

GAO

Report to the Chairwoman and the
Ranking Minority Member,
Subcommittee on Financial Institutions
and Consumer Credit, House of
Representatives

September 1996

FOREIGN BANKS

Implementation of the Foreign Bank Supervision Enhancement Act of 1991





General Government Division

B-271055

September 30, 1996

The Honorable Marge Roukema
Chairwoman
The Honorable Bruce F. Vento
Ranking Minority Member
Subcommittee on Financial Institutions
and Consumer Credit
Committee on Banking and Financial Services
House of Representatives

This report responds to your request for information on implementation of the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA). FBSEA gives the Federal Reserve enhanced supervisory and regulatory authority over foreign banks operating in the United States through branches, agencies, commercial lending companies, and representative offices.¹ The legislation was proposed primarily in response to the perceived need for more federal oversight resulting from misconduct by a few foreign banks operating in the United States.

You were interested in whether the act is being adequately implemented. As agreed with your subcommittee, the objectives of this report are to describe (1) the Federal Reserve's process for approving foreign bank applications for entry and expansion into the United States and (2) the examination process, including the coordination among U.S. regulators, and provide statistics on enforcement actions that have been taken since passage of FBSEA. In additional work now under way, we agreed to (1) review the Foreign Banking Organization (FBO) program, which the Federal Reserve developed to improve the supervision of foreign banks in the United States and (2) gather information on internal control problems in the U.S. offices of foreign banks and the use of internal and external audits by foreign banks and federal bank supervisors.

Results in Brief

FBSEA established minimum standards for foreign bank entry and expansion into the United States and strengthened federal supervision and

¹Agencies perform the same functions as branches except that they cannot generally accept deposits. Commercial lending companies are specialized nondepository institutions organized under state law. They may engage in borrowing and lending activities and have numerous other powers. They may maintain credit balances but may not accept deposits. New York Article XII investment companies are the only current examples. Representative offices generally are small marketing and research operations. Some are similar to the loan production offices of U.S. banks. They allow foreign banks to attract business for the parent bank and develop correspondent relationships with local U.S. banks. They are prohibited, however, from engaging in general banking activities, although they may conduct administrative functions, such as handling the signing of loan documents.

regulation. Under the act, before foreign banks can establish offices or acquire banking subsidiaries in the United States, the Federal Reserve must approve the applications. Our review of the Federal Reserve's process for approving such applications showed that as of January 29, 1996, the Federal Reserve had approved 45 applications after determining that the applicant banks met the standards specified in FBSEA and its implementing regulations. However, Federal Reserve staff have said that the processing of applications had taken longer than they would have liked. Federal Reserve staff told us that new guidelines were established in March 1993 to improve processing time. Available evidence indicates that average processing time has been reduced since these new guidelines became effective.

The Federal Reserve, as mandated by FBSEA, is to coordinate with the other federal and state bank supervisors to ensure that foreign branches and agencies are examined at least once every 12 months. Federal Reserve statistics indicated that FBSEA's 12-month mandate had been met in an average of 97 percent of the cases during 1993, 1994, and 1995. In addition, the act gave the Federal Reserve responsibility for examining representative offices of foreign banks in the United States, although it did not establish a time frame in which this must be done. The Federal Reserve examined over half of the representative offices of foreign banks operating in the United States during each of the years 1993, 1994, and 1995.

Examination results indicated that bank supervisors have found branches and agencies of foreign banks generally to be in satisfactory condition. For example, only 3 percent of foreign branches and agencies received ratings in the lowest two categories for safety and soundness in 1995. From 1993 through 1995, federal banking supervisors issued 40 formal enforcement actions against foreign banks operating in the United States.² Of these actions, the Federal Reserve used its civil money penalty authority in four cases and ordered that one foreign bank terminate its banking operations in the United States.

Background

Between 1972 and 1990 the presence of foreign banks in the United States increased rapidly—from 105 offices³ and subsidiary banks with \$95 billion

²These 40 actions include 6 voluntary terminations of deposit insurance. These actions are counted as formal enforcement actions, even though the termination is voluntary.

³The term foreign bank office refers to an entity of a foreign bank that is not separately incorporated in the United States.

in assets in 1972 (measured in 1995 dollars) to 737 offices and subsidiary banks with \$933 billion in assets (measured in 1995 dollars) at the end of 1990.⁴ Since then their number has fallen and growth in the volume of their assets has slowed.⁵ At the end of 1995, there were 656 foreign bank offices and foreign-owned subsidiary banks with \$974 billion in assets in the United States. Including an additional 247 representative offices, 371 foreign banks had a presence in the United States.

Branches and agencies⁶ are the most common organizational forms—accounting for about 78 percent of foreign bank assets at the end of 1995. (See table 1.) Foreign-owned U.S. bank subsidiaries held over 21 percent of foreign bank assets. Commercial lending companies and Edge Act/Agreement Corporations accounted for less than 1 percent of foreign bank assets, and representative offices held no banking assets.⁷

Table 1: Foreign Bank Organizations Operating in the United States as of December 1995

Dollars in billions		
Forms of organization	Number	Assets
Branches and agencies	545	\$761
Subsidiary banks	94	208
Commercial lending companies	3	1
Edge Act/Agreement Corporations	14	3
Representative offices	247	NA
Total U.S. offices^a	903	\$974

^aTotals may not add due to rounding.

NA: Not applicable.

Source: Federal Reserve.

U.S. branches and agencies are legal and operational extensions of their parent foreign banks and as such have no capital of their own. They may conduct a wide range of banking activities, including lending, money

⁴Data exclude representative offices. The Federal Reserve became responsible for supervising representative offices under FBSEA. Prior to this act, the only federal requirement for these offices was that they register with the U.S. Department of the Treasury.

⁵From 1972 to the end of 1990, real assets in these offices grew at an annual rate of almost 14 percent. Since then they have grown at an annual rate of almost 1 percent.

⁶Because they perform similar functions, branches and agencies are often discussed together. In this report we will follow this convention.

⁷Edge Act/Agreement Corporations allow U.S. and foreign banks to conduct international banking activities in the United States subject to more limited laws and regulations than those that apply to domestic banking activities.

market services, trade financing, and other activities related to the service of foreign and U.S. clients. They can also access the U.S. payments system through the Federal Reserve and obtain other Federal Reserve services.

Branches and agencies of foreign banks may be either state-licensed and therefore regulated and supervised by the respective state banking department, or federally licensed and regulated and supervised by the Office of the Comptroller of the Currency (OCC). As of December 1995, 473 branches and agencies were state-licensed and 72 were federally licensed. In addition, 41 of the branches were insured by the Federal Deposit Insurance Corporation (FDIC) and thus subject to additional supervision by FDIC.

U.S. bank subsidiaries of foreign banks are U.S.-chartered banks that have all the powers of U.S.-owned banks. They are insured by FDIC and are subject to all the rules and regulations governing U.S.-owned banks. Their assets and liabilities are separate from those of their parent foreign banks, and they must maintain their own capital in accordance with U.S. laws and regulations. They may be either state or federally chartered.

Branches and agencies of foreign banks were first subject to federal regulation with passage of the International Banking Act of 1978 (IBA). Adopting a policy of national treatment, IBA sought to allow foreign banks with branches and agencies to operate in the United States on an equal basis with U.S. banking organizations. Foreign banks were to receive neither significant advantages nor incur significant disadvantages. The act also gave the Federal Reserve responsibility for overseeing the combined U.S. operations of foreign banks.

Although IBA substantially equalized the treatment of the U.S. operations of foreign and U.S. banks, it did not require prior federal review of foreign bank entry into the U.S. market nor did it permit a federal role in the termination of a state-licensed branch or agency. Cases of fraud and other criminal activity by some foreign banks in the 1980s and early 1990s convinced the Federal Reserve and Congress that both state and federal supervisors needed to increase the attention they paid to foreign banks operating in the United States. In particular, Federal Reserve officials believed that prior federal review of foreign bank entry and expansion in the U.S. market was necessary. They also believed that a federal role in terminating a state-licensed branch or agency for unsafe and unsound banking practices was desirable.

In December 1991, Congress passed FBSEA. This act, which amended IBA, increased federal supervision of all foreign bank operations, giving the Federal Reserve authority to examine all foreign bank offices in the United States. FBSEA also mandated uniform standards for foreign banks establishing operations in the United States. Finally, it prohibited U.S. branches of foreign banks from obtaining deposit insurance⁸ and gave federal supervisors greater enforcement authority over the U.S. operations of foreign banks.

FBSEA also directed the Federal Reserve to levy examination fees on foreign banks with a U.S. branch, agency, or representative office. However, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 imposed a 3-year moratorium on this provision.

Applications for Foreign Bank Entry

FBSEA increased the Federal Reserve's supervisory and regulatory power over foreign banks by requiring Federal Reserve approval for all foreign banks seeking to establish U.S. offices, whether licensed by state or federal authorities.⁹ This requirement was designed to give the Federal Reserve, as the agency responsible for overall supervision of foreign banks in the United States, a role in determining whether such institutions may establish a U.S. banking presence.

Uniform Standards for Establishing a U.S. Office

FBSEA established uniform standards for foreign banks entering the United States, requiring them to meet financial, managerial, and operational standards similar to those of U.S. banking organizations. The act made the Federal Reserve responsible for ensuring that these standards are met.

Under FBSEA, foreign banks must meet two standards in order to establish a branch or an agency, or to acquire ownership or control of a commercial lending company. First, the Federal Reserve must determine that the foreign bank applicant (and any parent foreign bank) engages directly in the business of banking outside the United States and is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor. Second, the foreign bank must furnish to the Federal Reserve the information that the Federal Reserve requires in order to assess the application adequately.

⁸Those branches that already had deposit insurance were allowed to retain it.

⁹Foreign banks had previously been required to obtain Federal Reserve approval for establishment or acquisition of bank subsidiaries under the Bank Holding Company Act.

In addition to the two mandatory standards, the Federal Reserve also considers other factors. Among others, these include (1) whether the applicant's home country authorities have consented to the establishment of the proposed office, (2) the applicant's financial and managerial resources, including its capacity to engage in international banking, and (3) whether the applicant has provided adequate assurances that it will provide access to information sufficient to allow the Federal Reserve to determine its compliance with applicable U.S. laws.

Before FBSEA, the states were responsible for licensing representative offices and, at the federal level, applicants only had to register their office with the U.S. Department of the Treasury. FBSEA gave the Federal Reserve authority to approve establishment of these offices as well. However, it did not require the Federal Reserve to apply the standards mandated to establish other banking offices to its decisions regarding applications for representative offices. The Federal Reserve is to take these standards into account in evaluating a foreign bank's application to establish a representative office, but it can approve applications where the parent foreign bank does not meet all of the standards required to establish a branch or agency.¹⁰

Application Process

Before FBSEA, foreign banks wishing to establish a branch or agency in the United States were required to obtain approval from the appropriate banking regulator—OCC—for federal branches and agencies, or the state regulator for state branches and agencies. Since FBSEA, a foreign bank must also receive approval from the Federal Reserve.

To receive approval from the Federal Reserve, a foreign bank must submit an application to the reserve bank located in the district where it plans to establish an office or to its already designated "responsible" reserve bank. A copy of its OCC or state application and any additional information necessary for the Federal Reserve to determine that the bank meets the standards set out in FBSEA are to be included in the application. The application is not to be accepted (i.e., deemed informationally complete) until these criteria are met. Once the application is accepted for processing, it is reviewed by staff and submitted to the Board for action.

Before March 1993, applications were reviewed solely by the reserve bank before they were accepted. If an application lacked information, the

¹⁰The Federal Reserve has stated that the standards that apply to the establishment of branches and agencies need not apply in every case to the establishment of representative offices, because representative offices do not engage in a banking business and cannot take deposits or make loans.

reserve bank requested the applicant bank to provide the information. After the reserve bank determined that it had all necessary information to process the application, it was accepted and forwarded to the Board for review and disposition. At this point the Board could request additional information. This process often resulted in delays and multiple requests for additional information.

In March 1993, the Federal Reserve issued guidelines changing its procedures for processing applications to establish U.S. offices of foreign banks. The changes were intended to expedite processing and reduce the burden on applicants of responding to multiple requests for additional information. The guidelines require the reserve bank to send copies of the application to the Board within one business day of receiving an application. Both the reserve bank and Board staffs are then to simultaneously review the application to ensure that the information is complete. If additional information is needed, coordinated requests are to be made to the applicant bank before the application is accepted.

The guidelines also established time limits for Federal Reserve staff to review applications and ask for additional information. The reserve bank and Board staffs are to review an application and request additional information from the applicant bank within 15 business days of receipt of the application by the reserve bank. The applicant bank then has 20 business days to respond to these requests. If the applicant bank does not respond within that time, the application would normally be returned due to insufficient information. If the applicant responds within the time limit, the reserve bank and Board staffs have an additional 10 business days either to accept the application as complete or to request additional information. If additional information is requested, the applicant bank similarly has 10 business days to respond.

The Federal Reserve encourages all foreign bank applicants to meet with reserve bank and/or Board staffs before filing applications. These meetings are intended to identify relevant issues, apprise applicants of required information, and enable Federal Reserve staffs to obtain necessary information at an early stage of the process.

Once the reserve bank and Board staffs determine that the application is complete and it is accepted, the Federal Reserve has an internal guideline of 60 days to analyze it, have background checks completed, and make inquiries to home country authorities. After these tasks are completed, the

application is to be presented to the Board for action.¹¹ If the application cannot be presented for Board action within the 60-day period, the applicant is to be informed in writing of the reasons.

Results of Federal Reserve's Review of Foreign Bank Applications

As of January 29, 1996, the Federal Reserve had received 96 applications from foreign banks seeking to establish offices or bank subsidiaries under FBSEA. The Federal Reserve had approved 45 applications, had returned or applicant banks had withdrawn 23, and 28 were under review.¹²

Of the 45 applications approved by the Federal Reserve, 6 were for agencies, 15 for branches, 18 for representative offices, and 8 for bank acquisitions.¹³ The approved applications represented banks from 23 countries. Taiwan accounted for the most—7 of the 45 applications.

In its decisions approving the applications for branches and agencies and subsidiary banks, the Federal Reserve found that the foreign banks had met the standards required under FBSEA and its implementing regulations. The Federal Reserve's decisions indicated that the applicants had provided the necessary information, had met all conditions concerning their intended operation, and were in compliance with the requirements for approval.

The Federal Reserve's policy, as required by FBSEA, is to use the standards that apply to branches and agencies as guidance when considering an application to establish a representative office. Federal Reserve regulations do not require these standards to be met in every case because representative offices differ from branches and agencies in that representative offices cannot engage in a banking business and cannot take deposits or make loans.

Federal Reserve staff told us that, in general, representative office applicants have not been required to meet the supervision standards required for branches and agencies. A review of the orders indicated that the Federal Reserve examined the home country supervision of the applicant bank in every representative office case, but a determination

¹¹Under Federal Reserve regulations the Board can delegate certain approval authority to the reserve bank. This may occur when a foreign bank has already received approval to establish an office and approval is sought for an additional office with equal or lesser powers based on its license.

¹²These numbers include one representative office that was approved by the reserve bank under delegated authority.

¹³Two applications involved approval of more than one type of foreign bank office.

that the applicant bank or its parent foreign bank were subject to comprehensive consolidated supervision was not always made. Similarly, the Federal Reserve has not required foreign bank applicants wishing to establish representative offices to meet the same financial standards, including the standard related to capital, which are required for the establishment of branches and agencies. In our review of 17 orders approving representative offices, we found that in 13 cases the orders did not indicate whether the capital standards were being met by the parent foreign bank.

Most of the 23 applications that had not been approved by the Federal Reserve and were no longer under review were withdrawn by the applicant bank for various reasons. (See table 2.)

Table 2: Number of Applications Returned/Withdrawn as of January 29, 1996

Applications withdrawn ^a	17
Applications returned	
Insufficient information	5
Weaknesses in existing U.S. operations	1
Total	23

^aReasons for withdrawal of applications included: a change in strategy, a change in ownership, supervision factors, condition of U.S. operations, and financial factors relating to the applicant. In many situations, a combination of reasons applied.

Source: Federal Reserve.

Of the 28 applications under review as of January 29, 1996, 3 were for agencies, 5 were for bank acquisitions, 8 were for branches, and 12 were requests to establish representative offices. Federal Reserve staff told us that they had not received any applications to establish a commercial lending company since FBSEA was passed.

Processing Time for Establishing Branches, Agencies, and Representative Offices

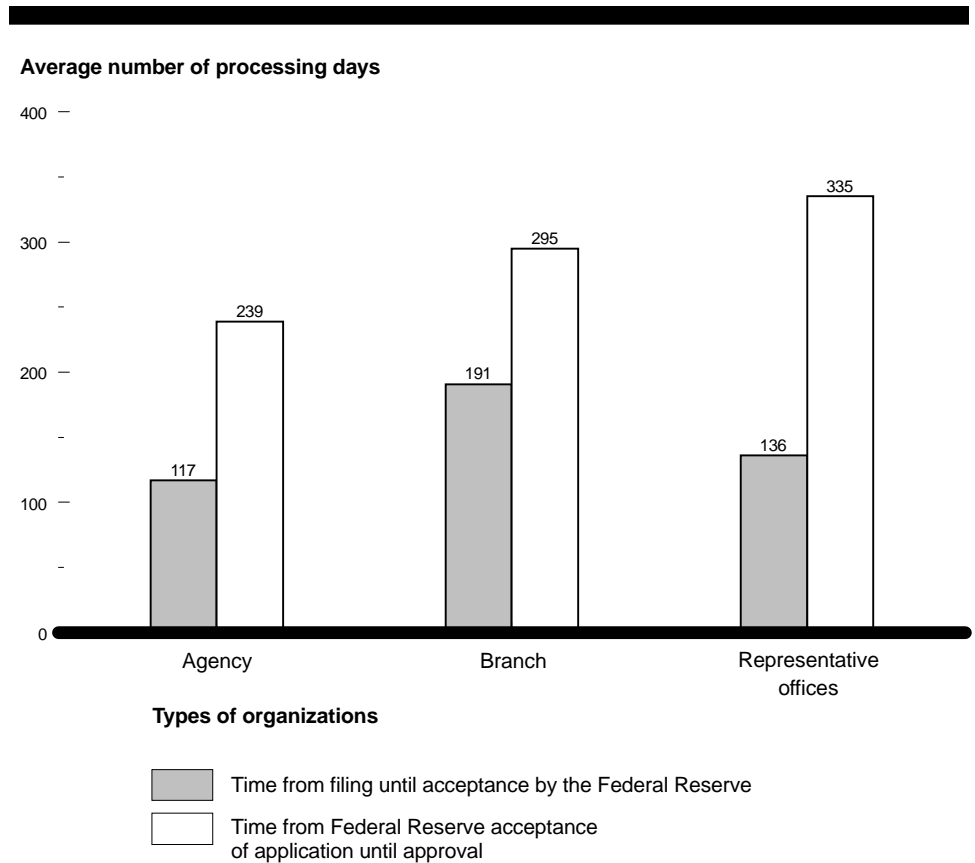
Processing foreign bank applications took more than a year on average, and this length of time concerned both the Federal Reserve and applicant foreign banks. Federal Reserve staff told us that the length of time it took to process applications can be attributed to the need for additional time to complete background checks and to review issues related to comprehensive supervision, bank operations, and internal controls. They also cited difficulties in obtaining translated information from some applicant banks, a lack of understanding by some applicants about the

level of detail required to review comprehensive consolidated supervision, and some applicants' unfamiliarity with FBSEA requirements as causes of delays.

After the Federal Reserve issued its March 1993 guidelines, there was a decrease in the amount of time taken to process branch, agency, and representative office applications. (See fig. 1.) On average, the total time it took to process such applications (from date of initial filing to disposition) dropped from 574 days to 293 days.¹⁴ Of this, the average time between the date that applications were initially filed and the date they were accepted decreased from 170 days to 130 days, and the average time between acceptance and approval decreased from 404 days to 163 days. Federal Reserve staff attributed this decline to a number of reasons, including commitment to meet the guidelines, experience with the process, and improvements in the name check process.

¹⁴Processing times were determined from data on 21 applications that were filed before the March 8, 1993, policy change and the 15 applications that were filed after the change. Data on the representative office approved by a reserve bank under delegated authority were not available.

Figure 1: Average Processing Time for 36 Approved Applications of Branches, Agencies, and Representative Offices, as of January 29, 1996



Source: Federal Reserve.

Examination of Foreign Branches, Agencies, and Representative Offices

FBSEA directed the Federal Reserve to coordinate the supervision of foreign banking organizations with federal and state bank supervisors to ensure an efficient and uniform approach in overseeing the operations of foreign banks in the United States. The act gave the Federal Reserve the responsibility for ensuring that branches and agencies of foreign banks are examined every 12 months and gave it the power to examine representative offices.¹⁵ It also broadened the enforcement powers of the Federal Reserve and OCC. Specifically, the act

- permitted the Federal Reserve to terminate the activities of a state-licensed branch, agency, commercial lending company, or representative office for violations of law or for unsafe or unsound

¹⁵Examinations of subsidiary banks are governed by other provisions of federal banking law. These banks are to be examined every 12 or 18 months, depending on the size and condition of the bank.

banking practices.¹⁶ The Federal Reserve may recommend to OCC similar action for federally licensed offices.

- modified and broadened the Federal Reserve's and OCC's authorities to assess civil money penalties on specific grounds against any foreign bank or office or subsidiary of a foreign bank and certain individuals of up to \$25,000 for each day during which a violation continues.

Coordination Among Bank Supervisors

To meet the requirements set out in FBSEA, Federal Reserve staff told us that each year they develop, in cooperation with OCC, FDIC, and state bank supervisors, an annual examination plan, to supervise the U.S. operations of foreign banking organizations. This plan includes branches, agencies, commercial lending companies, Edge Act/Agreement Corporations, and significant nonbank subsidiaries. They said the supervisors discuss the focus of the year's examinations and when they will be conducted. Their goal is to ensure that each branch and agency is examined every 12 months without undue burden imposed on the entity and that all supervisory issues are addressed in the examination process.

To meet this goal, the Federal Reserve may conduct an independent examination, rely on the other agencies to conduct the examination, or participate in a joint examination. Federal Reserve staff told us that, in order to form a baseline understanding of foreign bank operations, in 1992, they examined either independently or jointly all foreign bank branches and agencies in the United States. In 1993, the Federal Reserve, OCC, FDIC, and state bank supervisors developed a joint examination manual for branches and agencies. The purpose of the manual is to ensure to the extent possible that each regulatory agency examines branches and agencies of foreign banks in a consistent manner. Federal Reserve staff told us that in the future they intend to examine fewer foreign branches and agencies and rely more on the examinations conducted by OCC and the states. Table 3 shows the number of independent and joint examinations conducted by each agency for 1993 through 1995.

¹⁶The Federal Reserve must also determine that as a result of such violation or practice, continued operation of the entity would not be in the public interest or would be inconsistent with the purposes of FBSEA or other federal banking laws.

Table 3: Examinations of Branches and Agencies Done by Each Supervisor, 1993 Through 1995

Type	1993	1994	1995
Independent examinations			
Federal Reserve	146	167	150
State bank supervisors	145	122	161
OCC	18	36	49
FDIC	11	17	7
Total independent examinations	320	342	367
Joint examinations	261	246	203
Total examinations^a	581	588	570

^aThe number of examinations exceeds the number of branches and agencies because some branches and agencies may be examined more than once a year.

Source: Federal Reserve.

Most Branches and Agencies Have Been Examined Annually

Federal Reserve examination data indicated that federal and state banking supervisors have substantially been meeting the requirement that all branches and agencies be examined annually.¹⁷ For 1993, 1994, and 1995, we found that, on average, 97 percent of branches and agencies had been examined at least annually. In 1995, 542 of the 549 branches and agencies operating in the United States at the beginning of the year were examined. Federal Reserve staff reported that enhanced monitoring tools have been developed to quickly identify cases where the mandate appears to have been missed.

Examinations of Representative Offices

FBSEA did not establish a required frequency for examinations of representative offices. It is currently Federal Reserve policy to examine all representative offices at least once every 24 months.¹⁸ Examinations of representative offices differ from those of foreign branches and agencies in that they are intended primarily to verify that the type of business being conducted by an office is limited to that customarily viewed as a representative office function and to ensure that the office is operating in conformance with sound operating policies.¹⁹

¹⁷Although FBSEA mandated that foreign branches and agencies be examined every 12 months, this period is calculated from the end of one examination to the beginning of the next. Thus, start dates between examinations generally average about 14 months.

¹⁸It was originally Federal Reserve policy to examine representative offices on an 12-month cycle. This was modified to 24 months after experience showed a high degree of compliance with sound operating policy.

¹⁹For this reason, the Federal Reserve refers to these as visitations rather than examinations.

The Federal Reserve conducted a survey in 1992 to determine the number of representative offices operating in the United States. Federal Reserve staff told us that between 1993 and 1994 examiners visited all representative offices in the United States to verify that they were engaging only in activities appropriate for representative offices. From our review of Federal Reserve data, we found that for 1993 through 1995, 93 percent of representative offices, net of closures and new entrants, were examined at least once. The examination rates were 87 percent, 54 percent, and 66 percent for 1993, 1994, and 1995, respectively.

Examination Results Indicate Most Foreign Branches and Agencies Have Been Rated Satisfactory

Examinations by federal and state supervisors are intended to determine the safety and soundness of foreign branches and agencies. They result in a composite examination rating for the entity. These ratings range from 1 (fundamentally sound) to 5 (unsatisfactory). As table 4 shows, of the foreign branches and agencies examined during 1995, 88 percent received a rating of 1 or 2 at year-end, indicating that their operations were at least satisfactory and required only normal supervisory attention. Nine percent were rated 3 (fair). Only 3 percent received a rating of 4 or 5, meaning that they were considered to have significant weaknesses or were identified as having so many severe weaknesses that they required urgent attention by their head offices. These results are similar to those in 1993 and 1994 in which 79 percent and 85 percent, respectively, were found to have sound operations.

Table 4: Composite Ratings of U.S. Branches and Agencies of Foreign Banks, 1993 Through 1995

Rating	Number	Percent	Number	Percent	Number	Percent
1	23	4%	46	9%	59	11%
2	392	75	400	76	394	77
3	86	17	70	13	48	9
4	17	3	8	2	11	2
5	2	<1	2		3	1
Total^a	520	100%^b	526	100%	515	100%

^aThe number of ratings is less than the number of foreign bank branches and agencies because multiple branches or agencies of an entity operating in the same city may receive a single rating. The number of ratings is also lower than the number of branches and agencies examined because some branches and agencies may have been examined more than once during the year, and this table reflects only the latest ratings.

^bTotal does not add due to rounding.

Source: Federal Reserve.

Enforcement Actions Taken Against Foreign Banks

Federal and state banking supervisors may issue enforcement actions against foreign banks as well as their U.S. branches and agencies in cases where a branch, agency, or other U.S. office of the parent bank is determined to be operating in an unsafe or unsound manner in violation of applicable laws, regulations, or written conditions imposed during the applications process. These actions may be either formal or informal, depending upon the severity of the problem(s) and the bank's willingness to correct them.

Although the Federal Reserve had authority to initiate enforcement actions against foreign banks and their U.S. branches and agencies under the IBA and the Federal Deposit Insurance Act, FBSEA enhanced its enforcement powers. Specifically, it gave the Federal Reserve the authority to order a foreign bank with a state-licensed branch, agency, commercial lending company, or representative office to terminate its activities in the United States and the authority to recommend such action to OCC for federally licensed branches and agencies. Federal Reserve staff stated that the Federal Reserve had the authority to levy civil money penalties for violation of IBA and for failure to make certain reports and FBSEA modified and broadened this authority for both the Federal Reserve and OCC. FDIC can issue formal enforcement actions against foreign banks by virtue of its authority under the Federal Deposit Insurance Act.

Between 1993 and 1995, federal banking supervisors issued 40 formal enforcement actions against foreign banks operating in the United States.²⁰ In the most serious case, the Federal Reserve, in conjunction with FDIC, the New York State Banking Department, and several other state bank supervisors, used its termination authority to order Daiwa Bank to cease its U.S. banking operations. During this period, the Federal Reserve also issued three civil money penalties for failures to file regulatory reports and one for inadequate Bank Secrecy Act policies and procedures. Neither OCC nor FDIC issued any civil money penalties during this time. The remaining 35 formal enforcement actions issued by the Federal Reserve, OCC, and FDIC included 16 cease-and-desist orders. In practice, OCC exercises primary enforcement authority over federal branches and agencies, and the Federal Reserve takes the lead in issuing formal enforcement actions against state-licensed branches and agencies.

In addition to formal enforcement actions, each of the federal and state banking supervisors may take informal enforcement actions, such as

²⁰These 40 actions included 6 voluntary terminations of deposit insurance. Such actions are counted as formal enforcement actions even though the termination is voluntary.

memorandums of understanding and commitment letters, in which an institution agrees to remedy specific areas of supervisory concern. These actions are taken when supervisory concerns are identified that, while not overly serious, warrant some type of remedial action. In 1995, the Federal Reserve in conjunction with state bank supervisors issued 50 informal enforcement actions against foreign banks, OCC issued 9, and FDIC issued 5.

Scope and Methodology

To discuss the implementation of FBSEA, we reviewed the act and focused on those provisions that pertained specifically to the entry and examination of foreign banks in the United States. Although FBSEA contained provisions restricting some activities of foreign banks and set additional reporting and approval requirements, as agreed with the subcommittee, we did not do independent work to determine that these provisions have been followed.

We focused our work on branches and agencies of foreign banks because this form of organization accounts for the largest concentration of foreign bank offices and assets in the United States. We did limited work on representative offices because their activities are limited and they hold no banking assets in the United States. FBSEA also applies to commercial lending companies. However, there are only three of these companies in the United States and there have been no applications for this form of entry since FBSEA was implemented. Finally, since subsidiary banks are U.S.-chartered, they are governed by all of the laws and regulations applicable to U.S. banks and are supervised and examined in the same way as U.S. banks. Accordingly, FBSEA should have had minimal effect on the regulation and supervision of these banks.

To describe the Federal Reserve's applications process for foreign banks, we reviewed its implementing regulations and other banking correspondence and regulations. We also interviewed staff in the Federal Reserve's Division of Banking Supervision and Regulation and its Legal Division and officials and staff at the Federal Reserve Bank of New York, which is where most foreign banks operating in the United States are located. They gave us their views on the applications process and how it corresponds to the requirements set forth in FBSEA. We also reviewed all of the Federal Reserve's decisions approving foreign bank applications since 1992 to determine whether it addressed the statutory and regulatory requirements of FBSEA. In addition, we compared the length of time it took to process applications to the guidelines set forth by the Federal Reserve to determine whether the Federal Reserve was in compliance with its own

policies. We did not attempt to subjectively evaluate the Federal Reserve's decisions on foreign bank applications. To do so, we would have had to analyze and judge the merits of the facts presented by the foreign bank applicants and the reasoning in each application.

To describe the examination process and the results of examinations, we reviewed examination data for foreign branches, agencies, and representative offices provided by the Federal Reserve for 1993, 1994, and 1995. Because the Federal Reserve has overall responsibility for ensuring that foreign branches, agencies, and representative offices are examined in a timely manner, it maintains examination data for all such offices operating in the United States. The Federal Reserve did not maintain such data in a summary format prior to 1993. We also interviewed staff and officials from the Federal Reserve, OCC, and FDIC, in both Washington, D.C., and New York, and officials from the New York State Banking Department to determine how the Federal Reserve coordinates with other bank supervisors. To determine the extent to which federal supervisors have used enforcement actions against foreign banks operating in the United States, we collected data on enforcement actions from the Federal Reserve, OCC, and FDIC.

Our work was done in Washington, D.C., and New York, NY, between January and May 1996 in accordance with generally accepted government auditing standards.

Agency Comments

We received both written and oral comments on a draft of this report from the Federal Reserve. In its letter, the Federal Reserve stated that the information provided in the report accurately describes the policies and processes with respect to applications and examinations of foreign banks. The oral comments were technical in nature and have been incorporated where appropriate.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the House Committee on Banking and Financial Services and the Senate Committee on Banking and Urban Affairs, the Chairman of the Federal Reserve Board, the Chairman of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and other interested parties. We will also make copies available to others on request.

Major contributors to this report are listed in appendix II. If you have any questions, please call me at (202) 512-8678.

A handwritten signature in cursive script that reads "Thomas J. McCool".

Thomas J. McCool
Associate Director,
Financial Institutions
and Markets Issues

Contents

Letter		1
Appendix I Comments From the Federal Reserve		22
Appendix II Major Contributors to This Report		23
Tables		
	Table 1: Foreign Bank Organizations Operating in the United States as of December 1995	3
	Table 2: Number of Applications Returned/Withdrawn as of January 29, 1996	9
	Table 3: Examinations of Branches and Agencies Done by Each Supervisor, 1993 Through 1995	13
	Table 4: Composite Ratings of U.S. Branches and Agencies of Foreign Banks, 1993 Through 1995	14
Figure		
	Figure 1: Average Processing Time for 36 Approved Applications of Branches, Agencies, and Representative Offices, as of January 29, 1996	11

Abbreviations

FBO	Foreign Banking Organization
FBSEA	Foreign Bank Supervision Enhancement Act of 1991
FDIC	Federal Deposit Insurance Corporation
IBA	International Banking Act of 1978
OCC	Office of the Comptroller of the Currency

Comments From the Federal Reserve



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September 3, 1996

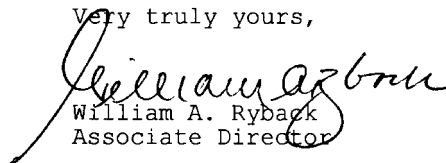
DIVISION OF BANKING
SUPERVISION AND REGULATION

Mr. Thomas J. McCool
Associate Director
Financial Institutions and Markets Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

We have read with interest the draft report, Foreign Banks: Implementation of the Foreign Bank Supervision Enhancement Act of 1991. The report accurately describes the Federal Reserve's policies and processes with respect to applications by foreign banks to establish U.S. offices and the examination of such offices. We have provided minor technical comments on the report directly to your staff.

Very truly yours,


William A. Ryback
Associate Director

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