REGULATION OF MULTINATIONAL BANKING INSTITUTIONS

On October 15-17, 1979, the International Faculty for Corporate and Capital Market Law (in cooperation with the Center for Study of Financial Institutions of the University of Pennsylvania Law School) sponsored a symposium in Geneva, Switzerland, on foreign banking in the United States. The last session of this symposium dealt with problems of secrecy in banking and their relationship to carrying out supervisory responsibilities over the activities of multinational banking organizations. The participants in this part of the symposium were:

Peter COOKE
Head of Banking Supervision, Bank of England
Chairman of the International Committee on Banking Regulation and Supervisory Practices

Alain HIRSCH
Professor of Law, Geneva University
Member of the Swiss Banking Commission
Member of the International Faculty

Fritz KÜBLER
Professor of Law, Frankfurt University
Member of the International Faculty

C.C. MUCKENFUSS, III
Senior Deputy Comptroller for Policy Planning Office of the Comptroller of the Currency

Bernhard MÜLLER
Director, Secretariat of the Swiss Banking Commission

Hon. Robert H. MUNDHEIM
General Counsel, U.S. Treasury
Member of the International Faculty

Neal PETERSEN
General Counsel, Board of Governors of the Federal Reserve System

Hon. Irving POLLACK
Commissioner, Securities and Exchange Commission
Professor Kübler: This afternoon we are going to look at some of the legal problems arising in the regulation of foreign banks. We will be faced with particularly difficult questions in a field which seems to be dominated by conflicting interests. On the one hand, there are the interests of those who want to gather information and perhaps want also to pass it on to other persons or other agencies or business enterprises and, on the other hand, there are the competing interests of those who want this information to be withheld, in their own interests or in the interests of their customers and clients. I think the first question which should be addressed this afternoon is what secrecy in banking means in the United States. Bob Mundheim has prepared an analysis and I want to ask him to tell us about the state of American law on this subject.

Mr. Mundheim: As the article by Bernhard Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 New Eng. L. Rev. 18 (1978) amply demonstrates, there is a substantially different attitude between Switzerland and the United States with respect to the confidentiality of information which banks obtain about their customers' transactions. Swiss law treats the banker–client relationship as more than an ordinary business relationship. The relationship, as I understand it, is considered one of trust and confidence. The confidentiality of the relationship is protected under law, with sanctions for breaches of duty in maintaining the confidentiality of that information. I think my colleague, Professor Hirsch, will have some comments on that point a little later.

Although many U.S. banks treat customer information with great care and discretion, U.S. law, and by that I mean both federal and state law, does not uniformly require such treatment. In fact, banks have made customer information available upon informal inquiry to federal and state law enforcement officials and to others. In 1976 the Supreme Court of the United States decided a very important case relating to the confidentiality of bank records maintained with respect to a depositor's account. That case is *United States v. Miller*, 425 U.S. 435 (1976), and it arose from an action involving the Treasury Department. In *Miller*, the United States Government had secured bank records by means of a defective subpoena; in other words, from a legal point of view, it was as though the Treasury Department had informally asked the bank, "Please let us look at certain records pertaining to your customers". Those bank records were of importance in securing a conviction of the defendant for illegally producing whiskey; catching illegal producers of whiskey is a Treasury function. The defendant had argued that the material from which the bank statements and records were made had been furnished by the customer to the bank solely for internal banking purposes and that he had a reasonable expectation that those records would be kept confidential, unless required by law to be disclosed. In other words, he argued that those records should be treated as if they were still in his personal possession. The Court rejected that argument. It said that the defendant had voluntarily turned over the information to the bank, that those records were now the property of the bank, and that the defendant had no protectable right in those records.

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The court relied in its opinion on the Bank Secrecy Act of 1970, 12 U.S.C. § 1829b. Our Bank Secrecy Act really has nothing to do with secrecy, but is actually a record-keeping requirement. The primary purpose of the law was to check the unreported flow of currency to foreign bank accounts; but it also imposed sweeping requirements on banks, credit card issuers and other financial institutions that received information, in the words of the statute, useful in “criminal, tax, and regulatory investigations” by the Federal Government. Banks were required to report major currency transactions and extensions of credit; make copies of the checks they handled and keep the copies for a specified period; set up systems for tracing all large deposit transactions and keep those for two years; and collect signature cards, social security numbers and names and addresses for each account holder. In other words, the bank had to have these materials available for the government to come and get in appropriate circumstances.

The opinion in the Miller case, whose description may have upset some of you, also upset many people in the United States. They saw nothing voluntary in a customer’s supplying information to a bank in connection with a deposit transaction. Their argument was that in the modern world people must use banks and must supply them with information, and that they are entitled to a reasonable expectation of privacy in documents furnished for that limited purpose. In 1974, prior to the decision in the Miller case, Congress had passed the Privacy Act, which established the Privacy Protection Study Commission to investigate the increasing collection, retention and use of personal information and to consider the privacy issues raised by those activities. The Miller case came, then, in the middle of the deliberations of this Commission.

The Commission decided that the Miller case should in effect be overturned and that a reasonable expectation of privacy with respect to bank records about a customer should be legislated. The recommendation of the Privacy Commission was partially enacted into federal law in 1978 as part of the Financial Institutions Reform Act. You will find it in Title XI of that Act. It is now codified in §§3401—3422 of title 12 of the U.S. Code. This portion of the Act is called the Right to Financial Privacy Act. That Act protects bank records against access by the federal government unless the government follows specified procedures for gaining access to the information. In other words, with the passage of the Right to Financial Privacy Act, a bank can no longer voluntarily give the federal government access to customer information. A failure to follow the statutory procedures will render the federal agency, and possibly the bank violating the Act, civilly liable to the customer for actual and punitive damages. The Act requires, normally, that the customer be given notice of the government’s demand for the information and be given an opportunity to object in court on the basis, for example, that the demand for the information is beyond the government’s authority or not relevant to the inquiry in which the government is engaged.

You will notice that my description contemplates that conceptually the federal government’s interest in the information does not give way to the customer’s inter-
est in maintaining the confidentiality of the record. Thus, the U.S. protection of customer records remains far more restricted than the Swiss protection. For example, the Internal Revenue Service may, by the use of appropriate process, demand and get customer information from a bank for use in connection with an income tax investigation in a civil tax case. In addition, there is no bar under the Act to state or local governments getting customer information. Moreover, there is no bar to non-governmental access. For example, if a credit company wants information on a bank customer, the Act does not prohibit the bank from giving it. That remains within the discretion of the bank. It also has an important implication for a foreign parent company with a subsidiary in the United States. Again, there is no bar under federal law to the subsidiary’s passing information about its activities, including customer transactions, to the parent company, although, depending upon the state, there may be some legal problems in the state in which the subsidiary is located. If a foreign government wishes access to information from the U.S. bank, which includes the subsidiary of the foreign bank, the Act imposes no bar to the bank’s yielding it. This, again, is subject to state law doctrines, which vary from state to state, concerning the need to keep such information confidential. Furthermore, the Act protects the records only of individuals and of partnerships of five persons or less. It does not protect the records of corporations or similar organizations, associations, or trusts. In other words, the Act is intended to protect the rights of individuals, not the rights of business entities.

When the Administration supported the Financial Privacy Act, it indicated that it was only a first step in expanding privacy protection. I think that that is the critical thing to understand. We are in the beginning of a major shift in U.S. attitudes toward the need to protect privacy. In April of this year, the President sent three privacy bills to Congress covering medical records, research records and government access to a reporter’s sources of information. The first two bills followed the scheme of the Financial Privacy Act in restricting government access to individual information contained in medical records and research records. Just this month the Administration submitted two new bills to Congress: the Fair Financial Information Practices Act and the Privacy of Electronic Transfers Act. The first bill extends a series of requirements to consumer reporting agencies, credit grantors, credit and check authorization services, depository institutions, and insurance companies. First, it provides individuals about whom information is collected an opportunity to see it, correct it, know how it will be used and know to whom it will be disclosed. The bills limit access by private persons; “private persons” appears to include foreign parents and foreign governments. The second bill safeguards electronic transfers in much the same way as telephone calls and letters are protected in the United States. In other words, there is to be no government eavesdropping without a court order and no private wiretaps. Criminal penalties are provided for violators.

Still to come on the Administration’s agenda are bills which would extend the Financial Privacy Act’s limitations on government access to information in insur-
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ance and certain credit records. At that time there will also be an initial evaluation of how seriously the right to financial privacy requirements impact on law enforce-
ment activity. We will have had a year of living with the Financial Privacy Act and, to the extent that any unusual burdens can be demonstrated, we may have some changes in that law.

So what you have is a bundle of bills in Congress aimed at extending privacy protection, strongly supported by the Administration, but not yet passed. I expect that those bills, in some version, will be passed in the near future [1]. Inevitably the drive for legislation will also make banks and other entities much more cautious about yielding up customer information voluntarily. There will be a much greater sensitivity in the United States, both on the government side and on the private side, to the privacy issue. That sensitivity will, I suspect, cause courts more readily to erect, on behalf of customers, a reasonable expectation of confidentiality and some kind of remedy if those reasonable expectations are disappointed.

Professor Kübler: I think it will be interesting to compare the obviously changing situation and changing attitudes in the United States with the way secrecy in banking is looked at and dealt with in Switzerland. Although Dr. Meyer's article on Swiss law is comprehensive, I think it worthwhile for Professor Hirsch, a member of the Swiss Banking Commission, to review a few essential points with us.

Professor Hirsch: Let me first make clear that the Swiss laws are being discussed here only as examples of European conceptions. Contrary to what is often still thought today, there is not much difference between Swiss conceptions of secrecy laws and French or German or Belgian conceptions. Secondly, we will shortly come to a discussion of details when we examine the more specific problems that secrecy laws raise for European banks doing business in the United States, which is our main topic.

In Switzerland, as in other European countries, we think that the right of privacy of the individual, and also of the business entity, is of high political, social and economic importance, and that the confidentiality of the relation between individuals and business entities is very important for the community. This does not mean that privacy and confidentiality deserve a priority over all other goals; it does mean that they have very great importance. This reminds me, if I may take a minute, of a conversation of some nine or ten years ago between two good colleagues of mine in the law faculty of Geneva. They were in my home and one of them, a little younger than the other, said, "Well, let's imagine that everybody knew exactly the income of everybody else, then it would be absolutely normal." And the other said, "It would be absolutely horrible!" And then, of course, they both laughed; but this just means that on some points there may be a different emphasis. But I think that most European people still think that confidentiality cannot be challenged just because there is a very small risk of abuse. We think there is a balance to be made between the advantages of confidentiality and the real effective risk of abuse. The
problem is that, today, this balance is made differently in our countries than it is made in the U.S. After having heard what Bob has just said, I only hope that we can find a way to come closer to each other. Just to finish with this first remark, we Europeans do not only have a negative feeling about foreign laws on disclosure, but rather, we have a positive feeling about the virtue of confidentiality.

This balance favoring the desirability of confidentiality will be overridden by public law duties. Indeed, in the courts Swiss banking secrecy is very often less extensive than the secrecy applicable to lawyers, doctors and other professionals. The banking law expressly states that federal and cantonal regulation concerning the obligation to testify and furnish information to a government authority is reserved. On this basis quite a number of federal and especially cantonal regulations mandate an obligation to testify. Again, this obligation is often greater for a bank official than for any other privileged professional. The great difference between Switzerland and many other countries is that in administrative law and procedure, particularly in fiscal matters, we have made the balance very much in favor of confidentiality. We have thought it worth the inconvenience to prevent the state from piercing the veil of confidentiality. We have taken the importance of our own state and administrative law less seriously than the other states have in making that balance.

My last remark relates to the national point of view. Now, of course, it is clear, and I think everyone will understand this readily, that it is unthinkable that any Swiss entity should be compelled, at least in Switzerland, to give more information to a foreign authority or court than it would be obligated to give to a Swiss court. I speak, of course, of acts being done in Switzerland. Within that limit Switzerland has concluded a great number of treaties with other countries, especially in civil and criminal matters, which provide a good deal of authority for lifting secrecy and requiring people, including banks, to testify or to disclose facts about third parties. The great exception here is that in all these treaties, and also in the Treaty of the Council of Europe, it is provided that no information will be given in fiscal, monetary and economic matters. The thinking behind these exceptions is that they are not really criminal cases in the common sense of the word, but are rather nearer to administrative cases. Indeed, in Switzerland that problem has very recently been the object of debate in the course of the adoption of a new law about international cooperation on criminal law. This law will soon be finally adopted and it is probable that cooperation will be given for criminal matters but not for other economic matters. I think it is fair to say that the problem presented in this treaty will be of greater importance to the international relations of Switzerland with other countries such as the United States, than to the definition of banking secrecy or even the definition of other privacy laws.

Mr. Müller: Mr. Mundheim told us that there is a basic difference between the American conception of banking secrecy and the Swiss one, and that is what I thought as well before my recent visit to the U.S. But to illustrate why I am not so
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sure about the extent of the difference, let me tell you the following story. Last year we had the opportunity to visit the United States and we went to see the President of the Federal Reserve Bank of New York. He at first asked us when we were going to abolish numbered accounts and banking secrecy, and we told him that we were not in a hurry to do so. After lunch we were shown the gold stocks in the cellar of the Fed and we were very impressed. We were told that they were not all owned by the Fed, but by foreign central banks and each compartment belonged to one of these banks. The compartments were numbered. So I asked who was the owner of compartment number 413 and one of the supervisors told me, “I'm not allowed to reveal the identity of the owner and even if I were, I couldn't say, because only the people on the first floor know it.” So we started laughing, as you can imagine, and they were slightly puzzled. We explained to them that they operated similarly to the system of Swiss numbered accounts and secrecy. So, finally, I think the difference is more in words than in facts. Let me remind you that the Swiss banking secrecy merely prohibits a bank from revealing customers’ secrets to unauthorized persons. Regulations concerning the obligation to testify and to furnish information to a government authority remain reserved. The duty of full disclosure to the Banking Commission and the duty to provide evidence in criminal matters are examples. The same principle applies to civil law procedures, except for some cantons which entitle all persons who hold professional secrets, including bankers, to refuse testimony. As a recent study has shown, the Swiss legal order thus does not differ essentially from the secrecy protection concepts of most other western countries.

Professor Kübler: Thank you, Mr. Müller. In spite of what you have been telling us about this changing situation in the United States, there still seems to be a marked difference between the American and the Swiss approach to secrecy problems. I think we should try to grasp the differences in the following discussion. Perhaps it might be easier when we do this by looking into a few fact situations. Let me for that purpose give you a relatively simple hypothetical. Let us start with the following case.

A Swiss bank has either a branch or a subsidiary in the United States. The Swiss banking supervisor asks for information concerning the relationship between the United States branch or United States subsidiary of the Swiss bank and certain of its customers — customers of the branch or of the subsidiary. Bob, would you like to tell if you see any problem?

Mr. Mundheim: I would have thought that the Swiss parent company of that branch or the subsidiary would be able to ask for that information to be sent to it at its head offices. Since that can be done, it seems to me the Swiss regulatory authority is in effect going to be able to look at that information. In other words, when the Swiss regulatory authority says to the parent company in Switzerland, “I want to look at those records”, I don’t see what defense the Swiss parent company
can raise under U.S. federal law to say, "You can't look at that information". Do you, Neal or Chuck, see any defense that could be properly raised?

Mr. Petersen: I see none whatsoever under federal law, Bob, but you might want to expand your comments to include whether you see any possible problems under state law. Specifically, I recall that in California there was a California Supreme Court case, preceding the Miller case in the United States Supreme Court, which held that under the California Constitution there was a state constitutional right to expectation of privacy in financial records [2]. Do you think that might be a problem in California and maybe other states?

Mr. Mundheim: Well, I indicated that you might have a problem under state law, either statutory or common law. For example, it may be relevant whether or not you are a branch organized under federal law and/or whether you are a state organized subsidiary corporation.

Mr. Petersen: It may not make that much difference whether you are a federal or a state branch with respect to state laws. State law might not be preempted by the federal rules, such as they are. I think state law is an important consideration.

Mr. Mundheim: I think you also have to look ahead. You should remember that the legislation the Administration proposed to Congress will affect the transmittal of customer information. At that point, depending upon how that legislation is ultimately worded, there may be substantial problems under federal law.

Professor Kübler: Mr. Müller?

Mr. Müller: Isn't there any difference between a branch and a subsidiary? I fully agree with what was said on the branch. A branch is a part of the whole and there should be no secrecy problem, whereas a subsidiary is a legally independent entity. The Swiss subsidiary of a foreign bank is a corporation under Swiss law. In our opinion there is a difference. The customer of a branch expects to be the client of the whole bank around the world. He will be known as a customer of this bank not only in Switzerland but also in Japan and in the United States. This is not the same in the case of a subsidiary.

Professor Kübler: We will come to the other situation of American supervision in a moment. Let me just ask you again, because I think that it is a very important point, do you think that from the Swiss point of view it makes a real and important difference if it is a branch or if it is a subsidiary in the United States?

Professor Hirsch: The question is the following. We have a bank in Switzerland and the bank in Switzerland has a branch in London and a subsidiary in New

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York. From the point of view of the supervisory authority of the Swiss bank we don't bother about what the British or New York authorities will say. From the point of view of the supervisory authority of the Swiss bank, will we ask very different things from the branch than from the subsidiary?

Mr. Müller: No. The Swiss bank has to bring us an approved consolidated balance sheet. And for this purpose we have to make sure that all of the assets and liabilities of the subsidiary are audited by a qualified private auditing firm. Under this aspect our supervisory system is a very practical one, because we have fewer political difficulties than those countries which carry out the auditing by government officers. Remember that the Swiss banking supervisory authorities themselves do not audit the banks, but each bank has the obligation to be audited by a private auditing firm, approved by us and carrying out its audits under the provisions of the Banking Law and the guidelines of the Banking Commission. Therefore, we have no serious problems with that. But, of course, a Swiss bank that owns subsidiaries around the world must be organized in a way to show us all the necessary data on its subsidiaries.

Mr. Mundheim: Having gotten the view of what the Swiss supervisory authority would be able to get where a Swiss bank has a branch or subsidiary elsewhere, could I just ask if an American bank had a branch or subsidiary in Switzerland and the Federal Reserve or the Comptroller wanted information about that Swiss branch or subsidiary as part of its examination of the U.S. bank, would there be any difficulty in its getting that information?

Professor Hirsch: Yes, we agree to touch that subject briefly because it is part of the picture, agreeing, however, that we cannot go into detail as the subject of this symposium is really not banking in Switzerland, but banking in the United States. Just to have the comparison it is possible to say the following.

I think that five or more years ago, the answer would have been that there is a total proinhibition against giving any information to anyone. Since then, people have become more realistic and have realized two things. First, they realized something that was always happening, that of course the branches and the subsidiaries of most of the foreign banks were, in fact, giving most of the information to the parent company. And it was difficult to forbid that because it was just good management. Secondly, we have to realize that as the Swiss supervisory body, we were asking the same information from the Swiss parent banks, so that is was difficult to resist in the reciprocal situation.

The actual view of the Swiss Banking Commission, of course in a provisional way, was published a few months ago. The Banking Commission said, with small theoretical differences between branches and subsidiaries, that disclosure of information which is designed to allow the foreign parent bank to put together a consolidated balance sheet should be allowed. Normally information about individual cus-
customers should be given only if really necessary to ensure the supervision of the branch or subsidiary by the parent bank. For instance, so that the parent bank may know whether the subsidiary has questionable assets, or it wants to know its total credit exposure to a particular person or company, it must have access to customer information pertaining to its Swiss subsidiary or branch. The last condition, and the most important, is that once information about Swiss branches or subsidiaries is given to the parent bank, let us say, in the United States, we admit that as far as supervision of the parent bank in the United States is necessary, this information can be given to the supervisory bodies in the U.S., i.e. the Federal Reserve or the Comptroller. This would be with the condition that this information is used solely for the purpose of banking supervision. We would not be ready to allow this transmission of information if the agency told us that, “Well, unfortunately if another agency or the government, or a judge demands it, we would be compelled to disclose such information”. That would certainly paralyze all of today’s international efforts toward cooperation in the international field of banking supervision.

Mr. Mundheim: I guess then your question really is, Neal, whether or not the U.S. supervisory authorities have sufficient statutory protection to restrict disclosure of such information to the U.S. banking authorities. Can it be kept from Congress and from exposure through court process?

Mr. Petersen: Yes, indeed that is the question. In the United States there is a statute called the Freedom of Information Act, enacted a few years ago and presently codified in title 5, §552 of the United States Code, which is generally intended to give the public access to government records upon request. Access to records used or maintained by a government agency is subject to a number of exceptions, whereby the agency can assert a privilege from revealing the document that is requested, although it is not necessarily required to do so. One of the exceptions that comes to mind relevant to this situation is the exception for information in, or related to, or derived from an examination report. That exception, and possibly some others, would be asserted against any request by, certainly, a member of the public for this kind of information. Now that is not to say that is the end of the problem. The Freedom of Information Act exemptions are not necessarily protection against a judicial subpoena, should one be issued by a court of competent jurisdiction. In that situation, if we wanted to maintain the confidentiality of any particular record, we would have to go into court and argue that the information was privileged, as a matter of American law of evidence and other public policy considerations, from disclosure in a court proceeding. The judge in that situation has a number of choices: he could agree with us and not permit disclosure of the information; he could disagree and require it and, unless we were successful and appealed to a higher court, we would have to give it up; or, finally, the judge might permit very limited disclosure, for example just to the parties in the action. So we still have the problem of the judiciary. There is no guarantee that we will be able to defend
successfully against a court order, although I think in the situation we are describing here it is likely that we would be successful. Finally, we have Congress. A very, very troublesome area for the bank regulatory agencies is the Congressional request for information which occasionally touches the area of examination reports and the kind of documents we are talking about here. We resist it, but we cannot assert the Freedom of Information Act defenses against the Congress of the United States; these defenses are not applicable. If Congress, or a committee of Congress, or an individual congressman insists on this material being divulged, we would normally resist in that kind of a situation. Congress would then have to obtain a subpoena, which in the usual circumstance would have to be approved by the appropriate committee. We could still refuse the particular committee and then the matter would be taken up either by the House or Senate and, depending on the committee involved, the whole Congress could vote that the individual who refused to deliver the requested information was in contempt of Congress. That subpoena would then be enforced in the courts. Only rarely has confrontation gone to that stage. More usually, things are worked out; cooler heads prevail, particularly when disclosure would create serious consequences with respect to international comity. But the point I am making is that a federal financial regulatory agency in the United States can give no absolute guarantee to other government agencies, or to anyone else, that information in its possession will not be revealed. It is conceivable that it could be revealed in a court proceeding. It is not too likely and it would be resisted, but the possibility does exist.

Mr. Mundheim: Do you have any special protection if the information is gathered as part of the examination process?

Mr. Petersen: Well, yes, you have protection that you can assert based on other statutory and public policy considerations. That is usually relevant in a court proceeding. I really question whether you can assert anything against the Congress of the United States if Congress chooses not to agree with you and votes to issue a subpoena.

Mr. Muckenfuss: Bob, that is right. We will defend as strongly as possible information that we get under the examination report and in virtually all cases we will be successful, but with respect to an absolute guarantee, I think Neal is correct. We have seen rare instances in which the privilege has been breached one way or the other. I do not think, though, that is necessarily the whole answer. Normally, if there was information that we desired for supervisory reasons, it would be possible, in dealing between central banks or between supervisors, for us to be reasonably assured that our supervisory interests were answered. We would only be compelled, for example, to give up information which was in our possession. That means, of course, that we could sit down and look at the information, or we might be assured through discussions with the other supervisor or central banker.
Professor Hirsch: This means you don't want to get any paper, is that your point?

Mr. Muckenfuss: It might mean that under certain circumstances, depending upon the kind of analysis that the other supervisor had made, we would be satisfied without asking for possession of documentation.

Mr. Müller: I flatly object, and I think this is not only Switzerland's point of view. Our country, like many others, can give information to a foreign supervisory authority only under the condition that the latter needs it for supervisory purposes and can guarantee that it will be used for supervisory purposes only. In our opinion the foreign authority has to prove that these conditions are fulfilled. If confidentiality is not guaranteed, no information can be given. The most sensitive information concerns the identity of a bank's depositors. However, that information is usually not required for supervisory purposes. May I add what we cannot do? We are not allowed to authorize foreign government officers to make on-the-spot examinations in Switzerland. This is not within the competence of the banking supervision authorities. It would need special approval by the government and until now it has never been given. As you can see, there are means and ways to exchange information, but you have to use the ways available under Swiss law and cannot impose any others.

Professor Kübler: Thank you very much. I don't want to interrupt this discussion, but I think we could get a little bit closer to the very difficult and perhaps the most controversial point if we change our case a little bit and go to a slightly different hypothetical. It is, again, our Swiss bank with either a branch or a subsidiary in the United States. But this time it is the United States regulatory agency, or the U.S. banking supervisor, who is asking for information concerning the relationship between the Swiss bank and certain of its customers. I think we should perhaps now ask you, Alain, what you think of this situation.

Professor Hirsch: I really think that before answering that question it should be put, possibly, in a more precise way. The most important point, as I said before, is that it is now assumed, even in Switzerland, that there may be good reasons for the parent company and even its supervisory authority to be responsible at least for the branches abroad and possibly also for the subsidiaries abroad. It is certainly not generally assumed that it is a responsibility of a branch or of a subsidiary, even less their supervisory authorities, to be concerned with the financial soundness of the parent company as a whole. But it appears that the United States authorities might possibly be inclined to look at the financial soundness of foreign banks having a branch or a subsidiary in the United States. Before answering your question, I think we should ask how far are we going to go in allowing that far-reaching examination.
We should look into that point here because I think it is a very new point in the financial world and financial business.

Mr. Mundheim: The Federal Financial Institutions Examination Council and the Federal Reserve Board have indicated in statements published on July 19, 1979, and February 23, 1979, respectively, that they need to assure themselves that the parent institutions are financially sound in order to satisfy their supervisory responsibilities over U.S. subsidiaries or branches of foreign banks or bank holding companies. How do American regulatory agencies think they can acquire that assurance?

Mr. Petersen: This is an area of potentially serious controversy between some countries and the United States supervisory authorities. It is the philosophy of the federal regulators of the United States that a foreign parent bank is intended to be a source of financial strength for a subsidiary or a branch operating in the United States. From my experience this is particularly true in the Federal Reserve. In order for that particular policy to be pursued you obviously have to know something about the foreign parent, its condition, and its affairs. Against that particular policy is the concern of other countries, in particular Switzerland since that's been the hypothetical situation, about revealing any information or a large amount of information. Certainly, there is a strong feeling that they do not want American bank examiners prowling about in Switzerland.

A lot of work is currently underway to try to accommodate these two conflicting policies both within the United States and, of course, with the International Committee on Banking Regulation and Supervisory Practices which is chaired by Peter Cooke. Speaking of the Federal Reserve, I think our approach would not be to seek to examine a foreign parent or anything like that at all, but to try to obtain information by way of reports not particularly different from the kinds of reports we are getting currently from our own domestic institutions. These reports give us the kind of information we need to make a judgment about the financial condition of the whole operation on a consolidated basis. We are concerned, because of the regulatory history in the United States, about transactions between a subsidiary and its affiliate that affect the safety and soundness of the subsidiary bank. We have had a number of major bank failures or severe solvency problems with banks in the United States in recent years which were occasioned by insider dealings, if you want to call them that, or rather loans to controlling persons or affiliated companies. So, there is a great concern based on fairly recent history in the United States. I think that, with the reasonable cooperation of all parties, the kinds of information we think will satisfy us can be provided without undue burden. I would hope that that approach would not be conceived as so overreaching as to raise sovereignty issues and the like.

In the near future the Board will be issuing proposed reporting forms [3] with respect to both foreign parents of subsidiaries in the United States and branches
Mr. Muckenfuss: I would like to add several points. One is that, in a sense, our responsibility with respect to branches and agency offices flows from a statutory framework. We are charged with conducting an examination. The statutory responsibility encompasses our assuring safe and sound operation.

The second point is to re-emphasize something that Neal said. That is, that the problem arises out of the increasingly prevailing view on the part of bank supervisors that you must look at these organizations on a consolidated basis. That flows not just from the international environment, but from lessons that the United States learned rather painfully in the mid-seventies, where in at least one instance the Comptroller of the Currency had focused on the parent national bank, but found that $80 million dollars of generally bad loans had been made by a mortgage subsidiary in a span of about eighteen months. So our interest in viewing entities as a whole is based upon this history. This means necessarily that if you have a foreign parent which, for example, might own a manufacturing subsidiary in the United States amounting to 30% of the parent's assets, we would be interested in being assured that there were not activities going on in that manufacturing subsidiary that might threaten the soundness of the whole enterprise.

The third point is that there are many ways to solve the problem, which is what I was emphasizing before. Neal pointed to reports; we have mentioned before conversations with other supervisors. It may very well be that, given the philosophy and law of the host country, the institution itself might welcome our personnel discussing our interest in and problems with that institution. I think our approach to these solutions would tend to be flexible and would tend to reflect the facts before us.

One last point, if I may, Alain. I discussed yesterday the proposed change in the definition of a foreign bank holding company, and that foreign bank holding companies have substantial flexibility to operate in non-banking areas. Under the pro-
posed definition a foreign bank holding company would have to be principally engaged in banking business overseas; the entire entity, on a consolidated basis, would have to have 50% or more of its deposits abroad. I think that the proposed change is tied into all this, since the Board was concerned with having to regulate an entity that was primarily a nonbanking organization overseas. A lot of developments are involved in this whole issue, not just the strictly examination side of it.

Professor Kübler: Alain, I think now we should get the Swiss point of view.

Professor Hirsch: I think our American friends would like us to be candid here and not just to walk around the problem. I think, first, that no one will oppose the American authority taking measures to see that, for instance, a New York subsidiary of a Swiss parent bank does not make bad loans to people who are shareholders or managers of the Swiss bank. This is still the problem of the subsidiary. To know that as a fact, the American authorities must have some knowledge about the organization of the parent bank. This can be achieved, as Chuck said, through a number of friendly means, but I would suggest to you that the published statements by the Federal Financial Institutional Examination Council and the Federal Reserve appear to go beyond that. The Council said: “The agencies will seek”, that is the American agencies will seek, “to ensure themselves that the parent institutions are financially sound”. Now I would very much like to know what the other European regulators feel about that. I suggest to you that it is an impossible suggestion. Imagine a Swiss, or a German, or any bank in the world with twenty branches or subsidiaries in twenty countries. Should we allow twenty supervisory agencies to look into whether the Swiss parent bank is really sound? It is politically and practically impossible. With all due respect I suggest to you that you can only envisage that because you are a very important country. You should really take care here not to take steps which you certainly would object to if taken by other countries. That does not mean that the international banking business should not be internationally supervised. I think everyone agrees to that. The problem is, who has the responsibility? I would suggest it is an acceptable solution that the responsibility is that of the supervisory authority of the parent bank cooperating with other interested authorities. It seems to me difficult to accept that each country should be responsible for each international group that has a foot in its country. So I think really, answering your question in few words, that we would do everything to resist a request to give to American agencies information which is designed to assure themselves that the parent institution is sound.

Mr. Mundheim: Just to be clear, I see nothing inconsistent with the statement of the Council for the American supervisory agencies to assure themselves by asking questions of the Swiss Banking Commission about the parent company. Would you resist that type of inquiry? Or, are you only saying you would resist the inquiry if they said, “We can’t rely on what you tell us, we must go and send our own
examiners in?” Because the words “assure themselves” do not say how the supervisory authorities would assure themselves. It is my understanding that in almost every case they would assure themselves through consultations with the regulatory authority in the country of the parent corporation.

Professor Hirsch: But the Council has gone from there and said the agencies plan “to collect information on the consolidated operations of the foreign banks as described below”, that is, the consolidated information based on the American accounting principles, “and to expand their contacts with senior managements of the banks”, that is senior managements of the foreign parent institutions. “Additionally”, and the emphasis is mine, “United States authorities are now working and will continue to work with bank supervisory authorities of other nations to improve both the coordinated exchange of banking information and the compatibility of international banking regulation.” So, I do think, unfortunately, the published statements are not in line with what I would accept and what you are suggesting.

Mr. Mundheim: Perhaps the statements were not artfully constructed.

Mr. Petersen: We can argue about subtleties of the text. I don’t think that Alain should read it quite the way he does. I am sure, Alain, that you would not have expected, in light of the situation in the United States, the regulators to issue a statement saying the financial regulatory agencies in the United States are not concerned about the financial soundness of a parent of a branch or subsidiary in the United States. Can we at least accept that that might not be too realistic a thing for us to say? Would you accept that we might have some concern?

Professor Hirsch: I fully accept that all banking authorities in the world are concerned with the financial soundness of the parent institution. That does not mean that they should begin to supervise them.

Mr. Petersen: I am not asking you that. Now, would you accept that it is reasonable for us to try to assure ourselves of that soundness?

Professor Hirsch: I don’t think I would.

Mr. Petersen: You wouldn’t? No matter how we do it, just by consultation? I think that is a fairly strong position.

Mr. Cooke: Can I comment for a moment, Mr. Chairman?

Professor Kübler: Yes, please.

Mr. Cooke: I have listened with great interest to what is being said and, as befits somebody in my position, I agree with most of what everybody has been say-
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I think I can justify that too. I would agree with what Chuck Muckenfuss is saying; there are many ways of skinning a cat. I think in this whole question concepts of consolidation are certainly involved. There are also, very importantly, concepts of responsibility involved. As most people here will know, we have gone to considerable pains over the last few years to seek to establish some basic concepts of responsibility. If you have concepts of responsibility that imply both concepts of primary responsibility and concepts of secondary responsibility, I think it would be generally agreed amongst everybody here that the parent bank’s supervisory authority has the responsibility for that bank and all its branches. The principle of consolidation extends further than branches, it extends to subsidiaries as well. I would say that the responsibility for subsidiaries is more shared. A subsidiary is a separate legal entity, incorporated sometimes under different legal systems. For consolidation purposes, for prudential purposes, there are good reasons why you should gather up the affairs of the subsidiary into the affairs of the parent bank, but it is certainly true to say that there is a difference in the legal status of the subsidiary as opposed to the branch. It is right and reasonable that the directors of the company that has a branch should have full access to all the information about what is going on in that branch to fulfill their responsibilities to the company of which it is a part. So, these general considerations give you a basis on which to work on the particular hypotheticals that have been advanced. I think that one has to be careful, certainly, about putting into words statements that are capable of being misinterpreted. As to the sentence to which Alain Hirsch has referred in the statements by the Federal Financial Institution Examination Council, although it is not my place to interpret it, I can at least give you my reading of it. The sentence which says that the American supervising agencies will seek to ensure themselves that the parent institutions are financially sound can be interpreted, as Alain Hirsch has done in a rather comprehensive way, to imply it is a kind of supervision of the parent authority, the tail wagging the dog, if you like. On the other hand, you could read it as meaning nothing more than a statement of intent to have access to a range of basic information about the institution, arguably no more than the consolidated annual published balance sheet of the company. Perhaps in the past, without these considerations in mind, supervisors had neglected to address themselves very carefully to this balance sheet, because they had chosen to address themselves solely to the entity operating within their own jurisdiction.

I make these general comments because I do think this is a very important subject. I do think that a lot of what Alain has said about the attitudes of the Swiss authorities on the first hypothetical goes a long way towards dealing with the needs of the supervisory authorities. I think there is a difference that has to be drawn between general information, general balance sheet information, and particular customer information. There are cases where you are looking at credit analysis where you do perhaps need particular customer information. Mr. Müller has said that is particularly true on the asset side of the balance sheet. The particularly sensitive issues of secrecy, considerations of disclosure or nondisclosure, more often arise on
the liability side of the balance sheet in relation to depositors where, arguably at least, there is a lesser degree of supervisory and prudential concern.

The EC Banking Directive states the principle that secrecy rules which apply within national jurisdictions should be capable of being relaxed where information is being transmitted from one supervisory authority to another supervisory authority for the purpose of supervision. That statement is a very valuable and very important principle which should be supported by all authorities. Indeed, I think it is. You have the Swiss point of view and you have the U.S. legislative and political environment perhaps at opposite poles. But I personally believe the principle could be accepted across the board. Of course, it may face difficulties when a particular case comes to court in the United States, or Congress may demand information which may put the cooperation being developed in jeopardy. One hopes the cooperation could be developed in such a way that the courts will have regard for the importance of that cooperation in reaching their decision. That's the end of my comments, Mr. Chairman.

Professor Kübler: Thank you very much. Mr. Müller, you have a comment.

Mr. Müller: One of the licensing conditions for a branch in Switzerland is the ability of the head office to supervise its Swiss branch. If we find that a branch's maturities are unbalanced or its assets are unevenly distributed, we ask for a confirmation from the head office that this is in conformity with its policy. In one case we went further and asked for a confirmation from the parent bank's supervisory authority and whether they were aware of the situation. I think there are different means to make sure that the whole bank is sound.

Mr. Cooke: Perhaps, Mr. Chairman, I will just add one supplementary point about the United Kingdom's own situation. Picking up the point that Bob Mundheim is making, now that we have a statute under which we operate, we feel we have to assure ourselves as to the soundness of the parent of the entity which is branching into the United Kingdom. We feel a certain obligation now. The way we most effectively or satisfactorily fulfill this obligation within our legislative framework is to seek assurances from the authority which has the primary supervisory authority over the bank concerned. We would not expect, I think ourselves, to go through the kind of rigmarole that you are suggesting might be in the Americans' minds to seek a great deal of information on the substance of the parent's business.

Commissioner Pollack: May I ask Peter a question or are you running out of time?

Professor Kübler: We have a slight time problem and we would like you to come in now anyhow. I could perhaps enlarge the subject of our discussion a little bit by introducing another hypothetical. Let us take our Swiss bank again, with its
United States branch or its United States subsidiary. Now an executive of a United States corporation whose stock is traded on the New York Stock Exchange is said to have bought and sold this stock through the Swiss bank. The SEC wants to know from this bank whether these transactions have been effected, the size of the transactions, the precise dates of the transactions, etc.

Commissioner Pollack: Is this a transaction that was done through the U.S. subsidiary or branch? Or was it done in Switzerland?

Professor Kübler: All you have heard is that the Swiss bank was asked to effect transactions for its client, the executive of the U.S. corporation, that is all you know.

Commissioner Pollack: All I would be able to say is that, if it were relevant to the inquiry we were making, we would endeavor, on behalf of the corporation's officer, to determine whether or not those transactions were as indicated, using government channels, if they were available, and where government channels were not available, through other investigative resources. In past instances, even though we may have been foreclosed because of secrecy laws or other reasons from obtaining information directly from the bank, we have used our other investigative techniques. Under the facts you have given me, I believe we would have enough jurisdictional reach in the United States to get a pretty good idea as to whose transactions they were. Our investigative subpoenas only run in the United States, but once we are in court we then have the full jurisdictional reach of the court and that includes measures for reaching evidence outside of the country as well. I really cannot answer for the other side as to what would be necessary in a foreign country to obtain that information. Again, we are not interested in upsetting bank privacy or bank secrecy, we are interested in satisfying ourselves that the foreign banking institution or other financial institution has not been used in a manner to violate our law. If I may just add one comment; as I approach this problem, I can see some value in the protection of individual or human rights for a country to permit secrecy or privacy so long as that account remains passive in that country. However, when the account is used, as I might describe it, aggressively to enter into another country, then it seems to me you have a need for international cooperation. It is in those circumstances that national interests will not protect any country in the world against an abuse of its own legal processes or requirements. It is there where international cooperation is needed just as in the examination or supervision of financial institutions which become multinational in their operations.

Professor Kübler: Thank you. Alain, would like to comment.

Professor Hirsch: As I understand it, the problem posed by this case is conceptually the same whether or not the bank has a branch or a subsidiary in the
United States. The only difference is probably a practical one. If the bank has a branch or a subsidiary in the United States and refuses to give the information to the SEC, the SEC will probably be tempted to utilize some power against the branch or subsidiary to convince the parent bank to give it the information, even if only the parent bank has the information and the branch or the subsidiary does not. That can be a practical difference and it has been an actual distinction in some cases.

Not let us look at the matter of principle. I think I could agree with you when you say that when an account in Switzerland is utilized for operations in the United States, it is not only the Swiss secrecy laws which are applicable. I hope you would agree with me if I suggest to you that it is not only the American securities law that should be applicable to that case. If we agree on these points, my suggestion to you would be the following.

The great problem with insider trading and international banking regulation is that in Switzerland insider trading is not a criminal offense. Of course, if it were a criminal offense in Switzerland — which is not the case today, but who knows about the future — then you would have no problem at all. You would have help from the criminal authorities in Switzerland. But as we have not yet introduced in our law regulation of insider trading, we would not today help you on the basis of international treaties. May I underline, just by the way, that the problem would be exactly the same in France, in Germany, and so on — exactly the same. Indeed, I have been told that a French bank, or even authorities, would refuse information about insider dealing to the Bank of England. Anyhow, I think the proper way of dealing with a situation where you find that in the United States you have a criminal offense that does not exist in Switzerland, would be to have such a problem dealt with in a treaty between Switzerland and the United States, as it was done a few years ago with organized crime. This would define the insider information about which Switzerland would agree to give help and it could produce an amicable solution. What we would probably, and more than probably, object to is the idea that, under the presumption that insider trading might have occurred, the Swiss bank should disclose the identity of its client to you when it is quite possible that the client was not an insider at all and possibly not a U.S. citizen. So, surely some middle of the road solution could be found.

Commissioner Pollack: What troubles me, Alain, is that if we assume that what you just said are the facts, it would seem that it would be beneficial to your people, and to us, if that information would show that it was not a U.S. person or not a violation. Then that takes care of your problem, it takes care of our problem, and it eliminates what I see to be the difficulty in asserting secrecy at all. Indeed, in our country the courts have taken the position that the existence of a foreign statute does not overrule the power of the court. The court could at least order the parties before it to produce the information, even though they may contend it violates foreign law. In determining the sanction to be imposed on the parties for
failure to produce, the court would then consider the validity of the contention that it was impossible for the responding parties to comply. We have had cases in the United States where very severe penalties have been imposed upon parties making that assertion when, after further discovery, it appeared that they did not make a good faith attempt to obtain the information they were ordered to furnish.

The second point, getting back to your branch or subsidiary in the United States, is yes, the practical avenue you mentioned might be used. In one instance, and where it was probably used the most, the foreign party had acted contumaciously with respect to an order issued by a judge in the United States District Court. I would expect that under all juridical systems throughout the world the court would take offense at that action and, therefore, use whatever court processes were available to it to make sure of compliance with its order. In the U.S. case, once the respondent became aware that the court did intend to have its order carried out, it became a matter for the U.S. and the foreign country to arrange an agreement under which the foreign country could and did undertake to deal with the situation under its supervision. That was perfectly agreeable to us. It was equivalent to our saying that we would rely on the supervision of the parent country.

What I am trying to emphasize is that in many of these areas the old legal precedents and arrangements do not seem to me to meet the dynamics of the present international community. I have in mind, for example, the intergovernmental committee that we set up in the IOS case. Those of you who read the article by Commissioner Loomis and Richard Grant, entitled The U.S. Securities and Exchange Commission, Financial Institutions Outside the U.S. and Extraterritorial Application of the U.S. Securities Laws, in Journal of Comparative Corporate Law and Securities Regulation, vol. 1, no. 3 (1978), will get a view of how we did that. There is no jurisdictional basis for what we did there in setting up the intergovernmental body. I can tell you that after some seven years of operation it has operated exceptionally well. It has effectively coordinated the work of a large group of liquidators in a number of countries and has resulted in the recovery of a substantial amount of money — hundreds of millions of dollars. That organization was worked out by people seeking a common objective. Had we thought about the problem in the old terms of power, leverage or national jurisdiction, we never could have achieved the result we sought. The creation of an ad hoc international committee by people pursuing a common objective permitted us to overcome many technical international problems and conflicts.

Professor Kühler: Thank you, Irv. Just to get a feeling of where we might be going, I would like to include a fourth and last hypothetical which brings us beyond the reach of regulation. Let us assume it's again the Swiss bank with its branch or subsidiary in the United States. Under one of the grandfather clauses of the International Banking Act, this Swiss bank also operates a securities business, a brokerage firm in the United States. It now wants to stimulate the business of the brokerage house and it has therefore asked its commercial banking branch or subsidiary to
give certain customer information to the brokerage house, the addresses, etc. of customers that might be possible clients of the brokerage firm. Bob, would that be in any way objectionable in American law? Would you say that they could go along with it? Would you have any objections, any doubts?

Mr. Mundheim: The problem is that, following the thinking about privacy, the customer provides information to the bank for one purpose, namely to do his commercial banking business with that bank. That is why, from the customer's point of view, the bank has that information about how much is on deposit, or, if he had made a loan from the bank, he may have given the bank some financial information about his net worth. What the bank is now seeking to do is to use that information for a totally different purpose, a purpose of which the customer has never been informed. If you said where are we on that today, I'd say that right at this minute, as a matter of law, we are not very far. But if you ask where are we going tomorrow, I think that is precisely the kind of protection which we are thinking about in terms of our proposed privacy legislation. In other words, we would view it as an abuse of the banking relationship to utilize that information for a different purpose. If the bank wanted to use that information it ought to get the consent of the customer. Interestingly enough, if you look at the customer authorization or disclosure provisions in the statute which governs access by the government, we allow that kind of blanket authorization. The card you fill out when you open up your deposit account lasts for only three months. The Congressional thought is that the customer really ought to know quite specifically what additional use will be made of that information other than what could be reasonably expected from the banking relationship into which he enters. I think we are going to have to have another seminar, let's say three or four years from now, to explore where we are in that area at that time, but I certainly think that is the area in which you are going to find enormous interest in the United States over the next few years.

Professor Kübler: Thank you very much. Are there any more questions for the panel?

Dr. Benninger: There is a regulation in German law by which banks are obliged to give the supervisory authority details about borrowers, that is, to name specific borrowers if the exposure is more than, let us say, one million German marks. The supervisory authorities must give this information in turn to the various banks so that other banks may have a fair view about the exposure of some borrowers. Does such a regulation exist in the United States?

Professor Hirsch: You are speaking about loans given by German banks to their clients; you are not speaking, are you, about loans given by subsidiaries of German banks abroad, be it in France, in the United States, or in Switzerland?
Dr. Benninger: That would be the impact.

Professor Hirsch: But today, is that the case?

Dr. Benninger: Yes, if a branch of a German bank, let us say in New York, gives such credit to an American borrower, the German parent company has to reveal all the details about the borrower to the authorities, just as if the branch were located in Germany. There is no difference.

Professor Hirsch: And for a subsidiary also?

Dr. Benninger: That does not apply to the subsidiary.

Professor Hirsch: Only branches.

Dr. Benninger: Yes.

Mr. Petersen: Was the second part of your hypothetical that then the authorities would reveal that information to other banks, if there was an undue concentration of loans to that borrower?

Dr. Benninger: Yes.

Mr. Petersen: Well, a short answer to your question is there is no disclosure by the bank supervisory agencies of bank examination data like that to other banks in the United States. Irv Pollack whispered in my ear he thought that would be a great idea however.

Commissioner Pollack: A practical answer to you, though, may be that if the banking authority received that information in an examination of a number of banks and saw that concentration, then they might classify the loans of that individual in a particular bank as being of a lesser quality and, therefore, require some action to be taken. But there is nothing in the United States as effective as your rule.

Professor Kübler: Mr. Müller?

Mr. Müller: There is a system in Germany, Belgium, France and — if I am not mistaken — also in Italy, under which each bank has to announce credits exceeding a certain amount and is informed by other banks. No such system exists in Switzerland. But, if Swiss banks operated branches or subsidiaries in a country with a compulsory central risk information system — which actually is not the case — the branch or subsidiary would be subject to the local foreign law and thus be obliged to provide the necessary information.
Professor Kübler: Thank you very much. I think it is time that we close this discussion. I think we all have the feeling that this is a field where things are moving and will be moving even more. We have learned to appreciate the very broad concepts of law with which this field is concerned, such as privacy, data protection, and the regulation of the flow of information in business affairs. I am not the only one present to be deeply impressed by the complexity of the problems we have been dealing with here. But I must say I am still more deeply impressed by the capability of our American friends not only to deal with these problems, but to explain them to us. Thank you very much.

Mr. Mundheim: I hope you will let me respond on behalf of the Americans here to say that we have very much enjoyed being here. This program could not have succeeded without the perceptive comments and questions of our European friends both on the panel and from the floor. I think that has given a welcome liveliness to the discussion. Please accept our thanks.
Notes

[1] Over forty privacy bills were introduced during the first session of the Ninety-sixth Congress, but as of November 1980, only the Privacy Act of 1979, Pub. L. No. 96–440 (1980) dealing with the news media has been passed.


[3] Forms F.R. Y-7, F.R. 2068, and F.R. Y-8(f) have been recently approved by the Board.