IIB **Institute of International Bankers**

ECONOMIC BENEFITS TO THE UNITED STATES FROM THE ACTIVITIES OF INTERNATIONAL BANKS: FINANCIAL SERVICES IN A GLOBAL ECONOMY

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The Institute is an association of over 200 banking organizations that operate in the United States and have their headquarters in 50 other countries.

PROFILE OF INTERNATIONAL BANKS' U.S. OPERATIONS -- 1996

Economic Impact of International Banks on the U.S. Economy[1/]

	Direct	Multiplier Effect [2/]	Total
Total Employees	118,291	173,612	291,903
Total Annual Expenditures	$16.6 billion	$7.2 billion	$23.8 billion

Breakdown of Expenditures during 1996:	
Total Employee Expenditures	$9.1 billion
Employee Earnings	$6.4 billion
Employee Benefits	$2.7 billion
Other Operating Expenses (including consulting fees and rental payments)	$6.5 billion
Capital Expenditures	$1.0 billion

[1/] Based on an Institute of International Bankers' survey as of December 31, 1996 of U.S. banking and nonbanking operations of international banks. See discussion in "Direct Economic Benefits of U.S. Operations of International Banks" below. For purposes of this study, the term "international bank" refers to a bank operating in the United States that has its headquarters in another country.

[2/] Based on direct-effect multipliers developed by the U.S. Department of Commerce, Bureau of Economic Analysis. See discussion in "Direct Economic Benefits of U.S. Operations of International Banks" below. This data does not include jobs, output and income generated by loans and other extensions of credit made by international banks.

Financial Benefits Provided by U.S. Banking Operations of International Banks

Total Assets[3/]	$ 1.34 trillion
Total Commercial and Industrial ("C&I") Loans[3/]	$ 316 billion
Total Loans Acquired in Syndications (including unfunded loan commitments)[4/]	$ 506 billion
Total Outstanding Standby Letters of Credit Issued on Behalf of State and Local Governments and other U.S. Borrowers[3/]	$ 451 billion
Total Investment in U.S. Government Securities[3/]	$ 93 billion
Total Notional Amount of Derivatives Contracts[3/]	$ 6.09 trillion
Net Capital Available To U.S. Borrowers[5/]	$ 158 billion

[3/] Based on Federal Reserve data as of December 31, 1996 for U.S. branches and agencies, offshore branches managed or controlled by U.S. branches or agencies, U.S. bank subsidiaries and New York Article XII investment company subsidiaries. The figures reported above do not include information regarding U.S. nonbank subsidiaries of international banks. Other data compiled by the Federal Reserve indicates that, as of December 31, 1996, such subsidiaries held total assets of $450.6 billion, total outstanding standby letters of credit issued on behalf of state and local governments and other U.S. borrowers of $36 billion and total notional amount of derivatives contracts of $4.35 trillion.

[4/] American Banker, January 29, 1997, at 1.

[5/] Based on Department of the Treasury data as of December 31, 1996 for U.S. branches and agencies of international banks. See the discussion below at pages 35-36.

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EXECUTIVE SUMMARY

The United States enjoys major benefits from the U.S. presence of international banks just as other countries benefit from the extensive activities of U.S. and other nondomestic banks in their markets.[1/] Any country that today discriminates against nondomestic banks in providing access to its markets ultimately damages the vibrancy of its financial markets and limits a major source of credit and liquidity for its economy. This paper documents the significant financial and direct economic benefits that international banks bring to the United States and describes the comprehensive system of regulation, supervision and examination under which international banks operate in the United States.

Cross-Border Presence of U.S. and International Banks

In today's global economy, U.S. and international banks alike maintain a significant presence in markets outside of their home countries. Over the past 50 years, banking has become truly international as a result of the increasing interdependence of national economies, the expansion of world trade, the deregulation of financial services and advances in transportation and communications.

As is the case with the operations of U.S. banks abroad, the U.S. operations of international banks tend to focus on wholesale banking activities. International banks provide lending and other services in the United States to corporations, banks, securities firms and state and local governments. Most of their funding is provided from the interbank market and wholesale deposits. They tend to focus on business relating to their home country, such as lending to subsidiaries of home country customers, financing trade with their home country and providing investment and deposit services to customers from the home country. Both U.S. and international banks operate outside of their home countries primarily through direct branch or agency offices, but they also utilize a variety of bank and nonbank subsidiaries.

[1/] For purposes of this paper, the term "international bank" refers to a bank operating in the United States that has its headquarters in a country other than the United States. The term "U.S. banks" refers to banks headquartered in the United States, and includes those domestic banks that engage in international banking activities abroad.

International banks currently operating in the United States come from over 65 countries and have diverse cultures, strategies and goals. As of December 31, 1996, 355 international banks maintained 499 U.S. branch and agency offices, 100 U.S. bank subsidiaries, 16 other U.S. banking affiliates and 255 U.S. representative offices. As of that date, the total assets of U.S. banking operations of international banks were approximately $1.34 trillion, representing 26.1 percent of total U.S. banking assets, and their total commercial and industrial ("C&I") loans were approximately $315.9 billion, representing 38.5 percent of total U.S. C&I loans. In addition, U.S. nonbank subsidiaries controlled by international banks had total assets of $450.6 billion as of December 31, 1996.

Nondomestic banks (including U.S. banks) have a significant presence in other financial markets around the world. For example, indicative of London's role as one of the pre-eminent international financial centers, nondomestic banks held approximately 58 percent of all loans booked in the United Kingdom as of December 31, 1996 and approximately 26.7 percent of all sterling-denominated loans as of that date. In Germany, as of the same date, nondomestic banks held 17.2 percent of all private commercial banks' loans and played a significant role in nonlending areas such as securities markets and swaps with approximately 23 percent of total securities portfolios and 10 percent of interest rate and currency swaps held by private commercial banks. In Japan, nondomestic firms recently had a higher volume of trades on the Tokyo Stock Exchange than the "Big Four" Japanese securities firms, evidence of the increasing expansion into the Japanese market by U.S. and other non-Japanese financial firms. The implementation of the Japanese government's "Big Bang" financial deregulation policy over the next several years is expected to create additional opportunities for nondomestic firms.

U.S. banks have a long history of maintaining a major banking and securities presence abroad. U.S. banks have put the asset quality problems of the late 1980s and early 1990s squarely behind them and have renewed their expansion outside the United States. As of December 31, 1996, the non-U.S. branches and subsidiaries of U.S. banks had more than $1.1 trillion in assets, which (even after reductions to exclude claims on affiliates) constituted 30 percent of the total assets of all U.S. banks, including those that do not have any international operations. In terms of direct banking offices, as of December 31, 1996, more than 180 U.S. banks had over 790 branches outside the United States. U.S. banks and financial firms are also playing a more prominent role in M&A transactions in Europe and other parts of the world.

Financial Benefits from U.S. Operations of International Banks

The important financial benefits provided by international banks to the United States include increased credit for U.S. borrowers (including U.S. banks), enhanced depth and liquidity for U.S. wholesale financial markets, facilitation of trade and investment (including export finance), and contributions to the growth and importance of U.S. financial centers in states such as New York, California, Illinois, Florida, Texas and Georgia. In the words of Federal Reserve Bank of New York President William J. McDonough, "foreign banks contribute importantly to the depth and breadth of financial markets throughout the United States, enhancing the sophistication and flexibility of our markets."

As discussed above, international banks are a key source of business lending in the United States. Their importance to the U.S. economy was particularly evident during the "credit crunch" of the early 1990s, a time when business lending by U.S. banks declined by approximately 12 percent while such lending by the U.S. branches and agencies of international banks increased by 21 percent. The diversity of international banks operating in the United States strengthens the U.S. economy by stabilizing sources of credit to U.S. borrowers. For example, European and Canadian banks recently have been more active in the U.S. market relative to Japanese banks, which have focused on developments in Japan.

Enhanced Credit Availability. The total assets of the U.S. banking operations of international banks (approximately $1.34 trillion as of December 31, 1996) include significant amounts of wholesale credit to U.S. borrowers in terms of commercial and industrial (“C&I”) loans ($315.9 billion), real estate loans ($81.8 billion), interbank loans and other extensions of credit ($234.1 billion), investments in securities issued by corporations and state and local governments ($67.0 billion) and investments in obligations issued or guaranteed by the U.S. government, U.S. agencies and U.S. government-sponsored enterprises ($92.6 billion). In addition to their lending and investment activities, the U.S. banking operations of international banks as of December 31, 1996 provided standby letters of credit and other credit enhancements of $451.2 billion for municipal and other borrowers. These credit enhancements enable municipalities and other borrowers to raise funds at a lower rate of interest. U.S. nonbank operations of international banks also provide significant additional credit with $102.1 billion in total loans and leases and $36 billion in standby letters of credit as of December 31 1996.

In 1996, international banks acquired approximately $500 billion in syndicated loans (including unfunded commitments to extend credit), representing approximately 57 percent of total syndicated loans during that year. The bulk of these loans were originated by large U.S. banks, which are the clear leaders in structuring and arranging syndicated loans and which obtain significant fees from originating and servicing such loans. By purchasing such loans, international banks contribute to the depth and liquidity of the syndicated loan market and facilitate the ability of U.S. banks to diversify their credit risk and allocate their capital to make new loans.

Significant Lending in All States. International banks provide significant amounts of loans and credit support in every state in the United States. During 1996, their loans to corporate borrowers and state and local governments exceeded $10 billion in 10 states and were in the range of $5 billion to $10 billion in 7 states and $1 billion to $5 billion in 18 states, the District of Columbia and Puerto Rico.

Net Contribution of Capital. On balance, international banks bring more credit to the United States than they take out, i.e., they are net contributors of capital to the United States. According to data collected by the U.S. Department of the Treasury, as of December 31, 1996, U.S. branch and agency liabilities to non-U.S. entities exceeded their claims on non-U.S. entities by $158 billion. This $158 billion was available to lend to U.S. borrowers and to invest in U.S. securities. Thus, rather than accepting deposits in the United States that are then lent to head office or to customers outside the United States, U.S. branches and agencies in the aggregate raise funds from these non-U.S. sources which are then available to U.S. borrowers.

Export Finance and Investment. Because of their knowledge of markets, economic conditions and buyers in their home countries, international banks are a key source of export financing for U.S. firms, including lines of business for which U.S. banks have been less inclined to make such loans. For example, during the late 1980s and early 1990s, international banks increased their financing of U.S. agricultural exports at the same time that U.S. banks de-emphasized their lending in this area. As of December 31, 1996, the U.S. banking operations of international banks held $15.2 billion in commercial letters of credit and $10.9 billion in customer liabilities on acceptances. International banks also facilitate investment in the United States by lending to their home country customers doing business in the United States.

***Increased Depth and Liquidity of Securities and Other Financial Markets*.** U.S. operations of international banks also contribute to the depth and liquidity of wholesale markets, including interbank lending, securities, derivatives and foreign exchange markets. As of December 31, 1996, U.S. banking operations of international banks held a total gross notional amount of $6.09 trillion in derivatives contracts, and U.S. nonbank subsidiaries of international banks held an additional $4.35 trillion as of the same date. The U.S. broker-dealer subsidiaries of international banks provide capital and liquidity to the U.S. securities markets and thereby enhance the ability of U.S. businesses to raise capital. International banks are also major participants in primary and secondary markets for U.S. government securities and, by providing depth and liquidity to these markets, help reduce the U.S. Government's cost of raising funds.

Direct Economic Benefits from U.S. Operations of International Banks

In addition to the financial benefits that U.S. operations of international banks bring to the U.S. economy, they bring significant direct economic benefits in terms of jobs and related payroll expenditures and other operating and capital expenditures. The Institute's survey of its membership shows the following economic benefits:

Job Creation and Employee Expenditures. The U.S. operations of international banks generated more than 291,000 jobs in the United States in 1996. Total direct employment by U.S. operations of international banks for 1996 was more than 118,000 people. Multipliers developed by the Bureau of Economic Analysis ("BEA") of the U.S. Department of Commerce indicate that direct employment by international banks created more than 173,000 additional jobs. Total employee expenditures in 1996 by the U.S. operations of international banks were approximately $9.1 billion, which, using the BEA multipliers, resulted in an additional $7.2 billion in employee earnings throughout the economy. According to the Institute's survey, as of December 31, 1996, over 90 percent of the employees of the U.S. operations of international banks were U.S. citizens or permanent residents, and over 85 percent of the management positions with total compensation exceeding $100,000 were held by U.S. citizens or permanent residents.

***Significant Operating and Capital Expenditures for U.S. Goods and Services*.** Total employee, other operating and capital expenditures of U.S. operations of international banks during 1996 were approximately $16.6 billion in the aggregate. In addition to the $9.1 billion in expenditures for employees, this amount consisted of $6.5 billion in expenditures for other operating expenditures and $1.0 billion for capital expenditures. Taking into account the additional $7.2 billion in employee earnings generated under the BEA analysis, the total economic impact of the U.S. operations of international banks during 1996 was $23.8 billion.

<u>Taxes and Other Payments.</u> U.S. operations of international banks are subject to the same U.S. federal, state and local tax rules that apply to U.S. banks, as well as a number of additional restrictions that affect only international banks. As a result, U.S. operations of international banks generate significant tax revenues in the United States. Data relating to taxes paid to New York City indicates that international banks paid over $138 million in income taxes in 1996, representing more than 30 percent of all income taxes paid by banks to New York City in 1996. International banks, like U.S. banks, also pay assessments to bank supervisors to cover the cost of supervision and maintain non-interest-bearing reserves with the Federal Reserve System.

Regulation of U.S. Operations of International Banks

Since the enactment of the International Banking Act of 1978, the policy of national treatment has been the cornerstone of the U.S. approach to regulating the activities of international banks in the United States. This policy is based on the guiding principle of parity of treatment between international and U.S. banks in like circumstances. Accordingly, the U.S. operations of international banks are subject to the same comprehensive system of regulation, supervision and examination that applies to U.S. banks, and the nonbank financial activities of international banks in the United States are subject to the same restrictions under the Bank Holding Company Act of 1956 that apply to U.S. bank holding companies. As the U.S. Government Accounting Office (the "GAO") concluded in its 1996 study of the role of international banks in the U.S. banking system, "[international] banks enjoy no significant advantages because of regulatory differences."

Under the U.S. bank regulatory system, international banks seeking to expand in the United States must demonstrate that their consolidated capital ratios are equivalent to those required of U.S. bank holding companies. International implementation of the risk-based capital guidelines developed by the Basle Committee on Banking Supervision (the "Basle Committee") has significantly influenced the evaluation of whether the capital adequacy standards applicable to international banks in their home countries are equivalent to the standards applicable to U.S. bank holding companies. This development has been effective in harmonizing differences in home country regulation that could otherwise lead to competitive advantages.

Bank supervisors in the United States have ample authority to supervise the U.S. operations of international banks and ensure that international banks conduct their U.S. operations in accordance with applicable regulatory and supervisory requirements. The federal and state banking agencies have developed comprehensive procedures and guidelines to enhance the supervision and examination of international banks. The centerpieces of this enhanced approach to supervising the U.S. operations of international banks are the Foreign Banking Organization Supervision Program and the "ROCA" rating system. The U.S. operations of international banks are generally conducted in accordance with supervisory expectations. The GAO has reported that 88 percent of the more than 500 U.S. branches and agencies of international banks examined in 1995 received a rating of 1 or 2 at year-end, indicating that their operations were satisfactory or better and required only normal supervisory attention.

International banks engage in nonbanking financial activities in the United States under the same restrictions applicable to U.S. banks. Thus, international banks are prohibited from controlling firms engaged in securities, insurance or other financial activities in the United States that are not permissible for U.S. bank holding companies. In recent years, the federal banking agencies have liberalized the powers of both U.S. and international banks, particularly in the areas of securities underwriting and insurance sales. In addition, a number of actions have been taken to reduce the regulatory burden on U.S. and international banks. Notwithstanding these important regulatory initiatives, there remain serious barriers to the ability of both U.S. and international banks to provide the full range of benefits they are capable of contributing to the U.S. economy. The international banking community in the United States continues to support the passage of financial modernization legislation that would enable all financial institutions to better serve their customers and the U.S. economy generally.

OVERVIEW OF INTERNATIONAL BANKING

Global financial markets and national economies have become closely integrated as a result of the expansion of world trade, the removal of barriers to national markets, advances in information technology and communications, the development of new financial products and the enhancement of cross-border settlement procedures. The cross-border operations of U.S. and international banks are playing an increasingly important role in national economies and global markets.[2/] These operations provide an important source of credit and other financial services, promote economic development and enhance economic and financial stability in mature economies and emerging market economies alike. Further, they promote the efficiency of the global financial system, facilitate cross-border capital flows, provide liquidity and depth to wholesale markets, on a national and a global basis, and spread risks that can arise more quickly and with potentially greater adverse effects with today's rapid communications and sophisticated technology. In addition, U.S. and international banks provide significant direct economic benefits in terms of jobs, expenditures, taxes, and other contributions to the financial centers and countries where they operate.

While banks have been operating internationally for centuries, the growth of cross-border banking operations accelerated significantly after World War II. The principal factors that have contributed to the development of cross-border operations are described below, followed by a more in-depth discussion of the growth and current profile of the non-U.S. operations of U.S. banks and of the U.S. operations of international banks.

International Wholesale Markets. An important reason why banks establish a presence in major international financial centers, such as London and New York, is to participate in the large and sophisticated wholesale markets centered in those cities, including interbank lending, wholesale funding, securities and derivatives transactions, commercial loan syndications and foreign exchange trading. As banking has become a 24-hour-a-day global business, major banks

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[2/] A recent World Bank report on East Asian financial systems underscored the important benefits provided by international banks in today's global economy: "Freer trade in financial services could generate considerable benefits, including improved access to foreign capital, deeper financial integration with the rest of the world, new and better domestic financial services, and stronger financial infrastructure (including regulation and supervision)." S. Claessens and T. Glaessner, Are Financial Sector Weaknesses Undermining the East Asian Miracle ?, 33 (World Bank, 1997) (the "1997 World Bank Study").

must have a presence in all of the major financial centers to transact business with each other and to provide their customers with international banking services.

The expansion of U.S. and other banks in the Eurocurrency markets in the 1960s is a prime example of banks seeking access to important financial markets. U.S. and international banks were attracted to London as a major center to obtain access to U.S. dollar funding following the imposition of exchange and capital controls in the United States. Similarly, the United States has traditionally attracted international banks because of the size, stability and general prosperity of its markets and its role as the largest market for U.S. dollar exchange. New York City is the major center for corporate finance, dollar exchange and investment banking. Los Angeles and San Francisco are natural centers for banks from the Pacific Rim, Chicago attracts banks to its sophisticated commodities markets and to opportunities in the Midwest, Miami is a gateway to Latin America, Atlanta is one of the leading financial centers of the South and Texas is an important center for energy-related lending.

International Expansion of Bank Customers. U.S. and international banks also establish operations outside of their home countries in order to provide services to the international operations of their customers. These services include foreign exchange trading, lending, including trade-related finance, and international cash management. For example, when U.S. businesses expanded in Europe, U.S. banks followed in order to service their customers' financial needs. Similarly, a major impetus for international banks to establish offices in the United States has been to provide banking services to U.S. subsidiaries of corporations from their home countries.

International Trade Finance. Another reason banks expand outside their home countries is to provide financial and advisory services relating to trade and investment between the home and host country. Banks frequently provide such services not only to their home country customers but also to customers in the host country which wish to trade with, or make investments in, the bank's home country.

International Capital Flows. Both international and U.S. banks also facilitate international capital flows. For example, U.S. trade deficits have created a large surplus of dollar assets overseas that are frequently deposited in non-U.S. offices of international banks. These deposits are used by international banks to fund loans in the United States. In its 1996 study of the role of international banks in the United States, the GAO concluded that this "recycling of dollar surpluses back into the U.S. economy helped the United States to finance its budget deficit as well as maintain economic expansion."[3/]

Retail Banking. With some notable exceptions, most banks do not pursue a strategy of retail banking outside their home countries, although many U.S. and international banks provide private banking services to high net worth individuals on a global basis. Because of cultural factors and their knowledge of local markets, home country banks are frequently better positioned to meet the retail deposit-taking and lending requirements of individuals. However, a few major banks, such as ABN AMRO Bank, Bank of Montreal, Bank of Tokyo-Mitsubishi, Citicorp and The Hongkong & Shanghai Banking Corporation, have made retail banking an important part of their international strategy.[4/]

Presence of U.S. Banks Abroad

U.S. banks have had a major international presence for nearly a century. Like the cross-border presence of banks based in other countries, the extent of the presence of U.S. banks abroad has varied with changing political and economic conditions in the United States and other countries. Recently, U.S. banks have shown a renewed interest in international expansion.

J.P. Morgan and several state-chartered banks began to establish overseas branches to finance international trade in the nineteenth century. The overseas presence of U.S. banks increased after the passage of the Federal Reserve Act in 1913, which permitted national banks to branch outside the United States.[5/] A new period of expansion began after World War II. In 1961, New York for the first time permitted international banks to establish deposit-taking branches because New York-based banks had begun to encounter resistance to establishing deposit-taking branches abroad in countries whose banks did not have similar opportunities in New York. Rapid international growth of U.S. banks continued through the 1960s as U.S. nonbank corporations increased their presence abroad. During this period, U.S. banks expanded

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3/ U.S. General Accounting Office, Foreign Banks: Assessing Their Role in the U.S. Banking System 15 (GAO/GGD-96-28, February 1996) (the "1996 GAO Report").

4/ "Xenophile Urges," The Economist, April 12, 1997, at S35 (discussing Citicorp's efforts to become a "global consumer bank").

5/ Page and Sons, Some Evidence on Transnational Banking Structure 7 (Office of the Comptroller of the Currency, September 1980) ("OCC Transnational Study").

their worldwide networks and provided international banking services to their multinational U.S. customers, including funding U.S. dollar and other currency loans in the Euromarkets.

In the 1970s, international funding and lending by U.S. banks increased in the wake of oil price rises that created huge reserves of U.S. dollars that were recycled in global financial markets. By the 1980s, the international networks of U.S. banks were firmly established, consisting principally of direct branches, Edge corporation subsidiaries and other subsidiaries (such as merchant banks that engage in extensive securities activities).

The late 1980s and early 1990s saw some major U.S. banks begin to focus more on the U.S. market and to consolidate their overseas offices, especially as they began to address the real estate loan and other asset quality problems of the late 1980s. By the middle of the 1990s, U.S. banks had put these problems squarely behind them. U.S. banks now rank among the top banks in the world in terms of return on equity and net operating profits.[6/] Twenty out of the world's 100 largest banks in terms of core capital are U.S. banking institutions.[7/] While consolidation of the banking industry within the United States continues to be a major trend, U.S. banks also have begun a new phase of international expansion.[8/] Non-U.S. operations represent an important source of profit to U.S. banks and provide an important means to diversify their risk.

[6/] See "The International Competitiveness of U.S. Banks," Journal of Commercial Lending, August 1995, at 10 (citing the study released by IBCA Inc. that among the world's 300 largest banks, 15 of the top 25 banks in profitability are U.S. banks); "The Americans Bounce Back," Euromoney, August 1994, at 68 (ranking 39 U.S. banks among the top 100 "best banks" in the world).

[7/] "The World's 100 Largest Banks," Institutional Investor, August 1997, at 131. The core capital assessment for the 100 banks was made at each respective bank's fiscal year end. Fiscal year end dates ranged from September 30, 1996 to March 31, 1997.

[8/] See "After Massive Retreat, U.S. Banks Rushing Back to Foreign Markets," American Banker, November 20, 1995, at 8 (discussing the return of U.S. banks to foreign markets after a decade); "NationsBank Widens Focus to Include Latin America," American Banker, July 24, 1997, at 1 (stating that NationsBank is "[s]haking off its reluctance to pursue markets outside the United States" and discussing the network of offices NationsBank is building in Latin America); "BankBoston Expanding From Its Strong Base in Brazil," American Banker, July 31, 1997, at 9 (discussing BankBoston Corporation's renewed efforts to expand its presence in Brazil in the face of increased competition from other U.S. banks, such as Wachovia Corporation and NationsBank).

Charts 1 and 2 show the growth in assets of the non-U.S. operations of U.S. banks and the changes in the number of non-U.S. branches of U.S. banks, respectively. As of December 31, 1996, according to Federal Reserve data, the total assets of the non-U.S. branches and subsidiaries of U.S. banks exceeded $1.1 trillion (including claims on related persons), more than double the amount from four years ago. These overseas assets (even after the exclusion of claims on affiliates) constituted approximately 30 percent of the total assets of all U.S. banks, including those that do not have international operations. As of year-end 1996, non-U.S. branches of U.S. banks had assets of over $665 billion, approximately 59 percent of all assets held abroad by U.S. banks.

The total number of branches outside the United States has also begun to recover from the decline that occurred in the late 1980s and early 1990s. Data as of December 31, 1996 compiled by the Federal Reserve indicates that more than 180 U.S. banks had more than 790 branches outside the United States, and there were more than 964 subsidiaries of U.S. banks outside the United States with almost $464 billion in assets. U.S. banks have more offices in Asian markets than banks from any other non-Asian country.[9/]

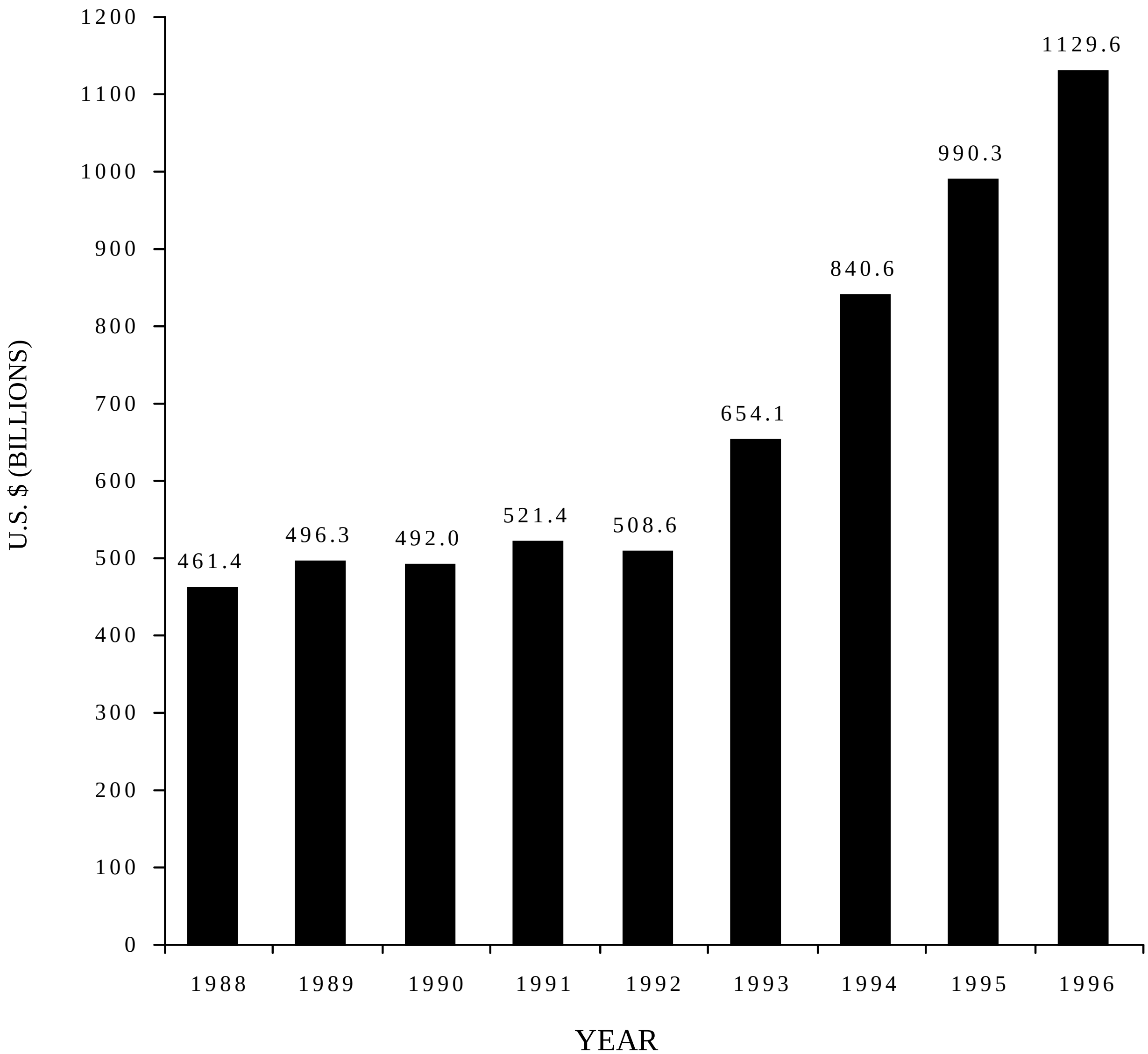
U.S. banks, along with other international banks, play a major role in international financial centers outside the United States. For example, in the United Kingdom, where London serves as the chief financial center in Europe and one of the pre-eminent financial centers of the world, approximately 58 percent of loans (in all currencies) and 26.7 percent of sterling loans were made by non-U.K. (including U.S.) banks as of December 31, 1996, as shown in Charts 3 and 4.

Similarly, as shown in Chart 5, nondomestic banks have a significant presence in Germany with approximately 17.2 percent of all loans made by private commercial banks at year end 1996. In addition to their role in lending activities, nondomestic (including U.S.) banking organizations also play a significant role in other areas such as the German securities and swap markets. For example, according to data supplied by the German Bankers Association, nondomestic banks accounted for approximately 23 percent of the total securities portfolios and approximately 10 percent of the total interest rate and currency swaps held by all private commercial banks in Germany as of December 31, 1996.

[9/] See "Growing Pains -- Foreign Banks in Asia," The Banker, May 1997, at 82 (discussing the presence of foreign banks in Asian markets).

CHART 1

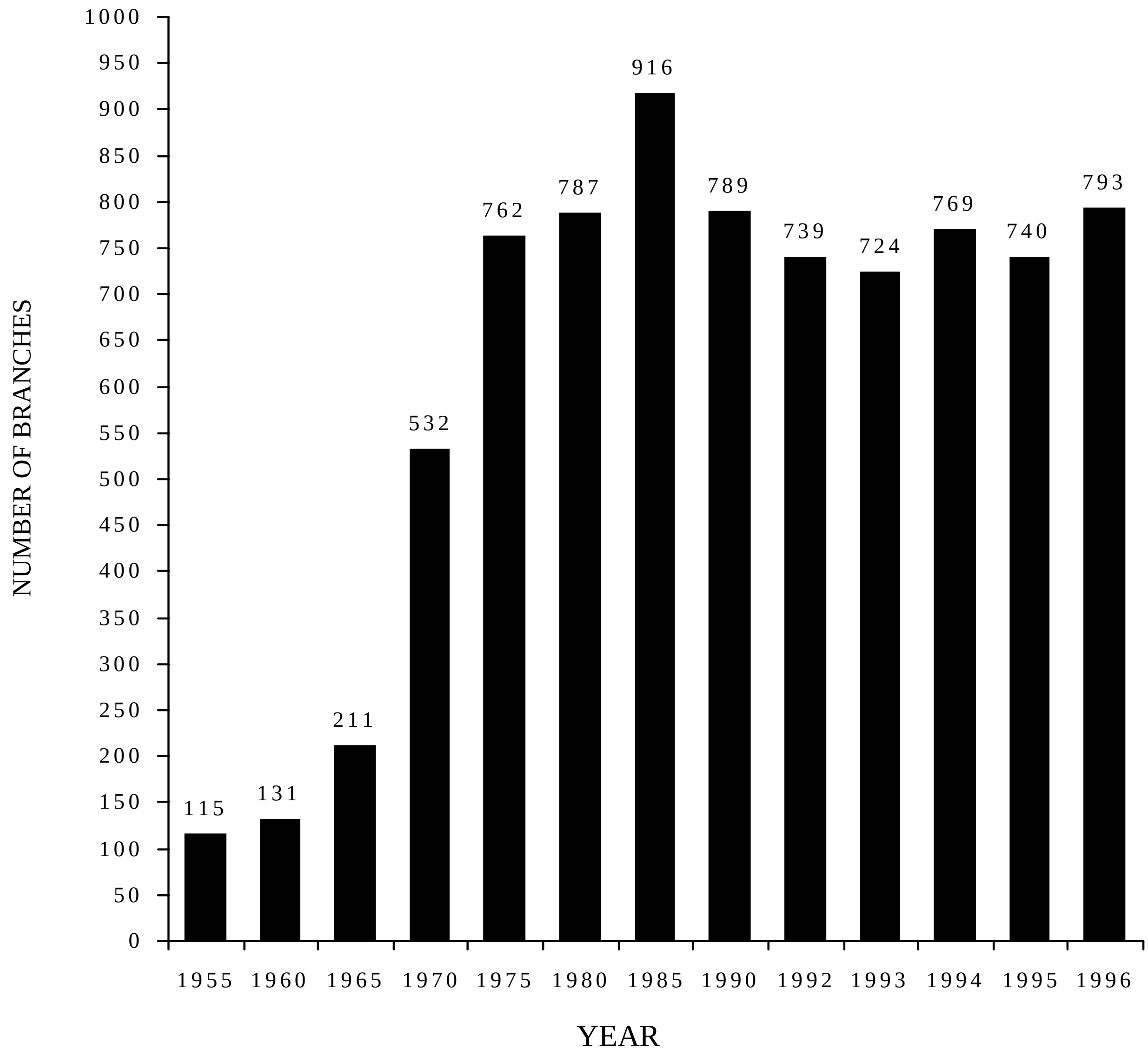
ASSETS OF OVERSEAS BRANCHES & SUBSIDIARIES OF U.S. BANKS



SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 2

NUMBER OF NON-U.S. BRANCHES OF U.S. BANKS*

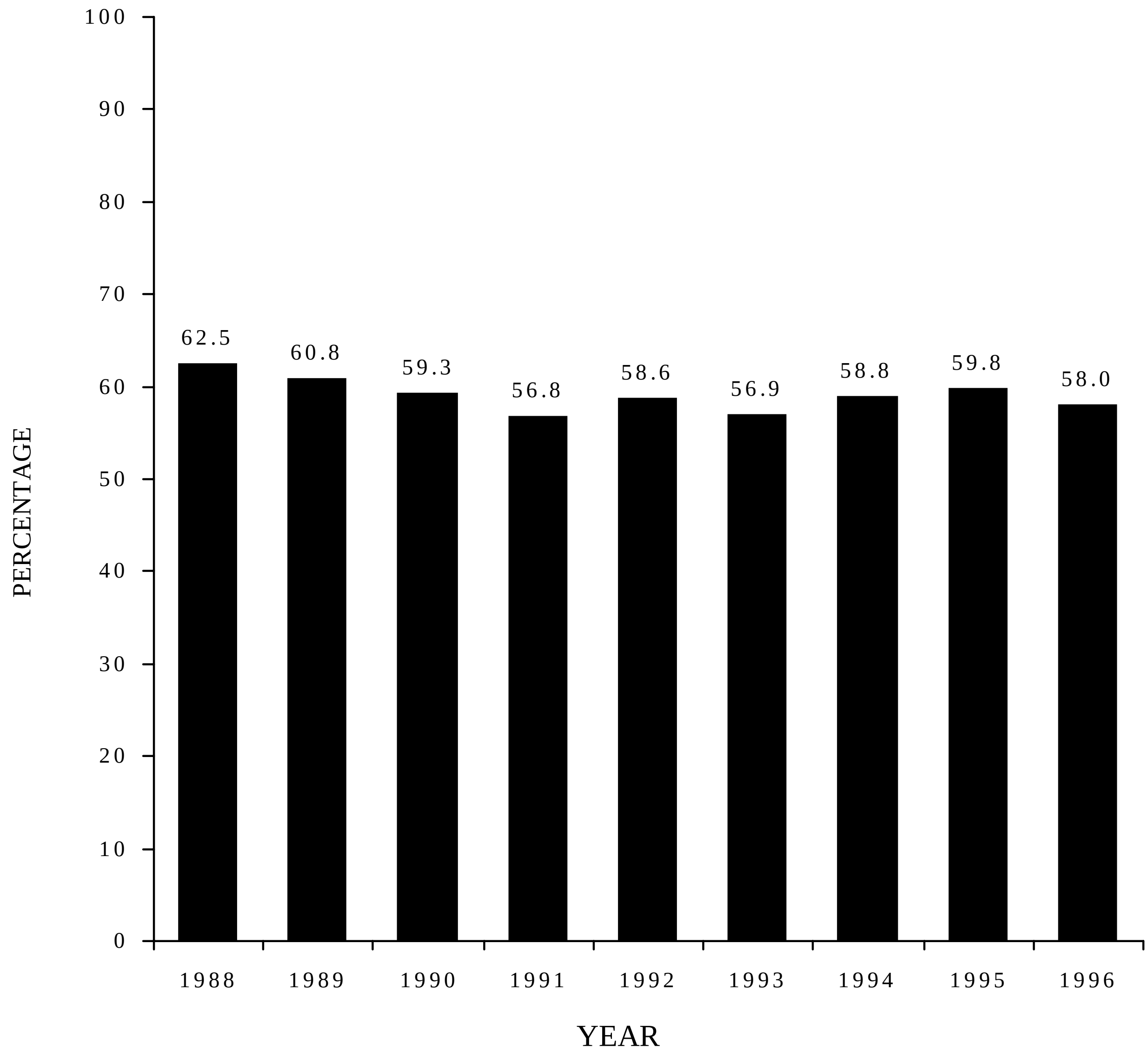


* Many U.S. banks have multiple branches outside of the United States.

SOURCE: Federal Reserve Board (As of December 31 for all years)

CHART 3

LOANS BY U.K. BRANCHES AND SUBSIDIARIES OF NON-U.K. BANKS AS A PERCENTAGE OF TOTAL U.K. LOANS*

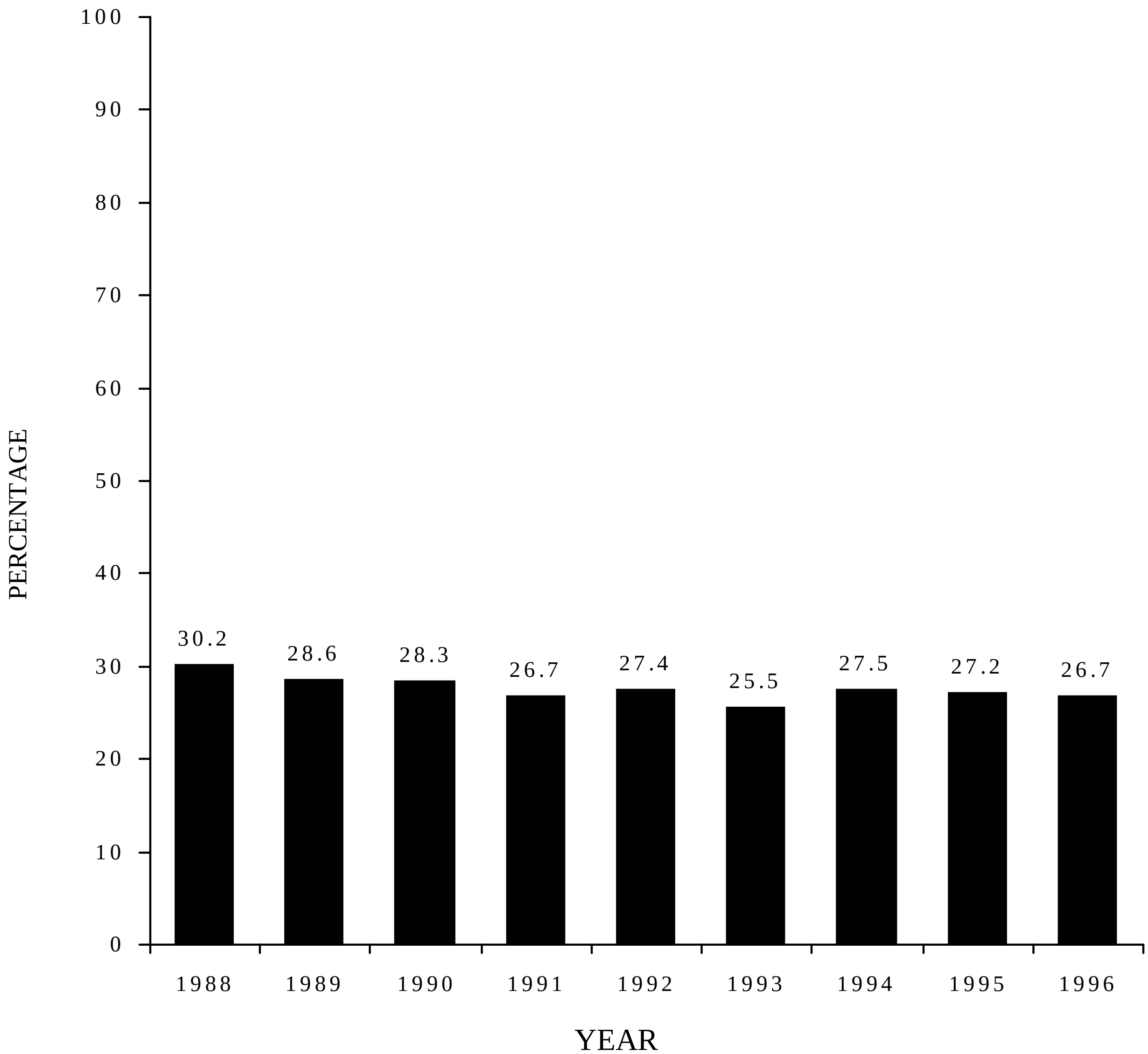


* Includes inter-bank lending.

SOURCE: Bank of England (As of December 31 for all years)

CHART 4

LOANS IN STERLING BY U.K. BRANCHES AND SUBSIDIARIES OF NON-U.K. BANKS AS A PERCENTAGE OF TOTAL U.K. STERLING LOANS *

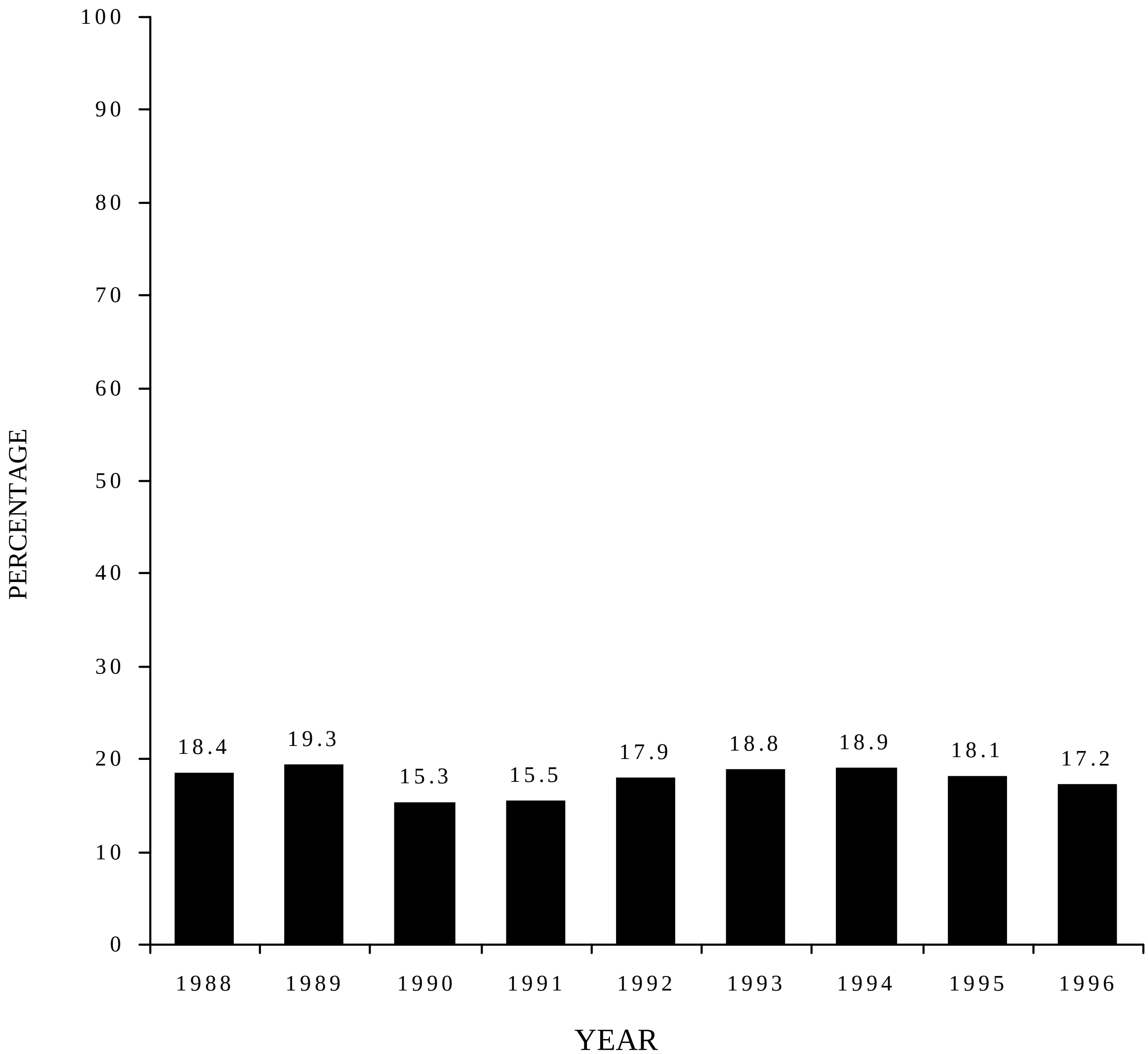


* Includes inter-bank lending.

SOURCE: Bank of England
(As of December 31 for all years)

CHART 5

LOANS BY GERMAN BRANCHES AND SUBSIDIARIES OF NON-GERMAN BANKS AS A PERCENTAGE OF TOTAL GERMAN LOANS BY PRIVATE COMMERCIAL BANKS



SOURCE: German Bankers Association
(As of December 31 for all years)

U.S. banks, which have had major investment bank affiliates in London and other overseas locations for many years, have also been expanding their securities business outside the United States in competition with the major investment banks. For example, J. P. Morgan ranked third among the top ten advisers on international M&A transactions during the first six months of 1997, and U.S. firms, including banks, have provided advice on fifty-three percent of all international M&A transactions during the same period.[10/]

In Japan, the government's "Big Bang" financial deregulation policy and market developments are creating new opportunities for nondomestic financial services firms, including U.S. institutions.[11/] Recently, the twenty-one foreign securities houses that operate on the Tokyo Stock Exchange (TSE) accounted for 32.4 percent of total trading volume on the TSE, up from 19 percent in 1996 and higher than that of the Big Four Japanese securities firms combined.[12/] Nondomestic investment advisers have increased their share of the investment advisory business in Japan from 8 percent to 22 percent during the last two years.[13/] In widely publicized developments, Bankers Trust and Swiss Bank Corporation have entered into cooperative arrangements with Japanese banks to take advantage of the new opportunities being created by the Big Bang.

Banking markets around the world are likely to have a continuing significant presence of U.S. and other nondomestic banks. For example, just as the establishment of the single market in the European Union is encouraging an expansion of cross-border banking operations within Europe, the North American Free Trade Agreement has created important new opportunities for banks operating in Canada, Mexico and the United States.[14/] Emerging markets in Latin America and Eastern Europe have seen a significant increase in the acquisition of local banks by U.S. and

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10/ "M&A Activity Hits New High," The Banker, August 1997, at 19.

11/ See "Foreigners Set Up in Tokyo for Big Bang," Financial Times, August 21, 1997, at 7.

12/ "Japanese Brokers Take Tumble," Financial Times, September 4, 1997, at 1; "Foreign Brokers Capture Big Share of Tokyo Trading," Wall Street Journal, October 8, 1997, at A19.

13/ "Japan Set to Widen Access to Corporate Pension Funds," Financial Times, September 24, 1997, at 21.

14/ See "Foreigners Snap Up Mexican Companies; Impact Is Enormous," Wall Street Journal, September 30, 1997, at 1 (citing regulatory and trade barriers being torn down by NAFTA).

other nondomestic banks.[15/] A successful resolution of the discussions currently under way to include financial services in the General Agreement on Trade in Services should result in further growth in international banking in emerging economies.

History of U.S. Operations of International Banks

International banks have had a significant presence in the United States for more than 100 years and helped finance the growth and development of the U.S. economy in the nineteenth century. For example, in 1880, British banks owned the third and fourth largest California banks, and held 15 percent of all deposits in that state. Canadian and Asian banks also had substantial operations in California. "Agency" offices began to flourish in New York after the Civil War, and helped finance the growth of U.S. railroads and other major industrial projects, including the New York City subway system.[16/]

The number of representative offices, agencies and subsidiaries in New York began to expand after World War I as international banks followed their customers who sought access to the growing U.S. market for foreign bonds and equities. The stock market crash in 1929 followed by the Great Depression and World War II checked that growth, and some U.S. offices of international banks were closed. However, even during that period major international banks continued to open offices in the United States.

In the late 1940s, the international banking community in the United States resumed its growth. The rate of expansion of international banks began to accelerate in the 1970s, and steady growth continued into the 1980s. In the 1990s, the expansion of international banks began to level off.

Chart 6 shows the change in total assets held by U.S. banking operations of international banks (including the large proportion of those assets held by branches and agencies) during the period from 1993-1996. Chart 7 shows the changes in the number of U.S. branch and agency

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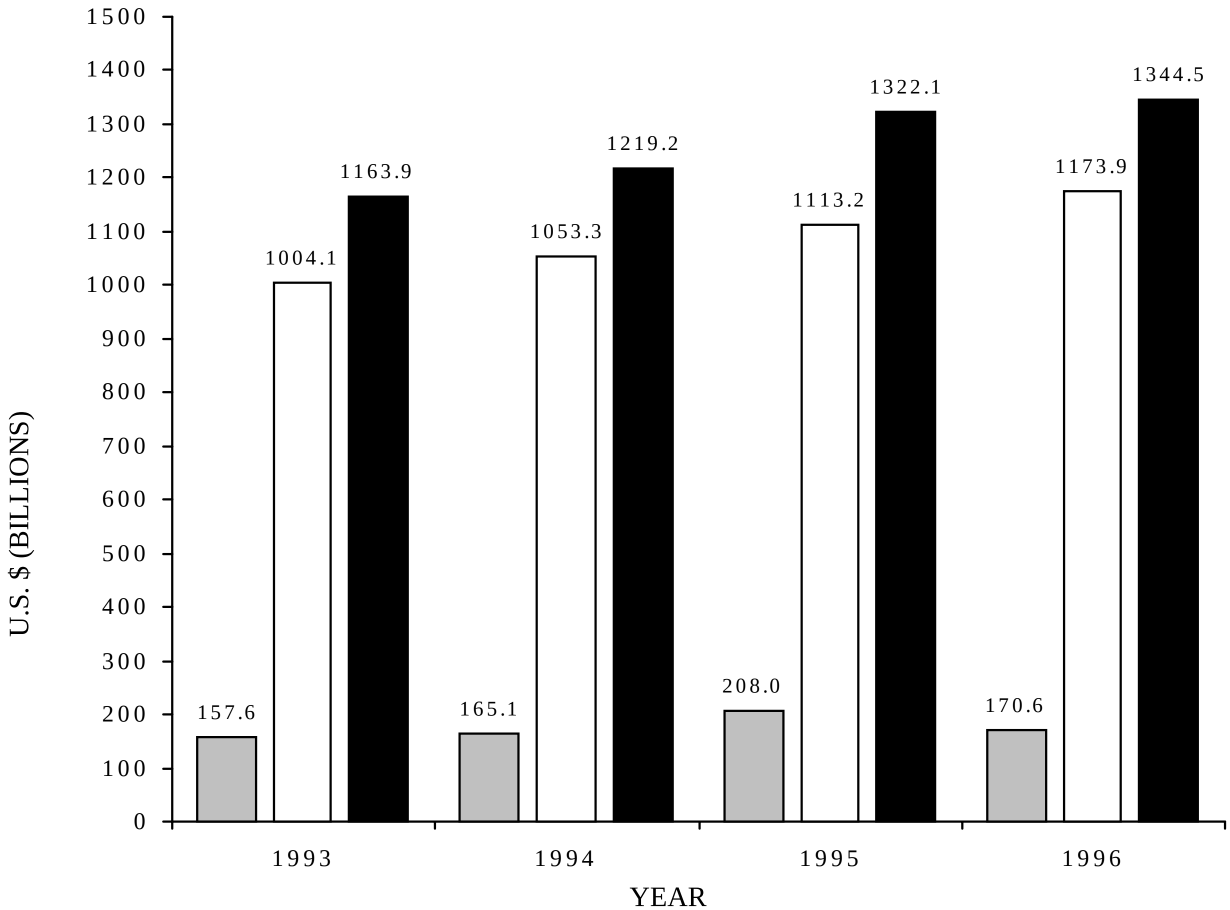
15/ The Institute's 1997 annual global survey of financial developments around the world documents the significant expansion of nondomestic banks in Latin America and Eastern Europe that is occurring as a result of privatization and consolidation. Institute of International Bankers, Annual Global Survey of Regulatory and Market Developments in Banking, Securities and Insurance Covering 50 Countries and the European Union (1997).

16/ See OCC Transnational Study, supra note 5, at 7; Barron's, May 23, 1983, at 22.

CHART 6

ASSETS OF U.S. BANKING OPERATIONS OF INTERNATIONAL BANKS

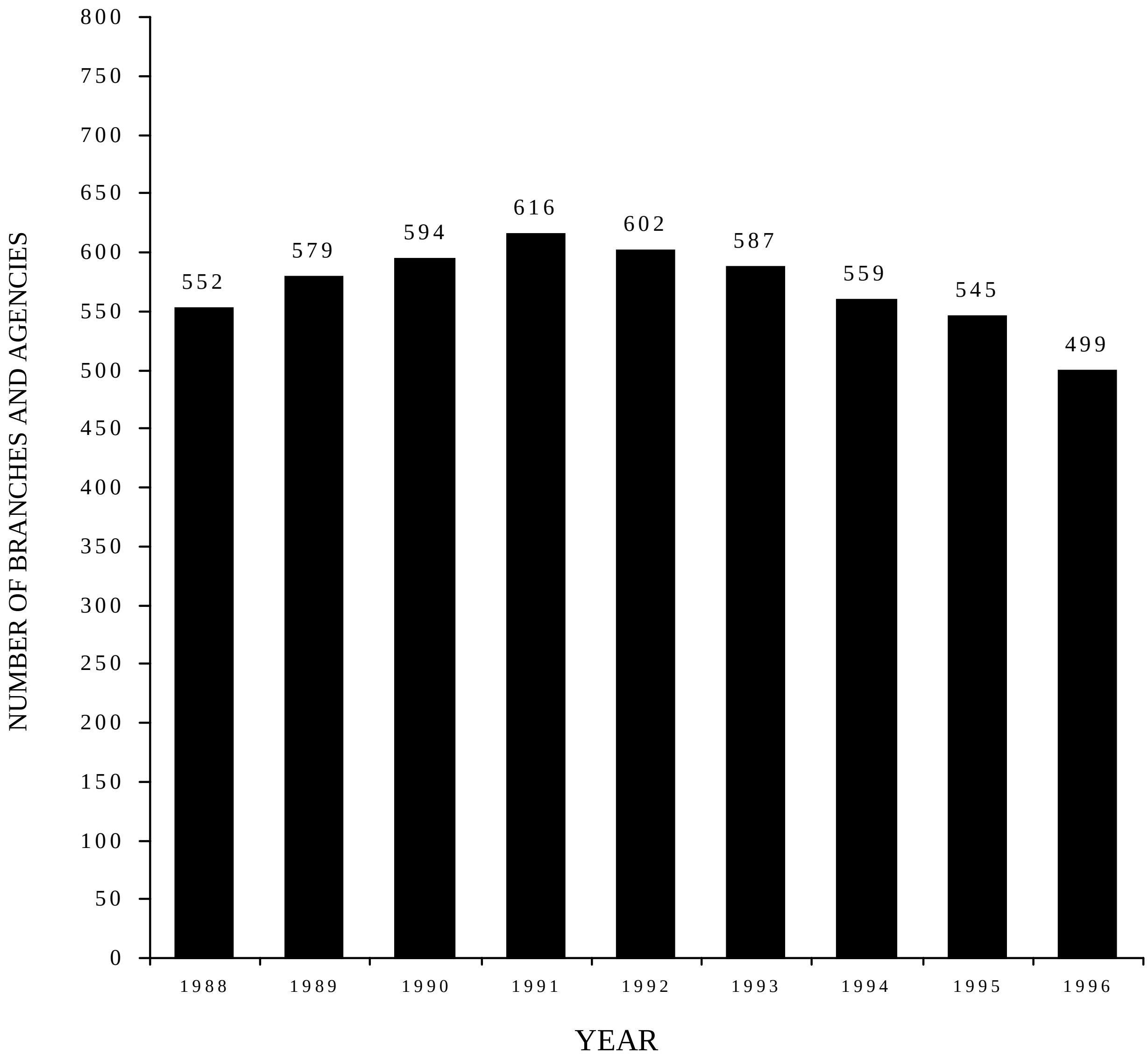


- Total Assets of U.S. Bank Subsidiaries of International Banks
- Total Assets of U.S. Branches & Agencies of International Banks and Offshore Offices Managed or Controlled by U.S. Branches and Agencies
- Total Assets of U.S. Banking Operations of International Banks

SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 7

U.S. BRANCHES AND AGENCIES OF INTERNATIONAL BANKS*



* Many international banks have multiple branches and agencies in the United States.

SOURCE: Federal Reserve Board (As of December 31 for all years)

offices during the period 1988-1996. The total number of branches and agencies has declined from a high point of 616 at the end of 1991 to 499 at the end of 1996. This trend reflects a wide variety of factors, including consolidation of existing offices as a result of mergers, efforts to reduce costs in a highly competitive wholesale banking market and the decision of some international banks to de-emphasize their international operations.

Current Profile of U.S. Operations of International Banks

The international banks operating in the United States today come from over 65 countries. Changes in their home countries as well as in other financial markets around the world strongly influence their operations in the United States.[17/] Not surprisingly, banks from different countries expand or decrease their lending in the United States at different rates. Understanding the trends in the U.S. presence of international banks must take into account that international banks from different countries represent a diverse collection of cultures, strategies and goals just as U.S. banks operating in other countries around the world have their own strategies and culture distinct from those of other nondomestic banks operating in such countries.

Chart 8 provides a breakdown as of December 31, 1996 of the different kinds of U.S. banking operations conducted by international banks consisting of 370 branches, 129 agencies, 100 commercial bank subsidiaries, 16 other bank affiliates (Edge and Agreement Corporations and New York State Article XII investment companies) and 255 representative offices.[18/] International banks operate offices in 24 states and the District of Columbia, but, as shown in Table I at page 25 below, the largest numbers of operations are in New York, California, Illinois, Florida, Texas and Georgia. The principal vehicles through which international banks conduct banking operations in the United States are described below.

Branch. Branches are direct offices of international banks. They are licensed by either a state banking supervisor or the Office of the Comptroller of the Currency ("OCC"). In either

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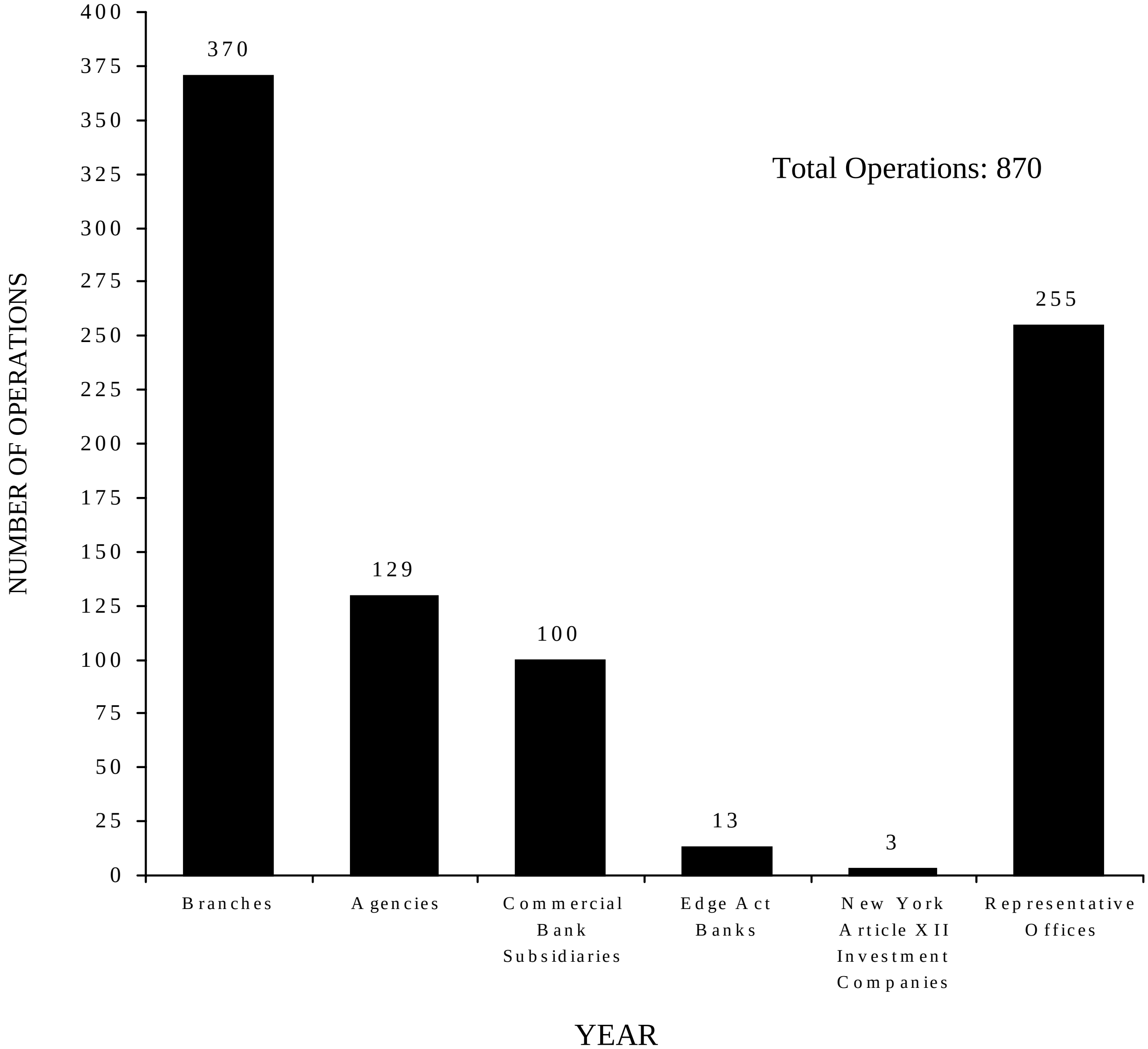
17/ For example, a detailed study of the activities of Japanese banks in the United Kingdom and the United States concluded that "U.S. activities of Japanese banks . . . appeared strongly related to Japanese domestic financial variables as well as to conditions in the U.S. market." H. Terrell, R. Dohner, B. Lowrey, The Activities of Japanese Banks in the United Kingdom and in the United States, 1980-88, 76 Fed. Res. Bull. 39, at 48 (1990).

18/ Federal Reserve Board Structure Data, December 31, 1996. Like U.S. banks abroad, many international banks maintain more than one branch or agency in the United States.

CHART 8

U.S. BANKING AND REPRESENTATIVE OPERATIONS OF INTERNATIONAL BANKS AS OF DECEMBER 31, 1996*



* Many international banks operate through more than one branch, subsidiary or other kind of office.

SOURCE: Federal Reserve Board

case, their establishment is subject to the prior approval of the Federal Reserve Board. Branches engage in lending and deposit-taking activities, except they may not accept domestic retail deposits under $100,000 unless they are also insured by the Federal Deposit Insurance Corporation (the "FDIC"). However, Congress in 1991 amended the International Banking Act of 1978 so as to prohibit branches from obtaining FDIC insurance. Branches that were insured at that time were grandfathered.

Agency. Agencies are also direct offices of international banks. While their lending powers are equally as broad as those of branches, they are limited in their deposit-taking powers. Federal agencies licensed by the OCC may not accept deposits from any source. Some state laws permit state-licensed agencies to accept foreign deposits or large wholesale deposits. The establishment of agencies, like branches, is subject to the prior approval of the Federal Reserve Board.

Bank Subsidiary. International banks also establish U.S. bank subsidiaries to engage in banking business in the United States, particularly for retail and consumer banking. The acquisition of a U.S. bank, whether by an international bank or a U.S. bank holding company, is subject to the prior approval of the Federal Reserve Board.

Edge and Agreement Corporation Subsidiary. Edge Corporations, named after the sponsor of Federal legislation authorizing their establishment and chartered by the Federal Reserve Board, are subsidiaries of U.S. and international banks that engage in international banking activities. Their lending and deposit-taking activities are generally limited to international or foreign business. Agreement Corporations are state-chartered subsidiaries of U.S. and international banks that enter into an agreement with the Federal Reserve Board to engage only in activities permissible to Edge Corporations.

Article XII Investment Company. Named after the authorizing authority of the New York Banking Law, Article XII investment companies -- also known as commercial lending companies -- are subsidiaries that engage in lending but not deposit-taking activities. Prior approval of the Federal Reserve Board is required for an international bank to acquire control of an Article XII investment company.

Representative Office. A representative office is a direct office of an international bank. In contrast to a branch or agency, its functions are generally limited to acting as liaison between customers and the head office of the bank and marketing the bank's products. A representative office may neither make loans nor accept deposits.

Table I shows the principal locations of branches, agencies, bank subsidiaries and other banking operations of international banks in the United States.[19]

Table I

Presence of U.S. Banking and Representative Offices of International Banks by State -- 1996

STATE	Total	Branches	Agencies	Commercial Bank Subsidiaries	New York Investment Companies	Edge or Agreement Corporations	Represen-tative Offices
California	165	46	62	18	—	1	38
Florida	79	42	1	3	—	7	26
Georgia	23	—	16	—	—	—	7
Illinois	93	40	—	35	—	1	17
New York	402	220	32	38	3	3	106
Texas	45	—	16	1	—	—	28
All other states	63	22	2	5	—	1	33

Source: Federal Reserve Board Structure Data as of December 31, 1996

Like U.S. banking organizations, international banks also engage in financial activities in the United States through a wide variety of nonbanking subsidiaries, including securities broker-dealers, investment advisers, futures commission merchants, finance companies, leasing companies and capital market subsidiaries. It is particularly noteworthy that the presence of U.S. broker-dealer subsidiaries of international banks in the wholesale capital markets is growing.

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[19] The data in Table I reflects the definitions of "branch" and "agency" used by the Federal Reserve Board. Whereas state law (e.g., in Florida) may describe offices as "agencies," the Federal Reserve Board considers agencies to be "branches" if they exercise powers that go beyond its definition of agency. For example, Florida agencies accept deposits from foreign persons and are therefore considered by the Federal Reserve Board to be branches.

International banks operate more than 50 broker-dealer subsidiaries in the United States and 23 of the top 100 U.S. brokers (ranked by consolidated capital) are owned by international banks.[20]

Most international banks focus on wholesale banking services, including lending and other services for corporations, banks, securities firms and state and local governments, trade finance and financing the U.S. operations of their home country customers. The GAO has concluded that branches and agencies "operate almost exclusively in selected wholesale banking markets in the United States, serving home-country and U.S. corporate customers and engaging in transactions with banks and other financial institutions."[21] Branches and agencies "conduct little retail activity. They hold few retail deposits and make few consumer loans."[22] Their primary funding sources are interbank liabilities, largely with other international banks, and liabilities to head office and related depository institutions. As of December 31, 1996, only 21 percent of the liabilities of U.S. branches and agencies of international banks consisted of deposits by U.S. persons.[23]

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[20] "Ranking America's Biggest Brokers - Good News, Bad News," Institutional Investor, April 1997, at 107. The estimate that international banks operate more than 50 broker-dealers in the United States is based on NASD membership data.

[21] 1996 GAO Report, supra note 3, at 23.

[22] Id.

[23] 83 Fed. Res. Bull. A73 (May 1997). The 1996 GAO Report contains a detailed analysis of the breakdown of the assets and liabilities of branches and agencies. See 1996 GAO Report, supra note 3, at 23-27.

FINANCIAL BENEFITS FROM U.S. OPERATIONS OF INTERNATIONAL BANKS

The operations of international banks in the United States provide significant financial benefits to the U.S. economy. Federal Reserve Board Chairman Alan Greenspan has stated that: "The participation of foreign banks has added to the liquidity and depth of the U.S. banking environment and has helped to assure the continued importance of the United States in international financial markets. . . . Foreign banks have been a significant source of credit for all types of American businesses in all parts of this country."[24/] In the words of Federal Reserve Bank of New York President William J. McDonough, "foreign banks contribute importantly to the depth and breadth of financial markets throughout the United States, enhancing the sophistication and flexibility of our markets."[25/] As discussed below, the data presented in this part of the study amply supports these statements.[26/]

Enhanced Credit Availability

24/ Statement of Alan Greenspan before the Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives (June 11, 1991), reprinted in, 77 Fed. Res. Bull. 644 (August 1991).

25/ William J. McDonough, Remarks before the Comptroller of the Currency Conference on Foreign Banks in the United States: Economic, Supervisory & Regulatory Issues (July 13, 1995). In 1993, then Federal Reserve Bank President Gerald Corrigan stated that loans by international banks "provide credit and liquidity which, in turn, help generate output, income and employment in the United States." Letter from E. Gerald Corrigan, President, Federal Reserve Bank of New York, to Hon. Donald Riegle, U.S. Senate at 2 (May 4, 1993). This theme was also noted in the Treasury-Federal Reserve Subsidiary Study, which stated that international banks "deepen the availability of credit to borrowers." U.S. Department of the Treasury and Board of Governors of the Federal Reserve System, Subsidiary Requirement Study (December 1992) at 6 ("Subsidiary Study").

26/ Except as otherwise indicated, the data presented in this study regarding financial benefits from the U.S. operations of international banks is as of December 31, 1996 and is based on data compiled by the Federal Reserve. The data for the U.S. banking operations of international banks consists of data for U.S. branches and agencies, U.S. bank subsidiaries, offshore branches managed or controlled by U.S. branches and agencies and New York Article XII investment companies. It does not include Edge and Agreement Corporation subsidiaries. Where available, data for offshore branches managed or controlled by U.S. branches or agencies are combined with data for U.S. branches and agencies.

As of December 31, 1996, the total assets of U.S. banking operations of international banks were approximately $1.34 trillion, representing approximately 26.1 percent of total U.S. banking assets. Chart 9 shows the changing percentages of total U.S. banking assets that were held by the U.S. banking operations of international banks during the period 1980-1996.[27/] Approximately 87 percent of the assets held by international banks in the United States as of December 31, 1996 were located in U.S. branches and agencies. A significant portion of the total assets consists of wholesale credit to U.S. commercial and industrial companies, U.S. banks, state and local municipalities and the U.S. Government. In addition to the assets held by their U.S. banking operations, international banks held, as of December 31, 1996, total assets of $450.6 billion through U.S. nonbank subsidiaries.

Business Loans. As of December 31, 1996, the C&I loans of U.S. banking operations of international banks were approximately $315.9 billion, approximately 38.5 percent of all C&I lending in the United States. The largest portion of this amount ($273 billion) were loans by U.S. branches and agencies. The U.S. bank subsidiaries of international banks held approximately $42.9 billion in C&I loans. In addition, U.S. banking operations of international banks held commitments to make or purchase loans of $642.0 billion, and U.S. nonbank subsidiaries of international banks held $31.7 billion in such commitments. Chart 10 shows the

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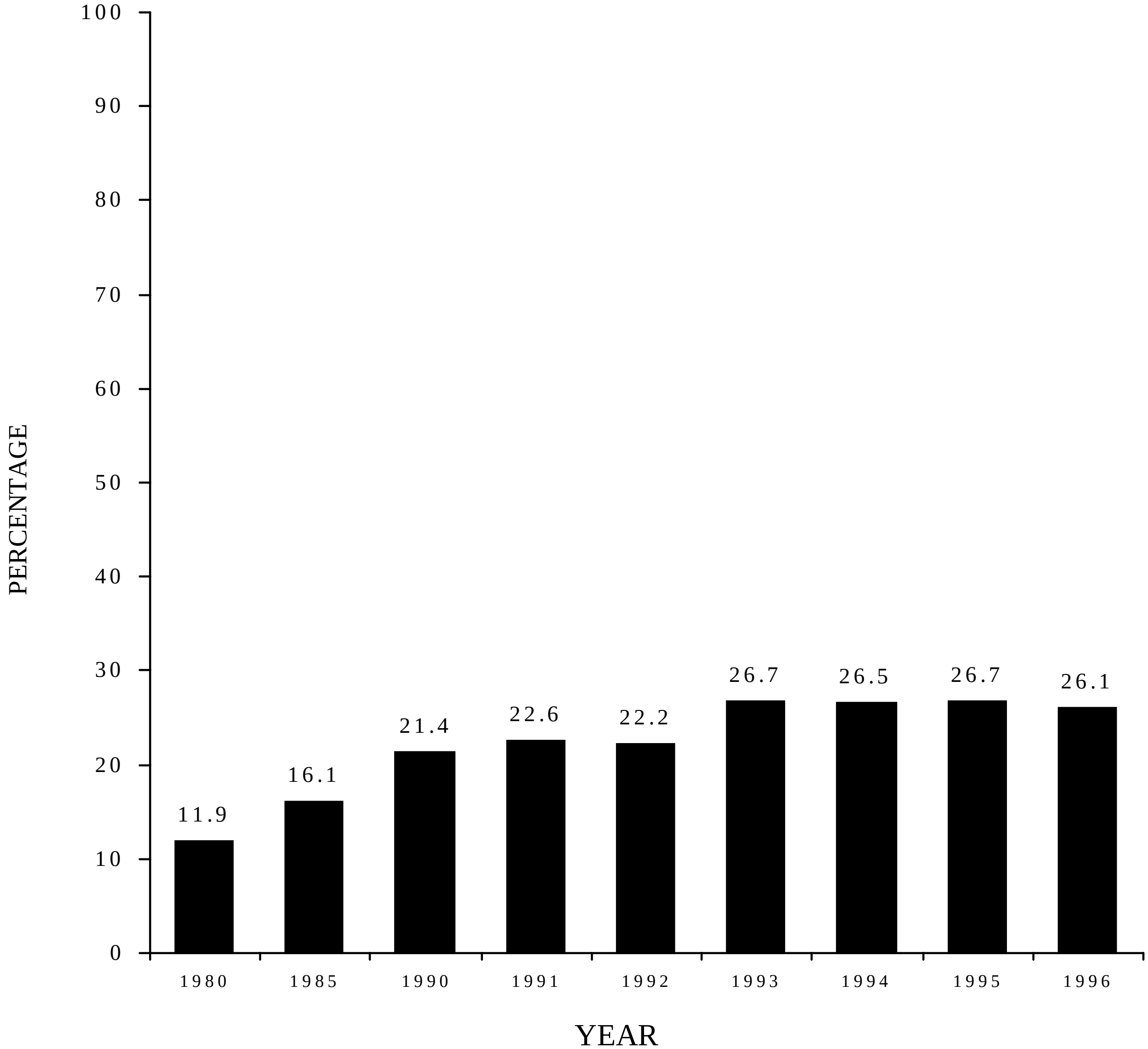
[27/] While international banks compete vigorously with U.S. banks, the relative size of international banks' presence in the United States does not present any special policy concern and does not adversely affect U.S. banks' competitive position. In response to questions from the Senate Banking Committee, Federal Reserve Board Chairman Alan Greenspan stated that he would be "hard pressed to come up with [a] national security concern" with the percentage of U.S. banking assets held by international banks where the ownership is spread "among a large number of banking institutions from a large number of different countries." Hearing on the Reappointment of Alan Greenspan to be Chairman of the Board of Governors of the Federal Reserve before the Senate Committee on Banking, Housing and Urban Affairs, 102d Cong., 2d Sess at 369 (1992). More recently, Chairman Greenspan has noted that "U.S. banks are world leaders in terms of efficiency and investing" and "such characteristics are likely to better serve the interests of U.S. firms -- in terms of their ability not just to compete but to expand their activities -- than sheer size." Letter from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to Hon. Ron Wyden, U.S. House of Representatives (May 5, 1995). U.S. bankers have specifically discounted the importance of assets in measuring competitiveness and instead have emphasized the importance of profitability and capital in interviews with the GAO. See 1996 GAO Report, supra note 3, at 5.

CHART 9

U.S. BANKING OPERATIONS OF INTERNATIONAL BANKS' PERCENTAGE OF TOTAL U.S. BANKING ASSETS*

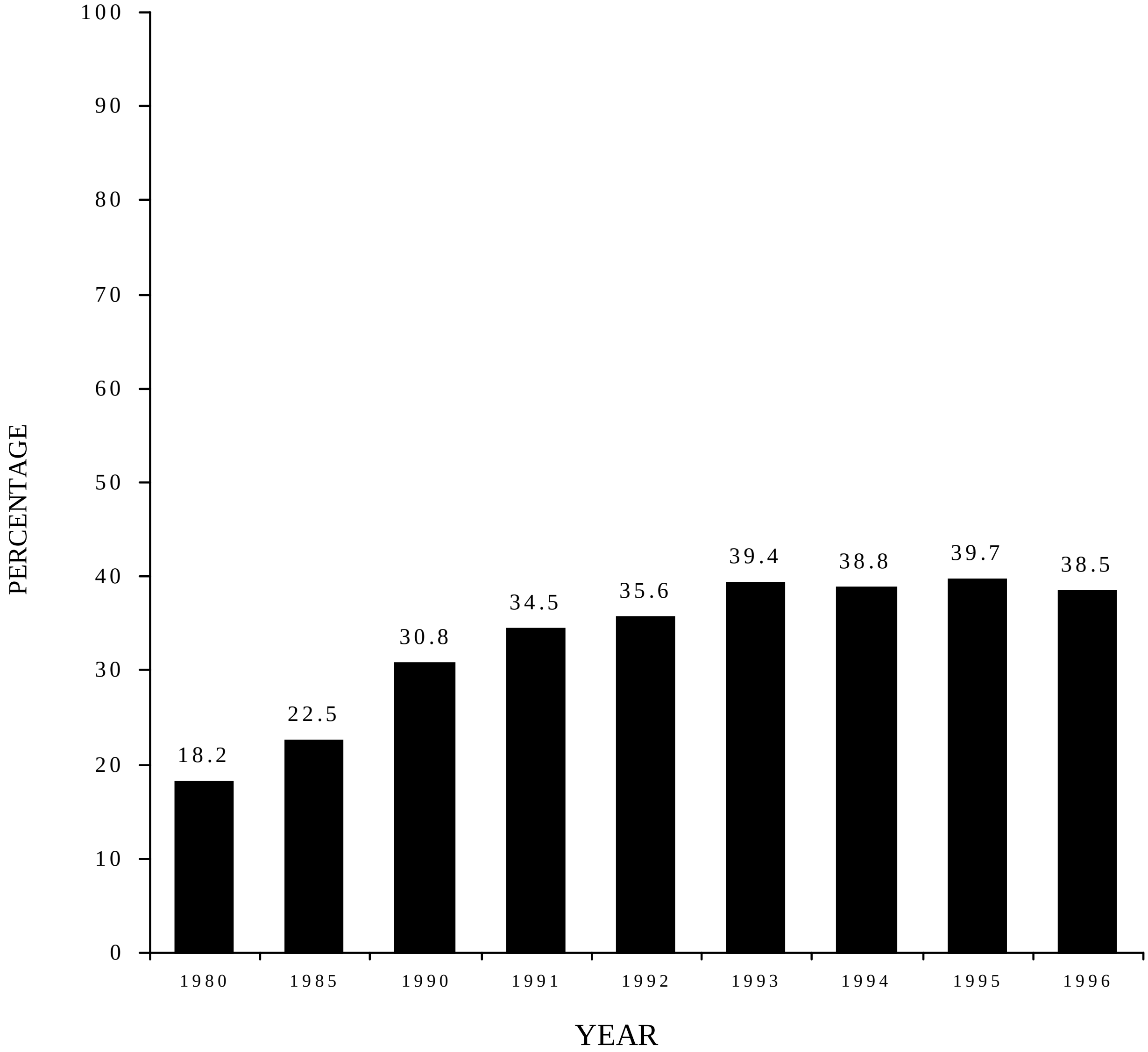


* Prior to 1993, data does not include assets booked at offshore offices of international banks.

SOURCE: Federal Reserve Board (As of December 31 for all years)

CHART 10

U.S. BANKING OPERATIONS OF INTERNATIONAL BANKS' PERCENTAGE OF TOTAL U.S. C&I LOANS*



* Prior to 1993, data does not C&I loans booked at offshore offices of international banks.

SOURCE: Federal Reserve Board (As of December 31 for all years)

changing percentage of total U.S. C&I loans held by U.S. banking operations of international banks during the period 1980-1996. As of December 31, 1996, the U.S. nonbank subsidiaries of international banks held $102.1 billion in total loans and leases.

Loan Syndications. As members of loan syndicates, the U.S. operations of international banks, in particular branches and agencies, acquire substantial amounts of loans originated by U.S. banks. In acquiring such loans, international banks provide funding necessary to finance major transactions structured by U.S. banks.[28] The U.S. banks acting as agents in such transactions also receive significant fees for originating and servicing the loans. By participating in loan syndications and acquiring interests in other loans originated by U.S. banks, international banks provide a market for U.S. banks to sell assets, thereby enabling U.S. banks to allocate their capital to make new loans, and facilitate the ability of U.S. banks to diversify their credit risk. It has been estimated that in 1996, international banks purchased 57 percent, or $506 billion, of the $888 billion in syndicated loans (including unfunded commitments to extend credit) in the United States.[29]

While these figures evidence the significant role of international banks in the syndicated loan market, the more meaningful measure of leadership in this market is the institution that originates and syndicates a loan, not the institution that purchases the loan and holds it on its balance sheet. The lead banks in such syndications, which principally are U.S. banks, obtain substantial fees in placing the loans, while the purchasers of such loans, which to a large extent are international banks, receive a smaller return. Thus, rather than taking loan business away from U.S. banks, international banks that are active in the syndicated loan market complement the syndication activities of U.S. banks.

Real Estate Loans. U.S. banking operations of international banks are also a significant source of credit for real estate transactions in the United States. As of December 31, 1996, the U.S. banking operations of international banks held total U.S. real estate loans of approximately $81.8 billion, of which $43.9 billion were loans made by U.S. bank subsidiaries of international banks, and $37.9 billion were real estate loans made by U.S. branches and agencies.

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[28] The GAO has reported that 9 of the top 10 originators of loans were U.S. banks. 1996 GAO Report, supra note 3, at 30.

[29] "Concerns Mounting Over Risks In Booming Syndication Market," American Banker, January 29, 1997, at 1.

Interbank Lending. A significant portion of the assets of U.S. banking operations of international banks consists of loans to and other claims on unrelated depository institutions. As of December 31, 1996, such operations had $234.1 billion in loans to and other claims on unrelated depository institutions. U.S. branches and agencies held approximately $213.1 billion of these loans and other claims. U.S. branches and agencies also made $40.9 billion in loans to non-depository financial institutions.

Corporate and Municipal Debt Securities. U.S. banking operations of international banks provide significant amounts of funding to U.S. businesses and state and local governments by investing in their securities, including corporate bonds, commercial paper, medium term notes, municipal revenue bonds, asset-backed securities and equity securities. As of December 31, 1996, U.S. banking operations of international banks held $67.0 billion in investments in securities (excluding U.S. government securities). Of this amount, $60.2 billion was held by U.S. branches and agencies. The nonbank subsidiaries of international banks held an additional $25.2 billion in securities (including U.S. government securities).

U.S. Government Securities. U.S. banking operations of international banks also hold significant amounts of investments in securities issued or guaranteed by the U.S. Government, its agencies or U.S. government-sponsored enterprises. As of December 31, 1996, U.S. banking operations of international banks held $92.6 billion in such securities. Of this amount, $77.2 billion was held by U.S. branches and agencies. International banks also hold significant amounts of such securities at their head offices and at other non-U.S. offices that are not managed or controlled by U.S. branches or agencies.

Standby Letters of Credit. International banks provide letter of credit support and other credit enhancements that enable local governments and other U.S. borrowers to issue bonds and other obligations at a lower interest rate than if their obligations had not been backed by a highly-rated bank. By "lending" their credit rating to U.S. issuers, international banks lower borrowing costs for local governments and their taxpayers and facilitate the financing of state and local government services. U.S. banking operations of international banks had $451.2 billion in standby letters of credit outstanding as of December 31, 1996, of which $440.2 billion was held by U.S. branches and agencies. In addition, U.S. nonbank subsidiaries of international banks held $36 billion in standby letters of credit outstanding as of the same date.

The "Credit Crunch". The importance of lending by international banks was demonstrated during the "credit crunch" of the early 1990s, when lending by U.S. banks declined. Over the three-year period 1990 through 1992, business lending by U.S. branches and agencies increased by 21.5 percent (to $168 billion) while business lending by U.S. banks declined by 12.4 percent (to $533 billion).[30] In correspondence relating to a Senate Banking Committee hearing in 1993, Federal Reserve Bank of Chicago President Silas Keehn noted that "without the lending capacity supplied by . . . [international] banks, U.S. borrowers would have experienced greater reductions in credit availability over the past three years. The result would undoubtedly have been slower economic growth."[31] U.S. bankers interviewed by the GAO have confirmed that international banks helped maintain funding for U.S. businesses while U.S. banks were rebuilding their capital.[32]

In addition, the fact that the international banks with U.S. operations come from over 60 countries assists their ability to provide a stable source of credit to U.S. borrowers. Even if lending by banks from a particular country may decline because of developments in the banks' home country, banks from other countries may be able to increase their lending. For example, recent developments in Japan have resulted in Japanese banks being less active in the U.S. market relative to Canadian and European banks.

Benefits of Competition. As a corollary to providing credit, international banks are also a source of competition for banking services in terms of price, quality and product innovation. Such competition promotes the public welfare by encouraging innovation and reducing costs. The U.S. operations of international banks therefore contribute to a more competitive U.S. financial services system that can meet a broad range of financial needs at the most competitive prices. As a result, U.S. borrowers' costs are reduced, just as U.S. banks through their overseas operations help bring similar benefits to other countries. There is a growing consensus that

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[30] Fed. Res. Bull. Special Tables at A72, A72, A70, A70 (June 1990; May 1991; May 1992; May 1993); Federal Reserve Board, April 1993.

[31] Letter from Silas Keehn, President, Federal Reserve Bank of Chicago, to Hon. Donald Riegle, U.S. Senate (April 28, 1993).

[32] See 1996 GAO Report, supra note 3, at 5.

competition by nondomestic financial institutions also contributes to the overall strength of a country's financial system.[33/]

Significant Lending in Every State in the United States

The Institute has collected information from international banks to show the breakdown of borrowers by state.[34/] The results show that the U.S. operations of international banks make significant amounts of loans and other extensions of credit to commercial borrowers and to state and local authorities in every state in the United States. Table II identifies the states with the largest concentrations of loans from international banks.

Table II

Aggregate Amount of Loans and Other Facilities to Borrowers in Individual States by U.S. Operations of International Banks (as of December 31, 1996)

Loans	States
Over $10 Billion	California, Connecticut, Florida, Illinois, Massachusetts, Michigan, New Jersey, New York, Pennsylvania, Texas
Between $5 Billion and $10 Billion	Colorado, Delaware, Georgia, Missouri, Ohio, Virginia, Washington
Between $1 Billion and $5 Billion	Alabama, Arizona, Arkansas, District of Columbia, Indiana, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Nebraska, Nevada, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Wisconsin and Puerto Rico

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33/ See 1997 World Bank Study, supra note 2, at 3 (building robust banking systems requires liberalizing financial systems to allow greater competition).

34/ The Institute requested information from its member banks regarding lending on a state-by-state basis by their (i) U.S. branches and agencies, (ii) U.S.-managed offshore branches, and (iii) U.S. bank and nonbank subsidiaries (excluding nonbank investments held pursuant to Section 2(h)(2) of the Bank Holding Company Act). A number of the banks surveyed do not have readily available data showing the state-by-state breakdown of their loans. Accordingly, the Institute believes that the actual amounts of loans in individual states are substantially higher than the results shown by the survey.

Examples of such financings can be found for every state in the United States. Whether they are issuing letters of credit or extending other financing to support the construction of new manufacturing plants in Alabama, Indiana, Kentucky, New Jersey, South Carolina and Texas, financing power plants in California, Florida, Massachusetts, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Texas, Virginia and West Virginia, or lending to state and local governmental authorities in California, Connecticut, Florida, New York, North Carolina, Texas, Utah and Wisconsin, international banks are providing significant financing throughout the United States.[35/]

Net Contribution of Capital to the U.S. Economy

On balance, international banks bring more credit to the United States than they take out, i.e., they are net contributors of capital to the United States. Data with respect to the activities of the U.S. branches and agencies of international banks developed by the U.S. Department of the Treasury from its International Capital Forms indicates that, as of December 31, 1996, deposits from and other liabilities to non-U.S. persons, including head office and affiliates, exceeded loans to and other claims on non-U.S. borrowers, including head office and other affiliates, by more than $158 billion.[36/] These funds are available to U.S. branches and agencies to lend to U.S. borrowers and to invest in U.S. securities.[37/] The data since 1987 is set forth in Table III below.[38/]

35/ These examples are all taken from survey responses of the Institute's members.

36/ See also 1996 GAO Report, supra note 3, at 6, 36-38 (examination of Federal Reserve data regarding U.S. branches' and agencies' sources and uses of funds).

37/ It is possible that portions of this excess capital could also be invested in long-term foreign government securities and other long-term non-U.S. instruments that are not reported on the Treasury International Capital Forms. However, based on Federal Reserve Board data, the Institute estimates that most of the $158 billion available as of December 31, 1996 was provided to U.S. persons through loans and investments in securities and other obligations. The Federal Reserve data shows that U.S. branches and agencies (excluding offshore branches managed or controlled by such offices) held total securities (consisting of securities of non-U.S. issuers and U.S. issuers, but not U.S. government securities) of $45 billion as of December 31, 1996, only $13 billion of which were issued by foreign governments.

38/ Table III is based on information reported on Treasury International Capital Forms BL-1, BC and BQ and aggregated by the Office of International Financial Analysis of the Department of the Treasury. This information includes loans, deposits and other balances arising from normal banking business, other than negotiable certificates of deposit. The information does not

Table III

Claims on and Liabilities to Non-U.S. Residents and Entities by U.S. Branches and Agencies of International Banks ($ billions)

Year-end	Claims	Liabilities
1987	278.8	310.8
1988	305.1	340.4
1989	328.0	371.7
1990	326.7	385.0
1991	350.5	402.3
1992	319.0	426.0
1993	293.3	424.3
1994	302.1	452.5
1995	323.3	496.8
1996	340.8	499.1

Export and Trade Finance and Investment

International banks also facilitate international trade and investment between the United States and other countries, including playing a major role in financing job-producing exports. An international bank is frequently in the best position to finance exports of U.S. goods and services to its home country. Indeed, because of its knowledge of markets, economic conditions and buyers in the home country, an international bank may be able to provide export finance in situations where U.S. banks are unable to do so. U.S. bankers have confirmed that international banks meet trade financing needs that are not met by domestic banks.[39/] International banks are also a source of information and advice for U.S. exporters concerning opportunities for sales in the banks' home countries.

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include capital investments, equities and long-term debt securities (original maturities of more than one year). Data for 1987-89 are subject to marginal changes due to later revisions to the data series.

[39/] See 1996 GAO Report, supra note 3, at 5.

As of December 31, 1996, U.S. banking operations of international banks held $15.2 billion in commercial letters of credit used to facilitate domestic and international trade and U.S. nonbank subsidiaries of international banks held $2.5 billion. International banks also provide significant amounts of trade finance through the use of bankers acceptances. Customer liabilities on acceptances to the U.S. operations of international banks were $10.9 billion.

Other data confirms the importance of international banks in U.S. export finance. As of September 30, 1996, international banks occupied 5 of the top 10 and 12 of the top 25 spots in a ranking of financial institutions obtaining guarantees and insurance from the Export-Import ("Ex-Im") Bank for loans that finance U.S. exports and services, including participation of U.S. firms in foreign projects.[40/] Between October 1, 1995 and September 30, 1996, the 12 top-rated international banks provided or committed to provide over $3.8 billion in loans guaranteed or insured through the Ex-Im Bank programs.[41/]

International banks play a major role in financing exports of grain and other agricultural products, and in providing loans generally to the agricultural sector. During the late 1980s, international banks increased their financing of agricultural exports at the same time that U.S. banks reduced their lending in this area.[42/] Latin American and Caribbean banks play an important role in financing exports from Florida to Latin America.[43/]

[40/] Top 200 Guaranteed Lenders, Export-Import Bank, October 30, 1996 (the "Ex-Im Bank Report"). A portion of these loans was booked at banks' head offices outside the United States. See also "The European Invasion," World Trade (September 1996) at 48 (discussing the prominence of international banks in export finance and stating that 5 of the top 10 banks that received guarantees from the U.S. Export-Import Bank were from Europe); "Export Finance Under Pressure," Project & Trade Finance (January 1996) at 22 (discussing the involvement of international banks in Ex-Im Bank financing).

[41/] Ex-Im Bank Report, supra note 40. The data includes loans booked both at the head office of the international bank and its U.S. branches, agencies and subsidiaries. Ex-Im Bank data indicates that 5 of the top 10 and 12 of the top 25 banks participating in Ex-Im Bank programs for the period between October 1, 1994 and September 30, 1995 were international banks.

[42/] "Love 'em and Leave 'em," Forbes, November 13, 1989, at 48.

[43/] See, e.g., "Trade Finance Drawing Latin Banks to Florida," American Banker, October 23, 1991, at 9 (Florida officials estimate that more than half of $9 billion in commodity exports was financed by Latin American banks).

International banks also assist in investment and generation of jobs in the United States through the financing of the U.S. operations of their home country customers, which operate like domestic businesses in the United States in terms of employment, expenditures and rental of office space. The Institute's survey indicates that approximately half of the C&I loans by U.S. banking operations of international banks are to customers which are subsidiaries or affiliates of the banks' customers in the home country.

Increased Depth and Liquidity of U.S. Financial Markets

The U.S. presence of international banks contributes to the overall depth and liquidity of wholesale banking, securities and other financial markets in the United States. The importance of international banks to the viable operation of the syndicated loan markets is apparent from the publicly available data cited above: during 1996, international banks acquired 57 percent of all syndicated loans in the United States.

International banks also play an important role in other markets, such as swaps and foreign exchange, where the credit rating of counterparties and capital are of paramount concern. In the case of foreign exchange markets, the expertise and large trading positions of international banks in the currency of their home countries bring important stability to markets where the number of active domestic institutions may be limited.

Securities Markets. International banks also contribute to the depth and liquidity of U.S. securities markets. As stated by Chairman Greenspan, one of the reasons "U.S. securities markets are the deepest, the broadest and the most liquid in the world" is the "openness of our markets to competition and investors from all sources including foreign-based competitors."[44/] International banks are typically the major securities underwriters and dealers in their home country, and, as discussed above, many international banks engage in securities activities in the United States through "Section 20" and other securities affiliates. A review of NASD membership data indicated that as of December 31, 1996, international banks operated more than 50 U.S. broker-dealers. These firms help to provide capital and liquidity to the U.S. securities markets and thereby help to reduce U.S. business' cost of capital and enhance their ability to

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44/ Letter from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to Hon. Ron Wyden, U.S. House of Representatives (May 5, 1995).

raise capital.[45] Moreover, these securities operations create jobs in the U.S. securities industry. Of the top 50 U.S. broker-dealers (ranked by number of employees), six are owned by international banks and employ an aggregate of 10,534 people.[46]

International banks are also major participants in primary and secondary markets for U.S. government securities. Of the 39 primary dealers as of September 4, 1997, 12 were owned by international banks.[47] By providing additional depth and liquidity to these markets, international banks reduce the U.S. Government's costs of raising funds.

Derivatives Markets. As of December 31, 1996, U.S. banking operations of international banks held for their own account a total gross notional amount of $6.09 trillion in derivatives contracts. U.S. nonbank subsidiaries of international banks held for their own account an additional gross notional amount of $4.35 trillion of derivatives contracts as of the same date. Thus, the total gross notional amount of derivatives contracts held by international banks' operations in the United States as of December 31, 1996 was $10.44 trillion.[48] The following table provides a breakdown of the contribution of U.S. branches and agencies of international banks as of December 31, 1996 based on information compiled by the Federal Reserve.

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[45] Id. at 4; see also letter from Arthur Levitt, Chairman, Securities and Exchange Commission, to Hon. Ron Wyden, U.S. House of Representatives (May 24, 1995) at page 4 of the attachment (international bank acquisition of U.S. broker-dealers could result in additional capital and liquidity that tends to decrease the cost to companies to raise capital).

[46] "Ranking America's Biggest Brokers - Good News, Bad News," Institutional Investor, April 1997, at 107.

[47] List of Primary Dealers, Federal Reserve Bank of New York, September 4, 1997.

[48] This amount does not include derivatives trades with U.S. counterparties that are booked at an international bank's head office or other offshore locations.

Table IV

Derivatives Transactions of
U.S. Banking Operations of International Banks
($ millions)

December 31, 1996

Type of Contract	Gross Notional Amount
Interest Rate Contracts	$3,951,830
Foreign Exchange Contracts	$2,064,064
Equity, Commodity and Other Contracts	$ 69,393
Total	$6,085,287

Financial Benefits of Direct Branches

U.S. and international banks operate in wholesale financial markets outside of their home countries primarily through direct branch or agency offices. Operating through direct offices significantly enhances the financial benefits that international banks bring to the United States. Most importantly, international banks that operate in the United States through direct branches rather than through separately chartered bank subsidiaries can borrow and lend on the basis of their worldwide capital, which is also available to support other wholesale transactions, including foreign exchange trading for the bank's own account.

In a comprehensive study of branch and subsidiary options for banking operations, the U.S. Treasury Department and the Federal Reserve Board concluded several years ago that international banks should be permitted to operate through branches in the United States rather than be required to operate through separately chartered bank subsidiaries. The study identified the following benefits of the branch form that are not available to subsidiaries: (i) the ability to deploy capital flexibly; (ii) a lower cost of funding; (iii) the ability to compete based on access to the worldwide capital base of the parent; (iv) freedom to engage in transactions with the parent without significant restraints; and (v) lower transaction costs.[49]

The study concluded that requiring international banks to operate through subsidiaries rather than branches and agencies would "impose substantial economic and financial costs" on international banks, could reduce the availability of credit in the United States and "would reduce the depth, efficiency and competitiveness of the U.S. banking market."[50] Moreover, as a result of such a subsidiary requirement, "the participation of [international] banks in lending syndicates, trade finance, and transactions in foreign exchange, swaps and other products would be restricted by the increase in costs and by their inability to access their worldwide capital base."[51]

U.S. International Banking Centers

The concentration of international banks in important U.S. financial centers such as New York City, Los Angeles, San Francisco, Chicago, Miami, Dallas, Houston and Atlanta results in significant contributions to the growth and importance of these financial centers and the geographic areas they serve. The assets of international bank operations in New York, California, Illinois, Florida, Texas and Georgia are shown in Charts 11 to 16, respectively. The locations of their offices by state are shown in Table I at page 25 above.

The U.S. presence of international banks plays a substantial role in New York City's status as one of the world's leading international financial centers.[52] The involvement of international banks in clearing international transactions for their customers and head offices through the Clearing House Interbank Payment System ("CHIPS") and Fedwire helps to maintain the pre-eminence of New York for U.S. dollar settlements. The New York operations of international banks also contribute to the stability, depth and liquidity of wholesale, interbank, foreign exchange, securities and derivatives markets. According to the New York State Banking

[49] Subsidiary Study, supra note 25, at 14.

[50] Id. at 15.

[51] Id. at 2.

[52] For a detailed study of the importance of financial services to New York City's economy, including the key contributions of international banks, see I. Walter and A. Saunders, National and Global Competitiveness of New York City as a Financial Center (1991).

Department, "the importance of the foreign bank presence to the New York economy cannot be overemphasized."[53/]

As of December 31, 1996, the New York banking operations of international banks had total assets of $697 billion, of which $638 billion were booked in New York branches and agencies. These assets constituted approximately 50 percent of all assets held by U.S. banking operations of international banks. As of December 31, 1996, New York branches, agencies and bank subsidiaries of international banks had total C&I loans of $145.9 billion, of which $129.7 billion were held by branches and agencies.

In California, branches, agencies and bank subsidiaries of international banks had, as of year end 1996, assets of $119 billion and total C&I loans of $45.8 billion. A recent report of the California State Banking Department states that international banks have been making "valuable contributions" to the California economy "for almost 150 years."[54/] International banks are also playing an increasingly important role in financing trade with the Pacific Region.

In Illinois, branches, agencies and bank subsidiaries of international banks had total assets of $108 billion and C&I loans of at least $40 billion as of December 31, 1996. International banks' operations in Illinois complement regional bank lending by helping fund large loans, and help finance transactions in Chicago's commodities markets. International banks also operate future commission merchants that participate in commodities markets in Chicago.

Miami is an important center for asset management and trade finance activities in Latin America. As of December 31, 1996, Florida agencies of international banks had total assets of $19.2 billion. Furthermore, the lending activities at the Florida offices of international banks are increasing rapidly.[55/]

53/ New York State Banking Department, Foreign Banks in New York (September 12, 1996).

54/ California State Banking Department, A Guide to International Banking in California (November 1996) at 8.

55/ See "Florida's Foreign Banks Ride Latin Wave," International Banking Regulator, March 24, 1997, at 1 (stating that the amount of loans booked at Florida agencies of international banks between 1995 and 1996 increased by 50 percent and the assets for the same period increased by 22 percent).

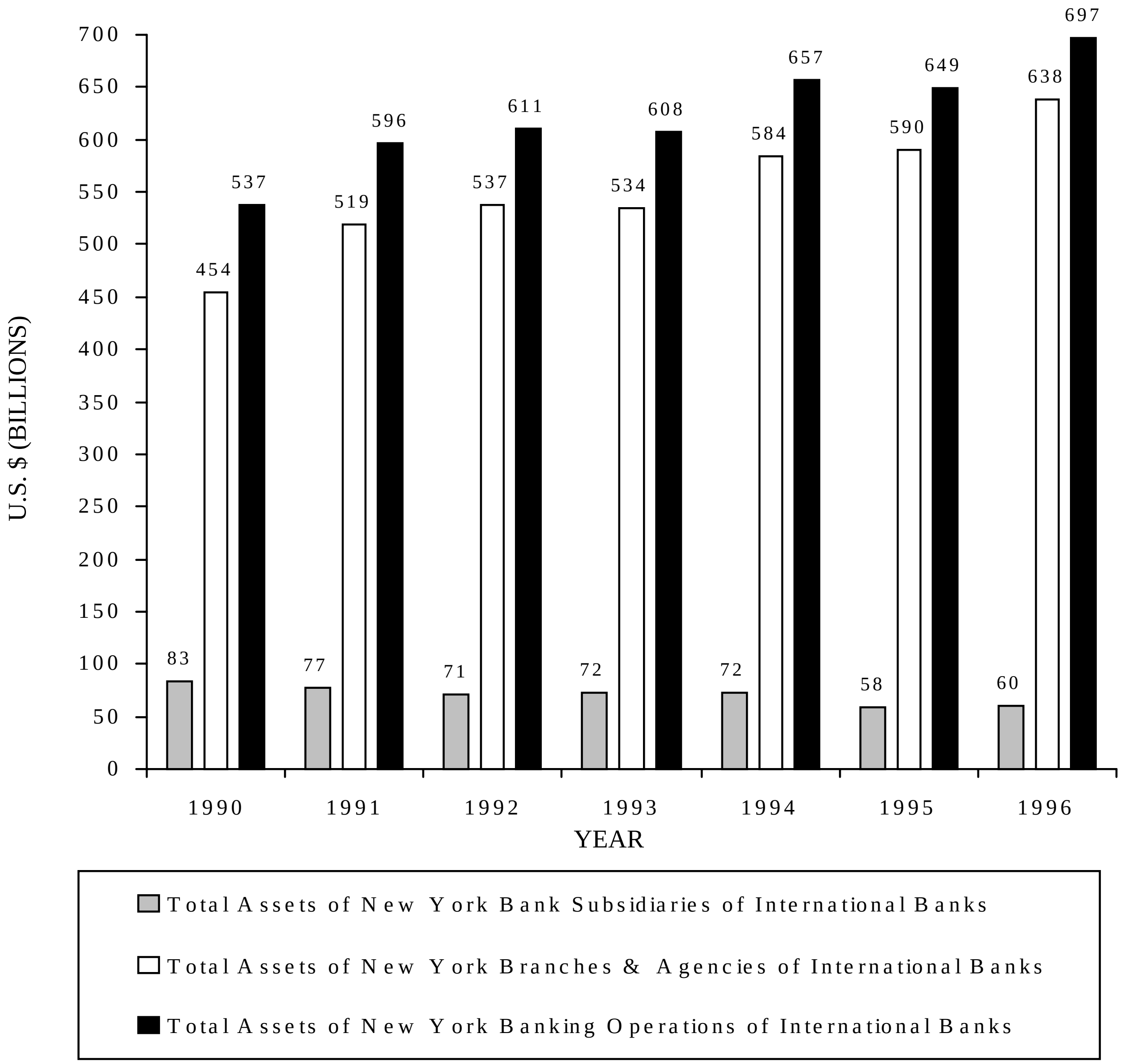
The contributions of international banks to the Texas economy have significantly expanded since Texas adopted legislation permitting international banks to establish agencies in the mid-1980s. As of December 31, 1996, 35 international banks operated agencies in Dallas and Houston with total assets of $11.4 billion. While they were initially attracted to the energy industry, international banks in Texas have expanded to provide financial services to regional corporations as well.[56/]

As one of the leading financial centers in the South, Atlanta is also an important center for international banks that want to participate in this region. As of December 31, 1996, 16 international banks operated in Georgia with total assets of $11 billion.

[56/] See "Eyes of Texas Are Smiling on Foreign Banks," American Banker, December 6, 1995, at 6.

CHART 11

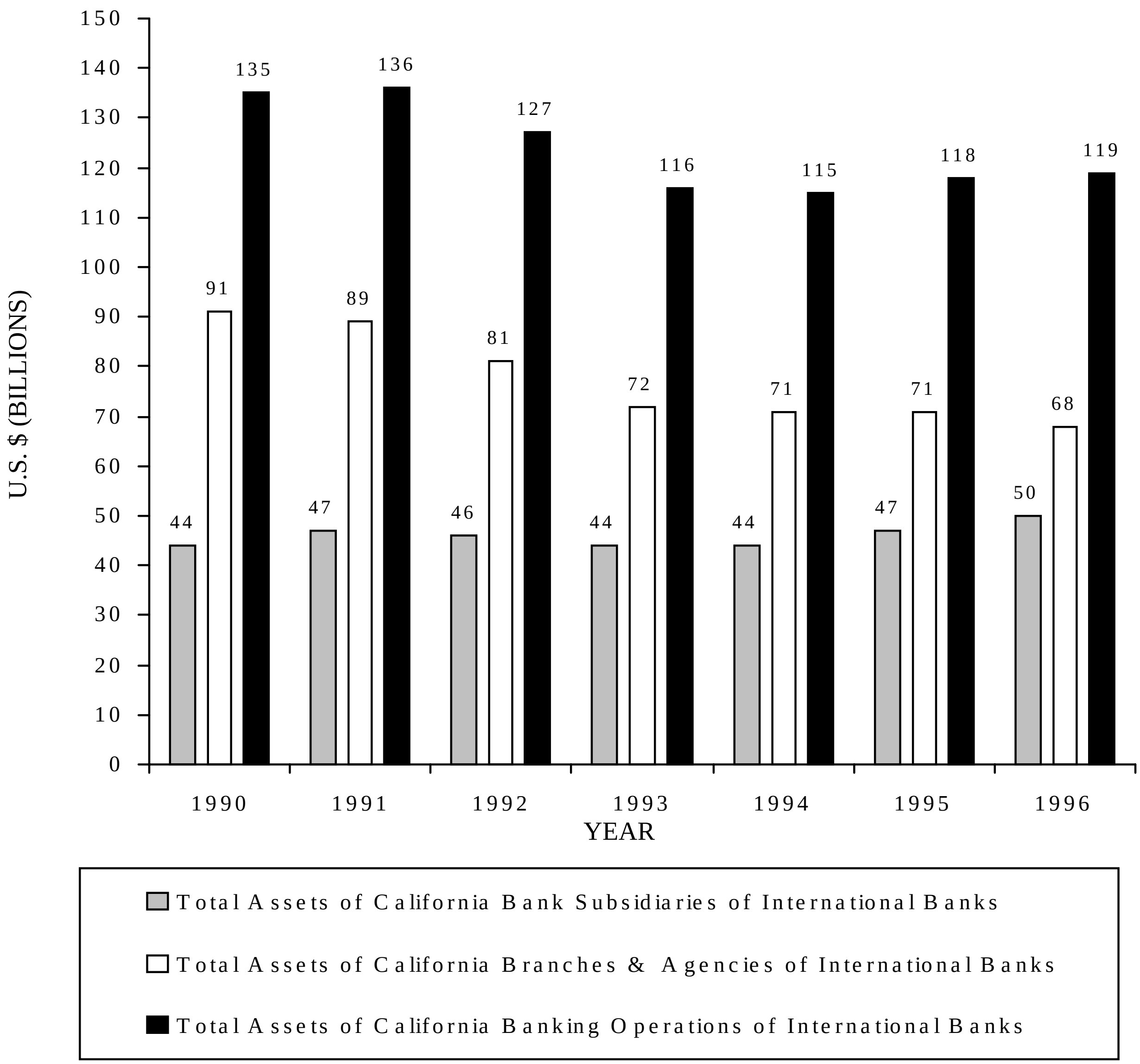
ASSETS OF NEW YORK BANKING OPERATIONS OF INTERNATIONAL BANKS



SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 12

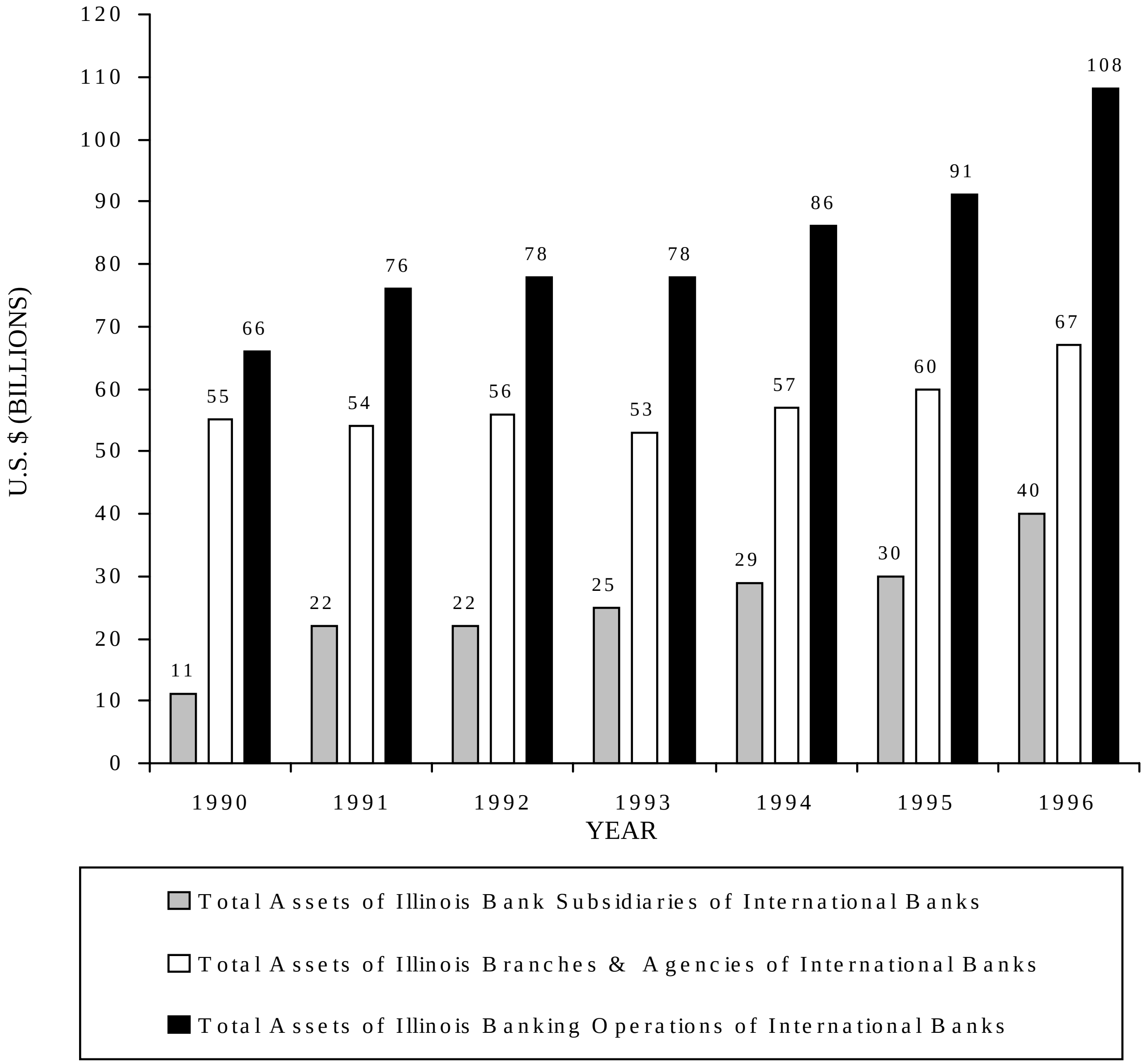
ASSETS OF CALIFORNIA BANKING OPERATIONS OF INTERNATIONAL BANKS



SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 13

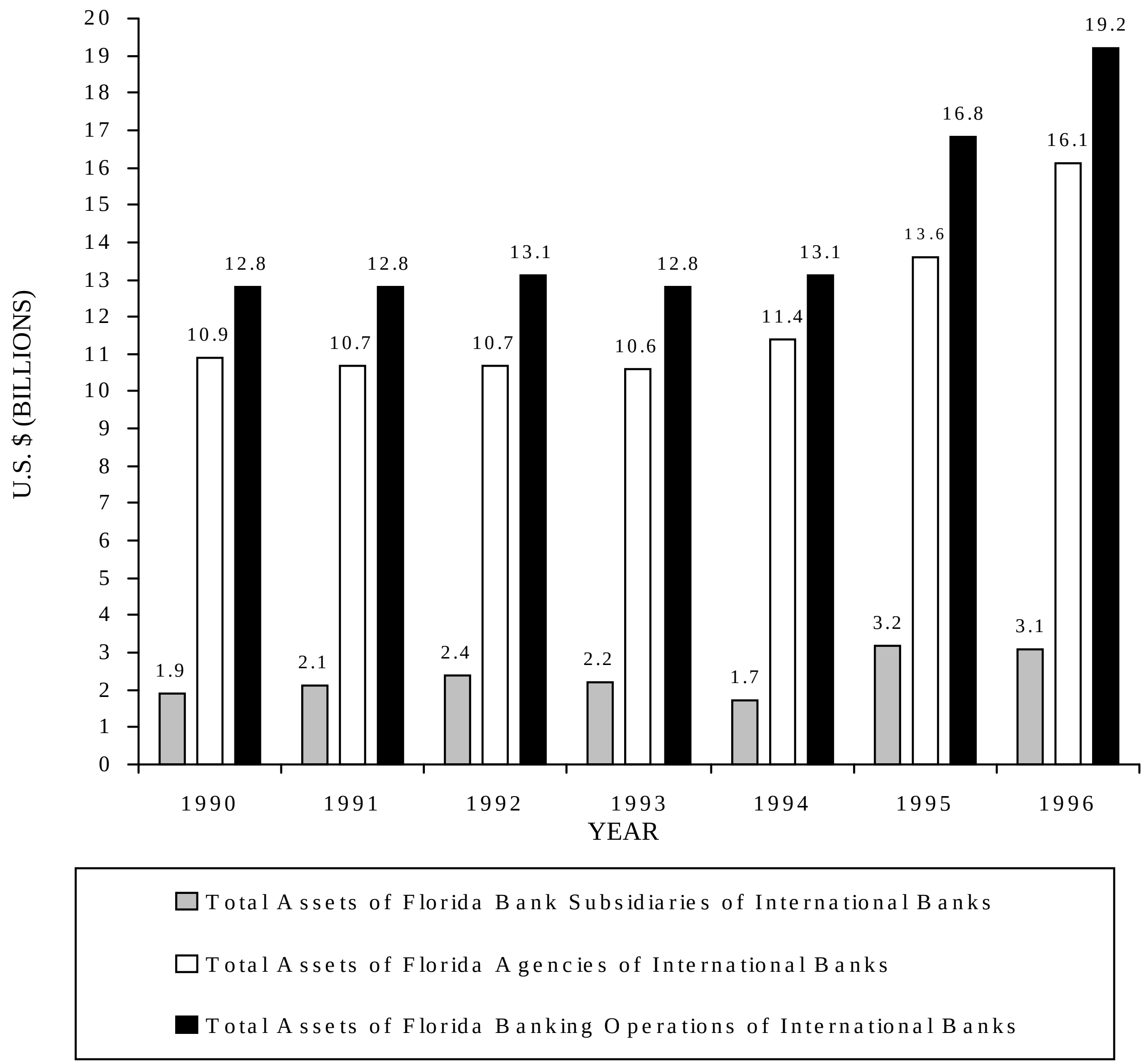
ASSETS OF ILLINOIS BANKING OPERATIONS OF INTERNATIONAL BANKS



SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 14

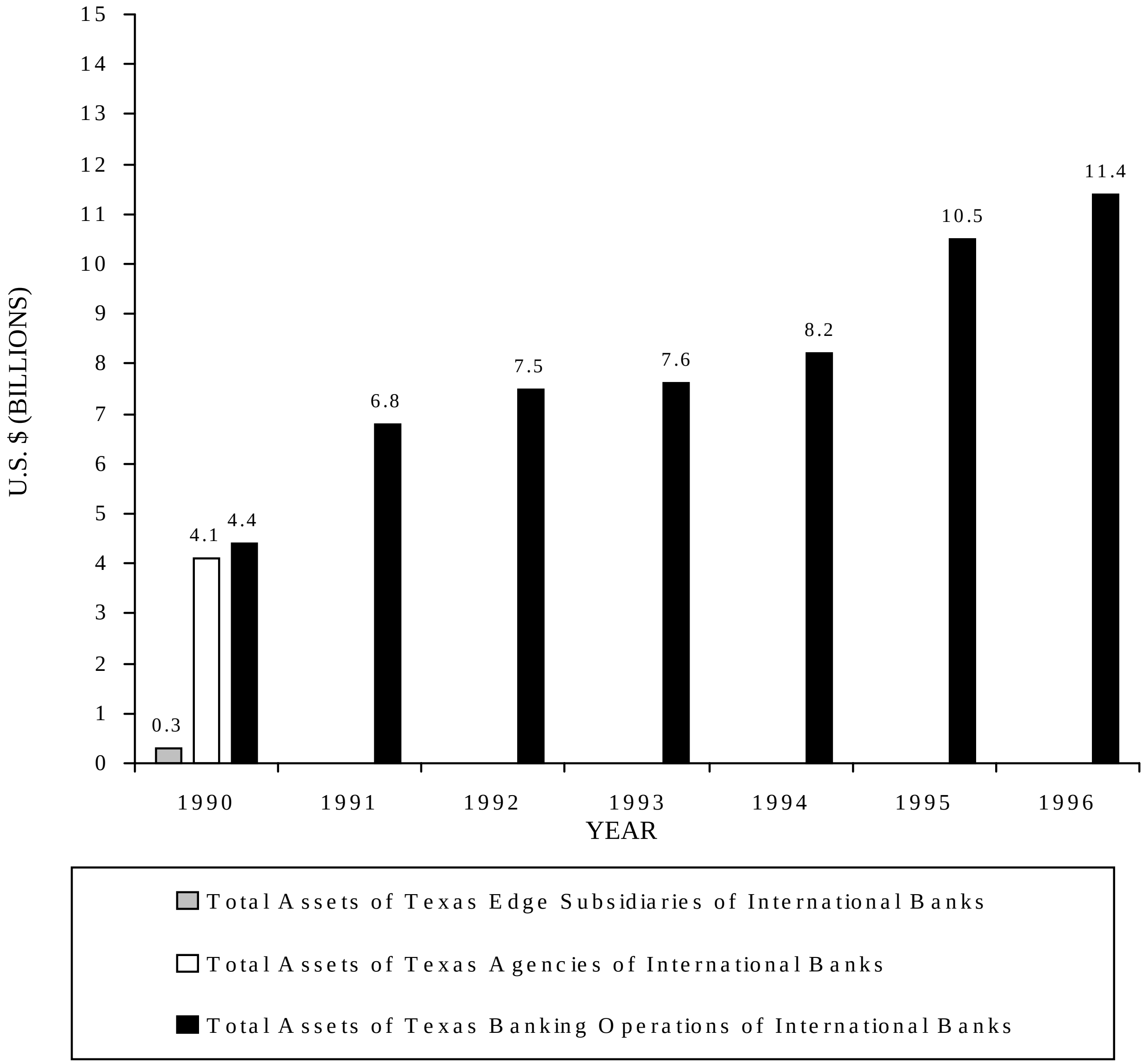
ASSETS OF FLORIDA BANKING OPERATIONS OF INTERNATIONAL BANKS



SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 15

ASSETS OF TEXAS BANKING OPERATIONS OF INTERNATIONAL BANKS*

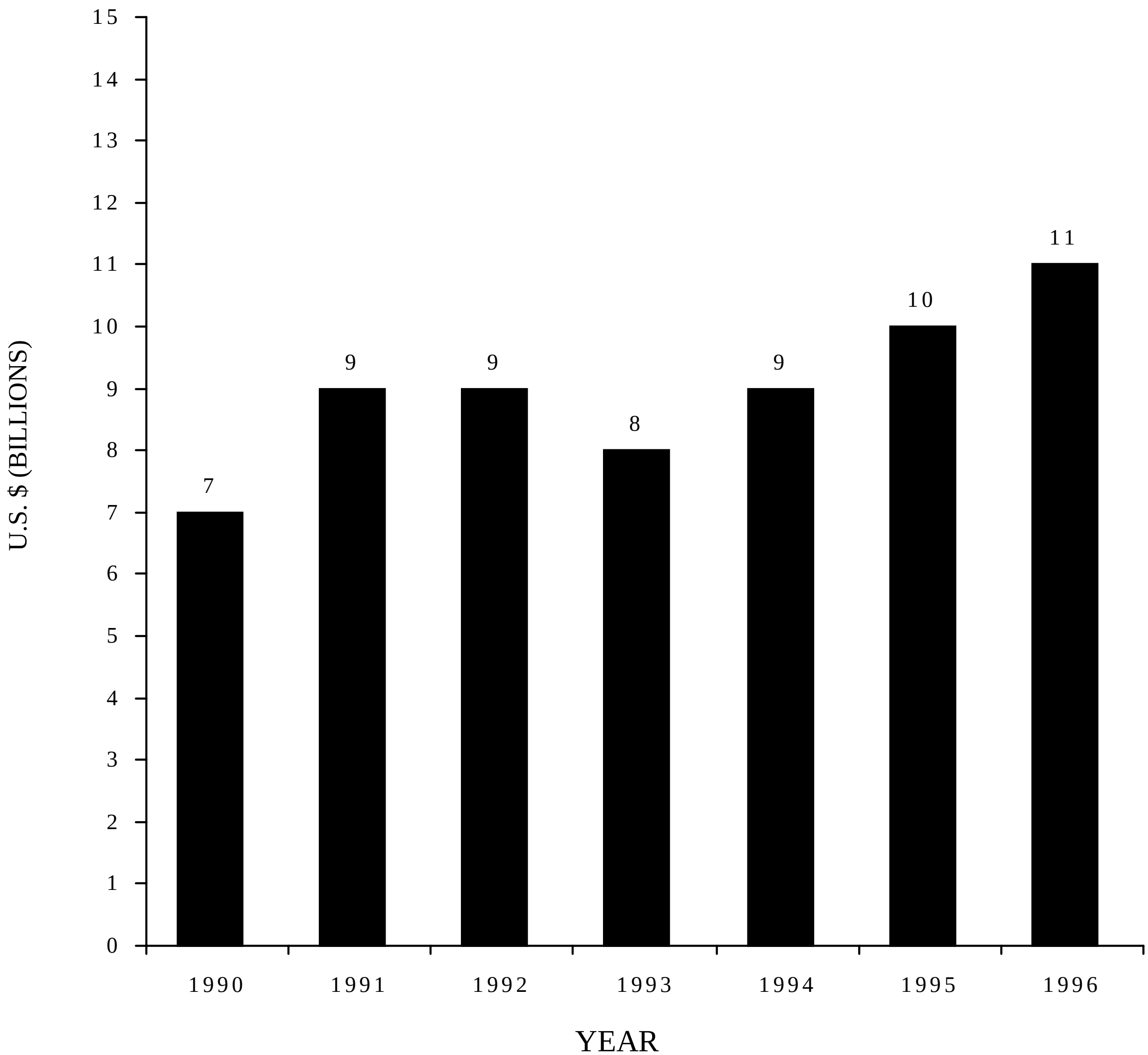


*Since 1991, agencies have been the only form of banking operation used by international banks in Texas.

SOURCE: Federal Reserve Board
(As of December 31 for all years)

CHART 16

ASSETS OF GEORGIA AGENCIES OF INTERNATIONAL BANKS*



*Agencies are the only form of banking operation currently used by international banks in Georgia.

SOURCE: Federal Reserve Board
(As of December 31 for all years)

DIRECT ECONOMIC BENEFITS OF U.S. OPERATIONS OF INTERNATIONAL BANKS

In addition to the foregoing financial benefits, the U.S. operations of international banks contribute significant direct benefits to the U.S. economy in terms of jobs and related payroll expenditures, along with other operating and capital expenditures. The expenditures of international banks to establish and maintain their U.S. operations and activities stimulate the U.S. economy generally and benefit a broad range of industries, including real estate and construction, manufacturers of computer hardware and software, and legal, accounting and other professional services. The Institute has surveyed its member banks to collect information on the direct economic benefits provided by their U.S. operations to the U.S. economy.[57/]

The survey shows that total direct expenditures by U.S. operations of international banks for 1996 alone were at least $16.6 billion, and total direct employment was at least 118,291 people. The effect on the U.S. economy extends beyond the direct hiring of employees and the purchase of various goods and services because expenditures by the banks and their employees result in additional jobs and related employee earnings being created in other industries. For example, if a bank purchases a computer from a local retailer, the retailer will use that income to pay for inventory, wages and other goods and services. Based on direct-effect multipliers

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[57/] The survey requested data on U.S. branches, agencies and representative offices of international banks, as well as on their U.S. bank and nonbank subsidiaries (excluding nonbank subsidiaries held pursuant to section 2(h)(2) of the Bank Holding Company Act). 159 of the Institute's 201 members responded to the questionnaire, a response rate of almost 80 percent. In addition, 30 non-members (or approximately 20 percent of the institutions that are not members of the Institute) completed the questionnaire. The findings presented in this section are an extrapolation from the data provided by the respondents to determine the expenditures and other statistics for all international banks operating in the United States. As the Institute has done in its earlier economic benefits studies, the data received from the member bank respondents to the questionnaire regarding direct economic benefits was multiplied by 1.1 to obtain an approximate total for all international banks that are members of the Institute. The actual data received from non-members was then added to this figure to obtain an approximate total for all international banks. Some banks did not fully describe their U.S. operations in their responses to the questionnaire. The Institute believes that its extrapolation is conservative and probably understates the total direct benefits to the U.S. economy contributed by the international banking community.

developed by the Bureau of Economic Analysis ("BEA") of the U.S. Department of Commerce,[58] international bank activities resulted in the creation of an estimated 173,612 additional jobs in all industries and an increase in employee earnings in all industries by at least an estimated $7.2 billion. When these multiplier benefits are considered along with the direct expenditures, the presence of international banks provided 291,903 jobs and $23.8 billion in total expenditures to the U.S. economy in 1996.

Job Creation and Employee Expenditures

U.S. operations of international banks had at least 118,291 employees as of December 31, 1996. Of this number of employees, New York accounted for approximately 38 percent, California approximately 20 percent, and Illinois approximately 16 percent. In addition, there were between 2,500 and 4,000 employees in each of Maryland, Massachusetts, Michigan, New Jersey, and Rhode Island and over 1,000 employees in each of Connecticut, Florida, Mississippi, Pennsylvania, and Puerto Rico. Based on the direct-effect multipliers developed by the BEA, this level of employment resulted in an estimated 173,612 additional jobs in all industries.[59]

Total payroll expenditures (including fringe benefits) during the 12-month period ending December 31, 1996 were $9.1 billion. Assuming that employee benefits payments constitute 29.2 percent of the total payroll expenditures,[60] total disposable income therefore was

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[58] Bureau of Economic Analysis, U.S. Department of Commerce, Regional Multipliers: A User Handbook for the Regional Input-Output Modeling System (RIMS II) (3d ed. March 1997). This study is intended to provide only a general indication of the multiplier effect of the expenditures of international banks on the U.S. economy. The Institute has used the BEA direct-effect multipliers for employment and earnings for the financial sector for each of the states for which the Institute has specific information -- New York, California, Illinois, Florida, Texas and Georgia. The Institute has assumed that the average of the multipliers for those remaining states in which international banks have significant operations, as indicated by the Institute's survey, is generally representative of the multipliers for the U.S. operations of international banks located in all other states. This average multiplier has been used to calculate the effect in all states other than New York, California, Illinois, Florida, Texas and Georgia.

[59] The total direct-effect multipliers for employment represent the total change in number of jobs in all industries for each additional job in the U.S. operations of international banks.

[60] See Bureau of Labor Statistics, U.S. Department of Labor, Employment Cost Indexes and Levels, 1975-1995 12, Table 7 (October 1995).

approximately $6.4 billion. The BEA direct-effect multipliers indicate that the U.S. operations of international banks resulted in additional employee earnings of approximately $7.2 billion.[61]

Significantly, the vast majority of employees of the U.S. operations of international banks are U.S. citizens or permanent residents rather than expatriates from the banks' home countries. The survey shows that, as of December 31, 1996, on average over 92 percent of international banks' employees in the United States were U.S. citizens or permanent residents. This reliance on U.S. persons is the case even at the most senior management levels. According to the survey, as of December 31, 1996, approximately 86 percent of the management and executive-level positions with total compensation exceeding $100,000 were held by U.S. citizens or permanent residents. In addition to the fact that U.S. persons are generally more familiar with the U.S. banking market, the cost of bringing expatriates to this country provides a strong incentive for international banks to hire U.S. persons.

Significant Operating and Capital Expenditures on U.S. Goods and Services

Total operating expenditures (excluding employee expenditures) by the U.S. operations of international banks during the 12-month period ending December 31, 1996 were approximately $6.5 billion. These expenditures include rental payments as well as payments for accounting, consulting and legal services, travel, business entertainment, telephone and equipment. New York accounted for approximately 59 percent of these expenditures, California for approximately 13 percent and Illinois for approximately 11 percent.

Total capital expenditures (before depreciation) of U.S. operations of international banks during the 12-month period ending December 31, 1996 were approximately $1 billion. These expenditures include the acquisition of bank premises and other real estate, improvements to office space, and the acquisition of computer hardware and software as well as other high technology business equipment used in international financial services (e.g., the construction and equipping of large trading rooms). These expenditures enhance the value of real estate in major U.S. markets, provide employment in the construction industry and provide a large market for sales of computer and other high-technology products.

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[61] The direct-effect multipliers for household earnings for each state represent the total dollar change in earnings of households employed by all industries for each additional dollar of earnings paid directly to households employed by the U.S. operations of international banks.

Taxes

The U.S. operations of international banks are subject to the same U.S. federal, state and local tax rules that apply to U.S. banks, as well as a number of additional restrictions that only affect international banks. The U.S. operations of international banks generate significant tax revenues in the United States. For example, the offices of international banks in New York City alone, which include branches and agencies, paid approximately $138 million in income taxes to New York City during 1996.[62/] Table V demonstrates that income taxes paid by international banks have constituted a significant percentage of all income taxes paid by banks to New York City in recent years.

Table V

New York City Income Tax Collections for Banks[63/]
($ thousands)

Year	Taxes Paid By International Banks	Taxes Paid By All Banks	Percent Paid By International Banks
1994	123,888	428,140	28.9
1995	92,229	338,008	27.2
1996	138,476	453,748	30.5

In addition to federal, state and local income taxes, the U.S. operations of international banks also pay significant real estate taxes, sales taxes and other taxes and fees incurred in the course of their U.S. business operations. Moreover, the employees of U.S. operations of international banks (and employees in jobs created by the expenditures of international banks) also pay taxes at all of these levels.

62/ Office of Tax Policy, New York City Department of Finance, September 10, 1997.

63/ Id.

Assessment Fees and Interest-Free Reserves

An analysis of the direct economic benefits of the U.S. operations of international banks must also consider the external costs to the United States created by their presence. Such costs are minimal in the case of international banks. The banking industry does not place major burdens on infrastructure or raise significant environmental or health concerns. The costs of federal and state banking regulation are substantially covered by the assessment, examination, licensing, application and other fees that international banks, like U.S. banks, are required to pay their primary regulator, either the state regulatory authority[64/] or the Comptroller of the Currency.[65/]

Finally, both international and U.S. banks maintain non-interest-bearing reserves with the Federal Reserve System that essentially constitute an interest-free loan to the Federal Reserve. As of December 31, 1996, U.S. branches and agencies of international banks maintained $964 million in reserves with the Federal Reserve System.[66/]

[64/] See, e.g., New York State Banking Department, Budget and Finance Manual, Section B, Bull. No. 1 (April 4, 1996) at 3.

[65/] See OCC Banking Bulletin No. 96-66 (December 2, 1996).

[66/] 83 Fed. Res. Bull. A72 (May 1997).

REGULATION OF U.S. OPERATIONS OF INTERNATIONAL BANKS

OVERVIEW

Since the enactment of the International Banking Act of 1978 (the "IBA"), the policy of national treatment has been the cornerstone of the U.S. approach to regulating the activities of international banks in the United States. This policy is based on the guiding principle of "parity of treatment between [international and U.S. banks] in like circumstances."[67] Adherence to the policy of national treatment both underpins the presence of international banks in the United States and their contribution to the U.S. economy, and strengthens U.S. efforts to obtain and maintain access to international markets for U.S. banks.

In accordance with the policy of national treatment, international banks are required to conduct their U.S. operations in accordance with U.S. regulatory, supervisory and examination requirements, and the nonbank financial activities of international banks in the United States are subject to the same restrictions under the Bank Holding Company Act of 1956 (the "BHC Act") that apply to U.S. bank holding companies.[68] The Federal Reserve's policy in reviewing applications from international banks continues to be that the capital ratios of international banks

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[67] S. Rep. No. 1073, 95th Cong. 2d Sess. 2, reprinted in 1978 U.S. Code Cong. and Admin. News 1421, 1422. However, national treatment does not mean identical treatment. For example, international banks are incorporated in other countries and conduct their U.S. banking operations principally through branches and agencies, just as most U.S. banks generally conduct their banking activities outside the United States through branches. The policy of national treatment accordingly recognizes that the legal and regulatory requirements applicable to U.S. banks must be adapted when applied to the U.S. operations of international banks to account for such differences. See 1996 GAO Report, supra note 3, at 18.

[68] The U.S. operations of international banks also are subject to consumer protection and fair lending requirements that apply to U.S. banks. Thus, for example, U.S. branches of international banks, including uninsured wholesale branches, are fully subject to the disclosure and other requirements imposed by the Truth-in-Savings Act and, to the extent they are "engaged in the business" of making consumer loans, the Truth-in-Lending Act. In addition, U.S. operations of international banks are subject to federal laws prohibiting discrimination in lending, and their residential real estate lending is subject to Home Mortgage Disclosure Act requirements. Finally, the FDIC-insured branches and U.S. bank subsidiaries of international banks are subject to the requirements of the Community Reinvestment Act of 1977, as are the FDIC-insured operations of U.S. banking organizations.

as global entities should be "equivalent" to those required of U.S. bank holding companies.[69] As stated in the 1996 GAO Report, "[international] banks enjoy no significant advantages because of regulatory differences."[70]

The federal and state banking agencies have developed the Foreign Banking Organization ("FBO") Supervision Program to enhance their oversight of both the banking and nonbanking activities of international banks in the United States. Under this program, the U.S. branches and agencies of international banks, like U.S. banks, are subject to supervisory standards concerning risk management, asset quality, operational controls and compliance with laws and regulations. On the whole, international banks conduct their U.S. operations in accordance with U.S. supervisory expectations. The GAO has reported that 88 percent of the more than 500 U.S. branches and agencies of international banks examined in 1995 received a rating of 1 or 2 at year-end, indicating that their operations were satisfactory or better and required only normal supervisory attention.[71] In the event deficiencies are identified in the U.S. operations of an international bank, U.S. banking supervisors are able to implement the same remedial measures and apply the same sanctions that would be applied to a U.S. bank in similar circumstances. Indeed, as evidenced by the experience of The Daiwa Bank, Limited, U.S. bank supervisors are empowered to terminate an international bank's U.S. operations in the most serious cases.

In recent years, actions by the federal banking agencies have liberalized the powers of both U.S. and international banks, particularly in the areas of securities underwriting and insurance sales, and have reduced the regulatory burden on their operations. The Federal Reserve's actions in increasing the revenue limitation and rescinding the "firewalls" applicable to so-called “Section 20” securities underwriting activities have been especially beneficial to U.S. and international banks alike. Implementation of legislation enacted in 1994 is permitting greater rationalization of interstate banking operations, and efforts are under way to apply the "home

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69/ See, e.g., Swiss Bank Corporation, 83 Fed. Res. Bull. 786 (1997). As discussed below at pages 66-67, international implementation of the risk-based capital accord developed by the Basle Committee has significantly influenced the evaluation of whether the capital adequacy standards applicable to international banks in their home countries are equivalent to the standards applicable to U.S. bank holding companies.

70/ 1996 GAO Report, supra note 3, at 54.

71/ U.S. Government Accounting Office, Foreign Banks: Implementation of the Foreign Bank Supervision Enhancement Act of 1991 (GAO/GGD-96-187, Sept. 30, 1996) 14 (the "1996 GAO FBSEA Report").

state rule" system established for state-chartered banks to the multi-state branches and agencies of international banks that operate under state licenses.

Notwithstanding important regulatory initiatives, there remain serious barriers to the ability of both U.S. and international banks to provide the full range of benefits they are capable of providing to the U.S. economy. Legislative repeal of Section 20 of the Glass-Steagall Act and reduction of other restrictions on the activities of securities affiliates, including merchant banking activities, would be particularly beneficial to U.S. and international banks alike. While regulatory actions by the OCC and court decisions have clarified the scope of permissible bank insurance sales activities under current law, the continued prohibition on affiliations between banks and insurance underwriters prevents the efficient integration of these two key segments of the financial services industry. It also causes particular problems for international banks that are affiliated with insurance companies outside the United States. The international banking community continues to support passage of comprehensive financial services modernization legislation that would enable all financial institutions to better serve their customers and the U.S. economy generally.

THE STATUTORY FRAMEWORK

The International Banking Act of 1978

The enactment of the IBA in 1978 created for the first time a comprehensive federal regulatory framework for international banks operating in the United States. Prior to 1978, the U.S. branch and agency operations of international banks were regulated almost exclusively at the state level. International banks that limited their U.S. banking operations to branches and agencies and did not own a U.S. commercial bank subsidiary were not considered to be bank holding companies, and therefore were not subject to the provisions of the BHC Act restricting permissible nonbanking activities to those determined by the Federal Reserve Board under Section 4(c)(8) of the BHC Act to be "closely related to banking."

The IBA significantly altered these arrangements by applying the nonbanking restrictions of the BHC Act to international banks conducting banking operations in the United States through branches and agencies rather than through a U.S. bank subsidiary, imposing interstate banking restrictions on the U.S. branch operations of international banks, providing the Federal Reserve with supervisory authority over all U.S. operations of international banks and granting to international banks the option to obtain from the OCC a federal license to conduct operations in the United States through branches and agencies. U.S. branches and agencies of international banks for the first time also became subject to the requirement to maintain reserves against deposit liabilities.[72] In addition, the IBA permitted, and in certain instances required, branches of international banks to obtain deposit insurance from the FDIC.[73]

The Foreign Bank Supervision Enhancement Act of 1991

In the aftermath of the savings and loan crisis in the United States, serious financial problems in the commercial banking industry and the collapse of the Bank of Credit and Commerce International, Congress expanded the supervisory requirements applicable to banks in the United States, including the U.S. operations of international banks. These requirements were contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), which included provisions, designated as the Foreign Bank Supervision Enhancement Act of 1991 (the "FBSEA"), addressing specifically the regulation and supervision of the U.S. operations of international banks.

Among its more important provisions, the FBSEA required international banks to obtain Federal Reserve approval before establishing a state- or federally-licensed branch or agency or a

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[72] As originally enacted in 1978, the IBA imposed reserve requirements on the deposit liabilities of U.S. branch and agency offices of international banks having consolidated worldwide banking assets in excess of $1 billion. The Depository Institutions Deregulatory and Monetary Control Act of 1980 extended the Federal Reserve's authority to impose reserve requirements on all "depository institutions," including U.S. branches of international banks, regardless of the size of their parent bank. As a result, all U.S. branches of international banks, and all agencies of international banks with more than $1 billion in worldwide assets, must comply with federal reserve requirements to the same extent as U.S. banks. Changes in reserve requirements adopted by the Federal Reserve in 1990 enabled U.S. banks to make loans to U.S. residents from either domestic or offshore offices on a reserve-free basis to the same extent as international banks.

[73] After enactment of the Foreign Bank Supervision Enhancement Act of 1991, the issue arose of whether the Federal Reserve, contrary to its long-standing interpretation of the IBA and the policy of national treatment, would be required to charge fees for its examinations of branches and agencies of international banks, even though it does not charge fees for its examination of domestic banks. This issue was finally resolved in 1996 by an amendment to the IBA to provide that the Federal Reserve should charge fees for its examinations of the U.S. offices of international banks "only to the same extent that fees are collected by the [Federal Reserve] for examination of any State member bank."

representative office in the United States. This requirement applies even to international banks with long-standing U.S. operations seeking to establish an additional U.S. office. Under the FBSEA, the Federal Reserve is prohibited from approving an application to establish a branch or agency unless (i) the Federal Reserve determines that the international bank is subject to comprehensive supervision on a consolidated basis by the appropriate authorities in its home country and (ii) the international bank has provided the Federal Reserve the information it needs to adequately assess the application.[74/]

The FBSEA amended the IBA to include a specific requirement that all U.S. branches and agencies of international banks be examined on-site on an annual basis, a requirement comparable to the annual on-site examination requirement made applicable to U.S. banks under other provisions of FDICIA.[75/] Under the FBSEA, the Federal Reserve was given expanded examination authority over the consolidated U.S. operations of international banks, and was

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[74/] Obtaining and evaluating the information required to satisfy the comprehensive, consolidated supervision requirement and conducting extensive background checks on directors, executive officers and principal shareholders of an international bank applicant have caused delays in processing applications. Both the Federal Reserve and Congress have taken steps to expedite the application process. A study by the GAO in 1996 found that measures introduced by the Federal Reserve in 1993 reduced the average processing time on branch, agency and representative office applications from 574 days to 293 days. 1996 GAO FBSEA Report, supra note 71, at 10. To provide greater flexibility in connection with the processing of branch and agency applications, Congress amended the IBA in September 1996 to provide the Federal Reserve the discretion to approve such applications if it determines that the appropriate authorities in the home country of an international bank are "actively working to establish arrangements for the consolidated supervision of such bank." In addition, the Federal Reserve must give consideration to whether an international bank has adopted and implemented procedures to combat money laundering and whether the bank's home country has undertaken to develop a legal regime to address money laundering. The Institute believes that continued dialogue between the Federal Reserve and the home country supervisors of applicant international banks is an important means by which burdens and delays can be further reduced.

[75/] FDICIA provided for the conduct of on-site examinations on an 18-month rather than annual basis with respect to any U.S. bank that (i) has total assets of less than $100 million, (ii) is well capitalized, and (iii) in connection with its most recent examination was found to be well managed and received a composite rating of 1. The FBSEA did not include any comparable exception for international banks. However, in 1996, the IBA was amended to provide that U.S. branches and agencies are to be examined "as frequently as would a national bank or a State bank."

required to coordinate its examinations of branches and agencies of international banks with the OCC, the FDIC and state bank supervisors, as the case may be.

The FBSEA granted the federal banking agencies enhanced enforcement powers over the U.S. operations of international banks. For example, the Federal Reserve was given authority to terminate the operations of a state-licensed branch or agency of an international bank upon a finding that either (i) the international bank is not subject to comprehensive supervision on a consolidated basis in its home country or (ii) there is reasonable cause to believe that the international bank or any of its affiliates have violated the law or engaged in an unsafe or unsound banking practice in the United States, and, as a result, the continued operation of the international bank's U.S. operations would not be consistent with the public interest or the purposes of the IBA, the BHC Act or, as the case may be, the Federal Deposit Insurance Act.[76/] The FBSEA also established specific civil and criminal penalties for violations of the IBA. These penalties are comparable to the penalties applicable to violations of other federal banking laws.[77/]

[76/] As required by the FBSEA, the Federal Reserve Board has adopted a regulation specifying the criteria that it applies in assessing the operations of U.S. branches and agencies of international banks that are not subject to home country consolidated, comprehensive supervision. As urged by the Institute and others, the Federal Reserve adopted a flexible approach in making such assessments, taking into account the individual circumstances of each international bank.

[77/] The FBSEA included several other provisions dealing with the U.S. operations of international banks. First, the FBSEA limited the authority of state-licensed branches and agencies of international banks to engage in any activity that is not permissible for a federal branch unless (i) the Federal Reserve determines that the activity would be consistent with sound banking practices and (ii) in the case of FDIC-insured branches, the FDIC determines that the activity poses no threat to the federal deposit insurance fund. This provision of the FBSEA parallels, and has been applied in a manner that is consistent with, comparable restrictions imposed on the activities of state-chartered U.S. banks under other provisions of FDICIA. Second, the FBSEA subjected all state-licensed branches and agencies of the same international bank to the aggregate lending limit that applies to national banks, thereby preempting state law (OCC-licensed branches and agencies of international banks have been subject to such lending limit since the enactment of the IBA in 1978). Third, the FBSEA amended the IBA to require any international bank seeking to engage in a domestic retail deposit-taking business to do so only through a U.S. commercial bank subsidiary, thus effectively prohibiting the establishment of new FDIC-insured branches of international banks. However, international banks were permitted to retain their existing FDIC-insured branches.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act") significantly liberalized restrictions on interstate banking activities. Prior to the Riegle-Neal Act, national banks and state-chartered banks that are members of the Federal Reserve System were prohibited under federal law from branching across state lines. Similarly, the IBA prohibited international banks from establishing full-service deposit-taking branches outside of their "IBA home state" (i.e., the state in which an international bank maintained an unrestricted deposit-taking branch or a bank subsidiary).[78/]

These prohibitions on interstate branching were coupled with restrictions on the acquisition of interstate bank subsidiaries. U.S. bank holding companies were prohibited under the BHC Act from acquiring control of a bank outside the state in which their subsidiary banks maintained the largest amount of deposits (the "BHC Act home state"), unless the state in which the target bank was located expressly permitted a bank holding company from that BHC Act home state to acquire a bank within that state. These provisions of the BHC Act also applied to international banks that owned a U.S. bank subsidiary, and, under the IBA, were applied to international banks that operated a full-service U.S. branch but did not own any U.S. bank subsidiary. Thus, international banks were subject to the same restrictions on interstate banking through bank subsidiaries that were applicable to U.S. banks.[79/]

[78/] International banks were permitted under the IBA to operate outside their IBA home states agencies and "limited" branches (i.e., branches which, pursuant to a written agreement with the Federal Reserve, are prohibited from accepting deposits other than deposits that would be permissible for an Edge Corporation (such deposits must be received outside the United States or, if received in the United States, must be incidental to an international transaction)). The restrictions imposed on such offices' deposit-taking activities ensured that international banks did not have any competitive advantage over U.S. banks, which were permitted to engage in essentially the same deposit-taking activities as such agencies and branches on an interstate basis through their own Edge Corporation subsidiaries.

[79/] Some international banks that had established full deposit-taking branches in more than one state prior to enactment of the IBA were permitted to keep those branches after enactment of the interstate banking restrictions in the IBA. These grandfather provisions were not affected by the enactment of the Riegle-Neal Act. This grandfathering of existing offices is no different in substance from the grandfather rights enjoyed by the U.S. bank holding companies that were permitted to continue to operate extensive interstate banking networks following enactment of the BHC Act in 1956 (including First Interstate, Norwest and First Bank System).

The Riegle-Neal Act eliminated the interstate banking restrictions under the BHC Act, thereby permitting U.S. bank holding companies and international banks to acquire bank subsidiaries located anywhere outside their BHC Act home state, provided that, among other conditions, the bank holding company is adequately capitalized and adequately managed. The Riegle-Neal Act also authorized interstate branching under certain circumstances. Subject to the right of states to prohibit such transactions within their borders by enacting "opt out" legislation prior to June 1, 1997 (only two states, Texas and Montana, took such action), the Riegle-Neal Act permitted the merger of banks across state lines to create a network of interstate branches. Further, the legislation permitted the acquisition of branches from banks located outside an acquiror's home state and the establishment of interstate branches on a de novo basis if the host state enacts "opt in" legislation specifically authorizing such acquisitions or de novo branching.

The Riegle-Neal Act amended the IBA to permit international banks to branch outside their IBA home state[80/] generally to the same extent as, and subject to the same limitations applicable to, U.S. banks.[81/] However, as compared to U.S. banks, international banks as a

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80/ The Riegle-Neal Act also amended the IBA to provide that the home state of an international bank that conducts multi-state banking operations in the United States is the state, among such states, selected by the international bank (or, if no such election is made, as selected by the Federal Reserve) to be its home state. In the case of an international bank that operates in only one state, that state is the bank's IBA home state. The home state provisions of the IBA are implemented through the Federal Reserve's Regulation K, which provides that the home state selected by an international bank prior to enactment of the Riegle-Neal Act shall continue to be that bank's IBA home state and permits international banks the ability to change their IBA home state only once upon 30 days' prior notice to the Federal Reserve. An international bank does not gain any competitive advantage over a U.S. bank by changing its IBA home state. Regulation K provides that in connection with changing its IBA home state an international bank must conform the operations of its U.S. branches, as well as its investments in U.S. bank subsidiaries, to those that would have been permissible had the new home state been selected as the international bank's home state originally. Moreover, a U.S. bank is permitted to change its home state more than once.

81/ With respect to capital requirements applicable to such transactions by international banks, the IBA was amended to provide that the Federal Reserve Board and, in the case of interstate branching through federal branches, the OCC must determine that the "financial resources, including the capital level of [an international bank seeking to establish a branch outside its IBA home state] are equivalent to those required for a domestic bank" under the Riegle-Neal Act. Under the Riegle-Neal Act, an international bank may be required to establish a U.S. bank subsidiary in order to conduct interstate banking activities if it is determined that the international bank's capital adequacy can be verified only by such action. The Riegle-Neal Act practical matter have only limited new opportunities under the Riegle-Neal Act to establish interstate branches. Few states have enacted "opt in" legislation for de novo branching or acquisition of existing branches,[82] and therefore the principal way in which banks are establishing interstate branches is through merger transactions. Given the prohibition under the FBSEA against international banks establishing new FDIC-insured branches, mergers with FDIC-insured banks in other states to create interstate branches are not feasible for international banks. Moreover, the Riegle-Neal Act provides that in situations where an international bank establishes an initial branch in a state other than its IBA home state through the acquisition and conversion of an FDIC-insured bank (or, if permitted under applicable state law, the acquisition of one or more branches of such a bank), the requirements of the Community Reinvestment Act of 1977 continue to apply to the resulting branch, even though it would no longer be FDIC-insured.

The benefits from interstate banking available to international banks, as compared to U.S. banks, are also diminished by the manner in which the "home state rule" system for state-chartered banks with interstate branches has been implemented. Under the "home state rule" system, the home state supervisor exercises principal responsibility for the out-of-state branches of banks subject to its jurisdiction, and home state law generally governs the activities of out-of-state state-chartered banks in a host state. The "home state rule" system that has been created for state-chartered banks does not apply to state-licensed branches of international banks with multi-state operations. Whereas under the home state rule system the interstate branches of a state-chartered bank are treated as a part of the bank, state-licensed branches of international banks banks are treated as separate entities, each subject to the supervision, examination and legal requirements of its licensing state.[83] Consequently, international banks operating through state-

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also amended the IBA to prohibit U.S. branches and agencies of international banks that manage or control offshore branches from managing activities at such offshore branches that could not be managed by a U.S. bank at its non-U.S. branches or subsidiaries.

[82] The Riegle-Neal Act continues to permit international banks to establish and maintain agency and limited branch operations and commercial lending company subsidiaries outside their IBA home state, subject to the same limitations that were applied under the IBA, as discussed above in note 78.

[83] The concerns arising with respect to the applicability of the home state rule system to state-licensed branches of international banks do not arise with respect to OCC-licensed branches, which are subject to the same provisions of the Riegle-Neal Act that apply to national banks. Under the Riegle-Neal Act, national banks with interstate branches are supervised and examined exclusively by the OCC. For purposes of regulating their activities in a host state, out-

licensed branches and agencies in multiple states are subject to multiple supervisory and legal requirements, whereas their state-chartered bank counterparts operate under the comparatively uniform requirements of the home state rule system. Federal and state bank supervisors currently are engaged in efforts to develop for multi-state branches and agencies of international banks that operate under state licenses a home state rule system that is comparable to the system established for the interstate branches of domestic state-chartered banks.

KEY ASPECTS OF THE REGULATION OF INTERNATIONAL BANKS

Examination and General Supervisory Authority

International banks are subject to the same supervisory and examination requirements and standards that apply to U.S. banks. Pursuant to the FBSEA, the federal and state banking agencies have developed comprehensive procedures and guidelines to enhance the supervision and examination of international banks. The centerpieces of this enhanced approach to supervising the U.S. operations of international banks are the FBO Supervision Program and the "ROCA" rating system.[84/]

The FBO Supervision Program constitutes a comprehensive scheme for coordinating the supervision of the U.S. operations of international banks, particularly those banks with operations in multiple states. Among the responsibilities of the Federal Reserve under the program are the coordination of the examination of each office of an international bank made by the appropriate supervisory authority and the integration of the results of such examinations into an assessment of the international bank's entire U.S. operations. The Federal Reserve also prepares a "strength-of-support assessment" ("SOSA"), which evaluates the international bank on a global basis, including consideration of the system of supervision in the international bank's home country, the record of home country government support of its banking system and transfer

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of-state national banks are treated in the same manner as banks chartered by the host state only with respect to laws of the host state regarding community reinvestment, consumer protection, fair lending and establishment of intra-state branches.

[84/] Another important product of this process is the <u>Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations</u> (the "Examination Manual"), which sets forth specific and uniform guidelines regarding objectives and procedures applicable to the examination of international banks' U.S. branches and agencies by both federal and state bank supervisors.

risks. The purpose of the SOSA is to determine whether an international bank has the internal and external resources to provide the necessary financial or managerial support to its U.S. operations.[85/]

Consistent with the development and implementation of a more risk-oriented approach to the supervision and examination of U.S. banks, the ROCA rating system gives increased priority to the effectiveness of the risk management processes and operational controls in place at each U.S. office of an international bank. The ROCA rating system is intended "to better assess the condition of a branch [and agency] within the context of the [international bank], of which it is an integral part, and to pinpoint the key areas of concern in a branch office."[86/] The ROCA rating system divides the activities of a branch or agency into three components that represent the major activities or processes that may raise supervisory concerns: risk management, operational controls and compliance.[87/] The rating system also provides for a specific rating of the quality of a branch's or agency's assets as of the examination date. Each component of the ROCA rating system is evaluated on a scale of 1 to 5, where 1 represents the least and 5 represents the greatest supervisory concern. The same scale is used to assign an overall, composite rating of each branch and agency.

The U.S. operations of international banks are generally conducted in accordance with supervisory expectations. Federal Reserve Board Governor Phillips recently testified to the "positive effects" that have resulted from the FBO Supervision Program, and reported that since its peak in 1993, "there has been a steady decline in the number of U.S. branches and agencies with an overall examination rating of fair or lower."[88/] Indeed, as discussed above, the 1996

85/ See SR 95-22 (Sup.IB) (March 31, 1995), Attachment I at 4.

86/ Id., Attachment III at 1.

87/ The inclusion of operational controls as a key component of the ROCA system reflects the heightened scrutiny that federal and state supervisors have given to the effectiveness of internal controls and internal audit procedures at banks in general. To enhance their oversight of operational controls, and to promote prompt correction of deficient practices, U.S. bank supervisors have required international banks to conduct special audits for operations where internal control weaknesses are detected. In June 1997, the New York State Banking Department also adopted regulations requiring international banks to conduct special internal or external audits of branches and agencies with significant internal control weaknesses.

88/ Testimony of Governor Susan M. Phillips Before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Banking and Financial Services, U.S. House of Representatives (Oct. 8, 1997) at 6. See also U.S. Government Accounting Office, GAO FBSEA Report found that 88 percent of the more than 500 U.S. branches and agencies of international banks examined in 1995 received a rating of 1 or 2 at year-end, indicating that their operations were satisfactory or better and required only normal supervisory attention.

Capital Adequacy

Prior to the implementation of the Basle Accord, differences between U.S. and other countries' regulatory, legal and accounting systems resulted in concerns that international banks from certain countries might have competitive advantages over U.S. and other international banks because of different minimum capital requirements. These concerns have been effectively addressed through the adoption of the Basle Committee's risk-based capital accord (the "Basle Accord") by bank supervisors in the principal financial centers of the world, including the United States, and in numerous other countries. The Capital Equivalency Report jointly issued by the U.S. Department of the Treasury and the Federal Reserve in June 1992 concluded that the capital standards applied in the countries with risk-based capital standards are generally equivalent to the risk-based standards imposed under U.S. law. The Report confirmed that implementation of the Basle Accord has effectively removed any advantages that some international banks may have had in the past by virtue of being able to operate under home country capital requirements that were less stringent than the capital requirements applicable to U.S. and other international banks.[89/]

Foreign Banks: Internal Controls and Audit Weaknesses in U. S. Branches (GAO/GGD-97-181, September 1997).

[89/] Since the adoption of the Basle Accord, additional measures have been taken to refine risk-based capital adequacy standards to encompass elements of risk other than credit risk and to give effect to certain bilateral netting arrangements. In July 1994, the Basle Accord was revised to expand the recognition of legally enforceable bilateral netting arrangements relating to interest rate and foreign exchange contracts. At the same time, the Basle Committee revised and expanded the set of conversion factors used to calculate the potential future exposure of derivative contracts. Corresponding revisions were made to the risk-based capital adequacy guidelines applicable to U.S. bank holding companies and banks in 1995. In January 1996, the Basle Accord was amended to include a market risk component. The Institute's 1997 Global Survey indicates that the market risk component has been adopted by at least 28 countries, including the United States, and by the European Union. The Basle Committee has also recommended development of a methodology for estimating the extent to which the financial strength of a bank would be impaired by adverse movements in interest rates. The methodology would be applied by supervisors to assist in identifying institutions that might be especially vulnerable to changes in interest rates and determining whether such institutions should be

Considerations relating to capital are particularly relevant to determining the ability of an international bank to expand its U.S. operations, whether through the acquisition of a U.S. bank or engaging in new activities through a nonbank subsidiary. Under recent revisions to the Federal Reserve's Regulation Y, bank holding companies and international banks that are well-capitalized and well-managed may qualify for expedited (and in some cases automatic) approval of applications for non-banking activities and expedited review of applications to acquire or invest in U.S. banks. The new rules define the term "well-capitalized" to mean a consolidated total risk-based capital ratio of at least 10 percent and a consolidated Tier 1 risk-based capital ratio of at least 6 percent. An international bank whose home country supervisor has adopted capital standards consistent in all respects with the Basle Accord may calculate its capital ratios for these purposes under either the home country standard or the Federal Reserve's standard. An international bank whose home country supervisor has not implemented the Basle Accord is required to obtain from the Federal Reserve a determination that its capital is equivalent to the capital required under the Federal Reserve's "well-capitalized" standard.[90/]

Regulation of Nonbanking Activities of International Banks in the United States

International banks engage in nonbanking financial activities in the United States under the same restrictions applicable to U.S. banks. Thus, international banks are prohibited from controlling firms engaged in securities, insurance or other financial activities in the United States that are not permissible for U.S. bank holding companies.[91/]

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subject to supervisory action. The Basle Committee has not recommended that the Basle Accord be revised to include an explicit capital charges for interest rate risk; the Basle Committee would leave to national authorities the discretion to determine what, if any, supervisory steps should be taken to address excessive interest rate risk.

90/ In addition, international banks from all countries, both those that have adopted Basle standards and those that have not, may request an individual determination of whether the institution has capital equivalent to the Federal Reserve's well-capitalized standard after consideration of appropriate adjustments. Adjustments may be warranted, for example, to reflect differences in home country accounting, capital standards or banking organization structure.

91/ A small number of international banks operating in the United States only through branch or agency offices were permitted under the IBA to continue to engage in the United States in securities and other nonbanking activities in which they were engaged prior to enactment of the IBA. These limited grandfather privileges were designed to avoid forced divestitures of activities that had been lawfully conducted in good faith under prior law and were fully consistent with the

The specific restrictions on securities activities of U.S. banks contained in the Glass-Steagall Act also apply to the U.S. operations of international banks. For example, international banks that have U.S. bank subsidiaries that are members of the Federal Reserve System (including national banks) are directly subject to Glass-Steagall prohibitions on affiliations with securities firms. In addition, because the Federal Reserve follows the policies contained in the Glass-Steagall Act when applying the general nonbanking prohibitions of the BHC Act, international banks operating U.S. branches or agencies, but not owning a U.S. bank subsidiary, are effectively subject to Glass-Steagall restrictions on affiliations.

The comparability of treatment of U.S. and international banks for the purposes of Glass-Steagall restrictions is well illustrated by their treatment under Section 20 of the Glass-Steagall Act. The Federal Reserve has interpreted Section 20 to permit both U.S. and international banks, acting through broker-dealer subsidiaries ("Section 20 companies"), to underwrite and deal in securities, including corporate debt and equity securities, that cannot be underwritten or dealt in by banks ("bank-ineligible securities"), provided that revenues from such bank-ineligible securities activities do not constitute more than a specified percentage of the total revenues of the Section 20 company. Originally set at 5 percent, the bank-ineligible revenue figure has been increased by the Federal Reserve to 10 percent and, in 1996, to 25 percent. The most recent increase in the revenue limitation enabled the acquisitions of several investment banks by U.S. bank holding companies and international banks, including the acquisition of Alex. Brown by Bankers Trust, the acquisition of Dillon, Read & Co. by Swiss Bank, and the acquisition of Montgomery Securities by NationsBank. Such cross-industry acquisitions have also been facilitated by the decision by the Federal Reserve in August 1997 to rescind the Section 20 "firewall" limitations in favor of a set of eight operating standards that apply to all Section 20 companies regardless of the identity of their parent.[92/]

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granting of similar grandfather privileges to U.S. bank holding companies under the 1970 amendments expanding coverage of the BHC Act. Moreover, a grandfathered affiliate of an international bank may not engage in new activities, may only expand through internal growth (expansion through acquisitions is expressly prohibited), and loses its grandfathered status if the international bank acquires a U.S. bank.

[92/] The new operating standards require that dealings between a Section 20 company owned by an international bank and U.S. branches and agencies of that bank be conducted in accordance with the requirements of Section 23A and Section 23B of the Federal Reserve Act that are applicable to comparable dealings between a Section 20 company owned by a U.S. bank holding company and an affiliated U.S. bank.

Many international banks, including major European banks from countries such as France, Germany and the United Kingdom, are authorized under the laws of their home countries to own interests in industrial and other companies that are engaged outside the United States in activities that are not permissible for U.S. bank holding companies under the BHC Act. To address these situations, Congress adopted certain provisions designed to limit the extraterritorial impact of the nonbanking prohibitions of the BHC Act. For example, international banks are permitted pursuant to Section 4(c)(9) of the BHC Act to own or control the voting shares of any company not engaged in any activities in the United States other than those that are incidental to the international business of that company.[93/] Similarly, U.S. banks are permitted under other provisions of the BHC Act to engage in a broad range of insurance, securities and other financial activities outside the United States that would not be permissible in the United States.

In certain instances, international banks own controlling interests in non-U.S. industrial companies that also conduct operations in the United States, either directly or through a subsidiary. Congress recognized that if international banks were categorically excluded from U.S. markets merely because they maintain certain affiliations with such companies outside the United States, then not only would competition, consumer interests and employment in the United States suffer, but also such a projection abroad of U.S. policy might well provoke retaliatory measures limiting access by U.S. banks and other firms to non-U.S. markets. Accordingly, the U.S. banking laws and the regulations thereunder include carefully crafted provisions that accommodate the ownership of such interests by international banks in a manner that preserves the competitive balance between international banks and U.S. banks.

[93/] Section 4(c)(9) of the BHC Act grants the Federal Reserve Board the authority, upon its determination that such action "would not be substantially at variance with the purposes of [the BHC] Act and would be in the public interest," to issue regulations and orders permitting international banks to acquire and retain interests in companies that conduct some limited nonbanking activities in the United States in connection with their nonbanking activities outside the United States. The Federal Reserve Board exercises its authority to issue orders approving the acquisition of companies under Section 4(c)(9) only sparingly to ensure that international banks are not able to obtain a competitive advantage over U.S. bank holding companies. For example, if in connection with its acquisition of a non-U.S. company an international bank also acquires an interest in a U.S. company that is engaged in activities requiring prior Federal Reserve approval under Section 4(c)(8) of the BHC Act, and the process required to obtain such approval would unduly delay consummation of the transaction as a whole, the international bank may apply for an order under Section 4(c)(9) granting it temporary authority to retain the interest in the U.S. company pending its receipt of the necessary approval under Section 4(c)(8).

Regulations issued by the Federal Reserve Board under Section 2(h)(2) of the BHC Act prescribe the conditions under which international banks are permitted to own non-U.S. subsidiaries that are engaged in the United States in nonfinancial activities. First, the international bank must be a "qualifying foreign banking organization" ("QFBO")[94/]. Second, the non-U.S. subsidiary must itself be an operating company or control an operating company. Third, more than 50 percent of the non-U.S. subsidiary's consolidated assets must be located and more than 50 percent of its consolidated revenues must be derived from outside the United States. Fourth, activities conducted in the United States pursuant to Section 2(h)(2) must be the same kind of, or be related to, activities conducted by the non-U.S. subsidiary outside the United States.[95/] Section 2(h)(2) of the BHC Act does not permit international banks to own subsidiaries engaged in securities underwriting or dealing activities or in any other financial activity; such activities are permissible for international banks in the United States only to the extent permitted, and subject to the same limitations applicable, to U.S. bank holding companies.

FINANCIAL SERVICES MODERNIZATION

Existing U.S. laws continue to create artificial barriers to the ability of U.S. and international banks alike to respond to global market trends, operate more efficiently and better serve the U.S. market. Although regulatory actions during the past ten years have resulted in significant liberalization of the restrictions imposed on affiliations between banking organizations and securities firms, the prohibitions against affiliations between banks and insurance underwriters remain in effect. These prohibitions place a particular burden on international banks seeking to affiliate in their home country with insurance companies that may conduct a portion of their operations in the United States. Because insurance is deemed to be a financial activity and thus not subject to the Section 2(h)(2) exemption, the creation of an affiliation with an insurance company outside the United States presents an international bank with the prospect of either divesting its U.S. banking operations or convincing its insurance

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[94/] The criteria for treatment as a QFBO under the Federal Reserve's Regulation K require that more than half of an international bank's business, as determined by measurements specified in the regulation, must be banking, and more than half of that banking business must be outside the United States, as determined by other measurements specified in the regulation.

[95/] 12 C.F.R. 211.23(f)(5)(iii). For these purposes, the activities of a non-U.S. subsidiary of an international bank are determined according to the four-digit "establishment" categories of the U.S. Standard Industrial Classification system.

affiliate to divest its U.S. insurance activities.[96] The same dilemma faces a non-U.S. insurance company seeking to acquire a controlling interest in an international bank with U.S. operations. Ultimately, U.S. consumers and markets suffer from the reduced competition that is the inevitable result of current law.

The structural barriers impeding the ability of U.S. and international banks to compete effectively in the financial services markets will persist without the enactment of comprehensive financial services modernization legislation in the United States. Several such proposals have been extensively debated in recent years, but a statutory framework that is adaptable to the realities of the marketplace has yet to be realized.

Financial services modernization proposals currently being considered in Congress would effect a significant restructuring of the U.S. banking system in a manner that would benefit the U.S. economy. The international banking community in the United States continues to support passage of financial modernization legislation that would enable all financial institutions to better serve their customers and the U.S. economy generally.

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[96] In a limited number of instances, international banks in fact have divested their U.S. banking operations in connection with their combination with a non-U.S. insurance company that conducted insurance activities in the United States.