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NATIONAL TREATMENT STUDY

1986 UPDATE

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Department of the Treasury

National Treatment Study: Report to Congress on Foreign Government Treatment of U.S. Commercial Banking and Securities Organizations

1986 Update

THE SECRETARY OF THE TREASURY
WASHINGTON

December 18, 1986

Jake

Dear Mr. Chairman:

Pursuant to your request of March 25, 1986, I am pleased to submit this second Update to the September 1979 "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations." As agreed, the 1986 Update discusses the degree of national treatment afforded U.S. financial institutions in eighteen banking markets and eight securities markets.

For convenience, the Summary and Conclusions have been placed in the front of the Update. Progress continues to be made in reducing barriers to operations of U.S. financial institutions in foreign markets. The Administration will pursue its efforts to reduce and remove remaining obstacles to equality of competitive opportunity for our firms operating abroad. Continued U.S. Government attention is clearly warranted.

We would be pleased to answer any questions you may have on this Update.

Sincerely,

Jim

James A. Baker, III

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D. C. 20510

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Summary and Conclusions

National Treatment -- Equality of Competitive Opportunity

The International Banking Act of 1978 established a federal regulatory framework, based on the principle of national treatment, governing the entry and operations of foreign banks in the United States. National treatment accords foreign banks equality of competitive opportunity with domestic institutions in similar circumstances, even if some specific regulations or requirements applied to foreign banks differ from those affecting domestic banks.

In adopting the principle of national treatment for foreign banks in the United States, Congress also expressed concern about the competitive position of U.S. banks abroad. The "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations," mandated by Section 9 of the International Banking Act, was completed in September 1979. A July 1984 Update was produced at the request of Senator Jake Garn, Chairman of the U.S. Senate Committee on Banking, Housing and Urban Affairs.

This Update, also requested by Senator Garn, reviews the treatment of U.S. banks abroad and extends that review. In the banking field, attention is given to automated teller machines (ATMs). In addition, in response to Senator Garn's request that the study be broadened, the treatment accorded U.S. firms doing securities business in eight major foreign markets is for the first time examined.

Progress Reports

At the time of the 1984 Update, as in 1979, U.S. banks generally received substantial access to most foreign markets important to them, both in terms of initial entry and operations once entry had been accomplished, although significant restrictions existed. In the countries where national treatment problems remained, overall conditions had, in general, improved somewhat in the five years since the 1979 Report.

In the period between the 1979 National Treatment Study and the 1984 Update, foreign banks had more than doubled their presence in the United States. In the two years between then and this Update, the growth of foreign bank offices on U.S. soil has far outpaced the growth of U.S. bank offices abroad. U.S. banks continue to express interest in participating more actively in a number of countries whose international economic importance and financial sophistication have grown significantly in recent years.

In the seven years since the 1979 Report, U.S. financial institutions have experienced major changes in the environment in which they operate. Capital markets have become increasingly integrated. The technology available to financial firms doing business internationally has improved dramatically. Deregulation and liberalization that affect their business at home and abroad have advanced rapidly.

It was against this background that Senator Garn requested that this Update of the National Treatment Study reflect the importance of financial services in addition to banking, such as the securities industry, and recent developments in technology, including electronic funds transfer systems.

Markets Selected for Review

The 18 banking markets reviewed in this Update include all 16 markets included in the 1984 Update, plus Singapore and Argentina, in which interest was expressed by U.S. industry. The eight securities markets were chosen on the basis of their importance as financial centers.

Interagency Effort

As were the 1979 National Treatment Study and the 1984 Update, this Update is a cooperative effort of the Departments of Treasury and State, and, in their respective areas of responsibility, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency. With the extension of the study to treatment of U.S. firms in securities markets abroad, the staff of the Securities and Exchange Commission assisted in preparing this Update. The Treasury Office of the Assistant Secretary for International Affairs oversaw preparation of the Canada and Japan banking chapters and the eight securities chapters. The Office of the Comptroller of the Currency had primary responsibility for preparation of the other 16 banking chapters.

Basic information on laws, regulations, policies and practices affecting U.S. and other foreign bank entry and operations in the 18 foreign banking markets and the eight securities markets reviewed was supplied primarily by the respective U.S. embassies and the American Institute in Taiwan, with supportive information gathered from interested U.S. financial institutions and industry associations. Host countries, the Taiwan banking authorities, and domestic and foreign industry representatives were also invited to comment on drafts of the individual markets under review.

Findings

Overall, the degree of national treatment received by U.S. banks abroad has somewhat improved since the 1984 Update. Over the eight years subsequent to passage of the International Banking Act, the record reflects sporadic and slow improvement in treatment. A review of trends in major financial markets also shows improved treatment of U.S. financial institutions doing securities business abroad, despite the existence of reciprocity requirements in a number of countries.

The relative nature of these changes as improvements over the prior situation must be emphasized. Significant improvements in a particular market do not necessarily mean that national treatment has been approached or achieved -- substantial areas of discrimination may still remain. Even though the degree of national treatment currently accorded foreign firms in a given market has improved, it may still be less than that accorded in another market which reflects no improvement in an only moderately restrictive climate. Furthermore, it must be recognized that some markets abroad, despite restrictions on additional foreign entry, may have a meaningful foreign presence resulting from more open policies in prior years.

While, as just indicated, a review of trends has been included in the securities market chapters of this Update, the focus of attention is on establishing a benchmark against which to measure future progress in achieving national treatment for U.S. firms doing securities business abroad. Most of the securities markets studied are found to be quite open to entry by U.S. firms, and in most instances the financial authorities seek to accord national treatment to U.S. and other foreign firms once they are established in their markets.

The conclusions of this report concerning national treatment in the securities area should for several reasons be read separately from those concerning banking. One reason is that the objectives of the assessments differ -- the former focus on the degree of access, while the latter evaluate short term changes in access. Second, there are fundamental differences in the approaches of regulatory authorities toward banking and securities activities, with attitudes toward banking activities often reflecting an emphasis on the fiduciary responsibilities of banks. Finally, the banking chapters of this report examine conditions in a range of countries in varying stages of development, while the securities chapters treat sophisticated markets in industrialized nations. For all these reasons, comparisons of conclusions concerning banking and securities should be approached with caution.

Banking

Four developed countries studied in the 1984 Update have taken significant steps to open their markets to foreign banks. Although foreign banks still find the Japanese market difficult to penetrate, Japan has continued to provide national treatment for foreign banks, and to implement a policy of gradually liberalizing domestic financial markets and internationalizing the yen. The Australian authorities offered full banking licenses to 16 foreign banks (including five U.S. banks) in February 1985. However, an unwillingness to grant additional full banking licenses limits other foreign banks from equal opportunity to compete in Australia. The Norwegian authorities allowed three U.S. and six other foreign banks to establish commercial banking subsidiaries in 1985 and 1986, but foreign banks still may neither branch nor offer all of the same other financial services as indigenous banks. Sweden opened its financial markets to foreign banks for the first time in 1986. Foreign banks may enter as subsidiaries, but not as branches or through acquisition of a domestic bank. Twelve foreign banks, including two U.S. banks, have established subsidiaries. Remaining questions, such as lending limits, will affect the opportunities for foreign banks to compete in Sweden.

Two newly industrializing markets, Korea and Taiwan, have taken steps to liberalize their banking sectors, although important obstacles to foreign banks remain. In Korea, foreign banks may only enter as branches, are restricted to two branches, and face limitations on funding, investment and collateral. In Taiwan, while several operational restrictions were removed, foreign banks have been limited to one branch, prevented from funding themselves competitively, and prohibited from engaging in the securities business as indigenous banks can. Proposals approved in mid-October 1986 should allow foreign banks to open a second branch and reduce the restrictions on their access to local funds.

Countries evidencing generally no improvement since 1984 in conditions for foreign banks were Argentina, Brazil, Canada, Finland, Mexico, the Philippines, Singapore, Spain, Thailand and Venezuela. Indian authorities granted entry to some foreign banks, but generally only from countries presently not represented in India (U.S. banks are currently represented in India). Foreign bank treatment in Portugal has deteriorated subsequent to the 1984 opening of its market to limited foreign entry.

Securities

U.S. firms doing securities business generally have available the conventional avenues for entering the major markets studied. In the key Canadian market of Ontario, entry by foreign firms into the full-services markets has been restricted since the early 1970s; however, the province announced in December 1986 its intent to expand substantially the possibilities of foreign entry. Entry by means of acquisition is questionable in the cases of Japan and France, and the United Kingdom (and perhaps others) might resist takeover of a major indigenous financial institution.

Most of the countries studied usually seek to provide national treatment to foreign, including U.S., firms established in their markets. Canada, particularly the province of Ontario, has been a major exception, but the policy of the province appears to have changed with the December announcement.

Membership on stock exchanges is restricted by one means or another in Canada (where the situation is expected to change), Japan, France, Italy and Switzerland. Opportunities for foreign firms to lead manage securities issues have increased but are in several instances subject to reciprocity considerations.

In a number of cases the ability of U.S. firms to do securities business is constrained by factors that are not normally encompassed in national treatment concepts but nevertheless cannot be ignored. Exchange controls have, for example, long weighed heavily on the operations of foreign firms which tend to specialize in international transactions. Attitudes toward the introduction into national markets of new products have more recently come to assume particular importance.

SYNOPSIS OF NATIONAL TREATMENT DEVELOPMENTS SINCE 1984

Banking

Canada: No improvement. There have been no significant changes in legislation affecting foreign banks since the 1984 Update. Foreign banks cannot enter Canada as branches. Restrictions on the capitalization of individual foreign banks, limits on offshore funding, application of prudential lending limits, and recommended lending to particular borrowers, in combination limit the opportunities of foreign banks to compete fully in the Canadian market. Legislation is expected in 1987 that will involve major financial regulatory reform for domestic and possibly foreign banks. Also, the Canadian authorities have indicated a willingness to negotiate trade in financial services issues bilaterally. Foreign bank ATMs have experienced no limitations of a discriminatory nature.

Japan: Continued improvement. Japan has continued to provide national treatment for foreign banks and to implement a policy of internationalizing the yen and gradually liberalizing domestic financial markets. Several measures implemented have provided new or significantly expanded competitive opportunities for foreign banks. Among the most important have been permission for selected foreign banks to enter the trust banking business, greatly expanded freedom for residents to engage in foreign exchange activities, authorization for foreign banks to deal in Japanese public securities, and the creation of new Euroyen instruments. Yet foreign commercial banks continue to find Japanese markets difficult to penetrate. The segmented financial structure reviewed in earlier reports remains essentially in place, with the attendant limitations on foreign banks expanding into areas that are the preserve of special classes of banking institutions. The share of bank deposits affected by interest rate decontrol had risen 9.8 percentage points over two years to 19.6 percent in September 1986. Improvements have been made in money markets, but long-standing problems remain for foreign banks to fund themselves in domestic yen. No national treatment issues have arisen with regard to ATMs.

Argentina: No change. Legally, foreign banks are not prohibited from entry or expansion; in practice, the authorities only very rarely approve such requests. Amidst ongoing consolidation of the financial system and government actions to limit inflation and credit expansion, foreign banks are constrained by regulations favoring domestic public sector banks and nonbank financial institutions, and have lost market share. Foreign banks are effectively prevented from expanding their ATM services beyond their existing branch networks.

Australia: Significant improvement. From a posture of prohibiting full-service commercial bank entry by foreign interests, the authorities acted in February 1985 to offer full banking licenses to 16 foreign banks, of which five were U.S. banks. These licenses carry essentially the same operating privileges as Australian banks. Further entry of full-service foreign owned banks appears doubtful. Australia's unwillingness to grant additional full banking licenses limits other foreign banks from having the same opportunities to compete. Other foreign banks may obtain more limited licenses. U.S. banks may operate ATMs and join ATM networks.

Brazil: No improvement. Essentially the same tight restrictions which existed in 1984 on entry and expansion by foreign banks still exist today. U.S. banks cannot enter de novo by new branches or new commercial banking subsidiaries. U.S. banks have been permitted to purchase minority interests in nonbank financial institutions. Foreign commercial banks already established in Brazil (of which three are U.S. banks) are denied permission to expand by merger or acquisition, and branching is restricted.

Although Brazilian banks may operate ATM networks or join those established by others, foreign banks may only join networks established by Brazilian banks.

Finland: No change. Treatment of U.S. banks in Finland has not significantly changed since 1984. Foreign banks have since 1980 been permitted to establish commercial banking subsidiaries, but interest rate controls on deposits and loans have made it difficult to compete for retail customers by price competition. The two U.S. bank subsidiaries operating in Finland experienced a decline in total assets during 1985. Because interest rate controls have inhibited foreign banks from developing retail customers, no foreign bank subsidiaries are operating ATMs.

India: Minor improvement for entry by foreign banks generally, but not for U.S. banks. Foreign banks remain restricted in operations and branching, subject to discriminatory tax treatment, and are unable to obtain deposits of Indian Government agencies and public enterprises. They are, however, exempt from credit allocation requirements. Indian authorities continue to be more receptive to entry by foreign banks, but generally only from countries presently not represented in India. This policy is likely to limit new entry and expansion of U.S. banks in India. ATMs have not yet been introduced in India.

Korea: Significant improvement. The Korean authorities have largely held to their schedule of liberalizing measures announced in April 1984. The scheduled measures and others beyond the schedule reduced a significant number of restrictions on foreign banks. Important restrictions remain: foreign banks may only enter as branches, are restricted to two branches, and face funding, investment, and collateral limitations. Progress toward greater national treatment for foreign banks has not been matched by progress in liberalizing the financial sector, a key factor if national treatment is to be meaningful. Most Korean banks operate ATMs; foreign banks do not because each ATM would count as a branch. There are no ATM networks.

Mexico: No improvement. Mexico is closed to foreign bank entry. Barriers to entry in existence since the 1930s ostensibly protect the development and operation of Mexican banks. The protectionist orientation of banking policy was reinforced by nationalization of the Mexican banking industry in 1982. Mexican policy in relation to foreign banks is unchanged since the 1984 report. One U.S. bank, in Mexico for fifty years, continues to operate under greatly restricted conditions. Mexican banks operate ATMs and expect to widen this service in the future.

Norway: Significant improvement. Previously opposed to foreign bank entry, the Norwegian authorities have allowed three U.S. and six other foreign banks to establish commercial banking subsidiaries. However, foreign bank subsidiaries face discriminatory treatment in important areas: they may neither branch nor offer all other financial services as may domestic banks. Norway has recently approved a U.S. bank's application to enter the securities business. Government policy toward additional foreign bank entry is uncertain. Because branching restrictions inhibit foreign bank subsidiaries from developing retail market customers, no foreign banks have sought entry into Norway's highly developed electronic banking environment.

The Philippines: No change. The establishment of new foreign bank branches in the Philippines has been prohibited since 1948. Two U.S. and two other foreign banks which operated branches prior to 1948 have been allowed to remain and hold 15 percent of the market, but may not branch further nor obtain expanded powers as domestic banks may. Foreign banks may undertake minority investments in indigenous financial institutions, and may establish offshore banking units. Like domestic banks, the foreign bank branches may operate only on-premises ATMs. Officials of the new government have expressed desires for increased foreign investment, but have not indicated whether this desire will translate into expanded opportunities for foreign banks.

Portugal: New entry permitted, but operating conditions have subsequently deteriorated. Since Portugal opened its doors in principle to new foreign bank entry in 1984, the authorities have granted entry to six foreign banks but have slowed the development of their competitive opportunities. Foreign banks enjoy only slightly less than equal competitive opportunities relative to new private banks, but are more severely discriminated against relative to the nationalized banks which dominate the financial system. Foreign banks face branching restrictions, credit ceilings, and heavy minimum capital requirements, and believe the recent, more restrictive attitude of the Portuguese authorities to be a change of the ground rules under which foreign banks expected to operate. Branching restrictions inhibit foreign banks from developing ATM services.

Singapore: Overall, no change. Singapore continues generally to restrict entry and operations in its domestic market by foreign banks, whose market share has been declining slowly and now stands at about 40 percent of domestic deposits (including interbank deposits). Singapore continues to promote the expansion of its offshore banking market, which is about four times the size of the domestic market. Foreign banks may not branch in Singapore and, depending on the type of license held, are subject to a variety of other restrictions inhibiting their ability to compete for domestic banking business. Singapore has a highly developed electronic banking environment, but foreign banks have generally been limited in their ability to offer competitive services.

Spain: No change. The clearly defined, moderately restrictive law of 1978 remains in effect. Although foreign banks have continued to gradually build market share in Spain, they remain limited to three branches, restricted in funding themselves from Spanish customers, and limited to investing in businesses related to banking. Branching restrictions inhibit foreign banks from developing ATM services.

Sweden: Significant improvement. Sweden opened its financial markets to foreign banks for the first time in 1986. Foreign banks may enter as subsidiaries, but not as branches or as acquirers of existing indigenous banks. Twelve foreign banks, including two from the United States, have established subsidiaries. These subsidiaries appear to enjoy generally equal treatment in law relative to other Swedish banks, and the Swedish banking system has been flexible in dealing with a myriad of new questions. However, the resolution of remaining questions, including lending limits, will have an impact on the opportunities of foreign banks to compete. Indigenous banks appear to be delaying foreign banks' access to the two existing ATM networks.

Thailand: No significant change. Overall, the treatment of foreign banks in Thailand has not significantly changed since 1984. Minor improvements in entry opportunities have occurred, but there has been minor deterioration in operating conditions. Foreign banks are still limited to only one office, and may neither join a Thai ATM network nor start their own. Continued viability of some foreign bank operations in Thailand is under question given the small domestic market niche to which foreign banks are confined. It is uncertain whether the authorities, in view of the difficulties faced by some Thai financial institutions, will permit greater future foreign bank participation in the Thai financial system.

Venezuela: No improvement. Since the early 1970s Venezuela has prohibited foreign banks from establishing subsidiaries, purchasing equity in existing Venezuelan banks, or extending branch networks. Existing foreign bank branches are subject to severe operating constraints which affect costs, earnings, and market share. ATMs were introduced in Venezuela four years ago but their use is still very limited.

Taiwan: Some improvement. Foreign banks operating in Taiwan still do so under serious competitive disadvantages relative to indigenous banks. The authorities have granted foreign banks some useful operating freedoms during the past two years, including removal of deposit ceilings and some foreign exchange operations restrictions, doubling of the guaranteed commercial paper limit, access to short-term lending from the central bank, and permission to lend to individuals and to commercial real estate projects. However, major obstacles to national treatment persist. Foreign banks have been restricted to one branch, cannot establish subsidiaries or invest in local banks, have been prevented from funding themselves competitively, face a variety of operating limits, and are shut out of the securities business. Proposals approved in mid-October 1986 should enable foreign banks to open a second branch and should reduce the restrictions on their ability to raise funds locally. Branching restrictions inhibit foreign banks from developing ATM networks.

Securities

Canada: Province of Ontario currently prohibits new entry by foreign firms into full-service securities business; opening to foreign firms announced and equality of competitive opportunity is expected to follow. Canadian securities markets are regulated primarily at the provincial level, with the Ontario and Quebec markets being dominant. While Quebec allows foreign firms to enter and operate in its market on the same terms and conditions as Canadian firms, in Ontario, the more important financial center, new foreign firms have been prohibited from entering the full-service market either as branches or subsidiaries or by means of acquisition. In December 1986, the Province of Ontario announced that by mid-1988 nonresidents would be permitted to acquire domestic securities dealers or to establish subsidiaries (but not branches) in Canada that can register and carry on business without capital limitations or restrictions on their activities. The ability of foreign bank subsidiaries to engage in the expanded activities is to be resolved by Federal action and is unclear at this time. Capital and market restrictions on four U.S. firms grandfathered when foreign ownership restrictions were imposed by Ontario in 1971 are to be lifted in mid-1987. In order to participate in the "exempt" market (certain transactions and types of securities have been exempt from registration requirements in Ontario and thus from foreign ownership restrictions), foreign as well as Canadian firms will be required to register as subsidiaries in Ontario.

Japan: Entry generally possible and national treatment policy followed; progress made toward full equality of competitive opportunity. In recent years, the Japanese authorities have taken a number of important steps to liberalize the treatment of U.S. financial institutions doing securities business in Japan. The Tokyo Stock Exchange has permitted some foreign firms including four U.S. firms to become members, trust banking has been opened up to nine foreign banks, and the Ministry of Finance has indicated its intention to consider applications by foreign securities firms to establish subsidiaries in Japan (branches were previously permitted). Efforts are continuing to clarify the possibility of entry by means of acquisitions. The Japanese financial authorities seek to provide national treatment for foreign firms established in Japan, and in recent years progress has been made toward this goal. Efforts will continue to achieve full equality of competitive opportunity, for example, by securing further expansion of foreign membership on the Tokyo Stock Exchange and achieving more equitable allocations for foreign firms participating in the government bond underwriting syndicate. Many U.S. firms believe developments not normally encompassed in the definition of national treatment such as willingness to allow introduction into Japan of innovative new products are key to their ability to compete successfully in the Japanese securities market.

<u>France:</u> <u>Entry generally possible and national treatment usually accorded; the market is becoming more competitive but exchange controls present difficulties</u>. U.S. firms may enter the French securities markets as branches or subsidiaries but entry by means of acquisition is subject to close control and may not be possible. Membership on the Paris Stock Exchange is prohibited for non-EC nationals, and obstacles remain to foreign firms' underwriting securities issues. National treatment is accorded in most other respects. The French authorities are moving in directions that provide a more favorable environment for foreign-owned firms doing securities business in France, although exchange controls still present difficulties.

<u>Germany:</u> <u>Entry is not restricted and, with the elimination of some remaining restrictions, national treatment is granted; practical market penetration difficulties remain</u>. U.S. banks as well as securities companies may enter the German markets through all the conventional avenues. The German commitment to liberalization has resulted in the elimination of some remaining restrictions and an equitable regulatory environment for U.S. firms. In considering foreign lead management of DM bond issues, reciprocity may be taken into account. Market penetration is difficult for U.S. firms primarily because of institutional characteristics of the universal banking system and the competitive disadvantages of newcomers.

<u>Italy:</u> <u>Exchange controls limit the attractiveness of a market characterized by an open regulatory framework</u>. Exchange controls make the market of limited interest to U.S. firms, but the market is quite open to U.S. firms and national treatment is generally given to established foreign firms. Execution of trades on securities exchanges is reserved to stockbrokers, which U.S. firms cannot be. The financial authorities are considering regulation of new intermediaries and actions to safeguard investors.

The Netherlands: Recent elimination of barriers to operations of U.S. firms has increased the attractiveness of this market. This market is quite open to U.S. firms. Established firms generally receive national treatment, although lead management of guilder-denominated bonds, to the extent it is possible, may be subject to a reciprocity requirement. Recent actions by the authorities have made the market more open and attractive.

Switzerland: Despite some restraints, U.S. firms are able to enter and generally receive national treatment. U.S. firms have long had considerable scope to enter the Swiss market and to undertake important securities business in Switzerland, and recent actions have increased opportunities. Entry in various forms is possible, and once established foreign securities firms generally receive national treatment. Personal licenses to trade on the floor of the Zurich Stock Exchange are not available to foreign nationals.

United Kingdom: A major reform promises to open up new opportunities for U.S. firms in a market in which they are already active. As this report was completed, a major reform of financial markets was being implemented in the U.K., with mostly favorable implications for U.S. firms. This reform also permits the U.K. authorities to take reciprocity into account in determining their treatment of foreign financial institutions in the U.K. Entry in various forms by U.S. firms is generally possible, although it is questionable whether the authorities would permit a foreign takeover of one of their largest banks. Once established, U.S. firms with limited exceptions receive national treatment.

Preface

Origins of this Update

This Update results from a letter dated March 25, 1986 from the Honorable Jake Garn, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, to the Honorable James A. Baker, III, Secretary of the Treasury, asking that the Secretary provide the Senate Committee an "updated National Treatment Report as soon as possible." Senator Garn's letter indicated that since the Treasury's 1984 national treatment update, new developments had taken place in electronic funds transfer systems (EFTS) and that exports of new technologies should play a part in U.S. efforts to reduce its balance of payments deficits. The Senator also noted that recent events had highlighted the fact that the national treatment issue is broader than just commercial banking. He therefore asked that this updated report on national treatment give special attention to the EFTS issue and be broadened to cover other segments of the financial services industry.

Secretary Baker responded to Chairman Garn on April 29, 1986. Citing the very real budgetary constraints facing government agencies, the Secretary indicated that it would be essential that the scope of the work be as limited and precise as possible, concentrating efforts on problem areas that have genuine significance for the overseas operations of the U.S. banking and financial community. Secretary Baker asked the Office of the Comptroller of the Currency (OCC) to take responsibility for the preparation of the Study as it pertains to banking, including electronic funds transfers through automated teller machines. The Treasury Office of the Assistant Secretary for International Affairs (OASIA) assumed primary responsibility for work on securities markets.

OASIA and OCC sought the views of the U.S. banking and securities industries, specifically asking where there were problem areas of genuine significance in their overseas operations. Taking account of the responses received, it was decided that this Update would examine the extent of, and progress made in granting, national treatment to U.S. banks in the 16 markets that were included in the 1984 Update. These are Australia, Brazil, Canada, Finland, India, Japan, Republic of Korea, Mexico, Norway, the Philippines, Portugal, Spain, Sweden, Thailand, Venezuela and Taiwan. Because of the considerable interest expressed, two countries, Argentina and Singapore, were added.

This is the first National Treatment Study report to include an assessment of securities markets. At a September 26, 1984 hearing on the 1984 National Treatment Study Update held by the

Senate Committee on Banking, Housing and Urban Affairs, Chairman Garn noted the internationalization of markets for a wide variety of financial services and suggested that the next Update should cover foreign government treatment of all U.S. financial service organizations, not just banks.

Treasury General Counsel Peter Wallison, who appeared before the Committee along with Secretary Regan, pointed to work on securities activities then being started by the Committee on Financial Markets of the Organization for Economic Cooperation and Development (OECD) in Paris and suggested that, in order to maximize resources, the Treasury wanted to utilize and work with the OECD countries and the OECD Secretariat to the extent possible. Since then, a major OECD Study on International Trade in Services: Securities has been underway and is currently nearing completion. This is a companion to the earlier OECD Report on International Trade in Services: Banking mentioned in the 1984 Update. This Update utilizes expertise gained in preparing the OECD studies.

Following consultations with the U.S. financial community concerning the countries to be included in the securities section of this report, it was decided that this part of the study would examine the extent to which national treatment was afforded U.S. financial firms in major foreign securities markets: Canada, France, The Federal Republic of Germany, Italy, Japan, the Netherlands, Switzerland and the United Kingdom.

Earlier National Treatment Studies

This Update should be viewed as a companion volume to the 1979 National Treatment Study and the 1984 Update. The general conclusions and individual country assessments of these three works provide an analytical framework to measure progress made in achieving national treatment in banking, both globally and in individual markets. The additional analysis of securities markets in the 1986 Update serves to provide a benchmark by which to measure future liberalization.

The 1979 Report, commonly referred to as the National Treatment Study, was mandated by Section 9 of the International Banking Act of 1978, which required the Secretary of the Treasury, in conjunction with the Department of State, the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, to conduct a study of the extent to which U.S. banks were granted or denied, whether by law or practice, national treatment in conducting banking operations abroad. The 1979 Report reviewed the degree of national treatment accorded U.S. banks in over 140 foreign banking markets, including in-depth analyses for 21 individual and six groups of countries.

The 1984 Update responded to a request by Senator Garn to then-Secretary Regan for an update of the 1979 Report. Secretary Regan and Senator Garn agreed that the 1984 Update would be limited to a study of the 16 markets cited above where U.S. banks desired an active presence but where national treatment was denied (to varying degrees) in 1979.

Organization of this Update

The summary and conclusions have been placed at the front of this volume for the convenience of the reader. They include a synopsis of national treatment developments since 1984 for the 18 banking markets reviewed. The summary and conclusions for the eight securities markets studied attempt to assess the treatment currently afforded U.S. financial institutions and recent trends in these markets toward liberalization and foreign participation.

Chapter 1 discusses the application of the policy of national treatment in the United States in the banking and securities areas. In addition to the bank regulatory agencies, the staff of the Securities and Exchange Commission cooperated in the preparation of this material.

The next four chapters of this Update, Chapters 2 through 5, are devoted to the two countries, Canada and Japan, whose banking and securities markets are both reviewed. Chapters 6 through 21 offer a national treatment review for each of the 16 other banking markets chosen for this Update. Attention is devoted to changes in treatment since 1984, as well as to the current degree of equality of competitive opportunity accorded foreign banks.

Each banking chapter in this Update consists of two main sections: "Summary Assessment" and "National Treatment Review."

The "Summary Assessment" briefly reviews present entry and operating restrictions, notes significant national treatment developments since 1984, and provides information regarding U.S. bank presence in the particular market (including automated teller machines -- ATMs) and the presence of banks from that market in the United States.

The "National Treatment Review" has four subparts:

- "Summary of 1984 Report" provides a brief synopsis of the degree of national treatment accorded U.S. and other foreign banks as reported in 1984;
- "Domestic Banking System" summarizes the salient features of the organization and structure of the domestic banking system, including ATMs;

- "Key Developments Since 1984" lists significant changes in national laws, regulations, or practices which have either directly or indirectly affected the degree of national treatment and equality of competive opportunity accorded U.S. and other foreign banks; and

- "Treatment of U.S. and Other Foreign Banks" provides a more detailed review of current entry and operating restrictions faced by foreign banks, as well as information concerning prospective changes.

The review of national treatment accorded U.S. financial institutions doing securities business in the eight markets studied, follows a similar, but slightly different, format.

As in the banking chapters, each securities chapter begins with a "Summary Assessment" designed to identify key entry and operating restrictions in the market in question. This section, however, (like the body of the assessment) describes the general trend of policy actions in the securities area, rather than focusing on developments since 1984.

The "National Treatment Review" sections of the securities chapters are not uniform. The importance of the Canadian and Japanese securities markets called for a more comprehensive approach paralleling that of the 1979 study in the banking area. For the other six countries reviewed in this Update, the focus is primarily on national treatment questions, with only such additional background as was considered necessary to permit balanced judgments concerning the treatment of U.S. financial institutions.

Appendix I contains copies of the correspondence leading to the preparation of this Update.

Appendix II presents a summary of the results of a survey by the Bankers' Association for Foreign Trade of its membership concerning their recommendations regarding the most important countries to include in the banking portion of this Update.

Appendix III acknowledges the contributions of the many people whose efforts were necessary to produce this Update.

Commitment to National Treatment: Equality of Competitive Opportunity

The United States has historically been a strong advocate of national treatment of foreign investment and the free international movement of goods, services, and capital. National treatment, defined as equality of competitive opportunity, when implemented worldwide offers the best hope of achieving global economic efficiency and prosperity.

On September 9, 1983, President Reagan, in a statement on international investment, affirmed continuing U.S. support for the policy of national treatment:

> "The basic tenet for treatment of investment is the national treatment principle: foreign investors should be treated no less favorably than domestic investors in like situations."

As discussed in the 1984 Update, concerns arise when a country keeps its borders open to foreign competition while others refuse to do likewise. The International Banking Act of 1978 explicitly adopted the principle of national treatment for foreign banks operating in the United States, from a conviction both that foreign bank competition is healthy for the U.S. financial system and that those nations not previously extending national treatment would recognize the benefits of foreign competition and work toward ending discrimination against U.S. bank operations abroad. However, if efforts to obtain national treatment fail to secure continued liberalization, the Administration will not hesitate to take vigorous action to promote or protect U.S. interests.

The Administration continues to believe that national treatment, accompanied by strong efforts to get others to follow suit, is the best policy. This Update provides background for assessing the effectiveness of this policy.

<u>Reciprocity vs. Equality of Competitive Opportunity</u>

Reciprocity usually implies efforts to assure a precise balancing of the treatment partner trading countries accord each other. There is, in many countries, an apparent tendency towards selective reciprocity, not rigidly applied, but rather subject to varying degrees of administrative discretion. These elements include recently introduced legislation in the U.K. providing for retroactive reciprocity. Such provisions are often adopted to influence other countries to liberalize their rules in favor of firms from the country adopting such policies.

The OECD 1984 Report on <u>International Trade in Services: Banking</u> indicated that of the 24 OECD member countries, 11 took account of reciprocity in the banking area, although some of these provisions applied only to banks from non-European Community countries. Four of the OECD countries surveyed did not permit any foreign bank establishment at all. The OECD noted that some of the individual U.S. states applied reciprocity provisions with regard to the entry of foreign banks. Since that time, two of the countries identified in the report as not allowing any foreign bank entry, Australia and Sweden, have amended their laws, and an amendment is proposed in New Zealand to permit foreign bank entry. In the United States, New York State has amended its reciprocity requirements.

Of the eighteen markets surveyed in the current banking Update, ten take reciprocity into account in some decisions. Of the eight countries in the securities chapters, six have some form of reciprocity provisions or requirements.

Congress, in the International Banking Act of 1978, established a federal regulatory framework based upon the national treatment principle to govern entry and operations of foreign banks in the United States. Since then, the Treasury Department has opposed initiatives aiming at strictly applied or "mirror image" reciprocity. In discussing a bill introduced by Senator Garn that would have required the Comptroller of the Currency to consider reciprocity when acting on foreign banks' applications to establish branches or agencies in the U.S., Secretary Regan, in testimony before the Senate Committee on Banking, Housing and Urban Affairs, in September 1984, said:

> "The proposed reciprocity legislation would require the Comptroller of the Currency to take into account' whether or not United States banks are permitted to conduct business in the home country of the applicant' when acting on any application to establish a Federal branch or agency. It does not require strict reciprocity. Strict reciprocity would mean that countries which limit U.S. bank presence to subsidiaries would be limited to subsidiaries here; or if U.S. banks were limited in the growth of their assets or deposits in specific countries, we would have to require similar practices in the U.S. on banks from those particular countries.
>
> "Such a policy would be nearly impossible to administer. Our markets are open. As a result, we benefit from competition and greater efficiency. There are over 550 foreign bank operating entities in the U.S. representing 250 different foreign bank families. Over 135 of these entities have U.S. assets of over $100 million. There are over 300 foreign representative offices in the U.S. All told, over 60 foreign countries are represented here. On the other side of the ledger, U.S. banks have 890 branches in 73 foreign countries.
>
> "Attempting to administer a policy of reciprocity would require a burgeoning regulatory bureaucracy and could lead to administrative chaos. If strictly applied, reciprocity would reduce U.S. policy to a lowest common denominator basis, remove flexibility, and work against building and developing the United States as a major international financial center."

A policy of strict reciprocity could also operate to the detriment of U.S. financial institutions operating abroad.

Specifically, difficulties could arise because of differences between national financial systems based on the principle of universal banking, in which banks engage in a broad range of securities activities, and systems that separate banking from many securities activities, as in the United States, Canada and Japan.

As noted in individual country chapters on securities, U.S. financial institutions generally receive national treatment in countries with universal banking systems. U.S. banks as well as securities companies are allowed to enter into the securities business. Because of the lack of parallelism in the activities that financial institutions from universal banking countries can conduct in the United States, U.S. financial institutions would be limited in their activities in universal banking countries should these countries follow a policy of strict reciprocity.

Reciprocity considerations are taken into account selectively in all the universal banking markets studied in the securities chapters. These provisions have to date not constrained the operations of U.S. financial institutions abroad. This may be explained in part by the fact that 17 foreign banks with securities affiliates were grandfathered under the International Banking Act of 1978, despite prohibitions in U.S. laws that bar U.S. banks from engaging in general corporate underwriting and certain other securities activities.

In his concluding remarks in the September 1984 testimony, Secretary Regan stated:

> "The Administration prefers to continue to pursue our policy of national treatment; it is a proven and pragmatic approach. The National Treatment Study 1984 Update shows that we have obtained meaningful results in our bilateral and multilateral efforts.
>
> "In many cases, we deal with major problems on a bilateral basis. We will continue our bilateral efforts in the future. Multilateral efforts such as those in the OECD are a useful supplement to help identify and understand the rationale for restrictions, to seek support from the international community for their removal, and to help prevent backsliding.
>
> "Should these efforts fail to provide a framework for continued progress, we will not hesitate to take vigorous actions to promote or protect our interests. I certainly would not close the door to other tactics or selective approaches. However, looking at the 1984 Update to the National Treatment Study, I conclude that national treatment currently remains

> the best policy for the U.S. This is true in terms of actively encouraging further liberalization in other countries, as well as of developing our own markets' efficiency. It maintains the international financial role of the U.S. while seeking better treatment for U.S. banks and financial firms overseas."

Since this testimony was given, the number of firms operating in the international markets has changed somewhat. As of year-end 1985, there were 625 foreign bank-operating entities in the United States representing 254 different foreign bank families. Of these, 387 entities have U.S. assets of $100 million or more. There were also 410 foreign representative offices in the U.S. as of October 7, 1986. In comparison, U.S. banks have 905 branches in 73 foreign countries.

Information reported to the Securities and Exchange Commission (SEC) indicates that at the end of 1985 there were 108 broker-dealers registered with the SEC that were affiliates or subsidiaries of foreign broker/dealers or banks. The latter included some U.S. broker-dealers with ownership interest in affiliates abroad. It is estimated that the number of broker/dealers with foreign parents is between 75 and 100.

It is estimated that there are approximately 35 foreign-owned members of the New York Stock Exchange (NYSE), including 12 Canadian and three Japanese-owned firms, among the total 624 member firms. Member firms on the NYSE include six firms owned by foreign banks whose securities operations were grandfathered by the IBA.

There is no precise estimate of how many U.S. securities firms have affiliates abroad. However, 54 U.S.-based members of the National Association of Securities Dealers (NASD) have 321 foreign offices located in 33 countries.

U.S. banks can participate in a wider scope of securities activities abroad than in the United States, including underwriting and dealing in U.S. corporate securities, although these activities are not unlimited. Sixteen U.S. banking families have 50 foreign subsidiaries engaged in securities activity abroad.

Opportunities for U.S. firms to participate in two of the major stock exchanges of the world have just begun to open up. In Tokyo, foreign securities firms were first permitted to purchase new seats created on the Tokyo Stock Exchange in December 1985. U.S. firms obtained four of the 10 new seats. The London Stock Exchange (LSE) opened this year to foreign membership, and a number of U.S. and foreign firms have applied. As of August 1986, one U.S. firm had been accepted. In addition, a number of U.S. banks have acquired ownership interests in London securities firms that are members of the LSE. Also, U.S. firms have increased minority shareholdings in LSE-member firms to 100 percent. On the principal stock exchange in Canada, the Toronto Securities Exchange, only three U.S. firms grandfathered when foreign ownership restrictions were imposed in 1971 are members.

National Treatment at the Sub-Federal Level

An issue raised in this Report, which arises in both foreign countries and the United States, is the role of political subdivisions in determining which foreign banking or securities firms will be admitted to do business. For example, the issue has arisen in the case of Canada, where the securities industry is regulated primarily by the provincial governments.

There are similar situations in banking in the United States, where individual states limit foreign participation to less than the treatment accorded by federal law. Generally, these rules also impact domestic banks headquartered in other states. For example, branching prohibitions in most cases apply equally to foreign banks and to out-of-state U.S. banks. However, the recent trend towards regional compacts among U.S. states has introduced elements of discrimination against foreign banks legitimately established in one of these states, which may not be allowed to do business in another state that is a member of the compact, although domestic banks would be able to do so.

This situation results from the dual banking system in the United States, where banks have the option of a state or federal charter, and states may to a large extent control their own banking structure. However, the adoption of an explicit policy of national treatment on the federal level has already had some impact on the state approach to foreign bank entry. More states now permit establishment of foreign bank offices, and New York State has abandoned its requirement of reciprocity. As a result of the adoption of the IBA, foreign banks may, through obtaining a federal license, enter through a branch any state that does not expressly bar foreign bank entry. A foreign bank also has the option to enter any one state by establishing a national bank. Hence foreign banks are not denied entry absolutely, but their form of entry depends on state law.

General Observations

The three National Treatment Studies on banking provide analysis of sixteen markets over seven years. This third Study supports an observation made in the 1984 Update that, although there continue to be exceptions, prospects for improved treatment of foreign institutions in a domestic economy generally increase as indigenous financial systems develop in their relative degree of financial sophistication and as domestic institutions seek to become more active internationally, especially with trading partners and geographic neighbors. It is thus not surprising that many of the largest industrialized countries generally had granted national treatment to U.S. and other foreign banks at the time of the 1979 Report, and it is not surprising that the major securities markets studied are relatively open to participation by foreign financial institutions.

Nevertheless, the Administration is concerned about the lack of progress toward liberalization in many less developed countries. In particular, heavily-indebted countries should have a genuine interest in encouraging foreign banks to establish branches or subsidiaries, in order to play a role in strengthening and broadening the domestic financial market framework. Entry by foreign banks, particularly into countries where little or no meaningful foreign bank presence exists, would help ensure that the banks see their self interest as more closely identified with the countries' own future.

Banking liberalization is linked to the U.S. Program for Sustained Growth, which is designed to address the debt problem with the concerted efforts of international financial institutions, commercial banks, and the debtor countries themselves, including their implementation of more market-oriented structural adjustment of their economies. In a statement April 9, 1986, Secretary Baker said:

> "A hospitable climate for both domestic and foreign banking institutions would improve the efficiency and resource mobilization capability of the local markets (in debtor countries)."

The willingness of the United States to take appropriate action to achieve more open competition in foreign markets has contributed to progress in achieving improvements in national treatment for U.S. banks and other financial institutions doing securities business abroad.

Both public and confidential U.S. Government efforts through bilateral and multilateral channels have contributed to the progress reported in this Update. The U.S. Government has conducted discussions bilaterally with Canada, Japan, South Korea, and the U.K., with the authorities in Taiwan through the appropriate instrumentalities, and with officials from other countries and in multilateral forums including the Organization for Economic Cooperation and Development and the International Monetary Fund, aimed at promoting greater liberalization and equality of competitive opportunity in both banking and securities markets. The results of the intensive discussions concluded in 1984 with the Japanese are detailed in the published Report of the Japanese Ministry of Finance-U.S. Treasury Working Group on Yen/Dollar Exchange Rate Issues. A status report on intervening developments is contained in this Update's chapter on Japan. Continued U.S. Government attention is warranted to assure future progress in achieving national treatment for U.S. banks and financial firms abroad.

The recommendations of the 1979 Report and 1984 Update thus appear generally valid today. Although written in terms of banks, the principles also apply to U.S. firms doing securities business overseas:

1. Since U.S. banks generally receive equitable treatment abroad, remedial efforts should be directed to areas in which U.S. banks do not receive national treatment and competitive equality. Where such efforts are necessary, departments and agencies of the U.S. Government should bring pressures to bear, as appropriate, for remedial action.

2. Because the principle of national treatment lays the best foundation for further growth of international banking and efficient capital markets, broad support for this principle should continue. The United States should use the many opportunities presented by formal and informal bilateral contacts and multilateral forums such as the OECD, in which broad investment issues are discussed, to encourage adherence to this principle, while recognizing that traditions, current policy concerns and financial structures vary widely across countries.

3. The Department of the Treasury, in collaboration with other U.S. Government agencies, should direct continuing review and maintenance of information concerning official policies, practices, and regulatory and legislative developments affecting operations of U.S. banks in foreign countries. This would enable the identification of important problems and determination of the need for remedial efforts. The Departments of State and Treasury should continue the implementation of these remedial efforts programs.

In some countries, significant progress and positive trends which benefit U.S. firms have been noted. In other countries, however, there has been a failure to remove restrictions, liberalize, make meaningful progress or show a genuine commitment to equality of competitive opportunity. Thus, the pattern of progress is not clear or uniform in all cases.

Comments

Because Chairman Garn indicated his desire to have current information within a short period of time, this Update has been limited by design to serve as background for further executive and legislative deliberations. As with the 1984 Update and any review of laws, regulations, official policy and practices, certain limitations of the information presented must be acknowledged.

One such limitation arises from the pace of change in banking and securities markets. Several markets under review were subject to legislative proposals or changing regulations that could affect national treatment. These ongoing developments, therefore, probably will result in future revisions of some of the information contained in this volume.

The chapters on Japan on banking and securities are based on ongoing negotiations between the U.S. Treasury and the Japanese Ministry of Finance. The chapters on Canada banking and securities precede anticipated discussions of key issues in the U.S.-Canada Free Trade talks.

Despite these limitations, it is hoped that this Update will increase understanding of current conditions under which U.S. banks and securities firms operate overseas, the major changes that have occurred, and the progress that has been made most recently and in the eight years since the International Banking Act of 1978 was enacted.

1. NATIONAL TREATMENT AND U.S. BANKING AND SECURITIES LAWS

Introduction

While there are exceptions, the prevailing policy of the United States has been to provide national treatment to foreign participants in the establishment and in the operation of financial service activities within the United States conducted under U.S. banking and securities laws. National treatment as extended in the banking and securities areas has generally provided foreign participants equality of competitive opportunity with domestic banks and nonbanks operating within the current separation in the United States of commercial banking from certain securities activities, principally involving corporate finance.

This chapter reviews evolution of the concept of national treatment to "equality of competitive opportunity" and then examines current treatment accorded to foreign participants under U.S. banking and securities laws. The discussion updates the status of national treatment for commercial banking at the state level and concentrates principally on a new discussion of national treatment as it is accorded to securities-related activities of banks and nonbanks. Included is a discussion of the criteria for primary dealers in the government securities market, regulation of securities activities at the state level, and issues for securities regulation that are arising from the internationalization of securities activities.

Discussion of national treatment as it is accorded to foreign participants in commercial banking in the United States is drawn principally from two previous studies, which covered aspects of this topic in greater detail. Chapters 1 through 7 of the 1979 "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations" should be consulted for expanded discussion of the International Banking Act of 1978 (IBA), concepts relating to restraints on foreign bank competition, entry restrictions, and operating restraints. Chapter 1 of the 1984 Update of the 1979 report summarized the concepts of national treatment and reciprocity from the earlier study and incorporated points to reflect intervening changes in the world's financial markets.

Evolution of the National Treatment Concept

The concept of national treatment is not new. It has been employed, for example, in many of this country's bilateral Friendship, Commerce and Navigation (FCN) treaties and in the 1976 multilateral OECD Declaration on International Investment. While the OECD Declaration covers the treatment of established enterprises, the FCN treaties are intended to facilitate establishment of enterprises from one country within the borders of another and to create a framework for mutually beneficial economic relations between the signatory states. Recently, the OECD's Code of Liberalization of Capital Movements was amended to provide for the right of establishment of foreign direct investment.

The FCN treaties typically define national treatment of a foreign enterprise as:

> "treatment accorded (to it) within the territories of a Party upon terms <u>no less favorable</u> than the treatment accorded therein, <u>in like situations</u>, to nationals, companies (or) products. . . . as the case may be, of such Party" (Emphasis added).

National treatment in this sense, as in the OECD instruments, is not necessarily the same as assuring equality of competitive opportunity, since the latter requires a more comprehensive analysis of regulatory effects, recognizing differences in the circumstances of domestic and foreign institutions. The national treatment concept of the IBA and practical application of federal securities laws have established a broad policy of national treatment in the United States in terms of equality of competitive opportunity.

NATIONAL TREATMENT UNDER U.S. BANKING LAW

The IBA has generally established a federal regulatory framework governing entry and operations of foreign banks that is nondiscriminatory in its treatment of domestic and foreign banks and affords foreign banks equality of competitive opportunity vis-a-vis domestic institutions in similar circumstances.

Application of a policy of national treatment, as embodied in the IBA, entails a pragmatic assessment of the overall legal and regulatory climate affecting foreign banks in a given country. The test is met if foreign banks are allowed to compete on essentially equal terms with domestic institutions in the host country, even if some specific regulations or requirements applied to foreign banks differ from those applicable to domestic banks.

Equality of competitive opportunity is a principle to be followed, not a numeric standard to be rigidly adhered to based upon the number of banks, offices, or assets of foreign versus domestic banks. Whether foreign banks, individually or as a group, are successful in taking advantage of competitive opportunities is not at issue.

The approach embodied in the IBA recognizes that rigid application of identical laws or regulations to both foreign and domestic banks may, in a particular set of circumstances, result in a disadvantage to one or the other. Equality of competitive opportunity may be lacking in some cases even though national treatment in a strict legal sense appears to be satisfied.

The IBA does not incorporate a policy of reciprocity of national treatment whereby the United States would allow entry and accord national treatment only to foreign banks from countries according U.S. banks entry and national treatment.

The IBA explicitly preserved national treatment and equality of competitive opportunity for foreign banks operating in the United States, not only from the conviction that foreign bank competition is healthy for the U.S. financial system, but also from the conviction that those nations not previously extending national treatment would recognize the benefits of foreign bank competition and end discrimination against U.S. banks operating abroad.

State Banking Law

Before passage of the IBA, the entry and operations of foreign bank branches and agencies in the United States were governed exclusively by state law. By providing for federal branches and agencies, the IBA gave foreign banks additional state/federal licensing options, which are an essential feature of the U.S. dual banking system. It, thereby, enhanced equality of competitive opportunity for foreign institutions.

Multistate branching and acquisitions by U.S. commercial banks are restricted by the McFadden Act and section 3(d) of the Bank Holding Company Act (the Douglas Amendment). Prior to the IBA, foreign banks had been able to establish branches and agencies in more than one state and had thus enjoyed a distinct competitive advantage over domestic banks. The IBA reduces that disparity but grants "grandfather" rights to previously established multistate operations of foreign banks.

The IBA also opened up some new competitive opportunities for foreign banks by ending the long-standing prohibition against foreign citizens serving as directors of national banks and by permitting foreign majority ownership of Edge Act Corporations, which are chartered by the Federal Reserve Board (the Board) for the purpose of engaging in international or foreign banking or other international or foreign financial operations. Congress also directed the Board to modify regulations applying to Edge Act facilities to make them a more flexible and attractive device for both domestic and foreign banks to provide international banking services in the United States. Regulations stemming from the IBA make it possible for foreign entities to establish a banking presence in states from which they were previously excluded entirely.

The IBA did not alter the fact that full-service foreign bank operations through branches were prohibited by law in many states of the United States, although states with major financial centers did permit foreign bank operations. (Even before the IBA most states did not restrict bank acquisitions by foreign banks.)

Moreover, several states have liberalized their laws since 1978 with respect to foreign bank entry. An example is Texas, which in 1978 was an exclusionary state. In 1985, Texas enacted legislation permitting foreign banks to establish agencies. In addition, Texas recently enacted legislation to allow out-of-state financial institutions, including foreign banks, to acquire a Texas bank or holding company, effective January 1, 1987. Another example is Delaware, which in 1986 passed a bill permitting foreign banks to open agencies in that state.

Regional Banking Compacts

Some states have entered into regional banking compacts that allow banking organizations from neighboring states to acquire banks in that state, but keep out all banks from states not included in the region. Some states also preclude acquisitions by foreign banks whose home state is in a neighboring regional state. Such denial of equality of competitive opportunity by states can undermine the federal policy of national treatment in such circumstances.

For example, Florida has enacted laws that permit a domestic bank holding company having the principal operations of its bank subsidiaries located in a state within the region to acquire a bank in Florida so long as reciprocity conditions are met. The same statutes, however, prohibit a bank holding company that is, or that is controlled by, a foreign bank, including one having its IBA home state in a state within the defined region, from acquiring a Florida bank. Other states, notably North Carolina, have removed such discriminatory provisions from their statutes.

Some states and the District of Columbia have enacted regional banking laws that, depending on interpretation of various provisions, would appear to discriminate against foreign banks by defining a "regional bank holding company" eligible for interstate expansion within the region as a bank holding company that holds a large proportion of its total deposits within the region. While the express purpose of these provisions is to prevent "leap frogging" by bank holding companies from outside of the region through the acquisition of a bank within the region, they would also have the effect of discriminating against bank holding companies that are, or that are controlled by, foreign banks having their IBA home states within the region, which in most cases have a majority of their deposits outside the United States. These kinds of provisions, of course, also discriminate against U.S.-controlled bank holding companies from outside the region.

Nonbanking Activities of Foreign Banking Organizations

The IBA generally established national treatment for the nonbanking activities of foreign banking organizations, which include foreign banks that operate a branch, agency, or commercial lending company subsidiary in the United States or that control a bank in the United States, and any company of which such a foreign bank is a subsidiary. The nonbanking activities of foreign banks generally are accorded national treatment. U.S. branches, agencies and subsidiary banks of foreign banks have powers comparable to those of domestically-owned institutions, i.e., powers accorded under the applicable banking laws as interpreted by the relevant federal and state banking authorities. Foreign-owned subsidiary banks are treated just as any other federally or state-chartered bank. The IBA authorized federal branches and agencies and made them subject to treatment comparable to national banks. The IBA also subjected other U.S. activities of foreign banks which have branches, agencies or commercial lending companies in the United States to the nonbanking provisions of the Bank Holding Company Act of 1956 (BHCA).

The Glass-Steagall Act of 1933 establishes a significant separation of the commercial banking and securities business. In the United States, banks are generally prohibited from underwriting or dealing in securities of corporate issuers. The IBA restricts the ability of a federal branch or agency of a foreign bank to underwrite or deal in securities by applying the restrictions applicable to national banks to such branches or agencies. State-licensed branches or agencies are similarly restricted by subjecting those branches and agencies to the prohibitions on underwriting or dealing in securities found in the Glass-Steagall Act as if they were member banks of the Federal Reserve System.

Glass-Steagall principles are also applied by the Board under the BHCA. Prior to the IBA, the BHCA applied only to foreign entities having U.S. subsidiary banks. Such foreign entities were bank holding companies and their direct and indirect U.S. activities were subject to the BHCA. The IBA established national treatment for other foreign banking organizations by generally subjecting their U.S. activities to the nonbanking provisions of the BHCA and thereby to the limitations that apply to domestic U.S. bank holding companies in their nonbanking activities. 1/

A bank holding company may not engage in any activity other than banking or activities that the Board finds are closely related to banking. The Board has found that certain securities activities can be considered closely related to banking and permissible for bank holding companies.

Grandfathered Securities Affiliates of Foreign Banks

The IBA provided a major exception to the policy of national treatment for those foreign banks that had operated securities affiliates in the United States before the passage of the IBA. Seventeen foreign banks had already established securities affiliates, which were permitted to remain, but new establishment of securities subsidiaries by foreign banks was limited to the same extent as for domestic holding companies.

The IBA grandfathered the investments that these foreign banks had in securities companies, but prevented them from acquiring additional securities companies or commencing new securities activities. They are otherwise free to continue to conduct any securities activity, including underwriting or dealing, that was being conducted on the grandfather date. The securities affiliate may expand through internal growth and establish new offices or subsidiaries to conduct the activities. Therefore, these foreign banks currently enjoy a significant competitive advantage over U.S. banks and bank holding companies and receive better than national treatment with respect to their U.S. securities operations.

Securities Activities of Banks in the United States

Although banks in the United States are generally prohibited from underwriting or dealing in securities of corporate issuers, banks may engage in certain other securities activities. A foreign bank is in the same general position as a U.S. bank or bank holding company with respect to ability to conduct securities activities in the United States, and is thus accorded national treatment.

National or state-chartered commercial banks, including their subsidiaries (referred to hereafter as U.S. banks), and bank holding companies or subsidiaries of bank holding companies (referred to hereafter as bank holding companies) located in the United States may engage in a similar (but not identical) range of securities and comparable activities. Both may underwrite and deal in obligations of the U.S. Government, general obligations of state and local governments, certain types of municipal revenue bonds (e.g., those issued to finance housing and university buildings and dormitories). They also may engage in transactions involving money market instruments such as bankers acceptances and certificates of deposit (CDs), and various other instruments. Currently, U.S. banks also privately place debt and equity securities.

U.S. banks and bank holding companies also may engage directly in discount brokerage or they may own discount brokers (i.e., securities brokerage firms which purchase and sell securities as agents for customers and do not provide investment advice) and futures commission merchants. Under Rule 3b-9 of the Securities and Exchange Commission (SEC), which is currently being challenged in the courts, a bank that (1) publicly solicits brokerage business for transaction-related compensation, (2) receives transaction-related compensation for providing brokerage services for trust, managing agency or other accounts to which the bank provides advice, or (3) deals in or underwrites securities, must do so through or as a broker-dealer registered under the Securities Exchange Act of 1934 (the Exchange Act). The Rule also contains several exceptions for banks that conduct only limited securities activities. A U.S. Court of Appeals recently invalidated this rule, and it is not clear at this writing whether or to what extent the SEC will seek further judicial review.

In addition U.S. banks or bank holding companies have engaged in a range of financial advisory activities, including offering investment advice to investment companies, institutions, and individuals. They have engaged in certain collective investment activities: have managed trust accounts; organized common trust funds, collective employee benefit plans, and collective Individual Retirement Accounts (IRAs); and have sponsored, organized and managed closed-end investment companies. Certain of the securities activities mentioned above may not have been available both to banks and bank holding companies.

Recent interpretations of the BHCA applying Glass-Steagall principles have allowed U.S. banking organizations to undertake additional securities-related activities, and foreign banking organizations have been able to engage in the same operations. For example, in a recent case, the Board approved an application under the BHCA by a foreign bank holding company to offer investment advice and securities brokerage services through the same subsidiary. This was the first application to the Board for this combination of activities and was processed in the normal course.

PRIMARY DEALERS

The core participants in the United States Government securities market are about three dozen primary dealers. Some of the primary dealers are banks or bank subsidiaries, some are departments of general securities broker-dealers, and others are firms specializing in government securities and other money market instruments.

Primary dealers maintain an active market through their willingness to buy and sell (make bids and offers on) a full range of Treasury issues at all times. These dealers are the most significant--but not the only--purchasers of new Treasury debt and provide investors with the liquidity that is a major characteristic of the most active capital market in the world.

Firms designated "primary" dealers voluntarily report daily to the Federal Reserve Bank of New York on their volume of trading and on their positions (holdings) in government and government agency issues. They also provide periodic reports on financing and their financial condition.

The Federal Reserve System is a major participant in the government securities market. In conducting open market operations, the Federal Reserve Bank of New York (FRBNY) buys and sells U.S. Government securities on behalf of the system. Open market operations are the major tool used by the central bank to influence the cost and availability of money and credit. While all dealers trading with the FRBNY's desk for system open market purposes must be primary dealers, not all primary dealers necessarily trade with the FRBNY, although most usually do.

To establish a trading relationship with the FRBNY, a dealer must be regarded as making sizeable and continuous markets in the full range of government securities and must achieve somewhat higher trading volume than required for designation as a primary dealer.

The FRBNY has outlined the standards and procedures it uses to determine whether a firm should be added to the list of primary dealers. In general, primary dealers are expected to: 1) make markets in the full range of Treasury issues for a reasonably diverse group of customers, 2) participate meaningfully in Treasury auctions, 3) be committed to continue as a market-maker in these securities over the long term, 4) have management depth and experience and good internal controls, and 5) have sufficient capital to support their activities and prudently manage their risk exposure. Given the current number of active participants and trading volume in the market, primary dealers are expected to have a minimum of about three-quarters of one percent of the total customer volume of all current primary dealers. While there is no specified minimum level of capital--which is evaluated in relation to risk--the FRBNY has indicated it believes a significant market-maker would have difficulty functioning prudently with less than about $25 million of capital.

Dealers aspiring to become primary dealers file no formal application. The FRBNY will accept informal reports on a monthly basis from firms indicating a desire to become primary dealers. Financial data and volume statistics are evaluated and a visit from the dealer surveillance staff is arranged. At the start of each calendar quarter the Fed will consider whether to begin accepting a full range of reports, including daily reports from aspiring dealers it believes likely to qualify as a primary dealer within a reasonable time. After evaluating these reports over time, the FRBNY may add the dealer to the list of primary dealers, or based on the evaluation, may discontinue acceptance of the more detailed reports.

FRBNY officials have endorsed open competition and the view that foreign firms should receive essentially the same treatment as U.S. firms. FRBNY officials have stressed that the policy of national treatment is consistent with urging that other countries open their doors as we have opened ours. Four of the 35 primary dealers are U.S. banks or firms which had established themselves as primary dealers and subsequently became foreign-owned. A number of foreign banks and firms that aspire to primary dealership have begun to file reports.

NATIONAL TREATMENT UNDER U.S. SECURITIES LAWS

Investment Banking, Brokerage and Dealing

The operations involved in public market "new issues" (i.e., syndicating, underwriting and marketing) have been performed by "investment bankers" or "investment banking firms." Secondary market operations, i.e., brokerage and market making, have been performed by broker-dealers. However, both categories of institutions fall within the broad definitions of "broker" or "dealer" under the Exchange Act and both types of operation are commonly conducted by a single firm. A broker or dealer engaged in interstate operations, as is usually the case, is subject to supervision by and registration with the SEC. Additionally there have been combinations by broker-dealer/investment banking firms with insurance companies, firms offering other financial services (e.g., credit cards and travellers cheques) and with some companies in unrelated areas such as commodities, travel and real estate.

The investment banking/broker-dealer firms have also been offering competition to the commercial banks in some activities such as organizing money market mutual funds or in selling bank CDs for fees. At the same time, commercial banks or their subsidiaries have been offering some securities-related services, notably in the domain of discount brokerage, the provision of investment advice, and offering self-managed individual retirement accounts.

Generally, the federal securities laws allow for national treatment and equality of competitive opportunity for firms conducting securities activities within the United States. That is, the laws generally accord foreign firms the same treatment as that given to domestic firms. Moreover, with regard to issuer activities, the SEC has adopted specialized registration and reporting forms to accommodate foreign issuers.

Brokers and Dealers

The Exchange Act gives the SEC broad regulatory authority over U.S. securities markets and persons in the securities business. Pursuant to the Exchange Act, the SEC supervises the activities of the national securities exchanges and the over-the-counter market.

A foreign broker-dealer doing business in the United States generally must register under the Exchange Act, as must domestic broker-dealers, unless it effects transactions solely on an intrastate basis or in certain exempt securities. The SEC's policy is one of equal market access, or national treatment, in that the SEC seeks to apply the same requirements to foreign broker-dealers as to U.S. broker-dealers. These requirements include the filing of a registration form with the SEC, meeting applicable standards of training, experience, and competence, complying with record-keeping and record maintenance requirements, and financial responsibility standards.

Broker-dealers must also join one or more securities self-regulatory organizations. These include the national securities exchanges and the National Association of Securities Dealers, Inc. (NASD), the only registered national securities association. The Securities Acts Amendments of 1975 specifically provide that any registered broker or dealer may become a member of a national securities exchange or of the NASD, ensuring that foreign ownership would not be a criterion for denial of membership. Foreign incorporation, or other organization, of the foreign-owned firm is not a bar to membership in the NASD and most regional exchanges, but it is on the New York and American Stock Exchanges. Thus, the rules of two principal exchanges permit foreign-owned members but require that the member be organized in the United States.

The extent to which brokers or dealers in the United States are foreign-owned is not fully known. That fact is itself an indication of the extent to which national treatment is accorded to foreign broker-dealers. At the end of 1985 there were 108 broker-dealers registered with the SEC who reported to the SEC that they were affiliates or subsidiaries of a foreign broker-dealer or bank. The number includes U.S. firms with ownership in affiliates abroad. The number of broker-dealers who have foreign parents is unconfirmed but may be between 75 and 100.

Starting in late 1987, brokers and dealers whose business is solely in U.S. government securities will for the first time be required to register and to meet standards established by the Secretary of the Treasury concerning financial capacity, protection of customer securities and balances, and recordkeeping and audit. The Government Securities Act of 1986 does not distinguish between foreign and domestic government securities brokers and dealers. Newly registered nonbank government securities brokers and dealers will be required to join a securities self-regulatory organization and register with the SEC. Bank government securities dealers, instead of registering with the SEC, will be required to notify their principal federal supervisory agency of their status as government securities brokers or dealers. This requirement applies to domestic banks and to foreign banks and United States branches and agencies of foreign banks engaging in the government securities business. The federal banking agencies will also be responsible for enforcing the new Treasury regulations with respect to bank brokers or dealers.

Investment Advisers

Under the Investment Advisers Act of 1940 (IAA), foreign investment advisers that use the U.S. mails or any means or instrumentalities of interstate commerce in connection with their business are required to register with the SEC, unless an exemption is available. An investment adviser is defined as one who, for compensation, "engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or . . . as a part of a regular business, issues or promulgates analyses or reports concerning securities. . . ."

The following are excluded from the definition of investment adviser: U.S. banks and bank holding companies (but not banks located abroad); lawyers, accountants, engineers, or teachers whose investment advice is solely incidental to the practice of their professions; brokers or dealers whose investment advice is solely incidental to the conduct of their business as such and who receive no special compensation for such advice; publishers of any bona fide newspaper or financial publication of general and regular circulation; and persons giving advice only with respect to U.S. Government securities. In addition, certain types of investment advisers are exempted from the registration requirements of the IAA: any adviser whose clients are all in the state in which the adviser conducts his business and who does not advise with respect to securities listed, or having unlisted trading privileges, on a national securities exchange; any adviser whose only clients are insurance companies; and any adviser with fewer than fifteen clients who neither holds himself out to the public as an investment adviser nor advises registered investment companies.

No particular qualifications are required for registration, and the SEC seeks to apply the same requirements to foreign and domestic investment advisers. Although foreign domicile may render a bank ineligible for the bank exclusion from the IAA, the law generally establishes a national treatment standard. Registered advisers are subject to antifraud provisions (as are unregistered advisers), limitations on advisory compensation, and disclosure and record-keeping requirements. The SEC requires foreign investment advisers, as a prerequisite of registration, to appoint the SEC as agent for service of process for any securities law-related claims. Approximately 150 foreign investment advisers are registered with the SEC.

Investment Companies

The Investment Company Act of 1940 (ICA) requires registration with the SEC of all non-exempt investment companies, such as mutual funds and closed-end companies. Investment companies required to register under the Act are subject to statutory provisions that regulate, among other things: composition of management and accountability to shareholders; approval of investment advisory contracts; changes in fundamental investment policies; transactions between the investment company and affiliated persons; and the capital structure of the investment company.

Foreign investment companies -- those not "organized or otherwise created under the laws of the United States or of a state" -- may not, in connection with a public offering, register, sell, or deliver their securities through the mails or interstate commerce unless the SEC by order finds that "it is both legally and practically feasible to enforce the provisions of [the Investment Company Act] against such company." In effect, the ICA requires the SEC to find that investors in foreign investment companies have exactly the same protections as investors in domestic investment companies. Although the SEC has been able to make such findings in a standardized manner regarding Canadian investment companies, it has indicated that such qualification will be nearly impossible for other foreign investment companies.

The SEC has suggested an alternative for these companies, which is to organize an investment company in the United States to mirror the foreign investment company, and register to sell its shares in the United States. 2/ The SEC has also recommended legislation to amend Section 7(d) of the ICA to make it easier for foreign investment companies to register with the SEC when that is consistent with the purposes of the Act and the protection of investors. Two Canadian and no other foreign investment companies are registered with the SEC.

A foreign bank may be considered an investment company under the ICA if it is sufficiently involved in holding or trading securities. Although banks operating under U.S. law are expressly excepted from the definition of investment company by Section 3(c)(3) of the ICA, foreign banks may not rely on that exception.

Since 1979, the SEC has granted exemptions to an average of twenty foreign banks a year to allow each to sell its own debt securities without registration as an investment company under the Act, and in September 1986 it proposed for comment Rule 6c-9. Under the proposed rule, foreign banks that are primarily engaged in accepting demand deposits and making commercial loans, and their finance subsidiaries, would be permitted to sell their debt securities or non-voting preferred stock if (1) the debt securities or non-voting preferred stock are registered under the Securities Act of 1933, or are offered or sold pursuant to an exemption from such registration and are of high quality as determined by at least two nationally-recognized statistical rating organizations, and (2) the bank, and any non-U.S. finance subsidiary, has filed with the SEC a Form N-6c9 appointing an agent located in the United States for service of process in actions arising out of the offer or sale of the securities.

Issuers

The Securities Act of 1933 prescribes general disclosure and antifraud standards for offerings of securities in the United States, and requires registration of securities prior to their offer or sale unless an exemption from registration is available.

Securities issued or guaranteed by a U.S. bank are not subject to the registration requirements of the Securities Act of 1933. This exemption applies only to securities issued or guaranteed by banks, as opposed to bank holding companies or non-bank affiliates of banks. Consistent with the principle of national treatment, the SEC has deemed U.S. branches and agencies of foreign banks to be included in the exemption, provided they are subject to state or federal regulation substantially equivalent to that applicable to U.S. banks doing business in the same jurisdiction. 3/

Congress has expressed its concern that exempting from registration securities guaranteed by certain foreign and domestic entities raises competitive and investor protection questions as regards the applicability of the federal securities laws to foreign and domestic banks and domestic financial guarantee insurance companies. The Government Securities Act of 1986 requires the SEC to study this exemption for bank-guaranteed securities, including the matter of whether a broad application of the principle of national treatment under the IBA is appropriate.

Under the Exchange Act, issuers whose securities are publicly traded in the United States are subject to, among other things, periodic reporting, proxy, and insider reporting provisions.

In principle, public offering and periodic reporting disclosure requirements for foreign issuers are the same as SEC requirements for domestic issuers. Thus, the federal securities laws apply the concept of national treatment to foreign issuers. In practice, the SEC has attempted to adjust its disclosure requirements to accommodate foreign issuers because of varying differences among the countries in legal and accounting practices.

Separate registration and reporting forms have been adopted, including Form 20-F in 1979. Form 20-F serves as both a registration statement and annual report form under the Exchange Act. Some of the accommodations made in that form include the requirements that management remuneration need be reported only on an aggregate group basis and information on transactions with management need be reported only if such disclosure has already been made pursuant to applicable foreign laws or regulations. Annual reports are required, but all other periodic reports are based solely on the requirements of applicable non-United States laws or applicable stock exchange requirements.

Annual and other periodic reports are required to be filed with the SEC for approximately 350 foreign issuers. The same annual and periodic reports as U.S. registrants are required for approximately 70 companies, including 65 Canadian companies. Form 20-F and the foreign integrated disclosure system are available for the remaining issuers. Foreign issuers reporting on Form 20-F are not subject to the United States proxy solicitation regulations or those pertaining to insider reporting.

Financial statements for foreign issues are not required to be prepared in accordance with United States Generally Accepted Accounting Principles (GAAP), established by the Financial Accounting Standards Board, or the SEC's Regulation S-X, so long as reconciliations of significant variations from those standards are provided. There are two types of reconciliation. Item 17 of Form 20-F requires a reconciliation only of the differences in the measurement items, i.e., the income statement and balance sheet amounts. Item 18 requires a full reconciliation, including all supplemental data, required by GAAP and Regulation S-X, e.g., full industry segment and geographic data. For most new issues, the Item 18 reconciliations would be required.

Form 20-F is the cornerstone of the separate integrated disclosure system for foreign issuers for public offerings under the Securities Act of 1933. The system presently consists of Forms

F-1, F-2, F-3 and F-4. Form F-6 is authorized to register American depositary shares represented by American depositary receipts which are issued against the deposit of the underlying securities of foreign issuers.

State Regulation of Securities Activities

The regulatory system for securities transactions in the United States is a comprehensive scheme administered by three groups: federal authorities, primarily the SEC; various self-regulatory organizations (SROs); and the individual states. In addition to being subject to Federal regulation, securities dealers and securities are also subject to the jurisdiction of the states in which the broker-dealer is established or where the security is offered.

All of the states but Nevada have enacted statutes, popularly referred to as Blue Sky laws, primarily to prevent fraud in the sale of securities to the general public and to protect the inexperienced investing public. Such laws regulate the issuance of securities and dealing in securities, as well as the qualifications of brokers, dealers, sales personnel, and others involved in the securities business.

State regulation is in many respects similar to federal regulation, although a number of states go beyond the disclosure-oriented federal regulation of securities offerings and impose substantive requirements--so-called "merit" regulation. Securities offerings must comply not only with federal law but also with the laws of each state where the security is offered. To minimize conflicting requirements, more than 30 states have enacted part or most of the Uniform Securities Act of 1956, proposed by the Commissioners on Uniform State Laws. 4/

Self-Regulatory Organizations

In general, SROs are statutorily authorized, quasi-private bodies, such as the National Association of Securities Dealers (NASD) and the stock exchanges. SROs are responsible for compliance by their members with rules of membership in the SRO as well as with the federal securities laws, and are subject to the supervision of the SEC.

The NASD, other SROs, and the states have cooperated to streamline the regulatory process in areas of examination and qualifications testing. In so doing, more uniform standards have emerged to provide a basis for consistent nationwide standards of national treatment in the securities area. Since 1981 the NASD and North American Securities Administrators Association have been operating an on-line, computerized central registration filing system known as the Central Registration Depository (CRD), a data bank and application processing facility.

CRD has reduced paperwork associated with the separate licensing and registration requirements of various state and national securities industry regulatory authorities. CRD enables broker-dealers to submit a single form and a combined payment of fees for multiregulatory registration. Particular states may, however, require supplemental information. The CRD system is designed to process applications for agent registration in all of the states except Hawaii, but not in the District of Columbia or Puerto Rico. As a result of agreements between the NASD and six securities exchanges, CRD also processes registrations for the Boston, Midwest, New York, Pacific, and Philadelphia Stock Exchanges, as well as the Chicago Board Options Exchange.

Internationalization of Securities Trading

Movements toward global trading of securities and the development of closer links between national securities markets are raising new questions as to which standards are appropriate to provide equality of competitive opportunity among domestic and foreign participants in domestic markets while giving adequate protection to investors. Recent proposals of the New York Stock Exchange and American Stock Exchange are intended to overcome the reluctance of non-U.S. companies to list securities for trading on those exchanges. The proposals would modify current listing standards applicable to a non-U.S. company in order to take into account the law and practice of the country in which it is domiciled. 5/

The SEC has already issued two concept releases on the issues raised by the internationalization of the securities markets. The first in February 1985 sought comments on methods to accommodate multinational offerings and to harmonize disclosure and distribution practices for foreign private issuers, in particular from the United States, Canada, and the United Kingdom. Two methods were offered for comment: a reciprocal approach among nations, where a prospectus accepted in an issuer's domicile would be accepted in each of the countries where the securities are offered; and the development of a common prospectus to be filed in all participating jurisdictions. The second concept release, issued in April 1985, provided a forum for consideration of the issues raised by internationalization of securities markets and requested comments concerning the direction in which global securities tradi g markets should develop.

1/ The IBA made the BHCA less restrictive in its application to foreign banking organizations than to U.S. bank holding companies with respect to their commercial and industrial activities but not with respect to their securities activities. In this respect the IBA provides foreign banks better than national treatment. A foreign banking organization is permitted under Section 2(h)(2) of the BHCA, which was added by the IBA, to own shares of a foreign nonbanking company that engages in otherwise prohibited activities in the United States, as long as the company is principally engaged in business outside the United States and the parent foreign banking organization is principally engaged in the banking business outside the United States. If the foreign nonbanking company in the United States is a subsidiary, additional limitations apply--the activities in the United States must be the same kinds of activities conducted outside the United States, and the company may engage in banking or financial operations in the United States only with the prior approval of the Board. This exemption prevents disruption in overseas affiliations that are permissible under foreign law.

2/ Investment Company Act Release No. 13691 (Dec. 23, 1983).

3/ See Securities Act Release No. 6661 (September 23, 1986).

4/ Discussion of state regulation of securities activities is based in part on information found in The Guide to American Law, Volume 2, West Publishing Company, 1983, p. 121, and Munn, Glenn G. and Garcia, F.L., Encyclopedia of Banking and Finance, Eighth Edition, Bankers Publishing Company, Boston, 1983, pp. 125-126.

5/ Federal Register. Vol. 51, No. 148, Friday, August 1, 1986, Notices, pp. 27618-27621.

2. Canada - Banking

SUMMARY ASSESSMENT

There have been no significant changes in legislation affecting the treatment of foreign banks in Canada since the Bank Act was amended in June 1984. Although satisfactory relations exist between the foreign banking community and the government regulators, the Bank Act continues to restrict foreign banks' entry and growth, and limits the ability of foreign banks to participate and compete fully in all segments of the Canadian market. Foreign banks cannot enter as branches. Entry as a subsidiary may be subject to reciprocity considerations. Foreign banks and individual Canadian shareholders also may not own more than ten percent of a domestic Canadian bank; however, in the fall of 1986, the Minister of Finance approved the acquisition of the assets of two widely-held, troubled, Canadian banks by foreign banks.

An amendment to the Bank Act in 1985 clarified that the ownership restrictions that apply to foreign banks also may be applied to foreign non-banks that are related even indirectly to a foreign bank. Proposals currently under consideration include exclusion of foreign banks as well as Canadian-owned banks from participation in financial holding companies, and a complete lifting of existing limits on banks' investments in securities firms. Other proposals range from immediate elimination of all distinctions between foreign and domestic banks, to postponement of any changes in the Bank Act until 1990 while proceeding with regulatory reform and increased activities and investment powers for non-banks.

The Federal Department of Finance is expected to determine its policies and objectives in late December 1986 and introduce legislation in 1987 that will involve major financial regulatory reforms that are expected to affect domestic, and possibly foreign, financial institutions. The Canadian authorities have indicated willingness to negotiate trade in financial services issues at the bilateral level with the United States.

There were 17 U.S. banking subsidiaries and three U.S. banks operating four representative offices with assets of C$11.8 billion ($8.4 billion) in Canada as of end-year 1985. That level of representation reflected a net decrease of two subsidiaries and an increase in assets about C$1 billion since 1984, when the Bank Act was liberalized.

Two U.S.-owned and one Canadian-owned Automatic Teller Machine (ATM) systems have networks in Canada. There is no differential treatment among the three systems. Customers accessing any system in Canada are permitted cash withdrawals.

The eight Canadian banks operating in the United States as of end-1985 had 18 branches, 11 agencies, 32 representative offices, and one Edge Act office. Canadian banks and individuals also owned 20 subsidiaries. Five Canadian banks are grandfathered under the International Banking Act of 1978 for multi-state banking operations. The total assets of Canadian bank offices located in the United States were $40 billion as of end-1985.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

In 1979, foreign banks could operate only near-bank subsidiaries in Canada. The 1980 Bank Act authorized foreign banks to establish federally-chartered banking subsidiaries, subject to an eight percent limit on their aggregate share of the market. By the end of 1983, there were 19 U.S. banking subsidiaries in Canada, with assets of $8.5 billion or 3.5 percent of the Canadian market. Foreign banks in aggregate held 7.5 percent of Canadian assets. An amendment to the Bank Act in June 1984 raised the limit on the share of domestic market permitted to foreign banks, from eight percent to 16 percent. However, the Bank Act continued to prohibit the entry of foreign banks as branches. Foreign banks -- and individual Canadian shareholders -- could not take significant equity positions in indigenous banks. Entry and expansion of foreign bank subsidiaries remained subject to administrative controls.

Domestic Banking System

Canada's commercial banking system consists of eight domestic banks and 55 foreign bank subsidiaries. All of the banks are privately-owned institutions, federally chartered by special acts of parliament or "letters patent" issued by the Minister of Finance on approval of the Cabinet. Two types of charters have been established by the Bank Act: a Schedule A bank, in which a single foreign or domestic firm may not hold more than 10 percent ownership, and all foreign owners combined may not hold more than 25 percent; and a Schedule B bank, which has no ownership restriction. Both domestic and foreign banks are subject to supervision by the Office of the Inspector General of Banks, a regulatory body within the Department of Finance. Six domestic banks dominate the banking industry, accounting for approximately 90 percent of the C$442 billion ($316 billion) in total bank assets (including overseas assets), the bulk of the nearly 7,100 bank offices nationwide, and most international operations of Canadian banks. In mid-1986, the foreign-owned banks had 222 offices and total assets of C$28 billion ($20 billion), which represented about 8.5 percent of the domestic banking market. In addition, foreign banks maintain some 46 representative offices in Canada.

In late September 1986, Lloyds Bank (a foreign bank) announced that Continental Bank (a domestic, Schedule A bank) and the federal banking authorities had agreed in principle to the acquisition of most of Continental's assets by Lloyds. In late November 1986, the Bank of British Columbia (a domestic, Schedule A bank) announced that it had agreed to transfer most of its assets and liabilities to the Hong Kong Bank of Canada (a foreign bank). With these changes, the number of domestic banks will drop to eight, foreign-owned bank offices will increase by nearly 100, total assets of the foreign banks will increase by about C$8.8 billion, and foreign banks' domestic assets as a proportion of total banks' domestic assets will rise to approximately 12 percent.

The large Canadian banks offer a wide range of retail and wholesale banking services. While many of the smaller foreign bank subsidiaries also engage in retail activities, some of the foreign banks concentrate largely on wholesale banking and capital market activities. Both domestic and foreign banks have expanded beyond traditional commercial banking functions. By means of non-bank subsidiaries, they operate in real estate financing, leasing, and factoring. A few domestic banks also process and route customers' orders to discount brokerage subsidiaries, but banks generally have been precluded from engaging in underwriting or providing investment counseling.

All commercial banks are required by the Bank Act to maintain in Canada records and data on their business in Canada. Several foreign banks initially objected to the requirement on the grounds they could more efficiently and economically process and maintain their data at central data processing centers in the United States. Some of the foreign banks were given a period of time to adjust to these requirements, and in recent years most of the foreign banks have installed the necessary equipment. However, like domestic banks, regardless of possible excess computer capacity, foreign banks may not offer diversified computer services. Consistent with the traditional Canadian regulatory compartmentalization of financial services, banks may provide data processing services to clients only to the extent that such services are directly related to banking.

Near-banks in Canada include trust and mortgage loan companies, credit unions, caisses populaires (the credit unions in Quebec), and one large savings bank in Quebec. Other financial institutions include sales finance and consumer loan companies, life and property-casualty insurance companies, investment or securities dealers, and various public sector savings and financial agencies. The near-banks and other financial institutions are established under either federal or provincial jurisdictions. They offer various banking and other financial services, including the acceptance of retail deposits. They are not subject, however, to the Bank Act, reserve requirements at the Bank of Canada, or the supervision of the Inspector General of Banks. Many of them are small and regionally concentrated. A few of the larger insurance companies, trust and loan institutions, and securities firms operate throughout the country.

CIRRUS System, Inc., a U.S.-owned system, currently the largest retail electronic banking system in the world, has been franchised to over 2,300 financial institutions in the U.S. and Canada with over 10,000 automated teller machines (ATMs) in the U.S. and 700 ATMs in Canada. The Canadian Payments Association Act and the Bank Act require that transactions between CIRRUS member institutions in Canada be routed and settled entirely within Canada.

PLUS SYSTEM, another U.S.-owned system, has an extensive electronic network consisting of about 1,500 member financial institutions and over 9000 ATMs in the United States and over 700 ATMs in Canada. The computer link between Canada and the United States accounts for approximately 5 percent of all transactions in the PLUS SYSTEM network.

Customers accessing PLUS SYSTEM ATMs in the United States are permitted three functions: cash withdrawals, balance inquiry, and transfer of funds. Customers accessing the CIRRUS system in the United States are permitted cash withdrawals and balance inquiries. Customers accessing either system in Canada are only permitted the cash withdrawal functions. The dominant shared ATM network in Canada (INTERAC), a Canadian system, is also only permitted cash withdrawals.

Key Developments since 1984

Since the 1984 amendment to the Bank Act increased the limit on the foreign banks' share of the market to 16 percent, there have been no significant changes in the legislation or the regulations specifically with regard to foreign bank subsidiaries. However, the Investment Canada Act of 1985 amended certain provisions of the Bank Act, clarifying that foreign non-bank institutions whose parents are even indirectly affiliated with a bank may be subject to the Bank Act restrictions that limit a bank's equity position in a non-bank corporation to no more than ten percent. To date, the banking authorities have enforced these provisions with flexibility and discretion, permitting one U.S. non-bank financial institution that is related to a bank in the U.S. to open and own a trust and loan company in Canada.

From mid-1984 to mid-1986, no new U.S. banks applied for entry. However, the applications of four non-U.S. foreign banks are pending and expected to be approved in late 1986. Three foreign banks (two U.S.) surrendered their licenses; two were absorbed by other U.S. banks and one by a non-U.S. foreign bank. Thus, the total number of foreign bank subsidiaries decreased by three to 55; U.S. bank subsidiaries decreased by two to 17. In addition, Citicorp sold its approximately 20 percent of equity in Mercantile Bank, a Canadian-owned bank that was amalgamated with National Bank, another domestic bank. Citicorp's investment position was all that remained from the original outright acquisition of Mercantile Bank by First National City Bank in 1965. In accordance with the Bank Act of 1967, Citicorp was obliged to reduce its holdings eventually to a maximum of ten percent.

The Canadian domestic banking system sustained several major changes in 1984-86 as the number of domestic banks declined from 14 to eight. In September 1985, two medium-sized regional banks, Canadian Commercial Bank (CCB) and Northland Bank, were declared insolvent and entered into liquidation proceedings. These were the first bank failures in Canada since 1923. Subsequently, three other banks encountered serious liquidity problems. As mentioned above, one of those banks, Mercantile Bank, was acquired by National Bank; two other banks -- Continental Bank and Bank of British Columbia -- remained highly dependent on funding assistance from the Bank of Canada well into 1986. Another small, domestically-owned bank, the last of the domestic closely-held Schedule B banks, was acquired by a foreign bank. The sale of Continental Bank to Lloyds in late 1986 (the first meaningful acquisition of a Canadian bank by a foreign bank in over 20 years) and the sale of the Bank of British Columbia to Hong Kong Bank of Canada reduces the number of Canadian-owned banks to eight.

The Canadian Federal Government enacted legislation in early 1986 to compensate uninsured depositors at the two failed banks and to strengthen the management and finances of the Canada Deposit Insurance Corporation. Legislation requiring Government approval for transfers in ownership of financial institutions has been introduced in the Parliament and final passage is expected in late 1986 or early 1987. That legislation also will enhance the powers of the Office of the Inspector General of Banks (OIGB) and the Superintendent of Insurance to issue cease and desist orders and to conduct independent valuation of real estate assets. In further response to the bank problems in 1985, the Government: (1) arranged for assessment of the mandate and operations of the Inspector General of Banks by a private accounting and consulting firm; (2) created a special commission, headed by Supreme Court Justice Willard Estey, to investigate the demise of the CCB and Northland Bank. The study of the OIGB, released in August 1986, called for further strengthening of OIGB staff and regulatory powers. The Estey Commission's Report, released in October 1986, had similar conclusions.

Since 1984 there have been a number of studies, reports, and proposals pertaining to the overall regulatory environment and structure of the financial services sector in Canada. The Federal Government released in April 1985 a major discussion paper and, subsequently, a technical supplement, which discussed enhancement of consumer protection, financial soundness and competitive efficiency. The report focused very largely on non-bank deposit-taking institutions and insurance companies. It proposed federal registration and control of financial holding companies and greatly increased regulatory powers to control self-dealing and conflict of interest.

In November 1985, the House of Commons Finance Committee released a comprehensive report on the restructuring of the financial services industry. While endorsing regulatory and deposit insurance reform, it rejected elements of the government's proposals for increased federal control of financial institutions. It proposed greatly expanded investment powers for life insurance and trust and loan companies, increased capital adequacy levels for all financial companies, elimination of reserve requirements for chartered banks, and the application of ownership rules to all large financial institutions.

The Senate Finance Committee, in May 1986, issued its own detailed report, which placed emphasis on creating "a more competitive financial environment," while also discussing consumer protection and federal-provincial jurisdictional considerations. In December 1985, a special task force on financial institutions submitted its report to the Ontario Provincial Government. Finally, in June 1986, the Ontario Minister for Financial Institutions (a position created in March 1986) announced the Provincial Government's intention to moderate the restrictions on entry of foreign securities firms and participation by banks and other financial institutions in the Ontario securities industry; in December 1986, Ontario announced specific steps for substantial opening up of the securities industry beginning in June 1987.

In the fall of 1986, the Federal Government stated that in December 1986 it will make a major policy announcement and introduce legislation to create "a new regulatory framework for the financial services industry that will promote competition, efficiency, and international competitiveness, while strengthening consumer protection." The Government also indicated that it is willing to engage in bilateral negotiations on issues of trade in financial services and, as of December 1986, was in a preparatory stage of discussion with the U.S. Government.

Treatment of U.S. and Other Foreign Banks

The Bank Act (as amended in 1980 and 1984) permits foreign banks to operate in Canada as wholly-owned federally-chartered banking subsidiaries. They also may have representative offices, and their subsidiaries may own selected non-bank financial subsidiaries. Foreign banks cannot enter Canada as branches, and they cannot acquire significant equity positions in indigenous banks, although the Federal Government recently allowed foreign banks to buy out two troubled Canadian banks. The inability to enter as a branch and use the resources of the parent bank accounts for many of problems faced by foreign banks in Canada.

The Bank Act makes no distinctions between domestic and foreign banks with regard to their powers. However, foreign banks are subject to different chartering provisions and to a number of different operating restrictions. The most important distinction concerns corporate ownership, two types of which are recognized in the Bank Act. Schedule A banks are widely-held, in that ownership is restricted to ten percent for a single entity (Canadian or foreign) and a total of 25 percent for all foreign ownership combined. The ten percent restriction is based on concerns about concentration of ownership and the possibility that a chartered bank could become dominated by a person or associated persons who have business interests other than banks, thus creating conflicts of interest and risks to depositors. The 25 percent restriction reflects a desire to prevent foreign ownership and control of Canadian banks. Both restrictions were written into the Bank Act in 1967 and have been carried over in subsequent reviews and amendments.

Schedule B banks are not subject to the ownership restrictions; i.e., they may be closely held or even wholly-owned by their parent banks. However, Schedule B licenses must be renewed annually for the first five years; Schedule A charters remain valid unless revoked. Also, Schedule B banks are prohibited from establishing branches or subsidiaries abroad. Generally speaking, renewal of licenses and restrictions on establishments overseas have not presented problems to U.S. banks.

The only practical avenue for a foreign bank to enter Canada is to establish a Schedule B bank. Chartering applications made to the Inspector General of Banks as representative of the Minister of Finance must be accompanied by a "comfort letter" from the foreign bank parent which states that it agrees to stand behind its Canadian bank. Approval also is subject to reciprocity considerations which, to date, have not hindered U.S. bank entry.

The Bank Act restricts foreign banks, as a group, to no more than 16 percent of total domestic assets of all banks in Canada. The mechanism used to enforce that restriction is based on specified levels of "deemed authorized" capital granted to the Schedule B banks, combined with a legal ceiling limiting each foreign bank's total domestic assets to 20 times its deemed authorized capital. Thus, the level of deemed authorized capital, in the aggregate, is key to the capital/assets regulations and the share-of-market limit placed on foreign banking activities in Canada. Deemed authorized capital is quite distinct from a bank's shareholders' equity and reserves. For de novo banks, initial deemed capital has been set at approximately C$4 million (about $3 million).

While the 16 percent share of domestic assets is an absolute limit, it has not constituted an effective restraint on the growth of foreign banks during the last two years. Just prior to the amendment to the Bank Act in June 1984, the then-applicable eight percent market share was nearly reached by the foreign banks. In the two years since the increase in the limit to 16 percent, the foreign banks have raised their aggregate share only marginally to approximately 8.5 percent (as mentioned above, the two recent acquisitions of Canadian Schedule A banks will raise that proportion to about 12 percent).

The relatively slow growth in market share has been attributed to a number of factors, the most important of which are increasingly keen competition in the face of slack loan demand by Canadian businesses and the development by foreign banks of more fee-related services in contrast to normal commercial loans. In addition, several foreign banks believe that regulatory operating restrictions and guidelines inhibit their ability to plan and expand loan portfolios effectively and competitively. Generally, the growth in domestic assets of the banking system since 1984 is attributable largely to growth in residential mortgages and personal loans, areas in which the foreign banks are not as active as the domestic banks.

Given the considerable scope for growth within the legislative limits, the Inspector General has approved increases in deemed authorized capital virtually automatically for at least a dozen banks since 1984 (some banks have received more than one increase). On the other hand, the nontransparency with which the approval process is carried out is a source of concern. Some foreign banks have perceived delays in receiving approval and have received approval of smaller-than-requested increases in deemed authorized capital. The Inspector General has been cautious in allocating additional capital, often granting increases which may provide the basis for only one year of growth. Some banks have suggested that reciprocity considerations have resulted in delays in approval for entry of certain non-U.S. banks.

Another concern for some banks has been the policy of the Inspector General to encourage foreign banks to provide loans to small- and medium-sized borrowers. This policy applies as well to domestic banks; however, compliance is perhaps more difficult for some foreign banks that specialize in wholesale banking and lack a retail base in Canada.

While the Bank Act specifically empowers banks established in Canada to open branches, a subsequent section restricts Schedule B banks to a head office and a single branch. However, the Minister of Finance is authorized to approve additional branches, and thus far, no request by a foreign bank to establish an additional branch has been denied. As of mid-1986, the 55 foreign bank subsidiaries operated 167 branches in addition to their head offices. Subsidiaries of U.S. banks account for 69 branches (most of which are simply foreign exchange offices), in addition to their head offices. Foreign parent banks also maintain 46 representative offices, of which four are owned by U.S. banks. Some banks applying for charters and/or additional branches have been encouraged to locate outside of Toronto, the nation's financial capital.

There are also leverage limitations based on banks' net worth and determined on an individual basis. Individual Schedule B banks generally have been restricted to the range between 20 and 25 to one, whereas the allowable range for Schedule A banks usually has been between 20 and 30 to one. The larger Schedule A banks often have been near the top of this range. However, the Inspector General has been pressing them to reduce their ratios, and currently none of the Schedule A banks is near 30 percent and most are below 25 percent.

Another requirement on foreign-owned banks is a prudential lending limitation requiring that their loans to any one customer not exceed 50 percent (up to 100 percent in extraordinary circumstances) of their shareholders' equity and reserves. Foreign banks believe that parent bank capital should be recognized for lending limit purposes and point to the parent's "comfort letter" as proof. The Inspector General requires a "comfort letter" from the parent bank with the application for entry as a subsidiary. He gives some weight to the letter for lending limit purposes, in that the lending limits for Schedule B banks are more generous that those for Schedule A banks (25 percent normally and up to 50 percent in some circumstances). The Inspector General indicated in late 1984 that, in time, foreign banks should have the same lending limits as the Schedule A banks, but he has not moved to implement such uniformity. If implemented, this would place U.S. banks in Canada at a competitive disadvantage, since they are forced to incorporate as a subsidiary.

Schedule B banks may encourage clients to seek exceptionally large loans directly from their parent banks offshore, but that practice is not necessarily consistent with the specific business objectives of the subsidiaries in Canada. Moreover, restrictions on the direct sale of assets to parent banks limit the operations of foreign bank subsidiaries. The Inspector General has indicated that he would view regular sales to parents as an effort to evade the intent of the Bank Act with respect to individual capital and asset restrictions. Nevertheless, the sale of portions of loans to parent banks is allowed in exceptional circumstances, with prior approval by the Inspector General.

An additional limitation on foreign banks prohibits them from obtaining more than 50 percent of their funds abroad. There is no such limitation on Schedule A banks. However, because of their extensive branch networks, the domestically-owned banks in fact currently raise offshore less than three percent of their funds for their Canadian operations. By comparison, foreign banks often look to the offshore market for low-cost funds. The Canadian authorities have indicated that this limitation is in place largely for prudential reasons. Also, the authorities have argued that in practical terms there is no restraint, in that foreign banks currently are funding an average of only about 25 percent of their Canadian dollar business from abroad.

The interaction of these several requirements, along with the relatively small individual capital of Canadian subsidiaries of foreign banks, limits their opportunity to participate fully in all segments of the Canadian market.

Implications of Proposed Reforms

Among the several reports and proposals on the financial sector released since 1984, only those prompted by the two bank failures in 1985 focused primarily on banks. The Estey Commission Report essentially reinforced other reports (the Wyman Report and the OIGB Study) that have led already to legislative initiatives to strengthen the inspection and enforcement powers of the federal financial regulatory bodies and to improve the financial condition of the Canada Deposit Insurance Corporation. There is no indication that these measures or the Estey Report will necessarily affect the treatment of foreign banks.

The Federal Government's discussion paper on the regulation of financial institutions, released in April 1985, explicitly stated that: "substantial changes to banking legislation are not being contemplated until the 1990 decennial review of the Bank Act"; and "with regard to foreign ownership, the government proposes to leave the present rules unchanged." The implication is that the government does not intend, until 1990 at the earliest, to consider moderation or elimination of existing restrictions on the entry, growth, operations, and non-bank investments of foreign banks.

The discussion paper also proposed the formal establishment of financial holding companies which could operate in several areas of activity including insurance, trust, securities (subject to provincial approval), and banking. A new category of closely-held bank -- a Schedule C bank -- would be created that could be held by a financial holding company. However, the discussion paper proposed exclusion of all existing banks (both foreign and domestic, with the possible exception only of certain small Schedule A banks) from participation in financial holding companies. In addition, the restrictions on foreign ownership would apply to the new Schedule C banks. Thus, a foreign bank could not establish a Schedule C bank, and a foreign non-bank institution could not form a financial holding company that would include a Schedule C bank.

Pertinent reports of the House of Commons Finance Committee have included recommendations of considerable relevance to foreign banks. In its November 1985 report, the Committee recommended, inter alia, "that the foreign-owned Schedule B bank classification, along with the aggregate asset ceiling of 16 percent of total domestic assets imposed on these banks, be eliminated," and "that the Schedule A and Schedule B classifications for chartered banks be eliminated and all banks be allowed to operate under the same rules regardless of their ownership structures." The House Finance Committee, with a different membership formed under a previous government, had recommended in October 1983 the complete removal of the then eight percent ceiling on foreign banks. The November 1985 report also proposed a scheme of ownership limits for all Canadian incorporated financial institutions (including foreign banks and other firms), wherein a firm would have to become increasingly widely-held as its domestic assets reached successively higher levels. This arrangement could pose a substantial problem for wholly-owned foreign banks.

The Ontario Government's December 1986 announcement of changes in the securities industry included a proposal that banks be permitted to establish subsidiary securities firms or to take equity positions of 100 percent in an existing securities firm. The province called on the federal authorities to amend the Bank Act to enable banks to invest above the current ten percent limit. The provincial authorities also stated that subsidiaries of foreign banks would be allowed the level of investment in Canadian securities firms permitted by the Federal Government. The Schedule B banks have made clear to both the provincial and federal authorities their strong desire to receive the same treatment as the Schedule A banks as regards the ownership of securities firms and involvement in the securities industry. The Federal Government has not yet officially responded to Ontario's proposal, nor has it confirmed whether it will consider lifting the investment/ownership restrictions on any banks (domestic or foreign). The Federal Government, in its April 1985 discussion paper, said it would favor investment in securities firms by financial holding companies, to the extent permitted by the provinces.

The Federal authorities currently are reviewing responses to the November 1985 discussion paper from the private sector and the Parliamentary committees. They also are considering the proposals of the Ontario Government regarding the securities industry. Also under consideration are the recommendations of the three separate reports dealing with the banking regulatory and deposit insurance authorities. The Department of Finance expects to determine in late December 1986 its policy objectives for reform of the structure and federal regulatory environment for financial services. Proposed legislation is expected in 1987. The Federal Government also has indicated its willingness to participate in bilateral negotiation of financial services issues with the United States.

The ultimate implications of these various provincial and federal initiatives for the treatment of foreign financial institutions in Canada remain unknown at this time.

3. Canada - Securities

SUMMARY ASSESSMENT

The securities industry in Canada is regulated primarily by the provincial governments. There are two major provincial securities markets: Ontario and Quebec. Foreign firms are allowed to enter and operate in Quebec on the same terms and conditions as Canadian firms. In Ontario, the more important market, new foreign firms are currently prohibited from entering the full-service market which includes stock exchange membership, underwriting of corporate securities in the domestic Canadian market, and retail services. Foreign firms currently may acquire individually no more than a 10 percent interest (several foreign firms may acquire up to 25 percent in the aggregate) in any domestic securities firm registered in Ontario.

On December 4, 1986, the Province of Ontario announced a major restructuring of the Ontario securities industry. While the regulations are not yet available, it appears that the new policy represents a major liberalization of the Ontario securities market. Effective June 30, 1987, nonresidents would be permitted to take a 50 percent equity interest in a domestic securities firm, with an option to purchase 100 percent one year later. Effective June 30, 1988, Ontario would permit nonresidents to acquire a 100 percent interest in domestic securities dealers or to establish subsidiaries in Canada that can register and carry on business without any capital limitations or restrictions on their activities. Foreign subsidiaries would be eligible for membership on the Toronto Stock Exchange, able to underwrite corporate securities, and empowered to engage in other full-service business. The Ontario authorities have not yet made clear their intentions concerning entry criteria, including possible reciprocity requirements. Branches of foreign parent securities firms would not be allowed.

The Province of Ontario announced that effective June 30, 1987, it would implement a universal registration system -- all activities in the "exempt" market for which registration was not required in the past would now require registration. Foreign dealers would still be permitted to carry on "exempt" activities, but only through a subsidiary, on which no capital ceiling would be imposed. On June 30, 1988 any foreign firm with a registered subsidiary would be unrestricted in its activities in Ontario.

Under the new proposals, the securities industry in Ontario would move towards a universal banking-type system, effective June 30, 1987. Canadian domestic financial institutions, including Canadian banks, would be allowed to acquire domestic securities firms or establish wholly-owned subsidiaries to engage in all securities activities. However, the statutes and regulations governing federally-registered domestic financial institutions, such as banks, must be amended by the Federal Government, which is expected to do so shortly. At this time it is unclear whether the Federal Government will grant national treatment to foreign banks and other foreign federally-regulated financial institutions to engage in full-service securities activities or to acquire domestic securities firms.

Four U.S. firms, grandfathered when foreign ownership restrictions were imposed in 1971, are currently registered with the Ontario Securities Commission and may participate in the full-service market. Their growth in the past has been restricted by regulation. The Province of Ontario announced that effective June 30, 1987, all capital and market restrictions on the grandfathered firms would be lifted.

NATIONAL TREATMENT REVIEW

Domestic Securities Markets

The four main industries in the financial sector in Canada -- banking, securities, trust, and insurance -- have traditionally been known as the "Four Pillars." Until the last several years, the financial sector has been highly compartmentalized, with relatively little cross-industry activity and virtually no cross-ownership of financial firms. The sector faces a variety of regulations and regulators -- banks are regulated by the Federal Government, securities firms by the provincial governments, and the trust and insurance companies by both.

The emergence of "financial supermarkets" and actions of financial institutions to introduce innovative services and to make use of continuously evolving technology have blurred the distinctions among the four pillars. These developments in turn have prompted numerous reviews of regulations at both the federal and provincial levels. Proposals announced recently by the Province of Ontario would, if the Federal Government concurs, further blur the distinctions among the four pillar system by allowing banks, trust companies, and insurance companies to engage in securities activities through wholly-owned subsidiaries.

Under Canada's constitution, the provinces have the predominant responsibility for securities matters. Twelve different statutes and regulatory authorities exist, one for each of the provinces and the territories. There are stock exchanges in five provinces; however, the markets in Toronto and Montreal account for approximately 90 percent of total trading of stocks in Canada by value. The Vancouver Stock Exchange ranks third and is known primarily as a venture capital exchange that attracts listings by mining companies and junior high-tech and industrial firms from abroad as well as from across Canada. The Ontario Securities Commission (OSC) and the Commission des Valeurs Mobilieres du Quebec (Quebec Securities Commission -- QSC) are the most important regulatory bodies. In addition, self-regulatory organizations such as the stock exchanges themselves and the nationwide Investment Dealers Association (IDA) have established certain standards. The Federal Government regulates the underwriting of its own debt instruments and governs certain practices of federally-chartered institutions that engage in securities activities.

The registered securities market in Canada was estimated in 1985 at C$38 billion ($28 billion) for new issues of securities (of which: C$23.8 billion for government issues, C$4.5 billion for corporate debt, and C$9.7 billion for corporate equity) and nearly C$1,000 billion ($730 billion) for secondary transactions (of which: C$719 billion for money market trading, C$222 billion for bond market trading, and C$58 billion for stock market trading). There are no reliable statistics on securities activities for which no registration is required (the so-called "exempt" market), but some estimates suggest it could approach the size of the regulated market. The "exempt" market clearly is the fastest growing capital market in Canada, and U.S. and other foreign firms are active participants (although usually located outside Canada). For one portion of the "exempt" market, primary distributions of securities to institutional investors, exempt transactions in Ontario in recent years were estimated to account for about one-half of the total reported to the OSC.

While not large by U.S. standards, the Canadian capital and money markets are well developed. Nonetheless, the Canadian securities industry per se (i.e., firms registered in Canada) is the smallest of the several categories of financial services industries. The largest investment firms are widely perceived as being undercapitalized, especially since the introduction of "bought deals" and other sophisticated securities activities. At the end of 1985, securities or investment dealers had total capital of approximately C$1.1 billion ($790 million) and total assets of C$9 billion ($6.4 billion), compared to total assets of C$422 billion ($316 billion) of the chartered banks, an estimated C$80 billion ($57 billion) for trust and mortgage loan companies, and an estimated C$110 billion ($79 billion) for life insurance companies.

Mergers among investment dealers in recent years have reduced the total number of IDA member firms from 106 in 1977 to 95 at the end of 1985 and only 65 in late 1986, and have concentrated capital among about seven leading companies. In the last two years, modest injections of foreign capital and several public share issues have raised the total capital of domestic securities firms. Some observers expect a continuation of these trends, especially with the liberalization of the Ontario securities market, and are projecting total industry capital to nearly double to C$2 billion ($1.4 billion) by the end of 1986.

Three stock exchanges in Canada have electronic linkups with exchanges outside the country. The Montreal Exchange and Vancouver Stock Exchange are linked together to both Amsterdam and Sydney for options trading. The Montreal Exchange (ME) is also linked to the Boston Stock Exchange (BSE). The linkage allows ME members to send orders in certain U.S. stocks to the BSE for execution and may be expanded to permit two-way trading. The Toronto Stock Exchange is linked to the American and Midwest Stock Exchanges for quotations and trading in interlisted Canadian stocks. In both cases, the bulk of the orders have been southbound. The respective Canadian exchanges have expressed their desire to receive northbound orders from U.S. traders but apparently requirements regarding the physical deposit of stocks in the United States and other factors have discouraged development of northbound trading.

Canadian securities firms have extensive foreign operations, especially in the United States. Nineteen Canadian firms or their subsidiaries are members of U.S. exchanges or the National Association of Securities Dealers (NASD), including 12 which are members of the New York Stock Exchange (NYSE). In both the NYSE and NASD, this level of representation probably exceeds that from any other country. One wholly-owned subsidiary of a Canadian bank is a primary dealer of U.S. Government securities. Canadian firms in the United States are generally afforded national treatment, with the same registration requirements and regulations affecting their operations as those for U.S. broker-dealers.

Ontario Securities Industry

The securities market in Ontario is by far the largest of all the provinces. It accounts for perhaps one-half of new public offerings, three-quarters of ongoing stock market activity, and probably a larger proportion of money market and bond market transactions. The securities industry has consisted in recent years of nearly 100 registered securities firms.

Registration and operations of securities firms in Ontario are governed by the Ontario Securities Act. Section 24 of the Act requires that any person or company who trades in a security, acts as an underwriter, or acts as an advisor must register with the OSC, unless exempt under Section 34. The regulations require a registered dealer to be classified in one or more of seven categories, depending on its activities: broker, broker-dealer, investment dealer, securities dealer, mutual fund dealer, scholarship plan dealer, or security issuer. Any firm granted registration as a broker-dealer, investment dealer, or securities dealer is automatically registered as an underwriter. During the application process, a firm must become a member of the Toronto Stock Exchange to register as a broker and/or a member of the Investment Dealers Association to register as an investment dealer. The largest securities firms are generally registered in several categories. Four predominantly foreign-owned, full-service firms have licenses that were grandfathered when foreign ownership restrictions were imposed in 1971. Under the current regulations, other nonresident dealers may not apply for registration.

While the Ontario Securities Act generally imposes a registration requirement upon any person or firm wishing to trade in securities or to act as an underwriter or advisor, the Act currently allows an exemption from the registration requirements for certain types of trades and securities. Section 33 of the Act governs the exemptions for advisors; Section 34 relates to dealers and underwriters. Section 34(1) exempts 23 trades, the most important being: trades with sophisticated investors (banks, insurance companies, trust and loan companies, certain other financial institutions and pension and mutual funds, and federal, provincial, and municipal governments); and trades in securities valued over C$97,000 ($70,300) if the purchaser purchases as principal. Section 34(2) exempts from registration any firm trading in 15 categories of securities, the most important being: debt securities of the Government of Canada, any foreign government, any Canadian provincial and municipal government, or international development banks; debt securities of a bank, insurance, trust or loan company; securities issued by mutual funds; short-term (less than one year) commercial paper over C$50,000 ($36,250) in value; and securities of a private company that are not offered publicly.

There is considerable functional overlap in the "exempt" market between the domestic securities industry per se and other financial institutions. For instance, firms not registered with the OSC (e.g., commercial banks, foreign securities firms, and merchant banks) are allowed to engage in certain activities in the "exempt" securities market. Both banks and securities firms trade call deposits, swap deposits, commercial paper, and government securities in secondary markets. Banks are leading dealers in Government of Canada Treasury bills in secondary markets, and the largest domestic banks participate in the primary selling group for federal government bonds. Securities firms normally are allocated approximately 90 percent of new long-term government issues by the Bank of Canada. Banks and other institutions may offer discount brokerage services. For their part, securities firms are allowed to accept deposits from their own securities customers and pay interest. Cross-ownership also is permitted to some extent, but is currently limited to ten percent holdings.

Quebec Securities Industry

The Quebec securities market declined in importance, along with other financial services in that province, in the 1960s and 1970s. Many institutions were discouraged from maintaining head offices in Montreal, despite the introduction of regulatory reforms and more liberal entry rules for foreign firms. Leading dealers, as well as the major banks, moved their headquarters and main activities from Montreal to Toronto. The Montreal Exchange, the oldest and for some years the country's most important exchange, by 1981 accounted for less than ten percent of stock trading in Canada.

Since the early 1980s, the Quebec authorities have sought to stimulate securities trading. The provincial government introduced preferential tax treatment of new share issues and earnings from investment in securities. The value of new offerings under the Quebec Share Savings Plan will probably exceed C$2 billion ($1.4 billion) in 1986 alone. The Caisse de Depot et Placements, the government-owned entity responsible for managing the Quebec Pension Plan, is encouraged to invest a sizable portion of its substantial portfolio in the securities of Quebec firms. In 1983, the Quebec Securities Commission relaxed constraints on the registration of financial institutions as brokers and on the activities of securities firms in other areas. The Bank of Nova Scotia recently took advantage of this provision, as well as a special clause in the Bank Act, to form a subsidiary in Quebec that is a full service securities dealer. Fully-owned foreign firms were also allowed to offer the complete range of brokerage activities in Quebec, subject to approval by the QSC.

In 1984, the provincial government adopted legislation that permits insurance companies to establish financial service supermarkets, thus broadening the sources of capital for the financial sector. Additional provincial legislation is under consideration with regard to the activities of trust companies and caisses populaires (Quebec's equivalent to savings and loan companies or credit unions). Another initiative currently underway involves enactment of tax and other incentives to stimulate the creation of an international finance center in Montreal.

As a result of regulatory changes, fiscal incentives, and active leadership, the Montreal Exchange has revived during the last five years. It has introduced numerous innovations, including commodity futures, various new options contracts, and electronic linkups with the Boston Stock Exchange and options exchanges in Europe and Australia. In the first half of 1986, turnover on the Montreal Exchange represented 20 percent of the combined stock trading activity on the exchanges in Toronto and Montreal. Quebec accounts for about 25 percent of national public offerings in Canada, and the Montreal Exchange conducts about one-third of all stock options trading.

U.S. Presence in the Canadian Securities Markets

While U.S. financial institutions sell foreign and U.S. securities to Canadian investors and underwrite Canadian institutional borrowings in the U.S. market, their activities in the Canadian domestic market have been limited by legislative and regulatory constraints. In the 1960s a number of U.S. securities firms and commercial banks established non-bank subsidiaries in Canada. However, the acquisition of Mercantile Bank by Citibank, and Royal Securities by Merrill Lynch, triggered legislation in the late 1960s and early 1970s that prohibited the entry of foreign banks and investment dealers. The Federal Bank Act excluded nonresidents in 1967 but was amended in 1980 to permit foreign bank subsidiaries, subject to restrictions on their capital and to fulfillment of specific performance requirements. Ontario securities regulations adopted in 1971, on the other hand, precluded the registration of fully-owned, nonresident securities dealers and restricted the extent to which foreign firms may acquire equity in a domestic firm.

There were some 26 foreign securities dealers present in Ontario in 1971, and they were grandfathered by the provincial legislation and regulations. Eight of those firms were members of the Toronto Stock Exchange and represented 12 percent of the capital of all TSE members. As a result of a number of factors, only four foreign subsidiaries remain in Ontario today, representing about eight percent of TSE members' capital at the end of 1985.

The four grandfathered firms also have offices in Quebec and other provinces. A fifth U.S.-owned firm has an office in Vancouver only.

Merrill Lynch Canada is by far the largest of the grandfathered firms, with about C$50 million ($36 million) in capital. MLC has seats on all five Canadian stock exchanges, and its chairman is vice-chairman of the TSE Board of Governors. MLC is a primary dealer in GOC securities and has purchase and resale privileges with the Bank of Canada.

Two of the grandfathered firms, Merrill Lynch and Bache, are considered to be major players in the Canadian stock exchanges and as retail brokers, especially in Montreal and Toronto. Those firms and the other grandfathered firms in Canada are also active in the "exempt" market.

In addition to the grandfathered firms, nonregistered foreign securities firms and investment banks located in the United States can trade in the equities of major Canadian corporations -- about 35 percent by value of all Canadian listed stocks are also listed on U.S. stock exchanges or NASDAQ. An estimated one-half of the trading in Canadian equities in Canadian and U.S. markets takes place in the United States.

Nonregistered foreign firms also are actively operating in the important "exempt" market in Ontario. Some observers suggest that nonresidents may account for up to one-half of the "exempt" market. Leading U.S. firms in the "exempt" market include three with wholly- or partially-owned subsidiaries in Canada -- First Boston Corporation, Morgan Stanley, and Discount Corporation. Goldman, Sachs announced in early 1986 that it plans to open an office in Toronto. Salomon Brothers, which has focused on Canadian government and corporate issues and institutional investors, and Drexel Burnham Lambert, which sells Canadian securities to U.S. and foreign customers, operate out of New York without a physical presence in Canada. The nonregistered foreign firms had no offices or subsidiaries in provinces other than Ontario as of end-1985. All of these firms also have been active in underwriting Canadian debt and equity issues abroad, mainly in New York and the Eurobond market.

U.S.-owned firms currently participate in Canadian capital markets in at least four other ways. First, at least two firms, a comprehensive financial services company and the Canadian subsidiary of a U.S. bank, each hold the current maximum allowable ten percent interest in domestic Canadian investment dealers. Second, U.S. bank subsidiaries are active in selected segments of the "exempt" market open to banks, including secondary trading in Treasury bills and bonds issued by the Federal Government. Citibank Canada is among the most active in the secondary market for GOC securities (but is currently not permitted in the group of primary dealers). As provided in the Bank Act and the Ontario Securities Act, foreign banks also may operate in the secondary equities market on an unsolicited basis through a registered broker and may participate in a selling group for underwriting corporate securities, again limited to filling unsolicited orders. Third, nonresident banks and non-bank institutions (e.g., insurance companies) actively market foreign collective investments to "exempt" market participants and the general public. Finally, subject to the discretion of the respective provincial authorities, U.S. securities and investment firms (but not commercial banks) provide investment and financial management advice to governments, public sector entities, and private institutional investors (but seldom to retail investors).

Treatment of U.S. and Other Foreign Institutions in the Canadian Securities Markets

Current Situation

The regulatory environment for foreign financial institutions is quite receptive in the Province of Quebec. In the Province of Ontario, the situation is in flux. In the past, the registration of nonresident securities firms has been prohibited, grandfathered foreign firms have been subject to discriminatory constraints on their growth, and nonresidents have been limited in the extent to which they may invest in domestic firms. However, the Provincial authorities announced new policy measures on December 4, 1986 which, when implemented, will eliminate these restrictions by June 30, 1988.

The Ontario Securities Act currently requires all firms wishing to do business in the Ontario securities market to register with the Ontario Securities Commission, unless specifically exempt. Under the regulations adopted in 1971, non-grandfathered foreign firms, even if they establish a subsidiary in Canada, have not been permitted to register with the OSC and therefore have not been able to engage in full-service business in Ontario. This has excluded them from underwriting public corporate debt and equity securities, membership in the Toronto Stock Exchange (also prohibited by separate TSE rules), access to the Bank of Canada for funding purposes, and involvement in retail brokerage activities.

The current Ontario regulations also provide that any domestic Canadian firm that is more than ten percent owned or controlled by a single foreign firm or more than 25 percent owned or controlled by several foreign firms may not register with the OSC. This so-called 10/25 rule has prevented meaningful direct investment by foreigners in Canadian domestic securities firms in the past. Federal and Ontario provincial laws have also applied this 10/25 rule to trust and loan companies, but they are not particularly active in the capital market.

The four foreign firms whose registrations were grandfathered by Ontario in 1971 have been subject to a complex code designed to limit their growth to not more than the average of the top Canadian firms in the securities industry (currently the eleven registered firms which have purchase and resale agreement privileges with the Bank of Canada). If profits result in faster growth than the average, they have been obliged to remit the excess earnings to the parent. Within the defined limits, the grandfathered firms may expand their equity base by selling shares to Canadians (i.e., by Canadianizing). However, they have not been able to acquire or absorb Canadian companies, and they have been able to bring in new capital only with the explicit approval of the OSC (which, as a matter of policy, has not been forthcoming).

Criteria applied by the Bank of Canada and the federal Department of Finance have effectively precluded foreign banks and non-grandfathered foreign securities from becoming primary dealers of long-term federal government paper. Traditionally, the Bank of Canada designated as primary dealers those firms with proven ability to assure widespread domestic distribution of federal securities. A major eligibility criterion is the amount of trading in GOC bonds in the secondary market. While most non-resident firms may lack the desired retail network to assure large-scale placement, Citibank Canada's secondary market activity in Canadian Government bonds exceeds the trading by the Big 5 Canadian banks. Nonetheless, Citibank Canada has not been able to become a primary dealer, while all the "Big 5" banks are primary dealers.

The Bank of Canada has also designated eleven registered securities firms in Canada (including Merrill Lynch) as "money market jobbers," giving them the ability to use the Bank of Canada as a lender of last resort to fund overnight inventories through purchase and resale agreements when the short-term money market dries up. The eligibility criteria are vague, but it is clear that the unregistered foreign firms in the "exempt" market are currently prohibited from using this facility.

Proposed Reform of the Ontario Securities Market

On December 4, 1986, the Ontario Minister of Financial Institutions, Monte Kwinter, announced the intention of the Ontario Government to allow full participation of nonresident firms as well as domestic financial institutions and non-financial investors in the Ontario securities industry.

During the last six months, the Ontario Securities Commission has consulted closely with the domestic securities industry and foreign dealers to develop the new proposals. The policy measures have received the approval of the Ontario Cabinet, and some reports indicate that the Federal Government has agreed to introduce complementary regulations to allow federally-regulated institutions to gain entry to the securities market when the new regulations take effect. The target for initial implementation is June 30, 1987, with full implementation for nonresidents by

June 30, 1988. According to the OSC chairman, the draft regulations will not be made public for several months, so a complete analysis is not possible at this time.

Minister Kwinter proposes to increase the limit on foreign ownership of a Canadian domestic securities firm in Ontario from 10 percent by a single foreign firm and 25 percent by several foreign firms, to 50 percent on June 30, 1987. Effective June 30, 1988, foreign ownership limits will be eliminated completely. Prior to that date, nonresidents will be able to have options or agreements in place to acquire 100 percent.

The Ontario Government intends to permit a foreign securities firm to establish as a subsidiary (but not as a branch), register, and participate unrestricted in the full-service market, effective June 30, 1988. Such a nonresident dealer could also become a member of the Toronto Stock Exchange and of the Investment Dealers Association. The Ontario authorities have not yet made clear their intentions concerning entry criteria, including possible reciprocity requirements. Between June 30, 1987 and June 30, 1988, a nonresident dealer will only be permitted to carry on "exempt" activities as a subsidiary.

Effective June 30, 1987, Ontario will impose no limit on investment in Canadian dealers by Canadian financial institutions or other Canadians. The Province would also not impose any restrictions on Schedule B (essentially foreign-owned) banks. However, it will be up to the Federal Government to introduce complementary regulations to allow banks to operate subsidiaries in the securities market.

Effective June 30, 1987, the Ontario authorities stated that the current grandfathered firms will not be subject to any capital or market restrictions.

The Province of Ontario announced that effective June 30, 1987, it would implement a universal registration system -- all activities in the "exempt" market for which registration was not required in the past would now require registration. Domestic financial institutions which engage in nonsecurities activities would be allowed to register, but only through a subsidiary. Foreign dealers would still be permitted to carry on "exempt" activities as set out in Sections 34(1) and 34(2) until June 30, 1988 through a subsidiary, at which time any foreign firm with a registered subsidiary would be unrestricted in its activities in Ontario.

Effective June 30, 1987, Schedule B banks will be able to maintain their presence in the Ontario "exempt" market, but only through a registered subsidiary. At this time it is unclear whether the Federal Government will grant national treatment to foreign banks and other foreign federally-regulated financial institutions to engage in full-service securities activities or to acquire domestic securities firms.

4. Japan - Banking

SUMMARY ASSESSMENT

Since the 1984 Update of the National Treatment Study, Japan has continued to provide national treatment for foreign banks and to implement a policy of internationalizing the yen and gradually liberalizing domestic financial markets. Several measures which have been implemented have provided new or significantly expanded competitive opportunities for foreign banks. Among the most important have been permission for selected foreign banks to enter the trust banking business, greatly expanded freedom for residents to engage in foreign exchange activities, authorization for foreign banks to deal in Japanese public securities, and the creation of new Euroyen instruments. Several specific problems of differential treatment of foreign banks have been resolved as the policy of national treatment has been pursued. Reciprocity considerations have occasionally entered into decisions on entry.

Despite major changes taking place in Japanese financial markets, foreign commercial banks continue to find Japanese markets difficult to penetrate and offering few competitive opportunities. The segmented financial structure reviewed in earlier reports remains essentially in place, with the attendant limitations on foreign banks expanding into areas that are the preserve of a different class of banking institutions. In the two years to September 1986, the share of bank deposits subject to interest rate controls had declined 9.8 percentage points to 80.4 percent. Improvements have been made in money markets, but the long standing problems foreign banks have had in funding themselves in domestic yen remain. The resulting funding and pricing practices make Japan a relatively uncongenial lending market for foreign banks. Foreign banks' small share of the loan market has declined modestly in the last three years.

Increasingly, foreign banks are shifting their attention to trading and capital market activities. New opportunities have developed in these areas both as a result of specific deregulation measures adopted by the authorities and as a by-product of the worldwide trend toward securitization. However, the guarded pace of deregulation has meant that sometimes foreign banks in Japan have been restricted in their ability to introduce and capitalize on techniques and products that have been successfully developed abroad.

Money market liberalization may continue to occur at a more measured pace than in other major financial markets. Further steps toward financial market liberalization are under consideration, and the Japanese authorities plan to liberalize interest rates on small denomination deposits. However, no public timetable beyond the spring of 1987 has yet been established to deregulate interest rates on time or interbank deposits under ¥ 100 million (about $650 thousand) which constitute the bulk of deposits, or Money Market Certificates (MMCs) under ¥20 million ($130 thousand). Nor is there a plan to shorten maturities on time or interbank deposits. The Ministry of Finance has reaffirmed its commitment to continued liberalization of Japanese financial markets. The Bank of Japan has made efforts toward achieving a more flexible short-term money market, and has indicated that if any obstacles should arise in the future, they are prepared to remove them. Treasury believes that some current practices and regulations still constitute obstacles to an efficient, self-adjusting money market.

As of August 1986, 27 Japanese banks were operating in the United States, through 25 subsidiaries, 70 branches, and 51 representative offices. As of year-end 1985, their total assets were $177.9 billion. In December 1983, 24 Japanese banks operating in the United States had $126 billion in assets.

Foreign bank presence in Japan has also changed over the last three years. In March 1983, there were 73 foreign banks from 20 countries; in August 1986, there were 79 foreign banks from 23 countries with a total of 115 branches. The number of representative offices has increased to 125 from over 100 three years earlier. American banks account for 19 of the foreign commercial banks established in Japan and 29 of the branches. In March 1983, there were 22 U.S. banks with 32 branches. Since 1985, nine foreign banks, including six American banks, have opened trust bank subsidiaries.

Foreign banks accounted for 3.9 percent of all bank assets in March 1986. This was down from 4.9 percent in March 1983. American bank assets were yen 4,666 billion, about 30 percent of the total foreign bank assets of yen 15,610 billion. In March 1983, the U.S. share was approximately 41 percent.

No national treatment issues have arisen with regard to the installation or use of automated teller machines (ATMs) in Japan, although no foreign banks have yet installed ATMs.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

In the 1984 Update, it was noted that substantial progress had been made toward national treatment since the 1979 Report. Among the important measures announced between 1979 and 1984 to improve the regulatory environment for foreign banks were: allowing foreign banks to enter the trust banking business and to trade

Japanese public sector securities; relaxing controls on overseas yen lending; eliminating swap limits; and liberalizing the regulations on yen certificates of deposit. It was expected that these measures combined with other steps announced in the Yen/Dollar Report would open a wide range of activities to foreign banks in Japan.

Domestic Banking System

The Japanese financial structure reviewed in earlier reports has remained essentially unchanged. Japan's banking system is composed of five major types of banking institutions: 13 large city banks, which operate nationwide; smaller local or regional banks, which are based in a prefecture and whose business activities are conducted primarily in the local area; three long-term credit banks, which were established for the purpose of lending long-term funds and which finance themselves primarily through issuing debentures; many small savings banks such as Sogo banks, Shinkin banks, credit cooperatives, and agricultural cooperatives; and 16 trust banks (of which nine are foreign banks with trust banking licenses). These trust banks conduct a general trust business and limited banking business, and are the major channel for pension fund management. In addition to private banking institutions, the postal system offers savings deposits to small depositors.

The city banks, which account for slightly more than half of all banking assets in Japan, are the principal competitors for foreign banks operating in Japan. Those banks, which include a number of large, multinational banks, are the major lenders to Japanese industry. The city banks finance a high proportion of their activities through deposits, especially time deposits. Because of the heavy demands for finance by major industries, the city banks are at times large net borrowers in the call, bill discount, and other short-term money markets and from the Bank of Japan. The funds obtained in the call and bill discount markets often come from the regional or local banks.

Long-term credit banks, which primarily engage in long-term financing, have fewer branches than city or local banks but operate on a nationwide basis. They are authorized to issue debentures but can accept deposits only from certain types of customers.

Automated teller machines (ATMs) at deposit-taking institutions were first introduced in Japan in 1969 and have grown to over 50,000. Each bank-owned ATM placed in a location other than the head office or a bank branch is considered a mini-branch of the bank; the Ministry of Finance limits these new ATMs to 30 per year per bank. Bank-owned ATM functions are limited to deposit making and withdrawals, and to transfers between accounts. Access to credits through bank-owned ATMs is permitted if the issuing credit card company is a bank subsidiary and the ATM used is owned by the parent bank. Bank-owned ATMs can be shared with ATMs of other domestic banks, but not with non-bank ATMs because of the separation of the cash and credit functions.

Participation by U.S. banks in a Japanese shared ATM system remains to be explored. No national treatment issues have arisen with regard to the installation or use of ATMs in Japan, although foreign banks have not yet installed any, primarily because their business is wholesale banking and their consumer deposit bases are of insufficient size to justify a network of Japanese ATMs.

Key Developments Since 1984

The 1984 National Treatment Update noted that the Japanese authorities were contemplating a number of steps which would liberalize yen markets and in the process improve equality of competitive opportunity for foreign banks. Numerous measures anticipated in the 1984 report have now been implemented. These include:

Establishment of Foreign Trust Banks

In June of 1985, nine foreign banks, including six American banks, were approved by the Ministry of Finance (MOF) for preliminary licenses to establish trust banking subsidiaries. Formal licenses were granted to all nine by March 1986. In addition to being the first authorization for foreign trust banks, this was also the first time foreign banks were permitted to establish a banking subsidiary of any form. Eight of the new trust banks are wholly-owned by their foreign parent. One has a small (five percent) participation by a Japanese trust bank. Approval for the subsidiaries required a waiver by the Japanese Trade Fair Commission of the standard legal requirement that a financial firm may not hold more than five percent of the shares of another firm. The waiver was granted without difficulty. Several additional foreign and domestic banks would be interested in obtaining trust banking licenses. At the present time MOF has no plans for granting additional licenses to either foreign or domestic banks.

Branching by Texas Banks

In June 1985, MOF announced it was lifting its restrictions on the establishment of branches in Japan of Texa banks. These restrictions had previously been an obstacle to entry into the Japanese market by Texas banks. To date, no Texas banks have applied for branch status in Japan. Three Japanese banks have established in Texas as agencies following repeal of the Texas constitutional provisions prohibiting branching into Texas by foreign banks.

Dealing in Public Bonds

In April 1983, MOF began the process of authorizing Japanese banks to deal in Japanese public bonds. The phased approval process involved an initial period when only retailing was permitted, a subsequent period during which dealing in maturities of up to two years would be permitted, and finally permission to deal in the full maturity range of Japanese public bonds. Some foreign banks were admitted to the government bond underwriting syndicate in April 1984. After two months, they were allowed to participate in retail business. In June 1986, MOF announced that it would waive the requirement that a bank deal only in bonds with less than two years' maturity for the first year after receiving the dealing license, for banks that had sufficient risk-taking abilities and experience in bond markets. An American bank was subsequently granted a license without the one year probation. The authorities have recently reconfirmed that membership in the government bond underwriting syndicate is not a prerequisite for qualification as a dealer. Moreover, they clarified that being a retailer of newly-issued GOJ bonds is not a prerequisite for qualifying as a dealer in government securities. Therefore, foreign banks with sufficient risk taking capacity and experience in bond markets may be granted a dealing license in GOJ bonds without the previous phase-in delays. By September of 1986, eleven foreign banks, including eight American banks, had been approved for dealing in the full range of maturities.

Bank Swaps

In June 1984, the limits on oversold spot foreign exchange positions, so-called swap limits on the conversion of foreign currency into yen, were entirely removed for both foreign and Japanese banks. With this liberalization foreign banks gained a major additional source of yen funding for their Tokyo operations. For most foreign banks, swaps now constitute an important source of yen funding. While unrestricted availability of swap funding has enhanced the flexibility and business scope of foreign banks, reliance on swaps reflects the limited network of branches and, in part, the still limited opportunities for efficient funding in Japanese money markets (as noted below). Use of swaps generally means funding is provided by overseas offices and American banks have pointed out that such funding is treated as country risk and subject to limits established by their head office. In addition, the swaps have exchange risks or additional costs due to hedging operations.

Certificates of Deposits

In the domestic market the allowed minimum maturity for CDs was reduced from three months to one month in April 1985, and in April 1986, the maximum maturity was extended from six months to one year. The ceilings on issuance of CDs were increased on three separate occasions for both domestic and foreign banks. Domestic banks may now issue CDs up to 250 percent of their net worth and foreign banks may issue up to 125 percent of their gross yen assets. These ceilings are well beyond actual issuance levels for both foreign and domestic banks. CDs could be made more attractive if among other things the one-month minimum maturity were reduced and the check-back requirement were eliminated.

Money Market Certificates

In the spring of 1985, domestic and foreign banks were allowed to issue a new funding instrument, a money market certificate (MMC). Interest rates on MMCs are linked to, but 75 basis points below, the average rate on CDs. Issue limits are set the same way as issue limits are set on CDs. The ceilings have been raised three times and are now well in excess of actual issuance. Maturity restrictions are the same as for CDs, although there are plans to extend the maximum maturity of MMCs to two years in the spring of 1987. Minimum denominations have been progressively reduced and are smaller than those on CDs but still remain relatively high for the small saver. MOF intends to reduce further the minimum denomination of MMCs from the current ¥ 30 million ($195 thousand) to ¥ 20 million ($130 thousand) by spring 1987.

Deposit Interest Rate Controls

In October 1985, the Ministry of Finance began deregulating deposit interest rates by allowing deposits with a minimum denomination of yen one billion (approximately $6.5 million) to be accepted at freely determined interest rates. The minimum denomination was reduced to yen 500 million (about $3-1/4 million) in April 1986, to yen 300 million (slightly under $2 million) in September 1986, and is scheduled to drop to yen 100 million (roughly $650,000) in April 1987. It is expected that this last step will be implemented on schedule. A specific timetable has not been established for further interest rate deregulation, leaving the bulk of deposits subject to interest rate controls. However, the Japanese Government is considering interest rate deregulation of smaller denomination deposits. There are no plans to reduce the three month minimum maturity restriction which exists on all time and interbank deposits.

Interbank Markets

In the interbank market a number of steps have been taken to broaden the call and bill discount markets. Maximum maturity on bills has been extended to six months. Maturity dates on call money have been increased. In addition, in response to requests from foreign banks, the Bank of Japan permitted for the first time in July 1985 dealing in uncollateralized call money in certain maturity ranges.

Uncollateralized call money now accounts for approximately 15 percent of the call market, with foreign banks the principal takers. Because collateral is not required, uncollateralized call money is generally about one-eighth percentage point more expensive than collateralized call money. Remaining collateral requirements in the two to six day maturity range appear unnecessary, given the smooth functioning of the uncollateralized market.

Liberalization in deposit taking and interbank funding has expanded the range of opportunities available to foreign banks and Japanese banks, and has provided some bank customers a greater opportunity to earn a competitive return. However, as discussed below, these liberalization measures have not yet created a commercial environment in which the new opportunities are widely attractive to foreign banks. Swaps, rather than domestic funds, still remain one of the most attractive sources of purchased funds for many foreign banks.

Treatment of U.S. and Other Foreign Banks

U.S. banks can enter Japan as branches, subsidiaries, or representative offices. Opening branches in Japan can be time-consuming and frustrating, but Japanese authorities have made efforts to render this process more rapid and straightforward. The acquisition of Japanese banks by foreign banks may be possible if the requirements, which would depend on the precise form of acquisition, of the Anti-monopoly Law, the Foreign Exchange and Foreign Trade Control Law, and/or the Banking Law are met. To date, there have been no foreign acquisitions of Japanese banks, and Ministry of Finance policy in this area has not been tested.

Despite numerous steps which have been implemented to liberalize Japanese financial markets and widen the scope of opportunities available to foreign banks, they remain fringe participants in the Japanese banking market. By some measures, the foreign bank share of commercial banking has eroded in recent years. In March 1983, foreign banks accounted for 3.5 percent of total bank lending and 0.9 percent of total bank deposits. By March 1986, these shares had declined to 2.3 percent and 0.8 percent respectively.

These results reflect competitive pressures and the disadvantages faced by foreign banks in Japan's regulated financial environment. As in other major centers, securitization has spread rapidly in Japan. Customers of greatest interest to foreign banks now have expanded alternatives and can command the finest terms on bank credits. Simultaneouly, major Japanese corporations have experienced substantial improvements in their balance sheets and have reduced requirements for bank credit. Throughout the Japanese banking system, bank lending margins have contracted.

Foreign bank lending in Japan has also been eroding as a result of liberalization of foreign currency lending to Japanese residents. Consistent with national treatment, this activity which had earlier been a monopoly of foreign banks was fully opened to Japanese banks in 1980. With their extensive international networks, Japanese banks are competitive in offering foreign currency loans. American banks retain their advantage in dollar business but the effect of the liberalization has been to dilute their share of the foreign currency lending business in Japan, which remains active.

The squeeze on lending margins has been particularly painful for foreign banks. Unlike the Japanese institutions with their extensive deposit gathering branch networks, foreign banks fund themselves almost exclusively with purchased funds. Although marginal cost pricing has made some headway, prevailing loan rates to a considerable extent still are set on the basis of the blended cost of funds to Japanese banks. Funding costs of Japanese banks tend to be lower than those of foreign banks since they have a large network of deposits at controlled interest rates on which to draw. Despite the partial liberalization of interest rates, 80.4 percent of ordinary deposits of Japanese banks remained subject to interest rate controls as of September 1986, although this was down from 90.2 percent in September 1984. Ordinary time deposits with a maturity of less than 90 days are not authorized, let alone liberalized, and demand deposits yield very low, controlled rates. This is the funding maturity of most interest to American banks since their loan book tends to have a very short maturity.

Money markets in Japan remain underdeveloped in comparison with the United States and recent improvements have generated only marginal benefits for foreign banks. Interbank transactions in the call money and bill discount market are still primarily conducted on a collateralized basis using first class commercial bills. Foreign banks have limited opportunity to generate such bills due to the nature of their business. Foreign banks' access to Bank of Japan (BOJ) discount facilities is also limited because prime commercial bills are customarily required to use these facilities. Newly introduced uncollateralized call transactions are actively used by foreign banks but are more expensive than the conventional collateralized transactions. No direct interbank deposit market in yen has developed because: (a) time deposits shorter than 90 days are not permitted; (b) rates on shorter maturities are controlled and low; (c) reserve requirements on interbank deposits add costs that are not incurred in the call or bill discount markets; and (d) the BOJ has indicated a preference that banks use the call and bill discount markets. Very tentative steps have been taken to introduce a Government of Japan Treasury-bill instrument, but due to the many unattractive features of this security, this market has not developed into a deep, liquid short-term market which can provide a benchmark for money market rates or a channel through which the BOJ could concentrate its open market operations.

For institutional or policy reasons, interest rates in the call and bill discount market do not move freely in response to changes in market supply and demand conditions. For example, between May 23, 1986 and July 15, 1986 the rate on two-month bills was unchanged at 4.63 percent. The short-term prime rate is set a fixed margin over the BOJ discount rate rather than being linked to a measure of the money market cost of funds. Recently, the short-term prime has been 4.125 percent while yields on two-month bills have been 4.81 percent.

This combination of market practices and rate setting procedures leaves foreign banks at a competitive disadvantage in the commercial lending business. For Japanese banks, the interbank rates provide a rough reference for establishing loan rates but are relatively insignificant as an indicator of funding costs since, as noted above, the bulk of Japanese banks' funding is generated from customer deposits at controlled interest rates. Foreign banks, on the other hand, fund themselves in the wholesale market while competing for loan customers at prevailing market rates.

With restricted opportunities in the lending business, major American banks have turned their attention increasingly to trading activity, capital market operations, and, to the extent permitted, securities operations.

Market developments and liberalization of Japanese foreign exchange rules have led to a major expansion in the Tokyo foreign exchange business. Removal of the real demand rule in April 1984 significantly expanded the latitude for Japanese residents to engage in foreign exchange transactions. Direct bank-to-bank trading in yen against dollars was permitted in February 1985. American banks have been highly competitive in the growing foreign exchange business and reportedly account for a significant share of foreign exchange dealing in Japan.

With the dramatic growth of Japanese investments in the United States, American banks have greatly expanded their activity in Japan in U.S. Treasury securities. Under the separation of the banking and securities business, banks are not, however, permitted to act as dealers in foreign securities in Japan.

Major U.S. banks would be interested in receiving a license to participate in the general securities business. In late 1985, the Ministry of Finance modified its policy to permit overseas affiliates of several European banks to enter the securities business in Japan. The applicability of its policy to U.S. banks is under review. The Ministry of Finance has indicated that it favors, to the extent possible under Japanese law, equal treatment of U.S. commercial banks and those from universal banking countries.

As noted above, Japan has implemented on schedule specific commitments in the 1984 Yen/Dollar Report concerning internationalizing the yen, gradually liberalizing domestic financial markets and providing national treatment for foreign banks. Nevertheless, despite major changes in Japanese financial markets, foreign commercial banks continue to find Japanese markets difficult to penetrate. Improvements in short-term money markets have provided only marginal benefits to foreign banks. The guarded pace of deregulation in Japan has constrained their ability to capitalize on techniques and services developed successfully abroad. The Japanese financial authorities have reiterated their commitment to continued liberalization of their financial markets.

5. Japan - Securities

SUMMARY ASSESSMENT

The securities industry in Japan is generally separated from the banking industry. In recent years, the Japanese authorities have taken a number of important steps to liberalize the treatment of U.S. financial institutions doing securities business in Japan. As a result of these changes, U.S. firms are experiencing increased business opportunities, rising employment, and strong increases in business volumes. Foreign firms, however, still find less than full equality of competitive opportunity in Japan. In some instances, national treatment problems remain. The transparency of the Japanese system also continues to pose some difficulties. Major problems of foreign firms seeking to do securities business in Japan, moreover, derive from laws and policies inhibiting introduction of innovative products -- raising issues not normally considered national treatment issues.

Foreign securities firms are able to enter Japan as branches and as representative offices. While foreign securities firms have not established subsidiaries to date in Japan, the Ministry of Finance (MOF) is now prepared to consider applications to do so from foreign securities firms.

Foreign securities firms have also considered entering the Japanese market through the investment in or the acquisition of domestic securities firms. An attempted takeover, or foreign acquisition, of more than a five percent interest in a Japanese firm in the securities business is subject to Japanese anti-monopoly law and review by the authorities.

Although securities activities in Japan have generally been confined to securities firms, MOF has recently permitted overseas affiliates of several European banks to enter the securities business, one under its own name. These banks have not been able to hold more than a 50 percent interest in the affiliate branching into Japan. The applicability of this policy to overseas affiliates of U.S. banks is currently under review. The Ministry of Finance has indicated that it favors, to the extent possible under Japanese law, identical treatment of U.S. commercial banks and those from universal banking countries.

The Ministry of Finance espouses a policy of national treatment for foreign firms once they are established in Japan, and progress has been made in recent years to improve the treatment of foreign financial institutions in the Japanese securities market. In December of 1985, the Tokyo Stock Exchange expanded the number of seats from 83 to 93, with U.S.-controlled firms purchasing four of the six seats awarded to foreign firms. In June of 1985, MOF allowed nine foreign banks, including six U.S. banks, to engage in trust banking, the major channel for corporate pension fund management in Japan. MOF has more recently addressed two previously outstanding national treatment issues: it has permitted foreign securities firms to align their leverage ratios with those of domestic firms and, as noted above, has indicated its willingness to consider applications by foreign securities firms to establish subsidiaries.

Despite this progress, foreign firms find less than full equality of competitive opportunity in Japan in some instances. Membership on the Tokyo Stock Exchange continues to be a fixed number which effectively denies access to some foreign as well as domestic firms which have expressed interest. Foreign firms receive a disproportionately small share of five and 10-year government bonds issued through the bond underwriters syndicate system. And, in authorizing rating companies to rate Euroyen, Samurai or Shogun securities, MOF applies different eligibility criteria to foreign and domestic rating firms.

As a practical matter, U.S. firms seem most frustrated by a combination of factors which make it very difficult for a newcomer to break into the securities business in Japan. These factors are not normally defined as national treatment issues, even though they may disadvantage firms seeking to offer their most competitive services. For example, many U.S. firms feel unable to exploit their strength in developing innovative products and services because such products/services are not permitted in Japan.

Since the 1984 Report on Yen/Dollar Exchange Rate Issues (the "Report"), important progress has been made regarding access to Japanese markets by foreign financial institutions, capital market liberalization, and the development of a Euroyen market. Specific measures contained in the Report have been implemented on schedule. Commitment to the spirit of the Report is essential to ensuring equality of competitive opportunity for foreign firms in Japan. The Japanese authorities have indicated that, as a policy matter, they intend to take additional steps to further liberalize their financial markets.

NATIONAL TREATMENT REVIEW

Domestic Securities Market

Japan has a large and growing securities industry, second in size only to the American market. By the end of 1985, bonds outstanding totaled yen 260 trillion ($1.7 trillion). Secondary trading in Japanese bonds expanded 44 times between 1975 and 1985. The market value of equities listed on the Tokyo Stock Exchange (TSE) in 1985 was nearly yen 200 trillion ($1.3 trillion), almost half the value of equities listed on the New York Stock Exchange (NYSE). Trading volume on the TSE was one third that of the NYSE.

Government paper dominates the bond market. Publicly offered central and municipal government bonds and government guaranteed bonds accounted for 60.3 percent of all outstanding bonds in Japan in 1985. Private placements, most of which are municipal bonds, accounted for another 16.4 percent. Bank debentures were 15.9 percent of the total, corporate bonds 3.7 percent, convertibles 1.7 percent and foreign yen-denominated bonds 2.0 percent.

Under the Securities and Exchange Law, the banking and securities business is strictly separated except for activities pertaining to national and local government bonds, and government guaranteed bonds. "Securities" and the "securities business" are defined in the Securities and Exchange Law and provide the framework for Ministry of Finance (MOF) regulations. Authorizations for dealing, brokering, underwriting and public offering require a specific license from MOF. A MOF license as an investment trust management company is also required to offer domestic collective investment trusts under the Securities Investment Trust Law.

Under the Pension Fund Law, management of pension funds is currently reserved for trust banks and life insurance companies, which also manage other types of non-pension funds. A new category of asset management has recently been created with the May 1986 passage of the Investment Advisors Act, which will permit investment advisors to engage in discretionary management subject to MOF license. The Pension Fund Law will limit management by investment advisers to non-pension funds.

As of August 1986, there were 76 Japanese companies licensed to do the full range of securities business as defined in Japanese law (brokering, dealing, underwriting and public offerings). A major reorganization of the securities industry occurred in the late 1960s, and no new domestic securities firms have been licensed since 1976. The four leading Japanese securities firms are among the largest in the world. They are well capitalized and offer a full range of securities services both in Japan and abroad, where they may offer a wider range of products and services than those permitted in Japan.

U.S. Presence in the Japanese Securities Market

With the growth of Japanese capital markets and increased internationalization of the securities business, foreign securities firms have in recent years rapidly increased their presence in Japan. Since September 1983, their revenues have risen roughly fourfold and the size of staffs in Japan have more than doubled. In 1983, only eight foreign securities firms, of which seven were American, had fully licensed securities branches in Japan. By October 1986, this number had risen to 28, of which 14 were American. In addition, 124 foreign securities firms had established representative offices. Thus far, no foreign firm has established a securities company subsidiary.

The scope of foreign securities firms' activities in Japan is broadening. The primary focus of their business in the past has centered on the intermediation of international securities transactions, selling foreign securities to Japanese investors or Japanese securities to foreigners. Increasingly, however, foreign firms, especially American firms, have sought to expand their Tokyo operations to participate in the Japanese debt and equity markets in competition with Japanese firms for Japanese customers. In particular, they have become more active in the Japanese government securities market, expanding their clients to include domestic Japanese institutional investors, and have provided them with advice on the U.S. Treasury market as well. Greater trading in Japanese equities is another major focus. Four of the six Tokyo Stock Exchange seats recently awarded to foreign securities were purchased by U.S. controlled securities firms.

Foreign banks and their capital market affiliates are also increasingly active in securities activities in which they are permitted to operate. Two U.S. banks have an equity interest in foreign securities firms which have a Japanese securities branch license. Other American banks have also approached MOF about obtaining securities licenses for overseas affiliates. Eight of the 11 U.S. banks participating in the government bond underwriting syndicate have received licenses to deal in the full maturity range of government and government-guaranteed bonds. In 1985, nine foreign banks, of which six were American, were for the first time permitted to establish subsidiaries or joint companies to engage in trust banking activities, the major channel for managing corporate pension funds in Japan.

Treatment of U.S. and Other Foreign Institutions in the Japanese Securities Market

The establishment of foreign securities companies in Japan is governed by two securities laws: the Law on Foreign Securities Firms and the Securities and Exchange Law. The Law on Foreign Securities Firms was designed to administer entry and regulation of foreign securities firms, although it refers primarily to the establishment of a branch, which requires a MOF license. The establishment of a representative office requires only prior notice to MOF. A firm wishing to establish as a subsidiary would have to apply under the provisions of the Securities and Exchange Law.

Application for establishment of an additional office of a foreign firm resident in Japan is treated as a de novo branch application, and can be burdensome and time-consuming. In response to requests by American firms, MOF has simplified applications for second and subsequent offices in an effort to make the procedure the same as that for licensing new branches of domestic firms. One reason a foreign firm might want to establish a subsidiary would be to consolidate multi-branch operations and facilitate the expansion of additional offices.

Thus far, no foreign securities firm has entered Japan in the form of a subsidiary. Until 1985, MOF indicated its preference that foreign firms enter Japan as branches established under the Law on Foreign Securities Firm. This may have been partially due to a general policy against the further licensing of securities subsidiaries, either by foreign or Japanese firms. In July 1986, MOF announced that it would be prepared to consider applications by foreign securities firms to establish subsidiaries.

The acquisition, or takeover, of a Japanese securities firm by either a domestic or foreign securities firm is regulated by Japanese antimonopoly law. In general, a financial firm may not hold more than five percent of the equity, whether voting or non-voting, of another firm, unless there is specific approval by the Japan Fair Trade Commission (FTC). Mergers or joint ventures are subject to the same provisions. The spirit of the law fosters limits on excessive concentration and discourages dilution of fair competition. Although some foreign firms have considered entry into the Japanese market via this approach, there have to date been no such acquisitions.

Banks are in general prohibited under the Securities and Exchange Law from entering the securities business. However, provisions under the Law on Foreign Securities Firms have been interpreted by MOF to permit licenses for some European banks to open securities branches in Japan through overseas affiliates in which they own no more than 50 percent. One of these entered the Japanese market in its own name. In addition, two U.S. banks have acquired an equity interest in foreign securities firms that had a securities branch in Japan or had substantially fulfilled the requirements for opening a branch prior to the acquisition. MOF policy with respect to entry into the securities business of overseas affiliates of foreign banks is currently under review. The Ministry of Finance has indicated that it favors, to the extent possible under Japanese law, identical treatment of U.S. commercial banks and those from universal banking countries.

The Japanese Government espouses a policy of national treatment for foreign securities firms once they are established in Japan. MOF has taken steps to remove barriers that had disadvantaged foreign firms relative to Japanese firms, and believes that all identified areas of explicit regulatory discrimination against foreign firms have been reconciled and that equality of competitive opportunity exists. In addition to allowing foreign banks to engage in trust banking and agreeing to consider establishment by foreign securities firms of securities subsidiaries, MOF encouraged wider membership on the Tokyo Stock Exchange, and has authorized foreign securities firms, previously subject to different and more restrictive capital ratio requirements, to employ the same ratios used by Japanese firms.

American firms have few remaining complaints about overt regulatory discrimination. In fact, many firms have acknowledged the numerous new opportunities currently available to do business in Japanese financial markets. Nevertheless, some problems continue to arise because of lack of full transparency of MOF's policies, criteria and operating procedures. And obstacles not normally related to national treatment inhibit the ability of U.S. firms to compete in the Japanese market.

Until 1985, no foreign firms were members of the Tokyo Stock Exchange. In August 1985, the TSE agreed to expand its membership from 83 to 93, and in December 1985, foreign firms were permitted to purchase six of 10 newly created seats. The Ministry of Finance believes that with the entry of the six foreign firms, national treatment is provided in regard to TSE membership. The limited number of seats continues to restrict membership, but this applies to domestic as well as foreign firms.

Membership on the Tokyo Stock Exchange will continue to be a matter of interest to many foreign as well as domestic firms. Several U.S. firms with extensive expertise in equities markets were among those not selected, and they remain interested in obtaining seats, as do numerous other firms expanding business in Tokyo. These firms are effectively barred from membership because the sale of existing seats is so rare. The Japanese authorities argue that, since the TSE expanded its membership to the maximum extent possible in light of the physical limitations of the trading floor space, it would be virtually impossible to expand membership further in the immediate future, given the present stage of progress in computerization. The U.S. view is that while the opening of the TSE to foreign firms last year was welcome, it was in itself insufficient and this inadequacy continues to be a major irritant. The U.S. feels that the TSE has a responsibility to make the Exchange more open to competition and that this can be achieved within present physical space conditions. Although the TSE is a private organization, the U.S. further believes that MOF should, given its ongoing supervisory authority, pursue efforts to encourage wider membership.

Foreign firms are allocated a very small proportion of bonds in the government bond underwriting syndicate. Five and 10 year government bonds are sold through a syndicate of more than 700 members. Thirty-six foreign securities firms or banks, including 9 U.S. securities firms and 11 U.S. banks, are members of the syndicate. Allocations are based on a syndicate member's size of operations and experience only in Japan. As a result, even large foreign securities firms and banks with extensive experience in government bond markets receive an extremely small fraction of each issue (less than 0.1 percent each), which is comparable to those often allocated to small Japanese securities firms and the regional banks.

The U.S. Treasury has raised this issue with the Japanese authorities. As one solution, it has strongly encouraged the issuance of all government bonds through the auction process. MOF has explained that while the proportion of bonds issued through auctions is rising, the underwriting system is still an important method of debt management. The Ministry of Finance has asked the underwriting syndicate to re-examine the question of allocations.

Foreign companies are also disadvantaged by the criteria MOF uses to authorize securities rating companies to issue ratings for use in the Euroyen, Samurai or Shogun bond markets. MOF believes it appropriate to apply eligibility criteria to foreign rating companies that differ from those applied to domestic companies in order to nurture Japan's fledgling securities rating industry. While the implications of this policy may be limited, it is a denial of national treatment. Discussions with the Japanese authorities on this subject are continuing, and the most recent contact has provided some encouragement that movement toward a resolution may be possible.

The transparency of MOF's policies and regulations continues to pose problems in some areas for foreign firms. In past Yen/Dollar discussions, the Japanese authorities indicated that "clear, straightforward guidelines, statements or rule interpretations will be made available in writing as appropriate." Despite important improvements in this area over the last two years, some American firms still feel that they are not fully consulted during the process of regulatory change and occasionally are not informed about such changes until after final decisions are taken.

For instance, foreign securities firms have been interested in bidding in the medium-term (2, 3, and 4 year) government bond auctions. They were excluded from these auctions until August, 1986, because they did not have the current accounts with the Bank of Japan required by the Ministry of Finance for participation. With the recent approval of two U.S. firms' applications for Bank of Japan accounts, these two firms are able to participate in the bond auctions and potentially borrow in the call money market. MOF has expressed a willingness to consider increasing the number of participants in medium-term auctions.

Foreign firms would also like to expand their activities in the non-government securities market, particularly in the yen bond private placement market for foreign issuers (Shibosai market). Although management of these issues had traditionally been the preserve of Japanese securities firms, long-term credit banks and trust banks, beginning in 1985 Japanese city banks have also been able to lead arrange these issues. Some foreign banks, however, recently attempting to lead arrange Shibosai placements for foreign customers were given conflicting information by MOF regarding their ability to do so. Subsequently, the Ministry of Finance has indicated that there should be no discrimination against foreign firms in lead arranging yen bond issues in Japan, including private placements. Recently, a U.S. bank was approved to lead manage an issue in the yen bond private placement market.

Foreign firms have also expressed uncertainty about regulations governing the sale of foreign investment trust funds in Japan. Until recently, MOF had imposed: an annual limit on the total number of foreign funds that could be introduced into Japan; a per-firm limit; and restrictions on the size of each fund. MOF has indicated that these restrictions no longer exist.

The established channel in the securities industry for discussing and disseminating information on regulatory change is the Securities Dealers Association of Japan (SDAJ). Foreign firms are members of the SDAJ. However, because of their prominence, the big four Japanese securities companies are perceived as having a dominant role in the SDAJ. As a result, foreign firms feel that decisions are sometimes effectively made before foreign firms are able to make their views known.

Apart from national treatment issues, there is a general feeling by foreign firms that the overall pattern of market practices and nonprudential regulations in Japan places them at a competitive disadvantage vis-a-vis Japanese firms in both the domestic and international market place. Outside Japan, foreign firms see themselves as very competitive in an increasingly internationalized securities market, in which their major competitors are frequently the foreign affiliates of Japanese firms. American firms, in particular, feel that their competitive advantage lies in their ability to offer new innovative financial products and a wide range of financial services. Some are frustrated, however, because they feel unable to exploit this strength in Japan due to their inability to offer many of these products and services there. On the other hand, Japanese firms are seen as having the ability to experiment, innovate and imitate in open and competitive markets outside Japan. These U.S. firms feel that by the time new products and techniques are permitted in Japan, Japanese firms have caught up with their foreign counterparts and the foreign firm no longer has any advantage over a Japanese firm. Meanwhile, Japanese firms have been able to compete aggressively for market share internationally, supported financially by their dominance of the Japanese market. MOF states that it admits new products when satisfied that there are no problems from the viewpoint of investor protection and that it has no intention of seeking advantage for Japanese firms.

In terms of entry into, or the introduction of, new product/ service areas in Japan, foreign firms are especially interested in selling foreign financial futures in Japan, offering money market accounts and indexed securities, and being able to sell government securities short.

As noted above, important progress has been made since the 1984 Report on Yen/Dollar Exchange Rate Issues regarding access to Japanese markets by foreign financial institutions, as well as capital market liberalization, and the development of a Euroyen market. Specific measures contained in the Yen/Dollar Report have been implemented on schedule. Commitment to the spirit of the Report is essential to ensuring equality of competitive opportunity for foreign firms in Japan and continued liberalization of Japanese financial markets. MOF has reaffirmed its commitment to such liberalization.

6. Argentina

SUMMARY ASSESSMENT

Since 1984 there has been no change in the degree of national treatment accorded foreign banks in Argentina, and the country has been essentially closed (since 1982) to new foreign bank entry and the expansion of existing foreign (and domestic private) bank operations. Although in principle foreign banks already operating in Argentina are treated equally in relation to private domestic banks, their competitive abilities are constrained by regulations favoring public sector banks and nonbank financial institutions. Very recent government proposals would, if adopted, aggravate the disadvantages facing foreign banks by doubling their capital requirement.

As a result of entry and expansion under less restrictive practices prior to 1982, foreign banks became well-established in Argentina. However, amidst ongoing consolidation of the financial system, foreign banks' market share of banking system deposits has declined from 14.7 percent in 1983 to 12.2 percent in 1985. Difficulties facing foreign banks in Argentina appear to result in part from government policies designed to address high levels of inflation and credit expansion, rather than to discriminate against foreign banks.

As of year-end 1985, eight U.S. banks had 70 branches (plus 2 representative offices) in Argentina with total assets of $1,376 million. An additional 12 U.S. banks maintained representative offices. As of year-end 1985, U.S. banking corporations reported a controlling interest in 17 subsidiaries or affiliates in Argentina with total assets of approximately $340 million. In late October 1986, BankAmerica, which owns a subsidiary bank in Argentina with $80 million in assets and 60 branches, announced plans to sell 20 of those branches to two other U.S. banks which already operate in Argentina.

At year-end 1985, three Argentine banks operated three branches, three agencies, and one representative office in the U.S. with total assets of $1,548 million. An additional seven Argentine banks maintained representative offices in the United States.

Two U.S. banks participate in Argentina's largest ATM network. Foreign banks are effectively prevented from expanding their ATM services beyond their existing branch networks.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

There was no individual country chapter on Argentina in the 1984 report. At that time, the Argentine Government policies prevented existing foreign banks from expanding their operations and also prevented new foreign banks from entering the Argentine market.

Domestic Banking System

Commercial banks dominate the Argentine financial system. They hold 89 percent of total deposits, operate 97 percent of total branches, and render a full range of services such as are offered by modern banks in other countries. There are three types of commercial banks: official banks (national, provincial, and municipal, which together hold 48 percent of deposits), private domestic banks (which hold 29 percent of deposits), and foreign-owned banks (holding 12 percent of deposits).

In addition to commercial banks, there are a small number of development and investment banks, a mortgage bank and a savings bank. Development banks operate as state-directed institutions to finance medium- and long-term fixed asset investments, a service typically avoided by commercial banks. Investment banks, as a result of the inflationary history and uncertain business climate in Argentina, have done little business in the recent past. The country's sole mortgage bank, a state-owned institution, grants loans for purchase of or construction on real estate. There is one state-owned savings and insurance bank. Together these institutions hold less than 10 percent of total deposits.

A variety of nonbank financial institutions (finance companies, savings and loans, and credit unions) round out the financial system but together hold less than 2 percent of total deposits.

Table 6.1
Financial Institutions in Argentina

(November 30, 1985)

	Number of Head Offices	Number of Branches	Deposits (Per Cent)
I. Banking Institutions:	198	4,513	98.3
A. Commercial Banks	191	4,374	88.7
1. Official Banks	32	1,803	47.8
of which:			
National	2	546	23.9
Provincial	25	1,191	20.6
Municipal	5	66	3.3
2. Domestic Private	128	2,231	28.7
3. Foreign Private	31	340	12.2
of which U.S.	10	117	5.3
B. Development Banks	2	33	1.6
C. Investment Banks	3	--	0.0
D. Mortgage Banks	1	53	5.2
E. Savings Banks	1	53	2.8
II. Non-Banking Institutions:	117	187	1.7
A. Finance Companies	71	149	1.1
B. Home Savings and Loans	13	29	0.4
C. Credit Unions	33	9	0.2
Total Financial Entities	315	4,700	100.0

Source: Banco Central de la Republica de Argentina.

Commercial banks' deposits are essentially short-term, the consequence of the country's history of high inflation. Seven-day certificates are perhaps the most popular and a 30-day term is considered the maximum for fixed-rate deposits. The public's sensitivity to Argentina's inflation is illustrated by its avoidance of checking accounts and the shrinkage of the money supply relative to GNP during the disintermediation of 1981-1985 (from 7.7 percent of GNP in 1980 to 2.45 percent by mid-year 1985).

The high volume of bank transactions evidenced by fast velocity of the money stock, combined with the rapid frequency of roll-over of time deposits, leaves the banking system with a heavy work burden. Yet automation is at a low level and transactions are usually recorded manually. As is frequently the case in Latin America, commercial banks also provide a variety of labor-intensive public services, such as collecting utility and credit card bills and some tax payments, and serving as a conduit for payment of pensions.

Due to the high labor content of recording bank transactions, plus the unusual strength of the bank employees' union, the Argentina banking industry has one of the world's lowest ratios of deposits per employee, one-twentieth the U.S. level.

As a consequence of these conditions, the financial system has undergone, and continues to experience, shrinkage and consolidation of operations. Twelve private domestic banks and another 75 nonbank financial institutions ceased independent operations between 1983-1985. In June 1986 it was estimated that the Banco Central de la Republica de Argentina (BCRA, the Argentine central bank and bank supervisor) still had 170 financial institutions under its emergency control. Financial institutions undergoing BCRA-controlled liquidation are typically kept open for 3 to 4 years or more pending sale, a practice which allows personnel to remain employed but which slows the removal of inefficient operations from the banking industry. The process of financial sector consolidation is ongoing.

As the central monetary authority and supervisor of the banking system, the BCRA establishes reserve requirements for banking institutions, regulates interest rates on a substantial portion of deposits, and sets limits on lending activity to achieve its policy objectives. A series of bank reforms undertaken in April 1985 (and subsequently complemented by the Austral economic adjustment plan which followed in June) permitted all banks to offer a greater volume of deposits and loans not subject to interest rate ceilings. The reforms were designed to attract funds back into the banking system, but initially damaged the credibility of the weaker private Argentine banks. The BCRA reacted by giving preferential treatment to private Argentine banks relative to the public sector and foreign banks, who were generally perceived to be more secure. As a result, by June 1986, private Argentine banks (as well as cooperatives and credit unions) were permitted to offer modestly greater relative volumes of free-rate deposits, compared to public sector and foreign banks.

The expansion of foreign banks' operations in Argentina occurred in the mid-1960s and in the period 1979-1982 when government regulations were relaxed to allow new banks to enter and existing banks to extend their branch networks. The decline over the last three years in the share of the Argentine market held by foreign banks is attributable in part to the Government's restrictions on all private banks, foreign and domestic, and in part to foreign banks' actions related to their desires to reduce their credit exposure to Argentine interests in light of Argentina's economic troubles. Deposits in the 10 U.S. banks currently operating in Argentina represent a 5.4 percent share of the total deposits of the Argentine system and about 44 percent of the total placed in foreign banks. Although there is no limitation on banks' establishing representative offices in Argentina, the recent trend has been to consolidate such offices.

Electronic banking has developed markedly in Argentina since 1984, although there is as yet no body of explicit government regulation over such activity. There are two limited systems of automated teller machines (ATMs), the largest of which is owned by a group of three Argentine, two U.S., and seven associated Argentine banks. ATMs are effectively considered branches if separate from bank premises; the authorities have largely restricted ATMs to existing commercial bank offices so as to avoid a de facto expansion of branch banking.

In September 1986, the Argentina Government drafted a financial reform bill which if adopted would require private banks to contribute to a deposit insurance fund, would require registration of separate categories of financial institutions, would restrict lending by financial institutions' affiliated companies, and would impose a discriminatory doubling of the capital requirement for foreign banks.

Key Developments Since 1984

Operating conditions in the Argentine financial system have deteriorated since 1984 due to ongoing inflation, disintermediation from the banking system, and recurrent business and financial institution insolvency.

The Argentine authorities have directed their efforts to attempt to stabilize the demonetization of the economy and begin the removal of inefficient operations from the financial sector. Government policy has favored public sector banks over foreign and domestic private banks.

Recently proposed legislation would double the capital requirements for foreign banks but not for domestic banks.

Treatment of U.S. and Other Foreign Banks

U.S. banks have a long history in Argentina; Citibank was the first U.S. bank to establish a branch office in 1914, and Bank of Boston followed suit in 1917.

There are now 10 U.S. banks which offer commercial banking services in Argentina. A U.S. bank was recently allowed to convert its majority interest in an Argentine bank into a direct branch bank operation. Another 14 U.S. banks are served by representative offices. U.S. banks hold 44 percent of the total deposits in foreign banks.

In general, Argentine banking regulation has limited private banks in their role as financial intermediaries. Together, private domestic and foreign banks held about 40 percent of financial system deposits at year-end 1985, a decline of 10 percentage points from year-end 1983. Regulations favor public sector banks, provincial banks, and nonbank financial institutions at the expense of Buenos Aires-based private banks and foreign banks. Public sector banks enjoy particular favor as the institutions used by the government for state transactions. The Government's favoritism for public sector institutions is also apparent through the higher reserve requirements levied on the Buenos Aires-based private banks and on foreign banks, as well as through the more stringent limits imposed on foreign banks' ability to take deposits in the unregulated market. The deposit-taking limitations directly affect an individual bank's ability to lend, because lending limitations are set by the BCRA on the basis of regulated rate deposits taken. Accordingly, these factors have contributed to the decline of the market share of foreign banks, which slipped from 14.7 percent of total deposits in 1983 to 12.2 percent in 1985.

Argentine law does not specifically prohibit foreign banks from entering the Argentine market or from expanding an existing branch network. In practice, however, the Argentine Government does not approve requests for new entry or expansion; exceptions to this practice are rare. Banco Nationale del Lavoro was allowed to enter in 1984, as an example, by taking over the Argentine assets of the failed Banco Ambrosiano in 1984. The Government may also be moving toward greater flexibility in allowing foreign banks to purchase the branches of failed domestic banks.

The Government does allow foreign banks to own a minority share in individual Argentine banks, provided the share is less than 30 percent. The ongoing consolidation process in the Argentine banking system and government proposals for possible debt for equity conversions may eventually create additional opportunities for greater foreign bank accessibility to the Argentine market. However, adoption of the recently proposed discriminatory doubling of capital requirements for foreign banks would decrease these opportunities.

7. Australia

SUMMARY ASSESSMENT

Since 1984, the Australian Government has made a number of major decisions to inject additional competition into the Australian financial system which have resulted in significant improvement in the degree of national treatment accorded foreign banks. In 1984, Australia invited foreign banks to apply for "trading" bank licenses (trading banks have full banking powers), and in 1985, invited 16 of the 42 applicants to finalize their proposals. As of October 1986, 15 have been granted licenses and begun operations. The approved foreign banks were allowed to establish subsidiaries; a foreign bank is not allowed to enter Australia as a branch or by acquiring control of an indigenous trading bank. The Government has also allowed the number of merchant banks to increase and has expanded their powers. Many merchant banks are foreign owned.

Once granted trading banking licenses, foreign banks have substantially the same operating privileges as Australian banks. However, additional entry opportunities are not anticipated. Although the U.S. banks granted trading bank licenses have competitive opportunities, Australia's unwillingness to grant additional trading banks licenses prohibits other banks from having the same opportunities.

When the Australian Government invited applications for trading bank licenses from foreign interests, eight U.S. banks applied. Five were approved, and four have commenced operations. As of year-end 1985, there were 41 subsidiaries and affiliates (including merchant banks) of U.S. banks in Australia with total assets of $5.6 billion.

As of year-end 1985, 5 Australian banks operated 11 branches, 3 agencies, 6 International Banking Facilities, and 6 representative offices in the United States with total assets of $2.6 billion. Three additional Australian banks had representative offices in the U.S.

As of June 1986, Australia had several linked ATM networks. Citibank and Chase were members of a network. U.S. bank networks have begun to explore expansion into Australia.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

At the time of the 1984 Report, foreign interests were not permitted to engage in commercial banking in Australia (except for two grandfathered, non-U.S. foreign operations). Laws limited foreign ownership in a domestic bank to less than 10 percent and to non-majority ownership in new nonbank financial companies. Foreign banks were reported to have controlled merchant banks in Australia which engaged in nearbank activities. Those activities included accepting and discounting bills of exchange, underwriting debt and equity issues, managing portfolios, providing merger and acquisition advice and general financial advisory services, and engaging in spot foreign exchange.

Progress between 1979 and 1984 was considered minor.

The Domestic Banking System

There are 25 trading banks, 4 state banks, 3 specialized banks, and more than 150 merchant banks in addition to 280 finance companies, 70 building societies, and 300 credit unions serving Australia's population of 15 million. Fifty-nine of the merchant banks have been established in the last two years. Many feel the banking and financial services markets are saturated.

Commercial banking in Australia has traditionally been dominated by four large Australian trading banks which account for over half of the assets of all commercial banks and about a quarter of total assets of all financial institutions. At year-end 1985, total assets of the four trading banks and their affiliates aggregated about $100 billion. The following two tables illustrate the trends and shares of the markets held by different groups of financial institutions.

Table 7.1
Australian Financial Institutions

Type of Institution	Percent of Assets	
	June 30, 1985	June 30, 1984
Reserve Bank of Australia	6.7%	6.2%
Banks	39.0	38.2
Insurance Companies	22.7	14.1
Finance Companies	8.3	8.4
Other	23.3	33.1
Total	100.0%	100.0%

Source: Financial Flows, June 1986, Reserve Bank of Australia

Table 7.2
Australian Banking System
excluding the Reserve Bank
(July 1986)

	Deposits (Millions)	Assets (Millions)	Percent of Banking Assets
Major trading banks	$26,479	$48,447	50.4%
Other trading banks	6,166	15,795	16.4
Savings banks	26,003	29,936	31.1
Other banks	1,084	1,942	2.0
	$59,732	$96,120	99.9%

Source: Commonwealth of Australia Gazette, September 23, 1986

The activities that can be undertaken by merchant banks in Australia are now virtually the same as those currently performed by trading banks. For example, merchant banks may: engage in all types of borrowing and lending in domestic and foreign currencies with no restrictions on term, quantity, or interest rate; accept and endorse bills of exchange and engage in all forms of off-balance sheet lending; issue letters of credit and guarantees; engage in the hedge market, futures market and stock trading; engage in "fee for service" activities; and sell their own shares without issuing a prospectus. Subject to capitalization of A$10 million (about $6.5 million) and the maintenance of a high level of expertise, merchant banks can obtain authority to deal in foreign exchange and participate fully in Australia's foreign exchange market. No asset ratios are imposed on merchant banks, unlike trading banks.

A major distinction between trading and merchant banks is the ability of trading banks to have checks drawn on themselves. While existing Australian law does not permit merchant banks to issue their own checks, there is no legal impediment to a merchant bank issuing a "check like" instrument drawn on itself, such as an "order of withdrawal". As regards the clearance of such orders, a merchant bank could negotiate access to the existing clearing system through an agency arrangement with a bank that is a member of the clearing system. The granting of a trading bank license does not of itself guarantee a new bank direct access to the check clearing arrangements in Australia. This clearance system is not regulated by the Government, but is a contractual arrangement among members.

Deregulation of banking has been in process since 1980 when interest rate controls on savings deposits were removed. In 1982, deposit maturity controls were partially removed and the Reserve Bank of Australia (the central bank) ceased giving quantitative "guidance" on bank lending. In 1984, interest on checking accounts was permitted. As of October 1986, the only bank lending rate control still in place related to owner-occupied housing.

As of June 1986, Australia had 2666 ATMs, and 7.2 million cards had been issued. There were numerous ATM and electronic point-of-sale systems, with links among them. Credit unions had also joined the networks, as had Citibank and Chase. U.S. bank networks have begun to explore expansion into Australia. About 6 million American Express ATM cardholders can access Australian ATMs. One of the Australian networks links over 1000 machines in financial institutions, supermarkets, convenience stores, and service stations, and allows access by both debit and credit cards.

Key Developments Since 1984

Since the publication of the 1984 Report, the Australian Government has made a number of major decisions to inject additional competition into the Australian financial system.

In particular, in September 1984, the Australian Government invited applications from foreign companies for a limited number of full banking (trading bank) licenses. This reversed a long-standing policy of successive Australian Governments prohibiting foreign banks from obtaining a trading bank license or acquiring a substantial shareholding in an existing Australian trading bank. Eight U.S. banks applied for licenses in response to the Australian Government's invitation. Australia received 42 applications and, in February 1985, Treasurer Paul Keating announced that the Government had invited 16 of the applicants to further refine their proposals so that licenses could be issued. Five U.S. banks were among these 16 banks. All 16 of these proposals were approved and most of these banks were operating by mid-1986. They have essentially the same operating privileges as Australian banks (including automated tellers).

One difference in official requirements on foreign-owned bank subsidiaries is that the new foreign banks are subject to a higher capital requirement than existing domestic banks, 6.5 percent versus 5 percent. The higher capital requirement applies to all new banks, whether domestic or foreign. Since 1984, three new domestic banks have also been licensed. The Government had advised foreign applicants that this higher requirement would be imposed on a temporary basis.

Considerable deregulation of financial institutions has occurred, foreign exchange controls have been eliminated, and foreign investment controls for nonbanks have been relaxed. In addition, 24 merchant banks have been restructured and 59 new ones established. The Government has said it has no objection to banks moving into life insurance or most other finance-related activities.

Treatment Of U.S. and Other Foreign Banks

The deregulatory moves taken by the Australian government enhanced the opportunities for foreign institutions to participate in the Australian financial system. Officials admitted 16 foreign banks in 1985, including 5 U.S. banks. With the abolition of foreign exchange controls and a recent liberalization of foreign investment policies, the way is open for institutions and individuals to undertake financial exchanges without official encumbrances.

The opportunities available for foreign banks to participate in the Australian financial system are not limited to applications for trading banking licenses. Foreign banks, and in particular U.S. banks, are extensively involved in the Australian financial system through their shareholdings in merchant banks and finance companies. The extent of this involvement is illustrated by the fact that 21 U.S. banks have significant interests in one or more merchant banks or finance companies, 18 of which are wholly owned. Foreign banks and securities houses also have 74 non-commercial bank financial subsidiaries, affiliates, and other offices operating in Australia.

When the Government of Australia received 42 trading bank license applications from 19 countries, it intended to approve only around 6 of the most qualified companies. The purpose was to make the Australian banking sector one of the strongest and most prestigious in the world so Australia could become one of the major financial centers of the world. This application period was to be a one-time event with no view to having any supplementary license procedure. Eight U.S. banks applied and five were approved; four are now open. Although further foreign bank participation in Australia's market may be achieved through merchant banks and nonbank companies, additional entry for new foreign trading banks is doubtful.

8. Brazil

SUMMARY ASSESSMENT

Very little has changed in Brazil's treatment of foreign banks since 1984, nor since 1979. Entry and expansion continue to be tightly restricted. It appears unlikely that there will be any change in this policy in the near future, even though foreign banks could be a source of capital and technological resources for weaker indigenous banks.

New entry into Brazil by U.S. banks through either branches or commercial banking subsidiaries continues to be prohibited. Four banks from Spain were, however, permitted to open commercial banking facilities under bilateral reciprocity agreements in the early 1980s. Foreign banks, including U.S. banks, have been permitted to take minority interests in financial institutions other than commercial banks.

Foreign commercial banks already established in Brazil, which account for about 6.5 percent of Brazil's commercial banking market, are treated similarly to private Brazilian banks in terms of most regulations affecting their operations. They are, however, denied opportunities to expand through mergers and acquisitions, and are not allowed to accept federal tax payments.

As of year-end 1985, two U.S. banks had 22 branches in Brazil with total assets of $3.4 billion. An additional 42 U.S. banks operated a total of 49 representative offices there. As of year-end 1985, U.S. banking corporations reported a controlling interest in 43 subsidiaries or affiliates in Brazil with total assets of approximately $3 billion, one of which was a wholly owned full service commercial bank with 40 branches and $600 million in assets.

As of year-end 1985, 17 Brazilian banks operated 26 commercial banking offices in the United States (17 branches and 9 agencies), with total assets of $6.5 billion, and maintained 3 representative offices. One additional Brazilian bank operated only a representative office. Also, as of year-end 1985, Brazilian individuals reported majority ownership in 4 U.S. banks with a total of 36 branches and aggregate U.S. assets of $7.4 billion. Majority ownership by Brazilian-owned interests was also reported for three Edge Act Corporations. At year-end 1983, 19 Brazilian banks operated 31 bank offices (16 branches, 12 agencies, and 3 Edge Act Corporations) and 8 representative offices in the United States.

There are approximately 450 ATMs in Brazil. Two Brazilian banks and a group of banks operate ATM systems. One U.S. bank is a member of an ATM network operating in Brazil.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

New foreign entry into the commercial banking business in Brazil was virtually prohibited at the time of the 1984 Report. This prohibition was the result of government policy, particularly a reluctance to permit an expansion of the total number of banks operating in Brazil (including foreign banks), rather than legal or regulatory restrictions.

Domestic Banking System

Brazil has one of the most sophisticated financial systems in all of Latin America. The major Brazilian banks have developed into financial conglomerates by expanding their activities beyond commercial banking. A typical Brazilian bank is a holding company with financial subsidiaries including an investment bank, a financing company, a leasing company, an insurance company, a consumer financial company, and a brokerage firm. Legally these subsidiaries are separate institutions, but in practice they constitute an integrated financial institution.

As shown in Table 8.1, the commercial banking system consists of the government-owned Banco do Brasil, 4 other federal banks, 24 state-owned banks, and 77 privately owned banks (19 of which are foreign-owned). The banking industry is dominated by a few giant commercial banks. The Banco do Brasil, one of the world's largest banks (ranked 44th in the world as of July 1986), leads the list. The next half dozen largest include some government-owned and some private banks (including Citibank), but their order varies depending upon size criteria. Six of the largest 18 private banks are foreign-owned when ranked by deposits, but the number would be greater if ranked by total loans. Consolidation of the banking sector and the trend toward integrated financial institutions is continuing.

Monetary policy and inflation have had a significant impact on how the financial system operates. Brazil has had to take steps to strengthen Brazilian banks, particularly banks owned by the smaller states. The Cruzado Plan, announced on February 28, 1986, ended the indexation of assets and liabilities, and reportedly has had a major effect on the financial sector.

There has been much discussion about reform of the banking system. A major restructuring of the financial sector is occurring voluntarily in response to the Cruzado Plan. For example, private financial institutions have closed branches and laid off workers to adjust to lower inflation.

Table 8.1

Financial Institutions in Brazil
(year-end 1985)

	Number of Institutions	Number of Branches	Assets (U.S. dollars in billions*)
Banco do Brasil	1	2,448	$35.9
Other Government Owned Banks	28	3,824	17.3
Privately Owned Domestic Banks	58	8,870	28.1
Foreign Banks	19	86	5.7
Public Savings Banks	5	2,390	25.2
Investment Banks	38	151	8.1
Private Savings and Loans and Housing Credit companies	75	1,049	14.9
Total	224	18,818	$135.2

*Converted at the rate of 10,465 Brazilian cruzeiros per U.S. dollar.

Source: Central Bank of Brazil

The 450 ATMs in Brazil are concentrated in Rio de Janiero and Sao Paulo, but some are scattered among smaller cities. Most perform a variety of functions, but some only disburse cash. ATMs are not considered branches and prior approval is not required for their establishment. The central bank does require after-the-fact notification.

Key Developments Since 1984

The most significant development over the past 2 years affecting the Brazilian financial system (and foreign banks operating within that system) has been the elimination of the indexation of assets and liabilities through the implementation of the Cruzado Plan early this year.

No change has taken place with regard to the application of Brazilian regulations to foreign banks, including the issue of more liberal entry or operations for foreign banks.

Treatment of U.S. and Other Foreign Banks

Brazil follows a reciprocity policy that relates entry into Brazil with the extent of Brazilian banks' operations in an applicant's home country. Such a policy has been used to deny further entry into Brazil by U.S. banks. Among the other arguments that the central bank has given for opposing foreign entry is that even the largest and most efficient Brazilian banks could not compete with foreign banks and, within a short period of time, foreign financial institutions would take over the Brazilian market. The validity of this argument is open to question given the size and sophistication of Brazil's largest banks.

Absent a reciprocal agreement, foreign banks have been able to enter Brazil only as minority participants in nonbank financial institutions. Long-standing regulations permit foreign banks to acquire no more than one-third of the voting stock of a Brazilian investment bank, brokerage firm, or leasing company. Recent changes have increased opportunities for investment banks, including those having foreign participation, to trade foreign exchange.

Currently, foreign banks are shareholders in 23 of the 38 investment banks, with 9 of these banks having U.S. participation. Because direct entry is prohibited, U.S. banks continue to use the investment bank as an entry vehicle. In 1985, the central bank permitted the First National Bank of Chicago to exercise a temporary (2 year) 100 percent control of Banco Denasa de Investimo, an investment bank, because of

Denasa's severe financial difficulties -- Denasa has subsequently been sold. Continental Illinois bought the investment banking license of Maissonaive, which was liquidated in November 1985, and is now seeking a Brazilian partner in order to re-open.

Domestic banks act as depositories for federal tax payments, accepting payments from individuals and businesses and periodically forwarding them to the federal government. Foreign banks are not permitted to compete for this business.

Foreign banks operating in Brazil are not permitted to expand through mergers or acquisitions. Both foreign and domestic banks are subject to branching restrictions. However, these restrictions affect foreign banks more severely than domestic banks since domestic banks may add branches by acquiring other banks. Foreign banks may buy and sell branches among themselves under a point system established by the central bank.

Foreign banks may join ATM networks, but may not operate their own systems. Brazilian banks may operate their own ATM systems.

Brazil's reluctance to approve the establishment of new foreign commercial banks has been pegged to domestic policy decisions to promote consolidation within the private Brazilian banking sector. Some Brazilian banks have capitalization problems and others have no interest in, nor ability to readily adopt modern electronic banking practices. Consequently, the Government has been very hesitant to grant any new charters and has instead encouraged acquisitions. Although foreign banks could provide much needed capital and technological assistance, they are prohibited from acquiring indigenous banks.

There has been no indication that Brazil's restrictive policies will change in the near future.

9. Finland

SUMMARY ASSESSMENT

Finland's treatment of U.S. commercial banking organizations has not changed substantially from the time of the 1984 Report. Since 1980, foreign banks have been permitted to establish *de novo* banking subsidiaries and to acquire limited interests in indigenous commercial banks, mortgage banks and credit companies on the basis of reciprocity, subject to prior approval of appropriate authorities. Foreign banks may not enter as branches of their parents or, without special permission, by acquiring control of an indigenous bank.

Although capital injections into foreign-owned subsidiaries are subject to licensing, recent requests by two foreign banks were granted. While there are no specific prohibitions barring foreign-owned subsidiaries from establishing branch networks, Finland's controlled interest rate environment has hampered foreign banks' opportunities to enter the retail banking market.

Since 1980, when foreign banks were granted permission to incorporate in Finland, two U.S banks (Citibank and Chase Manhattan) and one French bank (Banque Indosuez) have incorporated. A British bank, the London-based Samuel Montagu, recently sought and was granted permission to establish a subsidiary, which is expected to open very shortly. Of the three foreign banking subsidiaries in Finland, Citibank has the largest presence with $192 million in assets at year-end 1985, a decrease from the $213 million in assets at year-end 1984. Assets in Chase Manhattan totaled $70 million at year-end 1985, a decrease from approximately $150 million at year-end 1984, due to a decrease in domestically funded foreign currency lending attributed to regulatory changes imposed by the central bank.

Since 1984, Finnish banks have taken strides to advance themselves in international markets. In October 1984, the Union Bank of Finland and two other major Scandinavian banks agreed, through an exchange of shares, to represent each other in their domestic markets. As of year-end 1985, one Finnish bank reported a single branch and a representative office in the United States with total assets of $63 million. At present, two Finnish banks operate branches in the United States; one also owns a subsidiary bank in the United States.

Electronic banking is very highly developed in Finland. Although there are no legal barriers to doing so, no foreign bank subsidaries are operating automated teller machines.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The situation in 1984 represented a significant improvement over the restrictions in 1979, when foreign entry was prohibited. At the time of the 1984 Report, Finland had recently permitted foreign bank entry through locally incorporated subsidiaries. No branches or agencies of foreign banks could be established, nor could foreigners purchase a controlling interest in an indigenous bank without special permission. Limitations existed on the importation of capital by the new foreign-owned bank subsidiaries and on the degree of foreign equity interest in indigenous banks and companies.

Domestic Banking System

The Ministry of Finance, the highest administrative body supervising banking activity in Finland, prepares and presents to Parliament most legislation concerning the financial markets. Its permission is required to establish banking operations in Finland. The Bank Inspectorate is subordinate to the Ministry of Finance and supervises banks, collects data on their activities, and ensures compliance with banking laws and regulations. Finland's central bank, the Bank of Finland, directs monetary policy, is the sole bank of issue, and controls the discount rate and the call money rate.

Laws prescribing the operations of credit institutions in Finland were standardized as part of an overall reform of banking legislation in 1969. Currently, the Finnish Government is drafting a revision of this law which is expected to be submitted to Parliament in the near future. In recent years the tight regulation of the financial markets has been somewhat liberalized, and further deregulation is anticipated. Presently, however, the Finnish monetary authorities control banking directly through reserve requirements and by determining the interest rate at the central bank's call money window. Even though foreign banking subsidiaries have been present in Finland since 1982, they have had little, if any, competitive impact on the domestic banking system. Their impact on the foreign exchange market has been substantial.

The Finnish financial markets are narrow and continue to be dominated by depository institutions. By most standards, Finnish depository institutions have an extensive branching network. For a country with just under 5 million inhabitants, there are over 600 depository institutions and more than 7,600 total offices. As shown in Table 9.1, the major types of institutions are commercial banks, savings and cooperative banks, and the state-owned Post Office Bank (Postipankki).

Table 9.1

Depository Institutions in Finland
(year-end 1985)

Type of Institution	Number	Total Offices	Total Deposits ($ million*)	Total Assets ($ million*)
Domestic Commercial Banks	7	1,643	$9,938	$31,748
Foreign Commercial Banks	3	3	17	370
Savings Banks	254	1,570	7,573	9,557
Cooperative Banks	370	1,384	6,338	8,681
Postipankki	1	3,118	3,170	6,562
Total	635	7,718	$27,036	$56,918

*Converted at the rate of 5.478 Finnish markka per U.S. dollar.

Sources: Finnish Bankers Association and bank reports.

The corporate sector absorbs more than half of all commercial bank lending. Although the Finnish equity market has been slowly expanding in recent years, it is still relatively small. Partly because of tax disincentives and partly because of tradition, Finnish investors trade their shares infrequently. Income from dividends and capital gains is partly taxable, whereas the return earned on bank deposits is not taxable. This tax treatment has tended to curtail many equity issues. In addition, until August 1986 Finnish companies were hampered by central bank restrictions on foreign exchange, which meant that raising capital in international markets was often difficult. As a result, commercial banks had to satisfy much of the corporate sector's capital requirements. The next largest share of commercial bank lending goes to the household sector. Commercial banks have traditionally been the largest providers of total real estate financing in Finland.

Finland boasts a highly developed, yet notably conservative, savings bank network. By law, savings banks can provide commercial banking services, but may not pay dividends to any individual. The central savings bank, Skopbank, is the pivotal part of the second largest money market entity in Finland, the Finnish Savings Bank Group. Skopbank is essentially owned by the savings banks, and is responsible for safeguarding the solvency of the member banks through its own insurance system. However, Skopbank operates as a normal commercial bank. Savings banks exist to promote savings and primarily serve the needs of households, which receive almost two-thirds of savings bank lending. In addition, savings banks have close connections with small- and medium-sized businesses as well as municipalities. The savings banks have been developing these relationships to broaden their business base and expand their growth potential in anticipation of further deregulation.

Finnish cooperative banks are regional banks which operate under legislation that is very similar to that of savings banks. Cooperative bank services focus primarily on the needs of the household and the agricultural sectors. Close to three-quarters of all cooperative bank lending goes to households.

The Postipankki, the state-owned Post Office Bank, is a full-service commercial bank with 48 branch offices and over 3,000 post office service points. In addition to providing a wide array of services to the public, the Postipankki holds government cash funds and handles state payment transactions. The major portion of its lending is to industry, as loans to households account for less than 20 percent of its business. In addition, the Postipankki is active in international business, making it an aggressive competitor for other commercial banks.

Traditionally, Finnish financial markets have been closely regulated and largely closed to outsiders; however, there have been limited steps taken to deregulate them. Lending rates for new loans were decontrolled on a provisional basis as of August 1986, but the central bank reserves the right to restore restrictions as it deems appropriate. For the last 50 years, Finnish banks, in conjunction with the central bank, have maintained a vigorous cartel agreement to offer identical deposit rates tied to the central bank's discount rate. This interest rate cartel is closely linked to the Finnish system of granting tax-free status to income generated from such deposit accounts. Interest income obtained from accounts in banks not offering the interest rate established by the cartel is fully taxable, and thus, not as attractive to the investor. The legislative sanction for the interest rate cartel is scheduled to expire in 1988.

This unique policy was established with two objectives. The first objective was to encourage savings, and the second was to shield small, regional savings and cooperative banks from interest rate competition with large commercial banks. The inability to obtain a competitive edge through the use of interest rates has forced Finnish banks to offer a wide variety of services through an extensive branching network to attract depositors and borrowers.

The ceiling on deposit interest rates and an increase in liquidity in Finland's corporate sector led to the emergence of a parallel, unregulated "grey market" in the late 1970s in which banks accept large, short-term deposits from each other's customers at rates substantially higher than ordinary deposit rates. The exceptionally high interest rates in the deregulated money market have attracted a record amount of foreign capital to the country. This market has grown substantially and now comprises roughly one-third of Finland's total money market activity.

In May 1983, banks were permitted to pass on to their customers part of the interest costs incurred on their unregulated rate borrowing. The formula for calculating the costs which could be passed on determined the maximum permissible average lending rate, which depended on both the central bank's rate and the average deposit rate applied by the banks. The central bank has recently abolished the regulation of average lending rates, and market forces now generally control lending rates.

Until recently, Finnish banks had few differentiating characteristics. The imposition of a uniform lending rate by the central bank had forced banks to engage in vigorous nonprice competition, to improve profit margins by increasing productivity,and to seek other means to maintain a loyal customer base. Finland has developed two sophisticated money transmission systems: one for the commercial banks, the post office bank, and the labor savings bank (Suomen Tyovaen Saastopankki); the other for the remaining savings banks and the cooperative banks. There are over 14,000 counter terminals, 540 self-service automated teller machines, 4,230 interactive customer terminals and 360 customer video information services. There are approximately 1.2 million bank cards in circulation, many of them multipurpose cards, and another 1.4 million nonbank credit cards (including some issued by the oil companies that give access to 60, 24-hour point-of-sale terminals at gas stations). The electronic money system is so widely used that roughly 95 percent of all wages and salaries enter bank accounts by means of automatic transfer.

Key Developments Since 1984

Since May 1986, foreign banks have been able to fund Finnish exporters with foreign sources of funds, with prior approval of appropriate authorities.

Rates on loans were deregulated in the summer of 1986.

Treatment of U.S. and Other Foreign Banks

Legislation enacted during 1978-1980 enabled foreign banks to establish themselves in Finland as wholly owned subsidiaries. The situation has remained virtually unchanged since that time. The Finnish Government gives consideration to reciprocity when granting approval to establish a subsidiary. The Finnish Government is steadfast in prohibiting foreign banks from entering its domestic market through branches or purchases of controlling interests in indigenous banks. The Council of State's prior approval is needed for a license to establish any foreign banking operations in Finland. A foreign bank must also provide a letter of comfort or a guarantee from its parent bank.

Finland requires that its prior approval be obtained prior to any investment in a domestic company, and restricts foreign ownership of capital stock in indigenous banks and other companies to 20 percent of total equity unless special permission to acquire a larger portion is granted by the Council of State. To date, this special permission has not been sought: hence the impact of the prior approval requirement on foreign bank opportunities is unknown. In addition, the small number of domestic banks means that there are very few candidates for acquisition.

Indigenous banks need not apply for permission to purchase equity in other companies, but their participation is limited to 20 percent. Finnish banks tend to take full advantage of their ability to acquire equity in other domestic companies, and as a result exercise significant control over Finnish business.

The entry restrictions prevent foreign banks from beginning operations with a pre-existing customer base, and they are impeded by interest rate controls from attracting retail customers by price competition. As a result, foreign banks have to date concentrated on wholesale banking, and have been obtaining their funding from the unregulated money market or from the call money window at the Bank of Finland. Accordingly the cost of funds for foreign banks has been much higher than that of Finnish banks. Because of their inability to shift these additional costs to the customer, foreign banks also have difficulty engaging in the types of lending that indigenous banks have found profitable.

Foreign-owned banks are not allowed access to Finland's trade with the USSR, which comprises a significant proportion of all Finnish foreign trade.

There are no substantial legal barriers that inhibit either indigenous banks or foreign-owned bank subsidiaries from operating automated teller machines or joining the various electronic networks and systems. Because of the restrictions on foreign banks' opportunities to compete for retail business, none have requested permission to establish ATMs or join an ATM network.

10. India

SUMMARY ASSESSMENT

There have been minor improvements in the overall entry opportunities for foreign banks since 1984, but not for U.S. banks. Although four new foreign banks have entered since 1984, there have been no new entries from the United States. An application by a U.S. bank was denied in 1986.

Foreign banks are permitted to enter India on a limited and selectively reciprocal basis, and only as branches. This policy has continued despite measures to liberalize trade and industry since March 1985. No foreign bank has been able to acquire an equity participation in an indigenous bank, and reciprocity considerations are likely to limit new entry and expansion of U.S banks in India. Indigenous banks in India are primarily government-owned, and the Indian Government has no current plans to expand the presence of Indian banks in the United States.

Foreign banks are restricted in their operations and branching opportunities. They are unable to obtain deposits of Indian Government agencies and public enterprises and are subject to discriminatory tax treatment. They are, however, exempt from costly concessionary lending and rural branching requirements that apply to indigenous banks.

At year-end 1985, three U.S. financial companies operated a total of 13 branches in India. Another five U.S. banks maintained representative offices in India. The number of U.S. banks in India has remained constant since 1979, although their assets have risen during that period from about $300 million to over $1 billion.

At year-end 1978, two Indian banks operated three branches and two agencies in the United States. One representative office was also maintained. At year-end 1983, three Indian banks operated one subsidiary, six branches, and two agencies in the United States with assets totalling $340 million. One Indian bank maintained a U.S. representative office. At year-end 1985, three Indian banks operated six branches, two agencies and one representative office in the United States with total assets of $407 million. In addition, Indian individuals and companies reported majority interests in two U.S. chartered banks with a total of five branches and aggregate U.S. assets of $79 million.

Automated teller machines have not been introduced into India.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 report described the Indian banking system as essentially Government operated, with nationalized banks accounting for the bulk of the domestic deposits. Commercial banking operations were regulated by the Reserve Bank of India, the central bank. An increased flow of funds from the nationalized banks to the rural sector, as a result of expansion of the banking system to the rural areas, failed to eliminate the role of the traditional money-lenders who continued to remain a major source of finance. As is the case today, foreign banks in 1984 were permitted to enter India only as branches on a limited and reciprocal basis. This treatment represented only a limited improvement over the situation that existed in 1979.

Domestic Banking System

Until 1969, commercial banks in India were concentrated in the urban areas and primarily served the more modern manufacturing and trade sectors. Relatively little credit was extended to agriculture, small scale industry, or local trade in non-urban areas.

In 1969, the Indian Government nationalized the 14 largest private banks to acquire greater control over the nation's financial resources in order to advance economic development, particularly in rural areas. The nationalization increased the publicly-owned share of banking assets in India to roughly 85 percent. Six more privately-owned banks were nationalized on April 15, 1980, bringing the number of banks in the public sector to 28. Nationalized banks now account for over 90 percent of deposits; 21 foreign banks and 27 small, privately owned Indian banks account for the remainder.

Foreign banks were not nationalized on the grounds that they provided specialized financial services. It was also feared that their nationalization would create an unfavorable climate for the continued flow of much-needed foreign capital to India. Their locations and activities are, however, restricted, as the government views their role as limited primarily to trade finance and technology transfer.

Indigenous banks have been subject to mandatory domestic branching policies. Over 53,000 bank branches now operate in India, compared to about 30,000 in mid-1979 and 36,000 in mid-1981. The nationalized banks account for almost the entire increase. In March 1985, each bank office served an average of 13,000 inhabitants, compared to 18,000 in June 1982, and 65,000 in June 1969.

Both nationalization and mandatory branching policies have resulted in a rapid expansion in the number of branches in India's rural areas. Over half of Indian banking offices are now located in these areas, compared to one-fifth in 1969. These branches, along with the cooperative societies, now supply a growing portion of the credit needs in these areas, reducing the reliance on private money-lenders and landowners as a source of credit.

Banking is concentrated in India, and commercial banks dominate the depository institutions market. The largest bank, State Bank of India, with total assets at year-end 1985 over $31 billion, holds about 35 percent of all commercial bank deposits, while the 10 next largest banks hold another 49 percent of the total. Table 10.1 shows the size the major groups of depository institutions.

TABLE 10.1

Depository Institutions in India, December 1985

	Number of Reporting Banks	Domestic Deposits*
Commercial Banks**	264	$69,560
State Cooperative Banks	28	832
Postal System	1	2,281
Total	293	$72,673

* U.S. dollars in millions converted at the rate of 12.17 rupees per U.S. dollar

**Includes 189 regional rural banks set up by the Government.

Source: Reserve Bank of India Bulletin, February 1986.

Banks in India are regulated by the Reserve Bank of India, the central bank. Reserve requirements are relatively high and are keyed to demand and time liabilities. The central bank also sets specific controls on bank credit growth and single borrower lending limits, which may be exceeded only with specific approval. Interest rate ceilings are imposed on both deposits and loans. Except for a brief period in the spring of 1985, deposit interest ceilings have been well below free market levels for several years. Loans exceeding certain size limits, depending on their purpose, must also be referred to the central bank for approval. These controls also apply to foreign banks.

The central bank sets various targets and subtargets for lending to priority sectors of the Indian economy by domestic banks. A "New 20-Point Programme" was announced in early 1983 to improve living standards of the weakest segments of society, such as small and marginal farmers, landless laborers, tenant farmers and sharecroppers, artisans, and village and cottage industries. Subsequent instructions, issued on February 7, 1983, left unchanged the overall target of 40 percent of bank credit for priority sectors. Subtargets for lending to agriculture and other weak segments were revised upward. Loans to agriculture and related activities were to reach at least 15 percent of total credit by March 1985, and at least 16 percent by March 1987. Lending to the weaker segments was to account for 25 percent of priority sector advances, or 10 percent of total bank credit, by the end of March 1985. While the overall target of 40 percent by March 1985 was exceeded by 1.3 percentage points, subtargets for lending to agriculture and weaker segments fell modestly short of the goal. Despite targetting and the rapid increase in the number of rural branches, traditional lenders still provide an estimated half of all credit to rural areas, versus seven-eighths in 1977.

The country has initiated several reforms in the industrial sector for increasing productivity and reducing cost, and steps are underway to modernize banking operations through automation. Clearing operations in major towns have been mechanized, and about 1,500 electronic ledger posting machines had been installed by December 1985 in major bank branches in metropolitan areas. Most banks in Bombay, Dehli, and Madras have introduced "MICR" checks, and equipment to process them has recently been approved by the Reserve Bank of India. Automated teller machines have not been introduced. Concerns about the employment effect of automation, and financial constraints, make complete automation in the medium term unlikely.

Merchant banking in India is expected to grow at a much faster pace in order to finance industrial modernization. Also, other banking products, such as guarantees and letters of credit, may assume more significance in the years ahead.

The ongoing modernization of India's banking sector has also been accompanied by rapid growth in securities markets. Fourteen stock exchanges are presently operating, and the number of new issues of debt and equity securities has risen over 75 percent in each of the last 2 years.

Key Developments Since 1984

The Government continues to be receptive to very slow entry by foreign banks from countries not presently represented in India. Reciprocity continues to be the guiding principle governing entry into India. However, additional factors that now influence entry are bilateral trade relations, foreign collaborations and national economic interests. It is, therefore, no longer formally necessary for Indian banks to have a presence in the country of a foreign bank seeking a branch in India, as had been the case in 1984. However, the specific nature of the reciprocity considerations, and when they will be used by the Government, are unknown. A French bank, for example, was allowed to establish a branch in India in 1984. An application by a U.S. bank to enter India was denied in 1986.

The Export-Import (Exim) Bank of India was established by the Indian Government to finance exports and to coordinate the activities of other institutions engaged in financing India's foreign trade. Foreign banks are granted full access to Exim facilities. During its 4 years of existence, Exim Bank has expanded its overseas operations in trade and finance. In 1985, Exim Bank established offices in Washington, D.C. and Abidjan. A third office in Singapore is in the planning stage.

India continues to encourage foreign investment and has streamlined procedures for obtaining clearances. Foreign banks' involvement in overseas commercial loans has increased in recent years. Disbursements on commercial bank credits were about $1.5 billion annually in 1984 and 1985.

Treatment of U.S. and Other Foreign Banks

The Indian Government's unwritten policy over the last several years has been to permit slow, but controlled expansion of foreign banking. India has become more receptive to new foreign banks only from countries not already represented in India. The Government has used reciprocity considerations on a selective basis, and banks from countries other than the U.S. have been allowed to enter India. Prospects for new U.S. bank entry are not good. An application for entry by a U.S. bank was denied in 1986.

In 1979, the Government's policy had been to hold the level of foreign bank activity to the 12 foreign banks then present. By 1984, five new foreign banks had been allowed to enter, and a limited number of additional branches for foreign banks already established in India were permitted. Since then, four new foreign banks have been allowed to enter. As of July 29, 1986, 21 foreign banks are operating in India with a total of 136 branches. Grindlays Bank Group, now owned by Australian interests, has 56 of these branches. Representative offices of 14 foreign banks had been established by mid-1983 and their number has remained unchanged. Three U.S. banks have branches in India: American Express Bank Ltd. (3); Bank of America (4); and Citibank (6). The application of a fourth U.S. bank (Chase Manhattan) was turned down in 1986, apparently due to the Indian Government's intention not to open any more branches in the United States. Five U.S. banks have representative offices: Chase Manhattan, Irving Trust, Manufacturers Hanover, Chemical, and Bankers Trust.

Current policies still confine foreign banks to a small number of branches in major metropolitan areas, restricting their ability to develop a local deposit base and establish close contacts with a broad range of potential customers. Foreign banks, as well as privately owned Indian banks, are also unable to accept deposits from Indian Government agencies and state-owned enterprises.

Foreign banks have been subject to a higher tax rate than Indian banks since 1977: 70 percent compared to 55 percent. The 1985 Finance Act lowered these rates to 65 percent for foreign banks and 50 percent for Indian banks. In addition, the 5 percent tax surcharge levied earlier on all banks was abolished in 1986. Plans call for a further reduction in tax rates.

In order to increase their capital base, the 1982 Finance Act permitted nationalized Indian banks engaged in foreign operations to transfer 40 percent of their total income to a special reserve account and to deduct that amount when figuring taxable income. Small Indian banks were allowed a deduction of up to 1.5 percent of total average advances to borrowers in rural areas to cover bad debts. This provision had previously been available only to large Indian banks. The Finance Act of 1985 stipulates higher provisions for bad debts, i.e., up to 10 percent of total income or up to 2 percent of aggregate average loans made by the rural branches of such banks, whichever is higher. This change was designed to increase the after-tax profitability of indigenous banks. Foreign banks did not benefit from these tax measures.

Foreign banks are not required to open costly branches in rural areas, to lend to small, high-risk borrowers at concessionary rates, or to comply with the 1983 program directing loans to the agricultural sector. Foreign and domestic banks are obliged to make institutional loans at low rates to the government-controlled food corporation of India, but this obligation has been less rigidly applied to foreign banks than to domestic banks.

11. Republic of Korea

SUMMARY ASSESSMENT

Since the Ministry of Finance announced a schedule for reducing a significant number of restrictions on foreign banks in April 1984, the Korean Government has largely held to the schedule. Under the schedule, foreign banks were granted access to the clearing house association, were given an increased lending limit, were given partial access to the central bank's rediscount facility for pre-export financing, and were given access to a portion of the trust business. Beyond the scheduled actions, foreign banks were granted full access to the rediscount facility and were authorized to issue negotiable certificates of deposit. These measures significantly improved the treatment of foreign banks in Korea.

Nonetheless, foreign banks in Korea continue to face important impediments to achieving competitive opportunities equal to those of indigenous banks. These impediments include Korea's limiting each foreign bank to a maximum of two branches, restricting funding and investments, and setting limitations on taking collateral. In addition, foreign banks may enter Korea only as branches. Moreover, the progress toward creating opportunities for competitive equality for the foreign banks has not been matched by progress in liberalizing the financial sector, a key factor if national treatment is to be meaningful. The Korean Government continues to regulate closely the domestic banking system by making personnel decisions in the domestic banks, setting interest rates, and administratively requiring that loans be made to firms in particular economic sectors.

As of year-end 1985, 16 U.S. banks had 21 branches in Korea with a total of over $5.5 billion in assets. One major U.S. bank, which held approximately $225 million in assets in its Korean branch, has since ceased operations in Korea. Two additional U.S. banks maintain representative offices only. As of year-end 1985, U.S. banking corporations reported a controlling interest in three nonbank subsidiaries or affiliates in Korea with total assets of approximately $1.4 billion.

As of year-end 1985, six Korean banks operated a total of nine branches and seven agencies (plus three representative offices) in the United States with total assets of $2.5 billion. An additional six Korean banks maintained only representative offices in the United States. Also as of year-end 1985, Korean banks reported majority ownership in four U.S. chartered banks with a total of 11 branches and aggregate U.S. assets of $396 million.

Most Korean banks have established ATMs but there are no networks. Since each ATM requires a branch license and foreign banks are limited to two branches, foreign banks have not established ATMs.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report indicated that foreign entry into Korea, as a branch of the parent bank, had been relatively open for several years, although permission to enter was based on reciprocity and "contribution to Korea" considerations. These considerations had not limited entry by U.S. banks. Each foreign bank was limited to no more than two branches in Korea, and not more than one in any city. Many restrictions in Korea's closely regulated financial system applied equally to foreign and domestic banks. Foreign banks were also subject to additional discriminatory restrictions, such as exclusion from official sources of funding, a requirement for separate branch capitalization, and the inability to acquire title to property.

In 1984, foreign banks held about 1 percent of Won deposits, 6 percent of Won loans, and 52 percent of foreign currency loans. Foreign banks' share of the total assets of all banks in Korea had risen from 5.3 percent at year-end 1979 to just over 9 percent by November 1983.

The 1984 situation reflected modest improvement over conditions evident in 1979, especially in the Government's official, stated attitude toward national treatment. In April 1984, Korea had announced a 3-year program to reduce a number of restrictions on foreign banks, committing the country to policy changes toward national treatment.

Domestic Banking System

Seven nationwide "city banks," 6 specialized banks, 10 regional banks, 3 development banks, and 52 foreign bank branches make up the commercial banking sector in Korea.

The seven nationwide city banks play the dominant role in Korea's financial system, accounting for almost one-half of total commercial banking activities. Two of them --the Koram Bank, a joint venture between the Bank of America and a number of Korean businesses, established in March 1983; and Shinhan Bank, established in July 1982 by a group of Korean businessmen who have been long-term residents of Japan -- are only 3 or 4 years old and are relatively small in size compared to the "big five." The "big five" were denationalized in 1983.

Private sector deposits accounted for approximately 53 percent of the city banks' total financial resources as of year-end 1985. Direct borrowings from the Bank of Korea, the central bank, amounted to another 22 percent. Principal assets of city banks are loans to domestic enterprises (52 percent), foreign exchange and other foreign assets (10 percent), securities, including government bonds (6 percent), and reserve deposits with the central bank (3 percent).

Six specialized banks comprise the second major group of banks in Korea. These banks were established during the 1960s to provide financing for specific sectors of the Korean economy, including international trade, agricultural cooperatives, housing, and small businesses. Unlike other commercial banks, the specialized banks are not subject to the General Banking Act. However, they are increasingly engaging in commercial banking activities. Of these specialized banks, the Korea Exchange Bank, established in 1967 and owned by the central bank and the Government, plays the leading role in external transactions such as foreign exchange and trade finance. Although the Korea Exchange Bank extends loans in the domestic currency, its emphasis is on short-term export financing.

The third group of Korean banks consists of 10 small-scale regional banks which are privately owned and established in each of the nine provinces and in the city of Pusan. These banks have the same powers as the city banks, except they are restricted to their geographic region. The regional banks are allowed to maintain slightly higher interest rates than the city banks on both loans and deposits.

Historically, Korean firms have relied heavily on borrowed funds, rather than on equity financing, to take advantage of often negative real interest rates in earlier periods and because of the relatively underdeveloped nature of the Korean stock market. Under the tight control of the government, the Korean banking system has played a major role in amassing domestic savings and channeling them into the investment needs of Korean industries for rapid economic development. Nevertheless, banking efficiency and competitiveness lagged seriously behind other sectors of the economy. As a result of the artificial interest rates imposed on commercial banks and the required credit allocations in their lending, a sizable private money market flourished outside the established financial system, although it has gradually diminished in recent years. In 1983, there were banking scandals with alleged embezzlement and fraudulent loans by high ranking bank officials in collusion with large private money-lenders.

Since 1984, a variety of problems have severely impacted important sectors of the Korean economy and the banks lending to those sectors. The Korean central bank has made large loans to banks at below market interest rates to promote the continued viability of several major companies.

The Korean Government has initiated significant changes since 1979 consistent with long-term policy objectives to improve banking efficiency and reduce the role of private money-lending. Denationalization of the five city banks, completed in 1983, was the most important step. The two new city banks, with foreign participation, were established in 1982 and 1983 to promote competition and introduce more advanced banking technology. The commercial banking law was revised in 1982 to limit ownership of city banks by any single business group to no more than 8 percent. The Government continues to regulate the five city banks the most closely, including selecting certain of their officers.

A number of new activities have been authorized to diversify banking services. Indigenous commercial banks have been authorized to undertake new activities including trust business, mutual savings deposits, short-term commercial paper, credit card business, factoring, and underwriting of government securities. Since mid-1984, city banks and a few other banks have been authorized to issue negotiable certificates of deposit (NCDs) with maturities ranging from 91 to 180 days. They have also been granted some autonomy in banking operations, such as organization, budget and staffing.

In addition, rapid computerization of banking businesses has resulted in on-line systems, cash dispensers, night-depositories, etc. Most of the Korean banks have ATMs, although there are no networks. Most ATMs are located within or attached to branches; some are free-standing. Consumers may access their accounts with a card that is limited to only one bank. Since the establishment of an ATM requires a branch license and foreign banks may only have two branches, foreign banks have not established any ATMs.

In 1982, interest rates on both deposits and loans were lowered drastically, and the required interest rate differential on preferential loans was abolished. In early 1984, banks were permitted to pay higher interest rates on long-term savings and were given some flexibility to differentiate interest rates based upon a borrower's credit standing. As banking liberalization progressed, helped by a stabilized Korean money market, interest rates on certain financial instruments were deregulated; controls on interest rates on NCDs were liberalized in March 1986; and yield rules on corporate coupon bonds and convertible debentures were liberalized during 1984-85.

In spite of these steps, major segments of the Korean banking system continue to be closely regulated. The Government still maintains the right to set maximum interest rates on major financial instruments (which often become the rates actually charged); to appoint bank presidents, including those at privately-owned commercial banks; and to direct credit to selected sectors of the economy.

Key Developments Since 1984

Foreign banks were given the power to compete in portions of the trust business in 1985.

In 1986, foreign banks were authorized to issue negotiable certificates of deposit and to access the central bank rediscount facilities on the same terms as domestic banks. These changes were accompanied by the imposition of the same obligations that are imposed on domestic banks to lend to small and medium-sized business, and by a reduction in the "swap facilities" that had been established to enable the foreign branches to obtain local currency.

Treatment of U.S. and Other Foreign Banks

Foreign banks, the fourth group of banks in Korea, hold 10 percent of all bank assets in Korea. Currently, 52 foreign banks, including 20 branches of 15 U.S. banks, are operating in Korea.

Foreign bank branches account for about two-thirds of all foreign currency loans by banks in Korea and about 6 percent of domestic currency loans. Their share of the local currency deposit market is, however, only a little over 1 percent. Foreign banks in Korea have been funding their lending activities largely through net advances of funds from their affiliated offices in other countries. These funds are deposited with the Bank of Korea in return for withdrawals of local currency which the banks use to fund commercial lending within Korea. Included in the swaps has been a guaranteed margin over and above any losses that could result from exchange rate fluctuations, a feature available only to foreign banks. The volume of these swaps is limited by the Bank of Korea.

In April 1984, the Ministry of Finance announced a schedule to move government rules toward national treatment for foreign banks. To date, the Government has largely kept to the 1984 plan.

-- In 1984, foreign banks were granted permission to apply for membership in the influential clearing house association. By August 1986, two U.S. banks had joined, although they were not granted voting status. Foreign banks are denied full membership in the influential Korea Federation of Banks.

-- In 1984, the definition of capital for foreign branch banks was amended to increase the base upon which lending limitations are established. Accordingly, foreign banks are less constrained than before in lending activity or in issuing guarantees and acceptances. Despite this change, the limit on guarantees and acceptances remains extremely low.

-- In April 1985, foreign banks were given partial access to the Bank of Korea's rediscount facility for pre-export financing, but at the cost of a partial offset against their swap ceilings and an obligation to direct a minimum of 25 percent of their local currency lending (versus a 35 percent requirement imposed on domestic banks) to small and medium industry. Foreign banks continued to be unable to access the Bank of Korea for rediscounting other trade finance receivables.

-- In October 1985, foreign banks were granted the right to request access to a portion of the trust business. As of August 1986, three U.S. banks had received approval. With approval, foreign banks may accept discretionary trust accounts; domestic banks may accept discretionary and non-discretionary accounts.

In August 1986, foreign banks were granted full access to the rediscount facility, but at the cost of a greater reduction in swap ceilings and the acceptance of full adherence to the 35 percent requirement on domestic lending to small- and medium-sized businesses. A differentiation in treatment <u>among</u> foreign banks was introduced: they are permitted to opt for "A" status, which would include full access to the rediscount window on the terms above. Alternatively, they may choose "B" status, which would limit rediscount access to the export finance window, but at a reduced cost in swap ceiling reductions and with a 25 percent minimum for Won lending to small and medium business. Once a bank has opted for "A" status, it cannot return to "B" status. As of September 1986, no foreign bank had opted for "A" status. Future government actions towards national treatment are likely to be confined largely to banks who accept the "A" status.

In September 1986, foreign banks were authorized to issue NCDs. Issuance is presently limited to 7 percent of branch capital, and thus may be a very small proportion of sources of funds. Banks which decide to issue these certificates must give up an equivalent amount of swap rights on a permanent basis. None of the foreign banks have yet issued NCDs. Although many foreign bankers regard the liberalization of the NCD market as a step in the direction toward an expanded use of market instruments and national treatment, they are concerned about whether NCDs will be as profitable as the swaps the banks will be forced to give up.

Although the Government has made progress in the direction of national treatment for foreign banks, some serious problems remain.

-- Restrictions on number of branches: A foreign bank may not open more than two branches in Korea, nor more than one in any city. In addition, an ATM would count as a branch under this limitation. Since there are no ATM networks, foreign banks are prevented from offering ATM services. A related problem is that each branch is subject to a capitalization requirement which significantly inhibits foreign bank operations.

-- Restrictions on investments: Although under the General Banking Act banking institutions, including foreign banks, are permitted to invest in nonbank financial institutions with the approval of the Bank of Korea, only three U.S. banks have been granted approval to become affiliated with nonbank financial institutions. Other applications have been denied. Unlike indigenous banks, foreign banks are not allowed to gain access to the National Investment Fund.

-- Restrictions on asset-based financing: Foreign banks are placed at a disadvantage compared to their domestic counterparts due to government policies and regulations regarding asset-based financing. Foreign banks must obtain a special permit from the Ministry of Home Affairs in order to complete the requirements for taking a security interest in undeveloped land or residential or commercial property. These permits have proved to be extremely difficult to obtain.

   Foreign banks also face difficulties in the use of vessels and aircraft as collateral. In order to perfect a lien on such assets, a foreign bank must acquire an export license from the Ministry of Trade and Industry. The issuance of the license is discretionary and is not considered until after the loan has been made. Therefore, the lending foreign bank cannot be assured ahead of time that a license will be granted.

Restrictions on branches, investments, and asset-based financing have limited the range of foreign bank operations in Korea, forcing them to deal only in bank guarantee financing or with joint venture companies whose foreign partner can put up foreign-based assets as collateral. Progress in achieving more equal competitive opportunities for foreign banks has also been diminished in value by the slow movement in overall financial sector liberalization. This lack of progress in releasing domestic banks from day-to-day scrutiny of the banking authorities and in moving toward market interest rates is hampered by the serious problem of non-performing assets in the domestic banking sector. As long as the domestic banks are burdened by non-performing assets, estimated to be as much as 25 percent of total loans, the financial authorities are expected to continue to provide below market rate credit to achieve profitability for the domestic banks. At the same time, the Government is attempting to expand the activities of small- and medium-sized enterprises by forcing the banks to make more credit available to them without charging interest rates sufficiently high to reflect the risk of the specific loans made. Thus, domestic bank profits have remained low, while pressure to force foreign banks to fulfill Korean "social obligations" has increased.

Changes in the treatment of foreign banks have also coincided with an important shift in Korea's external accounts. After decades of current account deficits, Korea has moved rapidly to a surplus position. As of August 1986, the current account surplus had reached $1.6 billion, and the Ministry of Finance revised its foreign borrowing plans for the months ahead. The change in circumstances has resulted in a change in the official attitude toward the foreign banks' swap facilities. These are increasingly being viewed as an unnecessary aggravation to the domestic money supply situation which is already feeling the effects of the inflow of foreign currency due to the current account surplus.

Further Korean Government action to reduce its very tight control over the financial sector and further improvements toward national treatment may make the Korean market more attractive to foreign bankers. However, the present degree of government controls on the financial sector and the additional and discriminatory restrictions on foreign banks limit the ability of U.S. and other foreign banks to compete in the Korean market.

12. Mexico

SUMMARY ASSESSMENT

The treatment accorded foreign banks by Mexico remains unchanged, in effect, from that existing in 1979. Mexico is closed to foreign bank entry and the one grandfathered foreign bank is greatly restricted.

As of year-end 1985, Citibank, the only foreign bank allowed to operate in Mexico, had five branches. Forty-nine additional U.S. banks maintained representative offices. As of year-end 1985, U.S. banking corporations reported interests in 8 subsidiaries or affiliates in Mexico, with total assets of approximately $725 million.

The level of operations by Mexican banks in the U.S. has increased in recent years. At year-end 1978, three Mexican banks operated one subsidiary and five agencies in the United States. As of year-end 1985, six Mexican banks operated a total of nine agencies in the United States, with total assets of $3.4 billion. Four Mexican banks maintained representative offices. Further, Mexican banks reported majority ownership in 2 U.S. banks with a total of 14 branches and aggregate U.S. assets of $417 million.

Automated teller machines are available to some extent in all large urban centers in Mexico and that service is expected to expand rapidly. Citibank cannot participate in this activity.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

Barriers to new foreign bank entry in the form of full-service branches or through subsidiary or affiliate relationships with Mexican banks have been in existence since the 1930s. This policy is part of Mexico's overall foreign investment policy and is designed to protect the development and operation of indigenous banks.

In 1974, banking rules were changed in Mexico to permit universal banking operations. Affiliated commercial banks, investment banks, mortgage banks, savings banks, and other institutions were allowed to merge their separate operations under one roof in order to provide services more efficiently.

Mexico's privately owned domestic commercial and investment banks were nationalized in September 1982. Subsequently, there had been a consolidation of the banking system into three types: national, multi-regional, and regional banks.

Domestic Banking System

There has been a major consolidation of commercial banks during the past decade. In 1975 there were nearly 200 banking institutions in Mexico. Affiliated bank groups merged a number of their separate banks together over the next seven years. When the banks were nationalized in 1982, the number was further reduced to 60. The Mexican Government, in March 1985, announced that the number of nationalized banks would be further reduced to 19. This action reportedly was taken in order to increase efficiency and reduce operating cost in the banking system and to continue the trend begun in the mid-1970s toward increased concentration. The remaining 19 government-owned banks (National Credit Societies) offer a full array of deposit-taking instruments as well as long-term lending, mortgage financing, and trust services. One commercial bank, Banco Obrero, was excluded from the 1982 nationalization because it was, and remains, owned by Mexican unions, and Citibank was allowed to remain under restrictive operating conditions.

The shares of these government-owned banks are divided into two categories called Series A and Series B. Series A shares, which constitute 66 percent of each bank's capital, must be held by the Federal Government. Series B shares, which represent the remaining 34 percent of the total, can be owned by other public sector entities such as parastatals or state and city governments, employees of the banks, or even private investors. Except for the Federal Government, no public sector entity or individual can acquire more than 1 percent of Series B shares in any bank. Foreigners are prohibited from holding <u>any</u> shares.

At present, the Federal Government continues to own most of the Series B shares. Auction sales of the Series B shares to the private sector may begin in January 1987, although sales are expected to be gradual. The banks' former shareholders are expected to have preference over others in rights to purchase the series B shares.

The 19 commercial banks, which were designated as either national, multi-regional, or regional, reported year-end 1985 total assets of $34 billion. The six national banks are permitted to open branches anywhere in Mexico. Their charter is to provide financing for large investment projects in the public and private sectors, finance and strengthen foreign trade operations, and promote the development of technological innovation. The eight multi-regional banks are concentrated in the nation's largest production and consumption centers. These banks offer integrated financial service packages primarily to industry and business. The remaining institutions, regional banks, are intended to help implement the Government's strategy of encouraging decentralized economic activity by concentrating their resources on regional business.

In addition to the commercial banks, eight Mexican development banks are a major source of credit, reportedly holding total assets of $29 billion at year-end 1985. Development banks are government-owned specialized financial institutions which help implement national investment plans and objectives. They provide long-term financing for agriculture, foreign commerce, transportation, utilities, and heavy industries. The most important development bank is Nacional Financiera (NAFINSA). With assets of $16 billion at year-end 1984, it serves as the Government's principal instrument for developing the nation's economic infrastructure and basic industries. By extending long- and medium-term credits and by making equity investments, NAFINSA finances enterprises which are government owned or have difficulty in attracting sufficient private capital.

Since late 1985, the Mexican Government has taken a more liberal attitude with respect to granting licenses to open foreign exchange houses. In October 1985, the central bank stopped trading pesos in the Chicago futures market; in November, the central bank prohibited all peso transactions abroad.

Four of Mexico's national banks offer automated teller machines as part of their effort to modernize and expand the services offered to depositors. Banamex, Bancomer, Serfin and Comermex operate about 150 electronic tellers nationwide. Automated tellers are available in all large urban centers in Mexico and bankers anticipate that the service will expand rapidly. Citibank cannot participate in the ATM market.

Key Developments Since 1984

No significant changes in the treatment of foreign banks in Mexico have occurred since 1984, nor since 1979.

In January 1982, new regulations authorized the establishment of offshore banking facilities by Mexican and foreign banks. None were established because of the burdensome nature of the regulations. Mexico apparently intended this authorization to serve as a basis for meeting reciprocity requirements in other countries. The regulations were repealed in 1985.

Treatment of U.S. and Other Foreign Banks

Mexican law prohibits foreign bank entry into full service banking.

Citibank, the only foreign-owned bank in the country, continues to operate although it is constrained by Ministry of Finance policy from opening new offices or becoming a multiple service bank. Citibank may continue only as a specialized deposit-taking bank, limiting its scope of operations to taking deposits and making short-term loans, vis-a-vis major Mexican banks which have become multiple service banks. Moreover, restricting Citibank to its existing five branches in Mexico City is particularly significant because the Government's decentralization policy encourages government and industry to operate outside the Mexico City metropolitan area. The six national multiple service banks maintain nationwide branch networks.

Mexico does permit foreign banks to have minority interests in some nonbank financial concerns. Several U.S. bank holding companies have minority interests in Mexican leasing companies; the majority control is often held by Mexican banks.

The Mexican Government has given no indication that there are any prospects for new U.S. or other foreign banks entering Mexico, nor for a relaxation of the restrictions on the one grandfathered foreign bank.

13. Norway

SUMMARY ASSESSMENT

Norway, previously closed to foreign bank entry, allowed nine foreign banks (three from the United States) to establish banking subsidiaries in 1985 and 1986. This action represented significant improvement in Norway's treatment of foreign banks. Entry, however, was permitted only as a *de novo* subsidiary: foreign banks could not enter as branches or by acquisitions. The Ministry of Finance has not decided whether additional foreign entry will be permitted.

Although the Norwegian Government had indicated that, except for an initial prohibition against branching, the foreign banks' subsidiaries would receive treatment equal to Norwegian banks, this equality has not yet been provided. Among other discriminatory restrictions, foreign banks have been denied permission to invest in finance companies, to open other affiliated offices, and to issue subordinated debt capital. The discriminatory treatment severely restricts the competitive opportunities of the foreign banks in Norway. Foreign-owned banks were also unable to enter the securities business until mid-November 1986.

Three U.S. banks (Citibank, Chase Manhattan, and Manufacturers Hanover) now have subsidiaries in Norway, with total assets estimated at $200 million at year-end 1985. Citibank's subsidiary recently received permission to engage in the same securities activities as indigenous banks.

The three largest Norwegian banks own New York investment companies (in whole or in part) and maintain five representative offices in the United States. Two are in the process of opening branches in the U.S. In 1984, there were two Norwegian-owned New York investment companies and six representative offices.

Norway has an active and highly developed electronic banking system for retail customers, including ATMs, ATM networks, and point-of-sale terminals. While access to these systems is legally open to foreign banks, the limitations on foreign banks' opportunities to enter the retail market inhibit their use of these electronic systems.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report indicated that a significant improvement, the opening of Norway's closed market to foreign entry, was being implemented. The rate of entry was uncertain and there would be an initial prohibition on expansion, but operations were expected to be permitted generally consistent with the national treatment principle.

Domestic Banking System

Government-owned institutions--the central bank, 10 state-owned banks, and the Postal Savings Bank--represent about one-third of the Norwegian credit market. The role of the state-owned institutions has been declining in recent years under non-socialist governments.

Privately owned depository institutions--20 indigenous commercial banks, 9 foreign commercial banks, and 198 savings banks--hold about 40 percent of the market, with 24 percent for commercial banks and 16 percent for savings banks. Four large commercial banks (each with year-end 1985 deposits between $2.5 billion and $9.3 billion) dominate the commercial banking scene; the largest savings bank is of comparable size. The three largest commercial banks account for three-fourths of all commercial banking assets.

The commercial banks operate 650 branches. The three largest banks have 425 of these. Savings banks operate about 1,300 branch offices.

The Norwegian credit market also includes 11 life insurance companies, 7 other insurance companies, 50 finance companies, 5 leasing companies, and 13 bond issuing credit associations.

Table 13.1
Norwegian Credit Market
(July 1, 1985)

	Total Assets (Percent)	Total Loans (Percent)
Bank of Norway (central bank)	15.8%	0.2%
Postal Savings Bank	5.6	5.2
State banks	16.6	27.9
Commercial banks	24.8	23.9
Savings banks	16.0	19.4
Credit associations	8.1	13.0
Finance companies	2.8	1.8
Insurance companies	10.3	8.6
	100.0%	100.0%

Source: Bank of Norway

In the past, the highly regulated nature of the official credit markets had given rise to a substantial unregulated "grey market." Financial markets in Norway have undergone considerable liberalization in the last 2 years, and the "grey market" has shrunk. The government no longer sets the rates banks may charge on loans. Banks and other financial institutions may now issue certificates of deposit and short- and medium-term commercial paper; the Government has begun issuing short-term securities; and commercial banks have been granted greater branching powers. Previous distinctions between banks, securities firms, and other financial market participants have been allowed to erode. The requirement that banks and other institutions purchase government bonds was eliminated.

Important restrictions remain. Although limitations on foreign ownership of most domestic companies have been reduced or removed, they remain in place for financial concerns. Direct control over the growth of the credit market was removed, but the government continues to exercise such control through reserve requirements. There continue to be restrictions on foreign and international transactions.

By year-end 1985, about 300 of Norway's commercial and savings banks had established approximately 600 ATMs serving one half million customers. Two linked networks enable customers considerable access to the ATM system. Point-of-sale transactions are presently limited to gasoline purchases, but use is widespread in both urban and rural areas.

Key Developments Since 1984

Seven foreign banks were granted permission to establish subsidiaries in 1985 and two more entered in 1986.

Although the new, foreign-owned subsidiaries expected to receive essentially equal treatment with indigenous commercial banks, they have been denied important operating freedoms. Norway has continued to liberalize its financial markets, enabling indigenous financial institutions, but not foreign-owned banks, to compete in all financial services. However, on November 10, 1986, Norway granted an application by Citibank's subsidiary bank to engage in the same securities activities as indigenous banks.

The foreign-owned banks have not yet been given authority to branch.

The foreign-owned banks have been denied permission to issue subordinated debt capital.

Treatment of U.S. and Other Foreign Banks

Norway allowed seven foreign banks to enter as subsidiaries in 1985, the first time foreign operations had been permitted. Two more foreign banks entered in 1986. Entry was based in part on reciprocity. The Ministry of Finance has not decided whether additional entry will be permitted.

Under policies adopted by the Norwegian parliament in January 1984 and regulations issued in June 1984, foreign banks anticipated being given equal treatment with Norwegian banks, except for an initial ban on the establishment of branch offices. This expectation has not been borne out by subsequent events.

Foreign-owned banks continue to be denied permission to open branch offices. Indigenous institutions have large branch networks, and have recently been given greater freedom to open additional branches. The Ministry of Finance has indicated that branching will be allowed in the future, but that foreign-owned banks should expect to be allowed to have only a small number of branches.

Foreign-owned banks have been denied permission to invest in other finanancial companies; indigenous banks have not.

Foreign-owned banks cannot issue subordinated debt. Domestic banks may raise funds with such instruments.

Until November 10, 1986, indigenous banks had been able to participate in the securities business, while permission for foreign-owned banks to compete had been withheld. The U.S. banks had filed applications for securities powers, but the Government had rejected them. On November 10, 1986, on Citibank's third attempt, approval was granted.

In light of discriminatory restrictions and the requirement that foreign banks enter Norway only through new subsidiaries, a *de jure* even-handed application of ATM rules, lending limits, and interest rate controls serves to limit foreign bank opportunities. The foreign-owned banks cannot attract retail customers by offering convenient services at convenient locations and cannot offer larger-sized loans needed by medium- and larger-sized businesses. At the same time, the deregulated indigenous banks are engaging in greater competition than ever before. The Ministry of Finance has indicated its intent to further consider national treatment issues after it and the Norwegian market gain greater experience with foreign banks.

14. The Philippines

SUMMARY ASSESSMENT

There has been no change in the Philippines' restrictive entry environment. The establishment of new foreign bank branches in the Philippines has been prohibited since 1948. As in 1984, foreign bank entry into the Philippines is limited to minority participation in indigenous financial institutions and to offshore banking units.

Foreign banks which operated branches prior to 1948 have been allowed to remain. Although these four banks, with approximately 15 percent of the commercial banking market, are accorded domestic bank status and national treatment in some respects, there are important exceptions. They are not allowed to establish any additional branches, are prohibited from obtaining universal bank licenses, and may not offer domestic trust services. Foreign banks may, on a case-by-case basis, purchase minority interests in indigenous institutions. Since 1984, one U.S. bank has received permission to enter the Philippines by purchasing part of the equity of a Government-controlled bank.

Officials of the new government have stated their desire for increased foreign investment, yet it remains to be seen if this will translate into increased opportunity for U.S. and other foreign banks.

Two of the four grandfathered foreign banks in the Philippines are from the United States. Bank of America operates one branch and Citibank three, with assets of $615 million and $1.42 billion, respectively, at year-end 1985. Citibank is the second largest commercial bank in the Philippines. Eleven of the 24 offshore banking units are from the United States. Eight U.S. banks have minority interests in five commercial banks and four finance companies. Five more U.S. banks maintain representative offices.

As of March 31, 1986, six Philippine banks operated six branches, three subsidiaries, two agencies, and three representative offices in the United States with total assets of $291 million. As of year-end 1985, Philippine individuals or entities reported majority ownership in 8 U.S. chartered banks with a total of 27 branches and U.S. assets of $665 million.

At present, the central bank limits ATM facilities to on-premise locations for all commercial banks, regardless of ownership. Banks have established ATMs but the market is limited.

NATIONAL TREATMENT REVIEW

Summary of 1984 Report

Foreign bank entry into the Philippines was limited to minority participation in indigenous financial institutions. Establishment of foreign bank branches in the Philippines had been prohibited since 1948. Foreign banks could open Offshore Banking Units and representative offices. The granting of universal bank licenses only to domestic banks constituted a deterioration in national treatment since 1979.

Domestic Banking System

Until 1980, the Philippine financial system developed basically along a specialized structure patterned after that of the United States. Financial institutions were classified into two broad categories: banks and nonbanks. Banking institutions included commercial banks, thrift banks (including savings and mortgage banks, stock savings and loan associations, and private development banks), rural banks, and the three specialized government banks (the Land Bank of the Philippines, the Development Bank of the Philippines, and Philippine Amanah Bank). In addition, there are offshore banking units (OBUs) and foreign currency deposit units (FCDUs). Altogether, these banking institutions account for 90 percent of the assets of the Philippine financial system. Nonbank financial intermediaries include investment companies, securities broker/dealers, finance companies, pawnshops, investment houses, lending investors, fund managers, non-stock savings and loan associations, building and loan assiciations, and specialized government nonbanks. Table 14.1 summarizes the Philippine financial system.

The 26 domestic and 4 foreign commercial banks dominate the Philippines' financial system, accounting for over 66 percent of total financial assets and about 72 percent of total banking assets. The domestic banks operate 3,625 branches and offices throughout the country; the 4 foreign banks have 6 offices. All commercial banks are considered privately owned except the Philippine National Bank, which controls about 27 percent of total commercial bank assets in the country. A dimunition of its presence could be an indicator of progress in strengthening of the financial sector.

Six banks are classified as private but are presently controlled or owned by government entities. The Government is attempting to sell these banks, and a U.S. bank recently agreed to purchase a minority interest in one. (These six are Associated Banks, Combank, Republic Planters Bank, Pilipinas Bank, Union Bank, and Interbank.) The grandfathered foreign banks account for about 15 percent of total commercial bank assets, with Citibank (three offices) the largest privately owned commercial bank in the Philippines.

TABLE 14.1

Philippines Financial System*

March 31, 1986

	Number of Institutions	Number of Offices	Total Assets (millions of U.S. dollars**)
Banking Institutions			
Commercial Banks	30	1,756	$13,823
Thrift Banks	117	662	759
Specialized Government Banks	3	100	4,246
Rural Banks	902	1,113	432
Subtotal	1,052	3,631	$19,260
Nonbank Financial Intermediaries			
Investment Houses	12	39	332
Financing Companies	217	351	288
Securities Broker/Dealers	125	125	28
Investment Companies	80	80	482
Fund Managers	11	11	80
Nonbank Thrifts	82	83	45
Lending Investors	216	222	7
Pawnshops	984	1,150	42
Government Nonbanks	3	3	903
Venture Capital Companies	17	17	6
Subtotal	1,747	2,081	$2,213
Total	2,799	5,712	$21,473

* Does not include offshore activity.

**Converted at the first quarter 1986 average of 20.0945 pesos per U.S. dollar.

Source: Central Bank of the Philippines

In addition, FCDUs and OBUs were authorized in 1976 in an attempt to stimulate development of the Philippines as an Asian financial center. The FCDUs enable authorized domestic banks to bid for deposits from residents and non-residents. Depositors' interest income is exempt from Philippine tax, and transactions are free from exchange controls. OBUs have the same freedom as domestic banks to bid for foreign currency deposits and to deploy the funds locally or abroad. However, being wholly foreign owned, they may not bid for domestic currency deposits or make peso loans. In addition, OBUs may not perform certain foreign exchange transactions with indigenous companies. The grandfathered foreign banks are allowed to open either a FCDU or an OBU. Twenty-four offshore banking units are presently authorized, as several have closed or changed status in recent years. Eleven of these are operated by U.S. banks.

The principal laws governing banking institutions in the Philippines are the Central Bank Act, which defines the powers of the Central Bank of the Philippines in the administration of the monetary, banking, and credit system, and the General Banking Act, which regulates the operations of banks and banking institutions. The General Banking Act prescribes, among other things, the licensing, form of organization, and scope of permissible activities for each type of bank. The thrift, rural, and specialized government banks are also subject to various other banking laws.

The powers and functions of the central bank are exercised by the Monetary Board which is composed of the Governor of the central bank, the Minister of Finance, the Director General of the National Economic and Development Authority, the Chairman of the Board of Investments, the budget minister and two members appointed from the private sector. A perceived correlation between bank failures and mismanagement led to criticism of the efficacy of regulatory controls.

The economic efficiency of the Philippine financial system was long plagued by regulations which, by restricting the activities of financial institutions, resulted in over-specialization and fragmentation. The activities of governmental financial institutions also had a negative impact on systemic efficiency. Major amendments to liberalize Philippine banking law were enacted in 1980 in an attempt to reduce fragmentation, increase competition, and encourage bigger and stronger financial institutions better able to make medium- and long-term loans.

The most notable structural change was the 1980 creation of "unibanks", banks with very broad financial powers. The so-called "unibanking" law allows each indigenous bank with equity capital in excess of 500 million pesos (approximately

$25 million) to apply for an "extended license" to become a "unibank." Unlike other banks, unibanks are allowed to own or control venture capital institutions, finance companies, and other types of financial institutions. They may also acquire up to 35 percent equity in non-allied enterprises and may perform underwriting and other investment functions. Unibanks are allowed a lower net-worth to risk-asset ratio when capitalization exceeds specified levels. Ten indigenous banks have been granted unibank status. Foreign bank branches are not permitted to become unibanks.

Other changes have also been made. The differentiation among categories of financial institutions has been reduced by allowing thrift banks to perform all commercial banking activities except foreign exchange and by allowing rural banks to serve all sectors of the economy.

The powers and functions of the nonbank financial intermediaries have been increased and they have been granted access to central bank credit facitities. Financial institutions are also allowed to "graduate" into higher categories, subject to their compliance with eligibility criteria and the approval of the Monetary Board. Capitalization requirements for most types of financial institutions, increased in 1973 to encourage mergers and consolidation, were raised again in 1981.

Most ceilings on lending rates were removed in 1983 and greater competition in deposit rates is now permitted. New instruments such as certificates of deposit, NOW accounts, and more flexible treasury bills have been introduced.

Fiscal incentives were also provided to financial intermediaries to lengthen the maturity of their lending. Among these were the exemption granted unibanks and merged banks from the dividend income tax, a progressively declining gross receipts tax (normally 5 percent) on interest as loan maturities lengthen, and an absolute tax exemption for loan maturities beyond 7 years.

Some restrictions remain, however.

Fees for most non-funded transactions are stipulated by the Bankers Association of the Philippines.

The central bank requires its prior approval be obtained for foreign currency loans and it restricts foreign currency deposits to "qualified deposits" from business entities and individuals.

Government institutions are restricted by law from depositing their funds with non-government financial institutions.

All banks are required to set aside 25 percent of their loanable funds for agricultural credit, 40 percent of which is to be used for agrarian reform credit. In the absence of qualified borrowers, the amount set aside for agrarian reform credit may be temporarily invested in government securities; the amount set aside for agricultural credit may be invested in entities engaged in agricultural activities.

The results of the developments in the financial system since 1980 have been mixed. A number of large commercial banks have become more competitive and have improved their market position. However, these changes, coupled with Philippine debt problems and domestic economic and political uncertainties, resulted in very severe financial difficulties for a number of financial institutions, particularly smaller commercial banks and finance companies.

Automated teller machines (ATMS) were first introduced in 1982 by the Philippine National Bank, and only a few of the largest commercial banks have set up retail ATM services. By year-end 1985, approximately 50 ATMs were in use. Of that total, foreign bank branches operated 9 ATMs and 2 local banks with partial U.S. equity investments operated 30 units. One of the two U.S. banks, Citibank, operates seven ATMs at its three established branches. At present, the central bank limits ATM facilities to on-premises locations for all commercial banks, regardless of local or foreign status. ATM growth in the Philippines has been hampered by the expense involved in setting up ATM operations and the relatively small market for time-saving technology.

Key Developments since 1984

Several bank failures and mergers in 1984 and 1985 have led to a thinning out of the banking system. Greater efficiency within the financial system has resulted. Treatment of foreign banks has remained essentially unchanged, but the banking market remains attractive to foreign banks. More buy-ins (some through debt-to-equity conversions) are possible, although through mid-1986, only one U.S. bank had received permission to enter through the purchase of a partial equity in a government-controlled bank.

Treatment Of U.S. and Other Foreign Banks

Foreign bank entry into the Philippines is limited to minority participation in indigenous financial institutions and offshore banking units. However, officials of the Government are articulating a desire for foreign investors in all sectors of the Philippine economy. The Government has not indicated whether this will result in increased opportunities for foreign banks.

The establishment of new foreign bank branches in the Philippines has not been allowed since the adoption of the General Banking Act on July 24, 1948. Four foreign-owned banks (Bank of America, Citibank, Chartered Bank, and the Hongkong and Shanghai bank) were grandfathered by the Act. However, these four banks are not allowed to establish additional branches as a matter of policy of the Monetary Board.

A November 29, 1972 amendment to the General Banking Act prohibited any individual from owning more than 20 percent, and any corporation from owning more than 30 percent, of the voting stock of an indigenous bank. Total foreign ownership (individual and corporate) of any indigenous bank is also expressly limited to 30 percent, which can be increased to 40 percent with presidential approval. Such presidential approval would not, however, increase the 30 percent cap on single corporate holdings of voting stock.

Foreign banks are prohibited from offering domestic trust accounts. The foreign bank branches may receive central bank authority to operate "Expanded Foreign Currency Deposit Units," which may accept certain eligible foreign currencies as trust accounts.

Although the four grandfathered foreign banks in the Philippines are accorded domestic bank status and national treatment in some respects, there are important exceptions. These four banks have not been allowed to establish any additional branches since 1948. Foreign banks are prohibited from obtaining universal bank licenses. Although the impact of universal banking in the Philippines will only be felt over the long term, universal banking poses a competitive challenge to foreign banks and provides a potentially significant competitive edge to indigenous banks.

15. Portugal

SUMMARY ASSESSMENT

Since legislation passed in early 1984 reopened Portugal's nationalized banking system to new private domestic and foreign participants, the Portuguese authorities have slowed the pace of new entry in order to ease the adjustment faced by the large, financially-pressured, nationalized banks, and to avoid Portugal becoming "overbanked." The regulatory authorities have approved 10 of 20 entry applications, resulting in entry by 6 new foreign banks and 4 new domestic private banks (some with partial foreign ownership).

In principle, banking regulations do not appear to discriminate between foreign and Portuguese banks. However, their application in many cases has put foreign banks at a competitive disadvantage, particularly vis-a-vis the nationalized banks which hold by far the majority of financial system assets. Foreign banks face limitations on their power to open new branches, have been subjected to credit ceilings much more restrictive than they believed would be permitted and, most recently, have been subjected to a sharp and unexpected increase in their minimum capital requirement.

All of these conditions have adversely affected foreign bank operations and represent a change in the ground rules under which they submitted applications to enter Portugal. In particular, the sudden increase in the minimum required capital is likely to discourage future applicants, whether domestic or foreign, and may result in some foreign banks reviewing the scope and nature of their activities in Portugal.

As of year-end 1985, three U.S. banks operated three Portuguese branches with total assets of $156 million, and three representative offices. At year-end 1983, six United States banks had maintained representative offices in Portugal.

As of year-end 1985, three Portuguese banks operated one branch and two agencies in the United States with total assets of $314 million. Two other Portuguese banks maintained representative offices, and one or more Portuguese individuals held a majority interest in a United States bank with total assets of $89 million. At year-end 1983, Portuguese banks operated three agencies in the United States with total assets of $306 million. In addition, one Portuguese bank then maintained a representative office.

Although legally allowed to join an existing ATM network, U.S. banks are hindered in participating in ATM developments due to the branching restrictions they face and the already heavy investment cost to satisfy minimum capital requirements.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report indicated that Portugal was about to open its banking system to foreign and private domestic banks as a result of legislation passed in late 1983 and early 1984. Financial leverage formulas were expected to be the same for all banks. While describing the Portuguese Government's apparent attitude toward new banks as positive -- the new law promised national treatment to foreign banks -- the 1984 Report warned that the Portuguese authorities would "phase in" new entry by moving cautiously to approve licenses, whether for foreign or Portuguese banks, and would impose high capital requirements to limit the number of applicants.

Domestic Banking System

Following the April 1974 revolution, all 18 indigenous, privately owned Portuguese banks were nationalized; many were subsequently merged. The three Portuguese banking operations which were owned by foreign interests (not from the United States) were excluded from the nationalization.

The Portuguese banking system consists of 12 Portuguese commercial banks (9 government-owned banks existing before 1984 and 3 private banks established afterwards), 9 foreign banks (3 established before 1984 and 6 afterwards), 2 investment banks, 4 investment companies, and 3 other specialized credit and savings and loan-type institutions. The 9 government-owned banks are estimated to hold 97 percent of Portugal's banking market. Of the 9 foreign owned banking operations, one is a subsidiary bank exempted from the 1974 nationalization, while the other 8 operate through branches. Table 15.1 illustrates the changes in the banking market since 1984.

Table 15.1
Number of Financial Institutions
in Portugal as of August 1986

	Existing Before 1984	Established After 1984
Nationalized Banks	9	0
Private Banks	0	3
Foreign Banks Operating Full Branches*/	3	6
Investment Banks	1	1
Other (Specialized and Thrift)	3	0
Total: Number of Institutions	16	10

*/ Data on foreign banks exclude 12 representative offices maintained by foreign banks as of August 1986.

Source: Bank of Portugal.

The opening of the banking sector was one of several financial liberalization measures adopted after 1984. Interest rate controls were loosened during 1984 and 1985. Ceilings are still in effect for loans in 3 maturity categories: between 6 and 12 months; 2 to 5 years; and over 5 years. Time deposits for 180 days must pay a minimum interest rate.

Treasury bills were introduced in August 1985 to improve mechanisms for monetary control, manage public debt, and diversify savings instruments. At the same time, the interbank market was liberalized, allowing banks with excess reserves on deposit at the Bank of Portugal (the central bank) to place funds directly with other banks at mutually agreed upon rates. In practice, the maximum term of such placements has been 90 days. The Portuguese Government is also expected to authorize banks to offer certificates of deposit on a limited basis.

New financial institutions, such as investment funds, venture capital funds and leasing societies were also authorized to provide outlets for savings.

A spot foreign exchange market began operation in October 1985. A forward exchange market is expected in the near future, to be limited to local companies that need cover for goods, services, and short-term capital transactions.

The Government's approach to liberalization is influenced by its desire to support the nationalized banks, many of which face financial stress. A recently drafted decree law would change the ownership structure of five of the nine nationalized banks to allow Portuguese public entities other than the Treasury to take equity positions in the institutions. Some of the nationalized banks have issued equity certificates (titulos de participacao) to bolster their capital resources. It is uncertain whether either of these remedies will generate large new capital infusions, or whether the broadening of the shareholder structure will affect their operations and future profitability. So far, the increase in the required minimum capital, limitations on branching by foreign banks, and the application of credit ceilings on new entrants are working to lessen competition for the nationalized banks.

The Portuguese securities market is relatively small but growing rapidly. Portuguese regulations allow foreign banks to underwrite and privately place securities on the same basis as domestic banks. Stock exchanges exist in both Lisbon and Oporto.

Several leading Portuguese banks have introduced ATMs, and a Portuguese company has established a network. Foreign banks are legally allowed to join the network. However, no U.S. bank offers ATM services due to the restrictions on the number of branches they may operate and the high cost of investment incurred to satisfy the heavy capital requirement.

Key Developments Since 1984

The terms of entry granted to private domestic and foreign banks in 1984 have not been fulfilled. Foreign banks have not been permitted to develop the degree of financial leverage they were promised. In addition, in June 1986 the Portugese Government increased the minimum required capital for all banks from 1.5 billion escudos ($10 million dollars) to 2.5 billion escudos ($17 million dollars). This increase was imposed without prior consultation with the banks and caught them by surprise. While all but one of the nationalized banks have more than the new minimum required capital of 2.5 billion escudos, all but one of the new private banks and all of the foreign banks do not. The capital increase represents a visible shift toward a more restrictive policy on private domestic and foreign bank operations as compared to the status which existed at the start of 1986.

In September 1986, credit cilings were reduced, severely constraining foreign and private domestic bank lending.

Treatment of U.S. and Other Foreign Banks

The provisions of the 1984 law reopening Portugal's market state that foreign banks will be treated equally with Portugese banks. In practice, however, the regulatory authorities appear to place the nationalized banks in a favored category, and the new private and foreign banks in another category.

According to the understanding that foreign banks had with the Portugese Government prior to start-up, their loan portfolios would be allowed to grow to 10 billion escudos (about $68 million dollars), after which they would face the same credit ceilings as existing banks. At least two foreign banks are reported to have prepared feasibility studies for entering Portugal based on clear assurances from the regulatory authorities that the branches would be allowed 10:1 leverage ratios.

Foreign banks' expectations about credit ceilings and financial leverage were not met. They were assigned new credit ceilings within three months after opening which were much more restrictive than the foreign banks had been assured would be permitted. Foreign banks were initially restricted to financial leverage (liabilities divided by equity) as low as 1:1; now most operate in the range of 3:1 or 4:1. The ratios for the nationalized banks are 30:1 and higher. Foreign banks found the credit ceilings particularly burdensome since branching restrictions limit their capacity to collect deposits.

The Bank of Portugal had allowed foreign banks to increase their credit ceilings up to twice their equity by bringing in the equivalent amount in foreign exchange and swapping it with the Bank of Portugal. However, this alternative had not been satisfactory to all of the affected banks, some of whom wished to lend mainly from an escudo deposit base. The Bank of Portugal changed the method for calculating the credit ceiling in September 1986 to even more severely constrain foreign and domestic private bank lending.

Foreign banks have been encouraged to participate via joint ventures in the creation of new specialized financial institutions such as leasing companies and venture capital funds. The Portuguese regulatory authorities appear to favor the formation of these institutions as mechanisms to modernize the financial system.

Foreign banks may face discrimination in terms of branching freedom relative to new domestic private banks. After opening branches in Lisbon, three foreign banks (including two U.S.

banks) applied for permission to branch into Oporto. After repeated delays, the two U.S. banks were granted permission July 1986. On the other hand, new domestic private banks were granted permission at the time of their original applications to open in both Lisbon and Oporto, and in some cases, in other locations; thus some new private banks have permission to operate branch networks of between two and ten offices. Foreign banks are not actively seeking permission to open many new branches at this time. In contrast to the narrow branch networks of foreign banks and new private banks, the nine nationalized banks have a total of 994 branches. Some of the nationalized banks' branches were created for social rather than economic reasons after the banks had been nationalized.

With regard to the sudden and unexpected 67 percent increase in the foreign banks' minimum required capital (from 1.5 to 2.5 billion escudos), the Portuguese Government has indicated that this change was designed to reestablish the real value of bank capital in view of recent high annual inflation rates. The increase is also expected to discourage new applications.

The Portuguese Government and the nationalized banks have acknowledged the beneficial effect of competition provided by the new domestic and foreign banks. Although Portuguese banking laws do not discriminate between foreign and domestic banks, their application has placed foreign banks at a competitive disadvantage relative to domestic banks, particularly the nationalized ones. It was recognized in the 1984 Report that entry by new participants would be "phased in," but the recent shift toward a more restrictive policy on private and foreign bank operations represents a retreat from the posture of financial market liberalization which existed earlier. It remains to be seen whether the policy shift will be reversed as financial health is restored to the nationalized banks, or how long that will take. The Government has not indicated its intentions in these regards.

16. Singapore

SUMMARY ASSESSMENT

Overall, there has been no improvement in the treatment of foreign banks in Singapore in several years. Singapore continues generally to restrict entry and operations in its domestic market by foreign banks, whose market share has been declining slowly and now stands at about 40 percent in terms of domestic deposits (including interbank deposits). Singapore continues to promote the expansion of its offshore banking market and the foreign banks operating in that market also have some ability to participate in the domestic market.

Since the early 1970s, the Monetary Authority of Singapore (MAS) has permitted only limited access by foreign banks. The last full banking license was granted to a foreign bank in 1970, and the last restricted license, in 1977. Foreign banks already licensed in Singapore have not been allowed to open or acquire new branches. Those foreign banks already in Singapore's domestic market are restricted in their ability to expand their retail operations. Legislation enacted since 1984 has provided a significant degree of equality of treatment for activities related to the development of Singapore's securities markets. Prudential lending limits, which are based on onshore capital, have had a more detrimental effect on the operations of foreign banks than on domestic banks. Foreign banks are also placed at a competitive disadvantage versus the "Big Four" indigenous banks in certain activities.

Despite the restrictions on domestic activity, government policy actively promotes foreign bank offshore activity. Since year-end 1982, for example, 38 licenses have been granted for offshore banks and merchant banks. The offshore market is several times larger than the domestic market. The Government has argued that the growth of Singapore's financial sector has been the result of offshore, not domestic, bank operations, and offshore banking growth will continue to outrun that of the domestic banking sector. Given these perceptions and the current share of the domestic market held by foreign banks, it is not likely that the Singapore Government will liberalize its domestic commercial banking policies for foreign banks in the foreseeable future.

At year-end 1985, there were 4 full-licensed U.S. banks operating 11 banking offices in Singapore. In addition, 1 U.S. bank held a restricted banking license and 14 U.S. banks held offshore banking licenses. U.S. banks also operated 12 merchant banks and 5 representative offices. Assets of all U.S. banking interests in Singapore total nearly $22 billion.

At year-end 1985, five Singaporean banks operated two branches and six agencies in the United States with total assets of $140 million.

Automated teller machines and point-of-sale terminals have gained wide acceptance in Singapore. Singapore has one of the highest ratios of ATMs to population in the world. With some exceptions, foreign banks have not been permitted to establish off-premises ATMs in keeping with Singapore's policy of limiting further foreign bank penetration of the domestic retail market.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

Singapore was not the subject of a separate chapter in the 1979 or 1984 Reports. At the time of the 1984 Report, foreign bank branching was restricted and foreign banks were not permitted to acquire controlling interest in indigenous commercial banks. These conditions have not changed.

Domestic Banking System

The domestic financial sector is small when compared to the offshore banking sector. Total assets of financial institutions at the end of 1985 in both sectors exceeded $210 billion. Of this amount, over 73 percent was held by the offshore sector.

Singapore's financial system has a wide variety of participants. There are 13 indigenous "full license" banks with full powers, including branching and the right to establish an offshore banking unit. Twenty-four foreign banks also have "full licenses" with the same powers except that they may not branch. Fourteen foreign banks have "restricted licenses." These banks may not branch and are subject to restrictions that limit their participation in the domestic market to wholesale banking. All of these banks have established offshore banking units. Eighty-four foreign banks have received licenses to operate only offshore banking units. These units also have limited powers to operate in the domestic market. The final category of banks in Singapore is "merchant" banks. These have all established offshore units and concentrate on the offshore business, although they have limited powers in the domestic market.

Singapore also is the home of 51 representative offices of foreign banks. Discount houses, finance companies, money brokers, insurance and reinsurance companies, a post office savings bank, a compulsory retirement savings system, and a stock exchange comprise the balance of the financial sector. All banks in Singapore may engage in universal banking, i.e., both commercial banking and investment banking activities.

Table 16.1 shows the asset sizes of the major groups of financial institutions in dollars and as a percent of the total. Table 16.2 shows the number of institutions within the groups and the number of their offshore units. Table 16.3 shows the shares of the banking market held by the domestic and foreign interests in 1978 and in 1985.

Table 16.1

Financial Institutions in Singapore
December 31, 1985

Type of Institution	Total Assets (U.S. Dollars Millions)	Percent
Domestic Banking Units of Commercial Banks	$ 33,548	15.8%
Domestic Banking Units of Merchant Banks	2,316	1.1
Offshore Banking Units	155,376	73.3
Post Office Savings Bank	4,400	2.1
Central Provident Fund	10,643*	5.0
Finance Companies	3,295	1.6
Discount Houses	1,173	.6
Insurance Companies	1,201	.6
	$211,952	

*Amount is for December 31, 1984.
Source: Monetary Authority of Singapore.

Table 16.2

Financial Institutions and Offshore Banking Units in Singapore
(March 1986)

Units	Number	Number o Offshore Banking
Commercial Banks		
Full License Banks		
Local	13	9
Foreign	24	16
Restricted License Banks (Foreign)	14	14
Offshore Banks (Foreign)	84	84
Merchant Banks	55	55
Others	2	2
Subtotal	192	180
Other Financial Institutions		
Finance Companies	34	
Money Brokers	8	
Discount Houses	4	—
Subtotal	46	0
Total	238	180

Source: Monetary Authority of Singapore

Table 16.3
Singapore Banking Sector
Market Share, (in Percent)
(Includes Offshore Banking Units)

	1978	1985
Assets		
Domestic Banks	15%	11%
Foreign Banks	53	32
Offshore Banks	32	57
	100%	100%
Deposits		
Domestic Banks	33%	25%
Foreign Banks	58	48
Offshore Banks	9	27
	100%	100%

Source: Monetary Authority of Singapore

Retail banking in the domestic market is dominated by the "Big Four" -- the Oversea-Chinese Banking Corporation, the United Overseas Bank, the Overseas Union Bank and The Development Bank of Singapore, the latter 47.8 percent owned by the Singapore Government. These range in size from just under $3 billion to slightly more than $4 billion in total deposits. All "Big Four" banks also maintain offices in major markets abroad.

The other major participants in the domestic market are the Post Office Savings Bank (POSB), which was established as an independent statutory corporation in 1972 to encourage and mobilize individual savings, and the Central Provident Fund (CPF), a compulsory savings scheme leading to a lump sum retirement payment to which both employers and employees contribute. The POSB has the sector's fastest growing deposit base, increasing 25 percent in 1985 to nearly $4.4 billion (S$9.6 billion). The CPF receives both the employee and employer contributions, which represent about 35 percent of wages, and invests primarily in Singapore Government obligations. This prevents a significant amount of funds from entering the economy through the banking system.

The banking system is regulated by the Monetary Authority of Singapore (MAS). The MAS performs most central bank functions except for currency and coin issuance and redemption which are the responsibility of the Board of Commissioners of Currency. As Singapore's banking supervisor, the MAS has explicit authority to approve or bar the operation of any type of financial firm wishing to operate in Singapore and to issue directives governing virtually any of their activities. Its establishment in 1971, together with the abolition of the interest withholding tax on non-residents in 1968 (which helped launch the Asian currency market), marked the beginning of a major Singapore Government effort to promote the growth of the financial sector. The Government's liberalizing measures were designed mainly to create and expand offshore banking activity while limiting foreign bank participation in the domestic market.

In its attempts to maintain a stable economic environment, the MAS has acted to prevent the internationalization of the Singapore dollar. The MAS is concerned that too much Singapore dollar-denominated paper outside its control would pose a threat to the stability of the relatively small and open Singapore economy. Therefore, the MAS does not permit any bank, domestic or foreign, to lend more than S$5 million in local currency ($2.3 million) to a non-Singaporean person or institution, except on a case-by-case basis. This concern also explains the MAS' active role in maintaining a stable Singapore dollar exchange rate with the U.S. dollar.

Singapore continued to make progress toward a cashless society from 1983 to 1986 with general public acceptance of point-of-sale electronic fund transfers, automated teller machines (ATMs), and other electronic banking systems. Local banks and the Post Office Savings Bank have been expanding their ATM networks to the extent that Singapore's ATM density, when compared to its population, is relatively high. The number of ATMs in Singapore totaled 335 at the end of March 1986.

Recent trends in Singapore include enhanced regulatory powers for the MAS, continued growth in electronic banking, continued government encouragement for offshore banking, and government efforts to broaden the domestic securities market. In the regulatory field, 1984 amendments to the Banking Act and the Finance Companies Act updated and tightened MAS supervisory powers over financial institutions of all types.

A new securities industry bill giving the MAS watchdog authority over the Stock Exchange of Singapore (SES) was passed in March 1986 after the stock market's near-panic in late 1985 revealed weaknesses in the largely self-regulated SES. In an effort to diversify and deepen the domestic financial market, the authorities plan to promote a government securities market in the second half of 1986. A futures trading bill, passed in March 1986, is another indication of Singapore's interest in broadening capital market opportunities. Since September 1984, financial futures contracts have been traded on the Singapore International Monetary Exchange (SIMEX) although growth so far has been moderate.

Key Developments Since 1984:

Some laws passed since 1984 have treated foreign banks equally with respect to domestic banks. Foreign banks have been permitted to participate in the interbank giro system, engage in trading of new products on the Singapore International Monetary Exchange (SIMEX), and become members of SIMEX as brokers and corporate clearing members.

The MAS has stated that it would allow foreigners to own more than 50 percent of the equity of "stockbroking" houses so long as they demonstrate technical and marketing ability and are committed to introducing new foreign business. No such approvals have yet been granted.

Other measures passed since 1984 have placed foreign banks at a competitive disadvantage. These include the lowering of prudential lending limits from 60 percent to 30 percent of onshore capital in 1984; and legislation passed in 1986 authorizing Singaporeans to invest their retirement savings in the stock market but which required that they open a deposit account at one of the "Big Four" local banks to do so. Other government policies which restrict foreign bank access to the domestic banking market remain unchanged.

Treatment of U.S. and Other Foreign Banks

The Singapore Government policy since the early 1970s has been to attract foreign banks to, and promote the growth of, offshore banking, while restricting foreign bank access to the domestic market. Prior to 1971, commercial banks were permitted to engage in the whole range of banking services without regard to country of incorporation. Favorable regulatory and tax treatment accorded offshore banking units encouraged the establishment of a banking presence in Singapore by foreign banks. Unlike locally owned full licensed banks, foreign owned full licensed banks cannot branch in Singapore. The last full banking license was granted to a foreign bank in 1970.

Fearing that the influx of foreign banks would lead to excess competition and over-banking in the domestic sector, the Monetary Authority of Singapore created a new category of banking license called the "restricted" license. This enabled foreign banks to establish and operate offshore banking units within the same constraints applicable to "full" license banks. However, their domestic operations were, and remain, limited in that they may not branch, open savings accounts, or accept deposits from residents of less than S$250,000 ($115,000). These limitations exclude them from domestic retail deposit taking and inhibit other retail banking operations. The last restricted banking license was issued in 1977.

As Singapore concerns continued to grow over the influx of foreign banks, a third type of license was created. This license, the "offshore" banking license, significantly limited transactions involving residents of Singapore and essentially prevented banks from participating in the domestic retail market. Banks with an offshore license may not accept interest-bearing deposits from Singapore residents and are not permitted to extend more than S$30 million ($13.5 million) in local currency credit, in the aggregate, to residents of Singapore at any one time. The MAS has indicated that it may grant exceptions on a case-by-case basis depending on the purpose of the loan requiring the exception. Offshore banks are also restricted from accepting local currency deposits of less than S$250,000 ($115,000) from non-residents.

Banks licensed in Singapore were usually banks that ranked among the world's top 300, or the top 3 in a particular country. Admission was not restricted by quota per country. However, for countries with closed door banking policies, reciprocity was a key factor in the licensing decision. Licensed foreign banks in Singapore operate only as branches of their parent banks, except for merchant banks, which are usually subsidiaries or joint ventures incorporated in Singapore.

The MAS also has not allowed fully licensed foreign banks to open new branches, and has sometimes discouraged them from moving branch sites. The MAS defines ATMs as branches and thus does not generally permit full licensed foreign banks to install any off-premises, free-standing ATMs or participate in ATM networks. As an example of the MAS' restrictive posture towards branching by foreign banks, one U.S. bank was denied permission to establish an ATM at the entry of the building in which one of its branches was located since the branch was located on a different floor than the proposed ATM. In the MAS' view, the ATM would have constituted a new branch. In another case, one U.S. bank already in Singapore was denied permission to acquire two Singapore branches from another U.S. bank even though the net holdings by foreign banks would have remained unchanged. On the other hand, one foreign bank has been allowed to install terminals at the offices of a corporate customer for the customer's employees; four others have been allowed to operate ATMs at common carrier terminals. Most full license foreign banks are also precluded from any local point-of-sale business. Two non-U.S. foreign banks, Standard Chartered Bank and the Hongkong and Shanghai Banking Corporation, have been given more latitude in branching and ATM operations, reportedly because of their close connections with Singapore's colonial past.

The restrictions on branching are also a source of irritation to the foreign banks because of the higher profits associated with domestic lending (notwithstanding the increase in business failures that came with the 1985-86 recession) and the lack of access to cheaper sources of local currency funding.

Singapore reduced its prudential lending limits from 60 percent to 30 percent in 1984. Although the percentages are the same for both domestic and foreign banks, the foreign banks are affected adversely because the lending limits are based only on onshore capital. Since all licensed foreign banks operate as branches of their head offices, foreign banks argue that parent capital should be considered as the criteria for lending limit purposes.

The Stock Exchange of Singapore recently allowed the "Big Four" domestic banks to become full-fledged members. These banks also have an advantage over other banks and stockbroking firms, including foreign banks, in that Singaporeans who wish to invest part of their retirement savings in the stock market must open a deposit account at one of these four big banks. Foreign banks are precluded from competing for this service and are placed at a competitive disadvantage in deposit gathering and in the cross-selling of banking services.

The MAS has attempted to justify its restrictive posture toward foreign banks in the domestic market as necessary to prevent foreign banks from dominating the domestic financial system and to prevent Singapore from being "overbanked". Foreign banks hold 40 percent of local Singapore dollar deposits (down from over 50 percent ten years ago) and 55 percent of total domestic bank loans (up from 45 percent in 1981). Foreign banks are also a significant force in the domestic trade financing business.

Despite the restrictions they place on foreign banks, the Singapore Government values their presence because of their innovation and their role in attracting new foreign investment. The Singapore Government has also argued that the growth of Singapore as a financial center has not depended on the growth of the domestic financial system but has, instead, depended on offshore financial activity. The Government has cited as evidence the sustained growth of offshore banking unit assets which reached $168 billion by June 1986. The recession-induced consolidation of domestic loan portfolios by all foreign and domestic commercial banks and their increasing emphasis on fees, personal banking, money market, and foreign exchange operations have also been cited to support this view. The Singapore Government sees these changes as part of a transition of the Singapore banking market towards a center offering a full range of financial services to the entire region. A joint public and private sector economic committee set up to combat the 1985-86 recession also emphasized offshore banking as one of the economy's prime growth areas with particular emphasis on the development of Singapore as a center for risk management, fund management, and capital market activities. These perceptions, added to the desire to preserve the limited domestic market for domestic banks, make any change in the MAS's domestic commercial banking policy unlikely in the foreseeable future.

17. Spain

SUMMARY ASSESSMENT

The posture of the Spanish regulatory authorities toward foreign banks appears essentially unchanged from that of 2 years ago. Foreign banks have been operating in Spain since 1978 under clearly defined, moderately restrictive parameters set out by Royal Decree 1388. This law holds foreign banks to three branches, limits the amount of deposits those branches may obtain from Spanish customers, and restricts foreign bank equity investment in Spanish business to enterprises related to banking. Reciprocity and national economic interests are considered by Spanish authorities in granting entry.

New foreign banks seeking to enter under the terms of Royal Decree 1388 have encountered delays of up to a year in the processing of their applications. In addition, it was reported late in 1984 that the Bank of Spain was moving to restrict foreign bank entry either by raising the equity floor or by stipulating that foreign banks would have to acquire distressed local banks.

As of year-end 1985, 10 U.S. banks operated 16 branches (plus 1 representative office) in Spain, with total assets of about $4 billion. Four other U.S. banks maintained representative offices only. In addition, U.S. banking corporations reported a controlling interest in 19 subsidiaries or affiliates in Spain with total assets of approximately $3 billion.

As of year-end 1985, eight Spanish banks operated a total of six branches, nine agencies, and two representative offices in the United States with total assets of $2.3 billion. Two additional banks maintained representative offices only. Spanish individuals or banks reported a majority interest in 7 U.S. banks with 35 branches and aggregate U.S. assets of $1.6 billion. Ownership by Spanish interests was also reported in two Edge Act/Agreement corporations and one Title XII investment company.

The ATM market is highly developed in Spain. Foreign banks are essentially precluded from participating because of restrictions inhibiting their ability to compete for retail banking business.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report described the movement in Spain toward a more liberal, modern and lean banking system. Spanish authorities had begun to admit foreign banks 5 years before in a deliberate effort to increase the competitiveness and efficiency of the domestic banking sector. By year-end 1983, foreign banks had increased their office presence several fold, and held 8.5 percent of the Spanish banking market. The 1984 Report detailed the restrictions on foreign banks imposed by Royal Decree 1388, which still exist today.

The Domestic Banking System

Since the 1984 Report, the Spanish financial system has continued to become more modern and efficient. Well-publicized difficulties faced by the Spanish banking system in the early 1980s have been for the most part resolved, although some institutions remain under close supervision. Today, the financial system is characterized by rising competition between domestic institutions, particularly between commercial banks and savings banks (cajas de ahorros), and by growing competition and innovation from foreign banks. Margins on traditional deposit and lending operations have narrowed and service fees have become an increasingly important factor in bank profitability.

Foreign banks in the Spanish market have provided a catalyst for the creation of new financial instruments and raised the level of sophistication of banking operations. Before 1979, the only financial assets in the Spanish market were the traditional demand and savings deposits, vault bonds of industrial banks, and commercial bank certificates of deposit. Since then, new instruments such as commercial paper, bankers' acceptances, 6-month and 1-year Treasury bills, and mortgage bonds have improved efficiency and sharpened competition. In 1981, U.S. banks in Spain pioneered the creation of floating-rate peseta notes. U.S. banks have also widened the exposure of Spanish banks to new techniques, like revolving underwriting facilities and note issuance facilities, and have played a major part in developing the syndicated peseta loan market based on the Madrid interbank offered rate (MIBOR).

In January 1984, the Government increased the amount of funds which a bank must hold in compulsory reserves or lend at government discretion. In June 1984, a new regulation required banks to invest 12 percent of customer deposits in Treasury promissory notes and to lend 26 percent to priority economic sectors at favorable terms. Late in 1985, in a move to give

Spanish banks greater freedom to deploy their resources, the Spanish authorities announced plans to reduce these required ratios to 6 percent and 13 percent, respectively. Because the ratios apply to retail deposits, they constrain domestic banks more than foreign banks; domestic banks rely much more heavily on retail deposits than foreign banks.

The past 2 years have witnessed the gradual recovery of the Spanish banking system from the turbulence of the early 1980s. Between 1978 and 1983, 51 Spanish banks (representing about 20 percent of total domestic banking deposits) had to cease independent operations due to poor management or fraud, or as a consequence of the economic recession in the late 1970s following overexpansion of the Spanish banking system earlier in the decade. The majority of these 51 banks were merged or assumed by domestic or foreign banks. Only three were liquidated by Spanish regulatory authorities.

Most of the ailing Spanish banks were sold to the "big seven" Spanish banks, making the banking system more concentrated. The "big seven" now control about half of Spain's commercial and industrial banks, and about 80 percent of total commercial bank deposits, compared to 66 percent in 1979. As of year-end 1985, each of the two largest Spanish banking groups controlled over $23 billion in assets.

Eighty-two savings banks, with over 12,000 branches, form another significant portion of the Spanish financial sector, accounting for about 40 percent of total financial system deposits. In recent years, the savings banks have steadily widened their field of operation to the point where they now compete with commercial banks across virtually the entire range of banking services. Savings banks reported significantly more aggressive deposit and loan growth than the commercial banks in 1985, while keeping consistently lower operating costs.

Official credit institutions and numerous credit cooperatives round out the domestically-owned segment of Spain's financial system.

Forty-three foreign banks operate subsidiaries and branches in Spain and also own equity interests in a variety of other Spanish financial firms. Foreign banks have increased their share of the Spanish banking market in terms of total assets from 1.8 percent in 1978 to about 14 percent in 1985. As newcomers to the Spanish banking market, U.S. and other foreign banks have been able to maintain the economic efficiency of a small labor force, whereas Spanish banks, confronted by structural rigidities in national labor law, have been legally restricted from cutting staff to lower heavy overhead costs. Commentators on the Spanish commercial banking industry frequently cite the imperative of eliminating redundant staff as a prerequisite to returning the sector to acceptable profitability.

The branching limitation effectively prevents foreign banks from participating in ATM networks in Spain becase it inhibits their ability to compete for retail banking customers. Spanish banks have invested in this new technology relatively quickly and as of January 1985, they operated three electronic banking networks which deployed a total of 2,772 ATMs, involving 6.9 million access cards and 18 percent of the population.

Key Developments since 1984

In the past 2 years, there have not been significant changes in the regulatory environment for foreign banks. They face essentially the same restrictions as in 1984, but seem reasonably free to compete efficiently in the corporate, wholesale, and trade finance segments of the Spanish banking market.

In an effort to bring more consistent and reliable financial reporting to the banking system, and to strengthen the industry's capital base, the Spanish authorities in 1984 began to require uniform consolidated financial reporting, modified the minimum capital requirements, and introduced a system to evaluate capital adequacy based on risk.

Treatment of U.S. and Other Foreign Banks

There are two ways for foreign banks to enter the Spanish market. Foreign banks can purchase up to 50 percent of a Spanish bank. The purchase of more than 50 percent requires the approval of the Ministry of Economy and Finance, which is granted only exceptionally and usually only for the acquisition of a distressed bank.

Domestic banks acquired by foreign interests are accorded full national treatment and they enjoy all the rights and obligations of domestic banks. From 1981 to present, eight foreign banks were permitted to purchase controlling interests in Spanish banks. In addition, two foreign banks with "special status" (Banco Arabe-Espanol and Banco Saudi-Espanol) were authorized to operate in Spain as domestic banks without having purchased a Spanish bank. However, these two banks also come under some of the operational limits applicable to foreign banks.

The second avenue for foreign bank entry is to open branches or subsidiaries in Spain under the terms of Royal Decree 1388 of June 1978. Prior to the decree, foreign banks could only have representative offices, and approximately 80 did so. Since the issuance of the decree, 36 foreign banks, including 10 from the United States, have established branches in Spain. ^uthorization to establish operations in Spain is given by the Council of Ministers after recommendation of the Ministry of Economy and

Finance and hearings held by the Bank of Spain and the Banking Council. Spanish authorities' decisions on entry applications take into account reciprocity and national economic interests.

Foreign banks are effectively shut out of the Spanish retail banking market because Royal Decree 1388 limits them to a maximum of three branches. The two U.S. banks competing in the retail banking market have had to acquire previously distressed local banks in order to acquire branches. The branching limitation is made even more restrictive by the relatively heavy minimum capital requirement for each foreign bank branch, which was raised from 750 million to 2 billion pesetas in March 1983. (At year-end 1978, 750 million pesetas was equivalent to about $10.7 million; as of August 1986, 2 billion pesetas was worth approximately $15 million.) The Spanish authorities are rumored to be considering again raising the minimum capital for foreign banks, reflecting sentiment that there are enough foreign banks in Spain already.

Although the capital requirement for foreign entry remains 2 billion pesetas, there are a number of banks waiting for action on their requests to establish branches in Spain. Two Japanese banks recently received approval after voluntarily raising their proposed capital to 3 billion pesetas, and a Canadian bank received approval, reportedly due to reciprocity considerations, for entry with capital of 2 billion pesetas. Since the new 2 billion peseta minimum capital requirement has been in effect, no new foreign branches have actually been opened in Spain.

In the application of the risk-based capital formula, foreign bank branches are effectively favored compared to domestic banks. Because it is presumed that a parent foreign bank guarantees its branch, penalty ratios based on concentration of risk to individual borrowers or to companies belonging to a holding company, are not applied to foreign banks. For financial assets denominated in foreign exchange and financed with foreign borrowing, foreign banks (but not domestic banks) may apply ratios reduced to half their normal level.

Regulations, which apply to domestic banks and foreign-owned operations, limit the volume of foreign exchange transactions to multiples of capital and reserves. Upon application, foreign branches and subsidiaries have been authorized to have greater volumes based upon consideration of parent company capital. The practices in this matter are not described in regulations or written policies, and decisions have been made on a case-by-case basis.

The three major restrictions of Royal Decree 1388 remain. First, the amount of deposits a foreign bank can obtain from Spanish customers is limited to 40 percent of its portfolio of investments and loans to public and private Spanish entities. Foreign banks are allowed free access to the interbank market.

This regulation encourages foreign banks to fund themselves from their parent banks or from the Euromarkets, thus limiting competition for domestic deposits. Combined with the branching restriction, foreign banks are effectively prevented from competing in Spain's retail banking market.

The second restriction limits each foreign bank to a maximum of three branches. In practice, few foreign banks have more than two offices. In contrast, domestic banks now operate over 15,000 branches in Spain.

The third limitation prohibits foreign bank equity participation in Spanish non-financial businesses, even though Spanish banks control a significant portion of private industry. Foreign banks may, however, own equity in credit card companies, data processing service companies for banking operations, and other enterprises related to banking.

Spain's entry into the EEC begins a seven year transition period during which time the Spanish regulatory authorities will gradually repeal the discriminatory regulations of Royal Decree 1388 vis-a-vis banks from other member countries of the EEC. By 1992, these banks should be legally allowed to operate as many branches as an indigenous Spanish bank. The Spanish authorities have not declared whether equal treatment will be extended to U.S. or other non-EEC banks. Failure to grant equal treatment will create new competitive disadvantages.

18. Sweden

SUMMARY ASSESSMENT

In 1986, for the first time in history, Sweden opened its financial markets to foreign banks, which may now enter through de novo subsidiaries. However, branch entry and the purchase of indigenous banks are not permitted. Thus far, all applicants (2 U.S. banks and 10 other foreign banks) were approved and have established subsidiaries. Two other U.S. banks maintain representative offices. There also appear to be no legal obstacles to a foreign firm (including a bank) receiving a broker's license; one U.S. bank may soon file an application.

Swedish subsidiaries of foreign banks may legally engage in nearly all activities permitted domestic Swedish banks. It is uncertain whether operating rules will inhibit foreign banks from having equal opportunities to compete. Swedish banking authorities have clearly stated that foreign owned banks should have the same opportunities as Swedish banks. The practical application of this intention remains to be seen.

As of March 31, 1986, Swedish banking operations in the United States consisted of one agency, two New York investment companies and one Edge Act Corporation, with assets totaling $1.1 billion. An additional two Swedish banks maintained a total of four representative offices in the United States.

The Swedish automated teller machines environment is legally open to foreign owned banks. However, to date, no foreign owned bank has gained access to either of the two operating networks due to a lengthy approval process, which could prevent entry for several additional years. The delays apppear attributable to the actions of indigenous banks, not the Swedish government.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report noted that foreign banks were denied entry into Sweden, except for the establishment of representative offices. The 1984 Report described the expectation that these laws would be liberalized and foreign bank entry would be permitted.

Domestic Banking System

The Swedish financial system may be divided into three segments: commercial banks and other deposit-taking institutions, financial intermediaries, and long-term credit institutions. Recent market developments, however, have blurred the lines distinguishing these three segments.

Commercial banking is highly concentrated in four nationwide banks, including the 85 percent state-owned Post-Och Kreditbanken (PK Bank). Each of the three largest have over $20 billion in assets. There are also seven provincial banks, which are strong in their own regions, two local banks, and three other banks. The privately owned commercial banks are closely supervised by the Government, which may appoint five directors to each, although it normally elects to appoint only three or fewer. The function of these appointees is, by law, to represent the interests of "the society as a whole."

There are 119 savings banks which are predominantely small, local institutions, although some have become quite large through mergers. Savings banks have also diversified beyond their traditional emphasis on housing finance. The largest now compete for commercial and industrial loans, operate increasingly like commercial banks, and conduct foreign operations.

There are 391 smaller cooperative banks, formerly known as agricultural credit societies, with hundreds of local offices organized into 12 regional banks which, in turn, are served by a central institution. The cooperatives, which originally performed banking services for farmers, have widened their lending to serve all customers in agri-business and have grown rapidly as a result.

The market shares held by Sweden's depository institutions are shown in the table below.

Table 18.1
Market Shares Held by Sweden's Depository Institutions
Year-End 1985

Institutions	Percent of Deposits	Percent of Loans
Big 4 Commercial Banks	53%	60%
Other Commercial Banks	9	13
Savings Banks	26	21
Cooperative Banks	7	6
Postal Giro	5	--
	100%	100%

Source: Sveriges Riksbank

The Swedish nondeposit financial intermediaries are primarily involved in short- to medium-term financing. Insurance companies are very important in this sector. By far the largest of these (and the largest financial institution in the country) is the National Pension Insurance Fund (NPIF). NPIF is one of four government-influenced investing institutions, each of which has separate legal status and operates somewhat independently of the Government. The Government, for example, appoints the directors of NPIF. In addition, there are a large number of factoring, leasing, stock financing, and consumer financing companies. Many are owned by commercial banks. In the past few years, a new type of financial company has also emerged which functions like a merchant or investment bank.

Long-term credit institutions obtain funds from the NPIF and other insurance institutions, as well as affiliated savings banks. Most of these special institutions are owned by the banks; some are joint public-private ventures, such as the Swedish Export Credit Corporation, or are state-controlled companies, such as the Swedish Investment Bank. Although created by the Government to channel funds into priority sectors, particularly housing, shipbuilding, agriculture, and export finance, they also provide credit to the general business community.

Swedish depository institutions have historically been subject to a considerable degree of official supervision and direction, but this has been changing. Financial intermediaries and insurance funds are also closely supervised. Sveriges Riksbank (the central bank) and the Bank Inspection Board (the bank supervisory authority) jointly regulate the total lending of individual institutions, the structure of their asset portfolios, takeovers, mergers, and many other aspects of the banking business. In 1985, regulations governing trade in gold, and requirements that direct foreign investment from Sweden be supported by foreign loans, were abolished.

An important development in Sweden has been the emergence of a modern money market. This market arose as the Government, needing ways to finance budget deficits, began issuing securities directly to nonbank public institutions and financial intermediaries. As a result, an increasing proportion of loan and deposit rates are determined in the money market rather than by the official central bank discount rate. Nevertheless, remaining regulations require Swedish banks to purchase newly issued Government and housing bonds in amounts equal to 80 percent of the increase in the banks' investments at rates one half to one percent below market. The Government has proposed the abolition of this requirement.

A comprehensive system of foreign exchange controls restricts international banking transactions in Sweden. Although all foreign exchange transactions tied to trade and having a maturity of less than 180 days are exempted, exchange controls are used to restrict certain capital movements. Restrictions on long-term borrowing abroad have been eased in stages since 1974. This has allowed Swedish banks to provide foreign currency financing to Swedish companies and official institutions. As a result, foreign currency lending and refinancing by Swedish banks has increased dramatically. Banks' foreign currency assets, however, are still subject to specific limits, with ceilings placed on the net foreign exchange holdings and the type of foreign assets which these banks may hold. The principal objective of these restrictions is to limit capital flows in order to give the central bank leeway in the pursuit of its monetary policy goals. An important secondary goal of these controls is minimizing the Swedish krona's importance as a Eurocurrency.

Sweden's major banks have become increasingly involved in international finance. The two largest private banks, Skandinaviska Enskilda and Svenska Handlesbanken, as well as PK Bank, are active in international banking. Each has holdings in banks outside of Sweden including subsidiaries and consortium banks in London, Paris, Zurich, and New York.

Key Developments Since 1984

Foreign banks were permitted to establish subsidiaries in Sweden in 1986, reversing a long-standing prohibition.

Treatment of U.S. and Other Financial Institutions

In 1986, for the first time, Sweden allowed foreign banks to establish subsidiaries, but still prohibits branch entry and the purchase of indigenous banks. The arrival of 12 foreign banks more than doubled the number of commercial banks in Sweden. Licenses were granted to all the applicants (one license was for a joint venture). Of the four U.S. banks with representative offices in Sweden, two (Citibank and Manufacturers Hanover) expanded their operations into subsidiaries, and two (First Chicago and Chase Manhattan) remained representative offices. Additional applications are not prohibited.

The Swedish banking system has been flexible as it dealt with questions that had never arisen before. For example, since all Swedish banks were founding members of the Giro (a nationwide check-clearing system), the question of a new bank buying into the system had never come up. After negotiations, a price was agreed upon and foreign banks joined. Other steps toward full foreign participation in the Swedish banking system are under discussion.

An important issue now under consideration by the Government is whether the 15 percent lending limit on domestic banks will be imposed on foreign banks which, when combined with foreign exchange controls, could significantly affect their competitive ability. Swedish administrative guidance effectively limits Swedish banks to no more than 15 percent of capital to a single borrower. If this 15 percent limit is applied to foreign owned banks rather than their parents' capital, permissible loan amounts sink to an unprofitable size unless large foreign bank capital injections are made. It should be noted, on the other hand, that each of the three largest Swedish banks had deposits, at year-end 1985, in excess of $15 billion, and appear to have a reasonably entrenched market positions.

On October 2, 1986, the Bank Inspectorate announced a new policy which would allow foreign owned banks to loan more than 15 percent of their capital to a single borrower if the foreign parent bank guarantees the amont over 15 percent, and if the Swedish central bank approves. The subsidiary would also be allowed to increase the lending limit if its parent established a specified guarantee fund. It is not clear how this issue will be resolved, nor of the effect of the new policy.

The Swedish subsidiaries of foreign banks may in principle legally engage in almost any banking activity permitted domestic Swedish banks. U.S. banks are expected to concentrate on wholesale business and investment services.

There are two areas where legal comparability has not been achieved. First, merger with or acquisition of Swedish banks is not permitted and there is no current prospect of this changing. Second, there is presently a ban on Swedish banks establishing finance subsidiaries. Most indigenous banks already have such subsidiaries, so this moratorium, now more than two years old, primarily affects only the new foreign owned banks. In addition, the Swedish Bankers Association has allowed the foreign owned banks only associate member status.

There appear to be no significant barriers to a foreign owned company, including a bank, becoming a securities broker in Sweden. One U.S. owned bank has begun the process of applying to the stock exchange. There is also no legal prohibition against a Swedish subsidiary of a foreign bank buying an existing brokerage firm.

The Swedish market for automated teller machines is legally open. There are two existing networks of ATMs in Sweden which are, in theory, open to new members, including subsidiaries of foreign banks. However, no foreign bank entry to either network has been granted to date and entry could be delayed for several years due to a lengthy approval process.

Foreign banking in Sweden is less than one year old and issues are continuing to emerge. The impact of the new lending limit policy is uncertain. Existing foreign exchange controls are not scheduled to be considered by a special government credit committee report expected by year-end 1986. The resolution of these issues will determine whether foreign owned banks are, in reality, given opportunities to compete in Sweden on a par with indigenous financial institutions.

19. Thailand

SUMMARY ASSESSMENT

Overall, the treatment of foreign banks in Thailand has not significantly changed since 1984. There have been minor improvements in entry opportunities, but minor deterioration in operating conditions.

There has been no net addition, Thai or foreign, to the commercial banks operating in Thailand since 1978. However, Citibank was permitted to purchase an existing bank in Thailand, owned by other foreign interests, in 1984. Significant legal restrictions on entry to the Thai banking market continue to apply to foreign banks.

An informal relaxation of rules on acquiring a minority interest, under 25 percent, in an existing commercial bank has also effectively taken place on a case-by-case basis. The clear intent of the relaxation is to encourage qualified foreign interests to provide capital and management expertise to troubled institutions.

There are no specific barriers to entry into other financial businesses, such as leasing. Entry into these sectors has, in fact, become easier. However, a majority Thai ownership is required by law as a prerequisite to securing a seat on the stock exchange.

Previously imposed restrictions on foreign banks operating in Thailand continue to apply and new ones have been added. With the exception of a few grandfathered branches, foreign banks are precluded by law from expanding their number of offices.

As of year-end 1985, three U.S. banks were operating three branches in Thailand with total assets of $408 million. Five U.S. banks also reported interests in Thai subsidiaries or affiliates with total assets of $300 million. Eight other U.S. banks maintained representative offices.

As of year-end 1985, five Thai banks operated six branches and three agencies in the United States with total assets of $806 million. There are no representative offices of Thai banks in the United States. Also as of year-end 1985, a Thai individual or individuals reported majority ownership of one U.S. bank with five branches and with total assets of $154 million.

Off-site automated teller machines (ATMs) are considered the equivalent of branches under Thai law. Because foreign banks in Thailand may not establish additional branches, they are precluded from joining ATM systems of domestic Thai banks or from beginning their own ATM systems.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report found the Thai banking market essentially closed to new foreign participation because of restrictions on new foreign branch banking and on the ownership of finance companies. The report also highlighted restrictions, such as restraints on new branches, on existing institutions and disadvantages in funding Baht activities relative to domestic institutions. The degree of national treatment accorded foreign banks had deteriorated between 1979 and 1984.

Domestic Banking System

There are 30 commercial banks in Thailand, 16 domestic and 14 foreign, and many of these banks have equity positions in finance companies. Thirty-three foreign banks also have representative offices in Thailand. Ten of these are U.S. banks.

The role of foreign banks in Thailand continues to be marginal. As of year-end 1985, 97.7 percent of all deposits in the Thai commercial banking system were with Thai banks. The share of total assets (95.9 percent) and of employees (97.8 percent) at Thai banks were similarly high.

Commercial banks accounted for 74 percent of total financial system assets, 79 percent of total savings, and 78 percent of total loans at year-end 1985. The 16 domestic Thai commercial banks operated a total of 1,816 banking offices throughout the country as of year-end 1985, compared to only 19 for foreign banks.

The four largest Thai domestic banks account for about 65 percent of total commercial banking assets -- Bangkok Bank alone holds almost 35 percent.

The second largest segment of the financial sector in Thailand is composed of the finance and securities companies and "credit fonciers" (which finance transaction in real estate). Currently, there are 88 finance companies and credit fonciers (down from 109 in 1984). Finance companies and credit fonciers as a group, account for 13 percent of total assets, 11.4 percent of savings mobilized, and 14.6 percent of total credit extended.

The finance and securities companies largely emerged between 1969 and 1971 to fill the gap left by the official policy against the opening of new banks, usury restrictions, and the relatively little interest shown by Thai commercial banks in small businesses and individuals. Free from any government restrictions until 1973, they were able to cut quickly into the bank's share of business with more attractive interest rates on deposits and lending. By 1977 (when new licenses were suspended), 113 finance and securities companies and 33 credit fonciers companies had been authorized, and hundreds of other entities were actively, but mostly illegally, participating in the lucrative money business. Since then, the licenses of 21 firms have been revoked. Twenty-five other firms experiencing either management or financial difficulties participate in a joint management "lifeboat" scheme established by the Finance Ministry in 1984.

Smaller shares of the Thai financial system are held by three specialized government banks (the Government Savings Bank, the Bank for Agriculture and Agricultural Cooperatives, and the Government Housing Bank), the Industrial Finance Corporation of Thailand, and various life insurance companies. In addition, some new financial businesses, such as leasing and factoring, have recently emerged.

Even though the establishment of new banks is not precluded by law, the current policy of the Thai government is not to permit the establishment of new domestic banks (though additional branches are allowed) or any additional foreign bank branches. The last domestic bank incorporated in Thailand, the Asia Trust Bank, started operations in 1965. It was taken over by the Bank of Thailand (the central bank) after it failed and was recently reopened as the Sayam Bank.

The Krung Thai Bank was established in 1966 by a merger of two ailing government-owned banks, the Bank of Agriculture and the Provincial Bank. One foreign bank, The European Asian Bank, was authorized and began operations in 1978 as reciprocity for the establishment of Thai Bank branches in West Germany. Since that time, no new commercial banks have entered or exited the market.

All commercial banks, finance and securities companies, and credit fonciers come under the direct supervision of the Bank of Thailand and operate within a regulated environment. Except for restrictions on foreign bank branching, the rules and regulations for foreign and domestic banks are essentially the same. However, Thai military units may require bidding companies to use the Thai Military Bank for bid bonds. In addition, all government entities are required to use the facilities of a government-owned bank.

All banks are presently required to lend up to 13 percent of their previous year-end total deposits to the agricultural sector. Alternatively, they may deposit the same amount with the Bank for Agriculture and Agricultural Cooperatives at interest rates which are often unprofitable. At present, both loans and deposits are subject to maximum interest rate ceilings.

Off-site automated teller machines (ATMs) are considered the equivalent of branches under Thai law. Because foreign banks in Thailand may not establish additional branches, they are precluded from joining ATM systems of Thai domestic banks or from beginning their own systems of ATMs.

Key Developments Since 1984

Citibank was permitted to purchase an existing Thai bank, owned by Hong Kong interests, in 1984.

All banks were subjected to a requirement to make agricultural loans equal to 13 percent of deposits.

The Thai Government enacted, by decree, some reform measures to the country's banking control laws. The reforms gave the Bank of Thailand increased authority to intervene before a bank failed and provided for a kind of deposit insurance scheme. These measures, and the fact that they were enacted by decree, were politically controversial. When a package of decrees, including the banking sector decrees, came up for subsequent parliamentary ratification, the parliament voted against the first controversial decree it considered (a tax measure). The Government subsequently dissolved the parliament. Elections were held in July 1986, and new government, with Mr. Prem continuing as Prime Minister, was elected. On September 4, 1986, the House of Representatives endorsed the banking decrees.

Entry restrictions for under 25 percent equity interests in financially troubled nonbank financial companies have been relaxed.

Foreign banks have been precluded from participating in the growing ATM market.

Treatment of U.S. and Other Foreign Banks

New foreign bank entry into commercial banking is not allowed in Thailand. However, restrictive rules regulating the share foreign persons may own of both finance companies and existing commercial banks have been suspended on a case-by-case basis to encourage foreign banks to provide management expertise and capital to existing financial institutions experiencing difficulties. However, the informal limit on foreign equity ownership of indigenous commercial banks appears to be 25 percent. Membership on the Thai stock exchange is restricted by law to majority Thai owned firms.

Although foreign banks already established in Thailand generally receive the same treatment as domestic Thai banks, there are several significant exceptions. Most important, foreign banks may not open new branch offices. Each foreign bank is allowed only one branch, except for branches grandfathered in the late 1950s. The Chartered Bank has three grandfathered branches, while the Hongkong and Shanghai Bank, Banque Indosuez, and Mitsui Bank have two each. The Chartered Bank is the only foreign bank allowed to operate an office outside the Bangkok metropolitan area.

Foreign banks as well as domestic banks are required to allocate credit to sectors of the economy. Thirteen percent of deposits must now be lent to the agricultural sector.

In 1986, American Express announced an agreement with Bank of Bangkok to let American Express' ATM cardholders have access to 87 ATMs in Thailand. However, foreign banks in Thailand are precluded from joining an ATM network operated by a Thai bank, or from starting their own. The combined effect of the restrictions on branches and ATMs has hampered the ability of foreign banks to compete for Baht deposits and made them dependent on the frequently more expensive, inter-bank market dominated by Thai banks. Cost differentials between the two may be substantial, especially in periods of tight money.

Stringent loan-to-capital ratios and the 25 percent legal lending limit, both based on branch capitalization, place the foreign banks at a relative competitive disadvantage vis-a-vis the dominant Thai institutions. Foreign banks are also excluded from much of the defense contract and related business. Attractive government lines of credit are also not allocated to foreign banks on a fair and transparent basis.

Due to discriminatory restrictions, the 14 foreign banks that presently have branches in Thailand are allowed to play only a small role in Thailand's domestic banking system. Continued viability in Thailand for some of these operations remains uncertain as their parent banks increasingly ask whether the inherent risks of finding attractive Thai customers in the narrow share of the market actually available to foreign banks can be justified when the potential to compete with domestic banks and, if successful, to grow, is so severely limited.

On the other hand, the Bank of Thailand has said quite clearly that it favors increased foreign participation in Thai banking. Difficulties of Thai finance companies and some banks have led to an increased foreign presence in the Thai financial market, as the authorities are forced to look abroad for capital and management expertise. In the crisis atmosphere which has seemed to prevail for the last few years, it has been difficult for Thai authorities to make longer term decisions for the financial system. How they will do so when the situation stablizes is an open question.

20. Venezuela

SUMMARY ASSESSMENT

The situation in Venezuela remains at best unchanged from that existing in 1979. Venezuela's practices toward foreign banks are highly restrictive. Foreign banks historically have been prohibited from establishing subsidiary banks, purchasing existing banks, and acquiring significant equity positions in Venezuelan banks. Since joining the Andean Common Market in 1973, Venezuela has also denied non-Latin American foreign banks entry through branches. A 1975 law further restricted foreign bank opportunities. Existing grandfathered branches are prohibited from expanding in number and are subject to severe operating constraints which affect costs, earnings, and market share. Approved Latin American banks are, however, permitted entry and may be accorded domestic banking powers based upon reciprocity considerations on a case-by-case basis. New rules on reserve requirements and on foreign exchange transactions imposed in mid-1986 have further limited the opportunities of foreign banks.

As of year-end 1985, one U.S. bank operated four branches in Venezuela with total assets of about $200 million. Twenty-one other U.S. banks maintained representative offices there. As of year-end 1985, U.S. banking corporations reported controlling interests in four subsidiaries or affiliates in Venezuela with total assets of approximately $72 million. One U.S. bank also had minority interests in two Venezuelan affiliates.

As of year-end 1985, five Venezuelan banks operated two branches, four agencies, and one representative office in the United States with total assets of $806 million. Two other banks maintained representative offices in the United States. Also as of year-end 1985, Venezuelan individuals reported majority interests in 5 U.S. banks with a total of 34 branches and aggregate assets of $1,270 million. A minority interest was reported in one U.S. bank with two branches and total assets of $337 million. A Venezuelan interest also reported majority investments in four Edge/Act Agreement corporations and one Title XII investment company.

Automated teller machines were introduced in Venezuela 4 years ago, but their use is still very limited.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

In 1984, Venezuela, despite having the largest banking market of any of the Andean Pact nations, was the most stringent interpreter of the Pact's prohibitions on foreign investment in banking. Non-Latin American banks were prohibited from further commercial bank entry, except at less than 20 percent ownership of indigenous financial institutions through the purchase of stock already held by foreigners. Foreign banks established prior to 1975 could not open any additional branches. Because of severe operating limitations, foreign banks held a very small percentage of the Venezuelan commercial banking market, and prospects for increasing that share were not good.

Domestic Banking System

The Venezuelan banking system is composed of commercial banks, mortgage banks, financieras (merchant-investment banks, some owning leasing companies), and savings and loan institutions. Commercial banks hold approximately 56 percent of the banking system's assets (excluding those held by the central bank). They also control some of the other financial institutions. At year-end 1985, 38 commercial banks operated 1,500 banking offices in Venezuela. Twenty-seven banks were privately held by Venezuelans and seven were government-owned. Of the remaining four, one is Brazilian, one is Colombian (with a 20 percent Venezuelan minority interest), one has capital subscribed by Spain and the Andean Pact member countries, and the other is Citibank, with four grandfathered branches (and about 0.5 percent of total Venezuelan bank deposits). A large number of foreign banks maintain representative offices in Venezuela.

At year-end 1985, Venezuelan commercial banks had assets of approximately $10.5 billion. Private sector demand deposits accounted for 37 percent of total deposits; passbook savings, 25 percent; time deposits, 22 percent; and government and official institution deposits, 11 percent.

Commercial banks are regulated through executive decrees of the Venezuelan Government as well as official resolutions of the central bank and the Superintendent of Banks. Bank loans are subject to various interest rate ceilings and banks must pay minimum interest rates on deposits. Commercial banks are also required to invest 22.5 percent of their portfolio in agriculture. Any shortfall in meeting that requirement must be held as reserves with the central bank. No more than 5 percent of a commercial bank's local currency-deposits may be placed in foreign investments or foreign currency denominated loans.

Merchant-investment banks, or financieras, also subject to the general banking laws, are another important sector of the Venezuelan banking system, holding 11 percent of its assets. They are a source of medium- and long-term credit for the private sector and can promote enterprises through equity participation. Intermediation services, such as placing stock, bond, and domestic paper issues, playing a role in international capital markets, and organizing mergers and acquisitions are becoming more important. Many financieras have subsidiaries such as leasing companies, warehousing facilities, data-processing companies, or service firms. Following a period of rapid growth that ended with the onset of the 1983 recession, financieras have been among the most troubled banking institutions in recent years.

Automated teller machines appeared in Venezuela about 4 years ago and only the major commercial banks have limited networks of them. The cost of the equipment is a discouraging factor to the smaller banks. The need for all Venezuelan banks to reduce costs is considered likely to encourage further development of automated systems, particularly, through equipment shared among banks or through the use of service companies.

Key Developments Since 1984

Several commercial banks and financieras have been intervened by the Government since 1984, and some mergers have taken place to forestall such interventions. In general, the need for interventions and mergers is due to problems of poor bank management that were exposed by the sharp recession that began in early 1983. In response to the difficulties in the banking system, a deposit insurance fund was established in 1985. In mid-1986, the Government announced the liquidation of one of the intervened banks. The foreign bank creditors of the liquidated bank have complained to the Venezuelan authorities that they have received no compensation for approximately $260 million in loans, although domestic creditors have been paid by the deposit insurance fund.

In early 1986, a regulation was repealed that had limited commercial bank lending to firms which are 50 percent or more foreign owned to a maximum of 40 percent of capital plus legal reserves of the firm involved, thus opening the way to greater local financing of the many multinational firms operating in Venezuela.

In June 1986, a new decree was implemented which further limits the operations in bolivars (the local currency) by offices of foreign banks. It requires domestic banks to hold reserves equal to 100 percent of their deposits from foreign banks, or equal to 100 percent of transfers from head offices in the case of foreign banks with branches in Venezuela. In addition, new rules enacted in June 1986 restricting the foreign exchange market, requiring a report to the central bank of the details of every foreign exchange transaction, and requiring a 100 percent reserve against all commercial bank excess reserves greater than 2 percent of assets, have also adversely affected the climate in which the foreign banks operate.

Treatment of U.S. and Other Foreign Banks

Freedom of entry and equality of competitive opportunity for foreign banks, other than those from Andean Pact and approved Latin American nations, are almost totally absent in Venezuela.

The protectionist stance taken by the Venezuelan Government in the early 1960s resulted in the imposition of restrictions on foreign commercial banking in the country. New bank licenses were no longer issued to foreign banks, and established foreign banks could not expand their existing branch networks.

Banking law reforms initiated in 1970, and reinforced in 1973 when Venezuela joined the Andean Common Market, led to the eventual "Venezuelization" of the financial structure. The 1975 General Banking Law stipulated that the capital of any new bank be at least 80 percent Venezuela-owned, effectively prohibiting meaningful entry by foreign banks. However, Venezuela permits entry by banks from Andean Pact (Bolivia, Colombia, Ecuador, and Peru) and other approved Latin American countries, and may accord these banks domestic banking powers. Permission is based upon reciprocity considerations and is granted on a case-by-case basis.

Each foreign bank established in Venezuela before the 1975 law was required to either reduce its ownership to below 20 percent, enabling the bank to continue operating on the same terms as Venezuelan banks, or retain its level of ownership and operate under special discriminatory restrictions. Citibank was the only foreign bank which chose to retain its full equity position under the 1975 law. Chase Manhattan and five other foreign banks reduced their equity holdings in local banks to 20 percent or less and, subsequently, Chase and others have sold their minority holdings. Morgan Guaranty has also recently sold its interest in a finance company.

Foreign commercial banks retaining their controlling ownership of their Venezuelan operation are prohibited from expanding their branch networks and cannot accept government demand deposits or savings deposits of residents. Demand and time liabilities are limited to 6 times capital, while Venezuelan banks are permitted a liability-to-capital ratio of 20-to-1. Expansion of capital from any external source is prohibited and foreign exchange privileges with the central bank are denied. Foreign banks are also prohibited from issuing savings bonds, negotiable certificates of deposit, and any other bonds and obligations. They may, however, issue certificates of deposit with maturities in excess of 90 days. In June 1986, new rules were introduced which placed greater restrictions on local currency transactions by foreign banks and on all banks' foreign exchange transactions. Finally, foreign bank asset growth is limited to 7 percent per year.

Venezuela also limits foreign ownership of merchant-investment banks (financieras). One U.S. bank and four other foreign banks had minority ownership interests in Venezuelan financieras in mid-1986.

U.S. and other foreign banks from outside Latin America are essentially precluded from the Venezuelan market. The Venezuelan Government has not indicated any intention to improve the treatment of foreign banks.

21. Taiwan

SUMMARY ASSESSMENT

Overall, financial market liberalization measures in Taiwan have resulted in some improvement in national treatment since March 1984. However, significant restrictions continue to remain on the operations of foreign banks in Taiwan. Foreign banks are only permitted to operate branches in Taiwan, subject to various entry requirements. They have not been allowed to open more than one branch, although the authorities changed the rules on October 30, 1986, to allow banks meeting certain requirements to establish a second branch in Kaohsiung. Foreign bank equity participation in indigenous banks and establishment of wholly-owned foreign bank subsidiaries are prohibited. Foreign banks may invest in domestically incorporated leasing firms and investment and trust companies, subject to policy and legal restrictions which severely limit the number of such investments. An offshore banking center, open to foreign banks, was established in June 1984.

Foreign banks operate in Taiwan at a material competitive disadvantage relative to indigenous banks. Foreign branches have not been able to fund themselves competitively, have limited access to rediscount facilities, cannot avail themselves of concessionary export and import financing programs, are encumbered by limits on commercial paper guarantee levels, and are excluded from some influential banking organizations. Changes effective October 30, 1986, should reduce the restrictions on foreign banks' ability to raise funds locally. Unlike domestic banks, foreign banks are not able to obtain securities underwriting and brokerage licenses.

The past 2 years have been marked by numerous changes representing a cautious move towards greater liberalization of Taiwan's financial system. Interest rates are now allowed to be more market determined. Taiwan authorities have also established an offshore banking center and a prime rate system, and foreign banks have been included in both of these areas. A number of quantitative limits on foreign bank operations in Taiwan have also been raised since 1984.

Fourteen U.S. banks operated one branch each in Taiwan, with total assets of approximately $3.8 billion as of year-end 1985, up from $2 billion as of year-end 1983. U.S. banks have five representative offices in Taiwan, down from six in 1984. Six U.S. banks are affiliated with seven finance or investment companies in Taiwan. At year-end 1978, there were nine U.S. bank branches and five U.S. bank representative offices in Taiwan.

One Taiwan bank operates two branches, a subsidiary, a representative office, and an agency in the United States, with total assets of $2.3 billion as of March 31, 1986, up from $540 million as of year-end 1983, when it had only one branch and anagency. Another Taiwan bank maintains two representative offices in the United States. In addition, as of year-end 1985, Taiwan individuals or entities reported majority ownership of four banks in the United States. These banks had seven branches and total assets of $628 million.

Both domestic and foreign banks in Taiwan are permitted to have automated teller machines and an ATM network is being considered. Taiwan has also established a local currency debit card processing center.

NATIONAL TREATMENT REVIEW

Summary of the 1984 Report

The 1984 Report indicated that only minor improvement in the treatment of foreign banks had occurred between 1979 and 1984. Foreign banks were subject to a variety of entry and operating restrictions. Foreign banks operating in Taiwan did so at a material competitive disadvantage relative to indigenous banks.

The Domestic Banking System

Many changes have taken place over the past 2 years as part of Taiwan's cautious movement toward greater freedom for the financial sector. However, Taiwan's banking system still remains tightly controlled by the Central Bank of China (Taiwan's central bank) and the Ministry of Finance.

Commercial banks represent the bulk of Taiwan's financial system. The postal system also plays a significant role in the accumulation of domestic savings. Lesser roles are played by leasing firms, investment/trust companies, credit cooperative associations, credit departments in farmers' and fishermen's associations, and insurance companies.

Taiwan had 24 indigenous commercial and "medium business" banks as of June 30, 1986, the same as existed as of March 31, 1984, up from 22 at year-end 1978. "Medium business" banks are banks which direct their lending operations to medium size businesses in Taiwan. Central authorities owned four banks, the same as in 1985 and up one from year-end 1978. Provincial authorities owned nine banks, the same as in 1984 and up one from 1978. Eleven banks were privately owned, the same as in 1984 and 1978. The four banks owned by the central authorities had 38 branches at the end of June 1986, up two from the end of 1983; the nine banks owned by Taiwan provincial authorities had 601 branches, up 24; and the 11 privately owned banks had 164 branches, up 31.

Thirty-two foreign bank branches round out Taiwan's commercial banking sector. Since March 1984, two foreign banks from countries other than the United States have established branches in Taiwan. Between year-end 1978 and March 1984, 12 foreign banks from countries other than the United States and 5 banks from the United States established branches in Taiwan.

As shown in Table 21.1, the Taiwan financial system has grown over the past 2 years. Domestically-owned commercial banks and medium business banks added about 50 offices to their branch networks and had asset growth of approximately 46 percent. The number of foreign branches increased slightly in Taiwan. However, branches of foreign banks saw their share of Taiwan's financial assets fall from 3.1 percent to 2 percent over the period. The most dramatic increase in market share during this period occurred in the postal savings system, with an increase of more than 90 percent in assets.

With prior aproval from the Ministry of Finance, both domestic and foreign banks are permitted to have automated teller machines on- or off-premises. Establishment of an ATM network is being considered, and foreign banks anticipate being granted equal access opportunities. Taiwan has established a local currency debit card processing center and has invited foreign banks to apply to join, with the caveat that each customer may only have one bank relationship subject to the debit card.

Table 21.1

Taiwan Financial System

Type of Institution	June 30, 1986 Number Head-Quarters	June 30, 1986 Number Branch Offices	June 30, 1986 Assets* (U.S.$ Mil.)	March 31, 1984 Number Head-Quarters	March 31, 1984 Number Branch Offices	March 31, 1984 Assets* (U.S.$ Mil.)
Central Bank	1	0	$33,689	1	0	$18,158
Domestic Commercial Banks	16	593	59,270	16	560	40,831
Foreign Bank Branches	32	0	2,856	30	0	2,638
Medium Business Banks	8	211	5,925	8	190	3,756
Credit Cooperative Associations	75	298	8,115	75	0	3,267
Credit Departments of Farmers' and Fishermen's Assoc.	302	598	7,971	294	0	2,815
Investment and Trust Companies	8	27	3.084	8	29	2,829
Postal Savings System	1	1,603	17,144	1	1,550	8,995
Life Insurance Companies	8	56	2,467	9	N.A.	1,355
Property and Casualty Insurance Companies	14	69	411	14	N.A.	292
Others**	4	11	541	4	N.A.	188
TOTAL	469	3,466	$141,473	460	2,329	$85,214

*Converted at the rate of 39.92 NT$ per U.S. dollar for March 31, 1984, and 38.09 NT $ per U.S. dollar for June 30, 1986.

**Does not include Leasing Company Association members, for which branch and asset data are unavailable.

Source: Taiwan Ministry of Finance.

Key Developments Since 1984

The past 2 years have been marked by a cautious move towards greater liberalization of Taiwan's financial system. Although foreign banks have been included in a number of areas, they have been excluded in others.

In March 1984, the first joint venture leasing company was set up. An American investor was involved, contributing 50 percent (or $2.5 million) of the equity investment in the firm.

In November 1984, fees paid by a local bank to a foreign bank for repayment in advance of interbank loans began to be treated as interest income for the foreign bank and as exempt from income tax. Until then, the fees, treated as other income, were taxable.

In December 1984, a prime rate system went into effect. Banks were allowed to set their own interest rates for loans to borrowers.

An offshore banking center started operation in June 1984. The overbought ceilings imposed on banks in their foreign exchange operations were totally lifted in August 1984. Foreign exchange business was opened to foreign banks in the Hsinchu Science-based Industrial Park in October 1984 and in the three Export Processing Zones in July 1986.

The NT$2 billion maximum on deposits (including checking deposits, passbook deposits, and time deposits) held by each foreign bank was removed in April 1985. A foreign bank's total NT$ deposits still may not exceed 12.5 times the amount of the branch's capital.

In January 1986, domestic firms and private individuals were permitted to invest in foreign securities markets through appointed public banks; foreign banks are not permitted to participate in this activity.

The ceiling on commercial paper guaranteed by a foreign bank branch was raised from 5 times the branch's net worth to 10 times. The ceiling on commercial paper guaranteed by a foreign bank branch for a single customer was removed in March 1986; until then, the ceiling was 20 percent of a foreign bank branch's net worth.

Since March 1985, foreign bank branches have been allowed to obtain short-term secured accommodations from the central bank, a tool they find more useful than the rediscount facility granted them in March of 1980. Collateral for the short term secured accommodation may be Treasury bills, public bonds or securities acceptable to the central bank, while collateral for the rediscount facility is limited to certain types of commercial paper acceptable to the central bank. In April 1985, foreign banks were allowed to extend certain loans to individuals and, in December 1985, were allowed to make commercial real estate loans.

On October 15, 1986, the Executive Yuan, the cabinet in Taiwan, approved proposals effective October 30, 1986, to allow foreign banks meeting certain conditions to open a second branch, to ease conversions of representative offices to branches, and to allow foreign banks to accept certain time deposits.

Treatment of U.S. and Other Foreign Banks

Foreign banks are permitted entry into Taiwan through branches or representative offices, subject to certain business volume criteria and other limits. They are not permitted equity holdings (either minority or majority) in domestic banks, and may not establish wholly-owned banking subsidiaries in Taiwan (issuance of all commercial banking licenses for new domestic banks in Taiwan has been frozen since 1975).

While foreign banks may make investments in new domestic leasing firms and investment/trust companies, they are subject to policy and legal restrictions which severely limit the number of such investments. No one investor may own more than 20 percent of an investment and trust company, and total foreign investment in any such company may not exceed 40 percent. With respect to leasing companies, foreigners may own up to 90 percent of the equity in new or existing companies. Prospects for further growth of foreign investment in leasing, investment and trust companies are not encouraging.

Individual foreign banks have been limited to only one branch apiece in Taiwan. After the authorities had worked on a plan for a year to permit foreign banks to open a second branch, in Koahsiung, the cabinet approved the plan on October 15, 1986, effective October 30, 1986. A foreign bank operating a branch is precluded from operating a representative office. In contrast, domestic Taiwan banks may open up to three new branches each year, subject to adequate business volume, past business activities, and level of bad debts.

Regulations issued on February 19, 1980 and amended in August 1983 explicitly limit new entry by all foreign banks into Taiwan in the aggregate to only two branches per year, although exceptions can be made. One exception is that a foreign bank ranked among the 100 largest in the free world may be exempted from minimum lending criteria and the overall two branch limit if there is no foreign bank from the applying bank's home country with an office in Taiwan (U.S. banks cannot benefit from this exception). The second is that Taiwan authorities may waive the normal requirements on the basis of reciprocity. The latter exemption has been used to justify the opening of offices by banks from some countries; it has never been given to U.S. banks. The proposals approved by the cabinet on October 15, 1986 should result in revised regulations removing some of the quantitative tests used in issuing a new branch license.

A foreign bank branch capitalization requirement was introduced on February 19, 1980; each foreign bank branch must have a minimum capital of $2 million. The proposals approved October 15, 1986, allow the amount of capital in excess of $2 million at a foreign bank's first branch to count toward the capital requirement for its second branch. Domestic banks are subject to an overall capitalization requirement of $11 million on a consolidated basis; their individual branches are not subject to separate capital requirements.

Foreign banks must also meet other criteria before permission to open either a branch or representative office can be obtained. Foreign banks applying to establish a branch in Taiwan must have had correspondent relationships with domestic banks for at least 10 years and must have consummated at least $1 billion in business with Taiwan addressees in the prior 3-year period, must have maintained a representative office in Taiwan for at least two years, and usually must be among the 200 largest banks in the world.

Similarly, a foreign bank wishing to establish a representative office in Taiwan must have had correspondent relationships for at least 5 years with domestic banks and enterprises, and must have done at least $100 million in business with Taiwan addressees in the prior 3-year period. Under the proposals approved October 15, 1986, some representative offices will be able to convert more easily into branch operations.

Foreign banks in Taiwan are also still subject to considerable constraints on their operations, although somewhat better treatment has been forthcoming in a few selected areas. Regulations limiting foreign bank access to domestic funds historically have been restrictive. Prior to 1983, foreign banks had to rely on the interbank market for most of their domestic funding needs. Although foreign banks were allowed to accept demand passbook accounts, these were never a significant source of funds due to interest rate ceilings -- currently 2 percent. Unlike indigenous banks, foreign banks are prohibited from accepting savings deposits.

Some improvement occurred in 1983 when the Ministry of Finance permitted foreign bank branches to accept time deposits and issue certificates of deposit with maturities of up to 180 days. The October 15, 1986 actions extend the maximum period for NT$ time deposits to 3 years.

As a matter of policy, publicly-owned corporations are not permitted to have checking deposits with foreign banks and foreign banks remain ineligible to receive deposits from the postal savings system.

Foreign banks are also denied a variety of refinancing privileges at the central bank tied to exports and to imports. U.S. and other foreign banks are not allowed to finance strategic imports, or major bulk imports, such as oil, coal, machinery for strategic industries, raw materials and agricultural commodities. This prohibition is a major drawback as it forecloses a potentially large amount of trade financing that the foreign banks could undertake. There is an additional hindrance in that, with the foreign banks unable to finance such imports, they are not able to use such paper for rediscounting at the central bank--a potentially important source of funds. Taiwan officials have given informal indications of plans to abolish this rediscounting facility, however no action has been taken. Foreign banks, although they are excluded from most rediscount facilities, have been granted access to central bank loans on an unsecured basis to meet minimum reserve requirements.

Because of the funding restrictions, foreign branch liability maturities have remained limited to the short-term, and funding has been accomplished primarily through swaps with domestic banks since foreign banks have to pay a premium of 25 to 50 basis points in the interbank market.

One of the two restrictions on each foreign bank branch's aggregate deposits, 2 billion NT$, was eliminated in April 1985. The other, still in effect, requires each foreign bank branch to redeposit with the central bank the excess of aggregate time and other local currency deposits over 12.5 times the branch's capital. This requirement has, to date, resulted in little practical restraint for most U.S. banks in Taiwan, as deposits of only a few have reached the ceiling; it is more significant for those that have reached the ceiling. Domestic banks have not been subject to the maturity constraint, nor are they subject to the aggregate deposit ceiling.

Since April 1985, foreign banks have been permitted to extend loans to individuals and thus participate in this aspect of the consumer banking market. Foreign banks are not, however, allowed to make loans with maturity longer than seven years, limiting their ability to offer home mortgage products. Prior to December 1985, regulations also made it extremely difficult for foreign banks to extend commercial real estate loans. Changes in the regulations have opened this sector to foreign banks, but there are still various restrictions on the types of collateral foreign banks can accept.

Unlike foreign bank branches, some local commercial banks are permitted to hold both securities underwriting and brokerage licenses. Foreign banks are prohibited from selling travelers checks to Taiwan citizens going abroad, though designated domestic banks may.

Domestic and foreign banks are subject to different legal lending limits. On November 26, 1985, the limit on a domestic bank's secured and unsecured lending of both domestic and foreign currency to a single borrower was raised from 15 percent of the bank's net worth to 25 percent, of which the unsecured portion may not exceed 5 percent.

Legal lending limits were first imposed on foreign bank branches on September 2, 1980, when domestic currency credits to a single borrower were limited to the greater of NT$ 100 million or 7 percent of the branch's outstanding NT$ credits. The limit was raised in February 1985, and again in June 1986, to the greater of NT$ 300 million or 10 percent of the branch's outstanding NT$ credits. All foreign currency credits to a single borrower are limited to 25 percent of the net worth of the branch's head office. Foreign branches may now issue foreign currency loan guarantees to any firm. Prior to August 23, 1983, loan guarantees could only be extended to customers having previous foreign exchange business relationships with the branch.

Beginning in August 1983, foreign banks were also subjected, for monetary policy reasons, to a $6 million per week limit on foreign currency pre-export loans. Each foreign bank is also subject to an overall ceiling on total pre-export loans outstanding, based on economic policy and business volume. Domestic banks are not permitted, however, to make foreign currency pre-export loans.

Taiwan banking law permits both foreign and domestic bank branches to guarantee commercial paper. However, only domestic banks are allowed to treat such guarantees as ordinary extensions of credit for lending limit purposes. Beginning in 1979, commercial paper guarantees by foreign branches were limited to 5 times the branch's net worth in the aggregate and to 20 percent of the branch's net worth per customer. On April 1, 1986, the 20 percent limit per customer was lifted and the aggregate limit was raised from 5 to 10 times net worth.

Until recently, foreign branches were precluded from offering onshore foreign exchange settlement for exports and imports to local and multinational companies located in the three Export Processing Zones or in the Hsinchu Science-based Industrial Park. Three local banks, the Bank of Taiwan (owned by the Taiwan provincial authorities), the Bank of Communications (owned by the central authorities), and the International Commercial Bank of China (nominally private, but closely associated with the central authorities) were, in practice, the only banks allowed to do such business there. The restrictions on foreign banks were lifted on February 1, 1985, for the Hsinchu park and on July 1, 1986, for the export processing zones.

Foreign banks were first permitted to join the Taipei Bankers Association on August 29, 1985, and have observer status on its board. They are still not allowed to participate in the Foreign Exchange Center, which was organized by the five domestic banks with the greatest foreign exchange activity. These bodies are influential in determining interest rates and foreign exchange rates, respectively.

Foreign banks began to issue domestic currency bankers' acceptances in 1981. There are no limits on this business, except for the single borrower lending limit. Consequently, it has become one of the major activities for foreign banks in Taiwan.

Foreign banks received permission from the Ministry of Finance on May 20, 1983, to issue domestic currency cashier's checks under their own names. This change enabled foreign banks to provide better customer service and to reduce their operational costs. Prior thereto, only the Bank of Taiwan was authorized to issue such checks.

Permissible overnight foreign exchange position limits were liberalized in August 1984, with no current long limit and a $3 million short limit. However, in March 1984, the Ministry of Economic Affairs issued a temporary directive, ostensibly to control the growth of the domestic money supply, which effectively curtailed short term foreign currency borrowing by all state-owned enterprises. This directive, still in effect, further weakened U.S. and other foreign banks' competitiveness in Taiwan due to their inadequate access to domestic currency funding.

22. France

SUMMARY ASSESSMENT

The traditionally segmented French securities markets have been undergoing rapid change following the implementation of a new banking law in mid-1984, and are moving in the direction of a somewhat more favorable environment for foreign-owned as well as domestic firms engaged in securities activities. Institutional arrangements for conducting securities business in France closely resemble a universal banking system. However, all transactions in domestic stocks and bonds must be done through authorized stockbrokers -- of which there are 102 individuals in 61 firms, all of whom by law must be French or European Community nationals. Both foreign banks and securities firms may apply for banking licenses empowering them to engage in the full range of securities activities. Entry by foreign firms may be in the form of a branch or subsidiary; acquisition of existing firms is subject to Ministry of Finance approval. French law empowers the government to take reciprocity considerations into account, except for applicants from other EC countries. Foreign firms established in France with a banking license are in principle able to engage in the same range of activities as domestic institutions, but in practice obstacles to their securing equality of competitive opportunity remain in the areas of underwriting and stock exchange membership. In addition, the existence of exchange controls presents relatively greater difficulties to certain foreign firms because of the nature of their business as foreign firms.

NATIONAL TREATMENT REVIEW

France does not observe the same separation of banking and securities activities as mandated in the United States. Instead, the intermediary activity of brokering can by and large only be performed by recognized stock brokers through recognized exchanges. Other securities-related activities can be performed by institutions holding a banking license.

The French financial markets have been undergoing rapid liberalization since mid-1984, when a revised banking law took effect. Traditionally, the French market has been very segmented according to maturity, participants and regulatory authority. However, most of this segmentation is disappearing with the introduction of new instruments, such as bank certificates of deposit and commercial paper; the development of new markets, such as the financial futures market; and the opening of existing markets, such as the government securities market, to a broader range of financial market participants, including foreign institutions. In its place, there is evolving a more modern and efficient marketplace, where borrowers and lenders have access to a greater variety of instruments in a wider range of maturities.

There are various factors behind this liberalization process. First, there is a strong desire on the part of the French authorities to develop a more efficient financial system in order to finance the public sector debt on the most favorable terms possible and to facilitate the financing of increased domestic business investment. Second, there has been growing concern in France over the last several years that financial services were moving offshore to more dynamic markets. It was thought that without some fairly immediate deregulation to permit the French financial markets to keep up with developments in foreign markets, the French market would be permanently left behind. Finally, as the pace of deregulation has quickened, quantitative credit controls, the traditional tool of French monetary policy, have become less useful in controlling the amount of credit to the economy. The decision to phase out the use of credit controls and rely instead on open market operations has increased the incentive to develop an integrated financial market which is more sensitive to interest rate changes.

Overall, the change occurring in France is beginning to foster a more favorable environment for domestic and foreign-owned firms engaged in securities activities. Business opportunities are increasing, and because of their international experience and competitiveness, a number of foreign-owned firms are well-placed to benefit from new opportunities in France. Nevertheless, there are a few areas where foreign-owned firms do not receive national treatment.

Both foreign banks and foreign securities firms may apply for banking licenses and be established as branches or subsidiaries in France. However, although the banking license empowers foreign institutions to engage in the same securities business as domestic institutions, they are restricted by their inability to trade securities (debt and equity) on the exchanges. In principle, foreign applicants for banking licenses are judged on the same criteria as domestic ones. However, French law empowers the regulatory authorities to take reciprocity considerations into account for the establishment of institutions based in countries which are not members of the EC and which discriminate against French institutions in their home markets. There is no evidence to suggest that this authority has been used against U.S. institutions. Foreign branches must maintain an endowment capital of at least the minimum level required of companies incorporated under French law.

Foreign-owned firms wishing to expand securities activities in France through the purchase of a French institution face potential restrictions. As with all foreign investments in France, the acquisition of more than 20 percent of a company's capital requires the authorization of the Ministry of Finance and the Bank of France. This is currently an issue of considerable discussion because of the denationalization of 65 state-owned companies, including numerous banks and several bank-holding companies, which began in autumn 1986. For the institutions undergoing denationalization, no more than 20 percent of each firm's capital may be sold to foreign investors at the initial sale of government shares to the public. The French Minister of Economy has the authority to reduce this threshold if he considers that the national interest so requires. In addition, the government has the right to reserve a special preferential share in denationalized companies, giving the government authority to block any undesired investment, domestic or foreign, which represents over 10 percent of that company's capital. However, it is not yet clear whether the preferential share will be used to restrict foreign investment in the financial sector, since the denationalization process is just beginning.

Due to a recent change in government underwriting practices, foreign institutions are currently active participants in the primary markets for French Government securities. Prior to 1985, government securities were issued exclusively through a government bond syndicate composed of French banks. Since then, however, the Finance Ministry has issued an increasing amount of government securities by public auction.

Since February 1986, market conditions have been such that short-term Treasury bills and long-term bonds have been issued exclusively through public auction. As a result, foreign institutions currently have the same opportunities to participate as domestic firms, although in principle the Finance Ministry is still free to issue securities through its traditional syndicate of French banks. As the government securities market continues to develop, and as long as primary sales are by auction, certain foreign institutions with considerble experience in other markets, notably active participants in the U.S. Government Treasury bill and bond markets, may be particularly well-placed to become major market makers in French Government issues.

The French Ministry of Finance is in the process of developing a primary dealership system for government securities. In principle, the system will be open to foreign firms, and several foreign institutions have applied for membership. The plan is to choose about 15 institutions based on their ability and commitment to be active participants in government securities auctions, to quote bid and offer prices in the secondary market for a range of government securities, to provide the government information about market conditions, and to help widen the market for French Government securities. In return, the successful candidates for primary dealerships may receive permission to make non-competitive bids. The new primary dealership system is expected to go into effect in January 1987.

Other primary market activities are, in theory, fully open to foreign firms. However, although there is no formal prohibition against foreign lead management of bond issues on the domestic French franc or Eurofranc markets, custom dictates that French institutions perform this role. In practice, foreign firms have never lead managed such issues, although they have on occasion been part of the management group.

A queuing system exists whereby private sector public bond issues over FF 1 billion must be authorized by the issues committee of the Finance Ministry. There is no evidence to suggest that the authorization process is used to discriminate against issues in which foreign firms are involved. Commissions on new bond issues are negotiable.

Participation in the secondary markets is complicated by the requirement that practically all secondary market securities transactions formally take place on recognized security exchanges and thus pass through a government-licensed stockbroker to whom brokerage fees are paid. Orders may be placed with banks, securities firms or brokers, but only brokers have the right to execute orders on the exchanges.

All financial institutions, regardless of whether they are French or foreign-owned, face the same requirement of working through stockbrokers to execute all transactions in domestic equities and bonds. To become a stockbroker an individual must be accepted by other stockbrokers and then be officially appointed by the Ministry of Finance. Stockbrokers are then officials of the Ministry of Finance and personally liable, both individually and jointly, for the transactions for which they and any other stockbroker have acted as intermediary.

The nationals of non-EC member countries, including the United States, are prohibited from becoming stockbrokers. In principle, nationals of EC countries are eligible to become members of the stock exchange when seats are available, but so far none has become a member. Membership in the governing body of stockbrokers, the Chambre Syndicale des Agents de Change, is explicitly reserved for French nationals. Although the system is discriminatory, it is unlikely that the personal liability associated with becoming a stockbroker would be compatible with the current business activities of most domestic and foreign-owned financial institutions.

For the most part, foreign institutions are subject to the same regulations as domestic firms in the sale of securities to resident investors. In order to solicit orders for securities from clients at their homes or places of business, foreign securities firms must have a license and only solicit for stocks listed on a French securities exchange or authorized by the French Treasury and the Commission des Operations de Bourse, the French securities exchange regulatory body. Advertising is permitted as long as the securities in question are authorized for sale in France. Because of exchange controls, foreign securities purchased by French clients must be held by stockbrokers or credit institutions authorized under the French banking law, which includes foreign banks.

The major practical handicaps which foreign firms face in doing retail securities business in France result from the fact that their business is geared to the sale of foreign securities, which is limited by the existence of exchange controls. Although France is in the process of phasing out exchange controls, some significant restrictions still remain. As of September 1986, French residents were not permitted to hold accounts overseas. Thus, the French resident who wishes to purchase foreign securities may do so, but the securities must be held in France, and any remaining funds left over from sales or trading must be repatriated within three months. This repatriation requirement precludes foreign firms from offering cash management accounts to French residents. Since purchases of foreign securities by French residents involve a foreign exchange transaction, the transaction must pass through an "agent agree," i.e., an institution authorized to perform foreign exchange transactions, which includes certain foreign banks.

The long-standing difficulties posed by exchange controls have recently lessened due to the elimination of the so-called "devise titre" system. Under this system, French residents were obliged to acquire the foreign exchange necessary to purchase foreign securities at a premium in a special foreign exchange market reserved for buyers and sellers of foreign securities. The practical effect was to add additional risk to the purchase of foreign securities: not only did the investor have to consider the normal investment and exchange rate risks, he was also faced with the risk in the change of the devise titre premium over the market exchange rate. This was an additional disincentive to the purchase of foreign securities by French residents. With the abolition of the "devise titre" system in May 1986, French resident investors are now free to obtain foreign exchange for foreign securities purchases in the regular foreign exchange markets.

The management of investment trusts is open to foreign firms. In order to sell shares in an investment trust to French investors, the fund must be registered on a recognized securities exchange, although not necessarily on a French exchange.

23. Federal Republic of Germany

SUMMARY ASSESSMENT

The Federal Republic of Germany has a universal banking system which permits licensed financial institutions to engage in securities operations as well as traditional banking activities. Foreign banks and securities companies may enter the market by establishing branches or subsidiaries, or by acquiring existing institutions, any of which requires securing a banking license from the Federal Banking Supervisory Authority. The licensing procedure is quite exacting in its requirements, although there is no indication that foreign applicants face any special disadvantages relative to domestic applicants. Reciprocity considerations are taken into account with respect to establishment of branches.

Over the past several years, the German authorities have embraced financial market liberalization as a way to promote more efficient domestic allocation of resources and the development of Germany (particularly Frankfurt) as a significant international financial center. As a result, some residual, though significant, restrictions on the securities market activities of foreign financial institutions in Germany have recently been eliminated.

Foreign firms now operate within a legal and regulatory environment that is broadly similar to that affecting their domestic competitors, and foreign financial institutions are free to engage in the full range of financial market activities open to domestic financial institutions. However, reciprocity considerations may be taken into account with respect to foreign lead management of foreign DM bonds. The market penetration difficulties that do remain -- and they can be considerable -- result primarily from the institutional characteristics of the universal banking system and the fundamental competitive disadvantages faced by newcomers to any established market.

NATIONAL TREATMENT REVIEW

The German authorities have increasingly supported financial market liberalization as a way to promote more efficient allocation of resources and the development of Germany, and in particular Frankfurt, as a financial center. The Ministry of Finance has indicated its intention to remove the tax (up to 0.25 percent) on transactions in stocks and industrial bonds by non-bank investors. Although small, this tax has led to large volumes of transactions being handled off-shore and hindered the development of a broad, deep domestic capital market.

Under Germany's banking law and regulations -- which codify its universal banking system -- traditional securities market operations are defined as "banking-related" activities. Any firm wishing to engage in such operations must first secure a banking license from the Federal Banking Supervisory Authority (Bundesaufsichtsamt fuer Das Kreditwesen). The license application procedure and approval criteria for foreign applicants are essentially identical to those for domestic applicants, and there is no evidence that foreign institutions regard them as discriminatory. Possession of a full banking license entitles the holder to engage in the full range of approved securities activities, with all holders subject to virtually identical regulatory treatment. Foreign securities firms may also apply for less comprehensive licenses limiting them to securities, as opposed to banking, activities. Entry may occur through establishment of a subsidiary or branch or acquisition of an existing institution. Each of these methods of entry has been employed by foreign financial institutions, including U.S. firms, although most U.S. firms have entered as subsidiaries.

Foreign institutions may elect to establish a representative office for which no banking license is required. However, in the absence of a banking license, the activities of such offices are very restricted; representative offices may provide investment information and recommendations, and may act as a conduit between customers and the parent company, but without the license they may not actually fill investment orders. Under German law, investment orders placed with a non-holder of a banking license must be executed outside Germany. Indeed, any correspondence from the representative office to a client within Germany must be mailed from outside Germany in order to meet the proscriptions against representative offices conducting banking business within Germany.

Foreign financial institutions that hold a banking license are free to engage in the full range of securities market activities open to domestic financial institutions. The German authorities are prepared to issue banking licenses to financial institutions that are not banks in their home countries and that wish to engage only in securities business in Germany. A U.S. investment house may, for example, receive a banking license in Germany entitling it to engage, without particular restriction, in new securities issues, secondary market activities, collective investment operations, and portfolio management and counseling.

Although the text of the specific regulations affecting issuance of a banking license differs slightly as between domestic and foreign financial institutions, there has been no suggestion that these regulations disadvantage foreign institutions relative to their domestic competitors. Until the end of 1984, regulations applying to licensing of a foreign branch did include a provision empowering the supervisory authority to refuse a banking license "if its granting is not justified in the light of general economic needs." However, effective 1985, this provision was replaced by a provision under which a license could be refused "if reciprocity on the basis of international agreements is not assured." This provision has not been employed.

Foreign branches and subsidiaries may participate in and lead-manage domestic private-sector bond issues, although this has traditionally not been an especially important financial sector in Germany. More importantly, since May 1, 1985, German subsidiaries (but not branches) of foreign financial institutions have been permitted to lead manage foreign DM bond issues (those of non-resident borrowers, issued in Germany). Unlike domestic DM bonds, foreign DM bond offerings are not subject to any Finance Ministry approval requirements and thus are far less cumbersome to launch. To date U.S. firms have not been particularly active lead managers, although they attribute this primarily to their own internal corporate policy choices as well as to the dominant market positions and outstanding reputations enjoyed by some of the key German lead managers. (Non-resident foreign firms may participate up to the level of co-lead manager in an issue, as they could before the May 1 decision.)

In dropping its objection to foreign lead management of foreign DM bonds, the Bundesbank, however, reserved the right to apply a reciprocity guideline to financial institutions whose "home" country does not permit "similar possibilities" (i.e., lead management privileges) to German banks. In practice this reservation, which is not specified in either statute or regulation, has thus far been applied only to Japanese firms pending further progress in discussions with Japan concerning the licensing of German banks to do securities business in Japan. U.S. firms have not been affected. Also, while foreign DM bonds are heavily placed and traded offshore, the Bundesbank has insisted that these bond issues be "anchored" in Germany, i.e., be launched and listed there, with a designated German resident paying agent and entry in the domestic clearing system. This approach rules out an exclusively "offshore" foreign DM bond issue, even if led by a qualified FRG resident.

In connection with its decision to allow foreign lead management of foreign DM bond issues, the Bundesbank also dropped its opposition to the introduction of various non-traditional debt instruments and practices such as DM floating rate notes, multiple currency issues, zero coupon bonds, and swap-linked issues. Moreover, as of 1986, DM CDs are permitted. Because non-German, and particularly U.S., financial firms have relatively more expertise in these non-traditional instruments, the Bundesbank decision could be advantageous to foreign firms, at least in the near-term. Nevertheless, the preponderance of "new style" issues so far continues to be done by the major German banks.

In June 1986, the Bundesbank opened the hitherto "exclusively domestic" federal bond consortium to a number of German subsidiaries of foreign banks with some proven capital market capability. (Ten of the traditional 72 "domestic" members were in fact owned by foreigners, including one U.S. bank, reflecting earlier majority share acquisitions.) Under the June decision, 19 foreign bank subsidiaries, including four additional American operations, receive a collective total of about 20 percent of all new Federal bond issues, a share with which all are reportedly satisfied for the present. In connection with this expansion of the consortium, one foreign bank was invited to represent the others on the consortium's "inner committee," or management group.

Other public sector bond consortia, such as those for the Reconstruction Loan Bank (Kreditanstalt fuer Wiederaufbau) and the state governments, have until recently been limited to domestic membership, by the borrowers' choice. One state has now expanded its traditional consortium to include 12 subsidiaries of foreign firms. Presumably other public sector issuers will sooner or later follow. However, the offerings from these issuers have to date not been nearly as interesting to foreign investors as the Federal bond market. While some probing has occurred, it is questionable how interested most foreign firms are in participation. In the few cases so far where states have floated "new style" issues on the foreign DM bond market without their traditional consortia, foreign firms played major roles and foreign placement was key to the success of the issues.

The recent action to open the new issue market for federal government bonds to participation by foreign banks is an especially important step in the German context where competitive opportunities for foreigners in domestic primary bond markets in general (as mentioned above) are somewhat scarce. Specifically, as a result of the traditional reliance of the German domestic corporate sector on bank loans and/or internal resources rather than debt or equity issues for domestic financing -- and because of firms' evident aversion to undergoing the necessary Finance Ministry bond approval process -- the corporate bond market has been contracting for many years and offers few primary or secondary market opportunities to financial institutions, foreign or domestic.

In fact, domestic private sector bond issues in Germany have up to now been accounted for almost exclusively by German banks in their own names; thus individual issues have so far offered negligible market opportunities for other financial institutions.

On the other hand, the absence of any Finance Ministry or other approval requirement for foreign DM bond issues has led many domestic German corporations to tap this market through their offshore financial subsidiaries, with broad involvement by foreign underwriters.

Foreign firms seeking membership on one or more of Germany's eight independent regional stock exchanges are free to initiate an application process that is very similar to the banking license procedure discussed above and identical to the practice for domestic applicants. The application process is quite routine and no difficuties have been reported.

German law specifies two separate, and in some respects quite different, sets of regulations regarding the activities of investment funds in Germany. Investment funds "administered under foreign laws" (i.e., funds that are genuinely "foreign" in the sense that they are domiciled and regulated abroad) are regulated under a 1969 law (the Foreign Investment Company Act) written specifically for this purpose. Activities of domestic investment funds (i.e., funds established as corporate entities under German law irrespective of whether they are foreign-owned or domestic owned) are regulated under the Investment Company Act of 1957. Prior to 1969, investment funds falling under the former category (hereafter "foreign funds") were virtually unregulated. However, as a result of growing concerns about the investment and, particularly, the marketing practices of many such firms (indeed, the collapse of a major foreign investment fund led to substantial losses by many German households), the 1969 law established a series of representation, disclosure and marketing obligations.

Foreign funds must register with German regulatory authorities, be represented in Germany by a domestic financial institution or professionally-competent individual, and must clearly and regularly present the investment objectives and financial position of the fund. Foreign funds do not possess a banking license and must therefore execute all transaction orders outside Germany. The law says nothing about the portfolio composition of foreign funds. These regulations do not appear to be significantly more burdensome than those faced by investment funds operating under German law. Nevertheless, due largely to the lingering after effects of earlier foreign fund collapses, foreign funds continue to face resistance among German investors.

Regulations affecting Germany-based investment funds (i.e., funds managed by a German corporate entity) do not make any distinction on the basis of whether the fund is foreign-owned or domestically owned; the regulations are applied uniformly. The law does establish portfolio diversification requirements (no more than five percent of the value of the fund may be invested in any one entity, though in some cases this may be stretched to 10 percent), but no distinction is made as between foreign and domestic security holdings.

Despite this uniformity of regulatory treatment, German investor preferences and the structure of the domestic financial system do present considerable marketing difficulties for foreign-owned investment funds in Germany. In particular, continuing public concern about the risks, real or imagined, associated with collective investments in foreign securities is likely to be somewhat more of a hindrance to foreign-owned funds which, in view of their familiarity with and expertise in non-DM securities, would be expected to give their portfolios a relatively greater non-DM emphasis than their German competitors. Market penetration difficulties also arise from the fact that as a result of their extensive retail networks, German financial institutions enjoy much greater access to small investors than foreign firms, particularly new entrants, could ever hope to obtain. This is a competitive fact of life unrelated to the regulatory approach of the German authorities.

24. Italy

SUMMARY ASSESSMENT

Commercial banks and their affiliated finance companies dominate the securities business in Italy. However, execution of trades on securities exchanges is reserved to brokers. The Italian securities industry is growing rapidly as instruments and intermediaries multiply. Government authorities are considering how to safeguard investors in the evolving system and how to regulate the new intermediaries.

Foreign firms, securities companies as well as banks, are able to participate in the Italian securities market through branches or subsidiaries, directly in some cases, indirectly in others, and by acquisitions of existing institutions. Reciprocity is taken into account by the authorities in the case of investors from outside the European Community. Apart from being unable to become stockbrokers, U.S. firms generally receive national treatment once established in Italy, operating in a relatively free environment. The existence of exchange controls hinders cross-border transactions and therefore makes the Italian market less interesting for U.S. firms.

NATIONAL TREATMENT REVIEW

Italian financial markets were long dominated by commercial banks, with traditional bank intermediation accounting for most financial activity. Securities markets were limited. Following trends in other financial markets, the banking function of collecting deposits and extending credit has been declining in importance relative to other types of financial flows.

Legislation permitting the establishment of merchant or investment banks is under consideration in Parliament. In the absence of legislation, banks and recently-formed financial service companies provide a de facto underwriting mechanism, or what might be more accurately called a placement service for equity and debt instruments. Most of the financial service companies have been established by banks. The financial service companies cannot solicit public savings in their own name, a function which the proposed legislation would grant to investment banks. These companies can issue shares in the firm and float bonds up to the amount of their capital, as can any Italian corporation under existing legislation. They cannot use the word bank in their title.

The financial service companies operate in what must be considered a liberal context. They are subject to almost no regulation and are relatively free to do what they want in terms of securities transactions so long as their activities do not involve collecting savings from the public or extending credit in their own name.

The basic banking law dates to 1936. Commercial banks were prohibited from taking an equity interest in other firms, except for trading purposes. In recent years, banks have expanded their operations through the creation of either effectively wholly-owned subsidiaries or joint ventures. Universal banking is not, however, allowed. While there is agreement on the need for a general revision of the banking law, authorities have stated that universal banking will not be introduced.

A 1985 law provides that new share and bond issues as well as capital increases in excess of roughly 7 million dollars (10 billion lire) must receive the prior approval of the Treasury. The purpose of this law is to ensure orderly market conditions. The previous law had a lower threshold and required additional approvals. Bank of Italy prior approval is also required for all new issues.

Separately, all non-government securities offered to the public must be registered with the National Commission for Companies and the Stock Exchange (Commissione Nazionale per le Società e la Borsa or CONSOB). CONSOB is roughly the Italian equivalent of the Securities and Exchange Commission. The purpose of this registration requirement is to ensure that the relevant information is accurate. Companies listed on one or more of the stock exchanges can make an offering through the stock exchange, but new issues can also be placed directly with investors by the financial services companies.

Shares and bonds are traded on 10 stock exchanges located around Italy, with the bulk (about 90 percent) of transactions taking place on the Milan Exchange. In September 1985, the CONSOB decided that the 10 stock exchanges would create a country-wide trading network, while each exchange maintained its autonomy. Certain shares not eligible for listing on stock exchanges are listed on a second market called the Mercate Ristretto, which is also subject to CONSOB's regulations. A third market exists which is very informal and not subject to regulation.

The first two markets are important for setting prices, but the bulk of the purchases and sales of securities, especially bonds, on the secondary market take place outside the exchanges. CONSOB has ordered continuous trading in shares to begin later this year. This will replace the present procedure whereby official trading in a security takes place for a short period once a day. The practice of continuous trading may encourage more traders to take their business to the exchange to get the best price rather than use the "official price" as a basis for transactions outside the exchange.

Transactions on stock exchanges can be executed only by a stockbroker (agente de cambio), who must have Italian citizenship. They operate as individuals with full responsibility for their actions; that is, they do not have corporate status or limited liability. They only execute transactions; they are not permitted to take positions or underwrite share issues.

Commission dealers and banks handle the bulk of relations with buyers and sellers on the secondary market. They are permitted to have seats next to the trading floor and usually maintain a close relationship with one or more stockbrokers. They also purchase and sell securities without going through a stockbroker. Banks, mainly foreign, own commission dealers.

Changing the status of stockbrokers to permit them to engage in a variety of transactions is under discussion. A change would imply conversion from individual status to corporate-type status and from unlimited to limited liability.

The secondary market in Italian Treasury securities is more important than the secondary market for shares in terms of volume. Banks are the major participants in this market. The Bank of Italy serves as the clearing agent for most transactions in the government securities market, a role it also fulfills for transfers of non-government securities. Some trading of government securities occurs on the stock exchanges.

In March 1983, legislation was passed permitting the establishment in Italy of mutual funds. By April 30, 1986, 48 funds had been established, and these constitute the fastest growing category of financial intermediaries. Roughly three quarters of mutual funds' assets are invested in government securities, the balance in shares. Up to 10 percent of a fund's assets can be held in foreign securities without making a non-interest bearing prior deposit (see below). Some funds take their full quota, but overall holdings of foreign securities are only about 3 percent of total fund assets. Banks have been active in this market through the establishment of mutual fund management companies.

Portfolio management is a relatively underdeveloped industry in Italy. Trust companies which were to engage in this type of activity have existed since 1939. As interest in shares and other types of securities has increased in recent years, new portfolio management companies have been created. These are presently authorized by the Industry Ministry and CONSOB. They have not been subjected to specialized supervision by financial officials.

U.S. commercial banks constitute the bulk of the U.S. presence in Italian financial markets. U.S. securities firms have established offices in Italy to provide advice and collect orders for transactions by Italians in overseas markets. They do not appear to be active participants in investment banking under their own name, although they do have an indirect presence through various investments.

Transactions by Italians in foreign securities are constrained by foreign exchange controls. A non-interest bearing deposit formerly equal to 50 percent of the value of a foreign security purchased and recently reduced to 15 percent must be made with the Bank of Italy. The advent of mutual funds permitted to invest up to 10 percent of their assets in foreign securities without making the non-interest bearing deposit has generated additional interest on the part of securities dealers in Italy.

U.S. banks have been active in Italy for many years. In the late 1970's and early 1980's, foreign banks were able to fund themselves on the interbank market, then lend at an attractive spread thanks in part to credit controls. The spread has since diminished, reducing the profitabiity of Italian branches. This, combined with the evolving financial system, is causing U.S. financial entities to reassess their role in Italy. Some want to broaden their role by acquiring a local bank that would provide a deposit base as well as a sales outlet for a broader range of financial services. Others appear to be moving away from traditional lending activity toward a more investment-type banking activity.

Italian authorities grant banking licenses to banks with headquarters outside the EC on a reciprocity basis. Once banks are established in Italy, they receive national treatment. The U.S. banks have their headquarters in Milan. Earlier discussions with U.S. bankers have suggested no lack of national treatment. U.S. banks have been able to purchase majority control of existing Italian banks, and thereby obtain a branch network that would otherwise be time-consuming to establish.

Foreigners are not eligible to become stockbrokers. Indeed, no corporate entity can do so at this point. Foreign banks can purchase, and have in fact acquired, commission dealers, which enables them to compete with Italian banks in this respect. Foreign entities are also permitted to establish financial service companies that engage in the organization and placement of new capital issues. Establishing a financial service or portfolio management company is a relatively simple operation, though subject to the normal bureaucratic procedures.

A group of banks was formed in March, 1984, and expanded to 23 in 1986, to facilitate the placement of Italian Treasury bills. Under a "gentlemen's agreement," the banks are committed to purchase a predetermined quota of each issue. In 1985, 58 percent of the bills issued were subscribed in this way. With the expansion in the number of participating banks, the level is estimated to rise to 70 percent in 1986. In return for the banks' commitment to purchase Treasury bills up to an amount fixed in terms of their previous holdings, the central bank stands ready to offer partial financial assistance through repurchase agreements.

Although no foreign banks are currently involved in this group, they are not specifically barred. However, the central bank may not be interested in setting up an arrangement with a bank that did not already have a sizeable share of the Treasury bill market. Apparently, no foreign bank has yet expressed an interest in joining the scheme.

Longer-term Italian Treasury securities are sold largely through banks on a commission basis but generally are not underwritten as such. The Bank of Italy is a sort of de facto underwriter, but since the Treasury-Bank of Italy "divorce" of 1981, it no longer has an official obligation to buy Treasury securities. The Bank of Italy and Treasury together make a judgment on what the market will absorb. The interest rate is also fixed in advance. If the market does not absorb the fixed amount, the Bank of Italy can take part of the issue or part can be withdrawn by the Treasury. U.S. banks can and do participate in the secondary market for both Treasury short and medium/long-term securities. U.S. banks can and sometimes do participate also in the primary market.

Lead managers for domestic bond and share issues are Italian entities, almost by definition, as only they have the ability at the present time to market new issues. The lead managers are often banks as well as the financial service companies or Italy's one "full-service" investment bank, Mediobanca. While foreign-owned banks could participate in underwriting groups, they would probably do so through a financial services company. There have been very few foreign bond issues in Italy in recent years.

There does not appear to be any constraint on a foreign company setting up a mutual fund management company. The lack of a distribution system appears to be a deterrent. Another may be the $1.5 million minimum capital requirement.

The existence of exchange controls is a deterrent to participation of foreign securities firms in the Italian securities market. These controls hinder international transactions that would otherwise make operations in Italy more attractive.

The rapid growth of the Italian securities market has taken place in a regulatory vacuum of sorts. As a result, the development has taken place in a liberal context. The newly-created intermediaries have been relatively free to do whatever they want. There is a growing concern in Italy that the investor/saver may not be adequately protected. This implies measures to control intermediaries as well as the issuing and trading of securities. It is not yet clear what form controls might take.

25. Netherlands

SUMMARY ASSESSMENT

The Netherlands has a universal banking system, but other financial institutions also engage in the securities business. Several recent actions have served to liberalize aspects of the securities business in The Netherlands. Foreign banks and securities firms may enter The Netherlands to undertake securities business by establishing branches or subsidiaries, or by acquiring existing institutions. Reciprocity considerations may be taken into account. Foreign financial institutions established in The Netherlands to conduct securities business generally receive national treatment.

NATIONAL TREATMENT REVIEW

Banks in The Netherlands are licensed to engage in essentially all forms of securities related activities. The primary securities market is dominated by banks, but brokers and other institutions compete with the banks in offering securities trading and investment services.

The deregulation of Dutch capital markets effective January 1, 1986 significantly eased regulations for trading in financial securities. Requirements related to the Dutch Central Bank's issue calendar for bonds were significantly eased and issuance of commercial paper and floating rate notes were permitted for the first time. Restrictions on issuance by foreign banks of guilder denominated securities also were eased.

Foreign banks may establish branches or subsidiaries in The Netherlands after being granted a license by The Netherlands central bank.

Foreign securities companies may apply for and be granted a banking license in The Netherlands. The holder of such a banking license may engage in securities-related business in The Netherlands. There is a reciprocity provision in The Netherlands' law which prohibits granting of a banking license to any foreign firm from a country which prohibits Dutch firms from establishing banking subsidiaries in that country.

A foreign firm may purchase an existing establishment in The Netherlands that is engaged in securities-related business as a means of entry to that business in The Netherlnds. However, the approval of the Ministry of Finance is required for acquisition of a banking institution either by a Dutch or foreign purchaser.

Under The Netherlands Securities Transactions Act, which entered into force on May 1, 1986, stock exchange members in all EC countries, the U.S. and Switzerland may engage in securities brokerage activities in The Netherlands for all securities listed on their stock exchanges. For the United States this definition includes, in addition to the NYSE, securities listed on the NASDAQ over the counter market as well as listings on the futures exchanges that are supervised by the Commodities Futures Trading Commission.

Foreign persons or firms that are not a member of the Amsterdam, Swiss, U.S. or other EC stock exchanges may also engage in securities related activities in The Netherlands under a license granted by the Finance Ministry. Licensing conditions include experience, expertise, financial guarantees and information reporting requirements.

Foreign corporations or persons may become members of the Amsterdam Stock Exchange and engage in securities related business on the exchange. Membership requirements include establishment of a subsidiary, branch, or representative office in Amsterdam. As a condition of membership, foreign firms formerly were required to incorporate in The Netherlands. This requirement now has been amended to require incorporation within an EC member country. A number of foreign corporations and brokers, including the Dutch subsidiaries of two U.S. banks, are members of the Amsterdam Stock Exchange. The Amsterdam Exchange's membership rules were significantly eased in May 1986 through abolishment of a requirement that applicants for membership be recommended by a number of members before being accepted.

Foreign firms with branches or subsidiaries in The Netherlands may engage in securities-related activities under the same regulations that apply to Dutch banks, subject to a reciprocity requirement that prohibits foreign banks from acting as lead manager of guilder-denominated bond issues in The Netherlands unless Dutch banks are afforded comparable treatment in the parent country of the foreign bank in question. Foreign co-managers of such issues who are not established in The Netherlands are limited to underwriting no more than one third of an issue (this ceiling was recently raised from 20 percent).

Securities issued by the Government of The Netherlands are marketed by the agent of the Ministry of Finance which offers the securities for auction to members of the Amsterdam Stock Exchange. Thus there is no syndication of such issues. All other public authorities and institutions in The Netherlands do not themselves issue securities but rather finance capital improvements through private placements or issues floated by the Bank Voor Nederlandsche Geemeenten (Bank for Dutch

Municipalities) or The Nederlandse Waterschap Bank (Bank for Dutch Waterboards) on the Amsterdam Stock Exchange. The offerings of the Bank for Dutch Municipalities are marketed by a group of members of the Amsterdam Stock Exchange, while the offerings of the Bank for Dutch Waterboards are underwritten by a syndicate of Dutch banks. The two banks are quasi-public with shares owned both by local authorities and the Dutch state. The role for foreign financial institutions in marketing of Government of The Netherlands or other public sector securities in The Netherlands is dependent to a large extent on their membership on the Amsterdam Stock Exchange.

Mutual fund shares may be offered to the public either under a license granted by the Finance Ministry or without a license in case the shares are listed on a stock exchange covered under the Act or managed by a financial institution under the supervision of the central bank.

26. Switzerland

SUMMARY ASSESSMENT

Switzerland is a universal banking country that also allows finance companies to engage in the securities business. Swiss securities markets traditionally have been liberal, and recent trends have been toward further liberalization. Entry into the Swiss securities business by both foreign banks and securities companies is relatively easy; entry may be in the form of branching, establishment of subsidiaries, or acquisitions of existing institutions. Reciprocity is taken into account insofar as issuance of banking licenses is concerned. Foreign banks, including securities houses that establish a bank in Switzerland, may become members of the Zurich Stock Exchange. Swiss exchanges have had foreign members for decades. Personal licenses to represent professional securities traders and to trade on the floor are, however, available only to Swiss nationals. Once established, foreign securities firms generally receive national treatment in Switzerland, although foreign firms may not enjoy equality of competitive opportunity in several respects.

NATIONAL TREATMENT REVIEW

Under the Swiss system of universal banking, banks are permitted to engage in the full range of securities activities, from underwriting new issues to portfolio management. Switzerland has no comprehensive federal securities law that specifically regulates firms engaged in securities practices or regulates all forms of securities activities. While banks are subject to the supervision of the Federal Banking Commission, some other institutions engaging in securities transactions, such as finance companies and brokers, are not supervised by a federal agency. Investment trusts are subject to a federal law administered by the Banking Commission. Certain major capital exports from Switzerland, including those in the form of Swiss franc foreign bond issues, are subject to regulations promulgated by the Swiss National Bank.

The National Bank's capital export regulations, the most significant federal regulations regarding any securities activity, have been progressively liberalized. For example, since 1979 the obligation to convert proceeds from borrowings in Swiss francs into other currencies has been terminated, rules for placement of notes and secondary market trading have been liberalized, and the use of the multicurrency clause has been made easier. More recently, in January 1984, the queuing system was eliminated and the maximum amount for a publicly placed foreign bond issue was raised from SF 100 million to SF 200 million. In 1985, this SF 200 ceiling was lifted completely. In May of 1986 the National

Bank further streamlined its regulations by abolishing the maturity limitations on publicly placed bonds and notes, removing time restrictions on early redemption, dropping the minimum denomination requirement for notes, and terminating the obligation to hold notes physically on deposit in Switzerland. As a result of these steps, the National Bank's regulations now serve primarily to collect statistics on capital movements.

Evidence of liberalization, combined with other changes in the securities industry, is apparent in the evolution of the marketplace. Firms have introduced new financial instruments and competition has intensified. Many U.S. firms have established new entities or redirected their resources to become more actively engaged in capital market and portfolio management activities and have made significant progress in winning market shares. In the foreign bond sector, for example, about three years ago the "big three" Swiss banks led 90 percent of foreign bonds issued in Switzerland. In a strongly expanding market, this share fell to 62.5 percent in 1985 and to 57.2 percent in the first four months of 1986. 1/ With respect to portfolio management, foreign banks' and finance companies' share of fiduciary placements by all financial institutions resident in Switzerland has expanded from 43 percent in 1980 to nearly 51 percent in 1984. Beginning in 1983, fiduciary funds in foreign banks located in Switzerland exceeded those held by the "big five" Swiss banks.

Foreign firms' growth in financial activity in Switzerland reflects not only liberalization of capital export regulations, but also the relative ease with which U.S. enterprises can establish and operate in the Swiss securities market. Moreover, internationalization of capital markets, technological innovations in foreign currency operations, and the ease of application of these innovations in Switzerland have added to the traditional attractions of the Swiss market place.

Foreign banks and securities companies may enter Switzerland either by branching, establishment of subsidiaries, or acquisitions of existing institutions. (See separately a description of the situation with respect to membership on the Zurich securities exchange.) The Swiss authorities are prepared to offer banking licenses to securities companies that wish to undertake a full banking business, but most enter as financial companies.

To become licensed as a bank, the Federal Banking Commission must determine whether the law's reciprocity provisions are satisfied. In theory, the reciprocity provision could cause difficulties for U.S. banks. Experience in recent years, however, has revealed no apparent difficulties. Authorization to establish a bank-like finance company is not subject to reciprocity provisions.

Swiss federal law and regulations do not contain any overt discriminatory provisions toward U.S. or other foreign institutions. Nonetheless, certain Federal and local regulations or traditional market practices could diminish the equality of competitive opportunities afforded foreign firms in Switzerland.

Under the National Bank's capital export regulations, only banks and bank-like finance companies established in Switzerland (and, thus, subject to articles 7 and 8 of the Federal Banking Law) can lead or co-manage foreign bond issues. Non-Swiss based institutions can participate only as sub-underwriters and cannot be cited publicly in the syndicate membership.

Before 1980, by tradition, not by law, syndicates of major Swiss bank groups would serve as "primary dealers" for public sector securities by submitting bids at the auction. They, in turn, would sell the paper to investors. In 1980, the Swiss Federal Government (Confederation) adopted a tender system open to all banks, foreign and domestic, and syndicates are no longer used, although they can offer bids. The syndicate system still exists at the Cantonal level due to tradition and existing banking relationships they have established with local governments. The commercial significance of these issues is minor. In 1985 Cantons and local communities issued a total of SF 1.7 billion ($1 billion) of public and private bonds compared to the SF 36.4 billion ($21 billion) foreign bond market.

Issuers of both domestic and foreign public bonds and shares must provide detailed information to qualify for listing on Swiss stock exchanges. In addition, foreign bonds and shares must be approved by the Swiss Admissions Board (Zulassungsstelle) in order to obtain a listing. The Admissions Board is a private body established in 1938 as a result of government pressure. In the past the operation of this board has not raised serious problems. With the expansion of the market, however, certain so-called "outsider" syndicates, composed of mainly foreign banks, have encountered difficulties in securing approval for listing due to unforeseen questions regarding the quality of borrowers, an argument that, according to some, arose with the advent of so-called "junk bonds." The Admissions Board, comprised of representatives of the Swiss Stock Exchange Association (i.e., Swiss bankers), industrialists, and an advisor from the Federal Finance Department, has sought to provide transparency of its deliberations by issuing guidelines for listing, which include quality criteria, and by permitting independent legal arguments on questions in dispute. While these steps are considered important, the closed nature of the Board's proceedings and necessarily subjective nature of quality criteria could hold the potential for misunderstandings in the approval process and possible difficulties in obtaining listing approval.

Membership in the important Zurich Stock Exchange is not restricted by law to any particular form of securities firm. In practice, however, only banks (both foreign and domestic) have been granted membership. The stock exchanges do not conduct any surveillance of the financial soundness of their members, this being done by the Federal Banking Commission. Under these circumstances, U.S. securities firms would have to establish themselves as banks in Switzerland in order to join the exchange. Foreign banks as well as financial companies can get licenses for over-the-counter securities trading. In the absence of any obligation to trade on the exchange, this segment of securities trading is actually more significant in terms of trading volume.

To engage in professional trading in Zurich both the firm and its individual representative need to have a license "Concession A" for stock exchange trading, "Concession B" for over-the-counter securities trading. Firms can be Swiss-based subsidiaries or branches of foreign enterprises located in Zurich, but individuals must be Swiss citizens, as well as resident in Zurich, and have five years of trading experience.

While not officially sanctioned, agreements have existed and still exist on a local basis between some Swiss banks and foreign brokers according to which brokers desiring to do business with Swiss banks must use them as intermediaries for purchases of foreign securities. Under such agreements, limits have been or are placed on the ability of foreign securities firms to deal with the customers of the banks or private clients in general and to advertise. Breaches are said to result in losses of business from Swiss banks.

The present effect of such agreements, which exist in written form only in Geneva, is questionable. Initially such measures were adopted when foreign brokers began to open offices in Switzerland in order to ease contacts with Swiss banks, the primary attraction for brokers to establish themselves in Switzerland. In recent years, however, competition has increased between Swiss banks and foreign brokers both in Switzerland and in the United States, calling into question the effectiveness and the continued existence of such agreements. Many foreign brokers, for example, do not believe the agreement impedes their business opportunities in Switzerland. Foreign brokers tend to concentrate on institutional business, which includes Swiss banks, and have accepted foreign private clients. Thus, rather than posing explicit limitations, such agreement appears to be a reflection of many foreign brokers' marketing strategies in Switzerland. In any event, under Swiss law an appeal is possible to the Federal Cartel Commission against a private agreement which is deemed to restrict competition unduly.

Under Swiss law, foreign and domestic investment trusts are required to have a custodian bank. Authority to make public solicitations for investors in a foreign investment fund is granted only to banks. U.S. securities firms thus must establish themselves as banks in Switzerland to sell their foreign investment trusts.

Transfers of bonds, share and other participation rights, and investment fund units are subject to a stamp tax of 0.15 percent for domestic instruments and Eurobonds and 0.30 percent for Swiss franc foreign instruments. While this tax applies equally to domestic and foreign firms, it does impede trading in Switzerland of foreign issues and effectively precludes the marketing of short-term instruments.

1/ Corporate Finance, July 1986.

27. United Kingdom

SUMMARY ASSESSMENT

From a system noted for its separation of secondary securities market activities, the United Kingdom is in the process of moving to a regime that increasingly resembles universal banking. The broad thrust of measures affecting securities markets in recent years has been toward liberalization, and a further major reform is still in process. With the elimination of provisions that effectively prevented foreign membership on the London Stock Exchange, foreign financial institutions have a broad range of opportunities to enter the securities business in the United Kingdom, whether by branching, establishment of subsidiaries, or acquisition of existing institutions, although it is questionable whether the authorities would permit a foreign takeover of one of their largest banks.

Foreign firms doing securities business in the United Kingdom with limited exceptions, for example with respect to lead management of sterling securities issues, receive national treatment. However, under new legislation, explicit provisions would enable the authorities to apply the principle of reciprocity depending upon the treatment of U.K. financial institutions doing business abroad. This policy could be applied retroactively to foreign financial institutions conducting investment, insurance and banking business in the U.K.

NATIONAL TREATMENT REVIEW

The financial system in the United Kingdom is undergoing a major reform which is likely to have significant effects on virtually all segments of the industry, especially the domestic securities market. The centerpiece of this reform is a Financial Services Act establishing a comprehensive regulatory framework for the industry. As of this writing (November 1986), the legislative process has been concluded but many of the regulations needed to implement the statute have not yet been issued.

Naturally, this report cannot anticipate the content of the yet to be released regulations. However, based on information in the public domain and in view of the liberalization that has taken place in the past two years, it appears that the new U.K. regulatory regime will in the first instance provide for essentially non-discriminatory treatment for U.S. financial institutions. As spelled out below, however, U.K. authorities could adopt measures in the event indigenous firms do not enjoy reciprocal treatment abroad that would have the effect of introducing into the system a lack of national treatment in selected areas.

With the exception of restraints on membership on the London Stock Exchange, foreign financial institutions have generally had broad opportunities to enter the securities business in the U.K. Branching, subsidiaries, and acquisitions have been permitted. A number of U.S. firms have acquired control or total ownership of small- and medium-size brokerage houses specializing in sterling denominated securities. On other other hand, it is questionable whether a takeover attempt would be allowed by a U.S. or other foreign based firm of, for example, one of the largest indigenous merchant (or commercial) banks -- especially if resisted by the indigenous bank. U.K. authorities have from time to time in the past shown sensitivity to foreign takeovers and loss of local control of domestic concerns, both industrial and financial.

Under the Fair Trading Act of 1973, the Secretary of State for Trade and Industry may block a proposed merger or acquisition if it is determined not to be in the "public interest." Only qualifying mergers, currently those which would result in combined assets of over 30 million pounds or a market share of at least 25 percent, are examined by the Office of Fair Trading and may be referred to the Monopolies and Mergers Commission for a "public interest" determination.

The Fair Trading Act requires that the commission consider all relevant factors when making its determination. The current government's primary consideration has been the effect on competition. Foreign ownership may also be taken into account; but "....in normal cases the nationality of the owners (foreign or British) is immaterial. However, there could be exceptional cases when foreign ownership might affect the public interest -- for example, in relation to a sector of strategic importance or in cases where the nationality of the owner might affect export prospects. Such points would need to be considered." 1/

In addition, it is generally understood in the market that significant acquisitions of equities in financial firms by any investor must have the approval of the Bank of England. The Bank has statutory powers as supervisor of banks (including discount houses) and also supervises the gilts market on a non-statutory basis. Its ability to block mergers and takeovers rests, however, on its traditional authority and not on statutory powers.

In March 1986, the London Stock Exchange allowed corporate membership in the exchange, abolished the ceiling of 29.9 percent on non-members' equity holdings in member firms, and lifted the moratorium on admitting to membership firms in which non-members held any capital. Although these stock exchange restrictions had not been discriminatory, applying to U.K. and foreign institutions alike, applications by foreigners for membership in the exchange were discouraged by the exchange. Indeed, there were no foreign applications for membership prior to March 1986 and, consequently, no full foreign members of the exchange. The unfamiliar divided dealing system, which prohibited firms from acting as both brokers and market makers -- abolished on October 27, 1986 -- and the ban on corporate membership may have also discouraged foreign firms from applying for membership.

Since March 1986, a number of U.S. and other foreign firms have increased their minority shareholdings in domestic member firms to 100 percent. As of August 1986, two foreign firms, Merrill Lynch and Nomura, had applied and been accepted as members of the exchange. Other foreign firms intend to apply for membership after October.

The London Stock Exchange (LSE) and the International Securities Regulatory Organization (ISRO) have agreed to merge into a single, self-regulatory organization (to be named "The Securities Association") and form a recognized investment exchange (to be named "The International Stock Exchange of the United Kingdom and the Republic of Ireland" and known as "The Stock Exchange"). The latter will seek recognition from the Securities and Investments Board (SIB) to be the exchange for domestic and international equities, gilts and options, but not Eurobonds, which are expected to be handled on a separate exchange (the Association of International Bond Dealers). The Securities Association will seek recognition from the SIB to become the SRO for members' dealings in the new stock exchange and in the Eurobond market. As a result of the merger of the LSE and ISRO, numerous foreign banks and securities companies that are members of the latter will be eligible for membership on the new International Stock Exchange.

Once established in the United Kingdom, foreign financial institutions engaged in the securities business do with limited exceptions receive national treatment.

One area where U.S. firms have not enjoyed national treatment is in the underwriting of sterling denominated securities. When such issues are underwritten in the U.K., a U.K.-owned institution with a capacity to act as an issuing house must be included as a co-lead manager. Moreover, for a foreign-owned institution to be able to co-lead a sterling issue, the country in which its parent is located must provide reciprocal treatment to U.K.-owned firms. This requirement was originally imposed by the Bank of England to regulate international access to the sterling market within the context of the Control of Borrowing Act. There has been some relaxation in this area in the sense that indigenous U.K. firms which have recently become owned or controlled by U.S.

firms and have subsequently served as co-lead managers have satisfied this requirement.

As part of the reform of the securities markets, the authorities have established, effective October, 1986, a system of primary market makers in gilt-edged securities (medium and long-term government securities). Twenty-seven firms have the approval of the Bank of England to act as gilt-edged market makers, of which eleven are either affiliates of U.S. firms or firms in which U.S. houses have an equity interest.

There are no indications that U.K. affiliates of foreign firms typically experience national treatment problems either in the area of investment management services or collective investment trusts.

The stamp tax imposed by the U.K. authorities on the issuance of depository receipts in the U.K., including American depository receipts (ADR's), may weigh particularly heavily on foreign financial institutions operating in the U.K. This 1.5 percent levy was felt necessary to avoid circumvention of the 0.5 percent stamp tax on the purchase and sale of securities in the U.K., since an interest in such securities could effectively be obtained by purchase of depository receipts.

U.K. policy with respect to other countries' treatment of indigenous financial institutions permits application of the principle of reciprocity, rather than national treatment. The Financial Services Act contains provisions which conferred sweeping powers on British officials in cases where U.K. persons are deemed not to receive reciprocal treatment in their conduct of investment, insurance, and banking business in other countries.

Should U.K. persons not enjoy "terms as favorable" as those extended in the U.K. to persons from the country in question, U.K. officials may serve notice upon persons of such countries restricting the type of business those persons may undertake in the U.K. for either a specified or an indefinite period or prohibiting them from conducting all investment, insurance, or banking business in the U.K. The Act requires the authorities to consult "so far as they consider expedient" with persons likely to be affected before service of such notice. The Act does not in any way grandfather persons already conducting business in the U.K. Accordingly, it is a potentially powerful restrictive instrument.

The Act allows the authorities to revoke later any restrictive notice if it appears to them that the conditions that gave rise to it no longer pertain. However, revocation would not necessarily automatically confer upon the party affected the right to resume business in the U.K. New authorization would be required under some circumstances.

The United States has expressed concern about the sweeping and retroactive nature of the Act's reciprocity provision and has explained both bilaterally and multilaterally that reciprocity provisions are inappropriate given the wide disparity in the regulatory regimes of the major countries. The British Government, however, believes that without the authority provided by the Financial Services Act, it would have little chance of succeeding in its effort to correct what it perceives to be a significant imbalance in the way the U.K. and certain other countries treat each others' indigenous banks and other financial institutions.

1/ Office of Fair Trading, "Mergers: A guide to the procedures under the Fair Trading Act," 1973.

Appendix I

Correspondence Leading to the Update

Reprinted in this appendix are the two letters which led to the preparation of this Update. First is the March 25, 1986 letter from the Honorable Jake Garn, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate, to the Honorable James A. Baker, III, Secretary of the Treasury, requesting an update to the 1984 study. Secretary Baker's April 29, 1986 reply to Chairman Garn follows.

United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510

March 25, 1986

The Honorable James A. Baker III
Secretary
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

The International Banking Act of 1978 embodies the principle of national treatment. Foreign banks in the U.S. enjoy an equality of competitive opportunity with our own domestic banks under that principle.

Congress adopted the national treatment principle in the expectation that our trading partners would take steps to accord the foreign operations of U.S. banks a similar equality of competitive opportunity.

The 1978 Act required the Treasury Department to study the then-existing foreign competitive environment for our institutions, and in 1979, Treasury completed its "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations." That report identified many instances where U.S. banks seeking to operate abroad did not receive national treatment from our trading partners.

I have remained concerned over the continued slowness of progress by some of our trading partners toward treatment of our institutions with the same fairness that we treat theirs.

In 1983, I introduced legislation that would require the Comptroller of the Currency, when acting on an application by a foreign bank to open a U.S. branch, to consider the treatment of U.S. banks in the applicant bank's home country. In early 1984, I requested an update of the 1979 report. That new report, which the Treasury Department published in July, 1984, showed some progress had been made, but certain countries continued to maintain their barriers against U.S. participation.

I have actively pursued this issue through meetings with government officials and bank representatives from Canada and in several countries in the Pacific Basin, to discuss and push for competitive equity. The Banking Committee also held one day of hearings in September of 1984 on the subject of national treatment. One of the principal recommendations of the hearing was that there be a frequent updating of the national treatment study.

While improvement is taking place, I am not at all satisfied with the rate of change, and I remain concerned about the degree of change in certain countries and the total lack of improvement in other countries.

In order to get a clear assessment of what the current situation is, I would appreciate your providing this committee with an updated national treatment report as soon as possible.

Since publication of the Treasury's 1984 report, the ability of U.S. institutions to export their expertise in electronic funds transfer systems has continued to increase in importance. Opening foreign markets to our exports of such new technologies should be part of our effort to reduce our balance of payments deficits.

Recent events, moreover, highlight the fact that the national treatment issue is broader than just the commercial banking segment of the financial services industry. While the Japanese government continues discriminatory restrictions on securities activities of U.S. firms in Tokyo, three Japanese firms are seeking approval from the Federal Reserve Bank of New York to become primary dealers in U.S. government securities.

In preparing an updated report on national treatment as practiced by our trading partners, I would appreciate your giving special attention to the EFTS issue and your broadening the study to cover all segments of the financial services industry.

Sincerely,

Jake

Jake Garn
Chairman

cc: The Hon. George P. Shultz
The Hon. Paul A. Volcker
The Hon. L. William Seidman
The Hon. Robert L. Clarke
The Hon. John S.R. Shad

THE SECRETARY OF THE TREASURY

WASHINGTON

April 29, 1986

Jake

Dear Mr. Chairman:

This is in response to your letter of March 25, 1986, which requested an updated report on national treatment. Unlike the two earlier requests which covered only banking, you also ask that the study give special attention to the export of electronic funds transfer systems and that it be broadened to cover securities and "all segments of the financial services industry." This request breaks new ground, could be vast in scope, and entails a heavy strain on resources.

Given the very real budgetary constraints of Gramm-Rudman-Hollings, it is essential that the scope of the work be as limited and precise as possible. We must concentrate our efforts on problem areas that have genuine significance for the overseas operations of the U.S. banking and financial community. To the extent that we can utilize related work currently being done elsewhere (such as the OECD), we will do so.

I intend to ask the Office of the Comptroller of the Currency (OCC) to take overall responsibility for the preparation of the study inasmuch as it pertains to banking and electronic funds transfers. The Treasury will have primary responsibility for the work on securities markets. I will ask the agencies involved in the earlier studies and the Securities and Exchange Commission to assist as well. I believe the next step should be a meeting between senior staff from the OCC and the Office of the Assistant Secretary for International Affairs with members of your own staff to discuss the parameters and timing.

The Treasury continues to believe that a policy of national treatment, seeking equality of competitive opportunity, is preferable to a policy based on reciprocity.

Sincerely,

Jim

James A. Baker, III

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D. C. 20510

Appendix II

Bankers' Association for Foreign Trade Survey

The following page presents a summary of the results of a survey by the Bankers' Association for Foreign Trade of its membership concerning their recommendations regarding the most important countries to include in this Update.

BANKERS' ASSOCIATION FOR FOREIGN TRADE
1986 NATIONAL TREATMENT STUDY SURVEY
SUMMARY RESULTS

DISCRIMINATORY PROBLEMS ENCOUNTERED IN EACH COUNTRY:

1. Restrictions on the establishment of banking operations
2. Operating restrictions
3. Foreign Exchange Controls
4. Transborder date flows regulations
5. Restrictions on use of foreign personnel
6. Professional licensing requirements
7. Rules governing publication of financial statements.

Countries included in 1984 NTS Update		Country Inclusion rated: C = Critical I = Important Or Left Blank C/I	1	2	3	4	5	6	7
Australia	(9)	2/7	2/7	1/3	-/1		2/1	-/1	-/2
Brazil	(15)	7/8	7/3	3/5	5/5	3/2	1/-	1/-	
Canada	(10)	4/6	3/3	2/5		2/-	1/1	-/2	-/1
Finland	(2)	1/1	1/1	1/1	1/-				
India	(3)	-/3	-/2	-/2	-/1		-/1		
Japan	(14)	5/9	4/4	4/4		1/-	-/1		-/1
Korea (ROK)	(11)	10/1	9/1	8/-	7/-	2/-	1/-	1/-	
Mexico	(16)	7/9	6/5	4/3	3/7		1/1		
Norway	(3)	1/2	1/2	1/2	1/-		-/1	-/1	
Philippines	(7)	1/6	1/5	1/4	1/4				
Portugal	(4)	-/4	-/1	-/3	-/2				
Spain	(6)	2/4	1/2	-/3	-/3				
Sweden	(5)	1/4	1/4	1/2	1/-				
Thailand	(9)	4/5	3/4	3/3	3/-		-/1	1/-	1/-
Venezuela	(9)	1/8	1/4	1/3	-/5	-/1	-/1		
Taiwan	(13)	10/3	8/3	7/2	3/2	1/1	1/-	1/-	-/1
Additional Countries Suggested									
Argentina	(11)	4/7	3/2	1/3	1/5				
Chile	(7)	2/5	-/2	1/2	-/3				
China	(1)	1/-	1/-	1/-					
Columbia	(2)	-/2	-/2						
Egypt	(1)	-/1		-/1					
Germany	(1)	-/1		-/1					
Hong Kong	(3)	2/1	1/-	1/1				1/-	
Indonesia	(1)	-/1	-/1	-/1					
Malaysia	(1)	-/1	-/1	-/1					
Nigeria	(1)	-/1	-/1						
Paraguay	(1)	1/-	1/-	1/-					
Peru	(5)	-/5	-/1	-/2	-/3				
Saudi Arabia	(1)	-/1		-/1					
Singapore	(10)	4/6	3/4	2/3	-/1	-/1	1/-	1/-	
United Kingdom	(1)	1/-		1/-					
Uruguay	(1)	-/1		-/1					

NOTE: Number in parentheses indicates total responses per country, = Critical + Important.

Appendix III

Acknowledgments

Preparation of the 1986 Update to the National Treatment Study required the cooperative efforts of a large number of people from a number of departments and agencies, overseas posts, and the private sector. The Office of the Comptroller of the Currency (OCC) was responsible for the preparation of 16 of the banking chapters. The Office of the Assistant Secretary of the Treasury for International Affairs (OASIA) assumed responsibility for the preparation of the banking and securities chapters on Canada and Japan and for the other six securities chapters. OASIA also coordinated the preparation of the summary and introductory chapters. OCC handled production of the final report.

In addition to OASIA and OCC, other departments and agencies contributed substantially to preparation of the 1986 Update: the Department of State, the Board of Governors of the Federal Reserve System (FRB) and Federal Reserve Bank of New York (FRBNY), the Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC).

Timely information on the treatment of U.S. banks abroad was provided by individual U.S. and foreign institutions, the American Bankers Association, the Bankers Association for Foreign Trade, and the Institute of Foreign Bankers. In the securities field, consultations with individual firms were supplemented by seeking views from and drawing on the expertise of the American Stock Exchange, the Dealer Banks Association, the Investment Company Institute, the National Association of Securities Dealers, the New York Stock Exchange, the Public Securities Association, and the Securities Industry Association. U.S. diplomatic and consular posts in the countries being studied, the American Institute in Taiwan, American Chambers of Commerce in relevant markets, and the host authorities in the various countries were also helpful in preparing this report.

The individual chapters were principally drafted and edited by the following individuals:

Chapter	Principal Drafters and Editors	Affiliation
Summary and Conclusions	Margaret Sampson Nigel Ogilvie	Treasury OCC
Preface	Margaret Sampson James Ammerman	Treasury Treasury
1. Equality of Competitive Opportunity	Matthew Chambers Kathleen O'Day Ida May Mantel	SEC FRB Treasury

BANKING AND SECURITIES

2.	Canada: Banking	Carl Lohmann	Treasury (U.S. Embassy - Ottawa)
		William Murden	Treasury
3.	Canada: Securities	William Murden	Treasury
		Carl Lohmann	Treasury (U.S. Embassy - Ottawa)
4.	Japan: Banking	John Abbott	Treasury (U.S. Embassy - Tokyo)
		Christine Cannon	Treasury
5.	Japan: Securities	John Abbott	Treasury (U.S. Embassy - Tokyo)
		Patricia Haas	Treasury

BANKING

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		William Albrecht	OCC
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		Maureen Muldoon	FDIC
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		Frank Carbone	OCC
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		Alan Herlands	OCC
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	William Albrecht	OCC
15. Portugal	Christopher Webster	State (U.S. Embassy - Lisbon)
	Nigel Ogilvie	OCC
16. Singapore	David Peashock	State (U.S. Embassy - Singapore)
	Vincent Polizatto	OCC
17. Spain	Paul Hurley	State (U.S. Embassy - Madrid)
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26. Switzerland	James Wallar	Treasury (U.S. Embassy - Bern)
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27. United Kingdom	Jerry Newman	Treasury (U.S. Embassy - London)
	W. L. McCamey	Treasury

The following valuable contributions provided by members of the participating U.S. Government departments and agencies are worthy of separate note.

Department of State: Nicholas Burakow and Robert Glass of the Office of Monetary Affairs, as well as Robert Dry of the Office of Investment Affairs, participated in the planning and development of the 1986 Update and in the review of draft country and other chapters. They, along with Doris Eaglin and Tywana Pendleton of the Office of Monetary Affairs, assisted in the transmission of drafts and other communications between drafters and end-users in Washington and State and Treasury personnel stationed outside the United States. State personnel overseas prepared initial drafts of most of the banking chapters and shared revised draft chapters with national authorities and appropriate private institutions in the markets under study. Officers in the regional bureaus of the Department assisted in reviewing draft chapters and facilitating contacts among drafters and reviewers.

Board of Governors of the Federal Reserve System: The review and comment process was coordinated by Robert Gemmill and Ricki Rhodarmer Tigert. Substantial parts of chapters were drafted by Robert Emery and Kathleen O'Day. Chapters on countries were reviewed by specialists in the International Division and the chapter on U.S. markets by staff of the Board and of the Federal Reserve Bank of New York.

Federal Deposit Insurance Corporation: The FDIC preparation and review process was coordinated by William Crothers. Contributions were also made by Felicite Macfarlane and Maureen Muldoon throughout this effort. Leonard Samowitz provided valuable research support and Lori Francis provided secretarial assistance.

Securities and Exchange Commission: Members of the SEC staff who reviewed or otherwise contributed to portions of this study include Alden Adkins, Mary Beach, Carl Bodolus, Anne Chafer, Matthew Chambers, Andrew Feldman, Linda Fienberg, Kevin Fogarty, Daniel Goelzer, Hajo Lamprecht, Marie Lilly, Michael Mann, Carol Martin, Robert Mills, Philip Parker, Michael Simon and Elisse Walter.

Office of the Comptroller of the Currency: The sixteen banking chapters were prepared under the guidance of Robert Bench, Deputy Comptroller of the Currency. William Albrecht, Ardith Eymann, Vincent Polizatto, Nigel Ogilvie and Frank Carbone edited country chapters. Stewart Goddin, Anne Dewey, Larry Podrasky and Lee Tarrant reviewed all the draft banking chapters, and Richard Cleva reviewed the chapter on National Treatment and U.S. Banking and Securities Laws. Robert Dunn and Kevin Broderick helped provide data on U.S. operations of foreign banking institutions and on foreign operations of U.S. banks. Ellen Stockdale was responsible for producing copies of the final report and supervised the graphics provided by Lizabeth Carroll. Joanne Zaslow provided editorial assistance. Word processing was done primarily by Anna Howard, with considerable assistance from Gertrude Williams. Maureen Darcy, Evelyn Briggs, Lynn Hayes and Linda Hunter also provided many hours of secretarial support. Melvin Young handled reproduction of the numerous drafts in a timely fashion.

Department of the Treasury: Deputy Assistant Secretary Thomas Berger assumed overall responsibility within OASIA for staff work on this Update. Treasury overseas personnel provided initial drafts of the banking chapters for Canada and Japan and of seven of the eight securities chapters. James Ammerman (Director, International Banking and Portfolio Investment) was active in almost all phases of this Update, including review of all the banking and securities chapters. Ida May Mantel coordinated preparation of the chapter on national treatment concepts, which is based primarily on drafts provided by Matthew Chambers of the SEC and Kathleen O'Day of the FRB. In addition to her work on the Summary and Conclusions and Preface, Margaret Sampson coordinated review of most of the banking chapters for OASIA. Robert Fauver (Director, Industrial Nations and Global Analysis) and Ciro DeFalco (Director, Developing Nations Finance) and their desk officers reviewed their particular country chapters. Lynne Rosenblum provided the bulk of the secretarial support, with assistance from Candace Bennett and others in OASIA.

An endeavor of the magnitude of this Update necessarily involves contributions from many people not specifically mentioned above. The Study Directors wish to express their sincere appreciation to all who have assisted in the preparation of this study.

Alan Herlands
Study Director - Banking

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