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Review, International Banking by Michael P. Malloy

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International Banking—Cases, Materials and Problems

By MICHAEL P. MALLOY,* Carolina Academic Press, 1998

Reviewed By Patricia A. McCoy**

As BCCI,[1] Daiwa Bank and the Asian flu have painfully reminded us, federal banking regulation in the United States cannot afford to turn a blind eye to the onslaught of globalization. In his timely new casebook, *International Banking*, Michael Malloy canvasses the implications of increased globalization of financial services for international banking activities and banking supervision at large.

As a specialty niche in the American law school curriculum, a course on international banking law has no particular canon (apart from the U.S. regulatory regime) and could pursue a number of approaches. One might emphasize, for example, the economic basis of cross-border banking supervision, the desirability and feasibility of international convergence of regulatory standards, the relationship between banking regulation and global financial services generally, the socio-political implications of international banking law, the historical development of global regulation of financial services, or the role of multilateral financial institution organizations. Professor Malloy has elected to emphasize the foreign policy implications of transnational banking regulation. By veering away from the highly theoretical and by relying on primary texts, he has designed a book that provides firm and flexible grounding for whatever theoretical approach an instructor wishes to take.

Professor Malloy uses as his point of departure the oversight of international banking activities by federal banking regulators in the United States. Federal regulators have two main areas of purview in this regard: regulating the international activities of domestic institutions whose deposits are federally insured and overseeing the domestic activities of foreign banks that operate in the United States. Far from placing exclusive emphasis on supervision in the United States, however, the casebook provides admirable and extensive coverage of international banking law developments across the Atlantic, including the pronouncements of the Basle Committee on Banking Regulation, the banking ramifications of the Uruguay Round of GATT multilateral trade negotiations and the much awaited banking directives of the European Union.

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1. In the most notorious international banking scandal of the early 1990s, regulators from across the world shut down the operations of the Bank of Credit and Commerce International (popularly known as BCCI) in forty-four countries in 1991 amidst allegations that BCCI had manipulated its books and concealed huge derivatives losses. While allegations of money laundering and drug trafficking dogged BCCI, the real concern of American regulators was with BCCI's attempts to enter the U.S. banking market secretly through illegal fronts. *See generally* RAJ K. BHALA, FOREIGN BANK REGULATION AFTER BCCI (Carolina Academic Press, 1994).

Following a preliminary overview of current major issues in international banking supervision, Professor Malloy begins with the nuts-and-bolts of federal regulation of international banking. The idiosyncratic American system of dual banking, with the opportunities it affords for state protectionism, has the potential to inject profound complications into the foreign policy of the United States toward foreign banks. In recent clashes between federal regulators and the states over the "national treatment" of foreign banks mandated by the International Banking Act of 1978,[2] state courts have unexpectedly and rather remarkably cast aside parochial concerns in deference to federal primacy in foreign relations. This debate over whether to allow foreign bank entry at all, and if so, whether such entry should be based on condition of reciprocity, is one that all banking systems face in one form or another.

Just as banking has been one of the last preserves of internal trade barriers within the United States, that protectionism has been mirrored internationally. While entry barriers continue to fall domestically and internationally in banking, foreign bank entry around the world remains subject to higher barriers on the whole than trade in goods. Thus, any discussion of this subject must grapple with the effects of the General Agreement on Trade in Services (GATS), which emerged from the Uruguay Round of GATT multilateral trade negotiations in 1994. The GATS aspired to extend GATT's principles of nondiscrimination to trade in services generally and specifically to financial services. As Professor Malloy narrates, however, the United States dealt a blow to this aspiration when it decided in 1995 to withdraw from the GATS multilateral process for financial services and instead resorted to bilateral negotiations on reciprocal entry privileges for banks.

Professor Malloy also approaches the topic of cross-border entry by paying attention to decisions regarding the form of corporate entity (especially whether to enter through a branch or through a subsidiary) and the legal consequences that attach thereto. Decisions as to entity form are explored both through the relevant federal regulations and through decisions of claims by foreign depositors against U.S. banks for refunds of their deposits following expropriation of the foreign branches where their accounts were maintained.

Any treatment of cross-border entry must also focus on the types of trade barriers that banks seeking to expand internationally may confront. The casebook does an admirable job of surveying different types and degrees of barriers to entry by foreign banks in various countries, including the United States. Many readers will find the materials on the ramifications of the European Union's Second Banking Directive for expansion into Europe by American banks of particular interest.

The growth in cross-border banking has given rise to a concomitant need for transnational prudential supervision. The failure of Herstatt Bank in West Germany

2. Pub. L. No. 95-369, 92 Stat. 607 (1978) (codified at 12 U.S.C. §§ 3101-3111 (1998)).

in 1974 and, more recently, the BCCI scandal,[3] cast a spotlight on the difficulties of such supervision. The pronouncements of the Basle Committee on Banking Supervision,[4] which operates under the auspices of the Bank for International Settlements (BIS), have been especially influential in this regard. With time and experience, the Basle Committee has refined its approach to cooperation between supervisory authorities in host and parent countries. Using essential primary documents ranging from the Basle Concordat of 1983 to the Core Principles for Effective Banking Supervision of 1997, Professor Malloy traces how the Basle Committee's approach to supervision and capital standards evolved in reaction to a string of highly publicized international bank failures, including Banco Ambrosiano and BCCI. He then compares the European Union's approach to supervision and minimum capital requirements in anticipation of free cross-border branching within the European Union's geographic boundaries by banks in its member states.

A current topic of supervisory concern is the reprise of the less-developed-country (LDC) debt crisis of the late 1970s and early 1980s, which has resulted in losses to major money center banks from loans to emerging markets such as Russia and Latin America. International lending presents added risks, including the risks of socio-political upheaval and radically different legal regimes. The text introduces students to the risk elements in lending abroad, followed by directives of federal banking regulators on risk management and reserves for loan losses. The lawyer's role in facilitating risk management is flushed out through a detailed examination of decisions in U.S. courts on the enforceability of international loan agreements following a host country's decision to repudiate private, commercial obligations. Focusing on the text of disputed loan agreements in individual cases, Professor Malloy explores how agreements can be drafted to minimize country-specific risks. In a related vein, the book also surveys the enforcement, regulation and risks of credit equivalents and payment instruments such as letters of credit and bankers' acceptances.

In the wake of the LDC debt crisis, the credo of free capital flows has come under increasing attack for its effects in destabilizing emerging economies. To the astonishment of many observers (including the IMF), this problem has mutated into a worldwide contagion, ruining the economies of Southeast Asia, Russia and Brazil in one brief year. As the destabilizing effects of sudden capital outflows are being debated, currency controls, an idea that was only recently greeted with universal derision in the Western financial establishment, are now undergoing reappraisal both as a means of controlling volatility and of stemming illegal expropriation of assets by current or former elites.

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3. *See generally* BHALA, *supra* note 1 and accompanying text.
4. Formerly known as the Committee on Banking Regulation and Supervisory Practices.

Professor Malloy examines the renewed debate over the desirability of currency controls in the context of the law's treatment of LDC debts and the obligations of U.S. banks to pay foreign deposits. Such disputes typically arise when central banks of cash-poor countries with dwindling foreign reserves impose exchange controls barring international payments in foreign currencies, whether to repay loans denominated in foreign currencies, to repay deposits, or to honor local drafts. Shying away from an economic paradigm, American courts have instead treated the problem of currency controls as a clash between the freedom to contract and the sovereignty of foreign states. The casebook examines in thorough detail how U.S. courts have resolved this clash through resort to standard principles of contract law, the Foreign Sovereign Immunities Act, the act of state doctrine, the Articles of Agreement of the IMF, and even the hoary *in rem* doctrine in *Harris v. Balk*.[5] The book also canvasses new approaches to maximizing recovery on bad LDC loans.

Bank secrecy laws have likewise erupted into controversy, standing accused of facilitating crimes ranging from drug trafficking and the illegal expatriation of assets by corrupt regimes to economic plunder of the victims of the Holocaust. Nations such as Switzerland and the Cayman Islands have attracted deposits from around the world (and built formidable banking industries in the process) by offering guarantees of financial privacy that are considered to be virtually ironclad. In such countries, bank secrecy must be maintained, with few exceptions, under pain of criminal punishment.

The legal culture in the United States is notably different. It is fair to say that in the United States, the war on drugs and the prerogatives of commerce have taken precedence over privacy of individual citizens when it comes to the disclosure of banking data. While bank disclosures to government officials are regulated by the Right to Financial Privacy Act of 1978,[6] citizens have little legal protection against disclosures to private businesses. Now with the computerization of banking data and the advent of electronic banking, citizens are even more vulnerable to intrusions of their privacy through unauthorized divulgence of financial data to the government and private firms. Furthermore, in an effort to interdict money laundering, American banks are *required* to report voluminous data to the U.S. government on large cash transactions.

After contrasting the American and Swiss approaches to bank privacy, Professor Malloy focuses on the tension between those two approaches. This tension is explored through a series of U.S. decisions resolving claims by foreign bank defendants, within the jurisdiction of American courts, that they were shielded from disclosing customer data because such disclosures would violate the criminal law in their home countries. In the interest of comity, American courts have deferred to bank secrecy laws in Switzerland and elsewhere where the information

5. Harris v. Balk, 198 U.S. 215 (1905).
6. Pub. L. No. 95-630, Title XI, 92 Stat. 3697 (1978) (codified at 12 U.S.C. §§ 3401-3422 (1998)).

sought was duplicative or nonessential.[7] Where the requested information was crucial to law enforcement or where U.S. nationals availed themselves of bank secrecy laws abroad to evade domestic laws, however, American courts have mercilessly overruled bank secrecy claims.[8]

Economic sanctions, for which the banking system serves as a transmission belt, are the last topic of the book. Foreign governments commonly have substantial sums on deposit with U.S. banks, for clearing purposes or otherwise. When rival political factions vie to represent a foreign state, or when the United States imposes economic sanctions on an enemy, disputes over control of funds are inevitable and banks face exposure for making unauthorized payments. Professor Malloy approaches these problems through an in-depth examination of the three federal statutes on economic sanctions, followed by a simulation exercise for students. He concludes with consideration of the choice-of-law principles involved when disputed dollar-denominated accounts are located at foreign branches of U.S. banks.

The simulation on economic sanctions is only one of multiple client counseling and planning problems that are thoughtfully incorporated into the book. These problems give students repeated opportunities to probe the ambiguities, inconsistencies, and wisdom of principles in international banking law when applied to new scenarios. Students will be intrigued to learn how the top foreign policy news stories—whether those stories have to do with international drug cartels, warfare and economic sanctions, or revolutions and nationalization—are intertwined with international finance. The amount of material is very well-paced for a three-hour course.

A few minor quibbles can be expected with the first edition of any casebook, and this one is no exception. It would be helpful earlier on to define terms, such as "representative office" and "Edge Act Corporations," that eventually are explained in Chapter Four. Some readers may want a more extensive discussion of the problems requiring greater cross-border banking supervision in Chapter One. In isolated spots, federal regulations that are printed wholesale in the casebook either need editing or further guidance to students in the note material. Similarly, one or two cases suffer from awkward editing, apparently in order to defer presentation of crucial holdings to a later portion of the book.

These flaws do not detract in any major way, however, from what is unquestionably a major new addition to the banking law curriculum. As the only American casebook exclusively on international banking, Professor Malloy's new

7. *See* United States v. First Nat'l Bank, 699 F.2d 341 (7th Cir. 1983); *see also* Trade Dev. Bank v. Continental Ins. Co., 469 F.2d 35 (2d Cir. 1972).

8. *See In re* Grand Jury Proceedings, 532 F.2d 404 (5th Cir. 1976), *cert. denied sub nom.* Field v. United States, 429 U.S. 940 (1976); *see also* Securities Exchange Comm'n v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981).

casebook fills a badly needed gap.[9] It will be invaluable for courses that are already being taught and will undoubtedly inspire new courses in international banking law at law schools.

9. *See generally* HAL S. SCOTT AND PHILIP A. WELLONS, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION (Foundation Press, 5th ed. 1998) (covering some of the same material, but within the larger context of international finance generally, including the capital markets).