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STATEMENT OF

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COMPTROLLER GENERAL OF THE UNITED STATES

BEFORE THE SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS SUPERVISION, REGULATION,

AND INSURANCE

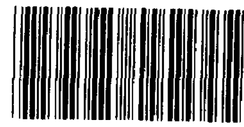
COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our report on the international activities of banks. That report, the result of your request, covered many topics in the international banking area, but it focused primarily on the activities of foreign banks and foreign individuals in the U.S. banking industry.

We found that although the International Banking Act of 1978 has provided for more equal treatment of foreign and domestic banks in the United States, foreign banks continue to realize some advantages over domestic banks. The greatest advantage which many foreign banks have is the ability to buy large-to-medium U.S. banks which, in most cases, other U.S. banks would not be permitted to buy.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Since 1970, foreign investors have acquired 93 U.S. banks. For the most part, the foreign investors exerted a positive influence by improving financially weak and maintaining financially strong U.S. banks. Despite these positive effects, we recommend a limited moratorium on the foreign acquisition of U.S. banks with total assets in excess of $100 million. We recommend this moratorium because of the existing unfairness between foreign and domestic banks in the acquisition of large-to-medium U.S. banks.

HOW GAO MADE ITS STUDY

Before I discuss our findings and recommendations in more detail, let me briefly describe the scope and method of our study. We conducted this review at Federal, State, and foreign financial institution regulatory agencies. We discussed the issues surrounding foreign banking in the United States with representatives of U.S. banking associations, officials of the bank regulatory bodies of six foreign countries, academicians of international finance and banking, and U.S. and foreign bankers in the United States and abroad.

To review the supervision of foreign banking in the United States, we gathered, compiled, and analyzed information on a wide range of regulatory functions at Federal and State banking regulatory agencies. The Federal banking regulators included the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation in Washington, D.C., and field offices in New York, Chicago, and San Francisco. The State banking regulators included New York, California, and Illinois.

These Federal banking field locations and State banking departments were chosen because 94 percent of the foreign banking activity in the United States is located in the areas supervised by these offices.

From an extensive literature search, interviews with State and Federal banking regulators, and agency files, we identified 93 U.S. banks acquired by foreign investors in the 1970s. We obtained bank examination reports for these banks and compared each bank's condition before and after foreign acquisition relative to average examination ratings of all U.S. banks in the 1970s.

I will now address some of our findings and conclusions in more detail.

FOREIGN BANKS ARE REGULATED BY FEDERAL AND STATE AGENCIES

The regulation of foreign bank branches, agencies, and representative offices is primarily a State responsibility because, prior to the International Banking Act of 1978, these organizations were State-chartered or licensed and were not able to obtain Federal licenses or deposit insurance. Now, U.S. branches and agencies of foreign banks may obtain Federal licenses from the Comptroller of the Currency, and branches are eligible for Federal Deposit Insurance. Also, the Federal Reserve System has been given residual supervisory authority over such offices. Because very few U.S. branches and agencies

of foreign banks have exercised the options for Federal insurance and licenses, the States will continue to be the primary regulators for U.S. offices of foreign banks.

The situation for foreign-controlled U.S. banks is different, however. According to our research, all foreign-controlled U.S. banks are either Federally chartered or State-chartered and Federally insured. Therefore all foreign-controlled U.S. banks are regulated by one of the Federal banking agencies: Comptroller of the Currency, Federal Reserve System, or Federal Deposit Insurance Corporation.

THE INTERNATIONAL BANKING ACT
ALLOWS FOREIGN AND DOMESTIC BANKS
TO COMPETE MORE EQUALLY

The International Banking Act of 1978, reflected congressional awareness of the competitive advantages favoring foreign banking activities. The Congress decided to deal with these increasingly evident inequalities by tightening the regulation of foreign banking in this country.

The act introduced a national treatment policy to the banking arena. The policy's purpose is to treat foreign banking operations as the competitive equals of their domestic counterparts. Federal regulatory agencies have also attempted to apply this policy in their regulatory approaches to both foreign and domestic banks. Through its enactment and implementation, the International Banking Act has narrowed the gap between the competitive positions of foreign and domestic banks. Specific areas where foreign and domestic

banks now have more equal opportunities include Edge Act Corporation activities, insurance of deposits, nonbanking activities, and the availability of Federal and State charters and licenses.

Despite this move toward equalization, the act and its implementation still give foreign banking interests an advantage in some areas, such as the ability of some to continue to operate deposit-taking offices multistate, even though domestic banks cannot.

Foreign banks had been able to establish multistate operations in the United States which, when linked to their international operations, were attractive to corporate customers. Because the McFadden Act and the Bank Holding Company Act effectively prevent domestic banks from establishing full service banking facilities in more than one State, foreign banks held a significant advantage. Because of this advantage, the International Banking Act of 1978 limits future foreign bank multistate endeavors. The act, however, permits the 63 existing foreign bank multi-state operations to continue. These organizations retain their preferential treatment.

CONTROL OF U.S. BANKING ASSETS BY FOREIGN INVESTORS NEARS 15 PERCENT

As of December 1979, foreign investors held $202.5 billion in U.S. banking assets. This accounted for 13.7 percent of the total U.S. banking assets. Foreign banks controlled $182.8 billion, or 90.2 percent, of the U.S. banking assets controlled by

foreign investors; foreign individuals and nonbank organizations held $19.7 billion, or 9.8 percent.

Subsequent and pending acquisitions will increase the level of banking assets under foreign control to 15.0 percent. If acquisitions which have recently been announced are consummated, the level of such assets under foreign control would move close to 16.0 percent.

Although those in and familiar with the U.S. banking industry generally agree that the current level of U.S. banking assets under foreign control is not too high, there is also general agreement that the situation bears watching. Many people in the financial community believe that should foreign banking continue to increase in the United States, particularly through the acquisition of existing U.S. banks, a level of foreign control of U.S. assets which is "too high" might be reached. These beliefs are based at least partially on the assumption that domestic-controlled banks may be, at some future time, more sensitive to local business and government credit needs than foreign-controlled banks. However, few people are willing to speculate on what level of foreign control would be too high.

The fact that foreign control of U.S. banking assets could reach 15 percent or more this year does not necessarily call for concern. Federal regulators have the authority to monitor the entry of all future foreign investors in the U.S. banking industry and to supervise the activities of those

currently operating here. However, any designation of a point at which foreign control of U.S. banking assets becomes worrisome or threatening is a matter of national policy--one which considers political, social, and foreign policy factors.

FOREIGN INVESTORS HAVE HAD A POSITIVE EFFECT ON THE U.S. BANKS THEY ACQUIRED

Although a few well-publicized bank problems have been attributed to foreign investors who gained control of U.S. banks, foreign investors have generally improved financially weak U.S. banks and maintained the condition of financially strong U.S. banks they acquired. Foreign investors gained actual control of 77 U.S. banks in the 1970s. The average bank examination rating for those 77 foreign-acquired banks at the time of acquisition was considerably below the average rating for all domestic banks during the 1970s. Indeed, 17 of these banks were considered problem banks by the Corporation, and 6 banks had failed prior to their foreign acquisition.

The general financial condition of the acquired banks was improved after their foreign acquisition. Examination ratings for foreign-acquired banks generally went up after their foreign acquisition, although most of the acquired banks still had ratings lower than the average rating for all U.S. banks. A greater improvement occurred in those banks which the Corporation considered problem banks before their acquisition. Of the 17 foreign-acquired problem banks, 10 were

removed from the problem list, 2 improved their problem rating, and 5 remained the same. Foreign investors improved the acquired banks by adding new capital, changing management, improving loan portfolios, and stopping self-dealing transactions.

Although foreign-controlled banks generally showed improvement after acquisition, they did not as a group pass as many financial ratio test areas as did all domestic controlled banks. Although failing one or more of these test areas does not necessarily mean a bank has a financial problem, it does serve to alert the supervising agency to expand the scope of its bank examination.

Further, these banks did not, as a group, improve at the same pace as domestic-controlled banks. Thus, when foreign-controlled and domestic-controlled banks which failed the same number of financial test areas in 1975 were compared in 1978, foreign-controlled banks displayed less of a tendency to improve than did domestic-controlled banks. We do not know at this time to what extent, if any, foreign control contributed to this disparity in results.

The slower rate of improvement for foreign banks does not negate the fact that foreign investors have acquired financially weak U.S. banks and improved them or have acquired financially strong U.S. banks and maintained them. The dominant share of foreign investors, like most domestic investors, buy banks for

legitimate business reasons, are reputable, and are a source of strength to the acquired banks.

FEDERAL REGULATORS HAVE DIFFICULTY ASSESSING THE QUALIFICATIONS OF FOREIGN INVESTORS IN U.S. BANKS

Federal and State banking regulators generally regulate and supervise foreign and foreign controlled banks the same as domestic banks. Domestic and foreign banks and individuals are subject to the same charter, examination, insurance, reporting, merger, and acquisition processes. However, banking regulators are not fully able to assess the qualifications of foreign applicants to purchase U.S. banks because they cannot always verify information submitted to them. When the foreign applicant is an overseas bank, the U.S. regulators cannot directly and independently examine it for financial strength because they lack the legal jurisdiction. When the foreign applicant is an individual, a lack of information generally inhibits the U.S. regulators' ability to independently verify the individual's character or business experience.

The difficulty of fully assessing foreign applicants is more readily apparent when foreign and domestic applicants are compared. Banking regulators can fully assess the strength of domestic bank applicants because they have onsite examination experience with them. However, the regulators must depend upon the financial data submitted to them by a foreign banking applicant, since they cannot legally make onsite

examinations. The applicant may appear strong on paper but actually be financially weak, as has actually occurred.

Banking regulators assess applicants' qualifications to purchase U.S. banks in order to ensure that the prospective owner can and will operate a safe and sound bank that serves its community. The difficulty in assessing and confirming information on foreign applicants hinders this review process. The regulators can also experience difficulty in recovering damages from foreign investors who harm U.S. banks. Thus, every effort must be made to insure that foreign investors will be a source of strength to the acquired banks.

Because of the inherent difficulties in verifying information provided by foreign applicants, we recommend that the Federal banking regulators

--contact the home country banking regulator to determine foreign individual acquirer's financial strength and reputation, and

--require that foreign banks and other businesses acquiring U.S. banks submit certified consolidated financial statements prepared in accordance with American Generally Accepted Accounting Principles.

When a foreign-controlled U.S. bank applies to merge with another U.S. bank, the Federal agencies have an opportunity to approve the merger contingent upon the foreign-controlled bank taking specific action to improve its current domestic operations. In the mergers we reviewed, the Federal regulators did not require the acquiring banks to alter undesirable

practices. Consequently, once the mergers are consummated, the unacceptable practices may reappear in the resulting bank. We believe the agencies should use the merger approval authority to help eliminate these practices.

We recommend that, in other than emergency situations, the Federal banking agencies require that action be initiated to correct major problems noted in bank examination reports of either bank as a condition for approval of any bank merger.

BASIC UNFAIRNESS IN DOMESTIC AND FOREIGN ACQUISITIONS OF U.S. BANKS PROMPTS NEED FOR MORATORIUM

U.S. acquisition laws, restrictions on interstate banking, and antitrust laws combine to give foreign banks an advantage over large U.S. banks when buying medium- to large-sized U.S. banks.

In a completely unrestricted economic environment, the list of potential purchasers for a U.S. bank would be open-ended: any person, group, or organization with enough money to make the purchase would be an eligible buyer. However, the United States does not allow unrestricted transfers of bank ownership. Various Federal and State laws shorten the list of potential buyers to the point that in some circumstances, possible buyers are limited to individuals, foreign banks, and foreign bank holding companies.

The issue of domestic versus foreign buyers of U.S. banks involves a basic conflict between existing U.S. policies. U.S.

policy is to allow relatively free foreign involvement in the U.S. economy, including banking. In many bank purchase circumstances, foreign banks have an unfair advantage over domestic banks. Yet, the laws and regulations which have caused the advantage are instruments of other U.S. policies.

There are several possible justifications for restricting foreign acquisitions of U.S. banks or limiting all foreign banking in the United States. A moratorium, ban, or limit could be justified if foreign control of U.S. bank assets was too high; if foreign owners of banks harmed the banks, and thus threatened the industry; or if existing regulatory and supervisory mechanisms were not sufficient to control foreign entry or activity. Given current policy guidance, we found none of the above factors should be of immediate concern and, therefore, they do not justify a moratorium or other action. We found only one reason to be compelling for a moratorium-- a basic unfairness stemming from uneven treatment of the potential domestic and foreign purchasers of U.S. banks.

U.S. law allows some foreign banks the opportunity to buy large domestic banks which U.S. banks are prevented from buying. Because this unfairness results from a conflict among various policies, it will take time to resolve. However, until the policy conflict is addressed, the unfairness should not be allowed to persist.

Therefore, we recommend that the Congress enact a moratorium on future foreign acquisitions of U.S. banks with total assets of $100 million or more. This moratorium should continue until the basic policy issues which have caused the unfair situation have been fully addressed. The moratorium should exclude foreign acquisitions necessary to prevent the bankruptcy or insolvency of domestic banks.

This moratorium should not continue indefinitely. The Congress should set an expiration date for the moratorium and a specific timetable for the actions it will take to address the policy issues. The moratorium should not be viewed as a long-term solution to the problem.

In making this recommendation, we recognize that the Congress may decide that the competitive disadvantages of U.S. banks are warranted by other considerations--but until the question of uneven treatment is posed and judged directly, this competitive disadvantage remains an unanticipated side effect of legislation framed for other purposes.

This concludes my prepared statement, Mr. Chairman. We will be happy to answer any questions you may have.