

Federal Reserve Bank of San Francisco

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International Banking Regs

The Federal Reserve last month proposed revisions to several international-banking regulations — those covering international activities of Edge Corporations (Regulation K), member banks (Regulation M), and foreign investments by bank holding companies (Regulation Y). The proposed revisions would consolidate all international-banking regulations into a single regulation entitled International Banking Operations (proposed Regulation K), and in that way would facilitate the banking industry's understanding of, and compliance with, the Fed's regulatory requirements.

The principal impetus came from the passage of the International Banking Act (IBA) of 1978, which directed the Federal Reserve to modify its regulations covering Edge Corporations. (These corporations are owned by banks, are chartered and regulated by the Federal Reserve, and are limited in their activities to the field of international finance.) Edge Corporations may be established in multiple locations in the United States, and thus they give banks a way of providing their customers with international-banking services from offices outside their home state of operation.

Edge Corporation regs

The Congressional intent regarding Edges was specifically stated in the International Banking Act. The IBA stated that Edge Corporations should be better able to "facilitate and stimulate the export of U.S. goods," and should be better able to "stimulate competition in the provision of international banking and financing services throughout the United States."

To achieve these purposes, the Federal Reserve has proposed a major amendment of its regulations to distinguish a new class of Edge customers. A corporation would tentatively be defined as principally engaged in foreign trade if two-thirds or more of its purchases or sales are directly attributable to foreign commerce. For this class of customers, an Edge Corporation could extend loans and accept deposits, without regard to whether specific transactions were trade-related. Past regulatory practice, requiring each Edge deposit and loan transaction to be linked to foreign trade, placed a regulatory burden on both the banks and the Federal Reserve. The proposed revisions would help alleviate this problem.

In addition, the new regulations would permit Edge Corporations to finance the production of U.S. goods designated for export. Previously, Edge Corporations could finance only the shipment and storage of export goods, and not their production. This proposed change would enhance their flexibility in financing U.S. exports, since a customer could then obtain both pre-export and export financing from an Edge Corporation.

A second important proposal would allow Edge Corporations to establish domestic branches. Edges currently may establish foreign branches, but a bank must establish separate Edge Corporations if it wants to conduct international transactions in multiple locations in the United States. A few large banks maintain individual Edge Corporations in several cities in the United States. Thus, the current re-

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quirement forces banks owning Edge Corporations to incur the expense and inconvenience of incorporating individual entities. Moreover, each Edge's loan limit for individual borrowers is based on its own capital, and this restriction has inhibited participation in major transactions in the past.

With domestic branches permitted, the competitive position of Edge Corporations should be enhanced. In that situation, a bank could consolidate its Edge Corporations into a single entity with a lending limit based on a larger capital base. Greater lending limits would make Edge Corporations more competitive in major credit transactions. In addition, a wider range of smaller banks could become involved in foreign-trade financing. They might not be able to afford multiple Edge Corporations, but they would be able to establish domestic branches of Edge Corporations currently in operation. Domestic branching by a greater number of institutions offering international banking services should facilitate competition in that area.

The International Banking Act involved another important related change — the abolition of the statutory minimum reserve requirement of 10 percent on total Edge Corporation deposits, regardless of composition of the deposits. The new reserve requirements will be at levels comparable to member-bank requirements. Since member-bank requirements are well below 10 percent for time and savings deposits, this change will make Edge Corporations better able to compete for such deposits.

Foreign-investment regs

The Federal Reserve Act and the Bank Holding Company Act give the Federal Reserve broad authority to approve foreign investments by member banks, bank holding companies, and Edge Corporations. The investments are generally limited to banking and financial activities; however, the Federal Reserve in the past has permitted U.S. banking institutions to invest in a range of activities abroad, so that they could compete better with foreign banks and thereby support the growth of U.S. foreign commerce.

As part of its current review, the Federal Reserve is proposing changes in its approval procedures for foreign investments. Under the proposed regulations, the Federal Reserve will give its consent to all investments in any foreign banking or financial institution in amounts up to \$2 million, or 5 percent of the investing institution's capital and surplus. In those cases where an investment reaches 10 percent of the foreign institution's capital and surplus, the investing institution

would be required to provide 60 days written notice before implementation. At the end of that period, the investment would be automatically approved unless the Federal Reserve disapproved the investment or requested a full application.

For larger foreign investments, or for investments in nonfinancial entities, a formal application would be required. To facilitate investors' planning, the Federal Reserve has included in the proposed regulation a list of the types of investments which it had previously approved — but has made it clear that the list does not necessarily limit the types of corporations in which a bank might invest. Investments in areas not covered by the list would be approved in cases where the investing bank could show that a proposal is of a financial nature, and is a normal activity for banks in the country involved.

Other issues

The Federal Reserve has also requested public comment on two issues on which it has not yet taken a position. First, international-banking regulations in the past have prohibited foreign subsidiaries of banks, bank holding companies, and Edge Corporations from lending to U.S. residents for domestic purposes, as a means of keeping foreign subsidiaries from circumventing domestic banking regulations. But the increasing integration of world financial and banking markets, with corporations maintaining borrowing and depositing facilities in several countries, has reduced the distinction between purely domestic and foreign customers, and thus has made this pro-

hibition difficult to interpret. Secondly, there is the question of whether Edge Corporations should be permitted to become member banks — a question which the International Banking Act requires the Federal Reserve to consider.

With the development of new regulations, the Federal Reserve hopes to meet several national goals which Congress intended to achieve through last year's legislation. In Congress' eyes, Edge Corporations should have powers sufficiently broad to enable them to compete with foreign banks in the United States as well as abroad, and to provide all segments of the U.S. economy a means of financing international trade — exports in particular. In addition, Congress intended that Edge Corporations should help foster the participation of regional and smaller banks in international banking and finance, and also should help stimulate competition in making those services available throughout the United States.

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