FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7639
May 22, 1975]

INTERPRETATION OF REGULATION M

Foreign Institutions That May Be Considered Foreign Banks

To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:

On April 21, 1975 the Board of Governors of the Federal Reserve System issued an interpretation of its Regulation M, "Foreign Activities of National Banks," in order to clarify the criteria under which foreign institutions that are principally engaged in commercial banking may be considered foreign banks for purposes of section 25 of the Federal Reserve Act.

Enclosed is a copy of that interpretation. Any questions regarding this matter may be addressed to our Foreign Banking Applications Department. Additional copies will be furnished upon request.

ALFRED HAYES,
President.

Board of Governors of the Federal Reserve System

FOREIGN ACTIVITIES OF NATIONAL BANKS

INTERPRETATION OF REGULATION M

Interpretation of Foreign Bank for Purposes of Section 25 of the Federal Reserve Act

Under section 25 of the Federal Reserve Act (12 U.S.C. 601), member banks may, with prior Board permission, directly or indirectly acquire and hold stock or other evidences of ownership in one or more foreign banks, and, notwithstanding the provisions of section 23A of the Federal Reserve Act (12 U.S.C. 371c), make loans or extensions of credit to or for the account of such banks in the manner and within the limits prescribed by the Board of Governors by general or specific regulation or ruling.

In several recent applications filed with the Board by member banks under section 25 of the Federal Reserve Act, the issue has arisen as to whether particular foreign institutions can be considered as foreign banks for the purposes of section 25 of the Act and sections 213.4 and 213.5 of this part (Regulation M) which implement the relevant provisions of section 25. In the Board's judgment, a foreign bank for purposes of section 25 of the Act should be interpreted to mean, with certain limited exceptions described in the following interpretation, foreign institutions that are principally engaged in a commercial banking business. In applying this test, however, the Board has adopted certain minimum criteria which have to be met in every case under section 25 unless a specific exception adopted by the Board applies.

Part 213 of Title 12 is amended by adding the following new section:

§ 213.105—Interpretation of foreign bank for purposes of section 25 of the Federal Reserve Act.

Under the third paragraph of section 25 of the Federal Reserve Act, as amended (12 U.S.C. 601), any national banking association[1] possessing a capital and surplus of $1,000,000 or more may file application with the Board for permission, upon such conditions and under such regulations as may be prescribed by the Board, "to acquire and hold, directly or indirectly, stock or other evidences of ownership in one or more banks organized under the law of a foreign country or a dependency or insular possession of the United States and 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; and, notwithstanding the provisions of section 23A of the Federal Reserve Act (12 U.S.C. 371c), to make loans or extensions of credit to or for the account of such bank in the manner and within the limits prescribed by the Board by general or specific regulation or ruling."

Pursuant to its authority under the third paragraph of section 25 of the Federal Reserve Act, the Board has promulgated section 213.4 of this part (Regulation M), which sets forth appropriate conditions and limitations on a member bank's acquisition and holding, directly or indirectly, of the stock or other evidences of ownership in one or more foreign banks, and section 213.5 of this part which allows a member bank, which holds directly or indirectly[2] stock or other evidences of ownership in a foreign bank, to make loans or extensions of credit to or for the account of such foreign bank without regard to the provisions of section 23A of the Federal Reserve Act (12 U.S.C. 371c).

In several recent applications filed with the Board by member banks under section 25 of the Act, the issue has arisen as to whether particular foreign institutions can be considered as foreign banks for the purposes of section 25 of the Act and sections 213.4 and 213.5 of this part. While

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

[2] Whether through a corporation operating under section 25 of the Act or organized under section 25(a) of the Act, or otherwise.

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the Board has by regulation defined the term "foreign bank" to mean a bank organized under the law of a foreign country and 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,[3] such definition imposes the statutory limitation on activities in the United States that can be conducted by a foreign bank, the shares of which are owned by a member bank, and does not define as a threshold matter which foreign institutions can be considered as foreign banks eligible for investment and Board exemption from the provisions of section 23A under section 25 of the Act.

Congress in the third paragraph of section 25 of the Act has imposed incorporation and other requirements intended to ensure that a foreign bank acquired under that section is not engaged in a domestic banking business. Congress did not, however, specify in section 25 the criteria a foreign institution must satisfy in order to be considered a foreign bank for purposes of that section.[4] The third paragraph of section 25 was enacted in 1966 in order to give member banks organizational flexibility in conducting their banking operations abroad. Prior to its enactment, the Board had interpreted the "stock purchase" prohibitions of Section 5136 of the Revised Statutes as preventing member banks from acquiring directly the shares of foreign banks. Thus, until that time, member banks were limited to conducting their banking operations abroad either through branches established under section 25 or through agencies, branches or subsidiaries of their Edge or Agreement Corporations established, respectively, under section 25(a) or section 25 of the Federal Reserve Act. Because the laws of some foreign countries prevented the establishment of branches and because the holding of shares of foreign banks through Edge or Agreement Corporation subsidiaries resulted in an unnecessary layering of organizational relationships, the enactment of the third paragraph of section 25 essentially was intended to allow member banks to hold *directly* the shares of foreign banks, instead of holding them indirectly through their Edge or Agreement Corporation subsidiaries.[5] The provision in that paragraph which gives the Board the power to waive the restrictions of section 23A on loans or extensions of credit from a member bank to its foreign bank affiliate was supported by the Board because section 23A in such circumstance tends to restrict normal correspondent banking relationships between banks and their foreign bank affiliates.

In the Board's judgment, a foreign bank for purposes of section 25 of the Act and sections 213.4 and 213.5 of this part should be interpreted to mean, with certain limited exceptions hereinafter described, a foreign institution that is *principally engaged in a commercial banking business*. The Board believes that such an interpretation is consonant with the limited purposes of section 25 and accords with Congress' intent in enacting that section. This interpretation will apply both for purposes of determining permissible investments for member banks under section 213.4 of this part and for purposes of the regulatory exemption from the provisions of section 23A under section 213.5 of this part. In adopting this interpretation, however, the Board has determined that, in general, certain minimum criteria should be met in every case. Accordingly, in order for a foreign institution to be considered as principally engaged in a commercial banking business, the institution must, at least, receive deposits to a substantial extent in the regular course of its business, and also have the power to accept deposits that the depositor has a legal right to withdraw on demand. In addition, the Board believes that for a foreign institution to be considered as a foreign bank under section 25, the institution should also be supervised, regulated, examined or otherwise recognized as a commercial bank by the approporate bank supervisory or monetary authority of either the country of its organization or the country of its principal banking operations.

The Board has also determined, however, that notwithstanding the above test and minimum criteria, foreign institutions organized for the sole purpose of holding the shares of a foreign bank, or organized for the sole purpose of performing nominee, fiduciary, or other banking services incidental to the activities of a foreign branch or banking affiliate of a member bank may be considered as foreign banks for purposes of section 25 and sections 213.4 and 213.5 of this part. The Board may recognize other exceptions to the criteria adopted in this general interpretation if it determines that any such exception would not be inappropriate under section 25 of the Federal Reserve Act and this part (Regulation M).

(Interprets and applies 12 U.S.C. 601)

By order of the Board of Governors, April 21, 1975.

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[3] Section 213.2 of this part.

[4] While the term "bank" is defined in section 1 of the Federal Reserve Act (12 U.S.C. 221), that definition ". . . State bank, banking association, and trust company" is not applicable in the context of section 25.

[5] See 112 Cong. Rec. 11866 (1966) (remarks of Senator Robertson).