Research Department
Federal Reserve
Bank of
San Francisco

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Foreign Bank Act

The Federal Reserve this month submitted to Congress the Foreign Bank Act of 1974—legislation that would extend Federal regulation to all foreign banks operating inside the United States. Foreign banks at present are primarily subject to state (not Federal) regulation, with the state controlling entry and specifying the rights of such organizations. In some states, entry is prohibited; but in others, foreign banks have been able to develop significant operations which extend across state lines.

There are now 60 foreign banks with domestic assets of $38 billion operating in the United States. It is believed that this sector is now large enough that foreign banks' rights should be brought into line with those of domestic banks. The object of the proposed legislation is to establish Federal control on the basis of nondiscriminatory national treatment, with foreign and domestic banks having substantially the same rights and privileges.

Extending control

At present, the only foreign banks under Federal regulation are those controlling state-chartered subsidiary banks. These banks must register as bank holding companies with the Federal Reserve System. The Bank Holding Company Act prevents bank holding companies (domestic or foreign) from acquiring newly-chartered banks in more than one state, but the Act does not cover state licensed branches or agencies. Therefore, foreign banks can form branches or agencies in more than one state. Since these offices may make loans and (in the case of branches) accept domestic deposits, they can be used to develop a multi-state banking network of the type denied to domestic banking organizations.

The proposed legislation would redefine "bank" to bring foreign branches and agencies under the Holding Company Act. This means that foreign banks would not be able to expand their banking business across state lines. However, the Act would permit interstate bank acquisitions if an individual state's law specifically allows such entry—a significant provision for domestic as well as foreign banks, since California and New York have been considering legislation to permit a limited number of acquisitions by out-of-state bank holding companies.

At the same time, foreign banks would obtain certain advantages by being brought under the Holding Company Act. They would then be able to enter approved nonbanking fields—leasing, mortgage banking, and so on—to which interstate barriers do not apply. Domestic bank holding companies have been able to build up their nonbanking business in recent years, and foreign banks would be able to do the same under the proposed legislation.

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Federal licensing

The Foreign Bank Act would require all foreign banking organizations in the future to obtain licenses from the Comptroller of the Currency, no matter whether they plan to operate under state or Federal law. Before granting a license, the Comptroller would consult with the Federal Reserve Board of Governors—and also with the Secretary of State, in order to ensure the coordination of domestic banking policy with foreign policy.

Other changes would facilitate the operation of foreign-controlled, Federally chartered, bank subsidiaries and branches. Currently almost all foreign bank subsidiaries have state charters because of certain restrictive provisions of the National Bank Act. The new law, by permitting foreign citizens to serve as directors of national banks, would make national charters a feasible alternative to state charters. A separate provision would allow foreign banks for the first time to open Federal branches. This provision is important because the lending limits of a branch would be based on the size of the foreign parent bank, whereas the lending limits of a subsidiary bank are determined by the (much smaller) corporate capital and surplus of the subsidiary.

Approval of applications for National-bank charters or Federal branch licenses would rest with the Comptroller of the Currency, the supervising agency for National banks. Meanwhile, applications for mergers and acquisitions within each state would continue to be determined by state law, as is the case with domestic banks. In a branch-banking state such as California, a foreign-controlled bank thus could branch freely, but in a unit-banking state such as Illinois, it would be limited to the single location permitted local banks.

The proposed Foreign Bank Act allows foreign banks to keep all their existing branches, agencies and subsidiaries;that is, they will have "grandfather rights." Future acquisitions would be limited to each bank's principal state of operations, although mergers and branching of grandfathered offices in other states would be permitted in accordance with state banking law. Grandfathering of existing operations is generally consistent with past legislative practice and conforms to

existing treaties of foreign commerce. Liberal grandfather rights do not change the main goal of the proposed legislation, which is to ensure that the same rules govern both foreign-bank and domestic-bank expansion within this country.

Other proposals

Under the Federal Reserve proposal, foreign banks would be able to form Edge Act corporations for international-trade purposes in more than one state. This privilege is already available to domestic U.S. banks, and it would benefit the foreign banks in view of their expertise in financing international trade.

Foreign branches and agencies also would be able to obtain FDIC insurance coverage on their deposits, thus permitting them to compete on an equal basis for domestic business. But at the same time, Federal Reserve membership would be required for all foreign banks whose worldwide assets are greater than $500 million. The foreign banks already operating here are generally banks of the size where an equivalent domestic bank would be a member. This requirement would put the foreign banks on an equal footing with domestic banks, and more importantly, would ensure that their future growth takes place under the effective monetary control of the Federal Reserve System.

In sum, the Foreign Bank Act of 1974 establishes a principle of equal or nondiscriminatory treatment for foreign and domestic banks, so that both groups would have similar powers and privileges. The bill would probably have little immediate impact on domestic retail-banking operations. Most foreign-banking activities are located in New York and California, and to a smaller extent in Chicago. Moreover, foreign banks would continue to emphasize international banking, essentially in the same locations where they are now operating.

In the future, foreign banks would operate within the same regulatory framework which governs the activities of domestic banks. The growth of foreign banks in the U.S. market would then depend upon their relative competitive skills, and not upon regulatory advantages. Internationally, the Foreign Bank Act would serve as a model for nondiscriminatory treatment of U.S. banks, thus encouraging the growth of international-banking competition.

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