[Vanderbilt Journal of Transnational Law](https://scholarship.law.vanderbilt.edu/vjtl)

Volume 6
Issue 2 *Spring 1973*

Article 9

1974

Foreign Banking in the United States

James A. Johnson

FOREIGN BANKING IN THE UNITED STATES

I. INTRODUCTION

Banking serves an increasingly important function in international trade. As a matter of business procedure, many businessmen engaged in international commercial transactions prefer to work through their home-country bank. Consequently, banks often attempt to locate facilities in other countries where their customers are engaged in trade. If a bank is denied entry, the government of the rebuffed bank may take measures against the rebuffing country's banks. In the United States, this situation is complicated because state governments,[1] rather than the federal government,[2] generally control the establishment of facilities by foreign banks.[3] As the volume of world trade has increased, the lack of uniform regulation of foreign banking at the federal level has become an obstacle to the financing of trade with the United States. Concurrently, American exports depend on the

1. *See* Gilbert, *Foreign Banking in the United States,* 15 SAIS REV. 20 (1971).

2. *See* J. ZWICK, FOREIGN BANKING IN THE UNITED STATES, JOINT ECONOMIC COMMITTEE, PAPER NO. 9, 89th Cong., 2d Sess. 1 (1966); 111 CONG. REC. 20,528 (1966) (remarks of Senator Javits). It should be noted that the federal government, through the 1970 Bank Holding Company Act, has some effect on the operations of foreign banks. *See also* MacKenzie & MacKenzie, *Penetration of the United States Market by a Foreign Bank,* 6 INT'L LAW. 876 (1972).

3. If a foreign bank is permitted to establish a facility, it is immediately confronted by state, and possibly federal, banking regulations. Federal deposit insurance, for instance, has been made a condition to receiving deposits in California.

When approaching the subject of foreign banking, it is helpful to understand something of the history of banking regulations in the United States. For a more detailed treatment of the growth of banking and bank regulation, see Hackley, *Our Baffling Banking System*, 52 VA. L. REV. 565, 771 (1966).

The National Currency Act of 1863 allowed banks to issue bank notes secured by government bonds. Act of February 25, 1863, ch. 58, 12 Stat. 665. The 1863 Act also established, within the Treasury Department, the Comptroller of the Currency, who executes all laws concerning the issuance and regulation of national currency and approves national bank organizations. Later, Congress attempted to drive state banks out of existence by enabling state banks to convert their state charters to national charters. Act of June 3, 1864, ch. 106, § 44, 13 Stat. 112. In 1865, Congress imposed a tax of ten per cent on the issuance of state bank notes in an effort to accelerate the conversion of state charters to federal ones. Act of March 3, 1865, ch. 78, § 6, 13 Stat. 484. Consequently, state bank issues declined markedly and the number of state banks dwindled temporarily, but state banks soon countered congressional efforts by obtaining funds through the receipt of deposits in lieu of the issuance of notes. Since the Civil War, the national and state banking structures have coexisted as a "dual banking system." This dual system, which evolved in an ad hoc manner, is characterized by an unjustifiable overlap of administration and duplication of effort. See Hackley, *Our Discriminatory Banking Structure*, 55 VA. L. REV. 1421 (1969).

Later legislation has affected both federal and state banking. In 1913, Congress enacted the Federal Reserve Act, which established twelve regional Federal Reserve Banks supervised by a Federal Reserve Board. Ch. 6, 38 Stat. 251 (1913) (codified in 31 U.S.C. § 409 and in various sections of 12 U.S.C.). National banks are required to purchase stock of the regional reserve banks, while state member banks may do so voluntarily. The Act also imposes reserve requirements and purchase, withdrawal and lending limits on member banks. Pursuant to the Act, the Federal Reserve Board regulates: branching of state member banks (12 U.S.C. § 321 (1970)); interest payments on deposits by member banks (12 U.S.C. § 371b (1970)); interlocking directorates (15 U.S.C. § 19 (1970)); foreign banking operations by American banks (12 U.S.C. § 601 (1970)); mergers (12 U.S.C. § 1828(c) (1970)); and bank holding company transactions (12 U.S.C. §§ 1842-43 (1970)).

The Federal Deposit Insurance Corporation (FDIC), created by the Banking Act of 1933, offers insurance to state and federal banks desiring it. Ch. 89, 48 Stat. 162 (codified in scattered sections of 12, 15 & 39 U.S.C.). The FDIC regulates the deposit interest paid by insured banks that do not belong to the Federal Reserve System (12 U.S.C. § 1828(g) (1970)), the establishment of branches (12 U.S.C. § 1828(d) (1970)), and bank mergers (12 U.S.C. § 1828(c) (1970)). Obviously, the FDIC's duties overlap the responsibilities of the Federal Reserve Board, the Comptroller, and possibly the states.

Several other federal statutes also have had sufficient impact on banking in the United States to merit attention. The Securities and Exchange Act of 1934 empowered the Federal Reserve Board to control the amount of credit that can be extended to purchasers of registered securities. 15 U.S.C. § 78 (1970). The 1956 Bank Holding Company Act was passed to discourage the purchase of smaller banks by larger bank holding companies. 12 U.S.C. §§ 1841-48 (1970).

Finally, the relation of federal laws to state laws should be mentioned. A bank may choose to be chartered either by the state or by the federal government. State regulations concerning minimum capital requirements and reserve requirements vary considerably; federal regulations generally are more stringent. Moreover, branching laws have undergone recent modifications that affect all types of banking: 12 U.S.C. § 36 authorizes a national bank, with the approval of the Comptroller, to establish in-town branches if similar branches would be "expressly authorized to state banks by the law of the state," and to establish out-of-town branches if such branches are authorized by the laws of the state. The Supreme Court, in First Nat'l Bank v. Walker Bank & Trust Co., 385 U.S. 252 (1966), held that state statutory branching limitations were adopted by federal law and applied to national banks. It is now generally concluded that federal law controls the definition of "national bank branch," but state law controls their establishment of American banking facilities in other countries.[4] In recent years, however, the establishment of American banks has met resistance in other countries, which demand that their banks be granted the reciprocal privilege of placing facilities in the United States. The Japanese, for example, apparently view reciprocity as a condition to further American banking in Japan.[5] Similarly, Canada has restricted American banking activities on the ground that Canadian banks have received comparable treatment in the State of New York.[6]

The first half of this Note examines the evolution of foreign banking in the United States, and the forms it has taken in response to the regulations imposed by state and federal governments. The remainder of the note advocates that the federal government assume exclusive control over foreign banking in this country.

II. DEVELOPMENT OF FOREIGN BANKING IN THE UNITED STATES[7]

The volume of foreign banking in the United States relates directly to the volume of foreign trade transacted in this country. Prior to World War I, therefore, few foreign banks were established in the United States. The first to initiate foreign banking in the United States were the Canadians, and the Japanese, who opened facilities in California during the 1870's; by the turn of the century, foreign bank facilities also were located in Oregon and Washington. In 1906,

---

establishment. *See* First Nat'l Bank v. Walker Bank & Trust Co., 385 U.S. 252 (1966); Dickinson v. First Nat'l Bank, 400 F.2d 548 (5th Cir. 1968), *aff'd on other grounds,* 396 U.S. 122 (1969). *But cf.* Ramapo Bank v. Camp, 425 F.2d 333 (3d Cir. 1970), *cert. denied,* 400 U.S. 828 (1970). For a summary of state branching laws see Gup, *A Review of State Laws on Branch Banking,* 88 BANK. L. J. 675 (1971).

For purposes of this note, it is significant that the many possible variations in the banking laws inevitably affect foreign banks, which must comply with one or more sets of state and/or federal laws.

4. "[C]orrespondent banking no longer meets the requirements of the international corporation, which expects its bank to be present in the principal countries of the world and to be able to serve it directly rather than indirectly." Heldring, *Multinational Banking Strives for Identity,* 3 COLUM. J. WORLD BUS. 49, 50 (1968). Mr. Heldring was Senior Vice President of the Philadelphia National Bank and in charge of international operations when this article was published.

5. *See* THE ECONOMIST, Jan. 27, 1972, at 64.

6. *See* Gilbert, *supra* note 1.

7. Much of the information contained in this section is taken from Gilbert, *supra* note 1. Ms. Gilbert is currently a staff member of the International Division in the Office of the Comptroller of the Currency.

Massachusetts enacted the first state legislation permitting foreign banking activity, followed by Oregon in 1907. After passing a liberal foreign banking statute in 1909, California restricted the trust activities of foreign banks in 1913, and circumscribed foreign banks still further in 1917 by prohibiting their receipt of deposits. During World War I, foreign banking activity was also restricted in Washington. Restrictive state laws remained in effect after World War I, and the 1930's witnessed further curtailment of foreign commerce, with consequent diminution of related foreign financing activity. Shortly after the attack on Pearl Harbor, the California banking department seized and liquidated three Japanese banks. In February 1942, the Comptroller of the Currency supervised liquidation of other Japanese banks located in Hawaii and Seattle, Washington. Following World War II, however, the infusion of economic assistance into Western Europe and Japan, coupled with the increase in international trade, produced a growing need for international banking activity. United States banking institutions responded to the need by opening offices in many foreign countries, and foreign banks located offices in the principal financial markets of the United States—New York, San Francisco and Chicago. The number of United States bank facilities in foreign countries has increased dramatically with the rise in foreign trade and foreign investment.[8]

Foreign banking within the United States likewise has enjoyed steady expansion after some states, most notably New York and California, relaxed their legislation restricting foreign banking. The legislative changes apparently resulted from substantial resistance to American banking activity abroad, which derived from the states' failure to accord reciprocity to foreign banking institutions.[9] By the late 1950's, the United States dollar had become the preeminent world currency, and the European central banks were accumulating substantial dollar accounts—both assets and liabilities—in New York and other American financial centers.[10] International banks apparently believed facilities in the United States were necessary to avoid

8. "At the end of 1955, there were 111 foreign branches of U.S. banks in operation. Ten years later, this number had almost doubled. With 51 new branches opened in 1967, the total number of overseas branches at the end of March 1968 [had] risen to 308." Heldring, *supra* note 4, at 50.

9. "It was not until a few U.S. banks had begun to encounter resistance to their overseas expansion programs during the late 1950's that the issue of permitting foreign banks to branch in New York was raised again." J. ZWICK, *supra* note 2, at 2. *See also* THE ECONOMIST, *supra* note 5, at 64.

10. J. ZWICK, *supra* note 2, at 2-3.

becoming merely regional banks, rather than enjoying full participation in the increasing world trade financing.[11]

Between 1946 and 1960, the majority of foreign banking facilities established in the United States were either representative offices or agencies.[12] In 1959, the State of New York, at the behest of leading New York banks, drafted legislation to permit foreign branches to receive deposits and exercise specified fiduciary powers.[13] In 1964, California also authorized foreign bank branching, but required foreign branches to obtain insurance from the Federal Deposit Insurance Corporation (FDIC)—an impossibility for foreign branches.[14] Since 1968, foreign bank agencies in California have been allowed to receive deposits originating in foreign countries without first obtaining FDIC insurance, and California recently authorized foreign branches to accept deposits. Although the acceptance of deposits by agencies is still subject to the impracticable procurement of FDIC insurance,[15] subsidiaries, which are allowed to engage in a broad scope of activities, can obtain FDIC insurance and thus meet the state's condition to receiving deposits.[16]

At the end of 1971, seven states permitted foreign agencies or facilities;[17] eight states prohibited foreign banking altogether;[18] five

---

11. California and New York were more conducive to foreign banking than other states because each had a great deal to gain in the financing of trade, and conversely, a great deal to lose if their financial institutions were barred from banking in other countries because of lack of United States reciprocity. *See generally* J. ZWICK, *supra* note 2, at 2-4.

12. For a more complete description of the various forms of facilities see MacKenzie & MacKenzie, *infra* note 21.

13. N.Y. BANK. LAW § 202-a (McKinney 1971). "The need to alleviate present discrimination, lessen the possibility of retaliation, and increase New York's prestige as an international financial center were the major arguments used to support the bill. . . . However, the law and supervisory procedure require that reciprocity be granted New York banks. A 1968 amendment provided for indefinite licenses after ten years of operations." Gilbert, *supra* note 1, at 22.

14. *See generally* 12 U.S.C. §§ 1811-31 (1970). Gilbert notes that FDIC insurance requirements imposed by California have kept the state closed to foreign branches, but foreign facilities other than branches are allowed. Gilbert, *supra* note 1, at 22.

15. CAL. FIN. CODE §§ 1756-56.1 (West 1958). Oregon also makes FDIC insurance a precondition to acceptance of deposits. OREGON REV. STAT. § 713.010 (1971).

16. *See* Gilbert, *supra* note 1, at 25. Since a subsidiary must be incorporated by the State of California, even though the stockholders may be outside the state, it is not foreign. *See generally* CAL. FIN. CODE §§ 1750 *et seq.*

17. Alaska, California, Hawaii, Massachusetts, New York, Oregon and Washington. Gilbert, *supra* note 1, at 23.

states expressly prohibited foreign branches;[19] and other states either had no laws specifically regulating foreign banking or referred to it only tangentially.[20] Despite this variety of state-imposed restrictions, foreign banking in the United States is expanding.

III. FORMS AND ACTIVITIES OF FOREIGN BANKING IN THE UNITED STATES

Often, foreign banking institutions have insufficient direct contact with local commerce to establish a local identity. Without local identity, the activity is in the nature of foreign commerce and the foreign bank need not qualify to do business under local law.[21] If,

TABLE 1*

Offices of Foreign Banks in the United States by Type of Office and by State(a)

	Foreign banking offices		Representative offices	State-chartered subsidiaries	Branches of State-chartered subsidiaries
	Agencies	Branches			
California	11		7	7	14
Illinois			6	1	
New York	24	23	62	6	
Oregon		2			
Texas			4		
Washington		1(b)			
Puerto Rico		7			
Virgin Islands		3			

(a) No offices currently exist in Massachusetts and Hawaii although laws in these States authorize foreign banking offices.
(b) Branch operates under grandfather clause.
*Source: J. ZWICK, *supra* note 2, at 31

18. Connecticut, Georgia, Kentucky, Maryland, Michigan, Mississippi, New Jersey and Ohio. *Id.*

19. Delaware, Minnesota, Rhode Island, Texas and Vermont. *Id.*

20. *Id.* Foreign banks were allowed to conduct business as foreign institutions in six states—California, Hawaii, Massachusetts, New York, Oregon and Washington. J. ZWICK, *supra* note 2, at 5 n.4. Of these six, only three—New York, Massachusetts and Oregon—permit foreign banks to choose the form of banking desired. *Id.* at 5.

21. MacKenzie & MacKenzie, *Penetration of the United States Market by a Foreign Bank*, 6 INT'L LAW. 876, 878 (1972).

however, the bank wishes to engage actively in local business, it may choose one of several forms, according to the requirements of state statutes. In order of increasing formality, these forms are: (1) representative offices; (2) agencies; (3) branches; and (4) partly-owned or wholly-owned subsidiaries (see Table 1).[22] Although many of the activities performed by these four foreign bank facilities are similar, several distinguishing characteristics should be noted. First, representative offices do not accept deposits; they merely inform the public of the home bank's services. This minimum activity is insufficient to require state supervision, and these offices are generally not registered with the state. Agencies perform financing activities beyond the advertising function of the representative office and must be licensed by the state. An agency may hold assets, but is prohibited from receiving deposits. Because state citizens do not establish checking accounts with the agencies, the states do not subject them to extensive examinations. Branches, located primarily in New York, must be licensed by the state and are required to undergo stringent examinations since they may receive deposits. The branch is not, however, a legal entity separate from the parent institution. The subsidiary, on the other hand, is an entity incorporated by the licensing state but owned wholly or in part by aliens. Subsidiaries are subjected to the most rigorous state inspections and are frequently required to have American directors. In addition, a few international financing companies have been chartered under the New York State Investment Company Act.[23] Because of their limited nature, these companies will not be discussed in this Note.

A. *Representative Offices*

Over one-hundred representative offices are presently open in the United States.[24] Their principal functions are to disseminate informa-

22. *See* MacKenzie & MacKenzie, *supra* note 21, at 878-79.

23. "Essentially, these international banks finance high-risk trade and participate in venture capital schemes, especially in Latin America. . . . Because of their expertise, they have been in a position to promote and finance the exports of small and often unknown firms. These firms have also provided nonrecourse financing to credit-worthy exporters. Finally, [these] companies have offered advice and direct financing to firms who are establishing marketing or franchised distribution networks for their products in foreign markets. Offering these services, which few domestic or foreign banks are willing to provide, the investment companies have expanded the scope of the financial community's services to international businesses." J. ZWICK, *supra* note 2, at 9-10.

24. "There were 79 offices in 1966, 78 in 1968, 103 in 1969, and 117 in 1970. Of these [as of 1970], 14 are in Los Angeles, 5 in San Francisco, 3 in the

tion about the parent bank and to encourage relations with American customers. Since these offices may not perform any active banking functions, they are generally not subject to state supervision.[25] It may often be difficult, however, to determine whether passive functions have evolved into active ones. For example, if a representative office accepts a check from a local citizen for deposit with the parent bank abroad, it may be argued that forwarding the sum to the home office is a mere convenience to the parent and not an active local banking function. Conversely, it may be claimed that this activity is an active banking transaction, since the deposit was received and acknowledged locally, and since the parent, in turn, often remits the amount to the American office to be held there as a credit due the parent. Similarly, it might be argued that an active banking function has occurred when a representative presents the foreign parent's loan agreement to the local customer for his signature and then returns the document to the home office.[26]

Questions about representative office activities have recently been raised in California. California's Attorney General has considered whether advertising could be done only by a licensed foreign bank facility and has concluded that advertising, via direct mail or public journal, for foreign deposits constitutes improper banking business for an unlicensed foreign bank office.[27] He has also indicated that acceptance of money in the state for transmission for deposit abroad, is the initial procedure in taking deposits.[28] Thus California, along with several other states, is attempting to regulate the activities of representatives by limiting the functions that unlicensed offices may perform.[29]

District of Columbia, 10 in Chicago, 1 in Pittsburgh, 2 in Dallas, 4 in Houston, and . . . 78 in New York City. Banks from almost every major nation, including Yugoslavia, have at least 1 representative office." Gilbert, *supra* note 1, at 24.

25. J. ZWICK, *supra* note 2, at 8. California, however, does exert some supervision by requiring the representative offices to obtain a license. Gilbert, *supra* note 1, at 24.

26. MacKenzie & MacKenzie, *supra* note 21, at 884.

27. MacKenzie indicates that the California Attorney General concluded that mere institutional advertising was not improper. *Id.* at 885.

28. MacKenzie, *supra* note 21, at 884. California has now enacted legislation that may clarify these vague areas. *See* CAL. FIN. CODE §§ 1756-56.2 (West 1968).

29. CAL. FIN. CODE §§ 1750 *et seq.* (West 1968).

B. *Agencies*

Foreign bank agencies, which must be licensed by the state, play a prominent role in international trade and in the money markets. They hold substantial amounts of domestic assets (see Table 2), even though prohibited from receiving deposits subject to withdrawal, and have supplied significant funds to the federal government.[30] Agency trade financing activities pertain mainly to transactions between the United States and the home country; they include issuing letters of credit and buying, selling, collecting and paying bills of exchange.[31]

TABLE 2*

Agencies of Foreign Banks

	New York Dec. 1968	New York Dec. 1969	California June 1969	California June 1970
ASSETS				
Total assets	$5,327,220,000	$6,646,040,000	$570,417,830	$780,808,952
Loans	2,204,405,000	3,212,872,000	267,485,552	398,517,978
Customers' liabilities on acceptances	705,409,000	871,704,000	261,240,144	339,874,295
LIABILITIES				
Due to own head office and branches	$4,120,853,000	$5,064,528,000	$169,818,060	$188,988,190
Deposits(a)	—	—	—	1,660,323
Acceptances outstanding(b)	325,543,000	434,730,000	261,240,144	339,874,295

(a) California agencies were permitted to accept foreign deposits in November 1969. These data represent two agencies.

(b) Excludes acceptances held for account of head offices and branches. These data were the composite of 27 agencies in New York and 14 agencies in California.

*Source: ANNUAL REPORT OF THE SUPERINTENDENT OF BANKS 201 (released Dec. 31, 1968); Superintendent of Banks, State of California, *Annual Report, 1969,* at 185-92, 201-06.

30. *See* Brimmer, *Foreign Banking Institutions in the United States Money Market,* 44 REV. ECON. & STATISTICS 76 (1962).

31. *See* J. ZWICK, *supra* note 2, at 13.

The impact of foreign bank agencies on the United States should not be overlooked. In 1965, for example, 27 New York agencies reported total assets of over 4 billion dollars.[32] By 1969, this figure had grown to over 6.5 billion dollars,[33] and at the end of 1971, 28 agencies reported total assets of 8.1 billion dollars (see Table 3). Of

TABLE 3*

Condensed Statements of Condition of New York Agencies
and Branches of Foreign Banking Corporations

(unit: thousands of dollars)

	Agencies		
	Dec. 31, 1971	Dec. 31, 1970	Dec. 31, 1969
Number of Agencies	28	28	28
ASSETS			
Cash and balances with other banks	$1,209,725	$1,534,618	$1,016,491
Bonds and corporate stocks	418,712	698,543	741,999
Loans and overdrafts	3,458,488	3,317,649	3,212,872
Customers' liabilities on acceptances	870,902	1,133,543	871,704
Due from own head office and branches	1,733,967	1,434,213	543,161
Other assets	418,336	222,145	259,813
TOTAL	$8,110,130	$8,340,711	$6,646,040
LIABILITIES			
Due to foreign banks	$ 384,545	$ 367,934	$ 333,637
Due to customers and other banks	319,024	338,826	268,218
Liabilities for borrowed money	493,717	229,663	166,252
Acceptances outstanding (a)	605,388	699,175	434,730
Other liabilities	920,821	480,126	378,675
Total liabilities exclusive of amounts due to own head offices and branches	$2,723,495	$2,115,724	$1,581,512
Due to own head offices and branches	5,386,635	6,224,987	5,064,528
TOTAL	$8,110,130	$8,340,711	$6,646,040

(a) Excludes acceptances held for account-of-head-offices and branches.

*Source: ANNUAL REPORT OF THE SUPERINTENDENT OF BANKS, SCH. A, PT. 9 (released Dec. 31, 1971).

32. *Id.*
33. *See* Gilbert, *supra* note 1, at 26.

the 1971 total, approximately 3.4 billion dollars was held in the form of loans and overdrafts, 1.2 billion dollars was held as cash and balances with other banks and 1.7 billion dollars was listed as "due *from* own head office and branches." The largest single reported liability was that "due *to* own head offices and branches"—5.38 billion dollars. The latter amount often represents sums either received for the home office, or deposited first with the home office then transferred to the agency for holding. It has been argued that this procedure is merely a method of avoiding state regulations prohibiting deposit solicitations by agencies.[34]

Japanese and Canadian banks conduct the most extensive agency banking activity in the United States. The Japanese have established numerous agencies to facilitate the financing of vast trading activities; they apparently consider the agency a more desirable mode of operation than the branch, since statutory restrictions on agencies are less rigorous than those applied to other banking forms.[35] For example, fractional reserve requirements do not apply to agencies, nor are agencies required to restrict individual customer loans to ten per cent of the parent bank's capital. Furthermore, assets of agencies in New York must exceed liabilities by only 100 per cent rather than by the 108 per cent required of branches.[36] Under the assumption that the protection of depositors is unnecessary for agencies, agency examinations generally are restricted to a peripheral survey of asset quality and composition to insure that capital requirements are met.[37]

Canadian agencies in New York, unlike the Japanese agencies, have actively financed trade between third countries.[38] The Canadian agencies, whose holdings account for approximately one-half the total agency assets in New York,[39] have dealt actively in street loans—loans to brokers and dealers—and have participated in interest rate arbitrage and the lending of Eurodollars.[40] The growth of foreign bank agencies

34. *See* J. ZWICK, *supra* note 2, at 14.

35. Fourteen of 35 agencies in the United States in 1966 were affiliated with Japanese banks. At least 80% of Japanese loans in 1966 were short-term and were used to implement import and export transactions. J. ZWICK, *supra* note 2, at 13.

36. *Id.* at 7.

37. *See* Gilbert, *supra* note 1, at 26.

38. *See* J. ZWICK, *supra* note 2, at 14.

39. *Id.* Canadian agency assets are substantial primarily "because of the bond flotations of Canadian provinces and municipalities which are free from the interest equalization tax . . . ." Gilbert, *supra* note 1, at 27.

40. Eurodollars are United States currencies held outside the United States.

appears to have slowed somewhat in recent years,[41] though their control of domestic assets remains more than merely nominal.

C. *Branches*

Foreign bank branches must be licensed by the state and must undergo regular examinations more stringent than those imposed on agencies. Branch banks provide all services necessary for trade financing, including letters of credit, discounts, acceptances, collections, foreign exchange transfers of funds and remittances. In addition to financing trade,[42] branches actively engage in fund investments, commerceial and personal lending and deposit solicitation. Branches service the home bank's customers, thereby enabling the foreign bank to handle the complete business transaction.

Branches may be preferable to the subsidiary form for several reasons: first, the organizational structure is less complicated; secondly, there is no necessity to maintain either American directors or American shareholders, as is sometimes required in the subsidiary form; thirdly, capital requirements are less stringent; and fourthly, loan limits for branches generally will be higher since limits are calculated on the basis of the parent bank's reported capital.[43] A major advantage may be the immediate enjoyment by the branch of the goodwill developed by the international parent bank.

Branches, however, may have disadvantages that must be weighed by the foreign institution contemplating expansion into the United States. The parent bank may find detrimental the increased cost of renting, staffing and maintaining a banking facility that is more elaborate than other banking forms and more closely scrutinized than the less formal types. In addition, New York, where branches are principally deployed, requires the foreign bank to elect between a branch and an agency, since those two forms cannot be used simultaneously in that state.[44]

---

41. "In 1965, there were twenty-seven agencies; in 1966 there were thirty-five; in 1967 there were thirty-eight; in 1969 there were forty-one. None have been established since then. Agencies [as of 1971] are located in California (13), New York (26), Washington (1), and Hawaii (1)." Gilbert, *supra* note 1, at 26.

42. In 1966 it was estimated that more than 50% of branch loans and discounts related to foreign trade transactions. J. ZWICK, *supra* note 2, at 10.

43. *Id.* at 5-6.

44. *See* Gilbert, *supra* note 1, at 29. A 1966 report to the Joint Economic Committee listed five requirements for the establishment of a foreign bank branch in New York: "(1) Evidence must be provided that the applicant's home nation

The number of branches in the United States has been increasing yearly, from 36 branches in 1966 to 59 in 1970, 38 of which were located in New York.[45] The financing of trade remains their major function but retail depositors often rely on the foreign branches' more complete services.

D. *Subsidiaries*

Subsidiaries—state-chartered banking corporations owned by the foreign parent—are established primarily to perform trust activities or to participate in a full spectrum of retail and wholesale banking.[46] Foreign branches cannot receive FDIC insurance, and, therefore, are prevented from accepting deposits in California.[47] But since subsidiaries are eligible for FDIC insurance, foreign banks wishing to conduct retail activities in California have favored the use of this banking form.[48] Foreign subsidiaries located in New York exist primarily to perform trust functions. Canadian subsidiaries have not been well received recently by New York authorities because of Canada's failure to give New York banks free access to the Canadian banking market. The Canadian subsidiaries presently conduct business in this country primarily to complement their parents' activity.[49]

---

does not prohibit the operation of branches or agencies by New York banks. (2) The Superintendent must be convinced that the foreign branch 'will be honestly and efficiently conducted and that public convenience and advantage will be promoted.' (3) A guarantee fund composed of cash and/or securities equivalent to 5 percent of liabilities (but not less than $100,000) must be deposited by the prospective foreign branch in an approved New York bank. (4) The parent bank must have capital funds of at least $1 million to be eligible for a branch license, which amount is higher than requirements for establishing a subsidiary, or even a domestic bank. (5) A license must be obtained from the Superintendent of Banks subsequent to affirmative evaluation of the branch application by the State banking board." J. ZWICK, *supra* note 2, at 5. California has similar requirements. *See* Gilbert, *supra* note 1, at 29. In addition, foreign branch licenses in New York must be renewed annually, assets must be maintained in that state equal to 108% of liabilities, and weekly condition reports must be submitted. J. ZWICK, *supra* note 2, at 6.

45. *See* Gilbert, *supra* note 1, at 29. New York statistics furnished by the New York State Superintendent of Banking.

46. J. ZWICK, *supra* note 2, at 9.

47. CAL. FIN. CODE § 3516 (West 1968).

48. *See* J. ZWICK, *supra* note 2, at 9.

49. *Id.*

IV. HOLDING COMPANY PROVISIONS

The federal government through the Federal Reserve Board maintains control over foreign banking activities in the United States that come within the provisions of the Bank Holding Company Act and its amendments.[50] In addition, regulations have been promulgated that define the limits of permissible foreign banking activity by holding companies.[51]

A consideration of the Bank Holding Company Act should begin with underlying policy assumptions. First, Congress deemed it desirable to prevent enterprises controlling banking activities from becoming monopolies, considered disadvantageous to the American economy.[52] Secondly, Congress considered the affiliation of banking with non-banking enterprises to be economically unhealthy, since bank activities should be isolated from other commercial activities in order to reduce speculation. Thirdly, banking outlets traditionally have been kept within state borders.[53] This limitation is probably the result of efforts to maintain the dual banking system—state and national banks—in its present competitive form.

To guard against monopolistic tendencies, Congress in 1956 enacted the Bank Holding Company Act, which requires bank holding companies: (1) to register pursuant to the Act;[54] (2) to divest control of all nonbank related operations;[55] and (3) to submit to examinations by the Federal Reserve Board.[56] Until recently, a bank holding company was statutorily defined as "any company (1) that directly or indirectly owns, controls, or holds with power to vote 25 per centum or more of the voting shares of each of two or more banks or of a company that is or becomes a bank holding company by virtue of this chapter or (2) that controls . . . the election of a majority of the directors of each of two or more banks . . ."[57] When the 1956 Act was passed, Congress discerned no need to extend the Act to companies controlling only one bank. After 1966, however, many large banks became affiliated with unregulated one-bank holding companies and

50. Act of May 9, 1956, *as amended,* 12 U.S.C. §§ 1841-49 (1970). Much of the analysis of the holding company provisions was taken from MacKenzie & MacKenzie, *supra* note 21.

51. *See* note 63 *infra.*

52. *See* S. REP. No. 91-1084, 91st Cong., 1st Sess. 2 (1970). *See generally* MacKenzie & MacKenzie, *supra* note 21, at 879-80.

53. MacKenzie & MacKenzie, *supra* note 21, at 877-78.

54. 12 U.S.C. § 1844(a) (1970).

55. 12 U.S.C. § 1843(a)(2) (1970).

56. 12 U.S.C. § 1844(c) (1970).

57. Act of May 9, 1956, ch. 240, § 2(a).

by 1970, an estimated 40 per cent of all bank deposits were controlled by the one-bank holding companies—a four-fold increase in only three years.[58] This dramatic development prompted Congress to revise the Act to bring the one-bank holding companies within its scope.

Specifically, Congress augmented the definition of holding company to include "any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this chapter."[59] In addition, the 1970 amendment[60] established a presumption that companies controlling less than five per cent of a bank's voting stock do not control the bank.[61] The amendment also requires any company planning either to acquire or to form a controlled bank subsidiary to obtain the prior approval of the Federal Reserve Board.[62] Any foreign banking institution wishing to maintain an American subsidiary is thus covered by the 1970 amendment.[63]

Foreign banks may be able to use the 1970 amendments to their advantage. For example, the pre-1970 statute did not explicitly prohibit wide geographical distribution of nonbank acquisitions,[64] although bank acquisitions were prohibited.[65] Foreign banks, by acquiring nonbank enterprises beyond state lines, could gain a market area more expansive than that now available to United States banks.[66]

---

58. *See generally* STAFF REPORT OF HOUSE COMM. ON BANKING AND CURRENCY, 91ST CONG., 1ST SESS., BANK HOLDING COMPANY ACT AMENDMENTS (Comm. Print 1969).

59. 12 U.S.C. § 1841(a)(1) (1970).

60. 12 U.S.C.A. § 1841 (1970).

61. 12 U.S.C. § 1841(a)(3) (1970).

62. 12 U.S.C. § 1842(a)(2)-(3) (1970).

63. For the Federal Reserve Board regulations pertaining to foreign bank holding companies, see 12 C.F.R. § 225.4(f)-(g). Among other things, the regulations allow a foreign bank holding company performing one-half or more of its business outside the United States to engage in nonbanking activities in this country, if they are incidental to its outside activities. 12 C.F.R. § 225.4(g)(2)(ii). A foreign bank holding company also may engage directly in any kind of activities outside the United States. 12 C.F.R. § 225.4(g)(2)(i).

64. Guenther, *The 1970 Bank Holding Company Act Amendments and State Influence on Banking Structure,* 89 BANK. L.J. 318 (1972).

65. 12 U.S.C. § 1842(d) (1970).

66. If different geographical areas are penetrated, in unrelated activities, the risk of antitrust actions should be reduced. *See* Guenther, *supra* note 64, at 327. Mr. Guenther, who was Executive Vice President-Economist of the Conference of State Bank Supervisors when he wrote his article, indicates that the 1970 amendment, as it related to nonbank acquisitions, implemented a public interest test in 12 U.S.C. § 1842(d) (1970) to determine the soundness of the acquisition.

Furthermore, loan production offices can be strategically placed throughout the country without violating the Act.[67] Implementation of such a design under the present statutory scheme could give foreign banks a competitive advantage over other banking institutions. In this way foreign banks conceivably might become the only "truly American" banks.[68]

V. POLICY CONSIDERATIONS UNDERLYING STATE CONTROL OF FOREIGN BANKING

Historically, foreign banking has been regulated almost exclusively by the states, but the important question is whether state control should be allowed to continue. The remainder of this note attempts to show that foreign banking is no longer a proper subject for state control, but is more appropriately within the exclusive province of the federal government.

A. *Power of the Federal Government to Regulate Foreign Banking*

1. *Fiscal Powers.* The power of the federal government to charter national banks—as a necessary and proper incident of the sovereign's jurisdiction over fiscal affairs[69]—was affirmed in *McCulloch v. Maryland.*[70] In addition, the Supreme Court has interpreted the Constitution to grant to the federal government all fiscal powers understood to belong to sovereigns.[71] This broad authority is the result of both the express constitutional grants and the implied powers derived from the necessary and proper clause.[72] *McCulloch* has been the basis for upholding the Federal Reserve System,[73] the Federal Land Bank System,[74] and the FDIC.[75] Chief Justice Marshall's reasoning in

---

67. *See* FEDERAL RESERVE BULLETIN 682 (August 1968); Guenther, *supra* note 64, at 324.

68. Some American banks fear that foreign banks will spread a network of affiliates throughout the country and "become the 'only truly American' banks." THE ECONOMIST, *supra* note 5, at 64-67.

69. *See* B. SCHWARTZ, CONSTITUTIONAL LAW, A TEXTBOOK § 46 Fiscal Powers (1972).

70. 17 U.S. (4 Wheat.) 316 (1819).

71. *See, e.g.,* Juilliard v. Greenman, 110 U.S. 421 (1884): "Congress has the power to issue the obligations of the United States in such form and to impress upon them such qualities as currency for the purchase of merchandise and the payment of debts, as accord with the usage of sovereign governments." 110 U.S. at 447.

72. B. SCHWARTZ, *supra* note 69, at 80.

73. *See* Hiatt v. United States, 4 F.2d 374 (7th Cir. 1924).

74. *See* Smith v. Kansas City Title & Trust Co., 255 U.S. 180 (1921).

75. *See* Doherty v. United States, 94 F.2d 495 (8th Cir. 1938).

McCulloch, when combined with the broad constitutional grant of fiscal powers to the federal government, indicates that Congress has "practically unlimited authority over every phase of currency."[76]

Obviously, foreign banking facilities in the United States exert an impact on the nation's monetary affairs[77] that undoubtedly will increase as international trade increases.[78] For example, the ability of foreign banks to transfer currency in and out of the United States may reduce the effectiveness of certain federal monetary control devices.[79] This point is illustrated by the practice of fund transfers employed recently by large multinational banks headquartered in the United States. In late 1969, the Federal Reserve maintained an interest rate ceiling below market yields on time deposits. This ceiling resulted in a shrinkage, or "run-off," of time deposits, which especially affected certificates of deposits (CD's). Eurodollar (United States currency held as assets abroad) borrowings during that period fluctuated in direct relation to the changes in CD holdings. As CD run-off continued, multinational banks increased the influx of Eurodollars to replace funds lost through CD attrition; thus by borrowing Eurodollars, these large institutions delayed the effect of federally imposed monetary restraints. The American financial system, as this illustration suggests, may be influenced by international, as well as national, financial developments.[80] This analysis applies equally to foreign

---

76. B. SCHWARTZ, *supra* note 69, at 80.

77. Recent Reports of the Federal Reserve Board indicate that United States assets of foreign banks operating here tripled from 1965 to 1972, and now total about $13 billion. Concurrently, the amount of deposits held has increased. For example, "liabilities due to customers and other banks [*i.e.* deposits]" totaled $384 million for New York agencies, and $1 billion for New York branches. ANNUAL REPORT OF THE SUPERINTENDENT OF BANKS, SCH. A, PT. 9 (released Dec. 31, 1971).

78. This country is currently pursuing a policy of expanding trade with other countries. *See The Trade Act of 1971: A Fundamental Change in United States Foreign Trade Policy*, 80 YALE L.J. 1418, 1424-26 (1971) [hereinafter cited as *Trade Act*].

79. This analysis is based on a recent study by Mr. Andrew F. Brimmer, (member, Board of Governors, Federal Reserve System), which was presented before a joint session of the Eighty-Fifth Annual Meeting of the American Economic Association and the Thirty-First Annual Meeting of the American Finance Association. A. Brimmer, *Multi-national Banks and the Management of Monetary Policy in the United States* (Dec. 28, 1972).

80. *Id.* at 1. Mr. Brimmer's statistical study concerns the economic effect that multinational banks have on money flow. The thrust of his analysis is that either a flexible use of reserve requirements based mainly on bank assets, or the flexible use of investment tax credits, should be adopted to prevent multinational banks

banks operating in the United States that can effect the transfer of funds from country to country to avoid fixed interest rates or other governmentally imposed monetary restraints. Clearly, lack of control over foreign banks dilutes the effectiveness of national monetary control efforts. Equally clear is that effective control of foreign banks is possible only by the sovereign, not by subsidiary states.

Another aspect of national fiscal policy—the balance of payments—is directly affected by foreign banking activity in this country. The funds that foreign banking institutions expend in this country to establish branch facilities improve the United States balance of payments. Moreover, since manufacturers establishing plants in the United States may encourage their banks to place banking offices in the United States for the manufacturer's convenience, a further improvement in the balance of payments could be realized.[81] Foreign banking in the United States can improve the balance of payments in other ways as well. Foreign banking activity in the United States reduces the American balance of payments deficit by the excess of deposits received over loans to borrowers outside the United States.[82] The impact of foreign banking on the United States balance of payments is sufficient now to demand its regulation at the federal level. As these banking activities continue to increase, the need for federal control steadily will become more apparent.

2. *Regulation of Commerce.* Apart from its impact on American fiscal policy, foreign banking comes within the aegis of the federal government by reason of its effect on foreign commerce. The Constitution expressly confers on Congress the power "To regulate

---

from freely moving funds across frontiers as interest rates fluctuate. *See also* Dahl, *International Operations of U.S. Banks: Growth and Public Policy Implications,* 32 LAW & CONTEMP. PROB. 100 (1967).

81. Devaluation of the dollar will have the effect of allowing foreign producers to build new United States factories at a cost lower than before the devaluation. Japan's Toyo Bearing Manufacturing Company, Ltd., and Sony Corp., are building substantial factories in this country. The Sony plant, for instance, will cost $15 million and will produce 240,000 television sets annually. *See generally* J. ZWICK, *supra* note 2, at 19; TIME, April 2, 1973, at 85.

82. J. ZWICK, *supra* note 2, at 19. Zwick notes that the balance of payments is also improved "to the extent that these U.S. offices [of foreign banks] have been successful in inducing foreign dollar-holders to convert liquid dollar holdings into non-liquid investments." Furthermore, foreign banks stimulate the purchase of American securities by foreign individuals, a function beneficial to the American balance of payments. *Id.* at 19, 20.

83. U.S. CONST. art. I, § 8.

Commerce with foreign Nations, and among the several States . . . ."[83] This affirmative delegation of power to the federal government is reinforced by constitutional "words of prohibition to the States . . . ."[84] Regretfully, however, the extent to which the commerce clause forbids state action never has been delineated clearly.[85] Rather, the Court has developed various theories that attempt to describe the federal-state relationship with respect to commerce.

For example, in *Gibbons v. Ogden*,[86] Mr. Chief Justice Marshall posited an expansive and dominant federal role on the theory that commerce includes all "intercourse among the states." In *Cooley v. Board of Wardens*,[87] the Taney Court proposed a more functional delineation of state and federal commerce: "Whatever subjects of this power are in their nature national, or admit only of one uniform system, or plan of regulation, may justly be said to be of such a nature as to require exclusive legislation by Congress."[88]

A later test was whether the effect of state activity on commerce was direct or indirect, only the latter being permissible.[89] In *NLRB v. Jones & Laughlin Steel Corp.*,[90] however, the Court discarded the direct-indirect standard and concluded that the essential issue was not directness, but whether the state activity had an appreciable effect on commerce.

More recently, it has been argued that two doctrines apply in the area of foreign commerce. One is concerned solely with whether the state-imposed burden is unreasonable or undue, regardless of local interest. The second involves a balancing of the competing state and

84. L. HENKIN, FOREIGN AFFAIRS AND THE CONSTITUTION 234 (1972).

85. "[W]hat Congress might do under the Commerce clause is not ipso facto forbidden to the States . . . . But the Supreme Court sometimes seemed to decide what the States cannot do by asking what Congress can; and it denied power to Congress to do what it could not bring itself to forbid to the States." *Id.* at 235 & n.32.

86. 22 U.S. (9 Wheat.) 1 (1824).

87. Cooley v. Board of Wardens, 53 U.S. (12 How.) 298 (1851). The *Cooley* doctrine has been said to lose utility when the concern is not purely local or purely national.

88. 53 U.S. (12 How.) at 319.

89. *See* Carter v. Carter Coal Co., 298 U.S. 238 (1936) (mining is not commerce). *See also* B. SCHWARTZ, *supra* note 69, at 94-95.

90. 301 U.S. 1 (1937). Regulation under the commerce clause, it should be noted, is not dependent on the quantity of activity. *See* NLRB v. Fainblatt, 306 U.S. 601 (1939) (regulated industry must affect interstate commerce; but it need not affect a large proportion of such commerce).

national interests.[91] The former test was applied in *Southern Pacific Co. v. Arizona ex rel Sullivan*,[92] which involved a state statute limiting the number of railroad cars that could be coupled to form a train. Noting that federal legislation did not expressly preempt state power to regulate, and that the purpose of Arizona's statute was to protect the health and safety of resident citizens, the Court nevertheless found the statute to be in contravention of the commerce clause.

Conceivably, state legislation limiting foreign banking might rest on the state's power to protect its citizenry by safeguarding banking activities. The Court in *Southern Pacific*, however, indicated that state protection will not outweigh national interests in the free flow of commerce, which certainly would suffer from restrictive state regulation of foreign banking activity.[93] If, as in *Southern Pacific*, state statutes vary in their methods of regulating foreign banking, the foreign banking institutions would face the almost impossible task of interpreting and attempting to comply with disparate regulatory schemes. The test embraced in *Southern Pacific* would find that the state banking laws contravene the commerce clause and, therefore, must fail. Otherwise, foreign banking may face difficulty in becoming established in the United States, thereby thwarting federal efforts to stimulate foreign trade and investment in this country.[94]

Under the second theory for determining permissible state action—a balancing of competing interests—several questions arise. First, who is to do the balancing? Obviously, when a federal opinion is expressed, whether by Congress or the Executive, the courts usually are called on to decide the conflict. When no federal position is stated, the initial problem of balancing federal and state interests may fall on the state legislature when it contemplates foreign banking legislation. If the state legislature is primarily responsible for applying this balancing test, one must consider whether state authorities ever are capable of

91. *See* L. HENKIN, *supra* note 84, at 235-36.

92. 325 U.S. 761 (1945). In *Southern Pacific*, the Court stated: "Between these extremes [of what is plainly within and plainly without] lies the infinite variety of cases, in which regulation of local matters may also operate as a regulation of commerce, in which reconciliation of the conflicting claims of state and national power is to be attained only by some appraisal and accommodation of the competing demands of the state and national interests involved." 325 U.S. at 768-69.

93. *See* L. HENKIN, *supra* note 84, at 236 & n.39.

94. Foreign producers often prefer to have their financing handled by their bank throughout all steps of the sales process.

adequately weighing federal interests.[95] How can state officials measure the impact of restrictive legislation on the foreign bank and/or its foreign corporate customers wishing to do business within the state or other states? A related question is whether state officials have adequate access to data necessary to determine this impact since relevant information is usually accessible only to federal authorities. Additionally, it is doubtful whether the potential loss of trade, even if measurable by state officials, would be given proper weight by a state body relatively unconcerned with trade outside its borders. Further exacerbating the problems inherent in a balancing-of-interests approach is the State Department's unwillingness to discuss trade implications with persons outside the Department. In initial stages, trade agreements require delicate diplomacy that state officials may be unable or unwilling to provide.

Regardless of which approach to the commerce clause is utilized, the states will not be allowed to exclude foreign commerce completely or to favor economic interests by discriminating against out-of-state commerce.[96] Yet most states either bar or restrict foreign banks,[97] thereby impeding foreign banking as well as the trade that it could facilitate. Clearly, then, foreign bank activity is so closely related to trade with other countries that it should be regulated as foreign commerce by the federal government.

B. *Foreign Affairs Conflict*

The conflict between state-imposed restrictions on foreign banking activity and the federal government's foreign affairs powers is another factor militating for federal control of foreign banking in the United States. Twenty-five years ago, the Supreme Court, in determining the breadth of valid state action, was not willing to give a broad interpretation to federal power in foreign affairs. Thus, in *Clark v. Allen*,[98] the Court upheld a California statute disallowing nonresident aliens from inheriting personalty in the United States unless United

95. *See* Maier, *The Bases and Range of Federal Common Law in Private International Matters*, 5 VAND. J. TRANSNAT'L L. 133 (1971). Maier asserts that a functional analysis is needed—*i.e.* "whether the matter is best decided by a national rather than a state decision-maker." *Id.* at 166.

96. *See* L. HENKIN, *supra* note 84, at 236. Discrimination against foreign or interstate commerce is constitutionally impermissible even when Congress is silent. *See, e.g.,* Southern Pacific Co. v. Arizona *ex rel.* Sullivan, 325 U.S. 761 (1945).

97. J. ZWICK, *supra* note 2, at 27.

98. 331 U.S. 503 (1947).

States citizens were accorded a reciprocal right by the country of the heir(s). Justice Douglas, speaking for the Court, observed that "... here there is no treaty governing the rights of succession to personal property. Nor has California entered the forbidden domain of negotiating with a foreign country ... or making a compact with it contrary to the prohibition of Article 1, § 10 of the Constitution. What California has done will have some incidental or indirect effect in foreign countries. But that is true of many state laws ...."[99] Apparently, the Court was not impressed with the possibility that such a state statute runs counter to an implied limitation on state intrusion into an area of foreign affairs in which the federal government has not acted.[100] *Clark*, when considered alongside the earlier case of *Hines v. Davidowitz*,[101] indicated that affirmative expression by the federal government was required before the Court could determine whether a state had eclipsed the permissible sphere of activity involving foreign affairs.

Zschernig v. Miller,[102] however, involving facts substantially similar to those in *Clark*, severely curtailed that case's relevance. An Oregon court, pursuant to state statute, denied an inheritance to an East German resident on the grounds that the East German was unable to convince the court (1) that his country would permit United States citizens to inherit from East German estates or (2) that the East German Government would not confiscate any inheritance payments allowed him. In its brief *amicus curiae* to the Supreme Court, the State Department pointed out that the federal government was not contending "that the application of the Oregon escheat statute ... unduly interferes with the United States' conduct of foreign relations."[103] Nevertheless, without expressly overruling *Clark*, the Court

99. 331 U.S. at 517.

100. L. HENKIN, *supra* note 84, at 238.

101. 312 U.S. 52 (1941). *Davidowitz* involved a Pennsylvania statute requiring registration of aliens. Congress had acted, and the Court found that the state regulation must fall to the federal one, not necessarily because the Constitution permits only one uniform system, but because "it cannot be denied that the Congress might validly conclude that such uniformity is desirable." 312 U.S. at 73. The Court left open the issue whether federal power in this area, exercised or not, is exclusive. 312 U.S. at 62.

One hundred years earlier, Chief Justice Taney had suggested that the states could not involve themselves in the foreign relations area of extradition even when the federal government had not acted. *See* Holmes v. Jennison, 39 U.S. (14 Pet.) 540 (1840).

102. 389 U.S. 429 (1968).

103. 389 U.S. at 434.

held that the statutory demand for reciprocity was "an intrusion by the State into the field of foreign affairs which the Constitution entrusts to the President and Congress."[104] Justice Douglas, who authored both the *Clark* and *Zschernig* opinions, attempted to distinguish the two cases by indicating that while *Clark* was limited to a review of wording of the statute, the Oregon statute reviewed in *Zschernig* required the state court to make inquiry into the application of foreign laws in addition to analyzing the statutory language.[105] The distinction is not overly persuasive, since the statutes involved in the two cases were nearly identical. The problems created in *Zschernig* were compounded by the majority's refusal to overrule *Clark* expressly. By not doing so, the Court implicitly adopted the three tests of *Clark* while failing to clarify the extent of each test or the weight it should be given. The three tests are: (1) whether the state action displays an "improper purpose" to influence foreign affairs; (2) whether the state action actually interfered with federal foreign policy; (3) whether United States foreign relations have been affected adversely. By not refining the *Clark* tests, the *Zschernig* Court sidestepped an opportunity to reexamine the scope of valid state law-making power and left lower courts struggling to determine the meaning of the *Zschernig* opinion.

Most cases interpreting the *Zschernig* opinion have determined that it proscribes only statutes requiring criticism of foreign governments by state judges or legislators.[106] A state statute that permits foreign banking on a showing of reciprocal banking privileges granted American banks[107] without requiring the state judge or legislature to

104. 389 U.S. at 432.

105. "We were there concerned with the words of a statute on its face, not the manner of its application.... State courts, of course, must frequently read, construe, and apply laws of foreign nations.... At the time *Clark v. Allen* was decided, the case seemed to involve no more than a routine reading of foreign laws. It now appears that in this reciprocity area under inheritance statutes, the probate courts of various States have launched inquiries into the type of governments that obtain in particular foreign nations . . . ." 389 U.S. at 433-34. "The Oregon Statute introduces the concept of 'confiscation,' which is of course opposed to the Just Compensation Clause of the Fifth Amendment. And this has led into minute inquiries concerning the exact administration of foreign law . . . ." 389 U.S. at 435. For a discussion of the constitutional basis of the analysis see L. HENKIN, *supra* note 84, at 239 n.51.

106. Maier, *supra* note 95, at 141. Maier analyzes *Zschernig* and later related cases, and offers an effective functional approach to the delineation of federal and state power.

107. *See, e.g.*, N.Y. BANK. LAW § 202-a (McKinney 1971).

qualitatively assess the foreign government conceivably might be upheld. The single aspect of state criticism of foreign governments, however, cannot be isolated from the impact of foreign banking on foreign commerce and fiscal policy. The combined effect of these elements is clearly sufficient to require control at the national level.

Several cases since *Zschernig* reflect a broad application of preemption to state activities that may hinder federal policy.[108] The court in *Bethlehem Steel Corp. v. Board of Comm'r*[109] considered California's "buy American" statute and applied the tests mentioned in *Zschernig* to find the statute an unconstitutional encroachment on the federal government's exclusive power over foreign affairs. Significantly, the court did not base its decision on a conflict between the California statute and the General Agreement on Tariffs and Trade,[110] but relied on the broader principle that foreign trade problems are inherently national in scope and cannot be resolved on a state-by-state basis. Necessarily, the court held that countervailing state policies are irrelevant when compared with the broad effect of embargoes placed on foreign products. The case represents an expansion of the application of the preemption doctrine to state laws that might detract from federal policy. State regulation of foreign banking produces precisely the type of obstruction to federal policy that was deemed prohibited in *Bethlehem Steel.*

The failure of the Supreme Court to delineate clear tests for preemption of state law has led to the application of three approaches to the preemption issue.[111] First, the states are prohibited "from exercising any law making power that interferes with an established policy being actively carried out by the national government."[112] Secondly, the states may not act so as to have a possible adverse effect on United States foreign relations. Thirdly, the states should not be allowed to act when the purpose of the action "is one properly carried

108. *See, e.g.,* Duple Motors Bodies, Ltd. v. Hollingsworth, 417 F.2d 231 (9th Cir. 1969) (Ely, J., dissenting); Bethlehem Steel Corp. v. Board of Comm'r, 276 Cal. App. 2d 221, 80 Cal. Rptr. 800 (1969); South African Airways v. New York State Div. of Human Rights, 64 Misc. 2d 707, 315 N.Y.S.2d 615 (1970).

109. 276 Cal. App.2d 221, 80 Cal. Rptr. 800 (1969).

110. General Agreement on Tariffs and Trade, *done* Oct. 30, 1947, 61 Stat. A3 (1948), T.I.A.S. No. 1700.

111. Maier, *supra* note 95, at 151-59. These tests were developed prior to *Zschernig.*

112. *Id.* at 151. Maier persuasively attacks each of the three tests, although he states that the third comes closest to being an effective tool for identifying the roles of the states and the nation.

out by the national government."[113] Each of these approaches supports the proposition that regulation of foreign banking should be a function of federal, not state, government.

Under the first approach, state regulations that exclude foreign banking institutions from certain regions of the United States discourage the improvement of foreign trade and, therefore, contravene established policy of the federal government.[114] In addition, the favorable balance of payments effect accruing from long-term investments by foreign banks in the United States may be impeded by restrictive state regulations unrelated to a national concern for the balance of payments. Finally, state control of foreign banks may enable foreign banking institutions to avoid the full and immediate impact of United States monetary policy by transferring funds to their offices in other countries.

A similar conclusion may be reached via the "potential adverse effect on foreign relations" approach. For example, if a foreign nation is unhappy because a particular state's foreign banking law requires reciprocity,[115] that nation will present its grievance to federal officials in Washington, not to the state whose law is responsible for the grievance. The decision-making is thus divorced from the responsibility for dealing with injured nations. If state regulation is not preempted, the federal government would be rendered powerless to control those states that may generate foreign protests with which only it may deal. Furthermore, the effect on foreign relations test would require the state to make "a judgment concerning the *degree* of effect required to invalidate the state action."[116] The difficulty of a state's making this judgment increases the likelihood of error, leaving the federal government without an effective recourse other than positive legislation.[117] For example, if a foreign country demanded complete reciprocity and denied entry to banks of one state because the foreign country's banks could not enter another American state, neither the rebuffed state nor the federal government under present law would have recourse against that state.[118]

---

113. *Id.* at 153-59.

114. *See generally Trade Act, supra* note 78.

115. New York, the state having the most liberal foreign banking laws, has such a requirement. *See* N.Y. BANK. LAW § 202-a (McKinney 1971).

116. Maier, *supra* note 95, at 154 (emphasis in original).

117. *Id.*

118. Japan is apparently demanding reciprocity. *See* THE ECONOMIST, *supra* note 5, at 64. One reason why New York drafted its relatively liberal foreign banking law is that New York-chartered banks encountered difficulty entering foreign markets. *Id.* at 64.

The third approach asks whether the purpose of the state action is one properly effected only by the national government. This test also suggests that federal control of foreign banking is appropriate, but the test is difficult to apply when several purposes are involved, some of which are properly entertained by state governments.[119] States whose regulations restrict foreign banking activity presumably act to protect their citizens. But, as was seen in *Southern Pacific*, this protection motivation may not be compelling to the Court. Moreover, *Zschernig* offers little guidance when both valid and invalid purposes motivate state action. To compound the problem, state officials having a duty to weigh purposes and interests may be unable to obtain information from the State Department about the interests of the federal government.[120] In any case, the potential adverse effect of state control of foreign banking on foreign relations, foreign commerce, and national monetary policy surely outweighs a state's interest in protecting its citizens who, in all probability, would be adequately protected from potentially harmful foreign banking practices by federal regulation.

Recently, a new methodology for analyzing the federal-state relationship has been proposed. This functional approach assumes that "the principal determination on which cases in this area should turn is whether the matter is best decided by a national rather than a state decision maker."[121] Three interrelated factors are applied in this approach: (1) whether the state's limited constituency offers "an appropriate political context in which to make the required policy judgment";[122] (2) whether the state has the necessary information on which to base its decision; (3) whether the entire nation or only the particular state will suffer any potentially adverse effects. Applying each of these factors, it is once again apparent that the regulation of foreign banking should emanate exclusively from the federal level.

---

119. *See* Maier, *supra* note 95, at 155.

120. *Id.* at 152. This problem is also faced under the first approach, which considers whether state action obviates implied federal policies.

121. *Id.* at 166-68. Maier notes that a functional analysis was early emphasized in Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824), and he synthesizes the approach of the Supreme Court in Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964). In *Zschernig,* preemption was to be judged by federal law. *Sabbatino,* however, questioned who would serve as the lawmaker, and the Court employed a functional analysis based on both the nature of the decision-making power and the necessity of determining the appropriate decision-making group—*i.e.* federal judiciary, the President, Congress, or the state government. *See* Maier, *supra* note 95, at 161-62.

122. Maier, *supra* note 95, at 168.

First, the state action need not be found unconstitutional under a specific constitutional provision. Rather, the state action will be inappropriate whenever the political context of the state actively represents a constituency too narrow to represent effectively the needs of the entire nation.[123] The strained situation arising in 1967 between Canada and the United States provides a useful example. Canada denied branch banking to United States banks in Canada; consequently New York denied establishment of more Canadian bank branches because of a lack of reciprocity, which is required under New York law. Following prolonged bad relations between Canadian officials and the United States State Department, Canada statutorily limited financial activities of foreign-owned subsidiaries. The precipitating factor to the furor apparently was the First National City Bank's purchase of the Dutch-owned Mercantile Bank in Canada.[124] The misunderstanding might well have been avoided or lessened if the United States Government had been able to effectively negotiate with Canadian officials because only a national constituency can properly gauge the potential adverse effects that one state's actions may have on other countries and states.

The second factor disallows state action whenever it might interfere "with a national foreign policy that is not readily identifiable or that cannot be publicly articulated by the national government for reasons of international or domestic politics."[125] Several difficulties posed by 50 potentially different sets of foreign banking rules in the United States can be avoided by federal regulation. First, trade with foreign countries must be coordinated at the federal level to insure that the rights and expectations of the trading countries and third countries are not infringed; secondly, monetary controls, which are affected by the balance of payments and international fund transfers by banks, can operate effectively only on a national level; thirdly, and most important, it is doubtful that the data necessary to weigh involved policies could be either obtained or properly analyzed in world perspective by state decision-makers.

The third factor—the tendency of state rules to affect adversely the banking ventures of banks of other states—was discussed earlier in connection with the effect of one state's reciprocity requirement on other states.[126]

123. *Id.*
124. Gilbert, *supra* note 1, at 24.
125. Maier, *supra* note 95, at 169.
126. *See* note 121 *supra* and accompanying text.

VI. Conclusion

Foreign banking in the United States is no longer a nominal activity. The assets of foreign bank agencies and branches tripled from 1965 to 1972, increasing to approximately 13 billion dollars. During this same time, assets of United States banks abroad rose to 75 billion dollars—an eight-fold increase.[127]

Yet, despite this dramatic growth—which surely will continue—the United States remains the only major country in which foreign banking is not supervised at the national level.[128] No valid constitutional or practical reasons exist to support state control. Although New York and California, which share the major portion of foreign banking at the present time, have enjoyed greater prestige as international financial markets,[129] there is every reason to believe that a national scheme of regulation of foreign banking would enable other states throughout the country to benefit from the increased trading and financing activity that foreign banking could bring. Conversely, smaller American bankers would not be injured economically by foreign banking since foreign banks would locate principally in major cities and would be engaged primarily in facilitating trade between their home country and the United States.

Moreover, variant state regulations may lead to restrictions on United States banking abroad. It appears entirely reasonable that a New York-based bank could be denied expansion in a foreign country because that nation's banking interests have not been allowed to penetrate another American state. Such uneven treatment should be replaced by uniform federal control.

Finally, the lack of federal control has discouraged foreign banking in the United States, which, in turn, may impede the nation's foreign commerce policy and activity as well as its monetary controls and balance of payments efforts.

The present situation seems a result of happenstance:[130] foreign banking remained under state control because the amount of

---

127. Federal Reserve System Press Release (Feb. 1, 1973).

128. No attempt is made in this note to apply a functional analysis to the horizontal control conflict at the federal level. Application of analytical approaches to proposed legislation such as S. 3765, which was proposed by Senator Javits in 1966, should be profitable. It is suggested that congressional action in this area under the commerce clause is preferable.

129. *See* Gilbert, *supra* note 1, at 22.

130. The overlapping authority between state and federal, as well as the overlap between the three federal regulatory authorities, can be attributed to no other reason. *See* Hackley, *supra* note 3.

international trade in early years[131] was too insignificant to warrant positive federal intervention. Federal inactivity no doubt has been aided by lobby pressure from small banks unjustifiably fearful of increased competition.

At present, the federal government has only limited jurisdiction over foreign banking in the United States in the form of the Bank Holding Company Act, which requires the Federal Reserve Board's approval for foreign bank acquisition of a banking subsidiary in this country.[132] The gross inadequacy of federal control allows a continuing vertical conflict between state and federal control that could eventually damage national foreign commerce and foreign policy objectives.

The solution is quite clear and available: Congress should enact positive legislation to deal with the growing multinational banking activity. Prior proposals, such as S. 3765,[133] introduced by Senator Javits in 1966 but never enacted, should serve as helpful guidelines. The codification of liberal federal control over foreign banking activity will strengthen world trade generally and benefit United States banks as they negotiate with other sovereigns.

James A. Johnson

131. *See* Gilbert, *supra* note 1, at 20-21.

132. *See* notes 50-63 *supra* and accompanying text. *See also* Federal Reserve System Press Release (Feb. 1, 1973).

133. S. 3765, 89th Cong., 2d Sess. (1966). It should be noted that proposed bill S. 3765 included a section requiring the Comptroller of the Currency to notify the State Department of applications to establish an office. The State Department then would have had 60 days in which to submit its views to the Comptroller on the desirability of allowing an office to be established. *See* S. 3765, 89th Cong., 2d Sess. § 3(b) (1966).