## FEDERAL RESERVE BANK OF NEW YORK

Circular No. 8553
April 9, 1979

# REGULATIONS D AND Q

## Extension of Comment Period Regarding Proposed Exemption for Designated International Banking Facilities

*To All Banking Institutions in the Second Federal Reserve District:*

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System announcing an extension of the time in which to comment on a proposal made by the New York Clearing House Association to exempt certain designated International Banking Facilities from the reserve requirement and interest rate restrictions of Regulations D and Q. A brief statement by the Board of the issues raised by the proposal was sent to you on December 20, 1978 with our Circular No. 8476.

The Federal Reserve Board has extended until May 18 the period for public comment on a proposal before the Board from the New York Clearing House Association to establish International Banking Facilities (IBFs).

The action was taken in response to a request for additional time for comment made by the American Bankers Association. The Board on December 14, 1978 made public a summary of the issues involved in the New York Clearing House proposal and invited comment by March 15.

At the same time the Board made public a summary of the 59 comments thus far received from the public.

The Clearing House proposed that banks be allowed to establish IBFs that would be allowed to conduct specified types of international banking operations, separately from the banks' other operations, at locations inside the United States, free from reserve requirements and interest rate restrictions on their deposits that member banks must observe. Federal Reserve approval is required for such exemptions.

The Clearing House said such IBFs would enhance the role of major U.S. banking centers as international banking centers, stimulate local economies, lower bank costs and improve bank efficiency.

Of the comments received, 26 generally favored the proposal, 10 were opposed and 23 comments favored the concept but did not support the Clearing House proposal.

Among the replies generally favoring the Clearing House proposal, 16 came from New York State banks and trade associations, the Governor of New York, the Mayor of New York City and other New York officials, New York Members of Congress and the New York State Banking Department. The remaining 10 comments in this group were from the Deputy Secretary of the Treasury, Senator Garn and another individual, six banks outside New York and a foreign bank.

Those favoring the concept but not the proposal included Senator Proxmire and the majority of non-New York bank respondents. Most of the bank respondents expected that New York City would become the center of IBF activity and that banks located outside New York would therefore be disadvantaged. Some respondents suggested legislation to permit out-of-state banks to establish special purpose branches in New York. Several banks suggested that competitive balance would depend on their having a clearing account with the New York Federal Reserve Bank and full membership in the clearing system for international payments operated by the New York Clearing House (CHIPS).

(Over)

Respondents generally opposing the proposal were for the most part banks outside New York, including the Chicago Clearing House Association. Among the reasons they cited was their opinion that IBFs in New York City would place non-New York banks at a competitive disadvantage.

Enclosed for member banks and foreign bank branches and agencies is the text of the Board's Notice in this matter, together with a summary of the comments received to date by the Board in connection with the proposal. A copy of these materials will be furnished to others upon request to the Circulars Division of this Bank.

Any comments regarding the proposal may be sent to my office; inquiries may be directed to Thomas C. Sloane, Senior Vice President and Senior Adviser (Tel. No. 212-791-6086).

PAUL A. VOLCKER,
*President.*

FEDERAL RESERVE SYSTEM

[12 C.F.R. Parts 204, 217]

[Docket No. R-0214]

INTERNATIONAL BANKING FACILITIES

Advance Notice of Proposed Rulemaking

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Board of Governors of the Federal Reserve System is extending until May 18, 1979, the comment period on a request by the New York Clearing House Association to consider a proposal that the Board amend Regulations D and Q to provide that deposits of specially designated International Banking Facilities be exempt from reserve requirements and interest rate restrictions.

DATE: Comments must be received by May 18, 1979.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should refer to docket number R-0214.

FOR FURTHER INFORMATION CONTACT: Thomas D. Simpson, Senior Economist, Division of Research and Statistics (202-452-3361); or James S. Keller, Attorney, Legal Division (202-452-3582), Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: On December 14, 1978, the Board requested that comments on the Clearing House proposal be submitted to the Board by March 15, 1979. The Board is extending the comment period until May 18, 1979, and in addition to those issues on which it previously requested comments, invites comments on the impact that IBF's might have on deposit-taking and credit extension in offshore markets.

The New York Clearing House Association proposes that the Board amend Regulations D and Q to provide that deposits of specially designated International Banking Facilities (IBFs) be exempt from reserve requirements and interest rate regulations. These facilities would be operated separately from other offices of the bank. The Clearing House maintains that such an action, coupled with special State and local tax treatment of IBFs, would: enhance the role of major domestic monetary centers as international banking centers by attracting business from abroad; stimulate local economies by providing new jobs and raise local tax revenues; and lower bank costs and improve bank efficiency. The State of New York has enacted a law giving eventual tax-free status to IBFs, contingent up on favorable reserve requirement and interest rate action at the Federal level. So far as is known, no other State has taken similar action.

The Clearing House proposal contemplates that an IBF would be allowed to accept funds only from foreign customers, the facility's own U.S. head office, and other IBFs. It could offer only obligations subject to withdrawal on call (after a specified notice period) or fixed-maturity obligations with a minimum maturity of one business day; IBFs would not be authorized to offer deposits subject to immediate withdrawal or negotiable CDs.

Although funds placed with IBFs may be regarded as deposits upon which the reserve requirement would be set at 0 percent, the member bank would be subject to the 3 percent statutory minimum average reserve requirement on the sum of its domestic time deposits. Since the 3 percent minimum could reduce the attractiveness of the proposal for many member banks, as an alternative, consideration might be given to exempting obligations of IBFs from deposit treatment similar to the treatment accorded Federal funds borrowings and certain repurchase agreements.

IBFs could not advance credit to U.S. customers, except to other IBFs or to their own head offices; and advances to their own head offices would be subject to the same reserve requirement that is imposed under Regulation D[1/] on net borrowings by member banks from their own foreign branches (which is zero at present).

Establishment of IBFs would be expected to result in the creation of a new dollar deposit in this country competitive with Euro-dollars but subject to U.S. laws and hence not subject to the "foreign country risk" generally attached to dollar deposits in banks outside the United States. Obligations issued by IBFs probably would carry somewhat higher yields than comparable deposits at domestic offices of members banks because of the absence of reserve requirements. As a result, foreigners might shift funds from other international banking centers and from banking offices in the United States to IBFs. Moreover, U.S. corporations--particularly those with foreign affiliates--might be encouraged by favorable terms to find ways of placing funds with IBFs.

Implications for Deposit Holdings. Various deposit shifts are likely to occur as a result of creation of an IBF. Foreign-owned Euro-dollar deposits may shift to an IBF. In addition, existing foreign deposits held in U.S. banking offices might also be eligible to move into an IBF. Foreign demand deposits in the United States total $18 million, while foreign-owned time deposits amount to $12-1/2 billion.

1/ By Board action of February 14, 1979, provisions of the Board's regulations regarding reserve requirements for foreign branches of member banks were transferred from Regulation M (12 C.F.R. Part 213) to Regulation D (12 C.F.R. Part 204). 44 Fed. Reg. 10,499 (1979).

The volume of funds placed in IBFs would also be affected by whether the facility is available to foreign subsidiaries of U.S. corporations. Domestic companies would not be able to place funds directly with IBFs, but could do so indirectly through a foreign affiliate. Even if IBF accounts were not used directly for transactions purposes, some U.S. depositors--with foreign affiliates--might find short-term IBF obligations to be an attractive cash management instrument and might substitute IBF obligations for other short-term investments--such as RPs--and for demand deposits.

The availability of IBF accounts to various types of depositors has implications for measures of the monetary aggregates; for the level of required reserves; and for competitive relationships among foreign corporations, U.S. corporations with foreign subsidiaries, and other companies should be permitted to hold funds in an IBF, or whether minimum maturities of funds placed in an IBF should be seven days rather than one day, would affect deposit holdings and competitive relationships. A 7-day minimum maturity would, for example, reduce the difference between time accounts in IBF's and minimum maturity time deposits in domestic banks.

Implications for Credit Availability. Currently, credit extended to foreigners (including their own foreign branches) by banking offices in the United States is estimated to exceed deposit and nondeposit liabilities to foreigners by about $20 billion.

However, it cannot be determined *a priori* whether the amount of foreign loans that could be shifted to IBFs from domestic offices would be larger or smaller than the amount of deposit and nondeposit funds that would be shifted, and thus it cannot be determined whether the availability of domestic credit to domestic sectors would be affected.

In the final analysis the impact on the availability of credit to domestic sectors will depend on the degree to which IBFs are linked to domestic markets. If no restrictions are applied to funds channeled from IBFs to domestic U.S. offices of the parent bank as would be the case with a zero reserve requirement on head office borrowings from the IBF, there would be no, or little, impact on the availability of domestic bank credit from creation of an IBF. Any difference between the volume of domestic deposits shifted to IBFs and the volume of foreign loans shifted from domestic offices could be reflected in transactions by IBFs with their domestic offices.

Alternatively, should reserve requirements apply to funds channeled from IBFs to domestic U.S. offices of the parent bank, there would be greater scope for a spread to develop between the rates at which IBFs would lend to head offices or other IBFs and the Federal funds rate.[2/] The larger the reserve requirement the less closely would IBFs tend to be linked to domestic money markets, and the more likely that variations in flows of funds from domestic deposits to IBFs would be reflected in variations in theri foreign lending.

Implications for Foreign Exchange Rates. The same general considerations would affect the extent to which shifts of funds from U.S. offices to IBFs would have an impact on the exchange rate for the dollar. By establishing a zero, or low, reserve requirement on lending by IBFs to domestic U.S. offices of the parent bank, the Board could minimize any possible adverse effect on the exchange rate that

---

2/ The Federal funds rate and the rate for loans by one IBF to another would tend to be equal in the absence of restrictions on flows of funds between IBFs and head offices; there would be no differences in country risk on loans in each market as there currently is between interbank Euro-dollar loans and Federal funds loans.

might otherwise result from a difference between the volume of deposits in domestic offices shifted to IBFs and the volume of foreign credits in the loan portfolios of those domestic offices that was shifted to IBFs. The Board's policy regarding reserve requirements on lending to domestic offices would thus likely receive increased attention if IBFs were established.

It may be noted that if IBF obligations were regarded as an especially attractive dollar asset, there might be an incentive for some foreign investors to shift funds from money market instruments denominated in foreign currencies to IBFs. As the IBFs advanced these funds to domestic U.S. offices, there would be a tendency for some modest strengthening in the exchange rate for the dollar.

<u>The Effects of Competitive Balance among Banks</u>. IBFs could affect the relative positions of banks, as well as of their foreign and domestic customers. The Board recognized that if IBFs are to be established on a nationwide basis, adequate time would be needed to permit an opportunity for changes in State laws and regulations. The Board also recognized that IBFs might also be operated by banks outside New York through Edge Corporations in New York. Various locations and modes of operations may have differing impacts on banking institutions under current circumstances.

. . . . . .

The Board is considering the proposal and its desirability in light of its impact on monetary conditions, regulatory control, competitive balance and other factors.

Comment is invited by May 18, 1979, from all parties on issues raised by the proposal. In its December 14, 1978 statement, the Board stated it would be particularly interested in views on the minimum maturity of accounts that might be held in an IBF, on reserve requirements applicable to head office borrowings from an IBF, on the advisability of making obligations offered by the facility available to foreign subsidiaries of U.S. corporations, on implications for competitive balance among banks, on the length of time that might be required for changes in State laws and regulations and the lead time that member banks would reasonably need in order to establish IBFs.

Board of Governors of the Federal Reserve System, April 2, 1979.

(signed) Theodore E. Allison
Theodore E. Allison
Secretary of the Board

[SEAL]

April 2, 1979

SUMMARY OF COMMENTS

The Board has received 59 public comments on the proposal to date including 33 from banks outside New York, seven from trade associations, seven on behalf of municipal, State and Federal governments, 6 from members of Congress, three from New York City banks, two from individuals, and one from a foreign bank. The comments can be classified as follows:

1. Comments Generally Favoring the Proposal. Of the 26 comments generally favoring the proposal, three were submitted by New York Clearing House banks (comments 1-3), three were by New York trade associations (comments 11-13), six were by New York State and New York City (comments 15-20),[1/] and four submitted by members of Congress from New York (comments 22-25). All of these comments gave strong support to the Clearing House proposal, and urged prompt Board action in amending Regulations D and Q.

The ten other comments generally favoring the proposal were from six banks located outside New York (comments 4-9), one foreign bank (comment 10), the Deputy Secretary of the Treasury (comment 14), Senator Jake Garn of Utah (comment 21) and an individual (comment 26). While these comments also generally supported the Clearing House proposal, two of the comments from the banks outside New York expressed concern about the effect of the proposal on the competitive balance between New York and non-New York banks (comments 5 and 8). Senator Garn's comment addressed principally the statutory authority for the Board to amend Regulations D and Q.

1/ Comment 15 transmitted to the Board letters supporting the proposal from Governors Shapp of Pennsylvania and Milleken of Michigan.

2. Comments favorable to the concept, but not the proposal.

The majority of the non-New York bank respondents indicated that they approved of the concept of IBF's but could not support the Clearing House proposal because it would afford a competitive advantage to New York based banks (comments 27-45). There was general agreement among this group that New York City would be the center of IBF activity. However, it was indicated that the New York market could be entered by non-New York banks only through an Edge Corporation, and that an Edge Corporation would be at a definite competitive disadvantage vis-a-vis New York banks because of the Edge's relatively smaller size (comments 28-34, 36, 38, 39, 42, 43). A number of these comments called for an amendment to the McFadden Act to permit the establishment of special purpose branches in New York (see, for example, comment 33). Several banks in this group also stated that competitive balance could only be achieved if banks outside New York could have an account with the Federal Reserve Bank of New York and full membership in the CHIPS system (comments 31-33, 40, 44).

Three trade associations favored the concept but expressed specific reservations about the proposal. The Bankers Association for Foreign Trade expressed the view that approval of the Clearing House proposal should not in any way inhibit the use of offshore "shell" branches (comment 46); the American Bankers Association sought additional time to address the issue of competitive equality between New York and non-New York based banks (comment 47); and the Institute of Foreign Bankers expressed concern regarding the potential competitive impact of IBF's on foreign banks operating in the United States, and suggested that foreign bank head offices be asked to comment on the proposal (comment 48).

Senator Proxmire raised a number of issues regarding the impact of IBF's on monetary policy, especially the "leakage" of funds from domestic deposits to IBF's. In addition, he raised issues regarding the relationship of IBF's to the membership issue, and the supervision and regulation of IBF's. He suggested that the Board might prefer to address this proposal by recommending appropriate legislative action to Congress rather than by taking regulatory action (comment 49).

3. Comments Generally Opposing the Proposal. Ten of the comments received generally opposed the proposal. Eight of these were from non-New York bankers, (comments 50-57); one was from a trade association, the Chicago Clearing House Association (comment 58), and one was from an individual (comment 59).. Among the reasons for opposition to the proposal cited in these comments were the competitive disadvantages that would be faced by non-New York banks (comment 51-53, 55, 56) and the "leakage" of funds from the domestic money market to IBF's (comments 52, 54, 57). In addition to these reasons, the Chicago Clearing House Association also questioned the Board's legal authority to exempt IBF funds from Regulations D and Q (comment 58).

4. Specific Issues on Which the Board Sought Comment. As discussed above, the competitive balance issue was the focus of most of the comments and opposition to the Clearing House proposal. On the other issues identified by the Board there was less divergence of opinion.

a. Minimum Maturity of Deposit Accounts. Nineteen of the 24 comments addressing this issue agreed that the maturities of IBF deposits should parallel the range of maturities for Eurodollar deposits available abroad with the minimum maturity being overnight, while five comments recommended a minimum maturity of more than one day in order to reduce the transactional character of the deposits involved.

b. Reserve requirements Applicable to Head Office Borrowings from an IBF. All 21 of the comments on this issue indicated that advances by an IBF to its own U.S. head office should be subject to the same reserve requirement that is imposed under Regulation D on net borrowings by a member bank from its foreign branch (currently zero).

c. Availability of Loans and Obligations of IBF's to Foreign Subsidiaries of United States Corporations. Eighteen of the 19 comments addressing this issue favored permitting foreign subsidiaries of United States corporations to place funds with, and obtain loans from, IBF's.

d. Length of Time for Passage of State Laws and Lead Time for Member Banks to Establish IBF's. There were very few comments addressing this issue specifically. In general, the comments from New York sources favored very little delay (e.g., 3 months), while comments from those concerned with the problem of competitive imbalance indicated that approval should be delayed until these problems were resolved. Some of these comments indicated Congressional action was necessary in order to implement the proposal.

Attached is a table of public comments received to date.

Attachment

## TABLE OF PUBLIC COMMENTS

### A. Parties Generally Favoring the Proposal:

#### 1. Banks

In New York

1. Morgan Guaranty Trust Company, New York, New York
2. Bank of New York, New York, New York
3. Manufacturers Hanover Trust Company, New York, New York

Outside New York

4. The Boatmen's National Bank of St. Louis, St. Louis, Missouri
5. City National Bank, Detroit, Michigan
6. Girard Bank, Philadelphia, Pennsylvania
7. Trust Company Bank, Atlanta, Georgia
8. First National Bank in Dallas, Dallas, Texas
9. Wachovia Bank & Trust Company, N.A., Winston-Salem, North Carolina

Foreign

10. Bank of Commerce, Toronto, Canada

#### 2. Trade Associations

11. New York State Bankers Association, New York, New York
12. New York Chamber of Commerce & Industry, New York, New York
13. New York Clearing House, New York, New York

#### 3. Federal and State Governments

14. The Deputy Secretary of the Treasury, Washington, D.C.
15. State of New York Office of Federal Affairs, Washington, D.C. (letters submitted by the Office of the Governor, Harrisburg, Pennsylvania and Office of the Governor, Lansing, Michigan)
16. State of New York Executive Department, Executive Chamber, Albany, New York (submitted by Hugh L. Carey)
17. State of New York, The Assembly, Albany, New York (submitted by Herman D. Farrell, Jr., Member of the Assembly, Chairman, Committee on Banks)
18. State of New York Banking Department
19. The Port Authority of New York and New Jersey
20. Mayor Edward Koch, New York City, New York

4. Members of Congress

21. Senator Jake Garn, Utah
22. Congressman Ted Weiss, New York
23. Congressman Stanley N. Lundine, New York
24. New York State Congressional Delegation, New York (submitted two letters dated March 8, 1979 and April 6, 1978)
25. New York Members of House Banking Committee (Congressmen John I. LaFalce, Stanley N. Lundine, Robert Garcia, James M. Hanley, S. William Green)

5. Other

26. Jay R. White, Flushing, New York

B. Parties Favoring Concept With Substantial Reservations About Proposal:

1. Banks

27. First Bristol County National bank, Taunton, Massachusetts
28. United California Bank International, New York, New York
29. State Street Bank and Trust Company, Boston, Massachusetts
30. First City National Bank, Houston, Texas
31. First National Bank, Boston, Massachusetts
32. Wells Fargo Bank National Association, San Francisco, California
33. American Security Bank, National Association, Washington, D.C.
34. First Pennsylvania Bank, N.A., Philadelphia, Pennsylvania
35. Merchants National Bank, Mobile, Alabama
36. New England Merchants National Bank, Boston, Massachusetts
37. Northwestern National Bank, Minneapolis, Minnesota
38. Bank of America National Trust and Savings Association, San Francisco, California
39. Crocker National Bank, San Francisco, California
40. First National Bank of Atlanta, Atlanta, Georgia
41. First National Bank, Baltimore, Maryland
42. First National Bank, St. Louis, Missouri
43. Security Pacific National Bank, Los Angeles, California
44. Rainier National Bank, Seattle, Washington
45. State National Bank of Connecticut, Bridgeport, Connecticut

2. Trade Associations

46. Bankers Association for Foreign Trade, Washington, D.C.
47. American Bankers Association, Washington, D.C.
48. Institute of Foreign Bankers

3. Members of Congress

49. Senator William Proxmire, Wisconsin (requests further information)

C. Parties Opposing the Proposal:

1. Banks

50. Farmers State Bank, Ingalls, Kansas
51. Whitney National Bank of New Orleans, New Orleans, Louisiana
52. Flagship Banks Inc., Miami Beach, Florida
53. Republic National Bank, Dallas, Texas
54. National Bank of Detroit, Detroit, Michigan
55. Connecticut Bank and Trust Company, Hartford, Connecticut
56. Mellon Bank N.A., Pittsburgh, Pennsylvania
57. Southeast First National Bank of Miami, Miami, Florida

2. Trade Associations

58. Chicago Clearing House Association, Chicago, Illinois

3. Other

59. Albert G. Hart, Professor Emeritus of Economics, Columbia University, New York, New York