A current look at foreign banking in the U.S. and Seventh District

Linda M. Aguilar

Foreign banks wield substantial influence within the financial services industry of the Seventh Federal Reserve District. The District, which encompasses all of Iowa and portions of Illinois, Indiana, Michigan, and Wisconsin, has more than ten percent of the approximately 652 foreign-owned banking offices in the United States.[1] (See box for definitions of the terms used in this article.) The 69 foreign offices in the District account for $86 billion, or 17 percent, of the District's banking assets. Foreign offices hold 17 percent of the total value of loans outstanding in the District, and 32 percent of the total value of commercial and industrial loans. The picture for the nation is comparable. What does this foreign influence imply for the future of the U.S. banking industry? Is there cause for concern?

To address these issues, this article begins with a review of global banking. First, I look at trends in world banking over the last 25 years and the evolution of the regulatory environments in the home countries of the major players. Next, I analyze the factors behind the global expansion in banking. Then I present a detailed analysis of trends in foreign banking in the U.S. and the Seventh District since 1980 and assess which countries have played the main roles. Finally, I address the potential consequences of an increased foreign banking presence in the U.S.

World banking in review

In 1969, U.S. banks were dominant in the world; seven of the top ten banks worldwide (as measured by assets) were U.S. banks, with Bank of America in the top position. The United Kingdom and Italy shared the remaining three slots. The biggest Japanese bank at that time was Fuji Bank, ranking 14th in assets.

By 1972 the top ten list was more internationally diverse. Bank of America still ranked first, but only two other U.S. banks shared the top ten. Four Japanese banks, two British banks, and one French bank filled out the category. The next decade saw further change as the assets of French banks soared. Four French banks reached the top ten in 1982, with the remaining spots evenly split among U.K., Japanese, and U.S. banks. Bank of America still ranked first.

By 1993 the global banking community had again been transformed. Japanese banks had completely edged out U.S. banks, holding nine of the top ten positions; Credit Lyonnais (France) was the only non-Japanese bank among the top ten. Citibank, 30th in the world, was the highest-ranking U.S. bank.

While total assets measures absolute size, the amount of foreign assets a bank can attract provides a measure of its international competitiveness. At the end of 1960, banks from the U.S., U.K., and Switzerland were the leaders in this category, with approximately $9 billion in foreign assets (current U.S. dollars). By 1992, banks from the U.K., Japan, and France topped the list, with a combined $2.1 trillion in foreign assets.

Linda M. Aguilar is a regional economist at the Federal Reserve Bank of Chicago. She would like to thank Sunmie Won and Nancy Andrews of the Statistics Division for data support.

On an individual bank basis, six banks conducted more than 50 percent of their business overseas in 1992—one French, two U.K., and three Swiss. Of these six banks' world-wide assets, nearly 10 percent were domiciled in the U.S.[2] Four U.S. banks ranked among the top 25 banks with substantial overseas business, with Bankers Trust and J. P. Morgan generating over 50 percent of their income overseas.

Reasons behind global expansion

One of the leading factors driving global expansion in the banking industry in the second half of this century has been the growth in number and size of multinational companies (MNCs). World-wide foreign direct investment has grown significantly over the last 20 years, from almost $10 billion in 1970 to almost $180 billion in 1990 (see table 1). MNCs have special needs that make foreign offices a smart business practice for banks. Firms borrow capital not only to finance their investments overseas, but also for ongoing plant and physical equipment, acquisitions, and trade finance. In addition, they need foreign exchange, cash management services, and lock box operations—services that generate substantial fee income. Banks that follow their customers abroad are better positioned to provide these services.

Competitive pressures led countries to deregulate their banking industries, an important factor enabling increased globalization. Prior to the 1970s, most major countries of the world had protective and restrictive banking regulations.[3] Interest rates paid on deposits were fixed or capped, and the division between banking and securities-related activities was fairly strict (as in Canada, the U.S., and Japan) or at least limited (as in Belgium, Denmark, Italy, Spain, and the U.K.).[4] France was an exception. It began to deregulate its banking industry in the mid-1960s by granting banks and securities firms somewhat equal power. As a result, French banks began developing new markets for personal and mortgage loans and offering securities-related services to their customers. Initially, French banks concentrated on the local market, not moving into the international market until the early 1970s.[5] In the U.S., the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) represented a major overhaul of the domestic banking system. It leveled the playing field for all U.S. institutions by phasing out

GLOSSARY OF TERMS

Agency – a separate office of a foreign-domiciled parent bank. Agencies provide full banking services but are prohibited from taking deposits from U.S. citizens (unless related to international activities), selling certificates of deposit, and offering trust services.

Branch – a separate office of a foreign-domiciled parent bank. Branches provide full banking services including deposit taking and lending.

Foreign banking offices – all foreign subsidiaries with 25 percent or greater foreign ownership, and all foreign branches and agencies as described above.

Foreign subsidiary – a U.S. subsidiary of a foreign bank with 25 percent or greater foreign ownership. Subsidiaries provide complete banking services.

Total U.S. banking market – all U.S. FDIC-insured commercial banks (both U.S.- and foreign-owned), and all foreign branches and agencies, excluding those located in U.S. territories and possessions.

U.S.-owned commercial banks – all FDIC-insured commercial banks excluding foreign subsidiaries with 25 percent or greater foreign ownership.

TABLE 1

Foreign direct investment in the reporting economy
(million U.S. dollars)

	World	U.S.	Industrialized countries	Developing countries
1970	$9,855	$1,464	$8,043	$1,812
1975	20,368	2,635	11,693	8,641
1980	49,288	16,906	40,309	8,978
1985	48,261	19,030	36,212	12,050
1990	179,558	37,190	150,913	28,645

Note: The definition of industrialized countries changed between 1970 and 1990.
Source: International Monetary Fund, *Balance of Payments Statistics Yearbook*, various years.

interest rate ceilings and granting new powers to both banks and thrifts. The U.S. banking industry responded with an array of new savings instruments such as interest-bearing checking accounts and money market demand accounts. Slowly, the major money center banks began their long-awaited entry into the securities market.[6]

Other countries also responded to competitive pressures by deregulating and diversifying the permissible activities of their banking industries. Japan, for instance, enacted a new law in the early 1980s permitting commercial banks to engage in more securities-related activities (such as selling over-the-counter government bonds and trading government bonds in the secondary market) as well as in factoring, credit card issuing, and mortgage lending.[7]

By the 1990s, deregulation had changed the global banking environment dramatically from the 1960s. Yet in most countries, banking and securities activities remain separated, permissible only through subsidiaries; underwriting insurance also is generally permitted only through subsidiaries.[8] The gains that deregulation allowed were primarily in unrestricted savings instruments and broader lending activities.

Advanced technology also was important in enabling the globalization of banking. Through telecommunications and fiber optic networks, banks became capable of offering new services such as credit cards, factoring, loan servicing, commercial paper, ATMs, money market funds, and foreign currency services.

Foreign banking in the U.S.

Foreign banks have had a presence in the U.S. since the mid-1700s.[9] In particular, British banks have been present in the U.S. since colonial times, and several Canadian banks have been active in California since the mid-1800s.[10] However, the growth in the number and assets of foreign banking offices in the U.S. did not take off until the late 1970s; between 1975 and 1980 their number nearly doubled.

Foreign banking offices, especially Japanese ones, made significant inroads into the U.S. market during the 1980s for several reasons. One was that U.S. banks were retrenching from problem loans to less developed countries, and later from too many excessively large real estate loans. Then in the late 1980s and early 1990s, the U.S. banking market was said to experience a "credit crunch"; foreign banks stepped in and provided the much-needed credit, increasing their share of commercial and industrial (C&I) loans in the U.S. to 32 percent in 1992, up from 21 percent in 1986.

By mid-1994, the total number of foreign offices in the U.S. stood at 652, a mere 6 percent of the total number of U.S. bank and branch offices. But these foreign offices held $952 billion in assets, or 21 percent of all U.S. banking assets. They held 17 percent of the value of all loans and 30 percent of the value of all C&I loans.

Recent trends in foreign banking in the U.S. and Seventh District

In 1980, the total combined foreign presence in the U.S. banking market consisted of 441 offices with assets of $252 billion dollars. Foreign branches and agencies accounted for the bulk of these numbers, with 334 offices or 75 percent of the total foreign offices, and 60 percent of the assets. The remaining offices were U.S. subsidiaries of foreign banks with assets of $103 billion. By 1991, the total number of foreign banking offices in the U.S. peaked at 726. Since then, their number has dropped to 652 in mid-1994. However, this decline is not unique to foreign banking offices, as the total number of U.S.-owned commercial banks also dropped over the period (see table 2).

While foreign offices in the U.S. increased significantly throughout the 1980s, recently their numbers have been declining. In terms of their share of the U.S. banking market, foreign banking offices peaked in 1992. In that year, foreign banking offices accounted for approximately 23 percent of all assets, 19 percent of total loans, and 32 percent of C&I loans. The corresponding numbers for 1994 are approximately 21 percent, 17 percent, and 30 percent (see table 3). The most recent figures for year-end 1993 and through second quarter of 1994 show U.S. commercial banks outperforming the foreign sector in asset and loan growth (see figure 1).

The growth of the foreign banking sector during the 1980s accelerated much more rapidly in the Seventh District than in the nation as a whole. While Japanese banks contributed to this growth, so did the acquisition of two major banks in Chicago by other foreign entities: In 1982 LaSalle National Bank was acquired by

TABLE 2

U.S. banking market, U.S.-owned versus foreign offices

	Assets (billions)			
	U.S.		Seventh District	
	U.S.-owned	Foreign offices	U.S.-owned	Foreign offices
1980	$1,688.8	$252.0	$253.7	$ 9.7
1985	2,502.9	485.8	310.8	27.5
1990	3,198.1	822.4	377.7	73.0
1991	3,200.6	910.3	383.6	77.7
1992	3,249.9	946.1	391.4	78.6
1993	3,429.7	933.1	410.4	78.5
1994	3,620.3	951.9	428.1	86.2

	Number of offices			
	U.S.		Seventh District	
	U.S.-owned	Foreign	U.S.-owned	Foreign
1980	14,015	441	2,745	37
1985	14,058	621	2,592	60
1990	12,221	700	2,159	76
1991	11,742	726	2,092	75
1992	11,307	686	2,010	71
1993	10,827	660	1,919	70
1994	10,583	652	1,879	69

Note: 1994 figures are second-quarter.
Source: Board of Governors of the Federal Reserve System.

ABN Amro, a Dutch banking concern, and in 1984 Harris Bank was acquired by Bank of Montreal. Both of these foreign banks have been active in acquiring other banking institutions in the District, thus expanding their market share even further. The foreign banking sector now accounts for 17 percent of the District's total banking assets, slightly less than the 21 percent for the total U.S. market. However, the foreign sector's share of the District loan market—also 17 percent—is similar to its share of the U.S. loan market.

Since lending has traditionally been one of the major lines of business in banking, it is useful to see how foreign banking offices have competed with their U.S. counterparts in this activity over the years. This is indicated by two measures: changes in portfolio composition and changes in the loan-to-asset ratio. The first measure reveals changes in response to demand or management strategies; the second gauges concentration, that is, the relative importance of loan production versus other assets.

Over the period 1985-94, both foreign banking offices and U.S.-owned commercial banks have responded to the needs of two important loan markets—real estate and commercial and industrial.[11] Within those categories, the two groups of banks have focused differently. Among U.S.-owned banks, real estate loans have grown from 27 percent of the value of total loans in 1985 to

TABLE 3

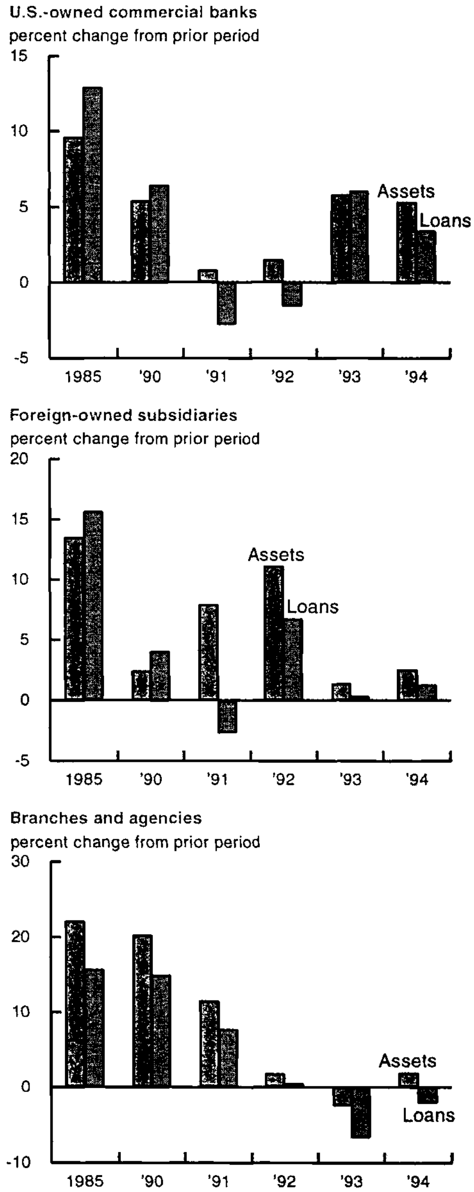
Foreign banking offices' market share

	Assets (billions)	Market share	Total loans (billions)	Market share	C&I loans (billions)	Market share
1980	$252.0	13.0%	$148.9	14.1%	N/A	-
1985	485.8	16.3	265.4	15.1	$115.3	19.7%
1990	822.4	20.5	408.1	17.1	198.8	27.6
1991	910.3	22.1	426.8	18.2	212.1	30.9
1992	946.1	22.5	435.8	18.7	215.9	32.2
1993	933.1	21.4	416.1	17.2	205.9	31.0
1994	951.9	20.8	412.0	16.6	210.0	30.3

Note: 1994 figures are second-quarter.
Source: Board of Governors of the Federal Reserve System.

FIGURE 1

Asset and loan growth, U.S.-owned versus foreign offices



Note: 1985 and 1990 are annualized five-year growth rates. 1994 figures are second-quarter.

Source: Board of Governors of the Federal Reserve System.

nearly 43 percent in 1994, while their share of C&I loans has decreased from 31 percent to 23 percent. Together, the loans in these two categories have grown from 58 percent to 66 percent of the value of total loans. The change in the loan portfolios of foreign banking offices is quite different. Both categories of loans have grown in proportion over this period, real estate loans from approximately 11 percent to 22 percent and C&I loans from 43 percent to 51 percent, for a combined increase of 19 percent (see table 4). Subsidiaries account for the largest portion of the absolute increase of each loan type over the period, but branches and agencies have had larger percentage increases.

Despite the above figures, foreign banking offices have reduced their loan-to-asset ratio every year since 1980. In 1980, loans comprised 59 percent of assets; by 1994 they had dropped to 43 percent. As figure 2 shows, foreign branches have been most active in reducing their loan-to-asset ratio, while agencies have maintained theirs at around 56 percent over the last ten years. U.S.-owned commercial banks and foreign subsidiaries did not begin to reduce their ratios until 1990.

The pattern of loan portfolio composition for U.S.-owned banks in the District is similar to that of U.S.-owned banks nation-wide. But foreign banking offices in the District hold a smaller proportion of real estate loans and a greater proportion of C&I loans in their loan portfolios, compared to foreign banking offices nation-wide (see table 4). The changes in the loan-to-asset ratios of commercial banks and foreign banking offices in the District is similar to the U.S. pattern; that is, U.S.-owned banks have only started to decrease their loan-to-asset ratio since 1990, whereas foreign banking offices have been decreasing theirs since 1980 (see figure 2). However, total foreign banking offices in the District have a higher loan-to-asset ratio than foreign offices nation-wide, 56 percent for the District versus 43 percent for the U.S. Branches in the District still have a much higher ratio than in the nation as a whole. This is probably because of the different home countries of the branches concentrated in the District as compared with the nation as a whole.

In sum, then, the lending patterns as well as the changes in loan portfolios of foreign banking offices versus U.S.-owned commercial banks do vary. Individual countries have exhibited patterns of their own in both the U.S. and the District.

Country analysis

In 1980, 56 of the 441 foreign branches and agencies in the U.S. were Japanese-owned, with assets of $61 billion, or almost 41 percent

TABLE 4

Real estate and commercial loans
(percent of total loans)

	U.S.-owned commercial banks		Total foreign banking offices	
	Real estate	C&I	Real estate	C&I
Total U.S.				
1985	27.1%	31.3%	10.8%	43.4%
1990	39.9	26.3	20.5	48.7
1994	42.7	23.3	22.1	51.0
Seventh District				
1985	27.3%	31.4%	7.2%	49.5%
1990	39.0	29.5	19.3	58.0
1994	42.9	26.6	16.5	61.9

Note: 1994 figures are second-quarter.
Source: Board of Governors of the Federal Reserve System.

of total foreign branches and agencies' assets (see figure 3).[12] Canadian banks had the next largest presence, with assets of $15 billion or 10 percent of the total, followed by French banks with $12 billion or 8 percent of total. By mid-1994, Japanese banks still had the largest foreign presence, with 128 offices and $326 billion in assets, or about 46 percent of total foreign branches and agencies' assets. French banks had moved into second place ($84 billion in assets, or almost 12 percent of total), followed by Canadian banks ($46 billion in assets, or more than 6 percent of total).

As table 4 shows, C&I loans dominate the total combined loan portfolios of foreign branches and agencies. Canadian, Japanese, and U.K. offices all had over 50 percent of their loan portfolios in commercial loans in 1985 (see table 5). In that year, only Canadian and Dutch offices had a significant portion of their portfolios in real estate loans. By 1990, other countries had entered the U.S. real estate loan market, with both Japanese and U.K. offices significantly increasing their portfolio share of real estate loans. By 1994, Japanese, German, U.K., and Canadian offices held significant portions of their loan portfolios in real estate loans.

Unlike the national picture, Canadian and Dutch banks have a larger presence in the Seventh District than French and Swiss banks do.[13] The District also varies from the rest of the nation in that for all major countries except Japan, District offices concentrate to a greater degree on the commercial loan market; that is, their ratio of commercial loans to total loans is larger in the District. Also, Dutch offices in the District hold more real estate loans and significantly more C&I loans as a percentage of their loan portfolios than Dutch offices in the rest of the U.S.

The slowing of most major countries' economies over the last two years has had an impact on foreign activities in the U.S. In the banking sector, assets at Japanese banks have fallen, as has Japan's share of both the total and foreign bank sector in the U.S. Italian banks have also lost market share in the foreign banking sector, allowing banks

FIGURE 2

Loan-to-asset ratios, U.S.-owned versus foreign offices

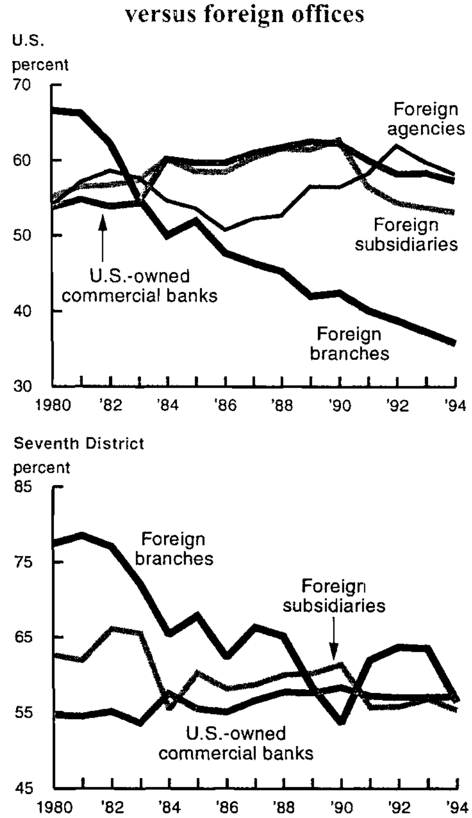
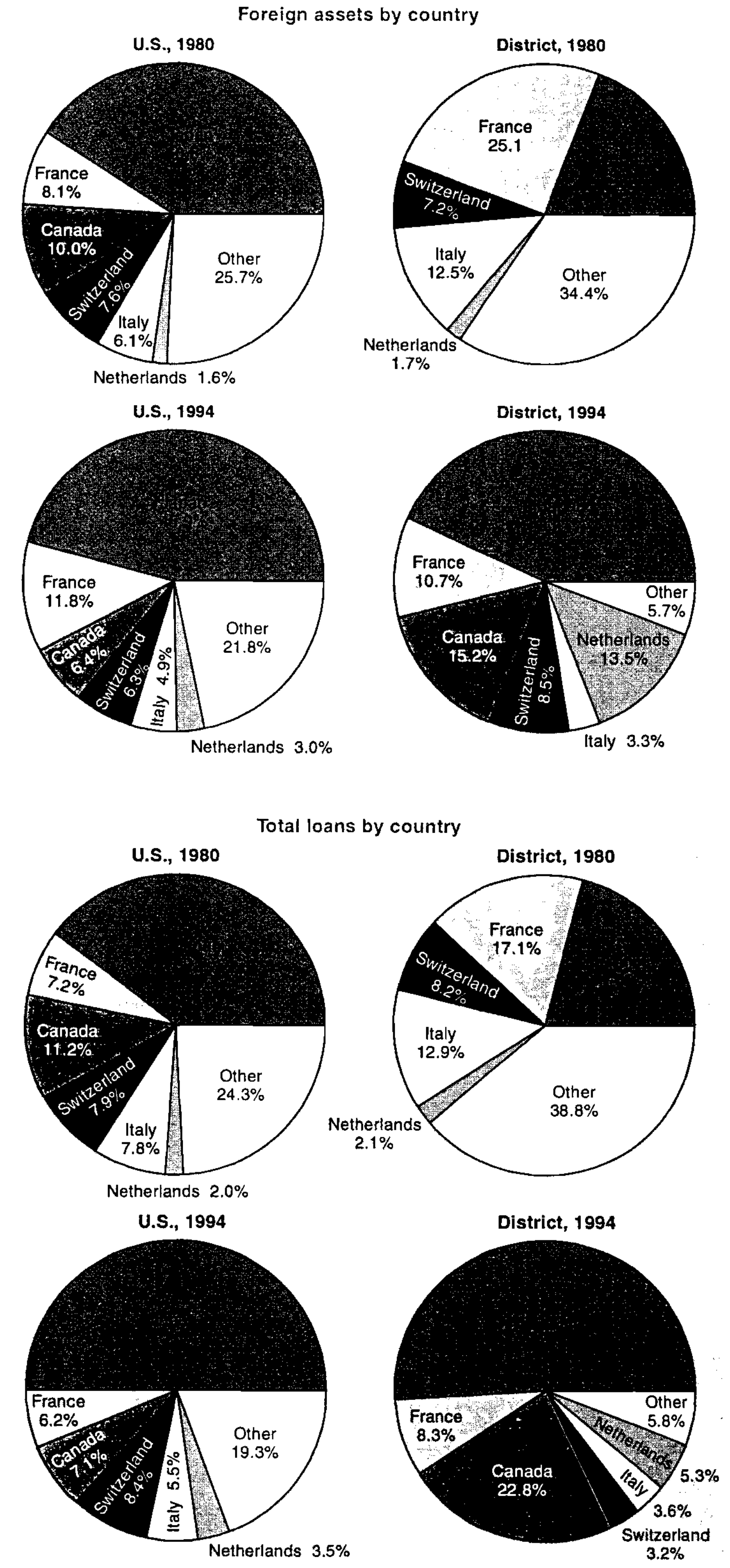


FIGURE 3

Major countries' assets and loans, U.S. and District



from France, Canada, Switzerland, and developing countries to capture more of the U.S. market.

Assessment and outlook

The U.S. benefits from foreign banks and their foreign customers in many ways. Foreign banks bring expertise and knowledge that U.S. banks may not have developed or not shown an interest in; foreign banks have contacts from their home countries that enable them to do business or enter markets that U.S. banks may be unwilling to enter; and foreign banks or their customers may bring capital from home country sources, as happened during the 1980s when many Japanese investors entered the U.S. market. Employment at U.S. nonbank affiliates with Japanese ownership grew from 6 percent of total affiliate employment in 1977 to 15.5 percent in 1992.[14]

Does it make a difference who provides U.S. credit needs as long as those needs are ultimately met? That was one of the questions posed by a task force of the House Committee on Banking, Finance, and Urban Affairs, formed in 1990 to study the international competitiveness of U.S. financial institutions. The report of this task force sketches some concerns regarding an increased foreign presence in the U.S. banking industry.[15]

TABLE 5

Loan portfolios of major countries' foreign branches and agencies

	U.S.			Seventh District			U.S. without Seventh District		
		Percent of total loans			Percent of total loans			Percent of total loans	
	Total loans	R/E loans	C&I loans	Total loans	R/E loans	C&I loans	Total loans	R/E loans	C&I loans
	(billions)			*(billions)*			*(billions)*		
1985									
Japan	$65.1	0.4%	50.0%	$3.3	0.2%	45.7%	$61.8	0.4%	50.2%
France	10.0	2.0	39.4	1.0	0.0	67.0	9.0	2.3	36.3
Switzerland	12.6	0.4	26.8	0.5	0.0	92.4	12.1	0.4	24.1
Germany	5.8	0.2	34.7	0.5	0.0	63.1	5.3	0.2	32.2
Italy	22.7	0.0	28.5	2.1	0.0	31.2	20.7	0.1	28.2
Canada	15.8	24.6	61.7	1.8	20.0	61.5	14.0	25.2	61.8
Netherlands	2.3	14.5	11.8	0.1	22.7	63.4	2.2	14.2	9.8
United Kingdom	9.3	2.7	51.0	0.6	4.5	89.6	8.7	2.6	48.4
1994									
Japan	$141.9	21.3%	58.0%	$17.0	12.4%	75.3%	$124.9	22.5%	55.6%
France	17.7	5.5	69.6	2.8	0.6	75.7	14.9	6.4	68.5
Switzerland	23.8	4.7	58.6	1.1	0.1	98.1	22.8	4.9	56.8
Germany	10.6	9.8	37.6	0.6	4.3	32.1	10.0	10.2	38.0
Italy	15.6	1.3	31.9	1.2	1.6	52.0	14.3	1.3	30.2
Canada	20.3	12.0	72.6	7.6	16.4	61.6	12.7	9.4	79.2
Netherlands	9.8	3.1	82.5	1.8	3.7	75.6	8.0	3.0	84.0
United Kingdom	11.7	10.7	32.8	0.3	9.6	73.2	11.4	10.7	31.6

Note: 1994 figures are second-quarter.
Source: Board of Governors of the Federal Reserve System.

Looking to the future, it seems likely that the foreign presence in the U.S. banking market will continue to level off or decline in the years ahead. This seems especially probable since countries such as China, Mexico, and Brazil are the emerging markets of the coming century, and businesses throughout the world will be expanding to meet the needs of those new markets. As has happened before, financial resources are likely to follow, perhaps to the point of reducing foreign market share in the U.S. even further.

NOTES

[1]The U.S. requires foreign banking offices to report financial data to the Federal Reserve Bank or the Office of the Comptroller, depending on the office's charter. The data used in this article were taken from these reports, known as call reports (FFIEC030 for FDIC-insured commercial banks, and FFIEC002 for U.S. agencies and branches of foreign banks).

[2]Connor (1994).

[3]Bröker (1989), p. 9.

[4]Ibid, p. 181.

[5]Ibid, p. 181.

[6]The granting of securities-related activities is still done on a case-by-case basis. To date, no U.S. bank has had a major presence in the securities market.

[7]The Japanese banking system has traditionally consisted of specialized banks and financial institutions serving unique markets or performing special functions.

[8]Japan still does not permit insurance underwriting, and the U.S. permits it only on a limited basis.

[9]Houpt (1988), p. 25.

[10]Ibid.

[11]Other factors have also affected the lending activities of banks including the growth of off-balance-sheet activities and increased competition from nonbank intermediaries.

[12]Branch and agency data are most commonly used in analyses of foreign banking. This is because such data are more readily available than data for foreign subsidiaries.

[13]Breaking out the District from the U.S. total shows how much variance there is among regions of the U.S. Statements about the U.S. banking system as a whole do not reflect the substantial variance across regions. Total U.S. figures are greatly influenced by the major money centers in the U.S.

[14]In the context of foreign direct investment, foreign ownership refers to that person or persons who own or control physical facilities located on U.S. soil. Ownership is defined as a 10 percent or greater interest in a U.S. firm.

[15]U.S. Congress (1990).

REFERENCES

Board of Governors of the Federal Reserve System, *Call Reports*, Washington, DC, various years.

Bröker, Günther, *Competition in Banking*, Paris: Organization for Economic Cooperation and Development, 1989.

Campbell, Mary, "The multinational banking framework," *The Banker,* Vol. 12, June 1971, pp. 628-639.

Connor, David, "Top twenty take to travel," *The Banker*, Vol. 144, February 1994, pp.49-52.

Houpt, James V., "International trends for U.S. banks and banking markets," Board of Governors of the Federal Reserve System, Washington, DC, staff studies, No. 156, 1988.

International Monetary Fund, *Balance of Payments Statistics Yearbook*, Washington, DC, various years.

Pecchioli, R. M., *The Internationalisation of Banking: The Policy Issues*, Paris: Organization for Economic Cooperation and Development, 1983.

U.S. Congress, House of Representatives, Committee on Banking, Finance, and Urban Affairs, *Report of the Task Force on the International Competitiveness of U.S. Financial Institutions,* 101st Congress, 2d Session, 1990.