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COMMENT

The Ramifications of the International Banking Act of 1978 on North Carolina: The Need to Adopt Legislation Enabling Foreign Banks to Establish Federal Agencies and Limited Branches

Over the last fifteen years, the growth in assets held by the United States offices of foreign banks¹ has been phenomenal. This great surge has been attributed to a number of factors, among them the increase in foreign direct investment in the United States, the general strength of the American economy, and the increased fluidity of the international money markets. But perhaps the feature that had been most attractive to foreign bankers was the competitive advantage they enjoyed over domestic banks.

A rather inadvertent combination of circumstances, involving the dual banking system of the United States and the absence of effective federal control over foreign banks, created these competitive advantages. But after years of debates and revisions, Congress responded to the "threat" of a foreign invasion of our banking system by enacting the International Banking Act of 1978² (IBA or the Act). Recognizing the benefits of a competitive environment, the Congress enacted this legislation not to unduly restrict the foreign banks but rather to place them on equal footing with American banks. Congress, which was not yet prepared to deregulate the domestic banks for fear of unleashing Darwinian competition, instead chose to increase its regulation over the foreign banks up to the level of American banks.

This comment will describe the banking environment and the competitive advantages enjoyed by foreign banks prior to the passage of the IBA. It will then provide an overview of the entire Act and some of the regulations and rules promulgated by the Board of Governors of the Fed-

¹ The definition of "foreign bank" includes banks organized in foreign countries, the Commonwealth of Puerto Rico, U.S. territories, and Guam, American Samoa, and the Virgin Islands. S. Rep. No. 1073, 95th Cong., 2d Sess. 1, 3 reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1423 [hereinafter cited as Senate Report].

² International Banking Act, Pub. L. No. 95-369, 92 Stat. 607 (1978) (codified in scattered sections of 12 U.S.C.) [hereinafter cited as IBA or the Act].

eral Reserve (the FED) since the Act's passage. Then it will examine, in depth, the provisions for regulating interstate banking by foreign banks and the impact of these provisions on North Carolina's banking environment. Finally, this comment will propose the adoption of a state statute authorizing the establishment and operation of foreign banks in North Carolina.

I. Foreign Banking in the United States and North Carolina Prior to the IBA

Until the mid-1960s, the relative insignificance of foreign banking operations in the United States meant that a comprehensive federal policy for regulating foreign banks was unnecessary.³ This absence of a federal policy and the country's dual banking system of separate federal and state regulatory schemes inadvertently worked together to provide significant advantages for foreign banks. One such advantage was the ability of foreign banks to conduct substantial interstate banking activity, which was prohibited to federal and state banks. By contrast, banking laws in other countries have placed foreign banks in an equal position with domestic banks, and often in a substantially less advantageous position.⁴

Foreign banks have three organizational forms open to them for U.S. operations: a separate entity, or subsidiary; a branch; or an agency.⁵ The distinctions among these three forms play an important role in the interstate banking arena, in terms of both the options for banking firms and the regulatory activities for the individual states. Generally speaking, a subsidiary and a branch may establish full-service banking including acceptance of both foreign and local deposits; an agency, on the other hand, may not accept local deposits, but may maintain credit balances for customers.⁶ Prior to the IBA, however, the federal banking system did not permit branches or agencies, and granted charters to only those subsidiaries whose president and members were all U.S. citizens.⁷ Thus, foreign banks were virtually precluded from receiving federal charters.

Under our dual banking system,⁸ however, foreign banks could establish a branch or agency under certain state banking laws. Laws

³ Reisner, A Developmental Perspective on the International Banking Act of 1978, 1980 U. Ill. L.F. 1, 2.

⁴ See Dep't of the Treasury, Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations 79-81, 147 (1979).

⁵ Foreign Bank Act of 1975: Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. 26, 29 (1975) [hereinafter cited as 1975 Hearings].

⁶ Id. at 20-21. New rules to distinguish credit balances from deposits have been promulgated by the Federal Reserve Board, see 12 C.F.R. § 211.22(a)(1) (1981). In addition, the FED has ruled conclusively that it will regard offices of foreign banks that accept "foreign source deposits" and no local deposits as agencies rather than as branches. Id. at § 211.113.

⁷ 1975 Hearings, *supra* note 5, at 29.

⁸ For more information on the U.S. banking system, see Hackley, Our Baffling Banking System, 52 Va. L. Rev. 565 (1966).

among the fifty states with regard to the establishment and operation of foreign branches varied and still vary significantly. North Carolina is one of twenty-three states that has remained silent on the subject, but at least eleven states have expressly authorized foreign banking offices within their borders: Alaska, California, Georgia, Hawaii, Illinois, Massachusetts, Missouri, New York, Oregon, Utah, and Washington.⁹ Of these eleven, further variations exist according to the types of banking activity in which foreign banks may engage, the number of offices that a foreign bank may establish, and whether the home country of the bank must grant reciprocal treatment for U.S. banks.¹⁰

Most foreign banks established in the United States were able to escape a broad range of federal regulations and restrictions by electing to operate under the state regulatory schemes. One of the federal restrictions avoided was the prohibition against interstate branch banking imposed by the McFadden¹¹ and Federal Reserve Acts.¹² Eluding that restriction was especially advantageous because even state banks have generally been refused entry into other states.¹³ Thus, foreign banks were able to organize in the United States on an interstate basis.

Armed with the competitive flexibility of interstate branching and nonbanking operations,¹⁴ the foreign bank presence in the United States grew in both size and number. Near the end of 1972, approximately 104 foreign outlets in the United States held just over \$24 billion in assets.¹⁵ By the time the IBA was enacted in September of 1978, the total assets of 305 foreign offices operating in the United States stood at \$129.5 billion¹⁶—a 433 percent increase in assets, compared with a 64 percent increase in the assets of domestic banks over the same period.¹⁷ Reflecting the interstate branching opportunity open to the foreign banks, the number of banking companies doubled during this period¹⁸ while the total number of their branches, agencies, and representative offices more

⁹ 1975 Hearings, *supra* note 5, at 20.

¹⁰ See Comment, *The Regulation of Foreign Banking in the United States After the International Banking Act of 1978*, 65 Va. L. Rev. 993, 1000 (1979) [hereinafter cited as *The Regulation of Foreign Banking*]. For a more complete discussion of the states' options, see *id.* at 999-1005.

¹¹ 12 U.S.C. § 36 (1976).

¹² *Id.* § 321.

¹³ See also Reisner, *supra* note 3, at 4, n.23.

¹⁴ Another important federal policy that foreign banks were able to avoid was the separation of the banking interests from the industrial and commercial sector. See Reisner, *supra* note 3, at 5. The federal prohibition of the direct or indirect ownership of any nonbanking enterprise by domestic banks did not apply to foreign branches or agencies. Banking Act of 1933, ch. 89, 48 Stat. 162 (1933) (current version codified in scattered sections of 12 U.S.C.). Thus, foreign bank holding companies could include both banking and industrial affiliates. Likewise, the federal statutes that preclude U.S. banks from underwriting, selling, or distributing securities in the United States did not apply to foreign operations. *Id.*

¹⁵ Wall St. J., Aug. 10, 1979, at 14, col. 2.

¹⁶ Wall St. J., May 15, 1979, at 21, col. 4.

¹⁷ Here Come Foreign Banks Again, *Bus. Week*, June 26, 1978, at 78.

¹⁸ Senate Report, *supra* note 1, at 2, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1422.

than tripled.¹⁹

The most significant increase in foreign banking activity came in commercial and industrial loans,²⁰ which increased over forty-five percent in 1978 alone.²¹ According to the Federal Reserve, at the time the IBA was passed foreign banks accounted for nearly twenty-six percent of the loans at large banks that report weekly to the FED.²²

Despite a credible rebuttal by foreign bankers,²³ it was apparent that the growth in assets and number of foreign banking institutions in the United States was unprecedented. Additionally, two celebrated bank failures,²⁴ the wealth accumulation in the Arab world, and increased instability in world financial markets caused Americans to become increasingly concerned about foreign influence on the U.S. economy. Foreign banks were no longer merely specialized financing vehicles for international transactions; rather, they had become aggressive competitors in the retail deposit and commercial loan markets²⁵ of the U.S. banking industry.

In the mid-1960s, after urgings from the Federal Reserve Board, Congress began examining the absence of federal control over foreign banking activity.²⁶ At that time, the principal motivation for federal supervision was not so much the competitive advantages available to foreign banks but rather the increasing impact of international monetary movements on domestic economic policy.²⁷ A comprehensive study undertaken by the Joint Economic Committee in 1966 cited the disparate state and federal banking regulations as the ultimate source of both the advantages and the disadvantages enjoyed by foreign banks.²⁸ The study provoked several bills but none were acted on.²⁹ Three more bills

¹⁹ Wall St. J., *supra* note 15.

²⁰ Another dramatic increase between 1972 and 1978 was that of deposits by Americans in U.S. branches of foreign banks, from \$3.9 billion to \$25.8 billion. *Id.*

²¹ Wall St. J., *supra* note 16.

²² *Id.*

²³ Naturally, the foreign bankers disputed these figures. They asserted that because they often include money market transactions as commercial loans on their books and because they must transfer a large portfolio of loans from the parent country for a start-up business base, their actual market share is less than half of that claimed by the Federal Reserve. Wall St. J., June 19, 1979, at 7, col. 1.

²⁴ See Comment, The Regulation of Foreign Banking, *supra* note 10, at 995.

²⁵ *Id.* at 997.

²⁶ International Banking Act of 1978: Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 95th Cong., 2d Sess. 94, 97 (1978) [hereinafter cited as IBA Hearings].

²⁷ Reisner, *supra* note 3, at 6. A basic example: when the FED tries to slow down the growth of the nation's money supply, interest rates rise because money is more scarce than before. The rise in interest rates, however, attracts foreign capital, particularly the very fluid Eurodollars, and increases the money supply, thwarting the FED's efforts.

²⁸ Senate Report, *supra* note 1, at 1, reprinted in [1978] U.S. Code Cong. & Ad. News 1421.

²⁹ *Id.*

were proposed and debated by Congress in 1975, 1976, and 1977,³⁰ before the final version of the IBA was passed on July 27, 1978. It became law on September 17, 1978.³¹

II. Overview of the IBA of 1978

When Congress debated the proposed legislation that was eventually shaped into the International Banking Act of 1978, the principal focus was on achieving substantial parity in the regulation of foreign and domestic banks.³² The issue of controlling international monetary movements had become secondary.

Congress began to achieve the objective of parity³³ by removing certain impediments that had made qualifying for a federal charter by a foreign bank difficult or impossible. For example, section 2³⁴ authorizes the Comptroller of the Currency to waive the requirement that all board members of national banks be U.S. citizens. With the Comptroller's permission, the IBA allows a minority of the directors to be citizens of foreign countries.

In addition, section 4³⁵ allows the chartering of branches or agen-

³⁰ Id. Most of the debate centered around section 5, the provisions on interstate banking. See text accompanying notes 66-78 *infra*.

³¹ IBA, *supra* note 2.

³² Congress had two larger policies to consider, however. The first was the existing regulatory system for domestic banks. Because the advantages for foreign banks in the United States were derived from permissive state laws, Congress could not achieve actual parity without abandoning the limited two-tier banking system. Instead of abandoning the existing system, Congress chose to modify each tier with regard to foreign banks and "sacrifice the goal of absolute equality." Reiser, *supra* note 3, at 8.

The second consideration was Congress' recognition of fundamental differences in the structure, function, and regulation of banks in the various countries around the world. Id. at 9. For example, some nations, especially in Europe, permit substantial nonbanking activities, *id.*, whereas in the U.S., even very closely related activities must be approved by the Federal Reserve Board. 12 U.S.C. §§ 1841-1850. (Supp. IV 1980). A sweeping prohibition of these activities for current or future foreign operations might appear unfair and possibly provoke retaliatory measures abroad. Thus, Congress provided generous grandfather provisions, see notes 60 and 92 *infra*, and a somewhat greater degree of freedom for interstate banking and for nonbanking activities than otherwise available to U.S. banks. See notes 79-92 and accompanying text, and note 94 *infra*.

³³ The IBA did leave intact some important differences between federally chartered domestic and foreign banks. First, neither foreign banks' federal agencies nor their federal branches are required to become members of the Federal Reserve System. IBA, *supra* note 2, § 4(b)(3), (codified at 12 U.S.C. § 3102(b)(3) (Supp. IV 1980)). Practically, this option is not available to domestic national banks. Second, foreign *agencies* are not required to obtain FDIC insurance, *id.* § 4(b)(4), (codified at 12 U.S.C. § 3102(b)(4) (Supp. IV 1980)), although foreign *branches* must obtain insurance for all deposits less than \$100,000. Id. § 6(a), (codified at 12 U.S.C. § 3104 (Supp. IV 1980)); see note 40 *infra* and accompanying text. Thus, the regulatory powers of the FDIC do not apply to uninsured agencies. However, foreign banks must keep a certain amount of dollar deposits or investment securities in an approved Federal Reserve Member bank, something that domestic banks do not have to do. This measure is designed to ensure that a certain level of assets, determined by the Comptroller of the Currency, is always available to U.S. banking authorities. Id. § 4(g), (codified at 12 U.S.C. § 3102(g) (Supp. IV 1980)).

³⁴ IBA, *supra* note 2, § 2, (codified at 12 U.S.C. § 72 (Supp. IV 1980)).

³⁵ Id. § 4, (codified at 12 U.S.C. § 3102 (Supp. IV 1980)).

cies, i.e. not just subsidiaries, on the federal as well as the state level. Subject to the provisions of section 5 on interstate banking, a foreign bank may establish in a single state one or more federal branches or agencies, but not both, so long as 1) it does not operate a state branch or agency in the same state, and 2) the establishment of a branch or agency by a foreign bank is not prohibited by state law.³⁶

North Carolina has no statute preventing a foreign bank from establishing a federal branch or agency in the state; but to determine section 4's applicability in North Carolina, section 5 of the IBA on interstate banking must also be considered. The use of the language, "is not prohibited," in section 4 is different from the requirement in section 5. In the latter section, to establish a branch outside the "home" state,³⁷ the *entering* state must "expressly permit"³⁸ the operation of a foreign branch or agency. The difference is very significant for North Carolina because North Carolina neither *prohibits* nor *expressly permits* the establishment of a foreign branch in this state. Based on sections 4 and 5 of the IBA, this neutrality³⁹ means that a foreign bank could establish a full-service, federal branch in North Carolina only if it designated North Carolina as its "home" state, but could not set up any other kind of federal branch.

In sections 6, 7, and 10 of the IBA, Congress substantially eliminated the incentives for obtaining or retaining state charters and provided further federal supervision of foreign banking. Section 6 requires federal and state *branches* of foreign banks to obtain FDIC insurance for all deposits under \$100,000, thereby subjecting them to substantial control by the FDIC.⁴⁰ In addition, this section imposes a complex series of reporting and inspection requirements on all U.S. offices of foreign banks with worldwide assets of one billion dollars or more.⁴¹ Meanwhile, section 10 requires "representative offices," the foreign banks' counterpart to domestic loan production offices, to register with the Treasury Department.⁴²

In section 7, Congress authorized the Federal Reserve Board to establish reserve requirements for federally-licensed foreign branches and

³⁶ Id. § 4(a), (codified at 12 U.S.C. § 3102(a) (Supp. IV 1980)).

³⁷ See *infra* notes 93-102 and accompanying text.

³⁸ IBA, *supra* note 2, § 5(a)(1)(A), (codified at 12 U.S.C. § 3103(a)(1)(A) (Supp. IV 1980)). This express permission does not apply to "home state" banks.

³⁹ The Comptroller of the Currency appears to support his view of "neutrality." "State law silence concerning branches and agencies of foreign banks does not amount to a prohibition." Comptroller of the Currency, Dep't of the Treasury, Supplementary Information to Proposed Rule: Federal Branches and Agencies of Foreign Banks, 12 C.F.R. § 28 (1979).

⁴⁰ IBA, *supra* note 2, at § 6(a), (codified at 12 U.S.C. § 3104a (Supp. IV 1980)). These FDIC insurance requirements generally apply only to domestic deposits. Senate Report, *supra* note 1, at 13, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1433.

⁴¹ Id. It is perhaps noteworthy that the IBA also extends these reporting, inspection, and reserve requirements to *state* chartered banks holding equivalent worldwide assets. This may be considered a serious infringement of the two-tier system.

⁴² IBA, *supra* note 2, at § 10, (codified at 12 U.S.C. § 3107 (Supp. IV 1980)).

agencies.⁴³ Additionally, "in consultation and cooperation with State bank supervisory authorities," the Board may establish reserve requirements for state-licensed branches and agencies.⁴⁴ The IBA gives the FED more flexibility in reserve requirements for foreign banks than for domestic institutions: the FED may waive the minimum and maximum levels permitted by Congress for reserve requirements, up to a maximum of twenty-two percent.⁴⁵

Section 7 also establishes the framework for the regulation, supervision, and examination of foreign banking operations in the United States. The Comptroller of the Currency, the Federal Depositary Insurance Corporation (FDIC), and the individual states are recognized as having the primary examining authority over foreign banking activity within their jurisdictions.⁴⁶ The Federal Reserve Board retains residual authority, however, so it can make a consolidated review of the multi-state banking network of foreign banks, observing national trends that state authorities might overlook.⁴⁷

Section 3 of the IBA modifies Section 25 of the Federal Reserve Act⁴⁸ to permit foreign banks to own Edge Act corporations.⁴⁹ Available for domestic banks since 1919, Edge Act corporations are restricted to deposits from foreign governments, and their agencies and instrumentalities, or from persons residing or conducting their operations principally abroad, or to deposits arising out of international transactions.⁵⁰ Congress made this organizational form available to foreign banks by totally

⁴³ Senate Report, *supra* note 1, at 13, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1433. Again, this provision applies only to foreign branches and agencies whose worldwide assets are one billion dollars or more. *Id.*

⁴⁴ *Id.*

⁴⁵ IBA, *supra* note 2, at § 7(a)(1)(A), (codified at 12 U.S.C. § 3105(a)(1)(A) (Supp. IV 1980)). While the original purpose of the reserve requirements was to dampen the adverse impact of international monetary movements on domestic monetary policy, Senate Report, *supra* note 1, at 13, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1433; see note 28 *infra*, it is now apparent that the Federal Reserve is equally concerned with maintaining the competitive parity of foreign and domestic banks. The Board has recently announced that foreign banks will be subject to the same interest rate ceilings and reserve requirements that apply to domestic Federal Reserve Member banks. In turn, foreign banks will be able to borrow from Federal Reserve banks and use their services, including securities safekeeping and wire transfer services. This provision took effect September 4, 1980, but includes a two-year phase-in for the reserve requirements, the same as allowed for new domestic Member banks. *Id.* Other privileges for foreign banks are set out by the IBA itself. See Senate Report, *supra* note 1, at 7-12, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1427-1432.

⁴⁶ Senate Report, *supra* note 1, at 13, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1433.

⁴⁷ *Id.* at 14, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1434.

⁴⁸ Federal Reserve Act of 1913, ch. 6 § 25a, as added Dec. 24, 1919, ch. 18, 41 Stat. 378 and amended Feb. 27, 1921, ch. 73, 41 Stat. 1145, (codified at 12 U.S.C. §§ 611-631 (1976)).

⁴⁹ Senate Report, *supra* note 1, at 3-6, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1423-1426.

⁵⁰ Regulation K of the Federal Reserve Board, 12 C.F.R. § 211.4 (1981). For a further examination of the structure and permissible activities of an Edge Act subsidiary, see Note, The Edge Act: Will Recent Changes Give Banks with Interstate Subsidiaries an Edge in Domestic As Well as International Banking?, 4 N.C.J. Int'l L. & Com. Reg. 285 (1979).

eliminating the U.S. citizenship requirement for the corporation's board of directors, and by allowing foreign banks to own more than fifty percent of the corporation's stock, subject to approval from the Federal Reserve Board.⁵¹ As section 5 of the IBA heavily restricts foreign bank's multistate branching, the Edge Act corporation still enables foreign (and domestic) banks to accept deposits and to make loans in more than one state, provided they are related to international operations.

The Edge Act requirements are important for another reason. The IBA allows federal branches outside the foreign bank's home state, provided the deposits are "Edge-like" and the entering state expressly permits the establishment of foreign banks.⁵²

Even with these provisions, the IBA retained a somewhat greater degree of flexibility for a foreign bank to conduct nonbanking activities and to establish offices outside of its "home state." These provisions are found in sections 8 and 5, respectively, and are for the moment the most important sections of the Act.

Generally speaking, section 8 makes the U.S. branches, agencies, and subsidiaries of foreign banks⁵³ subject to the provisions of the Bank Holding Company Act of 1956 (BHCA),⁵⁴ and to the other nonbanking provisions of title 12.⁵⁵ Prior to the IBA, a foreign bank operating in the United States through a branch or agency, rather than through a subsidiary, was not considered to control a "bank."⁵⁶ Thus, the BHCA did not prohibit foreign banks (except in the rare subsidiary form) from engag-

⁵¹ IBA, *supra* note 2, at § 3, (codified at 12 U.S.C. § 611a (Supp. IV 1980)). Section 3 also eliminates the mandatory 10% reserve requirement previously imposed on Edge Act Corporations. Now the reserve requirement for Federal Reserve Member banks is used. 12 C.F.R. § 211.4(d) (1981).

⁵² See *infra* text accompanying notes 79-87.

⁵³ Since nations have different ideas of what they consider to be a "bank", "foreign bank" under the IBA is defined to include "foreign commercial banks, foreign merchant banks and other foreign institutions that engage in banking activities usual in connection with the business of banking in the countries where such foreign institutions are organized or operating" IBA, *supra* note 2, at § 1(a)(7), (codified at 12 U.S.C. § 3101(7) (Supp. IV 1980)). Thus, the IBA also applies to those financial institutions which are considered "banking" organizations overseas, even though they may engage in activities overseas that are not considered "banking" activities in the United States. Senate Report, *supra* note 1, at 3, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1423.

⁵⁴ 12 U.S.C. §§ 1841-1850 (1976 & Supp. IV 1980). The Federal Bank Holding Company Act (BHCA) restricts the powers of companies who have "control" over any "bank" organized in the United States. This Act prevents the circumvention of various statutes regulating nonbanking activities through the establishment of subsidiaries. Section 4(a) of the BHCA restricts bank holding companies from (i) engaging in any activities other than banking or managing or controlling banks or other exempted subsidiaries, or engaging in any nonbanking activities other than certain exempted activities, (ii) acquiring direct or indirect ownership or control of any voting shares of any company which is not a bank or (iii) retaining direct or indirect ownership or control of any voting shares of any company which is not a bank or bank holding company or an otherwise exempted subsidiary. *Id.* § 1843(a)(1),(2).

⁵⁵ *Id.* § 1850 (1976); 12 U.S.C. §§ 1971-1978 (1976 & Supp. IV 1980).

⁵⁶ For the definition of "bank" under the BHCA, see 12 U.S.C. § 1841(c) (1976). As a result of the IBA the provisions of the BHCA now apply to "1) any foreign bank that maintains a branch or agency in a State, 2) any foreign bank or foreign company controlling a foreign bank that controls a commercial lending company organized under State law, and 3) any com-

ing in nonbanking activities, including securities transactions, in the United States.⁵⁷

The purpose behind section 8, therefore, is to prevent a foreign company and its subsidiaries from conducting both banking and nonbanking activities in the United States.⁵⁸ However, foreign financial institutions doing business in the United States may be able to operate under one of the substantial exemptions found in section 8 of the IBA and section 4 of the BHCA.⁵⁹ The five exemptions are as follows: permanently grandfathered nonbanking activities;⁶⁰ stock interests of five percent or

pany of which any foreign bank or company referred to in (1) and (2) is a subsidiary" Id. § 3106(a) (Supp. IV 1980).

⁵⁷ Gruson & Weld, *Nonbanking Activities of Foreign Banks Operating in the United States*, 1980 U. Ill. L.F. 129, 130.

⁵⁸ The prohibitions against nonbanking activities found in section 8 apply not only to the New York banking subsidiary of a foreign non-bank, but also to all the subsidiaries and companies in the "group" of which the New York sub may be a part. This may well include sister corporations and their parents and subsidiaries. Id. at 133.

Whether a company or subsidiary is within the "group" depends on the "control" relationships involved. "Control" may be based on stock ownership, ability to elect directors or other means of influence as determined by the Federal Reserve Board. For a given case, the Board uses the following guideline. A company is a subsidiary (and thus "in the group") if the other company, the parent, directly or indirectly owns or controls 25% or more of its voting shares, or controls the election of a majority of its board of directors. Shares of another company which are owned by the parent are "directly" held by the parent; if the shares of another company are owned by a sub of the parent, then the shares are "indirectly" held by the parent. Id.

Even if a company owns less than 25% of the voting shares in another company, the Federal Reserve Board may determine after a hearing that the parent company has the power, directly or indirectly, to exercise a controlling influence over the management or policies of the other company. If so determined, it too may be "in the group." 12 U.S.C. § 1841(a)(2) & (d) (1976). (Securities that are immediately convertible into voting shares are treated as voting shares. 12 C.F.R. § 225.2(b)(5) (1981)). However, when a company's ownership or control interest is less than 5% of the voting shares, then the other company is *presumed* not to be a subsidiary. 12 U.S.C. § 1841(a)(3) (1976). Where the ownership or control interest is somewhere between 5 and 25%, then the FED has significant discretion in determining whether or not a "control" relationship exists. See 12 C.F.R. § 225.2 (1979) and proposed amendments in 45 Fed. Reg. 30,082 (May 7, 1980) for the various presumptions of control established or proposed by the FED.

Thus, under section 8, if a British nonbanking firm, with a New York banking subsidiary, engages directly or indirectly in nonbanking activities in the United States—say, with a subsidiary, sister to its New York bank—then it must either close its New York bank subsidiary, branch, agency or commercial lending company, or the company must terminate its direct and indirect nonbanking activities. Of course, the British nonbanking firm could continue its operations if it can qualify for one of the exemptions in the IBA or the BHCA. Gruson, *supra* note 57, at 136.

⁵⁹ In certain respects, the exemptions available to *foreign* bank holding companies and certain holding companies under section 8(a) of the IBA are substantially broader than those available to *domestic* bank holding companies. Gruson, *supra* note 57, at 136. This may be a recognition of the cultural and philosophical differences around the world in various nations' treatment of their financial institutions. Alternatively, it may just be an attempt to soften the blow of these new restrictions to reduce the possibility of foreign retaliation.

⁶⁰ 12 U.S.C. § 33106(c) (Supp. IV 1980). A company under section 8(c) on Sept. 17, 1978, is "permanently" grandfathered as to any nonbanking activities, including securities activities, in three cases. First, where the company was lawfully engaged directly or indirectly through a "section 8(c) affiliate" on July 26, 1978. Under section 8(c), an "affiliate" means "any company more than 5% of whose voting shares is directly or indirectly owned or controlled or held with power to vote by the specified foreign bank or company." 12 U.S.C. § 3106(c) (last sentence).

less held by the foreign bank holding company;⁶¹ activities that are closely related to banking;⁶² activities of certain foreign bank holding

The second case is where the company became engaged after July 26, 1978, pursuant to a "bonding, written acquisition contract," entered into on or before that date if the acquired company was engaged in such activities at the time of acquisition. The acquisition contract does not have to be a *final* contract, but rather evidence of a well thought-out, comprehensive agreement. Senate Report, supra note 1, at 15, reprinted in [1978] U.S. Code Cong. & Ad. News, 1421, 1435. The final grandfather provision is where the nonbanking activities were covered by an application filed on or before July 26, 1978 to engage in such activities. 12 U.S.C. § 3106(c). If a section 8(a) company first engaged in nonbanking activities or acquired ownership or control of a nonbanking company in the United States between July 27, 1978, and Sept. 17, 1978, then it has until Dec. 31, 1985, to divest itself of ownership or control of the voting shares. *Id.* § 3106(b).

Although these activities are "permanently" grandfathered by section 8, the FED, after a hearing, may terminate these grandfathered activities if the Board determines that "such action is necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices in the United States." *Id.* § 3106(c). However, the Board cannot use this power to terminate an activity that is already exempt under the BHCA. See Gruson, supra note 57, at 139 n.44. A number of questions regarding this grandfather exemption remain to be answered by the Board, among them the treatment of related or expanded activities of a grandfathered company, the expansion by foreign banks of shareholdings in grandfathered affiliates, and the effect of an increase in the volume of a grandfathered non-banking activity. For a careful analysis of these issues facing the Board, see *id.* at 138-44.

⁶¹ 12 U.S.C. § 1843(c)(6) (1976 & Supp. IV 1980). In order to allow banks to invest their surplus funds and diversify their interests, the BHCA allows domestic and foreign bank holding companies to acquire up to 5% of the outstanding voting shares of any domestic or foreign company. Unlike the other exemptions in the BHCA, the approval of the Federal Reserve Board is not required. The Board does retain the right to disallow the stock ownership if it is coupled with other arrangements, such as a stockholders' agreement or substantial representation on the company's board, that effectively gives the holding company a "controlling" interest. *Id.* In addition, the regulations promulgated by the Federal Reserve allow the exemption "only for passive investments." 12 C.F.R. § 225.137(d)(2) (1981).

⁶² 12 U.S.C. § 1843(c)(8) (1976 & Supp. IV 1980). This provision is based on the belief that the benefits to the American consumer from having a bank perform a particular activity will outweigh the possible adverse effects. *Id.* The statute does not enumerate the activities exempted by this provision. Instead, Congress instructed the Federal Reserve Board to adopt the following standard in determining whether an activity is "closely related" enough to be exempted:

[whether performance of the activity by an affiliate] can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. *Id.*

The statute also instructs the Board to differentiate between activities actually initiated by a bank holding company and activities "commenced by the acquisition, in whole or in part, of a going concern." *Id.*

Since the passage of the BHCA, the Federal Reserve Board has determined that certain activities are permissible under this exemption: operating a mortgage, finance, factoring or lending company; operating an industrial bank; servicing loans; performing certain fiduciary activities; acting as an investment advisor; performing certain types of leasing, bookkeeping, insurance, internal courier and management consulting (to banks) activities; and selling money orders and travelers checks. 12 C.F.R. § 225.4(a). However, even if a particular activity has been classified as "permissible," a bank under section 8(a) of the IBA must still obtain the FED's prior approval by application through section b of Regulation Y. 12 C.F.R. § 225.4(b) (1981).

The FED has also classified certain other activities impermissible: insurance premium funding—the combined sale of mutual funds and insurance; underwriting life insurance not sold in connection with a credit transaction; real estate syndication or brokerage; land development; management consulting; property management; and operation of savings and loan associations. *Id.* § 225.126.

companies, the greater part of whose business is conducted outside the United States;⁶³ and the "Investor Company-Subsidiary" exemption.⁶⁴ These exemptions represent the congressional compromise between several competing policies involved in the regulation of nonbanking

⁶³ 12 U.S.C. § 1843(c)(9) (1976 & Supp. IV 1980). This exemption is available only to certain "foreign bank holding companies" as determined by the Board, and not to any domestic banks. If the Board determines that an exemption would not be "substantially at variance with the purposes of [the BHCA] and would be in the public interest," then shares held or activities conducted by any foreign company *the greater part of whose business is conducted outside the United States*, will not be subject to the general prohibition against nonbanking activities. *Id.*

As to what constitutes activities inside or outside the United States, the Board has ruled that a company that merely exports (or imports) products to (or from) the United States, or "furnishes services or finances goods or services in the United States" will not be considered to be engaged in activities in the United States. 12 C.F.R. § 225.124(c) (1981). Similarly, if its goods are sold to *independent* importers, or are distributed through independent warehouses, then the company is not engaged in activities within the United States. *Id.*

However, the FED will consider a firm to be operating in the United States "if it owns, leases, maintains, operates, or controls" a factory, wholesale distributor or purchasing agency, distribution center, retail sales or service outlet, network of franchised dealers, financing agency, or "similar facility for the manufacture, distribution, purchasing, furnishing, or financing of goods or services locally in the United States." *Id.*

To meet the "greater part of whose business" test and thereby qualify as a "foreign bank holding company," it must be a bank holding company organized under the laws of a foreign country, and more than 50% of its consolidated assets must be located, or its consolidated revenues derived, outside the U.S. 12 C.F.R. § 225.4(g)(1)(iii) (1981). The FED has recently adopted additional restrictions, including the requirement that the foreign organization must be principally engaged in the banking business outside the United States. The test, according to the FED, would require that more than half of the foreign organization's business be banking, and that more than half of its banking business be outside the United States. 45 Fed. Reg. 30,082 (1980) (amending 12 C.F.R. §§ 211, 225). Of course, this requirement means a foreign bank which is a member of a group whose nonbanking assets or revenues exceed its banking assets or revenues, would *not* be able to establish a branch, agency or subsidiary bank in the United States. Gruson, *supra* note 57, at 149. For a discussion of this new regulation, as well as some others that affect the nonbanking provisions, see *id.* at 149-52.

⁶⁴ 12 U.S.C. § 1841(h) (Supp. IV 1980). This amendment to section 2(h) of the BHCA applies to both foreign bank holding companies and companies covered under section 8(a) of the IBA, see note 56 *supra*, and represents a substantial liberalization of the scope of U.S. activities open to these two types of companies. See also Gruson, *supra* note 57, at 152.

Under these provisions, a foreign bank holding company that is organized under the laws of any foreign country and is engaged principally in the banking business outside the United States may, for example, own a banking subsidiary or branch in New York and a nonbanking subsidiary in London. As long as this London "Investor Company" is principally engaged in business of any kind outside the U.S., it may engage in the same line of or a closely related business, either directly or indirectly, (except in securities) in the United States. (Any banking or financial or "closely related activities" must have the FED's approval. 12 U.S.C. § 1843(c)(8) (1976 & Supp. IV 1980)). If the "Investor Company" establishes a "subsidiary," it does not matter whether the "subsidiary" is organized under foreign law or in the United States. The subsidiary need not be principally engaged in business outside the U.S. either, as this requirement only applies to the Investor Company. 12 U.S.C. § 1841(h) (Supp. IV 1980).

Before the amendment, section 2(h) prohibited the "Investor Company" from doing any business in the United States in order for the foreign bank holding company's shares of the Investor Company to be exempted. Gruson, *supra* note 57, at 152. Section 8(a) of the IBA made nearly all foreign offices and their parent holding companies subject to this requirement; however, this exception opens the door again, requiring that the Investor Company only be engaged principally in business outside the United States. Thus, with this exemption, foreign nonbanking enterprises are not precluded from investing in the United States simply because they are wholly or partly owned by foreign banks.

activity.⁶⁵

III. Section 5 of the IBA: Interstate Banking

A. Development of Section 5

By the time the regulation of foreign banks became a genuine congressional issue, the growing multistate presence of foreign banks had become "the single most controversial aspect" of foreign banking operations in the United States.⁶⁶ The ability to operate deposit banking facilities across state lines was believed to give foreign banks "a significant interstate advantage" over domestic banks.⁶⁷ Thus, Congress set out to reduce that advantage by restricting the acquisition and establishment of deposit-taking branches by a foreign bank outside its "home" state.⁶⁸

A "trilogy of controversial issues"⁶⁹ came to the forefront in the section 5 debate: 1) the preservation and enhancement of the ability of the states to attract foreign capital and develop international financial centers;⁷⁰ 2) the promotion of competitive equality between domestic and foreign banks; and 3) the need to provide the United States some leverage for more equitable treatment of U.S. banks abroad.⁷¹

⁶⁵ Some of the factors involved in the compromise were the policy that commercial banking should be separate from other commercial activities, the recognition that other countries do not require this separation, the desire to attract foreign participation in the U.S. financial markets, and the wish not to discourage investment in the United States by nonbanking companies owned wholly or partly by foreign banks. Gruson, *supra* note 57, at 161. For an evaluation of section 8 of the IBA and proposed and adopted regulations, see *id.* at 152-61.

⁶⁶ Senate Report, *supra* note 1, at 7-8, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1427-28.

⁶⁷ *Id.*

⁶⁸ IBA, *supra* note 2, § 5, (codified at 12 U.S.C. § 3103 (Supp. IV 1980)). The first proposal in this area was a part of the proposed IBA of 1977. It would have prohibited the interstate branching by federal or state branches of foreign banks until national banks were extended the same privilege. International Banking Act of 1977: Hearings on H.R. 7325 Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, 95th Cong., 1st Sess. (1977). The second version of section 5 was unrealistically mild, disallowing interstate branching for federally chartered foreign banks but permitting state chartered foreign banks to branch into those states that allowed it. H.R. 10899, 95th Cong., 2d Sess., 124 Cong. Rec. H1602 (daily ed. Feb. 28, 1978). The third attempt would have required explicit statutory authorization for interstate branching by state-chartered branches of foreign banks. House Comm. on Banking, Finance, and Urban Affairs, International Banking Act of 1978, H.R. Rep. No. 910, 95th Cong., 2d Sess. 1-2 (1978) [hereinafter cited as 1978 House Report]. The fourth version, discussed in text accompanying notes 79-87, took elements of each of these three prior proposals and eventually became part of the final IBA of 1978.

⁶⁹ Senate Report, *supra* 1, at 9, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1429.

⁷⁰ Senate Report, *supra* note 1, at 8-10, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1428-30.

⁷¹ Large American banks, with multinational operations throughout the world and thus highly dependent on foreign regulations, feared that restrictive U.S. legislation could trigger foreign retaliation. Competing in America, *Economist*, Mar. 4, 1978, at 52. Foreign activity by U.S. banks is much larger than the U.S. activity by foreign banks, meaning the United States had much more to lose than gain by excessive restriction of foreign banks. Indeed, foreign lending by large U.S. banks grew 13% in 1979 to \$246 billion, on top of a 12% increase to \$217 billion in 1978. *Wall St. J.*, June 13, 1980, at 3, col. 4. Large U.S. banks also harbored hopes of

With regard to the first issue in the trilogy, members of Congress and other interested parties registered the concern that restrictions would confine all future foreign banking activity to the states where international financial centers were already established, namely New York, California, and, to some extent, Illinois. This would deny other states, such as North Carolina, the opportunity to interest foreign institutions in their banking markets.⁷² This concern was justified; indeed, ninety percent of all foreign banking assets in the United States are held in New York and California, and in 1978, these states accounted for forty-three and thirty-five percent, respectively, of total outstanding commercial and industrial loans by foreign banks.⁷³

Congress resolved the first two issues by restricting only the interstate, domestic deposit-taking activity of the foreign banks.⁷⁴ The IBA left to the individual states the regulation of "those aspects of foreign bank operations which do not have substantial interstate impact,"⁷⁵ such as trade financing and commercial lending. Therefore, the states, including North Carolina if it so desires, may still attract foreign banks and "their supplies of loanable funds" to their financial markets.⁷⁶ However, the IBA took away authority over deposit-taking because of the belief that the state regulator probably would overlook the national impact of its decisions.⁷⁷

As for the third issue, the promotion of more equitable treatment of U.S. banks abroad, Congress left in place considerable flexibility for foreign banks to expand in the United States.⁷⁸ This congressional decision to loosen the bounds on U.S. banks rather than to restrict the activities of

using the foreign banks' ability to cross state lines as an argument to support legislation allowing the same for domestic banks. *Competing in America*, supra, at 52.

⁷² 1978 House Report, supra note 68, at 45 (additional views of Representatives Rousselot, Hansen, Hyde, Kelly, and Grassley). In addition, E.D. Dunn, president of the Conference of State Bank Supervisors, testified at the Senate hearings that "The real question in the interstate banking issue is not competitive equality between foreign and domestic banks, but competitive equality among the states themselves." IBA Hearings, supra note 26, at 144 (statement of E.D. Dunn).

⁷³ Comment, *The Regulation of Interstate Bank Branching Under the International Banking Act of 1978: The Stevenson Compromise*, 1 Nw. J. Int'l L. & Bus. 284, 287 (1979).

⁷⁴ According to the Senate Report, supra note 1, section 5 "meets the competitive advantage problem by narrowly focusing on the key interstate advantage enjoyed by foreign banks—the ability to accept deposits at locations in several states." Senate Report, supra note 1, at 11. Studies showed that domestic banks were not substantially hurt competitively by interstate branches of foreign banks in the areas of trade financing, interstate money market operations, lending activities, and retail deposit activities. See Farrar, Raiken & Clarke, *Choice of Home State Under the International Banking Act of 1978*, 1980 U. Ill. L.F. 91, 93-94. Where they suffered was in the area of wholesale or commercial deposit activities. *Id.* at 95. Since commercial customers generally prefer to conduct as much business as possible with one bank, a foreign bank with deposit-taking branches in several key commercial states enjoyed a significant advantage over domestic banks who are prohibited from accepting deposits in more than one state. *Id.*

⁷⁵ Farrar, supra note 74, at 95.

⁷⁶ *The Regulation of Interstate Branch Banking*, supra note 73, at 294.

⁷⁷ Farrar, supra note 74, at 95.

⁷⁸ For a further discussion of the effect of the new federal licensing option open to foreign

foreign banks was designed to avoid any foreign backlash and to encourage repeal of foreign legislation discriminating against U.S. banks. It is probably too early to determine the IBA's effect in foreign capitals.

B. General Provisions of Section 5

Section 5 of the IBA governs the acquisition and establishment of branches, agencies, and commercial lending companies⁷⁹ outside of a foreign bank's home state. Acquisitions and establishments are treated differently. Generally, acquisitions are subject to the requirements of section 3(d) of the Federal Bank Holding Company Act.⁸⁰ The BHCA requires that an acquisition of voting shares or a substantial share of the assets of a state bank by an out-of-state bank holding company be "specifically authorized by the statute laws of the state in which such bank is located, by language to that effect and not merely by implication."⁸¹ Thus, in North Carolina, for example, a foreign bank may not acquire a state bank if it claims another state as its home, because even though North Carolina does not prohibit such acquisitions, the state has no statute expressly permitting them either.⁸²

For the establishment and operation of branches, agencies, and commercial lending companies outside the home state, the IBA treats federal and state chartered offices differently. Under the IBA, a foreign bank may not establish or operate either a federal or a state branch outside of its home state unless the foreign bank agrees with the Federal Reserve Board to forego a domestic deposit business and to accept only deposits permitted for Edge Act corporations.⁸³ This may have been an attempt, albeit a weak one, to preserve the "have not" states' ability to attract foreign capital and establish international financial centers.

The establishment of even limited federal branches is not allowed in North Carolina, however; the IBA allows federal branches only in a state

banks, see Glidden & Shockey, *U.S. Branches and Agencies of Foreign Banks: A Comparison of the Federal and State Chartering Options*, 1980 U. ILL. L.F. 65.

⁷⁹ A "commercial lending company" is defined as "any institution, other than a bank or an organization operating under section 25 of the Federal Reserve Act, organized under the laws of any State of the United States or the District of Columbia, that maintains credit balances as may be maintained by an agency and engages in the business of making commercial loans." 12 C.F.R. § 211.22(a)(3) (1981).

⁸⁰ 12 U.S.C. § 1842(d) (Supp. IV 1980).

⁸¹ In addition, the Federal Reserve Board must approve such acquisitions. *Id.* § 1842(a)(3). For more information on section 3 of the BHCA, see generally Shay, *Interstate Banking Restrictions of the International Banking and Bank Holding Company Acts*, 97 *Banking L.J.* 524, 535-50 (1980).

⁸² Twenty-two other states have remained similarly mute, but sixteen states specifically prohibit out of state banks: Arizona, Connecticut, Florida, Idaho, Iowa, Maine, Maryland, Michigan, Minnesota, Montana, New Jersey, Ohio, Rhode Island, Texas, Virginia, and West Virginia. 1975 Hearings, *supra* note 5, at 20-21. See *supra* text accompanying note 9, for a list of the eleven states who have expressly authorized foreign banking offices in their states.

⁸³ IBA, *supra* note 2, § 5, (codified at 12 U.S.C. § 3103(a)(1)(B), (a)(2)(B) (Supp. IV 1980)). For deposits permissible for Edge Act corporations, see *supra* note 50 and accompanying text.

whose law expressly permits out-of-state branches,⁸⁴ which North Carolina's law does not. On the other hand, the establishment of *state* branches requires only the "approval by the bank regulator" of the target state.⁸⁵ Thus, in North Carolina, only state branches of out-of-state foreign banks may be *established*. Neither federal nor state branches may be *acquired*, and federal branches may not be established.⁸⁶ This is an unfortunate loss to the credit market in North Carolina because section 5 does not appear to restrict what a branch may do with its deposits, so long as they are Edge-like deposits.

The argument might be advanced that because North Carolina is inaccessible for out-of-state banks, the lack of express permission for foreign banking actually encourages foreign banks to select North Carolina as its "home." However, this argument exaggerates North Carolina's drawing power, especially relative to several more financially-oriented states, such as New York, California, Illinois, and Texas. The argument also ignores all the foreign banks who have selected "home" states. So far nearly ninety-five percent of home-state selections are New York and California.⁸⁷ Without positive state action, North Carolina will be unable to attract limited federal branches and federal agencies of any of these large foreign financial institutions.

Although section 5 also requires the target state's statutorily expressed permission for the establishment of a federal *agency* by a foreign bank outside its home state,⁸⁸ a state agency or commercial lending company need only meet the approval of the state's bank regulatory authority.⁸⁹ An agency or a commercial lending company may not accept deposits or exercise fiduciary powers, but may maintain credit balances related to their lawful activities.⁹⁰ Finally, a bank holding company may not maintain both a federal branch and a federal agency in the same state,⁹¹ nor may it maintain any mixture of state and federal branches or agencies within the same state.⁹²

⁸⁴ 12 U.S.C. § 3103(a)(1)(A) (Supp. IV 1980).

⁸⁵ *Id.* § 3103(a)(2)(A).

⁸⁶ For a general discussion on the differences among states and between state and federal laws regulating banking, see Hackley, *supra* note 8, at 580-86.

⁸⁷ As of June 5, 1981, the 112 foreign banking organizations operating in the U.S. had home-state selections as follows: New York—79; California—27; Florida and Illinois—2 each; and Massachusetts and District of Columbia—1 each. [1980] 1 FED. BANKING L. REP. (CCH) ¶ 3155A.

⁸⁸ 12 U.S.C. § 3103(a)(3) (Supp. IV 1980).

⁸⁹ *Id.* § 3103(a)(4).

⁹⁰ *Id.* § 3102(d).

⁹¹ *Id.* § 3102(e).

⁹² *Id.* § 3102(a). Not to be overlooked, however, is an important grandfather provision. It states that the above restrictions are not applicable to a foreign bank whose state branch, agency, or commercial lending company "commenced lawful operation or for which an application to commence business had been lawfully filed with the appropriate State or Federal authority, on or before July 27, 1978." *Id.* § 3103(b). This allows many foreign banks to maintain their existing multistate operations and keeps open several options for their future activities in the United States. It is a powerful provision that apparently was included to prevent foreign

C. Provisions for "Home State" Determination

Section 5 of the IBA provides only that the home state is whichever of such states, in which the foreign bank has branches, agencies, subsidiary commercial lending companies or subsidiary banks as of September 27, 1978, that is elected by the foreign bank as its home state, or in default of such election, by the Federal Reserve Board.⁹³ The Senate, however, through its legislative history, gave some guidance to the Federal Reserve regarding its home state provisions. For example, a foreign bank with a grandfathered branch should not be able to later establish a branch in another state, designate that second state as its home state, and thus seek to have full-service branch offices in two states.⁹⁴ Indeed, the Federal Reserve Board promulgated two rules to accomplish this suggestion.⁹⁵ But as presently stated, the Board's rules would also prohibit the election of a state in which the foreign bank has established or applied for an agency before the date of election, or before the date of enactment, but after the grandfather date, if the bank also has branches, subsidiaries or agencies established prior to the grandfather date.⁹⁶ These regulations need not have been this restrictive and perhaps gave insufficient weight to the issue of competitive equality among States.⁹⁷

These rules virtually eliminate North Carolina's prospects for attracting branches of foreign banks who are already grandfathered elsewhere in the country. The FED has promulgated rules for changing the home state, however. A foreign bank may change its home state only once and if the "[d]omestic branches established and investments in banks acquired in reliance on its original home state selection are conformed to those that would have been permissible had the new home state been selected as its home state originally."⁹⁸ This first change requires only thirty days prior notification to the Board; presumably, then,

retaliation against U.S. interests abroad. Nonetheless, the permanent exclusion of these grandfathered offices, as well as Congress' call for a review of the McFadden Act, IBA, *supra* note 2, § 514, keeps alive the domestic banks' arguments to repeal the prohibition on interstate branching in the McFadden Act and the BHCA.

⁹³ 12 U.S.C. § 3103(c) (Supp. IV 1980). The purpose of this provision was "to minimize dislocation and to provide maximum flexibility to existing foreign bank operations," assuming that "the Federal Reserve will provide by regulation a suitable procedure" for registering and for changing the home state. Senate Report, *supra* note 1, at 11, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1431.

⁹⁴ 124 Cong. Rec. S26123 (daily ed. Aug. 15, 1978). For those foreign banks who have been operating in the United States for some time, the grandfather provisions do permit full-deposit services on a multistate basis. The foreign bank may choose its home state from all the states in which it has a grandfathered operation; however, wherever the home state is selected, additional, full-deposit branching would not be allowed in any other state. Likewise, an agency in another state, though grandfathered, may not be converted to a full-deposit-taking branch. 12 C.F.R. § 211.22(b)(3).

⁹⁵ *Id.* § 211.22(b)(3), (4).

⁹⁶ *Id.* § 211.22(b)(4).

⁹⁷ For a sharp attack on the undue restrictiveness of these rules, see Farrar, *supra* note 74, at 97-100; and Shay, *supra* note 81, at 529-31.

⁹⁸ 12 C.F.R. § 211.22(c)(2) (1980).

subsequent changes might be available with the FED's express approval, provided the changes do not provide the foreign bank with undue advantages over domestic firms.

The Senate also suggested that foreign banks with no branches or subsidiaries in the United States on the grandfather date should "have their home State determined to be the State in which they open their initial deposit-taking office."⁹⁹ The Federal Reserve Board has adopted such a rule.¹⁰⁰

The Board has also ruled that a foreign bank which maintains only an agency or agencies in the United States, and which does not operate a domestic branch or lending subsidiary, would not be required to select a home state.¹⁰¹ These two rulings favor states like North Carolina and allow them the opportunity to attract foreign banks who have not yet established deposit-taking facilities in the United States. Indeed, the great majority of foreign bank agencies are located in New York and California, so this rule allows most foreign banks whose U.S. activities have been limited to agency facilities to branch into other markets,¹⁰² including North Carolina.

IV. Conclusion

North Carolina has a reputation for the equality and competitiveness of its banking institutions. These attributes have benefited commercial and retail users, and the general public as well. The State now has the opportunity to continue and enhance these benefits by increasing the capital resources located in North Carolina. It also can aid the expansion of international trade in North Carolina¹⁰³ because the international federal facilities operable in North Carolina would want to take deposits generated by international transactions or made by foreign persons. In addition, the possibility of foreign acquisition of state banks would further sharpen the competitive environment.

Without a statute expressly permitting foreign banks, none of this is

⁹⁹ Senate Report, *supra* note 1, at 12, reprinted in [1978] U.S. Code Cong. & Ad. News 1421, 1432.

¹⁰⁰ 12 C.F.R. § 211.22(b)(5) (1980).

¹⁰¹ *Id.* § 211.22(b)(2).

¹⁰² Farrar, *supra* note 74, at 97.

¹⁰³ The North Carolina legislature during the 1981 Session endorsed the promotion of international banking in the State when it enacted G.S. 105-130.5(b)(13) exempting income of an "international banking facility" (as defined by the Federal Reserve) from state income tax. In its preamble to the amendment, the legislature posited that the State's promise for further expansion in international trade "must necessarily have readily available international banking facilities conveniently available" and that "the expansion of international banking within the State would result in additional directly related employment and further the position of this State in international trade." An Act to Amend the Tax Law in Relation to an International Banking Facility, House Bill 1265, ch. 855, 1981 N.C. Adv. Legis. Serv.. Although this amendment was enacted to benefit domestic banks in North Carolina, the same persuasive economic arguments should apply for promotion of any international banking. The author does not naively believe, however, that the same political arguments will necessarily prevail.

possible. At present, a foreign bank cannot establish a federal agency or limited federal branch in North Carolina unless that foreign bank selects this State as its home state, which, as has been shown, is an unlikely event. Neither can foreign banks acquire control of a state-chartered bank. Congress has enacted several provisions to protect the local consumers and banks, such as the requirement of Board approval for acquisitions of state banks¹⁰⁴ and the obligation of the federal branches to accept only Edge-like deposits.¹⁰⁵ If the legislature wants guarantees in the event of federal deregulation of interstate banking, it can enact a statute that provides exactly the same restrictions that exist now. But with the protections derived from the federal legislation, North Carolina's legislature should be able to move now to open up this market for these special foreign offices that offer a clear benefit to the State's economy.

HAYNES PELL LEA

¹⁰⁴ See *supra* note 81; 12 U.S.C. § 1842(a) (Supp. IV 1980).

¹⁰⁵ See *supra* note 83.