

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 5916]
December 13, 1966]

**1967 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 made public today by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today issued new guidelines, effective immediately, for financial institutions cooperating with the President's voluntary program to improve the Nation's balance of payments.

The new bank guidelines are in substantially the same form as those in use since 1965. The December 1964 base is retained, as is the present ceiling of 109 per cent of that base. However, banks are requested to limit the use of their leeway as of September 30, 1966 to a rate not exceeding 20 per cent thereof per quarter beginning with the fourth quarter of 1966.

Moreover, banks are requested to limit the increase in nonpriority credits (credits other than those that finance exports or that meet credit needs of developing countries) over the amount outstanding on September 30, 1966, to 10 per cent of the total possible expansion, or to about \$120 million. This change is designed to give added stimulus to priority credits by suggesting a quantitative limit for nonexport credits to developed countries.

The program for nonbank financial institutions has been greatly simplified. The three guidelines used in the 1966 program are replaced by a single guideline, which permits an increase of 5 per cent during the 15 months ending December 31, 1967 in assets covered by that guideline. "Covered" assets are redefined to exclude certain types of assets previously subject to target ceilings; for example, bonds of the International Bank for Reconstruction and Development and of the Inter-American Development Bank.

In announcing the new guidelines, the Board expressed its appreciation for the cooperation of banks and other financial institutions since the program was inaugurated in February 1965, as well as its confidence that the Nation can continue to count on the cooperation of these institutions.

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

The text of the new guidelines is printed on the following pages.

Our Foreign Department (Telephone Extension 1000) will be pleased to confer with you on any questions regarding the guidelines. Questions on the reports to be filed under the guidelines should be addressed to our Balance of Payments Division (Telephone Extension 2000).

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

BALANCE OF PAYMENTS PROGRAM

Revised Guidelines for Banks and Nonbank Financial Institutions

During 1966, as in 1965, commercial banks and other financial institutions cooperated admirably in the President's voluntary foreign credit restraint program and contributed substantially toward the correction of the disequilibrium in the international payments of the United States. Foreign credits of commercial banks were actually reduced by \$508 million in the first ten months of 1966, with the result that the commercial banks are under the 1966 guideline ceiling by more than \$1.2 billion. Nonbank financial institutions reduced their foreign assets subject to the guidelines by \$321 million in the first three quarters of this year. Total foreign investments of these institutions in this period declined by \$46 million. Long-term investment in Canada and in less developed countries increased, but much less than in 1965.

Despite this record the balance of payments continues to be a serious national problem. Therefore, it is necessary to continue, and in some respects to intensify, the voluntary effort to restrain the outflow of private capital. Accordingly, the Board of Governors of the Federal Reserve System has revised the guidelines for financial institutions as set out hereinafter.

The 1967 Program for Commercial Banks

The 1967 ceiling for commercial banks will remain at 109 per cent of the 1964 base. No increase is provided in view of the fact that as of October 1, 1966, there existed a potential leeway for an outflow of bank credit in excess of \$1.2 billion. However, each commercial bank is requested to limit the use of its existing leeway so that it does not use more than 40 per cent thereof before March 31, 1967, more than 60 per cent before June 30, 1967, and more than 80 per cent before September 30, 1967.

Furthermore, each bank is requested not to use more than 10 per cent of its leeway to expand nonexport credits to developed countries between October 1, 1966, and December 31, 1967. For all banks combined, this would permit a maximum expansion of nonexport credits to developed countries of about \$120 million.

In order to give a relatively larger leeway to smaller banks so as to enable them more easily to extend export financing, banks with an original base between \$500,000 and \$10 million, in calculating their leeway, are authorized to use, instead of 109 per cent of their 1964 base, the amount of that base plus \$900,000.

This revision in the guidelines, effective as of October 1, 1966, is designed to give a further stimulus to banks to direct their foreign credits toward export financing and the financing of the less developed countries.

The 1967 Program for Nonbank Financial Institutions

Substantial changes are being made in the voluntary foreign credit restraint program for nonbank financial institutions in order to simplify both reporting under the program and the guidelines with which the institutions are requested to comply. The three different guidelines used in the 1966 program are replaced with a single guideline, which permits an increase of 5 per cent over the 15 months from October 1, 1966, through December 31, 1967. Covered assets are redefined to exclude certain types of assets previously subject to target ceilings.

The group of covered institutions includes 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 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 exclusions in A(3)(b) 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 U. S. banks and other U. S. 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) "Foreign 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).

(d) "Leeway" means the difference between the ceiling for 1967 as described in B below and the amount of foreign credits outstanding on September 30, 1966.

(e) "Nonexport credit" means a foreign credit other than one that arises directly out of the financing of U. S. exports of goods or services.

(f) "Developed countries" are Abu Dhabi, Australia, Austria, the Bahamas, Bahrain, Belgium, Bermuda, Canada, Denmark, France, Germany (Federal Republic), Hong Kong, Iran, Iraq, Ireland, Italy, Japan, Kuwait, Kuwait-Saudi Arabia Neutral Zone, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, 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 Viet Nam that is dominated or controlled by international communism.

(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 held for account of customers, acceptances executed by other U. S. 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 1967 ceiling with respect to the amount of foreign credits outstanding by a bank with a base of \$10 million or more is 109 per cent of its base. In lieu of a ceiling of 109 per cent of its base, a bank with a base of \$500,000 but less than \$10 million shall use as a ceiling for 1967 its base plus \$900,000.

However, all banks are requested to limit their outstanding foreign credits:

(a) During the fourth quarter of 1966 and the first quarter of 1967, to an amount not in excess of the amount outstanding on September 30, 1966, plus 40 per cent of the leeway.

(b) During the second quarter of 1967, to an amount not in excess of the amount outstanding on September 30, 1966, plus 60 per cent of the leeway.

(c) During the third quarter of 1967, to an amount not in excess of the amount outstanding on September 30, 1966, plus 80 per cent of the leeway.

(2) 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 \$900,000 above the bank's base.

In discussing the ceiling of such a bank, 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.

(3) Within the limitations specified in paragraphs 1 and 2, all banks are requested to limit their nonexport credits to developed countries so that the amount of such credits outstanding will not, at any time between October 1, 1966, and December 31, 1967, exceed the amount of such credits outstanding on September 30, 1966, plus 10 per cent of the leeway.

C. Reporting

(1) Banks that report on Treasury Foreign Exchange Form B-2 or B-3 or that have been granted a special ceiling under paragraph B(2) 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) Copies of Form FR 391 are available at the Reserve Banks.

2. Loans involving Export-Import Bank

Loans guaranteed or arranged 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.

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) drawdown of binding commitments entered into before December 12, 1966, or (b) extension of bona fide 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 will not be increased during 1967 unless a bank is in a position to meet all bona fide requests for priority credits within the overall ceiling.

5. Trust departments

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

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 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.

7. 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.

8. "Edge Act" corporations

"Edge Act" 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.

9. U.S. 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.

10. Loans to U. S. 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 and hence should be avoided. Examples are:

(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.

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, call for a reduction in necessary working balances held with foreign correspondents.

GUIDELINES FOR NONBANK FINANCIAL INSTITUTIONS

For calendar 1967, each institution is requested to limit its aggregate holdings of "covered" foreign financial assets to not more than 105 per cent of its "base date" holdings. Thus there is only one guideline applicable to all "covered" foreign assets, rather than the three different guidelines used in the 1966 program. Covered foreign assets are defined below.

"Base date" holdings, on which the 105 per cent ceiling is based, are defined as the lesser of (1) total holdings of covered foreign assets as of September 30, 1966, or (2) the amounts of covered foreign assets that could have been held as of September 30, 1966, in compliance with the guideline ceilings established by the 1966 voluntary program. Base date holdings are to be reduced in subsequent quarters, however, to the extent that equity securities of companies domiciled in developed countries¹ (except Canada and Japan), and included in the current base, are sold to American investors. For institutions previously reporting under the program, the Federal Reserve Banks will calculate current base date holdings as indicated by the reports on file and communicate that calculation to the institutions.

Covered foreign financial assets, subject to the guideline ceiling, include the following types of investments:

1. 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 foreign obligors written to mature in 10 years or less at date of acquisition. This category includes all bonds, notes, mortgages, loans and other credits, regardless of country of origin. Excluded are bonds and notes of international institutions of which the United States is a member, and loans guaranteed or arranged by the Export-Import Bank or insured by the Foreign Credit Insurance Association.

3. Net financial investment in foreign branches, financial subsidiaries and affiliates located in developed countries¹ other than Canada and Japan. 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. Excluded are earnings of a foreign affiliate directly retained in the capital accounts of the foreign corporation.

¹ *Developed countries other than Canada and Japan.* Continental Western Europe includes: 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 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 Viet Nam that is dominated or controlled by international communism.

4. Long-term credits of foreign obligors domiciled in developed countries¹ other than Canada and Japan. 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 countries¹ other than Canada and Japan except for 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 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.

In making those foreign loans and investments subject to the guideline ceiling, institutions are asked to observe certain priorities. First, top priority should be given to credits which represent the bona fide financing of U. S. exports. Second, nonexport credits and investments in less developed countries should be given priority second only to that for export financing. (Temporary excesses above the guideline ceiling may be permitted, where necessary, in order to accommodate these two types of priority credits.) Third, investment in shorter-term assets in Canada and Japan (aside from bank deposits and money market instruments) need be limited only to the extent necessary to remain within the overall guideline ceiling.

Within the leeway provided by the 105 per cent ceiling, however, institutions also are requested to observe the following limitations. First, the investment of liquid funds abroad, in both bank deposits and money market instruments, should be held to minimum practicable levels consistent with the operating policies of the institution. Second, investments in assets of all types in the developed countries of Continental Western Europe, except those directly financing U. S. exports, should be limited to the fullest practicable extent, and in any event should not be permitted to exceed the total of such assets held on September 30, 1966.

Each nonbank financial institution holding \$500,000 or more in foreign financial assets is requested to file a quarterly statistical report covering such assets with the Federal Reserve Bank of the 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 (FR 392R) may be obtained by contacting the Federal Reserve Bank.

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 ceiling limitations. Such non-covered foreign investments include the following:

1. Bonds and notes of international institutions of which the United States is a member, regardless of maturity.
2. Long-term investments in Canada, Japan and all less developed countries, including credit instruments with final maturities of more than 10 years at date of acquisition, direct investment in financial subsidiaries, and all equity securities issued by firms domiciled in these countries.
3. 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).

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) noncovered credits under this program which 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 which would enable them to make new foreign loans and investments inconsistent with that part of the program administered by the Department of Commerce; (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 credit 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 developed countries other than Canada and Japan. Any such arrangements to offset foreign borrowing against foreign investment should be discussed with the Federal Reserve Bank.

¹ See footnote on page 5.