

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 5732]
December 3, 1965]

**1966 Guidelines for Banks and Nonbank Financial Institutions
Under the President's Balance of Payments Program**

*To All Banks and Other Financial Institutions
in the Second Federal Reserve District:*

The following statement was issued by the Board of Governors of the Federal Reserve System and released for publication in morning newspapers, Monday, December 6:

December 3, 1965

The Board of Governors of the Federal Reserve System today issued new guidelines for financial institutions to follow during 1966 in cooperating with the President's program to improve the Nation's balance of payments.

For the year 1966 the guidelines for both banks and nonbank financial institutions have been revised to suggest limitations on expansion of foreign credits which are comparable to the limitations suggested for 1965, but with variations to remove certain inequities inherent in the 1965 program.

The basic feature of the guidelines for 1965 has been a percentage limitation on increases in foreign credits from the base date of December 31, 1964. In general, each bank was requested to restrict its foreign credits outstanding to an amount not in excess of 105 per cent of the amount outstanding at the end of 1964, and each nonbank financial institution was requested to operate within a framework roughly comparable with that suggested for banks.

Although the banking system as a whole has stayed well under the suggested ceiling for 1965, some further expansion has been provided for in the 1966 program for two reasons: (1) it is believed that banks will continue to cooperate with the spirit as well as the letter of the program and will utilize the expansion suggested only to the extent needed to meet priority credit requirements; and (2) it is intended to make certain that export financing is available in adequate amounts, and that the bona fide credit needs of less developed countries will continue to be met.

Under the 1966 program, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding does not exceed 109 per cent of the amount outstanding on December 31, 1964. Further, in order to spread throughout the year any outflow necessary to meet priority credit requirements, it is requested that the expansion be utilized at a rate of not more than one per cent per calendar quarter; that is, the target would be 106 per cent of the 1964 base during the first quarter, 107 per cent during the second, 108 per cent during the third, and 109 per cent for the remainder of the year. Special consideration for banks with small bases will add about one per cent to the total, bringing the possible expansion for 1966 for the banking system as a whole to about the same amount as that provided for 1965.

The 1966 guidelines for nonbank financial institutions have been made broadly comparable with those of the bank guidelines. But the foreign financial assets of such institutions continue to be classified into three groups—liquid funds, investments and credits maturing in 10 years or less and in financial subsidiaries, and long-term investments—each subject in whole or part to a guideline ceiling. In some cases the guidelines for 1966 are based on outstanding amounts at September 30, 1965, where the use of a December 1964 base might be inequitable to individual institutions.

The priorities established by the 1965 guidelines remain in effect; i.e., an absolute priority for bona fide export credits, and highest priority in nonexport loans to credit to less developed countries.

The Board expressed its appreciation for the cooperation of the financial institutions since February 10, 1965, and its confidence in the continued cooperation of the banks and other financial institutions—so essential to the success of the President's balance of payments program.

Copies of the new guidelines are being made available through the Federal Reserve Banks. Banks and other financial institutions having questions concerning their application are urged to consult with the Federal Reserve Bank of their District.

Following is the text of the guidelines:

THE 1966 VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM
FOR FINANCIAL INSTITUTIONS

Preface

Since inception of the voluntary foreign credit restraint effort, immediately following announcement by the President of his balance of payments program in February 1965, commercial banks and other financial institutions have contributed substantially to the improvement in the Nation's payments position. This has been accomplished by the high degree of cooperation and statesmanship exhibited by the financial community in restraining the growth of (and in some instances reducing) claims on foreigners in accordance with guidelines issued by the Board of Governors of the Federal Reserve System.

Although considerable progress has been made and although the voluntary restraint program is temporary in nature, perseverance by financial institutions in the program through 1966 is necessary to attain the goal of equilibrium in the Nation's balance of payments and represents the appropriate response to the President's message of February 10, 1965, in which he issued a personal "call on American businessmen and bankers to enter a constructive partnership with their Government to protect and strengthen the position of the dollar in the world today."

The main feature of the guidelines for 1965 has been a percentage limitation on increases in foreign credits from the base date of December 31, 1964. In general, each bank was requested to restrict its foreign credits outstanding to an amount not in excess of 105 per cent of the amount outstanding at the end of 1964, and each nonbank financial institution was requested to operate within a framework roughly similar to that suggested for banks.

For the year 1966 the guidelines for both banks and nonbank financial institutions have been revised to suggest limitations on expansion of foreign credits which are comparable to the limitations suggested for 1965. These will permit some further expansion in such credits, and provide for variations to remove certain inequities inherent in the 1965 program.

Notwithstanding the fact that the banking system as a whole is presently well below the suggested target for 1965, this additional expansion has been allowed for two reasons: (1) it is believed that banks will continue to cooperate with the spirit as well as the letter of the program and will utilize the expansion suggested only to the extent needed to meet priority credit requirements; and (2) it is intended to make certain that export financing is available in adequate amounts, and that the bona fide credit needs of less developed countries will continue to be met.

Continued restraint on the increase in foreign credits is the basic objective of the bank program for 1966. Generally speaking, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding at year-end will not exceed 109 per cent of the amount outstanding on December 31, 1964. Further, in order to spread throughout the year any outflow necessary to meet priority credit requirements, it is requested that the amount outstanding not exceed 106 per cent of the 1964 base during the first quarter, 107 per cent during the second, and 108 per cent during the third quarter. Special consideration for banks with small bases will add one per cent or less to the total, bringing the potential amount outstanding at the end of 1966 for the banking system as a whole to about 110 per cent of the 1964 base as compared with the 105 per cent target for 1965.

The guidelines for 1966 for nonbank financial institutions have been revised to reflect provisions broadly comparable with those of the bank guidelines. Investments of liquid funds abroad are to be held to minimum practicable levels and ordinarily should not be permitted to exceed the reduced September 30, 1965 total. Investments in credits maturing in 10 years or less and in foreign branches and financial subsidiaries are subject to the same ceiling as suggested for the banks. Long-term investments in developed countries other than Canada and Japan are subject to a ceiling of 105 per cent of the September 30, 1965 amounts during 1966; this base was selected because retroactive use of a 1964 year-end base might have been inequitable for some institutions.

As in 1965, financial institutions are requested to give priority to export credits and credits to less developed countries. In instances where the special base and ceiling calculations for banks with small bases result in a ceiling in excess of 109 per cent, it is requested that the amount in excess of 109 per cent of a bank's base be used exclusively for such priority credits. The leeway for additional foreign credits provided by the 1966 guidelines plus the funds available from repayments on outstanding credits will provide larger resources than last year to finance an expanded volume of exports and to satisfy credit requirements of less developed countries.

The guidelines for banks and nonbank financial institutions follow.

GUIDELINES FOR BANKS

(1) Base, ceiling, and reporting

(A) Base

1. The base is a bank's total claims on foreigners for own account, including foreign long-term securities, on December 31, 1964, except for the exclusion in (A)3 below.

2. Meaning of terms:

(a) "Foreigners" include individuals, partnerships, and corporations domiciled outside the United States, irrespective of citizenship, except their agencies or branches within the United States; branches, subsidiaries, and affiliates of United States banks and other United States corporations that are located in foreign countries; and any government of a foreign country or official agency thereof and any official international or regional institution created by treaty, irrespective of location.

(b) "Long-term securities" are those issued without a contractual maturity or with an original maturity of more than one year from the date of issuance.

(c) "Other claims" include all long-term claims other than securities, real assets, net investment in and advances to foreign branches and subsidiaries, and all short-term claims (such as deposits, money-market instruments, customers' liability on acceptances, and loans).

3. Specific inclusions and exclusions:

(a) Claims on foreigners should be included without deduction of any offsets. Foreign customers' liability for acceptances executed should be included whether or not the acceptances are held by the reporting bank. Participations purchased in loans to foreigners (except participations in loans extended by the Export-Import Bank) also should be included.

(b) Contingent claims, unutilized credits, claims for account of customers, acceptances executed by other United States banks, and participations in loans arranged by or guaranteed by the Export-Import Bank or insured by the Foreign Credit Insurance Association should be excluded.

(B) Ceiling

1. The 1966 ceilings with respect to the amount of foreign credits outstanding by a bank with a base of \$5 million or more are as follows:

- (a) In the first calendar quarter, 106 per cent of its base;
- (b) In the second calendar quarter, 107 per cent of its base;
- (c) In the third calendar quarter, 108 per cent of its base;
- (d) In the fourth calendar quarter, 109 per cent of its base.

2. In lieu of the ceiling prescribed in (B)1 above, a bank with a base of \$500,000 but less than \$5 million, may use the following special ceiling:

- (a) In the first calendar half, its base plus \$225,000;
- (b) In the second calendar half, its base plus \$450,000.

3. The ceiling for a bank with a base below \$500,000 is 150 per cent of its base. However, any such bank, or a bank which had no foreign credits outstanding on December 31, 1964, may discuss with the Federal Reserve Bank of the Reserve District in which it is located the possibility of adopting a ceiling that would permit expansion up to \$450,000 above the bank's base.

4. In discussing the ceiling of a bank described in paragraph (B)3, the Federal Reserve Bank will ascertain the bank's previous history in foreign transactions, including acceptance of foreign deposits or handling foreign collections, and the reasons why the bank considers it should have additional leeway. Prior to a decision, the Federal Reserve Bank will obtain clearance from the Board of Governors.

5. Any expansion under paragraph (B)2 or (B)3 that is in excess of 109 per cent of the bank's base should be limited to loans or acceptance credits that finance exports of U. S. goods or services or that represent credit extended to less developed countries. Export credits should be limited to transactions originated by the bank's regular customers or by residents of its normal trade territory. Such expansion should not involve (a) participations in loans originated by other banks or purchases of such loans, (b) investments in foreign securities, (c) deposits in foreign banks, or (d) investments in foreign short-term money market instruments.

(C) Reporting

1. Banks that report on Treasury Foreign Exchange Form B-2 or B-3 should file a monthly report on foreign claims (Form FR 391) with the Federal Reserve Bank of the Reserve District in which the bank is located.

2. Banks that have claims on foreigners in an amount of \$100,000 or more and do not report on Treasury Foreign Exchange Form B-2 or B-3 should file a quarterly report on foreign claims (Form FR 391A) with the Federal Reserve Bank of the Reserve District in which the bank is located.

3. Copies of Forms FR 391 and 391A are available at the Reserve Banks.

(2) Loans involving Export-Import Bank

Participations in individual export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees or insurance, and holdings of "Export-Import portfolio fund" participations 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 Problems.

(3) Credits in excess of ceiling

A bank would not be considered as acting in a manner inconsistent with the program if it at times exceeds its ceiling as a result of the (a) draw-down of binding commitments entered into before February 11, 1965; or (b) extension of priority export credits.

The bank should, however, reduce its claims on foreigners to an amount within the ceiling as quickly as possible. It should also take every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature and to assure that drawings under credit lines are kept to normal levels and usage. At time of renewal, each credit line should be reviewed for consistency with the program.

A bank whose foreign credits are in excess of the ceiling will be invited periodically to discuss with the appropriate Federal Reserve Bank the steps it has taken and proposes to take to reduce its credits to a level within its ceiling.

(4) Loan priorities

Within the ceiling, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of nonbank or foreign funds are not entitled to priority.

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

It is expected that the outstanding amount of nonexport credits to developed countries in continental Western Europe would not be increased during 1966 but rather would be reduced to the extent needed to meet bona fide requests for priority credits within the overall ceiling.

Without attempting to specify all types of loans that should be restricted, it is obvious that credits to developed countries that can be cut back with benefit to our balance of payments and with the least adverse side-effects include: credits to finance third-country trade; credits to finance local currency expenditures outside the United States; credits to finance fixed or working capital needs; and all other nonexport credits to developed countries that do not suffer from balance of payments difficulties.

(5) Banks whose foreign credits consist almost entirely of export credits

A bank whose foreign credits are consistently composed almost entirely of export credits usually should keep its credits within its ceiling. If such a bank exceeds its ceiling from time to time, it would not be considered as acting in a manner inconsistent with the program if the amount of such excess is reasonable and the bank makes every effort to bring the amount of its credits back within the ceiling at the earliest practicable date.

(6) Trust departments

Trust departments of commercial banks should follow the guidelines with respect to nonbank financial institutions.

(7) 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 must follow a customer's instructions, it should not encourage

customers to place liquid funds outside the United States. A bank should not place with a customer foreign obligations that, in the absence of the voluntary credit restraint program, it would have acquired or held for its own account.

(8) Foreign branches

The voluntary credit restraint program is not designed to restrict the extension of foreign credits by foreign branches if the funds utilized are derived from foreign sources and do not add to the outflow of capital from the United States.

Total claims of a bank's domestic offices on its foreign branches (including permanent capital invested in as well as balances due from such branches) represent bank credit to nonresidents for the purposes of the program.

(9) "Edge Act" corporations

"Edge Act" corporations and "agreement" corporations are included in the voluntary credit restraint program. Foreign loans and investments of such corporations may be combined with those of the parent bank or a separate ceiling may be adopted for the parent bank and each such subsidiary corporation. If such corporation is owned by a bank holding company, its foreign loans and investments may be combined for purposes of the program with any one or all of the banks in the holding company group.

An "Edge Act" corporation established before February 10, 1965, that had not made any significant volume of loans and investments before December 31, 1964, may take as a base, alone and not in combination with its parent, its paid-in capital and surplus, up to \$2.5 million.

(10) United States branches and agencies of foreign banks

Branches and agencies of foreign banks located in the United States are requested to act in accordance with the spirit of the domestic commercial bank voluntary credit restraint program.

(11) Loans to United States residents and substitution of domestic credit for credit from foreign sources

There are a number of situations in which loans to domestic customers may be detrimental to the President's balance of payments program. These include:

(a) Loans to U. S. companies which will aid the borrower in making new foreign loans or investments inconsistent with the President's program. Banks should avoid making new loans that would directly or indirectly enable borrowers to use funds abroad in a manner inconsistent with the Department of Commerce program or with the guidelines for nonbank financial institutions.

(b) Loans to U. S. subsidiaries and branches of foreign companies which otherwise might have been made by the bank to the foreign parent or other foreign affiliate of the company, or which normally would have been obtained abroad.

(c) Loans to U. S. companies with foreign activities which take the place of credit normally obtained abroad. Even though such loans are made to domestic firms or those domiciled here, the impact on the U. S. balance of payments is the same as if the bank had made loans to foreigners in the first instance.

To the extent possible, banks should also avoid making loans to domestic borrowers which have an effect similar to that of the loans described in paragraphs (b) and (c).

(12) 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 United States dollars. This does not, however, call for a reduction in necessary working balances held with foreign correspondents.

GUIDELINES FOR NONBANK FINANCIAL INSTITUTIONS

The types of financial institutions to which these guidelines on foreign lending and investing are applicable include domestic life, fire and casualty insurance companies; corporate noninsured pension funds and State-local retirement systems; mutual savings banks, mutual funds and investment companies; consumer sales and commercial finance companies; college endowment funds and charitable foundations. Also covered by the program are the United States branches of foreign insurance companies and of other foreign financial corporations. Trust companies and trust departments of com-

mercial banks are expected to observe the guidelines in the investment of funds entrusted to them or for which they serve as investment advisor. Investment underwriting firms, security brokers and dealers and investment counseling firms are also covered with respect to foreign assets held for their own account, and are requested to inform customers of the guidelines and to enlist their support in cooperating with the President's program.

Any nonbank financial institution holding \$500,000 or more in foreign loans, investments, or other foreign financial assets is requested to file a statistical report (Form FR 392) at the close of each calendar quarter with the Federal Reserve Bank of the Reserve District in which its principal office is located. Lending institutions not receiving copies of the reporting form may obtain them from the Federal Reserve Bank.

1. Investment of liquid funds abroad should be reduced to minimum practicable levels consistent with the operating needs of the institution. Such holdings ordinarily should not be permitted to exceed the September 30, 1965 total, except for temporary seasonal excesses.

This category includes all deposits held with foreign banks or foreign branches of U. S. banks, whether denominated in U. S. dollars or a foreign currency and regardless of maturity. It also includes all liquid money market claims on foreign obligors with an original maturity of one year or less, whether such claims are denominated in U. S. dollars or a foreign currency. The term "liquid money market claims" is interpreted broadly to include the securities of governments and their instrumentalities, commercial paper, finance company paper, bankers' acceptances and other readily marketable paper. This guideline is not applicable to short-term business credits that are not readily marketable (covered under Guideline 2).

2. Investments and credits maturing in 10 years or less at date of acquisition are subject to a percentage guideline based on the total of such holdings at the end of 1964. The aggregate amount of these investments, and of net financial investment in foreign branches, financial subsidiaries and affiliates (described below), should not exceed 105 per cent of the 1964 base date amount as of the end of 1965, and should not exceed 106 per cent of the base date amount during the first quarter of 1966, 107 per cent during the second quarter, 108 per cent during the third quarter, and 109 per cent in the final quarter of the year.

This category includes all bonds, notes, mortgages, loans, and other credits carrying maturities at date of acquisition of 10 years or less. The date of final maturity is to be taken in classifying individual credit transactions, except that a credit transaction should not be classified as "long term" (and hence subject to Guideline 3 below) unless 10 per cent or more of the amount to be repaid is scheduled to be repaid after 10 years. Loans guaranteed or arranged by the Export-Import Bank or insured by the Foreign Credit Insurance Association are not to be considered foreign credits for purposes of this program.

Net financial investment in foreign branches, financial subsidiaries and affiliates, if any, is included among the assets subject to the percentage ceilings of this guideline. Such financial investment includes payments into equity and other capital accounts of, and net loans and advances to, foreign corporations engaged principally in finance, insurance or real estate activities, in which the U. S. institution has an ownership interest of 10 per cent or more. Earnings of a foreign affiliate that are reinvested in the business are not included among assets subject to the guideline ceiling, although institutions are requested to repatriate such earnings to the fullest extent feasible.

In administering restraint in foreign lending and investing, institutions are requested to observe the following priorities or guides: (1) Credits and investments that represent bona fide U. S. export financing should receive absolute priority; (2) nonexport credits and investments in the less developed countries, and investments in the securities of international institutions, are to be given priority consideration second only to bona fide export financing; (3) the flow of investment funds to Canada and Japan, which are heavily dependent on U. S. capital markets, need be restricted only to the extent necessary to remain under the guideline ceiling.

It is recognized that some individual institutions may temporarily exceed the guideline ceiling, because of investments made under the first two priorities above, or the taking down of firm commitments to lend or invest entered into prior to June 22, 1965, the effective date of the previous guidelines. In any such case, an institution that exceeds its target should consult with the Federal Reserve Bank of the Reserve District in which it is located regarding a program for moving back within the ceiling in a reasonable period of time.

3. Long-term credits (exceeding 10 years in maturity) and stock investments in foreign companies are not subject to an aggregate ceiling for 1966.

This category includes bonds, notes, mortgages, loans, and other credits maturing more than 10 years after date of acquisition, as well as preferred and common stocks. (Loans and investment in certain subsidiaries and affiliates, however, are covered by Guideline 2.) Term loans and serial-payment notes and bonds are included in this category only if 10 per cent or more of the total amount of the credit is scheduled for repayment to the lender after 10 years beyond date of acquisition.

No percentage ceiling is suggested on long-term credits and investments in the priority categories relating to export financing and to less developed countries (including international institutions) as described in Guideline 2. Long-term investment in Canada and Japan also is not subject to a percentage ceiling, in view of intergovernmental agreements affecting the net amount of financing done by these countries in U. S. financial markets. Lending institutions are requested, however, to limit in 1966 the total of credits and investments in other developed countries to an amount not in excess of 105 per cent of the amount of such holdings on September 30, 1965. Within this category, institutions are expected to avoid any increase in long-term investments in the developed countries of continental Western Europe.

The attention of lending institutions is directed to the need to refrain from making loans and investments inconsistent with the President's balance of payments program. Among these are the following: (1) long-term credits covered by Guideline 3 which substitute for loans that commercial banks would have made in the absence of the voluntary foreign credit restraint effort administered by the Federal Reserve System; (2) credits to U. S. borrowers which would aid in making new foreign loans or investments inconsistent with the voluntary restraint program administered by the Department of Commerce; (3) credits to U. S. subsidiaries and branches of foreign companies which otherwise might have been made to the foreign parent, or which would substitute for funds normally obtained from foreign sources; (4) credits to U. S. companies with foreign activities which would take the place of funds normally obtained abroad. Reasonable efforts should be made to avoid accommodating credit request of these types, regardless of specific guideline targets detailed in this circular.

Notes to guidelines for banks and nonbank financial institutions. None of the guidelines in this circular is intended to apply to the reinvestment of reserves on insurance policies sold abroad in assets within the country involved, in amounts up to 110 per cent of such reserves.

Developed countries other than Canada and Japan are: Abu Dhabi, Australia, Austria, the Bahamas, Bahrein, Belgium, Bermuda, Denmark, France, Germany (Federal Republic), Hong Kong, Indonesia, Iran, Iraq, Ireland, Italy, Kuwait, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, Neutral Zone, New Zealand, Norway, Portugal, Qatar, Republic of South Africa, San Marino, Saudi Arabia, Spain, Sweden, Switzerland, and the United Kingdom.

Also to be considered "developed" are the following countries within the Sino-Soviet bloc: 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 which is dominated or controlled by International Communism.

Our Foreign Department (Telephone Extension 1000) will be pleased to confer with you on any problems that may arise under the guidelines.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.