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Tragedy, Irony, and Protectionism after BCCI: A Three-Act Play Starring Maharajah Bank

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TRAGEDY, IRONY, AND PROTECTIONISM AFTER BCCI: A THREE-ACT PLAY STARRING MAHARAJAH BANK

*Raj Bhala**

ABSTRACT

Post-BCCI legal developments regarding the regulation of foreign banks raise serious concerns of protectionism. The Foreign Bank Supervision Enhancement Act of 1991 and revisions to Federal Reserve Regulation K impose significant new legal burdens on foreign banks seeking to establish a physical presence in the U.S.

The new legal regime reflects a tragic sacrifice of the principle of free trade in banking services in order to placate a fear of "bad" foreign banks. Ironically, the sacrifice of this principle by Congress and the Federal Reserve is incongruous with efforts of the United States Trade Representative (USTR). The USTR has negotiated a final General Agreement on Trade in Services which could liberalize market access for banks around the world. The tragedy and irony of post-BCCI legal developments are highlighted by the case of a hypothetical foreign bank, the Maharajah Bank of India.

Greater efforts to ensure that the U.S. banking market remains open are necessary, or else the significant economic benefits from foreign bank presence in the U.S. will be lost. Accordingly, a market-oriented approach to foreign bank regulation is proposed.

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I. NIEBUHR AND FOREIGN BANK REGULATION

The *tragic* element in a human situation is constituted of conscious choices of evil for the sake of good. If men or nations do evil in a good cause; if they cover themselves with guilt in order to fulfill some high responsibility; or if they *sacrifice some high value for the sake of a higher or equal one* they make a tragic choice Tragedy elicits admiration as well as pity because it combines nobility with guilt.

Irony consists of apparently fortuitous *incongruities* in life which are discovered, upon closer examination, to be *not merely fortuitous*. Incongruity as such is merely comedy But irony is something more than comedy If virtue becomes vice through some hidden defect in the virtue . . . the situation is ironic.

—Reinhold Niebuhr¹

THE Bank of Credit and Commerce International (BCCI) affair was a horror story for bank regulators and law enforcement authority. Using Professor Niebuhr's definitions of "tragedy" and "irony," the legal aftermath can be understood as a play whose genre is tragedy and irony. That aftermath is the enactment of the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA) by Congress and the promulgation of revisions to Regulation K (revised Regulation K) by the Federal Reserve.² The thesis of this article is that the post-BCCI legal

1. REINHOLD NIEBUHR, *THE IRONY OF AMERICAN HISTORY* vii-viii (1952) (emphasis supplied).

2. FBSEA is Title II, Subtitle A of the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2286-2305 (1991). FBSEA amends numerous provisions of the International Banking Act (IBA) and is codified in various sections of Title 12 of the United States Code. 12 U.S.C. §§ 3101-3111 (Supp. IV 1992). Plainly, FBSEA was a response to the BCCI affair. See, e.g., James R. Kraus, *Congress Seen Tightening Oversight of Foreign Banks*, AM. BANKER, Oct. 28, 1991, at 1.

For discussions of the legislative history of FBSEA, see Daniel E. Danovitch & George P. Macdonald, *U.S. Congressional Banking Agenda Begins To Take Shape*, 6 BUTTERWORTHS J. INT'L BANKING & FIN. L. 224 (1991); David W. Fanikos, Note, *The Foreign Bank Supervision Enhancement Act of 1991: Necessary Additions and Amendments to the International Banking Act of 1978 or Legislative Overreaction to Recent Foreign Bank Scandals*, 16 SUFFOLK TRANSNAT'L L. REV. 482, 486-99 (1993); Cynthia Lichtenstein, *U.S. Restructuring Legislation: Revising the International Banking Act of 1978, For The Worse?*, 60 FORDHAM L. REV. S37, S39-44 (1992). For general treatments of the principle features of FBSEA, see Serge Bellanger, *Stormy Weather: The FBSEA's Impact on Foreign Banks*, 25 BANKER'S MAG. 7 (Nov.-Dec. 1992); David B. Gail et al., *The Foreign Bank Supervision Enhancement Act of 1991: Expanding the Umbrella of "Supervisory Reregulation"*, 26 INT'L LAW. 993 (1992); James C. Sivon, *The Impact of the Federal Deposit Insurance Corporation Improvement Act on the Supervision and Regulation of Foreign Banks Operating in the USA*, 7 BUTTERWORTHS J. INT'L BANKING & FIN. L. 54 (1992).

Regulation K of the Board of Governors of the Federal Reserve System is codified at 12 C.F.R. pt. 211 (1993). Interim revisions were published by the Federal Reserve at 57 Fed. Reg. 12,992 (Apr. 15, 1992). For an overview of the interim revisions, see Michael L. Whitener, *New Federal Reserve Board Regulations Regarding Banks in the United States*, 26 INT'L LAW. 1007 (1992). See also *Fed's Interim Rule May Result in Some Foreign Banks Choosing to Bypass the U.S.*, Banking Daily (BNA) (Apr. 30, 1992). The final revisions were published at 58 Fed. Reg. 6348 (Jan. 28, 1993). See *Fed Adopts Final Rule Replacing Interim Regulation on Foreign Bank Supervision*, Banking Daily (BNA) (Jan. 19, 1993).

regime for foreign bank regulation is tragically and ironically protectionist. This thesis is articulated through three acts, in which a hypothetical foreign bank, Maharajah Bank of India, attempts to enter and expand its activities in the U.S. banking market.

A. BCCI AND INTERNATIONAL TRADE IN BANKING SERVICES

In July 1991, the headline on the cover of *Time* magazine was "The World's Sleaziest Bank," referring, of course, to BCCI.³ On December 16, 1993, a headline in the *Wall Street Journal* proclaimed "Trade Pact Is Set by 117 Nations, Slashing Tariffs, Subsidies Globally."⁴ There would appear to be no connection between these two headlines. In fact, there is a very strong but tragic and ironic connection between stories about BCCI and multilateral trade negotiations. The hysteria surrounding the BCCI case led to the adoption of a protectionist statute by Congress and regulation by the Federal Reserve. These new rules effectively exacer-

Unless otherwise noted, the "Federal Reserve," as used herein, refers to the Board of Governors of the Federal Reserve System and the twelve regional Federal Reserve banks.

3. *TIME*, July 29, 1991, cover page.

The BCCI group had one top-tier shell holding company, BCCI Holdings, S.A., incorporated in Luxembourg. BCCI Holdings, S.A., in turn, owned all of the shares of two operating holding companies, BCCI, S.A., a Luxembourg company, and BCCI Overseas, incorporated in the Cayman Islands. The two operating companies owned subsidiaries, branches, agencies, and representative offices in sixty-nine countries covering every continent except Antarctica.

See *The BCCI Affair: Hearing Before the Subcomm. on Terrorism, Narcotics, and International Operations of the Senate Comm. on Foreign Relations*, 102d Cong., 2d Sess., pt. 5, at 323, 449-460 (1992) (testimony of Brian Smouha, Court Appointed Fiduciary for BCCI Holdings, S.A., and BCCI, S.A. [hereinafter *Senate Subcommittee Hearings*]).

At one time, BCCI was the seventh-largest private bank in the world and the 200th largest bank in the world overall, with stated capital of \$1.5 billion and stated assets worth over \$20 billion. *Senate Subcommittee Hearings*, 102d Cong., 1st Sess., pt. 1, at 86 (1991) (statement of J. Virgil Mattingly, Jr., General Counsel, and William Taylor, Staff Director for Banking Supervision and Regulation, Board of Governors of the Federal Reserve System). See also E. Gerald Corrigan et al., *The Federal Reserve's Views on BCCI*, 26 INT'L. LAW. 963, 968 (1992); Richard Donkin, *BCCI Dealings Are Being Watched by Central Banks*, FIN. TIMES (London), Oct. 18, 1988, at 28, col. 3. For diagrams of the complex organizational structure of BCCI and related entities, see RAJ BHALA, *FOREIGN BANK REGULATION AFTER BCCI*, charts I and II, pp. xxi and xxiii, respectively (1994) [hereinafter BHALA].

Officials at the Central Intelligence Agency humorously referred to BCCI as the "Bank of Crooks and Criminals International." Allegedly, BCCI provided financial services to terrorists, dictators, and narcotics and arms dealers, though few, if any, of these allegations have been proven in a court of law in any country. BCCI pled guilty to secretly owning and controlling banks in the United States, including the First American banks. For an explanation of the BCCI-First American relationship and a diagram thereof see BHALA, ch. I and chart III, p. xxiv.

On July 5, 1991, bank regulators in several countries shut down BCCI's offices. At the time BCCI was closed, two uninsured, state-licensed agencies operated in the U.S., one in New York and one in Los Angeles. Both were agencies of BCCI, S.A.

4. Bob Davies & Lawrence Ingrassia, *WALL ST. J.*, Dec. 16, 1993, at A3. Similar exultant headlines appeared in other publications. See, e.g., GATT, *Uruguay Round Negotiations Conclude Successfully*, (Dec. 21, 1993); *Surprise, Surprise*, *ECONOMIST*, Jan. 22, 1994; *GATT Comes Right*, *ECONOMIST*, Dec. 18, 1993, at 13; *Uruguay Round Agreement Is Reached: Clinton Notifies Congress Under Fast Track*, 10 Int'l Trade Rep. (BNA) 2103 (Dec. 15, 1993).

bate the difficulties faced by foreign banks seeking access to the U.S. financial market. Consequently, the new rules are at variance with the successful efforts of the United States Trade Representative (USTR) to negotiate a final multilateral General Agreement on Trade in Services (GATS).⁵ The provisions of GATS are aimed at enhancing market access around the world for banks and other financial institutions (as well as other service businesses) from countries that are members of the accord.⁶

Much has been said and written about both the BCCI affair and the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), under whose auspices the GATS was negotiated. The international financial community was rocked by allegations concerning the activities of BCCI. Hearings were held in the U.S. Senate before the Subcommittee on Terrorism, Narcotics, and International Operations of the Committee on Foreign Relations through 1991 and 1992, which produced six large volumes of testimonial and documentary evidence.⁷ Similarly, the international trade community was riveted by the Uruguay

5. 33 I.L.M. 46 (1994) [hereinafter GATS]. The GATS is reprinted in OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (version of 15 Dec. 1993). For overviews of the GATS, see 33 I.L.M. 44-46 (1994); Karl P. Sauvant & Jong Weber, *The International Legal Framework for Transactions in Services*, in LAW AND PRACTICE UNDER THE GATT AND OTHER TRADING ARRANGEMENTS 15-31 (Karl P. Sauvant & Jong Weber eds., 1992) [hereinafter Sauvant & Weber]. See also RAJ BHALA, THE UNFINISHED BUSINESS OF THE URUGUAY ROUND (forthcoming, manuscript on file with author).

The post-BCCI banking regime also conflicts with the efforts of the U.S. Secretary of the Treasury to negotiate bilateral accords directed at enhancing market access for financial services. These efforts have been especially vigorous with respect to Asian countries. See Kenneth H. Bacon, *China to Expand Foreign Banks' Rights As U.S. Helps with Economic Managing*, WALL ST. J., Jan. 24, 1992, at A2; Kenneth H. Bacon, *Bentsen Unveils Effort to Open Capital Markets*, WALL ST. J., Jan. 19, 1994, at A2.

The institutional inconsistencies are not limited to the behavior of the USTR, on the one hand, and the Congress and the Federal Reserve, on the other hand. Congress (namely, the Senate Finance Committee and the House Ways and Means Committee), along with the USTR, play important roles in the formulation of trade policy. See generally I. M. DRESTLER, AMERICAN TRADE POLITICS 11-30 (2d ed. 1992) (discussing the relationship between Congress and the Executive branch in formulating trade policy). Thus, the actions of Congress pertaining to trade in financial services seem inconsistent with its role in enacting FBSEA.

6. The contracting states are referred to as "Members." No general definition of "services" is contained in the GATS; however, "there is general agreement that it includes such activities as wholesale and retail trade, transportation, communications, banking, finance, insurance, business and professional services, community services (including public administration and defense), social services (including education and health) and personal services (like repair or laundry services)." Sauvant & Weber, *supra* note 5, at 17.

7. *The BCCI Affair: Hearings before the Subcomm. on Terrorism, Narcotics, and International Operations of the Senate Comm. on Foreign Relations*, 102d Cong., 1st Sess., pt. 1 (1991); and 2d Sess., pts. 4-6 (1992). The first generation of "BCCI scandal" books has emerged. See, e.g., JAMES R. ADAMS & DOUGLAS FRANTZ, A FULL SERVICE BANK: HOW BCCI STOLE BILLIONS AROUND THE WORLD (1992); JONATHAN BEATY & S.C. GWYNNE, THE OUTLAW BANK: A WILD RIDE INTO THE SECRET HEART OF BCCI (1993); NICK KOCHNAN & BOB WHITTINGTON, BANKRUPT: THE BCCI FRAUD (1991); MARK POTTS ET AL., DIRTY MONEY BCCI: THE INSIDE STORY OF THE WORLD'S SLEAZIEST BANK (1992); ROBERT E. POWIS, THE MONEY LAUNDERERS (1992); PETER TRUELL & LARRY GURWIN, FALSE PROFITS: THE INSIDE STORY OF BCCI, THE WORLD'S MOST CORRUPT FINANCIAL EMPIRE (1992).

Round, and a number of books concerning it have come out recently.⁸ There was understandable excitement when a final agreement on the GATS was struck covering trade in services among GATT members.⁹ Such trade is worth over \$900 billion annually among GATT members and was not covered previously by the GATT regime.¹⁰

Until now, no one has considered the relationship between the revolution in U.S. foreign bank regulation in the aftermath of BCCI affair, on the one hand, and the GATS, on the other hand. Exploring this relationship is particularly urgent. U.S. trade negotiators soon will begin successive rounds of negotiations, under the auspices of the GATS, aimed at the progressive liberalization of market access for banks and other financial institutions, as well as providers of other services.¹¹

The importance of these negotiations cannot be overemphasized. As a general matter, the service sector is "the most important and dynamic part of economic activity."¹² The service sector "is now the dominant employer and producer of income in all developed and the majority of developing countries."¹³ Services account for more than 50 percent of gross domestic product (GDP) in twenty-one developed countries¹⁴ and twenty-five developing countries.¹⁵ With respect to banking services in particular, an increasingly diverse constituency of banks hold a large share of the world's bank assets. In 1974, banks from the Group of Ten (G-10) countries held ninety percent of all bank assets.¹⁶ By 1991, banks

8. The most noteworthy is the official report of the Uruguay Round, GATT, *THE FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS* (Dec. 15, 1993). See also GEZA FEKETEKUTY, *THE NEW TRADE AGENDA, GROUP OF THIRTY OCCASIONAL PAPERS* 40 (1992); GATT, *THE URUGUAY ROUND* (1993); PATRICK LOW, *TRADING FREE THE GATT AND U.S. TRADE POLICY* (1993).

9. See, e.g., Memorandum from White House to United States Trade Representative (Dec. 15, 1993) on Trade Agreements Resulting from the Uruguay Round of Multilateral Trade Negotiations, 19-21, 58 Fed. Reg. 67,263 (Dec. 20, 1993) [hereinafter White House Memorandum]; *Success! — The Most Comprehensive Round Ever Is Concluded*, FOCUS (GATT Newsletter), Dec. 1993, at 1.

10. *The Uruguay Round's Key Results*, WALL ST. J., Dec. 15, 1993, at A6.

11. GATS, *supra* note 5, at arts. XIX-XXI; White House Memorandum, *supra* note 9, at 21.

12. Sauviant & Weber, *supra* note 5, at 17.

13. *Id.*

14. THE WORLD BANK, *WORLD DEVELOPMENT REPORT 1991* (1991). These countries may be grouped into three categories according to the share of services in their annual GDP: (1) 70-79 percent—Ireland; (2) 60-69 percent—Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Netherlands, New Zealand, Norway, Sweden, United Kingdom, and United States; and (3) 50-59 percent—Finland, Greece, Hungary, Japan, Portugal, and South Africa.

15. *Id.* Again, the countries may be grouped into three categories according to the share of services in their annual GDP: (1) 70-79 percent—Hong Kong and Panama; (2) 60-69 percent—El Salvador, Iran, Jordan, Peru, Singapore, and Uruguay; and (3) 50-59 percent—Argentina, Costa Rica, Dominican Republic, Congo, Egypt, Guatemala, Honduras, Jamaica, Madagascar, Mauritius, Mexico, Morocco, Namibia, Niger, Syria, Trinidad and Tobago, and Tunisia.

16. Claire Makin, *Learning from BCCI*, INSTITUTIONAL INVESTOR, 93, 97 (Nov. 1991). The G-10 is composed of Japan and the major industrialized countries of North America

from the G-10 countries controlled eighty percent of the world's bank assets.

In sum, the service sector is extremely important to the economies of newly industrialized countries (NICs) and less developed countries (LDCs), and an ever-greater amount of assets are maintained in accounts with Asian, Latin American, Middle Eastern, and African banks. As these banks become increasingly significant players in international finance, naturally, they will seek access to the banking markets of the U.S. and other G-10 countries. Legal barriers—such as those associated with FBSEA and revised Regulation K identified in this article—which restrict access do not reflect the changing status of banks from NICs and LDCs. The barriers are certain to be a source of heated debate at future rounds of GATS negotiations aimed at liberalizing market access for service providers.

B. TRAGEDY AND IRONY

There would appear to be no connections among Professor Niebuhr's definitions of tragedy and irony, foreign bank regulation, and the GATS. In fact, however, these definitions illuminate the relationship between the GATS and the post-BCCI legal regime applicable to foreign banks. Professor Niebuhr's definitions help delineate why Congress's and the Federal Reserve's responses to the BCCI affair are unsatisfactory.¹⁷ Their responses, embodied in FBSEA and revised Regulation K, reflect a choice of protectionism over free trade with respect to banking services. This is tragic. The choice is incongruous with efforts of the United States Trade Representative toward free trade in financial services through the GATS. This is ironic.

FBSEA and revised Regulation K are *tragic* because, in order to prevent "another BCCI," the Congress and Federal Reserve have adopted a distinctly protectionist stance toward foreign banks. This exemplifies Professor Niebuhr's identification of a tragic choice as one in which "they sacrifice some high value for the sake of a higher or equal one." The high value of free trade in financial services and free flow of capital is surrendered. The purportedly equal or higher value that ostensibly justifies this sacrifice is the goal of keeping out mischievous foreign banks. In the af-

and Western Europe: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, United Kingdom, and U.S.

17. Professor Niebuhr's language explaining tragedy and irony is measured and precise and, therefore, worthy of application—Niebuhr himself does so in a variety of contexts. See, e.g., NIEBUHR, *supra* note 1. This is not to suggest, however, that Professor Niebuhr's entire theology is applicable to the issues discussed herein, and no attempt is made to explore the relationship between his theological perspectives and these issues.

The application of the work of Professors Guido Calabresi & Philip Bobbit, *TRAGIC CHOICES* (1978) to foreign bank regulation is considered below. See *infra* notes 169-79 and accompanying text. Irony is the subject of a vast body of literary criticism, which is beyond the scope of this article. Apparently, there is no single understanding of what "irony" means, at least in the literary context. See, e.g., WAYNE BOOTH, *A RHETORIC OF IRONY* ix, 1, 6 (1974) (indicating stable irony is intentional and not explicit).

termath of BCCI, legislators in Congress and bank regulators at the Federal Reserve have fixed in their minds a "bad bank" model regarding foreign banks. Every foreign bank that seeks to gain access to the U.S. banking market is another potential BCCI. The tragic choice is made because of an underlying, unstated fear of "bad" foreign banks, particularly banks from the NICs and LDCs, and a determination that "no more BCCIs" shall occur. With this model in mind, the legislators and regulators over-reacted—FBSEA and revised Regulation K make entering and conducting business in the United States far more difficult for foreign banks.¹⁸

Further, the Congressional and Federal Reserve responses foster an "irony." FBSEA and revised Regulation K are not just an over-reaction to the BCCI affair, whose protectionist repercussions will, in time, subside. They are non-tariff barriers to foreign banks that will affect the structure and stature of U.S. banking markets for years to come. These barriers can be quantified, to some extent, by considering the increased transaction costs faced by foreign banks seeking to penetrate the U.S. banking market.¹⁹ Raising non-tariff barriers to foreign banks is completely at odds with a trend in U.S. international financial policy in favor of free trade in financial services. This alternative trend is evidenced by the final GATS accord negotiated by the USTR. Indeed, President Clinton recently stated that a key U.S. objective regarding trade in services was "to reduce or to eliminate barriers to, or other distortions of, international trade in services, including barriers that deny national treatment and restrictions on establishment and operation in such markets."²⁰

The incongruity is not merely fortuitous. Thus, according to Niebuhr, it is not simply comic, but ironic. On the one hand, three provisions of FBSEA and revised Regulation K have distinctly protectionist effects: the requirement that a foreign bank apply to the Federal Reserve for approval before opening a branch, agency, or representative office in the U.S.; the mandatory standard of home-country, comprehensive, consolidated supervision for evaluating applications submitted to the Federal Reserve; and the rule that a foreign bank take insured retail deposits through a U.S. subsidiary.²¹ On the other hand, the entire thrust of the

18. There is no doubt that, among the bank regulators, the Board of Governors of the Federal Reserve System advocated FBSEA. For an overview of the legislation as it was initially proposed, see Danovitch & Macdonald, *supra* note 2, at 225-26.

19. See *infra* notes 48-73 and accompanying text.

20. White House Memorandum, *supra* note 9, at 19.

21. Domestic bank holding companies and state-chartered banks that are members of the Federal Reserve System are, of course, subject to the Federal Reserve approval and examination process. See Regulation Y, 12 C.F.R. pt. 225 (1994) (governing bank holding companies); Regulation H, 12 C.F.R. pt. 208 (1994) (governing state member banks). Does FBSEA impose significantly more burdens on foreign banks that take insured retail deposits than the requirements for domestic banking entities? More generally, should such foreign banks be regulated differently than domestic banks? These questions raise the problem of national treatment, discussed below. See *infra* notes 66-73 & 83-85 and accompanying text.

GATS plainly is in the direction of free trade in financial services and liberalization of access for foreign banks to domestic markets.

Tragedy and irony are not the same genre, nor are they necessarily connected to each other. The essence of tragedy is the sacrifice of a value of fundamental importance. The sacrifice should be (though it not always is) readily apparent. Irony is not so obvious. Spotting an ironic condition requires a careful reconstruction of the intended meaning and effect of two (or more) laws or policies. Then, these reconstructions must be juxtaposed and found incompatible. In other words, a clash among the reconstructions is necessary for irony. The fact that a fundamentally important value is sacrificed does not suggest an irony is present. The fact that the intended meanings or effects of two laws conflict does not indicate the existence of a tragedy. Either genre can exist without the other. Only where the clash among reconstructed meanings or effects is associated with something given up or lost is there both tragedy and irony. Foreign bank regulation after the BCCI affair is an uncommon instance of both genres.

C. NO MORE BCCIS VERSUS OPEN BANKING MARKETS

Of course, arguing that foreign banks should be allowed to enter the U.S. with complete freedom would be irresponsible.²² An economically rational preference for free trade cannot wholly undermine domestic or international bank regulation. Commercial banks play a unique role with respect to monetary policy, are critically important to the payments system, and are a mechanism for transmitting financial shocks that can lead to serious systemic problems. In these respects, banks—foreign or domestic—are different from other commercial or industrial enterprises. No one wants “another BCCI.” The unique features of banks, coupled with the aim of minimizing the likelihood of serious bank fraud, explains the regulatory interest in foreign banks. But, to believe that another BCCI lurks behind every tree is erroneous. The critical underlying issue is how much regulatory intervention regarding foreign banks is appropriate?

This article does not attempt to formulate a general theoretical standard or policy prescription for resolving the underlying fundamental tension between the economic aim of free trade and the post-Depression era bank regulatory state.²³ The tension is a fascinating problem of trade-offs in the modern global marketplace—efficiency versus safety and free

22. As President Clinton noted, while pursuing free trade in services “taking into account legitimate U.S. domestic objectives including, but not limited to, the protection of legitimate health or safety, essential security, environmental, consumer or employment opportunity interests and the law and regulations in those areas” is also necessary. White House Memorandum, *supra* note 9, at 20.

23. *But see infra* notes 168-80 and accompanying text for a discussion of a market-based approach to tragic choices.

choice versus paternalism.²⁴ The problem is not unique to banking and surfaces, for example, in the international trade of pharmaceuticals, pesticides, and agricultural products. Remarkably, only recently has any attention been given to the problem in the context of the international trade in banking services.

The more modest aim of this article is to argue that FBSEA and revised Regulation K err too much on the side of regulatory intervention. The thesis advanced herein suggests a change in the burden of proof is needed. Legislators and bank regulators should have to explain why foreign banks ought to face increased non-tariff barriers to entry. Presently, two burdens seem to rest on foreign banks seeking to do business in the U.S. First, as a class, they confront the fact that free trade in financial services is not the presumptive starting point of American foreign bank regulation. Second, each individual foreign bank is guilty until proven innocent and must show it is not another BCCI.

In addressing the problem of non-tariff barriers, the Congress and Federal Reserve should show why increments in the regulation of foreign banks are justified on microeconomic grounds. The microeconomic arguments in favor of free trade are well known and need not be repeated in detail here.²⁵ The case for free trade in banking services is, in many regards, based on the same argument in favor of free trade for any good or service: the law of comparative advantage. Foreign banks offer U.S. consumers of banking services at least three obvious economic benefits: efficiency, liquidity, and innovation.

With respect to efficiency, foreign banks are able to offer services at lower cost than U.S. banks. For example, foreign banks in the U.S. are particularly skilled at lending to middle-market companies who seek export financing.²⁶ This seems to result from better quality services at lower prices.²⁷ The fact that foreign banks excel in certain market niches leads to an important related benefit for Americans: employment. Over 300,000 U.S. bankers and related workers are employed by foreign bank operations in the U.S.²⁸

In addition, foreign banks currently hold \$862 billion of assets, or 22

24. For a discussion of the problem, see RAJ BHALA, *THE UNFINISHED BUSINESS OF THE URUGUAY ROUND OF THE GATT* (forthcoming, manuscript on file with author).

25. See MELVYN KRAUSS, *THE NEW PROTECTIONISM* 1-4 (1978).

26. See, e.g., Lori Ioannou, *Friendly Invaders — Foreign Banks Score Big with U.S. Companies*, *INT'L BUS.*, Nov. 1992, at 29.

27. For example, a foreign bank branch or agency located in the U.S. can issue letters of credit for an account party in the U.S. such as an American importer. Suppose the beneficiary of the letter of credit is an exporter located in the home-country of the foreign bank. Then, the home office of that bank conveniently can serve as the confirming bank for the beneficiary. There may be cost advantages to this arrangement. The letter of credit fee charged to the account party may be cheaper where the same foreign bank issues and confirms the credit than where two independent banks are involved. Of course, there may be quality advantages to this arrangement as well.

28. James R. Kraus, *Foreign Banks: Major Players in the U.S.*, *AM. BANKER*, Sept. 21, 1993, at 13.

percent of all bank assets in the U.S.²⁹ They account for 45 percent of all loans extended to U.S. businesses.³⁰ They are, therefore, a significant source of liquidity in the U.S. banking market, as Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, readily admits:

The *liquidity* and *depth* of the U.S. banking environment has to a great extent been made possible by the participation of *foreign* banks. The active presence of foreign banks in this country has helped to assure the continued *importance* of the United States in international financial markets. Of equal significance, foreign banks have been a substantial *source of credit* for *all* types of American businesses in *all* parts of this country.

It is clear that foreign banks occupy an important and growing place among banking institutions in the United States.³¹

Foreign banks are a source of innovation, bringing new financial techniques and technologies to the U.S. market. They are known for providing innovative products and implementing sophisticated trading strategies originally developed in their home-country markets.³² In turn, they serve as a critical competitive stimulus to U.S. banks.

In sum, the law of comparative advantage suggests that we hurt ourselves when we deny market access to foreign banks or make their entry into the U.S. significantly more difficult. Yet, conventional economic wisdom is not the only microeconomic reason why the burden of justifying incremental regulations should be on the bank regulators and not the regulated foreign banks. Free trade in banking services is a value worth preserving because it promotes efficiency in international financial markets. Ensuring that capital flows freely across borders into the most productive, highest yielding investments is important. This flow is facilitated if the purveyors of capital—the banks—are allowed to open offices in different countries with relative ease. Conversely, denying foreign banks access to a domestic market can induce a “credit crunch” in that market. These benefits of an open banking market have been sacrificed by the post-BCCI international banking legislation and regulation.

29. *Id.* This statistic is as of the year ending Dec. 31, 1992. See also Henry Terrell, *U.S. Branches and Agencies of Foreign Banks: A New Look*, 79 FED. RES. BULL. 913, t. 3, at 919 (Oct. 1993) (reporting that, as of March 31, 1993, foreign bank branches and agencies held \$683.1 billion of assets, amounting to 18% of all assets held by banks in the U.S.).

30. This statistic is for 1991. James R. Kraus, *U.S. Banks Fighting Plan to Curb Foreign Institutions*, AM. BANKER, Nov. 30, 1992, at 2. See also Terrell, *supra* note 29, at 920 (reporting a figure of 42%, as of March 31, 1993).

31. *Regulation of Foreign Banks: Hearing before the House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. 4 (June 11, 1991) (testimony of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System) (emphasis supplied).

32. Beverly Hirtle, *Factors Affecting the Competitiveness of Internationally Active Financial Institutions*, 16 FED. RES. BANK N.Y. Q. REV. 38 (Spring 1991).

II. THE SETTING

A. INTRODUCING MAHARAJAH BANK

To articulate the thesis that FBSEA and revised Regulation K are tragic and ironic, in Niebuhr's sense of these terms, consider a hypothetical foreign enterprise—the Maharajah Bank Holding Company. This holding company is incorporated in Bombay, India; its principal bank subsidiary, which is its principal asset, is the Maharajah Bank. Maharajah Bank is incorporated in Bombay, India, but its principal place of business is Kuala Lumpur, Malaysia. Maharajah Bank has branches throughout South Asia, Southeast Asia, and the Middle East and specializes in serving the need of expatriate Indian communities to repatriate funds. Overseas Indian workers, called non-resident Indians (NRIs), deposit their wages and other earnings in their local Maharajah Bank branch. The NRIs instruct the branch to transmit some of the deposited funds to their families back home in India.

Maharajah Bank has aspirations of becoming a truly global bank and must, therefore, open a branch, agency, or representative office in major financial centers, namely, New York, London, and Tokyo. Market research indicates that there is a large NRI community in the New York metropolitan area. Thus, eventually Maharajah Bank would like to accept federally insured retail deposits from New York NRIs to service their repatriation needs. Maharajah Bank's efforts to enter the U.S. banking market are the focus of this article.

Maharajah Bank's India operations are regulated by the Reserve Bank of India (the Indian central bank and regulatory authority). In Malaysia, Maharajah Bank's activities are regulated by Bank Negara (the Malaysian central bank and regulatory authority). Whether either of these authorities regulates Maharajah Bank on a comprehensive, consolidated basis is not clear.³³

B. THE ACTS

There are four remaining parts to this article—three Acts and a Conclusion. The scene is set at the beginning of each Act. In the first scene, Maharajah Bank applies to bank regulatory authorities for permission to open a branch, agency, or representative office in the U.S. Act I argues that the new entry requirements established by FBSEA serve as non-tariff barriers to the establishment of foreign bank offices in the United States. They represent a significant increase in transaction costs that foreign banks must incur if they are to do business in the U.S. They also serve as a latent capital control. There is an incongruity between these requirements and Articles VI, XVII, and XIX of the GATS, which concern domestic regulation, national treatment, and progressive liberalization of market access, respectively.

33. See *infra* notes 92-101 and accompanying text for a discussion of comprehensive consolidated regulation.

The scene in Act II is the evaluation of the application of Maharajah Bank by bank regulatory authorities. Act II argues that the standards for approving foreign bank applications may serve as non-tariff barriers to market access. The requirement that a foreign bank be supervised in a comprehensive, consolidated manner by its home-country regulator raises concerns of discrimination against banks from NICs and LDCs and is potentially incongruous with Articles III and IV of the GATS. These pertain to transparency and increasing the participation of developing countries, respectively.

The scene of Act III assumes Maharajah Bank's application eventually is approved. In this scene, Maharajah Bank attempts to enter the retail-deposit taking business in the U.S. Act III argues that the deposit insurance requirement also serves as a non-tariff barrier to trade which, like the new entry requirement, is a significant increase in the transaction costs faced by foreign banks that seek to do business in the U.S. The deposit insurance requirement is incongruous with Article XVI:2(e) of the GATS, which relates to market access commitments and impermissible legal measures, and also is incongruous with the domestic regulation provision of Article VI of the GATS.

After the scene is set, each act proceeds in three structured steps. First, what are the new rules governing Maharajah Bank? Second, why are these rules tragic? Third, why are these rules ironic? The inquiry in step one focuses on what new rules are established by FBSEA and the revisions to Regulation K and how these rules contrast with the pre-BCCI legal regime. Step two shows how they act as non-tariff barriers, thereby highlighting the tragic element of the post-BCCI legal regime for foreign banks by evincing the choice made by U.S. legislators and bank regulators in favor of protectionism. Step three establishes the ironic aspect of the rules by exploring the contrasts between these rules and various provisions of the GATS. The deliberate incongruities of GATS, on the one hand, with FBSEA and revised Regulation K, on the other hand, are delineated in this step. This is the ironic element of the post-BCCI legal regime—it has and appears likely to continue to limit foreign bank access to U.S. markets in spite of the GATS.

In the Conclusion, modest proposals about how to rectify the deliberate incongruities are offered. They are based on the work of Professors Calabresi and Bobbit concerning tragic choices about scarce goods and resources. What is suggested is that a more market-driven scheme for determining foreign bank entry might be appropriate.

One preliminary caveat should be offered. To distinguish the identification of incongruities, on the one hand, and the existence of outright violations of the GATS, on the other hand, is critical. FBSEA was enacted, and Regulation K was revised, before agreement on the final text of the GATS was achieved. Only if the GATS is applied retroactively can such violations be legitimately alleged. Another potential violation committed by the U.S. arises under the international law of treaties. Under

this body of law, a country that has signed an agreement or otherwise expressed its consent to be bound by an agreement must refrain from acts that would defeat the object and purpose of the agreement.³⁴ A country's obligation to refrain from defeating the object of a treaty is triggered as soon as the country agrees to become bound by the treaty, even if the treaty has not yet entered into force. When FBSEA was enacted and the revisions to Regulation K were promulgated, the U.S. had not expressed its consent to be bound by the GATS. Thus, technically, the U.S. did not violate its international treaty law obligation. But, an argument could be made that the U.S. did not act in good faith when participating in the GATS negotiations because it passed protectionist banking rules contemporaneously with these negotiations.

III. ACT I: APPLYING TO GET IN THE SCENE

Enter Maharajah Bank and the Federal Reserve. Maharajah Bank wants a physical presence in New York and has the option of opening a federally- or state-licensed branch or agency in New York. Alternatively, the bank could commence operations in the form of a representative office in the U.S. Regardless of which option Maharajah Bank chooses, it faces an alarming barrier: the Federal Reserve licensing requirement.

A. FEDERAL RESERVE LICENSING

FBSEA substantially enhances the power of the Federal Reserve to determine which foreign banks can and cannot enter the U.S. and to examine those that are allowed to enter. The legal mechanism that leads to this result is the application process. A foreign bank like Maharajah Bank must obtain licenses to enter the United States. To get the licenses, a foreign bank must file applications that meet all statutory and regulatory requirements.

No foreign bank can establish³⁵ a branch or agency³⁶ without the prior

34. See Vienna Convention on the Law of Treaties, May 23, 1969, art. 18, U.N. Doc. A/CONF. 39/27, 63 A.J.I.L. 875, 8 I.L.M. 679, *entered into force*, Jan. 27, 1980 (the United States is a party to the Vienna Convention); RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 312(3) (1987).

35. "Establish" means more than just the *de novo* opening of a branch, agency, or representative office in the U.S., also covering four other types of transactions: (1) merging two foreign banks, at least one of which has U.S. offices, where those offices are assumed by the combined entity after the merger; (2) upgrading the status of a U.S. office by, for example, converting a representative office to an agency or branch; (3) relocating a foreign bank's U.S. office from one state to another; and (4) acquiring an office by acquiring a subsidiary where the subsidiary would not operate in the same corporate form after the acquisition. Regulation K, 12 C.F.R. § 211.22(k)(2)-(5) (1993). Because of the broad meaning of "establish," the Federal Reserve licensing requirement acts as a non-tariff barrier in a broad number of prospective transactions, even those that are changes in form rather than substance.

36. In contrast to a subsidiary of a foreign bank, a branch or agency of a foreign bank does not have assets that are independent of the parent foreign bank. Neither a branch nor an agency is a separately capitalized, free-standing legal entity. Branches are author-

approval of the Federal Reserve.³⁷ For the first time in its history, the Federal Reserve is cast in the role of a "licensing agency," with respect to foreign bank branches and agencies.³⁸ The Federal Reserve must now

ized to engage in a broader range of banking activities than agencies (or representative offices).

A "branch" can receive deposits, make loans, and undertake general banking functions. An "agency" is not permitted to take deposits from U.S. citizens or residents. Thus, agencies are used by foreign banks interested primarily in wholesale banking. Agencies of foreign banks are active in lending, paying checks, and maintaining "credit balances."

The key legal distinction between branches and agencies concerns credit balances. These are "active balances that arise from or are incident to transactions involving loans, funds in transition, letters of credit, and other identifiable events." Dennis J. Lehr & Cameron F. MacRae, III, *Foreign Banks in the United States: Acquisitions, Branching, and Other Techniques*, 3 J. COMP. CORP. L. & SEC. REG. 202, 203 (1981) [hereinafter Lehr & MacRae]. Credit balances are "incidental to, or arise out of the exercise of, other lawful banking powers," "serve a specific purpose," are "not solicited from the general public," "nor used to pay routine operating expenses in the United States such as salaries, rent, or taxes," are "withdrawn within a reasonable period of time" after their specific purpose has been accomplished, and "drawn upon in a manner reasonable in relation to the size and nature of the account." Regulation K, 12 C.F.R. § 211.22(b)(1)-(6) (1993). The straightforward test for distinguishing a credit balance from a deposit is that the holder of a credit balance cannot add to it, whereas the holder of a deposit account can add to the account by depositing additional funds. Lehr & MacRae, *supra*, at 203.

A second, more practical distinction between a branch and agency pertains to funding. An agency, unlike a branch, cannot take deposits and must, therefore, fund its operations from other sources. Agencies have three principal sources of funds: borrowing from the parent banking organization, borrowing in the inter-bank market (*i.e.*, from other banks), and borrowing through money market transactions (*e.g.*, issuing short-term certificates of deposit, entering into overnight repurchase agreements, etc.). See *Regulation of Foreign Banks: Hearing before House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. 91 (1991) (statement of Vincent Conlon, Acting Superintendent of Banking, New York State Banking Department).

37. 12 U.S.C. § 3105(d)(1) (Supp. IV 1992); Regulation K, 12 C.F.R. § 211.24(a)(1)(A) (1993). This is an amendment to § 7(d)(1) of the International Banking Act of 1978 (IBA).

The regulatory scheme for establishing a subsidiary bank in the U.S. is not affected by FBSEA. Prior approval must be obtained from the Federal Reserve under the Bank Holding Company Act "for any action . . . that causes any company to become a bank holding company." 12 U.S.C. § 1842(a) (1988). See also 12 U.S.C. § 3106(a) (Supp. IV 1992). The requirements of the state in which the bank is incorporated also must be satisfied.

Revised Regulation K calls for prior approval in transactions where only the corporate form of the subsidiary changes to avoid an overlap with approval under the Bank Holding Company Act in cases where the acquired subsidiary maintains the same corporate form after the acquisition. Under the Bank Holding Company Act, the U.S. offices of the subsidiary bank would be subject to regulatory scrutiny. Where the corporate form of the subsidiary changes after the acquisition, an independent basis for regulatory scrutiny is needed. This basis is provided by revised Regulation K. The logic is that where the corporate form of the acquired subsidiary changes, new U.S. offices are, in effect, established.

38. The use of the term "licensing" in connection with the Federal Reserve approval process may be met with some objections. Certainly, the Office of the Comptroller of the Currency (OCC) and state regulators insist that "[l]icensing remains in the hands of state banking regulators for state licensed banks and with the Office of the Comptroller of the Currency for federally licensed banks." James R. Kraus, *N.Y. Regulator to Retain Foreign-Bank Oversight*, AM. BANKER, Apr. 22, 1992, at 7. In a letter to all state-licensed foreign bank branches and agencies in New York, Derrick D. Cephas, Superintendent, New York State Banking Department, resolutely declared that "[t]he New York State Banking Department remains the principal licensing authority for transnational banks. . . . The Federal Reserve Board is not and, going forward, will not be, a licensing authority." *Id.* Nonetheless, the term "licensing" seems applicable in a broad sense. The Federal Reserve has final decision-making authority over foreign bank entry.

weed out and deny entry to the U.S. not only "potential BCCIs," but also foreign bank applicants that are weakly capitalized, badly managed, or poorly supervised.³⁹

For Maharajah Bank, the licensing requirement is deceptively simple. There are actually three levels of bureaucracy that Maharajah Bank must penetrate. Requiring receipt of Federal Reserve approval before operating in the U.S. imposes a dual burden. This is because applications are reviewed at two different levels in the Federal Reserve: the Federal Reserve Bank in the district in which the foreign bank proposes to operate, and the Board of Governors in Washington, D.C.⁴⁰ Thus, two of the bureaucratic levels are within the Federal Reserve system itself—the Federal Reserve Bank of New York and the Board of Governors.

To be sure, this regime does not differ from the one applicable to domestic banks, which also must traverse through two levels of Federal Reserve bureaucracy. What has never been clearly established is why two levels of review are needed in the domestic or international context. Suppose the Board of Governors approves virtually all Reserve Bank application recommendations. Then, why bother with this "rubber stamp"? If the Board of Governors has ultimate decision-making authority, but fails to exercise it in practice, then its review of applications is superfluous. Suppose, on the other hand, the Board of Governors aggressively reviews Reserve Bank recommendations and alters a large percentage of them. Then, what is the point of the Reserve Bank level review? If the Board of Governors routinely exercises its decision-making authority, then Reserve Bank review is superfluous.

The third level of application review is a legacy from the pre-BCCI legal regime. The Federal Reserve licensing requirement is in addition to (not in lieu of) licensing requirements imposed by the OCC and state bank regulators. The licensing requirements of these other government agencies existed before FBSEA was enacted and Regulation K revisions were promulgated and remain in force. Hence, the post-BCCI legal regime has three "regulatory hoops" through which a foreign bank applicant, such as Maharajah Bank, must "jump" before opening a branch or agency in the U.S.: the Federal Reserve Bank of New York, the Federal Reserve Board, and (depending on whether Maharajah Bank files a federal or state application) the OCC or state banking regulator.

Thus, the requirement of filing an application with the Federal Reserve does not replace the requirement of first seeking approval from the OCC

39. *Regulation of Foreign Banks: Hearing before House Comm. on Banking, Finance, and Urban Affairs*, 102d Cong., 1st Sess. 67 (1991), reprinted in 77 FED. RES. BULL. 644, 645 (1991) (prepared statement of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, indicating the Federal Reserve intended to prevent weak foreign banks from entering the U.S.).

40. James R. Kraus, *Fed Moves to Reduce Delays on Foreign Bank Applications*, AM. BANKER, Mar. 12, 1993, at 2.

or appropriate state bank regulator to establish a branch or agency.⁴¹ If Maharajah Bank seeks to establish a federal branch or agency, then it must obtain a license from the OCC.⁴² This is true whether or not Maharajah Bank already operates a branch or agency in the U.S. To be sure, the Federal Reserve licensing requirement is more significant. The OCC cannot approve a foreign bank's application to establish a federal agency or branch in the U.S. unless conditions imposed by the Federal Reserve are included.⁴³

In order to establish a state branch or agency, Maharajah Bank must get a license from the state banking regulator where it proposes to operate—the New York State Banking Department. Here too, a Federal Reserve license is needed, regardless of the fact that a state bank regulator has granted a state license.⁴⁴ The Federal Reserve has the upper hand with respect to the imposition of conditions. Moreover, it is not bound by views that may be expressed by the state bank regulator regarding Maharajah Bank's application.

Federal Reserve approval also is necessary if Maharajah Bank seeks to open a representative office.⁴⁵ Under the pre-BCCI legal regime, no reg-

41. 12 U.S.C. § 3102(a)(1) (Supp. IV 1992). See also Sivon, *supra* note 2. In the domestic bank regulatory context, an entity seeking to become a bank holding company must file an application with the Federal Reserve under the Bank Holding Company Act, 12 U.S.C. §§ 1841-1850, 1971-1978 (1988). A bank owned by a bank holding company has one primary federal regulator. For national banks, that regulator is the OCC. For state-chartered banks that are members of the Federal Reserve System, the primary federal regulator is the Federal Reserve. Finally, for state-chartered non-member banks, the primary federal regulator is the Federal Deposit Insurance Corporation. In contrast, under FBSEA, a federal branch or agency of a single foreign bank effectively has two primary federal regulators—the Federal Reserve and the OCC. Thus, the argument can be made that FBSEA represents an increased regulatory burden on foreign relative to domestic banks. See *infra* notes 83-85 and accompanying text.

42. The IBA forbids the OCC from approving the establishment of a federal branch or agency if the law of the state in which the branch or agency would operate prohibits foreign banks from establishing branches and agencies. 12 U.S.C. § 3102(a)(1) (Supp. IV 1992). This requirement is necessary to preserve the integrity of the McFadden Act of 1927, which prohibits national banks from establishing a branch in a state unless the law of that state allows a state bank to establish a branch in that state. 12 U.S.C. § 36(c) (1988). As a result, foreign banks are on a competitively equal position with U.S. banks that have national or state charters.

43. 12 U.S.C. § 3102(a)(2) (Supp. IV 1992). Under 12 U.S.C. § 3105(d)(5) (Supp. IV 1992), the Federal Reserve is authorized to impose conditions upon approval of a foreign bank's application to establish a U.S. agency or branch. See also 12 U.S.C. § 3102(h)(1)-(2) (Supp. IV 1992), which requires the OCC to provide the Federal Reserve with the opportunity to comment on a foreign bank application to establish a federal branch or agency in cases where the bank already operates a branch or agency in the U.S. For a discussion of conditions imposed by the Federal Reserve under the Bank Holding Company Act (12 U.S.C. §§ 1841-1850, 1971-1978 (1988)), see Alfred C. Amen, Jr., Note, *Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board*, 74 IOWA L. REV. 837 (1989).

44. 12 U.S.C. § 3105(d)(1) (Supp. IV 1992). See also Sivon, *supra* note 2. When considering an application, the Federal Reserve is supposed to consider the views of the state regulator. 12 U.S.C. § 3105(g) (Supp. IV 1992).

45. A "representative office" is anything other than a branch, agency, or subsidiary of a foreign bank and is part of the parent foreign bank, not a separately capitalized and distinct legal entity. This makes a representative office similar to a branch or agency and different from a subsidiary.

ulatory approval was needed. A foreign bank needed only to register its representative office with the Department of the Treasury.⁴⁶ The right to register a representative office could not be denied. FBSEA and revised Regulation K impose the same Federal Reserve licensing requirement on foreign banks seeking to open a representative office as those hoping to establish a branch or agency. This is despite the fact that a representative office cannot engage in any substantive banking functions.⁴⁷ Why impose such a requirement on innocuous entities?

B. THE TRAGEDY: TRANSACTION COSTS

In analyzing Maharajah Bank's application, a bank regulatory authority should seek to strike an appropriate balance between achieving an adequate level of comfort with a foreign bank applicant and discouraging inappropriate foreign bank entry. Each marginal increase in the length, complexity, or intricacy of the regulatory application process leads to a marginal decrease in the openness of U.S. banking markets to foreign banks. In turn, Maharajah Bank's ability to establish a physical presence in the U.S. will be less likely. FBSEA and revised Regulation K fail to strike the right balance. The Federal Reserve licensing requirement is a marginal increase in the non-tariff barriers against foreign banks, is at odds with the principle of national treatment, and imposes unacceptably high transaction costs on foreign banks.

Between six and fourteen percent of a foreign (or domestic) bank's non-interest expense is devoted to complying with government regulations.⁴⁸ The Federal Reserve licensing requirement for foreign banks materially increases this cost for foreign banks. Therefore, Maharajah Bank (assuming its application is approved) will have to recoup this cost by earning additional revenues; if its activities do not generate such revenues, then its U.S. operation is less efficient. The return on the capital investment made by Maharajah Bank in its U.S. branch, agency, or representative office is reduced, and the U.S. operation is less competitive rela-

Unlike the other forms of foreign bank organization, however, the powers of representative offices are tightly circumscribed by regulation. Representative offices cannot perform any basic banking activities, such as taking deposits, maintaining credit balances, extending loans, providing payments services, or making business decisions for the foreign bank they represent. Regulation K, 12 C.F.R. § 211.22(u) (1993). *See also* 12 C.F.R. § 250.141 (1993) (listing activities that do not constitute lending money). In practice, representative offices provide marketing and logistical support for the parent foreign bank, solicit new business, generate loans booked in affiliated agencies, branches, subsidiaries, or offshore offices, and serve as liaisons between the parent foreign bank and correspondent banks. A correspondent bank is simply a bank at which the foreign bank maintains an account.

46. 12 U.S.C. § 3107(a) (Supp. II 1990) and 31 C.F.R. § 123.3 (1990). Under the Treasury's regulations, the permissible activities of a representative office were described as: "representational functions common to a banking business such as, without limitation, solicitation of new business, loan production, liaison between the bank's head office and correspondent banks in the United States, [and] customer relations." 31 C.F.R. § 123.2(a) (1990).

47. *See supra* note 45.

48. David T. Johannesen & Sara C. Settembrini, Comment, *The Best of All Regulators: A Well-Informed Marketplace*, AM. BANKER, June 4, 1993, at 4.

tive to domestic banks.⁴⁹ In sum, there has been a marked increase in the transaction costs—the time, effort, and money—associated with establishing a foreign bank presence in the United States. This is a clear, quantifiable manifestation of the non-tariff barrier erected by FBSEA against foreign banks, a barrier Maharajah Bank must evaluate.⁵⁰

1. Delays

There is little doubt from the evidence heretofore available that the Federal Reserve is “microprocessing” applications, thereby causing outrageously long delays. Maharajah Bank does not simply drop an application to open a branch or agency in the mail and receive a license back a few weeks later. A successful application takes up to two years to process. In virtually every case, the Federal Reserve returns applications and requests additional information⁵¹ and will inquire about all aspects of the world-wide operations of even well-known foreign banks.⁵² Foreign bank applicants are compelled to prepare a voluminous amount of detailed information for the Federal Reserve to sift through. Not surprisingly, as of April 1993—almost two and a half years after FBSEA was enacted—the Federal Reserve had approved only three foreign bank applications.⁵³

Unfortunately, unsuccessful foreign bank applicants cannot look forward to a clear, formal, and final rejection from the Federal Reserve. Rather, they often withdraw their application after incessant questioning and requests for documentary material. In other words, the Federal Reserve says “yes” to a few foreign banks after one or two years, but does

49. See Serge Bellanger, *Stormy Weather: The FBSEA's Impact on Foreign Banks*, 25 BANKERS MAG. 7, 11 (Nov.-Dec. 1992); Sivon, *supra* note 2.

50. See James R. Kraus, *Ernst Execs See Foreign Banks Eyeing Reduction of Operations in the U.S.*, AM. BANKER, Oct. 19, 1993, at 8 (stating that increasingly burdensome regulations attributable to FBSEA have added costs and caused many banks to reconsider their U.S. operations).

51. See, e.g., James R. Kraus, *Fed's Delay on Foreign Banks Angers States*, AM. BANKER, Feb. 5, 1993, at 1 [hereinafter Kraus, *Fed's Delay*].

52. See, e.g., Richard Layne, *Fed Tougher on Investments from Abroad*, AM. BANKER, Apr. 10, 1992, at 1 (indicating that “[f]oreign banks that want to acquire, invest, or expand must be prepared to answer scores of questions on their worldwide operations”). As the chairman of National Westminster Bancorp (the U.S. subsidiary of the major multinational British bank) remarked, “BCCI caused us problems. . . . We have to explain what the parent company does around the world when we want to buy three branches in Queens [New York City].” *Id.* (quoting John Tugwell, Chairman, National Westminster Bancorp).

53. These were submitted by two Taiwanese banks (Taipei Bank and United World Chinese Commercial Bank) to open state-licensed branches in Los Angeles, and a Spanish bank. See James R. Kraus, *Foreign Banks Face Hurdles*, AM. BANKER, Apr. 19, 1993, at 2A; Kraus, *Fed's Delay*, *supra* note 51, at 1; James R. Kraus, *A First: Fed Approves Taiwan Banks' Units*, AM. BANKER, Dec. 22, 1992, at 10. Also, as of April 1993, nine applications of foreign banks have been approved by the Florida Department of Banking and Finance, but remain pending at the Federal Reserve. Four California applications need Federal Reserve approval. Three applications have been approved by the New York Banking Department and await Federal Reserve action (including an application from Banco Nacional de Mexico, the biggest bank in Mexico). Kraus, *Fed's Delay*, *supra* note 51, at 1. See *infra* notes 58-59 and accompanying text regarding the Federal Reserve's subsequent approval of two of the California applications.

not say "no" to the majority of foreign banks, inevitably winning a war of attrition against the majority.

One of the reasons for delays at the Federal Reserve in processing foreign bank applications is "name checks."⁵⁴ Before approving Maharajah Bank's application for a license, every officer, director, and principal shareholder of the Bank must be scrutinized to determine whether she possesses the character, integrity, and fitness to operate a branch, agency, or representative office in New York. A primary goal of the inquiry is to make sure that none of these individuals is acting as a nominee or "front person" for another individual or organization. The Federal Reserve is fearful of this scenario because it occurred in the BCCI case. Kamal Adham, the former director of Saudi Arabia's central intelligence agency, Faisal Saud Al-Fulaij, the former chairman of Kuwaiti Airways, Ali Mohammad Shorafa, the former director of presidential affairs for the United Arab Emirate of Abu Dhabi, Humaid Bin Rashid Al Naomi, the ruler of the United Arab Emirate of Ajman, and a host of other wealthy and well-connected Middle Easterners acted for BCCI as nominee shareholders of Credit and Commerce American Holdings, N.V. (CCA), the top-tier holding company of the First American banks.⁵⁵

The problem is that there are no time limits for completion of this name check. Delays of more than a year are not uncommon.⁵⁶ Name checks involve a number of U.S. governmental and international agencies. The Federal Reserve passes the names of individuals associated with the foreign bank to the Central Intelligence Agency (CIA), Department of State, U.S. Customs Service, Immigration and Naturalization Service, and Interpol so that these agencies may check the names against their records. As yet, there is no central database for this information. In the absence of a central database, performing name checks efficiently requires an extraordinary amount of synchronization and cooperation, a task that is practically impossible for governmental bureaucracies.

Recent Federal Reserve efforts to accelerate the foreign bank application process have proved futile.⁵⁷ Approved applications trickle out of

54. See BHALA, *supra* note 3, at ch. IV (discussing discretionary standards of approval and managerial resources).

55. *In re BCCI Holdings (Luxembourg) S.A. Luxembourg*, Before the Board of Governors of the Federal Reserve System, Docket Nos. 91-043-CMP-FHC *et seq.*, July 29, 1991, at 2, 21-22, 29-58 [hereinafter *July 29, 1991 Federal Reserve Order*].

56. See Gary M. Welsh, *Unshackle Foreign Banks*, WALL ST. J., Apr. 20, 1993, at A20.

57. See *Fed Speeds Up Foreign Bank Application Process Under FBSEA*, 60 Banking Rep. (BNA) 332 (Mar. 15, 1993). William Ryback, the associate director of the Federal Reserve's Division of Banking Supervision and Regulation in Washington, D.C., told foreign bankers that "[a]s we move forward, this approval process will be as painless as possible." *Quoted in Fed's Interim Rule May Result in Some Foreign Banks Choosing to Bypass the U.S.*, Banking Daily (BNA), Apr. 30, 1992, at 2. Mr. Ryback later admitted, however, that he "lied" when he promised the Federal Reserve would accelerate the foreign bank application process:

The usually reticent Federal Reserve Board is admitting a mistake. A key Fed staffer said last week that his division failed to make good on a promise to speed up processing of foreign bank applications.

the Federal Reserve at a snail's pace. Over two years were required for Dah Sing Bank, Hong Kong, to establish a federally-licensed branch in California.⁵⁸ KorAm Bank, Seoul, Korea, spent fourteen months securing a Federal Reserve license to establish a federal branch in Los Angeles.⁵⁹ Similarly, the Federal Reserve granted a license to Banco de Chile, Santiago, Chile, to establish a state-licensed agency in Miami after studying that bank's application for thirteen months.⁶⁰

The new procedures are ineffectual because they do not address the fundamental problems inherent to the system. For instance, while review of applications by regional Federal Reserve Bank officials and Federal Reserve Board officials now is supposed to take place simultaneously, instead of sequentially, the basic question of why a review is needed at each level is not addressed. Review at one of these levels should be eliminated. Moreover, why the Federal Reserve has not been required to employ fairly evident techniques for counteracting agency delay is puzzling. One such technique is to allow an affected party to proceed if the agency has not taken a final action within a certain period of time. Thus, a foreign bank applicant could be permitted to open a branch, agency, or rep-

"I know I promised, but I lied," associate director William A. Ryback told those attending a meeting of the Institute of International Bankers. In June, he pledged to clear up an application backlog "within 30 days."

Processing stalled last November in the wake of a new banking law. Mr. Ryback, who is in charge of implementing the Foreign Bank Supervision Enhancement Act, gave irate bankers little hope that things would speed up soon.

James R. Kraus, *Read Fed's Lips*, AM. BANKER, Oct. 21, 1992, at 2. See also James R. Kraus, *Fed Set to Tackle Backlog of Foreign Applications*, AM. BANKER, May 20, 1992, at 10.

58. On Dec. 16, 1993, the Federal Reserve announced approval of the application of Dah Sing Bank, Hong Kong, to establish a federally-licensed branch in California. Federal Reserve System, Order Approving Establishment of a Branch, Dah Sing Bank, Ltd., Hong Kong, Dec. 16, 1993. The notice of this application was published on Sept. 20, 1991. *Id.* at 1.

Publication of a notice "in a newspaper of general circulation in the community in which the applicant proposes to engage in business" is an additional burden imposed on each foreign bank applicant seeking to establish a branch or agency in the U.S. 12 C.F.R. § 211.24(b)(2) (1993). The notice must state a Federal Reserve application has been submitted and that anyone may provide comments on the application. 12 C.F.R. 211.24(b)(2)(i) (1993). Any person is entitled to submit comments. 12 C.F.R. § 211.24(b)(3) (1993). This is an unnecessary transaction cost imposed on foreign banks. While the requirement serves the public policy purpose of informing the public of a foreign bank's plan to open an office, the Federal Reserve could easily publish a notice in the Federal Register or the Federal Reserve Bulletin listing all foreign bank applications submitted and the date by which public comments must be received, thereby removing the burden from the foreign bank applicant. Persons interested in these applications are more likely to follow foreign banking developments through these publications than a local newspaper.

59. Notice was published on October 13, 1992 and approval was not obtained until December 22, 1993. Federal Reserve System, Order Approving the Establishment of a Branch, KorAm Bank, Seoul, Korea, Dec. 22, 1993, at 1.

60. The application of Banco de Chile, Santiago, Chile, to establish a state-licensed agency in Miami was approved on Dec. 16, 1993. Federal Reserve System, Order Approving the Establishment of an Agency, Banco de Chile, Santiago, Chile, Dec. 16, 1993. The notice of this application was published on Nov. 2, 1992. *Id.* at 1.

representative office if the Federal Reserve fails to make a final determination on the application within a set period. To preserve the intent of this sort of rule, the availability of extensions of time for the Federal Reserve to act should be severely limited.

2. Fees

Delays are not the only form of transaction cost. Before FBSEA was enacted and the revisions to Regulation K were promulgated, a foreign bank typically spent \$15,000 to \$20,000 in legal fees in connection with an application to a federal or state regulator to open an office in the United States.⁶¹ Since that time, the cost has risen to between \$50,000 and \$75,000.⁶² The reason for the skyrocketing legal fees is obvious: the costs associated with the duplication of effort in obtaining approval from the Federal Reserve, as well as the OCC or state bank regulator.

In addition to legal fees, Maharajah Bank will likely face other monetary transaction costs as a result of the delays in processing applications, such as rent for new office space and salaries to new personnel. The Chiao Tung Bank (CTB), a Taiwanese bank, is a case in point. CTB obtained a license from the New York State Banking Department to open a state agency in early 1992.⁶³ More than a year later, the Federal Reserve had not approved CTB's application.⁶⁴ CTB leased office space in Manhattan and sent staff from Taiwan to New York in late 1991. Neither premises nor personnel can be employed profitably until the Federal Reserve grants a license.⁶⁵ Plainly, to minimize these sorts of transaction costs, Maharajah Bank will have to consider delaying the procurement of office space and employees in the U.S. until a Federal Reserve license is in hand.

3. National Treatment

Transaction costs are not the only reason the Federal Reserve licensing requirement reflects a tragic choice of protectionism. The requirement that foreign banks like Maharajah Bank obtain a Federal Reserve license before establishing a branch, agency, or representative office in the U.S. undermines the principle of national treatment in the International Banking Act of 1978 (IBA).⁶⁶ According to that principle, foreign banks

61. Kraus, *Fed's Delay*, *supra* note 51, at 1.

62. *Id.*

63. *Id.*

64. *Id.* The application finally was approved by the Federal Reserve on March 18, 1993. Federal Reserve System, Order Approving the Establishment of an Agency, Chiao Tung Bank, Taipei, Taiwan, Mar. 18, 1993. Notice of the application was published on June 5, 1992. *Id.* at 1. In this case, the application appears to have been processed by the Federal Reserve rather rapidly—*i.e.*, less than a year between publication and approval dates.

65. *Id.* On the one hand, perhaps CTB acted prematurely in leasing office space and sending staff. On the other hand, the behavior seems appropriate; with the state license in hand, CTB reasonably believed that a Federal Reserve license would be forthcoming in the near future.

66. 12 U.S.C. § 3101 (Supp. IV 1992), as amended by FBSEA, *supra* note 2.

should be accorded substantively equal treatment as domestic banks:

By duplicating state regulatory approval processes and supervision, the FBSEA ensures that foreign banks will bear a greater regulatory burden than domestic banks. In subtle but significant ways, the FBSEA has imposed standards on foreign banks that are more strict or comprehensive than those facing domestic banks. The result is a departure from the policy of national treatment.⁶⁷

A domestic bank must get approval from the OCC in order to obtain a federal charter.⁶⁸ To obtain a state charter, a domestic bank must get approval from the state bank regulator in the state in which it seeks the charter. In neither of these cases is the Federal Reserve involved in the chartering or licensing process.⁶⁹ Thus, to procure a license to operate a bank, domestic organizers require one regulatory approval while foreign banks require two such approvals (the Federal Reserve license plus OCC or state regulatory permission).

Undermining the principle of national treatment is *prima facie* illogical. Increasing the number of applications that a foreign bank must submit to U.S. authorities is no guarantee that weak or bad banks will be filtered out from strong, upstanding banks.⁷⁰ To be sure, the probability of detecting "another BCCI" may increase. But, this logic would lead to an infinite regulatory burden—four approval requirements would be better than three, and so forth—and, therefore, an infinitely high non-tariff barrier.

The principle of national treatment is further undermined by the fact that once a Federal Reserve license is obtained and Maharajah Bank commences business in the U.S. as a branch, agency, or representative office, it must pay for its own periodic examinations. Domestic banks are not assessed fees for the costs bank examiners incur in conducting their exams. FBSEA empowers the Federal Reserve to examine each agency and branch of a foreign bank and to charge the examined institutions for the costs of the examination.⁷¹

67. Bellanger, *supra* note 49, at 10.

68. 12 U.S.C. §§ 21, 26, 27 (1988).

69. The Federal Reserve is, of course, responsible for approving applications to form bank holding companies. 12 U.S.C. § 1841(a)(5)(A) (1988).

70. See generally *Regulation of Foreign Banks: Hearing before House Comm. on Banking, Finance, and Urban Affairs*, 102d Cong., 1st Sess. 16 (1991) (testimony of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, acknowledging that problems of secret ownership of U.S. banks through several tranches of nominee shareholder arrangements may recur in spite of new legislation, such as FBSEA).

Interestingly, when FBSEA was being drafted, proponents of the legislation admitted they had sufficient powers under the IBA to prevent BCCI from acquiring a controlling interest in First American. After all, the Federal Reserve had the authority to deny the application of Credit and Commerce American Holdings, N.V., to purchase the shares of Financial General. *Fed-Drafted Bill on Foreign Control Gets Mixed Reviews before Senate Banking*, 56 Banking Rep. (BNA) 1041, 1042 (1991).

71. 12 U.S.C. § 3105(c)(1) (Supp. IV 1992). One could argue that the deposit insurance premiums paid by domestic banks (including subsidiaries of foreign banks) help defray the cost of examinations. This argument is implausible. First, the premiums are paid to the Federal Deposit Insurance Corporation (FDIC) and are not shared by the FDIC with the Federal Reserve or OCC to cover examinations conducted by these other regula-

Examination fee assessments represent not only another transaction cost for Maharajah Bank's U.S. operations, but also a departure from the IBA's principle of national treatment. The cost of operating a branch, agency or representative office in the U.S. increases for foreign banks because they have to pay for their own examinations, while domestic banks are not charged for their own examinations. Even Federal Reserve Chairman Alan Greenspan admits this policy contradicts the national treatment policy of the IBA.⁷² Nevertheless, the Federal Reserve recently issued a notice of proposed rulemaking regarding the assessment of examination fees on U.S. branches, agencies, and representative offices.⁷³ The amount to charge for an examination is calculated by multiplying the number of hours Federal Reserve examiners take to examine a foreign bank by an hourly rate. The number of examiner hours is not measured by recording the actual hours expended on an examination. Instead, the Federal Reserve applies a formula based on the characteristics of the foreign bank, such as asset size and organizational complexity. The hourly rate is approximately \$47, which includes personnel, travel, and other costs. Based on 1993 statistics, the Federal Reserve estimates that almost \$12 million in examination fees will be earned annually.

C. THE IRONY: UNNECESSARY BARRIERS

1. *The Incongruity with GATS Article VI*

Are the increased delays and monetary costs imposed on Maharajah Bank consistent with the GATS? To be sure, the GATS does not preclude Parties (*i.e.*, the member countries) from implementing domestic regulatory measures. These include "measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system."⁷⁴ But, "all measures of general application affecting trade in services" must be "administered in a reasonable, objective and impartial manner."⁷⁵ More-

tors. Second, given the recent problems involving the bank insurance fund, that premium revenue would be diverted to pay examination costs is unlikely.

72. Letter from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to Henry Gonzalez (D-Texas), Chairman, House Banking Committee, June 24, 1993. *See also Fed Reluctant to Charge Foreign Banks for Exams, Urges Congress to Intervene*, 61 Banking Rep. (BNA) 9 (July 5, 1993).

73. Board of Governors of the Federal Reserve System, Charging for Examinations of U.S. Branches, Agencies, and Representative Offices of Foreign Banks, 58 Fed. Reg. 239 (to be codified at 12 C.F.R. pt. 211) (proposed Dec. 15, 1993). Of course, whether this proposal, or a modified version of it, will be implemented is uncertain. *See also Fed Seeks Comment on Proposal to Charge Foreign Banks for Exams*, Banking Daily (BNA) (Dec. 14, 1993).

74. GATS, Annex on Financial Services, § 2.1 [hereinafter Annex]. A "financial service supplier" is a supplier of banking, insurance, or other financial services, *e.g.*, a commercial bank, insurance company, or securities firm. *Id.* §§ 5.1-2. A "measure" is any "law, regulation, rule, procedure, decision, administrative action, or [measure of] any other form." GATS, *supra* note 5, art. XXVIII:(a).

75. *Id.* art. VI:1.

over, the "measures relating to qualification requirements . . . and licensing requirements" must not "constitute unnecessary barriers to trade."⁷⁶ They must not be "more burdensome than necessary to ensure the quality of the service" and must "not in themselves [serve as] a restriction on the supply of the service."⁷⁷

If the Federal Reserve license were the only license required of Maharajah Bank, then perhaps it would be a justified prudential measure. Instead, the license is unnecessarily duplicative and, thus, in practice, does not play a particularly important role in protecting interested parties or safeguarding the financial system. Even Federal Reserve Chairman Alan Greenspan suggests that the delays caused by the Federal Reserve licensing requirement are not offset by a higher caliber of Federal Reserve review.⁷⁸ In essence, the Federal Reserve seems to find the FBSEA and revised Regulation K requirements "more burdensome than necessary," to quote the language of GATS Article VI:4(b).

Some have argued that through the new licensing requirement "the Fed is generally trying to upgrade the quality and transparency of international banking supervision and is specifically retaining its own regulatory trigger in the event overseas home-country supervision or the information available on a particular foreign bank is deemed inadequate in the view of the Fed."⁷⁹ This argument is not a compelling rebuttal to the contention that the Federal Reserve licensing requirement is incongruous with the GATS provisions discussed above because it is based on two implicit false premises regarding state bank regulators and, to a lesser extent, the OCC.

The first false premise of the rebuttal concerns the performance of these other regulators in the BCCI affair, holding that the New York and California bank regulators did a poor job of regulating BCCI's New York and California agencies, respectively. There is nothing in the record of the BCCI case, the legislative history to FBSEA, or the comments or justification for promulgation of the revisions to Regulation K that suggests the state regulatory approval process (or that of the OCC) was seriously defective. The interests of depositors and other creditors, and the financial system generally, appear to have been well protected through the licensing requirements of the OCC and the state regulators. In the BCCI affair, what is often forgotten is that the critical regulatory approval for the takeover of the First American banks by BCCI nominees was granted by the Federal Reserve (not by the states or the OCC).⁸⁰

76. *Id.* art. VI:4.

77. *Id.* art. VI:4(b)-(c).

78. Letter from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System to Senator Bob Graham (D.-Florida), Jan. 8, 1993 (stating that "[t]he processing . . . of applications has proved to be more cumbersome than the Board expected . . .").

79. Gail, *supra* note 2, at 997. See also Fanikos, *supra* note 2, at 506.

80. This approval came on Aug. 25, 1981. Approval from the New York State Banking Department followed, as an inevitable result, on Mar. 2, 1982. *July 29, 1991 Federal Reserve Order*, *supra* note 55, at 26. See also BHALA, *supra* note 3, at ch. I. An application was made to the Federal Reserve under the Bank Holding Company Act, 12 U.S.C. § 1842

Moreover, state bank regulators were instrumental in making sure that no creditors of BCCI's New York and California agencies lost money.⁸¹ They ensured that BCCI's U.S. operations had positive net worth and successfully "ring-fenced" (or shielded) BCCI's U.S. assets from liquidation proceedings conducted in Luxembourg. Creditors of the U.S. operations were thereby assured of payment in full for their claims.

A second false premise of the rebuttal is that, in the future, state bank regulators will be less able to cope with major multinational bank failures arising from fraud. Underlying the premise is the stereotypical view that state bank regulators are too small and unsophisticated to deal with large international banks. This view overemphasizes both the resources and competence of federal bank regulators. Federal regulators are neither particularly well-endowed with examiners and staff, nor infallible. This view also ignores part of the history of the BCCI case.

Bank regulators in New York and California protected creditors of BCCI's agencies in those states by imposing stringent asset maintenance requirements, thereby ensuring the agencies had positive net worth when BCCI was closed down. The state regulators also successfully fought efforts to consolidate the assets of BCCI's New York and California agencies with the general liquidation proceeding in Luxembourg (*i.e.*, ring-fencing the assets), thereby ensuring that the claims of creditors of the agencies would be paid in full. Finally, the stereotypical view of state bank regulators being too small and unsophisticated neglects the significant reforms undertaken by state bank regulators to strengthen further their abilities to supervise cross-border banking establishments.⁸²

Clearly, the higher the transaction cost of entering the U.S. banking market, the more likely Maharajah Bank will be deterred from the market. At the margin, similarly situated foreign banks that would have opened offices in the U.S., but for the licensing requirements imposed by FBSEA and revised Regulation K, will not do so because of the increased expense. This means otherwise profitable ventures are rendered unprofitable by the law. This is a restriction on the supply of foreign bank services. The results are that the liquidity these banks would have injected into the market is lost and innovative banking techniques they would have introduced are foregone. The transaction cost associated with the Federal Reserve license is a manifestation of the unnecessary non-tariff barrier erected against foreign banks.

(1988) by the nominees, because the shares of the First American banks were being acquired through a series of bank holding companies.

81. See BHALA, *supra* note 3, at chs. III & V (discussing the performance of state bank regulators).

82. See BHALA, *supra* note 3, at ch. V (discussing post-BCCI reforms at the state level). On the argument that the Federal Reserve licensing requirement unifies and clarifies regulatory procedures, see *id.* ch. III. See also MARIO CUOMO ET AL., REPORT OF THE SUPERINTENDENT'S ADVISORY COMMITTEE ON TRANSNATIONAL BANKING INSTITUTIONS (1992).

2. *The Incongruity with GATS Article XVII*

The Federal Reserve licensing requirement and the assessment of examination costs on Maharajah Bank are incongruous with the national treatment principle articulated in the GATS. Article XVII:1 states "each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers."⁸³

Domestic banks are not subject to the same strict Federal Reserve licensing process as foreign banks. The federal branch or agency of a foreign bank is subject to examination by two federal regulators (the Federal Reserve and the OCC). In contrast, a single entity within a domestic banking organization is subject to regulation by one primary federal regulator. A domestic bank holding company is subject to one primary federal regulator (the Federal Reserve).⁸⁴ Similarly, a domestic bank subsidiary is subject to one primary federal regulator (the Federal Reserve, OCC, or Federal Deposit Insurance Corporation (FDIC)).⁸⁵ The heightened regulatory scrutiny under FBSEA and revised Regulation K for foreign banks is, therefore, at odds with the GATS.

3. *The Incongruity with GATS Article XIX*

The licensing requirement faced by Maharajah Bank is troublesome, not only because it is burdensome and inconsistent with the national treatment principle, but also because it cannot be squared with the liberalization process set in motion by the GATS. Under Article XIX, Members commit themselves to "achieving a progressively higher level of liberalization."⁸⁶ This commitment is to be fulfilled through negotiations "directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access."⁸⁷

Under Article XIX:2 of the GATS, "due respect" is given to individual developing countries that might need to open fewer service sectors, liberalize fewer types of transactions, and generally extend market access to foreign service suppliers in a gradual manner that is "in line with their development situation."⁸⁸ In contrast, developed countries like the

83. GATS, *supra* note 5, art. XVII:1.

84. See Bank Holding Company Act, 12 U.S.C. §§ 1841-1850 (1988) (regarding regulation of bank holding companies by the Federal Reserve).

85. See the definition of "appropriate Federal banking agency" at 12 U.S.C. § 1813(q)(1)-(3) (Supp. IV 1992) (dividing regulatory responsibilities under the Federal Deposit Insurance (FDI) Act, 12 U.S.C. §§ 1811-1834b (1988), among the Federal Reserve, OCC, and FDIC). See also the National Bank Act, 12 U.S.C. §§ 21-26(e) (1988) (regarding regulation of national banks by the OCC).

86. GATS, *supra* note 5, art. XIX:1.

87. *Id.* The negotiations may be on a bilateral, plurilateral, or multilateral basis. *Id.* art. XIX:4.

88. *Id.* art. XIX:2. See generally Robert E. Hudec, *GATT and the Developing Countries*, 1992 COLUM. BUS. L. REV. 67, 76 (1992) (discussing "special and differential treat-

United States are expected to make their markets accessible on a swift basis, no doubt because their service suppliers are sufficiently competitive to withstand challenges presented by foreign service providers.

The licensing requirement might be more appropriate for a developing country concerned about the potentially ruinous effects that immediate and complete liberalization could have on "infant" domestic banks than for the U.S., whose banks compete effectively with their foreign counterparts. A staged approach to market access presumably might allow banks from LDCs and NICs time to develop the strength and standing to survive in a fierce, global marketplace. The provisions of the North American Free Trade Agreement (NAFTA) concerning access of U.S. and Canadian banks to the Mexican market are a case in point. The ability of U.S. and Canadian banks to establish operations in Mexico is enhanced on a progressive basis during a transition period ending in the year 2000. During this period, the aggregate market share limit allowed to U.S. and Canadian banks will increase from eight to fifteen percent.⁸⁹ After the transition period, there will be no market share limits on U.S. or Canadian bank operations in Mexico.⁹⁰ These provisions illustrate the special attention paid by NAFTA to Mexico's status as a developing country and are akin to Article XIX:2 of the GATS. Ironically, the licensing requirement established by FBSEA and revised Regulation K seem more fitting for Mexico pursuant to NAFTA or a developing country pursuant to GATS Article XIX:2, than for the U.S.

IV. ACT II: EVALUATING THE APPLICATION

THE SCENE

Enter the Federal Reserve lawyers and financial analysts, and assume that Maharajah Bank decides to attempt to open a branch in New York. These Federal Reserve officials study its branch license application. Long meetings are held at the Federal Reserve with Maharajah Bank representatives. The lawyers and financial analysts write lengthy letters to Maharajah Bank stating that its application contains numerous informational and legal deficiencies. The centerpiece of the Federal Reserve's evaluation is a potentially discriminatory standard: home-country, comprehen-

ment" for developing countries under the GATT and recent unilateral actions, which are "the diametric opposite of the idea of rewarding developing countries for their new liberalizations").

89. See North American Free Trade Agreement, Pub. L. No. 103-182, ch. 14, 107 Stat. 2057 (1993) [hereinafter NAFTA]; Governments of Canada, the United Mexican States, and the United States of America, *Description of the Proposed North American Free Trade Agreement*, 34-35 (Aug. 12, 1992) (stating that during the transition phase, no U.S. or Canadian bank may have a market share in Mexico in excess of 1.5 percent).

90. U.S. and Canadian banks, however, will not be permitted to acquire the largest Mexican banks, and must operate in Mexico through subsidiaries, rather than branches or agencies. NAFTA, *supra* note 89, at ch. 14. See also Harry G. Broadman, *International Trade and Investment in Services: A Comparative Analysis of the NAFTA*, 27 INT'L LAW. 623, 643 (1993).

sive, consolidated supervision.⁹¹

A. COMPREHENSIVE, CONSOLIDATED SUPERVISION

How does the Federal Reserve decide whether to grant Maharajah Bank a license to open a branch, agency, or representative office? FB-SEA and revised Regulation K establish three mandatory standards⁹² and nine discretionary standards⁹³ for the Federal Reserve to apply in making a licensing determination. Of the twelve standards, the most noteworthy and controversial is the mandatory standard that Maharajah Bank be supervised by its home-country bank regulatory authority on a comprehensive, consolidated basis.⁹⁴ This standard is consistent with the recommendations of the Group of Ten (G-10) countries acting under the auspices of the Basle Committee on Banking Supervision (Basle Committee) of the Bank for International Settlements (BIS) in Basle, Switzerland.⁹⁵ In the aftermath of the BCCI affair, the BIS member countries stated that "[a]ll international banking groups and international banks

91. This standard also would be applied if Maharajah Bank had opted for an agency or representative office.

92. 12 U.S.C. § 3105(d)(2) (Supp. IV 1992); Regulation K, 12 C.F.R. § 211.25(c)(1) (1993). Technically, two factors are listed in the statute, but the language makes clear that there are actually three. *See id.* § 3105(d)(2)(A), (B).

93. Satisfying the mandatory standards is a necessary, but not necessarily sufficient, condition for obtaining a Federal Reserve license. The Federal Reserve can consider any or all of the nine discretionary standards in examining a foreign bank application to open a branch, agency, or representative office in the U.S. 12 U.S.C. § 3105(d)(3) (Supp. IV 1992). These concern: (1) an exit visa (*i.e.*, whether the appropriate authorities in the home-country of the foreign bank applicant have consented to the proposed establishment of an agency or branch in the U.S.) (*see* 12 U.S.C. § 3105(d)(3)(A); Regulation K, 12 C.F.R. § 211.25(c)(2)(i)); (2) the financial resources of the foreign bank applicant (*see* 12 U.S.C. § 3105(d)(3)(B); Regulation K, 12 C.F.R. § 211.25(c)(2)(ii)); (3) the managerial resources of the foreign bank (*see* 12 U.S.C. § 3105(d)(3)(B); 12 C.F.R. § 211.25(c)(2)(iii)); (4) information sharing (*i.e.*, whether the home-country regulator of the foreign bank shares material information about the bank with banking regulators in other countries) (*see* Regulation K, 12 C.F.R. § 211.25(c)(2)(iv)); (5) the provision of adequate assurances by the foreign bank that it will provide the Federal Reserve with information on the bank and its affiliates, so that the Federal Reserve can enforce U.S. banking law (*see* 12 U.S.C. § 3105(d)(3)(C); Regulation K, 12 C.F.R. § 211.25(c)(2)(v)); (6) compliance with U.S. banking law (*see* 12 U.S.C. § 3105(d)(3)(D); Regulation K, 12 C.F.R. § 211.25(c)(2)(vi)); (7) the needs of the community in which the foreign bank proposes to operate (*see* 12 U.S.C. § 3105(d)(4); Regulation K, 12 C.F.R. § 211.25(c)(3)); (8) the length of time the foreign bank has operated and its operating history (*see* Regulation K, 12 C.F.R. § 211.25(c)(3)); (9) size (*i.e.*, the relative size of the foreign bank in its home-country) (*see* 12 U.S.C. § 3105(d)(4); Regulation K, 12 C.F.R. § 211.25(c)(3)).

In addition to the nine discretionary standards, the Federal Reserve can impose any additional conditions for approval that it deems necessary. Regulation K, 12 C.F.R. § 211.25(c)(4) (1993).

94. The other two mandatory standards concern the business of the foreign bank and the provision of information. First, the foreign bank must engage directly in the business of banking outside of the U.S. (*see* 12 U.S.C. § 3105(d)(2)(A) (Supp. IV 1992); Regulation K, 12 C.F.R. § 211.25(c)(1)(i)(A) (1993)). Second, the foreign bank must furnish information to the Federal Reserve that is needed to adequately assess the application (*see* 12 U.S.C. § 3105(d)(1)(B) (Supp. IV 1992); Regulation K, 12 C.F.R. § 211.25(c)(1)(i)(B) (1993)).

95. The G-10 countries are represented on the Basle Committee and at the BIS by officials from their central banks. *See supra* note 16.

should be supervised by a home-country authority that capably performs consolidated supervision."⁹⁶

The key factor in deciding whether a foreign bank regulator exercises comprehensive, consolidated supervision is whether that regulator "receives sufficient information on the worldwide operations of the foreign bank . . . to assess its overall financial condition and compliance with law and regulation."⁹⁷ To decide whether the home-country regulator receives such information, the Federal Reserve checks whether the home-country regulator (1) ensures that the foreign bank adequately monitors its global activities,⁹⁸ (2) obtains information on the condition of the foreign bank's offices outside of the home-country "through regular reports of examination, audit reports, or otherwise," and on the relationship between the foreign bank and its affiliates,⁹⁹ (3) receives consolidated financial reports from the foreign bank,¹⁰⁰ and (4) evaluates prudential standards such as capital adequacy on a world-wide basis.¹⁰¹

Thus, the Federal Reserve is cast in the role of judging not only Maharajah Bank, but also the foreign regulators that are responsible for supervising the Bank, and is legally empowered to deny license applications from any foreign bank from a country whose regulators do not meet the comprehensive, consolidated supervision standard.

B. THE TRAGEDY: DISCRIMINATION

1. *The Unquestioned Faith*

Generally, consolidated supervision is accepted with little or no critical analysis. Professor Dale argues that "[o]ne clear lesson from the BCCI affair, therefore, is that consolidated supervision should be mandatory for *all* international banks without exception."¹⁰² Professor Norton points out that "[t]he recent U.S. statute and regulations on foreign bank supervision incorporate the principles of 'effective' consolidated supervision into the application, termination, and examination processes for foreign

96. BASLE COMMITTEE ON BANKING SUPERVISION, BANK FOR INTERNATIONAL SETTLEMENTS, BASLE, SWITZERLAND, MINIMUM STANDARDS FOR THE SUPERVISION OF INTERNATIONAL BANKING GROUPS AND THEIR CROSS-BORDER ESTABLISHMENTS 3 (June 1992). For a critique of the work of the Basle Committee, see BHALA, *supra* note 3, at chs. VII & VIII. See also Duncan E. Alford, *Basle Committee Minimum Standards: International Regulatory Response to the Failure of BCCI*, 26 GEO. WASH. J. INT'L L. & ECON. 241 (1992).

97. Regulation K, 12 C.F.R. § 211.25(c)(ii) (1993).

98. *Id.* § 211.25(c)(1)(ii)(A).

99. *Id.* § 211.25(c)(1)(ii)(B)-(C).

100. *Id.* § 211.25(c)(1)(ii)(D).

101. *Id.* § 211.25(c)(1)(ii)(E).

102. Richard Dale, *Reflections on the BCCI Affair: A United Kingdom Perspective*, 26 INT'L LAW. 949, 951 (1992) (emphasis in original). See also Alford, *supra* note 96, at 272-73 (stating that the reaffirmation of the comprehensive, consolidated supervision was a response to the BCCI affair, not an effort to keep banks from the Third World out of U.S. markets.); RICHARD DALE, INTERNATIONAL BANKING DEREGULATION 199-202 (1991) (questioning the exception to the principle of comprehensive, consolidated supervision that allows for coordinated supervision of bank holding companies with separately incorporated subsidiaries in different countries).

banks.”¹⁰³ Professor Scott supports the principle of consolidated supervision, saying that, if bank regulators from two countries are responsible for the supervision of an international bank, then neither regulator “is in the position to determine the safety and soundness of the entire operation, and matters can easily fall between the cracks.”¹⁰⁴ State bank regulators in the U.S. and the European Union (EU) have jumped on the bandwagon. As a result of the BCCI affair, the New York State Banking Department requires foreign banks operating in New York to be supervised on a comprehensive, consolidated basis by a home-country regulator who cooperates with New York authorities.¹⁰⁵ The EU calls for consolidated supervision by the home-country bank regulator,¹⁰⁶ and British commentators have urged that it be applied in a rigorous manner.¹⁰⁷

This unquestioned faith is based, in part, on the common sense notion that only consolidated supervision of a bank with offices in more than one country can produce a “bird’s eye view” or the “big picture” of the entire international banking organization. Some commentators have said that banks with complex organizational structures can exploit gaps in regulation unless one bank regulator is allocated the responsibility of supervising the entire banking group.¹⁰⁸ The rationale assumes that bank

103. Joseph J. Norton, *Introductory Observations*, 26 INT’L LAW. 943, 944 (1992) (emphasis added). See also Fanikos, *supra* note 2, at 495 (“[c]onsolidated home-country review is the only method for making a global determination as to whether the foreign bank operates in a financially sound and acceptable manner [footnote omitted]”); Daniel M. Laifer, Note, *Putting the Super Back in the Supervision of International Banking, Post-BCCI*, 60 FORDHAM L. REV. S467, S479-83 (1992) (“no one regulatory authority was watching ‘the big picture’”).

104. Hal S. Scott, *Supervision of International Banking Post-BCCI*, 8 GA. ST. U. L. REV. 487, 493 (1992).

105. CUOMO, *supra* note 82, at 101. See also John G. Heimann, *Report of the State of New York Banking Department Superintendent’s Advisory Committee on Transnational Banking Institutions — Summary of Recommendations*, 26 INT’L LAW. 987, 988 (1992).

106. The EU’s adherence to the principle is established in a number of directives from the Council of Ministers. See Council Directive 83/350 of 13 June 1983 on the Supervision of Credit Institutions on a Consolidated Basis, 1983 O.J. (L 193) 18 (establishing the principle of home-country supervision) (First Consolidated Supervision Directive); Second Council Directive 89/646 of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780, 1989 O.J. (L 386) 1 (commonly referred to as the Second Banking Directive). See also the Second Consolidated Supervision Directive, adopted by the Council of the European Community on April 6, 1992. This was implemented on April 6, 1992, and replaces the First Consolidated Supervision Directive of June 13, 1983. Council Directive 92/30/EEC of 6 April 1992 on the Supervision of Credit Institutions on a Consolidated Basis, 1992 O.J. (L 110). An exception to the principle is allowed for the instance where a bank, like BCCI, is incorporated in one jurisdiction, but most of its operations are based in another jurisdiction. Then, the banking regulator in the second jurisdiction is primarily responsible for supervision. Under this scheme, the Bank of England, not the Institut Monetaire Luxembourgeois (Monetary Institute of Luxembourg) (IML) or the Inspector of Banks and Trusts of the Cayman Islands, would have been primarily responsible for regulating BCCI.

107. See, e.g., Sara Walker, *The Bank of England as Supervisor*, 6 BUTTERWORTHS J. INT’L BANKING & FIN. L. 489, 494 (1991).

108. Indeed, BCCI did just this by incorporating holding companies in Luxembourg (BCCI Holdings and BCCI S.A.) and the Cayman Islands (BCCI Overseas), while operating out of London, England (BCCI S.A. and, to some extent, BCCI Overseas). See David

regulators in different countries cannot effectively act in concert to ensure that every part of a complex international banking group is adequately supervised, *i.e.*, inevitably, there will be gaps.¹⁰⁹ This may be a needlessly pessimistic approach,¹¹⁰ but, for present purposes, the crucial point is that the approach is a tragic and ironic one because of its protectionist effects.

2. *The Two-Tiered International Banking Market*

From time to time, Federal Reserve officials have denied they seek to reduce foreign bank presence in the U.S. or protect domestic banks from foreign competition.¹¹¹ The effect of applying the mandatory standard of home-country comprehensive, consolidated supervision, however, is likely to be the denial or restriction of market access to banks from LDCs and NICs. In Professor Niebuhr's language, the value of free trade in banking services is sacrificed in favor of the value of rooting out perceived evil foreign banks.

Judging which foreign bank regulators satisfy the mandatory standard of comprehensive, consolidated supervision in order to root out the evil has interesting implications for the pattern of world trade in banking services. Regulators from certain countries are likely to be found deficient, thus their banks are likely to be excluded from the U.S. market or have an especially difficult time entering it. The list of countries whose bank regulators will not "make the grade" is easy to forecast—Latin American, Asian, and African countries,¹¹² *i.e.*, those from most LDCs

Lascelles, *First Steps Toward Tougher Regulation*, FIN. TIMES (London), Sept. 2, 1991, at 13, col. 1. As William Taylor, former Staff Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, argued in the BCCI context: "no one country had a clear view of the BCCI's worldwide activities or the responsibility to supervise the company on a consolidated basis." 77 FED. RES. BULL. 569, 571 (1991).

109. See, e.g., *Regulation of Foreign Banks: Hearing before House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. 5, 68 (1991) (testimony and prepared text of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System).

110. See BHALA, *supra* note 3, at ch. IV (arguing that why one bank regulator exercising comprehensive, consolidated supervision is more effective at penetrating the bank's organizational complexity than a group of regulators from the countries in which the bank operates if this group pools its resources and knowledge is less than clear).

111. For example, Robert P. Forrestal, President, Federal Reserve Bank of Atlanta, stated that "I am aware that some people argue that [FBSEA] was a thinly veiled attempt by the U.S. Congress to reduce foreign bank presence in the United States However, U.S. policy has long sought to ensure that foreign and domestic banks have a fair and equal opportunity to participate in our markets." *Quoted in Fed Unlikely to End Foreign Bank Activity in Light of FDICIA*, 58 Banking Rep. (BNA) 1071 (June 15, 1992). See also *Basle Committee on Banking Supervision Issues New Standards to Prevent Fraud*, 59 Banking Rep. (BNA) 82, 83 (July 13, 1992) (denial by E. Corrigan, former President, Federal Reserve Bank of New York, that protectionism was a motive behind the response of the BIS to the BCCI affair).

112. Fernando A. Capablanca, *Making Waves*, 50 LATINFINANCE TF52, Sept. 1993, available in LEXIS, News Library, Mags File, at *2 (stating that both larger and smaller Latin American countries are unlikely to meet the requirement of comprehensive, consolidated supervision); Gary N. Kleiman, Comment, AN RX TO SPUR GLOBAL FINANCIAL SERVICES, AM. BANKER, Aug. 9, 1993, at 19 ("[c]onsolidated oversight rules embraced last year in the wake of the Bank of Credit and Commerce International scandal have barred the expansion of Latin America-based and Asia-based groups, notably in the United

and NICs.¹¹³ This list will, therefore, include India and Malaysia, the two countries in which Maharajah Bank is principally located. Put bluntly, the Reserve Bank of India and Bank Negara, the respective bank regulators in India and Malaysia responsible for supervising Maharajah Bank, are unlikely to make the grade in the judgment of the Federal Reserve. Accordingly, Maharajah Bank will be denied access to the U.S. market.

Conversely, an exclusive "club" of bank regulators from the U.S., western Europe, and Japan is likely to develop. Bank regulators from the G-10 countries will be judged by the Federal Reserve to provide the requisite supervision:

One would like to think, however, that *foreign banks based in industrialized countries, such as Japan and countries in the European Community*, will have little difficulty in establishing that these standards [for comprehensive, consolidated supervision] are satisfied; however, it would likely create significant compliance burdens if every foreign bank, even from these countries, is required to establish in each application that its home-country meets these requirements. It would seem far more efficient if the [Federal Reserve] Board could assess at least the *principal industrialized nations* in this regard independent of the application process and perhaps publish a list of countries which it believes satisfy the comprehensive consolidated supervision standard.¹¹⁴

Regulators from other G-10 countries that adopt the Basle Committee's recommendation on comprehensive, consolidated supervision are likely to view U.S. banks favorably because of their favorable judgment of U.S. bank regulators. In this paradigm, comprehensive, consolidated supervision is a euphemism for the true underlying requirement — a foreign bank seeking to open an office in the U.S. should come from a club country.

The result may be a two-tiered market in international banking. In one market, banks from the G-10 countries will predominate. Citibank, Chase Manhattan Bank, National Westminster Bank, Barclays, Bank of

States, where the principles are embodied in the Foreign Bank Supervision Enhancement Act"); James R. Kraus, *Fed Approves Foreign-Bank Rules; Program to Control Entry was Mandated by Congress*, AM. BANKER, Apr. 3, 1992, at 5 ("[T]he regulations are likely to fall most heavily on banks from developing countries, which may not be subject to consolidated supervision and where supervision may not be up to U.S. standards."). See also James R. Kraus, *Venezuela Says New Bank Supervisory Law Satisfies U.S. Requirement*, AM. BANKER, Nov. 16, 1993, at 9 (concerning the enactment of a new Venezuelan bank regulatory law that might meet the comprehensive, consolidated supervision requirement).

113. See UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *NEW ISSUES FOR TRANSNATIONAL COOPERATION IN TRANSNATIONAL BANKING* (1992); Steve Lohr, *U.N. Study Assails the Way B.C.C.I. Was Shut by Western Central Banks*, N.Y. TIMES, Feb. 5, 1992, at D7. The Federal Reserve readily acknowledges that many countries simply do not exercise comprehensive, consolidated supervision. See *FBSEA Application Bottleneck Soon Will Disappear*, *Atlanta Fed Chief Says*, 60 BANKING REP. (BNA) 275 (Mar. 1, 1993) (quoting Robert P. Forrestal, President, Federal Reserve Bank of Atlanta, as saying that "[i]n many countries, this concept of consolidated supervision has not yet taken root").

114. Robert E. Hand, *How Foreign Banks in the United States Are Dealing with the Changing Legal and Supervisory Environment*, 26 INT'L LAW. 1015, 1017 (1992) (emphasis added).

Tokyo, Dai-ichi Kangyo Bank, Deutsche Bank, Dresdner Bank, Union Bank of Switzerland, Credit Suisse, and others will be the key players in the famous G-10 financial markets in New York, London, Tokyo, Frankfurt, and Zurich. Relatively few banks from the LDCs and NICs will be allowed to establish operations in these centers, and their market presence will be minimal. Banks from the LDCs and NICs—such as Maharajah Bank in this case and, in reality, Malayan Banking Berhad (Malaysia), Bank Negara Indonesia (Indonesia), Bank of Baroda (India), Bank of Commerce and Development (Egypt), Bahrain Middle East Bank (Bahrain), and Banco Frances del Rio de la Plata (Argentina)—will be consigned to the second market. Their financial centers will be peripheral—Kuala Lumpur, Jakarta, Bombay, Cairo, Bahrain, and Buenos Aires. The mandatory standard of comprehensive, consolidated supervision—if applied by G-10 countries, in addition to the U.S., pursuant to the Basle Supervisors Minimum Standards Paper—will be the device that separates banks into the first or second tier.

Interestingly, Mexico could be an example of a second-tier country. NAFTA specifies that “[n]o Party [*i.e.*, the U.S., Canada, or Mexico] may adopt any measure restricting any type of cross-border trade in financial services by cross-border financial service providers of another Party. . . .”¹¹⁵ The clear thrust of Chapter 14 of NAFTA is on liberalizing market access. Yet, the application of a large Mexican bank, Banamex, to establish a branch in Miami was denied by the Federal Reserve.¹¹⁶ The reason was that the Mexican banking authority did not examine banks in a consolidated manner locally, nor did it monitor their overseas operations.¹¹⁷ The Banamex rejection caused banks from other Latin American countries to curtail their plans for expansion in the U.S.¹¹⁸

C. THE IRONY: TRANSPARENCY

1. *The Incongruity with GATS Article III*

The problem of transparency of a non-tariff barrier concerns whether the nature of the barrier (as well as the manner in which it is implemented) is plainly evident in the case of Maharajah Bank. Non-tariff barriers potentially are more sinister and pernicious than tariff barriers, because they are less obvious, more hidden, more transparent, and more subjective than tariffs. Article III of the GATS requires each Party to publish promptly all relevant laws, regulations, and administrative guidelines that affect trade in services.¹¹⁹ Each Party is obligated to respond promptly to requests for specific information regarding its laws, regulations, and administrative guidelines and to establish an “enquiry point”

115. NAFTA, *supra* note 89, art. 1404. This is subject to certain limitations set forth in Annex VII(B) of each Party's schedule.

116. To be sure, the application was submitted before NAFTA entered into force.

117. Kleiman, *supra* note 112, at 19.

118. *Id.*

119. GATS, *supra* note 5, art. III:1.

that will provide such information.¹²⁰

In three respects, the post-BCCI legal regime for regulating Maharajah Bank is incongruous with these GATS provisions. First, which foreign bank regulators, in the eyes of the Federal Reserve, offer comprehensive, consolidated supervision is unclear. Accordingly, every bank that wants to establish a branch, agency, or representative office must attempt to prove that its home-country regulator provides comprehensive, consolidated supervision.

This raises the second incongruity. The GATS provisions imply that the nature of the measures enacted by a party are clear. But, how does the Federal Reserve interpret comprehensive, consolidated supervision? Maharajah Bank, as an applicant, may be hampered by a lack of certainty as to what must be proven to the Federal Reserve. To be sure, Section 211.25(c)(1) of revised Regulation K, discussed above, attempts to help resolve the issue;¹²¹ however, in doing so, the regulation raises a bevy of new issues that highlight the fact there is no widely accepted definition of "comprehensive, consolidated supervision."

What is the home-country of Maharajah Bank?¹²² The only time the answer is easy is when a one-parent, foreign bank is incorporated in a country, with its principal banking operations conducted there as well. But, Maharajah Bank, not unlike BCCI and other international banking groups, is incorporated in one jurisdiction (India) and has its principal place of business in another jurisdiction (Malaysia).¹²³ In order to obtain a Federal Reserve license, will Maharajah Bank have to choose the country with the regulator that the Federal Reserve perceives to be "tougher" for its "home"? Is this the Reserve Bank of India, or Bank Negara?

Who must prepare the information received by the home-country bank regulator, be it the Reserve Bank of India or Bank Negara?¹²⁴ Is that regulator expected to send examiners around the globe to check each office of a foreign bank from the regulator's country? Or, could the Reserve Bank of India or Bank Negara permissibly rely on reports prepared by independent auditors—as the Bank of England and IML did with respect to BCCI? Should there be independent verification of the information that is provided? The use of independent auditors as bank examiners is a matter over which Maharajah Bank has very little control.

120. *Id.* art. III:4.

121. See *supra* notes 92-101 and accompanying text.

122. This problem is created by Regulation K, 12 C.F.R. § 211.25(c)(1)(A) (1993). See Scott, *supra* note 104, at 493 (calling for the establishment of a procedure to determine the home-country of a bank); BHALA, *supra* note 3, at ch. IV (commenting on Professor Scott's suggestions).

123. BCCI Holdings, incorporated in Luxembourg, was the top-tier holding company of the BCCI group. BCCI (Luxembourg) S.A., incorporated in Luxembourg, and BCCI (Overseas), incorporated in the Cayman Islands, were the principal operating subsidiaries. The nerve center of BCCI, S.A., was in London, England. See BHALA, *supra* note 3, at xxi, chart I.

124. This problem is created by Regulation K, 12 C.F.R. § 211.25(c)(1)(ii)(B)-(C) (1993).

No foreign bank applicant can compel its home-country regulator to hire a staff of full-time examiners who are civil servants if this is what the Federal Reserve will require for comprehensive, consolidated supervision.¹²⁵

What procedures are "adequate" for monitoring and controlling the world-wide activities of Maharajah Bank?¹²⁶ Must Maharajah Bank prove to the Federal Reserve that it has obtained permission from its home-country regulator to establish each of its overseas offices? Or, will a sensible strategic expansion policy suffice?¹²⁷

To what extent does comprehensive, consolidated supervision imply that a foreign bank regulator, such as the Reserve Bank of India or Bank Negara, must have significant powers to take enforcement actions against banks from its country and, moreover, have a "proven track record" of prosecuting banks? Obviously, different bank regulators have different remedial powers and different approaches to investigation and enforcement matters.¹²⁸ What is the role of the bank regulator in conducting investigations and commencing enforcement actions? Must the source of the foreign bank regulator's power be explicit in foreign law? Foreign bank applicants will have to deal with these uncertainties and perhaps err on the side of attempting to demonstrate to the Federal Reserve that

125. See BHALA, *supra* note 3, at chs. IV (discussing a misplaced burden) & VIII (discussing the problem of independent auditors).

126. This problem is created by Regulation K, 12 C.F.R. § 211.25(c)(1)(ii)(A) (1993), which fails to specify what would be adequate.

127. In addition to the issues identified above, there are still more troublesome matters:

Does supervision necessarily require on-site examination? Should consolidated supervision cover nonbank subsidiaries or affiliates? Do the European Community countries, which have adopted the EC Directive on the Supervision of Credit Institutions on a Consolidated Basis, meet the requirement?

Serge Bellanger, *Stormy Weather: The FBSEA's Impact on Foreign Banks*, 25 BANKERS MAG. 7, 8 (Nov.-Dec. 1992).

128. For example, the Federal Reserve takes an active role in investigation and enforcement, and has broad powers under the Federal Deposit Insurance Act; 12 U.S.C. §§ 1811, 1834b (1988), and can, for example, issue cease and desist orders (12 U.S.C. § 1818(b)), assess civil money penalties (12 U.S.C. § 1818(i)), and remove officers and directors of a bank from their positions and prohibit them from working in the banking industry (12 U.S.C. § 1818(e)). Indeed, the Federal Reserve used these powers in the BCCI affair. BCCI was assessed a \$200 million civil money penalty for secretly owning and controlling First American. See *July 29, 1991 Federal Reserve Order*, *supra* note 55, ¶¶ 246-58 at 92-98. Removal and prohibition orders were issued against a number of individuals involved. *Id.* One can fairly say that the American approach to investigation and enforcement is an aggressive one.

The Bank of England provides a sharp contrast, and, traditionally, is rather passive and content to leave the pursuit of wrongdoers to Scotland Yard, the Serious Fraud Office, or other formal law enforcement authorities. In the aftermath of the BCCI case, the Bank of England was singled out for failing to pursue leads regarding fraudulent transactions and the manipulation of accounts aggressively. See BHALA, *supra* note 3, at ch. IV (discussing the Bank of England's failure to pursue the truth); THE RIGHT HONOURABLE LORD JUSTICE BINGHAM, *INQUIRY INTO THE SUPERVISION OF THE BANK OF CREDIT AND COMMERCE INTERNATIONAL* (Report prepared for The Right Honorable Norman Lamont, MP, Chancellor of the Exchequer, and the Right Honourable Robin Leigh-Pemberton, Governor of the Bank of England) (Oct. 22, 1992).

their home-country regulators are "tough." How they might show this is unclear.

The third incongruity between GATS and the post-BCCI legal regime is of concern to any foreign bank from a country that does not engage in comprehensive, consolidated supervision. Under FBSEA, the Federal Reserve (in consultation with the Secretary of the Treasury) is required to publish guidelines for the evaluation of applications of banks from these countries by December 19, 1992.¹²⁹ Heretofore, no such guidelines have been issued.¹³⁰ Consequently, foreign banks, including Maharajah Bank, that apply for a Federal Reserve license for a proposed branch, agency, or representative office potentially face four uncertainties: What does comprehensive, consolidated supervision mean? Does the bank's home-country regulator exercise comprehensive, consolidated supervision? If not, can anything be done to rectify the problem? If so, what should be done?

Until the Federal Reserve publishes the long overdue guidelines, foreign banks must guess at the answer to the last question. At one extreme, foreign banks from countries that do not exercise comprehensive, consolidated supervision may be absolutely barred from the U.S. market. At the other extreme, the Federal Reserve may undertake to exercise such supervision as a condition of allowing a foreign bank into the U.S. Both extremes are unpalatable.

The first is blatantly protectionist and will impact banks from LDCs and NICs with the greatest force. Essentially, only banks from the G-10 countries will be assured of access to the U.S. market. The second implies a commitment of Federal Reserve resources that the Federal Reserve is, in all likelihood, unwilling, and perhaps unable, to make. The second extreme also implies an arrogant extraterritorialism: the Federal Reserve sends the message to certain foreign bank regulators that "you cannot do the job we think you should do, so we will do it instead."¹³¹

Thus far, the Federal Reserve has adopted a case-by-case approach toward determinations under the comprehensive, consolidated supervision standard. This is not only cumbersome, but also could result in inconsis-

129. 12 U.S.C. § 3105(e)(7) (Supp. IV 1992).

130. On March 8, 1994, William A. Ryback, associate director of banking and supervision and regulation for the Board of Governors of the Federal Reserve System, said that work on an examination manual regarding the regulation of foreign banks is "about 95% done." *Bank Agencies Near to Finishing Some International Banking Guidance*, 62 Banking Rep. (BNA) 511 (Mar. 10, 1994). When the manual will be publicly available is not known. Whether the manual will provide useful guidance on issues relating to banks from countries held not to practice comprehensive, consolidated supervision is not clear either.

131. While Robert P. Forrestal, the President of the Federal Reserve Bank of Atlanta, defends the home-country comprehensive, consolidated supervision requirement as "essential to sound economic progress," he agrees that "FBSEA has proven frustrating to those banks that have applications pending and may even seem arrogant to foreign countries that are, in effect, asked to reform their bank regulatory systems if they want their banks to do business in the United States." Robert P. Forrestal, President, Federal Reserve Bank of Atlanta, *quoted in FBSEA Application Bottleneck Soon Will Disappear*, Atlanta Fed Official Says, 60 Banking Rep. (BNA) 276 (Mar. 1, 1993).

tent determinations over time. Indeed, "[t]he [Fed's] authority is so wide that it may decide consolidated supervision exists for one bank in a certain country but not for another bank in the same country. . . ." ¹³² Presumably, over time, the Federal Reserve should develop a "feel" for bank regulators from different countries and draw on its reservoir of experience with these regulators to determine whether they satisfy the standard. Yet, the Federal Reserve will be in a difficult position. On the one hand, its determinations should be consistent over time to afford certainty and predictability to foreign bank applicants. On the other hand, the Federal Reserve must be continually vigilant about changes in the nature and quality of regulation provided by foreign authorities. Inevitably, its determinations will, or should, accommodate these changes. Whether the Federal Reserve can strike the correct balance remains to be seen.

2. *The Incongruity with GATS Article IV*

If the premise that banks from LDCs will be disproportionately affected in an adverse manner by the mandatory standard of comprehensive, consolidated supervision is true, then still another incongruity between the GATS and the new U.S. legal regime exists. The GATS requires parties to give special consideration to the needs of service providers in developing countries. Maharajah Bank, while an example of this special class, will not, nevertheless, receive any favored treatment under the post-BCCI legal regime in the U.S. Article IV seeks to facilitate the increased participation of developing countries, such as India and Malaysia, in world trade in services by obligating parties to negotiate specific commitments aimed at "the liberalization of market access in sectors and modes of supply of export interest to them [*i.e.*, developing countries]." ¹³³ The parties must establish "contact points" to "facilitate the access of developing countries' service providers to information." ¹³⁴ "Special priority" in these matters must be given to the "least" developed countries. ¹³⁵

Nothing in FBSEA or revised Regulation K, or in the Basle Committee's Minimum Standards Paper, suggests any consideration for the interests of developing or least developed countries. To the contrary, the mandatory standard of comprehensive, consolidated supervision is based on the recommendation of the Basle Committee whose membership is exclusively limited to the G-10 countries. The standard is a rule of market access written by the members of the club for the club. Its nature and ambiguity operates against banks with global aspirations from non-members.

132. William O. Bascom, Chief, Bureau of International Banking, Florida Banking Department, *quoted in* James R. Kraus, *Florida Aide Assails Fed on Foreign-Bank Role*, AM. BANKER, May 1, 1992, at 21.

133. GATS, *supra* note 5, art. IV:1(c). The parties also are obligated to negotiate specific commitments to grant service providers from developing country access to technology and distribution channels. *See id.* art. IV:1(a)-(b).

134. *Id.* art. IV:2.

135. *Id.* art. IV:3.

Suppose a group of bankers in Sierra Leone wants to organize a bank, Sierra Leone International Bank (SLIB), with offices, not only in other African countries, but in London, Tokyo, and New York as well. Like the bankers at Maharajah Bank, SLIB officials correctly understand that SLIB will not be a major force in international finance without at least a representative office, and preferably a branch or agency, in each of these three cities. Suppose further that the Bank of England and the Bank of Japan, like the Federal Reserve, have implemented the Basle Committee's recommendation regarding home-country, comprehensive, consolidated supervision into their municipal law. In deciding whether to authorize SLIB to do business in their countries, regulators from the Bank of England, Bank of Japan, and Federal Reserve will assess whether the Bank of Sierra Leone (that country's central bank and bank regulatory authority) exercises comprehensive, consolidated supervision. This is the same evaluation made by the Federal Reserve with respect to Maharajah Bank's application; does the Reserve Bank of India (India's bank regulator) exercise this form of supervision?

Almost certainly, the Bank of Sierra Leone, like the Reserve Bank of India, fails to meet the standard. Nothing in the Bank of Sierra Leone (Amendment) Act 1994 suggests that the Bank of Sierra Leone exercises comprehensive, consolidated supervision;¹³⁶ moreover, in all likelihood, it cannot engage in that kind of supervision because of a lack of resources. Depending on how comprehensive, consolidated supervision is operationalized, the policy may call on bank regulators from NICs and LDCs to exercise a level of worldwide supervision that may be difficult for any LDC and many NICs to meet. Certainly, the Bank of Sierra Leone does not have the resources to hire a full-time staff of examiners dedicated to examining the foreign operations of banks from Sierra Leone. This entails not only the costs of overseas travel and lodging for the examiners, but also special training for them on international banking problems. The Bank of Sierra Leone will have to rely on assistance from the host-country bank regulators—the Bank of England, Bank of Japan, and Federal Reserve.

Assuming such assistance is not forthcoming, SLIB is likely to be denied authorization from the three G-10 bank regulators. In turn, SLIB's attempt to ascend to the ranks of the great players in international finance may be thwarted and the dominance of international banks from the G-10 countries may be perpetuated. Therefore, in contrast to the mandates of the GATS concerning the establishment of "contact points" and "special priority" for the least developed countries like Sierra Leone, home-country comprehensive, consolidated supervision can serve to retard the development of cross-border banking institutions from NICs and LDCs.

136. See Bank of Sierra Leone (Amendment) Act 1994 (on file with author).

To be consistent with GATS, the Bank of England, Bank of Japan, and Federal Reserve—the keepers of banking and financial expertise and possessors of the necessary supervisory resources—should help banking regulators from NICs and LDCs like the Bank of Sierra Leone by sharing their knowledge and resources. The GATS encourages the developed countries to eschew using their own ideas of what constitutes good regulatory practice as a shield to exclude foreign banks. Rather, the G-10 bank regulators ought to work with bank regulators from the NICs and LDCs to develop and implement supervisory standards that make sense in the economic, political, and cultural context of those countries and regions. This ought to be done with a view to strengthening banks from NICs and LDCs and enhancing their ability to compete in every financial center.

V. ACT III: THE LIMITED ROLL-UP

THE SCENE

Assume Maharajah Bank's application to the Federal Reserve to open a branch in New York is approved and the Bank commences operations. Maharajah Bank seeks to meet the banking needs of its NRI customers and, over time, identifies a significant demand for repatriation of funds. Many NRIs want to deposit funds in Maharajah Bank in insured accounts and subsequently transfer portions of these funds to their families in India. In seeking to provide repatriation services, however, the Bank confronts another alarming barrier: the subsidiary requirement.

A. THE SUBSIDIARY REQUIREMENT

Suppose that Maharajah Bank applies to open a branch (as opposed to an agency or representative office) in New York and, pursuant to the above laws and regulations, the application ultimately is approved. Because of Maharajah Bank's strategy to service NRIs in the New York metropolitan area and repatriate their earnings to their families in India, the Bank seeks to take retail deposits. Under FBSEA and revised Regulation K, no foreign bank branch established after December 19, 1991 can accept federally-insured retail deposits.¹³⁷ To maintain domestic retail deposit accounts of less than \$100,000 that require deposit insurance protection, a foreign bank must establish at least one banking subsidiary in the U.S. for that purpose and obtain deposit insurance for that subsidi-

137. Agencies and representative offices of foreign banks are unaffected because they are legally barred from accepting retail deposits. See Regulation K, 12 C.F.R. § 211.22(b), (d), & (u) (1993) (definitions of "agency," "branch," and "representative office," respectively); *supra* notes 36 & 45.

In addition, branches established by foreign banks before December 19, 1991—the date of enactment of FBSEA—are unaffected. This is because of a grandfather rule that allows insured branches that held retail deposits of less than \$100,000 before that date to continue to do so. See 12 U.S.C. § 3104(c) (Supp. IV 1992).

ary.¹³⁸ This requirement repeals the IBA provisions that allowed U.S. branches of foreign banks to obtain deposit insurance from the FDIC.

This "subsidiary requirement" means that if a foreign bank branch established after December 19, 1991 wants to accept insured retail deposits, it must convert from a branch to a subsidiary. Of course, as a practical matter, no bank (domestic or foreign) can engage in the retail deposit-taking business without obtaining FDIC insurance. Depositors demand such insurance as a trade off for the low returns of a bank account relative to money market accounts, cash management accounts, mutual funds, and other products offered by securities firms. The new rule is, therefore, a limited "roll up" mandate directed toward foreign banks that want to begin retail banking activities in the U.S. A foreign bank like Maharajah Bank that wants to expand into this activity will have to roll up its branch into a subsidiary, or establish a subsidiary in addition to its branch, to do so.

Accordingly, Maharajah Bank will have to apply to the Federal Reserve under the Bank Holding Company Act (BHC Act) to establish a *de novo* subsidiary or acquire an existing subsidiary. Maharajah Bank is subject to the BHC Act through FBSEA by virtue of maintaining a branch in the U.S.¹³⁹ The BHC Act bars any company from becoming a "bank holding company" without prior Federal Reserve approval.¹⁴⁰ Maharajah Bank would become a bank holding company by virtue of its control over a subsidiary bank in the U.S.¹⁴¹ This application process was not altered by FBSEA or the revisions to Regulation K.

B. THE TRAGEDY: MORE COSTS

1. *The Capital Differential*

The subsidiary requirement is further evidence of the Niebuhr-like tragedy of the post-BCCI legal regime. It represents another non-tariff barrier to foreign bank entry in the post-BCCI foreign bank regulatory regime.¹⁴² This is because the subsidiary requirement imposes a serious

138. 12 U.S.C. § 3104(c)(1)(A), (B). Initially, the statutory language incorrectly omitted the word "retail;" however, the Federal Reserve enforced the statute only with respect to retail deposit-taking activity. See James R. Kraus, *Foreign Banks Fear Burdens; Congress Added U.S. Rules Atop State Laws*, AM. BANKER, Dec. 27, 1991, at 2; Clyde Mitchell, *Foreign Bank Licensing Options Under FDICIA*, N.Y. L.J., Feb. 26, 1992, at 3; Michael L. Whitener, *New Federal Reserve Board Regulations Regarding Foreign Banks in the United States*, 26 INT'L LAW. 1007, 1011 (1992). The statute was later corrected by the Housing and Community Development Act of 1992, Pub. L. No. 102-550, § 1604(a)(11), 106 Stat. 3672, 4083 (codified at 12 U.S.C. § 3104 (West Supp. 1994)).

139. 12 U.S.C. § 3106(a) (Supp. IV 1992).

140. 12 U.S.C. § 1842(a) (1988).

141. *Id.* § 1841(a)(1). A "control" relationship exists if any one of three tests is satisfied: the company owns 25% or more of the voting securities of the subsidiary bank; the company controls the election of a majority of the board of directors of the subsidiary bank; or the company exercises a controlling influence over the management or policies of the subsidiary bank. *Id.* § 1841(a)(2).

142. FBSEA requires the Secretary of the Treasury and federal bank regulatory agencies to consider whether all U.S. operations of foreign banks ought to be conducted

additional cost on Maharajah Bank. The Bank faces the higher cost of establishing and operating a separately capitalized U.S. subsidiary, thereby making deposit-taking activity in the U.S. less appealing:

If formal requirements for entry into a particular market by means of establishing an office raise the costs for an offshore entity relative to the gains foreseen from that mode of entry, the offshore organization will remain offshore and participate in that market only by offering its services peripherally. If the U.S. indulges in raising this kind of barrier, whether for formalistic or protectionist reasons, ultimately the result of the indulgence will be to drive the market for U.S.-dollar-denominated financial instruments and products offshore into markets that permit the entrants to choose freely the corporate structure that best responds to the particular entity's own assessment of its needs.¹⁴³

The reason for the ineluctable new cost lies in the differences in the capital of branches and subsidiaries. Deposits in a bank branch are backed by more capital than deposits in a bank subsidiary. In the branch, deposits and other liabilities are backed by the capital of the entire banking organization, because the branch is an extension of the organization. The subsidiary is a legally-distinct, separately-capitalized entity. Invariably, the amount of capital of a foreign bank's subsidiary in the U.S. will be less than that of the entire foreign banking organization. Thus, there is less capital to back the deposits and other liabilities of a subsidiary than a branch in the event the subsidiary or branch incurs losses and must charge the losses against capital.

This capital differential has two important implications. First, branches are more competitive than subsidiaries.¹⁴⁴ The loan capacity of a subsidiary is always less than that of a branch because this capacity is based on

through subsidiaries. Pub. L. No. 102-242, § 215, 105 Stat. 230 (1991). Their recently-produced study concludes that an "across-the-board roll up" was not presently needed. DEPARTMENT OF THE TREASURY AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, SUBSIDIARY REQUIREMENT STUDY (1992) [hereinafter SUBSIDIARY REQUIREMENT STUDY]. The conclusion is based on an analysis of several factors, most notably: (1) regulatory practices and safety and soundness; (2) national treatment and competitive equity; (3) *international negotiations for liberalized trade*; (4) the need to prohibit money laundering and illegal payments; (5) the tax liability of foreign banks; (6) differences in treatment of United States creditors under bankruptcy and receivership laws; and (7) international trade. *Id.* See also *Treasury, Fed Advise Against Requiring Only U.S. Subsidiaries of Foreign Banks*, 60 Banking Rep. (BNA) 14 (Jan. 4, 1993).

Those who authored the subsidiary requirement study may not be the best suited to objectively analyze these factors—clearly, they are interested parties. Holding an open congressional hearing on the issue would allow for greater transparency as to deliberations and invite greater diversity among participants in the deliberations. More importantly, however, the fact that the authors considered international negotiations for liberalized trade is noteworthy. The argument above suggests that even the more limited version of the subsidiary requirement that was enacted into law represents a non-tariff barrier.

143. Cynthia Lichtenstein, *U.S. Restructuring Legislation: Revising the International Banking Act of 1978, for the Worse?*, 60 *FORDHAM L. REV.* S37, S46-7 (1992).

144. As Professor Scott points out, of the \$800 billion total foreign bank assets in the U.S., \$626 billion are in agencies and branches, whereas only \$174 billion are in subsidiaries. Scott, *supra* note 104, at 491.

reduced capital.¹⁴⁵ The interest of U.S. borrowers is for foreign banks to have large lending capacity in order to help preclude the problem of a "credit crunch." But, a decrease in the supply of loanable funds could result from the conversion of foreign bank branches to subsidiary form.¹⁴⁶

Similarly, financial market participants—i.e., banks and securities firms—have a strong incentive to favor a legal regime in which foreign bank operations in the U.S. are well capitalized. A foreign bank branch can engage in a larger volume of trading operations than a subsidiary because of the difference in capital. This extra capacity to conduct transactions is important in the markets for foreign exchange, derivative products, and interbank lending and for the international competitive position of U.S. financial markets:

One important consideration of global capital and its importance to banks that operate around the world, including American banks, relates to all kinds of trading activities, foreign exchange swaps, all kinds of interbank lending to one another.

I would make the point that if you switch to the subsidiary approach, you are going to do a great boon for London, Paris, Rome, Zurich, and all these other cities where these great banks, including the American banks, would be able to trade on the strength of that full capital position when they are doing transactions with one another.

When they came to New York and they traded with one another, they would be utilizing this much smaller capital base subsidiary. I think it would have a profound effect on the status of New York as an international financial center, and the jobs and all the economic benefits that have flowed to the State and city as a result.¹⁴⁷

More generally, a branch may be able to engage in larger and more diverse transactions because of this backing. If so, this suggests that a branch's potential revenues may be greater and its sources of revenue more diverse than would be the case for a subsidiary.

The second implication of the differential capital bases concerns efficiency. A branch can operate more efficiently than a subsidiary because of its larger capital base.¹⁴⁸ The branch can obtain funds at lower cost. Lenders—namely, other banks who lend to the foreign bank in the interbank market and investors who purchase securities issued by the foreign bank—face less risk in dealing with a branch, as opposed to a subsidiary.

145. James R. Kraus, *U.S. Banks Fighting Plan to Curb Foreign Institutions*, AM. BANKER, Nov. 30, 1992, at 2 ("[A] separately capitalized banking subsidiary would have a far lower U.S. lending limit than does a branch, which bases its lending limit on its parent's capital.").

146. See *Regulation of Foreign Banks: Hearing before House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. 104 (1991) (prepared text of Vincent Conlon, Acting Superintendent of Banking, New York State Department of Banking).

147. *Id.* at 55 (testimony of Lawrence R. Uhlick, Executive Director and Counsel, Institute of International Bankers).

148. See *id.* at 8, 78 (testimony and prepared text of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System).

If the subsidiary becomes insolvent, the lenders can look only to the subsidiary's capital to satisfy their claims. Given this competitive advantage of the branch over the subsidiary, there is no surprise that as of June 1992, eighty-two percent of all U.S. assets held in foreign banks were maintained in branches or agencies instead of subsidiaries.¹⁴⁹

Consequently, requiring Maharajah Bank to obtain deposit insurance through subsidiaries forces it to operate in a less efficient manner. The disadvantages of the smaller capital base such as the increased cost of funding makes operating in the U.S. less attractive. The disadvantages are manifest after Maharajah Bank's subsidiary commences operations in the U.S.

2. *Start-up Costs*

Yet, the cost headaches begin well before operations are commenced. Maharajah Bank, or Maharajah Bank Holding Company, will have to generate sufficient capital to downstream to the new U.S. subsidiary which must be capitalized. One way of doing this is for the Holding Company to issue securities and transfer the proceeds from the offering to the Bank in exchange for an obligation from the Bank. A second method is to re-allocate liquid resources that the Bank or Holding Company has on hand. In either case, there is a cost. Selling securities entails both issuance and costs of funding. If equity capital is raised, then dividends must be paid to investors. If debt is issued, then interest must be paid to investors, after paying the costs of issuing the debt. Reallocating existing liquid resources entails opportunity costs. Those resources might have been put to a use that would earn a greater return, but for the subsidiary requirement of FBSEA and revised Regulation K.

C. THE IRONY: ORGANIZATIONAL FORM

1. *The Incongruity with GATS Article XVI*

The subsidiary requirement means that foreign banks that seek deposit insurance do not have a choice as to corporate form. They must provide retail deposit-taking services through a subsidiary. Yet, the GATS prevents Members that have undertaken a market access commitment regarding a sector or sub-sector, unless otherwise specified in a schedule, from implementing "measures which restrict or require specific types of legal entity . . . through which a service supplier may supply a service."¹⁵⁰

149. SUBSIDIARY REQUIREMENT STUDY, *supra* note 142, at 2. See also *Treasury, Fed Advise Against Requiring Only U.S. Subsidiaries of Foreign Banks*, 60 Banking Rep. (BNA) 14 (Jan. 4, 1993).

150. GATS, *supra* note 5, art. XVI:2(e). Interestingly, the subsidiary requirement seems to be at variance with the liberalizing trend in cross-border banking services in other major industrialized countries. France, Germany, the Netherlands, and the United Kingdom insure deposits held in branches of foreign banks. Phillip F. Bartholomew & Vicki A. Vanderhoff, *Foreign Deposit Insurance Systems: A Comparison*, 45 CONSUMER FIN. L.Q. REP. 243, 248 (1991). (At the same time, certain countries—Australia, Canada, Norway, and Sweden, for instance—allow foreign banks to operate only through subsidiaries.) See

There are three ways to attempt to resolve this incongruity: the USTR can eschew entering into a market access commitment on banking; the USTR can reserve the right to impose a subsidiary requirement on foreign banks in a schedule pertaining to a market access commitment; or, the Congress and Federal Reserve can repeal the subsidiary requirement.

The third alternative is the best. Failing to enter into a market access commitment means U.S. consumers of banking services are deprived of benefits resulting from foreign bank competition for their business. Fewer banking services and products may be offered, and those that are available may cost more. The lack of foreign bank competition dampens liquidity, reduces the introduction of new banking innovations, and raises the specter of a credit crunch.¹⁵¹ Specifying the subsidiary requirement in a schedule presupposes it is a sound requirement—which it is not, for the aforementioned reasons concerning costs and efficiency.¹⁵²

2. *The Incongruity with GATS Article VI*

The subsidiary requirement also could be incongruous with a second provision of the GATS, namely, the Article VI:4 requirement that “measures relating to qualification requirements and procedures [and] technical standards” are not “unnecessary barriers to trade” and are “not more burdensome than necessary.” Presumably, this is a “qualification requirement,” in that only a foreign bank’s subsidiary is qualified to maintain insured retail deposit accounts. Arguably, this requirement is also a “technical standard.” Whether the subsidiary requirement is an “unnecessary barrier” or “more burdensome than necessary” could depend, in part, on the outcome of a cost-benefit calculation: are the increased transaction costs and reduced efficiencies imposed on a foreign bank by compelling it to form a subsidiary outweighed by the additional protection afforded to creditors of that subsidiary?

This calculation requires a prognostication regarding two scenarios about Maharajah Bank. In the first scenario, Maharajah Bank’s U.S. subsidiary maintains insured retail deposits and it fails. The subsidiary is liquidated by the FDIC.¹⁵³ In the second scenario, Maharajah Bank’s U.S.

Regulation of Foreign Banks: Hearing before House Comm. on Banking, Finance and Urban Affairs, 102d Cong., 1st Sess. 18 (1991) (statement of Rep. Roth). Indeed, in Germany, deposits in all currencies held in foreign bank branches are insured. In the United Kingdom sterling-denominated deposits are insured.

Certainly, U.S. banks prefer to operate overseas through branches rather than subsidiaries. Generally, 64% of all foreign assets held by U.S. banks abroad are held in branches. SUBSIDIARY REQUIREMENT STUDY, *supra* note 142, at 2 n.1.

Note that Mexico’s subsidiary requirement which will continue to be effective after the transition period ends in the year 2000 would appear to run afoul of the GATS requirement discussed above.

151. See *supra* notes 142-45 and accompanying text.

152. See *supra* notes 146-47 and accompanying text.

153. The liquidation would be conducted under the authority of Federal Deposit Insurance Act, as amended, 12 U.S.C. §§ 1811, 1834b (1988). See especially 12 U.S.C. §§ 1821-23 (concerning the powers and duties of the FDIC as a receiver). The FDIC would be appointed receiver because Maharajah Bank’s subsidiary is an “insured depository institu-

branch maintains such deposits—*i.e.*, the subsidiary requirement does not exist and, therefore, Maharajah Bank makes use of the cheaper corporate form. In this scenario, Maharajah Bank—the parent organization—fails and is the subject of a liquidation proceeding based in Bombay. In which scenario are depositors with accounts over \$100,000 and other creditors better off?

The answer is not clear. In the first scenario, there is a smaller pool of capital backing the failed entity than in the second scenario. Depositors with accounts over \$100,000, as well as other creditors of the failed subsidiary, risk being paid less than the full value of their claims. But, in the first scenario there is no risk that a foreign liquidator will attempt to consolidate the assets of Maharajah Bank's U.S. branch in the Bombay proceeding and stay the claims of its U.S. depositors and other creditors.¹⁵⁴ In the second scenario, the depositors and other creditors risk being forced to participate in the Bombay insolvency proceeding under Indian insolvency law. If so, their claims may not be treated so favorably as would be the case in a U.S. proceeding under federal banking law with the FDIC as receiver. A larger pool of capital, however, backs their claims. The outcome of the cost-benefit calculation is not clear and, indeed, may differ from one case to the next.

In deciding whether the subsidiary requirement is an "unnecessary barrier" or "more burdensome than necessary" under GATS, the interests of the FDIC are relevant. While these interests should be similar to those of depositors with funds of less than \$100,000, they are not co-extensive with those of larger depositors or other creditors (because they do not receive the full benefit of deposit insurance¹⁵⁵). The FDIC's concern about the exposure of the deposit insurance fund to "another BCCI" helps explain the logic in favor of the subsidiary requirement:

The chief argument in favor of requiring foreign banks to conduct operations in the United States via subsidiaries is that, if a foreign bank fails, U.S. regulators can more easily protect persons or entities that deal with the bank's U.S. subsidiary than those that deal with a U.S. branch or agency. The regulators can afford better protection because a subsidiary has its own capital and its own distinct assets and liabilities, is subject to restrictions on transactions with its parent bank, and can survive or fail independently of its owners. A branch or agency, in contrast, has no separate capital, may deal with the

tion." See 12 U.S.C. §§ 1813(c)(2), 1821(c)(1). For a discussion of bank insolvency law, see Peter P. Swire, *Bank Insolvency Law Now That It Matters Again*, 42 DUKE L.J. 469 (1992) (questioning the rationale for special rules for bank insolvency).

154. Even if a liquidation proceeding had been commenced in the U.S., the foreign liquidator might have the power to do this. Indeed, using Section 304 of the federal bankruptcy code (11 U.S.C. § 304 (1988)), the liquidator of BCCI Holdings and BCCI, S.A., attempted to consolidate the assets of BCCI's U.S. agencies into the Luxembourg-based insolvency proceeding and stay creditor actions in the U.S. Ultimately, a settlement was reached between the Luxembourg liquidator and the state bank regulators that allowed \$250 million of BCCI's \$550 million U.S. assets to remain in the U.S. See BHALA, *supra* note 3, at ch. X (discussing foreign insolvency proceedings and the BCCI experience).

155. 12 U.S.C. § 1821(a)(1) (1988).

home office or other branches without restriction, and will fail if the bank as a whole fails.¹⁵⁶

Ideally, the FDIC wants to look to the assets of a separately capitalized subsidiary in the event of a need to make depositors whole if a foreign bank fails. The FDIC is concerned about a scenario in which a foreign bank with U.S. branches that take insured retail deposits becomes insolvent. The FDIC is not likely to be able to reach the foreign bank's assets located outside of the U.S. Nor is the FDIC likely to relish the prospect of litigating with a trustee or receiver of the parent foreign bank in another jurisdiction about who has the right to consolidate the foreign bank's U.S. assets.¹⁵⁷

For three reasons, the FDIC's concern may be overstated. In turn, the possibility that the subsidiary requirement is more burdensome than necessary may be strengthened. First, there are limits on the activities of foreign bank operations in the U.S. Under FBSEA, a state-licensed foreign bank branch is permitted to engage only in those activities that are permissible for a federally-licensed foreign bank branch.¹⁵⁸ In turn, a federally-licensed foreign bank branch can do only what national banks are permitted to do by the OCC.¹⁵⁹ The same limitation on loans made to a single borrower that applies to a national bank also applies to a state or federal branch of a foreign bank.¹⁶⁰ In effect, there is national treatment regarding the activities of a foreign bank branch and a national bank.

The only exception to these limitations expressly accounts for the risks to the FDIC insurance fund. A state-licensed branch or agency of a foreign bank cannot engage in an activity that is not permissible for a federal branch or agency unless the Federal Reserve determines that the activity is "safe and sound" and does not pose a threat to the FDIC's deposit insurance fund.¹⁶¹

Thus, at least in theory, a foreign bank branch engaging in an activity that poses an undue risk to the deposit insurance fund should be an impossibility. As long as these limitations on activities are in effect, there may be no need to force foreign bank deposit-taking activities into subsidiaries. Of course, these limitations do not guarantee that the bank will remain solvent. Bad management, fraud, or poor economic conditions may cause a bank to fail.

Second, single borrower lending limits applicable to foreign bank branches help prevent undue concentrations of credit risk, which, in turn,

156. Michael L. Whitener, *New Federal Reserve Board Regulations Regarding Foreign Banks in the United States*, 26 INT'L LAW. 1007, 1013 (1992).

157. This problem occurred in the BCCI case. The Luxembourg-based receiver attempted—but ultimately was unsuccessful—to obtain control over the assets of BCCI's New York and California agencies. See BHALA, *supra* note 3, at ch. X (discussing foreign insolvency proceedings and the BCCI experience).

158. 12 U.S.C. § 3105(h) (Supp. IV 1992).

159. *Id.* § 3102(b).

160. *Id.* §§ 3102(b), 3105(h)(2).

161. *Id.* § 3105(h)(1).

can lead to problems, or even insolvency, at a foreign bank. Under FBSEA, a state-licensed branch of a foreign bank is subject to the same lending limits as a federal branch. All of the outstanding loans extended by all of the U.S. branches of the same foreign bank to a single borrower are aggregated to calculate the limit on loans to one borrower.¹⁶² This formula is an important safeguard that did not exist in the pre-BCCI legal regime. Under the IBA, each state-licensed branch in the U.S. could lend to the same borrower based on the total capital of the foreign bank, and there was no requirement for aggregating loans.

Third, there are no cases of claims on the FDIC insurance fund arising from the inability of a foreign bank to meet its insured deposit liabilities.¹⁶³ In part, the absence of claims may be due to the stronger capital position of foreign bank branches versus subsidiaries and the pre-BCCI tradition of taking deposits through branches.¹⁶⁴ Moreover, the record in the BCCI case suggests that state banking laws, when used adroitly by state bank regulators, help protect the interests of U.S. creditors of foreign banks.¹⁶⁵ The New York State Banking Department (NYSBD) successfully used state preference laws to ensure that creditors of BCCI's New York agency were paid in full.¹⁶⁶ NYSD employed the technique of "ring-fencing" BCCI's New York agency, that is, sealing it off from its parent foreign bank and affiliates.¹⁶⁷ In effect, the form of BCCI's New York operation—an agency—was disregarded; the state bank regulator treated the agency as if it were a separate entity from its parent organization, BCCI, S.A., in Luxembourg.

VI. CONCLUSION: TOWARDS A MARKET-ORIENTED APPROACH

Reinhold Niebuhr furnishes definitions of "tragedy" and "irony" that fit the post-BCCI legislative and regulatory play in which Maharajah Bank must act if it wants to do business in the U.S. The enactment of FBSEA and revision of Regulation K by Congress and the Federal Reserve, respectively, have tragic effects on the access of foreign banks to the U.S. market and create an ironic incongruity with the efforts of the

162. 12 U.S.C. § 3102(b) (Supp. IV 1992) (regarding federal branches and agencies); 12 U.S.C. § 3105(h)(2) (Supp. IV 1992) (regarding state branches and agencies); Regulation K, 12 C.F.R. § 211.29 (1993).

163. New York State Bar Association, International Law and Practice Section, Committee on International Banking, Securities, and Financial Transactions, *Treatment of Foreign Banks in Bank Restructuring Bills*, 5 INT'L L. PRACTICUM 25, 27 (1992).

164. See *supra* notes 142-49 and accompanying text.

165. To be sure, the world-wide closure of BCCI on July 5, 1991 posed no risk to the FDIC insurance fund because it operated in the U.S. as an agency and, therefore, could not lawfully accept insured retail deposits. See *supra* note 36 (discussing the legal distinction between agencies and branches).

166. See BHALA, *supra* note 3, at ch. III (discussing the irony regarding state banking regulators); ch. V (discussing the performance of state banking regulators in the BCCI case); ch. X (discussing paying claims and the principle of non-discrimination).

167. One could argue that the subsidiary requirement essentially formalizes and federalizes the ring-fencing technique. For a critical analysis of ring-fencing, see *id.* at ch. X.

USTR to negotiate a GATS. In the words of Professor Niebuhr, the legislators and regulators have done "evil in a good cause" and "cover[ed] themselves with guilt in order to fulfill some high responsibility."¹⁶⁸ Therein lies the tragedy. The "virtue" of tougher regulation of foreign banks is, upon closer examination, a "vice" because of the "hidden defect" of protectionism, the irony.

Because of the new foreign bank regulatory regime, Maharajah Bank must obtain a Federal Reserve license to operate a branch, agency, or representative office in the U.S. Maharajah Bank's ability to procure this will depend in large part on a standard of appraisal—home-country, comprehensive, consolidated supervision—that disfavors banks of "its kind." If Maharajah Bank gets the license and subsequently seeks to do what it does best, namely, provide banking services to expatriate workers, then it must incur substantial new costs to convert its branch to, or open anew, a subsidiary. Efforts of the USTR to guarantee access to foreign banking markets for American banks under the auspices of the GATS naturally imply a reciprocal openness to the U.S. market for foreign banks. The non-tariff barriers faced by Maharajah Bank illustrate that America's post-BCCI foreign bank regulatory scheme is not consonant with its international trade policies. Greater efforts to ensure that the U.S. banking market is not closed to foreign banks like Maharajah Bank are needed; otherwise, the many economic benefits brought by them will be lost.

This situation is unacceptable. U.S. policies toward foreign banks and international trade in banking services must be formed in a way that is least destructive to the fundamental value of free trade. At the same time, a minimally interventionist amount of prudential vigilance against infiltration of the U.S. banking market by unsafe, unsound, or fraudulent foreign banks is needed. In their book, *Tragic Choices*, Professors Calabresi and Bobbit effectively use the concept of tragedy and consider approaches to tragic choices, in a manner that illuminates the current unacceptable situation. For them, a tragic choice is one that implies "the rejection of values which are proclaimed to be fundamental."¹⁶⁹ The essence of a tragic choice is, therefore, the sacrifice of a value like free trade—an insight akin to that suggested by Niebuhr's definition of tragedy.

Unlike Niebuhr, however, Calabresi and Bobbit identify the source of a tragic choice: the scarcity of goods or resources. Licenses for foreign banks to operate in the U.S. are conceptually analogous to scarce goods or resources. To be sure, the causes of the scarcity are different. Goods and services may be scarce because of constraints on the factors of production that are used to make them (for example, land, labor, physical capital, and human capital is limited). In contrast, licenses may be scarce because of a rule that limits the number that may be issued. Or, as in the

168. NIEBUHR, *supra* note 1, at vii.

169. GUIDO CALABRESI & PHILLIP BOBBIT, *TRAGIC CHOICES* 195 (1978) [hereinafter *TRAGIC CHOICES*]. See also *id.* at 18, 198.

case of Federal Reserve licensing of foreign banks, they may be scarce because of agency behavior (*i.e.*, the bureaucratic process and associated costs). But, while goods and services may be scarce for real economic reasons and licenses may be scarce for artificial legal and political reasons, the practical effect is the same. The supply of the item cannot expand to meet current demand. There is excess demand for the item. If the market is allowed to operate, a stable equilibrium between supply and demand is reached through a rise in the price of the item.

With respect to scarce goods and resources, decisions must be made about how much to produce and how to distribute what is produced—so-called first- and second-order determinations.¹⁷⁰ The same production and allocation determinations must be made for scarce licenses. First, how many foreign banks should be allowed into the U.S.? Second, which foreign banks should be let in? These decisions lead to an inevitable tension between fundamental values such as life and well-being, on the one hand, and distributional mechanisms to assign entitlements to beneficiaries, on the other hand. Or, in the present context, the decisions led to tension between open banking markets and the prevention of future BCCI-type affairs.

In the long run, the tension, suggest Calabresi and Bobbit, is never resolved. “[S]ociety faces the paradox of being forced to choose among competing values in a general context in which none can, for long, be abandoned.”¹⁷¹ The object of public policy is, therefore, “to define with respect to each particular tragic choice, that combination of approaches which most *limits* tragedy.”¹⁷² The play starring Maharajah Bank suggests that the current policy concerning foreign bank regulation and international trade in banking services exacerbates, rather than limits, the tragedy. That policy is called, in *Tragic Choices*, a “pure political approach.”¹⁷³ Scarce foreign bank licenses are allocated by the Federal Reserve according to “standards set up through a responsible political process.”¹⁷⁴ The problems with this approach have been shown in the three Acts of the play. In the language of Calabresi and Bobbit, the political approach discriminates against disfavored groups, such as banks from NICs and LDCs, because the standards for political decision-making originate in social life.¹⁷⁵ Moreover, the political approach to tragic choices does not give effect to individual contexts, such as the needs and desires of a particular bank, like Maharajah Bank or its prospective consumers, like the NRIs in New York. Finally, the current approach necessarily means that a bureaucracy such as the Federal Reserve picks winners (those foreign banks that get licenses) and losers (those that do not).

170. *Id.* at 19.

171. *Id.* at 196.

172. *Id.* at 149 (footnote omitted, emphasis added).

173. *Id.* at 34-41.

174. *Id.* at 34.

175. *Id.* at 49.

This is not to suggest that a lottery, which is a second approach to making tragic choices, would be preferable to the political approach. In theory, there could be a lottery in which foreign bank applicants were granted licenses to do business in the U.S. based on a random selection of a small percentage of the names of all the applicants. Yet, a lottery would be "a choice not to choose."¹⁷⁶ The lottery suffers from a naive conception of equality among foreign bank applicants (that all are equally worthy of getting a license and equally important to prospective U.S. customers) and gives no weight to the interests of either individual foreign banks or the banking system as a whole. The worst feature of a lottery would be its spotlight on the fixed quota of foreign bank licenses available.¹⁷⁷ There would be no explanation of how the fixed supply was established, or why it should be fixed in the first place.

A third approach identified by Calabresi and Bobbit allows the market to allocate scarce goods and resources. The first- and second-order determinations depend on the price of the good or resource and the willingness and ability of prospective consumers to pay. While Calabresi and Bobbit have reservations about this approach to tragic choices, it might be a promising remedy for the lack of consonance between the post-BCCI foreign bank regulatory regime and U.S. international trade policies. Indeed, this market approach appears to underlie many of the provisions of the GATS.

A market approach would have two basic features. First, there would be no explicit or implicit cap on the number of foreign banks allowed in the U.S. or on the number of branches, agencies, or representative offices they could establish. At present, there is no such cap *per se*, though the comprehensive, consolidated supervision standard effectively establishes a low threshold on the number of foreign banks from countries outside the G-10. The potentially discriminatory aspects of this standard would have to be eliminated.

Second, decisions as to which foreign banks could establish and maintain a presence would depend, largely, on which ones could afford to do so, not on bureaucratic decision-making. In turn, each potential foreign bank entrant would make a cost-benefit calculation to see if direct investment in the U.S. would be worthwhile. This calculation would not need to take into account many of the transaction costs discussed in Act I that are presently incurred by foreign bank applicants.¹⁷⁸ Bank regulators like the Federal Reserve would examine established foreign bank operations for safety and soundness purposes, just as they examine certain domestic bank operations. But, the initial barriers to market access posed by FBSEA and revised Regulation K would be reduced substantially by, for instance, eliminating the Federal Reserve licensing requirement or greatly streamlining the procedures associated therewith.

176. *Id.* at 41.

177. *Id.* at 49, 145-46.

178. *See supra* notes 48-65 and accompanying text.

Overall, the aim of the market approach would be to change the burden of proof in the manner suggested above.¹⁷⁹ The Federal Reserve would have to show why regulatory burdens that depart from the presumption in favor of free trade in financial services should be permitted and why a particular foreign bank applicant is a potential BCCI.

A market approach would not be without problems. As Calabresi and Bobbit point out, the outcome of a pure market approach to tragic choices depends on the prevailing distribution of wealth, *i.e.*, it raises egalitarian concerns. Perhaps, then, bigger and better established foreign banks would find entering and competing in the U.S. banking market easier than would small banks from NICs and LDCs.¹⁸⁰ Nevertheless, what might be commendable about the two features of the market approach is their promise of equality of opportunity for foreign banks to enter and participate in the U.S. banking market. If a foreign bank cannot enter this market, or is unable to engage in certain banking activities through its existing U.S. operations, then at least this feature will be for objective market reasons and not the result of the overreaction of legislators and regulators to a unique case of a fraudulent foreign bank.

179. See *supra* notes 22-25 and accompanying text.

180. Other problems include the neglect of societal preferences and the cost of costing. *TRAGIC CHOICES*, *supra* note 169, at 144. The former seems less of a concern in the banking context than in the situations discussed by Calabresi and Bobbit as long as there is some, albeit scaled down, role for bank regulators and their prudential safeguards. The latter, which refers to the cost of putting a price on an item that is viewed as priceless, also seems comparatively unimportant. While foreign banks with global aspirations are eager to set up operations in the legal U.S., the right to do so is hardly viewed as priceless.

There are approaches in addition to the three identified above, most notably the modified political and market approaches. See *id.* at 44-49, 53-127, 146. These other approaches, however, suffer from a variety of defects, including subterfuge—they wrongly indicate that a tragic choice is avoided.