Industry & Trade Summary

Commercial Banking

USITC Publication 2638 (SV-4)
June 1993

OFFICE OF INDUSTRIES
U.S. International Trade Commission
Washington, DC 20436

UNITED STATES INTERNATIONAL TRADE COMMISSION

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PREFACE

In 1991 the United States International Trade Commission initiated its current Industry and Trade Summary series of informational reports on the thousands of products and services imported into and exported from the United States. Each summary addresses a different industry area and contains information on U.S. and foreign producers, trade barriers, and industry trends. Also included is an analysis of the basic factors affecting trends in consumption, production, and international trade.[1]

This report on commercial banking covers the period from 1980 to 1992 and represents one of approximately 250 to 300 individual reports to be produced in this series during the first half of the 1990s. Listed below are the individual summary reports published to date on the service industries sectors.

USITC publication number	*Publication Date*	*Title*
2456 (SV-1)	November 1991	Insurance
2569 (SV-2)	October 1992	Advertising
2594 (SV-3)	February 1993	Legal Services
2638 (SV-4)	June 1993	Commercial Banking

[1] The information and analysis provided in this report are for the purpose of this report only. Nothing in this report should be construed to indicate how the Commission would find in an investigation conducted under statutory authority covering the same or similar subject matter.

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INTRODUCTION

Scope of the Summary

This summary focuses solely on commercial banking markets in the United States, the United Kingdom, and Japan. Other important markets exist in Continental Europe and Asia, but trends in these markets largely follow from events in New York, London, and Tokyo. This summary examines industry structure, regulation, prominent industry trends, and international trade during the 1980-92 period.

Current Conditions

Despite their markedly different experiences during the 1980s, the commercial banking industries in the world's major financial centers—the United States, Japan, and the United Kingdom—all suffered disruption when slower economic growth or recession set in during 1990-91. Profits in these three countries' banking industries declined almost uniformly, the financial solvency of certain banks in each country became suspect, and some banks in the United States and the United Kingdom failed. As a consequence, regulatory frameworks imposed on the banking industry are being reassessed, most notably in the United States.

While the financial performance of commercial banks generally deteriorates during periods of economic downturn, the recent difficulties of the banking industries in these countries appear to exceed those normally experienced because of economic recession. Profit margins of British banks, for instance, have fallen well below the level recorded during the 1980-82 recession. And in Japan, certain banks currently find themselves precariously placed, in sharp contrast with the robust growth of Japanese banks during the 1980s.

Intense Competition

During the past 10-15 years, competition in the commercial banking market has intensified as a result of innovation, globalization, and government policy. Innovation in terms of financial instruments and information-processing has blurred the distinction between banks and other financial service providers, thereby introducing new competitors into banking markets. New financial instruments, such as cash management and money market accounts, have resulted in nonbank firms providing bank-like services. New information-processing technologies, moreover, have resulted in the development of many firms, across many industries, that resemble banks in their ability to extend credit and manage complex financial transactions on a large scale. These nonbank firms now compete with banks to provide traditional banking services, such as credit card and other consumer financing services.

Globalization of the banking industry has stemmed from continuous growth in international investment and trade and from the relaxation of capital movement restrictions. The latter has allowed domestic investors and borrowers to go abroad in search either of higher returns on investments or of lower cost funds. As national economies have become intertwined, commercial banks that have facilitated trade, investment, and other capital flows have become more alike and more competitive. Banks now compete among themselves and with other types of financial institutions to provide an international pool of financial instruments to a global customer base.

In large part due to the recognition of change wrought by innovation and globalization, governments have undertaken deregulation and liberalization programs intended to remove increasingly artificial regulatory and geographic bounds on commercial banking activity, although to varying degrees and at varying paces. In the United States and the United Kingdom, deregulation and liberalization schemes have been undertaken as means to reduce inefficiency and preserve or recapture status as major banking markets. In Japan, deregulation of the banking market has been slower, but innovation and globalization appear to be encouraging deregulation. In those countries furthest along in terms of deregulation, domestic banks are engaged in fierce competition with other domestic or foreign financial institutions. In the United States and the United Kingdom, intense competition has significantly narrowed interest margins between traditional deposit-taking and lending, and has reduced revenues once generated by nonlending, fee-based activities.

In response to intensified competition, commercial banks in all three countries have entered new markets. Some of these markets, like those for real estate, securities, and mergers and acquisitions (M&A), offer greater potential returns than traditional commercial and industrial (C&I) lending,[1] but they entail greater risk. As a natural consequence of entering businesses with greater inherent risk, certain commercial banks in all countries have endured painful setbacks. Commercial banks' loan-loss provisions have cost banks capital that was sorely needed to weather adverse economic conditions and to meet higher international capital adequacy standards during the early 1990s. Without that capital, the financial performance of many banks deteriorated as economies turned downward.

Growth and Competitive Position of Japanese Banking

A remarkable phenomenon affecting competitive conditions in the global banking market during the last decade has been the expansion of Japanese banks in terms of size and geography. Although banks in both the United States and Japan have experienced setbacks, the Japanese banking industry currently appears to have a competitive advantage relative to the U.S. industry. A number of factors have contributed to this outcome.

[1] Commercial and industrial loans are low-risk, short- and medium-term loans traditionally extended by banks to individuals and firms in the private sector, the income from which is principally derived from interest payments rather than fees.

One factor is that the United States is much further along than Japan in terms of deregulating and liberalizing financial service markets. Although deregulation and liberalization ultimately may improve the long-term competitive position of U.S. banks, U.S. and Japanese banks do not face competitive pressures of the same intensity at present. Due to deregulation, those who save with and borrow from commercial banks in the United States clearly have more alternatives than do clients of Japanese banks. This is especially true of Japanese households, which still endure interest ceilings on most bank deposits and are likely to have no checking accounts. In addition, markets such as those for commercial paper and corporate bonds are much smaller in Japan than in the United States. Consequently, Japanese banks are largely insulated from the effects of these financial instruments, which compete with bank loans to large corporations. Furthermore, Japanese banks face less intense foreign competition in their home market. Efforts to remove barriers to the banking market have had less success in Japan than in the United States and the United Kingdom.

Regulation has affected competitive conditions, too. One important advantage enjoyed by Japanese banks during the entirety of the 1980s was that they could extend more loans than foreign competitors having the same amount of capital. This advantage facilitated the growth of Japanese lending in foreign markets, especially in the United States, where domestic banks experienced a series of crises that reduced their ability to lend during a period of heavy consumer and corporate borrowing.

In addition, regulation of Japanese banks appears to be more flexible than U.S. regulation. For instance, Japanese regulators permit Japanese banks to hold information regarding nonperforming loans confidential, protecting the reputation, share price, and hence capital-raising ability of Japanese banks. Moreover, Japanese regulators appear more inclined to intervene when trends unfavorable to the banking industry appear. Japan's bank regulators intervened to support real estate prices as conditions in the property market deteriorated, thereby limiting the damage done to Japanese banks and many of their large borrowers.

U.S. AND FOREIGN INDUSTRY PROFILES

As stated earlier, banking has become a global activity in recent years. National borders separate savers, borrowers, and intermediaries less and less. Borrowers in one country can access capital saved in another while using banks or other financial institutions located in yet a third country. One result of globalization is that banking industries from different countries are becoming increasingly similar both in terms of structure and regulation. At present, however, significant differences exist across international boundaries.

Structure of the U.S. Commercial Banking Industry

The U.S. banking industry is principally composed of commercial banks and savings banks (thrifts), both of which accept deposits and originate loans. Commercial banks can be further separated into retail and wholesale banks. A retail bank tends to conduct business with households and small businesses whereas a wholesale bank conducts most of its business with large corporations and other banks.

By tradition, commercial banks have principally extended short- to medium-term C&I loans to private individuals and businesses, whereas thrifts have typically provided long-term mortgage financing for residential housing. However, this difference has lessened in recent years as commercial banks' C&I business has decreased while their real estate loans have escalated, and as thrifts have won the right to offer transaction accounts in addition to savings accounts.[2] In 1991, U.S. commercial banks held approximately $3.4 trillion in assets, and generated profits totaling $18.6 billion.[3]

Largely because of regulatory constraints imposed on interstate banking, a large number of commercial banks, about 11,600, currently exist in the United States. Assets and deposits, however, are concentrated among the largest firms. The largest 100 commercial banks, for instance, account for about 60 percent of total banking assets, whereas the smallest 10,000 commercial banks account for less than 20 percent of all banking assets.[4] The 20 largest banks in the United States are listed in table 1.

Structure of Foreign Banking Industries

Foreign banking industries are generally much more concentrated than the U.S. industry. Whereas the United States has 11,600 commercial banks, similar institutions in the United Kingdom and Japan appear to number no more than 300 apiece. The largest 10 banks in Japan account for over one-half of the Japanese banking industry's assets, and the largest 10 banks in the United Kingdom account for approximately 40 percent of total banking assets in that country. By contrast, the largest 10 banks in the United States account for less than 30 percent of the U.S. banking industry's total assets.[5] The world's largest 100 banks are listed in appendix A.

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[2] U.S. Department of the Treasury, *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks* (Washington, DC: U.S. Department of the Treasury, 1991), p. XVIII-10.

[3] Federal Deposit Insurance Corporation (FDIC), *Quarterly Banking Profile*, fourth quarter 1991, p. 1.

[4] Walter Adams, *The Structure of American Industry* (New York: Macmillan Publishing Co., 1990), pp.273-274.

[5] Allen B. Frankel and John D. Montgomery, "Financial Structure: An International Perspective," *Brookings Papers on Economic Activity* (1991), vol. 1, pp 281-283.

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Table 1
Largest 20 U.S. bank holding companies[1]

(Million dollars)

Rank	Company	Assets	Deposits	Net Income[2]	Return on Assets
1	Citibank	216,922	146,475	(457.0)	-0.21
2	Chemical Banking[3]	138,930	92,950	154.0	0.11
3	BankAmerica[4]	115,509	94,067	1,124.0	0.97
4	Nationsbank[5]	110,319	88,075	201.9	0.18
5	J.P. Morgan	103,468	36,976	1,114.0	1.08
6	Chase Manhattan	98,197	71,517	520.0	0.53
7	Security Pacific[4]	76,411	54,228	(774.5)	-1.01
8	Bankers Trust New York	63,959	22,834	667.0	1.04
9	Wells Fargo	53,547	43,719	21.0	0.04
10	First Chicago	48,963	32,091	116.3	0.24
11	First Interstate Bancorp	48,922	41,433	(288.1)	-0.59
12	Banc One	46,293	37,057	529.5	1.14
13	First Union	46,085	36,598	318.7	0.69
14	Fleet/Norstar Financial Group	45,445	35,245	97.7	0.21
15	PNC Financial	44,892	30,019	398.8	0.89
16	Bank of New York	39,426	28,974	122.0	0.31
17	Norwest	38,502	25,439	398.5	1.04
18	Suntrust Banks	34,554	27,988	370.7	1.07
19	Wachovia	33,158	23,006	229.5	0.69
20	Barnett Banks	32,721	28,855	123.8	0.38

[1] Figures reflect positions of banking operations as of December 31, 1991. Nonbanking operations are excluded, except as noted.
[2] Net income is not adjusted for securities gains and losses.
[3] Chemical Banking and Manufacturers Hanover merged on December 31, 1991. Figures reflect combined operations.
[4] BankAmerica and Security Pacific proposed a merger during August 1991 and obtained the Federal Reserve's approval during March 1992.
[5] C&S/Sovran and NCNB merged December 31, 1991, forming NationsBank. Figures reflect combined operations.

Source: *American Banker*, Top Numbers 1992 Edition, pp. 72-78.

Japan

Japan's banking sector is composed of approximately 13 city banks, 64 regional banks, 3 long-term credit banks, 13 trust banks, and 68 thrifts or mutual banks. In the aftermath of the Second World War, these institutions were designed to channel cheap capital to Japan's manufacturing sector. Japanese banks are separated according to function. Different types of banks perform different financial services, which limits interbank competition. By enforcing regulations regarding the types of funds that different banks can accept, banking authorities maintain clear demarcations. Different types of deposits result in propensities to extend different types of loans. Banks that accept short-term deposits, for instance, are likely to make short-term loans.

At the core of the Japanese commercial banking system are the city banks, which control assets in excess of $2 trillion.[6] City banks typically provide the funds with which Japan's largest corporations expand and modernize. Four of the thirteen city banks—Sumitomo, Mitsui, Mitsubishi, and Fuji—are partners in Japan's keiretsus (business conglomerates), linking large corporations together, often through the cross-ownership of shares. Six others are intertwined in similar but smaller corporate conglomerates.[7]

Regional banks, controlling assets of approximately $1 trillion,[8] are the only other domestic banks that participate in Japan's commercial banking market. Regional banks are more reliant on retail deposits than city banks, and principally lend to small and medium-size companies. Using their extensive retail deposit networks, the regional banks have provided city banks with additional funding during periods of heavy borrowing.[9]

The United Kingdom

At the core of the British banking system are 21 clearing banks, which reportedly accounted for assets of £300 billion ($480 billion) in 1990, or about 55 percent of the total assets held by foreign and domestic

[6] U.S. Department of the Treasury, *National Treatment Study 1990* (Washington, DC: U.S. Department of the Treasury, 1990), p. 211.

[7] David M. Meerschwam, *Breaking Financial Boundaries: Global Capital, National Deregulation, and Financial Services Firms* (Boston: Harvard Business School Press, 1991), p. 114.
[8] U.S. Dept. of the Treasury, *National Treatment Study 1990*, p. 211.
[9] Meerschwam, *Breaking Financial Boundaries*, p. 120.

banks in the United Kingdom. Clearing banks are comparable to U.S. commercial retail banks in the sense that clearing banks accept customer deposits and extend C&I and consumer loans.[10]

Other important deposit-taking institutions are the British building societies. Like U.S. thrifts, building societies obtain funds from small savers, and principally use these funds to finance home purchases. However, the societies have been able to offer a wider range of banking, investment, insurance and nonfinancial products since 1986, when the deregulatory Building Societies Act was passed.

Reflecting the international character of British financial markets, nearly 300 foreign banks have offices in the United Kingdom.[11] Foreign institutions reportedly account for about 30 percent of the United Kingdom's total banking liabilities and 25 percent of total assets. Among foreign banks, Japanese firms have become predominant in recent years; Japanese banks' share of total British banking sector assets stood at 5 percent by the end of 1990.[12]

The high degree of foreign participation in the British banking market principally stems from the broader range of activities that commercial banks may conduct in the British market. The British market is especially attractive to banks that operate within relatively strict regulatory guidelines in home markets, such as those from the United States and Japan. Although foreign banks located in London reportedly concentrate on commercial lending, they also participate heavily in London's securities, trade finance, and foreign exchange markets.[13]

Regulation

The structure of commercial banking is strongly influenced by banking regulation, both in the United States and abroad. To facilitate economic growth, banking authorities seek to establish regulations that promote both stability and efficiency, while recognizing that these two objectives are often in conflict. For instance, banking regulations may encourage vigorous competition in lending and deposit-taking markets, thereby promoting efficiency, but restrict competition in the potentially destabilizing market for securities, perhaps reducing market efficiency.

As a result of unique financial histories and traditions, countries have imposed different limits on banks' activities. Countries such as the United States and Japan strictly limit the business activities that banks may undertake, whereas other countries, such as the United Kingdom, allow banks greater freedom. U.S. and Japanese banks are largely segmented according to function, whereas British banks may provide a wide range of banking, securities, and insurance services. Combined with strict limits on inter-State banking and investment in commercial concerns, regulation in the United States appears to render U.S. banks most vulnerable to isolated geographic downturns. However, U.S. regulation may also enhance a bank's ability to gauge the creditworthiness of potential borrowers and monitor borrowers' performance after loans have been extended.

Regulation of the U.S. Banking Market

The U.S. regulatory system is complex. Four Federal and 50 State regulatory bodies preside over the U.S. banking industry. Federal regulators include the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). The last two regulatory bodies belong to the U.S. Treasury Department. As shown in figure 1, State- and Federally- chartered thrifts and their holding companies report to the OTS. Nationally-chartered banks are regulated by the OCC. The Federal Reserve Board regulates the holding companies of all commercial banks, regardless of their charter, and State-chartered banks that are members of the Federal Reserve System. The FDIC regulates any State-chartered bank that is not a member of the Federal Reserve System, as well as all banks that it insures.[14]

The U.S. banking and securities industries were largely separated by legislation enacted 60 to 70 years ago. Such legislation was intended to protect small banks and correct perceived deficiencies in the wake of the Great Depression. The McFadden Act, adopted in 1927, effectively vested State Governments with the authority to control the spread of bank branches National banks were permitted to branch only within their home State, and State member and nonmember banks were similarly restricted as a combined result of the McFadden Act and State laws.[15]

Enactment of the Banking Act of 1933, also known as the Glass-Steagall Act, was intended to reimpose soundness on the U.S. banking system by removing speculative business from commercial banking. As a result, commercial banking and investment banking have been altogether different businesses since the 1930s. In their entirety, the various sections of Glass-Steagall virtually prohibit institutions that receive deposits from underwriting, purchasing, or dealing in securities.[16] The Bank Holding Company Act of 1956 essentially banned bank holding companies from engaging in nonbanking activities by prohibiting banks from owning shares in most nonbank

[10] Financial Times Business Information, *Banking in the EC, 1991: Structures and Sources of Finance* (London: FT Business Information LTD., 1991), p. 341.

[11] Edward P.M. Gardner and Philip Molyneux, *Changes in Western European Banking: An International Banker's Guide*, (London: Unwin Hyman, 1990), p. 281.

[12] Financial Times Business Information, *Banking in the EC*, p. 337.

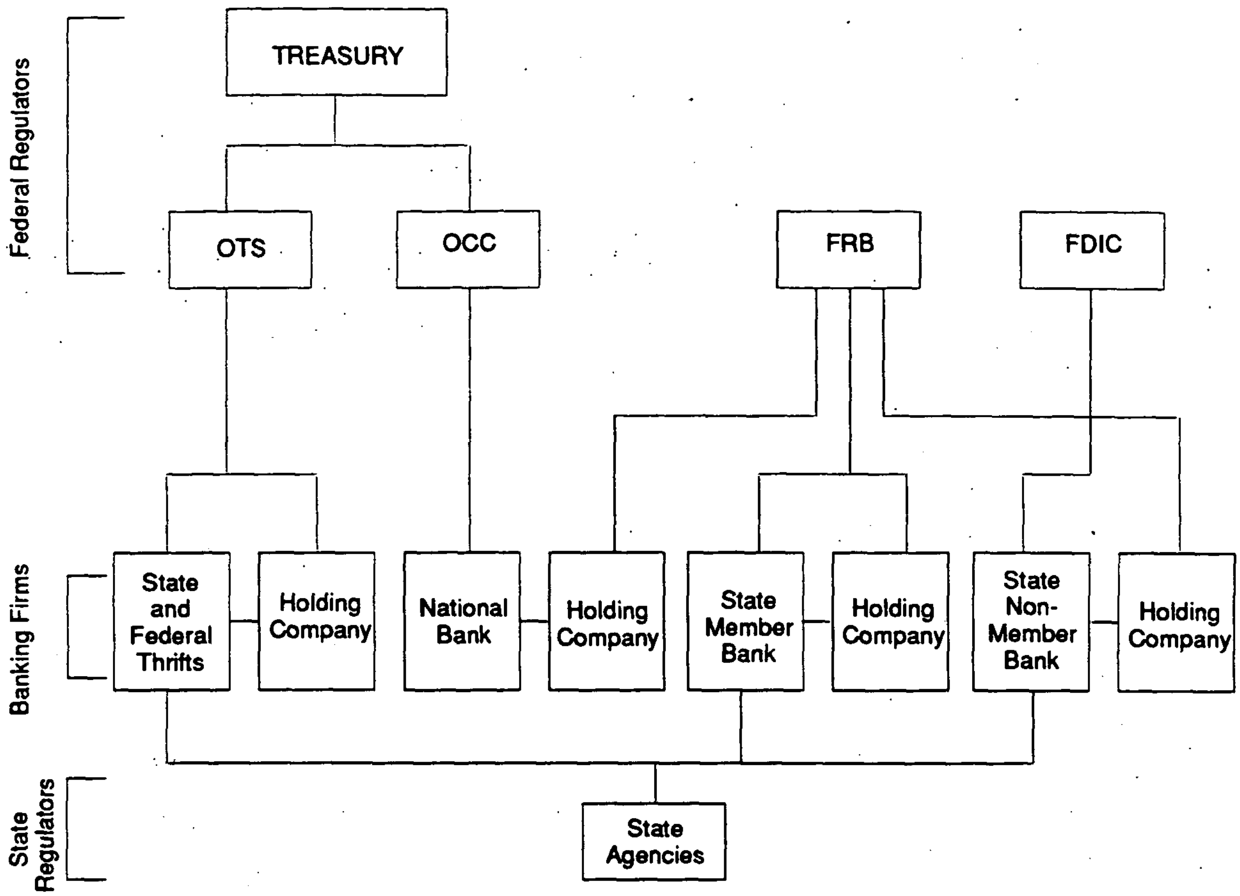
[13] Gardener and Molyneux, *Changes in Western European Banking*, p. 282.

[14] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XIX-1.

[15] Ibid., p. XVIII-4.

[16] Ibid., p. XVIII-5.

Figure 1
Current U.S. banking regulation



Source: U.S. Department of the Treasury, *Modernizing the Financial System.*

corporations.[17] In addition, until the 1980s, commercial banks were prevented from using interest rates to compete for deposits by Regulation Q, issued by the FRB pursuant to the Glass-Steagall Act, which placed interest rate ceilings on time and savings deposits and prohibited interest-bearing checking accounts.

In combination, the McFadden, Glass-Steagall, and Bank Holding Company Acts created a segmented market with specialized firms. Until the 1980s, commercial banks accepted deposits and extended loans to businesses and households. Thrifts collected household savings and provided long-term mortgage financing. Securities houses, on the other hand, underwrote and dealt in stocks and bonds.

Regulation of Foreign Industries

As shown in table 2, the range of permissible activities for banks in many foreign countries is broader than that for banks in the United States. Financial services commonly performed by foreign banks in their domestic markets include insurance and securities underwriting and brokerage, mutual fund management, and real estate services. Countries that appear to grant banks the widest range of business activities include Belgium, Germany, Luxembourg, and the United Kingdom. Many European banks engage in a wide range of financial services as a result of the popularity of "universal banking"[18] on that continent.[19] Universal banking is expected to become increasingly common in the European Community as a result of the harmonization and liberalization of

[17] Ibid., p. XVIII-8.

[18] Within the framework of universal banking, a single institution may provide securities and insurance services in addition to banking services. In addition, universal banks are likely to be subject to regulation by a single banking regulator, rather than by multiple supervisory agencies with oversight responsibility for the nonbanking services performed by the bank. Universal-type banking is permitted in Germany, Switzerland, Belgium, Luxembourg, the Netherlands, and to a lesser extent, in the United Kingdom.

[19] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-25.

Table 2
Services permissible for commercial banks, by country, 1990

Are banks allowed to provide these services?	Belgium	Canada	France	West Germany	Italy	Japan	Luxembourg	Netherlands	Switzerland	United Kingdom	United States
Insurance:											
Brokerage	Y	N	Y	Y	N*	N	Y	Y	N	Y	N*
Underwriting	Y	N	N*	Y*	N*	N	Y	N	N	Y*	N
Equities:											
Brokerage	Y	Y*	Y	Y	Y	N	Y	Y	Y	Y	Y
Underwriting	Y	Y*	Y	Y	Y	N	Y	Y	Y	Y*	N
Investment	Y	Y*	Y	Y	Y	Y	Y	Y	Y	Y*	N
Other underwriting:											
Government debt	Y	Y	Y	Y	Y	N	Y	Y	Y	Y*	Y
Private debt	Y	Y*	Y	Y	Y	N	Y	Y	Y	Y*	N
Mutual funds:											
Brokerage	Y	Y	Y	Y	Y	N	Y	Y	Y	Y	N
Management	Y	Y*	Y	Y	Y	N	Y	Y	Y	Y	N
Real estate:											
Brokerage	Y*	N	Y	Y	N	N	Y	Y	Y	Y	N*
Investment	Y	Y	Y	Y	Y	N	Y	Y	Y	Y	N
Other brokerage:											
Government debt	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Private debt	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y

Notes: N = No; N* = No, with exceptions; Y = Yes; Y* = Yes, but not directly by the bank.

Source: American Bankers Association, *International Banking Competitiveness*, March 1990, page 82, as presented in U.S. Department of the Treasury, *Modernizing the Financial System* banking regulations undertaken as part of the EC92 program. The foreign system most like the U.S. system in terms of banking regulation is that of Japan.

Regulation of the Japanese banking market

Japanese banks are regulated by quasi-independent bureaus located within the Ministry of Finance (MOF). The Banking Bureau of the MOF is the principal bank supervisor, whereas the International Finance Bureau and the Securities Bureau oversee banks' international and government bond businesses, respectively. In addition, bank regulators closely monitor commercial banks' reserve accounts at the Bank of Japan.[20]

As noted, Japan's banking market is presently regulated in a manner similar to that of the United States. Article 65 of Japan's Securities and Exchange Law separates Japanese commercial banking and securities-related activities in much the same fashion as the United States' Glass-Steagall Act, although Article 65 defines securities activities more narrowly than the Act.[21] As indicated in table 2, Japanese banks are largely prohibited from underwriting and dealing in insurance and corporate securities, although they are permitted to participate in markets for government and public securities, and futures and options on such securities.[22] Bank ownership of nonfinancial companies is limited to 5 percent of any company's shares, and ownership of securities firms is prohibited.[23] Differing from U.S. regulators, however, Japan's regulators place no branching restrictions on Japanese banks,[24] and nonbank companies are not restricted in their ability to own bank stock.[25]

Business relations within Japanese keiretsus are thought to partially offset certain restrictions on banks' activities. Banks are integral members of the largest keiretsus, and banks often own the maximum amount of shares in associated companies. Over 20 percent of outstanding stock in Japanese firms is held by Japanese banks, which may allow banks to exercise significant influence in industrial affairs. Moreover, as indicated in table 3, Japanese banks and other financial service firms share close relationships. These alliances reportedly allow banks, securities firms, insurance firms, and property firms to steer clients to associated financial service firms to provide valued customers with a full range of financial services.

[20] Federal Reserve Bank of New York, *Quarterly Review*, Winter 1987-88, p. 21.

[21] Testimony of Hikedi Kanda, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs, U. S. House of Representatives, Washington, DC, Jan. 22, 1992.

[22] Ibid.

[23] Institute of International Bankers, *International Banking Focus*, Fall 1991, p. 5.

[24] Frankel and Montgomery, "Financial Structure," p. 274.

[25] Testimony of Hikedi Kanda, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs, U. S. House of Representatives, Washington, DC, Jan. 22, 1992.

Regulation of the British banking market

The Banking Acts of 1979 and 1987 formalized British banking regulation. These acts identified the Bank of England as the chief supervisor of deposit-taking institutions. In addition, the Banking Act of 1979 details the requirements for participation in specific financial markets and specifies minimum reserve requirements. The 1987 act created the central bank's Board of Supervision and increases the responsibilities of auditors in monitoring and reporting activity in the retail and wholesale banking markets and the government bond market.[26]

Bank regulation in the United Kingdom is more liberal than in the United States and Japan. Like Japanese regulators, British regulators place no branching constraints on British banks.[27] As indicated in table 2, the United Kingdom's universal banking environment permits banks to engage in a wider array of financial activities than commercial banks in either the United States or Japan. Commercial banks are permitted to engage in the full range of securities and insurance activities, and may undertake industrial investments subject to permission by the Bank of England. Securities and insurance businesses are attractive to banks because they offer potentially higher returns on investment and more stable income streams over the business cycle.

Seven clearing banks currently own life insurance companies and cross-sell life insurance with mortgage loans. The deregulation of London's stock market in 1986, sometimes referred to as the "Big Bang," enabled banks to purchase securities houses. Through these securities houses and other banking agencies, clearing banks underwrite and deal in securities, offer mutual funds, and provide portfolio management services.[28] The so-called "Big Four" London clearing banks—Barclays, Lloyds, Midland, and National Westminster—provide the broadest range of such financial services.[29]

RECENT EXPERIENCE OF THE BANKING INDUSTRY

A mix of financial innovation and deregulation, compounded by globalization, have introduced new competitive pressures in the international banking market, especially as it operates in the United States and the United Kingdom. In these two countries, interest rate ceilings on bank deposits virtually have disappeared,[30] driving up the cost of funds. Additionally, traditional segmentation among financial services providers has largely evaporated. Firms such

[26] Meerschwam, *Breaking Financial Boundaries*, p. 189.

[27] Gardener and Molyneux, *Changes in Western European Banking*, p. 280.

[28] Financial Times Business Information, *Banking in the EC*, p. 341.

[29] Meerschwam, *Breaking Financial Boundaries*, pp. 153-157.

[30] The most important exception to the disappearance of interest rate regulation in these countries is the retention of limits on interest rates available on demand deposits held by U.S. corporations.

Table 3
Financial service firms of Japanese keiretsu

Business group	Affiliated firms	Type of firm
Mitsubishi Group:		
	Mitsubishi Bank	City bank
	Mitsubishi Trust	Trust bank
	Nippon Trust	Trust bank
	Hachijuni Bank	Regional bank
	Shinwa Bank	Regional bank
	Tokyo Marine & Fire	Nonlife insurer
	Meji Mutual Life	Life insurer
	Nisshin Fire & Marine	Nonlife insurer
	Diamond Lease	Leasing company
	Diamond Credit	Consumer credit company
	Nikko Securities	Securities company
	Ryoko Securities	Securities company
	Mitsubishi Estate	Property developer
Mitsui Group:		
	Mitsui Bank	City bank
	Mitsui Trust	Trust bank
	Taisho Marine & Fire	Nonlife insurer
	Mitsui Mutual Life	Life insurer
	Mitsui Leasing & Development	Leasing company
	Mitsui Real Estate Development	Property developer
Sumitomo Group:		
	Sumitomo Bank	City bank
	Sumitomo Trust	Trust bank
	Kansai Bank	Mutual bank
	Mie Bank	Regional bank
	Sumitomo Marine & Fire	Nonlife insurer
	Sumitomo Life	Life insurer
	Sumisho Lease	Leasing company
	SB General Leasing	Leasing company
	Daiwa Securities	Securities company
	Meiko Securities	Securities company
	Sumitomo Realty & Development	Property developer
Fuyo Group:		
	Fuji Bank	City bank
	Yasuda Trust	Trust bank
	Chiba Kogyo Bank	Regional bank
	Ogaki Kyontsu Bank	Regional bank
	Shikoku Bank	Regional bank
	Higo Bank	Regional bank
	Higo Family Bank	Mutual bank
	Yasuda Fire & Marine	Nonlife insurer
	Yasuda Mutual Life	Life insurer
	Nichido Fire & Marine	Nonlife insurer
	Fuyo General Lease	Leasing company
	Fuyo General Development	Leasing company
	Yamaichi Securities	Securities company
	Daito Securities	Securities company
	Tokyo Tatemono	Property developer

Source: Meerschwam, *Breaking Financial Boundaries,* p. 116.

as securities houses, thrifts, and certain nonfinancial companies now compete with banks to provide deposit-taking and commercial lending services. Banks in these two countries have defended traditional deposit-taking and lending businesses, in part, by reducing loan margins (which has reduced profits), and by increasing lending in new and often more risky markets. As a result, loan portfolios have changed rather dramatically. Commercial banks have also increased securities- and insurance-related activities. In addition, fee-generating off-balance sheet activities such as loan commitments/guarantees and currenc) and interest rate swaps, have mushroomed (se "Off-Balance Sheet Activities").

The nature of competition in the Japanese bankin market is changing, too. Although the Japanes banking market continues to display more rigi segmentation among different types of financia service providers, and therefore less interfirn competition, deregulation carried out since the mid-1980s has slowly created incentives for banks to change. Deregulation is slowly increasing Japanese banks' cost of funds, and large corporate customers are increasingly defecting from traditionally close relationships with Japanese banks to take advantage of the financial instruments and customized services offered in U.S. and British markets, among others. In response, Japanese banks have become more reliant on loans to individuals, small and medium-size companies, and real estate and securities market speculators.

Deposit Taking

Individual savers in the United States were among the first to recognize, and react to. prevailing market forces during the 1970s. Responding to high inflation and low fixed interest rates on deposits, savers transferred funds from accounts in commercial banks to market-sensitive instruments such as money market mutual funds (MMFs) beginning in 1972. MMFs offer market rates of return and acceptable levels of safety and liquidity. Partly at the expense of deposits held at U.S. commercial banks, MMF assets grew from $1.7 billion in 1974 to $414 billion in 1990.[31]

Largely coinciding with the growth of MMFs in the United States was a movement of funds from fixed-rate deposits or non-interest-bearing checking accounts at commercial banks to variable-interest-bearing NOW (negotiable order of withdrawal) accounts offered by certain thrift institutions. Later, thrifts were placed in direct competition with commercial banks with the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), which permits all banks, both savings and commercial, to offer interest-bearing transaction accounts to non- corporate customers.[32]

[31] U.S. Dept. of the Treasury, *Modernizing the Financial System*, pp. XVIII-9 and 10.

DIDMCA also increased U.S. commercial banks' cost of funds by providing for the gradual elimination of interest rate ceilings on savings and time deposits during 1981-86.[33] Due to these events, in part, commercial banks' share of all U.S. financial institutions' assets fell during the 1970s and 1980s, as shown in table 4.

Deregulation in the United Kingdom closely resembled the process in the United States. Interest-bearing checking accounts became available at British clearing banks in 1980, and interest rates on all deposits were essentially deregulated by 1984.[34] Adding to the competition for funds, British building societies were permitted to offer interest-bearing checking accounts in 1987.[35] In contrast, Japanese deregulation has begun only recently; interest rates on large time deposits were deregulated in 1985. Interest-bearing checking accounts were scheduled to be introduced during the summer of 1992,[36] and interest-rate ceilings on time and demand deposits are scheduled to be fully liberalized by 1994.[37]

[32] Ibid., p. XVIII-10.

[33] Sarkis J. Khoury, *The Deregulation of the World Financial Markets* (New York: Quoron Books, 1990), p. 88.

[34] Bank of Japan, *Developments Following the Deregulation of Retail Deposits in Major European Countries and the United States*, Mar. 1991, pp. 38 and 52.

[35] Ibid., p. 65.

[36] Institute of International Bankers, *International Banking Focus*, p. 24.

[37] Ibid.; and Bank of Japan, *Deregulation, Technological Progress, and Efficiency of the Banking Industry in Japan*, Jan. 1992, p. 5.

Table 4
Selected financial institutions' shares of total U.S. financial assets
(Percent)

Institution	1946	1950	1960	1970	1980	1988
Commercial banks	57.3	51.2	38.3	38.6	36.7	32.8
S&L associations	4.4	5.8	11.9	12.9	15.4	17.3
Mutual savings banks	8.0	7.6	6.9	5.9	4.2	3.6
Credit unions	0.2	0.3	1.0	1.3	1.7	2.2
Life insurance companies	20.3	21.3	19.3	15.0	11.5	13.2
Private pension funds	1.5	2.4	6.4	8.3	11.6	6.2
State & local pension funds	1.2	1.7	3.3	4.5	4.9	5.3
Other insurance companies	3.0	4.0	4.4	3.7	4.3	4.2
Finance companies	2.1	3.2	4.6	4.8	5.0	7.0
Real estate investment trusts	0.0	0.0	0.0	0.3	0.1	0.1
Mutual funds	0.6	1.1	2.8	3.5	1.5	4.2
Money market mutual funds	0.0	0.0	0.0	0.0	1.9	3.3
Securities brokers & dealers	1.5	1.4	1.1	1.2	1.1	0.7
Total[1]	100.0	100.0	100.0	100.0	100.0	100.0
Total (billion dollars)	234	294	600	1,342	4,404	6,817

[1] Columns may not add up to 100 percent because of rounding.

Source: Board of Governors of the Federal Reserve System, *Flow of Funds Accounts*, various editions, as presented in Meerschwam, *Breaking Financial Boundaries*, p. 79.

Lending

Commercial banks' lending activities have become subject to increased competition as well. Beginning in the 1950s, U.S. commercial firms that acquired thrifts and limited-service banks[38] began lending to consumers through "nonbank banks." Nonbank banks include auto-financing companies (General Motors Acceptance, Ford Motor Credit, Chrysler Financial), consumer finance companies (American Express), commercial finance companies (General Electric Financial Services, IBM Credit, Westinghouse Credit, etc.), and insurance companies. As shown in table 5, nonbank banks accounted for half of all U.S. commercial loans and over 40 percent of U.S. consumer loans by 1988. At yearend 1990, commercial loans extended by nonbank banks stood at $293 billion.[39]

During the 1980s, U.S. securities firms also began to offer services that competed with checking accounts held at commercial banks. Through large brokerage office networks, securities firms routinely began to sell investment services combined with checking accounts. These asset allocation services usually include investments in bank certificates of deposit (CDs) or other money market funds and limited check-writing privileges, typically referred to as cash management accounts (CMAs). Brokered certificates of deposit totaled $78.4 billion in June 1990.[40]

In addition to competition from other financial and nonfinancial firms, commercial banks have experienced declines in commercial loan business as a result of the increased use of commercial paper, a form of short-term debt that allows corporations with high creditworthiness to bypass financial intermediaries and borrow directly from investors at lower interest rates. The ratio of U.S. banks' commercial and industrial loans to commercial paper outstanding fell from nearly 10:1 in 1960 to 1.2:1 in 1989.[41] In 1990, the U.S. commercial paper market was estimated at $530 billion.[42]

Commercial paper has also become a popular capital-raising instrument for investment-grade corporations in the United Kingdom and Japan although the sums involved are smaller due to the relative newness of indigenous commercial paper markets. Commercial paper markets arose in the United Kingdom and Japan in 1986 and 1987, respectively. In the United Kingdom, the ratio of British banks' loans to commercial paper outstanding fell from 100:1 in 1986 to 40:1 in 1990. In Japan, the ratio fell from 100:1 in 1987 to 18:1 in 1990 (table 6).[43]

Commercial Banks' Response to Intensified Competition

Commercial banks have employed three principal strategies designed to compensate for revenues lost in the increasingly competitive loan market. One strategy has been to change loan portfolios. U.S., British, and Japanese banks have substituted real estate loans and loans to less developed countries (LDCs) for commercial and industrial loans. This particular strategy was reinforced by the indebtedness of traditional borrowers by the late 1980s.[44] The debt held by nonfinancial firms in the United States and the United Kingdom grew significantly as a result of the debt-financed mergers and acquisitions that occurred during the 1980s (table 7). Debt held by Japanese firms grew as well, due in part to aggressive business expansion abroad.[45]

Second, commercial banks, particularly those in the United States, have looked to off-balance sheet business to maintain or increase revenues. Last, a number of commercial banks have increased their presence in securities and insurance markets. All strategies offer higher potential yields but expose banks to greater risk. Certain banks' efforts to manage risks associated with real estate and LDC lending have been unsuccessful, resulting in historically high levels of banking losses. The long-term effects of off-balance sheet, securities, and insurance activities are unclear at the moment.

Changing Loan Portfolios

Real Estate Lending

During 1980-89, the share of U.S. commercial banks' total loans (excluding interbank loans) accounted for by real estate loans grew from 28 percent to 38 percent, whereas the share accounted for by commercial loans decreased from 36 percent to 32 percent.[46] Real estate loans appeared to expose banks to relatively small risks until the U.S. economy slowed in 1990, leaving commercial banks with very high loan exposure to firms with real estate portfolios that depreciated rapidly during the recession. The FDIC

[38] A provision in the Bank Holding Company Act, which defined banks as institutions that both accepted demand deposits and made commercial loans, allowed nonfinancial corporations to acquire and operate insured banks as long as they discontinued one of the banks' two functions. This provision was changed by the Competitive Equality Banking Act of 1987, but existing nonbanks were allowed to continue operations subject to certain limitations. See U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-21.

[39] Board of Governors of the Federal Reserve, *Federal Reserve Bulletin*, May 1991, p. A35.

[40] Merrill Lynch Capital Markets, as reported in U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-10.

[41] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. I-26.

[42] Board of Governors of the Federal Reserve, *Federal Reserve Bulletin*, p. A24.

[43] Bank for International Settlements (BIS), *61st Annual Report*, (Basle: Boehm-Hutter AG, 1991), p. 112.

[44] Representatives of U.S. banking industry, interview by USITC staff, New York, NY, Sept. 26-27, 1991.

[45] BIS, *61st Annual Report*, p. 107.

[46] Board of Governors of the Federal Reserve, *Annual Statistical Digest 1980-89*, pp. 88-95.

Table 5
U.S. banks' and nonbank banks' market shares, 1988

	Total finance receivables	Market share	Change from 1982	Commercial loans	Market share	Change from 1982	Consumer loans	Market share	Change from 1982	Earnings: Net income	Earnings: Return on investment
	$ billion	percent	percent	$ billion	percent	percent	$ billion	percent	percent	$ billion	percent
Carmakers	176.8	15.2	2.1	61.8	11.1	3.2	–	115.1	19.0 -	2.0	7.9
Consumer finance	130.9	11.2	-0.8	31.0	5.6	-0.5	99.9	16.5	-2.1	4.2	6.1
Commerical finance	73.2	6.3	1.5	65.9	11.8	6.1	7.3	1.2	-2.7	1.6	6.1
Insurance	150.4	12.9	-8.1	120.5	21.6	-6.3	29.9	4.9	-8.2	4.1	2.2
Total nonbank banks	531.3	45.6	-5.3	279.2	50.1	2.5	252.2	41.6	-13.0	1.9	5.1
Retail banks[1]	364.0	31.3	5.9	20.5	21.6	0.1	243.5	40.2	10.5	4.7	7.3
Wholesale banks[2]	268.3	23.1	-0.6	157.9	28.3	-2.6	110.4	18.2	2.5	5.6	7.1
Total banks	632.3	54.4	5.3	578.4	49.9	-2.5	353.9	58.4	13.0	0.3	7.2
Total	1,163.6	([3])	([3])	557.6	([3])	([3])	606.1	([3])	([3])	22.2	6.1

[1] Figures reflect lending activity of Citicorp, Security Pacific, Wells Fargo, First Interstate Bancorp, Bank of New England, NCNB, Barnett Banks, Banc One, First Union, and Citizens & Southern.

[2] Figures reflect lending activity of Chase Manhattan, Manufacturers Hanover, Chemical Banking, JP Morgan, First Chicago, Bankers Trust, Bank of Boston, Marine Midland, Mellon Bank, and Bank of New York.

[3] Not applicable.

Source: The Economist, April 7, 1990, p. 34.

Table 6
Commercial paper markets in the United States, Japan, and the United Kingdom[1]

Country	Market opening	Share of bank credit[2] 1986	1990
		Percent	
United States	pre-1960	12.0	18.9
Japan	1987	[3]0.7	5.5
United Kingdom	1986	0.7	2.5

[1] Issues by nonfinancial companies.
[2] Excludes bank credit extended to financial companies.
[3] Figure reflects share in 1987.

Source: Bank for International Settlements, *61st Annual Report*, p. 112.

Table 7
Private sector indebtedness in the United States, Japan, and the United Kingdom

Country	Non-financial companies 1975	1980	1985	1989	Households 1975	1980	1985	1989
	Percentage of GNP/GDP				Percentage of disposable income			
United States	36	34	39	48	67	77	83	96
Japan	94	86	101	13	45	58	68	92
United Kingdom	47	40	47	80	47	48	76	105

Source: Bank for International Settlements, *61st Annual Report*, p. 107.

estimated U.S. commercial banks' exposure to real estate debt at $865 billion as of October 1992.[47]

Similar trends have been evident in the United Kingdom and Japan, with comparable results. During 1980-90, British banks' real estate loans increased from 12 percent to 31 percent of total bank lending. Since 1983, however, housing prices in London and in the United Kingdom's Southwest have experienced 4-5 percent decreases, exposing British banks to large losses. Building societies' predominance as lenders for real estate purchases, however, may have limited British commercial banks' total exposure to bad loans. Building societies appear to account for two-thirds of all real estate lending in the United Kingdom.[48]

Market prices of Japanese properties have experienced significant declines in recent years, too, with land prices decreasing by as much as 30 percent in Tokyo, and by as much as 50 percent in Osaka. During 1980-90, Japanese banks' direct lending to the real estate industry and to nonbanks, many of which invested borrowed funds in the real estate market, increased from 10 percent of total loans to 26 percent.[49] Growing exposure to the real estate market was curtailed in April 1990 when the Ministry of Finance imposed temporary lending controls requiring that banks' property loans grow more slowly than total bank loans. Such action motivated many property owners to remove property from the market, thereby easing the downward pressure on real estate prices caused by excess supply. Bankruptcies in the real estate industry headed sharply upward in 1991.[50]

LDC Lending

U.S. commercial banks' lending to LDCs mushroomed during the 1970s and early 1980s, with claims on non-OPEC developing countries peaking at $112 billion in 1984. As with real estate loans, LDC loans were initially looked upon favorably by most banking executives and regulators, who assumed that countries, unlike corporations or individuals, could not go bankrupt. The attractiveness of LDC lending evaporated in 1982 when Mexico announced it could no longer service its debt, precipitating what became known as the debt crisis. At that time, U.S. banks held about 37 percent of all bank claims on developing countries,[51] with other large lenders being banks in the United Kingdom, Japan, West Germany, and France.[52]

[47] Federal Deposit Insurance Corporation, Quarterly Banking Profile, Third Quarter 1992, p. 3.
[48] David Barchard, "Big Fish to the Rescue—For Now," *The Financial Times*, November 5, 1991, p. 18.
[49] Bank of Japan, *Bulletin*, Spring 1992, p. 29.
[50] Bank of Japan, *Recent Developments in Lending Rates - Changing Behavior of Banks Under Interest Rate Liberalization*, Sept. 1991, p. 53.
[51] Roger M. Kubarych, "The Financial Vulnerability of the LDCs: Six Factors," ch. in *A Dance Along the Precipice* (Lexington: Lexington Books, 1985), ed. William N. Eskridge, Jr., p. 7.
[52] Philip Wellons, "Business-Government Relations in International Bank Lending: The Debt Crisis," ch. in *A Dance Along the Precipice*, pp. 136-137.

Due in large part to write-offs, the OCC estimated U.S. commercials banks' exposure to LDC debt at $64 billion in November 1990.[53]

Reflecting real estate losses and the LDC debt crisis, top lenders in the United States and the United Kingdom have set aside significant shares of gross income as provisions against loan losses in recent years. Japanese banks, too, have set aside large sums, although their smaller role in LDC lending has been partially responsible for their relatively lower loan-loss provisions. During 1981-90, loan-loss provisions as a share of commercial banks' gross income averaged 15 percent in the United States and 18 percent in the United Kingdom, in contrast to only 2 percent in Japan (see figure 2).[54]

Off-Balance Sheet Activities

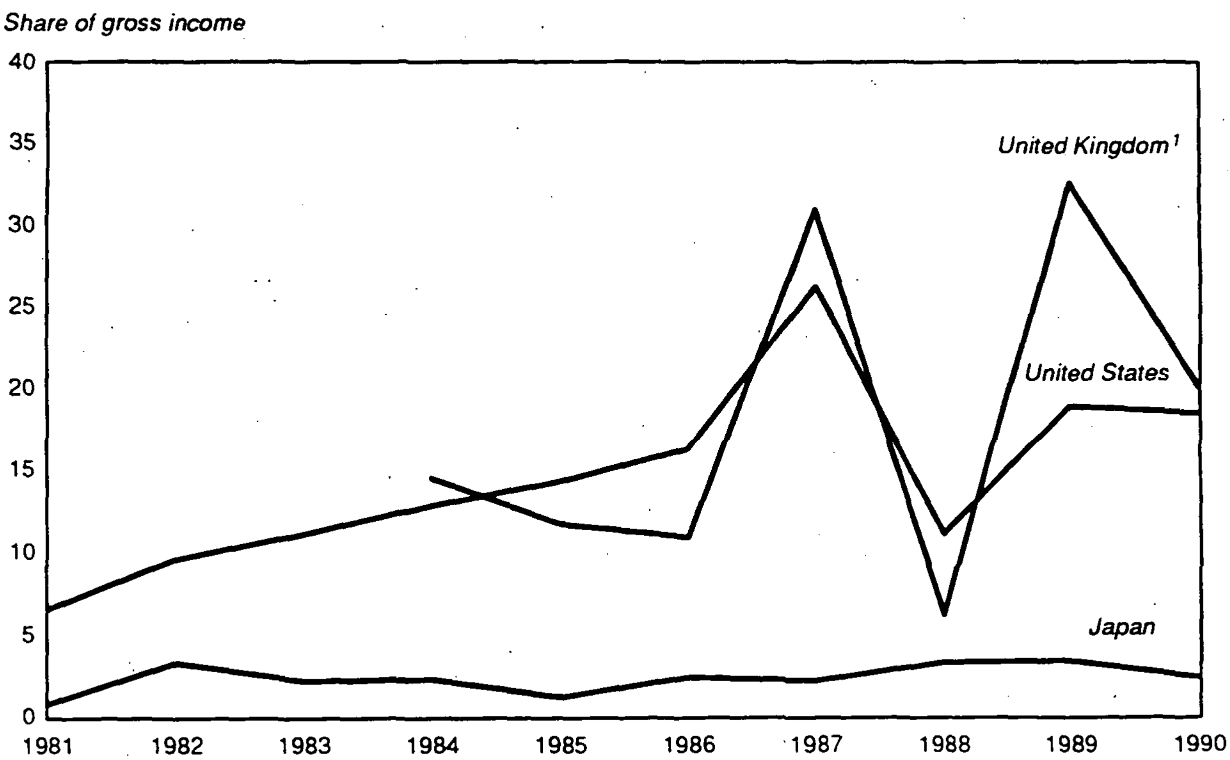
As commercial and industrial lending opportunities have decreased, nonlending activities that generate fees have become more attractive. Many of these activities are referred to as off-balance sheet activities because they are not normally captured as assets or liabilities under conventional accounting procedures. Some of the more traditional off-balance sheet activities include bank guarantees, in which a bank underwrites the obligations of a third party. A commonly issued bank guarantee is a standby letter of credit (SLC). SLCs are issued by banks to ensure that corporations borrowing directly from investors in commercial paper or other markets will be protected from the risks associated with decreased demand for their debt instruments.

Securitization of assets is a similar activity, and one that has experienced explosive growth as a result of innovations in information-processing technologies (see "Investments in Information Technology"). To increase liquidity or to improve capital ratios, banks have increasingly securitized assets by repackaging large loans or similar loans, such as home mortgages, credit card debt, and auto loans, into securities that are subsequently sold to investors. Securitization removes assets from the balance sheet while generating fee income for banks, but it does not entirely remove the risk assumed by banks as guarantees are often issued to make such securities attractive to investors. In addition, by increasing the efficiency of loan markets, securitization has reportedly helped to reduce interest rate spreads available to bank and thrift mortgage

[53] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-11.

[54] Organization for Economic Cooperation and Development (OECD), *Bank Profitability: Statistical Supplement 1981-89* (Paris: OECD, 1991), pp. 103-189; and Jan Schuijer, "Banks Under Stress," *OECD Observer*, Dec. 1991-Jan. 1991, p. 21.

Figure 2
Net loan-loss provisions as a share of gross income, 1981-90



[1] Data pertaining to British banks' operations during 1981-83 are unavailable.

Source: *OECD Observer*, Dec. 1991/Jan. 1992, p. 20.

lenders.[55] By 1989, off-balance sheet activities were 16-percent larger than activities captured on U.S. banks' balance sheets.[56] In 1990, the value of securitized mortgage pools stood at $1.1 trillion, representing about 29 percent of all U.S. mortgages.[57] Nonmortgage securitized assets in the public market stood at $60 billion in mid-1990, with perhaps an equal volume in the private market.[58]

The largest market for securitized assets outside the United States is in the United Kingdom, where banks and other lenders reportedly have securitized mortgages valued at about $20 billion. The smaller market for securitized debt in the United Kingdom appears to be due in part to the higher capitalization of British banks, which reduces the incentive to remove assets from the balance sheet. Japan's MOF allows securitization, but reportedly has discouraged the development of a secondary market for securitized debt, eliminating one of the principal benefits of investing in this instrument.[59]

Securities and Insurance Activities

U.S. commercial banks have also sought to boost revenues by performing certain activities traditionally performed by securities and insurance firms in the U.S. market. Fierce competition in traditional markets has driven commercial banks to take full advantage of securities activities that are permissible under existing guidelines, such as underwriting and dealing in U.S. Government securities, general obligation municipal bonds, mortgage-backed securities, and certain municipal revenue bonds. Commercial banks may also engage in private placement activities, discount and full service brokerage activities, and financial advisory services. In addition, 1987 and 1989 Federal Reserve interpretations of section 20 of the Glass-Steagall Act have permitted nonbank subsidiaries of bank holding companies to derive up to 10 percent of their revenue from a wide range of securities activities, including underwriting and dealing in commercial paper, municipal revenue bonds, securitized assets such as mortgage-backed securities, and corporate bonds and equities. About 30 bank holding companies had established so-called "Section 20" subsidiaries by 1990 (table 8).[60]

Section 92 of the National Bank Act authorizes Federally-chartered banks to provide general insurance services in towns with fewer than 5,000 residents, where insurance firms may not have offices or representatives.[61] In addition, State-chartered banks are allowed to underwrite or broker insurance policies in 16 States; 5 of these States permit banks to perform both activities.[62]

Investment in Information Technology

Banks have also increased spending on information technology, broadly defined as sophisticated computer hardware, software, and telecommunication equipment. Bank managers perceive investment in information technology as a means of controlling costs, penetrating higher value-added markets, and infusing banks with greater flexibility. Investments in information technology allow banks to interconnect multiple data centers and processing facilities, which increases efficiency and facilitates workforce reduction. In certain of the world's largest banks, relatively small staffs currently process up to 20 million transactions each day.[63]

Investment in information technology also improves bank earnings by allowing institutions to tailor-make higher value-added financial instruments for large investors. Enhanced computing capabilities, for instance, presently allow banks to securitize loans on a much greater scale with greater efficiency and lower costs than was possible 10 years ago. Securitized assets pay investors with the income streams generated by mortgage and other debt repayment. When the returns offered by securitized assets were calculated by hand, severe limits existed as to the complexity and availability of such instruments. Advanced computing power conferred on banks and other financial institutions the ability to bundle large amounts of loans together and offer them at profitable but competitive prices. Growing sales of derivative products, such as futures and options, have likewise motivated the widespread use of increasingly powerful computers.[64]

Investments in information technology were principally undertaken by large banks in the 1980s. Such investment had adverse effects on the competitive position of small banks, which increasingly became unable to provide the wide range of services offered by larger banks. The seven largest U.S. banks reportedly made annual expenditures of at least $300 million on information technology throughout the 1980s. Total U.S. commercial banks' annual investment in computer systems are reported to have tripled during the decade, from $4 billion in 1981 to $12 billion in 1989. Smaller banks' declining share of this investment, from 52 percent in 1981 to 28 percent in 1989, is currently one of the principal factors underlying industry consolidation.[65]

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[55] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. I-26.

[56] Ibid., p. I-27.

[57] Board of Governors of the Federal Reserve, *Federal Reserve Bulletin*, p. A37.

[58] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-12.

[59] Brooke Unger, "A Survey of World Banking: Time to Leave," *The Economist*, May 2, 1992, p. 10.

[60] U.S. Dept of the Treasury, *Modernizing the Financial System*, p. XVIII-15.

[61] Ibid, p. XVIII-17.

[62] Ibid., p. XVIII-16.

[63] Alan Cane, "A Change of Priorities," *Financial Times Survey: Computers in Finance*, Nov. 12, 1991, p. 2.

[64] See David H. Gowland, "Financial Innovation in Theory and Practice, "*Surveys in Monetary Economics Volume 2: Financial Markets and Institutions*, eds. Christopher J. Green and David T. Llewellyn (Padstow: T.J. Press, 1991).

[65] Representative of the U.S. banking industry, interview by USITC staff, New York, NY, Sept. 26, 1991; and Paul Maidment, "The Crunch that Competition Caused," *The Economist*, April 7, 1990, p. 21.

Table 8
Section 20 subsidiaries,[1] by Federal Reserve district, 1990

Federal Reserve district	Banking organization	Establishment date
Boston	Bank of Boston Corp.	August 1988
	Bank of New England	July 1987
	Fleet/Norstar Financial Corp.	October 1988
New York	Amsterdam-Rotterdam Bank of N.V.	June 1990
	The Bank of Nova Scotia	April 1990
	Bankers Trust N.Y. Corp.	April 1987
	Barclays Bank PLC[2]	January 1990
	Canadian Imperial Bank of Commerce[2]	January 1990
	Chase Manhattan Corp[3]	May 1987
	Chemical N.Y. Corp[4]	May 1987
	Citicorp[2]	April 1987
	The Long-Term Credit Bank of Japan, Ltd.	May 1990
	Manufacturers Hanover Corp[4]	May 1987
	Marine Midland Banks	July 1987
	J.P. Morgan & Co	April 1987
	The Royal Bank of Canada	January 1990
	The Sanwa Bank, Ltd	May 1990
	The Toronto-Dominion Bank	May 1990
	Westpac Banking Corp	March 1989
Cleveland	Huntington Bancshares, Inc	November 1988
	PNC Financial Corp	July 1987
Richmond	First Union Corp	August 1989
	NCNB Corp[5]	May 1989
	Sovran Financial Corp[5]	February 1990
Atlanta	Barnett Banks	January 1989
	South Trust Corp	July 1989
Chicago	The Bank of Montreal[2]	May 1988
	First Chicago Corp	August 1988
St. Louis	Liberty National Bancorp	April 1990
Minneapolis	Norwest Corp	December 1989
San Francisco	Security Pacific Corp[2 6]	May 1987

[1] Authorized to underwrite and deal in certain municipal revenue bonds, mortgage-related securities, commercial paper, and asset-backed securities.
[2] Also has corporate debt and equity securities powers.
[3] Also has corporate debt securities powers.
[4] Chemical Banking and Manufacturers Hanover merged on December 31, 1991.
[5] C&S/Sovran and NCNB merged December 31, 1991.
[6] BankAmerica and Security Pacific merged during March 1992.

Source: Federal Reserve Board, as presented in U.S. Department of the Treasury, *Modernizing the Financial System.*

Profitability

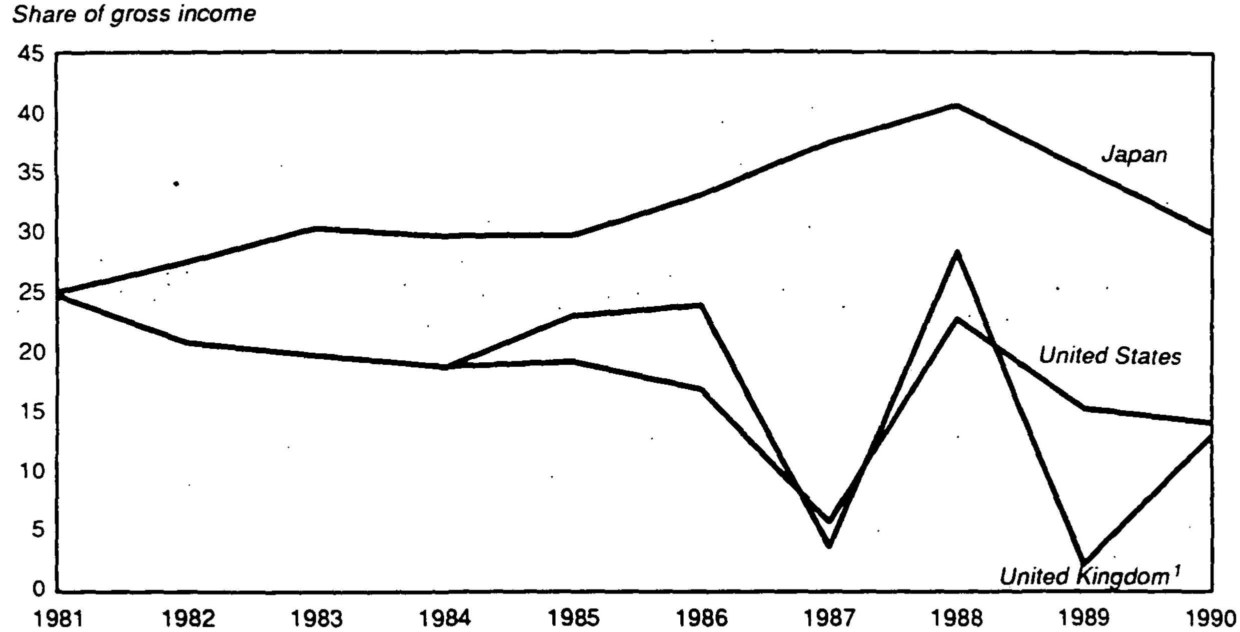
During the 1980s, Japanese banks led banks in the United States and the United Kingdom in terms of profitability. During 1981-90, profits as a share of pretax income averaged 32 percent among Japanese banks, versus 18 percent and 16 percent for U.S and British banks, respectively (see figure 3).[66] Higher profitability by this measure appears to be due to relatively milder competitive conditions in Japan than those prevailing in the other two countries. Indicative of milder competition in Japan's lending market during the 1980s, interest income represented 80 percent of Japanese banks' gross income, on average, compared to 72 percent and 63 percent among U.S. banks and British banks, respectively (see figure 4).[67]

Although U.S. and British banks were not as profitable as their Japanese counterparts, it appears that banks in the United States and the United Kingdom allocated their available capital more efficiently than Japanese banks. U.S. banks' returns on assets ranged from 0.4 to 0.9 percentage points during 1980-89, with the best returns recorded during the 1988-89 period (table 9). With the exception of 1987 (when U.S.

[66] OECD, *Bank Profitability*, pp. 103-189; and Schuijer, "Banks Under Stress," p. 20.

[67] OECD, *Bank Profitability*, pp. 103-189.

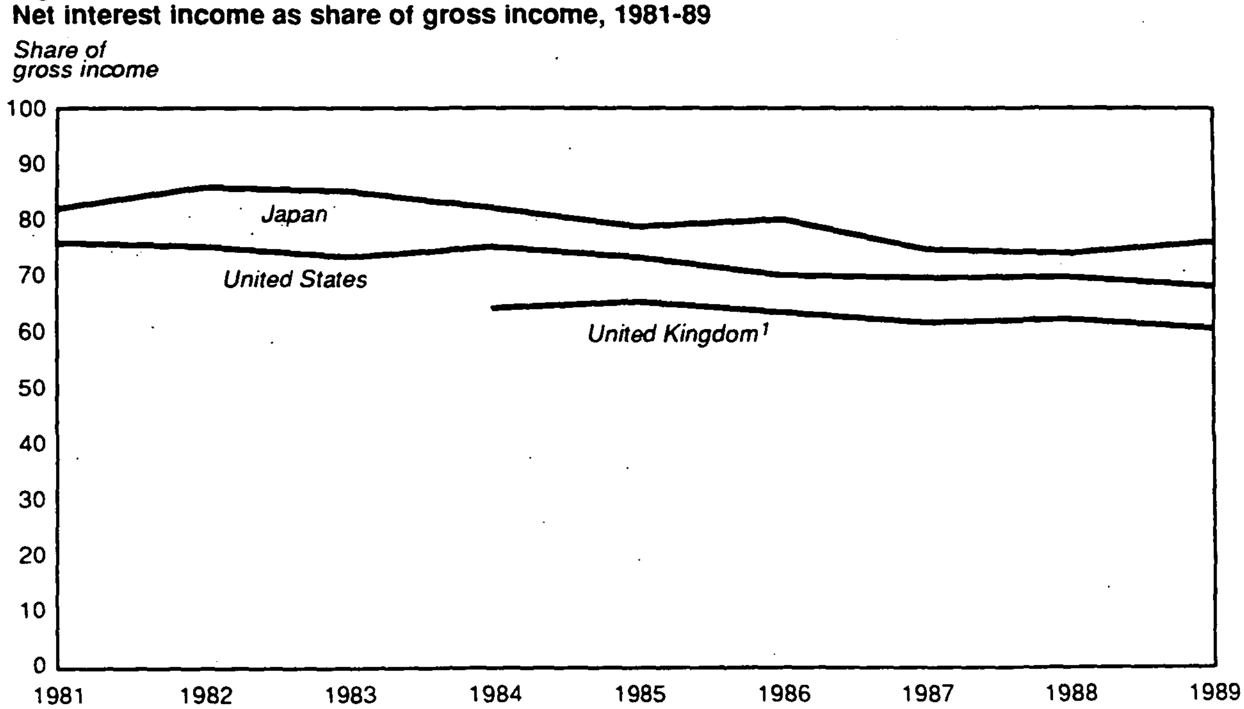
Figure 3
Commercial banks' pretax profits as a share of gross income, 1981-90



[1] Data pertaining to British banks' operations during 1981-83 are unavailable.

Source: *OECD Observer*, Dec. 1991/Jan. 1992, p. 20.

Figure 4
Net interest income as share of gross income, 1981-89



[1] Data pertaining to British banks' operations during 1981-83 are unavailable.

Source: OECD, *Bank Profitability: Statistical Supplement 1981-89*, pp. 103-189.

Table 9
Commercial banks' pre-tax profits to average total assets, 1980-90

Country	1980-82	1983-85	1986-87	1988-89	1989
United States[1]	0.83	0.78	0.44	0.93	0.64
Japan[2]	0.40	0.46	0.56	0.55	0.46
United Kingdom[1]	1.04	0.92	0.68	0.74	-0.03

[1] Large commercial banks.
[2] Large commercial banks. Fiscal years.

Source: Bank for International Settlements, *61st Annual Report*, p. 110.

banks' loan-loss provisions shot up dramatically), U.S. banks earned higher returns on assets than Japanese banks throughout the 1980s. The relatively poor performance of Japanese banks by this measure principally reflects their focus on asset size rather than asset quality. British banks' return on assets remained above that of U.S. commercial banks until the mid-1980s, but dropped below U.S. banks thereafter. This trend likely reflected the intensification of interbank competition after London's capital markets were liberalized in 1986.[68]

Reflecting investors' expectations that competition will drive future profitability downward, however, U.S. and Japanese banking share prices fell significantly after the mid-1980s. Downward pressure on share prices was likely reinforced by pessimistic expectations regarding nonperforming real estate loans in both countries. In nearly all countries, bank share prices performed poorly in relation to price indexes for all shares throughout the 1980s.[69]

THE EVOLVING MARKET

Regulatory change appears likely to be among the principal forces influencing the future of banking industries in the United States, the United Kingdom, and Japan. Regulatory change may occur in the United States and Japan as a result of recent difficulties experienced by the banking industries in these countries. The difficulties presently confronting Japan, moreover, will likely slow the spread of Japanese banks to foreign markets, and perhaps result in a temporary retrenchment among large banks. In the United Kingdom, certain regulatory changes are likely to result from the harmonization and liberalization of financial markets within the European Community.

Furthermore, intensified competitive pressures are likely to result in the consolidation of banking industries in all three countries. Consolidation will likely be most pronounced in the United States, where many thousands of small banks will find it increasingly difficult to compete with larger and more sophisticated domestic and foreign firms.

[68] BIS, *61st Annual Report*, pp. 104-110.
[69] Ibid, p. 110.

United States

Reform

Although the U.S. Congress rejected a broad banking reform package in 1991, some elements of the proposed reforms—particularly the repeal of the McFadden Act—are likely to resurface. Repeal of the McFadden Act, which restricts inter-State branching, was an element of each of the three initial reform packages proposed by the U.S. Department of the Treasury and by members in both Houses of Congress. Before the House Rules Committee agreed to link the reform of inter-State banking restrictions with the proposal to allow expanded insurance activities (one of the more controversial proposals of the reform packages), it appeared that there was broad congressional support for the repeal of inter-State branching restrictions. The House of Representatives voted strongly in favor of an amendment that would have allowed inter-State branching during the week prior to the final vote. This vote was taken despite opposition from certain industry critics, who maintained that expanded inter-State banking would injure small banks, ultimately reduce competition, and diminish consumer well-being.[70]

In addition to promoting geographic diversification, inter-State branching would likely expedite consolidation by allowing banks to merge with or acquire facilities in other States in a cost-efficient manner. Currently, all inter-State banking acquisitions must be undertaken by bank holding companies, which must establish subsidiaries, rather than branches, in newly acquired facilities. Subsidiaries require separate boards of directors, officers, accounting systems, and capital, whereas branches do not. Inter- State branching would therefore allow banks to merge operations at lower cost.[71]

Consolidation

Consolidation of the U.S. commercial banking industry has already started. The number of U.S. commercial banks fell from 15,000 in 1984, to 12,500 in 1991, representing a 17-percent decline. This trend

[70] Representatives of the U.S. banking industry, interview by USITC staff, New York, NY, Sept. 26-27, 1991.
[71] Robert P. O'Quinn, "Geographic Restrictions on Banks: A Prescription for Disaster," *Cato Review of Business and Government*, Spring 1991, pp. 19-22.

appears to have accelerated recently, with major money center banks like Chemical Bank, Manufacturers Hanover, and Bank of America announcing mergers in the latter half of 1991. It is estimated that by the mid-1990s, mergers among the largest 125 U.S. commercial banks may result in 10 to 15 larger, more efficient organizations. Through a process of mergers and market exit over the next several decades, 2,000 or fewer banks may ultimately constitute the U.S. banking industry.[72]

It is argued that consolidation would likely improve the competitive position of U.S. banks by reducing costs, increasing profits, and facilitating equity-raising. The merger of Chemical Bank and Manufacturers Hanover, for instance, will reportedly result in the elimination of 6,000 jobs and 100 branch offices. NCNB and C&S/Sovran (now called NationsBank) hope to save $350 million during the next 3 years, eliminating 9,000 positions. BankAmerica and Security Pacific estimate that their merger will save $1 billion annually by reducing staffing levels by 14,000 positions and eliminating redundant computer systems.[73]

Consolidation also may increase the geographic markets of U.S. banks and reduce their vulnerability to local economic downturns, thereby improving the ability of firms to compete in securities and other financial service markets if future regulatory change permits. Moreover, it is suggested that the gradual development of nationwide deposit networks will provide funds necessary to compensate for recent losses in real estate markets and the developing world. The banks regard broad domestic bases as desirable prior to expanding operations in the European Community and Japan, where ongoing regulatory change appears likely to increase future business opportunities for U.S. firms.

Japan

Deregulation

As a result of ongoing deregulatory efforts, Japanese banks are likely to encounter competition increasingly like that experienced by U.S. and British banks. Net interest margins will be increasingly squeezed by liberalized interest rates on deposits; large corporate customers will likely continue to defect to international capital markets to invest and lend capital at more attractive rates; and the pressure to earn greater returns on deposited funds will become more urgent. Like U.S. and British banks, Japanese banks will increasingly find it necessary to focus on increasing the quality of assets rather than increasing market share.

[72] Representatives of the U.S. banking industry, interview by USITC staff, New York, NY, Sept. 26-27, 1991.

[73] Representatives of the U.S. banking industry, interview by USITC staff, New York, NY, Sept. 26-27, 1991; "The West is Won," *The Economist*, Aug. 17, 1991, p. 70.; and Jerry Knight, "NCNB to Merge With C&S/Sovran," *The Washington Post*, July 23, 1991, p. A1.

In this environment, traditional segmentation among Japanese banks, and between banks and other financial service firms, will be far less feasible. Japan's banks, divided according to their narrowly defined financial activities, are increasingly under pressure to compete with foreign banks offering broader ranges of financial services. It is reportedly likely that the compartmentalization of Japanese banking will end, permitting different types of banks to compete with one another. In addition, the separation of commercial banking and securities businesses will likely be terminated, imposing additional competitive pressures on Japanese banks.[74]

Capital Adequacy

Two factors could restrain international expansion by Japanese banks in the future. One is compliance with the Capital Adequacy Accord (also called the Basle Accord) adopted by banking regulators in the Group of 12 during 1988. This accord is designed primarily to strengthen the banks of signatory countries by raising reserve requirements. Basle regulations require that banks in signatory countries hold 8 dollars in capital for every 100 dollars in assets (mostly loans) by April 1, 1993. Expressed differently, the Basle Accord requires that a bank's assets be no larger than 12.5 times the bank's capital base. During 1980-90, Japan's banks typically held assets 20 to 30 times their capital base, allowing them to gain share in international lending markets (figure 5).[75]

Compliance with the accord has required certain Japanese banks to reduce lending and to sell off existing assets, which may have contributed to Japanese banks' moderately reduced international activity during 1990-91. Moreover, recent weakness in Japan's stock and real estate markets are confounding efforts to comply with the Basle Accord. Because Japanese regulators allow banks to count 45 percent of unrealized gains on hidden assets (i.e., securities) as reserves, declines in the stock market threaten to drive capital ratios lower than those called for in the accord. When Japan's Nikkei stock index fell below 20,000 in early March 1992, it was estimated that the capital ratios of several of Japan's largest banks were below the 8-percent level specified in the Basle Accord.[76] Several large banks face constraints on their ability to increase capital given current market conditions, with the most likely affect being that those banks will reduce lending or shrink their existing asset (loan) base.[77]

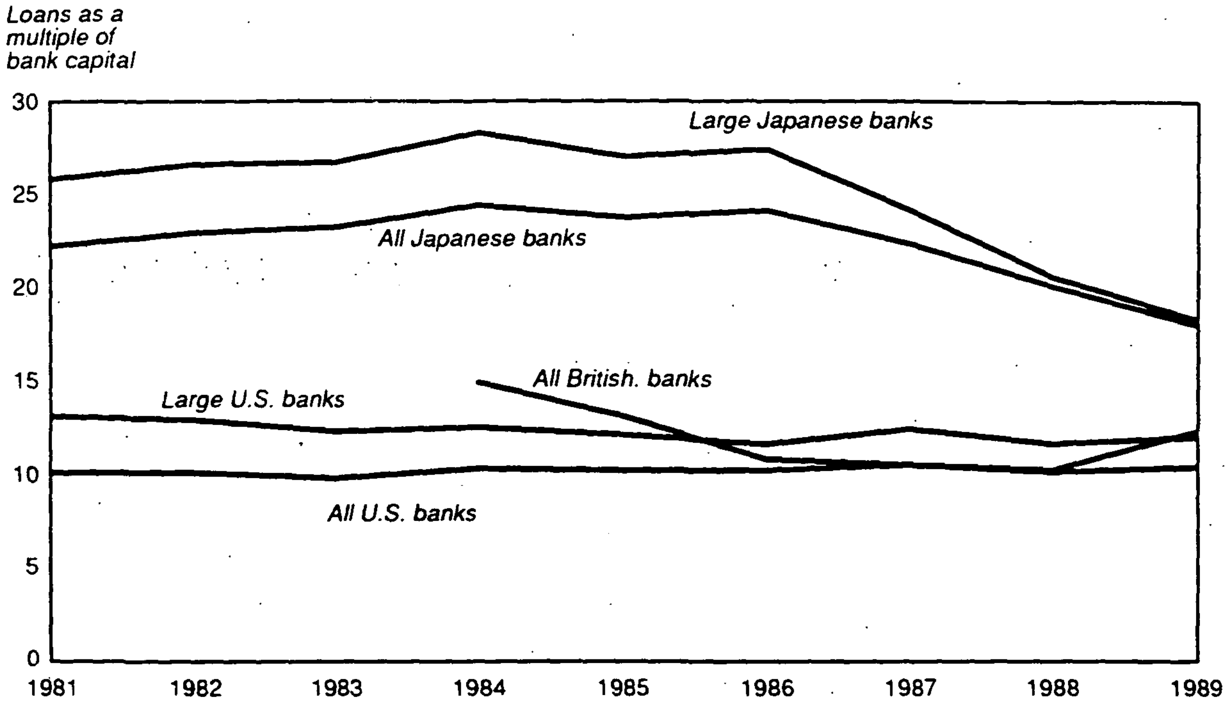
[74] Testimony of Hikedi Kanda, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs, U. S. House of Representatives, Washington, DC, Jan. 22, 1992.

[75] OECD, *Bank Profitability*, pp. 103-105.

[76] IBCA, *Japanese Banks: Hidden Reserves, Capital Ratios and the Stock Market*, Apr. 1992, p. 3; and James Capel Japanese Research, *The Japanese Banking System: How Fragile Is It?*, Mar. 17, 1992, p. 4.

[77] Ibid.

Figure 5
Loans as a multiple of bank capital,[1] 1981-89



[1] Includes bank reserves.

Source: OECD, *Bank Profitability: Statistical Supplement 1981-89*, pp. 103-189.

Problem Loans

The second issue important to future performance regards problem loans. The magnitude of bad loans facing Japanese banks has risen lately in large part due to declining securities and real estate prices. Long-term credit banks and trust banks have encountered the most difficulty. It is reported that the long-term credit banks' problem loans total ¥2.4 trillion ($18.4 billion), which represents 38 percent of their combined hidden assets, and that the trust banks' problem loans total ¥2 trillion ($15.3 billion), which represents 31 percent of their combined hidden assets. Problem loans reported by city banks, in contrast, total ¥2.8 trillion ($21.5 billion), but represent only 13 percent of combined hidden assets. Problem loans are unevenly distributed among the city banks, however, with just three—-Fuji, Mitsui Taiyo Kobe, and Sumitomo—-accounting for most of the city banks' difficulties.[78] Ministry of Finance officials indicated during April 1992 that nonperforming loans[79] extended directly by Japan's largest 21 banks stood between $50 billion and $60 billion during the 1991-92 fiscal year.[80]

Nonperforming loans extended by Japanese nonbanks may adversely impact Japanese banks as well. Japan's 22,000 nonbanks (e.g., leasing and consumer finance companies), which are largely unregulated, reportedly extended about $640 billion in highly speculative loans during 1980-90, mostly with money borrowed from Japanese banks. It is reported that about two-fifths of such loans were made directly to property and construction companies, many of which have since declared bankruptcy due to declining real estate prices. Estimates of problem loans held by nonbanks range much higher than those held directly by banks, at between $100 billion and $400 billion.[81]

[78] "Japanese Banks: Deep in Bad Debt," *The Economist*, Nov. 2, 1991, pp. 70-71.

[79] Ministry officials defined nonperforming loans as loans on which interest payment had been in arrears for 6 months or more.

[80] Japanese Embassy official, conversation with USITC staff, May 1992; Fumiko Fujisaki, "Bad Loans Called Long-Term Burden for Japan's Banks," *American Banker*, May 19, 1992, p. 5; and Stefan Wagstyl, "Japan Moves to Allay Fears on Health of Banking System," *The Financial Times*, Apr. 24, 1992, p. 1.

[81] Fumiko Fujisaki, "Bad Loans," p. 5; Stefan Wagstyl, "Uneasy Calm Amid a Gathering Storm," *The Financial Times*, Mar. 17, 1992, p. 19; "Nikkei's Decline Ruffles Japanese Bankers," *The Financial Times*, March 18, 1992, p. 24; "Shock Waves Around the Globe," *The Financial Times*, April 10, 1992, p. 16; and "Japan Moves to Allay Fears on Health of Banking System."

It is unclear whether problem loans will significantly reduce Japanese banks' international activity. Because many of the internationally active Japanese city banks remain relatively healthy, problem loans will not necessarily result in markedly reduced international lending. In addition, the true extent of Japanese banks' nonperforming loans is unknown. Japanese regulators do not require banks to report nonperforming loans. Moreover, the burden of nonperforming loans can be redistributed among the healthy affiliates of troubled banks until Japan's real estate and stock markets recover.

United Kingdom

Intense Competition

Conditions in the British banking and securities markets are strikingly similar to those in the United States. Large banks are currently concerned with bad debt, narrow margins, and cost reduction. Bad debt has resulted from the recessionary environment during 1991-92, which has bankrupted small businesses, especially those in London's service sector. The Big Four made specific loan-loss provisions of $3.4 billion in the first 6 months of 1991, following approximately $4 billion in such provisions in 1990.[82] London's large banks are also experiencing declining loan margins. Smaller loan margins are the result of fierce interbank competition, which is driving lending rates down, and the growth of interest-bearing checking, which is increasing the cost of funds. Like U.S. banks, banks in the United Kingdom have undertaken cost-reduction programs to accommodate smaller loan margins. Cost-cutting efforts include staff reductions and computerization, as in the United States. Unlike banks in the United States, however, London's large banks are also generating additional income by further diversification into insurance services. Two large clearing banks—Abbey National and National Westminster Bank—have recently acquired or formed joint ventures with insurance companies.[83]

European Harmonization

British banking regulations are becoming more formal as a result of the EC92 program. The United Kingdom has committed to abide by approximately 30 financial-sector directives that either have been or will likely be adopted by the EC Commission in the coming years. With respect to banking, the thrust of the EC program is to harmonize essential standards regarding authorization, supervision, and prudential rules and to provide for the mutual recognition of home-country control on the basis of those harmonized rules. The chief banking directive is the Second Banking Directive, which introduces the single banking license. A bank with a single license, including an EC subsidiary of a U.S. bank, will be able to undertake banking activities throughout the EC either through branching or through cross-border provision of services.[84] It appears likely that harmonization will ultimately reduce the informal facets of regulation that still remain in the United Kingdom, thereby adding to regulatory transparency.

[82] Robert Peston, "Banks Seek Easing of Capital Rules," *The Financial Times*, Nov. 6, 1991, p. 1.
[83] Robert Peston, "Economic Pause Swells Bad Debts," *The Financial Times*, Nov. 11, 1991, p. 22.

INTERNATIONAL TRADE IN BANKING

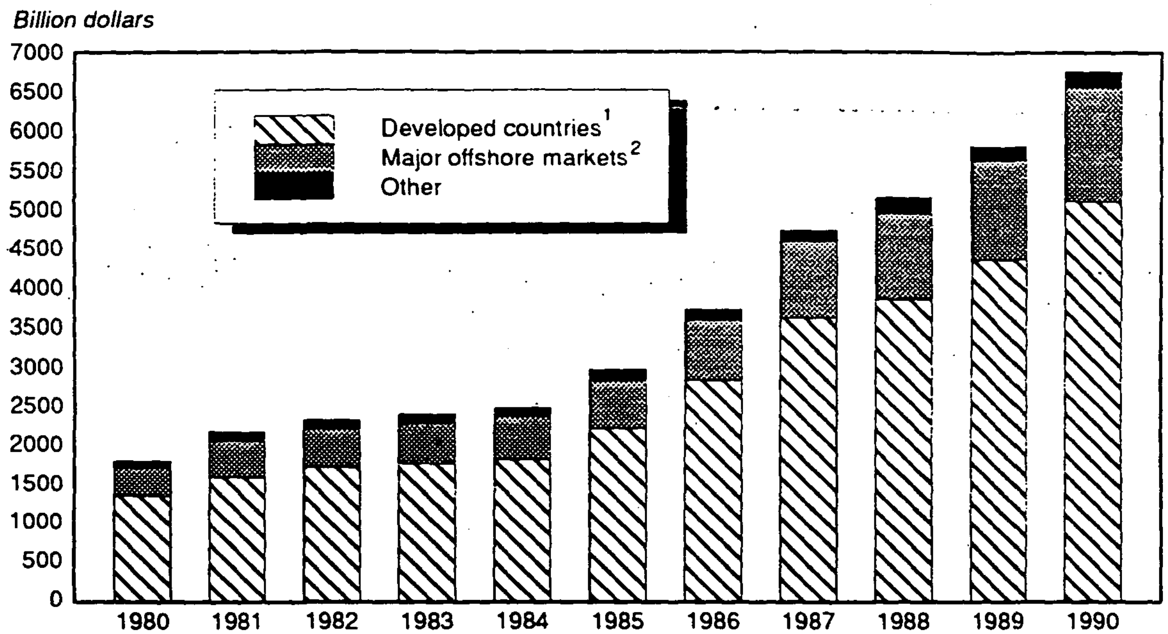
International banking principally consists of receiving deposits from, and extending loans to, nonresident banks and nonbanks. International banking also includes deposit taking and lending in offshore banking markets. At yearend 1990, loans to foreign entities (foreign assets) and deposits by foreign entities (foreign liabilities) held by all banks were in the neighborhood of $7 trillion, compared to about $2 trillion in 1980 (figures 6 and 7).[85]

Developed countries hold about 80 percent of international banking assets and liabilities, with banks residing in the United States, the United Kingdom, and Japan accounting for roughly 40 percent of the world totals (figures 8 and 9). The United Kingdom continues to be the world's premiere international banking center, although its lead over Japan has narrowed in recent years. International assets and liabilities in banks located in the United Kingdom totaled over $1 trillion each in 1990, accounting for 16-17 percent of total international assets and liabilities.[86]

Major offshore banking centers include Hong Kong, Singapore, Bahrain, the Bahamas, the Cayman Islands, the Netherlands Antilles, and Panama.[87] The largest of these are Hong Kong, Singapore, and the Cayman Islands. Offshore banking centers, which feature little regulation, are also known as Euromarkets. Euromarkets are principally composed of Eurocurrency deposits (euro-dollars, euro-yen, euro-sterling, etc.), Eurobonds, and Euro-commercial paper. Eurocurrency deposits are defined as bank deposits that are denominated in a currency other than that of the deposit-taking country (e.g., a U.S. dollar deposit in a Hong Kong bank).[88]

[84] For a fuller discussion, see The U.S. International Trade Commission, *The Effects of Greater Economic Integration Within the European Community on the United States: First Follow-up Report* (investigation No. 332-267), USITC publication 2268, Mar. 1990; U.S. International Trade Commission, *The Effects of Greater Economic Integration Within the European Community on the United States: Second Followup Report* (investigation No. 332-267), USITC publication 2318, Sept. 1990; and U.S. International Trade Commission, *The Effects of Greater Economic Integration Within the European Community on the United States: Third Followup Report* (investigation No. 332-267), USITC publication No. 2368, Mar. 1991.
[85] International Monetary Fund (IMF), *International Financial Statistics*, various issues.
[86] IMF, *International Financial Statistics*, Sept. 1991, pp. 48-49.
[87] IMF, *International Capital Markets: Developments and Prospects* (IMF: Washington, DC, 1991), p. 6.
[88] Christine Pavel and John N. McElravey, "Globalization in the Financial Services Industry," *Economic Perspectives* (Federal Reserve Bank of Chicago), May-June 1990, pp. 3-6.

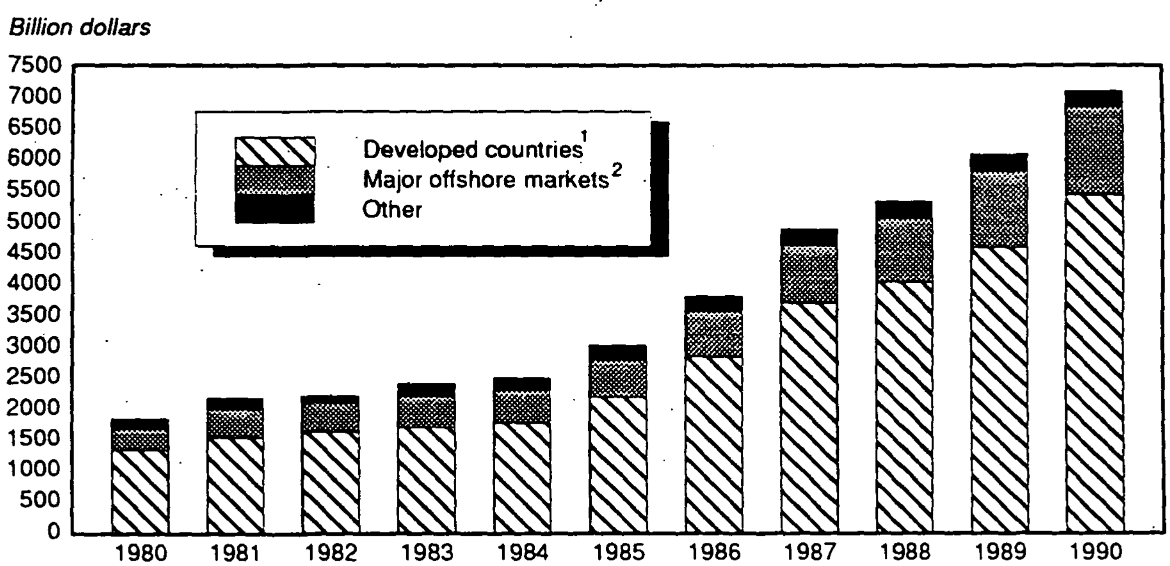
Figure 6
Total international bank assets, 1980-90



[1] Developed countries include United States, Canada, Australia, Japan, New Zealand, Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Norway, Spain, Sweden, Switzerland, and United Kingdom.
[2] Major offshore markets include Hong Kong, Singapore, Bahrain, the Bahamas, Cayman Islands, Netherlands Antilles, and Panama.

Source: International Monetary Fund, *International Financial Statistics.*

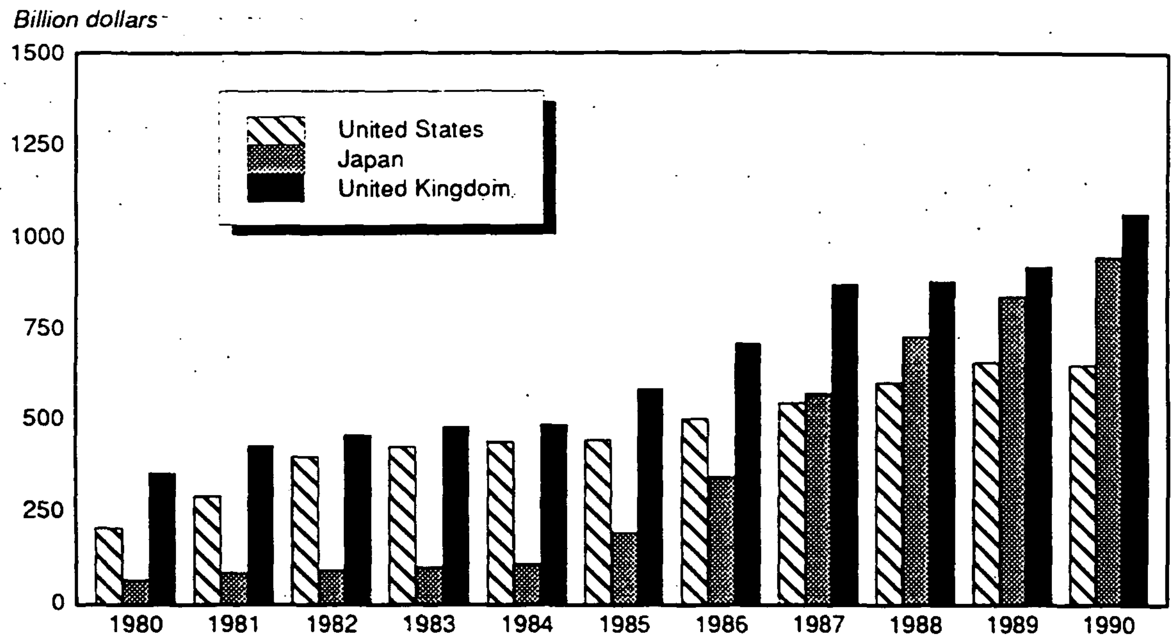
Figure 7
Total international bank liabilities, 1980-90



[1] Developed countries include United States, Canada, Australia, Japan, New Zealand, Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Norway, Spain, Sweden, Switzerland, and United Kingdom.
[2] Major offshore markets include Hong Kong, Singapore, Bahrain, the Bahamas, Cayman Islands, Netherlands Antilles, and Panama.

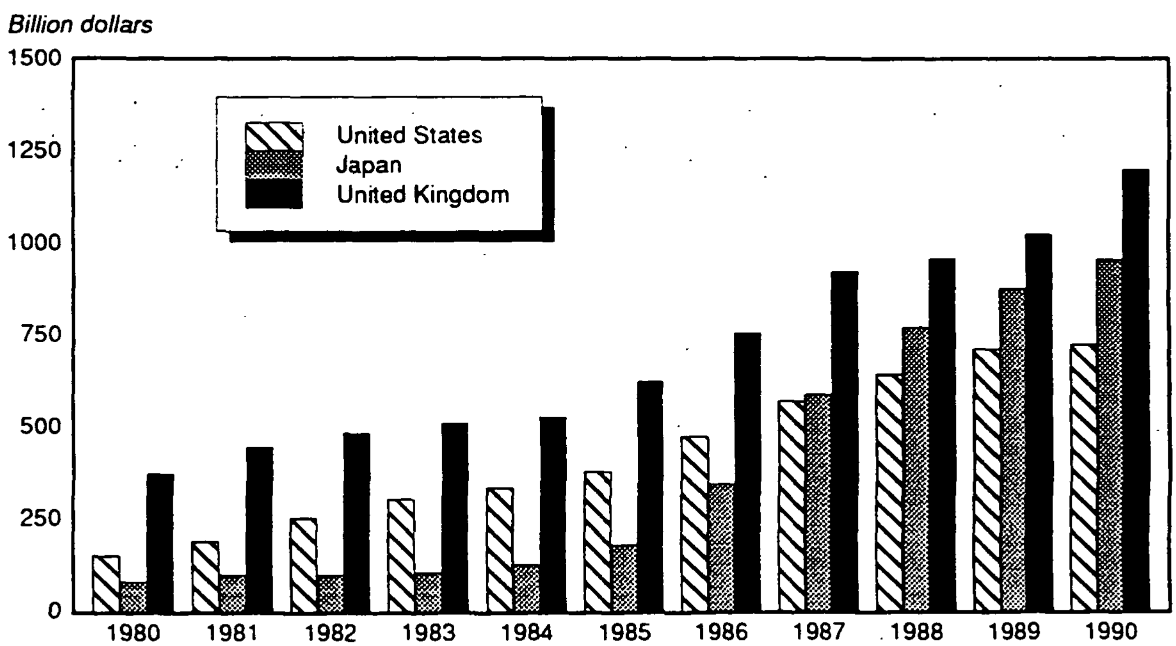
Source: International Monetary Fund, *International Financial Statistics.*

Figure 8
International bank assets, 1980-90



Source: International Monetary Fund, *International Financial Statistics.*

Figure 9
International bank liabilities, 1980-90



Source: International Monetary Fund, *International Financial Statistics.*

International assets and liabilities held in the seven major offshore banking markets each exceed $1.4 trillion. Foreign assets and liabilities held in these major offshore markets represent roughly 20 percent of the world international banking assets and liabilities, and over 80 percent of the international assets and liabilities held by banks in the developing world.[89]

Motivation for International Banking

International assets and liabilities have increased substantially as banking markets have been deregulated and liberalized. Where it has been carried out, deregulation has allowed capital to flow wherever rates of return are highest. Liberalization, on the other hand, has facilitated cross-border financial transactions. International lending and deposit-taking have grown as banks have moved capital across borders to earn higher interest rates on loans to or pay lower interest rates on borrowed funds.

International banking flows also mirror larger macroeconomic forces, especially savings rates and current account[90] positions, the latter being determined principally by international trade in manufactures and services. Capital accounts, principally composed of banking flows, direct investment, and portfolio investment, compensate for current account imbalances (table 10). Countries running deficits on the current account (such as the United States and the United Kingdom in recent years) must run surpluses on the capital account, meaning they must generate net capital inflows. Countries running current account surpluses (such as Japan and Germany) must run capital account deficits, meaning they must produce net capital outflows.

[89] IMF, *International Financial Statistics*, Sept. 1991, pp. 48-49.

[90] The current account records international transactions in merchandise, services, investment income, and unilateral transfers. Merchandise trade flows typically account for the largest entries in the U.S. balance of payments.

Because the United States has experienced consistent current account deficits since 1982, it has had to generate net inflows of capital, making it likely that the United States would experience net inflows of banking capital. As a result, U.S. foreign banking liabilities became larger than foreign banking assets during the 1980s (figure 10).[91]

Banking and other private capital flows have become increasingly important to overall international trade relations as means of financing persistently large current account imbalances. Private capital flows have been particularly important in financing U.S. merchandise trade deficits in recent years. During the past 20 years, private capital, as opposed to official (government) capital, has rapidly grown as a share of the gross capital flows recorded in the U.S. capital account. During 1970-74, private capital accounted for 65 percent of gross capital account transactions on average, whereas private capital accounted for 87 percent of these transactions during 1985-89.[92]

Interbank Market

In aggregate, about 80 percent of foreign liabilities are cross-border deposits made by one bank in another bank. The relative importance of interbank deposits, however, varies among countries (figure 11). Ninety-eight percent of the foreign liabilities held by Japanese banks, for instance, consists of interbank deposits.[93] This high ratio reflects Japanese banking

[91] Japan, which consistently runs capital account deficits, nevertheless shows net banking inflows during the 1987-89 period. In this case, banking inflows are more than offset by very large net outflows of direct and portfolio investment funds.

[92] Bureau of Economic Analysis, "U.S. International Transactions, First Quarter 1991," *Survey of Current Business*, June 1991, pp. 44-45.

[93] Christine Pavel and John N. McElravey, "Globalization in the Financial Services Industry," p. 6.; and IMF, *International Financial Statistics*, pp. 48-51.

Table 10
Financing of current account imbalances[1]

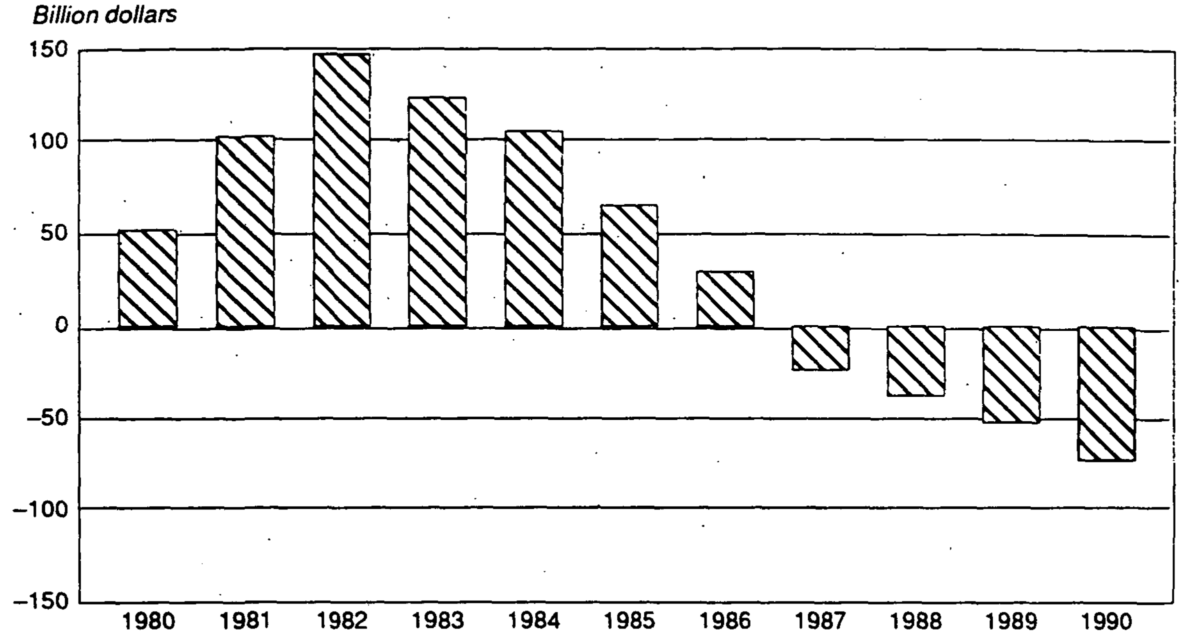
(Billion dollars)

	Current Account Balance	Net Direct Investment	Portfolio Investment: Bonds	Portfolio Investment: Equities	Bank Flows	Other	Changes in Reserves[2] (+ increase)	Errors and Omissions
United States								
1988	-129.0	42.2	41.7	-1.4	16.1	2.5	36.3	-8.3
1989	-110.0	40.5	54.9	-10.1	8.2	10.8	-16.8	22.6
Three Quarters 1990	-69.0	-17.4	-1.9	-15.7	27.0	14.1	8.9	53.7
Japan								
1988	79.6	-34.7	-56.6	3.8	38.4	-17.1	-16.5	3.1
1989	57.0	-45.2	-21.6	-10.9	3.7	26.1	12.8	-21.8
First half 1990	20.2	-25.7	1.3	-18.0	-14.0	30.8	9.8	-4.4
United Kingdom								
1988	-27.3	-20.5	3.0	3.6	18.5	6.9	1.9	14.0
1989	-32.1	-1.8	-15.5	-24.3	20.4	11.4	16.2	25.7
Three Quarters 1990	-24.4	11.8	-6.3	8.7	-14.5	0.1	6.6	17.8

[1] Postive numbers reflect capital inflows; negative numbers reflect capital outflows.
[2] Includes holdings of liabilities by foreign monetary authorities.

Source: International Monetary Fund, *International Capital Markets*, May 1991, p. 3.

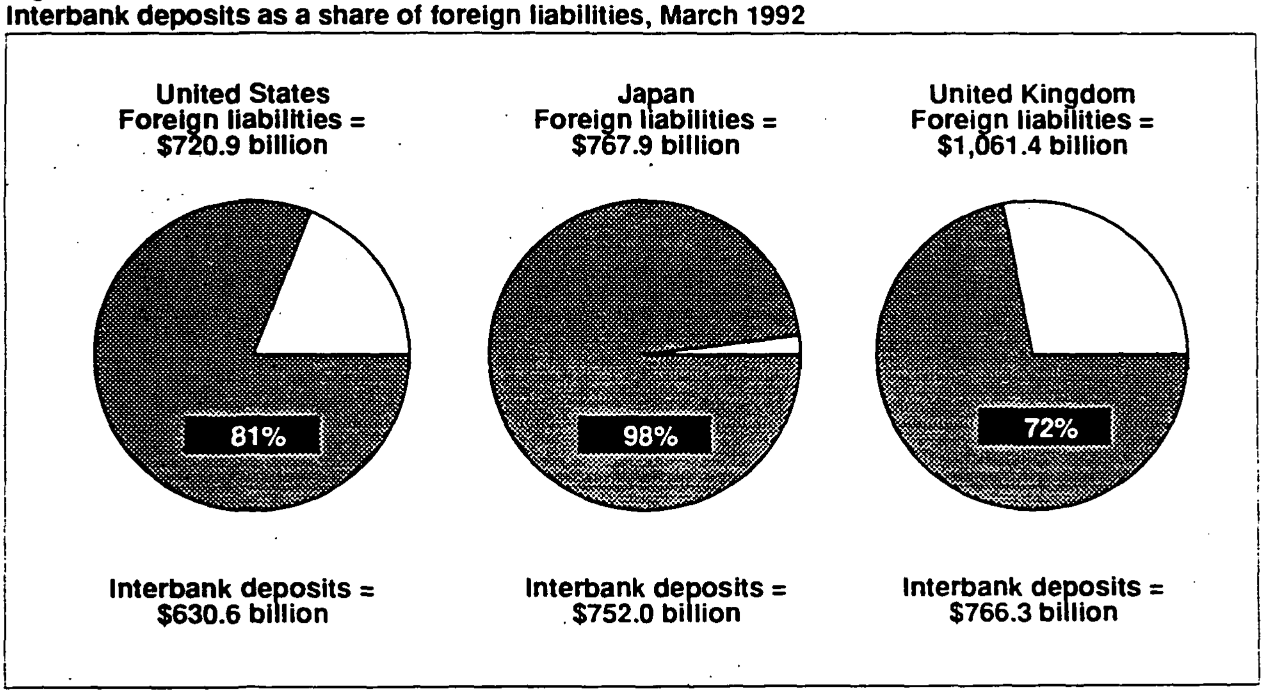
Figure 10
Net banking position[1] of the United States, 1980-90



[1] International assets minus international liabilities.

Source: International Monetary Fund, *International Financial Statistics*.

Figure 11
Interbank deposits as a share of foreign liabilities, March 1992



Source: International Monetary Fund, *International Financial Statistics*.

regulation. Because interest rate caps have limited the ability of Japanese city banks to attract deposits in their domestic market, Japanese banks have found borrowing in the interbank market a convenient way to provide funds to home offices.[94]

Similarly, loans to other banks compose about 80 percent of banks' foreign assets. Since 1982, the share of foreign assets comprised by interbank loans has grown among all developed countries.[95] In the United Kingdom, the relatively low share of foreign assets accounted for by interbank loans reflects the international character of London's banking market (figure 12). British banks have cultivated expertise in lending to foreign nonbanks for more than a century. In addition, many of the United Kingdom's resident banks are foreign-owned; these banks may be able to provide low-cost funds to clients in their country of origin by borrowing capital in the United Kingdom's fiercely competitive banking market.

U.S. Banking Operations in Foreign Countries

U.S. banks conduct the majority of their international activities through branches and subsidiaries located in foreign countries. Foreign branches are legally integral parts of the corporate bank and, in most countries, operate with lending constraints based on the parent bank's worldwide capital. Subsidiaries, on the other hand, maintain independent legal identities and are separately capitalized.

Foreign branches and subsidiaries of U.S. banks accounted for 48 percent and 30 percent, respectively, of the international assets of U.S. commercial banks and bank holding companies in 1991.[96] Foreign assets of U.S. branches are concentrated in Caribbean offshore markets and the United Kingdom. The Bahamas and Cayman Islands account for 31 percent of the assets held by foreign-based branches of U.S. banks, a small increase from 28 percent in 1981. The consistently high level of market participation in the Bahamas and the Cayman Islands principally reflects favorable tax treatment. Neither country levies corporate taxes, personal income taxes, capital gains taxes, estate taxes, sales taxes, or withholding taxes on dividends, royalties, or interest.[97] U.S. bank branches in the United Kingdom account for an estimated 30 percent of total assets held by overseas branches' of U.S. banks, down from 37 percent in 1981. Decreased

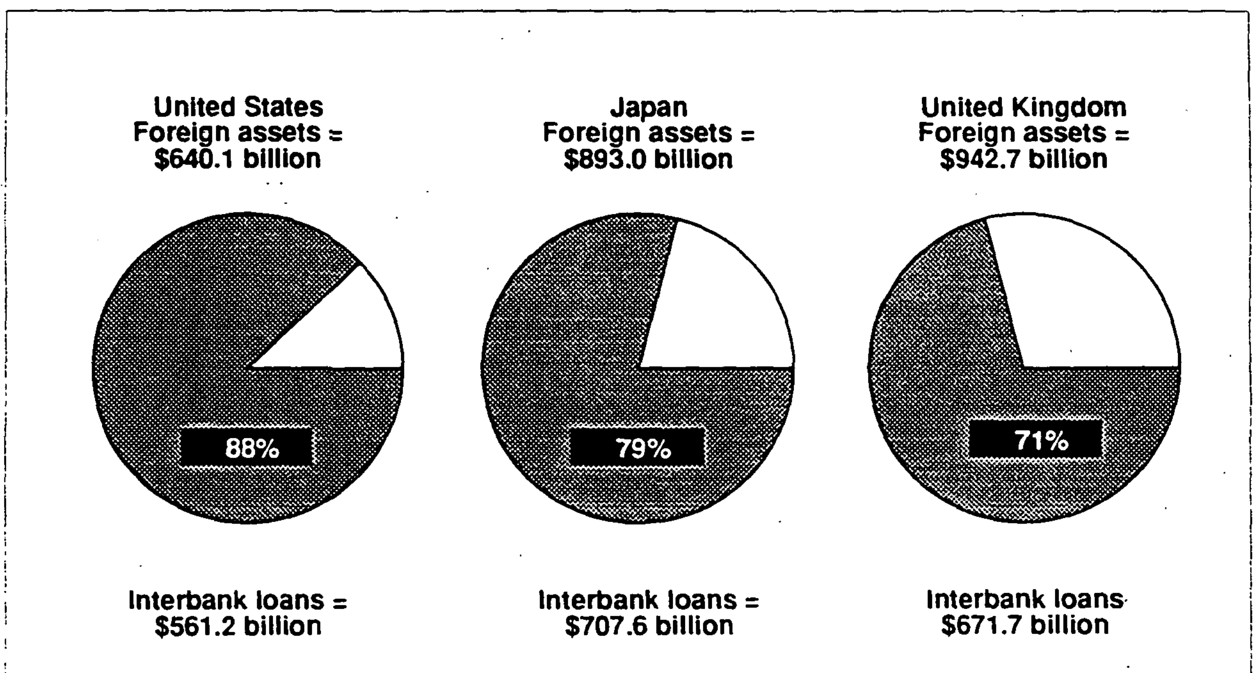
[94] Henry S. Terrell, Robert S. Dohner, and Barbara R. Lowery, "The Activities of Japanese Banks in the United Kingdom and in the United States, 1980-88," *Federal Reserve Bulletin*, Feb. 1990, pp. 44-45.

[95] IMF, *International Financial Statistics*, various issues.

[96] Board of Governors of the Federal Reserve System, staff study no. 156, "International Trends for U.S. Banks and Banking Markets," May 1988, p. 3.

[97] Euromoney, *The 1992 Guide to Offshore Financial Centers*, May 1992, p. 9.

Figure 12
Interbank loans as a share of foreign assets, March 1992



Source: International Monetary Fund, *International Financial Statistics*.

participation in the British banking market principally stems from oversaturation of the London market.[98]

Retrenchment of U.S. Banks

The number of foreign branches of U.S. banks has fallen from a high of 917 in 1984 to 773 in 1991.[99] Foreign branches of U.S. banks are closing due to a variety of reasons, including U.S. regulatory constraints, changing economic conditions and opportunities, and technological innovation. Although U.S. banks may generally engage in a wider variety of businesses overseas (subject to the Federal Reserve Board's Regulation K)[100] than in the United States, remaining constraints reportedly constitute competitive disadvantages for U.S. banks operating overseas. Glass-Steagall regulations prohibit U.S. banks from marketing foreign securities to U.S. investors, and limit the aggregate amount of any foreign securities issue that may be underwritten by a consolidated U.S. banking organization to $15 million ($2 million by any single subsidiary). These limitations reportedly preclude securities affiliates of U.S. banks from acting as lead underwriters for many large foreign equity issues.[101]

In addition, U.S. commercial banks may now be reducing their presence in foreign markets to enhance their competitive position in the United States, principally by acquiring ailing savings institutions and other commercial banks. The need to increase loan-loss reserves and capital-asset ratios may also underlay U.S. banks' reduced presence in foreign markets.[102]

Moreover, the number of U.S. branches may be declining because home offices equipped with sophisticated telecommunication and computer equipment can now provide many services to foreign clients from domestic offices. The domestic offices of U.S. banks reportedly account for about 20 percent of U.S. banks' international assets, compared to 14 percent in 1980. In the United States, domestic offices include head offices, Edge and Agreement corporations, and international banking facilities (IBFs). Edge and Agreement corporations are limited purpose banks, permitted to accept deposits and offer a full range of banking services provided that such activities are linked to international transactions.[103] International banking facilities are merely sets of accounts maintained by banks for the sole purpose of conducting international business. IBFs are popular because their deposits are exempt from deposit insurance assessment, interest rate limits, and reserve requirements. In addition, several States have enacted favorable tax treatment for earnings derived from IBF balances.[104]

Foreign Banking Operations in the United States

Foreign interest in the U.S. banking market has been evident for many years because of the size of the U.S. economy, the global circulation of the U.S. dollar, and the importance of large U.S. financial centers such as New York and Chicago. Market deregulation and liberalization in the United States and abroad has recently spurred foreign banks to increase their presence in the United States. During 1980-91 the number of foreign banking offices in the United States more than doubled, increasing from 345 offices in 1980 to 738 offices in 1991.[105] During the same period, foreign banking offices increased their assets in the United States by 320 percent, from $198 billion in 1980 to $832 billion by 1991. By mid-1991, U.S. offices of foreign banks accounted for 24 percent of total U.S. banking assets and 18 percent of total U.S. banking deposits, up from 14 percent and 10 percent, respectively, in 1980.[106]

Foreign banking establishments in the United States are predominantly organized as branches and agencies.[107] Branches and agencies of foreign banks located in the United States account for 80 percent of foreign offices' combined banking assets. Foreign banks' ownership of U.S. subsidiaries is also common, although its relative importance appears to be declining. Such establishments accounted for about 15 percent of foreign banking assets in 1991, down from nearly 30 percent in 1980.[108] Foreign banks' interest in acquiring U.S. banks waned in the early 1980s as the

[98] Board of Governors of the Federal Reserve System, *Annual Statistical Digest, 1980-89*, pp. 409 and 427.

[99] Board of Governors of the Federal Reserve System, statistical update to staff study no. 156, "International Trends for U.S. Banks and Banking Markets."

[100] The activities of U.S. banking agencies located overseas include general insurance and brokerage services; underwriting credit, life, and motor vehicle insurance; management consulting; mutual fund management; and limited underwriting, distributing, and dealing in corporate debt and equity securities. U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-17.

[101] Ibid., p. XVIII-19.

[102] Ibid., p. XVIII-19.

[103] Edge corporations allow banks to conduct international banking business outside their home States without the constraints imposed by inter-State branching rules. Domestic banks have long used Edge corporations to gain a presence in New York City and, more recently, in other regional ports and financial centers. See Houpt, "International Trends," p. 4.

[104] Board of Governors of the Federal Reserve System, staff study no. 156, "International Trends for U.S. Banks and Banking Markets," p. 4.

[105] These offices were comprised by 386 branches, 223 agencies, 100 subsidiaries, 18 Edge/Agreement corporations, and 11 New York-based investment companies.

[106] American Banker, *Ranking the Banks: Top Numbers 1992 Edition*, p. 133.

[107] Agencies of foreign banks are essentially branches that cannot accept deposits from the general public but otherwise perform the full range of banking services.

[108] Board of Governors of the Federal Reserve System, statistical update to staff study no. 156, "International Trends for U.S. Banks and Banking Markets."

value of the dollar rose, which increased acquisition prices, and as competition in the U.S. banking market grew more intense, which increased risk.[109]

Among all foreign banking offices in the U.S. market, Japanese banks are predominant, accounting for 22 percent of all foreign bank branches and agencies. In 1991, 54 Japanese banks accounted for 128 foreign bank offices. Foreign-held assets are concentrated among Japanese branches and agencies, which account for 51 percent of gross foreign banking assets. Offices established by French banks rank a distant second, accounting for 8 percent of total foreign banking assets.[110]

Competition Between U.S. and Foreign Banks

For U.S. banks, the most important arena of foreign competition is the U.S. market; in foreign markets, U.S. banks are increasingly limited to participation in narrowly defined niche markets due to capital scarcity. In the United States, U.S. banks and foreign banks compete fiercely in terms of extending commercial and industrial loans. In addition, U.S. banks compete with foreign banks in off-balance sheet activities, such as the extension of standby letters of credit. SLC business generates fee income that does not require an increase in assets and has a less direct impact on bank capital, which in turn improves earnings, capital ratios, and profitability.

Commercial Lending

Foreign banks have increased their share of the C&I market from 21 percent during 1983 to 32 percent during 1991. U.S. branches and agencies of foreign banks accounted for three-quarters of the C&I loans extended by foreign entities. Of foreign-extended C&I loans, Japanese banks accounted for 59 percent in 1991, reflecting the rapid growth of Japanese banks since 1980, when they accounted for 32 percent of such loans. Branches of Canadian, British, and Italian banks accounted for relatively large shares of foreign C&I loans too, although the largest of these (Canadian branches) accounted for only 8 percent of foreign C&I loans in 1991.[111]

Guarantees

Foreign issuance of SLCs has also been noteworthy. Although competition among banks has resulted in very low fees for this activity, and although the market for guarantees (valued at $290 billion in 1988) is significantly smaller than the market for commercial loans (valued at $660 billion in 1988), fee income is important as it partially offsets declining activity in traditional business segments.[112]

The growth in SLCs issued by U.S. branches of foreign banks resulted in foreign firms' accounting for over 50 percent of domestic SLCs by 1988, significantly higher than the 10-percent share represented by foreign-issued SLCs in 1980. Japanese banks reportedly accounted for one-third of this increase, whereas banks based in Switzerland, West Germany, France, and the United Kingdom accounted for most of the remaining growth.[113]

To a large degree, it appears that Japanese banks' penetration of the U.S. banking market, especially the C&I market, during the 1980s stemmed from rather unique circumstances. Japanese banks' capitalization underwent dramatic growth during the 1980s, when the value of Japanese bank portfolios mushroomed due to soaring stock and real estate prices. Prior to the Basle Accord, this capital could be transformed into an enormous number of loans. Simultaneously, U.S. demand for C&I loans, fueled by mergers and acquisitions, outpaced U.S. banks' ability to lend. U.S. banks' capitalization suffered from unprecedented high charge-offs and loan reschedulings stemming from downturns in real estate markets and loan defaults by less developed countries. Prospective U.S. borrowers therefore turned to well-funded Japanese banks, among other foreign banks, for large loans. Higher capital adequacy ratios, ongoing financial deregulation, and the high volume of nonperforming loans that Japanese banks currently shoulder will likely limit these banks' international activities during the near future.

IMPEDIMENTS TO TRADE IN BANKING

In highly regulated sectors such as banking, national treatment (i.e., treating foreign firms no less favorably than domestic firms with respect to regulation) is broadly considered equivalent to free trade. The application of reciprocity (i.e., opening up domestic markets only so far as foreign markets are opened), on the other hand, is generally considered a nontariff barrier.[114] Foreign banks in the United States, the United Kingdom, and Japan are generally accorded national treatment; in certain cases, foreign banks in the United States and Japan are accorded treatment more favorable than that accorded domestic banks.

Impediments to trade in banking generally take two forms: limitations on certain activities, and limitations on market access. Restrictions on activities that foreign banks may undertake are most common, especially in the United States and Japan, although such restrictions are not inconsistent with national treatment so long as domestic banks are subject to the same restrictions. Limited market access commonly takes the form of prohibitions on the establishment of foreign banks or prohibitions on foreign banks' acquisitions. In the

109 Board of Governors of the Federal Reserve System, staff study no. 156, "International Trends for U.S. Banks and Banking Markets," p. 28.

110 Board of Governors of the Federal Reserve System, statistical update to staff study no. 156, "International Trends for U.S. Banks and Banking Markets."

111 American Banker, pp. 31-32.

112 Baer, "Foreign Competition," p. 24.

113 Ibid.

114 Ingo Walter, *Global Competition in Financial Services: Market Structure, Protection, and Trade Liberalization* (Cambridge: Ballinger Publishing Company, 1988), p. 177.

United States, a small number of State regulators prohibit the establishment of foreign banks in their State.[115] Likewise, U.S. banks report that there are informal impediments to acquiring banks in Japan.[116]

Impediments to Foreign Banking in the United States

As stated, the United States accords foreign banks national treatment at the Federal regulatory level. Where regulatory inconsistencies are found at the Federal level, they generally benefit foreign banks. Before the enactment of the International Banking Act (IBA) of 1978, foreign banks were subject only to State regulation. As such, foreign banks were exempt from McFadden Act restrictions on interstate branching, Bank Holding Company Act restrictions on nonbanking activities, and Glass-Steagall restrictions on securities-related businesses. The IBA was enacted to eliminate such inconsistencies, thereby according foreign banks national treatment.

A number of foreign banks conducted activities that were consistent with State regulations but inconsistent with Federal regulations at the time of the IBA's enactment. These banks generally have been allowed to continue such operations as long as business is not expanded in an illicit manner.[117] As a result, a limited number of foreign banks have been allowed to continue operating branches established in several States as long as new branches are established solely in the home state of the foreign bank.[118] Moreover, approximately 19 foreign securities firms with ties to banking have been allowed to continue securities-related activities under section 8 of the IBA (table 11).[119] The IBA also grandfathers foreign banks' existing investments in securities companies, and allows commercial and industrial affiliates of foreign banks to continue traditional lines of business in the United States.[120]

Despite the trade-liberalizing effects of the IBA, foreign banks may encounter impediments to trade at the State regulatory level. One difficulty experienced by foreign banks in the United States is regulatory complexity; banking regulation varies significantly across States. Permissible activities for State-chartered banks are listed in table 12. Moreover, some State regulators prohibit the establishment of foreign banks in their State, although all States containing major financial centers currently permit the free establishment of foreign banks. In addition, certain States that are participants in regional banking compacts[121] exclude foreign banks from the privileges accorded to other banks established in the region.[122]

[115] U.S. Dept. of the Treasury, *National Treatment Study 1990*, pp. 34-35.
[116] Ibid., p. 217.
[117] Ibid., pp. 31-39.
[118] Ibid., p. 34.

[119] U.S. Dept. of the Treasury, *Modernizing the Financial System*, p. XVIII-16.
[120] U.S. Dept. of the Treasury, *National Treatment Study 1990*, p. 37.
[121] A State that is a member of regional banking compacts allows banking organizations from neighboring States to acquire banks in that State, but it prohibits acquisitions by banks from States that are not included in the region.
[122] U.S. Dept. of the Treasury, *National Treatment Study 1990*, pp. 34-35.

Table 11
Securities affiliates of foreign banks

Bank	Securities affiliate	Ownership
		Percent
Julius Baer	Julius Baer Securities	100.0
Campagnie Financiere de Paribas	A.G. Becker/Warburg	100.0
Bayerische Hypotheken Bank	ABD Securities	25.0
Berliner Handels and Frankfurter Bank	BHF Securities	100.0
Bayerische Verenisbank	Associated European Capital Corp	95.1
Cho Heung Bank	Korean Associated Securities	9.1
Commerzbank	Europartners Securities	40.0
Credit Lyonnais	Europartners Securities	40.0
Credit Suisse	Swiss American Corp	100.0
	Swiss American Securities, Inc. (First Boston)	80.0
Deutsche Bank	Atlantic Capital Corp	100.0
Dresdner Bank	ABD Securities	75.0
	German American Securities (inactive)	100.0
Long Term Credit Bank	Sanyo Securities	5.4
Societe Generale	Hudson Securities	100.0
Swiss Bancorp	Basle Securities Corp	100.0
Union Bank of Switzerland	USB Securities, Inc.	100.0
Westdeutsche Landesbank	RWS Securities	100.0
Bank Hapoalim	Ampal	100.0

Source: Federal Reserve Board, as presented in U.S. Department of the Treasury, *Modernizing the Financial System*.

Table 12
Expanded activities for State-chartered banks

Insurance underwriting	Insurance brokerage	Real estate equity participation	Real estate development	Real estate underwriting	Securities underwriting	Securities brokerage/no underwriting
Delaware	Alabama	Arizona	Arizona	Georgia	Arizona	Arizona
Idaho	California	Arkansas	Arkansas	Iowa	California[1]	Connecticut
North Carolina	Delaware	California	California	Maine[2]	Delaware	Delaware
South Dakota	Idaho	Colorado	Colorado	Massachusetts	Florida	Florida
Utah[3]	Indiana[4]	Connecticut	Connecticut	New Jersey	Idaho	Georgia
	Iowa[5]	Florida	Florida	North Carolina	Indiana[6]	Idaho
	Nebraska	Georgia	Georgia	Oregon	Iowa	Indiana[7]
	New Jersey	Kentucky	Kentucky	Utah	Kansas[8]	Kansas
	North Carolina	Maine	Maine	Wisconsin	Maine	Iowa
	Oregon	Massachusetts	Massachuestts		Massachusetts	Maine
	South Carolina	Missouri	Michigan		Michigan	Michigan
	South Dakota	Nevada	Missouri		Missouri[9]	Minnesota
	Utah	New Hampshire	Nevada		Montana[10]	Nebraska
	Washington[11]	New Jersey	New Hampshire		Nebraska[12]	New Jersey
	Wisconsin	North Carolina	New Jersey		New Jersey	New York
	Wyoming	Ohio	North Carolina		North Carolina[13]	North Carolina
		Pennsylvania	Ohio		Pennsylvania[14]	Ohio
		Rhode Island	Oregon		Puerto Rico[15]	Pennsylvania[2]
		South Dakota	Rhode Island		Tennessee	Texas
		Tennessee[16]	South Dakota		Utah	Tennessee
		Utah	Utah		Washington	Utah
		Virginia	Virginia		West Virginia	Vermont
		Washington	Washington			West Vriginia
		West Virginia	West Virginia			
		Wisconsin[17]	Wisconsin[17]			

[1] Underwrite mutual funds.
[2] May conduct discount brokerage.
[3] Grandfathered institutions.
[4] May not broker life insurance.
[5] Property and casualty only.
[6] Underwrite municipal revenue bonds and market mutual funds and mortgage backed securities.
[7] May conduct discount brokerage.
[8] Underwrite municipal bonds.
[9] Underwrite mutual funds and may underwrite securities to extent of the State legal loan limit.
[10] Limited to bonds.
[11] Banks located in small towns (5,000) may conduct insurance agency activities without geographic limitations.
[12] Underwrite U.S. government securities.
[13] U.S. Government Federal Farm Loan Act bonds and general obligation bonds of State and political subdivisions.
[14] Underwrite municipal and mortgage related securities to extent permitted savings banks.
[15] May underwrite bonds of the U.S. and Puerto Rican Governments, their political subdivions and instrumentalities and agencies.
[16] Banks not allowed to be active partners in real estate development
[17] Wisconsin: Enacted expanded powers legislation in May 1986.

Source: U.S. Department of the Treasury, *Modernizing the Financial System.*

"Blue Sky Laws" or State securities regulations may limit the securities-related businesses undertaken by foreign banks, some of which rely heavily on revenues derived from securities underwriting and dealing in their respective home markets. Blue Sky Laws differ with respect to scope and complexity across States, but are likely to be most extensive in large States with high populations of small investors. To protect bank depositors and investors, many States prohibit banks, both foreign and domestic, from securities-related activities. Moreover, certain States subject shares issued by small or less-known firms, whether foreign or domestic, to "merit reviews," designed to determine whether such securities are "fair, just, and equitable." Equity offerings made by smaller foreign firms to investors other than institutions are likely to be subjected to merit reviews if they are not listed on the American or New York Stock Exchanges or designated as national market systems (NMS) securities by the National Association of Securities Dealers Automatic Quotations (NASDAQ). Critics of merit review often charge that such reviews lack transparency and subject small firms to arbitrary application of State securities regulations.[123]

[123] See Charles H.B. Braisted, "Foreign Offerings: State Registration Requirements," *Blue Sky Laws 1990* (New York: Practicing Law Institute, 1990); and Laura M. Rubenstein, "State Security Regulation: Merit Review of Foreign Equity Offerings," *Virginia Journal of International Law*, vol. 25, No. 4, Fall 1985.

Impediments to Foreign Banking in Japan

Motivated by domestic and foreign pressure to deregulate and liberalize banking and securities markets, the Japanese Ministry of Finance has modestly loosened restrictions on foreign financial service firms' activity. With respect to banks, however, foreign penetration of the Japanese market has been slow and shallow in comparison with Japanese penetration of foreign markets. Eighty-eight foreign commercial banks had operations in Japan as of November 1991.[124] These institutions appear to account for only 2 percent of the assets of Japan's banking industry.[125] Many of the impediments encountered by foreign banks participating in the Japanese market stem from factors that affect all foreign firms in Japan. For example, close relationships among firms, including cross-shareholding, virtually preclude acquisitions of Japanese banks with large deposit bases. No foreign bank has been successful in acquiring any existing Japanese bank.[126] Foreign banks also report that Japanese banking regulation is not transparent; many important regulations continue to be communicated orally rather than in written form.[127]

The slow pace of reform has perpetuated foreign firms' competitive disadvantage in the Japanese lending market. Due to the imposition of interest rate caps on deposits placed in Japanese banks, these banks have access to large amounts of deposits earning below-market interest rates. Japanese banks are therefore able to provide potential domestic borrowers with loans featuring low interest rates. In comparison, U.S. and British banks, which extend loans on the basis of deposits earning market interest rates, can not offer loans featuring equally low interest rates.[128]

124 Testimony of Hikedi Kanda, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs, U. S. House of Representatives, Washington, DC, Jan. 22, 1992.

125 Ibid., p. 218.

126 U.S. Dept. of the Treasury, *National Treatment Study 1990*, p. 211; and Khoury, p. 119.

127 U.S. Dept. of the Treasury, *National Treatment Study 1990*, p. 217.

128 Ibid., p. 221.

Despite the difficulties encountered by foreign banks in Japan, there are certain instances in which foreign banks receive more favorable regulatory treatment than Japanese banks. Although article 65 separates banking and securities operations, foreign investment banks may establish banking branches of foreign affiliates in Japan. For instance, Goldman Sachs has established a banking affiliate in the United Kingdom, and the affiliate, which can not be more than 50-percent owned by the U.S. parent company, has established a branch in Japan. Merrill Lynch, Morgan Stanley, and Salomon Brothers similarly have established banks in Japan working through affiliates in Germany. In addition, the compartmentalization of banking in Japan has been relaxed for nine subsidiaries of foreign banks that operate trust and commercial banking businesses.[129]

Impediments to Foreign Banking in the United Kingdom

The principal motivation for the 1986 deregulation of the British market was to restore London's position as one of the world's leading financial centers. Since the liberalization of financial services in 1986, the United Kingdom's banking market has been among the most open in the world.

As stated earlier, foreign participation in the British banking market is widespread. More than half of all banking institutions located in the United Kingdom are foreign-owned.[130] In its extensive description of foreign trade barriers in financial services, the U.S. Department of the Treasury reported that U.S. banks have experienced no significant national treatment problems in the United Kingdom.[131] Participation in the EC92 Program is expected to make British banking regulation more transparent, and thereby contribute to the establishment of foreign branches and subsidiaries by firms without current representation in London.

129 Testimony of Hikedi Kanda, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs, U. S. House of Representatives, Washington, DC, Jan. 22, 1992.

130 Pavel and McElravey, "Globalization in the Financial Services Industry," p. 5.

131 U.S. Dept. of the Treasury, *National Treatment Study 1990*, p. 496.

APPENDIX A
STATISTICAL TABLES

Table A-1
World's largest 100 banks ranked by assets, December 1990[1]

(Million dollars)

Rank	Company	Country	Assets	Capital	Net Income
1	Dai-Ichi Kangyo Bank	Japan	470,299	20,683	1,067
2	Mitsui Taiyo Kobe Bank[2]	Japan	438,673	21,915	904
3	Sumitomo Bank	Japan	428,690	27,368	1,365
4	Fuji Bank	Japan	422,456	27,225	1,133
5	Mitsubishi Bank	Japan	419,747	20,493	1,049
6	Sanwa Bank	Japan	412,503	21,008	1,195
7	Credit Agricole	France	305,299	42,549	923
8	Industrial Bank of Japan	Japan	299,160	152,973	625
9	Banque Nationale de Paris	France	291,962	26,864	318
10	Credit Lyonnais	France	287,418	26,583	727
11	Deutsche Bank	Germany	266,504	39,326	714
12	Tokai Bank	Japan	264,406	10,395	368
13	Norinchukin Bank	Japan	256,712	26,182	258
14	Mitsubishi Trust & Banking[3]	Japan	252,575	8,832	516
15	Sumitomo Trust & Banking[3]	Japan	249,255	7,403	519
16	Barclays	United Kingdom	240,645	17,973	755
17	ABN AMRO Holdings[4]	Netherlands	233,274	44,306	786
18	Bank of Tokyo	Japan	232,534	56,013	578
19	Societe Generale de France	France	220,050	20,486	526
20	Mitsui Trust & Banking[3]	Japan	216,762	6,933	477
21	Long-Term Credit Bank of Japan	Japan	215,554	118,250	452
22	Citicorp	United States	214,821	32,956	318
23	Yasuda Trust & Banking[3]	Japan	202,665	4,957	371
24	National Westminster Bank	United Kingdom	201,467	18,958	402
25	Dresdner Bank	Germany	189,476	42,415	605
26	Compagnie Financierede Paribas	France	185,640	22,989	500
27	Union of Switzerland	Switzerland	183,302	27,817	704
28	Daiwa Bank[3]	Japan	181,460	5,280	243
29	Industrial & Commercial Bank of China	China	179,421	11,197	2,533
30	Cencep	France	174,058	13,992	551
31	Groupe Suez	France	157,819	32,947	729
32	Toyo Trust & Banking[3]	Japan	150,532	4,483	317
33	HSBC Holdings	Hong Kong	148,535	14,698	397
34	Commerzbank	Germany	143,808	19,427	371
35	Bank of China	China	139,945	10,774	1,178
36	Bayerische Vereinsbank	Germany	137,793	44,503	209
37	Westdeutsche Landesbank	Germany	137,258	99,309	40
38	Deutsche Genossenschaftsbank	Germany	136,493	23,691	162
39	Instituto Bancarrio San Paolo	Italy	133,938	20,671	672
40	Nippon Credit Bank	Japan	132,580	73,965	279
41	Banca Nationale del Lavoro	Italy	131,804	29,747	117
42	Swiss Bank	Switzerland	130,375	27,822	546
43	Rabobank	Netherlands	119,751	21,261	576
44	Credit Suisse	Switzerland	117,392	21,388	423
45	Saitama Bank	Japan	116,589	6,111	206
46	Bayerische Hypo-Bank	Germany	116,174	31,415	204
47	Kyowa Bank	Japan	114,146	5,482	230
48	Bayerische Landesbank	Germany	113,556	20,785	118
49	BankAmerica	United States	109,089	10,061	877
50	Bank Melli Iran	Iran	107,760	38,784	9
51	NMB Postbank Groep	Netherlands	102,915	13,600	377
52	Midland Bank	United Kingdom	102,367	9,344	(373)
53	Cariplo	Italy	100,284	18,811	623
54	Royal Bank of Canada	Canada	99,629	7,568	832
55	People's Construction Bank of China	China	99,013	6,193	368
56	Chase Manhattan	United States	97,205	11,134	(334)
57	Lloyds Bank	United Kingdom	97,039	8,961	564

See footnotes at end of table.

Table A-1—Continued
World's largest 100 banks ranked by assets, December 1990[1]

(Million dollars)

Rank	Company	Net Country	Assets	Capital	Income
58	Shoko Chukin Bank	Japan	95,457	70,412	102
59	Bank of Yokohama	Japan	94,459	4,273	150
60	Banca Commerciale Italiana	Italy	93,161	5,499	425
61	J.P. Morgan	United States	92,005	9,155	775
62	Agricultural Bank of China	China	91,851	5,346	221
63	Canadian Imperial Bank of Comm	Canada	90,531	7,390	692
64	Groupe CIC	France	89,925	10,049	159
65	Kreditanstalt fur Wiederaufbau	Germany	89,689	47,027	108
66	Banco Bilbao Vizcaya	Spain	86,673	9,454	1,061
67	Monte dei Paschi di Siena[5]	Italy	85,591	5,933	204
68	Security Pacific	United States	83,854	13,353	161
69	Zenshinren Bank	Japan	83,583	1,733	152
70	Norddeutsche Landesbank	Germany	82,971	19,858	46
71	Chuo Trust & Banking[3]	Japan	82,682	1,517	110
72	Hokkaido Takushoku	Japan	82,558	3,413	146
73	Credito Italiano	Italy	81,039	3,585	300
74	Skandinaviska Enskilda Banken	Sweden	80,067	22,204	107
75	Groupe Des Banques Populaires	France	78,532	9,360	228
76	Generale Bank Group	Belgium	76,292	3,914	260
77	Banco di Napoli	Italy	73,754	7,646	142
78	Westpac Banking Corp.	Australia	72,621	7,335	528
79	Chemical Banking	United States	72,488	7,140	291
80	Bank of Montreal	Canada	72,295	4,943	450
81	Banque Bruxelles Lambert	Belgium	68,615	2,712	139
82	Bank of Nova Scotia	Canada	68,562	5,019	441
83	Chiba Bank	Japan	67,721	4,507	123
84	Japan Development Bank	Japan	67,292	66,447	279
85	Banco di Roma	Italy	66,796	2,653	142
86	Svenska Handelsbanken	Sweden	64,855	14,770	140
87	NCNB	United States	64,784	4,887	366
88	National Australia Bank	Australia	64,128	7,760	592
89	Hokuriku Bank	Japan	64,092	2,850	121
90	Credit Foncier de France	France	63,960	35,332	137
91	Australia & new Zealand Banking Group	Australia	63,493	12,837	319
92	Deutsche Kommunalbank Germany	Germany	63,227	17,991	20
93	Joyo Bank	Japan	63,017	2,266	135
94	Den Danske	Denmark	62,986	4,627	(204)
95	Bankers Trust New York	United States	62,854	5,674	665
96	Swedbank (Sparbankernas Bank)	Sweden	62,242	32,528	27
97	Banco do Brazil	Brazil	60,464	9,382	207
98	Manufacturers Hanover	United States	60,352	5,226	139
99	ASLK-CGER Group	Belgium	59,201	15,550	96
100	Bank Melli Iran	Iran	107,760	38,784	9

[1] For comparative purposes, assets are calculated without customers acceptances and loan-loss provisions; operational trust assets of Japanese trust banks are added to consolidated assets if they are presented separately. Capital includes long-term debt, nonequity reserves, minority interest and shareholders' equity; figures may include short-term debt when such debt is not provided separately.

[2] Estimated combined result of Mitsui Bank and Taiyo Kobe Bank.

[3] Excludes custody assets and investment trusts.

[4] Formed by merger of Algememe Bank Nederland & Amsterdam-Rotterdam Bank.

[5] 1989 figures.

Source: *The Wall Street Journal*, Sept. 20, 1991, p. R-9.