FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 68-72
March 14, 1968

**To all Banks, Nonbank Financial
Institutions and Other Firms Addressed
in the Eleventh Federal Reserve District:**

There is enclosed a copy of changes in the guidelines for banks and the text of the revised guidelines for nonbank financial institutions. These revisions, which are effective immediately, amend the guidelines issued by this Bank on January 2, 1968, Circular No. 68-1. The text of the press release issued by the Board of Governors covering the changes in the guidelines for banks and nonbank financial institutions is quoted below:

"The Board of Governors of the Federal Reserve System has announced revisions in the guidelines for banks and nonbank financial institutions issued January 1, 1968, under the President's balance of payments program. These revisions have been made for the purpose of implementing the agreement reached between the Governments of Canada and the United States as set forth in an exchange of letters between Secretary of the Treasury Fowler and Finance Minister Sharp on March 7, 1968.

"Banks will now be permitted to increase claims on residents of Canada without reference to the ceilings suggested by the guidelines. The revisions in the bank guidelines, reflected in adjustments to be made in the applicable reporting form, exclude from a bank's reportable foreign assets *any change* in claims on residents of Canada after February 29, 1968, whether an increase or a decrease. Banks will not be able to increase foreign loans to other parts of the world by reducing their holdings of Canadian assets. There are no other substantive changes in the bank guidelines.

"The revised guidelines for nonbank financial institutions exclude all holdings of Canadian assets from the provisions of the guidelines. For this purpose, the reporting form will be changed to provide that Canadian assets, while still shown, will be deducted both from the base and from covered assets subject to the ceiling. Also, net financial investment in *non*financial subsidiaries and affiliates located in developed countries other than Canada and Japan has been added to the definition of covered assets. Formerly only such investment in foreign branches and *financial* subsidiaries and affiliates located in those countries was covered by the guidelines. The program for nonbank financial institutions still seeks a reduction in covered foreign assets of 5 per cent or more during 1968."

Additional copies of these guidelines may be obtained from this Bank or appropriate branch. Questions concerning this program should be directed to Assistant Vice President Cowan.

Yours very truly,

P. E. Coldwell
President

Enclosure

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CHANGES IN
GUIDELINES FOR BANKS

1. Ceiling and reporting

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B. Specific inclusions and exclusions in calculating the ceiling:

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(2) Contingent claims, unutilized credits, claims held for account of customers, acceptances executed by other U.S. banks, loans guaranteed or participated in by the Export-Import Bank or insured by the Foreign Credit Insurance Association, and any increase in claims on Canadian residents over the amount of such claims held on February 29, 1968, should be excluded.

2. Exclusions from the ceiling

Loans guaranteed or participated in by the Export-Import Bank or insured by the Foreign Credit Insurance Association are excluded from the ceiling. The role of the Export-Import Bank within the framework of the President's program is coordinated by the National Advisory Council for International Monetary and Financial Policies. Also excluded is any increase in claims on Canadian residents over the amount of such claims held on February 29, 1968.

4. Loan priorities

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With respect to nonexport credits, banks should give the highest priority to loans to developing countries and should avoid restrictive policies that would place an undue burden on Japan or the United Kingdom.

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6. Transactions for the account of customers

A bank should bear in mind the President's balance of payments program when acting for the account of a customer. Although the bank is obliged to follow a customer's instructions, it should to the extent possible discourage customers from placing liquid funds outside the United States, except in Canada. * * *

11. Management of a bank's liquid funds

A bank should not place its own funds abroad for short-term investment purposes, whether such investments are payable in foreign currencies or in U.S. dollars. This does not, however, apply to investments in Canada, nor does it call for a reduction in necessary working balances held with foreign correspondents.

GUIDELINES FOR NONBANK FINANCIAL INSTITUTIONS

Preface

The program announced on January 1, 1968 has been changed as follows:

1. Liquid funds in Canada, as well as short- and intermediate-term credits to Canadians, are no longer considered to be "covered" assets. With this change, all claims on Canadians, regardless of maturity, are exempt from the guideline ceiling.

2. All net investments in foreign businesses are now considered to be foreign financial assets reportable under the program. The effect of this change is to apply the same guideline treatment to investment in nonfinancial subsidiaries and affiliates located abroad as to investment in foreign branches, financial subsidiaries and affiliates.

All institutions are still requested to reduce their holdings of foreign assets covered by the program by 5 per cent or more during 1968, with the target reduction based on the amount of such assets held on December 31, 1967. They generally are expected to reduce their holdings of liquid funds abroad (other than in Canada) to zero during 1968, except to the extent that minimum working balances are required for the conduct of foreign business activities.

Institutions are expected also to refrain from making any new investments, in either debt or equity form, in the developed countries of continental Western Europe, except for new credits judged essential to the financing of U.S. exports as evidenced by exemption from the Interest Equalization Tax that otherwise would apply.

The definition of covered assets continues to: (a) exclude foreign assets of types otherwise covered by the program but acquired as "free delivery" items after December 31, 1967; and (b) provide that equity securities held at the beginning of 1968 be carried throughout 1968 at the values reflected in the report (on Form FR 392R-68) filed for December 31, 1967, and that equities purchased during 1968 be carried at cost.

Among the types of foreign assets covered by the program, institutions are still requested to give absolute priority to credits that represent financing essential to the sale of U.S. goods abroad. They may invest in noncovered foreign assets as desired.

Only financial institutions holding covered assets of $500,000 or more, or total foreign assets of $5 million or more, are asked to file quarterly reports with their Federal Reserve Bank. However, institutions with holdings below these amounts are also expected to abide by the provisions of the program.

The group of institutions covered by the nonbank guidelines continues to include trust companies and trust departments of commercial banks, mutual savings banks, insurance companies, investment companies, finance companies, employee retirement and pension funds, college endowment funds, and charitable foundations. Also included are the U.S. branches of foreign insurance companies and of other foreign nonbank financial corporations. Investment underwriting firms, securities brokers and dealers, and investment counseling firms also are covered with respect to foreign financial assets held for their own account and are requested

to inform their customers of the program in those cases where it appears applicable.

Guidelines

Through the end of calendar year 1968, each institution is requested to reduce its aggregate holdings of "covered" foreign financial assets to 95 per cent or less of its "adjusted base-date holdings."

Covered foreign financial assets, subject to the guideline ceiling, include the following types of investments, except for "free delivery" items received after December 31, 1967:

1. Liquid funds in all foreign countries other than Canada. This category comprises foreign bank deposits, including deposits in foreign branches of U.S. banks, and liquid money market claims on foreign obligors, generally defined to include marketable negotiable instruments maturing in 1 year or less.

2. All other claims on non-Canadian obligors written to mature in 10 years or less at date of acquisition. This category includes bonds, notes, mortgages, loans, and other credits. Excluded are bonds and notes of international institutions of which the United States is a member, and loans guaranteed or participated in by the Export-Import Bank or insured by the Foreign Credit Insurance Association, regardless of maturity.

3. Net financial investment in foreign branches, subsidiaries and affiliates, located in developed countries other than Canada and Japan.[1/] Such financial investment includes payments into equity and other capital accounts of, and net loans and advances to, any foreign

businesses in which the U.S. institution has an ownership interest of 10 per cent or more. Excluded are earnings of a foreign affiliate if they are directly retained in the capital accounts of the foreign business.

4. Long-term credits of foreign obligors domiciled in developed countries other than Canada and Japan.[1/] Included in this category are bonds, notes, mortgages, loans, and other credits maturing more than 10 years after date of acquisition. Excluded are bonds of international institutions of which the United States is a member.

5. Equity securities of foreign corporations domiciled in developed countries other than Canada and Japan[1/] except those acquired after September 30, 1965, in U.S. markets from American investors. The test of whether an equity security is covered will depend on the institution's obligation to pay the Interest Equalization Tax on acquisition. Exclusion from covered assets under this program normally will be indicated when, in acquiring an equity security that otherwise would be covered, the purchasing institution receives a certificate of prior American ownership, or brokerage confirmation thereof.

"Base-date" holdings for any reporting date in 1968 are defined as: (1) total holdings of covered foreign assets as of December 31, 1967; (2) minus, equity securities of companies domiciled in developed countries (except Canada and Japan),[1/] that are included in (1) but had been sold to American investors prior to the current quarter; (3) plus, or minus, the difference between sales proceeds and "carrying" value of covered equities sold prior to the current quarter to other than American investors or in other than U.S. markets. On each reporting date in 1968, "carrying"

value should be the value reflected in the institution's report (on Form FR 392R-68) for December 31, 1967, in the case of equities held on that date, and it should be cost in the case of equities purchased after that date.

"Adjusted" base-date holdings, to which the 95 per cent ceiling applies, are equal to "base-date" holdings as defined above, with the two types of adjustment for sales of included covered equities during the current quarter.

In making foreign loans and investments that are subject to the guideline ceiling, institutions are asked to give absolute priority to credits that represent the bona fide financing of U.S. exports, that is, financing necessary to consummate the export sale. At the same time, institutions generally are expected to reduce their holdings of covered foreign liquid funds (both deposits and money market instruments) to zero during 1968, even though it entails a reduction in total covered assets considerably larger than 5 per cent. However, an institution may maintain such minimum working balances abroad as are needed for the efficient conduct of its foreign business activities. In addition, institutions are requested to refrain from making any new investments, in either debt or equity form, in the developed countries of continental Western Europe, except for new credits judged essential to the financing of U.S. exports as evidenced by exemption from the Interest Equalization Tax that otherwise would apply.

For some institutions, repatriation of liquid funds, cessation of new investment in the countries of continental Western Europe, and

maximum restraint on reinvestment of current maturities of other covered assets may not be sufficient to reduce total covered assets by the target objective of 5 per cent or more. In such instances, or when there are other special circumstances--such as the existence at year-end 1967 of firm commitments to invest, or the need to accommodate requests for the *bona fide* financing of U.S. exports--an institution may consult with its Federal Reserve Bank with a view to working out an individually tailored program for achieving an orderly reduction in the institution's covered foreign assets. In the absence of such an arrangement, institutions will be expected to make progress from quarter to quarter on the reduction targeted for the year as a whole.

Foreign financial assets not covered by the guideline are still reportable on the quarterly statistical reports to the Federal Reserve Banks, but are not subject to the target reduction. Such non-covered foreign investments include the following:

1. All financial assets in, or claims on residents of, the Dominion of Canada.

2. Bonds and notes of international institutions of which the United States is a member, regardless of maturity.

3. Long-term investments in Japan and all developing countries, including credit instruments with final maturities of more than 10 years at date of acquisition, direct investment in subsidiaries and affiliates, and all equity securities issued by firms domiciled in these countries.

4. Equity securities of firms in developed countries other than Canada and Japan that have been acquired in U.S. markets from American investors (see Point 5 above).

Foreign assets of types covered by the program and acquired as "free delivery" items--that is, as new gifts or, in the case of trust companies or trust departments of commercial banks, in new accounts deposited with the institution--are not now defined as covered assets, if they are acquired after December 31, 1967. Such assets should be reported as a memorandum item, as should loans guaranteed or participated in by the Export-Import Bank or insured by the Foreign Credit Insurance Association.

Each nonbank financial institution holding, on any quarterly reporting date, covered assets of $500,000 or more, or total foreign financial assets of $5 million or more, is requested to file a statistical report, covering its total holdings on that date, with the Federal Reserve Bank of the Federal Reserve District in which its principal office is located. The reports are due within 20 days following the close of each calendar quarter, and forms may be obtained by contacting the Federal Reserve Bank.

GENERAL CONSIDERATIONS

In cooperating in the voluntary foreign credit restraint program, the nonbank financial institutions are requested to refrain from making loans and investments inconsistent with other aspects of the President's balance of payments program. Among these are the following:

(1) non-covered credits under this program that substitute for loans that commercial banks would have made in the absence of that part of the program applicable to them; (2) credits to U.S. corporate borrowers that would enable them to make new foreign loans and investments inconsistent with the corporate part of the program; (3) credits to U.S. subsidiaries and branches of foreign companies that otherwise would have been made to the foreign parent, or that would substitute for funds normally obtained from foreign sources.

The voluntary foreign crddit restraint program for nonbank financial institutions does not apply to the investment, within the country involved, of reserves accumulated on insurance policies sold abroad, in amounts up to 110 per cent of such reserves. Furthermore, in view of the balance of payments objectives of the program, it is noted that covered investments of nonbank financial institutions may be permitted to exceed the guideline ceiling to the extent that the funds for such investment are borrowed in countries that are subject to the same guideline limitations. Thus, funds borrowed in the developed countries of continental Western Europe may be used to finance investments in these countries, and funds borrowed in other developed countries (except Canada and Japan) may be used to finance investment in covered foreign assets elsewhere. Any institution desiring to offset foreign borrowing against foreign investment, however, should discuss its plans with the Federal Reserve Bank before entering into such an arrangement.

[1]/NOTE - Developed countries other than Canada and Japan: continental Western Europe--Austria, Belgium, Denmark, France, Germany (Federal Republic), Italy, Liechtenstein, Luxembourg, Monaco, Netherlands, Norway, Portugal, San Marino, Spain, Sweden, and Switzerland; other developed countries are: Abu Dhabi, Australia, the Bahamas, Bahrain, Bermuda, Hong Kong, Iran, Iraq, Ireland, Kuwait, Kuwait-Saudi Arabia Neutral Zone, Libya, New Zealand, Qatar, Republic of South Africa, Saudi Arabia, and the United Kingdom. Also to be considered "developed" are the following countries: Albania, Bulgaria, any part of China which is dominated or controlled by international communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by international communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Vietnam that is dominated or controlled by international communism.