FOREIGN BANKS IN THE UNITED STATES: Acquisitions, Branching, and Other Techniques

Dennis J. Lehr and Cameron F. MacRae III

MR. MUNDHEIM: The first subject that we want to discuss relates to the entry of foreign banks into the U.S. Dennis Lehr will start us off on that subject.

1. OPTIONS AVAILABLE TO FOREIGN BANKS

MR. LEHR: My presentation will focus heavily on certain statutory terms whose interpretation is essential and whose history is not as clear as one might hope. The most interesting issues relate to what Congress meant when it propounded the doctrine that we have come to call "national treatment" or "parity of treatment". Simple words like "prohibited" are now very actively being considered in the courts. I mention this because such questions will form the backdrop of the first three speakers--myself, Cam MacRae, and Neal Petersen--who will try to cover for you, perhaps with a bit of overlap, some of the key provisions of the International Banking Act [hereinafter IBA] [1]. Some of the Act's most important questions center around the meanings of its terms.

A. Before the International Banking Act

(i) Lack of national policy

Before we get right into the analysis of statutory terms, let us back up a little and talk about these concepts of "national treatment" and "parity of treatment". The Senate report on the IBA advanced the proposition that, unlike many other forms of foreign enterprise doing business in the U.S., foreign banks operating in this country were not subject to a uniform national policy. This, in fact, was true because except for those that were federally chartered--i.e., national bank subsidiaries--foreign banking organizations in this country were subject only to state law. This, it was felt, produced several undesirable consequences.

First, there was a lack of uniform national policy which hampered government efforts in the area of economic and monetary policy. Many foreign deposit-taking operations were not, for example, subject to federally imposed reserve requirements. Consequently, the Fed argued for years that this hampered its ability to control the money supply and, in turn, its fight to control inflation.

(ii) Competitive inequality

Second, foreign banks often enjoyed, it was felt, competitive advantages over federally chartered domestic counterparts. The most notable example of this was the inapplicability of the restrictions on multiple state branching that apply to U.S. banks.

At this point, let me interrupt myself and mention two names, as a shorthand, because we are going to be talking about them later. When we use the expression, "the McFadden Act", we refer to that part of U.S. banking law that restricts domestic banks from branching
across state lines. The "Douglas amendment" to the Bank Holding Company Act has a similar effect and prohibits holding companies that are presently operating in one state from acquiring subsidiary banks in another state [2]. But to continue . . . .

These concerns over the competitive inequality between foreign and domestic banks operating in this country obviously underlie the concept of parity of treatment and national treatment. The considerations involving parity of treatment fostered those provisions of the IBA that now restrict certain interstate expansion opportunities of foreign banks and subject them to reserve requirements, impose Bank Holding Company Act type restrictions on their non-bank activities, and subject many of them to the examination, asset maintenance, reporting, and other obligations to which national banks are subject.

Less widely known is the fact that the notion of parity of treatment has also been applied to eliminate or modify statutory provisions which were considered to be unfair to foreign banks in their efforts to compete fairly with domestic institutions. For example—and we will hear more of this later—foreign banks may now acquire a majority stock interest in an Edge Act corporation and establish U.S. as well as foreign branches of such Edge Act corporations.

(iii) Options
Again, to help us analyze the thrust of the IBA, let me state briefly the ground rules applicable to foreign banks prior to the passage of the IBA. Foreign banking institutions were then conducting their U.S. operations in one of three forms only: (1) A subsidiary bank could be established with a national charter or under state law; (2) They could establish a branch or an agency; or (3) They could operate by means of representative offices.

Subsidiaries and branches ordinarily enjoyed retail deposit-taking powers. The agencies, of course, could accept only so-called credit balances. For those who are not initiated, the simplest way to remember a credit balance is to recall that it is the kind of account that the holder cannot add to, e.g., by deposit of additional funds. They have been described as active balances that arise from or are incident to transactions involving loans, funds in transition, letters of credit, and other identifiable events.

Except in the case of federally chartered subsidiary banks—and there were not many subsidiaries owned by foreigners—the important issues of entry control, market expansion, and government supervision were solely the province of state law. Consequently, foreign banks were drawn to a handful of states—New York, Illinois, California—offering attractive banking opportunities and a hospitable legal environment. In addition, prior to the passage of the IBA, the non-banking activities of foreign bank holding companies were not subject at all to the U.S. Bank Holding Company Act.

B. The International Banking Act of 1978

Five different pieces of legislation were introduced in Congress during the 1960s to subject foreign banking to overall federal regulation, but none ever got out of committee. It was not until the mid-1970s, following the significant rise in foreign bank operations in the U.S., that there was serious demand for a rationalization of foreign bank supervision at the federal level. It was then that the idea of national treatment and parity of treatment emerged and—with a helpful push from the OPEC nations and public
concern in general over foreign ownership of U.S. property and industry—these concerns were focused in Congress and resulted in the passage of the IBA. As I have indicated earlier, the IBA has brought what I would consider sweeping changes in the structure of foreign banking in the U.S. and I predict that those changes will continue at an accelerating rate.

(i) Current options

First, the number of forms in which foreign banks operating here may be conducted has been greatly increased. In addition to federally or state chartered subsidiary banks and state chartered branches and agencies (the principal forms of pre-IBA entry) a foreign bank may now operate in the form of an Edge Act corporation and may have domestic and foreign branches of such a corporation. Including commercial lending companies (the IBA's term for Article 12 New York investment companies) the forms of operation available to foreign banks now number at least ten.

Equally important under the IBA, foreign banks now have the opportunity of selecting either a federal or a state charter for branches and agencies and have the option of chartering a branch with either limited or unlimited deposit-taking ability, further increasing their flexibility.

Let me illustrate this point with three hypotheticals. Let us take a foreign bank that wishes to establish its initial branch office with unlimited deposit-taking powers, and that wishes such branch to be federally chartered. A foreign bank may select any state in the union in which to locate such a branch, so long as the Comptroller of the Currency approves the establishment of the foreign bank branch and it is not prohibited by state law. Cam MacRae is going to discuss certain provisions of the Comptroller's regulations that are now being challenged in the courts [3].

Assume that our hypothetical foreign bank already has a retail deposit-taking branch in one state and wishes to establish another branch in another state. The foreign bank may do so if the deposit-taking powers of the second branch are limited to those allowed to an Edge Act corporation and—if the branch is to be federally chartered—its operation is expressly permitted by the law of the state in which it is to be located. With the exception of this restriction on deposit-taking powers, such a branch would have all of the banking powers, including fiduciary powers if it asked for them, of an existing national bank, not foreign owned.

Finally, assume a hypothetical bank wishes to establish a federally chartered entity of some kind outside its home state that can accept deposits from persons who are not citizens or residents of the U.S. Such a bank could seek to establish a federally chartered agency. The Comptroller's regulations allow such deposits. On the other hand, a state chartered agency of a foreign bank cannot accept such deposits. It can only maintain credit balances. In my view the Comptroller's regulation permitting a federally chartered agency to accept such deposits conflicts with a section of the IBA which prohibits receipt of such deposits.

(ii) Federal controls

As I have already suggested, the IBA establishes a substantial level of federal control in the areas of foreign bank entry, market expansion, and regulation. Except for the initial state branch in the home state, all forms of state and federally chartered foreign bank entities are now obligated to satisfy one or more requirements of the IBA before they commence operations. There is no time to go
into all of those now, but Neal Petersen is going to touch on some
of them later [4]. For example, a federal branch or agency of a
foreign bank must not be prohibited by state law and it must be
approved by the Comptroller.

In addition, in acting on an application to establish a federal
branch or agency, the Comptroller must consider the financial and
managerial resources and future prospects of the applicant and, in
language giving the Comptroller rather broad discretion, the IBA re-
quires the Comptroller to consider the effect of the proposal on
expansion of competition in the U.S. and in foreign commerce. That
is a rather strange provision and we will discuss the antitrust
issues a bit later [5].

(iii) Types of offices
I will conclude this part of my remarks by summarizing the
different types of offices maintained in the U.S. by foreign banks:

(1) REPRESENTATIVE OFFICES - 249
These offices must file a report with the Treasury Department
and, as far as I know, nothing much more happens with those reports
once filed. 192 banks from 48 foreign countries were represented
by these offices in 1980.

(2) COMMERCIAL LENDING COMPANIES - 6
These fit the description of the so-called Article 12 New York
investment companies.

(3) STATE CHARTERED AGENCIES - 171

(4) FEDERALLY CHARTERED AGENCIES - 5
Applications for three additional agencies are pending.

(5) EDGE ACT CORPORATIONS - 16
There are 121 foreign and domestically controlled Edge Act
corporations with 66 branches. Foreign banking organizations have
invested in only 16 of these, and one of the 16 presently has a
branch.

(6) STATE CHARTERED BRANCH WITH LIMITED DEPOSIT-TAKING POWERS

(7) FEDERALLY CHARTERED BRANCH WITH LIMITED DEPOSIT-TAKING
POWERS

(8) STATE CHARTERED BRANCH WITH FULL DEPOSIT-TAKING POWERS

(9) FEDERALLY CHARTERED BRANCH WITH FULL DEPOSIT-TAKING POWERS - 12

(10) SUBSIDIARIES - 42
A number of these represent acquisitions of existing U.S. banks.

This summary indicates that foreign banks have not yet taken
significant advantage of the federal option in branching, nor have
they taken advantage of the ability to branch Edge Act companies
that they now, or may in the future, own.

Before closing, I want to remind you of the substantial amount
of literature which has been growing in this area. A bibliography is
appended at the end of the chapter. I particularly recommend the
Fed's 1980 study of the first years of operating under the IBA.

(iv) Edge Act branches
I will end my comments at this point with an option that is
available to an international bank and is, I think, the wave of the
future: that is, the Edge Act route for foreign bank expansion.
The IBA amended the Edge Act by eliminating the requirement that the
directors of Edge Act corporations must be citizens of the U.S. It
also provides that the foreign bank may, with prior Fed approval,
own a majority of the shares of such corporation. I do not want to
sound like a law professor here, but an Edge Act corporation is a
rare and wondrous thing. There are three kinds of powers it has.
One would be what I have described as general banking powers. Those are enumerated in the Edge Act, and they run a page and a half or so. Edge Act corporations can purchase and sell securities, accept bills and drafts, issue letters of credit, and engage in a wide variety of finance transactions. The second kind of power they have—and again this creates a significant advantage over domestic banks—is the power to purchase stock in other corporations, something which is very restricted for domestic banks. Last—and this is a new power that all Edge Act corporations were given by the IBA—they can branch anywhere that the Fed allows. Prior to the IBA, a domestically-owned Edge Act corporation could not branch. By amending the Edge Act to provide for foreign bank ownership, the IBA extended this new entry option by allowing for branches. Although I predict that there will be significant litigation, I believe it will come to pass that the Edge Act entry option will be the most expeditious way to penetrate U.S. banking markets.

(v) Obstacles to Edge Act branching

MR. MUNDHEIM: Neal Petersen, has the Fed interposed any obstacles to the Edge Act branching of foreign banks?

MR. PETERSEN: We have not interposed any objections in that area. I do not think we have seen any instances yet of foreign Edge Act branching. Most of the branching has involved the conversion of existing domestic Edge Act subsidiaries into a branch structure. Large banks had established a number of Edge Act subsidiaries around the country as separate corporations; and with the change in the Federal Reserve regulations, many of those subsidiaries were converted to branches. There is nothing in the IBA that deals directly with branching; however, we felt that the general purposes of the Edge Act provisions and the IBA amendments to the Edge Act gave us the authority, which we had not previously decided we had, to permit branching.

As a result, there have been these conversions and mergers of existing multicorporate Edge Act operations into branch structures. These have been very routinely approved by the Board. I would expect that expansive branching by existing Edge Act corporations—including foreign owned Edge Act corporations—would not receive any particular objections from the Federal Reserve. I would caution you, though, that as this trend continues, and if it develops to the degree that Dennis Lehr suggests, there may well be some challenge to our interpretation that branching is permitted under the Edge Act as it was amended by the IBA. I think that issue still lingers. It will be a particularly troublesome issue if the Board ever adopts a version of the so-called qualified business entity concept.

In regard to qualified business entities, you may recall that the staff suggested that the Board propose a new creature by that name, for which an Edge Act corporation could provide a full range of banking services including full lending and deposit-taking powers. The test proposed at the time—about a year or so ago—was that the qualified business entity, on an unconsolidated basis, must base two-thirds of its business on sales or purchases from international business. There were various other tests proposed that would measure the qualifying "international business". This particular proposal was not acted upon by the Board when it adopted the branching regulations, because of the political fire storm in opposition that appeared to be developing among various state regulators and regional banks.

This concept has not gone away. The staff may well come back
to the Board in the near future with another attempt at redefining the idea of qualified business entity--maybe in a somewhat different fashion. If the Board adopts the concept, its implementation will considerably expand the ability of Edge Act corporations to do a full range of banking services, although to a rather discrete type of customer. Nevertheless, this might be perceived as a significant breach of the spirit of the McFadden Act--not necessarily the letter of the McFadden Act--and I would expect we would find much political and judicial effort to prevent it.

2. RESTRICTIONS ON FOREIGN BANKS

MR. MACRAE: Now that Dennis Lehr has focussed on the attractive options that are available to foreign banks, I am going to perform the typical lawyer's job of giving you the bad news and focus on some of the more important restrictions that are applicable to foreign banks. In so doing, I am going to try to give you a picture of the complex "banking landscape" that we now have in the U.S. as a result of the IBA.

A. Restrictions on Entry

First, let us examine the interstate banking restrictions. Dennis has told you briefly about the McFadden Act [6], which limits branching across state lines, and the so-called Douglas amendment [7], which limits interstate acquisitions by holding companies.

In essence, the IBA made these same general restrictions applicable to foreign banks--but it did so with a few "twists" and compromises. As a result, subject to a few important exceptions, a foreign bank is now prohibited from maintaining a branch outside something called its "home state". (I will tell you a little more about home state later.) Similarly, a foreign bank is now generally prohibited from acquiring another bank outside its home state [8]. But as I noted, there were some important exceptions that were made available to foreign banks.

(i) Exceptions to the general rule

The first major exception for foreign banks was the so-called grandfathering rule, which allowed a foreign bank to continue to operate any branch or banking subsidiary that had commenced operation (or had been applied for) on or before July 27, 1978, even though the office was outside its home state. This meant that a bank that had moved fast could have kept offices in, say, four or five states, if they had at least been applied for prior to the grandfathering date.

A second group of exceptions made it clear that the foreign bank could still establish other offices outside its home state, provided they eschewed the taking of domestic deposits. Thus, a plethora of interstate agencies or so-called limited branches could theoretically be permitted. (And note that the IBA actually expanded upon the practical availability of such options, because it opened the way for obtaining a federal license for agencies and limited branches.)

(ii) Home state rules

Obviously, the determination of a foreign bank's home state is a crucial linch-pin to the operation of the interstate banking restrictions. How then does a foreign bank go about selecting its home state? Does it just hang out a sign saying this is "home sweet
home"? Well, it is pretty close to that.

The Federal Reserve Board issued its definitive regulations in October of 1980, instructing banks how to go about selecting their home state [9]. Incidentally, the foreign banks that now have multi-state operations had until March 31, 1981, to select their home state, and there were some fascinating deliberations going on among certain institutions as to which state to select. Let me just quickly give you some highlights of the home state selection regulation.

First, as I said, a bank can select its own home state; but if a bank does not select it, then the Federal Reserve will graciously select it for the bank. The regulation also permits a bank to change its home state once, but only once. This restriction was not specifically contained in the IBA, but it was probably necessary to prevent possible abuses of the home state concept. Obviously, if a bank has just one branch in one state, then that has got to be its home state. But the real fascination occurs in the case of a bank that had offices as of July 27, 1978, in a number of states. Such a bank may have very tough decisions in choosing its home state.

Let me take an example. Let us say a bank had a branch in New York and an agency in another state, such as California [10]. Under the home state rules, if the bank were to designate the state in which its agency was located as its home state, then suddenly it would be able to expand the powers of that agency into a full deposit-taking branch and still keep its original grandfathered branch in New York. So you could get two branches for the price of one.

Now, it would get a bit more complicated if the bank later wished to change its selection. Let us say, after selecting California as the home state, a year later the bank wanted to acquire another bank located in New York. In such event, the bank would be permitted to switch its home state to New York; but it would have to give up its domestic deposit-taking powers in California, thereby reverting to an agency status in that state.

(iii) Three sets of rules

I am not going to spend any more time on these rules because they can get very complicated, particularly in the acquisition area. But I did want to tell you about them to illustrate that there are now really three sets of principles applicable to banks in the U.S. in the interstate area. First, there are the rules that apply to domestic U.S. banks. Second, there are the rules that are applicable to foreign banks that do not have any grandfathered branches (but are still allowed out-of-state agencies and limited branches). And third, there are the rules applicable to those lucky foreign banks that have grandfathered facilities [11]. Thus, it is true that the "playing field", if you will, has become a good deal more level, but there are still some interesting variations in the terrain.

B. Non-banking Activities

I now want to move from the pure banking area, and turn to the question of non-banking entry in the U.S. This is actually a very important area for foreign banks, because foreign banks quite typically have a lot broader powers and non-banking operations than American banks. They quite often engage in underwriting and distribution of securities, and indeed they often have manufacturing and industrial affiliates. In theory, the IBA attempted to apply to foreign banks the same types of general restrictions against non-banking entry that were previously applicable to domestic banks under
the Bank Holding Company Act [12]. Just as in the interstate banking area, they did so with some compromises.

(i) Securities
Let us take underwriting and dealing in securities. At present, the well-known Glass-Steagall Act [13] severely limits domestic banks' activities in that area. But if a foreign bank had an underwriting and securities affiliate established and operating on or prior to July 26, 1978, then it would be entitled to keep that affiliate. On the opposite side of the coin, if a foreign bank today had any ideas about setting up or acquiring a securities affiliate, I am sure Neal Petersen would quickly tell them that that is now flatly prohibited by the IBA. In short, with the exception of grandfathered securities operations, foreign banks are now covered by essentially the same restrictions on securities activities as domestic banks.

(ii) Manufacturing
The situation gets a bit more complex when one examines the status of manufacturing or industrial subsidiaries or affiliates of foreign banks. Let us take the case of a shoe manufacturing company. I am sure everyone in the audience is saying, "If you cannot have an underwriting affiliate in the U.S., certainly no foreign bank could ever have a shoe manufacturing affiliate here." Well, that is not true. The foreign bank may well be able to do just that. Under the provisions of Regulation K [14] of the Federal Reserve Board—which were quite recently promulgated and which interpret related provisions of the IBA—there are ways in which a foreign bank could be permitted to have a shoe manufacturing or other clearly non-banking subsidiary in the U.S. Briefly, assuming the foreign bank (and any parent holding company) qualify for the exemptions provided in Regulation K, then either it (or any parent company) could have a foreign subsidiary which directly or indirectly engages in a non-banking activity here, provided that (1) more than fifty percent of the foreign subsidiary's consolidated assets and revenues are located in or derived from outside the U.S. and (2) the proposed activities in the U.S. are the same kind of activities as the foreign subsidiary conducts abroad. Thus, to return to our hypothetical example, a qualifying foreign bank would be permitted to let one of its foreign subsidiaries or affiliates in the shoe manufacturing business open up or acquire a slightly smaller shoe manufacturing operation in the U.S. [15].

(iii) Compromises
What I am trying to illustrate here is that the rules we now have were based on some compromises that the draftsmen of the Act and the regulators have had to make, to take into account some existing facts that they really could not do much about. For example, one of those facts was that at the time of the passage of the IBA a number of foreign banks already had in place in the U.S. facilities that would not have been permitted to domestic banks under the Glass-Steagall Act. Another fact of life was the significant non-banking affiliations of a number of foreign banks.

I actually think the compromises that have been developed were fairly enlightened, given the existing landscape the legislators and regulators had to work with. But, just as in the interstate banking area, one is left asking some basic questions about the underlying restrictions that exist in our banking system. Put another way, the interstate and non-banking activities restrictions contained in the IBA have considerably leveled the playing field on which foreign and domestic banks now compete; but at the same time, the field is not
entirely level. One is thus left with the nagging question whether the American system of restrictions, or playing field if you will, is outdated in today's world of universal banks.

C. Dual Banking System Problems

Now I will not succeed in my goal of thoroughly confusing you if I do not touch on one other complication for entry of foreign banks in the U.S., which is caused by the fact that there is a dual banking system in the U.S. Prior to 1978, foreign banks could open a branch or agency only pursuant to a state license [16]; thus, they were mainly exposed to only one side of our dual banking system. However, since the enactment of the IBA, foreign banks now have the option to seek either a federal or state license for a branch or agency. This has exacerbated certain tensions that already existed in the dual banking system.

Some of these tensions have been healthy. Thus, there has been a certain amount of competition between the Comptroller of the Currency and certain state regulatory agencies to provide more options and powers for the banks that are licensed by them, in an effort to make their respective licenses more attractive.

For example, to compete against the fact that some perceive federal branches and agencies as being more attractive, the New York State Banking Department has spearheaded a legislative and regulatory revision to permit New York State licensed agencies to issue "large denomination obligations" that in essence are certificates of deposit [17].

At other times this competition between regulatory agencies might not prove to be so healthy, as there has been a bit of competition to eliminate certain protective requirements that were previously applicable to the foreign banks. For example, the Comptroller did not impose a so-called maintenance of assets requirement upon federally licensed branches and agencies, which for a while stood in contrast to New York's former requirement that foreign branches maintain a margin of 108 percent assets to liabilities. In response, the New York Superintendent of Banks sought legislation, and implemented regulations, to permit a relaxation of New York's requirement [18].

Finally, the competition within the system of dual banking regulation of foreign banks has even resulted in some genteel mudslinging between the federal and state regulatory agencies. The New York Superintendent of Banks and the Conference of State Banking Supervisors had noted with some alarm that the Comptroller of the Currency was permitting federal branches and agencies to do a few things that state branches and agencies could not do.

For example, federal agencies were permitted under the Comptroller's regulations to take deposits from non-U.S. citizens [19]; in contrast, neither domestic nor foreign deposits are permitted at most state agencies. Similarly, certain foreign banks that were previously foreclosed from obtaining a state license, because their home country lacked so-called banking reciprocity [20], were permitted to obtain a federal branch, under the Comptroller's interpretation of his authority under the IBA.

As a result of this dichotomy, the Conference of State Bank Supervisors and the Attorney General of New York brought a lawsuit against the Comptroller challenging certain of the regulations that the Comptroller had issued [21]. It is hard to predict how the action will turn out. But the ultimate decision will turn on the in-
terpretation of a very few possibly ambiguous phrases in the IBA. Thus, for example, the issue of the reciprocity requirement will primarily turn on whether the language that authorizes the Comptroller to license a branch in any state where the establishment of a branch "is not prohibited by State law" [22] bars a federal branch only in a state where there exists a flat prohibition against branching, as opposed to a statement of state criteria for an acceptable foreign bank branch.

3. DIRECT ACQUISITION OF EXISTING BANKS

At this point we are running short on time, and I wish to leave some time for Dennis Lehr to address perhaps the most controversial area of foreign bank entry—that is, direct acquisition of existing U.S. banks. I would only note, by way of introduction to this subject, that this is the area where the advantages of foreign banks are perceived (and I believe rightly so) to be the most significant at the present time.

MR. LEHR: I am going to skip most of the statistics on foreign bank ownership. These are readily available in the Comptroller of the Currency's studies listed in the bibliography. But for those who cannot resist some statistics, let me just point out that of the three hundred largest U.S. banks, only twenty-six are foreign owned, and that includes foreign banking organizations or individuals. Unfortunately, the meaning of "ownership" is not agreed on in the different government reports. One government study uses a ten percent ownership test and thus, if a foreigner owns ten percent of the stock, that study includes a hundred percent of the bank's assets as "foreign owned".

A. Antitrust Law in Banking

I have been asked to say something about antitrust law. This area of the law presents many issues that lawyers get excited about. In the banking context, antitrust prohibitions generally prevent one banking organization from acquiring another, because after the acquisition the combined entity will be too big—that is, it will reduce competition in the market. Just where is, and what is, the relevant market in any proposed combination leads to a lot of legal business.

In talking about competition in a market, we often find ourselves in a kind of numbers game. We talk about dominated markets, and controlled markets, and elimination of actual and potential competitors. There are certain assumptions built into our antitrust law which generally favor more, rather than fewer, competitive units. Ultimately, these laws are supposedly applied for the benefit of the consumers of the services of whatever business is expanding. In our case, that would be just the everyday bank customers.

(i) Anti-competitive effects

In the context of foreign bank expansion in this country, I believe our antitrust laws can be viewed from two perspectives. I have considered what the federal regulators have done with respect to the antitrust criteria that they are supposed to apply; and I have tried to ascertain what standards they may apply in the future. First, I will briefly summarize what the federal agency decisions have shown in the last few years.

Recent decisions have revealed that anti-competitive effects were of significant concern to the federal agencies in only a very
small number of acquisition cases. As an example, we shall look at
the Fed's opinion approving the acquisition of Union Bank in Cali-
forinia by Standard Chartered of London. The opinion, I think, is
worthy of examination for the manner in which it seems to downplay
the anti-competitive effects of the transaction and its emphasis on
the pro-competitive effects. I am personally in sympathy with this
approach.

At the time Standard Chartered sought to acquire Union, Union
was the sixth largest banking organization in California. Califor-
nia has some very large banks, including Bank of America. Standard
Chartered of London had a subsidiary located in San Francisco, and
that subsidiary was the twenty-first largest bank in the state.
The impact of the transaction on actual competition, according to
the Fed, was limited to only three markets. One of the primary rea-
sons that the Fed concluded that the effect of the transaction on
existing competition in those markets was only "slightly adverse"
was because Union Bank was a relatively small competitor compared
to the largest banks in those markets. I fully agree.

However, those who oppose this view would say that in one of
the three markets—in particular, the most significant market in the
state (the Los Angeles metropolitan area)—Union Bank was the fourth
largest bank. As the fourth largest bank in that market, it, to-
gether with the three other largest banks, controlled seventy-one
percent of all deposits; that is, the four banks out of one hundred
and five in that market had seventy-one percent of the deposits.
Had this been a domestic acquisition within the state, the Fed’s
decision, I believe, would have come out the other way. The Fed did
not believe there was any direct impact on potential competition.
Rather, it placed great significance on the pro-competitive aspects
of the acquisition, with particular emphasis on the representation
by Standard Chartered that it would provide Union with twenty-five
million dollars in new capital.

Here, again, was a situation that banking lawyers find quite
anomalous. Union was a bank in a weak capital condition. Yet be-
cause of our domestic antitrust laws, no eligible U.S. bank large
enough to supply the needed capital could acquire it; thus, Union
had to look out of state for help. I hope Bob Carswell later will
comment on the prospects for some loosening of those restrictions
[23].

(ii) Future trends

In short, my review of foreign acquisition decisions shows that
the federal regulators have not, to date, been significantly troubled
by the anti-competitive effects of foreign acquisitions. But what of
the future? Pressures have now been exerted on the federal agencies
by some members of Congress to consider the worldwide effect as well
as domestic competitive effects of U.S. bank acquisitions by foreign
banking organizations.

This is significant because the authority under which the do-
meric banking agencies approve these acquisitions clearly says that
they should look only to domestic markets. The Bank Holding Company
Act and the Bank Merger Act, both direct the federal agencies to
consider competitive effects in any section of the "country", mean-
ing the U.S.; and it has been the practice of the agencies to limit
their review accordingly. Perhaps the economists at the Board and
elsewhere, for one reason or another, sometimes gratuitously mention
the effects on commerce outside the U.S. Correct me if I am wrong,
Neal, but I think in the acquisitions of Marine Midland and National
Bank of North America, the Fed made reference to the effects of the

[212]
acquisition on international markets. To date, however, no federal agency has denied a bank acquisition based on international market considerations. As I indicated, my own view is that our federal regulators should continue to look at our own domestic markets, to which the statutes under which they operate direct them.

I find support for this view in a recent decision—handed down on February 20, 1981, by the U.S. Court of Appeals for the Second Circuit [24]—involving National Bank of Canada's loss of its Master Charge business, allegedly through a Sherman Act violation by an American financial institution. The violation of our antitrust laws, it was alleged, occurred outside of the U.S. In the last sentence of the opinion, the court said that "anti-competitive effect upon U.S. commerce" must either occur within the U.S. or affect export commerce from the U.S. Thus, I think it is irrelevant, and I hope it will remain so, whether Standard Chartered or any other foreign bank should choose to monopolize the markets in Indonesia, in Sri Lanka, or anywhere else. Our regulators should just confine themselves to the U.S. markets.

B. Acquisition Techniques

MR. MUNDHEIM: Laying aside antitrust problems, suppose a foreign bank has a branch in New York and it would like to acquire a bank in Atlanta. It has operated that New York branch since 1970. Any problem with that?

MR. LEHR: No, because that branch is grandfathered. When I say no, I am not current on Georgia law, but I am assuming Georgia law does not prohibit foreign bank ownership. The foreign bank could then acquire a bank in Georgia.

MR. MUNDHEIM: And make that its home state?

MR. LEHR: That is correct.

MR. MUNDHEIM: Now suppose that in addition to that New York branch, a subsidiary of the foreign bank also had securities activities in the U.S. The foreign bank now acquires the Georgia bank. You have said that it can continue to operate the New York branch and the new Georgia bank that it acquired. Must it dispose of its securities business?

MR. LEHR: My understanding is that those securities affiliates were also grandfathered if they were operating as of July 1978.

MR. PETERSEN: That is a correct interpretation only if the Georgia operation is a branch or agency.

MR. MUNDHEIM: If the Georgia bank becomes a subsidiary of the foreign bank, would there be Bank Holding Company Act problems? Could you rely on the IBA grandfathering provisions to help solve the Holding Company Act difficulty?

MR. LEHR: Bob, a banking lawyer would advise you to do the transaction as a purchase of assets and assumption of liabilities, and to go in as a full deposit-taking branch. Then you could keep all three operations going and you would not have the Bank Holding Company Act problem. You would get the benefit of the grandfathered branch and the securities company in New York.
C. Controlling Foreign Acquisitions

MR. PETERSEN: I have a comment regarding a couple of things that Dennis Lehr and Cameron MacRae mentioned with respect to entry alternatives. Dennis was very bullish on the Edge Act as a technique for foreign bank entry. I think I would agree with him in terms of the future prospects for Edge Act activities.

(i) Edge Act corporations

There is an additional advantage for Edge Act corporations which so far the Board has not taken away. Entry by way of an Edge Act subsidiary would not make the foreign banking organization subject to the various non-banking prohibitions of the Bank Holding Company Act, as would be the case if the foreign bank came in by way of a branch or a direct subsidiary. When the Board originally proposed its Edge Act revisions in 1979, it would have required conformity to the non-bank restrictions of the Bank Holding Company Act for any Edge Act subsidiary. Questions were raised about whether the Fed had authority to do that, and ultimately the Fed backed off. We still think we have the authority to review any such activities if they are inconsistent with the purposes of the Federal Reserve Act and the Bank Holding Company Act. But at the moment, there is a theoretical advantage (perhaps a real one if you do not push it too far) with respect to non-bank activities if you come in by way of an Edge Act corporation.

(ii) Non-banking activities

Another word about non-bank activities. In some instances a foreign bank holding company can have an ice cream manufacturing or shoe manufacturing company subsidiary but cannot have a subsidiary in a closely related financial field. That is anomalous. There is a provision in section 8 of the IBA which provides that if the foreign bank wants to engage in an activity that is of a financial nature or closely related to banking under Section 4(c)(8) of the Bank Holding Company Act (governing permissible non-banking activities for bank holding companies), the foreign bank holding company must make an application to the Federal Reserve. In that case, the holding company does not get the benefit of the automatic ice cream parlor exception.

The Board took the position that the statute meant that an application is required not only if the activity is already on the so-called laundry list (such as mortgage banking), but also if it is generally within Division H of the standard Industrial Classification Code (covering, generally, financial activities). The purpose was to avoid permitting foreign banks to gain a competitive advantage in providing financial services in the U.S.

The clearest example is an insurance activity that is not on the 4(c)(8) laundry list, but which, if conducted by a foreign bank, might give it a considerable advantage in competing with U.S. banks. On the other hand, if the foreign bank had an ice cream parlor, it would not, presumably, have any great competitive advantage over U.S. banks. This is an example of the push-pull between the need to understand domestic concerns and the desire not to discourage foreign bank entry into the U.S.

D. Objections to Foreign Acquisitions

MR. MUNDHEIM: When the Hong Kong and Shanghai Bank sought to acquire Marine Midland, a good deal of unfavorable publicity was generated, and one question raised was whether as a matter of policy it [214]
is undesirable to permit foreign acquisition of substantial U.S. banks. The recent speculation about the acquisition of a major bank on Long Island by a foreign bank has re-ignited that question. Fred Heldring, what do you think about allowing foreign banks to make acquisitions of substantial U.S. banks?

MR. HELDRING: Well, there are in my mind two issues. I go on the assumption that no country likes—to put it in an extreme—to have one hundred percent of its banking system owned by foreigners, and that would include the U.S. So the question arises, what is enough? Perhaps we have reached that point. A little clarity on that subject would be helpful.

The second point I would like to make—which has not been discussed as much—concerns the impact upon individual communities of acquisitions in the private sector generally and in banking in particular. The life of a community is dependent to a large extent upon a healthy, and sound, and independent private sector. In that kind of private sector an independent banking system plays quite an important role. To the extent that communities become branch towns or subsidiary towns, this health and soundness of the community is endangered, and we see the results of this in some cases.

I think these two questions arise when you think of the Long Island case. It is not just because a foreign bank is involved; the same situation would exist if any other bank acquired that particular bank on Long Island. There may not be much left on Long Island in terms of independent banking, and that raises a question as to what it does to a community.

MR. MUNDHEIM: Perhaps our German colleague, Professor Fritz Kübler, has a comment on that point of view.

MR. KÜBLER: I feel that this point is particularly interesting; and I am sure that my countrymen would be unhappy if even less than one hundred percent of the German banks were taken over by American banks. It might cause some uneasiness if, for instance, the Deutche Bank were taken over.

Concerning local communities, it occurs to me that the question is one of structure. We have been safe, but largely because the local banks tend to be cooperatives or savings banks, which are organized under public law. It might be possible to take over a savings bank, but it is technically and legally so complicated that it just has not been done so far. The question that arises for me is whether this is primarily a structural problem, so that you need do no more than keep banks reasonably small in the local community. Or, are banks somewhat different from normal businesses so that, because they are performing a public service, they should be under some form of special regulation as far as foreign acquisitions are concerned? I would like to give that question back to the panel.

MR. VAGLIANO: I think the question is basically one of the validity or non-validity of local control. Therefore the problem is not really foreign versus American: it is actually not a foreign bank problem. It is a question of the structure of the banking system here, and whether the local communities benefit more or less from local control. Of course, that is a terribly long argument.

I think there can be a political reaction in this country if it is perceived more and more that foreign banks have special advantages. The IBA has, in a sense, attempted to bring greater clarity and greater uniformity. Still, there are real advantages in terms
of functions (either because of grandfathering, or because of the
law and the interpretations that may follow from the law, or because
of antitrust regulation) and because of the fact that reciprocity is
not really part of this whole concept. So I can foresee, and this
might particularly happen if a very large bank were acquired by for-
ign interests, that this entire subject could be reopened politi-
cally.

MR. HUNDHEIM: Neal, you had a comment?

MR. PETERSEN: Yes. In a number of Board orders approving
major foreign acquisitions, there have been rhetorical—I guess I
would put it—statements raising concerns about the market share of
foreign organizations in a particular market. However, those state-
ments have not necessarily been a factor in any decision one way or
the other. Under the present Bank Holding Company Act there are real
questions as to whether the degree of foreign market share per se
necessarily gives the Board any basis for denial.

There is an argument, I suppose, that the so-called conveni-
ence and needs tests under section 3 of the Bank Holding Company Act
could be stretched a bit to cover the problem, particularly if a
record could be developed to show that, indeed, the local market
would not be adequately served because of excessive foreign ownership.
On that point, however, the studies done to date (for example, the
General Accounting Office report and our own report on foreign bank-
ing in the U.S.) have indicated that there has been no real walking
away from local markets after foreign banks have come in. Indeed,
the evidence seems to suggest the contrary. Having said all that,
I would certainly agree with the comment that this is a political
hot potato.

There have already been a number of hearings in the Congress
of the U.S. on this subject, and there have been proposals floated
that would change the test for acquisition of banks by bank holding
companies, both foreign and domestic holding companies. Anything
that might be adopted to change tests under the Bank Holding Company
Act, which would go beyond the present antitrust concerns and the
existing convenience and needs test, may well end up being applied
across the board to both foreign and domestic companies.

One proposal was to apply what we call a public benefits test
to either foreign bank acquisitions or—more likely—any bank acqui-
sition over a certain size. The test would be very similar in con-
cept to the so-called benefits test under section 4(c)(8) of the
Bank Holding Company Act, having to do with non-banking activities.
The test basically says, if there are any adverse effects as defined
in the statute (such as undue concentration of resources, unfair
competition, etc.) they would have to be outweighed by some public
benefit. On the other hand, if there are no adverse effects, we
interpret section 4(c)(8) to say you do not have to have a positive
public benefit. That test might be modified to require demonstration of a positive public benefit.

There have also been some who propose an automatic cut-off if
a market share gets over a particular size in the hands of foreign
banking organizations. That would be very difficult to apply admin-
istratively and could cause some very serious problems with our
friends overseas in terms of possible retaliation. This concept is
similar to Senator Proxmire's Competition In Banking Act (which he
introduces in every Congress) which would put a limit on an acquirer
if it would control more than a certain percentage of the deposits in a particular state.

I think that this subject will continue to be before the Congress notwithstanding a change in the leadership of the Congress or a change in the Administration. Senator Heinz—who is a Republican—and Representative Rosenthal and Representative St. Germain on the House side—who are Democrats—are also very concerned. So, I do not think it is a partisan political issue; but it is a very, very important issue for many members of Congress, in terms of the particular banking structure in their district and, indeed, in the country. I would say the Board has no pending proposals under consideration to make any of these changes. I am just mentioning that these are the kinds of ideas that have been suggested both by members of Congress and, informally, by some regulators.

MR. MUNDHEIM: Fred, one minute for a final comment on this issue.

MR. HELDRING: Right. I certainly do not want to pursue it any further, but I want to clarify the point I made on the soundness of the community. Admittedly, what I am saying applies to all acquisitions and not only to acquisitions by foreigners. When you have an independent local company, it will make contributions, both in talent and in money, to vital non-profit activities in the community. As soon as that company is taken over, both organizational and financial aid ceases. At the present time there are many communities where it is mainly the bankers and lawyers who are still involved in these kinds of effort. Now, if the bankers get acquired and lose their independence, that may be rather serious for some of these communities.

MR. LEHR: I want to note my deep disagreement with Fred Heldring.

MR. MUNDHEIM: I think we should recognize that there are two sides to this debate and we could argue the merits at length. But we must turn to our next topic.
NOTES


[6] The McFadden Act, as amended 1962, 12 U.S.C. §36(c) (1976), provides that a national bank may only establish branches "at any point within the State in which said association is situated." As to state banks, it should further be noted that no state has yet adopted legislation that would permit out-of-state banks to establish branches therein.


[10] It should be noted that the Federal Reserve Board concluded that the form of "branch" which foreign banks had previously been permitted to open in California was to be deemed to be an agency for purposes of the interstate banking regulations, because in the past such a California "branch" was effectively restricted from taking domestic deposits.

[11] Of course, there are also certain domestic bank holding companies that have grandfathered subsidiaries in more than one state.


[15] Interestingly, clearly non-banking activities that would be permitted under Regulation K would not require the approval of the Federal Reserve Board. However, activities to be engaged in by a subsidiary that "consist of banking or financial operations, or types of activities permitted by regulation or order under Section 4(c)(8)" of the Bank Holding Company Act will only be permitted upon the prior approval of the Federal Reserve Board.

[16] Of course, a foreign bank could have acquired either a state or federally chartered subsidiary bank.


[20] An example of a state reciprocity requirement can be found in §202-a of the New York Banking Law, which stipulates that a foreign banking corporation may be granted a branch license in New York provided a bank or trust company located in New York may maintain a branch, agency or wholly-owned subsidiary bank in the foreign bank applicant's country.


[23] Chapter V §2C(v) infra at 71.

APPENDIX I

INTERNATIONAL BANKING ACT OF 1978
A SELECTED BIBLIOGRAPHY*
(as of January 30, 1981)

A. Government Studies and Reports

Comptroller General of the United States. Considerable Increase in Foreign Banking in the United States Since 1972. U.S. General Accounting Office, August 1, 1979. (First of two reports made to the House Committee on Banking, Finance and Urban Affairs regarding the growth of foreign banking activities in the U.S.)


Goddin, C. Stewart and Weiss, Steven J. U.S. Banks' Loss of Global Standing. Comptroller of the Currency Staff Paper, June 1980. (Examines validity of concern that U.S. banks' competitive position in the international market place may be weakening.)


Smith, Wm. Paul and Weiss, Steven J. Potential Acquisition Partners for Large U.S. Banks: The Discriminatory Effects of Law and Policy. Comptroller of the Currency Staff Paper, June 1980. (Describes present restraints on domestic acquisitions and analyzes those effects in limiting the number of potential domestic acquirers of large U.S. banks.)


*This bibliography does not include the regulations or interpretive releases of the federal banking agencies. Please note that the bibliography is arranged chronologically within each category.
Weiss, Steven J. *Competitive Standards Applied to Foreign and Domestic Acquisitions of U.S. Banks.* Comptroller of the Currency Staff Paper, June 1980. (Indicates that global competitive effects are unlikely to be significant.)

Federal Reserve Board. *Foreign Takeovers of United States Banks.* Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 96th Congress, second session, Washington, DC: U.S. Government Printing Office, July 1980. (Foreign acquisition of U.S. banks, though limited, has provided no evidence that foreign ownership has led or will lead to bank supervisory problems.)


Goldberg, Ellen S. *Comparative Cost Analysis of Foreign-Owned U.S. Banks.* Comptroller of the Currency Staff Paper 1980-11, September 1980. (Examines foreign-owned U.S. banks to determine if they have any cost advantages from receipt of low cost or interest-free funds from their respective parent banks.)


Page, Diane and Soss, Neal H. *Some Evidence on Transnational Banking Structure.* Comptroller of the Currency Staff Paper 1980-12, September 1980. (Presents data on the activities of banking institutions outside of their home countries through branches, agencies and subsidiaries.)

Weiss, Steven J. *The Competitive Balance Between Domestic and Foreign Banks in the U.S.* Comptroller of the Currency Staff Paper 1980-13, September 1980. (Analyzes differences between domestic and foreign banks that affect their relative competitive advantages in the U.S. market.)

Federal Reserve Board. *The International Banking Act of 1978.* September 17, 1980. (Responds to IBA requirement that the Federal Reserve Board report to Congress within two years after enactment of the IBA; report makes recommendations on legislation dealing with Edge Corporations and with operations of foreign banks in the U.S.)

U.S. President. *Geographic Restrictions on Commercial Banking in the United States.* U.S. Department of the Treasury, January 1981. (This report was required under IBA and analyzes the geographic restraints on domestic bank branching.)
B. Books, Treatises and Conference Materials


C. Law Review and Journal Articles


Skigen, Patricia S. and Fitzsimmons, John D. "The Impact of the International Banking Act of 1978 on Foreign Banks and Their Domestic and Foreign Affiliates." *Business Lawyer*, v. 35, November 1979, pp. 55-82. (Discusses significant implications of the IBA for both domestic and foreign banks that presently conduct or plan to conduct business in the U.S.)


Lehr, Dennis J. and Hammond, Benton R. "Regulating Foreign Acquisition of U.S. Banks: the CBCA and the BHCA." *Banking Law Journal*, v. 97, February 1980, pp. 100-152. (Acts as a primer on the major banking laws affecting foreign acquisition of interests in U.S. banks.)


D. Miscellaneous

General


Summons and Complaint, Conference of State Bank Supervisors v. John G. Heimann, Civil Action No. 80-3284 (D.D.C. 1980). (Challenges the authority of Comptroller of the Currency to license and regulate the operations of branches and agencies of foreign banks.)

"Applications for Federal Branches/Agencies." Washington, DC: Office of the Comptroller of the Currency, December 31, 1980. (In-house listing of all foreign banks that have applied or are applying for federal branches or agencies within the U.S.)

(ii) News Articles


"A Drive to Keep Foreign Banks at Bay." Business Week. March 19, 1979, pp. 31-32.


