

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **9262**]
[March 19, 1982]

AMENDMENT TO REGULATION K

Economic and Investment Management Services by Edge Corporations

*To All Member Banks, Edge and Agreement Corporations, and Bank Holding
Companies in the Second Federal Reserve District, and Others Concerned:*

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has announced the adoption of an amendment to its Regulation K permitting Edge Corporations to engage in the United States in certain economic and investment advisory and investment management services.

The Board acted after consideration of comment received on its proposal published in October 1981.

An Edge Corporation is a company authorized under provisions of the Federal Reserve Act to engage in international or foreign financial or banking activities and certain incidental activities. The Board's Regulation K specifies those activities conducted in the United States that will ordinarily be considered incidental to an Edge Corporation's international or foreign business.

The amendment adds to this list:

- 1) Investment or financial advice by providing portfolio investment advice and portfolio management with respect to securities, other financial instruments, real property interests and other investment assets.
- 2) General economic information and advice, general economic statistical forecasting services and industry studies.

Under the amendment, such services provided to U.S. customers must be in connection with foreign assets or foreign economies and industries.

Enclosed is a copy of the amendment, effective March 12, 1982. Questions thereon may be directed to our Foreign Banking Applications Department (Tel. No. 212-791-5878 or 5881).

ANTHONY M. SOLOMON,
President.

Board of Governors of the Federal Reserve System

INTERNATIONAL BANKING OPERATIONS

AMENDMENT TO REGULATION K

(effective March 12, 1982)

ECONOMIC AND INVESTMENT MANAGEMENT SERVICES

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board of Governors of the Federal Reserve System is amending Regulation K by adding a new activity to the list of activities permissible for Edge Corporations in the United States. The amendment would permit Edge Corporations to offer certain investment and economic advisory and investment management services in the United States to their foreign customers, and such advice with respect to foreign investments to their U.S. customers. This action is being taken in response to a request from a member bank.

EFFECTIVE DATE: March 12, 1982.

FOR FURTHER INFORMATION CONTACT: Henry Schiffman, Division of Banking Supervision and Regulation, (202) 452-2523, James Keller, Senior Attorney, (202) 452-3582, or Melanie Fein, Attorney, (202) 452-3594, Legal Division, Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: Section 25(a) of the Federal Reserve Act (the "Edge Act"), 12 U.S.C. 611 et seq., authorizes the organization of corporations ("Edge Corporations") for the purpose of engaging in international or foreign financial or banking operations. The Edge Act specifies certain powers and activities that are permissible for Edge Corporations and authorizes other activities that are incidental thereto. Section 211.4(e) of the Board's Regulation K, 12 C.F.R. § 211.4(e), lists activities that will ordinarily be considered incidental to an Edge Corporation's international or foreign business and may be conducted in the United States. These activities include certain foreign or internationally related deposit-taking, funding, and financing activities. Section 3(a) of the International Banking Act of 1978 ("IBA") (12 U.S.C. 611a note) states that it is the policy of Congress to eliminate restrictions that disadvantage or unnecessarily restrict Edge Corporations in competing with foreign-owned banking institutions in the United States or abroad, or impede the purposes of the Edge Act to foster United States international business activities.

For this Regulation to be complete retain:

- 1) Printed regulation pamphlet dated June 14, 1979.
- 2) Amendments dated November 28, 1979, October 2, 1980, November 13, 1980, January 3, 1981, March 16, 1981, and July 29, 1981.
- 3) This slip sheet.

The Board has been requested by Bank of America National Trust and Savings Association, San Francisco, California to include on the list of activities permissible in the United States for Edge Corporations certain investment and economic advisory and investment management services. These activities would include managing investment portfolios comprised of securities, other financial instruments, and real estate, on behalf of foreign persons. Bank of America states that the customers to whom the Edge Corporation would offer these services would be individuals residing outside the United States who visit the United States infrequently and are therefore unavailable for consultation on a continuing basis. Bank of America believes that such individuals desire to grant an Edge Corporation discretionary authority over their U.S. investments.

The Board published notice of a proposed rule to add this activity to Regulation K in the Federal Register of October 13, 1981 (46 Fed. Reg. 50,975). Interested persons were invited to comment specifically on (1) whether the proposed activity would enable Edge Corporations to compete effectively with foreign-owned institutions in a manner consistent with the IBA and (2) whether the provision of such services should be extended to U.S. customers with respect to foreign investments.

The Board received 34 comments on the proposal, all but two of which favored the proposal. Generally, those favoring the proposal believed that it would enhance competitive equality between domestic and foreign banks operating in the United States, consistent with the IBA, by enabling domestic banks to offer a broader range of financial services to foreign customers through their Edge Corporations. Currently, a U.S. bank wishing to offer fiduciary services in more than one state may do so only through a bank holding company, whereas a foreign bank competitor may offer such services outside its home state through grandfathered operations or through limited federal or state branches. Several commenters observed that the proposal was a logical extension of the fiduciary services already permitted under section 211.4(e)(4)(ix) of Regulation K, which authorizes Edge Corporations to "hold securities in safekeeping for, or buy and sell securities upon the order and for the account and risk of a person."

Several commenters thought that the proposal could be improved by broadening the list of investments that Edge Corporations would be permitted to manage to include oil and gas interests and gold and silver. One commenter recommended that the term "other assets" be added to the list of investments to allow a wider range of investment activities.

All twenty-four of the commenters addressing the issue favored extending investment advisory and management services to U.S. customers with respect to foreign investments.

Only two commenters opposed the proposal. Their objections were that the proposal would benefit large money center banking organizations at the expense of smaller regional organizations. The smaller organizations cannot provide the range of services that the larger organizations provide, the opponents argued, and will lose customers if the large competitors are permitted to offer these services through Edge Corporations.

Based on a review of the public comments and consideration of the issues raised by the proposed activity, the Board has determined that the services are incidental to the international business of an Edge Corporation and would further the purposes of the International Banking Act. The addition of investment advisory and portfolio management services to Regulation K would eliminate restrictions that unnecessarily inhibit Edge Corporations in competing with foreign-owned banking institutions in the United States and that impede the purposes of the Act to foster U.S. international business activities. Accordingly, the Board has determined to adopt the proposal. The Board believes that the same considerations support the provision of investment and economic advisory and investment management services to domestic customers with respect to foreign investments, and the Board also has determined to amend Regulation K to permit these activities.

In taking this action, the Board has used terminology similar to that contained in sections 225.4(a)(5)(iii) and (iv) of Regulation Y (12 C.F.R. § 225.4(a)(5)(iii) and (iv)), which authorizes bank holding companies to provide portfolio investment advice and furnish general economic advice. The Board believes that the Regulation Y terminology would make more certain the scope of the advice permitted. For example, Regulation Y distinguishes the provision of economic advice and industry studies from management consulting, which is not permitted. In addition, the Board has previously interpreted "portfolio investment advice" as including the power to determine what securities or other property shall be purchased and sold. Although the language of the amendment states that portfolio management is included in the activities being authorized, the Board does not intend by the use of this term to authorize management consulting, property management, land development or any other activity denied to section 4(c)(8) subsidiaries under the Bank Holding Company Act.

Use of the Regulation Y terminology also is responsive to comments citing the need to make explicit that real estate interests may be the subject of investment services. In addition, the Board has added "other investment assets" to the list of permissible investments to allow a wider range of normal investment alternatives. However, as in the case of section 4(c)(8) subsidiaries, the Board expects that in furnishing portfolio investment advice under this authorization, the Edge Corporation shall observe the standards of care and conduct applicable to fiduciaries.

Further, the Board expects any Edge Corporation engaging in this activity to adopt written policies and procedures suitable to its particular circumstances to ensure that any inside information in its possession obtained in connection with the commercial lending activities of the Edge Corporation or its bank and nonbank affiliates is not used for any recommendation or decision to purchase and sell securities for its investment advisory customers. See 64 Federal Reserve Bulletin 339 (1978).

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. No. 96-354; 5 U.S.C. 601 et seq.), the Board of Governors of the Federal Reserve System certifies that the proposed amendment, if adopted, will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation. The proposed amendment would liberalize the existing regulations and does not have any particular effect on small entities.

Accordingly, pursuant to its authority under section 25(a) of the Federal Reserve Act, 12 U.S.C. 615, the Board of Governors of the Federal Reserve System amends 12 C.F.R. Part 211 as follows:

1. The authority citation for Part 211 reads as follows:

Authority. Federal Reserve Act (12 U.S.C. 221 et seq.); the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.); and the International Banking Act of 1978 (Pub. L. 95-369; 92 Stat. 607; 12 U.S.C. 3101).

2. Section 211.4 is amended as follows:

Section 211.4(e)(4)(xii): delete the "and" at the end of the paragraph.

Section 211.4(e)(4)(xiii): change the period (".") at the end of the paragraph to a semi-colon (";").

3. Section 211.4 is amended by adding the following:

§ 211.4 -- Edge and Agreement Corporations

* * * * *

(e) * * *

(4) * * *

(xiv) act as investment or financial adviser by providing portfolio investment advice and portfolio management with respect to securities, other financial instruments, real property interests and other investment assets, ^{1/} provided such services for U.S. persons shall be with respect to foreign assets only; and

(xv) provide general economic information and advice, general economic statistical forecasting services and industry studies, provided such services for U.S. persons shall be with respect to foreign economies and industries only.

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By order of the Board of Governors of the Federal Reserve System, March 12, 1982.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

1/ For purposes of this section, management of an investment portfolio does not include operational management of real property, industrial and commercial assets.

[SEAL]