

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7588]
March 17, 1975

MISCELLANEOUS INTERPRETATIONS

Establishment of Foreign Operations Subsidiaries

*To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System has issued an interpretation regarding the establishment of foreign operations subsidiaries by member banks. A convenient place for filing this interpretation would be with your copy of the Board's Regulation M, "Foreign Activities of National Banks."

Enclosed is a copy of that interpretation. Additional copies will be furnished upon request.

ALFRED HAYES,
President.

Board of Governors of the Federal Reserve System

MISCELLANEOUS INTERPRETATIONS

ESTABLISHMENT OF FOREIGN OPERATIONS SUBSIDIARIES

Title 12—Banks and Banking

CHAPTER II—FEDERAL RESERVE SYSTEM

Subchapter A—Board of Governors of the Federal Reserve System

PART 250—MISCELLANEOUS INTERPRETATIONS

Foreign Operations Subsidiaries

Part 250 is amended by adding the following new section:

§ 250.143—Member bank purchase of stock of foreign operations subsidiaries.

(a) In a previous interpretation, the Board determined that a State member bank would not violate the “stock-purchase prohibition” of section 5136 of the Revised Statutes (12 U.S.C. 24 ¶ 7) by purchasing and holding the shares of a corporation which performs “at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly”.¹ (1968 *Federal Reserve Bulletin* 681, 12 CFR § 250.141). The Board of Governors has been asked by a State member bank whether, under that interpretation, the bank may establish such a so-called “operations subsidiary” outside the United States.

(b) In the above interpretation the Board viewed the creation of a wholly-owned subsidiary which engaged in activities that the bank itself could perform directly as an alternative

organizational arrangement that would be permissible for member banks unless “its use would be inconsistent with other Federal law, either statutory or judicial”.

(c) In the Board’s judgment, the use by a member bank of operations subsidiaries outside the United States would be clearly inconsistent with the statutory scheme of the Federal Reserve Act governing the foreign investments and operations of member banks. It is clear that Congress has given member banks the authority to conduct operations and make investments outside the United States only through gradually adopting a series of specific statutory amendments to the Federal Reserve Act, each of which has been carefully drawn to give the Board approval, supervisory, and regulatory authority over those operations and investments.

(d) As part of the original Federal Reserve Act, national banks were, with the Board’s permission, given the power to establish foreign branches.² In 1916, Congress amended the Federal Reserve Act to permit national banks to invest in international or foreign banking corporations known as “Agreement” Corporations, because such corporations were required to enter into an agreement or understanding with the Board to restrict their operations. Subject to such limitations or restrictions as the

¹ National banking associations are prohibited by section 5136 of the Revised Statutes from purchasing and holding shares of any corporation except those corporations whose shares are specifically made eligible by statute. This prohibition is made applicable to State member banks by section 9 ¶ 20 of the Federal Reserve Act (12 U.S.C. 335).

² Under section 9 of the Federal Reserve Act, State member banks, subject, of course, to any necessary approval from their State banking authority, may establish foreign branches on the same terms and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks (12 U.S.C. 321). State member banks may also purchase and hold shares of stock in Edge or Agreement Corporations and foreign banks because national banks, as a result of specific statutory exceptions to the stock purchase prohibitions of section 5136, can purchase and hold stock in these Corporations or banks.

(OVER)

Board may prescribe, such Agreement Corporations may principally engage in international or foreign banking, or banking in a dependency or insular possession of the United States, either directly or through the agency, ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions of the United States. In 1919 the enactment of section 25(a) of the Federal Reserve Act (the "Edge Act") permitted national banks to invest in federally chartered international or foreign banking corporations (so-called Edge Corporations) which may engage in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions. Edge Corporations may only purchase and hold stock in certain foreign subsidiaries with the consent of the Board. And in 1966, Congress amended section 25 of the Federal Reserve Act to allow national banks to invest directly in the shares of a foreign bank. In the Board's judgment, the above statutory scheme of the Federal Reserve Act evidences a clear Congressional intent that member banks may only purchase and hold stock in subsidiaries located outside the United

States through the prescribed statutory provisions of sections 25 and 25(a) of the Federal Reserve Act. It is through these statutorily prescribed forms of organization that member banks must conduct their operations outside the United States.

(e) To summarize, the Board has concluded that a member bank may only organize and operate "operations subsidiaries" at locations in the United States. Investments by member banks in foreign subsidiaries must be made either with the Board's permission under section 25 of the Federal Reserve Act or, with the Board's consent, through an Edge Corporation subsidiary under section 25(a) of the Federal Reserve Act or through an Agreement Corporation subsidiary under section 25 of the Federal Reserve Act. In addition, it should be noted that bank holding companies may acquire the shares of certain foreign subsidiaries with the Board's approval under section 4(c)(13) of the Bank Holding Company Act. These statutory sections taken together already give member banks a great deal of organizational flexibility in conducting their operations abroad.

(Interprets and applies 12 U.S.C. 24, 335)

By order of the Board of Governors, February 26, 1975.