Fed says it is treating U.S., European banks the same

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By Douwe Miedema and Edith Honan

LONDON/NEW YORK (Reuters) - The U.S. Federal Reserve Bank is treating foreign banks the same as their U.S. peers, a policymaker said, putting himself at odds with a report that it was keeping a closer eye on European banks struggling with the continent's debt crisis.

Fears about bank funding were one of the reasons for another dismal trading day for bank stocks in Europe after heavy losses in the last two weeks, with the main bank stocks index giving up 7 percent in late trading.

The Wall Street Journal said earlier that the Federal Reserve was asking for more information about whether European banks with U.S. units had reliable access to the funds needed to operate in the United States.

William Dudley, the president of the Fed's New York branch, said the central bank was "always scrutinizing banks" and that it treated U.S. and European banks "exactly the same." Dudley was responding to the story in the Journal.

"This is standard operating procedure, this is something that we do as a matter of course," Dudley told New Jersey business leaders Thursday.

"It's really important to stress that we're not focusing on foreign banks any more than we're focusing on U.S. banks. We treat foreign banks and U.S. banks exactly the same."

The $2.5 trillion U.S. money market funds industry -- which supplies short-term dollar funding to banks -- has retreated from the euro zone in recent months, concerned that the continent's debt crisis is spiraling out of control.

That and the drying up of interbank lending has led to a trebling of dollar funding costs for euro zone banks in the last month. One bank was forced to borrow dollars at the European Central Bank Wednesday.

In a dramatic shift, the U.S. branches of foreign banks became net borrowers of dollars from their overseas affiliates for the first time in a decade, Federal Reserve data released last week showed.

One person at a European bank said that the crisis had heightened scrutiny on the U.S. operations of Europe's banks, although this was a typical response by local regulators.

U.S. regulators were concerned about over-reliance on short-term wholesale funding given how quickly that can dry up, the person said, and worried that funds could flow back to the parent group from overseas branches quickly in a crisis.

Wednesday, one euro zone bank borrowed $500 million from the European Central Bank at a rate much above those at which banks can get dollars in the open market. It was the first time since February 23 a bank used the central bank's facility.

French banks are most exposed to U.S. short-term funding, and it is access to U.S. dollar liquidity that is of particular concern. BNP's short-term borrowings were $94 billion and SocGen's were $56 billion, according to Citi estimates.

European shares dropped sharply in afternoon trade on Thursday after a set of gloomy data on the U.S. economy, with bank shares among the top losers. The STOXX Europe 600 banking index closed trading down 6.6 percent.

Franco-Belgian Dexia was hardest-hit, losing just under 14 percent on the day. The bank was the biggest borrower of the Federal Reserve's so-called discount window -- an emergency facility -- during the financial crisis.

"The French banks have been hit much more than other European banks ... They are more reliant on U.S. money-market funds," said Christophe Nijdam, analyst at Alphavalue.

Societe Generale's shares were more than 12 percent weaker. Its dollar exposure was around 23 per cent of its balance sheet, Nijdam added, and Dexia's around 14 per cent.

(Additional reporting by Steve Slater and Soham Chatterjee in Bangalore; Editing by David Cowell and Hans-Juergen Peters)