1995

The Foreign Bank Supervision Enhancement Act of 1991: Short Run Consequences En Route to the Long Term Goal

L. Todd Gibson

Follow this and additional works at: https://scholarlycommons.law.case.edu/jil

Part of the International Law Commons

Recommended Citation
Available at: https://scholarlycommons.law.case.edu/jil/vol27/iss1/10

This Note is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Journal of International Law by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.
THE FOREIGN BANK SUPERVISION ENHANCEMENT ACT OF 1991: SHORT RUN CONSEQUENCES EN ROUTE TO THE LONG TERM GOAL

L. Todd Gibson*

I. INTRODUCTION

In 1991, in the wake of a few highly publicized scandals, the international banking community collectively determined that the policies governing international banking activities needed to be revisited. On December 19, 1991, the U.S. Congress passed the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), creating a number of changes in the manner in which foreign bank operations are regulated in the

* J.D./M.B.A. Candidate, Case Western Reserve University School of Law and Weatherhead School of Management (1996).


4 "Foreign bank means an organization that is organized under the laws of a foreign country and that engages directly in the business of banking." 57 Fed. Reg. 12,992, 12,998 (1992) (amending 12 C.F.R. 211.22(m)).
and demanding heightened levels of accountability from all foreign participants. The changes reflect the emerging international consensus that each nation should regulate its marketplace so as to make market access dependent upon the structure of bank regulation in the international banks' home country. By being the first major marketplace to adopt the new international standards, the U.S. will be lowest on the learning curve and potentially cause the most severe consequences as other countries move to align their banking regulations with the marketplace requirements of the U.S. By committing the U.S. marketplace to the new progressive standards, Congress has taken a step towards strengthening the safety and soundness of the international banking paradigm.

This Note describes the background of foreign banks' presence in the U.S. market and their initial regulatory framework. Section III explains the intent, context and provisions of the FBSEA; Section IV outlines the international framework which formally emerged six months behind the FBSEA. Section V explores some of the initial costs and benefits precipitated by the legislation. The Note concludes that while the reform is strengthening the safety and soundness of international banking, short-term costs are being incurred, not entirely at the expense of the U.S., but at that of Latin America's and potentially other emerging markets as well.

II. EARLY PRESENCE OF FOREIGN BANKS

A. Growing Awareness and the International Banking Act of 1978

The first federal investigation into the activities of foreign banks in the U.S. was by the Joint Economic Committee in 1966. At that time, foreign banks were governed solely by the individual states within which they were licensed. The Joint Economic Committee concluded that due to the differences between state and federal regulation, and the differences between each individual state's regulations, it was possible for a foreign

---

6 Id.
bank to gain a competitive advantage over federally regulated domestic banks.  

While initially involved only with financing international trade (and indirectly gauged by trade balances), foreign banks' roles began to change during the seventies. In 1973, the Board of Governors of the Federal Reserve System (Fed) collected data for the first time on the foreign bank presence. At that time, sixty foreign banks had $37 billion in assets in the U.S. This represented three percent of all banking

---

10 S. Rep. No. 1073, supra note 8, at 1, reprinted in 1978 U.S.C.C.A.N. at 1427; see also H.R. Rep. No. 330, 102d Cong. 1st Sess., 126 (1991), reprinted in 1991 U.S.C.C.A.N. 1901, 1939, which indicates that one potential competitive advantage available to foreign banks at this time resulted from the combination of state chartering and the lack of significant Federal supervision of foreign banks. The report notes that "[a]n individual state does not have the authority to ensure that the multi-State operations are properly supervised." Id. at 106, reprinted in 1991 U.S.C.C.A.N. at 1919. A state granting a license to a foreign bank does not have the authority to cross state lines and examine the bank's out-of-state-operations (legitimately chartered in the second state). Therefore, without attention at the Federal level, foreign banks could effectively branch across state lines, unlike their domestic competitors. Id.

11 Trade finance usually takes the form of letters of credit. In international trade there is always a degree of hesitancy as to who performs first: the buyer or the seller.

The basic function of letters of credit is to act as a means of ensuring payment to a seller upon shipment of merchandise to a buyer. Under a letter of credit, the buyer requests his bank to establish a letter of credit in favor of the seller. In the letter of credit the bank (in place of the buyer) promises to pay the seller a specified amount if the seller presents documents which evidence that the shipment has taken place.


12 In 1913, President Woodrow Wilson signed the Federal Reserve Act into law, establishing the Federal Reserve System. The Federal Reserve System is a network of 12 District Banks (based in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco). At the center are the seven members of the Board of Governors in Washington, D.C. Governors are appointed by the President for 14-year terms, and confirmed by the Senate. The governors' terms are staffed so that one term expires every two years.

The purpose of the Federal Reserve is to regulate the supply of money and credit, and supervise commercial banking. This original purpose has been augmented over time to now include expectations of controlling inflation and deflation, national economic growth and stability and always guarding against any financial panic. See Thibaut de Saint Phalle, The Federal Reserve (1985).


14 The "assets" of banks are "claims issued by deficit-spending units." Lloyd B. Thomas, Jr., Money, Banking, and Economic Activity 56 (1986). For commercial
Between 1973 and 1978, the number of foreign banks operating within the U.S. more than doubled to 122, holding $90 billion in assets. This growing number of foreign banks began participating in more traditional banking activities, and gaining a significant share of the loans outstanding to large commercial and industrial interests, thereby moving out of their traditional niche of financing foreign trade.

In 1975 the Fed proposed a foreign bank act, but it was not until 1978 that Congress enacted the International Banking Act of 1978 (IBA). This law was the first substantial step towards formally addressing and regulating the presence of foreign banks at a federal level. The IBA had two objectives: first, federal regulation of foreign bank activities and second, formalization of a policy of national treatment.

In terms of federal regulation, the IBA, for the first time, offered foreign banks the opportunity to obtain a federal charter, to establish federal branches and agencies and to subsequently submit to the immediate supervision of the Office of the Comptroller of the Currency (OCC). Whether state or federally chartered, the Fed assumed a residual supervisory responsibility over all foreign banks. Furthermore, the IBA brought foreign banks under the jurisdiction of the McFadden Act which prohibit banks from branching throughout the country. Prior to the IBA, foreign banks were not

---

banks, assets can be classified into three categories: cash items (e.g. cash reserves, currency on hand), loans (e.g. business loans, consumer loans, home mortgages) and securities and investments (e.g. U.S. securities, municipal securities). Id. at 126.

16 Terrell, supra note 9, at 913.
18 Commercial and industrial loans - C & I loans - are the “principal income-producer[s] for commercial banks.” THOMAS, supra note 14, at 128.
22 Gail, supra note 13, at 995.
covered by these acts, and in 1978, thirty-one foreign banks had established operations in three or more states.\(^2\)

More important than the residual supervision it gained, the Fed established national treatment as a U.S. policy. The Fed saw national treatment as both strengthening the domestic marketplace and taking a first step toward greater global cooperation on such regulatory issues.\(^3\)

The legislative history of the IBA states that """the climate in which this bill has been considered is one of relative calm.""\(^4\) In light of this goodwill, the heart of the IBA is monetary policy and competitive equality,\(^5\) and it is less concerned with drum-tight supervision and safe and sound banking principles.\(^6\)

---

Company Act bars interstate branching through the use of bank holding companies).\(^2\)

The IBA gave the Fed a residual supervisory responsibility over all state-chartered foreign bank operations, and thus responsibility over these 31 branches and their respective multi-state organizations. This supervision, however, was mostly ineffective. The Fed was, for all practical purposes, blocked from examining multi-state foreign bank operations since the individual states were still the principal regulators of the operations in their jurisdiction. H.R. REP. No. 330, supra note 10, at 106, reprinted in 1991 U.S.C.C.A.N. at 1919.

Statement by John P. LaWare, Member, Board of Governors of the Federal Reserve System, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, November 9, 1993, reprinted in 80 FED. RESERVE BULL. 19 (Jan. 1994) [hereinafter LaWare Statement - Nov. 9, 1993] (discussing the Fair Trade in Financial Services Act, and how it violates the long standing policy of national treatment).

The principle of national treatment was established as U.S. policy with respect to foreign banks by the International Banking Act of 1978. . . . The U.S. policy of national treatment—which has long set an example to others—seeks to ensure that foreign and domestic banks have a fair and equal opportunity to participate in our markets. The motivation is not merely a commitment to equity and nondiscrimination, although such a commitment in itself is worthy. More fundamentally, the motivation is also to provide a deep, varied, competitive, and efficient banking market in which they can satisfy their financial needs on the best possible terms. . . .

The U.S. banking market, and the U.S. financial markets more generally, are the most efficient, most innovative, and the most sophisticated in the world. It is not a coincidence that our markets are also among the most open to foreign competition.

Id. at 20.


32 Gail, supra note 13, at 995.

B. Reevaluating the IBA, and continued growth by foreign banks

In 1991, 304 foreign banks held aggregate assets of approximately $866 billion\textsuperscript{34} across sixteen states.\textsuperscript{35} Ninety-four percent of these assets were distributed between 532 state branches and agencies, with the remaining six percent in eighty-four federally chartered branches and agencies.\textsuperscript{36} The assets in the state branches and agencies constituted almost twenty percent of total banking assets in the U.S.\textsuperscript{37} The aggregate assets of these foreign banks amounted to thirty percent of domestic commercial loans.\textsuperscript{38}

U.S. and foreign banks have traditionally maintained extensive activities in branches offshore, typically in the Bahamas or the Cayman Islands.\textsuperscript{39} While the Fed has traditionally monitored the status of U.S. banks' offshore operations,\textsuperscript{40} new procedures have been adopted to collect information on the offshore operations of foreign banks' U.S. offices.\textsuperscript{41} In the first quarterly reports (quarter ending March 31, 1993) collected by the Fed from the foreign banks, over two-thirds\textsuperscript{42} of total offshore assets in these branches were denominated in U.S. dollars and claimed against either the foreign banks' U.S. offices or other U.S. addresses.\textsuperscript{43} Similarly, fifty-seven percent of liabilities at foreign banks' offshore operations consisted of U.S. denominated deposits.\textsuperscript{44}

The surprising aspect of this new supplemental report on foreign banks' offshore operations is that in addition to the $143.7 billion in

\begin{itemize}
\item Gail, supra note 13, at 995.
\item Gail, supra note 13, at 994-5.
\item Id.
\item The offshore operations afford U.S. customers higher interest rates on deposits booked at these banking centers, as they have more liberal reserve requirements. Terrell, supra note 9, at 915.
\item Id. at 916.
\item Id.
\item $222.4 billion in U.S. dollar denominated claims on U.S. domiciled offices, or other U.S. addresses, of a total of $329.0 billion in total assets. These figures were gathered only from the offshore branches of non-U.S. banks, and therefore exclude the non-U.S. banks with subsidiaries in offshore banking centers. Id. at 918.
\item $187.6 billion liable to U.S. domiciled offices or other U.S. addresses, denominated in U.S. dollars, out of $329.0 billion in total liabilities. Id. at 918.
\item Id.
\end{itemize}
commercial and industrial loans to U.S. businesses booked at the foreign banks' branches and agencies in the U.S., another $78.7 billion are booked at foreign banks' offshore branches. The total of $222.4 billion amounts to almost half the amount that all U.S. chartered banks have listed in commercial and industrial loans. These figures provide surprising new support to the Fed's assertion that foreign capital provides an important source of liquidity in the U.S. marketplace.

In the late eighties, even before the offshore operations were accurately quantified, the Fed recognized that the IBA facilitated a competitive marketplace, but it did not adequately ensure the safety and soundness of this growing presence of foreign banks. At that point it was evident that only one of two purposes of the IBA - national treatment - had come into its own. The Fed's residual supervisory power - federal regulation - was largely unexercised. As an interim measure, the Fed shored up the IBA's regulatory side by ensuring that foreign banks were included in the Crime Control Act of 1990 for fraud, money laundering and similar crimes.

Meanwhile, the Fed began to draft a thorough legislative proposal that would make foreign bank supervision more comprehensive. On May 9, 1991, the Fed introduced draft legislation to the Congressional banking committees that would provide foreign banks with the same supervision

---

45 U.S. chartered banks have a total of $455.2 billion in commercial and industrial loans to U.S. businesses. Id. at 918.

Without the inclusion of offshore operations, Japanese banks hold 54.1% of the foreign owned loans to U.S. businesses. Their market share shrinks to 36.3% when loans originated offshore are included. France, Canada, Switzerland, Germany, the U.K. and Italy contribute 11.6%, 10.5%, 8.5%, 6.9%, 5.7% and 3.8% respectively of the lending to U.S. businesses by foreign banks' U.S. mainland and offshore operations. The sum of these seven countries' loans amount to 83.3% of foreign commercial and industrial loans originated by foreign banks. Id. at 920.

Between 1980 and 1990, the Japanese share of lending to U.S. businesses by foreign banks grew from one-third to two-thirds of the total foreign lending market, and accounted for 80% of the market's growth. Id. at 920-921.

46 Id. at 918.


48 See LaWare Statement - Nov. 20, 1991, supra note 47, at 32.

and examination procedures and expectations that domestic banks faced. Just as the IBA had established national treatment as a U.S. policy, this legislation was to finally fulfill the IBA's other objective: equivalent safety and soundness. Over the summer of 1991, the Bank of Credit and Commerce International and the Banca Nazionale de Lavoro incidents highlighted for Congress the gaps in the existing regulatory regime. On December 19, 1991, Congress passed the FBSEA (largely unamended and unaltered from its May 9th form), giving the Fed the approval authority, and direct supervisory authority, over foreign banks seeking state licenses. For foreign banks seeking federal licenses, the Fed assumed the responsibility for an entrance examination, upon which it makes a recommendation to the OCC.

III. THE FOREIGN BANK SUPERVISION ENHANCEMENT ACT OF 1991

A. Legislative Context and Intent

Congress enacted the FBSEA as Title II of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The FDICIA was intended to reform the financial services industry and the federal deposit insurance system in the U.S. More specifically, the

50 Misback, supra note 21, at 2.

"[The FBSEA] ensure[s] that foreign bank operations in this country are regulated, supervised and examined in the same manner as U.S. banks." Statement by Virgil Mattingly, Jr., General Counsel, Board of Governors of the Federal Reserve System, before the Subcommittee on Consumer and Regulatory Affairs of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (May 23, 1991), reprinted in 77 FED. RESERVE BULL. 572, 579 (July 1991) [hereinafter Mattingly Statement - May 23, 1991].

51 See supra note 1.

52 Misback, supra note 21, at 3.


55 12 U.S.C. § 3102(a)(2) (Supp. IV 1992) (obliging the OCC to heed the Fed's recommendation). If a foreign bank's state or federal branch was operating prior to December 19, 1991 (the date on which the Fed released guidelines for foreign bank applications for gaining Fed approval), then it was permitted to remain in operation. If the foreign bank had only obtained state or OCC approval, but had not begun operations, then it had to apply for Fed approval - and get it - before commencing operations. Misback, supra note 21, at 5.


57 H.R. REP. NO. 330, supra note 10, at 95, reprinted in 1991 U.S.C.C.A.N. at 1008. The FDICIA was the Bush Administration's attempt at banking reform. See
FDICIA provided additional resources to the Bank Insurance Fund (BIF) and strengthened supervision and examinations of federally insured institutions.\textsuperscript{28}

1. Title I - Banking Reform.

Title I of the FDICIA recapitalized the BIF\textsuperscript{59} which was necessitated by the unusually large number of S&L failures during the late eighties.\textsuperscript{60} These failures put unprecedented demands on the insurance fund, eventually tapping out all the reserves.\textsuperscript{61}

In addition to recapitalizing the BIF, the FDICIA strengthens the capital requirements of the U.S. banking system.\textsuperscript{62} Simultaneously, the Bank of International Settlements, in Basle, Switzerland,\textsuperscript{63} was pushing new guidelines for the capitalization of international banks.\textsuperscript{64} These guidelines called for levels of capital significantly higher than most international banks could meet at the time.\textsuperscript{65} Recognizing some wisdom in

\textit{America's Banking Battles}, \textit{ECONOMIST}, Oct. 30, 1993, at 81-82.


The retail deposit insurance program came as a result of the crippling bank runs in the Great Depression. President Roosevelt installed a federal guarantee on retail deposits to restore depositor confidence by assuring them of the safety of the banking system, thus ending the panic. \textit{Id.} at 89, \textit{reprinted in} 1991 U.S.C.C.A.N. at 1902.

In the late eighties, non-bank sources of financing captured a solid portion of low-risk loans. In order to make up for this shortfall, banks were forced to pursue riskier portfolios. They did so feeling protected from harm by government insurance. The economic downturn of 1990 resulted in a number of banks failing, putting increased demand on the BIF. The FDICIA replenishes the BIF's eroded reserves. \textit{Id.} at 93, 1991 U.S.C.C.A.N at 1906.

\textsuperscript{60} \textit{Id.} at 92, \textit{reprinted in} 1991 U.S.C.C.A.N. at 1905.

\textsuperscript{61} \textit{Id.}

\textsuperscript{62} 12 U.S.C. § 1831o (Supp. IV 1992). The FDICIA does not set specific capital ratio requirements, but instead sets up a five category system. Banks judged to have the best capital positions are subject to less regulatory supervision. (Capital requirements dictate levels and types of capital which a bank must have on its balance sheets.) H.R. REP. NO. 330, \textit{supra} note 10, at 96-7, \textit{reprinted in} 1991 U.S.C.C.A.N. at 1909-10.

\textsuperscript{63} See \textit{infra} text accompanying notes 111 - 122.


\textsuperscript{65} \textit{Id.}
the recommended levels, the international banks - including large U.S. banks - voluntarily committed themselves to attaining these capital positions. Congress, also recognizing the wisdom of the capital guidelines and seizing the momentum that the Bank of International Settlements had created, embodied capital guidelines of similar (but higher) levels in Title I of the FDICIA.

2. Title II - The Foreign Bank Supervision Enhancement Act

In effect, as Title II of the FDICIA, the FBSEA seals the nation's borders, preventing the entry of institutions which cannot demonstrate that they undergo consolidated supervision in their respective home country. In the U.S. all domestic banks, whether state or federally chartered, undergo comprehensive, consolidated supervision; the FBSEA now requires that foreign banks assure the Fed that they undergo the same sort of supervision in their home country.

In his statement to Congress on November 20, 1991, in support of the FBSEA, John LaWare, Member of the Board of Governors of the Federal Reserve System, pointed out that foreign banks have "contributed significantly to [the] liquidity and depth" of the U.S. marketplace. Acknowledging the need to maintain the presence of foreign banks in the U.S. marketplace, Mr. LaWare also stressed that the FBSEA only fills gaps in the "supervisory and regulatory framework governing foreign banks in this country." Furthermore, he emphasized that the FBSEA continues to extend the policy of national treatment for foreign banks.

---

68 "Consolidated" reporting is a financial statement which includes the parent organization and all affiliates and subsidiaries over which the parent company exerts substantial control. See 12 C.F.R. § 211.25 (1993).
70 LaWare Statement - Nov. 20, 1991, supra note 47, at 34.
71 Id. at 31.
72 Id. While foreign banks are now subject to a layer of regulation that state or Federal banks are not (i.e. the Fed and its entrance examination and annual examination), the prudential expectations are now the same for foreign and domestic banks. See 12 U.S.C. § 3105(e), (h) (state chartered banks) and 12 U.S.C. § 3102(b) (federally chartered banks).

Undoubtedly in this statement, Mr. LaWare was also indirectly responding to complaints that the FBSEA was just another layer of bureaucracy that would restrict foreign capital. Although published almost eighteen months after his statement, see Gary Welsh, Unshackle Foreign Banks, WALL ST. J., Apr. 20, 1993, at A20.
B. Provisions of the FBSEA

The FBSEA creates four primary changes in the IBA's existing regulatory regime. The net effect is a comprehensive response to the concerns about the differences between the individual states' regulation of foreign banks and the difficulty in monitoring the disparate and growing foreign presence.

1. Entry approval

The most prominent provision of the FBSEA is the requirement that all foreign banks seeking to establish either state or federally chartered operations in the U.S. receive approval from the Fed to enter the country. The Fed intends to ensure, through the application procedure (and subsequent supervision), that only "adequately capitalized and properly supervised non-U.S. banking organizations are permitted to participate in the U.S. markets for financial services." Clearing the Fed's initial or subsequent review is a necessary, but not sufficient condition for beginning or maintaining operations; a foreign bank must still gain initial and ongoing approval from the state in which it is chartered. If the foreign bank seeks a national (i.e. federal) charter, the Fed will grant initial approval, then the OCC must also approve the applicant before the Fed assumes supervisory and regulatory control.

In taking control of, and consolidating, the market entry requirements and channels, the Fed accomplishes two important objectives. First, the Fed takes the responsibility for overseeing all the foreign bank operations in the U.S. (and has a realistic opportunity for doing so by having all foreign banks come to it as they enter the country). Second, the entry criteria have been drafted so that upon approval of a foreign applicant, the Fed can be confident that the foreign bank, and its parent organization, are subject to consolidated comprehensive supervision by their home...
country supervisor. Recognizing the fact that the Fed cannot directly regulate a foreign branch's parent bank itself, the Fed must utilize this entry approval process to become confident with the foreign regulator's framework.

To be allowed entry into the U.S., the FBSEA establishes two standards that a foreign bank must meet: 1) "the foreign bank engages directly in the business of banking outside the United States and is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country," and 2) "the foreign bank has furnished to the Board [i.e. the Fed] the information it needs to adequately assess the application." While the second requirement sounds self evident, it is quite important to the Fed. The language of the statute allows the Fed a great deal of discretion in interpreting the term "adequately assess." Through this adequate assessment the Fed hopes to reach a level of trust in the foreign bank's domestic regulation that is so important to the Fed finding comprehensive consolidated supervision. Without comprehensive consolidated supervision, a foreign application cannot be approved. It was the lack of consolidated supervision that allowed the BCCI to create an octopus-like operation which effectively eluded supervision, thereby concealing the fraudulent practices for which that bank was later dissolved.

A major difficulty in finding that a specific foreign bank is subject to comprehensive consolidated supervision is that many countries do not have a single regulator that the Fed can evaluate, which would allow the Fed to accept or reject all applicants from that country. The U.S. is an example of an individual country that does not necessarily have a single bank regulator supervising all domestic banks. Furthermore, some coun-

---

81 This notion of trusting the effectiveness of foreign regulatory regimes is an emerging international trend. See infra Section IV (A).
83 Id.
84 The U.S. is not alone in putting such an emphasis on comprehensive consolidated supervision. See infra Section IV (A).
85 See supra note 1.
86 Currently the Fed, the OCC, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the individual states have overlapping regulatory authority. See 12 U.S.C. § 3105(c) (Supp. IV 1992). The Clinton administration, however, has pushed for a consolidation of these agencies. The existing proposal would merge the regulatory functions of the OCC, OTS and FDIC into a new Federal Banking Commission. See Kenneth H. Bacon, Fed, Treasury Progress on Plan for Bank Firms, WALL ST. J., May 11, 1994, at A3. See generally Alan Greenspan, No Single Regulator for Banks, WALL ST. J., Dec. 15, 1993, at A16 (arguing that the country
tries find it difficult to conclude that their supervision is consolidated; an example is Mexico. It was not until the North American Free Trade Agreement was drafted that the Fed determined that Mexican banks were not supervised on a consolidated basis, and thus were not eligible to enter the U.S. marketplace.\textsuperscript{87} The Fed, as a result, evaluates foreign bank applicants on a time consuming case-by-case basis.\textsuperscript{88}

To determine whether a specific applicant’s home country supervisor provides comprehensive consolidated supervision in a particular case, the Fed considers five factors.\textsuperscript{89} No factor is determinative, nor is the list exhaustive, but the factors were included in recognition that different countries have different financial instruments and that different regulators employ different definitions.\textsuperscript{90} The factors include:

1) ensuring that individual banks which they oversee have adequate procedures for monitoring and controlling domestic and international activities;

2) collecting regular reports (e.g. audits) on the condition of the parent bank, and the subsidiaries and offices outside the home country;

3) collecting information regarding the relationship between the parent bank and its foreign and domestic affiliates;

4) collecting financial reports that are consolidated on a worldwide basis; and

5) evaluating prudential standards (e.g. capital adequacy) on a worldwide basis.\textsuperscript{91}

\textsuperscript{87} See Statement by John LaWare, Member of Board of Governors of the Federal Reserve System, before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives (Sept. 28, 1993), reprinted in 79 FED. RESERVE BULL. 1031 (Nov. 1993).

\textsuperscript{88} IBR Annual Survey Shows Average Delay 14 Months, THOMPSON’S INT’L BANKING REGULATOR, Feb. 21, 1994, at 1A [hereinafter IBR Annual Survey].

\textsuperscript{89} 12 C.F.R. § 211.25(c)(1)(ii) (1993).


\textsuperscript{91} 12 C.F.R. § 211.25(c)(1)(ii) (1993).
Beyond the two required standards for entry approval, the FBSEA suggests four discretionary standards for consideration:

1) whether the home country authorities have consented to the bank's proposed U.S. expansion;

2) "the financial and managerial resources of the foreign bank, including the bank’s experience and capacity to engage in international banking;"\(^9\)

3) whether the bank can continually provide such information that the Fed deems necessary to ensure compliance with all applicable federal laws;\(^9\) and

4) whether the bank is currently in compliance with U.S. law.\(^6\)

These standards allow smaller foreign banks to demonstrate their merits, even if they are dwarfed in size and prestige by the Japanese or German banking giants.\(^7\)

2. Termination

To effectively maintain control over these foreign branches, the FBSEA provides that the Fed may terminate the operations of a state chartered foreign bank office, and recommend to the OCC that it terminate the operations of a federally chartered foreign bank office.\(^8\) The Fed may exercise this option if the foreign bank office: 1) is not subject to comprehensive consolidated home country supervision;\(^9\) or 2) if "there is reasonable cause to believe"\(^10\) that the office has committed a violation of law or engaged in unsafe or unsound banking practices, and this violation makes continued operation of the office inconsistent with public interest.\(^10\)

\(^11\) See infra notes 135-139 and accompanying text, concerning the difficulties experienced by grandfathered operations of banks lacking consolidated home country supervision.
\(^13\) Id.
3. Deposits

The FBSEA restricts the latitude of foreign banks to take deposits. Under the FBSEA, retail deposits of less than $100,000 may only be accepted by foreign banks that have set up an insured U.S. subsidiary. New insured retail branches may not be established by foreign banks; however, branches existing prior to the FBSEA are grandfathered provided that they continue to operate in compliance with section 6 of IBA. Uninsured deposits of less than $100,000 are acceptable, so long as they are wholesale deposits.

4. Examinations and reporting

In order to standardize regulations for state and federally chartered foreign banks, the FBSEA limits state chartered foreign banks to activities permitted by the OCC for federally chartered foreign banks. If a state chartered foreign bank wants to engage in activities permitted by state law, but not sanctioned by the OCC, the bank must seek specific Fed approval. Approval depends on the safety and soundness of the particular activity. In the case of an insured branch, the Federal Deposit Insurance Corporation must also determine that the activity poses no threat to the insurance fund.

The FBSEA grants the Fed the authority to conduct on-site foreign bank inspections annually. These federal examinations supplement the existing examination by the individual state or OCC. The Fed coordinates the annual examination schedule of each foreign bank, and has many options within its authority: it can conduct its own annual examinations; it can rely on the state or OCC examination results; it can alternate annual examinations with the state or OCC; or it can coordinate joint examinations. With this authority, the FBSEA puts the Fed in the position of “primary Federal regulator for State licensed branches and

109 Id.
agencies of foreign banks," and thereby effectively reverses the Fed’s former residual supervisory position under the IBA.

IV. THE BASLE COMMITTEE ON BANKING SUPERVISION

At the Bank for International Settlements in Basle, Switzerland, a committee entitled the Basle Committee on Banking Supervision (Basle Committee) was formed to address the differences between nations in domestic and foreign bank regulation and supervision. The committee is comprised of representatives from the central banks and regulatory agencies of Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the U.K. and the U.S.

A. International Bank Supervision

On July 6, 1992, six months after Congress passed the FBSEA, (and almost a year to the day that the Bank of England closed down the Bank of Credit and Commerce International) the Basle Committee set out minimum standards for the supervision of international banks. The guidelines, like the FBSEA, require that every international bank be regulated on a consolidated (i.e. global) basis by its home country regulators. That is to say that the guidelines prevent any sharing, or splitting, of supervisory responsibility between two or more nations over a bank with international operations. Additionally, the guidelines discourage bank regulators from accepting into their borders those international banks that they feel have otherwise insufficient home country supervision. The Basle Committee’s premise is that no other country can adequately supervise the cross border operations of a bank if that

\[\text{(10)}\]

\[\text{(11)}\]

\[\text{(12)}\]

\[\text{(13)}\]

\[\text{(14)}\]

\[\text{(15)}\]

\[\text{(16)}\]

\[\text{(17)}\]
bank’s home country regulators do not sufficiently regulate and supervise its domestic operations.\(^{118}\)

Altogether the Basle Committee guidelines on the minimum standards of international banking supervision contain four principles:

1. All international banks should be supervised on a consolidated basis by a home country authority;
2. Prior to the establishment of a non-home country branch or operation, the bank should receive the consent of the home and host country banking regulators;
3. Home country supervisors should be able to collect information on the foreign operations of domestic banks; and
4. Host countries should have the discretion of prohibiting the establishment of any foreign banking operation if the above guidelines are not met to their satisfaction.\(^{119}\)

These principles, although agreed upon by all twelve members of the Basle Committee, are not legally binding.\(^{120}\) Former chair of the committee, Gerald Corrigan, stated at the time these guidelines were issued that the Basle Committee would rely on the leadership and “moral authority”\(^{121}\) of the members to see that these guidelines were adopted on a larger scale.\(^{122}\)

B. Likelihood of compliance with the supervision standards

Agreements or minimum standards reached by the Basle Committee are not legally binding articles of international law; rather they are shared goals for the member countries’ domestic banking systems.\(^{123}\) The central bankers of the various nations must still present the agreement or

\(^{118}\) “The BCCI foul-up was made possible by the three-legged race of the regulators. . . BCCI’s home-country supervisor, the Monetary Institute of Luxembourg, shared responsibility with the Bank of England, supervisor of BCCI’s biggest western operations, and indeed with the Cayman Islands — so none assumed it.” Bank Supervision; Over the Hills and Far Away, ECONOMIST, July 11, 1992, at 72 [hereinafter Bank Supervision].

\(^{119}\) These principles appear in Basle Committee, supra note 114; and in a summarized format in Basle Committee on Banking Supervision Issues New Standards to Prevent Fraud, 59 Banking Rep. (BNA) 82 (July 13, 1992) [hereinafter Basle Committee on Banking Supervision Issues New Standards].

\(^{120}\) Basle Committee on Banking Supervision Issues New Standards, supra note 119, at 82.

\(^{121}\) Id.

\(^{122}\) Id.

\(^{123}\) Id.
standards for the approval of their respective legislatures. In the U.S., the FBSEA meets the Basle minimum standards for international bank supervision,\(^\text{124}\) and the U.K. is moving towards the implementation of legislation that would also likely meet the Basle minimum standards.\(^\text{125}\)

The momentum of these initiatives plus the continuing effort to homogenize the EC marketplace suggests that it might not be long before all G-10 countries\(^\text{126}\) meet the Basle Committee's minimum standards. A look at recent history provides a potentially relevant analogy. Before the push for standardizing international banking supervision regulations, the Basle Committee addressed the issue of bank capital.

C. Success of the Capital Adequacy Standards

In its efforts to equilibrate international banking standards, the Basle Committee, in 1988, issued minimum standards for risk-based capital ("capital"),\(^\text{127}\) for all international banking institutions. Due to capital's role as a reserve against poor earnings and economic downturns (and a foundation for investor confidence), the Basle Committee viewed capital requirements as a critical tool in maintaining and standardizing the credit risk and safety and soundness of all banks.\(^\text{128}\) Beyond the issues of safety and soundness, the Basle Committee recognized that banks should have competitive equality on a global scale, and that capital requirements could be an integral part of achieving that equality since capital levels determine the cost of funds available to a bank.\(^\text{129}\) The Committee set the minimum capital level for internationally active banks at eight percent.\(^\text{130}\) Further, the Committee stressed that this figure represented a

\(^{124}\) See Misback, supra note 21, at 6. "The comprehensive consolidated supervision set forth in the [FBSEA] is broadly consistent with the Basle Minimum Standards, but may also go beyond the standards in certain respects." Id.

\(^{125}\) Bank Supervision, supra note 118, at 72.

\(^{126}\) The "Group of Ten" consists of Belgium, Canada, France, Germany, the Netherlands, Italy, Japan, Sweden, the U.K. and the U.S.

\(^{127}\) Capital consists of subordinated debt, preferred stock and common equity. Bank capital is different from the common notion of capital. Capital acts as a cushion, or mini-insurance fund, for banks, whereas in other businesses capital finances the purchase of property, plant and equipment. The perceived "strength" of a bank is reflected in its capital position. See Alford, Capital Adequacy, supra note 64, at 190.

\(^{128}\) Id. at 192.

\(^{129}\) Id. "Capital is an expensive source of funds for banks. An increase in the amount of capital required by regulators increases the banks' costs of doing business and restrains their ability to increase deposits or loans." Id. at 193.

\(^{130}\) This figure is eight percent of risk adjusted assets. Id. at 200.
minimum, and that higher levels were encouraged.\footnote{Id. at 201.} In a review conducted in 1993, the Basle Committee found that all internationally active banks in the G-10 countries had met the minimum capital standards by the end of 1992.\footnote{G-10 Banks Meet Capital Ratio Requirements, Reuters Financial Wire, Sept. 13, 1993, \textit{available in} LEXIS, Banking News Library, Reuters Financial Wire File.}

Using the capital adequacy standards as an analogy, the prospects for uniform implementation of the Basle Committee's international banking minimum standards appear to be good.

V. POTENTIAL CONSEQUENCES OF THE NEW INTERNATIONAL STANDARDS

If all the G-10 countries adopt the Basle Committee minimum standards or something similar, the international banking community will become polarized. Those banks who have consolidated comprehensive supervision will be able to enter any and all banking markets, while those banks hailing from countries that lack consolidated comprehensive supervision will be effectively blocked from the major marketplaces (i.e. G-10 markets). Over time "in" lists and "out" lists will develop.\footnote{Gubman, \textit{supra} note 90, at 124.} On the "in" lists will be all the banks based in the G-10 nations plus a handful from developing nations that can effectively lobby into existence a supervisory scheme that abides by the Basle notion of comprehensive consolidated supervision. Developing nations populating the "out" lists will find themselves out of the important markets of the international banking community. The result will be a homogeneous, exclusive, international market for capital which is extraordinarily safe and sound, but does not easily or readily accommodate transactions between "in" list and "out" list countries. The consolidated supervision standard, therefore, will be all but inconsequential to those foreign banks that currently have such systems in place in their respective home countries. With the exception of the Fed coordinating examinations, it will be business as usual for these "in" list banks operating in the U.S.\footnote{Fernando A. Capablanca, \textit{Making Waves: The Potential Impact of New U.S. Banking Laws on U.S./Latin American Trade}, \textit{LATIN FINANCE}, Sept. 1993, at TF52, TF54.}

The Federal Reserve Bank has consistently rejected the notion that it has discriminated against banks from any one region of the world. While this may be true, it stands to reason that if the FBSEA is applied equally to every country, the results will create greater hardships to some regions of the world than to others. \textit{Id.} at TF54.
 Already, difficulty has arisen with the grandfathering of "out" list foreign banks, i.e. the foreign banks who were operating in the U.S. prior to December 1991, and whose continuing operations are grandfathered but whose home country regulators do not provide comprehensive consolidated supervision that would allow other banks from that home country to establish new operations in the U.S. In the fall of 1993, the Atlanta Fed severely reprimanded the Banco Boliviano Americano SA. In a spring 1993 examination of the Bolivian bank in Miami, the Fed determined that the bank had a number of policy and procedural shortcomings, none of which would have allowed for money laundering (a common concern with Latin American banks), but amounted to substandard practices. The Fed ordered the bank to produce an extremely detailed report of all extensions of credit and statements of internal policy and procedures. The signal to this foreign bank and those in similar circumstances, is that even if the home country supervisor does not require a number of various, detailed reports and ostensibly consolidated supervision, this host country supervisor does. The Fed has thereby made clear that it holds all banks, regardless of origin, to the same expectations.

A. Short run costs - stunting the growth of Latin American exports and Miami's status as an international banking center

Latin America provides the most severe example of the potential impact that the FBSEA might have on relations with non G-10 countries. Since the passage of the FBSEA, with its requirement of comprehensive consolidated supervision, only one Latin American bank has been granted

---

135 "Grandfathering" is an accepted international practice for "protecting investment in existing foreign banking operations at a time of statutory change." LaWare Statement - Nov. 20, 1991, supra note 47, at 33. The Fed considers grandfathering an important national banking policy that lends confidence and stability to market participants. See id.

136 Atlanta Fed Forces Bolivian Bank in Miami to Meet Strict Guidelines on Loan Policies, THOMPSON'S INT'L BANKING REGULATOR, Nov. 8, 1993, at 3. In this instance, the Bolivian bank operated an agency, offering no services which required federal deposit insurance (and hence put no U.S. taxpayer - i.e. BIF - money at risk). Id.

137 "I would estimate that a substantial amount of [foreign bank offshore activity] is involved one way or another in drug money laundering." Arthur D. Postal, Gonzalez Marshals Forces in Bid to Stiffen Bank Oversight, THOMSON'S INT'L BANKING REGULATOR, Apr. 19, 1993, at 1 (quoting interview with Chairman of the House Banking Committee Henry B. Gonzalez).


139 Id.
permission to enter the U.S., and as suggested above, grandfathered Latin American branches are coming under close scrutiny. This regulatory zeal comes at an inopportune time for Latin America. Overall, the region’s economy is expanding; it is experiencing increased Gross Domestic Product and reduced inflation, and growing central bank independence. Consequently, Latin America is one of the fastest growing export markets, and this growth is generating a tremendous need for trade financing. Scarce financing exists for its increased level of trade, due in part to the FBSEA.

U.S. and other G-10 banks are hesitant to loan any money with extended maturities to Latin American borrowers without government guarantees, due to the large losses incurred by these lenders during the early and mid-eighties. Instead, U.S. banks and other lenders are be-

140 IBR Annual Survey, supra note 88, at 1A.

Latin Banks certainly have plenty to complain about. Of the nine Latin banks that have banking applications [in] since 1991, only one has been approved - Banco de Chile in December, 1993. Even the Mexican banks haven’t received the Fed’s permission to open offices in the U.S., an ironic counterpoint to the recently approved free trade treaty.

Id.


143 Id.


146 “Economic progress and liberalization of trade have led to a huge increase in demand for trade finance in Latin America, but the increase in supply of trade finance has not been commensurate.” Luiga la Ferla & David Easton, Transformed Markets Make Way for Trade Finance; Latin America Trade Finance: Unprecedented Opportunity, LATINFINANCE, Sept. 1993, at TF4.

147 See Capablanca, supra note 134, at TF52.

148 U.S. and foreign banks had to write off billions of dollars in loans after most Latin American countries, including Brazil, Mexico, Venezuela and Argentina, defaulted. See James R. Kraus, Latin Economic Gains Seen Spurring Foreign Investing, AM. BANKER, Sept. 28, 1993, at 9. See also BIS: Short Term Lending Hits Record High of 52%, LDC DEBT REPORT/LATIN AMERICAN MARKETS, Feb. 21, 1994, at 8. The
ginnning to offer extremely short-term cash, such as six-month lines of credit. This type of lending however is insufficient to support sustained, long-term growth. This is where the FBSEA standards most noticeably present a restraint to free market machinations; the Latin American banks cannot expand to the U.S. to finance their growing domestic market. Ironically, financing foreign trade was originally the primary business for foreign banks in the U.S.

Domestically, the lawyers and bankers in Florida are concerned that the FBSEA has dampened Miami’s growth as an international banking center. Florida’s state banking regulators have complained bitterly that the Fed has first designed a law that is unduly restrictive and second, begun enforcing it with zeal that borders on usurpation of authority.

Bank Of International Settlements reports that in 1993, 52% of loans to Third World countries had maturities of less than one year. This result is spurred by two related movements: first, total loans outstanding to the public sector (e.g. government borrowers) have declined, and, second, the loans to private sector borrowers are mostly short-term investments made by international capital markets. Id.

Sound credit policy dictates that short-term debt finances short-term assets, therefore short term lines of credit cannot be used to finance the long term assets the Latin American countries need in order to support their expanded trade (e.g. factories, equipment, infrastructure). See RICHARD MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE, 780-806 (4th ed. 1984).

Some of the more adventurous European banks are entering into trade finance (in place of the reluctant American lenders), and also underwriting bonds for Latin American corporations which are placed with large institutional investors in Europe. James R. Kraus, Germany’s BHF to Use N.Y. Office as a Springboard for Latin Expansion, AM. BANKER, Dec. 16, 1993, at 24.

U.S. banks cannot establish foreign branches in Latin America - branches that would be more able to serve Latin American financing needs as a result of their presence and involvement in the marketplace - because these markets are largely closed to foreign banks. The U.S. Congress is currently considering the Free Trade in Financial Services Act (the FTFSAs) that would establish reciprocal national treatment. This bill would restrict U.S. market access available to an institution hailing from a country which restricts foreign firms’ access to its domestic marketplace. While the FTFSAs is aimed more at the Japanese market, the FBSEA has, in a de facto manner, achieved the FTFSAs’s intent with regards to the closed markets of Latin America. See Capablanca, supra note 134.

Federal Reserve Prepares to Begin Dialogue, supra note 144, at 4.

James R. Kraus, Florida Aide Assails Fed on Foreign-Bank Role, AM. BANKER, May 1, 1992, at 21. Most of the small Latin American banks in Miami are not subject to consolidated supervision and are having difficulty meeting the Fed’s prudential standards as well as demands for documentation. The net effect is that foreign
CONSEQUENCES OF THE FBSEA OF 1991

B. Long run benefits - standardization of diverse banking legislation

While Latin American trade struggles in the short run, progress is made towards the Fed’s and the Basle Committee’s ultimate goal: globalization of safe and sound banking supervisory standards. In the fall of 1993, the head of Venezuela’s central bank announced that Venezuela’s legislature had approved banking legislation which would provide comprehensive consolidated supervision, complying with the FBSEA and the Basle Committee’s international standards. Additionally, the new banking regulations eliminated laws that prevented foreign banks from entering the Venezuelan market. Approval of the legislation allows a consortium of Venezuelan banks to renew their application to purchase an American bank - Eagle National Bank - in Miami. They withdrew the application in early 1992 because the group’s members were not subject to consolidated supervision.

As a result of the delay (or impossibility) in getting a Latin American bank’s application through the Fed, several unauthorized individuals or companies have been representing Latin American banks in Florida. Florida’s state legislature, consequently, has made its own initiatives in helping these banks cope with the FBSEA. Legislation has been introduced that would crack down on the unauthorized representation of foreign banks, but would also create a new banking-type corporation that would not be subject to the FBSEA, but would engage solely in trade financing. Florida’s trade with Latin America has been estimated to be two-thirds of the state’s total, and therefore the state has been extremely proactive in trying to cooperate with Latin American countries, applications for Florida state banking licenses are down, and voluntary terminations are up. Id.

See Alford, Minimum Standards, supra note 7.


Kraus, U.S. Banks May Miss the Boat, supra note 145, at 1.


Charles Dusseau, A New Opportunity; Mercosur: Achievement and Perspectives, LATINFINANCE, Jan. 1994, at 94. In 1991 Argentina, Brazil, Paraguay and Uruguay formed a trading bloc ("Mercado Comun del Sur" or "Mercosur"). Trade between Florida and these counties totaled $4.5 billion in 1992. Id.
and help them adopt policies that will facilitate interaction with the U.S.\textsuperscript{161}

The Fed, too, recognizes the importance of foreign capital in the domestic market and the hardship the FBSEA presents for Latin American banks.\textsuperscript{162} In response, the Fed has entered a dialogue with Latin American governments and bank supervisors.\textsuperscript{163} In the fall of 1993, a conference between U.S., Canadian, Venezuelan, Ecuadoran and Bolivian bank supervisors was held in an attempt to help the Latin American banks reach the new international supervisory standards, and for the U.S. supervisors to refine and streamline the foreign bank application process.\textsuperscript{164}

VI. Conclusion

The FBSEA substantially strengthens and consolidates the business of supervising foreign bank operations in the U.S. marketplace. By requiring entering banks to be subject to consolidated comprehensive home country supervision, the FBSEA provides a new measure of safety and soundness to the U.S. banking market.\textsuperscript{165} The Fed recognizes that some foreign banks are being "locked out of the U.S. market,"\textsuperscript{166} by this provision. The immediate cost of this lock out is felt by Latin American countries, who, due to a lack of consolidated supervision, cannot establish branches in the U.S. (and, soon, most G-10 countries) to finance their expanding export sectors. U.S. and other G-10 banks are reluctant to finance this trade due to the sting of recent losses and the fact that they cannot enter the Latin markets to oversee any investment in Latin American trade financing. The unwillingness of the U.S. and the G-10 countries to allow exceptions to their new banking policies is beginning to force countries without comprehensive consolidated bank supervision schemes to undertake standardizing reforms. Through the FBSEA and the Basle Committee's international standards, the G-10 countries have

\textsuperscript{161} Id.

\textsuperscript{162} Federal Reserve Prepares to Begin Dialogue, supra note 144, at 4.

\textsuperscript{163} Id.

\textsuperscript{164} Id.

\textsuperscript{165} Fraud is extremely hard for any regulatory authority to detect, especially when bank employees actively conspire to prevent official scrutiny or when all relevant information relating to the fraudulent activity is maintained outside the United States. [The FBSEA is] designed to minimize the potential for illegal activity by creating a bar to entry by questionable organizations and, in the event that illegal or improper activities are suspected, to provide as many regulatory and supervisory tools as possible to investigate and enforce compliance.


\textsuperscript{166} Federal Reserve Prepares to Begin Dialogue, supra note 144, at 4.
used the importance of their collective marketplace to begin to force all nonstandardized countries to adopt safe and sound, and thus eventually globally uniform, bank supervision policies.