BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 25, 1973

To Chairman Burns

From Ralph W. Smith RWS

Subject: Analysis of Banking Directors' Responses to Your Inquiry of June 13

1. Responses were received from all ten of the banking directors to whom the questionnaire was sent. Of these ten, international activities were a substantial portion of the business of nine of the banks. Nearly all of these nine could be described as conducting "full service" international operations.

2. Eight of the nine replied that the recent situation prevailing in exchange markets had not interfered with their conduct of international banking activities in any substantial degree. One respondent said that it had had a substantial effect. The one bank that was not heavily involved in international business said that it had experienced no substantial interference.

3. The one bank that had experienced substantial interference with normal business cited wide fluctuations in exchange rates in thin markets as the source of its difficulties. It said that its management of currency positions now required [considerably] more attention. Thin, volatile markets were also cited by three other banks as being a source of [minor] difficulties. Minor problems resulting from capital controls were mentioned by three banks.

4. As for problems encountered by their commercial customers, four banks mentioned increased uncertainty caused by fluctuations in exchange rates, while two specifically mentioned increased costs of hedging.

5. Five of the ten banks indicated that recent experience had resulted in some <u>change</u> in their attitude with regard to floating rates. All five indicated that floating rates were working better than they had anticipated. Of those expressing a preference for floating versus "fixed" rates, five preferred floating and two preferred fixed. Of the remaining three, one indicated that it now prefers even more flexibility than it had previously (though it did not specifically endorse floating); one indicated that it saw no marked disadvantage for floating rates to continue; and one was ambiguous.

6. On the question of whether they would anticipate greater or lesser difficulties if floating rates should persist for an indefinite period, three respondents specifically answered less, while one implicitly answered less. Three specifically answered greater, while two indicated greater, <u>if controls should proliferate</u> (perhaps implicitly assuming that that might be the case).

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 15, 1974

To Governor Mitchell

From Robert J. Lawrence RJL

Subject: Data on Leading New York City Banks

At the Board Meeting on May 14, you indicated that you felt some data should be developed on the international positions of the leading New York City Banks. Attached are tables containing data on the domestic and foreign positions of the New York Banks from the Call Report of December 31, 1973. I have also included a table showing Euro-dollar borrowings of these banks.

Is this the type of material you had in mind? Should it be distributed to the Board?

cc: Sam Chase
Attachments

Deposits of Leading New York Banks (December, 1973)

Bank	Domestic Deposits ($ Millions)	Deposits in Foreign Branches ($ Millions)		Consolidated Deposits ($ Millions)	% of Foreign to Total
Chase Manhattan Bank	17,128	12,690	36	29,818	43
First National City Bank	18,278	16,005	42	34,283	47
Manufacturers Hanover Trust	11,421	5,556	19	16,977	33
Chemical Bank	17,119	12,699	36	29,818	43
Bankers Trust Company	8,528	5,487	18	14,015	39
Morgan Guaranty Trust	8,875	6,492	20	15,367	42
Marine Midland Bank	2,699	3,956	8	6,655	59
Irving Trust Company	4,837	2,133	8	6,970	31
The Bank of New York	1,413	540		1,953	28
Franklin National Bank	2,600	1,131	2	3,732	30
			189		

22
189) 420
378
520

20
156) 34.0

30
34
17
30
14
15
7
7
2
156

Selected Call Report Items (December 31, 1973)
(Millions $)

Chase Manhattan Bank

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	4,073	4,451	8,525	52
Federal Funds Sold	54	3	58	6
Other Loans, Gross	13,529	8,204	21,733	38
Securities	3,749	149	3,897	4
Other Assets	767	327	1,093	30
TOTAL ASSETS	23,106	13,217	36,317	36
TOTAL DEPOSITS	17,128	12,690	29,818	43
Demand Deposits	9,983	--	9,983	0
Time Deposits 1/	7,145	12,690	19,835	64
Federal Funds Purchased	1,694	--	1,694	--
Other Liabilities	1,114	208	907	23
TOTAL LIABILITIES	21,008	13,207	34,216	39
Capital Notes and Debentures	151	--	151	--
Preferred Stock	--	--	--	--
Common Stock	536	--	536	--
Surplus	709	--	709	--
Undivided Profits	385	--	385	--
TOTAL EQUITY CAPITAL	1,630	--	1,630	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slight for foreign branches.

Selected Call Report Items (December 31, 1973)
(Millions $)

First National City Bank

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	4,110	5,016	9,127	55
Federal Funds Sold	334	-206	128	-161
Other Loans, Gross	14,890	10,876	25,766	42
Securities	3,172	863	4,035	21
Other Assets	564	1,296	1,860	70
TOTAL ASSETS	24,195	18,090	42,285	43
TOTAL DEPOSITS	18,278	16,005	34,283	47
Demand Deposits	9,401	--	9,401	--
Time Deposits 1/	8,877	16,005	24,882	64
Federal Funds Purchased	1,810	491	2,301	21
Other Liabilities	701	694	1,395	50
TOTAL LIABILITIES	21,907	18,162	40,069	45
Capital Notes and Debentures	--	--	--	--
Preferred Stock	--	--	--	--
Common Stock	638	--	638	--
Surplus	764	-9	755	-1
Undivided Profits	583	-42	541	-8
TOTAL EQUITY CAPITAL	1,985	-51	1,934	-3

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items (December 31, 1973)
(Millions $)

Manufacturers Hanover Bank

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	3,708	701	3,779	2
Federal Funds Sold	9	--	9	--
Other Loans, Gross	7,768	5,654	13,422	42
Securities	1,246	154	1,400	11
Other Assets	241	120	361	33
TOTAL ASSETS	13,498	5,895	19,393	30
TOTAL DEPOSITS	11,421	5,556	16,977	33
Demand Deposits	7,233	--	7,233	--
Time Deposits 1/	4,188	5,556	9,743	76
Federal Funds Purchased	576	--	576	--
Other Liabilities	182	181	363	50
TOTAL LIABILITIES	12,473	5,878	18,351	32
Capital Notes and Debentures	100	--	100	--
Preferred Stock	--	--	--	--
Common Stock	210	--	210	--
Surplus	340	--	340	--
Undivided Profits	201	--	201	--
TOTAL EQUITY CAPITAL	751	--	751	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items (December 31, 1973)
(Millions $)

Chemical Bank

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	2,825	2,242	5,067	44
Federal Funds Sold	72	--	72	--
Other Loans, Gross	8,667	1,566	10,233	15
Securities	1,681	270	1,951	14
Other Assets	403	690	1,093	63
TOTAL ASSETS	14,207	22,110	36,317	61
TOTAL DEPOSITS	17,119	12,699	29,818	43
Demand Deposits	5,623	--	5,623	--
Time Deposits 1/	4,700	19,495	24,195	81
Federal Funds Purchased	1,835	-141	1,694	-8
Other Liabilities	515	392	907	43
TOTAL LIABILITIES	13,201	21,015	34,215	61
Capital Notes and Debentures	203	52	151	34
Preferred Stock	--	--	--	--
Common Stock	161	376	536	70
Surplus	302	407	709	57
Undivided Profits	198	187	385	48
TOTAL EQUITY CAPITAL	661	969	1,630	59

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items December 31, 1973
(Millions $)

Bankers Trust Company

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	2,791	2,997	5,788	52
Federal Funds Sold	18	--	18	--
Other Loans, Gross	6,902	2,454	9,356	26
Securities	1,032	603	1,635	37
Other Assets	241	117	358	33
TOTAL ASSETS	11,769	5,737	17,506	33
TOTAL DEPOSITS	8,528	5,487	14,015	39
Demand Deposits	5,447	--	5,447	--
Time Deposits 1/	3,082	5,486	8,568	64
Federal Funds Purchased	1,372	--	1,372	--
Other Liabilities	233	116	349	33
TOTAL LIABILITIES	11,051	5,713	16,764	34
Capital Notes and Debentures	--	--	20	--
Preferred Stock	--	--	--	--
Common Stock	91	--	91	--
Surplus	341	--	341	--
Undivided Profits	163	--	163	--
Total Equity Capital	595	--	595	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items December 31, 1973
(Millions $)

Morgan Guaranty Trust

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	3,350	2,715	6,065	45
Federal Funds Sold	87	--	87	--
Other Loans, Gross	6,545	3,926	10,470	37
Securities	1,408	1,073	2,481	43
Other Assets	685	175	861	20
TOTAL ASSETS	13,150	7,156	20,307	35
TOTAL DEPOSITS	8,875	6,492	15,367	42
Demand Deposits	5,761	--	5,761	--
Time Deposits 1/	3,111	6,495	9,606	68
Federal Funds Purchased	1,569	--	1,569	--
Other Liabilities	634	321	955	34
TOTAL LIABILITIES	11,764	7,149	18,913	38
Capital Notes and Debentures	191	--	191	--
Preferred Stock	--	--	--	--
Common Stock	237	--	237	--
Surplus	427	--	427	--
Undivided Profits	359	--	359	--
TOTAL EQUITY CAPITAL	1,024	--	1,024	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items December 31, 1973
(Millions $)

Marine Midland Bank

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Bank	1,106	2,592	3,698	70
Federal Funds Sold	11	--	11	--
Other Loans, Gross	1,686	1,379	3,065	45
Securities	345	167	512	33
Other Assets	53	110	163	68
TOTAL ASSETS	3,363	4,207	7,570	56
TOTAL DEPOSITS	2,699	3,956	6,655	59
Demand Deposits	1,817	--	1,817	--
Time Deposits 1/	888	3,950	4,838	82
Federal Funds Purchased	273	--	273	--
Other Liabilities	104	135	239	57
TOTAL LIABILITIES	3,140	4,177	7,317	57
Capital Notes and Debentures	--	30	30	--
Preferred Stock	--	--	--	--
Common Stock	61	--	61	--
Surplus	83	--	83	--
Undivided Profits	47	--	47	--
TOTAL EQUITY CAPITAL	190	--	190	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items December 31, 1973
(Millions $)

Irving Trust Company

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	1,616	1,631	3,247	50
Federal Funds Sold	51	---	51	--
Other Loans, Gross	3,230	527	3,757	14
Securities	765	31	796	4
Other Assets	94	45	139	32
TOTAL ASSETS	6,005	2,211	8,216	27
TOTAL DEPOSITS	4,837	2,133	6,970	31
Demand Deposits	3,124	--	3,124	--
Time Deposits 1/	1,693	2,153	3,846	56
Federal Funds Purchased	325	-7	318	-2
Other Liabilities	102	57	159	36
TOTAL LIABILITIES	5,638	2,206	7,844	28
Capital Notes and Debentures	--	--	--	--
Preferred Stock	--	--	--	--
Common Stock	91	--	91	--
Surplus	153	--	153	--
Undivided Profits	78	--	78	--
TOTAL EQUITY CAPITAL	323	--	323	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items December 31, 1973
(Millions $)

Bank of New York

Item	Domestic	Foreign	Total Consolidated	% of Foreign to Total
Cash and Due From Banks	392	440	832	53
Federal Funds Sold	3	--	3	--
Other Loans, Gross	1,071	97	1,168	8
Securities	303	2	305	1
Other Assets	24	9	33	27
TOTAL ASSETS	1,827	546	2,373	23
TOTAL DEPOSITS	1,413	540	1,953	28
Demand Deposits	995	--	995	--
Time Deposits 1/	418	540	958	56
Federal Funds Purchased	204	--	203	--
Other Liabilities	23	6	29	21
TOTAL LIABILITIES	1,648	546	2,194	25
Capital Notes and Debentures	--	--	--	--
Preferred Stock	--	--	--	--
Common Stock	31	--	31	--
Surplus	69	--	69	--
Undivided Profits	61	1	62	--
TOTAL EQUITY CAPITAL	161	1	162	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

Selected Call Report Items (December 31, 1973)
(Millions $)

Franklin National Bank

Item	Domestic	Foreign	Total Consolidated	% of Foreign to total
Cash and Due From Banks	615	581	1,196	49
Federal Funds Sold	110	--	110	--
Other Loans, Gross	2,172	595	2,767	21
Securities	626	103	729	14
Other Assets	84	27	111	24
TOTAL ASSETS	3,805	1,191	4,996	24
TOTAL DEPOSITS	2,600	1,131	3,732	30
Demand Deposits	1,410	--	1,410	--
Time Deposits 1/	1,189	1,131	2,321	49
Federal Funds Purchased	797	--	797	--
Other Liabilities	93	29	122	24
TOTAL LIABILITIES	3,551	1,192	4,743	25
Capital Notes and Debentures	58	--	58	--
Preferred Stock	19	--	19	--
Common Stock	27	--	27	--
Surplus	82	--	82	--
Undivided Profits	40	--	40	--
TOTAL EQUITY CAPITAL	168	--	168	--

1/ A small share of deposits in foreign branches is represented by demand deposits. Thus, this item is overstated slightly for foreign branches.

STRICTLY CONFIDENTIAL (FR)

Daily Average Euro-dollar Borrowings by U.S. Banks from their Foreign Branches in the Computation Period Ended March 13, 1974 and December 19, 1973 And Number of Foreign Branches
(millions of dollars)

	March 13, 1974 Net Liabilities + Assets Sold	December 19, 1973 Net Liabilities + Assets Sold	December 31, 1973 Number of Foreign Branches
Chase Manhattan Bank, N.Y.	389.9	501.8	104
First National City Bank, N.Y.	a/*	3.1	239
Manufacturers Hanover Trust Co., N.Y.	60.0	2.3	6
Chemical Bank, N.Y.	430.5	108.2	8
Bankers Trust Company, N.Y.	103.2	30.0	6
Morgan Guaranty Trust	a/*	42.6	12
Marine Midland Bank, N.Y.	13.0	27.7	5
Irving Trust Co.	a/*	114.3	5
The Bank of New York, N.Y.	31.2	60.7	2
Franklin National Bank, Brooklyn	1.0	1.1	2

*Less than $50,000
a/ Assets sold only; net liabilities were reported as negative but the amount was not shown.
b/ N.A. but assumed zero
c/ Did not report

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 25, 1974

To Chairman Burns

Subject: Bank Loans to Foreigners

From Robert F. Gemmill

In response to your request at a recent briefing, I am attaching two tables on bank loans to foreign commercial banks and to private nonbank foreigners from November 1973 through the latest date available.

The tables show both weekly and monthly data for these types of loans. As the figures on outstandings suggest, the coverage of the weekly data is considerably smaller than for the monthly data. The weekly data are reported only by the weekly reporting banks (as regards loans to foreign commercial banks) or by a sub-sample of these (as regards commercial and industrial loans).

By contrast, the monthly data are reported by all banks in the United States with foreign claims of at least $500,000, including the following institutions which are not weekly reporting banks: U.S. agencies, branches and subsidiaries of foreign banks, and Edge Act Corporations.

In addition to the difference in coverage, comparison of the two series is made difficult by the differences in timing of the reporting dates.

Table 1. Bank Loans to Foreign Commercial Banks
(millions of dollars)

	Weekly data[1/]		Monthly data[2/]	
	Date	Amount	Date	Amount
Outstandings				
	1973-Nov. 28	4,543	1973-Nov. 30	4,639
	1974-Jan. 2	5,093	Dec. 31	5,159
	Jan. 30	4,637	1974-Jan. 31	4,988
	Feb. 27	4,714	Feb. 28	5,572
	Mar. 27	5,863	Mar. 31	6,450
	May 1	6,365	Apr. 30	6,877
	May 29	6,328		
	June 12	6,209		
Changes (no sign = increase)				
	5 wks. to Jan. 2	550	December	520
	4 wks. to Jan. 30	-456	January	-171
	4 wks. to Feb. 27	77	February	584
	4 wks. to Mar. 27	1,149	March	878
	5 wks. to May 1	502	April	427
	4 wks. to May 29	-37		
	2 wks. to June 12	-119		

1/ From FR 416 filed by 328 weekly reporting banks.
2/ From Treasury foreign exchange forms.

Table 2. Bank Loans to Nonbank Private Foreigners
(millions of dollars)

	Weekly data[1/]		Monthly data[2/]	
	Date	Amount	Date	Amount
Outstandings				
	1973-Nov. 28	3,352	1973-Nov. 30	6,294
	1974-Jan. 2	4,092	Dec. 31	6,464
	Jan. 30	4,159	1974-Jan. 31	6,199
	Feb. 27	4,017	Feb. 28	6,311
	Mar. 27	4,198	Mar. 31	6,422
	May 1	4,381	Apr. 30	6,816
	May 29	4,478		
	June 12	4,647[p]		
Changes (no sign = increase)				
	5 wks. to Jan. 2	740	December	170
	4 wks. to Jan. 30	67	January	-265
	4 wks. to Feb. 27	-142	February	112
	4 wks. to Mar. 27	181	March	111
	5 wks. to May 1	183	April	394
	4 wks. to May 29	97		
	2 wks. to June 12	169		

1/ Commercial and industrial loans only. From FR 416a, filed by about 160 (one-half) of the weekly reporting banks.
2/ From Treasury foreign exchange forms.
p/ Preliminary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 26, 1974

To Chairman Burns

From Samuel Pizer SP

Subject: Foreign Lending and Borrowing by U.S. Banks

Reports on the balance of payments situation have indicated for some time that U.S. banks have been very active this year as foreign lenders, and also in borrowing from abroad. The data from the post-VFCR monitoring reports show vividly the steep rise in the foreign assets of U.S. banks through May, amount to $8-1/2 billion for their own account and $1.3 billion for the account of customers. Data from the Treasury reports used in compiling the balance of payments show the same pattern of increase, with foreign assets rising by $9.6 billion in the January-May period. The balance of payments data also show, however, that short-term liabilities of the banks to private foreigners rose by $7.1 billion in the same period, so the net bank-reported outflow was about $2-1/2 billion (table 1, attached).

Data for bank lending in June are still partial, but there was probably an increase in claims of over $1.5 billion. Whether this was fully offset by an increase in comparable liabilities is still not clear, though liabilities to foreign accounts have been rising substantially, especially in recent weeks.

I am attaching a note which explores the Treasury data in more detail. We are also examining other data available on banks' foreign activities and should be able to provide a more rounded picture of these activities when more information is pulled together.

Notes on Capital Flows Through U.S. Banks in January - May 1974

The following are the main points that emerge from a close look at the monthly Treasury data on international capital flows through U.S. banks for the period 12/73 - 5/74:

1) Total reported claims increased by $9.6 billion; total reported liabilities (apart from Treasury obligations held in custody for foreign official accounts) rose by $7.1 billion; consequently, net foreign claims by banks rose by about $2-1/2 billion (table 1).

2) The gross increase in claims includes an increase of $1.3 billion in claims held for account of customers (derived from the VFCR reports); if this also is netted out, the net increase in claims on foreigners by banks becomes about $1.2 billion.

3. Most of the large flows of funds in both directions have been vis-a-vis foreign banks (table 6) and much of this appears to be between U.S. banks and their foreign branches, or the U.S. agencies and branches of foreign banks and their head offices. Unfortunately, the Treasury data do not give a clear breakdown for dealings among banks, but most of what appears in table 6 represents such transactions. In that table, it can be seen that net claims on foreign banks increased about $0.9 billion in January-May, and that within that total there was a large increase -- about $3.8 billion -- in U.S. banks' net borrowed position vis-a-vis Europe, and an increase in net asset positions vis-a-vis other areas, especially a net increase of $2.9 billion in the net asset position with Japan.

4) Within the banking data (table 6), it can be estimated from various sources that of the \$6.5 billion increase in liabilities (from \$17.2 billion to \$23.7 billion) about \$3.2 billion represented liabilities to foreign branches of U.S. banks, and about \$1.8 billion was in liabilities to foreigners reported by U.S. agencies and branches of foreign banks. There was only a minor increase (\$0.5 billion) in deposit liabilities to foreign banks. Most of the increase in liabilities shows up opposite Europe, representing mainly Euro-market flows, plus an increase of about \$1.0 billion in amounts due to the Bahamas (presumably largely to U.S. branches there). On the asset side, increases are more scattered; the largest increase is \$2.6 billion for Japan, and there is also an increase of \$1.0 billion for the Bahamas, matching the increase in liabilities noted above.

5) Apart from transactions with foreign banks, foreign claims and liabilities of U.S. banks did not show any striking activity in the first five months of the year. Claims on other foreigners (tables 4 and 5) show a minor increase (\$0.1 billion) in loans to foreign official institutions and \$0.3 billion in other loans. Collections outstanding were up \$0.8 billion -- mainly against Japan -- and this could be largely customers' claims. On the liability side (tables 2 and 3), there was a small reduction in liabilities to foreign official institutions (other than their holdings of U.S. Government obligations), but a large element in this was a switch by international organizations out of CD's into Agency securities -- a matter of no significance. There were scattered increases in banks' liabilities to foreigners other than official institutions and banks, which aggregate to about \$1.0 billion for the five months -- but it is difficult to attach any particular significance to this.

What can be said in general about this pattern of flows?

a) The increases reported in claims probably could not have occurred without the lifting of the VFCR, so to some extent we are seeing foreign loan activity shifting back to U.S. offices of the banks.

b) Changes in borrowings from foreign banks -- largely drawings from the Eurodollar market -- are not necessarily related to the step-up in foreign lending from U.S. offices; use of this source of funds depends primarily on relative costs of funds here and abroad (not necessarily realistically measured by quoted interest rates), and probably also to a degree on banks' rules of thumb regarding some desired distribution over time among the various sources of funds they can draw on. In more recent weeks, there is probably an impact from large deposits in London by oil-producing countries, in the sensethat the London branches are unable to place such funds immediately into appropriate channels abroad, so that a large residual amount spills over into U.S. money markets.

c) There is little evidence of direct lending to countries especially hit by increases in their oil imports (except for Japan, where other factors also operate), and probably only the beginnings of any direct placements in the U.S. by the oil-producing countries.

Samuel Pizer
July 26, 1974

Table 1

International Capital Flows Reported by U.S. Banks
(in billions of dollars; outflow from U.S. (-))

	1973	1974						
	Year	Q-1	Jan.	Feb.	Mar.	April	May	Jan-May
Capital flows reported by U.S. banks								
Short-term claims on foreigners	-5.0	-4.9	- .4	-1.9	-2.7	- .9	-3.0	-8.8
Liquid	-1.1	-2.2	- .6	- .9	- .8	+ .5	-1.5	-3.2
Nonliquid	-3.9	-2.7	+ .2	-1.0	-1.9	-1.4	-1.5	-5.6
Short-term liabilities to private foreigners	+4.4	+4.3	+ .4	+1.7	+2.2	+ .2	+2.6	+7.1
To: Commercial banks	+3.0	+4.4	+ .4	+1.7	+2.3	*	+2.2	+6.6
International & regional organizations	+ .4	- .6	*	- .1	- .4	- .1	+ .3	- .4
Other foreigners	+1.1	+ .6	+ .1	+ .2	+ .3	+ .3	+ .1	+1.0
(to foreign branches of U.S. banks)	(+ .3)	(+3.4)	(- .2)	(*)	(+3.6)1/	(-2.0)1/	(+1.8)	(+3.2)
Net short-term banking flows	- .6	- .6	--	- .2	- .5	- .7	- .4	-1.7
Long-term claims on foreigners	- .8	- .2	+ .1	- .1	- .2	- .6	*	- .8
Net flows, short- and long-term	-1.4	- .8	+ .1	- .3	- .7	-1.3	- .4	-2.5

1/ Includes temporary month-end bulge in March of about $2.0 billion, which was reversed in April.

* = Less than $50 million.

Details may not add to totals because of rounding.

Table 2

CONFIDENTIAL (FR)

Liabilities to Foreigners Reported by U.S. Banks
(Treasury B-1 Reports), Outstanding 12/73 and 5/74
($ billions)

	Official					Commercial Banks				Other				
		Deposits		Treas.			Deposits				Deposits			Fgn.
	Total	Demand	Time	Oblig.	Other 1/	Total	Demand	Time	Other 1/	Total	Demand	Time	Other 1/	Curr.
December 1973														
Total	45.9	2.2	4.0	31.9	7.8	17.2	6.9	.5	9.7	5.7	2.2	2.5	1.0	.6
Europe	31.6	.6	1.8	24.7	4.6	7.7	3.8	.1	3.7	1.2	.5	.3	.5	.4
(U.K.)	(3.0)	(x)	(-)	(3.0)	-	(2.6)	(.7)	(.1)	(1.8)	(.4)	(.1)	(x)	(.3)	(.1)
Canada	.8	x	x	.7	.1	2.3	.2	.2	1.9	.7	.3	.3	.1	.1
Latin America	2.5	.8	1.1	.2	.4	2.0	1.0	.1	.9	3.0	1.0	1.6	.4	x
Venezuela	(1.0)	(.2)	(.7)	-	(.1)	(.1)	(.1)	(x)	(x)	(.3)	(.1)	(.2)	(x)	(x)
Bahamas	-	-	-	-	-	(.7)	(.1)	(.1)	(.5)	(.1)	-	-	-	-
Asia	5.5	.5	.6	3.4	.9	4.6	1.4	.1	3.1	.7	.3	.3	.1	.1
Japan	(3.7)	(.1)	(x)	(3.0)	(.5)	(3.2)	(.7)	(x)	(2.5)	(.1)	(x)	(x)	(x)	(x)
Africa	.6	.1	.1	.4	x	.3	.3	x	x	.1	.1	x	x	x
Other Countries	2.9	x	.3	2.0	.5	.2	.2	x	x	x	x	x	x	x
Int'l Orgs.	2.0	.1	.1	.3	1.5	-	-	-	-	-	-	-	-	-
May 1974														
Total	47.3	2.4	4.0	33.8	7.0	23.7	7.1	.8	15.9	6.7	2.3	2.9	1.5	.7
Europe	28.5	.6	1.5	22.3	4.1	12.8	3.9	.3	8.6	1.6	.6	.3	.7	.4
(U.K.)	(2.8)	(.1)	(x)	(2.6)	(x)	(5.4)	(.5)	(.1)	(4.7)	(.6)	(.1)	(.1)	(.3)	(.1)
Canada	1.0	x	x	.9	x	2.4	.2	.2	2.0	.6	.2	.2	.1	.2
Latin America	3.3	.8	1.3	.5	.7	3.4	1.0	.2	2.2	3.5	1.0	2.0	.4	x
Venezuela	(1.8)	(.4)	(1.1)	-	(.3)	(.1)	(.1)	(x)	(x)	(.4)	(.1)	(.2)	(x)	(x)
Bahamas	(x)	-	-	-	-	(1.7)	(x)	(.2)	(1.5)	(.1)	x	x	x	x
Asia	8.9	.6	.7	6.9	.6	4.5	1.4	.1	3.0	.9	.4	.3	.2	x
Japan	(6.0)	(.1)	(x)	(5.8)	(.1)	(2.9)	(.6)	(x)	(2.3)	(.1)	(.1)	(x)	(x)	(x)
Africa	1.5	.2	.1	1.1	(x)	.4	.4	x	x	.1	.1	x	x	x
Other Countries	2.8	x	.2	2.0	.5	.2	.2	x	x	x	x	x	x	x
Int'l Orgs.	1.3	.1	.1	x	1.1	-	-	-	-	-	-	-	-	-

1/ Includes CD's.

x = Less than $50 million.

Details may not add to totals because of rounding.

CONFIDENTIAL (FR)

Table 3

Changes in Liabilities to Foreigners Reported by U.S. Banks
(Treasury B-1 Reports), 12/73 -- 5/74
($ billions)

	Official					Commercial Banks				Other				
		Deposits		Treas.			Deposits				Deposits			Fgn.
	Total	Demand	Time	Oblig.	Other 1/	Total	Demand	Time	Other 1/	Total	Demand	Time	Other 1/	Curr.
Total	+1.4	+.2	-	+1.9	-.8	+6.5	+.2	+.3	+6.2	+1.0	+.1	+.4	+.5	+.1
Europe	-3.1	-	-.3	-2.4	-.5	+5.1	+.1	+.2	+4.9	+ .4	+.1	-	+.2	-
(U.K.)	(- .2)	(+.1)	(0)	(- .4)	(0)	(+2.8)	(-.2)	(-)	(+2.9)	(+ .2)	(-)	(+.1)	(-)	(-)
Canada	+ .2	0	0	+ .2	-.1	+ .1	-	-	+ .1	- .1	-.1	-.1	-	+.1
Latin America	+ .8	-	+.2	+ .3	+.3	+1.4	-	+.1	+1.3	+ .5	-	+.4	-	0
Venezuela	(+ .8)	(+.2)	(+.4)	(-)	(+.2)	(-)	(-)	(0)	(0)	(+ .1)	(-)	(-)	(0)	(0)
Bahamas	(0)	(-)	(-)	(-)	(-)	(+1.0)	(-.1)	(+.1)	(+1.0)	(-)	(0)	(0)	(0)	(0)
Asia	+3.4	+.1	+.1	+3.5	-.3	- .1	-	-	- .1	+ .2	+.1	-	+.1	-.1
Japan	(+2.3)	(-)	(0)	(+2.8)	(-.4)	(- .3)	(-.1)	(0)	(- .2)	(-)	(+.1)	(0)	(0)	(0)
Africa	+ .9	+.1	-	+ .7	0	+ .1	+.1	0	0	-	-	0	0	0
Other Countries	- .1	0	-.1	-	-	-	-	0	0	0	0	0	0	[illegible]
Int'l Orgs.	- .7	-	-	- .3	-.4	-	-	-	-	-	-	-	-	-

1/ Includes CD's.
x = Less than $50 million.
Detail may not add to totals because of rounding.

Table 4

Claims on Foreigners Reported by U.S. Banks
(Treasury B-2 & B-3 Reports), 12/73 and 5/74
($ billions)

December 1973

	Total	Loans Offic.	Loans Banks	Loans Other	Loans Total	Collect.	Accept.	Other	For. Curr.	B-3 Total	Total B-2 & B-3
Total	20.7	.3	4.6	2.9	7.7	4.3	4.2	3.9	.7	5.9	26.6
Europe	4.0	.1	1.4	.4	1.8	.5	.2	1.2	.3	1.2	5.2
(U.K.)	(1.5)	(x)	(.5)	(.1)	(.6)	(.1)	(.1)	(.6)	(.1)	(.1)	(1.6)
Canada	2.0	x	.2	.6	.8	x	.1	.8	.3	.5	2.5
Latin America	5.9	.1	1.8	1.6	3.4	.7	.9	.8	.1	2.1	8.0
Venezuela	(.5)	x	(.1)	(.3)	(.4)	(.1)	x	x	x	(.3)	(.8)
Bahamas	(.9)	-	(.2)	(.1)	(.2)	x	x	(.6)	x	(x)	(.9)
Asia	8.2	.1	1.1	.2	1.5	3.0	2.7	1.1	x	1.5	9.7
Japan	(6.4)	x	(.7)	(x)	(.7)	(2.6)	(2.2)	(.9)	x	(.2)	(6.6)
Africa	.4	x	.1	.1	.2	.1	.1	x	x	.4	.8
Other Countries	.3	x	x	x	.1	.1	.1	x	x	.2	.5

May 1974

	Total	Loans Offic.	Loans Banks	Loans Other	Loans Total	Collect.	Accept.	Other	For. Curr.	B-3 Total	Total B-2 & B-3
Total	29.6	.4	6.6	3.2	10.2	5.1	6.5	7.0	.9	6.7	36.[illegible]
Europe	5.6	.1	2.0	.4	2.6	.5	.3	1.8	.4	1.7	7.3
(U.K.)	(2.2)	x	(.6)	(.1)	(.7)	(.1)	(.1)	(1.2)	(.1)	(.2)	(2.4)
Canada	2.4	x	.2	.4	.6	x	.1	1.3	.3	.5	2.9
Latin America	8.3	.1	2.5	1.8	4.5	.7	1.1	1.8	.1	2.4	10.7
Venezuela	(.6)	x	(.1)	(.3)	(.4)	(.1)	x	x	x	(.3)	(.9)
Bahamas	(1.9)	x	(.3)	(.1)	(.4)	x	x	(1.5)	x	(x)	(1.9)
Asia	12.4	.1	1.6	.4	2.2	3.5	4.6	1.9	.1	1.6	14.0
Japan	(9.7)	x	(1.0)	(.2)	(1.3)	(3.1)	(3.7)	(1.7)	(.1)	(.2)	(9.9)
Africa	.6	x	.1	.1	.3	.1	.1	x	x	.3	.9
Other Countries	.4	x	.1	x	.1	.1	.2	x	x	.2	.6

Detail may not add to totals because of rounding.

x = Less than $50 million.

Table 5

Change in Claims on Foreigners Reported by U.S. Banks
(Treasury B-2 & B-3 Reports), 12/73 -- 5/74
($ billions)

		Loans									Total
		Offic.	Banks	Other	Total	Collect	Accept.	Other	For.	B-3	B-2 &
	Total								Curr.	Total	B-3
Total	+8.9	+.1	+2.0	+.3	+2.5	+.8	+2.3	+3.1	+.2	+.8	+9.6
Europe	+1.6	-	+ .6	-	+ .8	-	+ .1	+ .6	+.1	+.5	+2.1
(U.K.)	(+ .7)	(0)	(+ .1)	(-)	(+ .1)	(-)	(-)	(+ .6)	(-)	(+.1)	(+ .8)
Canada	+ .4	0	-	-.2	- .2	0	-	+ .5	-	-	+ .4
Latin America	+2.4	-	+ .7	+.2	+1.1	-	+ .2	+1.0	-	+.3	+2.7
Venezuela	(+ .1)	(0)	(-)	(-)	(-)	(-)	(0)	(0)	(0)	(-)	(+ .1)
Bahamas	(+1.0)	(0)	(+ .1)	(-)	(+ .2)	(0)	(0)	(+ .9)	(0)	(0)	(+1.0)
Asia	+4.2	-	+ .5	+.2	+ .7	+.5	+1.9	+ .8	+.1	+.1	+4.3
Japan	(+3.3)	(0)	(+ .3)	(+.2)	(+ .6)	(+.5)	(+1.5)	(+ .8)	(+.1)	(-)	(+3.3)
Africa	+ .2	0	-	-	+ .1	-	-	0	0	-.1	+ [illegible]
Other Countries	+ .1	0	+ .1	0	-	-	+ .1	0	0	-	+ .1

x = Less than $50 million.

Detail may not add to totals because of rounding.

Table 6 CONFIDENTIAL (FR)

U.S. Banks' Positions Vis-a-Vis Banks Abroad - 12/73 and 5/74

($ billions)

	Due to Foreign Banks			Due from Foreign Banks				Net	Change in Net Position
	Total	Deposits	Other[1/]	Total	Loans	Accept.	Other[1/]	Position	12/73 - 5/74
December 1973									
Total	17.2	7.4	9.7	12.7	4.6	4.2	3.9	-4.5	
Europe	7.7	3.9	3.7	2.8	1.4	.2	1.2	-4.9	
(U.K.)	(2.6)	(.8)	(1.8)	(1.2)	(.5)	(.1)	(.6)	(-1.4)	
Canada	2.3	.4	1.9	1.1	.2	.1	.8	-1.2	
Latin America	2.0	1.1	.9	3.5	1.8	.9	.8	+1.5	
Venezuela	(.1)	(.1)	(0)	(.1)	(.1)	(0)	(0)	(0)	
Bahamas	(.7)	(.2)	(.5)	(.8)	(.2)	(0)	(.6)	(+ .1)	
Asia	4.6	1.5	3.1	4.9	1.1	2.7	1.1	+ .3	
Japan	(3.2)	(.7)	(2.5)	(3.8)	(.7)	(2.2)	(.9)	(+ .6)	
Africa	.3	.3	0	.2	.1	.1	0	- .1	
Other Countries	.2	.2	0	.1	0	.1	0	- .1	
May 1974									
Total	23.7	7.9	15.8	20.1	6.6	6.5	7.0	-3.6	+ .9
Europe	12.8	4.2	8.5	4.1	2.0	.3	1.8	-8.7	-3.8
(U.K.)	(5.4)	(.6)	(4.7)	(1.9)	(.6)	(.1)	(1.2)	(-3.5)	(-2.1)
Canada	2.4	.4	2.0	1.6	.2	.1	1.3	- .8	+ .4
Latin America	3.4	1.2	2.2	5.5	2.5	1.1	1.8	+2.1	+ .6
Venezuela	(.1)	(.1)	(0)	(.1)	(.1)	(0)	(0)	-	-
Bahamas	(1.7)	(.2)	(1.5)	(1.8)	(.3)	(0)	(1.5)	(+ .1)	-
Asia	4.5	1.5	3.0	8.2	1.6	4.6	1.9	+3.7	+3.4
Japan	(2.9)	(.6)	(2.3)	(6.4)	(1.0)	(3.7)	(1.7)	(+3.5)	(+2.9)
Africa	.4	.4	0	.3	.1	.1	.1	- .1	0
Other Countries	.2	.2	0	.3	.1	.2	0	+ .1	+ .2

1/ "Other" includes, among other things, accounts between U.S. banks and their foreign branches or head offices.
x = Less than $50 million.
Detail may not add to totals because of rounding.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 22, 1974

To Records Section

From Frederick R. Dahl FRD

Subject: Changes in Overseas Branches of United States Banks and Foreign Banking Corporations during quarter ended June 30, 1974

Overseas Branches Opened

Chemical Bank, New York	Singapore	4-22-74
The First National Bank of Boston, Boston	Frankfurt, Germany	5-14-74
	Tokyo, Japan	6-3-74
The First National Bank of Chicago, Chicago	Bridgetown, Barbados	6-19-74
	Newcastle-Upon-Tyne, England	6-10-74
	Nairobi, Kenya	6-3-74
	Dubai, United Arab Emirates	4-15-74
The First National Bank of Denver, Denver	Georgetown, Grand Cayman, Cayman Islands, W.I.	6-12-74
First National City Bank, New York	Cartagena, Colombia	5-28-74
	Amman, Jordan	6-1-74
	Port Louis, Mauritius	6-3-74
Manufacturers Hanover Trust Company, New York	Bucharest, Romania	5-27-74
Mellon Bank, N.A., Pittsburgh	Tokyo, Japan	4-15-74
Seattle-First National Bank, Seattle	London, England	4-16-74
United Virginia Bank, Richmond	Georgetown, Grand Cayman, Cayman Islands, W.I.	5-1-74
Worcester County National Bank, Worcester	Georgetown, Grand Cayman, Cayman Islands, W.I.	4-22-74

Overseas Branches Closed

The Chase Manhattan Bank, National Association, New York	Castries, St. Lucia	4-9-74
First National City Bank, New York	Bahia Blanca, Argentina	4-30-74
M & I Marshall & Ilsley Bank, Milwaukee	Nassau, Bahamas	6-30-74
Wells Fargo Bank, National Association, San Francisco	Frankfurt, Germany	5-31-74

As of June 30, 1974, overseas branches of member banks and foreign banking Corporations totaled 736 as follows:

State Member Banks

American Security and Trust Company, Washington, D.C.	1	
The Bank of New Orleans and Trust Company, New Orleans	1	
The Bank of New York, New York	2	
Bankers Trust Company, New York	6	
Chemical Bank, New York	10	
The Cleveland Trust Company, Cleveland	1	
Commerce Union Bank, Nashville	1	
The Connecticut Bank and Trust Company, Hartford	1	
The Detroit Bank & Trust Company, Detroit	1	
The Fidelity Bank, Rosemont, Pennsylvania	2	
Fidelity Union Trust Company, Newark	1	
First Pennsylvania Banking and Trust Company, Bala-Cynwyd	3	
First Virginia Bank, Falls Church	1	
Girard Trust Bank, Bala-Cynwyd, Pennsylvania	1	
Harris Trust and Savings Bank, Chicago	2	
Irving Trust Company, New York	5	
Manufacturers Hanover Trust Company, New York	7	
Marine Midland Bank-New York, New York	5	
Marine Midland Bank-Western, Buffalo	1	
Morgan Guaranty Trust Company of New York, New York	12	
The Northern Trust Company, Chicago	2	
Old Kent Bank and Trust Company, Grand Rapids	1	
Peoples Trust of New Jersey, Hackensack	1	
Southern Arizona Bank and Trust Company, Tucson	1	
State Street Bank and Trust Company, Boston	1	
Trust Company of Georgia, Atlanta	1	
Union Bank, Los Angeles	1	
The Union Commerce Bank, Cleveland	1	
United California Bank, Los Angeles	3	
United Virginia Bank, Richmond	2	78

National Banks

American Fletcher National Bank and Trust Company, Indianapolis	2
American National Bank and Trust Company of Chicago, Chicago	2
American National Bank and Trust Company of New Jersey, Montclair	1
Bank of America National Trust and Savings Association, San Francisco	104

The Bank of California National Association, San Francisco	2
Bank of the Southwest National Association, Houston	1
Capital National Bank, Houston	1
Central National Bank in Chicago, Chicago	1
Central National Bank of Cleveland, Cleveland	1
Central Penn National Bank, Philadelphia	1
The Chase Manhattan Bank, National Association, New York	103
The Citizens and Southern National Bank, Savannah	1
City National Bank of Detroit, Detroit	1
Continental Illinois National Bank and Trust Company of Chicago, Chicago	15
Crocker National Bank, San Francisco	2
Equibank N.A., Pittsburgh	2
Exchange National Bank of Chicago, Chicago	3
The Fidelity National Bank, Lynchburg, Virginia	1
First and Merchants National Bank, Richmond	1
First American National Bank, Nashville	1
First City National Bank of Houston, Houston	2
The First National Bank and Trust Company of Tulsa, Tulsa	1
First National Bank in Dallas, Dallas	3
First National Bank in St. Louis, St. Louis	1
First National Bank of Arizona, Phoenix	1
First National Bank of Atlanta, Atlanta	1
The First National Bank of Birmingham, Birmingham	1
The First National Bank of Boston, Boston	31
The First National Bank of Chicago, Chicago	21
First National Bank of Commerce, New Orleans	1
The First National Bank of Denver, Denver	1
First National Bank of Fort Worth, Fort Worth	1
First National Bank of Louisville, Louisville	1
First National Bank of Maryland, Baltimore	1
First National Bank of Memphis, Memphis	1
The First National Bank of Miami, Miami	1
First National Bank of Minneapolis, Minneapolis	1
First National Bank of Oregon, Portland	1
The First National Bank of Saint Paul, St. Paul	1
First National City Bank, New York	247
The First New Haven National Bank, New Haven	1
First National State Bank of New Jersey, Newark	1
First Union National Bank of North Carolina, Charlotte	1
First Wisconsin National Bank of Milwaukee, Milwaukee	1
The Fort Worth National Bank, Fort Worth	1
Franklin National Bank, Brooklyn, New York	2

Hartford National Bank and Trust Company, Hartford	1
Hibernia National Bank, New Orleans	1
Houston National Bank, Houston	1
The Huntington National Bank, Columbus	1
The Indiana National Bank of Indianapolis, Indianapolis	2
Industrial National Bank, Providence	1
LaSalle National Bank, Chicago	1
The Liberty National Bank and Trust Company, Oklahoma City	1
Manufacturers National Bank of Detroit, Detroit	1
Marine National Exchange Bank, Milwaukee	1
Maryland National Bank, Baltimore	1
Mellon Bank, N.A., Pittsburgh	3
Mercantile Trust Company National Association, St. Louis	1
Merchants National Bank and Trust Company of Indianapolis, Indianapolis	1
Midlantic National Bank, Newark	1
National Bank of Commerce, Memphis	1
The National Bank of Commerce of Seattle, Seattle	2
National Bank of Detroit, Detroit	3
National Bank of North America, New York	1
National Central Bank, Lancaster, Pennsylvania	1
The National City Bank of Cleveland, Cleveland	1
National City Bank of Minneapolis, Minneapolis	1
The National Shawmut Bank of Boston, Boston	1
New England Merchants National Bank, Boston	1
New Jersey Bank National Association, Clifton	1
North Carolina National Bank, Charlotte	2
Northwestern National Bank of Minneapolis, Minneapolis	2
The Omaha National Bank, Omaha	1
The Philadelphia National Bank, Philadelphia	2
Pittsburgh National Bank, Pittsburgh	1
Provident National Bank, Bryn-Mawr, Pennsylvania	1
Republic National Bank of Dallas, Dallas	2
Republic National Bank of New York, New York	1
The Riggs National Bank of Washington, D.C.	1
Seattle-First National Bank, Seattle	2
Security Pacific National Bank, Los Angeles	4
Society National Bank of Cleveland, Cleveland	1
Sterling National Bank & Trust Company, New York	1
Texas Commerce Bank National Association, Houston	2
Third National Bank in Nashville, Nashville	1

Union Planters National Bank of Memphis, Memphis	1		
United Bank of Denver, National Association, Denver	1		
United States National Bank of Oregon, Portland	1		
United Virginia Bank/Seaboard National, Norfolk	1		
Valley National Bank of Arizona, Phoenix	1		
Virgin Islands National Bank, Charlotte Amalie, St. Thomas	4		
Virginia National Bank, Norfolk	1		
Wachovia Bank and Trust Company, National Association, Winston-Salem	1		
Wells Fargo Bank, National Association, San Francisco	3		
The Whitney National Bank of New Orleans, New Orleans	1		
Winters National Bank and Trust Company of Dayton, Dayton	1		
Worcester County National Bank, Worcester	1	644	722

Section 25(a) Corporations

Allied Bank International, New York	2		
Bank of America, New York	1		
Bank of Boston International, New York	1		
Detroit Bank and Trust International, Detroit	1		
First National City Overseas Investment Corporation, New York	1		
International Bank of Commerce, Seattle	5		
International Bank of Detroit, Detroit	1		
Philadelphia International Investment Corporation, Philadelphia	1		
State Street Bank Boston International, New York	1	14	736

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 23, 1974

To Board of Governors

Subject: Board policy on bank expansion: Applications to expand into the Middle East and/or OPEC countries.

From Divisions of Banking Supervision and Regulation and International Finance
MGM (Messrs. Martinson, Dahl and Gemmill)

Issues

The Board is currently following a policy of denying applications which involve "significant" expansionary projects by banks whose condition is viewed as less than satisfactory. Most of the large U.S. banks engaged in international banking fall into that category. Several of these are now seeking to enter the Middle East, a financially important area which has heretofore been largely neglected by U.S. banks. The issue before the Board is whether there are special public benefits, beyond those generally present in foreign investments, which warrant making an exception to the Board's policy on expansion for applications involving ventures in the Middle East and/or OPEC countries.

Accompanying this memorandum are applications from major U.S banks involving Iran, Kuwait, Bahrain, Egypt, and Nigeria. As can be seen, these applications involve oil producing countries and non-oil producing of the Middle East as well as one non-Middle East oil producing country. Because of the differences among the applications, not all of the policy arguments set forth in this memorandum may apply to each application.

The discussion in this memorandum refers to the Middle East as a whole and not just to the oil producing countries. This is done for two reasons. First, the "oil problem" is usually discussed in terms of the region as a whole because of political, cultural, and linguistic ties between the various countries. Second, probably the most important applications to other government agencies involve Egypt, a non-oil producing but politically important country in the region.1/

1/ The Nigerian application is included in the batch currently before the Board because, while it is not in the Middle East, it is a major oil producer and many of the policy arguments in the memo would apply to it. Also, this application helps to illustrate some of the problems involved in trying to distinguish between applications on the basis of the country involved.

Background

The presence of U.S. banks in the Middle East is currently limited except in Lebanon where many large U.S. banks operate branches or subsidiary banks. The only Middle East oil countries in which U.S. banks are well represented are the United Arab Emirates, where four banks have branches or joint venture banks. The other U.S. banking operations in the area are two branches of First National City Bank (FNCB) in Saudi Arabia, an FNCB branch in Jordan, branches of FNCB and Chase Manhattan in Bahrain, and joint venture banks by FNCB and Continental Illinois in Iran.

The recent massive flow of oil money to Middle East countries is now prompting major U.S. banks to seek to increase their presence in the area. The primary goals of the banks entering the area appear to be: (1) to share in the financing which will be involved in many of the internal development projects contemplated by countries in the region; (2) to obtain better access to deposits of the oil producing countries; and (3) to sell their international investment advisory and trust services to these countries. Banks hope that having operating facilities "on the spot" will better enable them to accomplish these goals.

Possible special public benefits associated with Middle East investments

The prinicpal economic argument that might be advanced in support of giving special consideration to ventures by U.S. banks in the Middle East is the possible assistance of such ventures in providing suitable investment outlets for revenues of oil producing countries. That argument has two strands. First, the ventures may facilitate increased local utilization of funds within the region, thereby increasing imports and reducing the Middle East's balance of payments surplus with the rest of the world. Second, operations of U.S. banks in the Middle East might aid in providing financing to oil consuming countries. On balance though, the staff finds neither of these arguments sufficiently persuasive to justify making an exception on economic grounds to the Board's general policy on expansion. The Board will, of course, wish to ascertain whether there are special political considerations to be taken into account in connection with these applications.

Increased local utilization of funds

The Middle East has long been neglected by major international financial institutions and because of its generally underdeveloped character, efficient local financial institutions have not developed. Bankers and others argue that the lack of such locally-based institutions severely limits the ability of the region to utilize its petroleum revenues for internal projects. It is possible that U.S. banks, by establishing new facilities in the area, would help fill this void. Indeed, one of the apparent reasons for the recent invitation by the Egyptians to the U.S. banks to establish offices in that country is the belief that those banks will be able to assist in the financing of the development projects Egypt is planning, and that their expertise will help Egypt attract "petrodollars" for these projects from other Arab countries. The latter have indicated an interest in placing money in Egypt but have reportedly been reluctant to do so on a large scale because of the inefficiency of Egyptian institutions. Many of the other proposed ventures before the Board are also to some extent aimed at providing local financing for internal capital projects.

Some of the applications before the Board involve joint ventures with local institutions (in some cases government entities). It is argued that these ventures can play an especially significant role in helping to solve the "utilization problem". This is because there are benefits resulting from these ventures in addition to those accruing from their financing activities. The joint ventures involve the local partner (usually a major institution) in a close working relationship with an international bank with the expertise which is often lacking in the local environment. This can increase the speed with which local institutions are able to accept and adopt modern financial practices. Another favorable aspect of some of these ventures is that they inject some Middle East money in the form of capital into the international banking system.

While operations of U.S. banks may in fact provide some of these benefits, their effect is likely to be marginal and then of a long-term character. The real limiting factor in the utilization of oil revenues within the Middle East is the non-modern character of the economic, social and political structures of the region. These structures are not likely to change appreciably in the near term. Even in Egypt, with its large population, the economic and political structure makes it unlikely that the country will be able to attract or utilize petrodollars in amounts large enough to make any appreciable impact on the "recycling" problem.

Facilitating lending to oil consuming countries

The establishment of facilities by U.S. banks in the Middle East is unlikely to have any significant impact on the provision of loans to oil consuming countries. To the extent that banks participate in the reallocation process, this function can be carried out adequately through facilities which U.S. and other international banks have already established in the major money centers. In fact, it appears that the proposed Middle East ventures seem to be designed primarily as local or regional lending institutions and not as international financial entities.

Effect on allocation of "petrodollar" deposits among U.S. banks

It is possible that the proposed Middle East ventures may help individual U.S. banks broaden their access to petrodollar funds, thereby adding to deposit stability. In particular, this seems to be the motivation of Continental Illinois National Bank and Trust Company (CINB) in its proposed joint venture in Bahrain. CINB believes that this joint venture will help it obtain deposits from Gulf states from which it is not currently receiving deposits. However, so far the record of joint ventures in achieving this goal is not impressive. For example, officers of CINB have stated that even though their bank has been a partner in a joint venture bank in Iran for about a year, CINB is not getting any of Iran's petrodollars. Similarly, a senior officer of Morgan Guaranty has indicated that he does not believe that Morgan's participation in a Lebanese joint venture bank with a Kuwaiti government agency has given Morgan any special benefits in dealing with Kuwait (Morgan though is apparently getting substantial Kuwaiti funds for other reasons).

It should also be noted that to the extent these ventures do give particular U.S. banks more favorable access to petrodollar funds, the benefits will probably go primarily to those few banks which are already receiving the "lion's share" of these funds. Most of the applications currently before the Board involve the "giant" banks, and it seems likely that these banks are precisely the ones which the Arabs will allow to enter future ventures in the area.

Problems associated with the Board distinguishing among countries

The primary difficulty with making an exception for the Middle East cases is the problem of differentiating among applications on the basis of the country involved. One aspect of the problem concerns how to make any distinction on this basis in such a manner that the Board's overall policy on expansion is not seriously compromised. Another concerns potential political problems for the Board associated with, in effect, saying that investments by "overextended" U.S. banks in some countries are in the public interest while similar ventures in other countries (or in the United States) are not. A third aspect of this problem is the effect any Board action on these cases will have on the nation's overall foreign policy goals.

The Board has taken the position that banks with "insufficient" capital should not be permitted to undertake new significant expansionary projects at this time. Therefore, any exception would have to be based on a finding that there were special public benefits associated with a particular application (assuming it was not "insignificant"), that outweighed the Board's concerns over the financial condition of the bank involved. The applications currently before the

Board illustrate some of the difficulties of making such exceptions on the basis of the country involved. For example, the Board could rule that there is a special benefit associated with permitting U.S. banks to go into major oil producing countries, since it would contribute to solving the "recycling" problem. However, a ruling on that basis would presumably exclude the Egyptian applications and could include countries like Canada, Venezuela, etc. Alternatively, if the Board based its decision on the grounds that because U.S. banks are not well represented in the Middle East, there is a special public benefit (e.g., the promotion of U.S. foreign commerce with the area) in allowing current entry, what about other areas where U.S. banks are not well represented? Also, how would the Board determine when an area had adequate representation? Could the Board make an exception to allow some "undercapitalized" U.S. banks into a country and then at a future date bar entry to other banks in similar financial condition on the basis that U.S. representation was now adequate?

In general, it seems possible to find some special circumstances associated with virtually any foreign application which could be used to justify an exception to the Board's expansion policy. Thus, by making an exception in the Middle East cases, a risk would be run that one exception will lead to another and to a consequent deterioration of the rule itself.

Distinguishing among applications on the basis of the country involved could also create certain political problems for the Board. Such distinctions would in effect result in the Board indicating publicly that it viewed some countries as more important (or more deserving of U.S. investment funds) than others. Already, the staff has had inquiries from the Philipping Embassy about whether the Board was discriminating against the Philippines because of the denial of a Bankers Trust application to invest there.[2] Approval of investments in some countries but not others would undoubtedly lead to more inquiries of this nature. Also, to approve new foreign ventures, while at the same time denying applications for domestic expansion, could lead to criticism that the Board was permitting U.S. banks to use their scarce capital resources to finance foreign ventures (particularly those involving rich Arab countries), but not allowing them to provide additional financial services to U.S. consumers.

These possible political consequences for the Board are intertwined with the U.S. Government's foreign policy considerations. As is well known, the Egyptian ventures were promoted and announced during Secretary Simon's trip to Cairo. Discussion has been held with State and Treasury Departments about their attitudes toward these investments. These discussions have included conversations by Governor Wallich with Assistant Secretary's Enders and Parsky, as well as conversations on the staff level. From these conversations it appears that the greatest interest is in the Egyptian applications and that much less importance from a foreign policy view is attached to investments in other Middle East countries. A formal response from Treasury (see attached) mentions only the Egyptian applications. Formal views of State have been requested and will be circulated to the Board.

2/ The Office of the Comptroller of the Currency has encountered similar reactions because of its classification of certain assets on the basis of country risk.

Recommendations and Conclusions

The staff believes that based on economic and banking considerations, no exceptions to the Board's policy on expansion should be made for applications involving Middle East countries. While the establishment of facilities by U.S. banks in these countries may help the area utilize more of its funds internally (and presumably reduce its balance of payments surplus by stimulating imports), the effect is likely to be marginal and any public benefits appear to be outweighed by the disadvantages associated with differentiating among applications on a country or regional basis. However, as discussed above, there are foreign policy considerations involved in some of these applications. In particular, the Board may wish to give special treatment to the Egyptian applications based on State and Treasury's strong interest in those proposals.

Attachment - Letter from Department of the Treasury dated October 23, 1974.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

OCT 23 1972

Dear Mr. Dahl:

Representatives of my office have discussed with you applications now before the Federal Reserve by Chase Manhattan Bank and Manufacturers Hanover Trust Company for authorization to establish certain banking operations in Egypt. I would like to set forth the reasons for our support of these applications.

As you are aware the Egyptian Government has made a major commitment to undertake significant and greatly needed liberalization of Egypt's economy, and to spur the development of both domestic and foreign investment as a means of providing a competitive influence presently lacking in Egypt's economic and financial system.

During his visit to Egypt in July, Secretary Simon warmly endorsed this policy, including Egypt's willingness to permit foreign banking institutions to operate in Egypt. While the Secretary was in Cairo, the Egyptian Government demonstrated its good faith and announced approval of the applications of four foreign banks to establish operations in that country. Several weeks ago Egyptian Minister Taher Amin asked the Secretary for assistance in facilitating U.S. approval of the present applications so that these new activities can commence.

We believe that the presence of U.S. banks in Egypt will be a first, but nonetheless significant step in introducing into the financial structure of Egypt institutions that will aid in more efficient allocation of resources through a more market-oriented mechanism. As such it will assist in the process of stimulating the economic development of Egypt, and will not only supplement other efforts by the U.S. Government to aid this process, but will help establish the conditions of self-sustaining development, bringing nearer the day when broad official aid is no longer required.

For these reasons, we feel that Board approval of the applications now before the Federal Reserve is extremely important in furtherance of our political and economic objectives in Egypt and that denial of, or undue delay in acting upon, these applications will be not only a source of embarrassment to the U.S. Government, but counterproductive to our other efforts in that country.

I hope that the Board will take these considerations into account in deciding upon the applications of the two banks with respect to Egypt and that it will be able to act upon them affirmatively.

Sincerely yours,

Gerald L. Parsky

Gerald L. Parsky

Mr. Fred Dahl
Assistant Director
Division of Banking Supervision
and Regulation
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 30, 1974

To Chairman Burns

Subject: Expansion of American Banks Into OPEC Countries and Egypt

From Brenton C. Leavitt

BCL

For Use When Talking to Secretary Kissinger

The expansion of large U.S. banks into oil producing countries and Egypt raises several issues possibly involving even the national wellbeing. Applications currently before the Board in this area are:

1. Chase Manhattan asks permission to acquire up to 40 per cent of Iran Chase International Bank (a commercial bank) for $10.5 million. The other partner in this joint venture is Bank Saderat, the largest privately owned bank in Iran with total assets of $1.2 billion. The total assets of the proposed bank in the near term are planned at $400-$500 million.

2. Chase Manhattan also seeks permission to acquire 49 per cent of a de novo commercial bank in Egypt at a cost of $13.4 million. The remaining 51 per cent will be held by the National Bank of Egypt which is one of four government-owned banks. This bank held total deposits of $2 billion as of December 31, 1972. Total assets at the new bank are expected to reach $500 million in a few years.

3. Chase also wishes to acquire all the shares of a new merchant bank in Lagos, Nigeria, at a cost of about $3.3 million. Chase would also expect to lend $10 million to the new bank to provide funds.

4. First National City Bank seeks permission to acquire up to 40 per cent of the shares of Liberal Bank, Beriut, Lebanon, for $4.3 million. This application involves a joint venture with prominent Kuwaiti organizations and individuals. The bank is expected to have $200 million in total assets in 4 or 5 years.

5. Continental International Financial Corp., an edge subsidiary of Continental Illinois Bank, seeks permission to acquire 50 per cent of a new bank to be chartered in the Caymen Islands at a cost of $2.6 million. At this time, the Caymen Island bank's only office will be in Bahrain. The remaining 50 per cent will be acquired by two prominent Bahrainians for $13 thousand. One of these is the Prime Minister and brother of the ruler.

6. Manufacturer Hanover seeks permission to establish a branch in Egypt. The total of local deposits are estimated at $7 million in a few years.

October 30, 1974

Chairman Burns

Brenton C. Leavitt

Expansion of American Banks

Into OPEC Countries and Egypt

For Use When Talking to Secretary Kissinger

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TELEGRAM

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ACTION:

November 21, 1974

Ambassador Eilts
Cairo, Egypt

Your recent telegram stresses the desirability of prompt approval of pending applications by American banks to expand into Egypt.

When I received your telegram, there were two such applications pending before the Board of Governors. One was a request by Chase Manhattan Bank to acquire a 49 per cent interest in a de novo bank in Egypt, and the other was a request by Manufacturers Hanover Trust Company to establish a branch in Cairo. The Board, after consideration of statutory criteria, promptly approved these applications and each bank was notified on November 15 of the Board's decision. The Board somewhat earlier had given First National Bank of Chicago permission to engage in banking activities in Egypt by joint venturing with Banco di Roma and Banc Misr of Egypt.

I am informed that First National City Bank of New York and Bank of America plan to engage in some form of banking activity in Egypt. Neither of these banks has filed an application with the Federal Reserve System, but I can assure you that the System will act promptly when such applications are received.

Arthur F. Burns
Arthur F. Burns, Chairman
Federal Reserve Board

DRAFTED BY: N.B.

DRAFTING DATE

TEL. EXT.

APPROVED BY:

CLEARANCES:

BCL:slc

Chm. Burns

Department of State TELEGRAM

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TAGS: EGEN EG
SUBJECT: MESSAGE TO FEDERAL RESERVE BOARD CHARMAN
ARTHUR F. BURNS

REF STATE 258858

PLEASE PASS FOLLOWING FROM AMBASSADOR TO CHAIRMAIN ARTHUR F. BURNS OF FEDERAL RESERVE BOARD: QUOTE THANK YOU FOR YOUR THOUGHTFUL LETTER. I GREATLY APPRECIATE THE BOARD'S ACTION IN APPROVING THE APPLICATIONS OF THE SEVERAL AMERICAN BANKS DESIROUS OF OPERATING IN EGYPT AND YOUR PERSONAL INTEREST IN THIS MATTER. THIS ACTION IS A SIGNIFICANT CONTRIBUTION TO THE FURTHERANCE OF US POLICY TOWARD EGYPT AND COMES AT A PARTICULARLY TIMELY MOMENT. PLEASE CONVEY MY DEEP APPRECIATION TO THE OTHER MEMBERS OF THE FEDERAL RESERVE BOARD. HERMANN FREDERICK EILTS, AMERICAN AMGASSADOR, CAIRO. UNQUOTE.
EILTS

LIMITED OFFICIAL USE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1975 SEP -9 AM 10: 42

RECEIVED
OFFICE OF THE CHAIRMAN

Alan Greenspan

TO: Chairman Burns DATE: September 8, 1975

FROM: Brenton C. Leavitt
B.C.L.

SUBJECT: Two Investments In the Financial Institutions in Oil Producing Countries by U.S. Banks

The Board recently reviewed an application of Chase Manhattan's Edge Corporation to invest in a Saudi Arabian bank. You stated that you wished to obtain views of Secretary Kissinger about this investment by an American bank in an oil producing country. Since that time, we have been informed that the Federal Reserve Bank of San Francisco has received an application from a subsidiary of Bank of America to make an investment in Kuwait. The purpose of your inquiry to Secretary Kissinger is to determine from him his views of the National interest involved and if denial of either one or both applications would adversely effect the National interest. I suggest that you might wish to ask Mr. Kissinger about both proposals at the same time.

The essential facts of the two applications are:

1. Chase Manhattan wants to acquire 20% (cost of $1,700,000) of a commercial bank to be established in Jeddah, Saudi Arabia. There will be various other partners none of whom will own more than 10%. Chase would appoint the General Manager, two of ten Directors and Technical Assistants.

2. The Edge subsidiary of Bank of America wishes to acquire 40% (cost of $1,800,000) of a finance company to be formed in Kuwait. The bank would have two Kuwait partners and will appoint 40% of Directors and all principle operating officers.

First National City Bank in New York has two branches in Saudi Arabia; no other U.S. bank has banking facilities in either Saudi Arabia or Kuwait.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date 6-14-76

To: Mr. Chairman

From: **KEN GUENTHER**

( ) Per Conversation ( ) For comments and suggestions

( ) For your information ( ) Phone me re attached

Reuss' latest press release — aimed at the Comptroller

K

( ) Over

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING, CURRENCY AND HOUSING

NINETY-FOURTH CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, D.C. 20515

225-4247

NEWS RELEASE

6:00 p.m. EDT
Sunday, June 13, 1976

REUSS WARNS COMMERCIAL BANKS ON LOANS TO CHILE, RELEASES CORRESPONDENCE WITH COMPTROLLER SMITH ON $125 MILLION SYNDICATE LOAN

Chairman Henry S. Reuss (D-Wis.), of the House Committee on Banking, Currency, and Housing, issued the following statement today about loans by private U.S. commercial banks to Chile:

"On May 21, sixteen U.S. and Canadian banks signed an agreement to lend $125 million to Chile. Today, I am releasing an exchange of letters between myself and Comptroller of the Currency James Smith, which raises serious doubts about the wisdom or propriety of this loan.

"The present military government, after nearly three years, has failed to control inflation, to restore industrial production, to reduce unemployment, or to create the conditions which might attract the productive private investment the country so desperately needs. To survive, the Pinochet regime relies on loans of hundreds of millions of dollars every year from the U.S. government and from multilateral lenders. Even the International Monetary Fund has concluded that the Chilean economy will need continuous debt relief (or debt financing) on a substantial scale over the medium term to keep its balance of payments manageable.

"Such debt relief or debt financing will happen only with the support of the United States Government. The fate of Santiago's Torquemadas thus lies squarely in the hands of those who make official lending policy in Washington.

"Given this situation, it is difficult to distinguish the ordinary economic risk associated with the recent commercial bank loan from the political risk posed by the possibility that the U.S. may withdraw Chile's financial crutch. Normal mitigating circumstances, such as participation in the loan by banks from a wide range of countries, or the existence of a stand-by agreement between Chile and the IMF, attesting to the soundness of Chile's economic policies and to the presence of competent international surveillance of its economic program, are not present.

"The response by the Comptroller of the Currency to this situation is a shallow one. The Comptroller has shown no inclination to criticize the banks he is supposed to regulate for pursuing short-term profit by the Chilean loan at whatever eventual risk to themselves or to the successful pursuit of U.S. foreign policy objectives. This contrasts with the Comptroller's recent eagerness to criticize U.S. commercial bank loans to Italy.

~~My~~ Chase Friend mentioned this

"In his reply, the Comptroller demonstrates that his office has not seriously considered several important issues raised in my letter. Among them:

1. What is the proper relationship between a private United States bank and the public government of a foreign nation? Should banks extend commercial loans to such governments, when they generally only lend to the Government of the United States through the medium of marketable notes, bills, and bonds?

2. What is the proper role of the International Monetary Fund as the arbiter of the creditworthiness of a developing nation? When, as at present, the IMF fails to extend the seal of approval represented by a stand-by agreement, indicating an agreed program for economic policy and for IMF surveillance, should U.S. bank regulators permit a loan to the country in question to pass without objection?

3. To what extent, finally, do such loans by private U.S. banks interfere with the conduct of U.S. foreign policy? Are we not unwisely permitting a linkage of interest to arise between our own domestic financial institutions and a morally abhorrent foreign regime?

"Secretary Kissinger's admirable speech before the General Assembly of the OAS in Santiago this week may signal the beginning of a shift in U.S. attitudes towards basic human rights in Chile. Certainly that shift will accelerate if a Democratic Administration takes office next winter. When that happens, we may expect the Administration to take a much harder look at the abysmal condition of the Chilean economy and the failure of the Pinochet regime either to restore industrial production or to control inflation.

"Certainly, the 16 banks who signed the $125 million loan agreement with Chile on May 21 should beware. Any shift in U.S. policy will leave them in perilous condition on this loan, given Chile's manifest inability to meet its commitments without massive outside support. These banks should expect to bear alone any loss that may come from a return to a sane Chile policy. For my part, I shall continue to press for a better and more clearly defined Administration policy on this area of activity by private commercial banks."

HENRY S. REUSS
5TH DISTRICT, WISCONSIN

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Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEES:
BANKING, CURRENCY AND HOUSING
CHAIRMAN

JOINT ECONOMIC COMMITTEE
CHAIRMAN, INTERNATIONAL ECONOMICS SUBCOMMITTEE

May 14, 1976

Honorable James E. Smith
Comptroller of the Currency
490 L'Enfant Plaza East, S.W.
Washington, D. C. 20219

Dear Mr. Smith:

According to recent press reports, fourteen of the largest banks in New York, California, and Canada are "close to agreement" on a loan to the government of Chile of $100 to $125 million, to be applied to Chile's balance-of-payments deficit. A letter of commitment is expected to be signed shortly, with a final loan contract to follow within weeks. While no single bank has been designated the formal syndicate leader, it appears that Citibank of New York is playing a leading role.

This proposed loan raises several disturbing questions about the relationship between private banks and U.S. foreign policy, and about the relationship between our banking system and the international lending institutions, such as the International Monetary Fund -- as well as doubts about the wisdom of this particular loan.

Chile's record on inflation is terrible. In January, 1974, the Chilean government set a target inflation rate of 80 percent for the year. In fact, inflation went to 375 percent in 1974, and was 340 percent in 1975. Since November, 1975, the <u>monthly</u> inflation rate has nearly doubled: from a range 7 - 8 percent in November and December, 1975, to 10.0 percent in January, 10.5 percent in February, and 13.5 percent in March. Annual inflation will continue in triple digits this year, and may well exceed 200 percent.

In 1975 the Chileans did manage to hold their balance of payments deficit to about $250 million, close to the target of 240 million dollars set in March, 1975,but only because their creditors accepted deferred payment on almost a quarter of a billion dollars worth of debt. Most of Chile's major European creditors -- who hold the largest share of Chilean debt falling due after 1976 -- are now refusing further debt relief. This year Chile's debt service is expected to consume about 38 percent of its export earnings, according to the World Bank, compared to only 27 percent in the export slump year of 1975. For the next five years, Chile will continue to labor under an extremely heavy debt service burden; its obligations will total over $700 million this year, and will remain at about $600 million per year through 1981, compared with $124 million in 1970, the last year that could be called normal.

In the meantime, the Chilean economy is being sustained by infusions of hard cash from the United States government, from the World Bank, the Inter-American Development Bank (IDB), from certain of the facilities of the International Monetary Fund (IMF) -- and from private U.S. banks. Direct U.S. assistance to Chile totalled $272 million in FY 1975, including $96 million in debt relief, and will total at least $120 million in aid and housing guarantees alone in FY 1976. The IMF, which has already extended credit to Chile equal to 327 percent of Chile's IMF quota, among the highest exposures of any nations, is contemplating an additional loan under the compensation facility this year. The World Bank, this year, has already committed $33 million to Chile's nationalized copper sector. The IDB has a tentative lending program for Chile of $120 million this year. Now our private banks are thinking of chipping in up to $125 million of their depositors' funds. It is clear that, in the absence of major new debt relief, which is unlikely, and without this assistance, Chile could not continue to meet current payments on its debts.

Chile's reliance on foreign lending to avert bankruptcy takes on added significance in light of the evident failure of the Chileans to reach an agreement with the IMF on the terms of a stand-by arrangement for this year. As you know, an IMF stand-by assures that the economic policies of the recipient nation will be subject to close supervision by the Fund's staff. Private institutions often consider an IMF stand-by to be the sine qua non for lending to a foreign government in balance-of-payments trouble. In fact, when a letter of commitment for a loan of $175 million to Chile was signed last January by the same group of banks currently negotiating the new Chilean loan, it was made explicitly contingent on Chile's obtaining an IMF stand-by. Significantly, although Chile obtained stand-bys in 1974 and 1975, this year no stand-by was agreed upon, and the January commitment has lapsed. Now, as the banks negotiate the new loan, it is without the assurance of a supervised economic policy that a stand-by arrangement would provide.

Accordingly, the large New York, California and Canadian banks who are engaged in this loan are assuming a very substantial risk: far more than would be involved in the usual temporary balance-of-payments assistance to a solvent country. They are effectively assisting Chile to roll over a massive foreign debt that it otherwise could not meet, at a time when the support that Chile might have hoped for from the IMF has not materialized. Chile's ability to pay off this loan when the time comes without yet another massive bank loan is seriously in doubt.

In light of these facts, I believe that you have a clear duty to review the situation, in conjunction with the banks, and to assure that they are not taking an excessive risk. This should be done now, before the loan is extended. In conducting such a review, it would be appropriate to ask the following questions, to which I also would like a response.

1. To what extent is the current loan an effort to protect assets the banks have already invested in Chile? Specifically, what is the current exposure, in dollar amounts and as a percentage of bank capital, in loans to the Chilean government, government agencies, private Chilean financial institutions, and to the rest of the Chilean private sector, of each of the 12 U.S. banks involved in this loan? Are there any other large U.S. banks with comparable exposure in Chile? How many, and how much have they loaned? What is the maturity structure of these loans?

2. What are the economic risks associated with this loan? Making reasonable assumptions about the path of copper prices, does the Chilean economy have the capacity to recover and meet all of its current debt commitments without major new debt relief? Can the Chilean government successfully squeeze enough foreign exchange from the economy to meet its debts if copper prices do not recover? What other economic risks are involved?

3. To what extent does the success or failure of this loan depend on political events? In particular, does repayment depend on the continued willingness of the United States to support the junta with more aid? If so, is not repayment of this loan effectively contingent on the assumption that the next Administration will continue to pursue a policy of financial support to the junta? What will happen if it does not?

4. What in your view is the proper regulatory posture toward such a loan? According to what criteria does your office classify for regulatory purposes a non-marketable loan to the public sector of a developing nation, a loan which is extended without collateral and whose repayment depends on volatile political factors as well as on economic ones? What was the basis of your reported decision, since revoked, to "redline" Italy as a borrower from U.S. banks? Does the same rationale now apply to Chile's loan? Recently lending from private sources to the governments of stable industrialized nations has shifted from direct loans by banks to the Eurobond market. Lending by private banks to the United States Government has long been in the

Hon. James E. Smith
May 14, 1976
Page 4

form of marketable Treasury bills, notes and bonds. Why should banks adopt the more lenient standard of lending that may be incorporated in a non-marketable direct loan in dealing with an unstable developing nation such as Chile?

5. What is the proper role of the International Monetary Fund as arbiter of the creditworthiness of a developing nation? Does your office, in classifying for regulatory purposes a loan to the government of a developing nation, use the professional analyses of the IMF? Is the existence of a stand-by arrangement between a country and the IMF a factor? If you make an independent evaluation, what is your evaluation at the present time of the creditworthiness of Chile?

6. What is the truth of the allegation that both the State and Treasury Departments have encouraged the U.S. banks to make this loan? If the Executive branch were to encourage private U.S. banks to lend to Chile, would that not be an evasion of the spirit of Congressional ceilings on aid to Chile?

7. It is difficult, in this case, to separate the purely economic criteria which should govern the actions of the banks from matters which impinge on international politics and United States foreign policy. Nevertheless the effort should be made. Would not an ill-considered loan at this time tie the fortunes of our largest banks to that of the Chilean regime in future years -- with painful consequences if the U.S. later ends economic support for the junta? In the event this loan did go sour, would not the banks be able to transfer a substantial part of the loss to the U.S. taxpayer, through the tax deduction for bad loans?

I look forward to your prompt response to these questions, surely before action is completed on this loan.

Sincerely,

Henry S. Reuss

Henry S. Reuss
Member of Congress

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

June 7, 1976

Dear Congressman Reuss:

This is in response to your letter of May 14, 1976, in which you raise several questions relative to the credit worthiness of the Government of Chile. You question the propriety of U.S. commercial bank loans to Chile as they relate to U.S. foreign policy, U.S. depositor funds and U.S. taxpayers. Further, you request my views on the proper regulatory posture with regard to these issues.

When the present Chilean government assumed power in September 1973, the need for complete economic reform was obvious. As you know, the country was bankrupt. It faced $4 billion in external debt and had no credit rating whatever. All of her revenues had been spent on nationalizations and debt service, leaving nothing available for investment. Chile's plant and equipment had been permitted to deteriorate almost beyond repair and inflation had reached estimated rates of 750 and even as high as 1,000%.

In recognizing Chile's old debt to foreign governments (The Paris Club), the new regime was forced, first, to try to restructure that debt into an overall term and amortization schedule realistic to Chile's already worse than "normal" economic condition simultaneously compounded by the quadrupling of oil prices. Secondly, the new government had to rebuild Chile's credit rating, primarily with commercial banks, by demonstrating that they would promptly pay for their trade imports. They restricted non-essentials and concentrated on the machinery and spare parts needed to revive mineral and industrial production.

Having been reasonably successful in accomplishing their primary objective and having performed perfectly on all of their short-term trade obligations, they were able to acquire some medium-term, commercial bank loans in late 1974 and throughout 1975. These loans have proved essential to the revitalization of Chile's economy. 1976 balance of payments deficits are projected to be much smaller than 1975 and after the signing of the $125MM loan in question, all but $20 million of the deficit will be financed. These 1976 projections were based on a copper price of 60¢, while copper prices are already at 70¢ and each one cent increase adds approximately $18 million to Chile's annual export revenue.

The sixteen banks involved in the loan to which you refer have indicated to the IMF that, in their view, the Chilean economy is well enough in hand, particularily given the steady increase in the price of copper, to warrant granting the loan without the IMF standby. The loan has been finalized. The agreement was signed on May 21, 1976. The formal syndicate leader is Morgan Guaranty Trust Company of New York and of the twelve U.S. banks involved, four are national banks and therefore come under the purview of my Office.

I do not feel that any of the national banks involved in this credit can be considered to have granted this loan to protect assets already on their books. Nor do I believe that any of the national banks have taken on excessive exposure by virtue of having participated in this loan. Data taken from each of the last reports of examination of the 20 largest national banks indicates outstanding loans to Chile as a percentage of gross capital funds at an average of .357% before the granting of this loan and .358% including the new loan. After disbursement, the largest percentage of Chilean loans at any of these twenty banks will be only 1.685% of gross capital funds. Aside from the largest twenty, one national bank carries 4.76% of its capital in loans to Chile. Approximately 36% of all national bank loans to Chile are in short-term trade credits due within one year with the balance spread over something less than five years.

Since there does not appear to be any imminent political change afoot in Chile, the major factors governing the quality of these loans are basically of an economic nature. In the event that higher copper prices do not hold, the quality of these loans would probably continue to weigh on the present government's ability to make the proper economic policy decisions but with a significantly stronger, more efficient, economic base than existed when the government assumed power in 1973. I believe that Chile's economic future is viable and I certainly do not consider these loans to be in danger of not being repaid.

The question of commercial banks lending U.S. depositor funds to international customers is somewhat academic in that these loans are funded by eurodeposits. The granting of such loans does not deprive U.S. customers of the use of any domestically lendable funds and, short of failure of the bank involved, does not effect U.S. depositors in any manner. It is true that both international loan profits and loan losses do alter the amount of dividends received by bank shareholders. Finally, the effect which individual international loan losses have on U.S. taxpayers depends significantly upon the income tax deductions granted each lending institution by the country in which the loss occurs. Tax deductions not permitted by the country in which the loan is granted, or by the country in which the loan is booked, would effectively be deductible in the United States. Perhaps this is a matter for discussion with the Internal Revenue Service.

National bank examiners do occasionally criticize specific loans to foreign governments or their agencies. These criticisms are based on well defined credit weaknesses apparent either in a borrower's overall financial condition or in an individual loan. Marketability is seledom a consideration since, unlike investments in securities, bank loans are expected to be held to maturity. Examiners' criticisms of individual loans are not to be construed as a "redlining" or blacklisting of the borrower concerned. Similarily, such criticism does not constitute a directive by which a bank is ordered to cease lending to that borrower. Rather, loan criticisms, individually and in their aggregates, constitute one of many major factors upon which this Office evaluates each national bank's condition, the capabilities of its management and its earnings performance by asset category. Until such time as minor asset categories are proved to have a noticeably adverse affect upon any of these measurement factors, or until such time as concentration in any one potentially risky activity appears likely, or until such time as those activities become violations of law, I believe that individual credit decisions should be left to the discretion of professional lenders.

I believe this to be proper regulatory posture and I am unaware of any allegations relative to either the State Department or the Treasury Department having encouraged U.S. banks to make this loan.

I trust that the above information is responsive to your request. However, should you have further questions, please do not hesitate to write my Office.

Sincerely,

James E. Smith

James E. Smith
Comptroller of the Currency

The Honorable Henry S. Reuss
Member of Congress
House of Representatives
2413 Rayburn House Office Building
Washington, D.C. 20515

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 4, 1977

To Board of Governors

Subject:

From John E. Reynolds

Attached is a memorandum from Henry Terrell and Robert Gemmill discussing two recent article in the New York Times on Nassau Branches.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 4, 1977

To Mr. Reynolds

Subject: Nassau Branches

From Henry S. Terrell and
Robert F. Gemmill

Introduction

An article in the New York Times of March 3, 1977 (copy attached) has raised several issues concerning the operations of and the Board's policy towards Nassau branches of U.S. banks. This memorandum briefly discusses the issues raised in that article.*

Background

As of December 31, 1976, 130 U.S. banks maintained 136 branches (of which 130 are shell branches and 6 full service branches) in Nassau and the Cayman Islands with total assets of $67 billion. The two principal assets of these branches were claims on foreign banks of $25.3 billion and claims on foreign nonbanks of $21.5 billion. Principal liabilities were $21.5 billion to foreign banks, $16 billion to related branches in other countries, and $14.5 billion to their head offices. On a net basis, Nassau and Caymans branches received $13.4 billion net from their head offices, $7.2 billion net from related branches in other countires, and were net lenders of $17.9 billion to foreign nonbank borrowers. The net funding from domestic U.S. offices has resulted from the ample liquidity of U.S. banks.

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* The March 3 article and follow-up article that appeared on March 4 are attached to this memorandum.

Issues Raised in Times Article

1. Lost Revenue to New York City and State. Income earned by Nassau branches is not subject to state and local income taxes but is subject to Federal income taxes. Therefore, to the extent banks have shifted loans from their domestic offices to their branches in offshore centers, state and local jurisdictions have suffered a reduction in tax receipts.

However, a follow-up article in the New York Times of March 4, 1977, seriously overstates the revenue lost. That article assumes that Citibank shifted an estimated $1 billion in loans from its New York office to its office in Nassau resulting in a $10 million loss of revenue to New York State. Assuming a generous 1-1/2 percent interest spread on the $1 billion in shifted loans results in a shift of $15 million in earnings from Citibank (New York) to Citibank (Nassau). A 12 percent New York state income tax combined with a 30 percent surtax results in a reduction in state income taxes of only $2.34 million, compared to the $10 million estimated in the Times article.[1/]

2. The Federal Regulatory Authorities Know Little About These Activities. A standard condition of approval for a branch in Nassau or the Caymans is that duplicate records of all transactions be maintained at the head office so that examination of these branches may be conducted at the head office. In addition, the Federal Reserve collects monthly data on the assets and liabilities of all foreign branches of U.S. banks by type of customer. These figures are published monthly in the Federal Reserve Bulletin with separate figures for branches in Nassau and the Caymans. In addition the Federal Reserve collects quarterly data on the geographical

1/ The March 4 article in The New York Times estimated the lost revenue to New York State alone. In addition, there would be a revenue loss of $2.07 million to New York City based on a city income tax of 13.823 percent.

distribution of the assets and liabilities of all branches. Federal Reserve statistics were in fact utilized in preparing the article in the New York Times.

There is of course, no Federal Reserve information on lending to U.S. borrowers from foreign offices of foreign banks because the Federal Reserve has no authority to collect such data.

3. The Federal Reserve has Sanctioned and Encouraged the Activities of these Branches. The Federal Reserve has approved these branches, often with dissenting votes, but has not actively encouraged their expansion. The Federal Reserve currently has a policy of limiting to one the number of limited service "shell" branches any bank may have. The principal reason for Board approval of these branches was to permit smaller banks without the financial resources to afford a London branch an opportunity to establish an offshore branch to permit them to compete in Euro-currency lending with larger banks.

The Federal Reserve has discouraged foreign branches of U.S. banks in Nassau and the Caymans and elsewhere from lending to U.S. residents through a 4 percent reserve requirement imposed on such loans under Regulation M. In approving applications for foreign subsidiaries, the Board has imposed a condition that subsidiaries not engage in transactions with U.S. residents other than those incidental to their international activities.

An Alternative to Nassau Branches

The Board has considered a proposal to allow U.S. banks to establish a "foreign window" in their domestic offices which could be used to accept deposits from (and make loans to) foreigners free from reserve requirements and ceilings on interest rates. That proposal did not contain a reference to the tax status of the earnings by the banks from the foreign window. The Board did not favor that proposal because it would be difficult in practice to prevent misuse of the window by domestic customers. Since deposits at the proposed window would be exempt from reserve requirements, banks could offer higher rates of interest on "window" deposits than are offered on regular domestic deposits, and some domestic customers might thereby be induced to shift their activities to the foreign window, perhaps using foreign affiliates to disguise the transaction. Such shifts could reduce Federal Reserve control over money and credit flows used domestically.

Nassau branches are not a perfect substitute for a foreign window. Deposits at foreign branches in the banks' view carry a certain element of "country risk". Moreover, some U.S. financial institutions are prohibited by law from placing funds abroad, even in the form of deposits at foreign branches of U.S. banks.

Attachment

March 3, 1977

Growing Bahamian Loan Activity By U.S. Banks Causes Concern

By ANN CRITTENDEN
Special to The New York Times

NASSAU, the Bahamas—For years this string of sun-blessed islands off the coast of Florida has enjoyed a lucrative, if slightly dubious, reputation as a tax haven—a pleasant locale where individual and corporate wealth finds refuge from income taxes, gains taxes, inheritance taxes, or any direct taxes at all.

More recently, however, thanks to a marked trend in American banking, this tiny Caribbean nation has achieved a new financial eminence that may profoundly affect both the United States economy and international capital markets.

This is the first of two articles on the shift in the international activities of American banks to the Bahamas.

A rapidly growing portion of the international banking business is being booked, or officially recorded, in the Bahamas. Helped by a recent British tax increase and enhanced by their convenience to New York, the islands have become a key link in the Eurocurrency market.

The little-known Eurocurrency market is a vast and largely unregulated pool of funds, four-fifths of them dollars, that are borrowed and lent outside their country of origin. The market, which has traditionally centered in London, has swollen from $65 billion to nearly $300 billion in only six years.

Long a crucial source of funds for multinational operations, it has more recently become the chief vehicle for recycling the surpluses of oil-producing nations to finance the huge oil-import bills of hard-pressed governments around the world.

The impressive growth of the Bahamas in this credit market reflects the steadily increasing activity of big American banks, which have more than doubled their lending in the last three years. In a sense, as one financial specialist put it recently, the American banking business "is moving aborad."

In the process, New York state and city have lost millions of dollars in tax revenues from banks—ironically at a juncture when the major New York banks are demanding still more stringent fiscal controls from the financially beleaguered city.

Little Known About Effect

Even more important, as the volume of offshore lending by United States banks increases, Federal regulatory authorities —and the public —know less and less about the banks' transactions and how they affect the American economy.

The widening gap in information has already made it more difficult to analyze what is happening in the nation's economy. For example, while most offshore lending is to foreign corporations or governments, an intriguing but unknown fraction of it is to United States corporations for use at home.

In other words, instead of routinely booking a short-term, $25 million loan to corporations like General Motors or Exxon in the United States, the companies' banks in recent months may well have booked such loans in the Bahamas. This "cross-border" lending was so great last year, according to Carlos M. Canal Jr., executive vice president and head of international banking for the Bankers Trust Company, that it "could account in part for lagging domestic loan demand."

"We're flying blind in this area," says Representative Fernand J. St. Germain, a Rhode Island Democrat who is chairman of a House Banking, Currency and Housing subcommittee on financial institutions. "We don't have a reporting system that enables us to track the impact of overseas lending on our domestic economy."

Underlies Monetary Policies

In the United States virtually all large banks have to report to the Federal Reserve detailed information on such things as the maturity of loans and deposits, volume of business, consumer and mortgage loans and interestcharges. This data is vital not only in measuring the stability of the banks themselves, but in determining the health of the overall economy. It underlies the monetary policies adopted for guiding the economy.

In contrast, banks are required to report almost no specifics concerning offshore loans. Thus, as banking shifts abroad, regulating not only the banks but the entire economy becores more uncertain.

Some Congressional figures are also concerned that the upsurge in bank Eurocurrency lending is occurring at the expense of more urgent credit needs at home. It is also charged that the system favors the largest corporate borrowers over smaller busineses.

Finally, while th earnings of offshore branches of Amerian banks are subject to Federal taxes, hey are beyond the reach of state an city tax collectors. Thus the surge inBahamas lending has meant a substantia revenue loss for New York, where most f the big international banks are based.

The banks have hifted New York business to the Bahamas in two ways. They are booking loans that formerly were put on their books i New York directly in the Bahamas. And some banks, including Citibank, have also transferred large blocks of loan from their New York books to their Nassau branch. In doing this, the leadin banks have engaged in "an unjustifiable avoidance of taxes," State Commissioner James H. Tull contended in a recent telephone conversation.

More and more of this lending, especially to Latin America, is being recorded on the books of American banks' Bahamian branches. Since the end of 1973, the assets of American bank branches in the Bahamas and Cayman Islands, a much smaller Caribbean tax haven, have increased by more than 150 percent, to 31 percent of the assets of all foreign branches of American banks.

(Foreign branch assets, in turn, amount to 40 percent of the total assets of the largest United States commercial banks, which total about $553 billion.)

By the end of last May, more offshore loans by American banks were recorded in the Caribbean than in London. The Bahamas had 31.9 percent of the total, versus 27.5 percent in the British capital. Only a year and a half earlier, loans booked in London had amounted to 38.3 percent of the total, compared with 24.8 percent in the Bahamas.

Unlike the Eurocurrency system in London, where American bank lending is mainly financed by outside deposits, most of the lending from the Bahamas is financed by transfers of the banks' own funds from London, or increasingly, New York.

$6 Billion More Than Year Ago

As of last Oct. 31, the latest date for which figures are available, banks with headquarts in the United States had $10.5 billion on loan to their Nassau and Cayman branches, some $6 billion more than a year earlier.

The total outflow was even greate if offshore banking centers other than the Bahamas are considered. At the end of October, all foreign branches of American banks carried $19.4 billion from their parent bank, other United States banks, or American corporations, up from $5.1 billion at the end of 1974.

Bankers and officials at the Federal Reserve Board and the Comptroller of the Currency, the two Federal agencies regulating international activities of American banks, view this development benignly, as simply the latest mutation in the ever-evolving Eurocurrency market.

In the Fed's view, with loan demand currently sluggish in this country, and plenty of money in their coffers, the big American banks are quite naturally putting their funds to work in the Eurodollar market, where the demand for credit, particularly from non-oil-producing deficit countries like Brazil, Mexico, and Britain, remains high.

Limit Was Lifted in 1974

No official impediment to this outflow of capital has existed since the beginning of 1974, when a program designed to protect the balance of payments by limiting what American banks could lend abroad was lifted.

Primarily because of a 1975 increase in the tax on bank earnings in Britain, the banks chose to book the new business not in London but almost entirely in the Bahamas. The former British colony had the advantage not only of having no taxes, but falls in the same time zone as New York. Executives in bank headquarters here can move funds in and out of Nassau for a full working day.

Thus, with the shift in bank lending from London, more of the actual arranging of Eurocurrency transactions is taking place in New York. This business is recorded in the banks' Nassau books, but for most banks, the Nassau "branch" apparently exists largely on paper.

Unlike the Fed, the Congressional committees responsible for monitoring the banks are troubled by those arrangements. Both the House and Senate Banking Committees and a subcommittee of the Senate Foreign Relations Committee have complained that they do not have enough information to evaluate the implications of the increased offshore lending.

The puzzle of lagging domestic loan demand is a case in point. For instance, outside of New York, business loans slipped only slightly in the last year, while in New York they fell by almost 10 percent. This suggests that the big New York banks were booking corporate loans offshore.

The banks, on the other hand, contend that it was the lag in corporate loan demand that led to the offshore lending in the first place. Without knowing what kinds of loans the banks are actually making, however, analysts cannot tell what really happened.

Still Lower Than Prime Rate

The lendin abroad may also have helped keep domestic interest rates abnormally high last year. Representative Henry S. Reuss, the Wisconsin Democrat who is chairman of the House Banking Committee, has charged, and some banking executives privately concede, that lendin in the Eurocurrency market to major American companies enabled banks to resist pressures to cut interest rates ine United States.

Because the difference, or margin, between the rates banks have to pay for money in the United States and the prime interest rate they charge major customers is so great, the banks can buy money here and lend it abroad, at a profit, at interest rates still lower than thei prime rate. Thus, favored corporate customers can be accommodated offshore, and they are no moved to demand significant discounts in he domestic rate.

The problem with this arrangement, Mr. Reuss charged last summer in a letter to Arthur F. Burns, chairman of the Federal Reserve Board, is that it discriminates against small businesses, which lack access to the Eurocurrency market. They hve to pay the higher domestic rates.

In a speech last year, Representative St. Germain contended that a siphoning off of domestic funds has happened at least once recently. In the fall of 1974, he said, small banks in the Midwest were putting deposits in Japanese banks that had reached their borrowing limits with larger international banks. Meanwhile, beef producers in the same areas were starved for credit and unable to maintain their herds at a time when beef prices were soaring to record levels. Eventually Dr. Burns had to pressure the banks, through the regional Federal Reserve Banks, to make adequate funds available locally.

The episode, Mr. St. Germain declared, showed that "problems in international financial markets—that remote never-never land—were really not so remote at all."

Currently two House banking subcommittees were reviewing the findings of a Government Accounting Office study on bank operations which found, among other things, that the regulation of international bank activities was highly inadequate. The subcommittees are expected to propose changes, but several key aides expressed pessimism about the ability of Congress alone to monitor the banks' offshore activities. They argue that Congress's main task will be to push the Fed. to take a tougher look at what the banks are doing offshore.

In the past, some legislators believe, the Fed has simply encouraged any trend that helped bank earnings, including the burgeoning offshore activity. "The Fed has cooperated with an effort on the part of the banks to make every last nickel they could," Mr. Reuss said in a recent interview.

Dr. Bruns did eventually send out a letter reminding banks not to take deposits from American entities in offshore branches — thereby circumvening the usual reserve requirements—unless the funds were needed "for a valid international purpose." This injunction is widely regarded as unenforceable and mainly designed to head off criticism of the Fed. A bank examiner, for example, could not tell whether an American deposit in a bank's Nassau branch is serving a valid international puropose.

Nor does the Fed object if, say, the General Motors Acceptance Corporation puts a $25 million, three-month deposit in a New York bank, which then immediately credits the money to its Nassau branch.

Why don't banks just transfer all their Eurocurrency activity to the warmer and more profitable Caribbean? "I ask them that," one bank analyst says, "and they say they know there are political limits. The banks aren't stupid."

New York TIMES
March 4, 1977
pg. 1

Citibank Found To Lead in Shift To Tax Havens

By ANN CRITTENDEN
Special to The New York Times

NASSAU, the Bahamas—In the sudden growth of international banking in the Bahamas, no institution has played as prominent a role as Citibank, the nation's second largest bank and in the scope of its global activities, the most truly international bank in the world.

The giant New York-based institution, which ranks only behind the Bank of America, has led the way in a pronounced

Second of two articles.

shift by American banks toward booking international loans in offshore tax havens, of which the Bahamas is the most important. The trend has involved a substantial loss of tax revenue for New York state and city. It has also meant that more and more of the activities of American banks are taking place outside the range of Federal regulatory authorities and beyond the knowledge of Congress and the public.

Network of 2,026 Offices

As a result, the growth of offshore banking has already made it more difficult to determine what the banks are doing and how their activity affects the American economy.

Although other major New York banks have transferred business offshore, none has done it on anything resembling the scale of Citibank, which already has far more loans and deposits offshore than in the United States. With its worldwide network of 2,026 offices and branches in more than 100 countries, the enormous bank can book its loans and take its deposits from multinational corporations and governments virtually whereever it chooses. It can readily shift funds from one country to another, depending on the demand for money.

Internal Citibank documents, itemizing its Bahamian loans and deposits, give a rare look into this highly secretive and complex world. Recently made available to the Times, the documents disclose that, as of last year, Citibank accounted for almost one-fourth of the Eurocurrency activity of American banks in the Bahamas and the Cayman Islands a much smaller Caribbean tax haven. They show that, although the Bahamas were not mentioned in Citibank's tabloid-sized, 43-page annual report last year, a healthy portion of the bank's profits are concentrated in this island nation.

The bank records reveal that a sizable portion of Citibank's lending is concentrated in two debt-laden developing countries, Mexico and Brazil, and that a substantial part of Citibank's deposits—perhaps 10 percent—come from a few Arab states. The documents also support the bank's frequent assurance thatte vast majority of its offshoreloans are sound.

Loans Shifted to Other Areas

Nassau is Citibank's largest banking center outside of the United States, larger than London, Hong Kong, Singapore and Bahrein in actual loans booked. In its ever-changing global strategy, the bank is now reducing the number of loans recorded in Nassau, as it shifts loans made in Asia and the Middle East to othr centers.

The bank's documents nevertheless show that, toward the end of last year, more than a third of Citibank's Eurocurrency loans made in dollars outside of the United States, were booked in the Bahamas. About one-fifth of the bank's total offshore loans and one-eighth of its loans of all sorts, domestic and foreign, were placed in Nassau.

Ironically, most of this enormous volume of business is conducted no coser to the bamy Caribbean than Citibank's Manattan offices, where dozens of shirt-sleeved employees and a sophisticated computer system transfer billions of dollars in and out of an entity called Nassau. Here is where most of the buying and selling and transferring of funds to finance the loans booked in Nassau takes place. They were actually negotiated either in New York more often in the bank's Latin-American branches. Nassau is above all else the bank's booking center for Western Hemisphere loans.

Nassau is to international banking what Liberia is to international shipping—a flag of convenience, a tax-free and compliant haven for officially recording business done elsewhere. Citibank's Eurocurrency operation in Nassau has some 65 employees, and their job is simply to keep the books on the transactions, just as the bank's loan department in New York handles the mechanics on domestic loans arranged by other departments.

The fundamental reason for the Bahamas' attraction, is clear: Nassau levies no pofits taxes or direct taxes of any sort. American banks began to increase their lending there after bank taxes in London, the traditional center for Eurocurrency lending, were raised. Nassau, with good communications and the convenience of the same time zone as New York's, was where the banks flocked.

About $1 Billion in Loans Moved

Citibank, in particular, has also shifted an enormous volume of loans from New York to Nassau, where the interest earned is not subject to New York State or city taxes. According to Donald S. Howard, senior vice president for finance, Citibank moved approximately $1 billion worth of loans already recorded on its New York books to the Bahamas.

This could mean a loss of more than $10 million in tax revenues to New York State alone, assuming the loans remained outstanding a year at the state bank tax rate of 12 percent plus a 30 percent surcharge. By comparison, total tax receipts from all comercial banks in New York are estimated at $106 million during the 1976-77 fiscal year.

In an interview, Mr. Howard said that the transfer to Nassau of loans originally booked in New York was a one-time occurence. He notes, that to his knowledge, all such loans were to foreign borrowers. The bank now books such loans directly in the Bahamas he said.

Mr. Howard acknowledged that the shift reduced Citibank's state and city taxes, although, for a complicated set or reasons, it could increase the bank's Federal tax liabilities, he said. He insisted that taxes were not the reason for the shift to Nassau. it is simply cheaper to fund loans here, he maintained.

'Where You Make the Most Profit'

"The essence of it all is where you make the most profit," he said. "It's true it has a tax advantage, but that's not why we do it."

Nevertheless, according to John Shanahan, a banking specialist with the accounting firm of Peet, Marwick, Mitchell & Company, "Nassau has become significant in the overall tax planning and in minimizing the effective tax rates of the major banks."

New York state and city tax officials say they have no idea of the loss to the public coffers, since they lack information on what the banks are doing offshore. The Department of Taxation and Finance expects bank tax collections from commercial banks to decline by $12.6 million, or more than 10 percent, during the fiscal year ending this March, though the publically reported earnings of the six biggest banks in New York City were up slighly on average.

Governor Carey, in his annual budget message, observed that "although large New York City banks recorded a substantial increase in receipts from foreign operations, bank income from foreign sources is not subject to state taxation. Thus the increase was not reflected in state bank tax collections."

Pessimistic on State Action

State Budget Director Peter C. Goldmark, Jr. said in an interview that, although he was aware of the shift of bank lending from New York to the Bahamas, he was "very pessimistic" about the state's ability to do anything about it.

The state may tax the earnings of a transaction if it took place in substance in New York. But as John Heimann, former Banking Department Superintendent and currently Housing Commissioner, put it in an interview, "If a president of a large corporation calls his account manager at a large bank, and says he wants a $150 million loan, and the banker says we'll book this one in the Bahamas, and the next thing is a letter from the Bahamian branch saying we'll extend the facility, where was that loan negotiated?"

The Citibank records also indicate that, as of a few months ago, direct deposits of more than $800 million by American corporations were booked in the Bahamas, where short-term deposits earn more in the Eurocurrency market than similar deposits in the United States.

The Federal Reserve Board frowns on offshore deposits, or offshore borrowing for domestic needs, by American companies. Such transactions, effectively remove the dealings between the major American banks and their corporate clients from the purview of United States authorities. But they are almost impossible to prevent, however, because leading corporations can deposit and borrow funds offshore almost at will through a myriad of foreign subsidiaries. The real source of a deposit, or end use of a loan, as one regulatory official said, "is almost impossible to tell."

Rule on Companies Called Firm

Citibank "does not seek deposits in Nassau from United States corporations," Mr. Howard said, though he conceded that a deposit from a foreign subsidiary might actually represent funds from its United States parent. As for loans, the bank has a firm rule, he added, against booking loans offshore to American companies for use at home. But he conceded that a credit to a United States company's foreign subsidiary could easily be intended for the Corporate parent. Companies have a clear incentive to borrow in the Bahamas because interest rates are lower there than in the United States.

The Citibank documents also disclose that, as of last fall, the bank had on deposit in the Bahamas $1.26 billion from one country—oilr-ich Kuwait. This sum amounts to fully 2.5 percent of the total deposits of Citibank. Put another way, the deposits from this single source are equivalent to 14 percent of the $9.1 billion in demand deposits placed by thousands of customers in Citibank's domestic offices.

A little more than one-third of the Kuwaiti money was on call, or subject to immediate withdrawal, with the remainder deposited for three-month periods.

In the Bahamas, Citibank then had total Arab deposits of $1.76 billion, from Kuwait, Bahrein, Dubai, and Sharjah. That constituted about 3.6 percent of the bank's total worldwide deposits, and 5.7 percent of all deposits in its overseas offices.

Only One Branch Getting Funds

The bank's Arab deposits are even greater, because Nassau is only one branch receiving such funds. According to Mr. Howard, funds from Arab oil producers could amount to 10 percent of Citibank's deposits.

Some observers worry that the concentration of Arab oil fund surpluses in a handful of the nation's largest banks jeopardizes both the domestic and the international financial systems. They fear that the Arab states could threaten an abrupt withdrawal of their money—much of it demand deposits—as leverage to influence American foreign policy.

The banks, supported by the Federal Reserve Board, have countered that the deposits are stable and pose no danger. In a staff memorandum last spring, the Fed contended that, even if the Arabs were to make massive withdrawals, they would have to redeposit the money with other international banks, and the American banks could buy back the funds in the Eurocurrency market.

The Fed has also supported the banks' repeated refusals to provide Congressional committees with data on offshore, deposits and loans.

As Andrew F. Brimmer, former member of the Fed's board of governors, said in a recent conversation, "these things are nobody's business."

Citibank's Bahamian records also showed loans totaling almost $2 billion to Brazil alone. That nearly equaled Citibank's total mortgage and real estate loan portfolio in the United States, some $2.2 billion late last year.

$3.8 Billion in Latin America

Its identifiable Bahamian loans to Latin America, including the Brazilian credits and more than $850 million to Mexico, totaled some $3.8 billion—equivlent to nearly one-half of the bank's $7.7 billion in commercial and industrial loans in the United States.

Citibank's Bahamian books listed few loans that were not paying interest, however. That would support the bank's frequent assertions that even though it lends enormous sums to debt-laden developing countries, only a tiny percentage of these credits are ever irretrievably written off.

But a handful of the loans listed were to borrowers that have announced a default on foreign debt and sought more lenient repayment terms. Among these were Government institutions in Argentina and Fundidora Monterrey, a Mexican steel producer. Citibank also had some $85 million in credits to official institutions in Peru, which has to renegotiate its huge foreign debt.

Interest Rates of 7 Percent to 8 Percent

The loans to Fundidora Monterrey—and to many other Mexican and Brazilian corporations last year—carried interest rates between 7 and 8 percent, compared with 6.25 to 7.25 percent for the United Sates prime rate then. But Citibank's actual earnings on these foreign credits were much greater than the nominal rate would indicate, because of the practice of "grossing up."

In "grossing up" interest income, banks require foreign borrowers to pay local taxes on that income, especially in high-tax countries like Mexico where withholding taxes on interest earnigs can go as high as 30 percent. The borrower gives the tax receipts to the United States bank, which turns them in to United States tax authorities for either a dollar-for-dollar credit against its Federal tax liabilities or a tax deducation, as it chooses.

The Internal Revenue Service does not object to this procedure, provided the banks have proper receipts showing that foreign taxes have been paid.

Some bankers worry, however, that the practice could become a political issue, either abroad, where foreign governments might inquire why local borrowers were paying taxes levied on foreign corporations, or in the United States, where few other taxpayers are allowed credits or deductions for taxes paid b ycustomers.

Another unusual transaction shown in Citibank documents are "back-to-back" deposits. These usually involve the bank taking a deposit from a company in one country on the understanding that it will lend an equal sum to an affiliated company in another. This arrangement permits an enterprise in a country with exchange controls, like Argentina or Britain, to move funds abroad.

In a variation, a subsidiary in a taxhaven like the Bahamas lends money to a home-based subsidiary of the parent. The interest the deposit earns in the Bahamas goes untaxed, while the interest payments on the loan are deducted as a legitimate business expense.

The Citibank records listed back-to-back deposits from (among others) the Government of Argentina and several United States corporations. They included a $3 million deposit by Denny's Inc., the California-based fast-food chain.

Vern O. Curtis, Denny's vice president and treasurer, told The Times that the funds were a loan to a Denny's financing subsidiary in the Netherlands Antilles, balanced by a $3 million deposit in Citibank's London Branch.

The largest transactions labeled "back-to-back" in Citibank's Bahamian records were five deposits totaling 75 million Swiss francs—the equivalent of $30 million—by the Rockwell International Corporation, the aerospace and automotive industrial company. According to William L. Neely, Rockwell's treasurer, however, the funds were straight deposits, made to offset a Swiss franc debt Rockwell acquired a few years ago.

Chairman Burns
B-2046

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 19, 1977

To Board of Governors

Subject:

From Mr. Welsh CWW

In light of Vice Chairman Gardner's inquiry last week concerning permissible activities for U.S. banks abroad, I am attaching for your information a copy of a paper prepared by Board staff and sent to the staff of the Senate Banking Committee in response to questions posed pursuant to their ongoing study of multi-national banking issues.

Attachment

SUMMARY OF THE KINDS OF FOREIGN ACTIVITIES PERMISSIBLE TO U. S. BANKS

Staff Memorandum

Board of Governors of the

Federal Reserve System

SUMMARY OF THE KINDS OF FOREIGN ACTIVITIES PERMISSIBLE TO U.S. BANKS

I. Board Jurisdiction.

The Board presently has jurisdiction to regulate the foreign activities of member banks, Edge Act and Agreement corporations, and bank holding companies. It has no jurisdiction over the foreign activities of federally insured nonmember banks that are not affiliated with bank holding companies.

II. Foreign Activities of U.S. Banks, Bank Holding Companies, and Their Affiliates.

At present, member banks are permitted to engage in a considerably broader range of activities indirectly through foreign affiliates than directly through foreign branches.

A. Foreign Branches of Member Banks.

Under section 25 of the Federal Reserve Act, the Board is given the authority to approve the establishment of foreign branches of national banks (12 U.S.C. 601) and to issue regulations which, in addition to regulating powers which a foreign branch may exercise under other provisions of law, may authorize foreign branches, subject to such conditions and requirements as such regulations may prescribe, to exercise such further powers as may be usual in connection with the transaction of the business of banking in the places where such foreign branch shall transact business (12 U.S.C. 604a). Under section 25 of the Federal Reserve Act, however, such regulations cannot authorize a foreign branch to engage in the general business of producing, distributing, buying or selling goods, wares or merchandise; nor, except as to such limited extent as the Board may deem necessary with respect to securities issued by any "foreign State" as defined in section 25(b) of the Federal Reserve Act (12 U.S.C. 632), can such regulations authorize a foreign branch to engage or participate, directly or indirectly, in the business of underwriting, distributing, or selling securities (12 U.S.C. 604(a)).

Under section 9 of the Federal Reserve Act, State member banks, which have the requisite power to establish foreign branches under State law, may establish and operate such foreign branches with the Board's approval and on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of foreign branches by national banks (12 U.S.C. 321). The Board thus has regulatory authority over the establishment and operation of foreign branches of both national and State member banks. Foreign branches of national banks are, however, examined by the Comptroller of the Currency.

The Board has implemented its authority over foreign branches of member banks through the adoption and promulgation of its Regulation M (12 CFR Part 213), a copy of which is enclosed in the Appendix. Regulation M prescribes in detail the regulatory procedures, conditions, limitations, and prohibitions governing the establishment and operation of foreign branches of member banks.

Through foreign branches, member banks have been permitted by the Board to exercise the normal banking powers that they enjoy domestically under the federal or State laws under which they are chartered (as limited by the Federal Reserve Act), plus certain enumerated additional powers of the same general character that are exercisable only to the extent usual in the business of banking in the foreign countries where those branches transact their business.

With respect to these latter additional powers not permitted domestically, the Board has not utilized its full regulatory authority under section 25 of the Federal Reserve Act to permit foreign branches of member banks (in the case of State banks, only to the extent authorized by State law) to exercise all powers usual in the business of banking in the places where they transact business. Rather, under § 213.3(b) of Regulation M (12 CFR § 213.3(b)), the Board has permitted foreign branches of member banks to engage only in the following powers where usual in the business of banking in the place where the foreign branch transacts business:

(1) Guarantee customers' debts or otherwise agree for their benefit to make payments on the occurrence of readily ascertainable events,1/ if the guarantee or agreement specifies its maximum monetary liability thereunder; but, except to the extent secured with respect thereto, no national bank may have such liabilities outstanding (i) in an aggregate amount exceeding 50 per cent of its capital and surplus

1/ Including, but not limited to, such types of events as nonpayment of taxes, retails, customs duties, or costs of transport and loss or nonconformance of shipping documents.

or (ii) for any customer in excess of the amount by which 10 per cent of its capital and surplus exceeds the aggregate of such customer's "obligations" to it which are subject to any limitation under section 5200 of the Revised Statutes (12 U.S.C. 84);

(2) Accept commercial drafts or bills of exchange drawn upon it;

(3) Acquire and hold securities (including certificates or other evidences of ownership or participation) of the central bank, clearing houses, governmental entities, and development banks of the country in which it is located, unless after such an acquisition the aggregate amount invested by the branch in such securities (exclusive of securities held as required by the law of that country or as authorized under section 5136 of the Revised Statutes (12 U.S.C. 24)) would exceed 1 per cent of its total deposits on the preceding year-end call report date (or on the date of such acquisition in the case of a newly established branch which has not so reported);

(4) Underwrite, distribute, buy, and sell obligations of the national government of the country in which it is located,[2/] but no bank may hold, or be under commitment with respect to, obligations of such a government as a result of underwriting, dealing in, or purchasing for its own account in an aggregate amount exceeding 10 per cent of its capital and surplus;

2/ Including obligations issued by any agency or instrumentality, and supported by the full faith and credit, of such government.

(5) Take liens or other encumbrances on foreign real estate in connection with its extensions of credit, whether or not of first priority and whether or not such real estate is improved or has been appraised, and without regard to the maturity or amount limitations or amortization requirements of section 24 of the Federal Reserve Act (12 U.S.C. 371);

(6) Extend credit to an executive officer of the branch in an amount not to exceed $100,000 or its equivalent in order to finance the acquisition or construction of living quarters to be used as his residence abroad, provided each such credit extension is promptly reported to its home office; except that, with the prior specific approval of the parent bank's board of directors, such amount limitation may be exceeded when necessary to meet local housing costs;

(7) Pay to any officer or employee of the branch a greater rate of interest on deposits than that paid to other depositors on similar deposits with the branch; and

(8) Act as insurance agent or broker.

B. Foreign Affiliates of U.S. Banks and Bank Holding Companies.

(1) Permissible Methods of Investment Abroad.

United States banking organizations have essentially three methods of acquiring and holding investments in foreign banks and corporations:

(a) Direct Investments. National banks may, with the Board's permission, invest directly in the stock of foreign banks not engaged, directly or indirectly, in any activity in the United States except as, in the judgment of the Board, shall be incidental to the international or foreign business of such foreign bank (12 U.S.C. 601). State member banks may, with the Board's permission, also make such direct investments, if also authorized by State law.[3/] The Board has implemented its authority under section 25 of the Federal Reserve Act by adopting and promulgating § 213.4 of Regulation M, a copy of which is enclosed in the Appendix. These regulations are discussed *infra*.

Under the Board's interpretation of the term "foreign bank" in section 25 of the Federal Reserve Act, member banks have only been permitted to invest directly in the stock of foreign institutions that are principally engaged in a commercial banking business abroad. To qualify as being engaged in a commercial banking business, a foreign institution must receive deposits to a substantial extent in the regular course of its business, must have the power to receive demand deposits, and must be regulated, supervised or otherwise recognized as a commercial bank by the banking or monetary authorities of its place of organization or principal banking operations. A copy of the Board's interpretation is enclosed in the Appendix.

3/ State member banks may only hold stock in corporations in which a national bank may invest (12 U.S.C. 335). Since national banks may directly hold shares of foreign banks, State member banks may also make such investments with the Board's permission, if otherwise permissible under State law.

In this regard, it should also be noted that the Board has ruled that member banks may not organize foreign operations subsidiaries abroad. A copy of this interpretation is also enclosed in the Appendix.

(b) Indirect Investments. Any national bank may, with the Board's permission, invest in the stock of either a corporation organized under section 25(a) of the Federal Reserve Act (12 U.S.C. 611-619) (an "Edge Act corporation"), or a corporation operating under an agreement with the Board pursuant to section 25 of the Federal Reserve Act (12 U.S.C. 601) (a so-called "Agreement Corporation"), so long as the aggregate amount of stock held in all Edge Act and Agreement Corporations does not exceed 10 per centum of the bank's capital and surplus (12 U.S.C. 618). Since stock of these corporations is eligible for investment by a national bank, State member banks may, with the Board's permission, also acquire and hold shares of these Corporations if permissible under State law. State nonmember banks seeking to organize an Edge Act Corporation must also obtain the Board's approval since such Corporations are chartered by the Board; State nonmember banks investing in State-chartered international or foreign banking corporations, such as Agreement Corporations, need not obtain Board approval under the Federal Reserve Act.

Edge Act Corporations are chartered with the Board's approval for the purposes of engaging in international or foreign banking or other international or foreign financial operations either directly or through the agency, ownership, or control of local institutions in foreign countries (12 U.S.C. 611). Edge Act Corporations may also, with the Board's consent, acquire and hold stock of any companies that are not engaged in the general business of buying or selling goods or commodities in the United States and that do not transact any business in the United States except such as may be incidental to such companies' international or foreign business (12 U.S.C. 615). Thus, through their Edge Act Corporation subsidiaries, U.S. banks may engage indirectly in international or foreign banking or other international or financial operations abroad; in addition, U.S. banks may indirectly acquire stock of foreign companies through their Edge Act Corporation subsidiaries.

Agreement Corporations are banks or corporations chartered or incorporated under the laws of the United States or of any State thereof principally engaged in international or foreign banking, or banking in a dependency or insular possession of the U.S., either directly, or through the agency, control, or ownership of local institutions in foreign countries, or in such dependencies or insular possessions (12 U.S.C. 601). In order for a member bank to invest in the shares of an Agreement Corporation, the corporation must enter into an agreement with the Board to restrict its operations or conduct its business in such manner or under such limitations as the Board may prescribe for the place or places where it transacts business (12 U.S.C. 603). The Board has by regulation limited the activities and investments of Agreement Corporations to those permissible for an Edge Act Corporation not engaged in banking.[4/] Thus, a member bank through an Agreement Corporation

4/ § 211.10 of the Board's Regulation K (12 CFR § 211.10), a copy of which is enclosed in the Appendix. An Edge Act Corporation not engaged in banking is a corporation whose aggregate demand deposits and acceptance liabilities do not exceed its capital and surplus. See § 211.2(d) of Regulation K. Such a corporation is given broader lending limits than a Corporation engaged in banking. See § 211.9(b) of Regulation K.

subsidiary may conduct the same foreign activities and hold the same foreign investments that it may conduct and hold through an Edge Act Corporation, unless the Agreement Corporation is subject to other specific requirements in its agreement with the Board or is otherwise limited by State law. For purposes of this memorandum, any reference to activities conducted or investments acquired and held by an Edge Act Corporation shall be deemed to include activities conducted or investments acquired and held by an Agreement Corporation, since the regulatory standards governing these Corporations are identical in each case.

Pursuant to its authority under section 25(a) of the Federal Reserve Act (hereinafter referred to as the "Edge Act"), the Board has adopted and promulgated its Regulation K, a copy of which is enclosed in the Appendix, which sets forth regulations governing the organization of Edge Act Corporations, their activities, and their investments. These regulations are discussed *infra*.

(c) Bank Holding Company Investments. The Board has discretion under section 4(c)(13) of the Bank Holding Company Act ("BHCA") to permit bank holding companies to acquire and hold stock of companies that do no business in the United States except as an incident to such companies' international or foreign business, if the Board concludes that such an exemption would not be substantially at variance with the purposes of the BHCA and would be in the public interest (12 U.S.C. 1843(c)(13)).

Pursuant to its authority under § 4(c)(13) of the BHCA, the Board has adopted and promulgated § 225.4(f) of its Regulation Y (12 CFR 225.4(f)) which sets forth the regulations governing the foreign investments of bank holding companies. A copy of Regulation Y is enclosed in the Appendix. These regulations are discussed infra.

Under § 4(c)(5) of the BHCA, bank holding companies are also permitted to acquire shares which are of the kinds and amounts eligible for investment by national banking associations. Since, as discussed earlier, national banks may acquire shares of Edge Act Corporations and Agreement Corporations with the Board's approval, the Board has also permitted bank holding companies under § 4(c)(5) to invest directly in the shares of Edge Act and Agreement Corporations. Such Corporations are, of course, subject to the Board's Regulation K to the same extent as if held directly by a member bank.

(2) Activities of Foreign Affiliates of U.S. Banks and Bank Holding Companies.

(a) U.S. Activities Prohibited Foreign Affiliates by Statute or Regulation. A member bank, an Edge Act Corporation, and a bank holding company are specifically precluded by statute or regulation from acquiring and holding, directly or indirectly, the stock or other certificates of ownership of any foreign bank or company engaged in any of the following activities in the United States:

(1) any activity in the United States which, in the Board's judgment, is not incidental to the international or foreign business of such foreign bank or company;[5/]

5/ See 12 U.S.C. 601, 12 U.S.C. 615 and 12 U.S.C. 1843(c)(13) (1970). An Edge Act Corporation itself may only directly engage in activities in the United States that are incidental to its international or foreign business (12 U.S.C. 616 (1970).

(2) the general business of buying or selling goods, wares, merchandise or commodities in the United States;6/ or

(3) the business of underwriting, selling or distributing securities in the United States.7/

The types of activities which the Board has determined to be permissible "incidental" U.S. activities under paragraph (1) above for foreign companies in which an Edge Act Corporation or a member bank has a share interest are generally set forth in § 211.7 of the Board's Regulation K (12 CFR § 211.7), which sets forth the kinds of limited activities an Edge Act Corporation itself may directly engage in in the United States. In general, such activities are confined to such limited business activities in the U.S. as are usual in financing international commerce. Foreign banks in which Edge Act Corporations or member banks have a share interest are also limited in the United States to the limited operations permissible an Edge Act Corporation under Regulation K. Thus, if a foreign bank in which a member bank or Edge Act Corporation has a share interest desires to open a branch or agency in the U.S., the branch or agency must confine its U.S. activities to those permissible an Edge Act Corporation under Regulation K. The Board has also ruled in this regard that it is not permissible for a foreign bank in which a member bank or Edge Act Corporation has a share interest to organize

6/ See 12 U.S.C. 615 for Edge Act Corporation affiliates. The prohibitions of the Edge Act are applied by regulation to bank holding company foreign affiliates under § 225.4(f)(1) of Regulation Y. Edge Act Corporations are by statute precluded from directly engaging in such activities (12 U.S.C. 617).

7/ See 12 CFR § 211.8(c)(1), § 213.4(b)(1), and § 225.4(f)(1) (by implication). Edge Act Corporations are also proscribed from directly engaging in such activities. See 12 CFR § 211.5(b).

a national or State-chartered subsidiary bank in the U.S., since it would be engaging in a domestic banking business not incidental to its international or foreign business.

Foreign companies in which bank holding companies have greater than a 5 per cent voting share interest are also subject to the same restraints on incidental U.S. activities as those imposed on companies in which Edge Act Corporations have a share interest, and in addition are subject to a regulatory prohibition against accepting deposits or similar credit balances in the U.S.

(b) <u>Permissible and Nonpermissible Foreign Activities of Foreign Affiliates</u>.

(1) <u>General Consent "Venture Capital Investment"</u>. Under current Board regulations,[8/] a U.S. bank through its Edge Act Corporation subsidiary may, without obtaining the Board's prior consent, indirectly purchase and hold the shares of foreign corporations not doing business in the U.S., irrespective of the kind of foreign activities engaged in by such foreign corporations, so long as no more than 25 per cent of the shares of the foreign corporation are acquired and no more than $500,000 is invested by the Edge Act Corporation in the shares of the foreign corporation. Bank holding companies are also permitted by regulation to make such investments abroad under the same percentage and amount limitations.

8/ § 211.8(a) of Regulation K and § 225.4(f)(2) of Regulation Y (12 CFR § 211.8(a) and § 225.4(f)(2)).

The Board has permitted these noncontrolling venture capital investments in foreign companies by Edge Act Corporations and bank holding companies because (1) they provide flexibility in structuring a financing package, (2) secure a limited voice in management to protect extensions of credit, and (3) promote good will with a bank customer (sometimes a foreign government) and seek to develop a stable source of foreign deposits.

In general, such "venture capital investments" are minority long-term passive investments in the stock of foreign companies (usually nonfinancial companies) that are made solely to earn a return and not with the intent to exercise influence over the operations of the companies invested in for the purposes of expanding the operating capabilities of the U.S. bank or bank holding company involved.

(2) Investments in Foreign Affiliates. An Edge Act Corporation must obtain the Board's prior consent to invest more than $500,000 in the shares of a foreign company or acquire more than 25 per cent of the shares of a foreign company.[9/] Bank holding companies, by regulation, are subject to similar requirements.[10/] A member bank, however, must in every case obtain the Board's prior consent to acquire a direct share interest in a foreign bank, irrespective of the amount invested or percentage of shares acquired.

If less than 25 per cent of the shares of a foreign company are proposed to be acquired with the Board's prior consent and if the

9/ § 211.8(b) of Regulation K (12 CFR § 211.8(b)).
10/ § 225.4(f)(2) of Regulation Y (12 CFR § 225.4(f)(2)).

Board determines the investment to be a purely passive venture capital investment which otherwise would be made under the general consent procedures but for the investing of more than $500,000, the Board will generally permit the Edge Act Corporation or bank holding company to purchase and hold the shares of such foreign company irrespective of the types of financial or nonfinancial activities it may engage in. Due to the greater amount of the investment, however, the Board, in such situations, carefully evaluates risks associated with nonfinancial activities.

When a U.S. bank indirectly through its Edge Act Corporation subsidiary, or when a U.S. bank holding company directly or indirectly seeks to acquire more than a 25 per cent share interest in a foreign company, the Board has adopted a policy of narrowing the activities which may be conducted through such foreign companies to those of a banking and financial nature. The Board has adopted this line of more than a 25 per cent investment for imposing limitations on the kinds of activities that may be engaged in by such foreign companies, because at that level of investment the Edge Act Corporation or bank holding company has a significant operating interest in the company.11/

11/ The Board generally evaluates foreign investments of Edge Act Corporations under a standard of "control" that is based upon majority ownership of voting shares of a foreign company or actual control of its board of directors or principal officers. If a foreign company is controlled by an Edge Act Corporation it is subject by Board letter to the provisions of Regulation K the same as if it were an Edge Act Corporation. Many of these provisions relate to financial restrictions such as lending limits and not to permissible activities. In cases where an Edge Act Corporation does not have exclusive control of a foreign company but has greater than a 25 per cent interest, the Board has applied only the Regulation K limitations on activities that may be engaged in by an Edge Act Corporation and has not applied the other limitations in the Regulation. In the Board's judgment, a greater than 25 per cent interest substantially involves an Edge Act Corporation in the operations and management of a foreign company and thus the foreign company should

Specifically, under current Board policy, an Edge Act Corporation or a bank holding company may, with the Board's consent, acquire and hold more than 25 per cent of the shares of a foreign company subject to the condition that such foreign company "shall confine its activities to international or foreign banking and other international or foreign financial operations." This same standard also applies to the activities of a foreign bank in which a member bank has a direct interest of more than 25 per cent. It should be noted in this regard that, under the governing statutes, there is no restriction on the types of foreign activities that can be conducted by foreign companies in which member banks, Edge Act Corporations or bank holding companies have an interest. The imposition of this standard is rather through the exercise of the Board's administrative discretion in this area.

This regulatory standard is taken from the Edge Act wherein it is stated that Edge Act Corporations are "to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations. . . ." The Board has thus generally determined that Edge Act Corporations through significant operating investments in foreign companies should only be permitted to do indirectly the activities which they are permitted to do directly. By regulation, the Board has imposed this same standard on bank holding companies.12/

11/ Con't.
be subject to limitations on activities. Most investments falling in this 25-50 per cent range are joint ventures, where the investing Edge Act Corporation regards the foreign company as establishing an operating presence for the Corporation or its parent bank. See in this regard the Board's recent statement of policy on foreign joint ventures (12 CFR § 211.52) which is included in the Appendix.

12/ § 225.4(f)(1) of Regulation Y. See press release and Federal Register Notice accompanying Board adoption of such Regulation enclosed in the Appendix.

In interpreting what constitutes permissible "international or foreign banking or other international or foreign financial operations" for companies or foreign banks in which Edge Act Corporations, member banks or bank holding companies have greater than a 25 per cent share interest (hereinafter collectively referred to as "foreign affiliates of U.S. banks"), the Board has determined that all of the specific international and foreign banking and financing activities which Edge Act Corporations may engage in directly under the Edge Act and the Board's regulations are also permissible for such foreign affiliates. (These activities are specified in detail at 12 U.S.C. § 615(a) and § 211.7 of Regulation K.)

Under the Edge Act, however, the Board is also authorized to empower Edge Act corporations to exercise additional powers usual in the business of banking or other financial operations in the foreign countries where they transact business. (12 U.S.C. § 615(a)). The purpose of such provision is to keep U.S. banks competitive abroad with their foreign bank counterparts.

In keeping with this purpose, the Board, in construing the standard "international or foreign banking or other international or foreign financial operations," has, thus, also sought to permit activities of general importance to international banking, such as underwriting of stocks and bonds, that should be capable of being performed by foreign affiliates of U.S. banks anywhere outside the United States in order to make them competitive with foreign banks, and has thus approved these activities as "international financial operations."[13/] While a foreign affiliate of a U.S. bank may be able to engage in investment banking abroad, as noted previously, such foreign affiliate may not, however, underwrite, distribute or sell securities in the U.S.

Since enactment of the 1970 Amendments to the BHCA, the Board has generally construed the standard "international or foreign financial operations" to include activities which the Board has determined to be activities "closely related to banking" under the domestic standards of § 4(c)(8) of the BHCA (12 U.S.C. 1843(c)(8)).

The Board has thus generally permitted foreign affiliates of U.S. banks to engage in (1) mortgage, finance company, credit card and factoring operations abroad; (2) servicing loans and other extensions of credit abroad; (3) performing or carrying on any one or more of the activities that may be performed or carried on by a trust company (including activities of a nominee, fiduciary, agency, or custodian nature) in the manner authorized in the foreign country where the business is to be transacted; (4) acting as investment or financial adviser abroad; (5) foreign leasing operations of a type permitted by section 225.4(a)(6) of Regulation Y; (6) providing bookkeeping and data processing services abroad; (7) acting as insurance agent or broker abroad; (8) underwriting credit-related insurance; and (9) management consulting advice on banking operations. In some cases, such as foreign leasing activities, the Board has retained restrictions imposed domestically under Regulation Y on the activity, because the restrictions relate to ensuring the financing

13/ A paper in the Appendix discusses the legal authority for such activities in light of the Glass-Steagall Act.

nature of the activity.14/ Thus, foreign affiliates of U.S. banks may not engage in nonfull-payout leasing operations abroad, because the Board has not determined these activities to be a financial operation. In the case of the majority of 4(c)(8) activities such as trust company activities, the giving of investment and financial advice, providing bookkeeping and data processing services, and acting as insurance agent or broker, the Board has not imposed conditions set forth in Regulation Y which were designed for the domestic market. Generally, foreign affiliates of U.S. banks may engage in such financial activities to the extent permitted competing foreign institutions in the foreign country.

The Board has also approved other foreign financial operations for foreign affiliates of U.S. banks that are not considered closely related to banking domestically. For example, foreign affiliates of U.S. banks may engage in management consulting activities abroad subject to the condition that such services relating to the U.S. market will be confined to the initial entry of foreign companies into that market. They may also manage foreign mutual funds subject to the condition that shares of any such funds will only be sold to nonresident aliens of the U.S. and that such funds will not directly or indirectly control or participate in the management of any company. The Board has also permitted foreign affiliates to engage in travel agency and warehousing services in certain countries. None of these activities is a permissible closely related to banking activity under § 4(c)(8). The Board has, however, used its discretion to approve these activities as permissible financial operations abroad for foreign affiliates of U.S. banks in

14/ See 12 CFR § 211.106.

order to keep U.S. banks competitive abroad because these activities are either generally performed by foreign banks in their foreign or international financial operations, or are performed by foreign banks in certain countries.

The Board has, however, specifically denied requests to permit foreign affiliates of U.S. banks to engage abroad in underwriting insurance that is not sold in connection with a credit transaction,[15/] in customs house brokerage and freight forwarding activities,[16/] in purchasing and selling of land, real estate development, participating as a joint venturer in real estate development, hotel ownership and management and other "non-financial" activities.[17/]

These requests were denied because the Board determined that these activities are not "financial operations" within the meaning of the governing standard, and U.S. banks would not be harmed competitively abroad if they could not engage in such activities.

SUMAMRY: In general, the Board has limited the activities of foreign branches of member banks in a way that closely parallels the standards applied to the activities of domestic offices of U.S. banks, and has limited the foreign activities of foreign affiliates of U.S. banks to international or foreign banking or other international or foreign financial activities.

15/ See Board Order of June 19, 1974, denying BankAmerica Corporation's request to invest in Allstate International, S.A., Zurich, Switzerland, and Board Order of same date denying First National City Overseas Investment Corporation's proposed additional investment in Companhia De Seguros Argos Fluminense, S.A., Rio de Janeiro, Brazil. Copies of the Orders are enclosed in the Appendix.

16/ See Board letters of June 28, 1974 to Bank of Virginia Company and Boston Overseas Financial Corporation, copies of which are included in the Appendix.

17/ See Board letter of March 10, 1975 to Citicorp re: investment in I.A.C. (Holdings), Limited, Melbourne, Australia, a copy of the letter is in the Appendix.

CHART II
Principal Foreign Activities Permissible to U.S. Banks, by Type of Organization

PRINCIPAL ACTIVITIES	Foreign Branches of Member Bank	Edge and Agreement Corportations[1/] and Their Foreign Affiliates[2/]	Foreign Bank Affiliates of Member Banks[3/]	Foreign Affiliates of Bank Holding Companies[4/]
A. <u>Normal Banking Powers Enjoyed in Home State in U.S.</u>	X			
B. <u>Enumerated Powers Usual in Business of Banking in Host Country</u>				
1. Guarantee customers' debts.	X	X	X	X
2. Accept commercial drafts or bills of exchange.	X	X	X	X
3. Acquire and hold securities of clearing houses, central and development banks, and government entities.	X	X	X	X
4. Underwrite, distribute, buy and sell obligations of host country's national government.	X	X	X	X
5. Liens on foreign real estate related to credit extension.	X	X	X	X
6. Extend credit to executive officers and pay higher rates on deposits for officers and employees.	X	X	X	X
7. Act as insurance agent or broker.	X	X	X	X
C. <u>Prohibited Activities</u>				
1. General business of producing, distributing, buying or selling goods, wares or merchandise.	X	X	X	X
2. Underwriting, distributing, or selling [non-government] securities overseas.	X	*		

1/ Corporations organized or operating pursuant to sections 25 and 25(a) of the Federal Reserve Act.
2/ Foreign companies acquired by Edge and Agreement Corporations under section 25 and 25(a) of the Federal Reserve Act.
3/ Foreign banks acquired by member banks under the third paragraph of section 25 of the Federal Reserve Act.
4/ Foreign companies acquired by bank holding companies under § 4(c)(13) of the Bank Holding Company Act.
*These activities may not be engaged in directly by Edge or Agreement Corporations engaged in banking.

PRINCIPAL ACTIVITIES	Foreign Branches of Member Bank	Edge and Agreement Corportations[1] and Their Foreign Affiliates[2]	Foreign Bank Affiliates of Member Banks[3]	Foreign Affiliates of Bank Holding Companies[4]
3. Underwriting, distributing or selling securities in the United States.	X	X	X	X
4. Engaging in activities in U.S. not incidental to international or foreign business.		X	X	X
D. Closely Related to Banking in U.S.				
1. Mortgage, finance company, credit card, and factoring operations.	**	X	X	X
2. Servicing loans and other extensions of credit.	**	X	X	X
3. Trust company activities.	**	X	X	X
4. Acting as investment or financial adviser.	**	X	X	X
5. Leasing operations.	**	X	X	X
6. Financially-related data processing services.	**	X	X	X
7. Financially-related insurance agent or brokerage services.	**	X	X	X
8. Underwriting credit-related insurance.	**	X	X	X
9. Management consulting advice to banking organizations	**	X	X	X
E. Not Closely Related to Banking in U.S.				
1. Underwriting and distribution of debt and equity securities abroad		X	X	X
2. General management consulting.		X	X	X
3. Management of mutual funds.		X	X	X
4. Operation of travel agency.		X	X	X
5. Operation of warehousing services		X	X	X
6. General data processing services		X	X	X
7. General insurance agency and brokerage services		X	X	X
8. Portfolio investments of not more than 25 per cent.		X	X	X

**Only to the extent permitted parent bank under domestic federal or State banking laws, and foreign branch under local law.

PRINCIPAL ACTIVITIES	Foreign Branches of Member Bank	Edge and Agreement Corportations[1] and Their Foreign Affiliates[2]	Foreign Bank Affiliates of Member Banks[3]	Foreign Affiliates of Bank Holding Companies[4]
F. Activities Specifically Denied				
1. Non-credit related insurance underwriting.	***	X	X	X
2. Land sales or real estate development.	***	X	X	X
3. Hotel ownership and management.	***	X	X	X
4. Custom house brokerage and freigt forwarding.	***	X	X	X
5. Investments in more than 25 per cent of the shares of nonfinancial companies.	***	X	X	X

***These activities have not yet been applied for by foreign branches.