CCE
STRASBOURG

TELEX IPE2 544
N° D'APPEL TELECOPIEURS
33.88.35.67.14
33.88.35.67.26
33.88.35.67.43
33.88.35.15.77

441.2(103) special

Renseignements : 33.88.17.43.61
De l'interieur cce bxls : 67881

DISTRIBUTION	
H.D.	AVA
D.H.D.	CPB
ADM/POL	1
AGR	1
COM./TR.	1
DEVT.	1
ECO/FIN	2
P.P.A.	3
S&T	1
SUP. AG.	
T.E.E.	1
C.F.	

TRANSMISSION FAC-SIMILE

STRASBOURG LE 11/6/91

NUMERO D'APPEL 1-202-429 1766
EC delegation Washington

ADRESSE A : Ambassador VAN DOT

EXPEDITEUR : Sir Leon BRITTAN

PAGES : 8 + COVER

SIGNATURE

COMMUNICATION EVENTUELLE

FOR ONWARD TRANSMISSION

THE RIGHT HONOURABLE
SIR LEON BRITTAN, QC
VICE-PRESIDENT OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES

RUE DE LA LOI, 200
1049 BRUSSELS - TEL. 235 25 14
235 26 10

11-06-1991

Dear David,

Thank you for your response of 21 May to my letter about the Treasury proposals for banking reform and the treatment of foreign banks in particular. I have to say that your arguments leave me unconvinced. It is my belief that not only are our concerns legitimate but also that they can be met without undermining the objectives of the bill. The European Community will therefore press for an amendment with that in mind.

You argue that the requirement for foreign banks to conduct traditional banking operations in the United States exclusively through separately incorporated subsidiaries, if they wish to undertake expanded securities or insurance activities in the United States, would be necessary to prevent foreign banks from receiving better than national treatment. This is not so. I acknowledge that it is the Treasury's intention to base its approach on the principle of national treatment. But in practice the need to choose between adapting to the proposed new structure under which all banking operations would have to be conducted through separate banking subsidiaries or limiting activities in the United States to traditional banking activities would significantly impair the ability of foreign banks to benefit from the banking reform in a way which would not be the case for US banks. For foreign banks the ability to conduct their activities through branches is crucial in order to compete effectively in foreign markets.

The need to conduct banking operations in the United States exclusively through subsidiaries would involve significant costs - including tax costs - associated with the restructuring of existing operations. By contrast, US banks would not incur comparable costs, since by definition they are incorporated in the United States. A further and extremely important point is that the foreign banks operating through their separately capitalized banking subsidiaries would not be able to operate or to extend credit on the basis of the consolidated worldwide bank capital. The United States banks would, however, be able to do so.

The Honorable David C Mulford
Under Secretary, International Affairs
Department of the Treasury
15th and Pennsylvania Avenue, NW
Washington DC 20220, USA

Your letter mentions the possibility for United States subsidiaries of foreign banks to sell back loans to the parent bank and suggests this would somehow be equivalent to allowing foreign banks to conduct their lending activities through branches. Unfortunately, this is not so. The need to sell back loans to the parent bank would imply unnecessary and artificial additional costs of processing of transactions and would prevent the foreign bank from dealing with its customers in the most efficient manner. From a supervisory perspective it would impair the transparency of banking lending operations in the United States and would represent a somewhat contrived and inefficient way of proceeding. In practical terms it would inevitably be more difficult and involve greater risks for the parent bank buying a loan from its subsidiary to have to handle affairs with a borrower geographically distant and of whom it has no first hand knowledge. Moreover, such transfers of loans could have significant adverse tax effects for foreign banks.

The importance of being able to operate through branches is quite clear and applies just as much to the United States as to other countries. In fact, most of the operations in foreign countries conducted by United States banks abroad are carried out by branches (as of December 1989, while US banks' subsidiaries abroad had total assets of $191 billion, foreign branches of US banks had total assets of $305 billion). The same is true as regards operations of foreign banks in the United States (as of December 1990, US branches of foreign banks had $626 billion in assets as compared with $155 billion at US subsidiaries of foreign banks). This importance of the branch structure is also recognized by the Treasury in its 1990 National Treatment Study and in the February 1991 Treasury report on "Modernizing the financial System" (see references in the enclosed paper).

The "roll-up" requirement would constitute a particular hardship for those foreign banks which have had grandfathered securities subsidiaries in the United States for many years; if they were obliged to reorganize substantially their operations, some of them might have no other choice than to divest.

The staff paper attached to your letter seeks to justify the restriction on branching in the United States on the grounds that the Second Banking Directive grants the benefits of the single banking license only to banks incorporated in the Community. This comparison is misleading. The Community's Second Banking Directive does not impose any restrictions on the ability of foreign banks to branch in the Community as a condition for a foreign bank or its affiliates to carry out securities or insurance activities in the Community or to set up a separate subsidiary enjoying the single banking license. Branching into the Community from third countries is not covered by the Second Banking Directive. The proposed restriction on branching would be a step in the wrong direction and a dangerous precedent for other countries as regards the regulation and treatment of foreign branches. It would undermine efforts being carried out in several international fora concerning the liberalization of banking operations abroad and could also discourage those countries which do not allow the establishment of branches of foreign banks from permitting the establishment of such branches in the future.

I was surprised by your statement that one of the aims of the requirement to operate through subsidiaries is apparently to encourage foreign banks to "consider carefully their long-term strategic business objectives in the United States". Surely we would agree that this is a matter which must be left to the commercial judgement of the banks themselves.

I hope it will be clear that the ability of foreign banks to operate through branches in the United States, even if they wish to expand into non-banking activities, is not better than national treatment. I must emphasise that the Community is not asking for special treatment but merely that its banks should be able to do business and compete on the same footing as US banks.

You also state that setting up a separate subsidiary avoids extraterritorial application of US capital adequacy requirements. I agree with the need to avoid the extraterritorial application of United States law. But this problem could be solved in an equally rigorous but less onerous manner if the appropriate Federal banking agency were given authority, in reviewing applications of foreign banks to set up securities or insurance subsidiaries in the United States, to consider whether the financial strength of the foreign bank is sufficient and comparable to that required for domestic banks. You will find in annex 2 of the enclosed paper a suggestion for language taking into account these concerns, while fully preserving the equality of competitive opportunity between domestic and foreign banks.

Although it is true that the capital adequacy guidelines agreed in Basle are minimum standards and that individual countries may apply higher ratios, the 8% ratio is nevertheless regarded not only as stringent, but valid for all international banks, irrespective of whether they wish to engage through subsidiaries in securities or insurance activities. As of course you know, negotiations are taking place between banking and securities regulators in the context of the G-10 in Basle with the object of convergence on the treatment of market risk. You refer to a leverage requirement in addition to the higher capital requirements; we have doubts about the need for such an additional requirement, and share the views of the Basle experts on the advantages of risk-based ratios over simpler gearing ratios.

I am enclosing a paper which sets out these arguments in more detail and explains the amendments to the Treasury bill which we would wish to support.

I am passing a copy of this letter to Nicholas Brady, Henry Gonzalez and Don Riegle in Congress and to Alan Greenspan.

Yours sincerely,

Leon B.

THE RIGHT HONOURABLE
SIR LEON BRITTAN, QC
VICE-PRESIDENT OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES

RUE DE LA LOI, 200
1049 BRUSSELS - TEL. 235 25 14
235 26 10

11-06-1991

Dear Nick,

I thought I should send you a copy of the reply which I have sent to David Mulford on the US Treasury's financial sector reform proposals. I had hoped to discuss these matters with you over the telephone last week, and consider that it would still be useful to do so as soon as is convenient. In the meantime, you will see that the letter gives a clear indication of our views and possible ways of addressing some of the problems which enactment of your proposals would cause for foreign banks. I would merely add that you should not underestimate the very serious concern with which certain features of your proposals are regarded in the Community. I understand that these concerns are shared by many commentators in the United States.

As you know, our main concern is with regard to branching. A requirement that foreign banks, if they wish to carry out non-banking activities in the United States through separate subsidiaries, must conduct their banking operations in the US exclusively through a separately incorporated and capitalized subsidiary would severely impair the ability of foreign banks to benefit from the US reforms in a way which would not be the case for US banks. Because such banks would no longer be able to operate branches in the US, they would be unable to operate or to extend credit on the basis of consolidated bank capital and would also incur substantial costs in restructuring their US operations. This would seriously harm their ability to enter and compete effectively in the US market.

This is why I put forward for your consideration a proposal that foreign banks wishing to conduct securities and insurance activities in the United States be permitted to continue a traditional banking business in the United States through branches and agencies. We do not object to the requirement to establish separate subsidiaries for securities and insurance activities.

The Honorable Nicholas F Brady
Secretary of the Treasury
Department of the Treasury
Room 3330
15th and Pennsylvania Avenue
Washington DC 20220, USA

Some people argue that my proposal would result in "better than national treatment" for foreign banks. This is not the case and cannot be sustained by the facts. The US Treasury itself has (in your National Treatment Study) demonstrated how a requirement for foreign banks to operate as a subsidiary can be an impediment to competition. My proposal merely seeks the removal of such an impediment, in other words the creation of a level playing field.

I therefore believe that our concerns can be met in a way which does not detract from the central objectives of your proposals, which is fair to US and foreign banks and which offers the necessary variety and security to the consumer. I look forward to discussing these matters with you.

THE RIGHT HONOURABLE
SIR LEON BRITTAN, QC
VICE-PRESIDENT OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES

RUE DE LA LOI, 200
1049 BRUSSELS - TEL. 235 25 14
235 26 10

11-06-1991

Dear Alan,

Following on our telephone conversation last Thursday I am taking the liberty of sending you a copy of a letter which I have today sent to David Mulford on the proposals for financial reforms in the United States. As we discussed, I do believe that our concerns are legitimate and that they can be met in a way which does not undermine the objectives of Treasury's proposals. The main purpose of my letter to David Mulford is to explain in more detail how we think this can be done.

May I say again how grateful I am for the interest and support which you have shown with regard to the implications of the proposals for foreign banks ?

With best regards,

Yours sincerely,

Leon Brittan

The Honorable Alan GREENSPAN
Chairman,
Board of Governors of the
Federal Reserve System
WASHINGTON, DC 20551
USA

THE RIGHT HONOURABLE
SIR LEON BRITTAN, QC
VICE-PRESIDENT OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES

RUE DE LA LOI 200
1049 BRUSSELS - TEL. 235 25 14
238 26 10

11-06-1991

Dear Senator Riegle,

I am taking the liberty of sending you a copy of a letter which I have today sent to David Mulford on the proposals for financial reforms in the United States. I am convinced that our concerns are legitimate, and seek to ensure no more than a level playing field for EC banks operating in the US.

They can also be met in a way which does not undermine the objectives of Treasury's proposals. The main purpose of my letter to David Mulford is to explain in more detail how we think this can be done.

I hope that this will be helpful to you.

Yours sincerely,

Leon Brittan

The Honorable Donald W. RIEGLE Jr.
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate,
534 Dirksen Senate Office Building
WASHINGTON, DC 20510
USA

THE RIGHT HONOURABLE

SIR LEON BRITTAN, QC

VICE-PRESIDENT OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES

RUE DE LA LOI, 200
1049 BRUSSELS - TEL. 235 26 14
235 26 10

11-06-1991

Dear Mr Gonzalez,

I am taking the liberty of sending you a copy of a letter which I have today sent to David Mulford on the proposals for financial reforms in the United States. I am convinced that our concerns are legitimate and seek to ensure no more than a level playing field for EC banks operating in the US. They can also be met in a way which does not undermine the objectives of Treasury's proposals. The main purpose of my letter to David Mulford is to explain in more detail how we think this can be done.

I hope that this will be helpful to you.

Yours sincerely,

Leon Brittan

The Honorable Henry B. GONZALEZ
Chairman, Committee on Banking,
Finance and Urban Affairs,
House of Representatives,
24113 Rayburn House Office Building
WASHINGTON, DC 20515 - 4320
USA