****

**Foreign banks can overcome hurdles to U.S. expansion.**

American Banker  |  Tuesday, May 10, 1994

By Isaac B. Lustgarten

Given the regulatory obstacles they face, foreign banks should begin to reexamine options for their entry or expansion into the United States.

The Federal Reserve investigates the nature and quality of bank regulation in the home countries of foreign banks seeking to establish certain U.S. offices. Foreign banks must demonstrate that they are subject to "comprehensive supervision" by home country authorities on a consolidated basis.

To avoid delay, a foreign bank should meet with its central bank to achieve a consensus about the scope of any explanation of regulation and supervision of the foreign bank.

Moreover, a foreign bank should review carefully any similar submission to the Federal Reserve by another bank from the same home country to ensure consistent and accurate description of consolidated supervision.

The Federal Reserve seems particularly concerned about privacy or secrecy laws in certain jurisdictions and about whether money laundering compliance procedures outside the United States and outside the home country meet the home country and the U.S. standards.

A foreign bank that can argue that its home country privacy or secrecy rules are comparable to the U.S. Right to Financial Privacy Act or that its money laundering compliance procedures are at least as stringent as a U.S. bank's would be in a stronger position.

Name Checks

Another potential barrier is the practice of "name checks," where the Federal Reserve investigates foreign banks seeking to expand their U.S. operations by asking several U.S. and foreign governmental agencies information about the reputation, competence, and integrity of a foreign bank and its management.

To speed the process, foreign banks should identify potential problems and prepare a response prior to the start of a name check.

In addition, a foreign bank should plan strategically the submission of its applications so that the name check is not permitted to expire.

Collecting Data

By becoming known to U.S. bank regulators and ensuring that the proposed transaction does not represent a "major expansion" a foreign bank may be able to avoid a name check.

Every foreign bank with U.S. operations must submit annually to the Federal Reserve a report regarding its U.S. investments, activities, and operattions. For several reasons, foreign banks often submit late and incomplete reports, and the Federal Reserve has threatened to impose fines on such foreign banks.

First, collecting data about a foreign bank's empire which extends around the world and to various industry sectors each with different accounting principles, financial reporting standards, and practices, can be extraordinarily time-consuming and can lead to significant problems.

Moreover, a foreign bank which meets the Federal Reserve's definition of control by owning 25% of the voting shares of a foreign company may have difficulty in persuading that foreign company that the foreign bank is entitled to information about all its U.S. activities, interests and operations.

Increasingly, foreign banks are plagued by the Federal Reserve's discovery that a foreign bank has indirectly (and often inadvertently) acquired a company with U.S. operations.

Here again, even foreign investments of a foreign bank should be reviewed for their U.S. connections through the monitoring system used for the form.

If a problem does arise, and the investment must be made quickly or has already occurred, the foreign bank should apply to the Federal Reserve for an exemption (usually a temporary one) which is usually granted on condition that the activities be divested or "regularized" through an application.

The advantage is that the foreign bank is given additional time to resolve a problem and may be able to prevent suspension of its other applications.

Compliance Program

A comparison of foreign banks' forms is instructive. Several banks that share an interest in a foreign company with U.S. operations (1) may not report the investment at all, (2) may report the authority for the investment inconsistently, and (3) may feel that the burden imposed on them is different.

A foreign bank can satisfy the Federal Reserve standards by using its "best efforts" to obtain the necessary information and by explaining its efforts and the results to the Federal Reserve.

The best way to ensure compliance and the timely and accurate submission of the information required is to implement a compliance program with easily prepared short forms eliciting the required information.

Such a compliance program should include memoranda instructing the bank's various offices, consolidated subsidiaries, and companies in which the bank owns 25% of any class of voting stock to obtain prior approval from head office for all participations or for all (changes in) participations of more than 5 percent in a U.S. corporation or a non-U.S. corporation engaged in business in the U.S.

Finally, when the Federal Reserve reconsiders the form this year, foreign banks should make clear to the Federal Reserve that:

\* Requiring the foreign bank to reflect only changes from the previous form relieves the Federal Reserve of an administrative burden fo reviewing a large document but requires the bank to collect and compare the same information as before.

\* Many foreign countries require the bank to report the amount of an investment, not the number of shares owned.

\* Particularly for passive investment vehicles and for permissible nonfinancial services investments in the United States, more information is not necessary to achieve U.S. regulatory objectives.

\* A "best efforts" standard should apply to the preparation of the form.

Small-Business Option

With the difficulties foreign banks face in making acquisitions, foreign banks should consider owning a small business investment company (SBIC) licensed by the Small Business Administration, which does not require Federal Reserve approval.

Generally, an SBIC may acquire, without Federal Reserve approval, up to 50% of the voting stock of small concerns and may be represented on the boards of these companies.

A business qualifies as a small concern if, together with its affiliates, its net worth does not exceed $6 million and does not have average after tax net income for the proceeding two years in excess of $2 million.

The SBA has proposed to increase the financial tests by increasing the net worth threshold to $18 million, and the net income threshold to $6 million. It is important, however, that an SBIC not be used to circumvent Federal Reserve policy even though the Federal Reserve's jurisdiction does not extend to an SBIC.

International Securities

The most expeditious procedure for a foreign bank to engage in a securities business in the United States is through a company which engages solely in international securities activities -- transactions for U.S. or non-U.S. persons in non-U.S. securities or for non-U.S. persons in U.S. or non-U.S. securities.

The Federal Reserve considers the U.S. activities of these companies to be incidental to their inherently international business.

The advantage is that the foreign bank only needs to submit a notice to the Federal Reserve after acquiring the shares of such a company.

No application or name check is required. Such a company's activities can always be changed, if appropriate Federal Reserve approval is obtained.

In addition, a foreign bank should consider that certain properly structured securities transactions with a U.S. connection when conducted from a non-U.S. office may be considered not to be an activity for U.S. bank regulatory purposes and therefore may not require a bank regulatory approval, although the U.S. securities laws may still apply.

Planning, not Fear

The U.S. regulatory environment poses a challenge to foreign banks seeking to expand their U.S. operations or enter the United States. Caution and strategic planning, not fear, are the best responses.

Through vehicles like an SBIC or an international securities subsidiary and proactive compliance steps, a foreign bank can expedite the processing of its applications and enter or expand its presence in the United States.

© 2009 American Banker and SourceMedia, Inc. All Rights Reserved.   
SourceMedia is an Investcorp company. Use, duplication, or sale of this service, or data contained herein, except as described in the Subscription Agreement, is strictly prohibited.

For information regarding Reprint Services please visit: <http://www.americanbanker.com/reprint-services-rates.html>