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INTERNATIONAL BANKING AND FINANCE

Multistate Branching and the International Banking Act of 1977

CHARLES E. M. KOLB*

I. INTRODUCTION

One of the uncertainties created by the quintupling of oil prices in October 1973 was precisely what would happen to the enormous reserves of petrodollars which Arab oil-exporting nations were expected to receive. Second only to the problem of finding the revenues to finance continued oil imports — a problem of acute importance for many non-oil producing developing countries¹ — was the problem of rechanneling these funds throughout world financial markets without triggering a destabilizing inflation or a widespread depression.² While all of these traumatic events were shaking world money markets, the United States itself was adjusting to the post-Watergate, post-Vietnam era in which many observers anticipated a stage of emerging neo-isolationism. In terms of its relations abroad, the United States was beset with a number of complex problems: foreign oil cartels, a Russian wheat sale gone sour, the much heralded yet unsuccessful “year of Europe,” rising competition from Japanese imports and the unraveling of a series of sordid stories relating to improper CIA activities abroad and illegal bribes made by U.S. corporate officers to obtain foreign contracts. In the face of these overseas frustrations, U.S. policy-makers felt that the only way of countering these disappointments was to exercise the economic leverage wielded by the trillion dollar U.S. GNP.³ Thus, in late 1973, the summer “farm boom” was followed by the creation of “new trade restrictions,” most notably an export embargo on soybean shipments and other foodstuffs.⁴ Talk of reducing trade barriers waned and concern grew for the protection of the national interest from foreign influences. William Diebold has explained the attitude that seemed prevalent in the leading Western industrial democracies:

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1. See, Beim, *Rescuing the LDCs*, 55 *Foreign Affairs* 717 (1977); Cleveland & Brittain, *Are the LDCs in OVER their Heads?* 55 *Foreign Affairs* 732 (1977); Levy, *World Oil Cooperation or International Chaos*, 52 *Foreign Affairs* 690 (1974).

2. See Levy, *supra* note 1, at 713.

3. Diebold, *U.S. Trade Policy: The New Political Dimensions*, 52 *Foreign Affairs* 472 (1974).

4. *Id.* at 481.

Malaise and discontent, common to the industrial countries, made governments and people focus on issues that seemed far more urgent than the distant promise of good results from international negotiations. The feeling grew that governments were rarely as well occupied as when they were knitting up their raveled societies. . . . For some people, nationalism took on a benign hue, while the gains of past international cooperation were more or less taken for granted.⁵

Coincidental with these restrictive influences in U.S. trade practices came an increased concern that the turmoil in world financial markets of 1974 and 1975, stemming from dollar instability due to recycled petrodollars, two major bank failures and large foreign exchange losses, required protective action at home.⁶ The result was an increased legislative concern for the scope of foreign banking activities in the United States. This concern found legislative outlets in proposals submitted by the Federal Reserve Board (the Fed) in 1974 and in the completion of the Financial Institutions and the Nation's Economy (FINE) Study in 1975. The latter identified some five areas in which foreign banks operating branches, agencies, or subsidiaries in the United States were deemed to have competitive advantages over domestic banks.⁷

This essay will examine the claims of the FINE report and the Fed with specific reference to the problem of multistate branching by foreign banks in the United States. The discussion will be conducted within the context of the contemporary Congressional debate over section 5 of the International Banking Act of 1977.⁸

II. U.S. INTERNATIONAL BANKING LEGISLATION

Congressional interest in regulating the U.S. activities of foreign banks can be traced to 1967 and the failure of the New York affiliate of Intrabank, a Lebanese bank.⁹ Ten years ago the presence of foreign banking in the United States was not nearly as visible as it is today, in large part due to the fact that the flow of funds was from the United States to foreign countries. Since the early 1970s, however, the influx of foreign capital into the country has been unprecedented. From November 1972 to May 1977 the "standard banking assets" of foreign banks (exclusive of clearing balances and balances from directly related institutions) has increased 1¼ times, from

5. *Id.* at 480-81.

6. Guenther, *Legislative Doldrums*, 126 *Banker* 1143, 1143 (Oct. 1976).

7. Nevans, *Foreign Banks in New York: The Great New Growth Centre*, *Euromoney* 18, 51 (June 1977).

8. See text at pp. *infra*.

9. Hendrickson, *Will Congress Finally Crack Down on Foreign Banks?* *Institutional Investor* 137, 137 (Sept. 1977).

\$18.3 billion to \$50.5 billion.¹⁰ *Business Week* magazine reported in 1974 that foreign banks in this country underwent a sevenfold asset increase in just eight years.¹¹ With Arab oil money being recycled through sophisticated money markets in London and New York, and with substantial investments being made in U.S. securities and real estate ventures,¹² members of the Federal Reserve Board and certain Congressmen became alarmed that the inflow of Arab petrodollars might carry with it increased Arab political and economic leverage which could jeopardize our national security.¹³

Serious legislative activity began after the Federal Reserve Steering Committee on International Banking developed a set of proposals in February 1974 which would promote equality of treatment as to the "regulation and supervision of foreign and domestic banks operating in this country."¹⁴ In early December 1974, the Fed sent legislation to the Congress in light of the criticisms received in connection with its earlier proposals.¹⁵ This legislation became known as the Foreign Bank Act of 1974¹⁶ and, due to its late introduction in 1974, was reintroduced the following year as the Foreign Bank Act of 1975.¹⁷ One commentator has described these proposals as follows:

The Federal Reserve proposals represent a comprehensive and coherent approach to regulatory reform which address each of the major problems associated with the expansion of foreign banking in the United States. The proposals are grounded in the principle of non-discrimination and would achieve equality of treatment in the regulation and supervision of foreign and domestic banks. Further, the proposal would bring foreign banks within the purview of the central bank, increasing the efficiency of monetary policy and making United States policies toward foreign banks responsive to various foreign policy considerations.¹⁸

This statement, in essence, reflects the major underlying premises of the Fed's proposals; however, given the structural characteristics of the present U.S. "dual" banking system, e.g., a system subject to both state chartering provisions and federal regulation, it is apparent that the Fed's approach is

10. Terrell & Key, *The U.S. Activities of Foreign Banks: An Analytic Survey* (Oct. 6, 1977) 5. (Prepared for Conference on Key Issues in International Banking Sponsored by the Federal Reserve Bank of Boston, presented at Bald Peak Colony Club Melvin Village, N.H.)

11. *The Fed's Drive to Regulate Foreign Banks*, *Business Week* 61 (July 13, 1974).

12. *Fretting Over Foreign Banking*, *Business Week* 24 (Dec. 8, 1975).

13. Halperin, *The Regulation of Foreign Banks in the United States*, 9 *Int'l Law.* 661, 661 (1975).

14. *Id.* at 684.

15. *Id.*

16. *Id.* at 681.

17. *Id.*

18. *Id.* at 687.

neither "comprehensive" nor "coherent." Furthermore, as the legislation has developed into the International Banking Acts of 1976 and 1977,¹⁹ doubts have arisen as to whether the reasons alleged for having such regulations in the case of foreign banks in the United States are in fact justifiable on either empirical or policy grounds. Furthermore, any proposal mandating membership in the Federal Reserve System would not only depart from the present treatment accorded domestic state banks to which membership is optional, but also would detract from the Fed's articulated concerns for the promotion of "non-discrimination" and "equality of treatment." This essay's major premise is that while concern over domestic activities of foreign banks is timely, it does not provide the occasion for drastic piecemeal alterations in the U.S. banking regulatory system. As will be explained in detail below, the necessary impact of the Fed's proposals concerning foreign banks would be a lessening of state prerogatives within the current "dual" banking system.²⁰ Opponents of the International Banking Act of 1977 suspect that granting the Fed increased power over the activities of foreign banks will only serve as the prelude to the end of the present dual banking system.²¹ As Donald Platten, the Chairman of Chemical Bank, has written, "[t]he need to promote national policy in the international arena has clearly justified an increase in the Federal Reserve's involvement."²² My chief concern, however, is that passage of the International Banking Act of 1977 in its present form would create a reverse effect, whereby the Fed would actually extend its alleged rationale for control over foreign banks into a means for eventually establishing a national, unitary, federal banking system. If a federal system is really what the Fed eventually wants, then Congress should concentrate on legislation to restructure the entire system. The present legislation has all of the drawbacks of a piecemeal approach which attempts to deal with some problems while only making the overall situation much worse. Nothing illustrates this situation better than the proposed measures dealing with multistate branching of banks.

19. These bills are shown as H.R. 13876 and H.R. 7325 respectively.

20. For a general discussion of the U.S. "dual" banking system see J. White, *Teaching Materials on Banking Law* 939-46 (1976).

21. This speculation has been openly voiced on a number of occasions and was stressed by some of the participants in the *Hearings Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs*, 95th Cong., 1st Sess., July 12, 13, and 19, 1977 at 309, 374, 448, and 604 [hereinafter cited as *Hearings*].

22. Platten, *The Mutterings of Nationalism Threaten America's Real Interests*, *Euromoney* 66, 68 (Oct. 1976).

III. MULTISTATE BRANCHING

A. *The problem*²³

Under the present system of U.S. bank regulation, domestic banks are not generally permitted to establish branches in other states. The McFadden Act provides that a nationally chartered bank may branch, but only to the extent that the law of the state in which it is located allows branching by a state bank.²⁴ The issue presented by branching regulation is crucial to the presence of foreign banking institutions in this country since foreign banks want access to capital markets which are now developing in regions other than the traditional ones in the industrial northeast and on the West Coast. From the domestic perspective, several states would clearly like to compete for foreign funds which would then be invested in their own regional development. Thus, as of 1975, ten states specifically authorized foreign banks to operate within their borders.²⁵ Ten others forbade such operations,²⁶ and it can be assumed that in the remaining states having no legislation on the subject, foreign branch banking would not be permitted.²⁷

In the absence of a national policy on the presence of foreign banks, states are virtually free to do as they please in this area, and the outcry by some small state banks has been that foreign banks enjoy a competitive advantage in U.S. financial markets not shared by domestic banks which are confined to the state in which they are chartered. As Stuart Pittman, Counsel for the Institute of Foreign Bankers, has observed, "[M]ultistate branching is the threshold issue without which foreign bank legislation would not have gotten started."²⁸ The obvious problem, of course, is that states like California, Illinois and New York — states where major foreign banks have chosen to do most of their U.S. branching — favor the current absence of national regulation over foreign banks. Conversely, states less successful in attracting foreign business have decried the absence of regulation as providing a competitive advantage to the foreign banks. To the extent that the United States favors a policy of (1) attracting foreign investment and (2) integrating world capital markets, the proper response to the presence of foreign banks calls for liberalizing domestic prohibitions against branching rather than restricting the operations of foreign banks in the United States to the state in which the foreign bank is initially chartered.

23. This essay will not discuss the general benefits and disadvantages of the varying organizational forms in which foreign banks may operate in the United States, e.g. subsidiaries, affiliates and branches. Several thorough presentations of this issue already exist and may be found in J. White, *supra* note 20 at 916-20 and Halperin, *supra* note 13 at 663-65.

24. 12 U.S.C. § 36 (1970).

25. Halperin, *supra* note 13, at 666.

26. *Id.*

27. *Id.*

28. *Hearings, supra* note 21 at 470.

B. *The Rationale for Anti-branching rules*

As of 1976, eighteen states allowed branching on a statewide basis; twenty-one allowed it but restricted it to particular geographical areas.²⁹ Twelve states forbid branching altogether.³⁰ Burton Barnes has suggested that contemporary restrictive branching policies in the domestic context stem from the 1930s, when there was fear that a concentrated banking industry would result in anticompetitive monopolistic tendencies threatening "competitive equality" under the U.S. dual banking system.³¹ As in the case of merger policy under the antitrust laws,³² however, such a per se approach to the problem ran the risk of denying the realization of economies of scale and often obscured the economic realities. Thus, with respect to anti-branching rules, a former head of the Department of Justice's Antitrust Division has written that

These restrictive rules are supported by a lot of excited rhetoric about "concentration" and "monopoly" which requires careful analysis. Highly restrictive state laws may limit statewide "concentration" at the price of protecting local "monopolies." Less restrictive measures — including greater reliance on anti-trust laws — are available to protect against undue concentration, coercive restraints, and predatory practices.³³

In recent years, given the influx of foreign banks, the worry has been that large foreign banks will gain entry into domestic state markets, thereby competing with state banks at the retail credit level since these large banks will necessarily have a lower cost of funds.³⁴ At the same time, the large U.S. national banks favor such expansion, as a substantial amount of their profits are generated from banking activities abroad.³⁵ Consequently, these large national banks are hesitant to support restrictions on foreign banking activity in the United States lest foreign countries adopt similar restrictive practices in retaliation.³⁶

29. Barnes, *The Fine Edge of Prohibition: Interstate and Foreign Banking in the United States*, 91 *Banking L.J.* 911, 912 (1976).

30. *Id.*

31. *Id.* at 914.

32. For the most recent discussion by the Supreme Court of merger policy which specifically rejects a per se approach in favor of particularistic inquiry into the economics of the situation see *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 45 U.S.L.W. 4828 (1977).

33. Barnes, *supra* note 29, at 916-17.

34. Festetics, *Strategic Considerations for Foreign Bank Expansion*, 9 *Colom. J. World Business* 81 (1974).

35. See *Regulation Looming For U.S. Banks Abroad*, *N.Y. Times*, Dec. 21, 1977, at 1, col. 4 (80 percent of Citibank's profits are from overseas banking interests).

36. See, e.g., Reimpell, *U.S. Plans to Restrict Foreign Banks Leave a Bad Taste in German Mouths*, *Euromoney* 61, 62 (Sept. 1976).

Fed Chairman Arthur Burns commented that the antibranching provisions of section 5 of H.R. 13876 (the International Banking Act of 1976), the language of which was virtually identical to that in H.R. 7325's section 5, sought "to equalize the ground rules for interstate banking competition between large domestic banks and foreign banks. . . . The Board prefers section 5 of H.R. 13876 in its present form because it would . . . be more consistent with the principle of national treatment."³⁷ The plain fact is, however, that "large domestic banks" see no need for such restrictive legislation. In its 1976 position paper on H.R. 13876, the New York State Banking Department, the department in whose jurisdiction are located such banks as Citicorp and Chase Manhattan, supported "the continuation of the existing authority for interstate banking despite the fact that the International Banking Act's ban on interstate branching by foreign banks might, in a limited way, *benefit* New York."³⁸ The benefit would be obvious: the grandfathering provisions would create a comparative domestic advantage for those financial centers having already accommodated foreign banking operations.³⁹ Similarly, Carl Schmitt, California's bank superintendent, wrote to Congressman Rousselot charging that the bill's restrictions on multistate branching "will impair California's development as an international financial center."⁴⁰

From an economic standpoint the argument that foreign banks should be subject to restrictive branching regulations because of fear of undue concentration or adverse competition is analogous to the contemporary arguments against allowing foreign imports of steel and shoes, for example, to compete with U.S. producers of these items. Assuming away instances of predatory pricing or dumping, both of which can be dealt with under the countervailing duty⁴¹ and anti-dumping⁴² sections of the Foreign Trade Act of 1974,⁴³ foreign imports competing purely in terms of their efficiency in their means of production provide a competitive stimulus to U.S. firms and a general consumer welfare benefit to U.S. purchasers. Forbidding these imports on non-economic, non-efficiency grounds denies U.S. consumers the realization of these efficiencies and established a negative precedent in terms

37. H.R. Jour. H 7948 (July, 1976) (debate on International Banking Act of 1976) [hereinafter, *Journal*].

38. *Id.* at H7936, H 7952.

39. See the principles articulated by the New York State Banking Department for the regulation of foreign banks in *id.* at H.R. 7951.

40. *Id.*

41. A countervailing duty is a duty imposed by an importing country to offset directly a trade preference accorded a particular export by the exporting country. See, 19 U.S.C. § 2411 (Supp. V 1975).

42. Anti-dumping provisions may be imposed to prevent the practice of an exporter's selling goods in a foreign market below cost in order to practice predatory pricing as a means to generate monopoly profits. See 19 U.S.C. § 2411 (Supp. V 1975).

43. Codified at 19 U.S.C. § 2251 (Supp. V. 1975).

of trade liberalization. Insofar as foreign banking activities in the United States are involved, there is little to fear either in terms of excessive concentration or unfair competition. As the New York State Banking Department explained in 1976, "[f]oreign banking organizations . . . have established rather limited banking activities across state lines. For one thing, any foreign bank which has established a full service bank in the U.S. is subject to all of the restraints on interstate banking which the Bank Holding Act imposes on domestic banks."⁴⁴

In summary, then, if foreign banks operating in the United States actually pose threats in terms of retail service competition with domestic banks or in terms of potential excessive concentration, we already possess the necessary legal machinery for regulating their activities just as we would do for similarly situated domestic banks.

IV. THE INTERNATIONAL BANKING ACT OF 1977

Introduced on May 23, 1977 as H.R. 7325, the International Banking Act of 1977 is intended "To provide for Federal regulation of participation by foreign banks in domestic financial markets."⁴⁵ Its key provisions deal with the establishment of Edge Act Corporations (Sec. 3), Federal branches and agencies (Sec. 4), interstate banking operations (Sec. 5), and the regulation of certain "nonbanking activities" such as the underwriting and distribution of securities in the United States by foreign banks (Sec. 8). The language of H.R. 7325 is virtually identical to that of H.R. 13876 which the House of Representatives passed in 1976 but which languished in the Senate at the end of the legislative session. Section 9 sets forth "guidelines for foreign bank operations" stating that the Act "shall seek to achieve a parity of treatment for foreign banks, branches, agencies, and commercial lending companies relative to their domestic counterparts."⁴⁶ Guidelines issued by the Secretary of the Treasury "shall endeavor to foster participation by foreign interests in international financial markets in the United States to the maximum extent consistent with maintenance of fair and vigorous competition in such markets. . . ."⁴⁷

A. *Provisions affecting branching*

Section 4(a) of H.R. 7325 states that, except as provided in section 5 (interstate banking operations), "a foreign bank may, with the approval of the Comptroller, establish a Federal branch or agency in any State in which (1) it is not operating a branch or agency pursuant to State law and (2) the

44. *Journal, supra* note 37 at 7952.

45. *Hearings, supra* note 21, at 3.

46. *Id.* at 28.

47. *Id.* at 29.

establishment of a branch or agency . . . by a foreign bank is not prohibited by State law."⁴⁸ When the bill was marked up on October 13, 1977, section 4(a) was qualified to apply only to a foreign bank "which engages directly in a banking business outside the United States."⁴⁹

Section 5(a) details the conditions under which foreign banks can engage in branching:

Except as provided by subsection (b), no foreign bank may operate a branch, agency, commercial lending company subsidiary, or bank subsidiary outside its home State unless (1) in the case of a Federal or State branch, the State is one in which it could operate a branch if it were a national bank located in its home State, (2) in the case of a State branch, agency, or commercial lending company, it is approved by the regulatory authority of the State in which such State branch, agency, or commercial lending company is to be operated, and (3) in the case of a Federal branch or agency, its operation is not prohibited by the State in which it is to be operated. . .⁵⁰

Subsection (b) provides a grandfather clause for foreign bank branching activities "lawfully commenced" or properly "approved" by State authority prior to May 1, 1976.⁵¹ The Report issued by the Committee on Banking, Currency and Housing states that the bill has two main policy objectives: (1) "to provide a system of Federal regulation of foreign banking activities," and (2) to provide "equal treatment" for foreign and domestic banks operating in the United States.⁵² Section 5(a) would, theoretically, accomplish the latter goal by prohibiting foreign banks from branching unless states provided equal treatment for national banks. In the markup session, the Committee deleted the grandfathering provisions entirely and changed section 5(a) by deleting subsection (1) and by requiring express permission from a State in which a Federal branch or agency would be operated. The overall effect is to sanction the status quo which leaves multistate branching to the discretion of individual states.

B. *Rationale for the provisions*

At the present time, regulation of foreign banks in the United States is left almost completely to the individual states. One argument frequently advanced against this approach is that the lack of a consistent, coherent treat-

48. *Id.* at 8.

49. H.R. 7325 § 4(a), at 7 (Comm. Print 1977).

50. *Hearings, supra* note 21, at 14-15.

51. *Id.* at 15.

52. Report from the Committee on Banking, Currency and Housing on H.R. 13876, submitted on May 26, 1976, H.R. Rep. No. 94-1193 at 2, 94th Cong., 2d Sess. (1976) [hereinafter cited as *Report*].

ment of bank branching results in "open inequality" which lets big foreign banks establish offices in major financial capitals while denying this right to domestic banks.⁵³ In making its plea for broad federal regulation of foreign banking, the Committee Report justifies its results "in view of the impact of foreign banking institutions on domestic financial markets and the domestic and foreign commerce of the United States, and because most foreign banks operate in the United States in more than one state."⁵⁴ The impact is never analyzed in terms of whether it is positive or negative, and the mere *fact* that foreign banks have multistate operations can be positive in terms of providing capital for regional development and offsetting U.S. balance of payments deficits. The unarticulated empirical premises behind the anti-branching provisions have a hollow ring reminiscent of the vague rationales with which the Fed has been lobbying on behalf of this legislation for the last three years.

Let us look at the empirical premises underlying the bill's general policy objectives. Specifically we can isolate the following concerns which federal restrictions on branching would supposedly remedy: (1) Competitive advantages of foreign banks, (2) inability of the Fed to implement a successful U.S. monetary policy, and (3) fear that international credit flows through foreign-owned branches will create increased political leverage for countries having a petrodollar surplus.

1. *Competitive advantages*

One of the overriding principles of U.S. policy toward foreign direct investment has been that of "national treatment," whereby foreign business entities are accorded the same treatment as domestic businesses.⁵⁵ The argument in vogue among supporters favoring restriction of branching rules is that multistate branching grants foreign banks a competitive advantage. In testimony before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance on H.R. 7325, William E. Whitesell, speaking on behalf of the Conference of State Bank Supervisors, observed that "[t]o prevent what is perceived as a competitive advantage favoring foreign banks, the bill would in fact discriminate against states other than New York and California in their international banking aspirations."⁵⁶ By requiring foreign banks to confine their operations to their "home" state unless branching was allowed to national banks in a given state, the bill would effectively coerce foreign banks to locate in the developed financial centers. Georgia, for example, with the support of then Governor Carter, in 1974 passed an International Banking Agency Act which was "aimed at ex-

53. Barnes, *supra*, note 29, at 926.

54. Report, *supra* note 52, at 2.

55. Hearings, *supra* note 21, at 267.

56. *Id.* at 315.

panding Atlanta's role as an international financial center."⁵⁷ In similar testimony to that of Whitesell, Governor Busbee of Georgia challenged the facts of the "comparative advantage" argument when he argued that "[d]omestic banks utilize a wide range of multistate bank holding company bank and nonbank affiliates, Edge Act corporations, loan production offices, traveling loan and deposit-producing offices, and a nationwide correspondent banking network to far outstrip foreign bank competition in this area."⁵⁸ Furthermore, there is little indication that foreign banks in the United States prefer to engage in the panoply of traditional consumer-oriented banking services such as trust service, mortgages, credit-related insurance, ordinary checking and savings account business, and the supplying of venture capital to small businesses.⁵⁹

Competitive advantage is one of the chief rationales behind the International Banking Act in general and the multistate branching provisions in particular. The empirical evidence, however, as to the demonstrated validity of this justification simply is not convincing. In light of this dilemma, until a more convincing demonstration of the inequities created by multistate branching can be presented, this rationale should be abandoned.⁶⁰

2. *Fed control over monetary policy*

If enacted as originally proposed, H.R. 7325 would permit the Fed to establish reserve requirements and reporting obligations which currently are not required by domestic state-chartered non-member banks.⁶¹ In terms of adherence to the original "equality of treatment" principle, such a provision amounts to a radical departure from this objective. One of the alleged reasons for this expanded requirement is that foreign banks should be considered as a "special category of banking institution" for which federal law must "fill the gap" in the absence of State branching laws.⁶² By offering this viewpoint the U.S. Treasury appears to be in accordance with the Fed which speculates that without such restrictions, its ability to implement successful monetary policy will be thwarted by the likelihood that foreign banks could escape any restrictive policy by drawing on the resources of their home offices. The problem with this rationale is that the Congress could easily create a set of currency movement restrictions or controls to prohibit such massive movements in potentially threatening contexts.

As part of the reason behind the Fed's argument, the increase in total assets of foreign banks in the United States — some 172 percent during the

57. *Id.* at 605.

58. *Id.* at 607.

59. *Id.* at 608.

60. *See id.* at 574.

61. *See Platten, supra* note 22, at 68.

62. *Hearings, supra* note 21, at 263.

last five years — is cited.⁶³ European banks have currently approximately \$30 billion in assets in this country, a growth of 329 percent since 1972.⁶⁴ U.S. banks operating overseas branches and subsidiaries, on the other hand, have assets of approximately \$225 billion located in some 728 branches abroad.⁶⁵ At the present, some 93 foreign banks maintain 210 foreign bank operations in the United States, a 101 percent increase since 1972.⁶⁶ Thus, in comparison with the aggregate presence of U.S. banks overseas, that of foreign banks in the United States is significantly smaller.

One of the vehicles by which the Fed attempts to regulate the domestic money supply is Regulation M.⁶⁷ This provision requires that a U.S. bank keep a reserve of 4 percent on foreign funds which are loaned to customers in the United States. Most of these funds in the past have been Eurodollars;⁶⁸ however, there is recent evidence that an increasing amount of foreign investment in the United States may be coming from the Far East.⁶⁹ Since foreign banks are not members of the Federal Reserve System, they do not have to comply with this reserve requirement, and the conclusion drawn by many observers is that this situation “gives a bank that is loaning dollars raised in the Euromarket an automatic price edge of between an eighth and a quarter.”⁷⁰ In 1973, during a brief monetary crisis, Fed Chairman Burns requested foreign banks in the United States to comply voluntarily with Reg M. For the most part, the foreign banks complied with the Chairman’s request.⁷¹ The countervailing position against the Fed’s position as regards foreign banks, however, is that U.S. banks are able to avoid the restraints of Reg. M, thereby defeating the Fed’s overall policy of monetary control over the flow of foreign funds:

“Reg M,” says an Italian banker, “was created to be avoided.” Yet American banks also easily avoid Reg M by crediting Eurodollar loans to the account of European offices of American corporations, which then transfer the money back to the U.S. “Except for some small U.S. banks that don’t have access to the Euromarket,” says a government economist, “nobody really has an important cost-of-funds advantage over anyone else.”⁷²

63. *Id.* at 578.

64. *Id.*

65. *Id.* at 579.

66. *Id.* at 578.

67. 12 C.F.R. §213 (1977). See also Lichtenstein, *Foreign Participation in United States Banking: Regulatory Myths and Realities*, 15 B.C. Indus. & Com. L. Rev. 879 (1974).

68. Welles, *Bankers, Bankers Everywhere — But How Much Business are they Getting?*, Institutional Investor 115, 130 (Sept. 1977).

69. Lachica & Lipsky, *Japan is Changing into Capital Source for Foreign Governments, Corporations*, Wall St. J., Jan. 5, 1978 at 14, col. 1.

70. Welles, *supra* note 68, at 130.

71. *Id.*

72. *Id.*

Once again, the principle of national treatment and the empirical data show the rationale for the bill's restrictions on foreign banking activities in the United States to be unwarranted. Although legally free from the necessity of compliance with Reg M, foreign banks do not gain either a competitive advantage or the power to "end run" U.S. monetary policy. The Fed has simply failed to make its case.

One of the principal reasons behind the growth of foreign banking operations in the United States is the relative absence of "any elements of 'country-risk' associated with dollar investments in banking facilities outside the United States."⁷³ Foreign banks' deposits in the United States reflect both the relative stability of the U.S. investment climate and the desire by foreign banks to service industries from home in their trade relations with the United States. As essentially "service facilities," foreign banks in this country still need to retain a certain level of demand balances in order to carry on routine clearing and settlements activities. Demand balances, then, function in part "as compensation for services rendered" by U.S. banks for correspondent activities.⁷⁴ Under the present regulatory framework, foreign banks operating in New York, California, and Illinois must comply with State reserve requirements "similar in magnitude to Federal Reserve requirements, but which can be satisfied by demand balances at domestic banks."⁷⁵ According to Terrell and Key, however, the requirement that U.S. offices of foreign banks must join the Federal Reserve System would mean that "their demand for these balances would be reduced substantially because they would satisfy their reserve requirements through balances at Federal Reserve banks, and their access to Federal Reserve services would reduce their need to hold demand balances as compensation for correspondent services."⁷⁶ Once again, federal regulation in this area would be preemptive of state control, and the overall impact would be negative in terms of the correspondent relationships between foreign and state banks.

3. *Political leverage through currency flows*

The presence of foreign banking operations in the United States is not something new. The Rothschilds established an agency in San Francisco in 1849, to be followed in 1875 by the Hong Kong & Shanghai Bank. Canadian banks began operations in the United States in the 1880s.⁷⁷ Only since the massive problems created by the need to recycle petrodollars have become politically salient, however, has there been any serious concern over the increasing presence of foreign capital in this country. Best-sellers such as

73. Terrell & Key, *supra* note 10, at 8.

74. *Id.* at 10

75. *Id.* at 9-10.

76. *Id.*

77. Terzakis, *How to Regulate Foreign Banks?*, *Banking* 72, 72 (July 1976).

Paul Erdman's *The Crash of 1979* speculate as to the consequences of a politically-motivated major funds transfer of OPEC nations out of the U.S. banking system. The problem with Erdman's scenario, however, is its assumption that OPEC nations would willingly jeopardize their own reserves by wrecking the international monetary system. Furthermore, he fails to explain just where OPEC nations would deposit such large amounts of money outside the United States in a fashion which would keep it out of the U.S. economy. In other words, assuming a stable and vibrant U.S. economy in the near future, the initial decision to export capital to the United States is unlikely to be reversed for *political* reasons as long as the U.S. economy is strong.

Supporters of the International Banking Act of 1977 seem to feel that the problem of foreign capital coming into the United States is a direct offshoot of the problem of recycling petrodollars. Since recycling is a "global" problem, so the argument goes, individual states have no role to play in the outcome. As James J. Terzakis has observed, "[t]he Fed has taken the position that a national perspective as to foreign banks is essential, and that that perspective can only be effective on the federal level."⁷⁸ This national perspective, however, is premised largely on a set of fears which are primarily speculative. Aside from the investment opportunities offered by U.S. businesses, the predominant reasons behind the presence of foreign banks in this country are fourfold: (1) To obtain presence in the U.S. capital and industrial market, (2) to gather information for their own country's overseas businesses, (3) to keep up with their competition, and (4) to service business interests of U.S. corporations with foreign interests and vice versa.

If a problem exists in this area, it is one involving attitudes and not political leverage. For the first time in recent history, countries other than the United States are becoming capital exporters. For American sensibilities, a significant foreign presence in this country is an unusual phenomenon.⁷⁹ By way of contrast, Germany has thirteen banks from six American states doing business. As one writer has stated, the general timing of H.R. 7325 is poor because "it happens when the one-way flow of American investment abroad is turning into a reciprocal two-way flow. Yet this evolution should be seen as beneficial to U.S. worldwide business interests."⁸⁰ From a purely domestic standpoint, H.R. 7325 is being considered within the context of a national debate about free trade and the alleged "perils" of foreign competition.⁸¹ For these reasons, the timing is

78. *Id.* at 74.

79. See J. Higham, *Strangers in the Land* (1963) for a discussion of xenophobia in American history.

80. Reimpell, *supra* note 36, at 62.

81. See Conderacci, *Rising Pressure for Protectionism*, Wall St. J., Dec. 29, 1977, at 8, col. 4, and Dewar, *Meany Calls Free Trade A 'Myth,' Urges Strict Imports Control Plan*, Wash. Post, Dec. 9, 1977, at A3, col. 1.

poor, and final action on the bill should be delayed until the domestic political climate is more settled. Action which is at best hasty and based on speculation about the competitive effects of foreign banks in the United States runs the risk of foreign retaliation, especially if the intended legislation "goes beyond what is considered fair treatment."⁸²

V. THE FUTURE OF MULTISTATE BRANCHING AND H.R. 7325

The markup session on H.R. 7325 resulted in elimination of the prohibitions on multistate branching through the use of language which deleted the provisions requiring equal treatment as to branching for national banks. The bill as reported out of committee also requires *express* permission by a State before a foreign bank can set up a Federal branch or agency in a particular State. The Fed originally had proposed "that direct imposition of the branching restrictions of the McFadden Act should be limited to Federal branches and agencies."⁸³ As initially intended, the legislation would have meant that future foreign branches and agencies located outside the State where their main office was situated had to be federally chartered.⁸⁴ Section 5 of H.R. 7325, as it stands after the markup session, represents a complete rejection of the Fed's position. Judging by the testimony presented at the July 1977 hearings, the interests of the foreign banks,⁸⁵ the large U.S. banks having international and global operations,⁸⁶ and the Conference of State Bank Supervisors⁸⁷ had the most persuasive effect.

Without the provisions limiting multistate branching, has the International Banking Act of 1977 lost its overriding *raison d'être*? The remaining key sections of the bill deal with other issues which are also of import to foreign banks seeking entry into the United States. Section 6(a), as amended after the markup, requires the "[n]o foreign bank may establish or operate a Federal branch unless the branch is an insured branch as defined in section 3(s) of the Federal Deposit Insurance Act."⁸⁸ This requirement is discriminatory and violative of the equal treatment premise behind foreign bank regulation. Furthermore, it imposes an extra cost-of-funds element which U.S. banks are exempt from if they choose to be. Similarly, section 8(c)'s inclusion of foreign banks within the Glass-Steagall prohibitions against commercial banks undertaking investment banking activities could well contravene a number of the Treaties of Friendship, Commerce and

82. Reimpell, *supra* note 36, at 62.

83. *Hearings, supra* note 21, at 39.

84. Reimpell, *supra* note 36, at 62.

85. *Hearings, supra* note 21, at 336-38, 341, 374, 431, 445.

86. *Id.* at 294, 296.

87. *Id.* at 309.

88. See H.R. 7325, § 6(a), at 18 (Committee Print 1977).

Navigation⁸⁹ signed by the United States and several of its trading partners. Before this provision becomes operative — and regardless of the use of grandfathering provisions to cushion its impact — attention should be paid to any potential treaty violations. Part of the problem here stems from the fact that foreign banks often have significantly different operating structures from U.S. banks, and any attempt to regulate their dealings in the U.S. securities market must take into account that in most foreign countries, banks can perform both investment and commercial banking activities.⁹⁰ Perhaps the proponents of this section of H.R. 7325 would be advised to consult with the Securities and Exchange Commission in order to develop an approach which can accommodate the foreign banks as concerning these particular non-banking activities.

One can readily note that the directional outlook of this legislation is both national and international: the standard for domestic comparison is taken to be “equality of treatment” while from an international standpoint the bill is meant to facilitate the functioning of “the international payments mechanism and implementation of reciprocal arrangements with other countries to strengthen international trade.”⁹¹ The chief difficulty with the bill in its current form, however, is that these standards are by no means commonly accepted. Providing “equality of treatment” necessarily means allocating more power to federal regulation of domestic banking activities, thereby undermining the present dual banking system; however, such a major change should stem from a much broader effort to restructure the *entire* system of U.S. banking regulations. H.R. 7325 suffers, then, from a bureaucratic schizophrenia to the extent that it endeavors to erect standards at a time when the regulation of the U.S. domestic banking industry is, according to many observers, badly in need of major overhauling.

A simple example relevant to the multistate branching issue will illustrate this point. As explained earlier, anti-branching rules were justified as necessary means to guarantee competition in order to lessen the likelihood of excessive concentration.⁹² Within the last two decades, changes in commuting and hiring patterns and the invention of electronic fund-transfer systems (EFTS) along with customer-bank communication terminals (CBCTS) have enabled domestic banking institutions to engage in essentially interstate activities. These technological changes alone have created an environment which suggests the relaxation of strict antibranching

89. For instance, Peter Reimpell suggests that the bill's “retroactive application of a new law to well-established operations” might be contrary to the German-American Treaty of Friendship, Commerce and Navigation, *supra* note 36, at 62. See also Treaty with the Netherlands on Friendship, Commerce and Navigation, March 27, 1956, art. VII, paras. 1 & 2, 8 U.S.T. 2043, T.I.A.S. No. 3942 (effective Dec. 5, 1957).

90. See *Hearings*, *supra* note 21, at 341, 344.

91. *Id.* at 29.

92. See text and accompanying notes 28-44.

rules.⁹³ Similarly, the rise of debit cards in accessing credit balances located out of state have given finance companies and retailers expanded opportunities. Savings and loan associations have recently become active in lobbying for interstate branching, and regional banks, attuned to increased opportunities of obtaining capital, have been active setting up out-of-state Edge Act corporations.⁹⁴ These recent developments in the domestic banking arena suggest that the concept of restrictive branching is seriously in question. Consequently, it makes little sense to establish regulation of foreign branching activities on the basis of "equality of treatment" when that same domestic standard is itself in flux.⁹⁵

VI. CONCLUSION

Both politicians and economists have realized that future world prosperity requires positive adaptation to economic interdependence. As Richard N. Cooper, Under Secretary of State for Economic Affairs, has stated, "[f]our conditions . . . are critical to a well-functioning world economy:" economic growth, efficiency, equity, and adaptability.⁹⁶ Cooper has also been the most recent advocate of an "open international economic system" in recognizing that "[w]e all have a stake in insuring that international flows of capital, goods, services, and technology continue to move competitively according to fundamentally liberal economic principles."⁹⁷ In order to comply with these principles and Cooper's four conditions, the attitude of the United States government must be one of neutrality, thereby allowing foreign investors and bankers to make their decisions on the basis of relevant economic criteria rather than in light of "structural rigidities" meant to dissuade the presence of foreign economic entities from American entry by making their operations more costly. The real issue at stake in H.R. 7325 concerns the degree to which the United States is willing to open its doors to foreign capital and foreign banking activities so as to grant effective reciprocity of treatment. The justifications offered by the Fed, H.R. 7325's chief sponsor, are not only ambiguous in light of the available em-

93. See Guenther, *supra* note 6, at 1146.

94. 12 C.F.R. § 211.1-10 (1972).

95. For recent court decisions dealing with this new technological impact on the scope of multistate branching see *Cheshire Nat'l Bank v. Smith*, 427 F. Supp. 277 (D.N.H. 1977); *Illinois ex rel. Lignoul v. Continental Ill. Nat'l Bank*, 409 F. Supp. 1167 (N.D. Ill. 1975); *Oklahoma ex rel. State Banking Bd. v. Bank of Okla.*, 409 F. Supp. 71 (N.D.Okla. 1975); *Bloomfield Fed. Sav. & Loan Ass'n v. American Community Stores Corp.*, 396 F. Supp. 384 (D. Neb. 1975).

96. Cooper, *U.S. Position in International Economic Relations*, 77 Dep't State Bull. 696 (1977).

97. Cooper, *The Role of Investment in Expanding an Open International Economic System*, *ID.* at 127, 131.

pirical data, but also implicate a whole series of different concerns relating to the restructuring of U.S. banking laws. One commentator has surmised that

with no clear definition either here *or abroad* of what constitute "banking" and "non-banking" activities, mutual non-discrimination as a principle may even be a misnomer. If the world is an international banking market, inseparable as to its components, even the seemingly middle-of-the-road approach of the Fed loses its point.⁹⁸

George Sharp, an international banker with Citicorp, defines the entire issue as "a non-problem area,"⁹⁹ while a member of the New York State Banking Department calls the legislation "overkill." Even the manager of the West Deutsche Landesbank Girozentrale branch in New York suggests that foreign bank regulation should evolve within the context of a new domestic banking structure: "You should first try to set up a totally new banking system, then find out how foreign banks would fit into it."¹⁰⁰

Tracing the history of foreign banking legislation in the United States yields the inevitable conclusion that the Fed's concerns are really a by-product of the series of shocks created by the OPEC price hike in 1973. This essay has explored the ways in which the main provisions of H.R. 7325 would restrict the activities of foreign banks in the United States. In light of these evaluations, the author suggests the following conclusions:

- (1) The legislation should be scrapped, primarily because the Fed has simply failed to justify its case.
- (2) the provisions governing the non-banking activities of foreign banks in the United States — in particular, investment banking activities — should be dealt with by the Securities and Exchange Commission under the rubric of the Glass-Steagall Act.
- (3) the proposed change in the National Banking Act allowing up to one-half of the directors of a national bank to be foreigners is a valuable change which should be instituted.
- (4) requiring membership of foreign branches, etc. in the Federal Reserve System is discriminatory and violative of both the equal treatment and mutual non-discrimination theories of foreign bank regulation in the United States.

⁹⁸. Terzakis, *supra* note 77, at 76.

⁹⁹. Nevans, *supra* note 7, at 51.

¹⁰⁰. *Id.* at 52.

- (5) H.R. 7325 is really a *domestic* banking act which attempts to deal with the presence of foreign banks in this country. Since the case for purely federal, as opposed to state regulation, has not been convincingly articulated *and* since the main provisions limiting multistate branching have been cut out of the proposed bill, the legislation has lost its chief *raison d'être*.

International financial markets are still reacting with uncertainty to a number of recent developments stemming from the six-fold increase of oil prices since 1973. The International Banking Act of 1977 represents a unilateral approach to a multinational dilemma. Recently, George Meany has voiced support of such a one-sided approach to international economic policy, emphasizing "fair" trade rather than free trade. Calling free trade "a joke and a myth," Meany urges "a strict imports-control policy" in order to "do unto others as they do to us, barrier for barrier, closed door for closed door."¹⁰¹ Ignoring the fallacies of this protectionist attitude, we can conclude with an observation that even by Meany's own standard, the provisions of H.R. 7325 concerning multistate branching should quite properly be abandoned since their passage would, in effect, erect barriers in the United States when there are no similiar barriers imposed abroad. If the worries articulated by the Fed ever do become serious enough to require the passage of legislation, the United States should respond by taking action through existing international organizations such as the OECD or UNCTAD. Unilateral action runs the risk not only of retaliation from abroad but also of creating the impression that the United States openly talks free trade while practicing protectionism.

101. Dewar, *supra* note 81.