

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 9918
September 6, 1985]

ACTIVITIES OF EDGE CORPORATIONS

Proposed Change to Regulation K

*To All Edge Corporations, 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 has issued for public comment a proposed change to Regulation K — International Banking Operations — that would prohibit all lending to affiliates by Edge Corporations¹ that are not subsidiaries of U.S. insured banks.

Comment is requested by October 28.

The Board is requesting comment on the effect of the proposal on the operations of existing Edge Corporations and whether any exceptions or exemptions are appropriate to the prohibition of affiliate lending.

The proposed change is designed to preserve the safety and soundness of Edge Corporations and would result in more equitable treatment for all categories of owners of Edge Corporations. These include U.S. insured banks, U.S. bank holding companies, foreign banks, and U.S. nonbank companies.

Printed on the reverse side is the text of the Board's proposal, reprinted from the *Federal Register* of August 30, 1985. Comments on the proposal should be submitted by October 28, 1985 and may be sent to our Foreign Banking Applications Department.

E. GERALD CORRIGAN,
President.

¹ Edge Corporations are specialized banking companies that are chartered by the Board to engage in international banking or financial operations. Edge Corporations may not engage in activities in the United States except as may be incidental to foreign business.

(OVER)

FEDERAL RESERVE SYSTEM

12 CFR Part 211

[Reg. K; Docket No. R-0550]

Regulation K; International Banking Operations; Restriction on Affiliate Transactions of Edge Corporations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is publishing for comment a proposed change to Subpart A of Regulation K, the Board's regulation on international banking operations. The Board proposes to restrict affiliate transactions of Edge corporations that are not subsidiaries of insured banks in order to help ensure the safe and sound operation of Edge corporations.

DATE: Written comments must be received on or before October 28, 1985.

ADDRESS: Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to the C Street entrance, 20th & C Streets, NW., Washington, D.C., between the hours of 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to Doc. No. R-0550. All comments received will be available for inspection in room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Ricki Rhodarmer Tigert, Assistant General Counsel (202/452-3428); Kathleen M. O'Day, Senior Counsel (202/452-3786), Legal Division; Frederick R. Dahl, Associate Director (202/452-2726); James S. Keller, Manager, International Banking Applications (202/452-2523), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System; or Joy W. O'Connell, Telecommunication Device for the Deaf (202/452-3244).

SUPPLEMENTARY INFORMATION: Edge corporations are specialized banking companies that are chartered by the Board to engage in international banking or financial operations (12 U.S.C. 611 *et seq.*). Edge corporations may not engage in activities in the United States except as may be incidental to foreign business. Until recently, these organizations were held, almost without exception, by U.S. banks, and in every case by a U.S. banking organization that is subject to federal banking supervision. Since 1978, however, foreign banks have been authorized by law to acquire Edge corporations with the prior approval of the Board. Nonbank companies in the United States have also recently acquired existing Edge corporations.

In light of the increase in the number

of owners of Edge corporations that are not subject to federal banking supervision, the Board has become concerned about the potential for adverse effects that might result from such affiliations. These adverse effects include potential conflicts of interest, undue concentration of resources, impairment of the ability of an Edge corporation to be an impartial arbiter of credit, and other safety and soundness concerns. Of particular concern is the issue of affiliate lending. The Board has not previously placed restrictions on loans and extensions of credit by Edge corporations to affiliates because, as noted, Edge corporations have generally been held by U.S. banking organizations that themselves are restricted in their activities and are subject to supervision. Indeed, most Edge corporations are subsidiaries of U.S. insured banks and are indirectly subject to the restrictions imposed by section 23A of the Federal Reserve Act (12 U.S.C. 371c) restricting transactions with affiliates.

Nonbank owners of the Edge corporations are not subject to the supervisory authority of the Federal Reserve Board. As a result, they may engage, to an unlimited degree, in activities that are not permissible for banking organizations. Because an Edge corporation that is not owned by an insured bank is not itself subject to the restrictions on transactions with affiliates imposed by section 23A of the Federal Reserve Act, a nonbank-owned Edge corporation may lend 10 percent of its capital and surplus to any number of its affiliates, none of which is regulated by banking authorities and a number of which may engage in a broad range of nonbanking activities. Because affiliation with a nonbank company could create pressures to lend to affiliates regardless of creditworthiness and thus undermine the safety and soundness of the Edge corporation, the Board is proposing to prohibit all lending to affiliates by Edge corporations that are not subsidiaries of U.S. insured banks.

The proposal is designed to preserve the safety and soundness of Edge corporations, entities for which the Board has exclusive supervisory responsibility. The proposal would also result in more equitable treatment for all categories of owners of Edge corporations¹ because all Edge corporations would be subject to some level of restriction on affiliate lending.

The Board is requesting comment on (1) the effect of the proposal, if any, on the operations of existing Edge corporations, including the lending transactions with affiliates that may be hindered, and, in particular, how it

¹ These include U.S. insured banks, U.S. bank holding companies, foreign banks, and U.S. nonbank companies.

would affect the operations of Edge corporations controlled by foreign banks; (2) whether any exceptions or exemptions are appropriate to the prohibition on affiliate lending, specifically (i) how such exemptions would address the concerns about the potential for conflicts of interest and safety and soundness that prompted the Board to propose the prohibition on affiliate lending and (ii) whether there should be exemptions for Edge corporations that are owned by companies that only conduct activities permitted to bank holding companies; and any other comments that would be useful in the Board's consideration of the issue.

List of Subjects in 12 CFR Part 211

Banks, Banking, Federal Reserve System, Foreign banking, Investments, Reporting and recordkeeping requirements, Export trading companies, Allocated transfer risk reserve, Reporting and disclosure of international assets, Accounting for fees on international loans.

Regulatory Flexibility Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 *et seq.*), the Board of Governors of the Federal Reserve System certifies that the rule adopted will not have a significant economic impact on a substantial number of small entities.

PART 211—[AMENDED]

The Board proposes to amend 12 CFR Part 211 as follows:

1. The authority citation for Part 211 continues to read as follows:

Authority: Federal Reserve Act (12 U.S.C. 211 *et seq.*); Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*); International Banking Act of 1978 (12 U.S.C. 3101 *et seq.*); International Lending Supervision Act (12 U.S.C. 3901 *et seq.*).

2. In Part 211, it is proposed that § 211.6(d) be added to read as follows:

§ 211.6 Lending limits and capital requirements.

(d) *Transactions with affiliates.* An Edge corporation that is not a subsidiary of an insured bank in the United States may not engage in lending transactions with any affiliate of the corporation. For purposes of this subsection, "affiliate" shall have the meaning set forth in section 23A of the Federal Reserve Act (12 U.S.C. 371c) as if the Edge corporation were a member bank.

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By order of the Board of Governors of the Federal Reserve System, August 28, 1985.

James McAfee,

Associate Secretary of the Board.

[FR Doc. 85-20733 Filed 8-29-85; 8:45 am]

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