FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8930
October 9, 1980]

INTERSTATE BANKING ACTIVITIES OF FOREIGN BANKS

Changes in Regulation K, Effective October 2, 1980

*To All Foreign Banking Organizations, and Others Concerned,
in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System has adopted amendments, effective October 2, 1980, and an interpretation to its Regulation K, "International Banking Operations." The changes are designed to implement provisions of the International Banking Act that limit the interstate banking activities of foreign banks in the United States.

The following is quoted from the text of the Board's announcement:

The International Banking Act establishes certain restrictions on the interstate operation of branches, agencies, commercial lending companies and subsidiary banks of foreign banks. Under the Act, each foreign bank operating in the United States will have a "home State" and its domestic deposit taking activities that are not grandfathered are limited to that State.

The IBA provides that the U.S. offices that foreign banks established or applied to establish as of July 27, 1978 are "grandfathered." Foreign banks may thus continue to operate these offices indefinitely.

Highlights of the rules adopted by the Board to implement these provisions of the International Banking Act include:

1. *Home State Selection*

—Foreign banks without a deposit taking office (branch or subsidiary) in the United States need not select a home State.

—Where a foreign bank has one branch or one subsidiary bank and no other banking office in the United States, the State with that branch or subsidiary will be the foreign bank's home State.

—A foreign bank that has one or more deposit taking offices in the United States must select a home State by March 31, 1981. If it does not do so, the Board will make the selection.

2. *Changing a Home State*

A foreign bank may change its home State one time if it either closes, or converts to agencies or branches that are limited to the deposit taking authority of Edge corporations, all non-grandfathered branches in its original home State, and divests any non-grandfathered interests in banks in its original home State.

3. *Branches, Agencies and Credit Balances*

The IBA restricts the establishment of branches, but not agencies, outside a foreign bank's home State. Under the Act, branches may receive deposits but agencies may receive only credit balances. The various States currently determine what constitutes a credit balance. To assure that credit balances are distinguished from deposits, the Board adopted minimum criteria for what constitutes a credit balance. These criteria specify from what sources such obligations may be derived and the uses to which they may be put.

4. *Control of Foreign Bank and its Affiliates and Home State Attribution*

The Act provides that a foreign bank may not directly or indirectly establish and operate a Federal or State chartered branch outside its home State.

To implement this provision, the Board ruled that two or more foreign banks operating in the United States, each of which is majority owned by a common parent company, will be regarded as one banking organization, entitled to only one home State.

(OVER)

5. *Acquisition by Merger*

A foreign bank holding company that has a grandfathered subsidiary bank outside its home State must give 60 days' notification to the Board before the subsidiary acquires all or substantially all of the assets of a bank that is larger than the subsidiary.

If the Board determines that the resulting acquisition by merger would be contrary to the interstate banking provisions of the IBA the foreign bank holding company must show cause why its home State designation should not be changed to that of its subsidiary bank. In the case of such a change, the foreign bank holding company must, with the exception of grandfathered offices, terminate domestic deposit taking in its original home State.

In a recent report to Congress on the implementation of the IBA, the Board supports legislation that would amend the Bank Holding Company Act to prohibit such merger acquisitions for both foreign and domestic bank holding companies.

6. *California Offices*

The Board determined that for purposes of the interstate restrictions of the IBA, it will regard offices of foreign banks that accept foreign source deposits, but not domestic deposits (as certain offices may do under California law), as agencies rather than branches.

Enclosed—for foreign banking organizations, U.S. branches and agencies of foreign banks, and foreign bank holding companies in this District—is the text of the changes in Regulation K. Printed copies of the amendments and interpretation, in slip-sheet form, will be sent to you when available.

Questions on this matter may be directed to our Domestic Banking Applications Department (Tel. No. 212-791-5865).

ANTHONY M. SOLOMON,
President.

TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation K]

(Docket No. R-0258)

PART 211--INTERNATIONAL BANKING OPERATIONS

Interstate Banking Restrictions For Foreign Banks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: The International Banking Act of 1978 limits the expansion of the interstate domestic deposit-taking capabilities of foreign banks by restricting the establishment of branches and the acquisition of interests in banks by a foreign bank outside of its "home State." The Board has adopted amendments to Regulation K (International Banking Operations) to implement these provisions of the International Banking Act.

DATE: October 2, 1980.

FOR FURTHER INFORMATION CONTACT: C. Keefe Hurley, Jr., Senior Counsel (202/452-3269), or James S. Keller, Senior Attorney (202/452-3582), Legal Division, Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: Section 5(a) of the International Banking Act of 1978 (12 U.S.C. 3101 et seq.) ("IBA") provides that, with the exception of grandfathered offices, no foreign bank may directly or indirectly establish and operate either a Federal or a State branch outside its "home State" unless the foreign bank enters into an agreement or undertaking with the Board to accept only such deposits at the out-of-home State branch as would be permissible for an Edge Corporation. Under the Edge Act (12 U.S.C. 611 et seq.), Edge Corporations may only receive deposits in the U.S. as may be "incidental to or for the purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States." In addition to the requirement of an agreement to restrict deposit-taking, a Federal branch or agency may be established or operated outside a foreign bank's home State only if the operation of such an office is expressly permitted by the receiving State, while a State branch, agency or commercial lending company may be established outside a foreign bank's home State only if it is approved by the bank regulatory authority of the receiving State. A foreign bank is also prohibited from acquiring directly or indirectly an interest in a bank located outside of the foreign bank's home State if the acquisition

would be prohibited under section 3(d) of the Bank Holding Company Act ("BHCA") if the foreign bank were a bank holding company whose State of principal banking operations was the foreign bank's home State.

Subsection 5(b) grandfathers for purposes of the interstate banking restrictions, any branch, agency, subsidiary bank or commercial lending company subsidiary that commenced operation or for which an application to commence business had been filed on or before July 27, 1978. Subsection 5(c) provides that the home State of a foreign bank that has any combination of branches, agencies, subsidiary lending companies, or subsidiary banks, in more than one State, is whichever State is chosen by the foreign bank (or by the Board in the event the foreign bank does not make a choice).

On October 30, 1979, the Board requested public comment on proposed amendments to Regulation K to implement the provisions of section 5 of the IBA (44 Fed. Reg. 62,902). The period for public comment ended on February 3, 1980. After consideration of the 32 comments received, including those on behalf of the Institute of Foreign Bankers whose membership includes more than 170 U.S. offices and subsidiaries of foreign banks from 42 countries, the Board adopted the amendments to Regulation K substantially in the form proposed. However, certain modifications were made, as discussed below, relating to out-of-home State mergers and the attribution of home State. In addition certain technical changes were made in order to clarify the regulations.

Selection of home State. The Board proposed that a foreign bank with more than one office as of the grandfather date, one of which accepts domestic deposits, be required to select a home State within 90 days after the Board's regulations on this matter become final. In the event a foreign bank failed to select a home State, the Board proposed to exercise its authority to determine on the basis of total deposits as of the latest report of condition a foreign bank's home State.

The Board's final regulation with respect to selection of home State is the same as that originally proposed by the Board except for a modification allowing a foreign bank to file its declaration within 180 days, rather than 90 days, of the regulation's effective date, i.e., by March 31, 1981.

Change of Home State. No provision in the IBA explicitly allows a foreign bank to change its home State. Nevertheless, it is clear from the legislative history of this section that Congress intended that the Board provide by regulation "a suitable procedure for registering with the Federal Reserve the home State and for changing it." The Board recognized that the ability of a foreign bank to change its home State

could, if unrestricted, afford a foreign bank a significant advantage over a domestic bank. A domestic bank is, for the most part, restricted to operating in the State in which it is organized and, depending upon State law, may be restricted to a particular city or county. In order to afford a foreign bank some flexibility in its operations without causing undue competitive imbalance, the Board proposed that a foreign bank be permitted to change its home State only once, and that such a change in home State be conditioned upon the foreign bank: (1) either closing branches opened in reliance on its original home State designation, converting the branches to agencies or entering into an agreement with the Board regarding deposit-taking activities of such branches as prescribed in section 5(a) of the IBA, and (2) divesting any interests acquired in banks in reliance upon its original home State designation. This procedure was intended to be self-implementing in that it would require notification to the Board but no Board action (unless divestiture should require a control determination under section 2(g)(3) of the BHCA).

A number of commenters contended that the Board's proposal was too restrictive and that there should be no limit upon the number of times that a foreign bank could change its home State. The Board did consider an alternative proposal that would have allowed a foreign bank to change its home State an unlimited number of times but would have required that both grandfathered and non-grandfathered deposit-taking offices in its previous home State be relinquished in order that the number of States in which the foreign bank engaged in deposit taking activities not be increased. The Board, however, concluded that its proposed provision for change of home State affords foreign banks the degree of flexibility contemplated by the legislative history of the IBA and at the same time preserves the IBA's concepts of grandfathering and competitive balance between foreign and domestic banks. Accordingly, the Board adopted its proposed provision for change of home State. However, the Board noted, in its September 17, 1980 report to Congress on implementation of the IBA required by section 7(d) of that Act, that Congress might wish to reconsider section 5 in the light of the issues raised by the Board in its report and make any changes in that section Congress feels are necessary.

Out-of-home State mergers. Under section 5(a) of the IBA and section 3(d) of the BHCA, a foreign bank with a subsidiary bank in one State (State X) and a branch or agency in another State (State Y) that declares State Y as its home State is prohibited from: (1) acquiring more than 5 per cent of the shares of an additional bank in State Y (by the provisions of section 3(d) of the BHCA); or (2) acquiring

more than 5 per cent of the shares of an additional bank in State X (by the provisions of section 5(a)(5) of the IBA). The Board is concerned that a foreign bank in this situation that selects Y as its home State might be able to acquire an additional bank by merger in State X and at the same time continue to expand its deposit-taking capabilities in State Y by further branching.

The ability of a foreign bank to continue to expand its deposit-taking capabilities significantly in more than one State through mergers appears to contravene the intent of section 5. Accordingly, the Board proposed that a foreign bank with a subsidiary bank (or banks) and branches located in different States that chooses as its home State a State other than that in which a subsidiary bank is located be required to give the Board 60 days' notice prior to acquiring all or substantially all of the assets of a bank outside its home State. The Board would then make a determination whether the foreign bank should be required to show cause why its home State should not be changed to the State where its subsidiary bank is located. Absent an adequate showing by the foreign bank, the Board would redesignate the foreign bank's home State upon consummation of the transaction. Redesignation would require that the foreign bank terminate any domestic deposit-taking operations undertaken as a result of its original home State selection. In addition, the foreign bank would be precluded from future expansion of its domestic deposit-taking capability in its original home State. Such a procedure would enable the Board to ensure that home State selection is not used in a manner to circumvent the domestic deposit limitations of the IBA.

Several commenters contended that the Board lacked authority under the IBA to adopt such a provision. However, the Board believes that it is consistent with the legislative history of section 5 to prevent a foreign bank from undertaking significant expansion of its domestic-deposit taking business in two States by branching in its home State and acquiring other banks by merger in its subsidiary bank State. The Board has modified its original proposal by requiring notice under this provision only when the bank to be acquired by merger is larger (in terms of deposits) than the acquiring bank. The Board believes that this modification will serve to differentiate between those merger acquisitions that are more analogous to de novo branching, which is permissible, and those that might be considered a manipulation of the home State selection process.

There are seven domestic bank holding companies and five foreign bank holding companies that have multi-State operations grandfathered under the BHCA. Under the BHCA, these bank holdings companies may acquire an additional bank by merging it into a subsidiary bank located outside of the bank holding company's principal State of banking operations. The regulations adopted by the Board give a foreign multi-State bank holding company treatment parallel to that for a domestic multi-State bank holding company in that such a foreign organization would not be required to

follow the out-of-home State merger provisions if the foreign bank selects as its home State one of the States in which it owns or controls a subsidiary bank.

In its September 17, 1980 report to Congress, referred to above, the Board noted that the merger acquisition issue could be better addressed by a legislative solution applicable to both foreign bank and domestic bank holding companies. The Board recommended in that report that section 3(a)(4) of the Bank Holding Company Act be amended so as, in effect, to prohibit acquisitions by merger outside of both a bank holding company's principal State of banking operations and a foreign bank's home State.

Credit balances. The Board proposed minimum criteria by which an account would be presumed to be a credit balance and not a deposit. Several commenters stated that the determination of what constitutes a credit balance should be left to the appropriate State or Federal licensing authority. The Board believes, however, that, absent a workable Federal standard for determining whether an obligation at an office of a foreign bank is a credit balance or a deposit, the interstate banking restrictions of the IBA would be difficult to enforce. The adopted minimum criteria are generally consistent with standards that have been applied by the Board as well as by States through their statutes, regulations and practices governing credit balances. The States and the Comptroller of the Currency remain free to adopt more specific limits on credit balances that are deemed necessary for their own regulatory purposes. It is to be noted that these criteria do not affect the reservability of a credit balance obligation under Regulation D.

Attribution of home State. Section 5 of the IBA states that "no foreign bank may directly or indirectly establish and operate a [State or] Federal branch outside of its home State." (emphasis added). In the view of the Board, a foreign organization and the institutions that it controls should be entitled to only one home State. It is necessary, therefore, to determine which elements of a foreign organization are under common control. Under section 2(a)(2)(A) of the BHCA, a company is considered to control a bank or another company if it directly or indirectly owns, controls or has the power to vote 25 per cent or more of any class of voting shares of the bank or company. The Board believes that, in recognition of the differences between banking in foreign countries and banking in the United States, this statutory test for determining control of banks and companies should not be imposed upon foreign organizations. Rather, the Board proposed that the test for what constitues acting indirectly under section 5 of the IBA be ownership or control of a majority of the voting shares. While majority ownership would be conclusive presumption of ownership or control, the Board would reserve the right to determine administratively whether the ownership of less than a majority of the voting shares constituted acting indirectly. Under its regulation, the Board would treat as one organization entitled to one home State a foreign bank or foreign banking organization and its majority owned

subsidiaries. Also treated as a part of the same organization would be those less than majority owned banks or companies that the Board determines after notice and opportunity for a hearing are actually controlled by the foreign organization.

The proposed regulation would have established a presumption that a 10 per cent interest in another organization constitutes control. In response to comments received, this aspect of the original proposal has been eliminated. This provision had been intended to obtain an inventory of potential control relationships. This information will be obtained through the Board's forthcoming annual reporting form for foreign banking organizations.

The Board also adopted an interpretation, which is attached, stating that for purposes of section 5 of the IBA certain offices of foreign banks that accept foreign source deposits but not domestic deposits will be regarded as agencies rather than branches.

In its proposed amendments to Regulation K dealing with the nonbanking activities of foreign bank holding companies and foreign banks that have banking offices in the United States (45 F.R. 30,082), the Board indicated that Regulation K would be reorganized into two Subparts: Subpart A would contain what are currently sections 211.1 through 211.7, dealing with international operations of United States banking organizations, and Subpart B would include the regulations concerning interstate banking operations of foreign banks and bank holding companies and the regulations regarding nonbanking activities of foreign banking organizations. Accordingly, the organization of these final regulations will correspond to the revised format of Regulation K. A form for selection of home State and a model agreement for foreign banks operating or establishing out-of-home State branches will be available at the Federal Reserve Banks in 15 days.

Pursuant to its authority under the International Banking Act of 1978 (12 U.S.C. § 3101 et seq.), the Board has amended Regulation K (12 C.F.R. Part 211) as follows:

1. Regulation K is amended by adding "Subpart A--International Operations of United States Banking Organizations." Within Subpart A, the current sections 211.1 through 211.7 are retained.

2. Regulation K is amended by adding Subpart B. Within Subpart B, new sections 211.21 and 211.22 are added as follows:

SUBPART B--FOREIGN BANKING ORGANIZATIONS

SECTION 211.21 AUTHORITY, PURPOSE, AND SCOPE

(a) Authority. This Subpart is issued by the Board of Governor of the Federal Reserve System ("Board") under the authority of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) ("BHCA"); and the International Banking Act of 1978 (92 Stat. 607) ("IBA").

(b) Purpose and Scope. This Subpart is in furtherance of the purposes of the BHCA and the IBA. It applies to foreign banks and foreign banking organizations with respect to the limitations on interstate banking under section 5 of the IBA (12 U.S.C. 3103); and to foreign banks and foreign bank holding companies with respect to the exemptions from the nonbanking prohibitions of the BHCA and the IBA afforded by sections 2(h) and 4(c)(9) of the BHCA (12 U.S.C. 1841(h) and 1843(c)(9)).

SECTION 211.22 INTERSTATE BANKING OPERATIONS OF FOREIGN BANKING ORGANIZATIONS

(a) Definitions. The definitions of section 211.2 in Subpart A apply to this section subject to the following:

(1) "Agency" means any office or any place of business of a foreign bank located in any State of the United States or the District of Columbia at which credit balances are maintained, checks are paid, or money is lent, but at which deposits may not be accepted from a citizen or resident of the United States. Obligations shall not be considered credit balances unless they: (i) are incidental to, or arise out of the exercise of other lawful banking powers; (ii) are to serve a specific purpose; (iii) are not solicited from the general public; (iv) are not used to pay routine operating expenses in the United States such as salaries, rent, or taxes; (v) are withdrawn within a reasonable period of time after the specific purpose for which they were placed has been accomplished; and (vi) are drawn upon in a manner reasonable in relation to the size and nature of the account.

(2) "Banking subsidiary," with respect to a specified foreign bank, means a bank that is a subsidiary as the terms "bank" and "subsidiary" are defined in section 2 of the BHCA (12 U.S.C. 1841).

(3) "Commercial lending company" means any organization, other than a bank or an organization operating under section 25 of the FRA, organized under the laws of any State of the United States or the District of Columbia, that maintains credit balances as may be maintained by an agency and engages in the business of making commercial loans.

(4) "Domestic branch" means any office or any place of business of a foreign bank located in any State of the United States or the District of Columbia that may accept domestic deposits and deposits that are incidental to or for the purpose of carrying out transactions in foreign countries.

(5) "Foreign Bank," for purposes of this section, is an organization that is organized under the laws of a foreign country and that engages in the business of banking.

(b) Determination of home State. (1) A foreign bank selecting its home State shall do so by filing with the Board a declaration of home State within 180 days of the effective date of this subpart. In the absence of such selection, the Board shall designate a foreign bank's home State. Within one year after the home State of a foreign bank has been determined, unless the Board authorizes a longer period:

(i) the foreign bank shall close domestic branches whose activities are not permissible under section 5(b) of the IBA, convert such domestic branches to agencies, or enter into an agreement with the Board regarding the deposits of such branches as prescribed in section 5(a) of the IBA; and

(ii) the foreign bank shall divest voting shares of interests in, or assets of banks that are not permissible under section 5(b) of the IBA.

(2) A foreign bank that currently does not operate a domestic branch or banking subsidiary shall not be required to select a home State and shall not have its home State designated by the Board.

(3) A foreign bank (except a foreign bank to which paragraph (b)(5) of this section applies) that has any combination of domestic branches, banking subsidiaries, agencies, or commercial lending company subsidiaries that, before July 27, 1978, were established or applied for in more than one State may select its home State only from those States in which the foreign bank has continuously operated such offices.

(4) A foreign bank that established or applied for one domestic branch or one banking subsidiary before July 27, 1978, and that was not otherwise engaged in banking in the United States on that date, shall have as its home State the State in which such domestic branch or banking subsidiary is located.

(5) A foreign bank that before July 27, 1978, had no domestic branches or banking subsidiaries or had only agencies or commercial lending companies, and, after that date, has established or establishes any domestic branch or banking subsidiary shall have as its home State that State in which its initial domestic branch or banking subsidiary is located.

(c) Change of home State. A foreign bank may change its home State once if:

(1) 30 days' prior notification of the proposed change is filed with the Board; and

(2) domestic branches established and investments in banks acquired in reliance on its original home State selection are conformed to those that would have been permissible had the new home State been selected as its home State originally.

(d) Bank mergers. (1) A foreign bank with one or more banking subsidiaries that selects as its home State a State other than that in which a banking subsidiary is located, and that proposes to acquire through its subsidiary bank all or substantially all of the assets of a bank larger than its subsidiary bank (in terms of deposits) located outside the foreign bank's home State shall give 60 days' notification to the Board prior to consummation of the proposed transaction.

(2) If, after receiving the notification, the Board makes a preliminary determination within that period that the proposed acquisition would be inconsistent with the foreign bank's home State selection, the foreign bank shall:

(i) redesignate as its home State the State in which its subsidiary bank is located; or

(ii) show cause why in the facts and circumstances of its case its home State should not be redesignated (the foreign bank's submission may include a request for a hearing).

(3) On the basis of information available, the Board shall:

(i) direct that the foreign bank redesignate as its home State the State in which its subsidiary bank is located; or

(ii) take no action with respect to the foreign bank's home State.

(4) Factors to be considered by the Board in making its preliminary and final determinations include the size of the proposed acquisition relative to the foreign bank's other operations in the United States and the ability of the foreign bank to change its home State.

(e) Attribution of home State. (1) A foreign bank or organization and the other foreign banks or organizations over which it exercises actual control shall be regarded as one foreign bank and shall be entitled to one home State.

(2) Actual control shall be conclusively presumed to exist in the case of a bank or organization that owns or controls a majority of the voting shares of another bank or organization.

(3) Where it appears to the Board that a foreign bank or organization exercises actual control over the management or policies of another foreign bank or organization, the Board may inform the parties that a preliminary determination of control has been made on the basis of the facts summarized in the communication. In the event of a preliminary determination of control by the Board, the parties shall within 30 days (or such longer period as may be permitted by the Board):

(i) indicate to the Board a willingness to terminate the control relationship; or

(ii) set forth such facts and circumstances as may support the contention that actual control does not exist (and may request a hearing to contest the Board's preliminary determination); or

(iii) accede to the Board's preliminary determination, in which event the parties shall be regarded as one foreign bank and shall be entitled to one home State.

By order of the Board of Governors, October 2, 1980.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]

TITLE 12--BANKS AND BANKING

CHAPTER II--FEDERAL RESERVE SYSTEM

SUBCHAPTER A--BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation K]

(Docket No. R-0259)

PART 211--INTERNATIONAL BANKING OPERATIONS

Interstate Banking Restrictions For Foreign Banks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Interpretation.

SUMMARY: The Board of Governors of the Federal Reserve System has issued a final interpretation of the term "agency" as defined in Subpart B, section 211.22(a)(1) of its amendments to the Board's Regulation K (12 CFR § 211).

FOR FURTHER INFORMATION CONTACT: C. Keefe Hurley, Jr., Senior Counsel (202/452-3269), or James S. Keller, Senior Attorney (202/452-3582), Legal Division, Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: Section 5(a) of the International Banking Act of 1978 (12 U.S.C. 3101 et seq.) ("IBA") provides that, with the exception of grandfathered offices, no foreign bank may directly or indirectly establish and operate either a Federal or a State branch outside its "home State" unless the foreign bank enters into an agreement or undertaking with the Board to accept only such deposits at the out-of-home-State branch as would be permissible for an Edge Corporation. Under the Edge Act (12 U.S.C. 611 et seq.), Edge Corporations may only receive deposits in the U.S. as may be "incidental to or for the purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States."

In addition to the requirement of an agreement to restrict deposit-taking, a Federal branch or agency may be established or operated outside a foreign bank's home State only if the operation of such an office is expressly permitted by the receiving State; a State branch, agency, or commercial lending company may be established outside a foreign bank's home State only if it is approved by the bank regulatory authority of the receiving State. A foreign bank is also prohibited from acquiring directly or indirectly an interest in a bank located outside of the foreign bank's home State if the acquisition would be prohibited under section 3(d) of the Bank Holding Company Act ("BHCA") if the foreign bank were a bank holding company whose State of principal banking operations was the foreign bank's home State.

Section 5(b) of the IBA grandfathers, for purposes of the interstate banking restrictions, any branch, agency, subsidiary bank, or commercial lending company subsidiary that commenced operation or for which an application to commence business had been filed on or before July 27, 1978. Section 5(c) provides that the home State of a foreign bank that has any combination of branches, agencies, subsidiary lending companies, or subsidiary banks, in more than one State, is whichever State is chosen by the foreign bank (or by the Board in the event the foreign bank does not make a choice).

California offices. Section 1(b) of the IBA defines "agency" as an office that maintains credit balances but at which "deposits may not be accepted from citizens or residents of the United States," while it defines "branch" as any office "at which deposits are received." Offices of foreign banks in California have generally been prohibited from accepting deposits by a requirement of State law that such offices obtain Federal deposit insurance; an office of a foreign bank could not obtain such insurance before the passage of the IBA. California law, however, permits offices of foreign banks, with the approval of the Banking Department, to accept deposits from any person that resides, is domiciled, and maintains its principal place of business in a foreign country. Therefore, according to a literal reading of the IBA, a California office of a foreign bank that accepts deposits from certain foreign sources (e.g., a U.S. citizen residing abroad) is a branch rather than an agency.

If the Board were to determine that such an office, established or applied for prior to July 27, 1978, was a branch rather than an agency, then that office would be grandfathered as a branch. Accordingly, a foreign bank that has a branch outside California and an office in California that accepts foreign source deposits could elect a State other than California as its home State, obtain deposit insurance for the California office, and convert that office to a full domestic deposit-taking facility. If, however, the Board were to determine that such an office was an "agency," then it would be grandfathered as an agency and could not expand its deposit-taking capabilities (unless the foreign bank selected California as its home State).

The Board proposed that, for purposes of section 5 of the IBA, the Board will regard offices of foreign banks that accept foreign source deposits, but not domestic deposits, as agencies rather than branches. The Board has adopted this proposal. The Board has determined that both the legislative history and the purposes of section 5 of the IBA support such an interpretation. Furthermore, funds that may be received by these California offices are the type that Edge Corporations and, therefore, branches established and operated outside of a foreign bank's home State may receive. Treating these offices as agencies appears to be consistent with their method of operation and with the purposes of section 5 of the IBA.

Under the Board's interpretation, a foreign bank may continue to accept these foreign source deposits at its California office without selecting California as its home State and upgrading such an office to a branch.

Pursuant to its authority under the International Banking Act of 1978 (12 U.S.C. § 3101 et seq.), the Board has issued the following interpretation of the term "agency" as defined in Subpart B, Section 211.22(a)(1) of its Regulation K:

§ 211.601 Status of certain offices for purposes of the International Banking Act restrictions on interstate banking operations.

The Board has considered the question of whether a foreign bank's California office that may accept deposits from certain foreign sources (e.g., a United States citizen residing abroad) is a branch or an agency for the purposes of the grandfather provisions of section 5 of the International Banking Act of 1978 (12 U.S.C. § 3103(b)). The question has arisen as a result of the definitions in the International Banking Act of "branch" and "agency," and the limited deposit-taking capabilities of certain California offices of foreign banks.

The International Banking Act defines "agency" as "any office . . . at which deposits may not be accepted from citizens or residents of the United States," and defines "branch" as "any office . . . of a foreign bank . . . at which deposits are received" (12 U.S.C. § 3101(1) and (3)). Offices of foreign banks in California prior to the International Banking Act were generally prohibited from accepting deposits by the requirement of State law that such offices obtain Federal deposit insurance (Cal. Fin. Code § 1756); until the passage of the International Banking Act an office of a foreign bank could not obtain such insurance. California law, however, permits offices of foreign banks, with the approval of the Banking Department, to accept deposits from any person that resides, is domiciled, and maintains its principal place of business in a foreign country (Cal. Fin. Code § 1756.2). Thus, under a literal reading of the definitions of "branch" and "agency" contained in the International Banking Act, a foreign bank's California office that accepts deposits from certain foreign sources (e.g., a U.S. citizen residing abroad), is a branch rather than an agency.

Section 5 of the International Banking Act establishes certain limitations on the expansion of the domestic deposit-taking capabilities of a foreign bank outside its home State. It also grandfathers offices established or applied for prior to July 27, 1978, and permits a foreign bank to select its home State from among the States in which it operated branches and agencies on the grandfather date. If a foreign bank's

office that was established or applied for prior to June 27, 1978, is a "branch" as defined in the International Banking Act, then it is grandfathered as a branch. Accordingly, a foreign bank could designate a State other than California as its home State and subsequently convert its California office to a full domestic deposit-taking facility by obtaining Federal deposit insurance. If, however, the office is determined to be an "agency," then it is grandfathered as such and the foreign bank may not expand its deposit-taking capabilities in California without declaring California its home State.

In the Board's view, it would be inconsistent with the purposes and the legislative history of the International Banking Act to enable a foreign bank to expand its domestic interstate deposit-taking capabilities by grandfathering these California offices as branches because of their ability to receive certain foreign source deposits. The Board also notes that such deposits are of the same general type that may be received by an Edge Corporation and, hence, in accordance with section 5(a) of the International Banking Act, by branches established and operated outside a foreign bank's home State. It would be inconsistent with the structure of the interstate banking provisions of the International Banking Act to grandfather as full deposit-taking offices those facilities whose activities have been determined by Congress to be appropriate for a foreign bank's out-of-home State branches.

Accordingly, the Board, in administering the interstate banking provisions of the IBA, regards as agencies those offices of foreign banks that do not accept domestic deposits but that may accept deposits from any person that resides, is domiciled, and maintains its principal place of business in a foreign country.

By order of the Board of Governors, October 2, 1980.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

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