

# *Fordham International Law Journal*

---

*Volume 13, Issue 4*

1989

*Article 5*

---

## The Application of the U.S. Bank Holding Company Act to Instrumentalities of Foreign Governments

Joseph Arkins\*

\*

Copyright ©1989 by the authors. *Fordham International Law Journal* is produced by The Berkeley Electronic Press (bepress). <http://ir.lawnet.fordham.edu/ilj>

# The Application of the U.S. Bank Holding Company Act to Instrumentalities of Foreign Governments

Joseph Arkins

## **Abstract**

The Note argues that the Fed's approach in applying the BHCA to foreign government instrumentalities incorrectly characterizes them as "companies" under the Act. It further argues that the Fed's approach to regulating foreign government owned subsidiaries in the U.S. insufficiently accommodates the financial interrelationship between these governments U.S. banking affiliates and their non-banking activities outside the U.S. The Note argues that the Fed has incorrectly characterized foreign banking instrumentalities as "companies", and therefore would excessively restrict their financial interrelationships in the event these instrumentalities acquire a U.S. subsidiary.

# NOTES

## THE APPLICATION OF THE U.S. BANK HOLDING COMPANY ACT TO INSTRUMENTALITIES OF FOREIGN GOVERNMENTS

### INTRODUCTION

The Bank Holding Company Act (the "BHCA" or the "Act")<sup>1</sup> regulates the activities of bank holding companies, primarily by restricting the non-banking activities of such companies to activities closely related to banking.<sup>2</sup> Foreign governments often function in a manner similar to bank holding companies. Such "foreign government instrumentalities" may take the form of government-operated central banks, or they may hold shares in banks either directly or through government holding instrumentalities.<sup>3</sup> These foreign government controlled banking organizations have maintained agencies or branches in the United States, and have sometimes acquired banks there.<sup>4</sup> Traditionally, the U.S. Federal Reserve Board

---

1. The Bank Holding Company Act, 12 U.S.C. § 1841-1850 (1988) [hereinafter "the BHCA" or "the Act"].

2. See 12 U.S.C. § 1843(c)(8) (1988). Section 4(c)(8) provides an exemption from the non-banking restrictions of BHCA section 4 for "shares of any company the activities of which the Board after due notice and opportunity for hearing has determined [by order or regulation] to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." *Id.*

3. See generally S. KHAN, NATIONALIZED BANKING & ECONOMIC DEVELOPMENT 1-32 (1970). Khan discusses the role of nationalized banking in economic development, and notes that

[t]he banking system thus becomes an important instrument of economic development in capitalist as well as socialist economies. Its importance increases all the more in a mixed economy like that of India. In this type of economic system, planning is largely of the indicative, persuasive type, "planning by inducement," as it is called. The market mechanism retains most of the characteristics which it had in a capitalist system. Moreover, private enterprise continues to be a major sector. Consequently, it makes [the] banking system a very important instrument in economic development if its working is based on social objective rather than private profit motive.

*Id.* at 22; see S. HOLLAND, THE STATE AS ENTREPRENEUR 242-65 (1972) (discussing state investment companies and their activities).

4. See Staff Memorandum: A Technical Analysis of Some Implications of Applying The Bank Holding Company Act to Foreign Government Entities, submitted by letter from Paul A. Volcker, Chairman of the Federal Reserve Board to Doug Barnard, Chairman, Subcommittee on Commerce, Consumer and Monetary Affairs of

(the "Board"), which administers the BHCA,<sup>5</sup> has not applied the BHCA to foreign government instrumentalities because the Act's definition of "company" does not explicitly include foreign government instrumentalities which own banks.<sup>6</sup> Recently, however, the Board has indicated that it would include foreign government instrumentalities under the Act's definition of "company" and would, accordingly, apply the BHCA to foreign government instrumentalities owning U.S. banks.<sup>7</sup>

This Note argues that the Board's approach in applying the BHCA to foreign government instrumentalities incorrectly characterizes them as "companies" under the Act. This Note further argues that the Board's approach to regulating foreign government-owned subsidiaries in the United States insufficiently accommodates the financial interrelationship between these governments' U.S. banking affiliates and their non-banking activities outside the United States. Part I sets forth the history of the BHCA's regulatory scheme addressing foreign banks, culminating in the International Banking Act's amendments of the BHCA regarding foreign banking activities in the United States. Part II analyzes Board practice in relation to foreign government instrumentalities that operate banks in the United States. Part III argues that the Board has incorrectly characterized foreign government banking instrumentalities as "companies," and therefore would excessively restrict their financial interrelationships in the event these instrumentalities acquire a U.S. subsidiary. This Note concludes that a uniform statutory approach to these issues is the appropriate mecha-

---

the House Committee on Government Operations, at Attachment B (Oct. 28, 1983) [hereinafter 1983 Staff Memorandum].

5. See Federal Reserve Act of 1913, Pub. L. No. 43, ch. 6, 38 Stat. 251 (1913) (codified at 12 U.S.C. § 226 (1988) and scattered sections of Titles 12, 15, and 18); see generally B. BECKHART, *THE FEDERAL RESERVE SYSTEM* (1972) (describing functions of Federal Reserve System). The Board of Governors of the Federal Reserve System is the U.S. institution analogous to a central bank, operating through a method of supervision over twelve regional Federal Reserve banks, and manages central banking functions of monetary control and supervises banks and bank holding companies under various statutory authorities. *Id.* at 29-51.

6. See *infra* notes 85-96 and accompanying text.

7. See Letter from William Wiles, Secretary, Federal Reserve Board, to Patricia S. Skigen, Esq. and John B. Cairns, Esq. (Aug. 19, 1988) [hereinafter 1988 BCI Letter]. In the 1988 BCI Letter, the Board announced its intent to require IRI, an Italian government-owned holding instrumentality, to make a BHCA application before acquiring Irving Bank Company of New York. *Id.*

nism to accommodate the sovereignty questions raised by the application of the BHCA to foreign governments.

## I. *THE BANK HOLDING COMPANY ACT AND FOREIGN BANKS*

### *A. History and Operation of the Bank Holding Company Act*

Congress first recognized the need to regulate holding companies that control banks in the banking statutes enacted during the Great Depression of the 1930s.<sup>8</sup> The Banking Act of 1933,<sup>9</sup> commonly known as the Glass-Steagall Act, required bank holding companies to obtain a permit and submit to an examination by the Board before exercising their voting rights in stock holdings of subsidiary Federal Reserve member banks.<sup>10</sup> Between 1938 and 1955, Congress made several attempts to create a statute that would regulate the activities of bank holding companies.<sup>11</sup> In 1956, such a law was enacted: the Bank Holding Company Act.<sup>12</sup>

In its amended form, the BHCA still regulates bank holding company activities<sup>13</sup> by limiting the non-banking activities and financial interrelationships of affiliates within holding

8. See S. REP. NO. 1095, 84th Cong., 1st Sess., at 3-4 (1955), *reprinted in* 1956 U.S. CODE CONG. & ADMIN. NEWS 2482, 2484-85 (describing history of legislative initiatives between 1938 and 1956, leading to the Bank Holding Company Act) [hereinafter 1955 SENATE REPORT].

9. See Federal Reserve Act, ch. 6, § 1, 38 Stat. 251 (1913), *as amended* Pub. L. No. 66, § 19, 48 Stat. 186 (1933); see H.R. REP. NO. 609, 84th Cong., 1st Sess., at 7 (1955) (discussion of Federal Reserve Act's voting requirements) [hereinafter 1955 HOUSE REPORT].

10. See Federal Reserve Act, Pub. L. No. 66, § 19, 48 Stat. 186 (1933).

11. See 1955 SENATE REPORT, *supra* note 8, at 3-4 (describing initiatives leading to the BHCA). Those initiatives began in 1938, when President Roosevelt, in a special message to Congress, urged that the legislature enact legislation that would control the operation of bank holding companies, to prevent holding companies from acquiring any more banks, to prevent bank holding company owned banks from establishing any more branches, and to make it illegal for a bank holding company to borrow from or to sell securities to a bank in which it holds stock. *Id.* at 2384. Senator Glass introduced a bill in response to this suggestion, but the bill failed to get out of committee. *Id.* In 1941, 1945, 1947, 1949, and 1953, efforts were made to introduce similar legislation. *Id.* at 2384-85. Finally, in 1955, Senator Capehart and others introduced S. 880, which after modifications, was passed on May 9, 1956. *Id.* at 2385.

12. Pub. L. No. 511, ch. 240, § 2 *et seq.*, 70 Stat. 133 (1956).

13. *Id.*

companies, and by limiting interstate branching.<sup>14</sup> The BHCA's objectives are to control the creation and expansion of bank holding companies, to separate their business of managing and controlling banks from their unrelated business, to maintain competition among banks, and to minimize the dangers resulting from concentration of economic power in centralized control of banks.<sup>15</sup> In addition, the BHCA subjects bank holding companies to Federal Reserve Board examination and regulation.<sup>16</sup> To implement these goals, the original version of the BHCA required that existing bank holding companies divest themselves of non-banking holdings within two years of the Act's effective date.<sup>17</sup> Section 4(c)(8) of the BHCA and its implementing regulations limit bank holding companies' non-banking activities to those "closely related to banking . . . [and] a proper incident thereto."<sup>18</sup> The 1956 BHCA also contained a flat prohibition on lending from subsidiary banks to their parent bank holding companies, a practice often referred to as "upstream lending."<sup>19</sup> A 1966 amendment to the Act eliminated this blanket prohibition;<sup>20</sup> lending is now allowed within the limits specified in section 23A of the Federal Reserve Act.<sup>21</sup>

Section 23A limits lending between bank holding company affiliates and affiliates that are Federal Reserve member banks or insured by the Federal Deposit Insurance Corpora-

---

14. See 12 U.S.C. § 1843(c)(8) (1988) (non-banking restrictions of the Act); 12 C.F.R. § 225.25 (1989) (Board regulations implementing 12 U.S.C. § 1843(c)(8) (1988)); 12 U.S.C. § 1842(d) (1988) (limitations on interstate branching); 12 U.S.C. § 371(c) (1988) (limitations on interaffiliate lending). For the text of section 23A, see *infra* note 23.

15. 1955 HOUSE REPORT, *supra* note 9, at 11-12.

16. See 12 U.S.C. § 1844 (1988) (role of Federal Reserve Board in regulating bank holding companies).

17. See 1955 HOUSE REPORT, *supra* note 9, at 16-17.

18. See 12 U.S.C. § 1843(c)(8) (1988); see also 12 C.F.R. § 225.25 (1989) (listing specific activities Federal Reserve Board considers "closely related to banking").

19. Pub. L. 511, ch. 240, § 6, 70 Stat. at 137-38 (1956), see 1955 HOUSE REPORT, *supra* note 9 at 17-19 (1956) (prohibiting against upstream and cross-stream credit).

20. See Pub. L. No. 89-485, §§ 12a, 13h, 80 Stat. 241, 243 (1966) (codified at 12 U.S.C. § 371c(b)(1) (1988)).

21. The Federal Reserve Act, 12 U.S.C. § 371c (1988). This section is applicable to all Federal Reserve member banks, and is also applicable to all banks insured by the Federal Deposit Insurance Corporation. See Federal Deposit Insurance Company Act, 12 U.S.C. § 1828(j) (1988) (regulations governing depository institutions under the Federal Deposit Insurance Corporation).

tion.<sup>22</sup> Under section 23A, loans to any single affiliate are limited to ten percent, and loans to all affiliates to twenty percent, of the bank's capital stock and surplus.<sup>23</sup> Section 23A also im-

---

22. See 12 U.S.C. § 371c(1)(A)-(C) (1988) (affiliates of bank holding companies covered by section 23A); 12 U.S.C. § 1828(j) (1988) (Federal Deposit Insurance Corporation insured banks covered by section 23A's lending restrictions).

23. 12 U.S.C. § 371c(a)(1)(4) (1988). Section 23A limits intra-company lending as follows:

(A) in the case of any affiliate, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 10 per centum of the capital stock and surplus of the member bank; and

(B) in the case of all affiliates, the aggregate amount of covered transactions of the member banks and its subsidiaries will not exceed 20 per centum of the capital stock and surplus of the member bank.

(2) For the purpose of this section, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.

(3) A member bank and its subsidiaries may not purchase a low-quality asset from an affiliate unless the bank or such subsidiary, pursuant to an independent credit evaluation, committed itself to purchase such asset prior to the time such asset was acquired by the affiliate.

(4) Any covered transactions . . . shall be on terms and conditions that are consistent with safe and sound banking practices.

*Id.*

"Affiliate" as used in the context of section 23A is defined as follows:

(1) [T]he term "affiliate" with respect to a member bank means—

(A) any company that controls the member bank and any other company that is controlled by the company that controls the member bank;

(B) a bank subsidiary of the member bank;

(C) any company—

(i) that is controlled directly or indirectly, by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the member bank or any company that controls the member bank; or

(ii) in which a majority of its directors or trustees constitute a majority of the persons holding any such office with the member bank or any company that controls the member bank;

...

(E) any company that the board determines by regulation or order to have a relationship with the member bank . . . such that covered transactions by the member bank or its subsidiary with that company may be affected by the relationship to the detriment of the member bank or its subsidiary . . .

12 U.S.C. § 371c(b)(1) (1988).

"Company" as used in section 23A, is defined as "a corporation, partnership, business trust, association, or similar organization and, unless specifically excluded, the term 'company' includes a 'member bank' and a 'bank'." 12 U.S.C. § 371c(b)(6) (1988).

"Control" as used in section 23A, is defined as follows:

poses collateral requirements on interaffiliate transactions.<sup>24</sup> Section 23B, added to the Federal Reserve Act in 1987, imposes further restrictions on interaffiliate lending.<sup>25</sup> Under section 23B, a wide range of transactions between affiliates must be at non-preferential terms, including sales of securities and assets to affiliates, and brokerage transactions.<sup>26</sup> The pur-

(3)(A) a company or shareholder shall be deemed to have control over another company if—

(i) such company or shareholder, directly or indirectly, or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the other company;

(ii) such company or shareholder controls in any manner the election of a majority of the directors or trustees of the other company; or

(iii) the Board determines, after notice and opportunity for hearing, that such company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company . . .

12 U.S.C. § 371c(b)(3)(A) (1988).

24. 12 U.S.C. § 371c(c)(1)-(5) (1988) (listing collateral requirements imposed by section 23A).

25. 12 U.S.C. § 371c-1 (1988). Section 23B requires that

[a] member bank and its subsidiaries may engage in any of the transactions described in paragraph (2) only—

(A) on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or

(B) in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.

12 U.S.C. § 371c-1(a)(1) (1988).

26. 12 U.S.C. § 371c-1(a)(2)-(3) (1988). The non-preferential lending requirements of section 23B apply to

(A) Any covered transaction with an affiliate.

(B) The sale of securities or other assets to an affiliate, including assets subject to an agreement to repurchase.

(C) The payment of money or the furnishing of services to an affiliate under contract, lease or otherwise.

(D) Any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or to any other person.

(E) Any transaction or series of transactions with a third party—

(i) if an affiliate has a financial interest in the third party, or

(ii) if an affiliate is a participant in such transaction or series of transactions.

(3) Transactions that benefit affiliate

For the purpose of this subsection, any transaction by a member bank or its subsidiary with any person shall be deemed to be a transaction with an affiliate of such bank if any of the proceeds are used for the benefit of, or transferred to, such affiliate.

12 U.S.C. § 371c-1(a)(2)-(3) (1988).



pose of the lending restrictions in section 23 is to avoid the possibility that the parent company might take advantage of the resources of its subsidiary banks by borrowing excessively from them, thereby putting those banks at financial risk.<sup>27</sup>

The BHCA defines a bank holding company as any company that has "control" over any bank or bank holding company.<sup>28</sup> "Control," as used in the Act, means an ownership of twenty-five percent or more of any class of voting securities of a bank, the bank holding company's ability to control the election of a majority of the directors or trustees of a company, or a Board determination that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.<sup>29</sup> The BHCA further provides that only a "company" as defined in the Act may become a bank holding company.<sup>30</sup> The Act defines "company" as any corporation, business trust, association, or similar organization.<sup>31</sup> The Act presently excludes companies owned by fed-

27. See Miles, *Banking Affiliate Regulation Under Section 23A of the Federal Reserve Act*, 105 *BANKING L. J.* 476 (1988).

28. 12 U.S.C. § 1841(a)(1) (1988).

29. *Id.* As defined in the BHCA, a company which "controls" a bank does so when

(A) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company;

(B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company;

(C) the Board determines, after notice and opportunity for a hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

12 U.S.C. § 1841(a)(2) (1988).

30. 12 U.S.C. § 1841 (1988). "Bank holding company" is defined as follows in the BHCA: "Except as provided in paragraph (5) of this subsection, 'bank holding company' means any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this chapter." 12 U.S.C. § 1841(a)(1) (1988).

31. 12 U.S.C. § 1841(b) (1988). The BHCA defines "company" as [a]ny corporation, partnership, business trust, association, or similar organization, or any other trust unless by its terms it must terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust but shall not include any corporation the majority of the shares of which are owned by the United States or by any State.

12 U.S.C. § 1841(b) (1988).

The original text of the Act excluded individuals, partnerships and companies owned by religious, charitable and educational organizations from this definition.

eral or state governments, but is silent on the status of foreign government instrumentalities that own or control banks.<sup>32</sup>

*First National Bank of Blue Island Employee Stock Ownership Plan v. Board of Governors of the Federal Reserve System*<sup>33</sup> is the only federal case that offers an in-depth examination of the BHCA's definition of "company."<sup>34</sup> In *Blue Island*, the U.S. Court of Appeals for the Seventh Circuit held that an employee's stock ownership plan (an "ESOP") that owned a bank was a "company" under the BHCA.<sup>35</sup> The Seventh Circuit explained that the definition of "company" includes any formalized structure through which individual economic interests are combined for common business objectives.<sup>36</sup> The court reasoned that ES-

Pub. L. No. 511, ch. 240, § 2(b), 70 Stat. 134 (1956). The exemption for religious, charitable and educational organizations was eliminated by Pub. L. No. 89-485, § 2, 80 Stat. 236, 237 (1966), and that for partnerships by Pub. L. No. 91-607, § 101(6)(b), 84 Stat. 1762 (1970). See S. REP. No. 1095, 84th Cong., 1st Sess., pt. 2, at 7 (1955) (limited scope of exemptions). The Senate Report stated that

[t]he exemptions previously mentioned in this report (for state/local governments, and charitable, religious and educational entities) are the only ones given by this bill from the definitions of company and bank holding company. All other such organizations are required by the bill to subject themselves to such regulation as the bill prescribes as a condition to growth by means of bank share or asset acquisition.

*Id.*

32. See 12 U.S.C. § 1841(b) (1988). Section 1841(b) makes no mention of foreign governments in its exception for federal and state government instrumentalities.

*Id.*

33. 802 F.2d 291 (7th Cir. 1986).

34. See *id.* Two other cases have, in passing, examined the BHCA's definition of "company." See *Independent Ins. Agents v. Board of Governors of the Fed. Reserve Sys.*, 890 F.2d 1274 (2d Cir. 1989); *Borden v. Sinskey*, 530 F.2d 478 (3d Cir. 1976). *Borden* held that a trustee in bankruptcy was not a "company" under the Act's definition, saying that

[t]he relevant legislative history fails to disclose any reason in policy or logic for depriving the plaintiff-trustee of his status as an individual merely because he represents Corpamerica's interests. Individuals were and are excluded from the Act's operation because, unlike corporations, they have a finite existence and, therefore, cannot exercise control over a bank in perpetuity.

*Id.* at 499.

In the *Independent Insurance Agents* case, the court noted that "section (4)(c)(8) . . . uses the term 'company' to describe those entities [exempted from section 4's non-banking restrictions], and 'company' is defined by section 2(b) broadly enough to include a bank." *Independent Ins. Agents*, 890 F.2d at 1283.

35. *Blue Island*, 802 F.2d at 294.

36. *Id.* The court concludes that "any formalized structure through which individual economic interests are combined for common business objectives comes under BHCA's definition of 'company' and is to be regulated by the Board." *Id.*

OPs, while not "business trusts" or "associations," are clearly included under the "similar organizations" part of the Act's definition of "company."<sup>37</sup> The *Blue Island* court further emphasized that the broad definition of "company" used in the Act has been expanded by the legislature's progressive elimination of the exemptions from the definition of "company" included in the 1956 Act.<sup>38</sup>

### B. BHCA Regulation of Foreign Banks

Initially, the BHCA applied only to bank holding companies that owned two or more banks.<sup>39</sup> One-bank holding companies, however, began to proliferate as a means of evading the Act's non-banking restrictions.<sup>40</sup> Consequently, in 1970 Congress amended the Act to include these organizations under the BHCA's jurisdiction.<sup>41</sup> As a potential result of this amendment, foreign bank holding companies operating a single U.S. subsidiary bank, yet conducting the majority of their business outside the United States, would have found their non-U.S. activities subject to the BHCA's stringent non-banking restrictions.<sup>42</sup>

Most foreign countries do not follow the U.S. practice of segregating banking from non-banking activities.<sup>43</sup> Banks in

37. *Id.* "Congress' main concern was on long-term continuous control over bank shares of assets . . . . Both [BHCA] amendments [1966 and 1970], their legislative history, and the widening scope of organizations covered demonstrate an intent to bring all business and business-related organizations under the BHCA." *Id.*

38. *Id.* (citing S. REP. NO. 1179, 89th Cong., 2d Sess., reprinted in 1966 U.S. CODE CONG. & ADMIN. NEWS at 2391).

39. See Pub. L. No. 511, ch. 240, § 2(a), 70 Stat. 133 (1956) (definition of "bank holding company").

40. See S. REP. NO. 1084, 91st Cong., 2d Sess., at 2-4, reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS at 5520-22, see also Lichtenstein, *Foreign Participation in United States Banking: Regulatory Myths and Realities*, 15 B.C. COM. & INDUS. L. REV. 879, 917-21 (1974).

41. Pub. L. No. 91-607, § 2(a), 84 Stat. 1760 (1970) (codified at 12 U.S.C. § 1841(a)(1) (1988) (definition of "bank holding company" amended to read company owning "any bank" rather than "two or more banks")); see Lichtenstein, *supra* note 40, at 913-29 (description of circumstances leading to the amendment of the Act to cover "one bank" holding companies, and its relevance to foreign banking institutions).

42. See Lichtenstein, *supra* note 40, at 923-30.

43. See generally U. IMMENGA, STUDY: PARTICIPATION OF BANKS IN OTHER SECTORS OF THE ECONOMY (1975) (study of banking practices in European Community countries prepared by European Commission).

those countries are typically owned by industrial corporations or own such companies themselves. In addition, these banks deal in securities.<sup>44</sup> To apply the non-banking restrictions of the BHCA to the non-U.S. activities of foreign bank holding companies would extend the reach of U.S. law to activities conducted outside the United States under substantially different legal rules.<sup>45</sup> In 1970, Congress created an exemption for foreign bank holding companies, to avoid the potential for extra-territorial application of the Act.<sup>46</sup> This exemption, section 4(c)(9) of the BHCA, gives the Board authority to exempt shareholdings or activities conducted by primarily foreign bank holding companies with operations in the United States.<sup>47</sup> Pursuant to section 4(c)(9), the Board may make exemptions for individual foreign bank holding companies by order or for all bank holding companies by regulation.<sup>48</sup> These exemptions are at the Board's discretion, provided they are in conformity with the purposes of the Act and in the public interest.<sup>49</sup>

The legislative history underlying section 4(c)(9) evinces concerns that application of the BHCA to foreign banks should have a minimal extraterritorial effect.<sup>50</sup> U.S. banking regula-

---

44. See generally *id.* (describing activities in which European banks participate).

45. See Lichtenstein, *supra* note 40, at 924, 929 (discussing comments of Federal Reserve Chairman Arthur Burns and comments of Samuel R. Pierce, General Counsel, Treasury Dept.).

46. § 4(c)(9), Pub. L. No. 91-607, Title 1, § 103, 84 Stat. 1760 (1970) (codified at 12 U.S.C. § 1843(c)(9) (1988)).

47. 12 U.S.C. § 1843(c)(9) (1988). Section 4(c)(9) of the BHCA gives the Board authority to make exemptions from the non-banking restrictions of BHCA section 4(c)(8) for

shares held or activities conducted by any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of this chapter and would be in the public interest.

*Id.*

48. *Id.* A section 4(c)(9) exemption can be made for an individual foreign bank holding company through an order, or to foreign bank holding companies generally, by regulation. *Id.* An order is defined as a Board decision following an adjudicatory hearing. See *Investment Co. Inst. v. Board of Governors of the Fed. Reserve Sys.*, 551 F.2d 1270, 1278 (D.C. Cir. 1977).

49. 12 U.S.C. § 1843(c)(9) (1988).

50. See *One-Bank Holding Company Legislation of 1970, Hearings on S. 1052, S. 1212, S. 1664, S. 3823 and H.R. 6778, Before the Senate Comm. on Banking and Currency*, 91st

tors testified in hearings that the potential for extraterritorial jurisdiction in the 1970 BHCA amendments would impose U.S. ideas of banking upon other countries.<sup>51</sup> This imposition might invite foreign retaliation against U.S. banks operating outside the United States.<sup>52</sup>

Section 4(c)(9) of the BHCA was the first significant provision of the Act to address the presence of foreign bank holding companies in the United States.<sup>53</sup> The Board, in the years since 1970, has used the section 4(c)(9) exemption very sparingly when making exemptions for individual bank holding companies.<sup>54</sup> It has generally used the section to make tempo-

---

Cong., 2d Sess. 145-46 (1970) (statement of Federal Reserve Chairman Burns) [hereinafter Burns Comments]. Then Board Chairman Arthur Burns had the following comments regarding the need for a non-banking exemptive provision for foreign bank holding companies:

[w]e do not believe Congress intended the act to be applied in such a way as to impose our ideas of banking upon other countries. To do so might invite foreign retaliation against our banks operating abroad, to the detriment of the foreign commerce of the United States. The provisions of the House-passed bill authorizing the Board to grant exemptions in this area would be most useful in dealing with these problems.

*Id.*; see Letter from Samuel R. Pierce, General Counsel of Treasury to Rep. William Widnall, Chairman, House Banking Committee, *reprinted in* 116 CONG. REC. 41,955 (Nov. 17, 1970) [hereinafter Treasury Letter]. In commenting on the difference between the House and Senate versions of H.R. 6778, the General Counsel of the Treasury, in a letter to the Banking Committee echoed Burns' views:

Also, with respect to the exemption which would be granted for foreign banking under both bills, we believe it to be highly desirable that there be omitted the restrictive words "by directly or indirectly facilitating the foreign commerce of the United States." These words, which appear [in the House bill] are not contained in the Senate bill. These words are unnecessarily restrictive as there can be other ways in which exemptions for foreign banks can be in the public interest as, for example, avoiding the possibility of retaliation against American branch banks abroad.

*Id.*

51. Treasury Letter, *supra* note 50.

52. See Burns Comments, *supra* note 50; Treasury Letter, *supra* note 50.

53. See Lichtenstein, *supra* note 40, at 917-18. Prior to BHCA section 4(c)(9) and its concurrent amendments which applied the BHCA to one-bank holding companies, the vast majority of foreign banks in the United States were not covered by the Act, as they did not have two subsidiaries in the United States. *Id.*

54. See 1988 BCI Letter, *supra* note 7, at 4 ("[t]he Board has used this exemptive authority [BHCA § 4(c)(9)] sparingly in order to maintain maximum consistency of treatment of domestic and foreign banking entities . . ."); see also P. HELLER, FEDERAL BANK HOLDING COMPANY LAW § 5.06(1) (1988). While the authority granted to the Board by section 4(c)(9) is broad, the Board has rarely used it liberally. Heller notes that

[t]he inclusion of these special exemptions for foreign related acquisitions

rary exemptions for foreign bank holding companies' non-banking holdings in the United States owned prior to their acquisition of U.S. subsidiaries, allowing the bank holding companies adequate time to dispose of such holdings.<sup>55</sup>

The 1970 amendments brought only foreign bank holding companies with U.S. subsidiaries under the BHCA's jurisdiction.<sup>56</sup> After their enactment, foreign holding company subsidiaries became subject to regulations governing their non-banking activities in the United States, promulgated by the Board in 1971 under section 4(c)(9).<sup>57</sup> Most foreign bank holding companies, however, did not then, and do not now, maintain full subsidiaries in the United States.<sup>58</sup> Between 1970 and 1978, these bank holding companies preferred branch or agency status, thus circumventing BHCA jurisdiction.<sup>59</sup> In the mid-1970s, the number of foreign bank holding companies operating in the United States grew rapidly.<sup>60</sup> This increased foreign banking presence led to a congressional initiative to address this issue, culminating in the International Banking Act of 1978 (the "IBA").<sup>61</sup> The IBA implemented a "national

---

[i.e., section 4(c)(9) and 4(c)(13)], without making section 4(c)(8) inapplicable to such acquisitions, suggests that Congress intended to provide, or to enable the Board to provide, a more liberal policy for such acquisitions than is applicable to U.S. bank holding companies seeking investment in domestic companies. However, the Board has expressed a concern that "foreign banking institutions not gain competitive advantages in the United States over domestic banking institutions" through investment in domestic corporations under Section 4(c)(9) of the BHCA. Because of these concerns, the Board rarely has granted approval under Section 4(c)(9). Rather, the Board is likely to treat a Section 4(c)(9) application as a temporary situation and require the applicant to apply under Section 4(c)(8) and be subject to the procedures and standards required for Section 4(c)(8) applications.

*Id.* (footnotes omitted).

55. P. HELLER, *supra* note 54, at § 5.06(1) (1988).

56. Pub. L. No. 91-607, § 101, 84 Stat. 1760 (1970). Branches or agencies were not covered by the 1970 amendments, as they were not "banks" within the BHCA's definition, because they did not accept deposits. *Id.*; see 12 C.F.R. § 225.4(g) (1973) (regulations promulgated under authority of BHCA section 4(c)(9)).

57. See 12 C.F.R. § 225.4(g) (1973).

58. See Carr & More, *Developments in the Regulation of Foreign Bank Operations in the United States*, 1988 U. ILL. L. REV. 225, 228-30.

59. *Id.*

60. See *id.* at 225-26. In 1980 there were 350 U.S. operations of foreign banks; in 1987 there were 658 such operations. *Id.* at 226.

61. The International Banking Act, Pub. L. No. 95-369, 92 Stat. 607 (1978), as amended by Competitive Equality in Banking Act of 1987, Pub. L. No. 100-86, § 204, 101 Stat. 552 (1987); Garn-St. Germain Depository Institutions Act of 1982, Pub. L.

treatment" approach to regulating U.S. activities of foreign banks. Under the IBA, foreign banks were permitted opportunities equivalent to those of similarly situated domestic banks.<sup>62</sup>

The IBA extended BHCA jurisdiction to foreign bank holding companies' branches and agencies in the United States, allowing each bank one "home state" where they can establish a presence.<sup>63</sup> The IBA also allowed the continuation

No. 97-320, §§ 704, 705, 96 Stat. 1539 (1982); Act of Sept. 4, 1979, Pub. L. No. 96-64, 93 Stat. 412 (1979) (codified as amended at 12 U.S.C. §§ 3101-08 (1988) and in scattered sections of 12 U.S.C.) [hereinafter IBA].

62. See P. HELLER, *supra* note 54, at § 5.06(2). In characterizing the goal of the IBA, Heller stated that

[t]he International Banking Act of 1978 ("IBA") was designed to strive for competitive equality between domestic and foreign banks, to preserve and enhance the ability of States to attract foreign capital and develop international banking centers, and to provide some leverage to secure more equitable treatment for United States banks abroad.

*Id.* (footnotes omitted); see Wallich, *The Case for National Treatment of Foreign Banks*, *ISSUES IN BANK REGULATION* 59 (Summer 1984). Henry Wallich, former Federal Reserve Board Chairman, described "national treatment" as

the guiding principle for the regulation of foreign banks in the United States. It provides a nondiscriminatory regulatory environment in which domestic banks and the domestic affiliates of foreign banks can compete on equal terms, with departures from precise regulatory parallelism that allow for special features of the two types of institutions. . . . [It] is derived from the longstanding policy of openness to foreign enterprise which the United States has always followed. It is the basic principle that underlies the International Banking Act.

*Id.*

63. See 12 U.S.C. § 3106(a)(1) (1988). The IBA extended the jurisdiction of the BHCA to cover branch and agency presences of foreign banks in the United States.

*Id.* The IBA provides that

[e]xcept as otherwise provided in this section (1) any foreign bank that maintains a branch or agency in a State, (2) any foreign bank or foreign company controlling a foreign bank that controls a commercial lending company organized under State law, and (3) any company of which any foreign bank or company referred to in (1) and (2) is a subsidiary shall be subject to the provisions of the Bank Holding Company Act of 1956.

12 U.S.C. § 3106(a)(1) (1988). Interstate branching is addressed by 12 U.S.C. § 3103(a), which provides that

no foreign bank may directly or indirectly establish and operate a Federal branch outside its home State unless (A) its operation is expressly permitted by the State in which it is to be operated, and (B) the foreign banks shall enter into an agreement or undertaking with the Board to receive only such deposits at the place of operation of such Federal branch as would be permissible for a corporation organized under section 25(a) of the Federal Reserve Act.

12 U.S.C. § 3013 (1988).

of specific non-banking activities of certain bank holding company activities that had been established in the United States prior to the date of the IBA's enactment.<sup>64</sup> Foreign banks established in the United States after that time could not engage in these activities.<sup>65</sup>

The IBA also amended the BHCA to add section 2(h)(2), an exemption for non-banking activities of foreign bank holding companies principally engaged in banking activities outside the United States.<sup>66</sup> This amendment statutorily incorporated the Board's 1971 regulations under section 4(c)(9).<sup>67</sup> It exempts foreign banks' non-banking shareholdings from the BHCA's non-banking prohibitions when the shares are held by a bank holding company principally engaged in the banking

---

64. See 12 U.S.C. § 3106(c)(1)-(2) (1988) (engagement of foreign banks in pre-existing non-banking activities in the United States).

65. *Id.*

66. See Pub. L. No. 95-369, § 8(e), 92 Stat. 623 (1978) (codified at 12 U.S.C. § 1841(h)(2) (1988)).

67. See *International Banking Act of 1977, Hearings before the Subcommittee on Financial Institutions Supervision, Regulation, and Insurance, of the Committee on Banking, Finance and Urban Affairs on H.R. 7325, 95th Cong., 1st Sess., July 12, 13, and 19, 1977 at 110-11* (statement of Federal Reserve Board) [hereinafter 1977 HOUSE REPORT]. The Board, in a prepared statement, asked for statutory ratification of its regulatory approach under section 4(c)(9), stating that

[w]hile the Board believes that it has sufficient regulatory authority under section 4(c)(9) to deal with problems that may occur in this area [i.e., non-banking restrictions], we also believe that it would be desirable at this time for the Congress to adopt a more well-defined legislative policy. A great number of foreign banks emanating from a great variety of banking environments would become subject to the nonbanking prohibitions of the Bank Holding Company Act as a result of this proposed legislation. The lack of a statutory policy could initially cause some misunderstanding by foreign banks of the Act's effects on foreign companies with U.S. operations and would make more difficult the task of formulating appropriate general regulations.

Therefore, the Board recommends that H.R. 13876 be amended to make clear that the nonbanking prohibitions of the Bank Holding Company Act are not meant to prevent foreign banks principally engaged in banking abroad from retaining or acquiring interests in foreign-chartered nonbanking companies that are also principally engaged in business outside the United States. We do feel however, that as a corollary to any such amendment, a domestic office of a foreign bank should be required to deal with the domestic operations of a foreign company in which it may have an equity interest on a strictly arms-length basis so as not to give the firm or bank involved an advantage over their respective U.S. competitors.

*Id.* at 110-11.



business outside the United States.<sup>68</sup> This differs from section 4(c)(9) of the BHCA in two important ways. Initially, section 2(h)(2)'s exemption is not dependent on the Board's discretion. Moreover, section 2(h)(2) applies only to foreign companies principally engaged in the banking business outside the United States.<sup>69</sup> In contrast, the section 4(c)(9) exemption does not require the bank holding company to be principally engaged in banking outside the United States to obtain a discretionary exemption for its non-banking activities.<sup>70</sup>

By the close of the 1970s, the Board subjected all foreign bank holding companies active in the United States to BHCA jurisdiction, except those owned by foreign government instrumentalities.<sup>71</sup> The Board had followed this practice consistently in the period from 1970, when the BHCA became applicable to foreign banks owning U.S. subsidiaries, until 1988, when the Banca Commerciale Italiana attempted to acquire the Irving Bank Company.<sup>72</sup>

---

68. See 12 U.S.C. § 1841(h)(2) (1988). Section 2(h)(2) provides an exemption from BHCA for

shares of any company organized under the laws of a foreign country (or to shares held by such company in any company engaged in the same general line of business as the investor company or in a business related to the business of the investor company) that is principally engaged in business outside the United States if such shares are held or acquired by a bank holding company organized under the laws of a foreign country that is principally engaged in the banking business outside the United States.

*Id.*

69. Compare 12 U.S.C. § 1843(c)(9) (1988), with 12 U.S.C. § 1841(h)(2)(1988) (illustrating difference between two provisions in overall proportion of banking activity required of holding company to be eligible for exemptions).

70. See 12 U.S.C. § 1843(c)(9) (1988) (no requirement in BHCA section 4(c)(9) that foreign bank holding company be primarily involved in banking business).

71. See Gruson & Weld, *Nonbanking Activities of Foreign Banks Operating in the United States*, 1980 U. ILL. L.F. 129, 130. All possible forms of foreign banking presence in the United States were subject to the BHCA's jurisdiction when branches and agencies were included under the Act. *Id.* The only exemption was that made by the Board for foreign and non-state and federal government owned banking instrumentalities. See *infra* notes 76-108 and accompanying text (discussing history of exemption of foreign and non-state and federal government owned holding companies).

72. See *infra* notes 76-108 and accompanying text.

## II. FEDERAL RESERVE PRACTICE IN REGULATING FOREIGN GOVERNMENT BANK HOLDING INSTRUMENTALITIES

### A. 1970 to 1988: Non-Application of the BHCA

In foreign countries, banks are often directly or indirectly owned by the government.<sup>73</sup> This ownership can take place in several ways. These government controlled banks can be a part of the government, such as a central bank.<sup>74</sup> Another form of government ownership is the holding of shares in a bank held either directly by the government, or indirectly by a government-owned holding instrumentality.<sup>75</sup> Prior to 1988, the Board avoided application of the BHCA to foreign government instrumentalities that owned banks, or operated branches or agencies in the United States. The Board avoided such application because governments did not fit within the BHCA's definition of "company" and because the Act is silent on the status of foreign government instrumentalities as "companies."<sup>76</sup> Furthermore, the Board determined that the foreign policy issues raised by application of the BHCA to foreign government instrumentalities militated against applying the Act in this situation.<sup>77</sup> The Board enumerated these reasons in interpretive letters that it issued in response to inquiries from foreign government instrumentalities wishing to acquire U.S. banks and in a 1983 Federal Reserve staff memorandum (the "1983 Staff Memorandum") addressing foreign government ownership.<sup>78</sup>

The concern for regulatory comity<sup>79</sup> between states was

---

73. See S. HOLLAND, *supra* note 3, at 245-65.

74. See *State Bank of India*, 68 Fed. Res. Bull. 430 (1982) (considering bank owned directly by Indian government bank).

75. See *Banca Commerciale Italiana*, 68 Fed. Res. Bull. 423 (1982) (considering bank owned in part by Italian government holding instrumentality).

76. See *infra* notes 91-108 (Board's statutory interpretation of BHCA's definition of "company" held not to include foreign government instrumentalities).

77. See 1983 Staff Memorandum, *supra* note 4, at 2.

78. See 1983 Staff Memorandum, *supra* note 4 (prepared at Congress' request); Letter from Paul A. Volcker, Chairman of the Federal Reserve Board to Doug Barnard, Chairman, Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations, at 1 (Oct. 28, 1983) (copy on file at *Fordham International Law Journal* office) [hereinafter Volcker Letter].

79. The legal concept of comity was described by the U.S. Supreme Court in *Hilton v. Guyot*, 159 U.S. 113, 163-64 (1895). The Supreme Court stated that comity is

evidently a strong factor favoring non-application of the Act to foreign government instrumentalities.<sup>80</sup> Application of the Act to foreign government instrumentalities would raise not only U.S. banking policy issues, but also issues of U.S. foreign relations and foreign economic policy.<sup>81</sup> Specifically, application of the BHCA to these instrumentalities and their banking presences in the United States would bring customary government activities, not just commercial activities, within the scope of the Act.<sup>82</sup> In addition to these foreign policy implications, the application of the BHCA to foreign government instrumentalities and their U.S. banking presences also presents an issue of statutory construction.<sup>83</sup>

Although the Act specifies that domestic federal and state government-owned instrumentalities that own banks are not

---

neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.

*Id.* Another court has described the concept as

[a] necessary outgrowth of our international system of politically independent, socio-economically interdependent nation states. As surely as people, products and problems move freely among adjoining countries, so national interests cross territorial borders. But no nation can expect its laws to reach further than its jurisdiction to prescribe, adjudicate, and enforce. Every nation must often rely on other countries to help it achieve its regulatory expectations. Thus, comity compels national courts to act at all times to increase the international legal ties that advance the rule of law within and among nations.

*Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909, 937 (D.C. Cir. 1984).

80. See 1983 Staff Memorandum, *supra* note 4, at 9.

81. See Volcker Letter, *supra* note 78, at 1. Volcker characterized the basic issue in regulating foreign government banking instrumentalities in stating that

[t]he basic question is whether foreign governmental entities may engage in broader banking and nonbanking activities here than private U.S. or foreign companies with a banking presence in the United States. This question is one that involves not only U.S. banking policy but broader U.S. policy interests including foreign investment policy and more generally, U.S. foreign relations and foreign economic policy.

*Id.*; see 1983 Staff Memorandum, *supra* note 4, at 9. The Staff Memorandum noted that "[a]s a nonqualifying organization, the foreign government would be automatically subject to all the rules governing nonbank activities of domestic bank holding companies, thus bringing within the scope of the Act not only the conduct of commercial activities here and abroad but also customary government functions." *Id.*

82. 1983 Staff Memorandum, *supra* note 4, at 9.

83. See P. HELLER, *supra* note 54, § 1.01 n.13.1, § 5.06(1) n.2.

“companies” and, thus, are not subject to BHCA jurisdiction, the Act is silent on the issue of whether foreign government instrumentalities are to be given a similar exemption.<sup>84</sup> Until 1988, the Board maintained that foreign as well as non-state or federal governmental instrumentalities with banking activities in the United States should be so exempted. Two interpretive letters issued by the Board clarify its reasons for this policy.

In 1978, Bank Hapoalim considered acquiring a U.S. bank.<sup>85</sup> Before undertaking the acquisition, the bank sought a Board ruling as to whether its parent organization, the Israeli labor organization Histadrut or its affiliated company Hevrat Ovdim, was a “company” under the BHCA.<sup>86</sup> Histadrut and Hevrat Ovdim owned interests in non-banking subsidiaries.<sup>87</sup> The Board reasoned that foreign government instrumentalities owning U.S. banks, like those of domestic government instrumentalities, were something other than partnerships, business trusts, associations, or similar organizations.<sup>88</sup> Consequently, the Board held that a foreign government instrumentality owning a bank was not a “company” under the Act, and thus the Act would not apply.<sup>89</sup> The Board stated that neither His-

---

84. 12 U.S.C. § 1841(b)(1988). The 1956 Act's legislative history explains this definitional exemption by acknowledging that such organizations are already subject to the control of either the United States or of the state owning such shares, and need no further regulation. The 1955 Senate Report stated: “The first exclusion is provided on the theory that any corporation the majority of whose shares are owned by the United States or any State is subject to the control of either the United States or of the State owning such shares.” 1955 SENATE REPORT, *supra* note 8, at 6-7; see 12 U.S.C. § 1841(b) (1988) (no mention of an exception for foreign governments).

85. See Letter from Theodore E. Allison, Secretary of the Federal Reserve Board, to Rita E. Hauser, Esq. (June 27, 1978) (copy on file at *Fordham International Law Journal* office) [hereinafter *Histadrut Letter*].

86. *Id.* at 1.

87. *Id.* Histadrut's profits were not distributed to its members, but were re-invested in new or existing enterprises. *Id.* Hevrat Ovdim also owned several trading companies active in the United States. *Id.*

88. *Id.* at 2. The Board, in the *Histadrut Letter*, acknowledged that [b]y specifically exempting from the definition corporations majority owned by the government of the United States or of the States, Congress implied that the governments themselves were not “companies” for purposes of the Act . . . .

[A] foreign government, just as the government of the United States and of the States [is] something other than a “corporation, partnership, business trust, association or similar organization.”

*Id.*

89. *Id.* at 1-2.

tadrut nor its affiliate Hevrat Ovdim, were part of the government of Israel, they were government-like institutions and were therefore not companies under the BHCA.<sup>90</sup> The Board concluded that Bank Hapoalim could acquire a U.S. bank without a Board application under the BHCA, because neither Histadrut nor Hevrat Ovdim were companies under the Act.<sup>91</sup>

Similarly, in an interpretive letter concerning the American Indian National Bank ("AINB"), the Board ruled that AINB, a bank holding company owned by several American Indian tribes, was not a "company" under the BHCA's definition.<sup>92</sup> The Board found that the tribes owning AINB performed governmental functions, promulgated and executed civil and criminal laws, chartered corporations, and levied taxes.<sup>93</sup> These attributes resembled the state and federal governments more closely than the corporations, business trusts, and similar organizations enumerated in the BHCA's definition of "company."<sup>94</sup> Furthermore, the Board found that the tribes' financial activities were incidental to its governmental activities and were intended for the benefit of all tribal mem-

90. *Id.*

91. *Id.* at 2. The Histadrut Letter did not require Histadrut to file an application under the BHCA. *Id.* The Board stated that "[a]ccordingly, in the event Bank applies to form a bank holding company and the Board acts favorably on such application, the Board would not require similar applications from Histadrut or Hevrat Ovdim despite the fact that those organizations directly or indirectly control Bank." *Id.* The Board did, however, reserve the right to ensure that the U.S. operations of the Bank would be conducted independently of Histadrut and Hevrat Ovdim. *Id.* at 2-3.

92. Letter from Robert E. Mannion, Associate General Counsel, Federal Reserve Board to David Martin, Esq. (June 9, 1978) (copy on file at *Fordham International Law Journal* office) [hereinafter AINB letter].

93. *Id.* at 2. The Board found that the tribes performed functions equivalent to that of a sovereign government. "Specifically, the Tribes have jurisdiction to promulgate civil and criminal laws, to execute those laws and to maintain a judicial system, to charter corporations and to levy taxes and that such jurisdiction is, in fact, exercised by both tribes with respect to their members." *Id.*

94. *Id.* at 2. The Board concluded that government entities other than those of federal and state governments were to be treated in accordance with those of domestic governments. The Board stated

[a]s indicated above, it is apparent that Congress in section 2(b) did not consider the United States and the States to be either corporations, business trusts, associations or similar organizations. Because of their functions and purposes, the Tribes . . . should not be regarded as "companies" as that term is defined in section 2(b) and, thus, would not be bank holding companies.

*Id.*

bers.<sup>95</sup> The policy of the Board, therefore, was to treat foreign and domestic sovereign instrumentalities as federal or state governments and to exempt them from application of the BHCA.<sup>96</sup>

The Board, however, had suggested a potential change in position in a 1982 order (the "1982 BCI Order").<sup>97</sup> In the 1982 BCI Order, the Board approved the acquisition by an Italian bank, Banca Commerciale Italiana ("BCI"), of a New York medium-sized consumer bank, Long Island Trust Co. ("LITCO").<sup>98</sup> The Istituto per la Ricostruzione Industriale ("IRI"), a large holding instrumentality owned by the Italian government and involved in diverse non-banking activities, owned BCI.<sup>99</sup> Although the Board did not find that IRI was a "company" subject to BHCA jurisdiction,<sup>100</sup> it concluded in an internal legal memorandum (the "1982 Memo"), that it had BHCA jurisdiction over foreign government instrumentalities when they or their subsidiaries operated banks in the United States.<sup>101</sup> The Board's 1982 BCI Order maintained that apply-

---

95. *Id.* The Board acknowledged that the motivations underlying the Tribe's ownership of a bank holding company were different from those of private entrepreneurs. *Id.* "Further, it appears that the Tribes' financial activities, such as their investments in AINB, are incidental to the Tribes' governmental activities and are intended ultimately to promote the well-being of all tribal members." *Id.*

96. See *Post-och Kreditbanken, PKbanken*, 68 Fed. Res. Bull. 787 (1982); *State Bank of India*, 68 Fed. Res. Bull. 430 (1982); *Banca Commerciale Italiana*, 68 Fed. Res. Bull. 423 (1982) [hereinafter 1982 BCI Order]; *Societe Generale*, 67 Fed. Res. Bull. 453 (1981); *Banco Exterior de Espana*, 66 Fed. Res. Bull. 504 (1980); *Korea Exchange Bank*, 39 Fed. Reg. 20,423 (1972).

97. 1982 BCI Order, *supra* note 96.

98. *Id.* at 424-25.

99. See generally S. HOLLAND, *supra* note 3 (extensive discussion of IRI's history and methodology); Pontarollo, *Italy: Effects of Substituting Political Objectives for Business Goals* in STATE INVESTMENT COMPANIES IN WESTERN EUROPE 25-58 (B. Hindley, ed. 1983) (describing of IRI's history and activities).

100. See 1982 BCI Order, *supra* note 96, at 425.

101. See Legal Memorandum: Status of Foreign Governments and Foreign Government-Owned Corporations under the Bank Holding Company Act (Feb. 7, 1983) [hereinafter the 1983 Memo], reprinted in *Foreign Government and Foreign Investor Control of United States Banks, Hearing Before a Subcommittee of the Committee on Government Operations, House of Representatives, 97th Cong., 2d Sess. at 505-10 (1983)* [hereinafter 1983 House Report]. At the time of the 1982 BCI Order, the Board had prepared an internal memorandum which concluded that the Board had BHCA jurisdiction over foreign government bank holding companies. The internal memorandum emphasized that the BHCA explicitly exempts state and federal government instrumentalities, but is silent on foreign government-owned instrumentalities. *Id.* at 505-06. By negative inference, the Act probably applies to such entities. *Id.* at 506. However,

ing the BHCA to foreign government instrumentalities without prior notice would be inappropriate. The Board, however, left open the possibility of a future policy change in that order.<sup>102</sup>

In the 1982 BCI Order, the Board justified its non-application of the BHCA by noting that any excessive financial interrelationships between LITCO and IRI's non-banking companies would be controlled by applying section 23A of the Federal Reserve Act, which limits interaffiliate lending.<sup>103</sup> The Board required that all Italian government-owned businesses (including non-IRI companies) would be "affiliates" of LITCO for the purposes of applying section 23A.<sup>104</sup> This expansive application of section 23A allayed Board concerns about the potential effects of not including BCI and LITCO under the BHCA's jurisdiction.<sup>105</sup>

In the 1982 BCI Order, the Board requested legislative attention to the policy questions raised by foreign government-affiliated banks acquiring U.S. banks.<sup>106</sup> Congress held hearings on the issue of foreign government instrumentalities' ownership of U.S. banks in 1982 and 1983, but these hearings did not result in amendment of the BHCA to address the status

---

the same considerations that allow for exemption of U.S. governmental entities may also apply to foreign governments. *Id.* The BHCA's legislative history sheds little light on this issue. *Id.* Congress may not have intended that BHCA regulation should interfere with sovereign or governmental functions. *Id.*

The memorandum also emphasized that the term "person" as used in antitrust statutes has been construed as including foreign governments within its scope, allowing such governments standing to sue under these statutes. *Id.* at 507. The memorandum also noted that the Foreign Sovereign Immunities Act (the "FSIA") allows suit against foreign governments when they act in a commercial capacity. *Id.* at 507-08. By analogy, a foreign government need not be excluded from BHCA regulation solely because of its sovereign status. *Id.* The purpose of the BHCA—maintaining the separation of banking and commerce and avoiding interstate banking—suggests that the Act should apply to foreign governments, even if they are not specifically mentioned in the Act. *Id.* at 508. Finally the internal memorandum expressed the view that the IBA's guiding principle of "national treatment," might be violated if foreign governments were allowed a greater degree of non-banking activity or interstate branching than domestic or foreign privately owned bank holding companies. *Id.* at 509-10.

102. 1982 BCI Order, *supra* note 96, at 425.

103. *Id.* at 424.

104. Memorandum in Support of the Applications of Banca Commerciale Italiana Pursuant to Sections 3(a)(3) and 4(c)(8) of the Bank Holding Company Act of 1956, as amended, to Acquire Control of Irving Bank Corporation, at 8-9 (copy on file at *Fordham International Law Journal* office) [hereinafter BCI Memo].

105. *See* 1982 BCI Order, *supra* note 96, at 425.

106. *Id.*

of these instrumentalities under the Act.<sup>107</sup> As late as 1986, the Board still exempted foreign government instrumentalities from BHCA regulation. It applied the Act only to the applicant banking instrumentality, and not to all other instrumentalities of the foreign government that owned the banking instrumentality.<sup>108</sup>

*B. A Change in the Board's Approach: The Foreign Government Instrumentality as a "Company" under the BHCA*

In the 1982 BCI Order, the Board identified acquisitions by foreign government instrumentalities of additional U.S. banks as a reason for a future policy change.<sup>109</sup> An opportunity occurred in 1988, when BCI made a takeover offer challenging the Bank of New York's ("BNY") hostile attempt to acquire the Irving Bank Company, a large, internationally active, New York commercial bank.<sup>110</sup> BNY mounted a concerted advertising campaign to arouse public sentiment against the acquisition of a large U.S. bank by a foreign government instrumentality.<sup>111</sup> BNY also pressured the Board to issue a ruling requiring BCI's government-owned bank holding company, IRI, to file an application under the BHCA.<sup>112</sup> BNY

---

107. See 1983 House Report, *supra* note 101. These hearings did not progress beyond the preliminary stage.

108. See *Compagnie Financiere de Suez*, 72 Fed. Res. Bull. 141 (1986). This order applied the BHCA to the banking corporation (Compagnie Financiere de Suez) owning the U.S. entity (Indosuez Options) but not to the other commercial enterprises owned by the French government which owned Compagnie Financiere. *Id.* at 142.

109. 1982 BCI Order, *supra* note 96, at 425.

110. See Application to the Board of Governors of the Federal Reserve System by Banca Commerciale Italiana for prior approval of the acquisition of Irving Bank Corporation, at 7-9 (May 19, 1988) (copy on file at *Fordham International Law Journal* office) (describing BNY's takeover attempt) [hereinafter BCI Application]; see also Cowan, *Irving Takes Improved Bid by Italian Bank*, N.Y. Times, July 6, 1988 at D1, col. 3; Cowan, *Irving Board Weighing Latest Takeover Offer*, N.Y. Times, June 22, 1988, at D2, col. 5.

111. See Duffy, *BCI Angry Over Bank of New York Tactics*, American Banker, June 17, 1988, at 1; Duffy & Kraus, *Bank of New York Ads Termed Xenophobic*, American Banker, May 9, 1988, at 2. Mauro Galli of Banco di Roma's New York office was quoted as saying: "Bank of New York has started a campaign that is very close to slander . . . . I don't question the economic argument put forward by Bank of New York. But the press campaign is offensive, unprofessional, and inaccurate." *Id.* BCI said in a press release that "[w]e truly regret the appearance of the Bank of New York's most recent advertisement. The advertisement, in our view, is very nearly xenophobic and borders on the offensive." *Id.*

112. See Fraust, *Bank of New York Intensifies Attack on Irving Bid: Hostile Suitor Pushes*



wanted this ruling to be issued quickly so as not to impede its takeover plans.<sup>113</sup> The Board responded to this situation in an interpretive letter (the "1988 BCI Letter").<sup>114</sup> The 1988 BCI Letter clearly articulated a change in policy, holding that IRI was a "company" under the BHCA and, thus, subject to Board jurisdiction.<sup>115</sup>

In contrast to BCI's earlier acquisition of LITCO, its acquisition of Irving would have resulted in indirect foreign government control of an internationally active, major U.S. commercial bank.<sup>116</sup> The Board, in addressing this situation, announced a general policy change. Henceforth, all foreign government instrumentalities with banking branches and agencies in the United States would be subject to the BHCA.<sup>117</sup>

---

*for Separate Application from Banca Commerciale's Parent*, American Banker, June 9, 1988, at 3 [hereinafter Fraust, *BNY Intensifies Attack*]. Fraust described the Bank of New York's tactical reasons for pressing the Board for a regulatory stance favoring their position noting that

[l]awyers for the Bank of New York . . . pressed federal and state regulators for rulings that they hope will deter Banca Commerciale Italiana from pursuing its bid to buy a 51% interest in Irving Bank Corp.

In letters to the Federal Reserve Board and the New York State Banking Department, Bank of New York requested expedited rulings on several legal issues. If the regulators back Bank of New York's position on one key issue, Banca Commerciale's parent would be required to file its own applications to acquire Irving, in addition to those filed by the Milan-based bank.

*Id.* See Fraust, *NY Fed Queries Banca Commerciale On Dealings with Italian Conglomerate*, American Banker, June 7, 1988, at 2; Matthews, *Italian Bid for Irving May Face Fed Scrutiny*, American Banker, Apr. 20, 1988, at 8.

113. See Fraust, *BNY Intensifies Attack*, *supra* note 112.

114. 1988 BCI Letter, *supra* note 7.

115. See *id.* at 3-4.

116. *Id.* at 3.

117. See 1988 BCI Letter, *supra* note 7. So as to maintain equality of treatment between foreign government-owned entities, the Board applied the BHCA to all such entities, but exempted their non-banking activities under section 4(c)(9) stating that

[t]he Board recognizes that, under the International Banking Act, its decision in this matter would subject IRI as well as a number of other foreign government-controlled companies of a similar character to the provisions of the BHC Act due to their ownership of foreign banks with branches and agencies in the United States. None of these companies now owns a subsidiary bank in the United States . . . [T]he Board has decided to exempt under section 4(c)(9) the existing and prospective nonbanking activities of these foreign government-controlled companies insofar as they have indirect banking operations in the United States through branches or agencies. This exemption would continue for so long as these companies continue to meet the requirement in section 4(c)(9) that a majority of their business is conducted outside the United States and they do not acquire control of a U.S. bank. In addition, these companies would also be exempt from filing re-

The Board stated that the wide scope of the BHCA's "company" definition and its duty to interpret the Act "as written" mandated a finding that IRI and all foreign government instrumentalities operating U.S. banks were "companies" under the Act.<sup>118</sup> The Board emphasized that its 1982 BCI Order had

---

ports with the Board under its various regulations, except insofar as the Board may specifically require, and from compliance with capital requirements applicable to bank holding companies.

*Id.* at 7-8.

118. *See id.* at 3. The Board based its decision on the broad scope of the BHCA's definition of "company." In its 1988 BCI Letter, the Board stated that [i]n this regard, the Board has considered first the definition of "company" in section 2(b) of the [Bank Holding Company] Act . . . . By its terms, this definition exempts only trusts of limited duration and majority-owned corporation of Federal or State governments. The definition does not exempt foreign government controlled corporations or similar entities.

*Id.* at 3-4; *see* Memorandum in Further Support of the Applications of Banca Commerciale Italiana Pursuant to Sections 3(a)(3) and 4(c)(8) of the Bank Holding Company Act of 1956, as amended, to Acquire Control of Irving Bank Corporation (copy on file at *Fordham International Law Journal* office) [hereinafter BCI Memo II]. BCI emphasized that the Board's Histadrut and AINB letters had found that foreign government bank holding companies were not "companies" under the BHCA, and maintained that the exemption of U.S. government instrumentalities from that definition extended to foreign governments. *Id.* at 15, 17. BCI attributed the limitation to U.S. government instrumentalities to the lack of foreign banking presence in the United States in 1956. *Id.* at 14. Thus, it was more a legislative oversight than a conscious omission. *Id.* at 15. BCI emphasized that the BHCA defines "company" as "corporations, business trusts . . . and similar associations," but these terms themselves are not defined in the Act. *Id.* at 11-12. A "corporation" is usually understood as two or more persons associated pursuant to statute, in a common business enterprise. Governments do not fit this description, nor are they "similar organizations." *Id.* at 11. They cannot, therefore, be "companies" under the BHCA. *Id.* at 12-13. BCI emphasized that IRI was instead an Italian governmental instrumentality implementing economic development objectives. *Id.* at 24-27.

BCI emphasized that IRI is only structurally similar to a private holding company. BCI Memo II, *supra*, at 27 (citing Legal Opinion of Studio Avv. Ercole Graziadei, 30 June, 1988 (copy on file at *Fordham International Law Journal* office) [hereinafter Graziadei Opinion]). Under Italian law, it is called "an autonomous management entity operating according to criteria of economic efficiency." Graziadei Opinion, at 2 (citing art. 3 of law No. 1589 of Dec. 22, 1956). Unlike a conventional company, IRI does not issue stock, and the Italian government's interest in it is not that of a shareholder. BCI Memo II, *supra*, at 8. IRI's profits are part of the State Treasury. *Id.* at 7-8. The government finances IRI from public funds, and receives IRI's profits. *Id.* The government supervises the instrumentality through its Ministry of State Holdings, the Interministerial Economic Planning Committee, the Interministerial Committee for Industrial Planning, and appoints the members of IRI's Board of Directors. *Id.* at 6-7. It is not autonomous from the government, whose permission it must obtain before acquiring or disposing of its subsidiaries' shareholdings. Graziadei Opinion, *supra*, at 3. IRI has been characterized as a "transmission belt" that converts governmental directives into management acts by exercis-

foreshadowed the likelihood for a policy change on this issue.<sup>119</sup> IRI would therefore have to make an application under the BHCA.<sup>120</sup> If the merger were approved, IRI would be subject to the Act, with certain exemptions from the BHCA's prohibitions on non-banking activities and reporting requirements made by the Board pursuant to section 4(c)(9) of the Act.<sup>121</sup> This exemption would be granted for a three-year period, at the end of which IRI's status would be reviewed.<sup>122</sup>

---

ing its voting rights at its affiliate's shareholder meetings. *Id.* at 4-5. Though resembling a "holding company," IRI exists substantially to implement government economic policy. *Id.* at 4.

In contrast to IRI itself, its affiliates (including BCI) operate independently of the government, and are organized as private joint-stock corporations. BCI Memo II, *supra*, at 35. IRI's influence in their management is limited to exercise of its shareholder voting rights. The majority of BCI's directors are non-IRI affiliated, and a substantial percentage of BCI is privately held. *Id.* at 23, 35-36. IRI, then, is analogous to those U.S. governmental organizations known as "public authorities." Graziadei Opinion, *supra*, at 2. Conversely, BCI is equivalent to a private corporation. BCI Memo II, *supra*, at 35-36. For these reasons, BCI concluded that IRI was an instrumentality of the Italian government, not a "company" subject to the BHCA. See BCI Memo II, *supra*; see also Comments of the Bank of New York Company, Inc. on the Application of Banca Commerciale Italiana S.p.A. to Acquire Control of Irving Bank Corporation, June 24, 1988 (copy on file at *Fordham International Law Journal* office) [hereinafter BNY Memo]. BNY characterized IRI as functionally equivalent to a private holding company. *Id.* IRI's creditors could only look to IRI's assets and not to the Italian government for satisfaction of IRI's debts. *Id.* at 7. IRI's contractual undertakings are not governed by the special rules for government agencies, but by the civil law, as are private corporations. *Id.* It also emphasized that IRI is described as a "financial public corporation" in Italian law. *Id.* (emphasis in original).

BNY's most emphatic distinction between IRI and a typical government instrumentality is IRI's lack of regulatory power. BNY Memo, *supra*, at 8. BNY cited Italian case law holding that financial public corporations like IRI are subject to the economic rules that govern markets, and are governed by the same law applicable to private parties. *Id.* at 8-9. Such status is incompatible with the possession of regulatory powers. *Id.* at 9. For these reasons, BNY asserted that IRI was equivalent to a private holding company and should be regulated as such. *Id.* at 8-12.

The Board's 1988 BCI Letter strongly reflects the legal argument advanced by the Bank of New York. Compare 1988 BCI Letter, *supra* note 7, at 3-4 with BNY Memo, *supra*, at 12-19 (similarity of arguments advanced by the Board and by BNY's attorneys as to applicability of BHCA to foreign government instrumentalities). The Bank of New York's attorneys had emphasized the decisive importance of the BHCA's "company" definition, its broad reach, and its application to IRI. *Id.* at 12-19. The Board in the 1988 BCI Letter implicitly accepted the Bank of New York's assertion that foreign governments were covered by *Blue Island's* view of the BHCA's "company" definition. See 1988 BCI Letter, *supra* note 7, at 3-4.

119. 1988 BCI Letter, *supra* note 7, at 2.

120. See *id.* at 4.

121. 1988 BCI Letter, *supra* note 7.

122. *Id.* at 7.

The Board stated that its exemption of IRI's non-banking activities would avoid any excessively extraterritorial effects of the BHCA's non-banking restrictions, which it recognized as an important issue in regulating the U.S. banking activities of foreign government instrumentalities.<sup>123</sup> It also stated that this exemption would permit the Italian government to operate within the scope of the laws of Italy while achieving the objectives of U.S. banking regulations.<sup>124</sup> This exemption, however, would have imposed a rigid managerial and financial separation between IRI, BCI, and Irving, including an absolute prohibition of intra-company lending.<sup>125</sup>

This prohibition against intra-company lending was far more restrictive than the 1982 BCI Order's use of section 23A's inter-affiliate lending restrictions would have led BCI to expect.<sup>126</sup> The prohibition of lending between Irving and any

---

123. *Id.* at 4-5.

124. *Id.* at 5.

125. *Id.* at 5-6. The 1988 BCI Letter imposed several stringent limitations on most managerial and financial interrelationships. It stated that

[t]he [4(c)(9)] exemption would be conditioned upon compliance by IRI with the following limitations [no loans to affiliates, no interlocking management relationships, or cross marketing of services not permitted to U.S. banks, maintenance of Irving's lead bank status in the Federal Reserve System and maintenance of capital adequacy requirements] designed to minimize the potential for conflicts of interest, concentration of resources, unsound banking practices and other adverse effects that section 4 of the Act is designed to prevent.

*Id.*

126. See 1982 BCI Order, *supra* note 96, at 424. The 1982 BCI Order noted that the financial interrelationships between IRI and LITCO would be controlled by application of section 23A. The 1982 BCI Order stated that

[BCI] through common government ownership, is affiliated with a number of banking and nonbanking organizations, some of which operate locally in Italy and others internationally. Upon acquisition of LITCO by BCI, Bank will become affiliated with these organizations. Section 23A of the Federal Reserve Act [12 U.S.C. § 371c] applies to extensions of credit to and investments in affiliates by member banks. Generally, section 23A sets limits on the amounts that may be loaned by a member bank to affiliates and sets strict collateral requirements for any loans to an affiliate. Thus, Bank's extensions of credit to any majority-owned subsidiaries of the Italian government, including IRI and its majority-owned subsidiaries, will be subject to the requirements of section 23A.

*Id.*; see 1988 BCI Letter, *supra* note 7, at 5. The 1988 BCI Letter carried this approach to the extreme of prohibiting such lending. *Id.*; see BCI Memo, *supra* note 104. BCI maintained that IRI's corporate affiliates, including BCI, would be affiliates of Irving as well, under subsection (C)(1) of section 23A, because IRI's affiliates were companies that are controlled directly or indirectly by a shareholder (IRI) which controls

Italian government instrumentality<sup>127</sup> suggests that the Board viewed all Italian government enterprises as bank holding company affiliates for the purposes of applying section 23A.<sup>128</sup> The non-banking activities of foreign banks and bank holding companies, often a significant component of their activities, were a strong concern of the Board in the past.<sup>129</sup> Those activities motivated this prohibition.<sup>130</sup> A 1984 interpretive letter, for example, noted that section 23A's exemption for transactions between fellow banks in a bank holding company would not generally be available to foreign banks.<sup>131</sup> The Board

---

the member bank (BCI/Irving). *Id.* at 9-11. BCI maintained that IRI itself or the Italian government would not be affiliates of Irving, because they were not "companies." *Id.* at 11. The definition of "company" in section 23A of the Federal Reserve Act, is nearly identical to the BHCA's, comprises corporations, partnerships, business trusts, associations, and similar organizations, but has no governmental exemption. 12 U.S.C. § 371c(B)(6) (1988). Because of this similarity, BCI took the position that the definition of "company" in section 23A would not include Italian government subsidiaries other than the IRI group. BCI Memo, *supra* note 3, at 7-12.

127. See 1988 BCI Letter, *supra* note 7. The Board imposed the following restrictions on intra-company lending:

Irving and its subsidiaries could not, directly or indirectly, extend credit in any manner to or for the benefit of, purchase securities issued by or purchase assets from, sell assets to, issue a guarantee, acceptance, accommodation endorsement, letter of credit, or standby letter of credit for the benefit of, or confirm a letter of credit on behalf of, IRI or the Republic of Italy or any company or entity owned or controlled by IRI or the Republic of Italy. This limitation would not be applicable in the case of transactions entered into by Irving and IRI's subsidiary banks in the normal course of correspondent relationships involving deposits and payments.

*Id.* at 5.

128. See BCI Memo, *supra* note 104, at 8-9. With BCI's consent, the Board, in its 1982 BCI Order, decided that the application of section 23A to BCI would apply to transactions between BCI's U.S. affiliate (LITCO) and any instrumentality of the Italian government. *Id.* Effectively, this equates the entirety of the Italian government with a holding company, in that managerial unity and influence is implied on a government-wide basis. *Id.*

129. 1983 Staff Memorandum, *supra* note 4, at 5-9.

130. See 1988 BCI Letter, *supra* note 7, at 5.

131. See Letter from William W. Wiles, Secretary, Federal Reserve Board, to Barry Swart (Mar. 19, 1984) (copy on file at *Fordham International Law Journal* office) [hereinafter Barclay's Letter]. In the Barclay's Letter, the Board noted that Federal Reserve Act § 23A's exemption of transactions by "sister banks" in a holding company did not generally apply to foreign banks, because foreign banks' U.S. branches were not included under section 23A's definition of "bank." *Id.* In the Barclay's Letter, the Board further stated that

[i]n creating these statutory exemptions for certain transactions between domestic banks, Congress did not include foreign banks out of a concern that a foreign bank "can often engage in activities impermissible to domestic banks," activities that could involve greater risk to the safety and soundness

based this observation on clear legislative history that called for denial of this exemption for foreign banks, because their intra-company lending, even between banks, may indirectly benefit non-banking activities.<sup>132</sup>

Immediately after the Board's issuance of the 1988 BCI Letter, IRI indicated that it would provide the information necessary for a BHCA application.<sup>133</sup> The Board offered to meet with IRI representatives to discuss this issue.<sup>134</sup> The Italian government, however, indicated that meetings of this kind were not appropriate for a foreign government instrumentality.<sup>135</sup> BCI offered to pursue discussions on behalf of IRI, but the Board rejected this offer.<sup>136</sup> BCI representatives stated that the application of the Act to IRI was a prime factor in its abandonment of the Irving takeover attempt.<sup>137</sup> Commentators on the Board's decision believed that it had underesti-

---

of a domestic bank involved in a transaction with a foreign bank. Second, Congress premised the two statutory exemptions in question in part upon its belief that both banks involved in such a transaction would be under the supervision and examination of state and/or federal bank supervisory authorities.

*Id.* at 4-5 (citation omitted). In the Barclay's Letter, however, the Board made an exception to this principle because of the unique circumstances surrounding the transaction. *Id.* at 5.

132. *Id.* at 4-5.

133. See *Italian Firm to Provide Data on Irving Offer: Banca Commerciale Officer Expresses Some Surprise on Request by the Fed*, Wall St. J., Aug. 23, 1988, at 4, col. 1; Bartlett, *Italians Will Push Irving Bid: Information Sought by Fed is Promised; Options Are Studied*, N.Y. Times, Aug. 23, 1988, at D1, col. 6.

134. See Fraust, *Did Fed Misread How Milan Bank Would React?*, American Banker, Aug. 31, 1988, at 1, col. 4 [hereinafter Fraust, *Did Fed Misread?*]. This article noted that

[a]ccording to one source close to the Italian bank, Banca Commerciale representatives in the United States had offered to meet with the Fed in place of its parent company, but Mr. Bradfield rejected this offer. The source said the Italian government conglomerate had balked at being summoned to a meeting by the Fed. "It's as if the Italian government were to say to the U.S. Treasury, 'Come to Milan and talk to us,' the source said."

*Id.*

135. *Id.*

136. *Id.*

137. See Bartlett, *Italian Bank Ends Irving Bid: Bank of New York's Offer is Bolstered; Other Suitors Sought*, N. Y. Times, Aug. 30, 1988, at D1, col. 5. The Italian Government felt it was inappropriate for the Board to require an Italian government instrumentality (IRI) to file with an application. Bartlett reported that

Banca Commerciale said yesterday, "As a matter of Italian law, I.R.I. is a Government instrumentality and not a company and, therefore, it would be inappropriate for it to file with the Fed." As a result, a spokesman said,

mated the importance of the sovereignty issue to IRI and the Italian government.<sup>138</sup>

### III. FOREIGN GOVERNMENT INSTRUMENTALITIES ARE NOT "COMPANIES": THE NEED FOR STATUTORY AMENDMENTS TO ADDRESS FOREIGN GOVERNMENT INSTRUMENTALITIES' BANK OWNERSHIP IN THE UNITED STATES

BCI's attempt to acquire Irving was unprecedented: never before had a foreign government instrumentality attempted to acquire a large U.S. bank involved in extensive international business.<sup>139</sup> The nature of this takeover attempt led the Board to change its policy and to apply the Act to IRI.<sup>140</sup> The Board exempted IRI's non-banking activities under section 4(c)(9), attempting to reconcile U.S. banking regulatory goals with IRI's governmental functions.<sup>141</sup> The Board's use of that exemption proposed an untenable isolation of Irving from its potential Italian government affiliates.<sup>142</sup> This isolation, would have prevented Irving's financial assistance of IRI and the Ital-

---

Banca Commerciale notified Irving that it was terminating its agreement to buy a controlling interest in the New York bank.

*Id.*

138. See Fraust, *Did Fed Misread?*, *supra* note 134, at 1. Fraust noted that [t]he Fed was attempting to chart a middle course in the takeover battle. But the Fed may have underestimated the importance of the sovereignty issue to Irving's Italian bidder. "The Fed did not understand that they were dealing with a government entity, not a company," said one lawyer close to the source.

*Id.*

It was widely felt that the Commission of the European Communities would not look favorably on this decision, which might, in response, limit U.S. entry into E.C. banking markets. See Duffy, *Backlash May Follow Fed Ruling on Italian Bidder: European Community Could Limit U.S. Entry into Market in Wake of Irving Decision*, *American Banker*, Aug. 26, 1988, at 3, col. 4 [hereinafter Duffy, *Backlash*]. Members of the Commission felt that the Board's decision in the 1988 BCI Letter could have wide implications, especially if it was applied to other state-controlled banks. *Id.* (comments of Robert Hull, Assistant Director of the European Commission's Directorate for Financial Institutions).

139. See 1988 BCI Letter, *supra* note 7, at 3. Unlike BCI's earlier LITCO acquisition, its ownership of Irving could lead to extensive financial interrelationship with the affiliates of Irving's foreign parent. *Id.*

140. *Id.* at 4.

141. *Id.* at 4-5.

142. See 1988 BCI Letter, *supra* note 7, at 5-6 (stringent restriction on management and credit interrelationships).

ian government's other instrumentalities. In effect, this isolation would also hinder the economic development goals those companies attempt to achieve.<sup>143</sup> Although the restrictions of the section 4(c)(9) exemption made for BCI and IRI would have been limited to that acquisition, they are indicative of the Board's position on foreign government instrumentalities' acquisitions of large U.S. banks.<sup>144</sup>

The Board's application of the Act in the 1988 BCI Letter extended not just to IRI, but to all banks owned by foreign government instrumentalities.<sup>145</sup> Although no such instrumentality currently owns a U.S. bank, the potential for such acquisitions in the future gives the letter policy implications beyond the facts and circumstances of BCI's attempted takeover of Irving.<sup>146</sup> The 1988 BCI Letter's application of the Act makes it tantamount to a regulation, the issuance of which is generally accompanied by a public comment process.<sup>147</sup> Sig-

143. See *infra* notes 175-198 and accompanying text.

144. See Duffy, *Backlash*, *supra* note 138, at 4 (describing European perception of 1988 BCI Letter's provisions).

145. See 1988 BCI Letter, *supra* note 7, at 7-8.

146. *Id.* at 7. The Board stated that: "This exemption [for non-banking activities] would continue for so long as these companies continue to meet the requirement in section 4(c)(9) that a majority of their business is conducted outside the United States and they do not acquire control of a U.S. bank." *Id.* (emphasis added); see Letter from Lane Grijns and Lawrence Uhlick, Institute of International Bankers to William Rutledge, Federal Reserve Bank of New York (June 28, 1988) (copy on file at *Fordham International Law Journal* office)[hereinafter IIB Letter]. The IIB Letter was concerned with the precedential significance of the Board's decision on whether a BHCA application would be required of IRI, and noted that

the Board's long-standing policy on foreign government ownership under the BHCA is fundamentally sound and should not be changed. If the Board were nevertheless to decide to reconsider its established policy, the Institute urges that it not do so in the context of an individual foreign bank's application. Because of the significant implications of any change in that policy, any such reconsideration should be conducted in a manner which affords all parties whose interest would be affected, particularly foreign banks that are state-owned and their foreign government owners, an opportunity to comment on the basis for the current policy and the consequences of any change to that policy.

*Id.* at 1-2; see Duffy, *Backlash*, *supra* note 138, at 3 (comments of Robert Hull).

147. See IIB Letter, *supra* note 146, at 1. International bankers in the United States were concerned about a policy change being made in the context of a single bank's application. *Id.* at 1. The IIB letter also noted that

[i]f the Board nevertheless decides to reconsider its established policy, we urge that it not do so in this or any other application by an individual foreign bank applicant. Because of the significant implications of such a change in policy for foreign governments and state-owned foreign commer-



nificantly, the Board again requested congressional consideration of the appropriate treatment under the BHCA of foreign government instrumentalities' U.S. banking activities.<sup>148</sup> The lack of public input on these issues, the Board's request for legislative consideration, and its reluctance to make a more liberal section 4(c)(9) exemption in this situation, all point to the need for an explicit statutory treatment of these issues.

A. *The BHCA's Definition of "Company" Does Not Include Foreign Government Instrumentalities*

The Board's decision that foreign government instrumentalities having banking activities in the United States are included under the BHCA's definition of "company" is misguided. Conflicting inferences may be drawn from this definition and its applicability to foreign government instrumentalities.<sup>149</sup> Because the BHCA's definition of "company" explains its meaning by an enumeration of private business organizational forms, it does not acknowledge a distinction between foreign government instrumentalities and private companies.<sup>150</sup> The Board in the 1988 BCI Letter used a facial analysis of the BHCA's "company" definition.<sup>151</sup>

---

cial banks as well as for the foreign policy interests of the U.S., we would urge that any review be noticed in the *Federal Register*, affording all interested parties including the Institute an opportunity to formulate their comments on the Board's view of the issue and how the Board might contemplate implementing any change in policy. Consultations with foreign governmental authorities from the countries affected would also appear to be appropriate.

In this connection, the Board's 1982 BCI Order emphasized the need for more extensive analysis and broader participation in any further review of the foreign government ownership issue. As in 1982, such an opportunity is not provided by the pending application. Indeed, the *Federal Register* notice of BCI's application does not mention the foreign government control issue.

*Id.* at 5.

148. 1988 BCI Letter, *supra* note 7, at 7. The Board indicated its ongoing discomfort with the government ownership issue by noting that "[t]he three year time period provided to IRI before the Board again reviews the exemptions would also allow time and opportunity for Congressional review of these issues raised by the present case." *Id.*

149. *See supra* note 118 (describing positions of attorneys for BNY and BCI on foreign governments as BHCA "companies").

150. *See supra* notes 83-95 and accompanying text (discussing Board acknowledgement that definition of "company" in BHCA does not include uniquely governmental functions).

151. *Compare supra* notes 85-96 and accompanying text (discussing Board analy-

The Board based this analysis (1) on the lack of a specific exemption for foreign government instrumentalities, (2) legislative history suggesting that the enumerated exemptions from the "company" definition are exclusive,<sup>152</sup> and (3) *Blue Island*, which is the only case offering an in-depth construction of that definition.<sup>153</sup> This reliance on the definition of "company" to establish jurisdiction over foreign government instrumentalities with a U.S. banking presence fails to recognize the unique issues raised by such regulation.

The BHCA's closest analogue to foreign government instrumentalities is its exemption for domestic federal and state government instrumentalities in its "company" definition.<sup>154</sup> The BHCA does not govern these instrumentalities because they are already regulated by governments.<sup>155</sup> Furthermore, this exemption has seldom been applied because nationalized banks are not found in the United States.<sup>156</sup> This exemption's limitation to U.S. governmental instrumentalities does not by negative inference indicate an intent to exclude foreign government instrumentalities.<sup>157</sup> Foreign bank holding companies of any kind were so uncommon in the United States in the

---

sis in late 1970's of status of foreign and non-federal/state governments as companies under BHCA in Histadrut and AINB Letters) *with supra* note 118 (discussing 1988 BCI Letter's analysis of foreign governments as "companies" under BHCA).

152. 1988 BCI Letter, *supra* note 7, at 3.

153. See 1988 BCI Letter, *supra* note 7, at 3 (discussing cases construing BHCA's definition of "company").

154. See 1983 Memo, *supra* note 101, at 505. The appropriateness of the federal and state government exception as a guide to addressing foreign government bank holding companies was also pointed out in the Histadrut Letter, *supra* note 85, at 2.

155. See 1955 HOUSE REPORT, *supra* note 9, at 6-7.

156. A search of the *Federal Reserve Bulletin* has revealed no instance where this exception has been applied in the context of U.S. government instrumentalities.

157. See Lichtenstein, *supra* note 40, at 917-18. In discussing the 1956 Act's applicability to foreign banks, Lichtenstein notes that

the Act as originally promulgated in 1956 contained neither recognition of the problems of transnational banking nor any recognition of the extent to which the Act, if made applicable to foreign bank holding companies, would extend United States concepts of banking structure and regulation to the foreign activities of foreign companies. In 1956, the Act's lack of recognition of the problem of foreign bank entry was hardly crucial: the multinational banks that had entered the United States markets . . . had chosen to do so only in New York, California and Illinois. Those few foreign banks covered by the pre-1970 two-bank test did not have non-bank subsidiaries which would not fall within an exception to the apparent application of section 4 to foreign subsidiaries.

*Id.* (citations omitted).

mid-1950s that the original Act did not address them.<sup>158</sup> Moreover, only domestically active organizations then qualified as "banks" within the regulatory scope of the Act.<sup>159</sup> Examined in this context, it is apparent that the BHCA's definition of "company" was developed to reach essentially private, domestic enterprises.<sup>160</sup> Because of this limited focus, the definition does not take account of the motivations of foreign government instrumentalities that own banks as opposed to the motivations of private investors.<sup>161</sup> Nor does *Blue Island*, the leading case construing this definition, afford additional clarification on this point.<sup>162</sup>

The *Blue Island* case, which involved an ESOP and not a foreign government instrumentality, determined that the BHCA's usage of "company" covered any formalized structure through which individual economic interests are combined for common business objectives.<sup>163</sup> Governments do not meet the "individual economic interests" portion of this definition.<sup>164</sup> Additionally, the "common business objectives" part of this definition is inapplicable to government organizations because they are not a confederation of individuals that have common

158. See Pub. L. No. 511, § 2(c), 70 Stat. 134 (1956) (definition of "bank" excluded any organization which does not do business within the United States and Edge Act corporations involved in exclusively foreign transactions).

159. S. REP. No. 1095, 84th Cong., 2d Sess., pt. 2, at 4-5 (1955). Indicative of the domestic orientation of the 1956 Act was its definition of "bank":

Section 2(c) of the bill as reported defines "bank" so as to exclude any organization which does not do business within the United States. Thus, technically any foreign banking subsidiary of a bank holding company would be a nonbanking investment and would be required to be divested pursuant to section 4(a) of the bill. . . .

However, in order to make it unmistakably clear that foreign banking subsidiaries are not subject to divestment, the committee ordered a new subparagraph (8) to section 4(c) specifically exempting such subsidiaries.

*Id.*

160. *Id.*

161. See 12 U.S.C. § 1841(b) (1988). Section 1841, by exempting U.S. government instrumentalities views such organizations as distinct from private, profit-making enterprises. See *id.*

162. See *infra* notes 163-65 (discussing inapplicability of *Blue Island* analysis to foreign governments).

163. *First Nat'l Bank of Blue Island Employee Stock Ownership Plan v. Board of Governors of the Fed. Reserve Sys.*, 802 F.2d 291, 294 (7th Cir. 1986).

164. In the Histadrut Letter, *supra* note 85, at 1-2, and the AINB Letter, *supra* note 92, at 2, there were acknowledgements that the benefits from the business enterprises of a government-like instrumentality benefitted the collective membership of the government unit.

business objectives.<sup>165</sup> The Board's prior rulings on the status of foreign government instrumentalities operating U.S. banks acknowledged the inapplicability of the Act's definition of "company" to these organizations, even when they were not a division of a foreign government.<sup>166</sup>

The descriptions of the governmental instrumentalities exempt from BHCA jurisdiction in the Histadrut Letter and the AINB Letter demonstrate how those instrumentalities diverge from this definition of "company" under the BHCA.<sup>167</sup> In each of these cases, the government instrumentality performed a governmental function analogous to state and federal government instrumentalities. Profits from its investments were not distributed to members but were held for reinvestment in new and existing enterprises or were intended to benefit all members of the government unit regardless of ownership interest.<sup>168</sup> Foreign government instrumentalities that own U.S. banks diverge from the Act's definition of "company" because they do not financially benefit individual shareholders. This divergence is due to their public, governmental purposes, which distinguishes them from corporations, partnerships, and similar organizational structures.<sup>169</sup>

*Blue Island* found that the "similar organizations" part of the BHCA's "company" definition indicates legislative intent

---

165. BCI Memo II, *supra* note 117, at 10-12.

166. See Histadrut Letter, *supra* note 85, at 2 (noting that government-allied trade union's holding company was "something other than a 'corporation, partnership, business trust, association or similar organization'").

167. See *supra* notes 85-96 and accompanying text (discussing nature of governmental functions).

168. Histadrut Letter, *supra* note 85, at 2; AINB Letter, *supra* note 92, at 2.

169. See First Nat'l Bank of Blue Island Employee Stock Ownership Plan v. Board of Governors of the Fed. Reserve Sys., 802 F.2d 291 (7th Cir. 1986). The Seventh Circuit's analysis of the status of ESOPs as business instrumentalities focused on their close relation to management and the individual benefit to shareholders. *Id.* at 294-95. The court stated that

[t]he function of ESOPs are business-related. ESOPs, like other retirement plans, provide for deferred compensation. ESOPs are established by management, and typically administered by management, as a method of distributing benefits to the companies' employees in the form of stock. The underlying trust invests the employer contributions primarily in the employer's stock. Thus the ESOP is closely related to the business in which it is established. It provides a deferred compensation plan and investment program for employees, as well as an attractive method of financing for employers.

*Id.*; see BCI Memo II, *supra* note 118, at 20 (discussing how ESOPs effect this distribution to individual shareholders, but governments do not).

to encompass all entities that can maintain long-term control of a bank.<sup>170</sup> Foreign government instrumentalities, however, do not resemble corporations, partnerships, or business trusts.<sup>171</sup> Under the *ejusdem generis* principle of statutory construction, "similar organizations" in the BHCA's definition of "company" cannot include foreign government instrumentalities.<sup>172</sup> The Board viewed *Blue Island* as dispositive of whether "similar organizations" includes foreign government instrumentalities, despite the fact that these instrumentalities do not resemble the enumerated items in the definition. This suggests that regulatory comity is secondary to a statutory mandate that the Board must regulate every institution that can maintain long term control of a bank in the same fashion as a private, domestic company.<sup>173</sup> This interpretation led to an application of the BHCA to foreign government-owned U.S. bank subsidiaries that is inconsistent with the Act's goal of minimum extraterritorial effect in its application to foreign banking activities. Relying on the Act's definition of "company," as the Board did in the 1988 BCI Letter, to dictate a regulatory approach to foreign government instrumentalities' banking subsidiaries within and outside the United States, does not recognize the divergent goals and purposes of those instrumentalities from those of privately owned enterprises. Failure to accord them a regulatory exemption equivalent to that available to domestic sovereign instrumentalities that conduct banking activities also raises questions of what "national treatment" means in this context.

---

170. *Blue Island*, 802 F.2d at 294.

171. See BCI Memo II, *supra* note 118, at 10-13.

172. See *id.* at 10-13, 18-21; see also SUTHERLAND, STATUTORY CONSTRUCTION § 47.18 (1975) (application of *ejusdem generis* principle). The principle of *ejusdem generis* is defined as "a rule of statutory construction, generally accepted by both state and federal courts, that where general words follow enumerations of particular classes or persons or things, the general words shall be construed as applicable only to persons or things of the same general nature or kind as those enumerated." GIFIS, LAW DICTIONARY (1975).

173. See 1988 BCI Letter, *supra* note 7, at 2-3. Indicative of the Board's discomfort with this position is its desire that Congress review the applicability of the BHCA to foreign governments during the three-year period during which it would have exempted IRI's non-banking activities under section 4(c)(9). *Id.* at 7.

B. *The Interaction Between Banking and Non-Banking Activities of Foreign Government Instrumentalities Can Be a Sovereign Activity*

A meaningful accommodation of the banking subsidiaries of foreign government instrumentalities in the United States must allow for a limited amount of financial interaction between their non-banking activities and their U.S. banking subsidiaries. Under the 1988 BCI Letter's approach, the Board would have allowed co-existence of foreign governments' banking and non-banking activities within and outside the United States, but would have allowed no financial interaction between those activities.<sup>174</sup> This does not acknowledge the importance to governments of financial interaction between these activities.<sup>175</sup> This approach to foreign government instrumentalities' banking subsidiaries in the United States does not comport with the commercial reasons that private and government bank holding companies make investments in subsidiaries.<sup>176</sup> If a foreign government instrumentality invests capital in acquiring a U.S. bank, it is unreasonable to expect it to refrain completely from financial transactions with its fellow government-owned companies.<sup>177</sup> The principles of U.S. banking regulations can be applied without the degree of isolation imposed in the 1988 BCI Letter.

In addition, this restriction contravenes Congress' desire for regulatory comity, expressed in the legislative histories of both section 4(c)(9) and section 2(h)(2), the BHCA's two provisions allowing foreign banks exemptions for non-banking activities.<sup>178</sup> The Board equated foreign government instrumen-

---

174. *See id.* at 5-6.

175. *See id.* at 5-6. These restrictions address most aspects of the ways in which a bank holding company would interact with its banking affiliates—management, financial assistance, and cross-marketing. *Id.* These place nearly total isolation between the holding company and the banking affiliate.

176. *See* I. SWARY, CAPITAL ADEQUACY REQUIREMENTS AND BANK HOLDING COMPANIES 64-66 (1980) (describing rationale for bank holding company's acquisition of non-banking business entities); *see also* M. JESSEE, BANK HOLDING COMPANIES AND THE PUBLIC INTEREST: AN ECONOMIC ANALYSIS 78-81 (1977) (describing rationale behind bank holding companies' acquisition practices).

177. *See* I. SWARY, *supra* note 176, at 64-66; M. JESSEE, *supra* note 176, at 78-81; *see also* S. HOLLAND, *supra* note 3, at 199-200.

178. *See* Burns Comments, *supra* note 50; Treasury Letter, *supra* note 50; *see also* 1977 HOUSE REPORT, *supra* note 67. The prohibition on lending is harsher than the

talities with conventional, privately owned companies under the Act's definition of "company."<sup>179</sup> This approach does not acknowledge the sovereign component of foreign government instrumentalities' banking activities.<sup>180</sup> The Board's 1983 analysis of the BHCA's applicability to foreign governments made analogies to the Foreign Sovereign Immunities Act (the "FSIA").<sup>181</sup> This legislation exempts foreign sovereigns from federal jurisdiction but allows jurisdiction over foreign governments' commercial activities in the United States.<sup>182</sup> The Board's position was that the FSIA's view of foreign governments' commercial activities supports Board regulation of foreign government instrumentalities' U.S. banking activities.<sup>183</sup>

---

restrictions applicable through section 23A to domestic and foreign private bank holding companies. *See supra* note 23 (noting section 23A's lending limits).

179. 1988 BCI Letter, *supra* note 7, at 3-4.

180. *See* 1983 Staff Memorandum, *supra* note 4, at 9 (considering foreign governments as "companies" could impinge on government's sovereign functions by restricting their non-banking activities).

181. *See* 1983 Memo, *supra* note 101, at 507-08. The Board invoked the FSIA in support of its argument that it had jurisdiction over foreign government entities. *Id.* at 507. The Board stated:

In addition, it is well recognized in U.S. and international law that when a government acts in a commercial capacity, it may lose its claim to sovereignty and thus immunity from the law. This principle has been codified by the Foreign Sovereign Immunities Act [28 U.S.C. § 1602 *et seq.*] which provides that a foreign state is not considered immune from suit where an action is based on commercial activity in the United States. Thus, foreign governments and foreign government-owned corporations need not be excluded from the provisions of the BHCA solely because of their sovereign status.

*Id.* at 507-08.

182. *See* Foreign Sovereign Immunities Act, 28 U.S.C. § 1602 *et seq.* (1988); 28 U.S.C. § 1605(a)(2) (1988) (defining extent of immunity). The scope of federal court jurisdiction over foreign governments is set forth in section 1605(a)(2), which provides that

[a] foreign state shall not be immune from the jurisdiction of the courts of the United States or of the States in any case—

. . . .

(2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

*Id.*

183. *See* 1983 Memo, *supra* note 101. The 1983 Memo invoked the FSIA as a justification for Board jurisdiction over foreign government bank holding companies: [The argument that foreign governments fall within BHCA jurisdiction] may

This analogy, however, avoided a key issue. Cases considering the application of the FSIA have noted the conflict between “commercial” activities giving rise to FSIA jurisdiction and “governmental” activities integral to a government’s sovereignty and, thus, outside FSIA jurisdiction.<sup>184</sup> For example, in *International Association of Machinists and Aerospace Workers v. The Organization of Petroleum Exporting Countries*,<sup>185</sup> an antitrust case alleging price-fixing by the OPEC member states, the district court held that price controls on exports of these states’ natural resources were outside FSIA jurisdiction.<sup>186</sup> The court reasoned that controls of this kind, while appearing merely commercial, were inherently governmental activities that conserved the states’ natural resources and were

---

be further supported by examining analogous statutes and the reasoning of the courts in applying those laws to governments or governmental entities. In addition it is well recognized in U.S. and international law that when a government acts in a commercial capacity, it may lose its claim to sovereignty and thus immunity from the law. This principle has been codified in the Foreign Sovereign Immunities Act . . . .

*Id.* at 508.

184. See *MOL, Inc. v. People’s Republic of Bangladesh*, 736 F.2d 1326 (9th Cir. 1984), *cert. denied*, 469 U.S. 1037 (1985); *Claco Petroleum Corp. v. Occidental Petroleum, Inc.*, 712 F.2d 404 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984); *International Ass’n of Machinists and Aerospace Workers v. The Organization of Petroleum Exporting Countries*, 477 F. Supp. 553 (C.D. Cal. 1979), *aff’d*, 649 F.2d 1354 (9th Cir. 1981). See generally C. EBENROTH, *BANKING ON THE ACT OF STATE* (1985). Ebenroth discusses the ongoing tension between the Foreign Sovereign Immunities Act and act of state doctrine. *Id.* He discusses that tension in the context of several cases involving non-U.S. government freezing of assets allocated to repayment of debts incurred by non-U.S. government taking such action. *Id.*

185. 477 F. Supp. 553 (C.D. Cal. 1979), *aff’d*, 649 F.2d 1354 (9th Cir. 1981).

186. *Id.* *International Machinists*, an antitrust case challenging OPEC’s alleged price fixing of crude oil prices, made a distinction between “commercial” and “governmental” activities. The district court opinion found that such price control was a sovereign activity not giving rise to jurisdiction under the FSIA. The court stated that

[i]t is clear that the nature of the activity engaged in by each of these OPEC member countries is the establishment by a sovereign state of the terms and conditions for the removal of a prime natural resource—to wit, crude oil—from its territory . . . .

The control over a nation’s natural resources stems from the nature of sovereignty. By necessity and by traditional recognition, each nation is its own master in respect to its physical attributes. The defendants’ control over their oil resources is an especially sovereign function because oil, as their primary, if not sole, revenue-producing resource, is crucial to the welfare of their nations’ peoples.

*Id.* at 567-68.



thus exempt under the act of state doctrine.<sup>187</sup>

This judicial deference to commercial means of implementing foreign government policy suggests that the U.S. banking activities of foreign government instrumentalities can have a governmental component meriting a similar regulatory deference. The Italian government's broad-ranging investments in varied industries through IRI have achieved economic development goals that could be considered the result of "governmental" activities.<sup>188</sup> IRI has systematically developed the Italian steel, telephone, and automobile industries.<sup>189</sup> Financial interaction between government-owned banks and other government enterprises is a means of achieving these goals.<sup>190</sup> In this context, intra-company lending to non-bank-

187. *Id.*; see *International Ass'n of Machinists v. Organization of Petroleum Exporting Countries*, 649 F.2d 1354 (9th Cir. 1981). The Ninth Circuit rejected jurisdiction on different grounds. *Id.* at 1358. It reasoned that

[c]onsideration of their (i.e., the OPEC nations) sovereignty cannot be separated from their near total dependence upon oil. We find that these concerns are appropriately addressed by application of the act of state doctrine

....

The act of state doctrine declares that a United States court will not adjudicate a politically sensitive dispute which would require the court to judge the legality of the sovereign act of a foreign state . . . [i]t requires that the courts defer to the legislative and executive branches when those branches are better equipped to resolve a politically sensitive question. . . .

*Id.*

188. See Pontarollo, *supra* note 99, at 25; see also Graziadei Opinion, *supra* note 118, at 4. The Graziadei Opinion noted that

[t]he mere fact that IRI is structured to operate in its external activities in the field of the civil law is a consequence of the provisions of Art. 41 of the Italian Constitution which separated the Government's entrepreneurial activities from the sovereign acts of the Government but detracts nothing from the basic purpose of IRI as an instrumentality to act in furtherance of purposes of a public and social interest. IRI, like all *enti autonomi di gestione*, is not vested with regulatory powers but . . . is subject to the *supervision* of the Ministry of State Participations which conveys to IRI appropriate directives as dictated by the Government and in particular by the Interministerial Committee for Economic Planning (CIPE).

*Id.*

189. See Pontarollo, *supra* note 99, at 25; see also IRI 1987 YEARBOOK at 10-11 (explanation of IRI's history and range of activities) (copy on file at *Fordham International Law Journal* office). See generally S. HOLLAND, *supra* note 3 (giving extensive discussion of IRI's history).

190. See IRI 1987 YEARBOOK, *supra* note 189, at 10. The genesis of IRI occurred when the Italian government acquired three large commercial banks that failed during the Great Depression. The IRI Yearbook notes that:

ing activities may be a "governmental" activity that merits a flexible jurisdictional approach.

The Board has expressed concerns that foreign government instrumentalities' combination of banking and non-banking activities in the United States might conflict with the BHCA's goal of separating banking and commerce, because foreign governments, by their nature, are not primarily involved in the banking business.<sup>191</sup> It is also concerned that such instrumentalities will not be a source of financial and managerial strength to their U.S. affiliates.<sup>192</sup> These concerns

---

The commercial banks had been a major force in financing the country's industrial development, to a large extent through long-term loans and the acquisition of holdings, and these methods had been applied mainly in favour of companies operating in capital intensive industries.

The disproportion between the small amount of private venture capital available and the huge investments required in a number of areas of industry because of technological development and, from 1915 to 1918, because of the war, had led the commercial banks to take such a big hand in the Italian industrial system that by the end of the First World War they had practically taken over a number of major companies and thus a high proportion of their capital was locked up.

In this situation, IRI was incorporated as a temporary institution with the aim of rehabilitating struggling banks by acquiring their holdings . . . . [in] 1937 IRI was converted to a permanent body for the management of industrial companies under state shareholding.

*Id.*; see S. HOLLAND, *supra* note 3. Holland notes that IRI has heavy short-term borrowing needs, which between 1958 and 1969 amounted to one-tenth of IRI's total financial requirements. *Id.* at 199-200. He notes that the financial relationships between banking and non-banking companies within IRI are not excessive or overly preferential:

One conclusion which certainly should *not* be drawn from the level of IRI's short-term borrowing is that it gained preferential rates from its own banks. In a recent examination of this question Alberto Bertoni concluded that 'it does not appear that their particular position (IRI banks) has favoured the establishment of connections which varied from normal banking practice.' As evidence for this he cites the fact that in December 1966 only 12.6% of total lending by the three main IRI banks (Banca Commerciale, Credito Italiano, and Banco di Roma) was to public enterprise as a whole . . . . He allows that this does not exclude the presumption that IRI banks may show 'greater solicitude' towards the firms of the Group than for the rest of their clientele, but emphasizes that, such preference does not concern the interest rates demanded from firms so much as possible precedence in the granting of credit in the event of restrictions imposing a degree of rationing. In fact this is a more qualified judgement than strictly necessary.

*Id.* (citations omitted) (emphasis in original).

191. See 1983 Staff Memorandum, *supra* note 4, at 5-7 (noting that no government could be considered primarily involved in banking).

192. *Id.* at 15.

also impact on the Board's views regarding intra-company lending between U.S. subsidiaries of foreign banks and their parent companies' non-banking activities. The Board has addressed the issue of non-banking activities by allowing private foreign bank holding companies to maintain their non-banking activities in the United States only when the bank holding company is primarily involved in the banking business.<sup>193</sup> Regarding intra-company lending, the Board has observed that section 23A's exemption for transactions between banks within a common bank holding company does not generally apply to foreign bank holding companies because of their involvement in non-banking activities.<sup>194</sup> These positions acknowledge the dangers inherent in any completely unregulated intra-company lending between foreign banks and their U.S. affiliates.

The dangers posed by the financial interrelationship of banking and non-banking activities when a foreign government instrumentality acquires a large U.S. bank can be controlled by means less drastic than a complete prohibition of intra-company lending.<sup>195</sup> Non-application of section 23A to lending relationships between the U.S. banking presences and the foreign government instrumentalities that own them would represent too deferential a regulatory approach. This approach would give the banking subsidiaries of foreign government instrumentalities a substantial competitive advantage over similarly situated domestic and foreign private institutions.<sup>196</sup> This could endanger U.S. bank depositors' funds.<sup>197</sup> To permit lending by such banks within the parameters of section 23A, however—especially when applied to transactions with all the foreign government's instrumentalities—would limit intra-company lending to an amount equivalent to that permissible

---

193. *Id.* at 7.

194. See Barclay's Letter, *supra* note 131, at 4-5.

195. See 1982 BCI Order, *supra* note 96, at 424, 426; BCI Memo, *supra* note 104, at 7-12. The 1982 BCI Order recognized this, and relied on section 23A to shield LITCO's banking operations from IRI's—and the Italian government's—non-banking affiliates. 1982 BCI Order, *supra* note 96, at 426.

196. See BCI Memo, *supra* note 104. BCI argued that due to the "company" definition of Federal Reserve Act section 23A, affiliates of the Italian government other than those of IRI would not be subject to that section's lending restrictions. *Id.* at 7-12.

197. See Miles, *supra* note 27, at 480-82 (discussing origin of section 23A in context of Depression-era bank failures).

to U.S. and privately held foreign bank holding companies. This limitation would restrain any potential for excessive competitive advantage and would achieve the protective goals of U.S. banking regulation. At the same time, this limitation would allow foreign government instrumentalities to achieve their economic development objectives through a controlled amount of intra-company lending between their U.S. banking affiliates and their other activities both inside and outside the United States.<sup>198</sup>

### C. *Proposals for Statutory Change*

The BHCA should be amended in several ways to address the U.S. banking activities of foreign government instrumentalities. The general nature and extent of regulatory exemptions for non-banking activities and managerial interrelationships for their U.S. banking activities should be provided for in the BHCA. There should be a definition addressing foreign government instrumentalities that parallels the BHCA's definition of "company." This definition should specify what parts of the foreign government's instrumentality are analogous to the "bank holding company." An over-broad definition of that term could make the application process unwieldy and onerous.<sup>199</sup> For example, if IRI were required to submit a Board application, it would have to report financial information on approximately 100 companies, if the definition of the government instrumentality was not narrowly defined.<sup>200</sup> If the Board held that an entire foreign government was the equivalent of a "holding company," even greater difficulties in reporting could result, because the government may hold interests in

---

198. See 1982 BCI Order, *supra* note 96, at 425. This would entail a definition of "company" similar in effect to the agreement made between the Board and BCI in the 1982 BCI Order. See BCI Memo, *supra* note 104, at 7-12. In the 1982 BCI Order, all Italian government entities were "affiliates" of LITCO for the purposes of Federal Reserve Act section 23A. 1982 BCI Order, *supra* note 96, at 425.

199. See BCI Memo II, *supra* note 118, at 40-41 (discussing difficulties involved with BHCA application and reporting requirements).

200. See 1988 BCI Letter, *supra* note 7, at 1-2; see also IRI 1987 YEARBOOK, *supra* note 189 (description of range of IRI subsidiaries' activities). Since BCI withdrew its takeover offer, the practical aspects of the application process were not tested by an actual application. One commentator at the time of the 1988 BCI Letter noted that it was doubtful if IRI would—or could—comply with the necessary reporting process. See *Italian Firm to Provide Data on Irving Offer; Banca Commerciale Officer Expresses Some Surprise on Request by the Fed*, Wall St. J., Aug. 23, 1988, at 4, cols. 1-2.

many companies.<sup>201</sup> A more effective approach would be to scrutinize the acquiring government banking instrumentality and its fellow government-owned banks, which in the case of the 1988 Irving acquisition, would have been BCI and its IRI-affiliated banks.<sup>202</sup> The Board should direct particular inquiry towards these institutions' management and credit interrelationships with other government instrumentalities. Complete disclosure of this information should be a part of any acquisition application made to the Board.<sup>203</sup> Considering the "company" as the group of banks owned by the foreign government would also avoid any interstate branching issues that might arise. Two or more separate government owned banks could not, under this definition, operate separate subsidiaries in the U.S.

As a complement to a restrictive view of the foreign government "company" under the BHCA, a broad definition of the foreign government instrumentality should be added to section 23A of the Federal Reserve Act, paralleling its definition of "company." Section 23A, like the BHCA,<sup>204</sup> defines "company" in terms of corporations, partnerships, associations, or similar organizations, none of which resemble governments.<sup>205</sup> If the BHCA's definition of "company," however, is construed to include foreign government instrumentalities, the term "company" in section 23A should also embrace such instrumentalities and allow lending between them and their U.S. subsidiary banks.<sup>206</sup>

The present deficiency of section 23A's definition of "company" is that the scope of its application to governmental organizations is unclear. A broad definition of "company" would control the financial interaction between the foreign

---

201. *Id.*

202. *Id.*

203. See *Compagnie Financiere de Suez*, *supra* note 108 (acquiring government-owned bank, and not all French government-owned industries, was instrumentality required to apply). BCI had tried to suggest such an approach at the time of the 1988 BCI Letter, but the Board would not meet with BCI, and insisted on meeting with IRI. See Fraust, *Did Fed Misread?*, *supra* note 134, at 1.

204. Compare *supra* note 31 (definition of "company" in BHCA) with *supra* note 23 (definition of "company" in 12 U.S.C. § 371c (1988)).

205. See BCI Memo, *supra* note 104, at 7-12.

206. Compare *supra* note 31 ("company" definition in BHCA) with *supra* note 23 (definition of "company" in 12 U.S.C. § 371c (1988)).

government instrumentality owning a U.S. bank, the foreign government's other enterprises, and the government's commercial affiliates in the United States.<sup>207</sup> This amendment should specify that all government-owned enterprises are part of the holding "company" and thus subject to section 23A's lending restrictions.<sup>208</sup> For example, in the case of IRI, loans to all Italian government instrumentalities, not just to IRI, would be subject to section 23A's lending restrictions.<sup>209</sup>

This approach, which was adopted by the Board in the 1982 BCI Order, is the most prudent approach. It acknowledges that the foreign government instrumentality's management could be influenced by broader government financial pressures.<sup>210</sup> This influence could lead to extensive lending to government instrumentalities other than that which owns the U.S. bank, and possible endangerment of the U.S. bank's resources.<sup>211</sup> The current definition of "company" in section 23A does not give the Board clear guidance on how to address this issue in the context of foreign governments. That definition's limitation to corporations and similar organizations does not articulate which parts of foreign government instrumentalities may be "affiliates" to which section 23A's lending restrictions apply.<sup>212</sup> Amendment of section 23A to cover explicitly foreign government instrumentalities would give the Board

---

207. See 1982 BCI Order, *supra* note 96; see also BCI Memo, *supra* note 104 at 11-12 (discussing Board's use, in 1982 BCI Order, of expansive definition of "affiliate" in context of foreign governments).

208. 1982 BCI Order, *supra* note 96, at 424, 426; see BCI Memo, *supra* note 104, at 7-12.

209. 1982 BCI Order, *supra* note 96, at 424, 426.

210. Commentators on the liberalization of non-banking restrictions for U.S. non-banking holding companies have noted that application of section 23A would limit imprudent lending between banks and their non-banking affiliates, thus reconciling the prudential concerns of the Glass-Steagall Act with a wider range of permissible activities for bank holding companies. See Miles, *supra* note 27; see also Longstreth, *Glass-Steagall: The Case for Repeal*, 31 N.Y.L. SCH. L. REV. 281 (1986); O'Brien, *Financial Deregulation: The Securities Industry Perspective*, 31 N.Y.L. SCH. L. REV. 271 (1986).

211. See 1982 BCI Order, *supra* note 96, at 426. The Board noted, regarding financial problems posed by foreign government-owned banks' non-conformance with BHCA's non-banking restrictions, its belief that "the application of section 23A of the Federal Reserve Act, as described above, will make a contribution towards limiting the potential for actions inconsistent with the policies of the Act [the BHCA]." *Id.*

212. See *supra* note 23 and accompanying text (definition of "company" in section 23A).

clear statutory guidance in regulating foreign government instrumentalities' financial interrelationships with their U.S. banking subsidiaries.

An amendment of section 23A should also provide for a reporting process to monitor the level and nature of intra-company lending.<sup>213</sup> The 1988 BCI Letter exempted IRI from the BHCA's reporting requirements, which includes a report of the intra-company transactions between foreign banking organizations and their U.S. banking subsidiaries.<sup>214</sup> Because of the Board's unique status as both a government agency and a federation of private banks, foreign governments might be reluctant to comply with Board-imposed reporting requirements without express statutory authority.<sup>215</sup> For this reason, reporting requirements should be provided for by statute. This approach to intra-company lending would address the central concern of allowing a government instrumentality involved primarily in non-banking activities to own a U.S. bank subsidiary, specifically, the danger that the U.S. bank's assets will be imprudently channeled into non-banking activities.

### CONCLUSION

Capital markets are becoming increasingly internationalized, and less developed economies often use government controlled banking instrumentalities as a means of participating in those markets. In this context, regulatory comity in the treatment of partially or totally government-owned banking instrumentalities will become an increasingly important consideration. To avoid retaliatory regulation against U.S. banks and to create a favorable climate for U.S. investment outside the United States, a liberal treatment of foreign government instrumentalities' U.S. banking activities is desirable. This is particularly true in the case of Eastern Europe, where major banks are government-owned. Amendment of the BHCA and Federal Reserve Act section 23A to address the status of for-

---

213. See P. HELLER, *supra* note 54, § 1.06(3) (describing BHCA's reporting requirements, which include an annual report (Form FR Y-7), and a Report of Intercompany Transactions of Foreign Banking Organizations and their U.S. Bank Subsidiaries (Form FR-Y8f)). *Id.*

214. See 1988 BCI Letter, *supra* note 7, at 7.

215. See 1983 Staff Memorandum, *supra* note 4, at 10; see also BCI Memo II, *supra* note 104, at 41.

eign government bank holding companies is an integral step in avoiding potential incursions on the sovereign financial activities of foreign governments.

*Joseph Arkins\**

---

\* J.D. Candidate, 1990, Fordham University.