

FEDERAL RESERVE BOARD

WASHINGTON

December 24, 1920.

X-3002

SUBJECT: Rights of National Banks to invest in the Stock of International Financial Corporations.

Dear Sir:-

The Federal Reserve Board recently has received a number of inquiries as to whether a national bank desiring to invest in the stock of corporations organized or to be organized under the provisions of the so-called "Edge Act", which constitutes Section 25(a) of the Federal Reserve Act, must make application to the Federal Reserve Board for permission to purchase such stock, and if so, whether such applications must be filed prior to January 1, 1921, in view of the provisions of the so-called McLean-Platt Amendment to Section 25. In order to correct certain misapprehensions which appear to have arisen in this connection, the Federal Reserve Board feels that it is advisable to set forth its interpretation of the pertinent provisions of Section 25 and Section 25(a).

Section 25, as amended September 7, 1916, and September 17, 1919, makes provision for the investment by national banks in the stock of certain kinds of international financial corporations organized under the laws of the United States or of any State thereof. Prior to the passage of the Edge Act, however, there was no provision for the incorporation of international financial corporations under the laws of the United States. In enacting the Edge Act, Congress has now provided a means for the incorporation of such corporations under Federal law, thus enabling national banks to exercise to the full extent the rights which were given to them by the amendments to Section 25. In addition to making provision for the organization of international financial corporations the Edge Act among other things expressly provides:

"Any national banking association may invest in the stock of any corporation organized under the provisions of this section, but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus."

It is evident, therefore, that this provision of Section 25(a) to some extent has modified the provisions of Section 25, so far as the

right of national banks to invest in the stock of corporations organized under the laws of the United States is concerned.

Section 25 and Section 25(a) both contemplate two classes of international financial corporations, (1) international banking corporations engaged in granting ordinary short time commercial credits, and (2) international investment corporations engaged in granting long time credits and in issuing their own debentures secured by foreign securities. Section 25 authorizes a national bank with a capital and surplus of \$1,000,000 or more to make application to the Board for permission to invest not to exceed 10 per centum of its capital and surplus in the stock of one or more corporations organized under the laws of the United States or of any State thereof and principally engaged in international or foreign banking; and the McLean-Platt Amendment of September 17, 1919 authorizes any national bank, irrespective of the amount of its capital and surplus, until January 1, 1921, to make application to the Board for permission to invest not to exceed 5 per centum of its capital and surplus in the stock of one or more corporations organized under Federal or State law and principally engaged in such phases of international financial operations as may be necessary to facilitate exports from the United States, i.e. international investment corporations as distinguished from international banking corporations. Section 25(a), however, without qualification, authorizes any national bank to invest in the stock of international financial corporations organized under that section, whether engaged in international banking or in the international investment business, provided, only, that the aggregate amount of stock held in all corporations engaged in the business of the kinds described in that section and section 25 does not exceed 10 per centum of the subscribing bank's capital and surplus.

It will be noted that the pertinent provision of Section 25(a) contains no such restrictions upon the powers of national banks to invest in the stock of international financial corporations as are found in Section 25, other than the provision with regard to the aggregate amount of stock which a national bank may hold in all such corporations. As the provision of Section 25(a) is limited to corporations organized under that section, this specific provision must be construed as superseding the more general restrictions in Section 25 as to the capital and surplus requirements of the subscribing bank and as to the amount which may be invested, the time limit and the phases of the international financial operations of the corporations in whose stock the national bank desires to invest, so far as investments by national banks in corporations organized under the laws of the United States are concerned.

In view of these considerations, it is clear that the January 1, 1921, limitation in the McLean-Platt Amendment restricting the right of national banks to make application to the Board only until January 1, 1921, does not relate to the right of a national bank to invest in the stock of an Edge corporation, whether the Edge corporation is organized for the purpose of engaging in international banking operations or in an international investment business. Similarly, the provision of the McLean-Platt Amendment which places a limitation of 5 per centum upon

the amount which a national bank may invest in a corporation of the kind described therein has been modified by virtue of the provisions of Section 25(a) to the extent that a national bank may now invest not more than 10 per centum of its capital and surplus in a corporation organized under the laws of the United States irrespective of whether such corporation is organized to carry on a banking business or an investment business, provided that the aggregate amount of stock held in all corporations engaged in business of the kind described in Section 25(a) and in Section 25, whether organized under the Edge Act or under State law, does not exceed 10 per centum of the subscribing bank's capital and surplus.

In brief, under the present provisions of Sections 25 and 25(a) the situation after January 1, 1921, will be that any national bank, irrespective of its capital and surplus, may invest in the stock of any corporation organized under the provisions of Section 25(a) regardless of whether such corporation is a foreign banking corporation or a foreign investment corporation issuing its own debentures; that a national bank having a capital and surplus of \$1,000,000 or more may invest in the stock of a State incorporated banking institution but may not invest in the stock of a State incorporated investment corporation; that a national bank having a capital and surplus of less than \$1,000,000 may not invest in the stock of a corporation organized under State law whether that corporation is a banking corporation or an investment corporation; and that the aggregate of the investments of any national bank in the stock of corporations engaged in the business of the kind described in Sections 25 and 25(a) may not exceed ten per cent of the subscribing bank's capital and surplus.

The Board has ruled that a national bank which desires to invest in the stock of corporations such as are described in Section 25 and in Section 25(a) must make application to the Board for permission to subscribe to such stock irrespective of whether the corporation is to be organized under Section 25(a) or under State law. The Board will not consider an application by a national bank to subscribe to the stock of a corporation to be organized under State law until the corporation has filed an agreement with the Board to restrict its operations as the Board may require pursuant to the provisions of Section 25, and will not consider an application to subscribe to the stock of a corporation to be organized under Section 25(a) until the corporation has submitted its title to the Board for approval and reservation for thirty days pursuant to the Board's Regulation K, Series of 1920, and the Board has approved this title.

In the case of an Edge corporation which is in the process of organization, the Board has ruled that while it will consider an application after the approval of its title the Board will approve the application only upon the condition that the national bank shall not be authorized to pay out any money in payment for such stock until the international financial corporation in which the national bank desires to invest shall have been duly incorporated under the provisions of Sec-

tion 25(a) and shall have received from the Board a preliminary permit to exercise such of the powers conferred upon it by that section as are incidental and preliminary to its organization.

Heretofore the Board has not required that these applications be in any particular form, but has accepted as an application a letter signed by an officer of the national bank requesting permission to invest in the stock of the international financial corporation. In view of the increasing number of national banks desirous of investing part of their capital and surplus in the stock of such corporations, the Board is now having prepared a form of application for use by national banks. As soon as these forms are available, national banks desiring to purchase stock in international financial corporations must make application to the Board upon the prescribed forms. The applications in the first instance must be forwarded to the Federal Reserve Agent of the district in which the applying bank is located, who will in turn forward them to the Federal Reserve Board with his recommendation noted thereon. This form will be suitable for use in making application to purchase stock either in Edge corporations or in corporations organized under State law.

Very truly yours,

Governor.

To Governors and Chairmen of Federal Reserve Banks.