FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 77-21
February 3, 1977

INTERPRETATION OF REGULATIONS K, M, AND Y

Utilization of Foreign Subsidiaries To Sell Long-Term
Debt Obligations in Foreign Markets and To Transfer the Proceeds
To Their United States Parent(s) for Domestic Purposes

TO ALL MEMBER BANKS,
BANK HOLDING COMPANIES,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

On December 27, 1976, the Board of Governors of the Federal Reserve System issued an interpretation to its Regulation K, "Corporations Engaged in Foreign Banking and Financing Under the Federal Reserve Act;" Regulation M, "Foreign Activities of National Banks;" and Regulation Y, "Bank Holding Companies." The interpretation relates to the issuance by a foreign subsidiary of long-term debt obligations in foreign markets with transfer of the proceeds to its United States parent for domestic purposes.

Enclosed is a copy of the interpretation. Any inquiries concerning the matter should be directed to George H. McElroy of our Regulations Department at (214) 651-6169. Additional copies of the interpretation will be furnished upon request to the Secretary's Office of this Bank (214) 651-6267.

Sincerely yours,

Robert H. Boykin

First Vice President

Enclosure

This publication was digitized and made available by the Federal Reserve Bank of Dallas' Historical Library (FedHistory@dal.frb.org)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CORPORATIONS ENGAGED IN FOREIGN BANKING AND FINANCING UNDER THE FEDERAL RESERVE ACT

FOREIGN ACTIVITIES OF NATIONAL BANKS

BANK HOLDING COMPANIES

INTERPRETATION OF REGULATIONS K, M, AND Y

SECTION 211.112 — UTILIZATION OF FOREIGN SUBSIDIARIES TO SELL LONG-TERM DEBT OBLIGATIONS IN FOREIGN MARKETS AND TO TRANSFER THE PROCEEDS TO THEIR UNITED STATES PARENT(S) FOR DOMESTIC PURPOSES*

(a) In a request for an interpretation filed with the Board by a member bank and its parent bank holding company, the issue arose whether it would be a permissible activity for one of their existing foreign subsidary corporations, subject to the provisions of either Sections 25 or 25(a) of the Federal Reserve Act or Section 4(c)(13) of the Bank Holding Company Act, to sell long-term debt obligations in foreign markets and to transfer the proceeds of these obligations to its United States parent(s) for domestic purposes.

(b) Under the specific proposal put forward, a foreign subsidiary of the parent bank holding company would sell debt obligations in foreign markets, which obligations would have initial maturities in excess of seven years and may or may not be supported by the guaranty of its parent bank holding company. The foreign subsidiary in question would have substantial other international or foreign business and would be performing an activity that its parent bank holding company could perform directly, *i.e.*, raising capital funds through the sale of long-term debt obligations.

(c) Under the eighth paragraph of Section 25(a) of the Federal Reserve Act (12 U.S.C. 615), an Edge Corporation may, with the prior consent of the Board, purchase and hold stock of a corporation that is "not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States, and not transacting any business in the United States except such as in the judgment of the Board . . . may be incidental to its international or foreign business." Similarly, under the tenth paragraph of the same section, an Edge Corporation shall not "carry on any part of its business in the United States except such as in the judgment of the Board . . . may be incidental to its international or foreign business." Pursuant to the third paragraph of Section 25 of the Federal Reserve Act, a national banking association[1] may acquire and hold, directly or indirectly, stock or other evidences of ownership in a foreign bank as long as such foreign bank is "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." Finally, Section 4(c)(13) of the Bank Holding Company Act exempts from the non-banking prohibitions of Section 4 of the Act "shares of, or activities conducted by, any company which does no business in the United States except as an incident to its international or foreign business."

(d) In the Board's judgment, the slight wording differences between the quoted portions of the above statutes were not intended by Congress to bear any meaningful significance. Accordingly, the Board has interpreted these provisions in the past as being synonymous[2] and this interpretation applies to each of the above statutory provisions.

---

*This interpretation is also indexed as sections 213.106 and 225.136.

[1] Paragraph 20 of Section 9 of the Federal Reserve Act (12 U.S.C. 335) makes the provisions of Section 25 applicable to State member banks.

[2] See section 225.4(f)(1) of Regulation Y, wherein the Board has by regulation applied to foreign subsidiaries of domestic bank holding companies the Edge Act limitations on activities in the United States.

[3] While such a foreign subsidiary may be viewed as providing a service to its parent bank holding company, the Board nevertheless believes that any bank holding company that plans to acquire shares of a foreign corporation to engage solely in the activities described herein will have to file an application under §4(c)(13) of the Bank Holding Company Act and §225.4(f) of Regulation Y. (See in this regard the Board's prior ruling on foreign operations subsidiaries at 12 CFR 250.143)

(e) To the extent that the foreign subsidiary in question is involved in the issuance of long-term debt obligations in foreign markets, there is no legal issue raised since that subsidiary would clearly be engaging in permissible foreign activities. However, an issue is raised whether the transfer of the proceeds of those obligations to its parent institution causes such foreign subsidiary to be "doing" or "transacting" business within the United States in violation of the statutory provisions set forth above.

(f) The Board has determined that the foreign subsidiary in question is not "transacting" or "doing" business in the United States by the mere transfer of proceeds of its long-term foreign debt obligations to its parent corporation. In the Board's judgment, the foreign subsidiary is essentially providing a service to its parent in that it is serving as its parent's *alter ego* for the limited purpose of obtaining long-term funds that the parent could otherwise obtain directly.[3] The transfer of borrowing proceeds between a United States parent and its foreign subsidiary in this situation can thus be viewed as not more than an intra-organizational transaction for the parent's benefit. In the Board's view, such a transaction is distinguishable from a commercial loan to a third-party United States resident by a foreign subsidiary, which loan would bring a foreign subsidiary into direct lending competition with domestic banking organizations.

(g) In the Board's judgment, this interpretation applies only to a situation where a foreign subsidiary, acting strictly on behalf of its parent organization, issues debt obligations abroad for the sole and express purpose of supplying funds to its parent organization. To meet this test, the Board believes three conditions must be satisfied: (1) the foreign subsidiary should be wholly-owned (except for directors' qualifying shares, if any) by its United States parent organization(s); (2) the proceeds repatriated should be no greater in amount than the amount of debt issued abroad; and (3) the proceeds should be repatriated on approximately the same terms and conditions as the obligations issued by the foreign subsidiary.