

BRANCHES, SUBSIDIARIES AND FOREIGN BANK INSOLVENCY

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1. Introduction

On March 28, 1980, the central bank of Argentina revoked the authorization of Banco de Intercambio Regional (Intercambio), an Argentine banking corporation with a branch in New York, to operate as a commercial bank within and outside Argentina and directed that the bank be liquidated under the provisions of Argentine law. On the same day, the New York State Superintendent of Banks took possession of Intercambio's New York branch on the grounds that Intercambio was in liquidation in Argentina [1]. Depositors of the New York branch at first feared that they would not be able to recover on their claims against the bank. Ultimately, the New York State Bank Examiner found that the branch was solvent, with assets of approximately \$19.9 million and liabilities of \$5.2 million [2]. Under these circumstances, the Superintendent of Banks was able to pay in full all depositors of the New York branch [3].

Notwithstanding this satisfactory outcome, the Intercambio liquidation underscored the complicated regulatory and supervisory [4] issues associated with banks [5] operating outside their home countries. To what extent, for example, should the bank's home country be responsible for the supervision and solvency of the bank's foreign operations? In the Intercambio incident, the Argentine central bank was unwilling to provide financial assistance to Intercambio's troubled international operations [6]. If assistance from the home country is not guaranteed, how should the bank regulations of a host country be modified to assure the safety and soundness of the host's [7] banking system? In the case of a country with a dual banking system [8], such as the United States, what division of regulatory functions among the various federal and state authorities will promote safety and soundness without unnecessarily sacrificing the economic efficiency of the system?

This article examines these issues in the context of the United States' bank regulatory system. Section 2 sets out the nature and extent of the expanding

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foreign banking presence in the United States. Section 3 briefly reviews the U.S. bank regulatory scheme, the restrictions on interstate expansion, and the treatment of a foreign bank's U.S. branches under the International Banking Act of 1978 [9]. Section 4 highlights the shortcomings in the existing procedures for liquidating or rehabilitating a U.S. branch or subsidiary of a failing foreign bank. Preventative measures taken by the U.S. bank regulators will also be discussed in this section. Section 5 explores proposals for coordinating the regulatory efforts of the host and home countries. Several suggestions for improving these schemes are put forth. Section 6 is a brief conclusion.

2. Growth of foreign banks in the United States

Foreign banks' activities in the United States have grown dramatically since the mid-1970s. At the end of 1973 there were approximately sixty foreign banks operating U.S. banking offices [10] with combined assets of \$32 billion [11]. By June 30, 1984, there were 242 foreign banks operating 528 offices in the United States with combined assets of \$340 billion [12].

Foreign banks establish U.S. offices for a number of reasons: to service their corporate clients that expand operations in the United States and other countries, to gain access to U.S. money markets and stabilize their source of dollar funds, to grow in an economically sound and politically safe market, and to compete for the domestic banking business of U.S. corporations [13]. Most foreign branches in the United States operate solely in the wholesale [14] banking area [15]. Recently, however, a small number of foreign banks have expanded from wholesale banking to retail banking with individuals who are in some way affiliated with the bank's home country [16]. The foreign banks' emphasis on wholesale banking has created a high concentration of these banks in New York, California, Illinois, and Florida [17].

The foreign banks operating in the United States are generally headquartered in the major industrial countries. Approximately seventy percent of the assets are held and over thirty-five percent of the offices are operated by banks from four countries: the United Kingdom, Canada, Japan, and France [18].

The self-restriction of foreign banks' U.S. operations to the wholesale market and the dominance of banks from economically stable countries have significantly reduced the probability that small depositors will face the insolvency of their foreign bank. These limits have also reduced the chance that a foreign bank failure will seriously disrupt the U.S. banking system. However, the recent influx of banks from less developed countries and the trend toward retail banking activities are increasing the risk that the U.S. banking system and U.S. depositors will face the insolvency of a foreign bank.

3. Banking in the United States

3.1. *The dual banking system*

The banking system in the United States is regulated by both state and federal authorities. Under this “dual banking system,” commercial banks can choose to be regulated either under a state scheme, a federal scheme, or both. The scope and intensity of regulation depends on which category a bank falls into [19]. A bank can choose the regulatory framework in which it will operate. More importantly, an existing bank can change its regulatory framework [20].

3.1.1. *Federal supervision*

Federal banking law is administered by three agencies: the Comptroller of Currency (Comptroller) [21], the Board of Governors of the Federal Reserve System (FRB) [22], and the Federal Deposit Insurance Corporation (FDIC) [23]. The Comptroller is the chartering authority for national banks and has the power to supervise and examine national banks [24]. The Federal Reserve is the country’s central bank and is responsible for shaping and controlling monetary policy [25]. National banks must belong to the Federal Reserve System [26]; state banks may elect to join the system [27]. Reserve System member banks (member banks) must comply with FRB regulations regarding such matters as the adequacy of capital, mergers, and the establishment of branches [28]. In return, member banks may, for example, borrow from the Federal Reserve Banks when it is necessary to obtain additional currency [29]. The FDIC was created to restore and maintain public confidence in the banking system after the disastrous bank failures of the 1930s by insuring the deposits of participating banks [30]. Each depositor in an insured bank [31] is protected by federal deposit insurance up to the current limit of \$100 000 [32].

The federal deposit insurance scheme is effective because the FDIC both insures against failure and enforces sound practice so as to reduce the number and degree of bank failures [33]. Banks admitted to the insured group must satisfy a minimum standard of quality [34]. After admission, insured banks are subject to continuing supervision by the FDIC. If the FDIC finds that a bank has not complied with the FDIC’s reporting requirements, or has engaged in unsafe and unsound practices, or is in an unsafe or unsound condition, then the FDIC may terminate the insured bank’s status as an insured bank [35]. Because FDIC insurance is mandatory for national banks and highly desirable for most state banks, the threat of termination gives the FDIC extraordinary influence over the insured banks’ operations. The insurance scheme is effective only because the FDIC can control the risk against which it must insure [36].

3.1.2. *State regulation and supervision*

While there is no uniform state regulatory structure, a number of issues are

usually addressed. Thus, minimum capital, reserve requirements, limitations on types and amounts of loans or investments, permissible interest rates, and establishment of branches are regulated in most states [37]. Supervisory power is lodged in a state superintendent of banking, who oversees the state's banking department [38]. Because most state banks are FDIC-insured, the state banking authorities share responsibility for certain regulatory functions with the FDIC.

3.2. Legislation affecting foreign banks' operations

A number of federal laws affect foreign bank operations in the United States: the McFadden Act of 1927 [39], the Douglas Amendment to the Bank Holding Company Act of 1956, [40] and the International Banking Act of 1978 [41]. A brief review of the McFadden Act and the Douglas Amendment is a necessary prelude to the discussion of the International Banking Act.

3.2.1. McFadden Act and Douglas Amendment

The McFadden Act was intended to place national and state banks on an equal basis with regard to branch banking [42]. The Act, as amended, allows the national banks in a state to establish branches to the same extent that the state permits state banks to branch [43]. Moreover, national banks may branch only if the state explicitly permits such branching [44]. Because state banking statutes generally do not authorize branching outside the state, the McFadden Act effectively limits national banks to intrastate branching.

The Douglas Amendment ensures that national banks do not use the bank holding company [45] form of organization to avoid the McFadden Act's restrictions [46]. The Amendment prohibits a bank holding company from acquiring a bank outside its home state unless the other state explicitly permits such acquisition [47]. Although its overseas affiliates will not qualify a foreign bank as a bank holding company, the acquisition or establishment of a single U.S. commercial bank will make the foreign bank a bank holding company [48]. Therefore, a foreign bank may not, in general, acquire or establish bank subsidiaries in two different states.

3.2.2. International Banking Act of 1978

The International Banking Act (IBA) was enacted to provide federal regulation [49] and supervision [50] of foreign banks' operations in the United States and to establish to the fullest extent possible "equal treatment" for foreign and domestic banks in the United States [51].

Section 4 of the IBA makes the dual regulatory system applicable to branches and agencies of foreign banks. Subject to the approval of the Comptroller of the Currency, [52], a foreign bank may establish a federal branch or agency in any state where the bank does not already operate a

state-licensed branch or agency, and in which the establishment of a branch or agency is not prohibited by state law [53]. This section offers foreign banks a state-federal option in those states that permit federal offices. Furthermore, foreign banks have the option to convert state branches or agencies into federal branches or agencies [54].

Section 4(b) provides that the operations of a federal branch or agency of a foreign bank are to be conducted with the same duties, restrictions, penalties, liabilities, conditions, and limitations that would apply to a national bank doing business at the same location [55]. While section 4(b) embodies the concept of equal treatment, foreign banks do suffer certain restrictions and limitations designed to protect the safety and soundness of the U.S. banking system. Because branches and agencies are operationally and legally offices of foreign banks, not separate incorporated entities, section 4 provides that limitations or restrictions based on the capital stock and surplus of a national bank are deemed to refer to the assets of the foreign bank [56], and that branches and agencies must satisfy through a deposit arrangement the capital equivalency and asset maintenance requirements imposed by the Comptroller [57].

Sections 6, 7, 11, and 13 of the IBA complete the framework for the regulation, examination, and supervision of foreign banks' activities in the United States. Under section 6, all federal and state branches of foreign banks may seek FDIC insurance of their domestic deposits [58]. Insurance is mandatory for branches that accept retail deposits [59]. An insured branch is subject to asset maintenance and capital equivalency ledger account requirements [60] and to country exposure limits [61]. Branches accepting only wholesale deposits need not obtain insurance; depositors at these branches must rely on the remaining regulatory and supervisory scheme [62]. Under section 7, the FRB has authority to establish reserve requirements for federal and state branches and agencies [63]. In order to ensure adequate supervision of foreign bank operations under the dual regulatory system, section 13 provides that the Comptroller, the FDIC, and the states have primary examining authority over operations within their jurisdiction [64]. Thus, federal branches and agencies are subject to examination by the Comptroller; insured state branches are examined by state authorities and the FDIC; noninsured state branches and all state agencies are examined by the state or, if not so examined, by the Federal Reserve [65].

The IBA was a move toward equal treatment of foreign and domestic banks. There is some evidence that the states have responded in kind [66]. Prior to enactment of the IBA a number of states had imposed stringent asset maintenance requirements to protect depositors, other creditors, and the general public from the insolvency of foreign banks operating in their state. New York, California, and Illinois, for example, required a foreign bank's branch to hold liquid assets [67] equal to 108% of its aggregate liabilities [68] within the state

[69]. After enactment of the IBA, the Comptroller did not impose an asset maintenance requirement on federal branches. In response, New York, California, and Illinois amended their asset maintenance statutes to give the state banking authority discretion in establishing asset maintenance requirements [70]. These authorities have largely eschewed establishing these requirements and, for example, the New York Superintendent generally imposes no asset maintenance requirement [71].

The IBA attempts to place U.S. and foreign banks' operations on equal footing, with certain exceptions to protect the U.S. banking system and U.S. depositors. In the next section the article considers how the U.S. authorities handle the insolvency of a foreign bank.

4. Insolvency and foreign banks with U.S. offices or subsidiaries

4.1. *Insolvency of a majority-owned subsidiary*

Because U.S. law treats subsidiaries as distinct legal entities, a parent company bank has a significant opportunity to escape liability for the obligations of its insolvent subsidiary banks [72]. Although the failure of only the majority-owned subsidiary appears unlikely at present [73], the simultaneous insolvency of a foreign parent and its U.S. subsidiary [74] would create the anomalous situation of depositors and other creditors of the subsidiary in one state having claims only against the subsidiary while similar depositors and creditors at the parent's branch in another state would have claims against the U.S. branch and the home office [75]. This potential anomaly has prompted various commentators to propose the elimination of the branch/subsidiary distinction in the insolvency area [76].

One method by which dissatisfied creditors of the subsidiary could claim against the parent would be to invoke the common law doctrine of "piercing the corporate veil." This doctrine holds the entity controlling the corporation liable for the corporation's obligations if the controlling entity has so ignored the separate existence of the corporation that it would be inequitable to consider the corporation a distinct entity [77]. The foreign parent would be held liable for the subsidiary's obligations. Piercing the veil would appear to be difficult in the banking context, however, because courts are reluctant to disregard the corporate form unless the misconduct rises to the level of fraud, crime, or evasion of existing obligations [78]. Mere use of the parent bank's name by the subsidiary would probably not constitute fraud, although the subsidiary's affirmative identification of the subsidiary with the parent so as to mislead depositors could be fraud. While the U.S. banking authorities cannot totally prevent fraud by the parent, the constant monitoring by the Federal Reserve [79] makes it less likely that fraud could occur over an extended period of time.

4.2. Insolvency of foreign banks with U.S. branches

Many foreign banks have established branches in the United States. Regardless of how well the branch is regulated and supervised, the failure of the “parent” bank [80] will cause the branch to fail as well [81]. A proper understanding of the possible effects of a foreign bank’s insolvency requires an examination of the procedures for dealing with insolvency under each of the available regulatory schemes.

4.2.1. Noninsured federal branch

A federal branch of a foreign bank need not obtain FDIC insurance if the branch does not receive retail deposits or if the Comptroller determines by order or regulation that the branch is not engaged in domestic retail deposit activities requiring deposit insurance protection [82]. This exemption recognizes the tradeoff between the costs of FDIC insurance and the need to protect the interests of small depositors. Presumably, large depositors are better able to assess the risks of doing business with a noninsured bank and to negotiate a deposit agreement that reallocates that risk [83]. In addition, the large depositor may bargain to receive some of the branch’s cost savings from noninsurance.

Whenever the Comptroller revokes a foreign bank’s authority to operate a federal branch [84], or the Comptroller becomes satisfied that the foreign bank is insolvent, or a creditor with a judgment arising out of a transaction with the federal branch has been unpaid for thirty days, the Comptroller may appoint a receiver who will take possession of all the property and assets of the foreign bank in the United States, including the assets of state-licensed branches and agencies, and exercise the same rights, privileges, powers, and authority as would a receiver of a national bank appointed by the Comptroller [85].

A national bank’s receiver stands in the place of the bank he represents [86]; he takes title to the bank’s assets and property subject to all equities which existed against the assets in the hands of the bank [87]. The receiver is charged with the collection and conservation of the bank’s assets for the benefit of creditors [88]. He is not limited to just what is sufficient to pay off liabilities but may collect all debts due [89]. The receiver pays over all money collected to the Treasurer of the United States, subject to order of the Comptroller [90]. The Comptroller, in turn, satisfies *pro rata* all proven or adjudicated claims [91]. If all claims are satisfied, the remaining assets are paid to the bank’s shareholders [92].

The IBA modifies the usual distribution scheme by requiring that depositors and creditors whose claims arose out of their transactions with any branch or agency of the foreign bank located in the United States be satisfied *in full* before the Comptroller turns over the remaining assets to the bank’s head office or duly appointed domiciliary receiver for distribution to the other creditors [93].

The receiver will not, however, be able to attach property located outside the United States. To the extent that these assets may be needed to satisfy the depositors' claims, the depositors of the branch may be only partially satisfied. To obtain a larger recovery, the depositor will have to claim against the bank in its home country, unless the home country's central bank decides to ensure that depositors of the insolvent bank's foreign branches are paid in full [94].

4.2.2. Insured federal branch

A federal branch of a foreign bank that receives retail deposits must obtain FDIC insurance unless the Comptroller determines that the deposit-taking activities at the branch do not require insurance protection [95]. As with a noninsured branch [96], the Comptroller may appoint a receiver of an insured federal branch if he is satisfied that the parent bank is insolvent, if the branch's authority to operate is revoked, or if a judgment creditor remains unpaid for thirty days [97]. The Comptroller may, but is not required to, appoint the FDIC as receiver [98]. If the receiver finds that the branch has assets sufficient to satisfy the demands of depositors and creditors with claims arising out of transactions with the bank's U.S. branches, then those claimants will be paid in full. If, however, the branch's assets are insufficient, then the branch will be deemed closed and unable to meet the demands of depositors [99].

The FDIC can protect depositors of failed or failing banks in two ways. With the first technique, called the payoff or payout method, the FDIC pays insured depositors to the extent of the insurance coverage [100]. The payment may be in cash or by making available to each depositor a transferred deposit in a new bank [101] or in an insured bank in the full amount insured [102]. In a payoff transaction, the FDIC is subrogated to the depositors' claims against the closed branch to the extent of the payment [103].

With the second technique, known as an assumption or a purchase and assumption transaction, the FDIC arranges for another insured bank to purchase the assets and assume the liabilities of the distressed bank [104]. In order to make the assumption attractive, the FDIC will exercise its power to purchase assets and assume liabilities of the distressed institution, make loans to the acquiring bank, and guarantee the acquiring bank against losses incurred by reason of the assumption [105]. The advantage of the assumption transaction is the greater level of protection afforded individual depositors [106]. In an assumption transaction, all depositors receive full protection because the consolidated bank assumes all depositors' liabilities—the matter of the insurance ceiling is not relevant.

Although the FDIC has no experience with liquidating a foreign insured branch, it is likely that the FDIC would employ the payoff method [107]. The primary reason for not using the assumption technique is that few banks would be willing to assume the risks of contingent liabilities (including unrecorded accounts, deposits made outside the United States but designated for the U.S.

branch, and potential liabilities for actions by agents of the branch) without a guarantee against loss by the home country's central bank [108]. The assuming bank would likely attempt to shift such risks by seeking a letter of compensation from the FDIC. The FDIC, however, believes such a guarantee would pose an unacceptable risk to the deposit insurance fund [109].

Hence, if there are insufficient assets located in the United States to cover uninsured domestic creditors' claims, both these creditors and the FDIC will have to join the group of creditors seeking payment in the home country.

4.2.3. Insured state branch

State branches accepting retail deposits must obtain FDIC insurance, unless the FDIC determines that the deposit activities do not require insurance or the state does not require state banks to obtain insurance [110]. Although a state branch's status as an insured branch usually leads the state banking authorities to appoint the FDIC as receiver when a receiver is appointed [111], the branch's insured status does not significantly affect the analysis because the FDIC must follow state law when acting as receiver of a state banking institution [112]. The FDIC exercises the rights, powers, and privileges granted by state law to a receiver of a state bank [113].

4.2.4. Noninsured state branch

Although relatively few states permit foreign banks to establish branches [114], New York [115], Illinois [116], and California [117] – the major financial center states – do allow such branching. Furthermore, two other states have recently permitted foreign banks to branch [118]. Although the procedures for liquidating or rehabilitating a distressed bank differ in detail from state to state, the same general rules apply in New York, California, and Illinois. This article will focus on these three states because eighty-eight percent of all foreign bank branches are located in these states. [119].

The state superintendent of banking (superintendent) is authorized to take possession and control of the branch's business and assets in the state [120] if he finds that the branch (1) has violated the law, (2) is conducting its business in an unsound manner, (3) is in an unsound or unsafe condition, (4) has ceased operations, (5) is insolvent or has impaired its capital, or (6) has had a receiver or similar person appointed for the bank in the jurisdiction in which the parent is domiciled [121]. After taking possession of the bank the superintendent may liquidate or reorganize the bank [122]. While liquidating or reorganizing, the superintendent is empowered to collect, use, and sell the bank's assets, to collect debts due, to compromise claims, to execute instruments, and to pursue and defend actions in the bank's name [123]. The superintendent, or the receiver appointed by him, shall pay *pro rata* creditors with proven claims. New York grants a preference to creditors with claims arising out of transactions with the New York branch [124]. California gives priority to California

creditors to the extent of the bank's business in the state [125]. Illinois grants no preferences. After all creditors and the expenses of liquidation have been paid, the superintendent turns over the remaining assets to the head office or the receiver in the home country [126].

The various state schemes, in effect, treat the state branch of an insolvent foreign bank as a separate entity. This treatment is manifested by the priority given to claims of the branch's creditors and by the superintendent's power to marshal the branch's assets.

The broad grant of authority to the superintendent may create conflicts with receivers or liquidators in other jurisdictions. If the branch is treated as a separate entity in a liquidation proceeding, then two liquidators may be competing for the same assets. For example, the California superintendent may take possession of the property and business of the parent bank if the parent is put into liquidation in its own country [127]. The New York superintendent may collect all the assets of the New York branch, wherever situated [128]. It is not inconceivable that a large foreign bank with operations in New York and California may book assets located in California with the New York branch. Such assets would be claimed by both the New York and California superintendents.

A simple solution would be to consolidate the liquidation proceedings, with a pooling of assets and equal treatment of claims filed in either proceeding. This solution is sensible to the extent that the branches are legally parts of the same entity. A single, neutral receiver could be appointed in place of the New York and California superintendents; after pooling, the claims of all creditors would be paid ratably.

However, there are two problems with consolidation: (1) some states require preferential treatment of creditors of the in-state branch in order to protect the interests of the state's citizens [129], and (2) if the branch liquidations are consolidated, a further argument may be made that there should be only *one* proceeding, to be located in the home country. A sole receiver would marshal the assets of the parent bank and its branches, and perhaps, the subsidiaries. All claims could be satisfied *pro rata*. This, however, would put U.S. depositors at the mercy of a potentially hostile foreign receiver.

5. Cooperation among bank regulatory authorities

The simplicity and efficiency of a consolidated proceeding for a distressed multinational bank make the concept of consolidation very appealing. The United States would probably oppose consolidation, however, on several grounds. First, the host is concerned that the home country's central bank will not arrange a satisfactory solution for the distressed bank. In the Intercambio incident, for example, there was tremendous concern that the central bank of

Argentina would not resolve Intercambio's affairs in a satisfactory way [130]. Second, the host's bank regulatory officials are concerned that creditors of a host branch would not receive fair treatment by the liquidators and legal tribunals in the home country. To return to the Intercambio incident, one U.S. congressman noted that Argentine banking authorities would be more concerned with protecting Argentine depositors than New York depositors [131].

Finally, banks in other nations often differ from U.S. banks in significant ways. In many nations, there is no division between commercial and investment banking activities [132]. Furthermore, banks often engage in nonfinancial operations [133]. If such a bank becomes insolvent, its liquidation will leave a myriad of creditors competing with depositors for assets with speculative or little value. In addition, foreign banks based in weakly regulated financial centers are not subject to the scrutiny of meticulous bank examiners nor to strict accounting standards [134]. The resulting record-keeping laxity may prevent even the identification of the bank's assets and liabilities. These problems can be exacerbated by changes in national governments and massive dismissals and appointments of bank regulators. Absent an agreement among nations and their central banks on acceptable methods for marshalling and distributing the assets of a failed multinational bank, each country that allows entry of foreign bank branches has an interest in treating the branch as a separate entity and imposing various precautionary requirements such as maintenance of assets within the jurisdiction. Of course, such requirements and separate treatment involve certain costs and impair, to at least some extent, the efficient international flow of capital. The inefficiencies and costs of unequal treatment and special requirements may be an acceptable tradeoff for protection of the host's banking system and depositors. The United States, for one, follows this policy.

Host countries will be more willing to equalize regulation of a foreign bank's branches if the home country's bank regulatory structure is sound and its supervisory authorities are diligent. Fortunately, banking practices in the major industrial countries are generally sound. Such practices reduce the likelihood that a host country's banking system and depositors will face the insolvency of their branch because of the parent bank's failure. Unfortunately, no bank regulatory scheme can guarantee that no bank will fail. Supervisory improvements by individual nations cannot take the place of an internationally coordinated bank regulatory system.

A major step toward an international system was taken when the Committee on Banking Regulations and Supervisory Practices was formed to coordinate supervision of international banking activities. The Committee comprises the central bank governors from the Group of Ten Countries [135] and Switzerland. The Committee's general statement, known as the Basle Concordat, was approved in 1975 [136] and revised in 1983 [137]. The 1975 Concordat established certain fundamental principles: (1) supervision of for-

eign banking establishments is the joint responsibility of the home and host countries, (2) no foreign banking establishment should be unsupervised, (3) practical cooperation should be provided by exchanges of information between host and home banking authorities, and (4) supervisory responsibility for liquidity and solvency should be allocated between the host and home authorities [138].

The 1983 revisions addressed the adequacy of supervision and the need for supervision of the bank as a consolidated entity. The Concordat provides for adequate supervision by encouraging a host authority that considers the parent bank's supervision to be inadequate to prohibit or discourage the continued operation of the foreign bank in its jurisdiction or to impose specific conditions on the bank's operations [139]. Similarly, a home country that considers the host authority's supervision to be inadequate should extend its own supervision or bar the parent from continued operation abroad [140]. These provisions attempt to reverse the usual tendency for banks to seek weakly regulated jurisdictions [141].

The revised Concordat also encourages supervision of the bank as a consolidated entity. Thus, a foreign subsidiary's solvency is the joint responsibility of the home and host countries—the host country because the subsidiary is host-chartered, the home country because the subsidiary is part of a multinational banking organization overseen by the home supervisor [142]. Solvency of a branch is the responsibility of the home country because the branch's solvency is considered identical to the parent bank's [143]. Liquidity of both the branch and the subsidiary, on the other hand, is the sole responsibility of the host country, which is presumed to be more familiar with local banking conditions [144].

The Concordat is a first step toward international bank supervision, but it is only a first step. To be fully effective, the principles set forth in the Concordat need to be endorsed by bank supervisors worldwide [145]. Universal acceptance of the Concordat is unlikely to occur soon, however, given the great variations in bank regulatory and supervisory schemes in the developing countries.

Even if the Concordat were widely accepted, the agreement is directed only toward the supervision of ongoing banking organizations. The failure to agree on the principles and procedures for handling a distressed banking institution is a major gap in the international regulatory structure. A truly comprehensive agreement would address the issues of emergency support (sometimes referred to as the lender of last resort problem), liquidation, and deposit insurance. The Concordat specifically avoids the lender of last resort issue [146]. Although at least one central banker has argued that rules and procedures for temporarily ensuring liquidity would undermine market discipline [147], it is difficult to justify a general regulatory scheme that does not provide for emergency assistance to a distressed banking institution.

The inability to prescribe generally accepted procedures for liquidating or rehabilitating a failed bank is also a serious problem. A worldwide consolidated liquidation proceeding is, perhaps, the goal [148], but the great variety of liquidation procedures and the possibility that creditors in the home country would benefit at the expense of the host countries' depositors still prevent consolidated liquidations. Deposit insurance is less of a problem. If each nation were assured that sound banking practices were being followed in all other nations, then each nation could insure its depositors by assessing the branch or subsidiary an insurance premium. The assessment would, of course, be determined by international agreement.

The Concordat's failure to address the problem of distressed banks and the lack of worldwide consensus about the concepts espoused in the Concordat make it clear that bank regulatory officials cannot rely on the Concordat to resolve the issues that would arise in the event of a multinational bank's failure. At best, there may be tacit understandings among various central banks regarding ultimate liability to creditors of a failed multinational bank.

Under these uncertain circumstances depositors of foreign bank branches and subsidiaries will look to the parent bank (if it is solvent) [149], the home country's central bank [150], and the host's deposit insurance scheme [151]. The host country's banking system and bank regulators will expect intervention by the parent bank [152] (if it is solvent) and the home country's central bank.

The existing patchwork of regulatory and supervisory responsibility often obscures the real issues of promoting good banking practice and protecting national and international banking systems and depositors from the harmful effects of bank failures. One commentator suggests that the current confusion arises from the conflict of three regulatory principles: (1) national autonomy in regulatory matters, which permits wide variations among national regulators; (2) neutrality, which advocates regulatory parity between the foreign and domestic banks operating in the same country; and (3) parental responsibility, which asserts that the parent bank is responsible for its foreign operations [153].

Modification of any one of these principles would greatly simplify the present regulatory problem. Reversing the principle of parental responsibility, for example, would prevent the transfer of risk and liability from the parent to the foreign operation or vice versa. This would be accomplished by confining foreign operations to the subsidiary form and limiting financial dealings between parent and subsidiary. Rigorous supervisory measures would be necessary to enforce this separation, which has the effect of placing the regulatory and supervisory burden on the host country. Under this arrangement, depositors of the subsidiary would look to the host authorities for preventive and emergency protection.

An alternative approach would repudiate the neutrality principle. Although

this approach would require the United States to abandon the policy of the International Banking Act, the elimination of national treatment would permit domestic regulators to develop special regulations to protect depositors of the foreign bank's domestic operations. At present, careful screening and special capital requirements have been the primary mechanisms on which U.S. regulators have relied. Other more stringent possibilities would include extending deposit insurance to all deposits held in foreign banks and requiring the bank to pay additional premiums, and/or imposing an asset maintenance requirement on foreign branches.

Increasing deposit insurance may be worthwhile to the extent that the FDIC will not effect purchase and assumption transactions for insolvent foreign bank branches. It is not clear, however, whether the benefits of additional insurance will outweigh the attendant costs because foreign branches still engage primarily in the wholesale business. The large customers of these branches simply may not need insurance.

In effect, the deposit insurance issue illustrates the problem involved with abandoning national treatment: there is an adverse competitive effect if banks must conduct business on unequal terms within the same jurisdiction. Nevertheless, if foreign banks continue to operate branches and if there is no international agreement among central banks regarding preventive regulation and emergency arrangements for multinational banks, then national regulatory officials must continue to take special precautions with foreign banks in order to protect domestic creditors.

The most appealing approach to reform would require nations to relinquish some of their sovereignty. A binding international agreement among bank regulators of all nations regarding supervisory responsibilities, lender of last resort obligations, and liquidation proceedings, would remove the need for inefficient regulatory restrictions imposed by the host countries on foreign banking operations. It could resolve the problem depositors and other creditors face in deciding where to raise their claims, and the problems associated with receivers from different jurisdictions trying to take title to the same assets.

One of the major difficulties with this solution would, of course, be securing agreement of all the countries that have financial centers. If an agreement among a majority of these nations could be reached, however, participation of the remaining nations could probably be arranged if the majority refused to host banks headquartered in nonparticipating countries and prohibited their own banks from establishing offices in such jurisdictions.

6. Conclusion

Foreign banking in the United States has increased dramatically in the past decade. The United States has responded to this influx of foreign bank offices

by attempting to place foreign and domestic banks on equal footing and by ensuring federal regulation and supervision of these offices. Foreign bank branches are regulated somewhat differently, however, because the branches are legally and operationally extensions of the home office. But because the U.S. banking authorities, particularly the FDIC, cannot adequately protect against the harmful effects of bank failure unless the banks are properly regulated on a consolidated basis, there is a danger that banks from a weakly regulated jurisdiction or a politically or economically unstable country could fail – injuring the U.S. banking system and U.S. depositors.

This danger could be reduced or eliminated if the significant banking nations agreed to a uniform regulatory and supervisory scheme and allocated responsibility for assisting or liquidating distressed banks. Absent such cooperation, all nations, and the United States in particular, will be forced to impose special regulations on foreign banks in order to protect their own depositors and banking system. Such regulation impedes the efficient flow of international capital at a time when the world cannot afford to waste this resource.

Notes

[1] See *Connolly v. Williams Real Estate Co.*, 80 A.D. 2d 109, 438 N.Y.S. 2d 3 (1981). This action is authorized by N.Y. Banking Law § 606(4)(a) (McKinney 1971).

[2] *Seattle First National Bank v. Banco de Intercambio Regional*, Settle Order at 4 (N.Y. Sup. Ct. June 25, 1980).

[3] *Foreign Acquisitions of U.S. Banks and the Nonbanking Activities of Foreign Bank Holding Companies: Hearings before Subcomm. on Commerce, Consumer, and Monetary Affairs of House Comm. on Government Operations*, 96th Cong., 2d Sess. 32 (1980) (statement of Muriel Siebert, Superintendent of Banks, State of New York) [hereinafter cited as *Hearings*].

[4] For purposes of this article "regulation" will refer to the statutory and administrative rules governing banking activities. Thus, regulation affects or prescribes the location of banks, bank expansion, the services provided, the activities engaged in, the capital structure employed, and similar matters. "Supervision" will refer to the activities of the various banking authorities which monitor banks to promote good banking practices, rehabilitate failed or failing banks, and engage in similar activities. "Examination" will refer to the periodic inspection of an individual bank's records, loan portfolios, and practices to ensure compliance with the law.

[5] Identifying a "bank" is not always an easy task. In the United States a bank is "any association organized to carry on the business of banking." 12 U.S.C. § 37 (1982). The powers a bank may exercise are enumerated in 12 U.S.C. § 24. A commercial bank is defined as an institution that accepts demand deposits and makes commercial loans. 12 U.S.C. § 1841(c) (1982). Commercial banks are subject to special regulation and supervision. A foreign bank is a company, organized under the laws of another country or a territory of the United States, that "engage[s] in banking activities usual in connection with the business of banking" in the country of organization. 12 U.S.C. § 3101(7) (1982).

[6] *Hearings*, *supra* note 3, at 31-32.

[7] This article refers to the host country as the nation in which a foreign bank conducts operations. The home country is the nation that charters the parent bank.

[8] The dual banking system in the United States is discussed *infra* notes 19-38 and accompanying text.

[9] Pub. L. No. 95-369, 92 Stat. 607 (codified principally at 12 U.S.C. §§ 3101-3108 (1982)).

[10] "Banking offices" comprise agencies, branches, and majority-owned subsidiary commercial banks. Agencies and branches are extensions of the parent bank; subsidiaries are distinct legal entities with their own capital stock. See White, *Foreign Banking in the United States: A Regulatory and Supervisory Perspective*, 7 F.R.B. N.Y. Rev., Summer 1982, at 48, 49. A foreign bank's subsidiary operates pursuant to a national or state charter from the host country; the subsidiary is subject to the same restrictions and enjoys the same powers as other domestic banks operating under the same chartering authority. While branches and subsidiaries are conceptually different, both institutions may accept deposits, make loans, and engage in essentially the same types of banking activities. Foreign bank agencies may not accept deposits from U.S. citizens or residents. 12 U.S.C. § 3101(1) (1982). Agencies are not considered in this article because they account for only 15% of the assets held by U.S. offices of foreign banks, see *infra* note 12, and because their inability to accept deposits limits the harm their failure will inflict on their customers or the banking system.

[11] Federal Reserve Board, Selected Assets and Liabilities of U.S. Offices of Foreign Banks, May 1984 (copy on file with *Journal of Comparative Business & Capital Market Law*).

[12] Federal Reserve Board, Structure Data for U.S. Offices of Foreign Banks as of 06/30/84 (computer run on Dec. 12, 1984) (copy on file with *Journal of Comparative Business and Capital Market Law*) [hereinafter cited as Structure Data].

[13] White, *supra* note 10, at 51.

[14] Retail banking usually refers to the acceptance of bank deposits of less than \$100,000. *See, e.g.*, 12 U.S.C. § 3104 (1982) (deposit insurance must be obtained if bank accepts deposits of less than \$100,000 unless Comptroller of Currency determines deposits do not constitute retail deposit activities). Wholesale banking refers to deposits equal to or greater than \$100,000.

[15] White, *supra* note 10, at 51.

[16] *See Hearings, supra* note 3, at 31. The few foreign banks entering the U.S. retail market usually have done so by acquiring a U.S. bank with an existing retail branch network in order to avoid a large investment in plant, equipment, and personnel training. White, *supra* note 10, at 51.

[17] Federal Reserve Board, Foreign Investment in U.S. Banking Institutions, *reprinted in* Bank Expansion Rep., Feb. 20, 1984, at 7. Most foreign bank operations in Florida are conducted through agencies, *id.*, which cannot accept deposits. 12 U.S.C. § 3101 (1) (1982). Because agencies are outside the scope of this article, foreign bank operations in Florida will not be considered.

[18] *See* Structure Data, *supra* note 12.

[19] *See* Hackley, *Our Baffling Banking System*, 52 Va. L. Rev. 565, 565–66 (1966). This footnote summarizes the banking system by type of bank. The text accompanying notes 21–32 summarizes the system by type of regulatory agency.

National banks, which are chartered under federal law, are automatically members of the Federal Reserve System (“member banks”) and their deposits are insured by the Federal Deposit Insurance Corporation (FDIC). Most large banks fall into this category.

State member banks are state banks which are members of the Federal Reserve System and are insured by the FDIC. Nonmember insured banks are state banks which do not join the Federal Reserve System but nevertheless obtain deposit insurance. Most small banks fall into this category. Finally, noninsured state banks are state banks which choose neither to join the Federal Reserve System nor to obtain deposit insurance. These banks are regulated solely by state law. *See generally* Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 Stan. L. Rev. 1 (1977).

[20] A state chartered bank can withdraw from the Federal Reserve System or the FDIC. Scott, *supra* note 19, at 8; Hackley, *supra* note 19, at 568.

National banks can convert to state banks so long as the state law allows conversion. 12 U.S.C. § 214c (1982). For examples of state statutes, *see* Cal. Fin. Code § 1091 (West Supp. 1984); Ill. Ann. Stat. ch. 17, § 332–333 (Smith-Hurd 1981); N.Y. Banking Law § 136 (McKinney 1971 & Supp. 1984).

[21] *See* National Bank Act, ch. 106, 13 Stat. 99 (1864) (codified at 12 U.S.C. §§ 1–21 (1982)).

[22] *See* Federal Reserve Act, ch. 6, 38 Stat. 251 (codified principally in 12 U.S.C. §§ 221–522 (1982)).

[23] Banking Act of 1933, ch. 89, 48 Stat. 162 (codified in scattered sections of 12, 15, and 39 U.S.C.).

[24] 12 U.S.C. §§ 26–27 (1982); *see also*, Scott, *In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies*, 42 U. Chi. L. Rev. 235, 235–38 (1975).

[25] *See* 1 W. Schlichting, T. Rice & J. Cooper, Banking Law § 2.04 [6] (1984) [hereinafter cited as Banking Law]. Essentially all banks must maintain monetary reserves with the System’s Federal Reserve Banks. The FRB controls the money supply in part by adjusting the reserve requirements.

[26] 12 U.S.C. § 282 (1982).

[27] *Id.* §§ 321–324 (1982).

[28] *See* Banking Law, *supra* note 25, at § 2.94 [6].

[29] *Id.*

[30] K. Randall, *The Federal Deposit Insurance Corporation: Regulation Functions and Philosophy*, 31 Law & Contemp. Probs. 696, 698 (1966).

[31] All national banks and state member banks must be insured by the FDIC. 12 U.S.C. § 1814(b) (1982). State nonmember banks and state branches of foreign banks may apply for FDIC insurance. *Id.* § 1815(a), (b).

[32] 12 C.F.R. § 330.2 (1984). Insurance is on the aggregate of all the investor's deposits made in the same right and capacity. *Cf.* 12 C.F.R. §§ 330.0–330.12 (1984).

[33] *See Note, Federal Insurance of Deposits*, 36 Col. L. Rev. 809 (1936); Kress, *The Banking Act of 1935*, 34 Mich. L. Rev. 155 (1935).

[34] Before approving a bank for deposit insurance, the FDIC considers, among other factors, the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of management, and the convenience and needs of the community to be served by the bank. 12 U.S.C. § 1816 (1982). In considering the application of a foreign bank's branch, the FDIC will also consider whether the information supplied and to be supplied will be sufficiently adequate and reliable for the FDIC to carry out its duties. *Id.* § 1815(b) (7) (1982).

[35] 12 U.S.C. § 1818(a) (1982).

[36] Before national deposit insurance was introduced a number of states experimented with deposit insurance. These schemes always failed – usually because the states admitted all banks, however risky, to the insured group and because no steps were taken to improve banking practices so as to reduce the risk of bank failures. *See Note, supra* note 33.

[37] *See generally Comparative Regulations of Financial Institutions*, Subcomm. on Domestic Finance of House Comm. on Banking and Currency, 88th Cong., 1st Sess. (Subcomm. Print (1963)).

[38] *See, e.g.*, Cal. Fin. Code §§ 210–215 (West 1968&Supp. 1984); Ill. Ann. Stat. ch. 17, §§ 451–460 (Smith-Hurd 1981); N.Y. Banking Law §§ 10–14 (McKinney 1971 &Supp. 1984).

[39] Ch. 191, 44 Stat. 1224 (1927) (current version at 12 U.S.C. § 36 (1982)).

[40] Ch. 240, § 3(d), 70 Stat. 134, (current version at 12 U.S.C. § 1842(d) (1982)). The Bank Holding Company Act, codified at 12 U.S.C. §§ 1841–1850 (1982), regulates, among other things, the acquisition and control of any national or state bank. 12 U.S.C. §§ 1841(a), 1841(c), 1842(a) (1982). The Act applies both to acquisitions of existing banks and to *de novo* establishment of a bank. In approving an acquisition, the FRB must consider the financial and managerial resources and future prospects of the applicant and the bank, the convenience and needs of the community to be served, and the effect on competition in the banking business. *Id.* § 1842(c) (1982).

[41] Pub. L. No. 95–369, 92 Stat. 607 (codified in scattered sections of 12 U.S.C.). The Edge Act of 1919, ch. 18, 41 Stat. 378 (1919) (current version at 12 U.S.C. §§ 611–631 (1982)) entitled the Federal Reserve Board to charter “Edge Act Corporations” which engage only in international banking business. Edge Act corporations are beyond the scope of this article. *See generally* McGuire, *The Edge Act: Its Place in the Evolution of International Banking in the United States*, 3 Law. Am. 427 (1971).

[42] *First Bank of Logan, Utah v. Walker Bank & Trust Co.*, 385 U.S. 242, 261, *reh'g denied*, 385 U.S. 1032 (1961); *First Nat'l Bank v. Dickinson*, 396 U.S. 122 (1969).

[43] 12 U.S.C. § 36 (1982). National banks must also get prior approval from the Comptroller of the Currency. *Id.* § 36(e).

[44] *See id.*

[45] A bank holding company is any company that has control over a bank or a bank holding company. 12 U.S.C. § 1841(a)(1) (1982).

[46] 102 Cong. Rec. 6860 (1956) (statement of Sen. Douglas).

[47] 12 U.S.C. § 1842 (d) (1982). No state generally permits such an acquisition. *See* Ginsberg, *Interstate Banking*, 9 Hofstra L. Rev. 1133, 1167–69 &n. 169 (1981).

[48] *See* 12 U.S.C. § 1841(c) (1982).

[49] Foreign banks that were not bank holding companies were free to establish, pursuant to state law, branches in more than one state. International Banking Act of 1978, S. Rep. No. 1073, 95th Cong. 2d Sess. 7 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 1427. These branches were licensed and regulated by the individual states. *See generally* Note, *The Regulation of Foreign Banking in the United States After the International Banking Act of 1978*, 65 Va. L. Rev. 993,

999–1005 (1979). U.S. banks, in contrast, were prohibited by the McFadden Act from establishing branches outside of their home states. *See supra* notes 42–44 and accompanying text. To remedy this problem, the IBA requires selection of a “home” state for a foreign bank with offices in more than one state. Foreign banks are therefore prohibited from interstate branching unless it is permitted by state law. International Banking Act, § 5(c), 12 U.S.C. § 3103(c) (1982). Any bank not selecting a home state will have a state selected for it by the Federal Reserve. *Id.*

[50] Prior to enactment of the IBA, only FDIC insured subsidiaries of foreign banks were subject to federal oversight. Noninsured subsidiaries and branches were monitored solely by state authorities.

[51] International Banking Act of 1978, H.R. Rep. No. 910, 95th Cong., 2d Sess. 5 (1978).

[52] Section 4 grants the Comptroller primary examination, regulatory, and supervisory authority over federal branches and agencies. S. Rep. No. 1073, 95th Cong. 2d Sess. 7 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 1427.

[53] International Banking Act, § 4(a), 12 U.S.C. § 3102(a) (1982).

[54] *Id.* § 4(f), 12 U.S.C. § 3102(f) (1982).

[55] *Id.* § 4(b), 12 U.S.C. § 3102(b) (1982). A federal branch need not, however, join the Federal Reserve System. 12 U.S.C. § 3102(b)(3) (1982).

[56] International Banking Act § 4(b)(2), 12 U.S.C. § 3102(b) (1982).

[57] *Id.* § 4(g), 12 U.S.C. § 3102(g) (1982). The minimum deposit required is the greater of (1) the capital required of a national bank at the same location or (2) five percent of the branch’s liabilities. 12 U.S.C. § 3102(g)(2) (1982). The Comptroller may require the capital equivalency deposit to be increased to conform with the accepted banking practices in the branch’s area. 12 C.F.R. § 28.6 (1984). Although empowered to impose asset maintenance requirements, 12 U.S.C. § 3102(g)(4) (1982), the Comptroller has not done so. Apparently, the Comptroller is relying on careful initial licensing and the capital equivalency requirement to preserve sound financial conditions and protect depositors and creditors.

[58] International Banking Act § 6(b), 12 U.S.C. § 3104(b) (1982). The IBA limits the insurance to those deposits payable in the United States to (a) an individual citizen or resident of the United States, (b) a business entity organized under federal or state laws and having its principal place of business in the United States, or (c) an individual or business that the FDIC determines to have sufficient relationships in the United States. *Id.* § 6(c), 12 U.S.C. § 1813(m)(2)(A) (1982).

[59] *Id.* § 6(a), 12 U.S.C. § 3109(a) (1982).

[60] The FDIC requires a foreign bank with an insured branch to pledge five percent of the average of the branch’s liabilities for the last 30 days of the most recent calendar quarter. 49 Fed. Reg. 49,614, 49,620 (1984) (to be codified at 12 C.F.R. § 346.19(b)). The pledged assets must be deposited in an FDIC-approved depository institution. *Id.* In addition, the insured branch must maintain a capital equivalency ledger account, a liability account computed on a daily basis and equivalent to at least five percent of the branch’s liabilities. *Id.* at 49,622 (to be codified at 12 C.F.R. § 346.20).

[61] Exposure of an insured branch to borrowers in the foreign parent bank’s home country is limited to 200% of the capital equivalency account, *id.* at 49,623 (to be codified at 12 C.F.R. § 346.23); exposure to any other single country is limited to 100% of the capital equivalency account, *id.*

[62] *See* S. Rep. No. 1073, 95th Cong. 2d Sess. 12 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 1432.

[63] International Banking Act § 7(a), 12 U.S.C. § 3105(a) (1982). Requirements for state branches and agencies are set after consultation with state banking authorities. These requirements have increased the reserve costs for foreign banks, which requires the banks to monitor and manage their reserve positions more closely. *See White, supra* note 10, at 54.

[64] International Banking Act § 13, 12 U.S.C. § 3108 (1982).

[65] S. Rep. No. 1073, 95th Cong. 2d Sess. 13 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 1433. All banking offices are subject to examination by the Federal Reserve, which provides

a federal supervisory umbrella over U.S. operations of foreign banks. A Federal Reserve examination will make as much use as possible of relevant reports by the Comptroller, the FDIC, and the state authorities. *Id.*

[66] An alternative interpretation of the states' response sees the relaxation of state requirements as part of a "competition in laxity" as state and federal banking authorities seek to make their bank charters more attractive to foreign banks. *See, e.g.,* Address by FRB Chairman Burns, American Bankers Convention, at 18-19 (Oct. 21, 1974), *quoted in* Scott, *supra* note 19, at 2.

[67] Liquid assets include currency and bonds, notes, debentures, bills of exchange, or other obligations payable or guaranteed by a federal or state government. *See, e.g.,* N.Y. Banking Law § 202-b(2) (McKinney 1971 & Supp. 1984).

[68] These liabilities include, among others, current accounts, time deposits, letters of credit, certified or bank checks, federal funds purchased, acceptances, borrowings, and accounts payable. *See, e.g.,* N.Y. Banking Dep't, Superintendent's Regulations, Part 323, § 323.1(c) (1977).

[69] N.Y. Banking Law § 202-b (McKinney 1971) (amended 1980); Cal. Fin. Code § 1756.1(b) (West 1968) (repealed 1981); Ill. Ann. Stat., ch. 17, § 2720 (Smith-Hurd Supp. 1978) (amended 1982).

[70] N.Y. Banking Law § 202-b(2) (McKinney Supp. 1983) (requires asset maintenance as superintendent shall permit); Cal. Fin. Code § 1762(c) (West Supp. 1984) (foreign bank shall hold assets as superintendent determines to be necessary for sound financial condition, protection of creditors, and protection of public interest; in no such event shall amount exceed 108% of adjusted liabilities); Ill. Ann. Stat. ch. 17, § 2720 (Smith-Hurd 1981) (foreign bank shall hold assets as Commissioner will permit in an amount which will bear such relationship to liabilities as the Commissioner shall prescribe).

[71] 3 N.Y. C.R.R. § 52 (1983).

[72] *See* Kübler and Mundheim, *Current Problems in International Banking: A Report on the Königstein Banking Symposium*, 5 J. Comp. Bus. & Cap. Mkt. L. 233, 241 (1983).

[73] The Federal Reserve Board closely scrutinizes applications by foreign banks to acquire a U.S. subsidiary. In addition to the usual factors, *see supra* note 40, the Board evaluates whether the foreign bank is operating properly in its home regulatory environment. The foreign banking authorities are contacted. If the acquirer is a group of individuals, they must submit financial statements and other information sufficient to assess their ability to manage and support the U.S. bank. Thus, obvious problems are avoided at the start. *See Foreign Government and Foreign Investor Control of U.S. Banks: Hearing Before Subcomm. on Commerce, Consumer and Monetary Affairs of the House Comm. on Government Operations*, 97th Cong. 2d Sess. 52 (1982) (statement of Henry Wallich, Member, Board of Governors of the Federal Reserve System), *reprinted in* 68 Fed. Res. Bull. 617 (1982). After the foreign bank acquires its subsidiary, the Board requires annual reports from the foreign bank to ensure compliance with U.S. law and to monitor the parent's financial condition. A reporting system monitors parent-subsidary transactions on a quarterly basis, and the parent must report any nonbanking activities commenced in the U.S. *Id.* These preventative measures appear to be effective: in 1982 the Board reported to Congress that U.S. subsidiaries of foreign banks had improved earnings and stronger equity ratios after acquisition and that the business orientation of the subsidiaries had not changed materially. *Id.*

[74] The Federal Reserve Board's careful examination of foreign banks' applications, *supra* note 73, includes an inquiry into the acquirer's willingness to infuse new capital into the subsidiary. *See id.* (discussing capital infusions into Crocker National, Long Island Trust Co., and Financial General Bankshares). If the parent were, for any reason, suddenly unable to support the subsidiary, both banks could fail simultaneously.

[75] The discussion in this section applies whether or not the subsidiary is insured by the FDIC. While deposit insurance will protect each individual depositor up to \$100,000, trade and other creditors will still have claims. In addition, because the FDIC is subrogated to the rights of the insured depositors, the FDIC has an interest in recovering from the parent bank.

[76] See Kübler & Mundheim, *supra* note 72, at 241. Another approach, adopted by the Bank of England, is to require comfort letters from the foreign parent. These letters imply, at a minimum, a moral obligation to support the subsidiary. *Id.* Of course, the parent's guarantee of the subsidiary's obligations may be worthless if the parent has troubles of its own.

[77] To reach this finding, three elements must be demonstrated: (1) control by the parent, (2) wrongdoing by the parent through the subsidiary, and (3) unjust loss to the claimant. A prima facie case would be made by showing that (1) the subsidiary was wholly owned and its directors did not act independently, (2) the subsidiary was undercapitalized or the claimant was led to believe that he was dealing with the parent, and (3) the claimant was injured by the subsidiary's insolvency. See, e.g., *Bernardin Inc. v. Midland Oil Corp.*, 520 F. 2d 771, 775 (5th Cir. 1975); see generally *H. Henn & J. Alexander, Laws of Corporations* 344–52 (1983).

[78] See e.g., *H. Henn & J. Alexander, supra* note 77, at 347–48 & n.18 (citing cases).

[79] The Federal Reserve Board requires disclosure of parent–subsidiary dealings. See *supra* note 73.

[80] To refer to the foreign bank's home office as the “parent” is, of course, incorrect because the home office and the branch are one bank. The host's regulatory structure, however, often treats the branch as a separate bank, see *supra* notes 56–57 and accompanying text, in order to protect its banking system. This is the crux of the problem.

[81] The branch's failure is both legal, see *infra* note 84 and accompanying text, and, usually, economic, cf. *supra* note 74.

[82] 12 U.S.C. § 3104(a) (1982).

[83] Every federal branch maintains a capital equivalency deposit with a member bank. See *supra* note 57. This requirement is designed to further the goal of equal treatment for federal branches; it does little to protect uninsured deposits in the event of liquidation of the branch.

[84] The Comptroller may revoke a federal branch's authority to operate if the Comptroller believes that the foreign bank has not complied with 12 U.S.C. § 3102 or the regulations promulgated thereunder, or if a conservator or liquidator is appointed for the foreign bank in its home country. 12 U.S.C. § 3102(i) (1982).

[85] 12 U.S.C. § 3102(j)(1) (1982). Although a receiver is functionally equivalent to a trustee in bankruptcy, a foreign bank engaged in the banking business in the United States is exempted from liquidation under the U.S. bankruptcy laws, see 11 U.S.C. § 109(b)(3) (1982), because the bank regulatory scheme provides for liquidation of banking institutions. S. Rep. No. 989, 95th Cong., 2d Sess. 31 (1978), reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 5817. Foreign banks not engaged in banking in the United States, but with assets in the United States, are subject to U.S. bankruptcy laws. *Id.*; cf. *Israel–British Bank (London) Ltd. v. FDIC*, 536 F. 2d 509 (2d Cir. 1976) (interpreting similar language in the old Bankruptcy Act) (British bank with assets in the United States but not conducting banking activities there could avail itself of the bankruptcy law). Operation of a bank branch anywhere in the United States is probably sufficient to satisfy the “engaged in banking” test. Cf. *id.* at 513–14.

An argument may be made, however, that a bankruptcy court should be entitled to assert jurisdiction in situations where the receiver of the foreign branch is not able to attach certain of the foreign bank's assets. Such a situation would arise, for example, if the insolvent foreign bank had a branch in New York and assets in other states that do not appear on the bank's books as constituting part of the business of the New York branch. Under these circumstances, the receiver of the New York branch would have no statutory authority to take title to these out-of-state assets. See *infra* note 120 and accompanying text. Hence, unless a federal bankruptcy court asserted jurisdiction, these assets would be available to the bank's receiver in the home country. In the interests of protecting domestic creditors, and in view of the fact that there is no conflict with any bank regulatory authority in the United States, the participation of a bankruptcy court in this matter appears not to violate the Bankruptcy Code's policy of permitting banking authorities to manage the liquidation of banks.

[86] See 3 Michie, Banks and Banking § 96 (3d ed. 1974) (citing cases).

[87] See, e.g., Lantry v. Wallace, 182 U.S. 536 (1901).

[88] 12 U.S.C. §§ 192, 194 (1982). For a thorough discussion of the receiver's powers and duties, see 3 Michie, *supra* note 86, §§ 96–101.

[89] 12 U.S.C. § 192 (1982).

[90] *Id.*

[91] *Id.* § 194.

[92] *Id.*

[93] 12 U.S.C. § 3102(j)(2) (1982). Excepted from this preferential treatment are (a) claims that would not represent an enforceable legal obligation against such branch or agency if such branch or agency were a separate legal entity, and (b) amounts due and other liabilities to other offices or branches or agencies of, and wholly owned subsidiaries of, such foreign bank. *Id.*

[94] Although the Federal Reserve will provide member branches of foreign banks access to the discount window to avert a liquidity crisis, the FRB maintains that the foreign bank's solvency is the responsibility of the home country. Conversation with Frederick Dahl, Federal Reserve, Division of Banking Supervision and Regulation (Feb. 3, 1984).

[95] 12 U.S.C. § 3104(a) (1982).

[96] See *supra* notes 84–85 and accompanying text.

[97] See 12 U.S.C. § 3102(j)(1) (1982); see also *supra* note 85.

[98] 12 U.S.C. §§ 1821(e), 3102(j)(2) (1982).

[99] See 12 U.S.C. § 1821(f) (1982). The FDIC cannot pay depositors the insured value of their deposits until the bank is closed and unable to pay. See *id.*

[100] 12 U.S.C. § 1821(f) (1982).

[101] A new bank is a new national bank organized by the FDIC to assume the insured deposits of a closed bank or branch. *Id.* § 1821(h). The FDIC may sell the stock of the new bank to investors. If capital sufficient to organize a national bank is raised, the new bank becomes an ordinary national bank. *Id.* § 1821 (k). If insufficient capital is raised, and if no insured bank will assume the new bank's assets and liabilities, the FDIC will liquidate the new bank within two years. *Id.* § 1821(i).

[102] *Id.* § 1821(f).

[103] *Id.* § 1821(g).

[104] 3 W. Schlichting & J. Cooper, Banking Law § 49.02 (1984).

[105] See 12 U.S.C. § 1823(c)(2) (1982).

[106] 3 W. Schlichting & J. Cooper, *supra* note 104, § 49.09.

[107] Telephone interview with Hugh Conway, FDIC (Feb. 6, 1984).

[108] *Id.*

[109] *Id.* Thus, the risk of these contingent liabilities is borne by uninsured creditors of the foreign branch. After the insured depositors have been paid off, the FDIC will join this group of general creditors. Included in this group will be the uninsured depositors and individuals who claim that they deposited in non-U.S. branches funds that were designated for a U.S. branch of the bank.

[110] 12 U.S.C. § 3104(b) (1982).

[111] Telephone interview with Hugh Conway, FDIC (Feb. 6, 1984). The FDIC must accept receivership of an insured state branch, if receivership is tendered. 12 U.S.C. § 1821(e) (1982). State banking authorities may appoint a receiver for a variety of reasons. See *infra* note 121 and accompanying text.

[112] 12 U.S.C. § 1821(e) (1982). The branch's status as an insured institution does have two effects. First, the branch must comply with FDIC's asset pledge, capital equivalency ledger account, and country exposure regulations. See *supra* notes 60–61. But these regulations are intended to promote equal treatment of foreign and domestic banking institutions rather than to provide an asset pool for depositors and creditors. Second, the insured depositors will be paid to

the full extent of the insurance protection. See *supra* notes 100–06 and accompanying text. But this payoff merely replaces the depositors' claims with the FDIC's claims. The FDIC will compete with uninsured depositors and other creditors for the branch's assets.

[113] 12 U.S.C. § 1821(e) (1982).

[114] As of May, 1982, only nine states permitted foreign banks to branch. See *State Laws on Foreign Banks Categorized*, Bank Expansion Rep., July 2, 1984, at 5–7 (listing Alaska, California, Illinois, Massachusetts, New York, Oregon, Pennsylvania, South Carolina, and Washington).

[115] N.Y. Banking Law §§ 200 to 202–6 (McKinney 1971 & Supp. 1984).

[116] Ill. Ann. Stat. ch. 17, ¶ 2710 (Smith-Hurd 1981).

[117] Cal. Fin. Code § 1753(a) (West Supp. 1984).

[118] Pennsylvania in 1977, 1977 Pa. Laws 101 (codified at 7 Pa. C.S.A. § 105 (b.1)), and South Carolina in 1978, 1978 S.C. Acts 644 Part II § 25 (codified at S.C. Code Ann. § 34–3–100 (Law. Co-op. Supp. 1983)).

[119] See Structure Data, *supra* note 12.

[120] New York empowers the superintendent to collect all property of the branch (1) wherever situated, if constituting part of the branch's business and so appearing on the branch's books and (2) situated in New York, whether or not constituting part of the branch's business or so appearing on the books. N.Y. Banking Law § 606(4)(c) (McKinney 1971).

[121] See N.Y. Banking Law § 606(1)(a)–(j) (McKinney 1971 & Supp. 1984); Cal. Fin. Code § 1781(a)–(j) (West Supp. 1984); Ill. Ann. Stat. ch. 17, ¶¶ 362–363 (Smith-Hurd 1981).

[122] See N.Y. Banking Law § 606(4)(a) (McKinney 1971); Cal. Fin. Code § 1785(a) (West Supp. 1984); Ill. Ann. Stat. ch. 17, ¶¶ 365–373 (Smith-Hurd 1981).

[123] See N.Y. Banking Law § 618 (McKinney 1971); Cal. Fin. Code § 3104 (West 1968); Ill. Ann. Stat. ch. 17, ¶¶ 365, 372 (Smith-Hurd 1981).

[124] See N.Y. Banking Law § 606(4)(a) (McKinney 1971). No priority is given to claims that would not represent an enforceable legal obligation if the branch were a separate legal entity nor to claims arising from liabilities to other branches and wholly owned subsidiaries of the parent bank. *Id.*

[125] Cal. Fin. Code § 1760(b) (West Supp. 1984).

[126] See N.Y. Banking Law § 606(4)(b) (McKinney 1971); Cal. Fin. Code § 1785(d) (West Supp. 1984); Ill. Ann. Stat. ch. 17, ¶ 377 (Smith-Hurd 1981).

[127] Cal. Fin. Code § 1785(a) (West Supp. 1984).

[128] N.Y. Banking Law § 606(4)(c) (McKinney 1971).

[129] See *supra* notes 124–25.

[130] *Hearings, supra* note 3, at 31–32. Similar problems arose when Banco Ambrosiano (Ambrosiano) collapsed. Ambrosiano was a Milanese bank with a 69.7% interest in a Luxembourg subsidiary called Banco Ambrosiano Holding. The subsidiary owed more than \$400 million to some 200 banks when the parent failed. Six major Italian banks, three of them government owned, supported the parent bank but denied liability for the subsidiary's obligations. See generally Schmitthoff, *Banco Ambrosiano and Company Law*, 1982 J. Bus. L. 316 (citing sources).

[131] *Hearings, supra* note 3, at 31–32.

[132] Note, *supra* note 49, at 1027. The Glass-Steagall Act of 1933, ch. 89, 48 Stat. 162 (codified in scattered sections of 12 U.S.C.) prohibits U.S. commercial banks from engaging in investment banking activities.

[133] See Note, *supra* note 49, at 1027.

[134] See Cooke, *Techniques for Cooperation Among Supervisory Authorities*, 3 J. Comp. Corp. L. & Sec. Reg. 45, 62–63 (1981).

[135] The Group of Ten consists of Belgium, Luxembourg, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States.

[136] Principles for the Supervision of Banks' Foreign Establishments (1975).

[137] Bank for International Settlements, Press Review No. 113, Principles for the Supervision of Banks' Foreign Establishments (1983) [hereinafter cited as Basle Concordat].

[138] Dale, *Basle Concordat: Lessons from Ambrosiano*, *The Banker*, Sept. 1983, at 55.

[139] *Basle Concordat*, at 3.

[140] *Id.*

[141] Dale, *supra* note 138, at 57.

[142] *Id.* at 58.

[143] *Id.*

[144] *Id.*

[145] White, *supra* note 10, at 56.

[146] See, e.g., *International Bank Lending: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 98th Cong., 1st Sess. 337 (1983), reprinted in 69 Fed. Res. Bull. 341, 344 (1983) (statement of J. Charles Partee, Member, Board of Governors of Federal Reserve System).

[147] *Support for Banks: Whose Responsibility*, *The Banker*, Aug. 1982, at 7 (statement of Christopher MacMahon, Deputy Governor of the Bank of England).

[148] See *supra* text accompanying note 129.

[149] The parent often will not be solvent, e.g., Intercambio and Ambrosiano were both insolvent. Indeed, the parent's insolvency will probably be the reason that the branch or subsidiary was placed in receivership. Cf. *supra* notes 80–81, 84–85, 120–21 and accompanying text.

[150] As in the Intercambio incident, the central bank may be unwilling to rescue the parent bank's foreign operations. The central bank's reluctance probably will persist in the absence of a treaty compelling rescue, even if the foreign operations were well managed, cf. *supra* note 134, because a rescue operation is expensive.

[151] Assuming such a scheme exists.

[152] After the Ambrosiano incident the Luxembourg bank supervisor sought and obtained from six foreign parent banks guarantees of their subsidiary's obligations. See Schmitthoff, *supra* note 130, at 362.

[153] Dale, *Safeguarding the International Banking System*, *The Banker*, August 1983, at 55.

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