into the Federal Reserve Board's system of monetary control and assures federal supremacy with respect to questions of national and foreign commerce.

Section 4 of the IBA extends the option of entry at either the federal or state level to foreign bank operatives.[108] Subject to the approval of the Comptroller of the Currency a foreign bank may now establish a "Federal branch" or "Federal agency" in any state where it does not presently operate a state-licensed branch or agency and in which the establishment of branch or agency operations is not prohibited by state law.[109] Furthermore, the act provides that present or future state branches or agencies may convert into their federal counterparts.[110] Operations of a foreign bank at a federal branch or agency are to be primarily regulated and supervised by the Comptroller of the Currency as any national bank.[111] Additionally, these federal branches and agencies are subject to the restrictions of the McFadden Act.[112] Only one form of federal organization, either branch or agency, may be undertaken in any one state.[113] For

105. S. 3765, 98th Cong., 2d Sess. (1966); *see* Lichtenstein, *Foreign Participation in United States Banking: Regulatory Myths and Realities*, 15 B.C. INDUS. & COM. L. REV. 879, 882-84 (1974).

106. *See* S. 958, 94th Cong., 1st Sess. (1975) (produced language approaching a workable political compromise between state and federal authorities under the dual banking system); H.R. 11440, 93d Cong., 1st Sess. (1973) (proposing stringent federal control).

107. There exists an underlying tension in any attempt to reorganize or alter the means of supervising foreign banks. Any attempt at revision must be balanced between the need for federal control over what are essentially national and international concerns, and the political resistance by the states to encroachments upon state regulatory authority.

108. International Banking Act of 1978, Pub. L. No. 95-369, §4(a), 92 Stat. 607 (1978).

109. *Id.*

110. *Id.* §4(f).

111. *Id.* §4(g)(1).

112. 12 U.S.C. § 36 (1970).

113. International Banking Act of 1978, Pub. L. No. 95-369, §4(e), 92 Stat. 607 (1978).

foreign banks that would rather use the subsidiary method of entry, section 2 of the IBA permits the Comptroller of the Currency to waive United States citizenship requirements.[114] In the Comptroller's discretion up to a minority number of directors of a national bank which is, or is to become, an affiliate or subsidiary of a foreign bank may be non-citizens.[115]

Section 3 of the IBA will allow foreign banks to enjoy the privileges of Edge Act Corporations. The requirement that all directors of an Edge Corporation be United States citizens is dispensed with.[116] Additionally, language has been added to 12 U.S.C. § 619 to allow a majority of the shares of the capital stock of any such corporation to be held, upon the approval of the Federal Reserve Board, by one or more foreign banks.[117]

In keeping with the extension of "national treatment" to foreign bank operatives,[118] section 6 requires Federal Deposit Insurance Corporation insurance as a precondition to the acceptance by any foreign branch, whether state or federal, of retail deposits, expressly excluding agency "credit balances."[119] A "retail" deposit is a deposit in an amount less than $100,000.[120] For deposits which by their size are considered to be "wholesale" banking, such insurance is voluntary.[121]

The cornerstone of the International Banking Act of 1978 is the delicate structuring of permissible interstate activities outlined in section 5. It is with respect to interstate activities that the question of foreign banking in the United States most tangibly strikes the emotional and financial concerns of the majority of banking inter-

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114. *Id.* § 2. Citizenship requirements are found at 12 U.S.C. § 72 (1970).

115. International Banking Act of 1978, Pub. L. No. 95-369, § 2, 92 Stat. 607 (1978).

116. *Id.* § 3(c). The citizenship requirement is found in 12 U.S.C. § 614 (1970).

117. International Banking Act of 1978, Pub. L. No. 95-369, § 3(f), 92 Stat. 607 (1978). There are additional Edge Act amendments which, although not pertaining exclusively to foreign bank activities, deserve serious mention. The ten to one leverage ratio and the ten percent reserve requirement for Edge Corporations is eliminated. *See id.* § 3. Hereafter, these corporations are to be subject to the same reserve requirements as all Federal Reserve member banks. *See* 12 U.S.C. § 461(1970). Although the Federal Reserve is to report annually on the capitalization and activities of Edge Corporations, no specific leverage requirement or capital structure is mandated. *See* International Banking Act of 1978, Pub. L. No. 95-369, §§ 3 (g), (h), 92 Stat. 607 (1978).

118. *See* S. REP. No. 1073, 95th Cong., 2d Sess. 8, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2827, 2835. The report states in pertinent part: "The committee thus believes national treatment is the most appropriate policy to adopt with respect to foreign banks in the United States . . . ." *Id.* at 2835.

119. International Banking Act of 1978, Pub. L. No. 95-369, § 6, 92 Stat. 607 (1978).

120. *See id.* § 6(a).

121. *Id.* § 6(a).

ests.[122] Out of the numerous proposals for dealing with this area and the "strong and sound arguments made by those on the differing issues" which it raises, emerged a compromise that, in the words of the Senate Committee, "equitably reconciles the interests and concerns of Federal and State Officials, and domestic and foreign banks."[123] Section 5 allows a foreign bank to establish branch or agency offices in any state where they are permissible under state law.[124] This flexibility was created in order to ameloriate the earnest fears of many state banking authorities that severe restrictions upon foreign banks would deprive these states of the competitive benefits that the presence of these foreign operatives provides.[125] When a branch is to be established and operated outside the foreign bank's home state, this interstate branch will be limited to the acceptance of credit balances.[126] A foreign bank with interstate operations may elect, however, which one of the states in which it operates is to be deemed its home state, but in absence of such election, the Federal Reserve Board will designate one.[127] Thus, the new statute, through section 5, endeavors to belay fears that multistate foreign bank operations will continue to threaten and impinge upon their domestic counterparts while nonetheless purporting to satisfy the needs of non-money center banking customers. As the committee report states:

> The Section meets the competitive advantage problem by narrowly focusing on the key interstate advantage enjoyed by foreign banks—the ability to accept deposits at locations in several States . . . by focusing on deposit-taking only, competitive equality is achieved by not at the expense of stifling legitimate State objectives, or limiting desirable foreign bank entry.[128]

Concerning non-banking activities of foreign bank operations, the new Act provides that any foreign bank or any foreign company controlling a foreign bank that maintains a branch, agency, or

122. *See* S. Rep. No. 1073, 95th Cong., 2d Sess. 6, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2827, 2833.

123. *Id.* at 2836.

124. International Banking Act of 1978, Pub. L. No. 95-369, § 5, 92 Stat. 607 (1978).

125. *See* S. Rep. No. 1073, 95th Cong., 2d Sess. 8-9, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2827, 2835-36 (testimony of Mr. E. Dunn, President of the Conference of State Baking Supervisors before the Senate Subcommittee on Financial Institutions).

126. International Banking Act of 1978, Pub. L. No. 95-369, § 5, 92 Stat. 607.

127. *Id.* § 5(c). Section 3(d) of the Bank Holding Company Act continues to apply, however, prohibiting interstate subsidiary operations. *Id.* § 5(a)(5).

128. S. Rep. No. 1073, 95th Cong., 2d Sess. 11, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2827, 2837.

subsidiary in a state of the United States shall be subject to the provisions of the Bank Holding Company Act "to the same extent that Bank Holding Companies are subject thereto, except . . . for purposes of Section 3 [of the IBA]."[129] Accordingly, the strictures and requirements of the Bank Holding Company Act pertaining to non-banking activities will prohibit future entry into the United States securities business by foreign entities that are engaged in United States banking operations.[130] In what was a matter of serious concern to numerous legislators,[131] section 8(c) of the IBA grandfathers any non-banking activity that was engaged in, or applied to be engaged in, by a foreign bank on or before July 26, 1978, which would otherwise be prohibited under the application of section 4 of the Bank Holding Company Act.[132] Furthermore, shares of a company engaged in a prohibited non-banking activity acquired subsequent to the grandfather date, but prior to the date of the act's enactment may be retained until December 31, 1985.[133] As under the Banking Holding Company Act, section 8(c) of the IBA empowers the Federal Reserve Board to terminate the grandfather status of any company if it determines that this action is necessary to prevent "undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices in the United States."[134]

One additional wrinkle in the IBA concerns an amendment to the House Bill which allows a "domestically controlled affiliate covered in 1978" to expand, merge, or diversify so long as the foreign bank owner does not increase its percentage ownership in the otherwise prohibited affiliate.[135] A "domestically controlled affiliate covered in 1978" refers to any affiliate the majority of whose stock has been owned or controlled by United States persons or companies since July 26, 1978, and in which a foreign bank or group thereof owns less than twenty-five percent of its voting shares.[136] Thus, for ownership interests encompassed by this definition, the strict prohibition con-

129. International Banking Act of 1978, Pub. L. No. 95-369, § 8(a), 92 Stat. 607 (1978).

130. See notes 80-87 *supra* and accompanying text.

131. *See* H. R. REP. No. 95-910, 95th Cong., 2d Sess. 47-50 (1978); 124 CONG. REC. H 2551, 2551-2575 (daily ed. Apr. 6, 1978) (debate on H.R. 10,899 prior to passage).

132. International Banking Act of 1978, Pub. L. No. 95-369, § 8(c), 92 Stat. 607 (1978).

133. *Id.*

134. *Compare* International Banking Act of 1978, Pub. L. No. 95-369, § 8(c), 92 Stat. 607 (1978) (termination of grandfather status) *with* 12 U.S.C. § 1843(a)(2) (1970) (termination of grandfather status).

135. International Banking Act of 1978, Pub. L. No. 95-369, § 8(c), 92 Stat. 607 (1978).

136. *Id.*

tained in section 4(a)(1) of the Bank Holding Company Act against direct or indirect ownership of "any voting shares of any company which is not a bank"[137] will be permanently relaxed.

In accordance with the application of the Bank Holding Company Act to all types of United States operations of foreign banks, section 8(e) of the IBA elaborates upon and slightly expands the exemption provided by section 2 of the Bank Holding Company Act from the operation of the non-banking activity restrictions.[138] Henceforth, excepting United States securities operations[139] and financial operations permitted under section 2(h) of the Bank Holding Company Act,[140] exemptions shall extend to any company organized under the laws of a foreign country that is "principally engaged in business outside the United States."[141] This language contrasts with the exemptions allowed in the Bank Holding Company Act to only those companies that do "not do any business within the United States."[142]

The International Banking Act of 1978 broadly restructures the treatment of foreign banking operations in the United States. Although direct deposit-taking activities of foreign bank operations are to be subject to the McFadden Act, and thus restricted to a single state, some multistate expansion is permitted. It is doubtful, however, that the ability to offer agency services and to accept foreign source deposits will unfairly prejudice domestic retail bankers. Subject to the rather broad grandfather provisions, domestic and foreign banks will henceforth compete on an even basis with respect to non-banking activities. For retail deposits, Federal Deposit Insurance Corporation insurance is mandatory and all foreign branches and agencies may, at the Federal Reserve Board's discretion, be subjected to the reserve requirements and interest rate limitations applied to member banks under section 19 of the Federal Reserve Act.[143] Likewise section 7 of the IBA empowers the Board

137. 12 U.S.C. § 1843(a)(1) (1970).

138. *Compare* International Banking Act of 1978, Pub. L. No. 95-369, § 8(c), 92 Stat. 607 (1978) *with* 12 U.S.C. § 1843(c) (1970).

139. When an "exempt foreign company" chooses to engage in or hold shares of a company engaged in the business of underwriting, selling, or distributing securities in the United States, it may do so "only to the extent that a bank holding company may do so." International Banking Act of 1978, Pub. L. No. 95-369, § 8(e), 92 Stat. 607 (1978). Accordingly, the securities option will be unavailable.

140. 12 U.S.C. § 1843(c)(8)(1970).

141. International Banking Act of 1978, Pub. L. No. 95-369, § 8(e), 92 Stat. 607 (1978).

142. 12 U.S.C. § 1841 (1970).

143. International Banking Act of 1978, Pub. L. No. 95-369, § 7, 92 Stat. 607 (1978).

to make examinations of any branch or agency of a foreign bank, or any commercial lending company controlled thereby, as it should deem necessary.[144] In order to avoid administrative duplicity, and to preserve the integrity of state examining authorities, this provision mandates that "the Board . . . insofar as possible, use the reports of examinations made by the Comptroller, the Federal Deposit Insurance Corporation, or the appropriate State Bank Supervisory Authority."[145] These provisions, combined with the extension to foreign banks of the option to enter into United States banking activities at either the state or federal levels, display a cogent effort at both preserving the integrity and autonomy of state regulatory operations and extending the monetary control mechanisms of the Federal Reserve Board to all bank operatives.[146]

CONCLUSION

The United States has finally formulated its response to the penetration of its domestic banking markets by foreign-based financial institutions. The ever increasing volume of foreign bank activity within the borders of the United States has begged urgently for such a solution.[147] As an effort to mollify the divergent and often conflicting interests concerned with the regulatory issues that it has sought to address, the International Banking Act of 1978 provides a complicated, yet comprehensive, solution. Recognizing both the positive, pro-competitive impact of foreign bank entry and the urgent need to draw such entrants firmly within the grasp of the domestic regulatory framework, the IBA has endeavored to strike a balance that will stimulate additional foreign bank expansion throughout the internal markets, while denying to such operatives the opportunity to engage in activities that are unavailable to similarly situated United States banks.

144. *Id.* § 7(c)(1).

145. *Id.* § 7(c)(1).

146. As is permitted domestic banking institutions, foreign banks may continue to establish representative offices in any state whose law authorizes them. *Id.* § 10(a). Any such office must register, however, with the Secretary of the Treasury. *Id.* § 10(a).

147. *See* Wall St. J., Apr. 5, 1978, at 2, col. 2. The April 5, 1978, *Wall Street Journal* article reported the tentative acquisition by the Hong Kong and Shanghai Banking Corp., Hong Kong, of a significant equity interest in Marine Midland Banks, Inc., Buffalo, New York. The transaction contemplates one of the largest foreign banking takeovers to date, with the infusion by Hong Kong and Shanghai Banking Corp., a $17 billion bank of $200 million worth of capital into Marine Midland Banks, Inc., an $11 billion bank, over the next two years. *See also* Foldessy, *Banking Industry in America is Facing Onslaught of New Foreign Competition,* Wall St. J., Apr. 12, 1978, at 4, col. 2; N.Y. Times, May 13, 1978, at 29, col. 4.

Appendix A

The Dual Banking System

Function	National Banks (NB)	State Member Banks (SMB)	Non-Member Insured Banks (NMI)
Chartering (entry)	OCC/State	State	State
Branching	OCC/State	FRB/State	FDIC/State
Deposit Insurance	OCC	FRB	FDIC
Mergers	OCC	FRB/State	FDIC/State
Loan Limitations[1]	OCC	State	State
Examinations	OCC	FRB/State	FDIC/State
Reports (to be filed with)	OCC/FRB	FRB/State	FDIC/State
Reserve requirements[2]	FRB	FRB/State	State
Interest on loans (usury)[3]	State	State	State
Interest on deposits[4]	FRB	FRB	FDIC
Management interlocks	FRB	FRB	
Foreign branches	FRB	FRB	FDIC
Issuance of securities	OCC	FRB/State	FDIC/State
BHC activities, formation	FRB/State	FRB/State	FRB/State
Permissible investment	OCC	FRB/State	State

1. An advantage for state banks, most states impose less stringent loan limits than the "10-rule" of 12 C.F.R. § 7.1100 (1978).

2. Another potential advantage, many states allow interest-bearing securities to function as reserves, contrary to the requirements of 12 C.F.R. § 204 (1978) for FRB members, and require lower amounts of such reserves than 12 U.S.C. § 461 (1970). Of course, this advantage will accrue only to NMI banks.

3. 12 U.S.C. § 85 (1970) adopts the state law with respect to usury.

4. For FRB members, 12 U.S.C. § 371a (1970) and 12 U.S.C. § 371 (1970 & Supp. V 1975), *interpreted in* 12 C.F.R. § 217 (1978), govern the payment of deposit interest; for NMI banks, 12 U.S.C. § 1828(g) (Supp. V 1975) and 12 C.F.R. § 329 (1978) apply.

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Appendix B

Foreign-Controlled U.S. Securities Affiliates of Foreign Banks Operating in the U.S.[1]

Securities Operation	Affiliated Bank (s)
ABD Securities Corporation	Algemene Bank Nederland, Amsterdam; Dresdner Bank, Frankfurt
Basle Securities Corporation	Swiss Bank Corporation
Daiwa Securities Company America, Inc.	Daiwa Bank, Tokyo
Europartners Securities Corporation	Banco di Roma, Rome; Commerzbank, Frankfurt; Credit Lyonnais, Paris
RWS Securities Services	Westdeutsche Landesbank Gironzentrale
Sogen Swiss International Corporation	Amsterdam-Rotterdam Bank N.V.; Societe Generale, Paris; Societe Generale de Banque S.A.; Brussels
Suez American	Compagnie Financiere de Suez
Swiss American Securities, Inc.	Swiss Credit Bank
UBS-DS Corporation	Deutsche Bank, Frankfurt; Union Bank of Switzerland
Yamaichi International (America) Inc.	Fuji Bank of Japan; Industrial Bank of Japan; Mitsubishi Bank

1. 10 COLUM. J. WORLD BUS. 104, 104 (1975)