FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5665
June 11, 1965]

Interpretations of Guidelines Nos. 1, 3, and 4 for Foreign Lending Activities of Commercial Banks

To All Commercial Banks in the Second Federal Reserve District:

The guidelines issued by the Board of Governors of the Federal Reserve System for commercial banks to follow in complying with the President's program to improve the Nation's balance of payments were sent to you in the form of our Circular No. 5628, dated March 5, 1965, as amended by Circulars Nos. 5630 and 5647, dated March 11 and April 28, 1965, respectively. The guidelines were written to cover broad areas, and it was recognized that many questions would arise as to the proper interpretation. The Federal Reserve System does not expect, nor would it want, to pass on specific loan transactions—this is a matter for the business judgment of banks acting under the guidelines. However, considerations of competitive equity make it important that all banks be informed as to the position of the System with respect to the application of the guidelines to certain types of transactions. Accordingly, there are listed below System interpretations as to the application of the guidelines to establishing a base for banks (Guideline No. 1), as to banks in excess of the 5 per cent target (Guideline No. 3), and as to which loans should receive priority (Guideline No. 4). Other interpretations will be released from time to time.

Questions relating to Guideline No. 1, *Establishing a target base for an individual bank.*

1. Should the issuance of a stand-by letter of credit, or an outright guarantee, by a U.S. bank to a foreign bank for the purpose of guaranteeing a loan made by the foreign bank to a foreign subsidiary of a U.S. concern, be counted in the ceiling?

No. Such transactions have the effect of substituting foreign for U.S. capital. However, if the line of credit were used or the terms of the guarantee invoked, the resulting loan would be a foreign loan subject to the ceiling.

2. Are loans made to foreigners to finance exports of products owned by the Commodity Credit Corporation to be regarded as foreign or domestic loans?

Foreign loans.

3. Should loans to foreign concerns owned by U.S. citizens—for example, loans to corporations organized in flag-of-convenience countries—be regarded as foreign or domestic loans?

Foreign loans.

4. Do loans made by foreign branches of a U.S. bank count in the bank's base or against the 105 per cent ceiling?

No. While the foreign branch is expected not to draw down its deposits with the head office *for the purpose of making such loans,* nor to solicit dollar deposits from U.S. residents or other U.S. sources, the branch's loans are not a part of the base of the head office and do not count against the ceiling.

5. Should loans made to U.S. branches and agencies of foreign firms, and loans made to domestic firms, be regarded as foreign or domestic loans when the proceeds of the loans are to be used abroad?

Such loans are to be regarded as domestic loans. However, Guideline No. 13, revised April 28, 1965, points out that banks should determine to the extent possible that the proceeds of such loans will not be used in a manner inconsistent with the purpose of the program.

6. Does a loan made to a less developed country and guaranteed by an agency of the U.S. Government come within the ceiling?

Such a loan is subject to the ceiling unless it is guaranteed by the Export-Import Bank or is insured by the Foreign Credit Insurance Association. However, under Guideline No. 4, and within the 105 per cent ceiling, such a credit would have absolute priority if it financed U.S. exports, and the highest priority in the nonexport category.

7. Are loans to U.S. military personnel and other employees of the U.S. Government stationed abroad foreign or domestic loans?

Domestic loans.

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8. Should loans to foreign governments or concerns, the proceeds of which are to be left on deposit in the U.S., be regarded as foreign or domestic loans?

Foreign loans. Such transactions increase U.S. short-term liabilities to foreigners and short-term claims on foreigners, thus increasing the balance-of-payments deficit as it is currently measured.

9. Should a loan made to a foreign concern with recourse to a U.S. resident be regarded as a foreign or a domestic loan?

A foreign loan. See the explanation accompanying the previous question.

10. May firm commitments or term letters of credit on the books as of December 31, 1964, be included in a bank's base?

Only that portion of a commitment or letter of credit which had been utilized on December 31, 1964, may be included in the base. Since the objective is to reduce the expansion in foreign loans to a given figure, the inclusion of commitments in the base would make it necessary to reduce the percentage by which loans could be increased over the chosen base. Inclusion of commitments in the base would merely have the effect of redistributing the suggested expansion in favor of those banks whose firm commitments on December 31, 1964, were relatively large.

11. Are personal loans to individual representatives of foreign governments resident in the United States foreign loans or domestic loans?

Domestic loans.

Questions relating to Guideline No. 3, *Banks in excess of 5 per cent target.*

1. If a bank is at or over the ceiling, should it fail to honor a firm commitment, or reduce or cancel lines of credit?

Firm commitments are to be honored. Banks should endeavor to keep the use of other lines of credit within normal patterns. When a bank is over the ceiling for any reason, a program for getting below the ceiling should be discussed immediately with officers of the Federal Reserve Bank.

2. May a bank exceed the 105 per cent ceiling because of seasonal variations or as a result of individual transactions?

Seasonal variations or individual transactions may result in a bank's being temporarily over the ceiling. In such cases the bank should discuss the matter with officers of the Federal Reserve Bank and attempt to work back within the ceiling as quickly as possible.

Questions relating to Guideline No. 4, *Loan priorities.*

1. What priority should be given to loans to support third-country financing?

A low priority unless made to a less developed country. In that case the less developed country priority relating to nonexport credits would apply.

2. Would a loan to a concern in a developed country for use of a subsidiary in a less developed country be given a high priority because of the place in which the credit is to be used, or a low priority because of the location of the borrower?

Assuming that the loan is not financing a U.S. export, it would have a low priority. Developed countries should arrange such financing in their own markets.

3. Which countries are to be considered as "less developed" for the purposes of this program?

Developed countries are: Australia, Austria, the Bahamas, Belgium, Bermuda, Canada, Denmark, France, Germany (Federal Republic), Hong Kong, Ireland, Italy, Japan, Kuwait, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Portugal, Republic of South Africa, San Marino, Spain, Sweden, and Switzerland.

4. Within the 105 per cent ceiling, what is meant by the terms "absolute" and "highest" with reference to export credits and credits to the less developed countries? How do these terms relate to the suggestion that "banks should avoid restrictive policies that would place an undue burden on . . . Canada, Japan . . . and the United Kingdom . . . ."?

All *bona fide* export credits have priority over all nonexport credits. Within nonexport credits, all credits to less developed countries have priority over all other nonexport credits.

If it is necessary to make adjustments in credits to developed countries in order to conform to the suggested priorities, consideration should be given to the special circumstances of Canada, Japan, and the United Kingdom.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.