INTERNATIONAL BANKING:
WHERE DO WE GO FROM HERE?

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Staff Report #10

I am indebted to Maureen L. O'Connor for research assistance and to Fred Dahl, Bob Gemmill, Paul Jessup, Bob Johnston, and Henry Terrell for their helpful comments, but retain responsibility for any remaining errors. The views expressed herein are solely those of the author and do not necessarily represent the views of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

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I. INTRODUCTION

International banking has grown rapidly since 1960. The expansion primarily reflects the increasing international interdependence of the world economy and the changing international financial environment. How the interaction of these forces have affected international banking is discussed in Section II of this paper.

Bank regulators around the world perceive the need to revise policies in response to the evolution of international banking and finance. The expansion of foreign banking activities in the United States, which are discussed in Section III, have prompted bank supervisors and legislators to consider several regulatory stances. Details of proposed legislation are discussed in detail in Section IV.

The regulation of foreign banks in this country is only part of the issue. Bank regulators are also concerned about the need to revise their policies toward United States banking operations overseas, and these issues are discussed in Section V. Foreign banking supervisors have also been reviewing their policies, primarily in regard to the international operations of banks within their borders. Recent changes implemented by foreign banking authorities are discussed in Section VI.

Concern has been expressed in several quarters that the needs and problems of present international financial markets and institutions may call for international regulation. The problems associated with this issue are also discussed in Section VI. Some conclusions about the prospects for international banking are presented in Section VII.

II. THE EXPANSION OF INTERNATIONAL BANKING

A. Background

Many forces spurred the dramatic expansion of international banking over the last decade and a half. World trade and finance grew at an unprecedented pace. By 1974 world exports were more than six times their 1960 level. International liquidity exploded: world holdings of gold and foreign exchange reserves almost quadrupled in the 15 years after 1960, totaling $800 billion by the end of 1974.

Moreover, during the same 15 years, the Eurocurrency[1/] market developed into an important factor in international finance. From its inception in 1958 to 1966, the Eurocurrency market grew to about $20 billion in net assets. However, the really dramatic expansion of this market occurred after the mid-1960s: by the end of 1974 the net volume of assets in the Eurocurrency market had risen tenfold to almost $200 billion. Whether the Eurocurrency market creates or redistributes international liquidity is unclear. Nevertheless, it is clear that the Eurocurrency market now links together the domestic money markets of all major industrial countries.

Current international banking activities evolved against this background of expanding and increasingly sophisticated world trade and financial relationships. Initially, as businesses expanded overseas, banks followed in order to continue providing services to long-standing customers. But as businesses grew into multinational corporations and

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[1/] Eurocurrency refers to any currency deposited outside its country of origin, that is, a Eurodollar is a United States dollar deposited outside the United States. The Eurodollar is the principal currency, and London is the major market for Eurocurrencies.

the international financial system grew in size and complexity, commercial banks here and abroad met the challenge by growing in numbers, size of operations, and types of services provided.[2/]

B. The Size of World Banking

International banking has become very big indeed. The 30 largest banks in the free world had combined assets of $840 billion at the end of 1974--an amount exceeding that year's gross national product of every country in the free world except the United States.

The free world's 30 largest banks are listed by country of origin in Table I. The assets of each bank at the end of 1974 is listed, and each bank's ranking based on relative asset size is also shown. Individual bank data is summarized in Part B of the table, which lists the number of banks, combined assets, and percentage of assets of the 30 largest banks by country of origin.

Three American banks--BankAmerica Corporation, Citicorp, and Chase Manhattan Corporation--are the world's largest banks by far. Almost half of the total assets of this group of 30 banks are held by American and Japanese banks. Although there are more Japanese banks among the 30 biggest banks in the world than those of any other country, the 7 United States domiciled banks have larger combined assets. The rest of the world's big banks originate in the other industrial countries of Canada and Europe, with a single exception. The Banco do Brasil ranks 18th among the world's largest banks with $24 billion in assets.

[2/] For an excellent discussion of the causes of the worldwide expansion in banking, see Fred Klopstock, "Foreign Banks in the United States: Scope and Growth of Operations," Monthly Review, Federal Reserve Bank of New York, June 1973.

TABLE 1

THIRTY LARGEST BANKS IN THE FREE WORLD

A. Individual banks by Nationality--Ranked by 1974 Assets

Banks by Country of Origin	Rank	Assets $ Billions
AMERICAN		
BankAmerica Corp.	1	$59.4
Citicorp	2	55.5
Chase Manhattan Corp.	3	41.7
J. P. Morgan & Co.	14	25.6
Manufacturers Hanover Corp.	17	25.0
Chemical New York Corp.	23	21.7
Bankers Trust New York Group	30	19.2
BRAZILIAN		
Banco do Brasil	18	24.0
CANADIAN		
Royal Bank of Canada	22	21.8
Canadian Imperial Bank of Commerce	28	19.7
ENGLISH		
Barclays Bank	5	33.3
National Westminister	7	31.9
Midland Bank	21	23.3
Lloyds Bank	25	21.0
FRENCH		
Banque Nationale de Paris	4	$35.8
Crédit Lyonnais	9	29.7
Société Générale	10	28.5
GERMAN		
Deutsche Bank	6	32.4
Dresdner Bank	15	25.5
Westdeutsche Landesbank Gironzentale	19	23.7
ITALIAN		
Banca Commerciale Italiana	26	20.1
Banco Nazionale del Lavoro	27	19.9
JAPANESE		
Dai-Ichi Kangyo Bank	8	31.2
Fuji Bank	11	27.6
Sumitomo Bank	12	27.1
Mitsubishi Bank	13	25.7
Sanwa Bank, Ltd., Osaka	16	25.2
Bank of Tokyo	20	23.5
Industrial Bank of Japan	24	21.1
Tokai Bank	29	19.6

B. Country Summary--Number of Banks and Total Assets

Country	No. of Banks	1974 Assets $ Billions	Percent of Total Assets
United States	7	$248.0	29.5
Japan	8	201.0	23.9
England	4	109.6	13.1
France	3	94.0	11.2
Germany	3	81.6	9.7
Canada	2	41.5	4.9
Italy	2	40.0	4.8
Brazil	1	24.0	2.9

Individual country totals are subject to rounding errors.
Source: American Banker, July 31, 1975.

C. 1974: The Lessons

The 1974 environment was particularly difficult for international financial markets. The excesses generated by the preceding boom created problems in every country in the world. International liquidity was extraordinarily high, as were rates of inflation and interest rates in all industrial countries. These problems were compounded by the new era of floating exchange rates, the possible dangers of which were not fully understood, and by the sudden quadrupling of oil prices in late fall 1973. In early 1974 international banks began receiving massive deposits of funds from the Organization of Oil Producing Countries (OPEC),[3/] which were accumulating greater amounts of foreign exchange than could be spent immediately on imports.

The banks initially absorbed these funds in short-term deposits, but eventually they became hard-pressed to find acceptable long-term investment opportunities. Both bankers and bank regulators were concerned about the problems of short-term liabilities versus long-term investments and appropriate capital bases.

The fact that the banks involved in these large international transfers of funds were also national financial institutions caused domestic economic difficulties. The problems were potentially more troublesome when the banks involved were foreign banks inside a nation's borders--moreover, foreign banks which were not always subject to all domestic regulations. The problems were similar whether the banks in question were, for example, American banks in London or British banks in New York and California.

[3/] The members of OPEC are Abu Dhabi, Algeria, Ecuador, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, and Venezuela; Gabon is an associate member.

Bank regulators in many countries expressed concern about the situation during 1974. George Mitchell, Vice Chairman of the Board of Governors of the Federal Reserve System, summarized the situation by stating:

> The integration of money and capital markets has accelerated the transmission of changing money and credit conditions among national economies, and has probably reduced the scope for independent national financial policies . . . there is greater concern on the part of governments nowadays as to the implications of multinational banking for the financial structure of their countries and for the formulation and conduct of their own financial policies. 4/

As 1974 progressed additional shocks jarred the international financial scene. In June a large German bank was suddenly closed, producing panic in international money markets. Subsequently, a few other banks closed, partially as a result of losses in their foreign exchange transactions but primarily because of more general management problems.5/ In addition, a few well-known international banks experienced substantial losses in their foreign exchange dealings. The result was that international financial markets remained unsettled for months. All these factors converged in the already unfavorable inflationary environment of 1974: the activities of foreign-owned banks within other countries, the few well-publicized cases of foreign exchange losses and bank closings, large and volatile short-term capital flows, and the

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4/ George W. Mitchell, "Multinational Banking the United States: Some Regulatory Issues," speech at the Annual Convention of the Bankers Association for Foreign Trade, April 8-11, 1974, pp. 5-6.

5/ The crisis in international banking markets occurred after Bankhaus Herstatt of Germany closed on June 26, 1974. For a chronology of foreign exchange losses and bank closings in the summer of 1974, see Appendix A.

indisputable international linkage of banks through the Eurocurrency markets. In light of these developments, it is not surprising that bank supervisors around the world began to question the appropriateness of their banking supervision and regulation.

III. FOREIGN BANKING OPERATIONS CURRENTLY IN THE UNITED STATES

A. Expansion of Foreign Banking

The dramatic expansion of international banking during the 1960s took place in two ways: (1) United States banking operations abroad and (2) foreign banking operations in this country. The activities of American banks abroad are discussed in Section V of this paper.

Until the 1960s foreign banks' United States operations were relatively insignificant, primarily because foreign bank expansion up to that time had been largely limited to representative offices and agencies.[6/] However, after 1960 foreign banks began to establish United States branches and subsidiaries in growing numbers. By 1965 a congressional study reported that foreign banks were operating 35 agencies, 36 branches, and 14 subsidiaries (which had 14 additional branches) with total United States assets of about $7 billion.[7/] This was only the beginning of the accelerated growth in foreign banking in the United States which took place during the next decade.

By the end of 1974 foreign banks' branches, agencies, and subsidiaries had net intrastate United States assets of $56 billion, eight times the 1965 level. In that year 180 foreign banks were represented

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[6/] There are five organizational forms available to foreign banks desiring to establish an American presence: (1) a representative office, (2) an affiliate, (3) a subsidiary, (4) a branch, and (5) an agency. Some of these five types can be jointly owned by a group of foreign banks and are then called consortium banks. It is also possible for foreign individuals or corporations to buy an existing United States bank in some states. The differences among these types of organizations are described in Appendix B.

[7/] U.S., Congress, Joint Economic Committee, "Foreing Banking in the United States," by Jack Zwick, in Economic Policies and Practices, Joint Economic Committee Paper No. 9 (Washington, D.C.: Government Printing Office, 1966).

in the United States. Foreign banks had 62 subsidiaries or affiliates, 77 branches, and 72 agencies, virtually all of them concentrated in New York, California, and Illinois. There were 26 foreign bank holding companies registered under the Bank Holding Company Act (BHC Act) which operated 25 subsidiaries in New York, California, and Illinois, and 24 agencies and branches, most of them concentrated in the same three states. More than 20 foreign banks owned or had some share in securities companies. In addition, foreign banks had 141 representative offices.

B. State Regulation of Foreign Banking

At present there is no federal legislation--other than the BHC Act--regulating the activities of foreign banks in the United States. Foreign banking organizations are chartered by the individual states, and they can therefore engage in any form of banking operation which is permitted (or not prohibited) by state laws.

Of the ten states[8/] in the United States which expressly authorize foreign banks to conduct banking operations in some manner within their states, New York, California, and Illinois have the most liberal laws. This is partially due to pressure from commercial banks in these states for reciprocity to protect their banking operations abroad. Moreover, since the nation's major financial centers are in these three states, it is not surprising that they also have by far the greatest number of foreign banking offices.

8/ The ten states authorizing foreign banking are Alaska, California, Georgia, Hawaii, Illinois, Massachusetts, Missouri, New York, Oregon, and Washington, Robert Huff, "Entry of Foreign Banks Into the United States" (unpublished staff paper of the Bureau of Economic and Business Affairs, Department of State, September 4, 1973).

1. New York

Traditionally, most foreign banks have gravitated to New York. New York has many attractions: the biggest financial center in the United States, the biggest money market in the world, the focal point for financing much of the world's trade, and by no means least, the liberal New York State laws regulating foreign banking. There are more foreign banking operations in New York than in any other state. At the end of 1974 these consisted of 35 agencies, 25 branches, 14 subsidiaries, and 3 New York State investment companies.[9/] In recent years, however, foreign banks have been moving into San Francisco and Chicago, the two other largest United States financial centers.

2. California

Nowhere has the expansion of foreign banks been more remarkable than in California. In 1965 only nine foreign banks had branches in California; by the end of 1974 there were 40 foreign banks with branches and/or agencies in the state. Subsidiaries of foreign banks have grown even more rapidly and have had an even larger impact on the banking community in California. Table 2 lists the foreign banking subsidiaries operating in California as of December 31, 1974, and gives some indication of their importance. It will be noted that eight of these subsidiaries, or over half of the total, have parent banks headquarters in the Far East.

Taken individually, none of the subsidiaries appears very large. There were only two foreign subsidiaries with large enough

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9/ Klopstock, op. cit., contains a comprehensive review of the activities of foreign banks in New York.

TABLE 2

FOREIGN BANKING SUBSIDIARIES OPERATING IN CALIFORNIA

as of December 31, 1974

Bank	Deposits ($ million)	Percent of Total State Deposits	Rank
Lloyds Bank of California	1,022.7	1.29	8
Bank of Tokyo of California	791.8	1.00	9
Sumitomo Bank of California	603.4	.76	11
Barclays Bank of California	304.1	.38	15
California Canadian Bank	187.5	.24	21
Chartered Bank of London	142.0	.18	24
Sanwa Bank of California	138.2	.18	26
Hongkong Bank of California	100.7	.13	38
Mitsubishi Bank of California	89.8	.11	40
Bank of Montreal (California)	86.6	.10	43
French Bank of California	46.1	.06	59
Mitsui Bank	42.3	.05	64
Tokai Bank of California	38.3	.05	70
Toronto Dominion Bank of California	30.9	.04	77
Korea Exchange Bank	9.7	.01	145
TOTAL--FOREIGN BANKS	3,634.1	4.58	---
TOTAL--ALL CALIFORNIA BANKS	79,466.5	---	186

Source: Federal Reserve Bank of San Francisco, September 1975

deposits to account for even 1 percent of total demand deposits in the state at the end of 1974. However, these two banks, Lloyds Bank of California (British) and Bank of Tokyo of California (Japan), ranked as the eighth and ninth largest banks in the state.[10/]

Out of the total of 186 banks in California, 15 are foreign subsidiary banks which have just over 4.5 percent of the state's total deposits. However, California permits statewide branching, and the branching systems of some of these subsidiaries and their competition for deposits with indigenous California banks has attracted considerable attention, much of it unfavorable.

In the spring of 1973 a bill, which would have restricted the expansion of foreign banking operations, was introduced into the California Legislature. The bill was extremely discriminatory and was primarily aimed at restricting the growth of Japanese banks, which were making strong inroads into the deposit base of the small California banks due to their attraction to the Nisei population. Interestingly, this is one of the few examples of foreign banks securing an indigenous deposit base in the United States:[11/] Most foreign banks rely on their parent

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[10/] The Board of Governors of the Federal Reserve System has approved the merger of Bank of Tokyo and Southern California First National Bank of San Diego. The merger would result in foreign banks' share of total deposits rising to about 6 percent, and the resulting bank would rank as the eighth largest in the state.

[11/] There are a few exceptions to this generalization, including the Israeli and Puerto Rican banks in New York. And Barclays Group (British) has been quite aggressive in attempting to secure a domestic deposit base for its operations in New York, California, and Massachusetts. However, the principal method by which foreign banks have acquired a substantial United States deposit base is through the purchase of an existing bank. For instance, Lloyds Bank acquired a domestic deposit base along with 95 branches when it bought First Western Bank of California in 1973, and European American Trust acquired a domestic deposit base when it bought Franklin National and its 104 New York branches in 1974.

organization, customers from their own country, and the money markets for funds. Strong support of small independent banks in California made passage of the legislation appear likely for a time, although the large banks lobbied against the bill, fearing possible retaliation against their operations in Japan. Possible enactment of this legislation stimulated the Federal Reserve System to concentrate on drafting legislation that would regulate the activities of foreign banks in the United States and would forestall different laws in each state. The proposed Federal Reserve legislation is discussed in Section IV.

3. Illinois

In the early 1970s although state law did not permit any foreign branches to be established, Illinois granted state charters to two subsidiaries of foreign banks. The First Pacific Bank is a subsidiary of the Dai-Ichi Kangyo Bank of Japan and Banco di Roma (Chicago) is a subsidiary of the Banco di Roma of Italy. In addition, the Bank of Tokyo acquired a 4.9 interest in the Chicago-Tokyo Bank.

The large Illinois commercial banks, however, had two reasons for wanting to make it easier for foreign banks to enter the Chicago market. In the first place, they felt that easier entry for foreign banks would stimulate Chicago's growth as an international financial center. And, secondly, it was hoped that offering reciprocity to foreign banks would facilitate the expansion of Illinois banks overseas. Largely due to their efforts, in August 1973 the Illinois Legislature passed the "Foreign Banking Act," which permits foreign banks to establish one branch office in the Chicago's Loop. By the end of 1974, 22 foreign banks, including many of the world's largest multinational banks, had

filed applications for branches under the terms of this Act and 18 licenses had been approved.[12/]

4. States Prohibiting Foreign Banking

There are ten states[13/] which expressly prohibit foreign banking within their borders; prominently among them are Florida, Texas, and Minnesota. Florida has a long-standing prohibition on branching, which applies to both domestic and foreign institutions. But in 1972, after a Canadian bank had acquired a small trust company in the state and other foreign banks had shown an interest in engaging in banking, Florida passed a law prohibiting "any foreign bank from maintaining an office within the state."[14/] The Texas State Constitution prohibits out-of-state banking and, thus, foreign banks are prohibited from operating in that state.[15/]

The relevant portion of the Minnesota law states that: "No foreign corporation shall transact in this state the business which only a bank, trust company, or savings, building and loan association may

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[12/] The 18 banks for which branch licenses have been granted are: Banque Nationale de Paris, Banque de l'Indochine (a part of the Suez group), and the Credit Lyonnais of France; Commerzbank and Dresdner Bank of Germany; the National Bank of Greece; Bank Leumi le Israel; Banca Commerciale Italiana; the Sanwa Bank and the Sumitomo Bank of Japan; Algemene Bank Nederland; Swiss Bank Corporation; Barclays Bank International, The Chartered Bank, Lloyds Bank International, and the National Westminster Bank of the United Kingdom; the European Banking Company, a branch of a United Kingdom merchant bank owned by seven major European banks; and the Hongkong and Shanghai Bank of Hong Kong.

[13/] The ten states prohibiting foreign banking are: Florida, Maine, Maryland, Minnesota, New Jersey, Ohio, Rhode Island, Texas, Virginia, and West Virginia. Huff, op. cit.

[14/] Florida Banking Code, Section 659.57. Huff, op. cit.

[15/] Texas Constitution; Article 16, Section 16.

transact in this state."[16/] Although the law may have been written originally to prevent out-of-state banking, it effectively prevents non-United States entities from entering the banking industry in Minnesota. Holding company legislation proposed during 1974 by the Minnesota Independent Bankers' Association would expressly bar the entry of holding company banks from abroad as well as from other states. "No bank holding company organized or based in any other state or country shall be allowed to operate any business of any kind in this state, directly or indirectly . . ."[17/]

The remaining Ninth Federal Reserve District states are among the 30 states which make no mention at all of foreign banking in their statutes. However, foreign banking is implicitly prohibited in at least 10 of these 30 states.

16/ Minnesota, Minnesota Statutes Annotated, Section 303.02 and 303.04.

17/ American Banker, August 30, 1974.

IV. PROPOSED FEDERAL REGULATION OF FOREIGN BANKING

A. The Stimulus for Regulation

By the early 1970s the United States operations of foreign banks had become an important part of the American banking scene. For instance, loans by foreign banks had become a significant source of credit for domestic concerns--in 1974 foreign banking organizations extended about 10 percent of all commercial and industrial loans made in the United States.[18/]

From the point of view of the monetary authority, this growth presented problems because almost all foreign banks are nonmember banks, that is, banks which are not members of the Federal Reserve System and are, therefore, not subject to the Fed's reserve requirements. Although foreign banks represent only a small percent of the 8,400 nonmember banks in the United States, their role as conduits of international funds, subject to great volatility, makes them important to the monetary authority. Foreign banks are also not subject to the Fed's Regulation Q limitations on interest payments. Particularly during periods of tight monetary policy, the ability of foreign banks in the United States to attract funds from abroad handicaps the Fed's ability to control the money supply.[19/] Advocates of federal regulation for foreign banks in

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[18/] Franklin R. Edwards and Jack A. Zwick, "Activities and Regulatory Issues: Foreign Banks in the United States," Columbia Journal of World Business, Vol. 10, No. 1 (Spring 1975).

[19/] The international banking activities of both foreign and domestic banks have made it more difficult for the Federal Reserve System to control the money supply at times. For a detailed discussion of this point see Irving Auerbach's, "International Banking Institutions and the Understatement of the Money Supply," Monthly Review, Federal Reserve Bank of New York, May 1971, pp. 109-118.

the United States frequently point out that in no other country in the world is a significant portion of the banking community outside the scope of the monetary authority.

From time to time, the Federal Reserve has brought some activities of foreign banks under its regulation. The Federal Deposit Insurance Corporation (FDIC) and state banking authorities have generally cooperated with the Federal Reserve in maintaining Regulation Q ceilings. Moreover, foreign banks have been requested to voluntarily comply with reserve requirements on increases in large certificates of deposit (CDs) and in net Eurodollar borrowings, and they have done so. In 1973 foreign branches and agencies were requested to comply, on a net basis with the now-expired Voluntary Foreign Credit Restraint program, and again, foreign banks voluntarily maintained these limitations. But despite the high level of cooperation among bank regulators and foreign banks' willingness to voluntarily comply with the Fed's requests, inequities in the regulation of the United States operations of domestic and foreign banks remain.

By the early 1970s both the foreign and domestic commercial banking communities expressed concern over the injustices that existed because of differing laws governing entry and regulation of foreign banking in the various states. Both the domestic and the foreign banks seemed to feel that the existing situation made them the injured party. On the one hand, foreign banks and their diplomatic representatives protested the injustice of American banks operating in their countries, while they were not allowed to engage in banking in the home state of those same American banks. Illinois was often cited as a case in point, prior to the passage of the Illinois Foreign Banking Act in 1973. The

prohibitions on foreign banking in Texas and Florida are presently a source of irritation to some foreign banks.

On the other hand, some United States banks complained that foreign banks had an unfair advantage over domestic banks. It should be noted, however, that large United States banks rarely complain about being disadvantaged by foreign banks. When a grievance is voiced, the intention is usually to promote more liberal laws for United States banks, not more restrictive laws for foreign banks. Indeed, large American banks fear that any restrictive United States legislation will lead to foreign retaliation. The American banks which do complain about foreign competition cite three specific items that alledgedly give foreign banks a competitive edge: (1) their freedom from Federal Reserve Regulations, (2) their ability to engage in multistate banking, and (3) the contravention of the Glass Steagall Act's prohibition against combining investment and commercial banking.

The multistate operations of foreign banks have probably elicited the most vocal criticism by United States banks despite the fact that some United States banks have multiple out-of-state Edge Act subsidiaries conducting a wholesale international banking business and many bank holding companies have a number of interstate nonbank affiliates. BankAmerica Corporation reportedly had 336 nonbank affiliates in 32 states in the fall of 1975.[20/] However, the fact remains that United States banks cannot conduct domestic bank operations in more than one state, while foreign banks can and do.

[20/] American Banker, October 23, 1975, p. 1.

The multistate operations of foreign banks in this country, as of December 31, 1974, appear in Table 3. Banks of four countries--Canada, Hong Kong, Japan, and the United Kingdom--were engaging in banking in four states of the United States. The Barclays Group had full-service banking operations in four states plus a United States territory. In addition, 11 foreign banks from 7 countries were conducting banking operations in at least three states, and banks from a total of 13 countries were engaged in at least some form of multistate banking operation. According to the Federal Reserve Bank of San Francisco, 38 of the foreign banks located in California have banking offices in at least one other state.[21/]

About a dozen or so foreign banks have, over a period of many years, acquired broker-dealer security affiliates in New York. Some of these institutions have become members of regional United States stock exchanges. These affiliates trade and distribute securities, underwrite issues, and offer management and investment services to their customers. They can engage in many activities which are proscribed for American banks by the Glass-Steagall Act of 1933.

B. Proposed Federal Legislation

As early as 1967 four bills were introduced in Congress to regulate foreign banking in the United States, but all of them died in committee.[22/] In November 1973 Representatives Patman of Texas and Rees of California each introduced legislation aimed at the regulation of

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[21/] John J. Balles, "The Proposed Foreign Bank Act and its Probable Effect on California Banking," speech at the President's Seminar, California Banker's Association, January 10, 1975, p. 3.

[22/] The bills were based on the so called Zwick Report prepared for the Joint Economic Committee of U.S. Congress, op. cit.

TABLE 3

MULTISTATE BANKING OPERATIONS OF FOREIGN BANKS IN THE UNITED STATES

Country/Bank Name	Banking Operations By State and Type				Total No. of States and Terr.[1/]
	New York	California	Illinois	Other	
CANADA					
Bank of Montreal	Agency/Sub.	Agency/Sub.(4)*			2
Bank of Nova Scotia	Agency/Sub.	Agency		Branches in Puerto Rico(3) and Virgin Islands(5)	2 + 2 T
Can. Imp. Bk. of Comm.	Agency/Sub.	Agency/Sub.(19)		Branches in Oregon and Washington	4
Royal Bank of Canada	Agency/Sub.	Agency		Branches in Puerto Rico(5) and Virgin Islands	2 + 2 T
Toronto Dominion Bank	Agency/Sub.	Agency/Sub.(2)			2
JAPAN					
Bank of Tokyo[2/]	Agencies/Sub.(4)	Agency/Sub.(22)		Branches in Oregon and Washington	4
Dai-Ichi Kangyo Bk[3/]	Agency	Agency	Sub.		3
Daiwa Bank	Agency	Agency			2
Fuji Bank	Agency/Sub.	Agency			2
Hokkaido Takushoku Bk.	Agency	Agency			2
Indust. Bk. of Japan	Agency/Sub.	Agency			2
Kyowa Bank	Agency	Agency			2
Mitsubishi Bank[4/]	Agencies	Agency/Sub.(5)			2
Mitsui Bank[4/]	Agencies	Agency/Sub.			2
Saitama Bank	Agency	Agency			2
Sanwa Bank	Agency	Agency/Sub.(4)	Branch		3
Sumitomo Bank	Agency	Agency/Sub.(19)	Branch		3
Taiyo Kobe Bank	Agency	Agency		Branch in Washington	3
Tokai Bank	Agency	Agency/Sub.			2
EUROPE					
France					
Banque Natle de Paris	Investment Co.[5/]	Agency/Sub.(1)	Branch		3
Credit Lyonnais	Branch	Agency	Branch		3
Germany					
Commerzbank	Branch		Branch		2
Dresdner Bank	Branch	Agency	Branch		3
Greece					
National Bk. of Greece	Sub.(2)		Branch		2
Italy					
Banca Comm. Italiana	Branch	Agency	Branch		3
Banco Di Roma	Branch	Agency	Sub.		3
Netherlands					
Algemene Bk. Nederland	Branch	Agency	Branch		3
Switzerland					
Swiss Credit Bank	Branch(4)	Agency			2
Swiss Bank Corp.	Branch(2)	Agency	Branch		3
United Kingdon					
Barclays Group	Branch(2)/Sub.(24)	Agency/Sub.(37)	Branch	Branches in Massachusetts and Virgin Islands	4 + 1 T
Lloyds Bank Ltd.	Branch	Branch(94)	Branch		3
Nat'l Westminister Bk.	Branch	Agency	Branch		3
Stand-Chartered Group	Agency/Branch(2)	Agency/Sub.(14)			2
Jointly-Owned					
European-American Gr.	Invest Co.[5/]/Sub.(106)	Agency(2)	Branch		3

For notes see next page.

TABLE 3 (continued)

MULTISTATE BANKING OPERATIONS OF FOREIGN BANKS IN THE UNITED STATES

Country/Bank Name	Banking Operations By State and Type				Total No. of States and Terr.[1/]
	New York	California	Illinois	Other	
LATIN AMERICA					
Brazil					
Banco do Brasil	Branch	Agency(2)			2
Mexico					
Bk. Nacional de Mexico	Agency	Agency			2
OTHER					
Hong Kong					
Hong Kong Shanghai Bk.	Branch	Agency/Sub.(9)	Branch	Branch in Washington	4
Korea					
Korea Exchange Bk.	Agency	Agency/Sub.			2
Philippines					
Philippine Nat'l Bk.	Branch	Agency		Agency in Hawaii	3

Note:

Sub. = subsidiaries

*Figures in parentheses indicate number of branches or agencies. Absence of number indicates only one office of the specified organizational firm.

[1/] Terr. indicates U.S. territories.

[2/] In addition, Bank of Tokyo has a 4.9 percent interest in the Chicago-Toyko Bank, Chicago, IL.

[3/] In addition, Dai-Ichi Kangyo Bank has a 4.5 percent interest the Japan California Bank, Los Angeles, CA.

[4/] In addition to the New York agency, the parent bank has also established a Bank and Trust Company which has an agency in New York.

[5/] Indicates investment in a New York state investment company.

Source: Board of Governors, Federal Reserve System

September 1975

foreign banks in this country. Both bills were very restrictive. Both bills would have reduced the scope of foreign bank operations to fully capitalized subsidiaries of the foreign parent bank. Under the terms of these bills, foreign subsidiaries would have needed approval of the Secretary of the Treasury for all activities. Foreign banks would have been required to obtain FDIC insurance and to meet Federal Reserve requirements, but not to become members of the Federal Reserve System. Foreign banks would have been prohibited from expanding through acquisitions and mergers, and they would have been required to divest themselves of securities affiliates and multistate operations within a limited number of years. The Rees bill contained additional special provisions to accommodate Japanese banks, where such banks were in violation of United States antitrust laws, and to permit interstate banking in the event states passed enabling legislation. No congressional hearings were ever held on either bill.

On December 3, 1974, the Board of Governors of the Federal Reserve System submitted to Congress legislation entitled "The Foreign Bank Act of 1974." A number of revisions and technical changes were made to the original legislation, and it was resubmitted to the new Congress on March 4, 1975. The December 1974 cut-off date was retained for purposes of "grandfathering"[23/] existing institutions, and the bill was retitled, "The Foreign Bank Act of 1975." The legislation was prepared by the System Steering Committee on International Bank Regulation

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23/ "Grandfathering" is a common term in United States banking laws and refers to the practice of permitting existing institutions and practices to continue to exist, even though new institutions or associations of this type may be prohibited from being formed in the future.

(SSCIBR),[24/] which the Federal Reserve System established in early 1973 to study international banking.

Initially, the SSCIBR focused its attention on the activities of foreign banks in the United States. Among the forces which spurred the Committee to first consider foreign banking in America were: (1) the growth of foreign banks' activities in the United States, (2) concern about foreign competition by the United States domestic banking industry, (3) congressional interest in foreign banking, and (4) the legislation introduced in the California Legislature to restrict the activities of foreign banks in that state (see Section III).

One of the early conclusions of the SSCIBR was that regulations governing foreign banking should be based on the principle of national treatment or nondiscrimination. Under this principle all nations would be expected to apply the same rules to both foreign and indigenous institutions within their borders. In this way, all institutions operating within one national market would be afforded equitable treatment. The principle of nondiscrimination would preserve the right of every country to establish the rules governing the activities of banks within its jurisdiction.

The general purposes of the Act are: (1) to achieve equality in the treatment of domestic and foreign banks in both their banking and nonbanking operations, (2) to provide a federal presence in licensing and supervision of foreign banks, and (3) to bring foreign bank operations within the scope of the Federal Reserve System. The bill would amend

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[24/] Present members of the SSCIBR are Governors Mitchell, Bucher, Holland, and Wallich, and Presidents Volker (New York), Balles (San Francisco), and MacLaury (Minneapolis).

the Bank Holding Company Act to include branches and agencies of foreign banks in its definition of "banks." Currently, branches and agencies do not fall under the purview of federal bank regulations because they are considered to be an integral part of the parent foreign bank's operations.

On the other hand, subsidiaries of foreign banks in this country are chartered as separate entities by state authorities. Because they are United States chartered institutions foreign subsidiaries come under the provisions of the Bank Holding Company Act just as do domestic banks that are part of a bank holding company organization. Moreover, as United States chartered institutions, foreign subsidiaries are eligible for insurance by the FDIC, while deposits in branches are not.[25/]

Additionally, the legislation would require Federal Reserve membership for all foreign banks conducting banking operations through branches, agencies, and subsidiaries and would require branches and agencies of foreign banks to obtain FDIC insurance. The proposed Act would enable the establishment of a federally licensed branch in any state, which could then operate on the same terms as a national bank; that is, lending limits would apply to the parent bank's assets, not those of the branch. By relaxing citizenship requirements, foreign

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25/ For additional information on the differences between agencies, branches, and subsidiaries, see Appendix B.

banks would be allowed to own Edge Act corporations[26/] and one-third of the directors of national banks could be foreigners.

In mid-1975 Representative Rees of California circulated for comment a draft law to regulate foreign banking in the United States, which differed substantially from both his own earlier proposal and the Federal Reserve's draft bill. In circulating his proposal, Representative Rees noted that he did not expect Congress to consider any legislation on foreign banking (his own, the Federal Reserve's, or others) before 1976, when the House of Representatives' study on Financial Institutions and the Nation's Economy (FINE) is completed. International banking is a part of the FINE study.

There are three key differences between the positions of the Federal Reserve and Representative Rees. These are highlighted in the following provisions of Representative Rees' new proposal:

1. Require divesture of interests in security affiliates.
2. Eliminate the differences between foreign agencies and branches, and limit the deposits of these institutions to foreigners with only credit balances[27/] allowed for United States citizens.

[26/] The so-called Edge Act is Section 25(a) of the Federal Reserve Act (12 U.S.C. 611-631). The Edge Act provides for the establishment of "corporations . . . for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations . . . ." Agreement corporations may be formed under Section 25 of the Federal Reserve Act for very similar purposes. Appendix C contains a more detailed description of Edge Act and agreements corporations.

[27/] Credit balances arise from customers' international transactions, rather than customers' deposits; such balances are not payable on demand, but rather are payable only under specific regulatory limitations.

3. Permit foreign-chartered national banks only in those states which would grant state charters to such banks.

As the proposal by Representative Rees makes clear, there are several major issues left unresolved in the area of foreign banking in the United States. The three issues which are likely to prove most contentious are: (1) grandfathering, (2) compulsory Federal Reserve membership, and (3) compulsory FDIC membership.

The Federal Reserve's draft legislation provides for permanent grandfathering of all multistate banking operations, securities affiliates, and other nonbank activities, which existed prior to December 1974; the Rees proposal grandfathers only the multistate banking operations. The provision for permanent grandfathering not only recognizes that foreign banks made their investments in the United States in full compliance with existing laws but also helps to defuse a substantial amount of adverse reaction from foreign central and commercial banks to the proposed legislation. Some large American banks favor the proposal to grandfather existing multistate operations of foreign banks because they feel it is a wedge which will promote interstate banking for United States banks. However, at least one knowledgeable official feels that the provision to grandfather existing foreign banking operations is unlikely to have a significant effect on any decision to permit domestic banks to engage in interstate banking.[28/] In any event, opposition to the Fed's foreign banking legislation solely because of its grandfathering provision would not appear to be very strong.

[28/] Mitchell, op. cit., p. 20 and Balles, op. cit., pp. 15-16.

From time to time, attempts have been made to provide for interstate banking between a few states. In the early 1970s Governor Rockefeller of New York State proposed that the states of Illinois, California, Massachusetts, Texas, and New York permit reciprocal interstate commercial banking in the major money market centers of the other states. This proposal was greeted with little enthusiasm in the other states. However, in the spring of 1973 legislation was introduced in both the New York and California Legislatures which would have provided for reciprocal interstate banking. The bill moved as far as the floor of the assembly in New York before it died. In California the bill was tabled in the senate committee on banking. Proponents expect the bills to be revised in future legislative sessions.

The requirements for compulsory Federal Reserve membership and FDIC insurance are issues which have stimulated considerable adverse reaction and debate both at home and abroad. In fact, the proposed legislation can be considered discriminatory de jure, since all domestic banks are not required to be members of the Federal Reserve System nor to obtain FDIC insurance. The extreme case against compulsory Federal Reserve membership is represented by the statement that "since compulsory membership is not required for domestic banks, this would be asking foreign banks to be more Catholic than the Pope."[29/]

Proponents, however, argue that requiring Federal Reserve membership is not de facto discriminatory, since the foreign banking institutions to which it would apply compete almost exclusively with

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[29/] Henry S. Ruess, "The Legislative Outlook for Foreign Banks Operating in the United States," speech at the 9th Annual Banking Law Institute, May 3, 1974.

large United States money market banks which are already System members. Governor Mitchell of the Federal Reserve has remarked, "The question of requiring Federal Reserve membership on the part of foreign banks has evoked a surprising amount of talk. The United States must be the only country in the world where the foreign banks do not have an established relationship with the central bank. There are no 'nonmember' banks abroad!"[30/]

Foreign banks usually oppose mandatory FDIC insurance because the premiums would be an added expense and because they claim such a requirement would be discriminatory. Moreover, they argue that FDIC insurance is not as necessary for the wholesale banking in which they primarily engage as it is in retail banking.

It is not surprising that foreign banks are against restrictions on their current United States banking operations. It is surprising that some large United States banks also oppose any restrictions on the activities of foreign banks in this country chiefly because they fear retaliation abroad. The New York Clearing House[31/] and a past Superintendant of New York State Banks have raised the issue of foreign retaliation against American banks abroad if the United States imposed any restrictions on the activities of foreign banks in this country. The superintendant said that restrictions on foreign banks "would invite foreign nations to correspondingly limit U.S. banks to a single province

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30/ Mitchell, op. cit., p. 19.

31/ Members of the New York Clearing House are The Bank of New York, The Chase Manhattan Bank, First National City Bank, Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank-New York, United States Trust Company of New York, European American Bank and Trust, and National Bank of North America.

or city or to take other retaliatory measures. Or the European Common Market might well limit U.S. banks to a single country within the Market, thus forcing U.S. banks to divest their assets in other countries."[32/] Because American banking assets abroad are much greater than foreign assets in the United States, the threat of retaliation is taken seriously in some quarters.

32/ Harry W. Albright, Jr., "Critical Choices in Banking," speech to the New York State Bankers' Association, January 21, 1975.

V. UNITED STATES BANKS ABROAD

A. Expansion of Branches, Subsidiaries, and Affiliates

While foreign banks were vigorously expanding their operations in this country, American banks were engaged in simultaneously expanding their activities overseas. At the end of 1960 there were eight United States parent banks operating 131 overseas branches with $3.5 billion in assets. As late as 1967 there were only 15 United States banks operating 295 branches with $15.7 billion in assets. But, six years later, at the end of 1974, 125 American banks had 732 overseas branches in 76 countries with total assets of over $150 billion.

Table 4 lists the foreign branches of United States banks abroad, as of December 31, 1974, ranked by country of greatest concentration. The table points up clearly the large number of so-called "shell branches" operated in the Bahama and Cayman Islands. These branches are called shells because transfers of funds appear on the branches' books to avoid reserve requirements and other federal bank regulations, although all decisions are made by the United States domiciled parent bank.

Not surprisingly, 37 United States banks maintained more than 50 branches in London, the center of the Eurodollar market as well as a leading international financial center. There was a great deal of concern about the viability of some of the London branches of American banks in the early 1970s. Fierce competition among the many United States bank branches and other banks headquartered in London (both British and those of other national origins) led to very small interest rate margins on loans. A comparison of relative rates of return on assets of United States banks with London branches to the rate of return

on assets of total United States commercial banks led one observer to conclude that "profit margins in the London-based banking business are remarkably narrow."[33/] Because of low profit margins and the extreme caution which followed the 1974 bank failures (see Appendix A), there were many rumors that several American banks were considering closing their London branches. It was often said that no American bank wanted to be the first bank out of London, but that several American banks wanted to be second. In any event, no contraction of United States branches in London had taken place through the spring of 1975.

United States banks are represented in all of the European Community (EC) Common Market countries. In addition to the 55 banks in the United Kingdom, there are a total of 82 branches of United States banks in the other member countries: 30 in Germany, 17 in France, 9 in Belgium, 10 in Italy, 6 each in the Netherlands and Luxembourg, and 5 in Ireland. In 1975 an American bank opened a branch in Denmark.

United States banking is also well represented in most other industrial countries: 29 in Japan, 9 in Switzerland, and 1 in Austria. Among the industrialized nations, Canada, Australia, and the Scandanavian countries are notably absent from the list because their laws forbid foreign banks to establish branches. United States banks are, however, active through subsidiaries and affiliates in Canada and Australia. The developing countries of Latin America and Asia also host a number of American banks, and the Middle East boast a number of American bank branches.

[33/] Andrew F. Brimmer, "American International Banking: Trends and Prospects," paper presented at the 51st Annual Meeting of the Bankers' Association for Foreign Trade, April 2, 1973.

TABLE 4

FOREIGN BRANCHES OF U.S. BANKS

December 31, 1974

Countries (Ranked By Number of Branches)	Number of Branches Located in Each Country
Bahamas	80
United Kingdom	55
Cayman Islands	44
Argentina	37
Columbia	36
Panama	33
Germany	30
Japan	29
Hong Kong	24
Puerto Rico	22
Virgin Islands (U.S.)	20
Brazil	19
Dominican Republic, Greece, Singapore	18
France	17
Ecuador	15
India, Other (West Indies)	11
Italy	10
Belgium, Switzerland	9
Guam, Jamaica, Taiwan	7
Barbados, Indonesia, Luxembourg, Netherlands, Peru, Trinidad and Tobago, United Arab Emirates	6
Fiji Islands, Malaysia, Mexico, Paraguay, Uruguay	5
Ireland, Netherlands Antilles, Nicaragua, Pakistan, Philippines, Venezuela	4
Brunei, Bolivia, Guatemala, Haiti, Honduras, Korea, Lebanon, Vietnam, Virgin Islands (British)	3
Bahrein, Canal Zone, Israel, Kenya, Liberia, Okinawa, Saudi Arabia, Thailand	2
American Samoa, Austria, El Salvador, Guyana, Jordan, Mariana Islands	1
Marshall Islands, Mauritius, Monaco, Qatar, Romania, Truk Islands	1

TOTAL--76 foreign countries and overseas territories	732

Addendum Note:

Number of foreign countries in which U.S. banks operate	79
Operated by 97 national banks	653
Operated by 28 state member banks	79
TOTAL--125 U.S. banks	732

Source: Annual Report 1974 Board of Governors of the Federal Reserve System

In addition to the foreign branches of United States banks, American banks have also expanded their overseas network through subsidiaries and affiliates. Restrictions in both United States banking regulations and foreign bank laws prohibiting the foreign ownership of branches encouraged the growth of subsidiaries and affiliates as the most practical and sometimes the only vehicle through which United States banks could conduct a banking business overseas. At the end of 1973 American banks were engaged in foreign banking through 78 foreign subsidiaries, 31 of which were in Europe.[34/] A number of these subsidiaries were engaged in merchant banking, underwriting, and other types of financial activity prohibited to domestic offices of United States banks.

B. Edge Act Corporations

In addition, American banks have increasingly taken advantage of the provisions of the Edge Act to engage in foreign banking and investment.[35/] In 1960 there were only 15 Edge Act and agreement corporations with assets of $550 million. By the end of 1973 there were 104 such corporations with assets of nearly $7 billion,[36/] and the number of Edge Act and agreement corporations had further expanded to 117 by the end of 1974.

[34/] For a more detailed discussion of the activities and growth of United States banks abroad, see Andrew R. Brimmer and Frederick R. Dahl, "Growth of American International Banking: Implications for Public Policy," paper presented at the American Economic Association Meeting, December 28, 1974.

[35/] See footnote 26 and Appendix C for a definition of Edge Act corporations.

[36/] Brimmer and Dahl, op. cit., Table I.

One special feature of this law is that it is the only vehicle through which United States banks can establish subsidiaries, that is, Edge Act corporations, for the purpose of engaging in banking operations related to international trade and finance in various domestic locations outside their home state of operation. As such, the Edge Act provides a major exception to the general prohibition against interstate banking in the United States, although as was mentioned earlier, United States banks have greatly expanded their interstate nonbank offices.

The growth in these out-of-state banking corporations has been dramatic over the last 10 years, as shown in Table 5. From less than $1 billion in 1964, the assets of these subsidiaries has grown to over $7 billion by the end of last year. Although most of the Edge Act corporations are still located in New York, as they all were in 1964, a number of them are now established in such centers as Los Angeles, San Francisco, Chicago, Houston, and Miami.

Allowing foreign banks to charter Edge Act subsidiaries on the same terms as domestic banks is among the provisions of both the Federal Reserve and Rees proposals to regulate foreign banks. The Fed legislation also proposes some liberalization in lending powers for both domestic- and foreign-owned Edge Act corporations, at the discretion of the Board of Governors. It has been pointed out to foreign bankers concerned about future United States restrictions on interstate banking that this vehicle for expanding outside the state of initial chartering would then be available.

C. Issues Raised By United States Foreign Banking Operations

Concentration on the activities of foreign banks in this country has overshadowed discussion of the issues involved on the reverse

TABLE 5

NETWORK OF OUT-OF-STATE EDGE CORPORATIONS[1/]

1964 and 1974

Out-of-state Edge Corporations	1964	1974
Located in New York	6	23
Other Locations		
Miami, Florida	--	9
Los Angeles, California	--	8
San Francisco, California	--	4
Chicago, Illinois	--	6
New Orleans, Louisiana	--	1
Houston, Texas	--	5
Total Assets of out-of-state Edge Corporations ($ billion)	0.72	8.97

Source: Board of Governors, Federal Reserve System

[1/] Out-of-state Edge Corporations are international banking subsidiaries located ouside of the headquarters city of the parent.

side of international banking--the activities of United States banks abroad. The Fed's System Steering Committee on International Bank Regulation is assigned the study of these problems, and people connected with the Federal Reserve have outlined some of the major problem areas.[37/] There seem to be five major issues which need to be resolved:

1. entry into foreign countries by United States banks and restrictions on permissible activities abroad;
2. capital adequacy of the foreign operation and the degree of involvement of the parent bank's capital;
3. the treatment of joint venture and consortium banks;
4. the impact of multinational banking on domestic monetary policy, and the lender-of-last-resort role of central banks; and
5. questions of bank regulation--reporting, examination, and surveillance.

The issues are complex, and their resolution may well prove time consuming. Congressional spokesmen have said that these issues will be reviewed in the House Banking Committee's study of Financial Institutions and the National Economy (FINE), currently underway.

[37/] Brimmer and Dahl, op. cit., and Robert C. Holland, "Public Policy Issues in U.S. Banking Abroad," Bankers' Association for Foreign Trade Convention, April 8, 1975.

VI. OTHER DEVELOPMENTS AFFECTING INTERNATIONAL BANKING

Banking supervisors in many other industrial countries have also either proposed or implemented changes in some of their regulations regarding international banking in the last year or so. However, to date, none of these changes has had the far reaching implications contained in the proposed United States legislation. The Bank of England is considering alternative new approaches to international bank regulation. In the wake of the collapse of Herstatt and several other small banks in Germany, the authorities there substantially revised domestic bank supervision and regulation.[38/]

A. Foreign Exchange Regulation and Supervision

The foreign exchange losses sustained by large commercial banks in many industrial countries in the summer and fall of 1974 caused authorities in several countries to increase their monitoring of foreign exchange and lending operations. In some cases more stringent foreign exchange regulations were imposed.

Both the U.S. Treasury and the Comptroller of the Currency have implemented new procedures with regard to the international transactions of domestic banks. Pursuant to the Par Value Modification Act, the Treasury began requiring a new foreign exchange reporting form as of October 30, 1974 (revised during 1975). Basically, the new form required United States banks to list their net position on both spot and forward

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[38/] Among the changes were an increase in the powers of the bank supervisory agency, the Credit Supervisory Board, to permit it to conduct regular audits at its discretion; specific limitations on the banks' lending activities; and a set of management standards. In addition, the responsibilities of the "liquidity consortium" formed by the German Banker's Association were greatly expanded.

foreign exchange transactions. The Comptroller's office also initiated a program of tougher evaluation of United States banks' lending to foreign countries and companies in countries that were experiencing financial difficulties.

The United Kingdom, Germany, and Switzerland have all tightened their surveilance of foreign exchange transactions. The Swiss Central Bank required commercial banks to report monthly on all forward foreign exchange transactions beginning July 15, 1974. Germany's Bundesbank and the Bank of England have also announced more stringent reporting requirements on foreign exchange transactions. In addition, Germany instituted limitations on foreign exchange transactions, effective October 1, 1974. German banks are required to limit total foreign liabilities to the value of their foreign assets plus 30 percent of a bank's nominal capital and paid-in reserves. Within this overall limitation, open forward foreign exchange positions are limited to 40 percent of the bank's capital.

B. Supervision of Multinational Banking

Authorities in the industrial countries have very different policies with regard to supervising the foreign activities of their domestic banks. Banking in the United States has historically been a highly regulated industry, and this principle of regulation has been extended to the overseas operations of American banks. On the other hand, bank regulators in other countries have tended in the past to concern themselves only with the domestic operations of their banks, particularly in Canada and England. However, this hands-off attitude

toward foreign operations is gradually changing, as the link between domestic and international operations becomes more apparent.[39/]

The amount and degree of domestic bank supervision also varies substantially from country to country. Table 6 describes differences in supervision or regulation of a few key banking variables on the basis of law or specific regulations issued by the banking supervisors in a number of important industrial countries. By these standards the United States has minimal bank regulation. American banks would almost certainly argue that this is not the case in practice.

Views also differ with respect to which central bank has lender-of-last-resort responsibilities for banks which are located in one country but are owned or controlled by banks from another country. In many ways, difficulties involving foreign branches appear easier to resolve than those involving subsidiaries and multiple-owned banks. Because the assets and liabilities of the parent domestic bank and its foreign branch are so intermingled, it seems reasonable to expect the parent bank to assume initial responsibility for the problems of its branch. If the resources of the parent bank prove insufficient, the central bank of the parent bank seems likely to become the lender-of-last-resort. However, central banks have not explicitly agreed to take this position.

If questions involving branches are difficult, the problems surrounding subsidiaries and multiple-owned banks are even more complex. In the spring of 1975, the Bank of England explored with the parent banks of London subsidiaries the parents' willingness to stand behind

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[39/] Brimmer and Dahl, op. cit., p. 4-5.

TABLE 6

BANK REGULATION IN MAJOR INDUSTRIAL COUNTRIES

	Bank foreign exchange positions:		Bank capital ratios [1]	New bond issue activity [1]
	Surveillance	Controls		
United States	Yes	No	No	No [2]
Belgium	Yes	Yes	Yes	Yes
Great Britain	Yes	Yes	Informal	No
France	Yes	Yes	Yes	Yes
Germany	Yes	Yes	No	No [3]
Holland	Yes	Yes	New rules pending	Yes
Italy	Yes	Yes	Unused powers	Yes
Japan	Yes	Yes	Yes	Informal
Switzerland	Yes	No	Yes	Yes

Source: "World Finance," Economist, Vol. 253, No. 6851 (December 14, 1974) p. 6

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[1] Permissable limits specified by law or specifically set forth in regulation of monetary authorities

[2] New regulations which would require all Federal Reserve member banks to received prior approval from the Board of Governors of the Federal Reserve System before issuing subordinated debentures are under consideration

[3] But the banks have their own capital market committee

their offspring. Although the Bank of England announced satisfaction with the outcome, the nature of any agreement was never made public.

Although it is generally assumed that parent banks have the first line of responsibility for troubled offspring, this still leaves unanswered the question of which central bank is ultimately responsible if support by parent banks proves inadequate. One point of view is that the central bank of the country where the subsidiary (or multiple-owned bank) is located should act as lender-of-last-resort; in the case of a London subsidiary, that would be the Bank of England. On the other hand, some banking authorities feel that this responsibility rests with the central bank of the parent bank. The latter position would make it very difficult technically to assign lender-of-last-resort responsibility in the case of consortium banks.

Moreover, there is the question of what currency a central bank acting as lender-of-last-resort uses to meet its obligations. It is not difficult to envision a scenario in which the London-based foreign offspring of a continental bank experiences difficulties with its Eurodollar obligations. In this event the intervention currency might have to be United States dollars. The question becomes, Who acts as lender-of-last-resort--the Bank of England, the Federal Reserve System, or the parent bank's central bank?

The issue of regulation and supervision of international banks frequently touches on the separate but related issue of control of the Eurocurrency market. The Eurocurrency market has several characteristics which made it a candidate for regulation. In the first place, the Eurocurrency market is very large--the net volume of transactions at the end of 1974 was about $200 million. Secondly, the Eurocurrency market

has experienced rapid growth--an increase of about $50 billion annually in 1973 and 1974. Moreover, the Eurocurrency markets is considered to be the primary source of the massive and quickly moving short-term capital flows of recent years. Finally, the Eurocurrency market is presently not regulated or supervised by any institution.

Various suggestions for regulation of the Eurocurrency market tend to surface in the aftermath of developments that strain international financial markets. This happened in 1974 after OPEC funds poured into the Eurocurrency market and especially after the bankruptcy of the Herstatt bank. One recurring suggestion is for uniform reserve requirements on Eurocurrency deposits similiar to those on domestic deposits. Central banks have not accepted this or other proposals, but rather they have emphasized the need for clear coordination and cooperation on international monetary matters. The questions of who should do the regulating would seem to be critical to this issue just as it is the central question in the lender-of-last-resort issue.

VII. CONCLUSIONS

The international banking community has withstood the disturbances of the past few years, particularly those of 1974, remarkably well. However, those events and the experience bank regulators gained thereby are likely to effect international banking's future.

New restrictions on the activities of foreign banks in the United States seem likely. The extent to which the Federal Reserve's draft legislation will be modified is, of course, uncertain, since hearings have yet to be held. It was noted that legislators themselves have recommended considerably different restrictions. Strongly defended positions both supporting and rejecting the imposition of new restrictions indicate that any legislation will be hotly contested. The passage of a law regulating the operations of foreign banks appears dependent upon significant compromise by both sides.

In any event, legislation regulating foreign banking will almost certainly not even be considered until mid-1976 at the earliest. Congress' Financial Institutions and the National Economy (FINE) committee is reviewing foreign banking as part of its study, and consideration of other foreign banking legislation apparently will be delayed until the FINE conclusions are available. This suggests that enactment of a new law regulating foreign banking in the United States may not occur for a considerable time.

The principle of mutual nondiscrimination is one of the Federal Reserve System's most important contributions to the entire subject of international banking regulation. Ideally, this principle will be emodied in any future United States legislation relating to international

banking. It is hoped that other nations will follow the United States' lead in granting equal opportunities for both foreign and indigenous banks, while preserving the rights of national banking regulators to control the activities of all institutions within their borders.

It is important that the international banking community perceive the advantages to be gained from universal acceptance of this concept. From a realistic standpoint, no fairer principle offering so many benefits to the entire international banking community has likelihood of international acceptance.

APPENDIX A

Chronology of 1974 Bank Failures and
Foreign Exchange Losses

Substantial foreign exchange losses had previously been announced by Franklin National Bank of New York (reported at $46 million) and Union Bank of Switzerland ($150 million). But panic prevailed in the foreign exchange markets when Bankhaus I.D. Herstatt of Cologne, West Germany, was closed on June 26, 1974, after sustaining $150-$200 million in foreign exchange losses. Subsequently, Bankhaus Wolf and Co., K.G. Dortmund closed at the end of June. In August, three small private German banks closed: (1) on August 12, Bankhaus Bass & Herz, with assets of $46.1 million; (2) on August 23, Bankhaus Wolf K.G. of Hamburg (not related to the Dortmund bank), with assets totaling $21 million; and (3) on August 27, Frankfurter Handelsbank, with assets of $5.3 million. However, the closure of these banks was not related to foreign exchange losses. Fifty percent of the shares of Bankhaus Wolf of Hamburg were owned by Italian financier Michele Sindona's holding company--the largest shareholder in Franklin National Bank of New York.

Closings of banks in Austria, Switzerland, Italy, and the Cayman Islands followed. During September, First National City Bank of New York took over two European banks that were experiencing liquidity problems: Trinkhaus & Burkhardt of Dusseldorf, West Germany, and the British Bank of Commerce in Glasgow, Scotland. In October of 1974, United States regulatory authorities declared Franklin National Bank in New York insolvent. The bank's viable assets were acquired by European-American Bank and Trust, a consortium owned by six large European banks. Although there was no question of these banks failing too, the announcements

in September that Lloyds Bank International had lost about $75 million through its Swiss branch and in October that Banque de Brussels (Belguim) had lost about $50 million did nothing to calm the nervousness prevailing in foreign exchange markets.

APPENDIX B

Organizational Forms of Foreign Banks in the United States

Representative Offices. Numerically, representative offices are the most common type of foreign banking organization in the United States. Banks from almost every country in the world maintain a representative office somewhere in the United States.

A representative office is not permitted to engage in any actual banking operations. Rather, representative offices serve as a convenient facility through which a foreign bank's employees can attract customers for the parent bank and can provide United States services for their parent's customers. Representative offices, for example, can arrange industry contacts and introductions for home country businessmen or act as a troubleshooter when misunderstandings arise between the parent bank and a foreign client.

In many instances representative offices are an inexpensive first step by which a foreign bank can gain a foothold in American banking. Since representative offices do not engage in actual banking operations, they are not usually supervised by American banking authorities.

Affiliates. Another way for a foreign bank to gain entry to United States banking is by becoming affiliated with an American bank through a noncontrolling investment, ususally the purchase of a minority share of the United States bank's stock.

Affiliation has not generally proven attractive to foreign banks. On the other hand, affiliation has been a popular form of foreign bank entry into the United States securities business, an activity prohibited for American banks under the Glass-Steagall Act of 1933. In

addition to broker-dealer affiliates, foreign banks have a number of other nonbank affiliates in trust and investment companies, real estate development companies, trading companies, and many other activities.

Subsidiaries. The three types of foreign banking in the United States which have grown most rapidly in the past decade are the subsidiary, the branch, and the agency. The critical distinction between a subsidiary, on the one hand, and branches and agencies, on the other hand, is a legal one.

A subsidiary has a separate legal identity from its parent bank, while branches and agencies do not. A subsidiary is a new corporate entity chartered by the state[1B/] and is subject to the same state corporation and banking laws as a domestic bank chartered by that state. The foreign parent bank owns at least a majority or controlling interest in the subsidiary, and usually a subsidiary is wholly owned by its foreign parent bank or banks. Branches and agencies do not have a separate legal identity, however; they are considered to be integral parts of their foreign parent bank's operations. This legal distinction is the primary basis for the differences in banking operations between subsidiaries and branches and agencies.

The subsidiary of a foreign bank requires the same capitalization as that of a domestic bank applying for a state charter. For this reason, the subsidiary form of entrance to United States banking may prove expensive for the foreign parent bank. Moreover, the loans of the

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1B/ Although a subsidiary can apply for a national charter, the requirement of the National Bank Act (Title 12, Sec. 72) that "every director must, during his whole term of service, be a citizen of the United States" has meant that in practice this is not a reasonable option for foreign banks.

subsidiary are limited, as are those of domestic banks, by its own capital. A subsidiary may not lend more than 10 percent of its own capital to any one borrower; the capital of the parent bank has no bearing on the loan limits of the subsidiary. This may prove a drawback to this form of organization for some foreign banks.

On the other hand, the subsidiary form of organization offers several advantages over that of branches and agencies to the foreign bank considering a United States presence. Because a subsidiary is an institution chartered by the United States, it can provide the same banking service as a domestic bank. Subsidiaries of foreign banks can accept deposits from United States citizens as well as foreign customers, and they can offer checking accounts. A subsidiary is eligible for insurance by the Federal Deposit Insurance Corporation (FDIC) and membership in the Federal Reserve System, although only four subsidiaries of foreign banks have opted to become members.

The Bank Holding Company Act (BHCA) applies to certain activities of foreign subsidiary banks just as it does to domestically owned banks.[2B/] The Board of Governors' list of permissible nonbanking activities for bank holding companies applies to both foreign and domestically owned bank holding companies. The prohibition against multistate operations of bank holding companies also applies to foreign banks: the five foreign banks which have subsidiaries in both California and New York were grandfathered, just as the multistate banking operations of several domestic banks were grandfathered. However, since the Board does not

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[2B/] Section 225.4 (G) of the BHCA deals specifically with Foreign Bank Holding Companies.

have any jurisdiction over branches or agencies, there is nothing to prohibit a foreign bank from having a subsidiary in one state and branches and agencies in several other states, if state laws permit. Moreover, state laws allow subsidiaries of foreign banks to engage in activities that are not on the Board's list of approved activities, and the same foreign bank may still have branches or agencies conducting a banking business. Subsidiaries are supervised by the state banking authorities, and usually by one or more federal banking authorities (the FDIC, Federal Reserve, etc.).

Branch. A branch is an office of a foreign bank to which the state issues a license which permits the branch to operate in that state on the basis of the parent bank's charter in the foreign country. The branch is regarded as an integral part of the foreign parent bank's operations. A branch bank license permits the branch to accept time, savings, and demand deposits, but sometimes with restrictions.[3B/] However, since the branch is not a United States chartered institution, it is not eligible for FDIC insurance; in practice, this has severely limited the ability of branches to acquire a domestic deposit base.[4B/] Branches can borrow in the United States money market through CDs or similar instruments, however; and this provides branches with a source of funds not available to agencies.

[3B/] Washington law limits the deposits in foreign branches to a small percentage of total assets.

[4B/] California and Oregon laws require any banking institution accepting domestic deposits to have FDIC insurance; since branches are ineligible for FDIC insurance, they are effectively limited to the same sources of funds as agencies in these two states. Two foreign branches in Oregon were grandfatherd at the time this legislation was passed, and they can therefore accept deposits.

A branch is initially less expensive than a subsidiary for a foreign bank because it does not have to be separately capitalized. A second advantage the branch has over the subsidiary is that the branch's loan limit is based on the parent's capital and not on the assets of the branch alone.[5B/] Branches are required to keep a separate set of books from that of the parent bank for supervisory and tax purposes. Branches are supervised only by the state banking authorities. Since branches are not subject to federal laws, there are no restrictions on foreign banks' multistate branching.

Agencies. Agencies, like branches, are issued state licenses allowing them to operate on the basis of the parent bank's charter from the foreign home country. The agency is also regarded as an integral part of the foreign parent bank's operations. Agencies, however, are much more restricted in their sources of funds. Agencies cannot accept domestic deposits nor borrow funds in the United States money market. As a result, agencies are limited to acquiring funds from their parent banks, non-United States customers, and the Eurodollar and federal funds markets. Agencies, like branches, are ineligible for FDIC insurance. The loan limit of the agency is based on the parent's capitalization, not on the agencies' assets.

Agencies are the most unrestricted of all forms of foreign banking in the United States. Agencies have no capital or asset requirements and no liability ratios which must be maintained, and they are subject to no reserve requirements and no lending limits. Like

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[5B/] Loan limits may be imposed on branches by state law. New York State limits branch loans to 10 percent of the parent bank's capital. This limitation does not apply to agencies.

branches, there are no restrictions on the multistate activities of agencies, and the BHCA does not apply to the nonbanking activities of subsidiaries of their parent banks.

Some of the most important distinguishing features of foreign banks in this country are presented in Table 7. In the legislation regulating foreign banking, which the Board of Governors submitted to Congress as the Foreign Bank Act of 1975, the Board proposes defining branches and agencies of foreign banks as "banks," as defined in the Bank Holding Company Act. This proposal would eliminate many of the distinctions which currently exist between subsidiaries, and branches and agencies.

TABLE 7

IMPORTANT CHARACTERISTICS OF DIFFERENT FORMS OF U.S. DOMICILED FOREIGN BANKING ORGANIZATIONS

	Representative Offices	Affiliates	Subsidiaries	Branches	Agencies
1. U.S. chartered institution, with independent capitalization	No	Yes	Yes	No	No
2. Judged as part of foreign parent bank's operations	Yes	No	No	Yes	Yes
3. Can accept domestic deposits	No	Yes	Yes	Yes*	No
4. Can borrow funds in the U.S. money markets (CSs, etc.)	No	Yes	Yes	Yes	No
5. Eligible for FDIC insurance	No	Yes	Yes	No	No
6. Eligible for Federal Reserve membership	No	Yes	Yes	No	No
7. Subject to regulatory limits on loans	Not allowed to make loans	Yes	Yes	No**	No
8. Multistate banking permitted	Yes	No	No	Yes	Yes
9. Other U.S. organizations of parent bank can engage in activities not permitted by BHCA	Yes	No	No	Yes	Yes

* Subject to limitations in some states (i.e., Washington) except in California and Oregon, where state law requires FDIC insurance for domestic deposit-accepting institutions.

** Subject to limitations imposed by state law in some cases. In New York, for example, loans of branches are limited to 10 percent of the parent bank's capital.

APPENDIX C

Edge Act and Agreement Corporations

Although both Edge Act and agreement corporations engage in international finance, there are several distinctions between the two types of organizations. Agreement corporations were the first organizational form through which American banks were allowed to engage in international finance. Agreement corporations were permitted by a 1916 amendment to Section 25 of the Federal Reserve Act. Under the terms of this amendment, national banks with capital and surplus of $1 million or more were permitted to invest up to 10 percent of their capital and surplus in the stock of banks or corporations "principally engaged in international or foreign banking." Only state chartered corporations could be formed for this purpose, however, since the amendment did not provide federal chartering authority.

Before a national bank could purchase the stock of these state chartered corporations,

> . . . the said corporation shall enter into an agreement or undertaking with the Board of Governors of the Federal Reserve System to restrict its operations or conduct its business . . . as the said Board may prescribe. . . . 1C/

Because of this requirement, such corporations became known as "agreement" corporations. At the end of 1974 there were five agreement corporations in operation.

In 1919 Senator Walter E. Edge of New Jersey sponsored the amendment to the Federal Reserve Act that became Section 25(a) and

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1C/ Author's underscoring. United States Code, Title 12, Sec. 603.

bequeathed the name Edge Act corporations to organizations chartered under the new section's provisions. The Edge Act provides for the federal chartering of

> Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations . . . either directly or through the agency, ownership, or control of local institutions in foreign countries, . . 2C/

At the end of 1974, there were 112 Edge Act corporations in operation.

There are several major differences between Edge Act and agreement corporations. In the first place, as the preceding discussion indicates, Edge Acts are federally chartered and are not subject to state corporation or banking laws. Agreement corporations, on the other hand, are chartered by states and are subject to state laws.

A second difference is that it costs less to charter an agreement corporation. Any state or national bank having $1 million in capital and surplus can apply for an agreement corporation charter, and there is no minimum capital requirement for the agreement corporation. An Edge Act corporation must have a minimum capitalization of $2 million, and since the parent bank is limited to an investment of 10 percent of its own capital and surplus, only a bank with at least $20 million capitalization can establish an Edge Act corporation.

There is also some difference in the scope of activity permitted: Edge Act corporations have more leeway, since they can engage in "foreign financial operations" as well as banking. The terms of Section 25 quoted above would appear to limit agreement corporations to banking.

2C/ Ibid., Sec. 611.

Edge Act corporations may be owned by more than one bank or company. Additionally, there are other technical differences between the two types of organizations.

Regulation K, "Corporations Engaged in Foreign Banking and Financing Under the Federal Reserve Act," sets forth the Board of Governors' guidelines for the operations of Edge Act and agreement corporations. In 1963 Regulation K was amended to permit a corporation to engage in both banking and investment activities; until that date, Edge Act corporations had been limited to either one or the other activity.

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