The Regulation of Foreign Banks in the United States

I. Introduction

It is a cardinal principle of United States policy that foreign companies operating in this country should be subject to the same rules and regulations which govern domestically owned companies. Foreign banks, however, because they are subject to disparate state and federal legislation, have come to enjoy certain competitive advantages and suffer some disadvantages relative to their domestic counterparts. With the recent emergence of foreign banks as a factor of importance in United States banking, these competitive inequalities have assumed greater importance. In the past eighteen months a number of proposals have been presented which would change the regulation of foreign banks; these different and frequently conflicting approaches to reform provide an appropriate opportunity to review the growth of foreign banking in the United States together with the range of regulatory, constitutional and monetary issues which this growth has created.

Foreign banks first established United States offices during the late nineteenth century. However, there was no significant amount of foreign banking activity in the United States until the 1920's. The most dramatic expansion of foreign banking has occurred since 1960. Recent estimates of United States assets of foreign banks approach $35 billion, representing approximately 4 1/2 percent of the $762 billion total assets held by domestic banks. Although 10 states presently authorize foreign banks to operate within their borders, most

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2J. Zwick, Joint Economic Committee, Paper No. 9, Foreign Banking in the United States, 89th Cong., 2d Sess., 1 (1966); Johnson, supra note 1, at 598.
3Hearings Before the Subcommittee on International Finance of the Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 2d Sess. (1974) [Hereinafter cited as 1974 Hearings]. Moreover, by the end of 1972, commercial and industrial loans extended to parties in the United States by foreign owned banking institutions amounted to approximately $7 billion, or 8% of such loans by large commercial banks.
foreign banking activity is concentrated in New York and California.

A number of factors are responsible for the expansion of foreign banking in the United States. Since foreign direct investment increased from $5.6 billion in 1965 to $113 billion in 1971, foreign banks responded to the expanded United States operations of their corporate clients by setting up offices here capable of providing a full range of banking and financial services. Another important reason for opening United States offices has been the need of foreign banks for dependable deposit bases of dollars to meet worldwide foreign exchange demands.

Further, New York offices have given foreign banks direct access to the New York money markets, particularly the market for call loans to securities dealers. This access permits foreign banks to engage in various arbitrage operations and other profitable financial transactions associated with the shift of funds from the Euromarket to New York. A United States office also facilitates the settlement on a daily basis of the parent bank's dollar transfers as well as those of its customers. One final motivation for the establishment of United States offices has been the access such offices afford to the United States securities markets. Acting through United States offices, foreign banks have been able to underwrite new domestic security issues and invest for their own accounts and those of clients. Additionally, through United States offices foreign banks may offer their clients the sort of asset-management and investment advisory services offered by United States banks and establish contact with major United States institutional investors.

The operations of domestic banks and the United States offices of foreign banks differ in significant respects. The principal sphere of activity of most foreign banks has been the financing of international trade. Because foreign banks engaged in international banking have difficulty in establishing a large stable dollar deposit base, they have generally relied on funds supplied from the home office, supplementing these resources by drawing on the United States money market. A large share of the resources of foreign banks are used to

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12BUS. WEEK, supra note 6.
13Klopstock, supra note 7 at 146.
14The daily volume of transfers involving foreign accounts in United States banks now exceeds $30 billion. Id., at 148. See generally, 1974 Hearings supra note 3.
15Zwick, supra note 2 at 16.
161974 Hearings, supra note 3.

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make commercial and industrial loans in the United States which account for approximately 40 percent of their assets, a substantially higher proportion than for domestic banks belonging to the Federal Reserve.13

Until recently foreign banks have preferred to concentrate on wholesale banking and trade financing. In New York and also California, however, a number of foreign banks have recently begun to move into retail banking, assisted by state laws which permit statewide branching.14 Foreign banks have tended to expand their retail operations by merging with or acquiring United States banks which already possess a number of retail branches. Examples of such expansion include the acquisition by Lloyds Bank of California's 94-branch First Western Bank, and the acquisition by Barclay's of the First Westchester National Bank with 18 retail offices. Antitrust enforcement efforts directed against domestic bank mergers have facilitated the entry of international banks into American markets.15

The expansion into retail banking has provoked the most heated opposition from small and medium sized independent banks who are facing increasingly aggressive competition from foreign banks bidding for consumer business.16

II. Organizational Forms Available to Foreign Banks

Foreign banks seeking to enter the United States banking market may choose among various forms, electing one or another depending upon the functions to be performed and the flexibility afforded by individual state law. Representative offices, subsidiaries, branches and agencies are the more important available forms, and each has a distinct set of characteristics.

A. Representative Offices

Foreign banks have regarded the representative office as the most flexible and least expensive means of entering a new banking market. Representative offices are not permitted to perform any banking functions, but serve merely as sales or service offices. In most states there is no regulation or supervision of representative offices on the grounds that they are not directly involved in banking functions; California, however, requires that representative offices obtain a license.17

13Id.
14Klopstock, supra note 7, at 145.
15Amer. Banker, January 16, 1974, at 1, col. 3.
17Johnson, supra note 1, at 602.
B. Subsidiaries

If a foreign bank intends to receive deposits subject to withdrawal it must establish either a subsidiary or a branch.\(^1\) Although most foreign banks prefer to establish branches because they are structurally less complicated than subsidiaries, a subsidiary may provide the only alternative for a foreign bank which desires to engage in a broad range of banking activities where branching is prohibited.\(^19\) Banking subsidiaries may be chartered either under state law or federal law, but since federal charters require that directors be United States nationals, foreign banks have uniformly elected to operate under less restrictive state charters. Although three states have issued charters to foreign banking subsidiaries,\(^20\) most have been formed in New York where they are primarily engaged in performing corporate trust work.\(^21\)

C. Branches

Branch banks provide a full range of trade financing facilities including letters of credit, discounts, acceptances, collections, foreign exchange transfers of funds, and remittances. Additionally, branches actively engage in fund investments, commercial and personal lending and the solicitation of deposits.\(^22\) In general, a branch affords the broadest range of permissible banking activities of all forms, and foreign branches are offered banking privileges virtually identical to those of domestic banks.\(^23\) They are also subject to a number of the same restrictions which apply to domestic banks and are required to maintain the same fractional reserves against deposits, to abide by the same restrictions and limitations regarding loans, and to comply with the same rate ceilings on deposits and loan charges.\(^24\) Branches have the additional significant advantage that their loan limit is a function of the capital position of the parent bank, while that of a subsidiary is a function of its own capital.\(^25\)

D. Agencies

Although agencies are prohibited from receiving deposits subject to withdrawal, their activities are even more varied and complex than those of foreign

\(^1\)Zwick, supra note 2, at 5.
\(^19\)For example, foreign branches cannot receive FDIC insurance, and therefore are prevented from accepting deposits under California law. But since subsidiaries are eligible for FDIC insurance, foreign banks wishing to conduct retail activities in California have favored the use of this banking form. However, under a 1969 California statute, branches may accept deposits from overseas sources if authorized to do so by the State Department of Banking. Several branches have received such authorization. Klopstock, supra note 7, at 141.
\(^20\)1974 Hearings, supra note 3.
\(^1\)Johnson, supra note 1, at 607.
\(^2\)Zwick, supra note 1, at 607.
\(^2\)Id., at 7.
\(^2\)Id.
\(^2\)Klopstock, supra note 7, at 141.
branches. Most agencies are active in financing trade between the United States and the home country, and are able to issue letters of credit, to buy, sell, pay and collect bills of exchange in connection with United States-foreign trade, and to handle the dollar balances and administer the dollar needs of their head office and its branches. Agencies account for more than half of the assets of all foreign banking offices in the United States. Because they can neither accept local deposits nor sell certificates of deposits, they rely heavily on interbank (federal funds) borrowing and borrowing from directly related institutions abroad (Eurodollars). These sources account for a total of 75 percent of their funds, which are employed in money market loans and commercial and industrial loans often related to international transactions. In New York State an election must be made between a branch and an agency, since foreign banks are not permitted to operate both instrumentalities. However, although establishment of a branch precludes operating an agency, a foreign bank is permitted to operate both an agency and a subsidiary; and a number of foreign banks have apparently concluded that the freedom from restrictions which agencies enjoy, coupled with the authority to receive deposits in affiliated subsidiaries, is preferable to operating through branches. Canadian and Japanese banks both appear to favor the use of agencies in New York.

III. United States Regulatory Scheme

In general, federal law neither provides for nor prohibits foreign banking operations in the United States, and the entry of foreign banks is governed almost exclusively by state laws and regulations. With every state adopting its own regulations, highly permissive and highly restrictive climates for foreign banking may exist in neighboring states. Each of the ten states which presently permits some form of foreign banking has its own distinct set of requirements which must be satisfied. This has been confusing to many banks desiring to establish facilities in the United States; they see the American regulatory pattern as less than ideal and cannot understand why the federal government leaves to the states the politically and economically important areas of foreign bank entry, expansion and supervision. Moreover, the present pattern has significant implications for the reciprocal rights of American banks attempting to expand overseas. Many foreign countries demand reciprocal treatment for their banking institutions before they will allow a foreign branch within their

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26Zwick, supra note 2, at 7.
271974 Hearings, supra note 3.
29Id.
30Zwick, supra note 2, at 7.
31Klopstock, supra note 7, at 154.
33Lehr, supra note 5, at 956.
borders. This means that American banks in states with liberal banking laws have greater opportunities abroad than banks from states which do not permit foreign branch banking.

A. State Regulation

At least ten states presently authorize foreign banks to conduct business within their borders: Alaska, California, Georgia, Hawaii, Illinois, Massachusetts, Missouri, New York, Oregon, and Washington. Ten states specifically prohibit foreign banks from operating within their borders: Florida, Maine, Maryland, Minnesota, New Jersey, Ohio, Rhode Island, Texas, Virginia, and West Virginia. With the exception of New Jersey, the statutes appear to be directed at banks chartered in other states, and not against banks from foreign countries. The remaining states have no laws which specifically deal with foreign banks. Where a state does not expressly permit the entry of foreign banks and the state law is otherwise silent, it may be assumed that no foreign branch banking will be permitted, although certain other limited forms of banking may be allowed.

Although state enabling statutes vary greatly with respect to comprehensiveness, they are generally specific with respect to the type of office permitted, the necessity for insurance, license periods, required reserves, and asset and capital requirements.

In reviewing state laws regarding foreign banks, certain patterns are discernible. The two most important centers of banking activity, California and New York, have been extremely liberal in allowing foreign banks to operate through various flexible banking forms, and to function within the state in much the

33See generally, Alaska Stat. § 06.05.367; § 06.05.360; 06.10.010-06.10.050 (1960).
40See generally, N.Y. Banking Law § 200-209 (McKinney 1971).
41See generally, Ore, Rev. Stat. § 706.070; §§ 708.005-708.060; §§ 713.010-713.110 (1953).
50Tex. Const. art. 16, § 16.
same way as domestic banks. In both states, however, officials from the smaller banks have argued with increasing force for tighter regulation of foreign banks and more restrictions on the activities in which foreign banks are permitted to engage. The large international banks have been successful, thus far, in preventing the adoption of such restrictions by stressing the likelihood of retaliatory action abroad. However, in the last year or two there have been indications of a growing protectionist spirit which may curb the largely unfettered expansion of foreign banks in California and New York. Two bills introduced in the California legislature in the summer of 1973 would have conditioned further foreign bank expansion on reciprocal treatment of California banks abroad. Although these measures were defeated, they attracted considerable support in the state legislature. In New York, the state banking authority refused to permit the acquisition by Barclay's New York subsidiary of the Long Island Trust Company, with $508 million in assets, because it would have given the British bank too large a deposit base in the New York City area. These two incidents suggest that both New York and California may have begun to move gradually away from their historically permissive banking climates.

Many other other states appear willing to permit foreign banks to operate within their borders so long as such banks do not compete with the state's retail banks. This may be accomplished by preventing foreign banks from accepting deposits, or more indirectly by restricting foreign banks to activities related to international trade, or by limiting foreign banks to a single office.

It is generally recognized that foreign banking can add new resources and capabilities to the banking and financial community, particularly in areas related to international trade and foreign investment within the state. With this in mind, state legislatures appear to be trying to create regulatory schemes which encourage foreign banks to operate in those areas which complement but do not compete directly with the existing activities of domestic banks.

B. Federal Regulation

Although the entry and regulation of foreign bank branches and agencies are matters of state discretion, the federal government does have some limited

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12Allen, supra Note 16.
14Alaska, Georgia, Hawaii, Missouri and Oregon are among the states which permit foreign banking but prohibit the acceptance of deposits by foreign banks.
15Under a new statute Washington permits foreign banks to conduct certain limited banking activities where reciprocal banking privileges are extended to Washington banks by the foreign country under whose laws the foreign bank is chartered. The new statute appears to limit foreign banking activity to business related to international trade. See generally, Wash. Legislative Service, supplementing WASH. REV. CODE ANN. ch. 53, §§ 1-38 (1973).
16Under a recent comprehensive Illinois statute, foreign banks are permitted to establish a branch office in Illinois empowered to conduct a general banking business, but only with the central business district of Chicago. See generally, ILL. REV. STAT. ch. 16-1/2 §§ 501-19 (1972).
jurisdiction over the subsidiaries of foreign banks. Subsidiaries may elect to be chartered under state or federal law; if a subsidiary opts for a national charter it automatically receives FDIC insurance and therefore becomes a member of the Federal Reserve system, subject to regulation by the Comptroller of the Currency. Foreign banks wishing to conduct retail business in California have favored the use of federally chartered subsidiaries, as have foreign banks performing trust functions in New York, and in this way they have become subject to limited federal supervision.

Another way in which federal agencies have achieved a means of control over foreign banks is through the Bank Holding Company Act, which requires all bank holding companies, whether domestic or foreign, to register if they own or control one or more domestically chartered banks. Under the 1970 Amendments to the Bank Holding Company Act, holding companies, including foreign holding companies, are prohibited from operating banking subsidiaries in more than one state unless these operations were in existence prior to 1956. Five foreign-owned banks with multi-state operations qualify under this grandfather clause, but others are able to circumvent the interstate branching restrictions by a complex mechanism which permits foreign bank holding companies to operate through an inter-state network of affiliates. This cannot be duplicated by domestic banks, and so it appears that, in the single area where foreign banks have been subject to direct federal regulation, this regulation has enabled them to seize advantages not available to domestic banks.

It should be pointed out that despite the inability of federal agencies to regulate foreign banking directly, the foreign banks have complied voluntarily whenever their cooperation was requested. For example, in June, 1973, the Federal Reserve Board introduced marginal reserve requirements for large certificates of deposit issued by member banks. When the Board asked foreign-owned banks to also maintain reserve deposits against increases in large certificates of deposit, they complied. This is characteristic of the way in which the Federal Reserve System is able to regulate foreign banking activities by "moral suasion"; foreign banks have thus far been willing to cooperate in order to forestall any more formal efforts at federal supervision.

60 Bank of Montreal, Barclays Bank, Bank of Tokyo, Canadian Imperial Bank of Commerce, and the Toronto Dominion Bank.
62 1974 Hearings, supra note 3.
IV. Problems Associated With Foreign Bank Expansion

The rapid expansion of foreign banks in the United States and their emergence as a competitive force here has focused attention on a number of problems in the regulatory framework within which foreign banks must operate. It is clear that foreign banks do enjoy certain advantages over domestic banks because of the way in which they are regulated. However, they also operate under certain restrictions which do not apply to United States banks. These competitive inequalities, which have increased in significance as the scope of foreign banking has expanded, have been sharply criticized by many United States bankers. In addition to these regulatory inequities, the expansion of foreign banking also has some significant foreign and monetary policy implications. Gradually there has been a recognition that the regulation of foreign banks should be modified to minimize present competitive inequalities and to insure that the regulatory scheme properly reflects broad national policies and goals. Regulatory reform was attempted in 1966, 1967 and 1969 without success, but a new set of legislative measures is now under active consideration. Before discussing them it is first necessary to understand the types of problems and issues to which these proposals for legislative reform are addressed.

A. Competitive Inequalities

George Mitchell, Vice Chairman of the Federal Reserve System Board of Governors, recently reaffirmed the principle that foreign companies operating in the United States should be subject to the same rules and regulations governing domestically-owned companies. He stated that with respect to both entry and activities, comparable foreign and domestic banks should be given equivalent treatment. The Comptroller of the Currency, James E. Smith, also spoke out last year on the need for a non-discriminatory national banking policy which would treat foreign and domestic banks alike, and which would eliminate the present branch advantages enjoyed by overseas banking institutions.

The ability to establish branches in more than one state is in fact the most significant advantage which foreign banks have over domestic banks. United States banks may not branch outside their own state and domestic holding companies may not acquire a bank outside the state of its principal bank. Although United States banks may operate across state lines in a very limited sense through the use of representative offices or Edge Act subsidiaries, they are clearly unable to match the geographic flexibility of foreign banks.

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7Amer. Banker, February 8, 1974 at 1, col. 3.
Foreign banks are also in an advantageous position because they are not subject to the provisions of the Bank Holding Company Act. As a result, foreign branch banks may engage in a wide range of non-banking activities which are prohibited to United States banks. Most importantly, foreign banks are entering the securities markets and finding ways to combine brokerage or investment business with commercial banking—either directly, by having a branch operate a brokerage or investment banking department, or indirectly, by a foreign parent which creates both a domestic branch and a brokerage or investment banking subsidiary. Under the Bank Holding Company Act, these approaches are prohibited to domestic banks since they violate the spirit of the Glass Steagall Act, not applicable to foreign banks.

United States banks are prohibited from investing in securities affiliates both by the Glass Steagall Act, which applies to all Federal Reserve System member banks, and by Regulation Y of the Bank Holding Company Act which generally excludes bank holding companies from the non-banking activities of investment banking and also precludes significant investment in brokerage firms or companies engaged in securities underwriting. Thus, whereas United States banks are unable to offer brokerage or underwriting services, foreign banks have an increasing number of United States affiliates actively engaged in the securities business, in some cases as underwriters for new issues. Several affiliates of foreign banks have also become members of regional stock exchanges in the United States. Although the brokerage and underwriting activities of foreign banks are not yet significant in terms of business volume, they do represent another competitive advantage of growing importance to foreign banks.

Yet another advantage enjoyed by foreign banks stems from the fact that they are exempt from certain federal regulations governing insurance, interest rates and reserves. Depending on the state, foreign banks may operate under lower reserve requirements than United States banks, which lowers the cost of lendable funds. Also, it appears that in some states foreign banks may invest their reserves in interest-bearing securities, a privilege denied to members of the Federal Reserve System.

In addition to these foreign bank advantages, there are several statutory disadvantages which should be noted. As mentioned, disparate state regulatory schemes require foreign banks to comply with a complex set of overlapping and often conflicting regulations. Further, the inability to secure FDIC coverage

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51974 Hearings, supra, note 4.
may discourage depositors from banking at foreign branches since the risk of failure is not fully covered. Also, because they are not members of the Federal Reserve System, foreign banks do not have access to the discount window, and their long-term deposits are subject to the interest equalization tax.\[^6\]

It is clear that the present regulatory framework which treats foreign and domestic banks differently results in some significant advantages accruing to foreign banks, as well as some less important disadvantages. This competitive inequality argues strongly for regulatory reform which would provide similar treatment to foreign and domestic banks, consistent with a policy of non-discrimination. Moreover, the regulation of foreign banks by our dual banking system has led to certain other more general problems which also call for structural reform.

B. Impact of Foreign Banks on Monetary Policy

The rapid expansion of foreign banking activity in the United States has the potential for frustrating domestic as well as international monetary policies. Because of the absence of any direct control over foreign bank reserves, foreign bank offices in the United States can shift funds in and out of the country using overseas sources which are unresponsive to United States policies. Vice Chairman Mitchell of the Federal Reserve Board recently stated that: "There has been greater movement of funds internationally, creating some problems in implementing U.S. monetary policy."\[^6\]

In at least one respect, foreign banks have had a positive impact on that policy. Foreign banking activity has exerted a favorable influence on the United States balance of payments in several ways. First, the initial capital invested by foreign banks to establish offices, coupled with subsequent advances to American affiliates, represents a net inflow of capital. Secondly, deposits made by foreigners in United States offices of foreign banks have generally exceeded the volume of foreign loans made by these institutions, and to this extent our payments deficit has been reduced. Also, the American payments position has been improved by the ability of United States offices of foreign banks to induce foreign dollar holders to convert liquid dollar holdings into non-liquid investments. Lastly, those foreign banks which have played a major role in trade financing have contributed to improving our trade balances.\[^7\]

Although it is difficult to quantify the net effect of foreign banking on this nation's balance of payments because of a lack of published data, there appears to be a consensus among authorities that the expansion of foreign banks has had a positive, if uncontrolled, impact.

\[^6\]1974 Hearings, supra note 3.
\[^7\]Id.
C. Reciprocity

As has already been mentioned, some United States banks have encountered difficulty in expanding overseas because of state laws relating to foreign bank entry. California banks, for example, have been handicapped by their state’s attitude toward foreign branch banking, as were a number of Illinois banks prior to the recent statutory changes.71 The present United States system of regulating foreign banks, critics argue, discriminates against banks from certain states and also raises the possibility of retaliatory restrictions by foreign countries.

Also, it may reasonably be asked whether it is appropriate for state legislatures to retain discretion over an issue of such national concern. Moreover, state regulation of foreign banking may represent an unconstitutional intrusion by the states into the field of foreign relations. But before examining the Constitutional issue, it is worth considering how foreign governments have dealt with the question of foreign bank entry and reciprocity.

Most countries lack specific legislation governing the entry of foreign banks; restrictions on entry are generally imposed by discretionary policy of the government or the particular agencies charged with bank regulation and supervision.72 Where legislation does exist, as in Sweden, Mexico, Australia and Canada, it usually prohibits the establishment of foreign banking corporations, either by making ownership of facilities illegal (as in Sweden and Mexico), or by sharply limiting the domestic activities of foreign banks (as in Australia).73

In the absence of such legislation, foreign authorities have generally permitted United States banks to operate abroad in much the same manner as indigenous banks. Reserve requirements, loan restrictions, interest and capital ceilings and branching restrictions are in most cases the same for both foreign and domestic banks. The one area where the activities of foreign banks are occasionally circumscribed is the acceptance of deposits. A few countries confine overseas banking to agency operations and permit no acceptance of deposits at all, but the more characteristic restriction simply precludes the acceptance of savings deposits.

Brazil and Japan are among the few foreign countries which require a demonstration of reciprocity on the part of the applicant’s home country. Domicile in a state which permits foreign banking has been held to satisfy the foreign reciprocity demand for American banking applicants, but a number of issues are yet unresolved. It is unclear, for example, whether and to what extent re-

71Lehr, supra note 5, at 956.
73Id.
strictions placed upon operating practices but not on entry weaken an assertion that reciprocal treatment is being afforded. Also, where the national government is prepared to accept a foreign bank but local government agencies limit the ability of the bank to conduct operations, it is unclear whether reciprocal treatment is being extended. Identical treatment may not be necessary for reciprocity to exist, but there is considerable uncertainty as to the degree of dissimilarity which may occur.

Even though foreign restraints on foreign banking per se are uncommon, a number of countries indirectly control the form of foreign banking organizations which may be permitted within their borders. For example, Brazil and Japan have virtually precluded the use of branches by American banks, although in most other countries including France, Germany, the United Kingdom, Belgium and the Netherlands, branches are no more difficult to operate than any other banking form. In some countries which do not discriminate against particular banking forms, there are nevertheless limits placed on the total number of banking licenses which can be issued. Foreign banks seeking entry may therefore have to purchase an existing bank where this is permitted, or possibly a dormant banking license with the prospect of converting it to a direct branch. Finally, a few countries attempt to restrict foreign banks to activities more or less directly related to international trade and the servicing of multinational corporations.

Japan has been one of the most conservative foreign countries in permitting foreign banks to enter. Only about ten foreign banks a year have been allowed to open branches apparently because of a fear of domestic overbanking and lingering concern over the large-scale banking collapse of the 1930's. Japan has further limited the expansion of foreign banking within Japan by stipulating that the deposits of all the branches of foreign banks within Japan cannot exceed 1 percent of deposits held by domestic banks.

Despite the fact that foreign countries have occasionally discouraged foreign banks from using certain organizational forms, limited the number of entering banks, or restricted their activities to foreign trade financing, in general the pattern has been to subject the activities of foreign banks to the same banking regulations which are applied to indigenous banks. In considering modifications to the American regulatory scheme which would increase the differentiation between foreign and domestic banks by further circumscribing the

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7Id., at 25.
10Id. The number of foreign banks with branches or representative offices in Japan has increased from 13 in 1960, to 18 in 1970, and 41 by the end of 1973. The number of representative offices was 67 by 1974 and this number appears to be increasing by roughly two per month.
activities of foreign banks or subjecting them to additional requirements or
distinct standards, it should be kept in mind that such proposals might cause
foreign countries to review their essentially nondiscriminatory policies and
adopt a more restrictive posture with respect to American banking activities.

D. Constitutionality of State Statutes

A broader question concerns the desirability of vesting in the states collective
discretion for determining our national policy with respect to foreign banking.
The ability of states to adopt widely varying, independent policies with regard
to the entry and regulation of foreign financial institutions inhibits the orderly
formulation of coherent national policies. This general argument for increasing
the degree of federal control over foreign banks is strengthened by some strong
constitutional arguments which suggest that foreign banking is not an ap-
propriate subject of state control, but rather should be within the exclusive
province of the federal government.

These constitutional arguments are grounded primarily in the Commerce
Clause, which expressly confers on Congress the "power to regulate commerce
with foreign Nations, and among the several States," and also in an implied
constitutional limitation barring state impingement on the federal domain of
foreign relations.

1. IMPACT ON INTERSTATE AND FOREIGN COMMERCE

The affirmative delegation of power to the federal government under the
Commerce Clause of the First Amendment is reinforced by prohibition to the
states. The extent to which the Commerce Clause prohibits state action, how-
ever, is not clear. An early standard was laid down in Cooley v. Board of
Wardens which attempted to distinguish between areas where state regulation
would be tolerated and areas where state action is excluded. The court stated,
"whatever subjects of this power are in their nature national, or admit of only
one uniform system, or plan of regulation, may justly be said to be of such a
nature as to require exclusive legislation by Congress." This test has been
difficult to apply, however, because few subjects are so inherently national or
so wholly local in character as to provide an effective basis for distinction.

Two subsequent tests have attempted to provide more workable standards,
although the relationship between the two remains somewhat unclear. In
Southern Pacific Co. v. Arizona ex rel. Sullivan the court stated that, "Recon-
ciliation of the conflicting claims of state and national power is to be at-

"U.S. Const. art. I, § 3.
\(7\) Henkin, Foreign Affairs and the Constitution, 235 (1972).
\(^8\) 53 U.S. (12 How.) 298 (1851).
\(^9\) 53 U.S. (12 How.) at 319.
\(^10\) 325 U.S. 761 (1945).
tained only by some appraisal and accommodation of the competing demands of the state and national interests involved. This formula has, like the Cooley standard, proved easier to mandate than to apply; and in some cases courts have relied on a second, distinct test: whether the state burden on commerce is "unreasonable" or "undue," irrespective of its impact on local interests. Under both tests, the courts have refused to sustain state regulations which exclude or overly discriminate against foreign commerce. State legislation grounded in non-economic, local interests has been more favorably received, but even here regulations have been struck down if less burdensome means of achieving their objectives are found to exist. It would seem, then, that state statutes regulating foreign banking are at least arguably unconstitutional. Under Southern Pacific, such regulation will only be upheld "provided it does not materially restrict the free flow of commerce across state lines, or interfere with . . . matters with respect to which uniformity of regulation is of predominant national concern." Restrictive state regulation of foreign banking both materially restricts interstate commercial flows and effectively precludes the development of a coherent national policy in an area in which there is increasing need for a single set of uniform regulations. The same conclusion is reached by evaluating the extent of the burden placed on interstate commerce by restrictive state statutes. Moreover, regardless of the magnitude of the burden on commerce, it has been repeatedly held that states may not pass laws where the objective of such legislation is to insulate state enterprises from the effects of out-of-state competition. The argument that the limitation of competition would contribute to safety and conservation and therefore indirectly serve an end permissible to the state was rejected in Buck v. Kuykendall and in H.P. Hood & Sons v. Du Mond. States may not protect their domestic banking industry by excluding foreign banks completely or discriminating against them in certain ways; thus, existing state statutes, by barring or restricting foreign banking, attempt to promote local economic advantages by interfering with the free flow of interstate commerce in a way which may be found to violate the Commerce Clause.

2. FOREIGN POLICY IMPLICATIONS

The conclusion that foreign banking is more appropriately regulated by the federal government finds support particularly where state regulation...
impinges on the foreign policy and foreign relations of the United States. Although the Constitution does not expressly delegate the power to conduct foreign relations to the federal government, a new constitutional doctrine has emerged under *Zschernig v. Miller* which invests the President and the Congress with primacy in the field of foreign relations. Until 1968 no such principle had been recognized, and although some state statutes were struck down for violating the 14th amendment, or because they were inconsistent with federal policy as expressed in a treaty, statute, executive act or judicial decision, it had not been suggested that such statutes might violate an implied constitutional prohibition barring state impingement on the federal domain of foreign relations, even in the absence of federal legislation. In fact, the court expressly rejected such a theory in *Clark v. Allen*, where it upheld a California statute allowing an alien to inherit in the state only if his country permitted Americans to inherit. The court stated that "what California has done will have some incidental or indirect effect on foreign countries. But that is true of many state laws. . . ." Under *Clark*, some affirmative federal action was required, before the court could determine whether a state had eclipsed the permissible sphere of activity involving foreign affairs.

*Zschernig v. Miller*, decided on facts similar to those in *Clark*, has significantly reduced the relevance of *Clark* without expressly overruling it. *Zschernig* involved an Oregon state statute under which the Oregon courts had denied an inheritance to an East German resident because he could not satisfy the courts that his country allowed Americans to inherit estates in East Germany. Notwithstanding a brief *amicus curiae* filed by the State Department which stated that the federal government was not contending that the Oregon escheat statute unduly interfered with the United States' conduct of foreign policy, the court held that the statutory demand for reciprocity was "an intrusion by the states into the field of foreign affairs which the Constitution entrusts to the President and Congress." The court acknowledged the direct effect of reciprocity and retention statutes upon foreign relations and held that an Oregon probate statute, as applied, represented an invalid invasion by the state into an area reserved for the federal government. Speaking for the majority, Justice Douglas stated that the present Oregon Law, "Has a direct impact upon foreign relations and may well adversely affect the power of the central government to deal with those problems." By failing to overrule *Clark*,

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*389 U.S. 429 (1968).*

*HENKEN, supra note 79, at 238.*

*331 U.S. 503 (1947).*

*331 U.S. at 517.*

*Johnson, supra note 1, at 616.*

*389 U.S. at 432.*

*Note, Reciprocity and Retention Statutes—A New Direction, 22 Rutgers L.R. 770 (1968).*

*389 U.S. at 440-441.*
however, the court in Zschernig implicitly adopted the three tests articulated in Clark without indicating their relative importance. The tests are: (1) whether the state action displays an “improper purpose” to influence foreign affairs; (2) whether the state action actually interferes with federal foreign policy; and (3) whether U.S. foreign relations have been affected adversely.

Under Zschernig and the cases construing it, so long as state courts do no more than routinely read foreign laws in applying reciprocity statutes, their decisions will be constitutional. Where the courts go further and construe statutes in such a way as to create an impact on foreign relations, their decisions will be struck down as unconstitutional. That is, Zschernig proscribes only statutes requiring some criticism of foreign governments by state courts or legislatures. So a state statute which permits foreign banking on a showing of reciprocal banking privileges granted American banks without requiring the state judge or legislature to qualitatively assess the foreign government, might be upheld. But state statutes regulating foreign bank entry do not operate in such a passive way. Rather, a principal statutory objective is to induce foreign governments to grant reciprocal rights to United States banks, and possibly also to provide a mechanism for excluding the banks of those nations with whom the U.S. does not enjoy friendly relations. Thus, state statutes regulating the entry and activities of overseas banks could certainly have the effect of increasing tensions between the United States and other nations and so be held unconstitutional under Zschernig. An example may help illustrate how a conflicting pattern of state regulation in the area of foreign banking would adversely affect the conduct of foreign policy. The development of economic relations with the Soviet Union is an important secondary aspect of detente; the Soviet desire for foreign trade, technology and investment from abroad is at least partly responsible for that country’s interest in reducing international tensions. Presumably the United States will support a gradual and controlled development of economic relations with the Soviet Union. Such developments might very well call for the extension of reciprocal banking privileges, with the timing and nature of the privileges to be determined in accordance with larger economic and foreign policy objectives. Such a program assumes the ability of

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*Some commentators, however, have argued that all reciprocity statutes are suspect, including those which involve no judgment or qualitative assessment of other foreign governments. It is argued that reciprocity statutes are infected with foreign policy judgments and in view of the delicate considerations involved, the danger that foreign governments would take offense, and the disruptive effect of different state statutes, reciprocity statutes represent unconstitutional incursions into the prerogatives of the Executive and Congress. The Supreme Court, 1967 Term, 82 Harv. L. Rev. 238 (1968).
the President and Congress to confer and coordinate banking privileges on the basis of national policy considerations. Viewed in this light it becomes apparent that the national interest would conflict with state discretion over the regulation of foreign banking.

The conclusion which might be inferred from Zschernig that state regulation of foreign banking is an intrusion into an area reserved for the federal government is supported by two approaches formulated by the Supreme Court prior to Zschernig—and which presumably survive, at least to the extent that Clark survives.

Under the first approach, the states were prohibited from exercising any law-making power that interfered with an established policy being actively carried out by the United States. And under the second approach, the state could not act so as to have a possibly adverse effect on United States foreign relations.\footnote{Johnson, \textit{supra} note 1, at 618.}

Under the first approach, the Supreme Court has invalidated state and municipal statutes affecting interstate commerce where the court considered them inconsistent with federal policy or federal objective.\footnote{See, e.g. California v. Zook, 336 U.S. 725 (1949).} If a national policy in the field of interstate commerce may be thwarted by state and local interference, the court has found that such regulation would have to give way; however, state laws are only to be invalidated if their enforcement would significantly hinder an obvious congressional policy.\footnote{C. \text{Antieau}, \textbf{Modern Constitutional Law} \S 10.23, at 46 (1969).} By this standard, state regulations restricting foreign bank activities or excluding foreign banks altogether would at least arguably be held unconstitutional insofar as such laws or regulations would frustrate the improvement of foreign trade and direct foreign investment, impede the favorable balance of payments effect associated with the expansion of foreign banks in the United States, and interfere with the application of federal monetary controls.

Under the second approach, a state statute restricting the entry of foreign banks would be unconstitutional to the extent that such a law has a potentially adverse effect on foreign relations. Admittedly, such a statute would not irreparably cripple United States foreign policy; but the likelihood of increasing tensions or triggering retaliatory measures is significant. Moreover, it is the federal government with whom complaints will be registered by aggrieved foreign governments, and unless the states are preempted, the federal government will be unable to respond to such complaints. Thus, under both these pre-Zschernig approaches the constitutionality of state regulation of foreign banks is called into question.
A third, more recent methodology reinforces the conclusion that foreign banking should be regulated exclusively by the federal government. This analytical approach assumes that the "principal determination on which cases should turn is whether the matter is best decided by a national rather than a state decision maker." Three factors are considered under this approach: whether the state's constituency provides an appropriate political context in which to make the policy judgment; whether the state has the necessary information to reach an informed judgment; and whether potentially adverse effects will be suffered by the state or the nation. Applying each of these criteria, it appears evident that foreign banking in the United States is most appropriately regulated at the federal level.

3. CONTRAVENTION OF UNITED STATES TREATIES

A separate and distinct constitutional issue is whether state statutes which regulate foreign banking contravene certain United States treaty provisions. The national treatment clause of a post World War II Friendship, Commerce and Navigation Treaty with the Netherlands provides that:

1. Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other activity . . . within the territories of the other Party . . . Accordingly, such nationals and companies shall be permitted within such territories . . . to establish and maintain branches, agencies . . . and other establishments. . . .
2. Each Party reserves the right to limit the extent to which aliens may within its territories establish . . . or carry on enterprises engaged in . . . banking involving depository or fiduciary functions. . . .

Under this treaty it would appear that Dutch banks not accepting deposits or carrying out fiduciary functions must be accorded national treatment; to the extent that state statutes grant such banks less than national treatment they will be struck down since treaties will supersede inconsistent state law.

Although the National Treatment clauses of other FCN treaties differ, the provisions cited are sufficiently characteristic as to call into question the validity of restrictive state legislation under which foreign and comparable domestic banks are accorded dissimilar treatment.

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105 Henken, supra note 79, at 166. See, e.g. Asakura v. Seattle, 265 U.S. 332 (1924), which held that treaty provisions "Cannot be rendered nugatory in any part of the United States by municipal ordinances or state laws." 265 U.S. at 341.
V. Proposals for Regulatory Reform

The preceding discussion has identified many of the problems and issues associated with the expansion of foreign banking in the United States, and has presented a number of arguments for modifying the present regulatory scheme to increase the power and authority vested in the federal government. At the present time there are several congressional proposals being actively debated which would increase the extent of federal supervision over foreign banking. A significant New York state legislative proposal which was recently considered would have addressed some of the problems of foreign banking without conceding state regulatory authority. Finally, the Federal Reserve System has recently introduced legislation which would substantially alter the regulation of foreign banking, consolidating principal regulating authority in the Federal Reserve. Before considering these proposals, several earlier attempts to achieve legislative reform will be reviewed.

A. Early Reform Efforts

The first thorough study of foreign banking in the United States was conducted in 1966 by Dr. Jack Zwick of Columbia University for the Joint Economic Committee and other Members of the Congress. As a result of the study and its recommendations, three bills were introduced in the 90th Congress to bring foreign banks operating in the United States under some greater degree of federal supervision by Congressman Fino of New York, Wright Patman of the House Banking and Currency Committee and Senator Javits. The bills each attempted to deal with the principal issues arising under a federal scheme of regulation, including federal supervision of entry, designation of a federal agency to exercise principal regulatory authority, handling of deposit insurance, reciprocal treatment by foreign countries, and the question of whether a national interest determination should be made prior to allowing a foreign bank to commence operations in the United States.

All three bills would have permitted foreign banks to enter the United States, but the bills varied in the scope of activity allowed to such banks. They also took different approaches with respect to deposit insurance and the standard to be used in determining which foreign banks were to be chartered.

Although the bills stimulated vigorous debate on the subject of foreign banking, there was substantial opposition to all three legislative proposals and none of them ever left Committee. In 1969 Chairman Wright Patman again introduced legislation which would have placed controls on foreign banking

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activities in the United States. The bill received no Administration support, was condemned by the major bankers' trade association\textsuperscript{107} and suffered the same fate as its predecessor.

In 1972 there was renewed interest in improving the supervision of foreign banks and the Federal Reserve System established a Steering Committee consisting of three Board members and three Reserve Bank Presidents to analyze the foreign activities of United States banks and the United States activities of foreign-owned banking institutions. The Committee, headed by Vice Chairman Mitchell, was also charged with responsibility for considering changes in the regulatory framework and in March, 1974 draft legislation was circulated informally. In December, 1974 the Federal Reserve Board sent to Congress the proposed Foreign Bank Act of 1974; when this failed to get considered before the end of the session, the Federal Reserve Board resubmitted the legislation with slight modification in March of this year. At the same time the Federal Reserve proposals were being circulated, informally, two different bills were introduced in the 93rd Congress. Also, a Commission appointed by the New York Superintendent of Banking released a report containing concrete legislative proposals in March of 1974.\textsuperscript{108} Each of these legislative proposals represented quite distinct and essentially conflicting approaches to regulatory reform.

\textbf{B. Significant Congressional Proposals}

Comprehensive foreign bank legislation was submitted in the 93rd Congress by Representative Patman,\textsuperscript{109} Representative Dent\textsuperscript{110} and Representative Rees of California.\textsuperscript{111} No action was taken before the Congress adjourned, and the bills have not been resubmitted in the 94th Congress. Congressman Rees has, however, circulated proposed legislation and indicated that he intends to reintroduce a bill in 1975 after comments on his draft have been received and analyzed.\textsuperscript{112} The Rees proposal is generally more restrictive than the Federal Reserve recommendations and is intended to place foreign bank operations in the United States under tight federal regulation, imposing on them the same rules and regulations applicable to domestic banks. The Rees proposal would restrict retail banking business of foreign banks in certain respects but would permit foreign banks with branches in more than one state to continue to

\textsuperscript{107}The American Bankers Association.
\textsuperscript{112}AMER. BANKER, June 6, 1975, at 6.
operate them if they were established by December 3, 1974, the cutoff date of the grandfather provision contained in the Federal Reserve bill. However, a foreign bank intending to retain its branches in more than one state would be required to convert all branches to federally licensed branches within one year. Further, foreign banks would be allowed to enter only those states where they could operate under state law. And, they would be given a certain period to eliminate or substantially curtail their non-banking activities.

Because his approach to reform would significantly restrict the operating flexibility presently available to foreign banks, there has been considerable criticism of the Rees proposal. The Chairman of the Federal Reserve Board has attacked the Rees proposal, as have spokesmen for state banking authorities. Mr. Harry Albright, New York Superintendent of Banking, has sharply criticized the Rees approach because of the deepseated protectionist attitude it reflects and because it applies "extravagant, disruptive and self-defeating solutions" to the relatively narrow complaints directed against foreign banks.\(^\text{11}\)

Concern has been expressed that the Rees approach would invite foreign nations to retaliate by limiting United States banks geographically. The Common Market, for example, might limit U.S. banks to a single country within the Market, forcing them to divest their assets in other countries. United States overseas banking assets, now worth over $100 million or more than four times as much as foreign banking assets in this country, would be extremely vulnerable to such foreign retaliatory action.

The apprehension concerning foreign retaliation expressed by both Mr. Albright and Chairman Burns is shared by the large United States banks. A position paper issued March 6, 1974 by the New York Clearing House (to which 12 of the largest New York Banks belong) strongly opposes any legislation changing the existing system of regulation, on the grounds that such changes would result in retaliation by foreign regulatory authorities through more restrictive legislation.\(^\text{11}\) Because it is composed of large United States banks with substantial overseas activities which are vulnerable to foreign retaliation, the New York Clearing House appears to be the most strongly opposed of all the professional banking organizations to any form of regulatory change or reform. Other trade organizations, however, have expressed greater willingness to support regulatory changes.

In addition to the Rees proposal, there are a number of other bills pending which would substantially restrict foreign investment in the United States, and

\(^{11}\)Address by Harry W. Albright, Jr., 46th annual midwinter meeting of the New York State Bankers Association, January 21, 1974.

would thus incidentally affect foreign banking. Most of these measures reflect the same protectionist views that characterize the Rees proposal.

C. New York Reciprocity Proposal

To forestall what it regards as the "draconian" measures of the Rees legislative proposals, the New York State Department of Banking has generated a set of reform proposals which, in the view of the Department, would correct many of the competitive inequalities between foreign and domestic banks without sacrificing the primacy of state regulatory authority. The most significant of these proposals was first suggested by Governor Rockefeller in June 1973 and presented publicly by Mr. Albright, Superintendent of Banking, in Montreal on September 1, 1973. In order to give domestic and foreign banks a similar ability to operate branches in several states, Mr. Albright proposed that bank holding companies be permitted to expand across state lines and operate full service banks as long as other states reciprocated.118

In March, 1974 the Superintendent's Advisory Committee on Financial Reform formally proposed that "Legislation should be enacted in New York and the Superintendent should actively seek similar legislation in other states that would permit reciprocal interstate banking through bank holding company acquisitions in major cities."119 On March 19, 1974, Governor Wilson introduced enabling legislation which would allow out-of-state banks to do business in New York and New York state banks to operate in other states. The proposed bill120 would have allowed out-of-state bank holding companies to acquire and operate no more than two offices in New York State provided that the state in which the bank did its chief business permitted similar acquisitions by New York-based bank holding companies. The proposed bill would have required the State Superintendent of Banks to approve an out-of-state holding company's entry into the New York Market, considering the public interest as well as traditional antitrust criteria.

Response to the New York proposal was particularly enthusiastic in California, where Donald Pearson, State Superintendent of Banks, expressed confidence that such legislation would eventually pass.121 State banking officials in Massachusetts, Texas and Illinois, however, have indicated that full-scale interstate banking is not entirely welcome in their states, and banking officials in yet other states have expressed uncertainty or disinterest.122 Large banks with

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118Allen, supra note 25, col. 3.
119N.Y. REPORT, supra note 108.
122AMER. BANKER, March 20, 1974, at 1, col. 3.
substantial international activities have supported the New York legislative proposals over the reforms drafted by the Federal Reserve Board. The President of J.P. Morgan & Co., for example, has spoken out in favor of the New York state legislation, and the Chairman of the Chemical New York Corp., parent of the Chemical Bank, also came out in favor of interstate bank branching as proposed by the New York State Banking Department.120

These New York proposals were intended to prevent the expansion of federal authority over foreign banking by adjustments in state regulation which would ease restraints on domestic banks rather than increasing restrictions on foreign banks as the preferred means of equalizing their competitive positions. Notwithstanding some modest amount of support for the New York proposal, the measure has not been reintroduced this year.

D. Federal Reserve Proposals

In February, 1974 the Federal Reserve Steering Committee on International Banking presented a sweeping set of reforms. A draft outline was circulated containing a set of proposals designed to achieve equality of treatment in the regulation and supervision of foreign and domestic banks operating in this country.121

On December 4, 1974, after comments had been received, the Federal Reserve Board sent to Congress legislation reflecting most of the features of the draft proposal.122 Because it was introduced so late in the session it failed to get consideration, and similar legislation was reintroduced on March 5, 1975.123

The proposed legislation would restrict foreign banks to those activities permitted to domestic banks—with the principal exception that foreign banks having subsidiaries which dealt in securities would be permitted to retain them if they had owned them before December 3, 1974, the grandfather date for non-conforming affiliates. All branches, subsidiaries and agencies of foreign banks with worldwide assets in excess of $500 million would be required to join the Federal Reserve System. Approval of the Secretary of the Treasury would be required for mergers and acquisitions and all foreign banks would be required to register with and be licensed by the Comptroller of the Currency. The proposed legislation would also require foreign banks to buy Federal Deposit Insurance for deposits held in United States branches. Multistate banking operations being carried on at the time the bill was first introduced would be

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120 AMER. BANKER, March 21, 1974, at 1, col. 1; J. COMMERCE, March 28, 1974, at 3.
121 Mitchell, supra note 63.
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permanently grandfathered and could be expanded where state law permitted. Federal law which now requires that all directors of national banks be United States citizens, would be changed to permit up to one-half of the directors to be non-United States citizens.\(^{124}\)

It does not presently appear that the Federal Reserve proposals have any likelihood of being adopted this year since the House Banking, Currency and Housing Committee disclosed in April that it will undertake a major study of financial institutions—including foreign banks—with a view to producing legislative recommendations by 1976; it now appears that regulatory reform will await the completion of this study.\(^{125}\)

These most recent Federal Reserve legislative proposals may be viewed as part of a trend, apparent since the 1950s, to add new and significant responsibilities to federal regulatory agencies in the area of banking.\(^{126}\) Much of the criticism of the Federal Reserve proposals has focused on this alleged erosion of the dual banking system. It has also been argued that implementation of the draft legislation, particularly the provision limiting foreign banks to one state, could lead to retaliation by foreign governments. Mr. Juergen Ponton, Chairman of the Board of Managers of the Dresden Bank, stated at a recent news conference that West German bankers regarded the measures being contemplated by the Federal Reserve Board as unfriendly; he further pointed out that reciprocal restrictions in West Germany would severely hurt major American banks.\(^{127}\) Other European bankers have reacted more cautiously but have expressed similar objections to the tightening of regulations governing their American operations.\(^{128}\)

European bankers have been even more critical of the Patman and Rees proposals.\(^{129}\) German officials, for example, have conceded privately that the Federal Reserve proposals cannot be construed as discriminatory, but that the provisions of other bills now under consideration are a source of much greater concern.\(^{130}\)

Although the Federal Reserve proposals attempt to make foreign bank operations subject to the same regulations which apply to domestic banks, such changes are viewed from a foreign perspective as discriminatory in that they

\(^{124}\)For a summary of the provisions and discussion of the December and March versions of the Federal Reserve legislative proposals, see AMER. BANKER, December 4, 1974, at 1; AMER. BANKER, March 1, 1975, at 1; FED. RESERVE BULL., December 1974 at 881. For a survey of reactions to the Federal Reserve proposals see AMER. BANKER, December 5, 1975 at 1.

\(^{125}\)AMER. BANKER, April 25, 1975, at 1.


\(^{127}\)J. COMMERCE, March 29, 1974, at 1.

\(^{128}\)AMER. BANKER, March 21, 1974, at 1.

\(^{129}\)Id.

\(^{130}\)J. COMMERCE, March 29, 1974, at 1; BUSINESS WEEK, July 13, 1974 at 61.
would operate to restrict the present activities of foreign banks. Both United States and foreign banking officials have claimed that the proposed regulations would violate the principle of reciprocity, but this has proved to be an illusive and unsatisfactory concept on which to focus. Because the regulation of banking varies so greatly between the United States and foreign countries, it is not possible to define reciprocity between them. For example, American banks may presently branch throughout Germany, France and the United Kingdom; whereas branches of banks of these countries are restricted in the United States to a relatively few states. Foreign governments could certainly argue that the United States is therefore lacking in reciprocity by not permitting branching in any state. Or, it could be argued, reciprocity is lacking unless an equal number of banks from each country is permitted to establish banks in the other country. As is apparent, the concept of reciprocity is an elusive standard against which to evaluate regulatory changes. Rather, the principle of non-discrimination appears fundamentally more appropriate and workable. This is clear in considering the Federal Reserve proposals with respect to monetary policy and the United States balance of payments. Foreign banks or their governments would not object to having their branches subject to the same reserve requirements, interest rate ceilings, lending restrictions and similar tools of monetary policy which are applied to American banks. The lack of significant or sustained foreign opposition to these proposed reforms can be explained through the generally accepted rule abroad that foreign banks are subject to and must comply with the same central bank rules to which local banks have to respond. This represents an easily definable system of equality or non-discrimination which both United States and foreign banks, as well as regulatory agencies will accept as essentially equitable.

X. Conclusion

Until the emergence of foreign banks as a major competitive force in the United States, it was understandable that their regulation should have been left to the states. The volume of foreign banking activity was, until recently, so small that any disparities in the opportunities available to foreign and domestic banks were not sufficiently important to call into question the historic and traditional state regulatory authority over banking operations.

In the last few years, however, this has changed. The growing volume of

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\textsuperscript{113}In an interview, the Illinois Commissioner of Banks, H. Robert Bartell said that the various aspects of foreign bank regulation and reciprocity are closely linked and actions in one area may have unexpected results in another area. \textit{Amer. Banker}, March 14, 1974, at 1.


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banking being conducted by foreign banks has increased the significance of competitive inequalities, and has precipitated a number of proposals to place foreign and domestic banks on a more competitively even footing. The Rees proposal would remove those regulatory advantages which foreign banks presently enjoy and replace them with additional restrictions not applied to domestic banks. This protectionist approach violates a policy of non-discrimination fundamental in our approach to the regulation of foreign direct investment in the United States and is understandably the most likely to trigger foreign reprisals.

The New York proposals, made ostensibly to eliminate the competitive advantages enjoyed by foreign banks, would operate to ease restraints which apply to domestic banks, paving the way for the multi-state expansion of the large New York banks. Under New York proposals, significant advantages would accrue to New York banks, but many of the present regulatory problems associated with foreign banks would be unaffected. Not all of the competitive inequalities would be eliminated, and those foreign and monetary policy considerations related to the expansion of foreign bank activity would remain similarly unresolved.

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

State banking authorities may view the Federal Reserve proposals as contributing to the erosion of the dual banking system, but it does not follow that the loss of state control over certain aspects of foreign banking will weaken or destroy the virtues of a decentralized system. Rather, we have seen how in recent years the federal government has gradually expanded its jurisdiction over certain banking activities which were more appropriately regulated at the national level; this process has not seriously weaken the dual banking system but has been a means of accommodating that system to a set of emerging regulatory issues national in scope and most appropriately dealt by federal regulatory agencies.

To the extent that the Federal Reserve proposals would provide essentially similar treatment of foreign and domestic banks, it is hard to imagine that foreign opposition to such measures would be extreme or that retaliatory measures would be taken abroad. Foreign apprehensions should be largely
alleviated by the inclusion of a grandfather clause protecting those foreign banks already established in the United States. Of the three approaches to regulatory reform here considered, the Federal Reserve proposals would deal most effectively and fairly with the full range of problems which have accompanied the expansion of foreign banking in the United States.