INTERNATIONAL BANK COMPETITION & SUPERVISION

AN ADDRESS BY

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Good afternoon, it is a pleasure to be here today. Chicago is "my kind of town" - a great sports town (especially in football), the financial center of the midwest and . . . balmy breezes. A perfect setting for discussing international banking. Chicago is not only the hub of commerce for the entire central region of the U.S., but it is a beehive of international banking activity.

As honored as I am to speak before such a prestigious group, I think it's somewhat telling that I'm here at all. Not too long ago there was relatively little focus on international activity at the FDIC. Our agency functioned almost exclusively as the supervisor of smaller state chartered banks which were not really affected by what happened in Hong Kong or London. What happened on the international scene was left to others. A lot has changed. International banking and its repercussions can and does affect the entire U.S. financial system, even to its smallest units.

For example, a number of insured banks have become heavily exposed, through their lending operations, to the economic progress of other nations. And, a number of smaller agricutural banks complain that efforts to collect this foreign debt are hurting their ability to sell abroad. Banks, along with the rest of the country, have become increasingly dependent on foreign sources for funding. In a few cases the dependency is very high, causing us some concern about the stability of the funding situation. Since this is the hometown for Continental Illinois National Bank, I am sure I don't have to explain to you why we get concerned.

The world is getting smaller; banking is becoming more global. The approach to banking taken by other countries will influence the longer term outlook for our own banking industry. Head-on competition between U.S. banks and foreign controlled banks has increased considerably over the last several years - not only abroad but here in this country as well. Again, you see this in your home town where a number of foreign banks compete.

We don't always like the changes we see. But usually we can't prevent them. As Alvin Toffler said, "The problem is not, therefore, to suppress change, which cannot be done, but to manage it."

Today, I'd like to cover some aspects of international competition in banking, particularly in its newest form, the deregulation of competition in England - known by a typical English decription as the "Big Bang." First, competition.

The increase in foreign bank activity in the U.S. in recent years has been impressive. In 1978, foreign banks held about $46 billion in deposits in this country. By 1985, the volume of deposits had grown fivefold to $245 billion. Their market share of U.S. deposits jumped from 4.5 percent to over 12 percent. The competition is not one-sided. U.S. banks are still going abroad.

At last count, over 260 U.S. banks had foreign offices with deposits totaling $322 billion, compared to $221 billion in 1978. But, in recent years, the growth of foreign bank offices on U.S. soil has far outpaced the growth of U.S. bank offices abroad.

I think this competition is healthy, and - provided it's fair - good for the economy. Further, from a somewhat selfish standpoint as Chairman of the FDIC, I welcome foreign interest in U.S. banking. Finding buyers for failing banks gets harder all the time. We can always use a few more . . . buyers, not failing banks.

International competition is not always fair. In this country, entry and operations of foreign banks are, for the most part, governed by a regulatory framework based on the principle of national treatment. Essentially, this means foreign banks are given competitive equality with domestic banks. Not all countries adhere to this principle. Since Congress adopted the principle of national treatment with the International Banking Act of 1978, it has asked for reports on how foreign governments treat U.S. banks.

The studies have concluded that U.S. banks generally receive substantial access to most major foreign markets, both in terms of entry and subsequent operations - although significant restrictions were noted. Since the first report, a number of countries have made substantial progress toward national treatment, although some countries still have a ways to go.

For example, let's look at Canada. As you know, Harris Bank and Trust, Chicago's third largest bank, is owned by the Bank of Montreal. But, foreigners cannot acquire more than a minority interest in any widely held, domestic bank in Canada (known as Schedule A Banks). The only exception in over 20 years is the recent approval for Lloyds Bank to acquire the assets of Continental bank. Foreign banks cannot enter Canada as branches. For all practical purposes, foreign banks can only enter Canada by establishing a Schedule B bank, which is subject to different chartering provisions. Moreover, there are a number of restrictions and limitations relating to capitalization, funding and lending which limit the opportunities of foreign banks to compete fully in the Canadian market.

As of year-end 1985, 17 U.S. banking subsidiaries and four representative offices of three U.S. banks operated in Canada. Their assets total about $8.4 billion. Conversely, eight Canadian banks operate in the United States with 18 branches, 11 agencies, 32 representative offices and 20 subsidiaries. They held $40 billion in assets.

Financial regulatory reform is expected in 1987 and Canadian authorities have indicated a willingness to engage in bilateral negotiations on issues of trade in financial services.

Japan is another interesting case. Currently, 27 Japanese banks operate in the United States, through 25 subsidiaries, 70 branches and 51 representative offices. At the end of 1985, these banks held almost $180 billion in U.S. assets, up 41 percent from 1983. Japan now controls about 6.5 percent of the bank assets in this country. Two years ago their share was about 5.5 percent. Eight Japanese banks have assets in U.S. offices that would rank them among the top 50 banks in this country. As Lawrence Peter (of the Peter Principle) once said, "America is the land of opportunity if you're a businessman in Japan."

How are foreign banks doing in Japan? Foreign banks account for about 4 percent of all bank assets in Japan. U.S. banks hold a little over one percent.

Japan has taken numerous steps to liberalize its financial markets and expand the scope of opportunities for foreign banks. Nevertheless, outsiders have found Japanese markets very difficult to penetrate. There are a number of reasons for this. Competition has intensified. Asset securitzation has spread rapidly. Japanese banks now make foreign currency loans, which prior to 1980 could only be done by foreign banks. Prevailing loan rates are largely based on the blended cost of funds to Japanese banks, and 80 percent of Japanese deposits are subject to rate controls. Foreign banks, which rely largely on funds purchased at market rates, have found it difficult to be competitive. Japan is a situation where a very guarded pace of deregulation makes it very difficult for foreign banks to compete.

There are other developed and developing countries where foreign bank restrictions exist. Several Latin American countries have significant limitations against entry or operations by foreign banks.

Moving on to the good news, a number of countries have opened their markets to wider competition.

The biggest move toward open markets and freer competition for all types of financial services institutions was taken by England in October of this year.

October witnessed the arrival of the United Kingdom's "Big Bang" -- an apt catchphrase for a major change in the regulatory structure for that country's (and the world's) financial services industry.

Banks from any country in the free world can operate in England. They can offer a wider range of financial services. Previously, such products could only be obtained separately from investment bankers, securities brokers, market makers and commercial banks. The wide scope of the deregulatory effort will bring the "supermarket" flavor to the financial markets.

England's "Big Bang" should help demonstrate the benefits of a deregulated and diversified financial services industry. Hopefully, it will motivate some progress in this country, where Congress has been in deadlock over these issues since 1982. The British experience may provide other insights. It should help us in developing the appropriate supervisory approach as we go toward a worldwide competitive financial system. I think it will illustrate the essentiality of developing new, and more effective, safety surveillance and supervisory programs in a deregulated environment.

As airline deregulation has shown, free markets encourage competition and innovation, which in turn result in tremendous benefits for the consuming public. But deregulation of airlines also illustrates the need for reinforced "safety surveillance." Increased freedom of airline companies to fly where they like and charge what the market will bear, puts pressure on these competitors to increase risk by cutting safety spending. Supervision directed primarily toward safety surveillance will differ from the old compliance regulation, which emphasized the control of all prices and activities. Safety surveillance means an aggressive, case-by-case approach designed to control excessive risk-taking by the few who ignore safe operation and threaten the stability of the financial marketplace.

In conjunction with the Big Bang, the United Kingdom is changing its regulatory apparatus to emphasize surveillance for safety. Britain is not moving back into the environment of the Roaring Twenties, when banking entreprenuers were free to carry on their affairs as they saw fit. Instead, the United Kingdom intends to emphasize "safety surveillance" through self-regulation by specialized industry panels. Such an approach may be a useful guide for our own regulatory system as it meets the challenge and dangers of a more deregulated financial system.

Deregulation will challenge the regulators of the world's financial systems to develop ways to maintain a margin of safety in the new freer environment. And, because of the growing global interdependence of banking, cooperation among supervisors and consistency in approach will become increasingly beneficial. Lest I leave you with the wrong impression, I must emphasize that progress has been made toward international regulatory cooperation.

The effort began in 1974 with the creation of a standing committee of bank supervisors from the G10 countries and Switzerland. The FDIC joins the Federal Reserve and the Comptroller of the Currency in representing the U.S. This committee (often called the Cooke Committee after its Chairman, Peter Cooke of the Bank of England) meets regularly to coordinate surveillance over the international banking network.

One accomplishment of the Cooke Committee was to establish guidelines known as the "Basle Concordat" for dividing supervision responsibilities between host and home supervisory authorities.

The Concordat also encouraged cooperation between host and parent supervisory authorities, through the exchange of information and by authorizing bank inspections in the host country, by or on behalf of, the parent supervisors. Although more needs to be done, the "Basle Concordat" has done much to improve cooperation and coordination among supervisors. International Supervisory conferences and Cooke Committee meetings have put us on a first-name basis with supervisors in the industrialized nations. The closeness of relationships helps retain the confidentiality of sensitive information and enhances the informal communications network.

One area receiving considerable attention by the Cooke Committee has been development of a uniform standard for the level and quality of bank capital. Bank capital ratios declined on a worldwide basis over the 1960s and 1970s. After the LDC debt crisis surfaced a few years ago, the Committee looked for ways to prevent further capital erosion.

The committee has emphasized the advantages of a risk-based capital system; i.e. one where capital requirements are determined by assigning predetermined risk factors to different types of bank activity. A system of this kind is already the primary capital measurement device within many G10 countries.

In this country, capital standards are expressed solely in terms of capital-to-total-book-value assets, called a "gearing ratio" by those in the trade in other countries.

Several months ago, the FDIC, the Federal Reserve Board, and the OCC all advanced similar risk-based capital proposals for public comment. The three agencies are now close to developing a joint proposal which, with a little luck, will be ready for public comment shortly. A good example of the close cooperation between the Federal regulators which, hopefully, will move toward a more uniform standard worldwide.

Conclusion

In summary, The "One World" economy has arrived. Financial institutions are scrambling to meet its challenges and take advantage of its opportunties. Regulators are scrambling to keep up with the changes and, as usual, they're a little behind. International finance certainly confirms that we do live in "interesting times".