

**FEDERAL RESERVE BANK
OF NEW YORK**

Circular No. 9519
July 1, 1983

BANKERS' ACCEPTANCES

— Reservability of Ineligible Acceptances

— Application of Bank Export Services Act to Eligible Acceptances

— Proposed Definition of Participations in Acceptances

*To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:*

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

The Federal Reserve Board took two final actions and issued a new proposal for comment in connection with bankers' acceptances. One of the final actions was an amendment to Regulation D, dealing with the reservability of ineligible acceptances. The other final action and the draft regulation issued for comment related to bankers' acceptances under the Bank Export Services Act (BESA).

Adoption of the final rules follows consideration of comment received on proposals published in February.

Regulation D now applies reserve requirements to ineligible* acceptances only when the creating institution itself discounts and sells the acceptance. Under the amendment to Regulation D adopted in final form by the Board:

- An ineligible bankers' acceptance not held in portfolio by the creating bank will be treated as a reservable deposit regardless of whether the depository institution that created the ineligible bankers' acceptance, or another, subsequently discounts and sells it.

The Board took this action in order to prevent the use of so called "agented" acceptance arrangements with third parties from being used as a device to avoid reserve requirements.

The Bank Export Services Act raised the limits on the aggregate amount of eligible* bankers' acceptances that may be granted by an individual member bank from 50 percent of the bank's capital stock and surplus (100 percent with the permission of the Board) to 150 percent of the bank's capital (200 percent with the permission of the Board). The Act also applied these limits to U.S. branches and agencies of foreign banks where the parent bank has, or is controlled by a company or companies with, over \$1 billion consolidated bank assets worldwide. These limits do not apply to nonmember banks.

The BESA also provided that any portion of an eligible bankers' acceptance created by a member bank or by a U.S. branch or agency of a foreign bank covered by the BESA that is sold through a participation agreement to another covered bank† should not be included in the calculation of the creating bank's limits on bankers' acceptances. Instead, the amount of the participation in the acceptance is to be applied to the limitations applicable to the covered bank that purchased the participation. The BESA also provided that eligible bankers' acceptances growing out of domestic transactions are not to exceed 50 percent of the aggregate of all acceptances authorized for a covered bank.

* "Eligible" bankers' acceptances are not subject to Federal reserve requirements. They must meet criteria in Section 13 of the Federal Reserve Act including requirements that the acceptance (1) grows out of a trade transaction involving exporting, importing or domestic shipment of goods or storage of readily marketable staples and (2) has a maturity of less than six months. "Ineligible" acceptances are those not meeting these requirements.

† "Covered banks" — those subject in BESA to quantitative limits on eligible acceptances — are member banks and U.S. branches and agencies of foreign banks whose parent foreign bank has or is controlled by a foreign company that has worldwide consolidated bank assets of \$1 billion or more. All other institutions — "non-covered" banks — are not subject to BESA quantitative limits on eligible acceptances.

In the other final rule issued today, the Board clarified that:

- Eligible acceptances created by covered banks and sold through participations to *non-covered banks* (including Edge and Agreement corporations) are subject to the quantitative limitations of the selling covered banks; and
- Eligible acceptances created by *non-covered banks* (including Edges) sold through participation agreements to covered banks are included in the quantitative limitations applicable to the purchasing covered banks.
- The parent of U.S. offices of foreign banks is defined as the institution that owns the U.S. branch or agency "most directly" and the capital of the parent is defined in accordance with procedures currently used for reporting to the Board on F.R. Y-7.
- The 50 percent limitation on eligible acceptances growing out of domestic transactions is applied to the maximum permissible amount of eligible acceptances that a covered bank could create, not just of outstandings.

In addition to these final rules, the Board issued for comment a proposed definition of participations in acceptances that would be eligible for the BESA acceptance limitations covered in the final rule just issued. Under this proposal, such a participation would have to meet certain minimum requirements, which are consistent with the Act and the legislative history, including a written agreement between the bank acquiring the participation (junior bank) and the accepting bank conveying the participation (senior bank) under which:

1. The junior bank acquires the senior bank's claim against the account party to the extent of the amount of the participation that is enforceable in the event that the account party fails to perform in accordance with the terms of the acceptance; and
2. The senior bank obtains a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

The Board requested comment by August 5, 1983.

Enclosed is the text of (a) an amendment, effective June 20, 1983, to Regulation D, on the application of reserve requirements to ineligible acceptances, and (b) an interpretation, effective July 20, 1983, on the application of the BESA to eligible acceptances. In addition, printed on the following pages is the text of the Board's proposed interpretation to clarify the meaning of participations in bankers' acceptances for purposes of the bankers' acceptance limitations of the BESA. Comments on the proposal should be submitted by August 5, 1983 and may be sent to our Regulations Division.

ANTHONY M. SOLOMON,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 250

[Docket No. R-0474]

Miscellaneous Interpretations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rulemaking.

SUMMARY: The Board is proposing to clarify the meaning of participations in bankers' acceptances for purposes of the bankers' acceptance limitations of the Bank Export Services Act.

DATES: Comments must be received by August 5, 1983.

ADDRESS: Interested parties are invited to submit written data, views, or arguments concerning the proposed rule to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, D.C. 20551, or such comments may be delivered to room B-2223 between 8:45 a.m. and 5:15 p.m. Comments may be inspected in room B-1122 between 8:45 a.m. and 5:15 p.m., except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information (12 CFR 261.6(a)).

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625), or Robert G. Ballen, Attorney (202/452-3265), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Section 207 of the Bank Export Services Act (Title II of Pub. L. 97-290) ("BESA") provides that a member bank or a Federal or State branch or agency in the United States whose parent foreign bank has, or is controlled by a foreign company or companies that have, more than \$1 billion in total worldwide consolidated bank assets, may create eligible bankers' acceptances ("BAs")¹ in the aggregate up to 150 percent of its paid up and unimpaired capital stock and surplus and, with the permission of the Board, up to 200 percent of its paid up and unimpaired capital stock and surplus ("capital") (12 U.S.C. 372). Section 207 also prohibits these institutions from creating eligible BAs for any one person in the aggregate in

excess of 10-percent of the institution's capital. Eligible BAs growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for such an institution.

This section of the BESA also provides that any portion of an eligible BA created by an institution subject to the bankers' acceptance limits contained therein ("covered bank") that is conveyed through a participation to another covered bank shall not be included in the calculation of the creating bank's BESA limits. However, the amount of the participation is to be applied to the BA limits applicable to the covered bank receiving the participation.

The language of the statute does not define what constitutes such a participation for purposes of the applicability of the BESA limitations. However, the statute does authorize the Federal Reserve Board to further define any of the terms used in section 207 of the BESA (12 U.S.C. 372(7)(G)). In addition, the legislative history of this statute indicates that Congress took note of and encouraged a then ongoing analysis by the Federal Financial Institutions Examination Council ("Council") on participations in BAs and required the Council to report to the appropriate congressional committees. H. Rep. No. 97-924, 97th Cong., 2nd Sess. 25 (1982). In its report to Congress of March 25, 1983, the Council stated that it was not addressing the matter of the definition of a participation in eligible BAs for purposes of determining compliance with the BESA limits because the statute specifically granted the Board the authority to define further any of the terms used in section 207.

The Board is proposing for public comment a clarification of the meaning of participations in BAs for purposes of the BESA limitations. The proposed interpretation describes the minimum requirements that such a participation would have to meet if the eligible BA (or portion thereof) that the participation conveys is to be excluded from the BA limitations applicable to the bank creating the BA. Commenters may wish to address whether the Board should impose additional minimum requirements upon such participations—in addition to commenting on other aspects of the proposals.

The impact of this proposal on small entities had been considered in accordance with section 603 of the

Regulatory Flexibility Act (Pub. L. 96-354; 5 U.S.C. 603). The Board's proposal will provide small member banks that are covered by the BESA limitations with increased flexibility with regard to the usage of eligible BAs. No new recordkeeping or reporting requirements will be imposed as a result of this action.

List of Subjects in 12 CFR Part 250 Federal Reserve System.

PART 250—[AMENDED]

Pursuant to its authority under the seventh paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 372), the Board of Governors proposes to amend 12 CFR Part 250—Miscellaneous Interpretations—by adding a new § 250.165 to read as follows:

§ 250.165 Bankers' acceptances: definition of participations.

(a)(1) Section 207 of the Bank Export Services Act (Title II of Pub. L. 97-290) ("BESA") raised the limits on the aggregate amount of eligible bankers' acceptances ("BAs") that may be created by a member bank from 50 percent (or 100 percent with the permission of the Board) of its paid up and unimpaired capital stock and surplus ("capital") to 150 percent (or 200 percent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 percent of the institution's capital. Eligible BAs growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for a member bank. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).

(2) This section of the BESA also provides that any portion of an eligible BA created by an institution subject to the BA limitations contained therein ("covered bank") that is conveyed through a participation to another covered bank shall not be included in the calculation of the creating bank's limits. The amount of the participation is subject to the BA limitations applicable to the covered bank purchasing the participation. The language of the statute does not define what constitutes such a participation. However, the statute does authorize the Board to

¹ An eligible BA is a BA that meets the criteria of the seventh paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 372).

further define any of the terms used in section 207. The Board is clarifying the term participation for purposes of the BA limitations of the BESA.

(b) The legislative history of section 207 of the BESA indicates that Congress intended that the bank receiving the participation ("junior bank") be obligated to the creating bank conveying the participation ("senior bank") in the event that the account party defaults on its obligation to pay, but that the junior bank need not also be obligated to pay the holder of the acceptance at the time the BA is presented for payment. H. Rep. No. 97-629, 97th Cong., 2nd Sess. 15 (1982); 128 Cong. Rec. H 4647 (daily ed. July 27, 1982) (remarks by Rep. Barnard); and 128 Cong. Rec. H 8462 (daily ed. October 1, 1982) (remarks by Rep. Barnard). The legislative history also indicates that Congress intended that eligible BAs in which participations had been conveyed not be required to indicate the name(s) (or interest(s)) of the junior bank(s) on the acceptance in order for the BA to be excluded from the BESA limitations applicable to the senior bank. 128 Cong. Rec. S 12237 (daily ed. September 24, 1982) (remarks of Senators Heinz and Garn); and 128 Cong. Rec. H 4647 (daily ed. July 27, 1982) (remarks of Rep. Barnard).

(c)(1) In view of Congressional intent with regard to what constitutes a participation in an eligible BA, the Board has determined that, for purposes of the BESA limits, a participation must satisfy the following two *minimum* requirements:

(i) A written agreement entered into between the junior and senior bank

under which the junior bank acquires the senior bank's claim against the account party to the extent of the amount of the participation that is enforceable in the event that the account party fails to perform in accordance with the terms of the acceptance. The agreement between the senior bank and the account party must indicate that the rights that the senior bank acquires under the agreement are assignable by the senior bank, and

(ii) The agreement between the junior and senior bank provides that the senior bank obtains a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(2) An eligible BA that is conveyed through a participation that does not satisfy these minimum requirements would continue to be included in the BA limits applicable to the senior bank. Further, an eligible BA conveyed to a covered bank through a participation that provided for additional rights and obligations among the parties would be excluded from the BESA limitations of the senior bank provided the minimum requirements were satisfied.

(3) A participation structured pursuant to these minimum requirements would be as follows: Upon the conveyance of the participation, the senior bank retains its entire obligation to pay the holder of the BA at maturity. The senior bank has a claim against the junior bank to the extent of the amount of the participation

that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance. Similarly, the junior bank has a corresponding claim against the account party to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(d) The Board stressed that both the junior bank's claim on the account party and the senior bank's claim on the junior bank involve risk. Therefore, it is essential that these risks be assessed by the banks involved in accordance with high credit standards. The junior bank should review the creditworthiness of each account party on a case-by-case basis before it acquires a participation and the senior bank should review the creditworthiness of the junior bank. The examiners will ensure that these creditworthiness reviews are appropriately effected. Similarly, the Board has determined that it is appropriate that the actual assets acquired be included for purposes of assessing capital adequacy and determining compliance with capital guidelines.

(e) The Board believes that these minimum requirements reflect the nature of the relationships involved. This treatment of participations in eligible BAs is analogous to the treatment of participations in the context of loans and is consistent with safety and soundness considerations.

FEDERAL RESERVE SYSTEM

REGULATION D

12 CFR Part 204

[Docket No. R-0451]

RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

Ineligible Bankers' Acceptances

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has amended Regulation D--Reserve Requirements of Depository Institutions (12 CFR Part 204)--to apply reserve requirements to bankers' acceptances ("BAs") that do not meet the criteria of section 13 of the Federal Reserve Act ("ineligible BAs") regardless of whether the instrument is discounted and resold by the depository institution that created it. Previously, an ineligible acceptance was regarded as reservable only if the institution that created it also discounted and resold it. The purpose of this amendment is to prevent the avoidance of reserve requirements through the use of third parties that would discount and resell an ineligible acceptance created by a depository institution.

EFFECTIVE DATE: June 20, 1983.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625); or Robert G. Ballen, Attorney (202/452-3265), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Section 19(a) of the Federal Reserve Act authorizes the Board to determine what types of obligations are reservable deposits (12 USC § 461(a)). In addition, section 19(a) grants the Board authority to prescribe regulations necessary to prevent evasions of reserve requirements.

Agented ineligible BAs. Regulation D previously regarded an ineligible BA as a reservable liability only if it was created, discounted, and sold by the same depository institution. Some banks have recently entered into arrangements with brokers and other third parties that provide

For this Regulation to be complete, retain:

- 1) Regulation D pamphlet, amended effective December 31, 1981.
- 2) Amendments effective April 28, 1982, April 29, 1982, September 1, 1982, October 28, 1982, December 9, 1982, December 14, 1982, December 30, 1982, December 31, 1982, January 5, 1983, January 13, 1983, March 31, 1983, April 28, 1983, and February 2, 1984.
- 3) This slip sheet.

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for the creation of an ineligible BA by the bank and the subsequent discount and resale by the third party. Since the bank creating the BA did not discount and resell the acceptance, it previously was not required to maintain reserves against the BA. Similarly, if the third party that discounted and resold the BA pursuant to such an arrangement was a depository institution, it would not be subject to reserve requirements on the transaction since it did not create the BA.

The Board's proposal. The Board believed these arrangements serve only as a device to avoid reserve requirements under Regulation D. Accordingly, the Board proposed to amend Regulation D such that the creation of an ineligible BA that is outstanding results in a reservable deposit regardless of whether the depository institution that creates the BA subsequently discounts and sells it. 48 F.R. 5750 (Feb. 8, 1983). The Board specifically requested comment on whether reserve requirements should be applied only to agented BA transactions and how such agented arrangements could be identified. The Board also proposed that the amendment apply to outstanding ineligible BAs that were created after the announcement of the proposed amendment.

Discussion of comments. The Board received a total of 24 comments. Thirteen of the commenters favored the Board's proposal, ten commenters opposed the proposal, and one commenter expressed no opinion. The principal reason these commenters cited for supporting the proposal was the need to eliminate a "loophole" through which reserve requirements could be avoided.

Commenters opposed to the proposal gave the following reasons for their opposition: agented ineligible BAs offer a flexible and cost effective means by which depository institutions can respond to the short term credit needs of their customers (such as small businesses) and compete with the commercial paper market and with foreign banks in the international market; ineligible agented BAs do not threaten the safety and soundness of depository institutions because of the applicability of lending limits; the proposal will not enhance monetary policy objectives; and agented ineligible BAs afford the depository institution creating the BA an opportunity for fee income with no funding risk to the institution.

Four of the commenters suggested that if the proposal is adopted, it should not apply to all ineligible BAs, but only to certain agented ineligible BAs. However, none of the commenters indicated how an ineligible BA transaction subject to the proposal could be identified from an ineligible BA transaction not subject to the proposal. Indeed, two

commenters in favor of the proposal specifically recognized that where the discounter or seller of a BA was different from the depository institution that created the BA, the Board would be unable to determine whether the discounting and sale occurred pursuant to a prearranged agented BA transaction.

Finally, five commenters stated that applying a final rule to outstanding ineligible BAs created after the announcement of the Board's proposal was inequitable because depository institutions could not discontinue the practice of agented ineligible BAs on such short notice and imposing reserve requirements on such agented ineligible BAs would have a ripple effect on the depository institution's business beyond the agented ineligible BAs it had outstanding.

After consideration of the issues raised by the commenters, the Board has determined to amend Regulation D such that an outstanding ineligible BA would be treated as a reservable liability regardless of whether the depository institution that created the ineligible BA subsequently discounts and sells it. Reserve requirements would not apply to an ineligible BA that the creating institution itself discounts and holds since, under current practices, such acceptances are not regarded as acceptances outstanding.

Application of reserve requirements to ineligible BAs that the creating bank does not also discount and sell will, as the commenters assert, raise the cost of this type of financing. However, since agented BAs are essentially identical to other ineligible BA transactions that are subject to reserve requirements, the Board has determined that agented ineligible BAs should also be subject to reserve requirements. In both transactions, the creating bank has the same obligation to pay the holder the face amount of the instrument at maturity. The account party (borrower) has the same obligation to pay the creating bank at maturity, and the beneficiary of the draft has received funds as soon as the BA is discounted (by the creating bank in the nonagented case and by the third party in the agented case). The third party, not a participant in the nonagented transaction, generally has exchanged assets (cash for the BA) by reselling the BA in the secondary market and has merely accommodated the creating bank (most likely for a fee) in providing proceeds from the sale of the BA to the beneficiary of the draft. Accordingly, the only purpose of structuring the transaction as an agented BA appears to be to avoid reserve requirements.

Since ineligible acceptances are regarded as close substitutes to bank CDs by investors and since the commercial activities that can be financed by ineligible acceptances are virtually indistinguishable from those financed by bank CDs, if

described in section 204.2(a)(1)(vii) that is issued to, or any bankers' acceptance of the depository institution held by, any office located outside the United States of another depository institution or Edge or agreement corporation organized under the laws of the United States, to any office located outside the United States of a foreign bank, or to institutions whose time deposits are exempt from interest rate limitations under section 217.3(g) of Regulation Q (12 CFR 217.3(g)).

* * * * *

By order of the Board of Governors, June 20, 1983.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

agented ineligible acceptances were not reservable, control over bank managed liabilities and credit may well be loosened.

Agented ineligible BAs are not a riskless source of fee income for the depository institution creating the BA as suggested by some of the commenters. By creating a BA, the creating bank incurs an obligation to pay the holder the amount of the BA at maturity and acquires a corresponding claim against the account party. Thus, the creating bank assumes the risk of default of the account party. Further, there is no Federal limitation on the aggregate amount of agented ineligible BAs a depository institution may create.

The amendment makes reservable all ineligible BAs outstanding (that are not held in portfolio by the creating bank), regardless of whether the third party discount and sale occurred pursuant to a prearranged agented BA transaction. No commenter indicated how agented arrangements could be identified. The Board believes that where the discounter or seller of a BA is different from the depository institution that created the BA, it will in many cases be difficult, if not impossible, to determine whether the discounting and sale of the BA has occurred pursuant to a prearranged agented BA transaction. Indeed, it is unlikely that a bank would create a BA and not be indirectly or directly involved in some way with its subsequent discount or resale.

The Board believes that good cause exists to make this amendment effective immediately. Such an action will minimize any market distortions that would likely result if the amendment did not apply to ineligible BAs issued for a period of time after adoption of the final rule. In addition, the Board's prior February announcement proposing the amendment put depository institutions on notice that the amendment would apply to outstanding ineligible BAs created after adoption of the final rule. However, in view of the concerns raised by the commenters regarding applying this amendment to outstanding ineligible BAs created after the announcement of the Board's proposal on February 1, 1983, but before final adoption of the rule, the Board has determined not to apply this amendment retroactively.

The impact of this proposal on small entities has been considered in accordance with section 604 of the Regulatory Flexibility Act (Pub. L. 96-354; 5 USC § 604). Section 411 of the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97-320; 96 Stat. 1520) provides for an exemption from reserve requirements for the first \$2.1 million in reservable liabilities at all depository institutions. The Board believes that its action would not add any reserve requirement burden to small depository institutions that have zero reserve

requirements as a result of section 411 of the Garn-St Germain Act. In addition, small entities typically do not issue ineligible BAs. No new recordkeeping or reporting requirements will be imposed as a result of this action.

List of Subjects in 12 CFR Part 204

Banks, banking; Currency; Federal Reserve System; Penalties; Reporting Requirements.

Pursuant to its authority under section 19(a) of the Federal Reserve Act (12 USC § 461(a)), the Board amends section 204.2 of Regulation D (12 CFR Part 204), effective June 20, 1983, by adding a new subparagraph (a)(1)(viii) and by revising (c)(1)(ii) and (f)(1)(v) as follows:

SECTION 204.2 -- DEFINITIONS

* * * * *

(a)(1) * * *

(viii) any liability of a depository institution that arises from the creation after June 20, 1983, of a bankers' acceptance that is not of the type described in paragraph 7 of section 13 of the Federal Reserve Act (12 U.S.C. 372) except any such liability held for the account of an entity specified in § 204.2(a)(1)(vii)(A); or

* * * * *

(c)(1) * * *

(ii) borrowings, regardless of maturity, represented by a promissory note, an acknowledgement of advance, or similar obligation described in section 204.2(a)(1)(vii) that is issued to, or any bankers' acceptance of the depository institution held by, any office located outside the United States of another depository institution or Edge or agreement corporation organized under the laws of the United States, to any office located outside the United States of a foreign bank, or to institutions whose time deposits are exempt from interest rate limitations under section 217.3(g) of Regulation Q (12 CFR 217.3(g)); and

* * * * *

(f)(1) * * *

(v) a time deposit represented by a promissory note, an acknowledgement of advance, or a similar obligation

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

APPLICATION OF BANK EXPORT SERVICES ACT TO ELIGIBLE BANKERS' ACCEPTANCES

(effective July 20, 1983)

FEDERAL RESERVE SYSTEM 12 CFR Part 250

[Docket No. R-0453]

Miscellaneous Interpretations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has clarified the meaning of the seventh paragraph of section 13 of the Federal Reserve Act as amended by the Bank Export Services Act (Title II of Pub. L. 97-290) ("BESA"). This clarification covers the treatment of (1) participations in BAs that are created by institutions subject to such limitations of the BESA and sold to institutions not subject to such limitations, (2) participations in BAs that are created by institutions not subject to the limitations of the BESA and sold to institutions subject to such limitations, (3) the limitation on BAs growing out of domestic transactions, and (4) the dollar equivalent of the paid up capital and surplus of the foreign bank parent of U.S. branches and agencies subject to the limitations of the BESA.

EFFECTIVE DATE: July 20, 1983.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625), or Robert G. Ballen, Attorney (202/452-3265), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: The BESA

Section 207 of the BESA provides that a member bank or a Federal or State branch or agency in the United States whose parent foreign bank has, or is controlled by a foreign company or companies that have, more than \$1 billion in total worldwide consolidated bank assets, may create eligible bankers' acceptances ("BAs")¹ in the aggregate up to 150 per cent of its paid up and unimpaired capital stock and surplus ("capital") and, with the permission of the Board, up to 200 per cent of its capital (12 U.S.C. 372). Section 207 also prohibits these institutions ("covered banks") from creating eligible BAs for any one person in the aggregate in excess of 10 per cent of the institution's capital. Eligible BAs growing out of domestic transactions may not exceed 50 per cent of the aggregate of all acceptances authorized for a covered bank.

Section 207 of the BESA also provides that any portion of an eligible BA created by a covered bank that is conveyed through a participation to another covered bank shall not be included in the calculation of the individual creating bank's BA limits. However, the amount of the participation is to be applied to the BA limits applicable to the covered bank receiving the participation.

¹ An eligible BA is a BA that meets the criteria of the seventh paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 372).

For purposes of determining the BA limits applicable to U.S. branches and agencies of foreign banks, the statute provides that a branch's or agency's capital is to be calculated as the dollar equivalent of the capital of the parent foreign bank as determined by the Federal Reserve.

The Board's proposed interpretation.

The Board proposed for public comment in February a clarification of the meaning of the seventh paragraph of section 13 of the Federal Reserve Act, as amended by section 207 of the BESA. 48 FR 5570 (Feb. 7, 1983). Under the proposal, an eligible BA created by a covered bank that is conveyed through a participation to an institution that is not subject to the limitations of BESA would continue to be included in the limitations applicable to the creating covered bank. The Board proposed that since Edge Corporations, like covered banks, are subject to separate per customer and aggregate BA limits, an eligible BA created by a covered bank that is conveyed through a participation to an Edge Corporation would be included in the calculation of the limits applicable to the Edge Corporation and not in the calculation of the limits applicable to the creating covered bank. In addition, under the proposal, a participation conveyed to a covered bank from an institution not covered by the limitations of the BESA would be included in the calculation of the limits applicable to the receiving covered bank.

As to the application of the BESA

limitations to U.S. branches and agencies of foreign banks, the Board proposed that the parent of a U.S. branch or agency of a foreign bank be the same as for reserve requirement purposes; that is the bank entity that owns the branch or agency most directly. The procedures currently used for purposes of reporting to the Board on the Annual Report of Foreign Banking Organizations, Form F.R. Y-7, were proposed to be used in the calculation of the BA limits applicable to U.S. branches and agencies of foreign banks. (The F.R. Y-7 generally requires financial statements prepared in accordance with local accounting practices and an explanation of the accounting terminology and the major features of the accounting standards.) Conversions to the dollar equivalent of the worldwide capital of the foreign bank would be made periodically.

Finally, the Board proposed that the 50 per cent limitation on eligible BAs that grow out of domestic transactions apply to the maximum permissible amount of eligible BAs (150 to 200 per cent of capital) that a covered bank could issue, regardless of the bank's amount of eligible BAs outstanding.

Discussion of Comments

The Board received a total of 29 comments. Comments were received from 14 depository institutions, 11 Reserve Banks, the Institute of Foreign Bankers, the American Bankers Association, the California Bankers Association, and the Bankers' Association for Foreign Trade. The commenters generally supported the Board's proposals.

Ten commenters suggested that an eligible BA created by a covered bank that is conveyed through a participation to an institution *not* subject to the limitations of the BESA should *not* be included in the calculation of the limits of the creating covered bank. These commenters argued that the Board's proposal to include such BAs in the creating covered bank's BA limits was not in accord with the purpose of the BESA to provide smaller banks with more flexibility in providing acceptance financing and restricted otherwise desirable efforts of covered banks to use participations in BAs to diversify risk.

After consideration of the comments, the Board continues to believe that the BESA permits a covered bank to exclude an eligible BA it has created from its BA limits if the BA is conveyed through a participation *only* to another

covered bank.³ This ensures that the total amount of eligible BAs that may be created by *all* covered banks does not exceed the limits established by Congress—150 or 200 per cent of the capital of all covered banks.⁴ To conclude otherwise would permit covered banks to create eligible BAs without limit by selling participations to institutions not covered by the Act. In addition, this promotes the Congressional intent, at least with respect to covered banks, to "place all banks, foreign and domestic, on an equal footing and under the same legal requirements."⁵ To conclude otherwise would provide an advantage to foreign banks by permitting covered banks to convey participations to foreign banks without limit while conveyance of participations to domestic covered banks would be limited to 150 or 200 per cent of the capital of the recipient domestic bank. Finally, this provision ensures that participations in eligible acceptances are not used as a device for avoidance of reserve requirements. To conclude otherwise would permit covered banks to avoid reserve requirements by creating an unlimited amount of reserve-free obligations by conveying participations in eligible BAs to institutions not covered by the Act.

In this regard, the Board also has determined that an eligible BA created by a covered bank that is conveyed through a participation to an Edge or Agreement Corporation should continue to be included in the calculation of the creating covered bank's BA limits, even though Edge and Agreement Corporations are subject to separate aggregate and per customer BA limits. First, Edge and Agreement Corporations are not specifically included within the BESA definition of a covered bank.

Second, if an eligible BA created by a covered bank that is conveyed through a participation to an Edge or Agreement Corporation is excluded from the

calculation of the creating covered bank's BA limits, it would seem to follow, as suggested by several of the commenters, that an eligible BA created by a covered bank that is conveyed through a participation to other institutions that are not covered banks under BESA but are otherwise subject to other BA limits should also be excluded from the calculation of the creating covered bank's BA limits. This would expand the exception to state nonmember depository institutions subject to BA limits pursuant to state law, certain U.S. branches and agencies of foreign banks whose foreign bank parent has less than \$1 billion in total worldwide-consolidated bank assets,⁶ and perhaps other institutions such as foreign banks or domestic nonmember banks that voluntarily adopt appropriate BA limits. Such a result could undermine the BA limitations established by Congress and provide a device for avoidance of reserve requirements as discussed above. Finally, there is no evidence to suggest that Edge or Agreement Corporations are having difficulty creating their own BAs.⁷ The BAs of these institutions generally are marketable on the strength of the name of their bank parent. Thus, special treatment of Edge or Agreement Corporations in this regard would not appear to further significantly the access of these institutions to acceptance financing, which was a primary purpose of BESA.

Eight of the twelve commenters that specifically commented upon the Board's proposal regarding the application of the BESA limits to U.S. branches and agencies supported the Board's proposal in its entirety.

³ Federal branches and agencies of foreign banks whose parent has less than \$1 billion in total worldwide consolidated bank assets are subject to the BA limitations of BESA pursuant to an interpretation of the Comptroller of the Currency (12 CFR 28.101(5)). State branches and agencies of foreign banks whose parent has less than \$1 billion in total worldwide consolidated bank assets may be subject to comparable limits under state law.

⁴ In this regard, an eligible BA that is created by an Edge or Agreement Corporation is not included in the BA limitations applicable to the Edge or Agreement Corporation if (1) the BA represents the international shipment of goods, and (2) the Edge or Agreement Corporation is fully covered by primary obligations to reimburse it that are also guaranteed by another bank or the Edge or Agreement Corporation has sold a participation to another bank. (12 CFR 211.6(a)). Under the Board's proposal, such a participation received by a covered bank would be included in the calculation of the covered bank's BA limits. A guarantee issued by a covered bank also would be included in the calculation of the BA limits of the covered bank.

⁵ Specifically, section 207 of the BESA states that, "with respect to an institution which issues an acceptance, the limitations contained in this paragraph shall not apply to that portion of an acceptance which is issued by such institution and which is covered by a participation agreement sold to another institution" (emphasis added). The term "institution" is defined in the section as [a]ny member bank and any Federal or State branch or agency of a foreign bank subject to reserve requirements under section 7 of the International Banking Act of 1978."

⁶ 12 U.S.C. 372(7) (A), (B), (C), and (F).

⁷ 128 Cong. Rec. H4647 (daily ed. July 27, 1982) (remarks of Rep. Barnard); 128 Cong. Rec. H4661 (daily ed. October 1, 1982) (remarks of Rep. Barnard).

However, two commenters suggested alternatives to the Board's proposed approach of calculating the foreign bank capital by using the same procedures as are currently used for purposes of reporting to the Board on the Annual Report of Foreign Banking Organizations, Form F.R. Y-7. (The F.R. Y-7 generally requires financial statements prepared in accordance with local accounting practices and an explanation of the accounting terminology and the major features of the accounting standards used in the preparation of the financial statements) One commenter suggested that the Board reference its determinations as to what constitutes member bank capital and specifically advise foreign banks as to which accounts may be used for purposes of the capital calculation. Another commenter suggested that the Board's capital computation include all those items of capital and surplus that any foreign bank would be permitted to include for purposes of lending limit computations in its home country.

After consideration of the comments, the Board has determined to adopt its proposed approach of calculating foreign bank capital using the same procedures as are currently used for purposes of reporting to the Board on the F.R. Y-7. The Board believes the first alternative of specifying the accounts to be included is too inflexible and complicated in view of the differences in the treatment of capital among countries. The second alternative of using the same definition that applies to the determination of local lending limits is similar to the approach proposed by the Board in that they both recognize the variations in the treatment of capital among countries. In view of the experience the Board has had in determining the capital of foreign parent banks based upon the F.R. Y-7 approach, the Board determined to adopt the proposed approach.

Three commenters disagreed with the proposed manner in which the effect of foreign exchange rate fluctuations would be taken into account in the calculation of the worldwide capital of the parent foreign bank. While these commenters indicated that they appreciated the Board's concern with the problem of foreign exchange fluctuations, these commenters preferred a rule (such as quarterly conversion to dollars) rather than the flexible case-by-case approach proposed by the Board. To

accommodate the concerns of these commenters, the Board has determined that such conversions to the dollar equivalent of the worldwide capital of the foreign bank be made periodically, but in no event less frequently than quarterly.

Two commenters indicated that it may be difficult to determine the compliance of U.S. branches and agencies of the same foreign bank where the branches and agencies are located in more than one state. (The BESA requires that the BA activity of all branches and agencies of the same foreign bank be aggregated.) Accordingly, the Board has determined that each foreign bank is to be responsible for coordinating the BA activity of its U.S. branches and agencies (including the aggregation of such activity) and establish procedures that ensure that examiners will be able to determine compliance with the BESA limits.

With respect to the limitation on eligible BAs growing out of domestic transactions, all eight commenters that commented specifically on this aspect of the proposal supported the Board's proposal that this 50 per cent limitation apply to the maximum permissible amount of eligible BAs (150 or 200 per cent of capital), regardless of the bank's amount of eligible acceptances outstanding. Accordingly, the Board has adopted its proposal with regard to the BESA limitation on eligible BAs growing out of domestic transactions.

The impact of this proposal on small entities has been considered in accordance with section 604 of the Regulatory Flexibility Act (Pub. L. 96-354; 5 U.S.C. 604). The Board's clarification will provide small member banks that are covered by the BESA limitations with increased flexibility with regard to the usage of eligible BAs. No new recordkeeping or reporting requirements will be imposed as a result of this action.

List of Subjects in 12 CFR Part 250

Federal Reserve System.

Pursuant to its authority under the seventh paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 372), the Board of Governors amends 12 CFR Part 250—Miscellaneous Interpretations, effective July 20, 1983, by adding a new section 250.164 to read as follows:

§ 250.164 Bankers' acceptances.

(a) Section 207 of the Bank Export Services Act (Title II of Pub. L. 97-290) ("BESA") raised the limits on the

aggregate amount of eligible bankers' acceptances ("BAs") that may be created by an individual member bank from 50 per cent (or 100 per cent with the permission of the Board) of its paid up and unimpaired capital stock and surplus ("capital") to 150 per cent (or 200 per cent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 per cent of the institution's capital. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105). The Board is clarifying the proper meaning of the seventh paragraph of section 13 of the Federal Reserve Act, as amended by the BESA.

(b)(1) This section of the BESA provides that any portion of an eligible BA created by an institution subject to the BA limitations contained therein ("covered bank") that is conveyed through a participation to another covered bank shall not be included in the calculation of the creating bank's BA limits. The amount of the participation is to be applied to the calculation of the BA limits applicable to the covered bank receiving the participation. Although a covered bank that has reached its 150 or 200 percent limit can continue to create eligible acceptances by conveying participations to other covered banks, Congress has in effect imposed an aggregate limit on the eligible acceptances that may be created by *all* covered banks equal to the sum of 150 or 200 percent of the capital of all covered banks.

(2) The Board has clarified that under the statute an eligible BA created by a covered bank that is conveyed through a participation to an institution that is *not* subject to the limitations of this section of the BESA continues to be included in the calculation of the limits applicable to the creating covered bank. This will ensure that the total amount of eligible BAs that may be created by covered banks does not exceed the limitations established by Congress. In addition, this ensures that participations in acceptances are not used as a device for the avoidance of reserve requirements. Finally, this promotes the Congressional intent, with respect to covered banks, that foreign and domestic banks be on

an equal footing and under the same legal requirements.

(3) In addition, the amount of a participation received by a covered bank from an institution not covered by the limitations of the Act is to be included in the calculation of the limits applicable to the covered bank receiving the participation. This result is based upon the language of the statute which includes within a covered bank's limits on eligible BAs outstanding the amount of participations received by the covered bank. This provision reflects Congressional intent that a covered bank not be obligated on eligible bankers' acceptances, and participations therein, for an amount in excess of 150 or 200 percent of the institution's capital.

(c) The statute also provides that eligible acceptances growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for covered banks. The Board has clarified that this 50 percent limitation is applicable to the maximum permissible amount of eligible BAs (150 or 200 percent of capital), regardless of the bank's amount of eligible acceptances outstanding. The statutory language prior to the BESA

amendment made clear that covered banks could issue eligible acceptances growing out of domestic transactions up to 50 percent of the amount of the total permissible eligible acceptances the bank could issue. The legislative history of the BESA indicates no intent to change this domestic acceptance limitation.

(d) The statute also provides that for the purpose of the limitations applicable to U.S. branches and agencies of foreign banks, a branch's or agency's capital is to be calculated as the dollar equivalent of the capital stock and surplus of the parent foreign bank as determined by the Board. The Board has clarified that for purposes of calculating the BA limits applicable to U.S. branches and agencies of foreign banks, the identity of the parent foreign bank is generally the same as for reserve requirement purposes; that is, the bank entity that owns the branch or agency most directly. The Board has also clarified that the procedures currently used for purposes of reporting to the Board on the Annual Report of Foreign Banking Organizations, Form FR Y-7, are also to be used in the calculation of the acceptance limits applicable to U.S. branches and agencies of foreign banks.

(The FR Y-7 generally requires financial statements prepared in accordance with local accounting practices and an explanation of the accounting terminology and the major features of the accounting standards used in the preparation of the financial statements.) Conversions to the dollar equivalent of the worldwide capital of the foreign bank should be made periodically, but in no event less frequently than quarterly. In this regard, the Board recognizes the need to be flexible in dealing with the effect of foreign exchange rate fluctuations on the calculation of the worldwide capital of the parent foreign bank. Each foreign bank is to be responsible for coordinating the BA activity of its U.S. branches and agencies (including the aggregation of such activity) and establishing procedures that ensure that examiners will be able readily to determine compliance with the BESA limits.

By order of the Board of Governors, June 20, 1983.

William W. Wiles,
Secretary of the Board.

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