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GAO

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General Accounting Office
Washington, D.C. 20548

General Government Division

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The Honorable Alan Greenspan
Chairman
Board of Governors of the Federal
Reserve System

Dear Mr. Greenspan:

The General Accounting Office is reviewing the implementation of the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA). As you know, this act gives the Federal Reserve significant new authority with respect to U.S. branches, agencies, and representative offices of foreign banks, including enhanced authority to examine these offices.

Fulfilling these additional examination responsibilities is having major funding implications for the Federal Reserve. The purpose of this letter is to remind the Federal Reserve about a source of funds that as yet has remained untapped. Although FBSEA requires the Federal Reserve to charge the costs of its annually required examinations of U.S. offices of foreign banks to the foreign bank or foreign company that controls the foreign bank, the Federal Reserve has not yet established any policy to do so. As a result, its own budget is currently bearing the full cost of its growing examination workload. In particular, the cost of these exams at the Federal Reserve Bank of New York, the bank most affected by these additional responsibilities, is estimated to have been about $5 million in 1992 and is expected to grow to over $10 million by 1994, according to officials of the Federal Reserve Bank of New York.

Some foreign bank officials have suggested to the Federal Reserve that FBSEA provisions relating to charging for foreign bank examinations may be interpreted as applying only to periodic specialized examinations and not to annual examinations. However, we believe a better reading of the statute is that the Federal Reserve is required to charge foreign banks for the costs of both types of examinations.

APPROACH

The issue of the Federal Reserve's charging for examinations conducted under FBSEA arose during a broader review of implementation of that act. That review examines the broader issue of international coordination among national bank supervisors. We examined FBSEA since it sets standards for foreign banks operating in the United States.

We conducted our review from September 1992 to December 1992 in accordance with generally accepted government auditing standards.

BACKGROUND

In recent years U.S. law enforcement and bank regulatory officials have uncovered unlawful activities at several foreign banks operating in the United States. These events led the Federal Reserve to propose strengthening the system of federal regulation and supervision of these operations. Congressional deliberations on this proposal resulted in the 1991 passage of FBSEA.

FBSEA gives greater authority and responsibility to the Federal Reserve in approving and examining foreign bank operations in the United States. Before the passage of the FBSEA's examination provisions, the Federal Reserve was required to use, "insofar as possible," the examination reports of other bank regulatory agencies. FBSEA modified the former requirement that the Federal Reserve defer to the examinations of other regulators. It explicitly authorized the Federal Reserve to conduct and coordinate examinations of U.S. agencies, branches, representative offices, and other offices and affiliates of foreign banks. Under the statute, agencies and branches are required to be examined on-site at least once annually.

In discharging these new responsibilities, Federal Reserve examiners are taking a more active and involved role in examinations of branches and agencies of foreign banks. They are undertaking some exams jointly with other federal or state bank regulators, and conducting others independently.

FBSEA IMPLEMENTATION WILL REQUIRE MORE FUNDS AND STAFF

Carrying out the FBSEA provisions on foreign bank examinations will require a major increase in the money and staff that the Federal Reserve will have to devote to reviewing these operations in the United States. Along these lines, both Federal Reserve Board and Federal Reserve Bank of New York officials have told us they are planning to hire significant additional staff to meet the new responsibilities. At the Federal Reserve Bank of New York alone, staff days devoted to exams of U.S. branches, agencies, and representative offices of foreign banks will sharply increase in future years, as shown by the following estimates supplied by the Federal Reserve Bank of New York.

Table 1: Estimated Federal Reserve Bank of New York Staff Day Requirements to Examine Foreign Bank Offices, 1992-94

Year	Staff days
1992	14,513
1993	26,642
1994	26,771

Source: Federal Reserve Bank of New York.

At an average cost of between $360 and $390 per staff day during this period, the Federal Reserve Bank of New York will incur a cost of nearly $26 million for these examinations in the 3 years beginning January 1992--roughly the date on which the Federal Reserve began to exercise its new responsibilities under FBSEA.

FBSEA PROVISIONS SPECIFY PAYMENT RESPONSIBILITY

Despite the fact that the Federal Reserve has already completed many examinations pursuant to its responsibilities under FBSEA, it has not charged foreign banks for any examination costs. We believe that, as a result, it has missed the opportunity to fund its expenses in conducting these mandated examinations.

FBSEA provides for foreign banks to pay for Federal Reserve examinations of their branches, agencies, representative offices, and other offices and affiliates. Specifically, section 7(c)(1) of the International Banking Act of 1978, as amended by section 203 of FBSEA, provides as follows:

> "(1) EXAMINATION OF BRANCHES, AGENCIES, AND AFFILIATES.--
>
> > "(A) IN GENERAL.--The Board may examine each branch or agency of a foreign bank, each commercial lending company or bank controlled by 1 or more foreign banks or 1 or more foreign companies that control a foreign bank, and other office or affiliate of a foreign bank conducting business in any State.
> >
> > . . . .
> >
> > "(C) ANNUAL ON-SITE EXAMINATIONS.--Each branch or agency of a foreign bank shall be examined at least once during each 12-month period (beginning on the date the most recent examination of such branch or agency ended) in an on-site examination.
> >
> > "(D) COST OF EXAMINATIONS.--<u>The cost of any examination under subparagraph (A) shall be assessed against and collected from the foreign bank or the foreign company that controls the foreign bank, as the case may be</u>." (Emphasis added.)

The Federal Reserve has advised us that, according to some foreign bank officials, one possible reading of the above-quoted provisions is that the requirement for charging costs in subparagraph (D) applies only to examinations the Federal Reserve chooses to do on a periodic, specialized basis, and not to the annual on-site examinations required by the statute. The rationale for this interpretation is that the language in subparagraph (D) refers only to examinations done under the Federal Reserve's general authority in subparagraph (A) and does not specifically link the cost-charging requirement to the annual on-site examinations mandated under subparagraph (C).

In our view, the better reading of the statute is that it requires the Federal Reserve to assess costs for all of its examinations, whether done on an annual or specialized basis. While subparagraph (C) requires that at a minimum foreign branches and agencies be examined at least once a year, it does not provide the Federal Reserve with "annual" examination authority separate from its general powers or, for that matter, even require that the Federal Reserve, as opposed to other regulators, conduct the annual examinations. Since the Federal Reserve can only conduct annual and other examinations pursuant to its general examination authority in subparagraph (A), we believe that any examination it performs is subject to the cost-charging requirement in subparagraph (D).[1]

The Federal Reserve has also raised the concern that, even if it is required to charge foreign banks for examination costs, the charging of such costs may result in a competitive disadvantage to foreign banks. While the Federal Reserve has not explored this issue in detail, it is concerned that the examination charges in question would add to the examination charges that foreign banks already have to pay to other supervisors (including, for example, the Office of the Comptroller of the Currency and state banking agencies), burdening them with duplicate costs not imposed on domestic banks. Federal Reserve officials told us that this requirement could conflict with international treaties and trade agreements that obligate the United States to accord equivalent regulatory treatment to domestic and foreign-owned institutions.

RECOMMENDATION

Given the explicit statutory mandate and the positive budgetary impact that would result, we recommend that the Federal Reserve require each Federal Reserve Bank to begin charging foreign banks for the costs of examining their U.S. agencies, branches, and representative offices. Alternatively, if the Federal Reserve continues to believe that the assessment of examination charges under FBSEA creates a conflict with U.S. treaty and trade obligations, it should seek an amendment to FBSEA.

AGENCY COMMENTS

We have discussed the issues in this letter with the Associate General Counsel and other members of the Federal Reserve's Board of Governors staff in Washington, D.C., and with cognizant vice-presidents of the Federal Reserve Bank

[1]In addition, section 10(a) of the International Banking Act of 1978, as amended by FBSEA, specifically authorizes Federal Reserve Board examination of the representative offices of foreign banks, with examination costs to be assessed against and paid by such foreign banks.

of New York. They concurred with the information presented here on the funding implications of the required examinations and the presentation of possible interpretations of the statute that have been suggested to the Federal Reserve. They noted that the Federal Reserve has not yet taken a formal position on implementation and did not comment on our recommendation.

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Please contact me on 202-512-4812 if you have any questions concerning this letter. The information in this letter was developed by James McDermott, Assistant Director; John Tschirhart, Evaluator-in-Charge; Christina Porche, Evaluator; Lynn Gibson, Assistant General Counsel; and Maureen Murphy, Senior Attorney.

Sincerely yours,

Allan I. Mendelowitz

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