CONGRESSIONAL
April 1983

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Congressional
April 1983

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Federal Reserve Bank of St. Louis

April 29, 1983

The Honorable James J. Florio
Chairman
Subcommittee on Commerce, Transportation
and Tourism
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Chairman Florio:

Thank you for the invitation to testify on May 5 before the Subcommittee on Commerce, Transportation and Tourism. However, a schedule conflict will prevent me from appearing at your hearing.

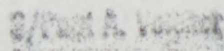
I understand that your invitation to discuss the exchange rate system and the implications of fluctuating exchange rates for international trade was prompted by some remarks I delivered in Rome recently.

In this regard, I think you will find helpful the remarks I made yesterday to a group of foreign exchange traders in which I discussed, among other topics, exchange rates and exchange market intervention; a copy is enclosed. These are essentially the same remarks I made in Rome.

I also have enclosed a copy of an international study released today on exchange market intervention, and a copy of a statement by finance ministers and central bank governors on that study and subject.

I hope that you find these items useful in your Subcommittee's inquiry.

Sincerely,



Enclosures (4/28/83 speech and Intervention Study & Statement)

WRM:EMT:pjt (#V-75)
bcc: Mr. Truman
Mrs. Mallardi (2)

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Don Winn will be discussing with Chairman; copy given to Ted Truman

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CHIEF COUNSEL AND STAFF DIRECTOR

U.S. House of Representatives

Committee on Energy and Commerce

SUBCOMMITTEE ON COMMERCE, TRANSPORTATION, AND TOURISM

Washington, D.C. 20515

April 20, 1983

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 APR 22 AM 9:17
RECEIVED
OFFICE OF THE CHAIRMAN

Mr. Paul A. Volcker, Chairman
Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Volcker:

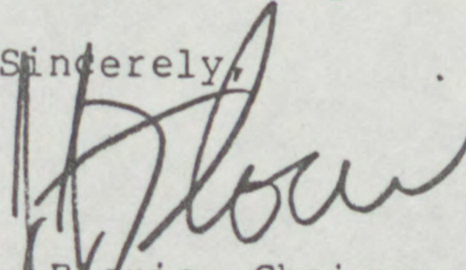
I am writing to invite you to testify at a hearing of the Subcommittee on Commerce, Transportation and Tourism on issues affecting the international competitiveness of U.S. industries.

This year the Subcommittee is holding a series of hearings on general trade policy and on related issues under its jurisdiction, including proposals to set domestic content requirements for automobile manufacturers. In the course of its inquiry, the Subcommittee's attention has been drawn repeatedly to the disruptions in international trade caused by fluctuating exchange rates. Noting with interest your remarks on this matter, as reported recently in the press, the Subcommittee wishes to benefit from your knowledge and experience in exploring policy measures that could bring greater stability into the world monetary system and international trade patterns.

The Subcommittee will be holding its hearing on these issues on May 5, 1983 at 9:30 a.m. Should this date be inconvenient, we suggest the alternative date of April 28, at 9:30 a.m., when the Subcommittee will be continuing its investigation of problems facing the U.S. automobile industry.

On behalf of the Subcommittee on Commerce, Transportation and Tourism, I wish to thank you for your cooperation and express my hopes that you will join us on either May 5 or April 28.

Sincerely,



James J. Florio, Chairman
Subcommittee on
Commerce, Transportation and Tourism

JJF:bgs

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 28, 1983

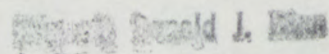
The Honorable James A. McClure
United States Senate
Washington, D. C. 20510

Dear Senator McClure:

Thank you for your recent request for comment on correspondence received by your office from Mr. Robert Bissett of Moyie Springs, Idaho. Mr. Bissett asks several questions concerning the recent revision of Title 31, "Money and Finance". The House Report No. 97-651 on the "Revision of Title 31, United States Code, 'Money and Finance'", is an extremely good explanation of the reasons for, and meaning of, the many changes made to Title 31 during the recodification. Rather than duplicating the time and effort put into preparation of that Report, I have enclosed a copy of the Report, which you may wish to send to Mr. Bissett so he can have the benefit of its thorough discussion of Title 31. Since the Department of the Treasury exercises the authority conveyed by Title 31, that Department may be better able to answer any further questions Mr. Bissett may have concerning Title 31.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,



Donald J. Winn
Assistant to the Board

Enclosure

ET:GTS:HJ:AFC:vcd (V-47)
bcc: E. Boutilier
G. Schwartz
H. Jorgenson
G.C. Log 76
Legal Files (2)
Mrs. Mallardi

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Action assigned Mr. Bradfield

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

1983 MAR 14 AM 8:59

March 11, 1983

#47

Mr. Paul A. Volcker
Chairman
Federal Reserve System
Twentieth Street and Constitution Ave., N.W.
Washington, D.C. 20551

Dear Chairman Volcker:

I have enclosed a copy of a letter I received from Robert Bissett concerning the Monetary System of the United States. Mr. Bissett recently read Title 31 of the United States Code, and had several questions regarding our monetary laws. I would appreciate any assistance you could provide me with in answering this request.

Thank you for your attention to this matter.

Sincerely,

Jim McClure

James A. McClure
United States Senator

McC:jck
Enclosure

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, D.C. 20510

March 11, 1983

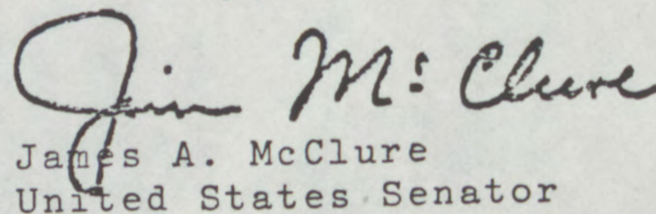
Mr. Robert Bissett
Box 38
Moyie Springs, Idaho 83845

Dear Robert:

You raised some interesting questions in your recent letter concerning the Monetary Laws of the United States. I have forwarded your letter to Paul Volcker, Chairman of the Federal Reserve System, and asked that he look into your concerns. I have enclosed a copy of my letter and will forward you his response as soon as I receive it. Also, I have enclosed a copy of a publication I received from the Library of Congress concerning the Federal Reserve System. I hope you find it informative.

If I may be of further assistance please let me know.

Sincerely,



James A. McClure
United States Senator

McC:jck
Enclosures

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Federal Reserve Bank of St. Louis

February 5, 1983

Seator James McClure
Senate Office Building
Washington, D. C.

RE: Lawful Monetary System of United States 26207

Dear Senator: Dear Robert

In reading the new reives Title 31 USC, certain questions have arisen and your help would be greatly appreciated in resolving them. If possible, in each case, please give in detail the authority for your answer (section and title, public law, executive order, regulation, etc. as appropriate) and a photocopy.

1. Terms from Table 2A: As used in this table what is the meaning of: Unnecessary, obsolete, omitted, superceded, executed, obsolete and superseded, expired and technical? What, if any, status do sections so labled have in law?

2. Terms from Subtitle IV-Money: As used in this subtitle what is the meaning of:

   United Ststes money, dollars, United States coins and currency, Federal reserve notes, Federal reserve circulating notes, Federal Reserve banks, national banks, legal tender, United States coins, United States currency, bonds of the United States Government, security documents, United States currency notes, and

   payable to bearer, payable, direct obligations of the United States, asset, coins(5116(b)(2)), security(5117(b)), gold, domestic obligation guaranteed by the U.S., repay, may(5118 (b)), pay out(5118(b)), deliver(5118(b)), exchange(5118(b)), money, payment, discharged,redeem, paid, pay?

   If the specific meaning of any term used in revised title 31 is different form the general meaning ascribed to it please so indicate.

3. What is the status of the laws from which revised title 31 was derived, especially those parts of such laws as are not rpealed or restated in the revision?

4. Coinage Act of April 2, 1792: Is this Act still positive law? If not, what is it's status? How does it relate to the present lawful monetary system? to revised Title 31?

5. Under revised Title 31, Section 5118(b), what are the regulations prescribed by the Secretary for making the exchanges.

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6. Under revised Title 31, Sec 5119(b)(2), what rules or regulations prescribe how to present currency to the Secretary for redemption? What places hve been designated for presentation?

7. Under 31 USC 371 from which revised 31 USC 5101 is derived, are all accounts in the public offices and all proceedings in the courts still to be kept and had in the money of account? Is "United States money" the present equvalent of "money of account"?

8. Is the monetary spstem of the United States now based on silver only, in distinction from gold and silver as originally?

9. What thing(s) can the United States Government lawfully tender for it's debts?

10. What thing(s) can lawfully be required to be accepted by the creditors of the United States Government in payment of debt? by any creditor?

11. What thing(s) can lawfully be tendered for debts to the U.S. Government by persons? by the States?

12. What thing(s) can lawfully be accepted in payment of debt by the U.S. Government? by the States?

13. Is the present standard of value the silver dollar as implied by revised 31 USC 5116(b)(2) with a value of $1.292929292 a fine troy ounce or the equivalent, 371.25 grains per dollar, as in the Coinage Act of April 2, 1792?

14. What is the meaning of the symbol "S" with one vertical line through the middle?

15. What does the term "money" mean as used in Subchapter I- Deposits and Depositories, revised 31 USC?

16. Under revised 31 USC 3303, what depositories have been designated?

17. In EO 10289, as noted under 3 USC 301, and in view of revised Title 31, what do the terms "silver bullion", "silver" and "standard silver dollar" mean? Is this "standard silver dollar" the present standard of value for the lawful monetary system? How many grains of silver does it weight?

18. Have laws enacted before 1802 been codified? What is their status? How may a complete list and copies of them be obtained.

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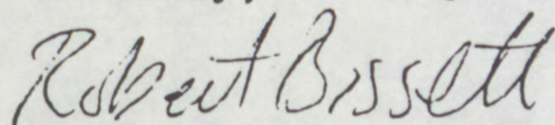
In addition to the answers requested above, any other information available to explain the present monetary system would be appreciated.

19. What is the relationship between the "dollar" of the Federal reserve banks and the lawful dollar of the United States Government, if any?

In view of the extensiveness of this request, please send answers as they become availble, if possible.

Thank you for your time and effort.

Sincerely,



Robert Bissett
Box 38
Moyie Springs, ID
83845

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Federal Reserve Bank of St. Louis

April 26, 1983

The Honorable Donald W. Riegle
United States Senate
Washington, D. C. 20510

Dear Senator Riegle:

In my concern about answering your question this morning, I neglected to thank you for your kind words about my government service. I very much appreciated your remarks.

Sincerely,

MB:dmg-b

cc: Miss Wolfe (2)

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Federal Reserve Bank of St. Louis

April 26, 1983

The Honorable Doug Barnard
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Chairman Barnard:

Thank you for your letter of April 11 enclosing the report of the General Accounting Office regarding bank policies on dormant checking and savings accounts. As soon as our review of the report is completed, I will be back in touch with responses to the questions you have raised.

Sincerely,

S/ Paul

RS:AFC:CO:vcd (V-67)

bcc: Rugenia Silver (for follow-up)
Mrs. Mallardi (2)

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Action assigned Mr. Garwood

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NINETY-EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

JUDD GREGG, N.H.
WILLIAM F. CLINGER, JR., PA.
TOM LEWIS, FLA.

MAJORITY—(202) 225-4407

#67

April 11, 1983

Hon. Paul A. Volcker
Chairman
Federal Reserve Board
Washington, D. C. 20551

Dear Chairman Volcker:

The Commerce, Consumer, and Monetary Affairs Subcommittee has been concerned for some time about the practice of certain banks of imposing dormant account service charges on customers' savings and checking accounts without proper notice to or informed consent by the affected depositors. The U.S. General Accounting Office has recently completed for the subcommittee a report (copy enclosed) on the results of a sample survey of banks' dormant account practices that documents systematically the extent of these practices nationwide. Using very conservative assumptions about the practices of survey nonrespondents, the GAO estimates that U.S. banks service charged approximately 2 million savings accounts and half a million checking accounts for dormancy in 1981, collecting a total of $16 million in such charges. Over $120 million in savings account balances were estimated to be receiving no interest because of the banks' decisions to suspend interest payments when the accounts became dormant. I am writing to request your review of the survey findings with the objective of determining whether there is any basis for further investigation or action by the Federal Reserve under its statutory responsibilities for regulating unfair and deceptive banking practices.

In hearings the subcommittee held on this subject in July 1980, numerous instances of banks' practice of service charging dormant accounts without notice to the account owners, as well as some instances of banks stopping interest payments on savings accounts without proper notice, were documented. Some banks were shown at that time to be employing the service charge device to wipe off their books entirely the accounts of small children who did not maintain sufficient activity in their accounts. One witness at this hearing was a young boy whose bank had done exactly that to his savings account and had then refused to reinstate the account or refund the money, even though no notice had ever been given to him or his parents that bank service charges would be imposed that would have this effect.

In order to determine whether these reported practices represented isolated cases or an industry-wide phenomenon, the subcommittee then conducted, with substantial technical assistance from the General Accounting Office, a sample survey of the dormant account practices of several hundred banks. The survey results, as compiled and tabulated by the GAO in the enclosed report, clearly show that dormant account service charging and suspension of interest on dormant savings accounts are widespread practices.

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Furthermore, a serious question must be raised in most of these cases as to whether the account owners were properly informed in advance about the service charges or interest suspensions. It seems highly likely that many or most depositors, if they had been adequately informed, would have avoided the service charges or interest suspensions by the simple expedient of conducting some activity in the account from time to time: making either an occasional deposit or an occasional withdrawal. There appears to be no benefit that most depositors would derive from having their accounts classified as dormant that would lead them willingly to incur these costs.

Finally, it is important to note that these costs are indeed real, notwithstanding the policy cited by many banks of refunding the dormancy service charges if requested. At the banks that provided information on the number of refunds, fewer than one percent of the depositors whose accounts were service charged actually received refunds.

Because of these questions about whether the banks gave proper notice to and secured the informed consent of the affected depositors, I am writing to request the Federal Reserve's review of these survey results and the practices they report in order to assess the need for further investigation and/or regulatory steps under the Federal Reserve's statutory responsibilities for regulating unfair and deceptive practices in banking. This responsibility is assigned to the Federal Reserve, as you know, by the Federal Trade Commission Act. At the time this review is completed, please report to the Commerce, Consumer, and Monetary Affairs Subcommittee on the following questions, including a full statement of reasons for each answer:

a. Is there any valid basis for banks to impose a service charge or to discontinue the payment of interest on a savings or checking account solely because there has been no customer-generated activity in the account for a certain period of time?

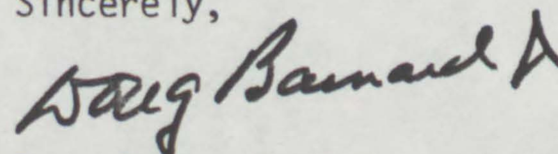
b. What standards of disclosure should banks adhere to, and what specific disclosure methods should they employ, in order to assure that their deposit customers are adequately informed of these service charge and interest suspension policies?

c. On the basis of the enclosed survey results, can you conclude that substantially all banks -- and especially the largest banks that account for a major portion of retail deposits -- currently employ suitable disclosure methods?

d. Will the Federal Reserve undertake further investigation and/or regulatory steps regarding these dormant account service charging and interest suspension practices under its responsibilities for regulating unfair and deceptive practices in banking?

I would appreciate your response by Friday, May 20.

Sincerely,



Doug Barnard, Jr.
Chairman

Enclosure

DB:dpt:b

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April 26, 1983

The Honorable Walter E. Fauntroy
Chairman
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and
  Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman Fauntroy:

Thank you for your letter of April 15 regarding hearings on the prospects for unemployment both in the nation as a whole and in our industrial heartland.

Vice Chairman Preston Martin of the Board of Governors and President Silas Keehn of the Federal Reserve Bank of Chicago are both looking forward to appearing before your Subcommittee on May 5.

Sincerely,

CO:DJW:pjt(V-71)

bcc: Vice Chrmn. Martin
President Keehn
Mr. Zeisel
Mrs. Mallardi (2)

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Copies given V. C. Martin and Silas Keehn

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H2-109, ANNEX NO. 2
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(202) 226-7315

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JOHN HILER, IND.

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

#71

April 15, 1983

The Honorable Paul Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Avenue N.W.
Washington, D.C. 20551

Dear Paul:

On Thursday, May 5, 1983, the Subcommittee on Domestic Monetary Policy will hold hearings on the prospects for unemployment both in the nation as a whole and in this country's industrial heartland. These hearings will explore the current unemployment conditions, expectations of the Federal Reserve for unemployment this year and afterwards, how much unemployment will and will not be reduced by the currently projected cyclical recovery, and what the Federal Reserve is doing and can do to reduce unemployment.

I would like you or your designee to testify at these hearings on the prospects for unemployment in the nation as a whole. I would also like one or more Presidents of the Federal Reserve Banks in regions with high unemployment to testify on the prospects for unemployment in those areas. Specifically, I would like you or your designees from the Federal Reserve Board to address the following questions:

1. What are the dimensions of current unemployment? How does the distribution of unemployment by age, sex, race, industry, region, and type of work in this recession compare with those of the past? What is the current status of inflation?

2. What are the Federal Reserve's projections for unemployment and inflation this year and next? What factors could make unemployment and inflation better or worse than projected?

3. To what extent will unemployment be reduced by a cyclical recovery in the economy, and to what extent will structural unemployment persist despite a cyclical recovery?

4. What is the Federal Reserve doing to reduce unemployment? How important is a reduction in unemployment among the Federal Reserve's objectives?

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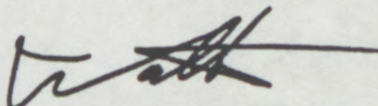
I would also like the Federal Reserve Bank President(s) who testify to address these questions in regards to their Districts.

Accordingly, I ask you or your designee and the Federal Reserve President(s) to appear before the Subcommittee to testify on this issue at 2:00 p.m. on Thursday, May 5, 1983, in Room 2128 of the Rayburn House Office Building. Committee Rules require that 100 copies of your testimony be made available to the Subcommittee 24 hours in advance. If you have any questions, please contact Howard Lee or Andrew Bartels at 202/226-7315.

Thank you very much for your cooperation. I look forward to the hearing on May 5.

Sincerely yours,



Walter E. Fauntroy
Chairman

P.S. I understand that Preston Martin and Silas Keehn have been designated by you to testify at these hearings. That is an acceptable arrangement to me. I extend my deepest welcome to both of them.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 26, 1983

The Honorable Charles E. Bennett
House of Representatives
Washington, D. C. 20515

Dear Mr. Bennett:

Thank you for your letter of April 19 requesting comment on correspondence you received from Mr. Donald K. Jelks regarding the Federal Reserve System. I regret the delay in responding to your original request and hope that the following information will be useful.

The Federal Reserve was established by an Act of Congress in 1913. As Mr. Jelks requested, I am pleased to enclose a copy of the Federal Reserve Act. The Federal Reserve is made up of twelve regional Federal Reserve Banks which are supervised by the Board of Governors in Washington. The Reserve Banks are corporate instrumentalities of the United States, and were established by Congress for public purposes.

The Board is an agency of the Federal Government, and its seven members are appointed by the President with the advice and consent of the Senate. The Board is required by law to make an annual report to Congress, and members of the Board, especially the Chairman, are called upon frequently to testify before Congressional committees.

The Federal Reserve is not operated for a profit and returns substantial sums to the U.S. Treasury each year. The earnings of the Federal Reserve System are derived chiefly from interest on U.S. Government securities held in the System's Open Market Account, which are acquired as a part of the System's monetary policy actions. The System returns all earnings in excess of expenses to the U.S. Treasury; in calendar year 1982 payments to the Treasury by the Federal Reserve amounted to more than $15 billion.

With respect to our nation's currency, Section 16 of the Federal Reserve Act (12 U.S.C. Sec. 411) provides that Federal Reserve notes may be issued at the discretion of the Board of Governors. In fact, Federal Reserve notes are issued in response to the public's growing needs for currency. As the economy expands, currency is needed by the public in order to carry out transactions. Virtually all of the new currency issued is put in circulation to facilitate the public's need for cash. The amount of notes that may be issued is not unlimited. For example, the amount of notes in circulation is constrained by Section 16 of the Federal Reserve Act, which

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Federal Reserve Bank of St. Louis

requires that Federal Reserve notes be backed by collateral security with a value at least equal to the notes issued. The Federal Reserve Act also specifies the types of collateral that are acceptable.

Due to the complex nature of our central banking system, it is difficult to provide a brief explanation of the mechanical process of money creation in a "fractional reserve" banking system. Therefore, I am enclosing, for Mr. Jelks' information, a copy of "Modern Money Mechanics", published by the Federal Reserve Bank of Chicago, which provides an uncomplicated explanation of the process.

Please let me know if I can be of further assistance.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

Enclosures

CO:vcd (#V-73 & 82)

bcc: Mrs. Mallardi

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Federal Reserve Bank of St. Louis

CHARLES E. BENNETT
MEMBER
3D DISTRICT, FLORIDA

ARMED SERVICES COMMITTEE
CHAIRMAN OF SEAPOWER SUBCOMMITTEE
MEMBER: RESEARCH AND DEVELOPMENT SUBCOMMITTEE

HOUSE DEMOCRATIC STEERING AND POLICY COMMITTEE

CHAIRMAN OF FLORIDA CONGRESSIONAL DELEGATION

Congress of the United States
House of Representatives
Washington, D.C. 20515

#173

TRACY D. CONNORS
ADMINISTRATIVE ASSISTANT

W. DEKLE DAY
LEGISLATIVE ASSISTANT

SHARON H. SIEGEL
BARBARA L. FETHEROLF
DARLA E. SMALLWOOD
WENDY S. LEAVITT
ELIZABETH R. P. BOWEN
PATRICIA A. CANDELA
GRETCHEN A. PEMBERTON
STAFF

JACKSONVILLE OFFICE:
352 FEDERAL BUILDING 32202
TELEPHONE 904-791-2587

JOHN W. POLLARD, JR.
BRENDA DONALDSON
ALLISON R. ABBOTT

April 19, 1983

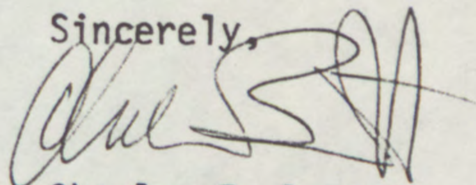
Mr. Paul A. Volcker
Chairman, Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Volcker:

I am writing to you again regarding the matter my constituent, Mr. Donald K. Jelks, brought to my attention. Have you had an opportunity to review the matter? I will greatly appreciate your providing me with a response so that I may be back in touch with my constituent.

With kindest regards, I am

Sincerely,



Charles E. Bennett

CEB:bf

cc: Mr. Donald K. Jelks

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 APR 20 AM 10: 27
RECEIVED
OFFICE OF THE CHAIRMAN

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

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Federal Reserve Bank of St. Louis

Congress of the United States
House of Representatives
Washington, D.C. 20515

February 24, 1983

Mr. Paul A. Volcker
Chairman, Federal Reserve System
Twentieth Street and Constitution
Avenue NW
Washington, DC 20551

Sir:

The attached communication is sent for your consideration. Please investigate the statements contained therein and forward me the necessary information for reply. Please refer to the date of my letter to you in your response.

Sincerely,

Charles E. Bennett,
Member of Congress

CEB:hlc
Enclosure

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Federal Reserve Bank of St. Louis

Congressman Charles E. Bennett
Congressional Building, Wash, DC 2-8-83

Dear Charlie,

I am interested in the law that resulted in the creation of the Federal Reserve Board.

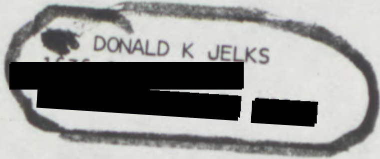
Please send me a copy of that law.

Does the Federal Reserve Board have the power to create money at their will?

What happens to the profit that the Federal Reserve Board makes?

Thank you for your prompt response.

Sincerely,



Donald K. Jelks

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Federal Reserve Bank of St. Louis

BILL GRADISON
2ND DISTRICT, OHIO

MARGARET TOTTEN
ADMINISTRATIVE ASSISTANT

2311 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-3164

FEDERAL OFFICE BUILDING
550 MAIN STREET
CINCINNATI, OHIO 45202
TELEPHONE: (513) 684-2456

190 EAST MAIN STREET
BATAVIA, OHIO 45103
TELEPHONE: (513) 732-1786

Congress of the United States
House of Representatives
Washington, D.C. 20515

April 26, 1983

Paul A. Volcker
Chairman, Board of Governors
Federal Reserve
20th and C Streets, N.W.
Washington, D.C. 20551

Dear Paul:

I am delighted to hear that you will be our guest speaker at the SOS and C & M breakfast meeting on Wednesday, May 25, 1983.

We meet at 8:00 a.m. in the Members Private Dining Room, H-130 of the Capitol, and end promptly at 9:00. Our session is informal and strictly off-the-record. You can say whatever is on your mind for five or ten minutes, or longer, if you wish. We then go around the room with questions.

I'm looking forward to seeing you and will meet you a few minutes before 8:00 by the elevators on the first floor of the House side of the Capitol. In the meantime please let me know if I can be of assitance.

Sincerely,

Bill

Bill Gradison
Representative in Congress

BG/k

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 APR 28 AM 10: 22
RECEIVED
OFFICE OF THE CHAIRMAN

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April 25, 1983

The Honorable Barber B. Conable, Jr.
House of Representatives
Washington, D. C. 20515

Dear ~~Mr. Conable~~ Barber:

Thank you for your letter of April 4 recommending Mr. John R. Riedman for appointment as a possible director of the Buffalo Branch of the Federal Reserve Bank of New York. I will see that Mr. Riedman's name is added to our "pool" of potential directors, both here and at the Bank.

We maintain a constant search for talented individuals for possible service in these positions, and we certainly appreciate having his biographical information to draw on in the future.

Sincerely,

REB:vcd (V-64)

bcc: Mr. Allison
Mrs. Robinson (2) (w/copy of incoming)
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

Action assigned Mr. Allison

BARBER B. CONABLE, JR.
NEW YORK, 30TH DISTRICT

COMMITTEES:
WAYS AND MEANS
STANDARDS OF OFFICIAL CONDUCT
JOINT COMMITTEE ON TAXATION

Congress of the United States
House of Representatives
Washington, D.C. 20515

WASHINGTON OFFICE:
237 CANNON HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-3615

DISTRICT OFFICES:
311 FEDERAL OFFICE BUILDING
100 STATE STREET
ROCHESTER, NEW YORK 14614
(716) 263-3156

P.O. BOX 85
10 ELLICOTT STREET
BATAVIA, NEW YORK 14020
(716) 343-6732

#64

April 4, 1983

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 APR -8 AM 8:57
RECEIVED
OFFICE OF THE CHAIRMAN

The Honorable Paul A. Volcker, Chairman
Board of Governors of the Federal Reserve System
20th St. at Constitution Ave.
Washington, D. C. 20551

Dear Mr. Chairman:

I would like to recommend for your consideration the appointment of John R. Riedman of Rochester, New York, as a member of the Board of Directors of the Buffalo Branch of the Federal Reserve Bank of New York.

John Riedman is one of the outstanding business and community leaders in western New York. As president of the Riedman Corporation he directs one of the nation's leading independent insurance marketing firms, and has developed major office buildings in downtown Rochester. He is a director of the Security New York Corporation; a former president of the Rochester Chapter, Chartered Property and Casualty Underwriters; was a delegate to the White House Conference on Small Business and a member of the President's Commission on Personnel Interchange.

Among his community activities, he is a director of the Rochester Museum and Science Center, a member of the Board of Overseers of Strong Memorial Hospital, and a director of Downtown Development Corporation of Rochester.

I have known John Riedman for about twenty years and have the highest regard for his personal qualities of competence, reliability and integrity. He is well acquainted throughout the western New York business and banking community and would make a substantial contribution to the Board in western New York.

Very truly yours,

Barber Conable

Barber B. Conable, Jr.

C/nm

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April 22, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

Thank you for your letter of April 20 regarding your Committee's oversight hearing.

I am looking forward to being with you on April 26 at 9:30 a.m.

Sincerely,

S/ Paul

CO:pjt (V-74)

bcc: Don Kohn

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April 20, 1983

The Honorable Thomas P. O'Neill, Jr.
Speaker of the House of Representatives
Washington, D. C. 20515

Dear Mr. Speaker:

In accordance with the requirements of the Freedom of Information Act, I am submitting the Annual Report of the Federal Open Market Committee of the Federal Reserve System covering the implementation of its administrative responsibilities under the Act during the calendar year 1982.

Sincerely,

S/Paul A. Volcker

Enclosure

Speaker of the House of Representatives

Received ______________________________

By ______________________________

NB:crl

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Federal Reserve Bank of St. Louis

April 20, 1983

The Honorable Glenn English
Chairman
Subcommittee on Government Information,
Justice and Agriculture
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Chairman English:

In accordance with the requirements of the Freedom of Information Act, I am submitting the Annual Report of the Federal Open Market Committee of the Federal Reserve System covering the implementation of its administrative responsibilities under the Act during the calendar year 1982.

Sincerely,

S/Paul A. Volcker

Enclosure

NB:crl

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Federal Reserve Bank of St. Louis

April 20, 1983

The Honorable John Tower
United States Senate
Washington, D.C. 20510

Dear Senator Tower:

I appreciated reading your highly constructive statement on the IMF and related questions.

Best regards,

PAV:ccm

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Federal Reserve Bank of St. Louis

JOHN TOWER
TEXAS

COMMITTEES:
ARMED SERVICES
CHAIRMAN
BANKING, HOUSING, AND
URBAN AFFAIRS
BUDGET

United States Senate

WASHINGTON, D.C. 20510

April 13, 1983

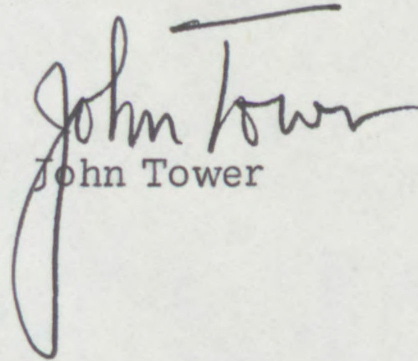
BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 APR 18 AM 9:28
RECEIVED
OFFICE OF THE CHAIRMAN

The Honorable Paul A. Volcker
Chairman
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

I am enclosing for your information a copy of the remarks which I recently made during consideration of S.695 and S.502, regarding the International Monetary Fund, by the Committee on Banking, Housing, and Urban Affairs. I hope you will find these comments of interest.

Sincerely,



John Tower

JGT/jfh
Enclosure

Dear Senator Tower,
I appreciated your reading
lively constructive statement on
the IMF & related questions.
Best regards

STATEMENT BY SENATOR JOHN TOWER

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
HEARING ON S.695 (RE: U.S. PARTICIPATION
IN THE INTERNATIONAL MONETARY FUND), AND
S.502, THE INTERNATIONAL LENDING REFORM
ACT OF 1983

APRIL 11, 1983

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Federal Reserve Bank of St. Louis

Thank you, Mr. Chairman. I am pleased to have this opportunity to express to the Committee and the distinguished witnesses present my views on this matter of economic and political importance.

I intend to support the proposed International Monetary Fund quota increase. With our own economic difficulties, it is tempting to say no -- to take the position that it is not our responsibility to bail out either the nations who took on too much debt or the banks that made the loans. However, the issue is not that simple.

The stability of the international financial system is at stake. If nations begin defaulting on large loans, the system could begin to crumble -- sending interest rates up around the world and thus effectively ending economic recovery. Additionally, it is not in the best national security interests of the United States to throw these developing nations into financial chaos.

But at the same time, we must correct the causes of the problem so that we do not find ourselves in this same situation again. We in Congress need to look at changes in banking regulations designed to make financial institutions more responsible in making international loans. The IMF must work with the borrowing countries to insure that necessary and complementary changes in trade, fiscal, and monetary policies are made.

The financial difficulties of the developing countries are not abstract topics of interest only to diplomats and bankers. To the

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PEOPLE OF TEXAS, THE INTERNATIONAL DEBT CRISIS IS ALL TOO REAL. THE DISASTROUS CONDITION OF THE MEXICAN ECONOMY BROUGHT ABOUT BY RUNAWAY DEFICIT SPENDING AND THE WORLD RECESSION HAS BROUGHT DEPRESSION-LIKE CONDITIONS TO LOCAL COMMUNITIES ALONG THE 1,952 MILE BORDER WITH MEXICO. BUSINESS SALES IN SOUTH TEXAS ARE OFF 60 TO 80 PERCENT WITH UNEMPLOYMENT AVERAGING IN EXCESS OF 25 PERCENT.

TOWN OFFICIALS IN EAGLE PASS TELL ME THAT HALF OF THE LABOR FORCE IS UNEMPLOYED. WITH BUSINESS ACTIVITY FALLING AND UNEMPLOYEMNT SKYROCKETING, THE TAX BASE OF LOCAL COMMUNITIES IS RAPIDLY ERODING.

IN ADDITION, THE ECONOMIC DIFFICULTIES IN MEXICO HAVE LED TO INCREASED ILLEGAL IMMIGRATION TO THE UNITED STATES. ILLEGAL BORDER CROSSINGS ARE ESTIMATED TO HAVE INCREASED NEARLY 50 PERCENT OVER THE SAME PERIOD A YEAR AGO. IT IS LIKELY THAT MANY OF THESE IMMIGRANTS WILL SETTLE IN TEXAS, PLACING EVEN GREATER BURDENS ON LOCAL GOVERNMENTS ALREADY STRAINING TO PROVIDE SOCIAL AND EDUCATIONAL SERVICES TO THOUSANDS OF ILLEGAL ALIENS.

IT IS MY HOPE THAT AS CONGRESS CONSIDERS EFFORTS TO IMPROVE THE STABILITY OF THE INTERNATIONAL FINANCIAL SYSTEM THAT WE REMEMBER AS WELL THE PROBLEMS FACED BY U.S. CITIZENS IN THE BORDER COMMUNITIES OF TEXAS, CALIFORNIA, NEW MEXICO, AND ARIZONA.

I HAVE BEEN PLEASED WITH THE LEADERSHIP EXERCISED BY THE IMF IN ITS DEVELOPMENT OF AUSTERITY MEASURES AS A CONDITION FOR EXTENDING

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LOANS TO THOSE COUNTRIES BURDENED BY THE WEIGHT OF EXCESSIVE DEBT. IT IS THE ASPECT OF CONDITIONALITY THAT DISTINGUISHES IMF LOANS FROM MUCH OF THE WELL-INTENTIONED BUT UNSUCCESSFUL FOREIGN AID EXTENDED IN THE PAST TO THE DEVELOPING WORLD. IT IS CRUCIAL THAT THE IMF CONTINUE ITS INSISTENCE UPON FISCAL AND MONETARY RESPONSIBILITY.

AT THE SAME TIME, THE UNITED STATES MUST INSIST THAT TRADE BARRIERS IN BORROWING COUNTRIES MUST BE LIFTED. SOME SAY THAT CONGRESS AND THE UNITED STATES HAVE NO LEVERAGE WITH MULTILATERAL ASSISTANCE ORGANIZATIONS. I DISAGREE. BECAUSE OF ITS 20 PERCENT VOTING BLOC, THE UNITED STATES EFFECTIVELY HAS VETO POWER OVER MAJOR IMF POLICY CHANGES. WE HAVE A RESPONSIBILITY TO CITIZENS OF THE UNITED STATES AND THE WORLD TO EXERCISE THIS POWER TO ENSURE THAT THE CONDITIONS OF IMF LOANS MAKE GOOD ECONOMIC SENSE.

WHILE THE IMF SETS OUT CONDITIONAL MEASURES IN ORDER FOR A COUNTRY TO QUALIFY FOR ASSISTANCE, WE IN THIS COMMITTEE MUST DEMAND RESPONSIBILITY ON THE PART OF OUR DOMESTIC BANKS INVOLVED IN LENDING ABROAD. IN MY VIEW, THE BEST REGULATION, IF IT IS ALLOWED TO FUNCTION, IS THE FREE MARKETPLACE.

HOWEVER, IN OUR HIGHLY REGULATED FINANCIAL SYSTEM, THE FREE MARKET HAS ONLY IN RECENT DAYS BEGUN TO COME INTO PLAY. THEREFORE, IT IS MY BELIEF THAT THIS COMMINTTEE SHOULD REVIEW THE MYRIAD OF LEGISLATIVE AND REGULATORY PROPOSALS BEFORE US DEALING WITH INTERNATIONAL LENDING PRACTICES AND ACCOUNTING.

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Federal Reserve Bank of St. Louis

I BELIEVE THAT THE POSITIONS TAKEN BY CHAIRMAN VOLKER, CHAIRMAN ISAAC, AND COMPTROLLER CONOVER IN THEIR PROPOSALS TO REVIEW THEIR REGULATORY ROLE IN OUR BANK'S INTERNATIONAL LENDING ACTIVITIES HAVE A GREAT DEAL OF MERIT. SEVERAL OF THESE PROPOSALS HAVE APPEAL, WHILE OTHERS, IN MY VIEW, SHUT THE ISSUE OF FREE MARKET DISCIPLINE COMPLETELY OUT OF VIEW. THE IMPORTANT POINT HERE IS THAT WE ACT PROMPTLY ON THE BEST COMBINATION OF THESE MEASURES FOR THE OVERALL BENEFIT OF THE SYSTEM.

AS WE PROCEED TOWARD MARK-UP ON THIS CRITICALLY IMPORTANT MEASURE, I URGE EACH OF MY COLLEAGUES TO REVIEW THIS REQUEST WITH PRIMARY CONSIDERATION NOT TOWARD PETROBRAS, PEMEX, OR THE CHASE MANHATTAN, BUT INSTEAD TOWARD THE WELFARE OF THE AMERICAN CONSUMER AND TAXPAYER. ~~AND~~ I SAY TO YOU THAT SUPPORTING THIS QUOTA INCREASE IS NOT INCONSISTENT WITH THESE GOALS.

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Federal Reserve Bank of St. Louis

April 20, 1983

The Honorable Charles E. Grassley
Chairman
Subcommittee on Administrative Practice
and Procedure
Committee on Judiciary
United States Senate
Washington, D. C. 20510

Dear Chairman Grassley:

In accordance with the requirements of the Freedom of Information Act, I am submitting the Annual Report of the Federal Open Market Committee of the Federal Reserve System covering the implementation of its administrative responsibilities under the Act during the calendar year 1982.

Sincerely,

S/Paul A. Volcker

Enclosure

NB:crl

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Federal Reserve Bank of St. Louis

April 20, 1983

The Honorable George H. W. Bush
President of the U.S. Senate
Washington, D. C. 20510

Dear Mr. Vice President:

In accordance with the requirements of the Freedom of Information Act, I am submitting the Annual Report of the Federal Open Market Committee of the Federal Reserve System covering the implementation of its administrative responsibilities under the Act during the calendar year 1982.

Sincerely,

S/Paul A. Volcker

Enclosure

President of the U.S. Senate

Received ______________________________

By ____________________________________

NB:crl

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Federal Reserve Bank of St. Louis

April 20, 1983

The Honorable David Pryor
United States Senate
Washington, D. C. 20510

Dear Senator Pryor:

Thank you for your letter of March 21 recommending Mr. Jack E. Adams for a position on our Consumer Advisory Council.

I can assure you that Mr. Adams' qualifications will receive full consideration when the Board selects new Council members this fall to fill the positions of individuals whose terms expire in December 1983.

The Board has been gratified at the large number of qualified persons whose names have been submitted for consideration in previous years, and we very much appreciate having your recommendation. Thank you for your interest in the Council.

Sincerely,

S/Paul A. Volcker

CO:pjt (#V-53)
bcc: Mrs. Mallardi (2)
Mrs. Bray (w/copy of incoming)

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Federal Reserve Bank of St. Louis

Action assigned Mr. Garwood

DAVID PRYOR
ARKANSAS

RUSSELL SENATE OFFICE BUILDING
WASHINGTON, D.C. 20510
(202) 224-2353

ARKANSAS OFFICE:
3030 FEDERAL BUILDING
LITTLE ROCK, ARKANSAS 72201
(501) 378-6336

United States Senate
WASHINGTON, D.C. 20510

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
FINANCE
SPECIAL COMMITTEE ON AGING
SELECT COMMITTEE ON ETHICS

#53

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 MAR 23 AM 11: 10
RECEIVED
OFFICE OF THE CHAIRMAN

March 21, 1983

The Honorable Paul A. Volcker
Chairman
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

This is to recommend Jack E. Adams, Professor of Economics at the University of Arkansas at Little Rock, who is currently interested in being named to the Consumer Advisory Council of the Federal Reserve.

Professor Adams is a man of wide reputation, not only on the campus of the University but throughout the state as well. He is interested in the workings of the Federal Reserve and would bring the point of view of both an expert and a consumer. His qualifications are spelled out in his communications with your office, and I am adding to these my own recommendation and encouragement. Please let me know if there is further information I might supply.

With best wishes and thanks for your attention.

Sincerely,

David Pryor

DP/dhk

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Federal Reserve Bank of St. Louis

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 20, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Claiborne Pell
United States Senate
Washington, D. C. 20510

Dear Senator Pell:

Thank you for your letter of February 22 relating the concerns of the Rhode Island Bankers Association regarding the procedures used by the Treasury Department in claiming refunds from Rhode Island banks for amounts paid out for government checks subsequently found to have been cashed improperly. The Bankers Association is concerned that in many instances the returned checks were, in fact, cashed in accordance with Treasury Department procedures, and the checks are being returned up to two years after they were cashed, making it difficult for the bank to locate the person who cashed the check.

The Federal Reserve Banks handle government checks as fiscal agents of the United States, under the direction of the Secretary of the Treasury. As fiscal agents, the Reserve Banks are required to follow the rules, regulations, and policies established by the Treasury Department in the processing of government checks.

Treasury's right to recover funds previously paid out for a check bearing an unauthorized endorsement has been recognized by the courts. (See Clearfield Trust Co. v. United States, 318 U.S. 363 (1943).) This is now part of federal law. The Treasury's regulation in this area provides that --

> The presenting bank and the indorsers of a check presented to the Treasury for payment are deemed to guarantee to the Treasury that all prior indorsements are genuine . . . . (31 CFR Sec. 240.4)

This guaranty is similar to that which the Uniform Commercial Code places on endorsers of checks drawn on private sector banks (U.C.C. Secs. 3-417, 4-207). If the check is discovered to have been stolen and the payee's endorsement forged, the collecting banks are deemed to have breached their guaranty to Treasury. Consequently, the Treasury is entitled, as is any private sector payor in similar circumstances, to a refund. This rule is based on the principle that in such cases the person who took directly from the forger should bear the loss. In order to make depository institutions aware of their potential

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liability, the Treasury has printed on the back of each government check a warning that the institution should require proper identification before cashing such checks.

Due to the inherent nature of the process, in many instances there are substantial delays before a refund is requested from a depository institution. This delay is due to the fact that a claim for a refund is not made to the depository institution until the payee himself has indicated that he had not received the check or until the Treasury has been notified that the intended payee died before receipt of the check. Until that time, the Treasury is unable to determine that there has been a forged or unauthorized endorsement. Under federal law, a payee may submit a claim up to six years after the date that the check was issued (31 U.S.C. Sec. 3702). The Treasury advises that most delays in beginning a claim for a refund against the presenting bank are caused by the delay in receiving the claim from the payee. Further, the law provides the United States with at least six years from the date a check is presented to it for payment to make a claim for a refund against a prior endorser (31 U.S.C. Sec. 3712).

Generally, the Treasury reclaims funds directly from the presenting institution and does not seek the assistance of the Federal Reserve. If, however, the endorsements on the check are illegible or unclear, the Treasury may ask the appropriate Reserve Bank to identify the presenting institution and forward the request for a refund to that institution. The Reserve Banks usually are able to perform this service within two business days of the time of the Treasury's request.

I am advised that the Treasury is taking steps to enable presenting banks to identify prior endorsers so that they may enforce their own rights to refund under the Uniform Commercial Code. The Treasury provides a copy of the check and the payee's claim, where the payee has filed a claim. Recently, Treasury has been able to improve the quality of microfilm check copies provided to presenting institutions. I also understand that a special unit of Treasury's Bureau of Government Financial Operations has been set up to process requests from bankers for information regarding reclamations, and that the Treasury is considering proposing legislation to shorten the time in which a payee whose check has been stolen may file a claim. The Treasury is also actively promoting the use of direct deposits of payments by electronic funds transfer to reduce claims resulting from loss and theft. In the long run, I believe that this latter approach is a most promising one.

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Federal Reserve Bank of St. Louis

I can understand the Rhode Island Bankers Association's concern with this issue. There are some difficult prolems involved and I hope that the efforts being made to reduce the exposure of depository institutions that accept government checks will be successful.

Sincerely,

S/Paul A. Volcker

JRA:GTS:DJW:pjt (#V-34)
bcc: Gil Schwartz
Joe Alexander
Legal Records (2)
Gene Snyder
Elliott McEntee
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

Action assigned Mr. Allison

CHARLES MC C. MATHIAS, JR., MD., CHAIRMAN
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United States Senate
COMMITTEE ON
RULES AND ADMINISTRATION
WASHINGTON, D.C. 20510

1983 FEB 24 AM 11:48

February 22, 1983

The Honorable
Paul A. Volcker
Chairman
Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Dear Mr. Chairman:

The Rhode Island Bankers Association (R.I.B.A.) has recently brought to my attention their concern over the procedures followed by the Federal Reserve System and the Treasury Department in handling of federal government checks which are determined to have been forged or chashed illegally and are returned to Rhode Island banks.

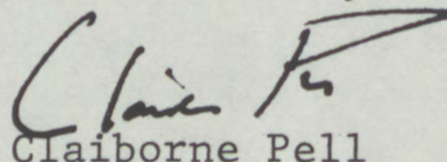
The Bankers Association complains first that in many cases the returned checks were in fact cashed in accordance with U.S. Treasury Department procedures. Secondly, the Association complains that the questioned checks are being returned to their members from one to two years after cashing, making it difficult for security personnel to trace the check to its source.

The Bankers Association say they have been unable to obtain relief from these problems from either the Federal Reserve System or the Treasury Department and that the continuing cost of these problems to the member banks in Rhode Island is about $400,000 a year.

I would appreciate your comments on this situation and your recommendations on how these problems might be resolved. I am making a similar request to the Treasury Department.

With every good wish.

Ever sincerely,



Claiborne Pell

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

April 20, 1983

The Honorable Jack Kemp
House of Representatives
Washington, D. C. 20515

Dear Mr. Kemp:

Thank you for your recent letter on lending by American banks to developing countries and the relationship of the external financing problems of some of those countries to the IMF legislation now before Congress. Your letter raises several important issues. I am pleased to respond to your questions and provide you with my evaluation of the ways in which the long-run interests of the United States can best be served in this area.

The plan you have outlined for dealing with the accumulated debts of selected developing countries appears to have several elements:

1. The debts of these countries should be reduced relative to their exports.

2. The debt service of these countries should be reduced by consolidating short- and medium-term loans to them into longer-term loans, and granting a grace period on the repayment of principal.

3. Interest payments on the consolidated debt would be maintained, and part of this stream of income, as well as other income, should be diverted by the banks to setting up reserves commensurate with their foreign exposure.

The arrangements that have been put into place over the past year on a case-by-case basis to deal with the external financial problems of some of the major borrowing countries have a substantial similarity to some elements of your plan. In the cases of Argentina, Brazil, and Mexico, bank lenders have entered into restructuring arrangements governing the public sector, external debts of these countries. The precise structure and terms of the arrangements have differed, as they should, in individual cases, reflecting differences in the situations of the borrowing countries. A common concern in each of these arrangements has been to structure them to ensure as far as possible that their economic terms are realistic. Debt burdens are reduced sharply in the short run, and those burdens shrink in the medium term in relation to the debt servicing capacities of the borrowers. The International Monetary Fund has played a major role in assessing the economic

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viability of these arrangements. A frequent feature of this approach has been a restructuring of maturities so that current payments (coming due over various time intervals) of principal on most public sector, external debt were postponed (for various time periods). Another main feature is that interest payments are to be maintained.

While the actions that have been taken with respect to some of the major borrowing countries have been broadly consistent with certain elements of your plan, important differences are also involved. One of the major differences with your proposal is the process by which the borrowers are expected to adjust their external accounts. In your plan they would be expected to keep up their interest payments, but not to increase their debts. In simplest terms, this rule implies that these countries must be in current account balance; as a first approximation, their trade surplus must cover their required interest payments. For the three major borrowers, Argentina, Brazil, and Mexico, interest payments to banks amounted to about $20 billion in 1982, and their combined current account deficit was about $21 billion. In 1983, these countries' interest payments to banks are expected to be about $18 billion, reflecting lower interest rates, more debt and higher spreads. Their combined current account deficit is expected to be about $12 billion, reflecting lower interest payments and a larger trade surplus. If the expected 1983 current account deficits of these countries had to be eliminated while interest payments are maintained, their trade surplus would have to be increased significantly, which would imply a devastating economic and political burden on these countries on top of the adjustment burden that they are already carrying. Alternatively, if required interest payments were reduced by writing off the underlying debt, the adjustment of claims on these three countries--on the order of one-half or two-thirds--would hardly be consistent with your stated objective that "a gradual reduction of the ratio of the banks' foreign exposure to their equity must not result either in unintended diminution of the banks' ability to extend domestic loans or in a sharp economic contraction in debtor countries." Thus, I believe it is both realistic and appropriate that the commercial banks continue to lend to these countries as they adjust their economies.

At the same time, such lending by banks to these countries must be reduced from the substantial pace of the past several years. Under the plans worked out between these countries, the IMF, and the lending banks, bank claims would increase, but on a much reduced scale. Under these plans, the

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fraction of banks' assets and capital that is at risk in countries that are having difficulties servicing their debts will be gradually and steadily reduced. Essentially, the breathing space for adjustment that you recognize as a key element in this situation requires more than a cessation of principal repayments--it also requires a prudent and careful maintenance of the credit lines that keep economic activity in these countries alive.

Another aspect of your proposal that causes me concern is that it seems to contemplate the application of a generalized formula to a broad spectrum of countries. You mention that it would apply to "selected debtor countries," but it is not clear how the selection would be made, or by whom. These troublesome external debt situations turn out to be exceedingly complex and varied. Within the borrowing countries, the debts are owed not only by the public sector, but also by private borrowers who have different possibilities for keeping up service on their debts. About one-third of U.S. banks' claims on non-OPEC developing countries consists of claims on non-bank borrowers in the private sector, another third is to banks, and less than a third is to non-bank borrowers in the public sector. Moreover, banks of nearly every large country are involved in these lending activities--U.S.-chartered banks account for less than 40 percent of the claims of banks on the major developing countries. In addition, these countries have significant intergovernmental debts and require a constant flow of credit to finance their trade and other external transactions. (I am enclosing a copy of my February 2 testimony before the House Committee on Banking, Finance and Urban Affairs which presents a detailed discussion in the text and attachments of the dimensions of the international debt situation and efforts to deal with it.)

In these conditions, it is difficult to envision the process by which your approach could be uniformly applied on a multilateral basis. It is best, I believe, to deal with each borrowing country on its own merits--some will manage their affairs better than others, some will be luckier, perhaps, in their experience with oil prices or other events beyond their control, and some will be better organized in dealing with their creditors.

We need to be very careful, in my view, in putting forward proposals that might encourage borrowers and lenders to believe that some multilateral international scheme for settling debts will provide a low cost way of meeting obligations and avoiding losses. Such generalized schemes are likely to be

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inherently inequitable in their application to individual borrowers. They would also establish precedents that could inhibit the flow of international credit for decades, as was the case after the debt problems of the early 1930s, and inhibit the recovery of the world economy. That is why I believe that the best course is to support the efforts of the parties directly involved to work out solutions, but not to substitute a government-imposed solution for the normal negotiating process.

My third concern with your proposal is that it provides no role for the International Monetary Fund. Although one of the main elements of your approach is to reduce the debts of these countries relative to their capacity to service them, you do not provide a mechanism to bring about such adjustment smoothly, which is in the interests of the borrowers, the lenders, and all the participants in the international financial system. The IMF is such a mechanism. It provides temporary financial assistance to the borrowing country; it works with the country to establish an economic stabilization program that is consistent with an open international economic system; and it sometimes works with the country's creditors to ensure that the overall financial program is realistic and viable. Once such an IMF-approved, stabilization program is established, if the country fails to take measures deemed necessary to correct its imbalances, it cannot count on further financing from the IMF, and must expect private financing also to dry up. Thus, the role of the Fund, far from encouraging a continuation of imprudent lending, is to support a continuation of financing only as long as the performance of the borrower is satisfactory within the context of an overall stabilization program designed to establish a sustainable external position.

The process of financial and economic adjustment is complex. It is likely that most borrowing countries will prove capable of carrying their current debts and even larger debts, given their potential for growth. But others may not be able to service their debts without interruption, and banks may be required to recognize this impairment of their assets and their earnings capability by writing off assets and taking charges against their earnings. I am enclosing a table that will convey the general picture of the relationships of claims on non-OPEC developing countries to the capital of selected groups of U.S. banks. Given the hypothetical nature of some of your questions, and the wide range of possible economic developments over the next several years, I do not believe it is prudent or realistic to be more specific. As you suggest, the major lending banks are generating substantial earnings. At the same time, their claims on developing countries are substantial.

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For instance, the enclosed table shows that the nine largest U.S. banks have claims on developing countries on the order of $60 billion; those same banks had earnings after taxes on the order of $3 billion in 1982. Consequently, the fraction of debt that might be written off in any year without a major impact on the equity of these banks is quite limited.

The recent external financial difficulties of some international borrowers have raised a number of important questions about the supervision of international lending activities of U.S. banks. In response to these concerns, the federal banking regulators submitted to the Senate and House Banking Committees a "Joint Memorandum" presenting a five-part program for improved supervision and regulation of international lending. (Copies of the Joint Memorandum and my April 11 testimony on the proposal before the Senate Committee on Banking, Housing and Urban Affairs are enclosed.) In light of your comments on the subject, I would note that one element of the proposed program is the establishment of a system of provisioning against certain country exposure; when a country has been unable to service its debt for a protracted period of time, a bank would be required to recognize the diminished quality of the assets represented by most claims on that country.

The basic premise of the proposed program is that international lending by banks is in the U.S. interest; it should not be abruptly curtailed, but that banks should maintain adequate financial strength to deal with unexpected contingencies and diversify their risks. Indeed, I believe it would be a mistake to downgrade too drastically the great bulk of the foreign lending by U.S. banks. There have been very few cases of outright default on foreign credits since the 1930s, and I believe the borrowing countries recognize the great advantages of maintaining their credit ratings. The greater part of the accumulated debt of non-OPEC developing countries is accounted for by half a dozen countries that have greatly increased their economic strength over the past decade. Once they get back on an even keel, I would expect them to resume a more normal--albeit somewhat slower--rate of expansion of external debt. Just as with most successful businesses that expand their use of invested capital, the main consideration is that the borrower makes productive use of the capital it employs. On the whole, the main borrowers have done reasonably well on that score.

A separate question, involving other considerations, is the debt of Communist countries. I have not dealt specifically with banks claims on these countries, because they are

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relatively small as far as U.S.-chartered banks are concerned. At the end of last year, total claims on Communist countries by U.S. banks were about $6.2 billion, of which $2.2 billion were on Yugoslavia and $1.6 billion on Poland.

On the whole, we have many points of agreement, and a few important points of disagreement. In particular, I share your view that we should devote our energies to ensuring that our efforts to assist the transition to a sustainable equilibrium of world growth and stability should not be swallowed up in a new cycle of crisis. It is precisely because of that concern that the Board of Governors of the Federal Reserve System has strongly supported a substantial strengthening of the financial resources of the International Monetary Fund. The case for increasing the financial resources of the IMF does not fundamentally rest on either the need to support bank lending to a few of its members or on the need to "bail out" banks--many of the IMF's members are not significant borrowers from banks. That case rests on the IMF's central role in the international monetary system.

The IMF's role is considerably broader than dealing with today's critical external financing problems--though those provide the immediate need to accelerate action to increase the resources of the Fund. Over the longer run, the Fund is an important influence in maintaining free and open international channels for financial and commercial flows among countries, for establishing rules of conduct among countries for carrying on their exchange rate policies, and for guiding domestic policies of countries in directions that reduce their international imbalances and enhance their viability as borrowers in private capital markets. The United States has benefited over the years from the expansion of our foreign trade that has been possible in the sort of climate fostered by the Fund, and we stand to lose a great deal if there is a sudden contraction of world trade resulting from intensified external financing difficulties in some of our major markets. From that perspective, it would be unwise, imprudent and dangerous to fail to approve the U.S. share in the IMF's increased resources, since U.S. support and leadership are essential to the IMF's continued effective functioning.

While I sympathize with many of your longer-run concerns about the functioning of our international financial system, I would not advise a fundamental reform of that system at this time. This is a time for supporting the efforts of market forces to accommodate and gradually absorb any misallocation of bank credit. We can and will take measures to lessen

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the possibility of a repeat of recent experience. Our immediate problem, however, is to avoid a financial crisis that might interfere with the economic recovery that has just begun. To accomplish this, I am convinced that the IMF's resources must be increased, and that the banks should be allowed to continue to lend abroad on a reasonable scale consistent with the protection of their long-run interests.

Sincerely,

S/Paul A. Volcker

Enclosures

SP:EMT:vcd (#V-56)

bcc: Mr. Pizer
Mr. Truman
Mrs. Mallardi (2) ✓

IDENTICAL LETTERS SENT TO: CONGRESSMEN LOTT, LEWIS AND PAUL; SENATORS HUMPHREY, EAST AND GOLDWATER

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Selected Data on U.S. Banks' Claims on Non-OPEC Developing Countries
(Billions of dollars)

	All Reporting Banks[1/]				Nine Largest Banks				Next Fifteen Largest Banks			
	Dec. 1977	Dec. 1979	Dec. 1981	June 1982	Dec. 1977	Dec. 1979	Dec. 1981	June 1982	Dec. 1977	Dec. 1979	Dec. 1981	June 1982
Total claims on non-OPEC developing countries	46.9	61.8	92.8	98.6	30.0	39.9	57.6	60.3	8.8	11.3	17.4	19.0
a. Banks	13.0	22.1	31.6	33.0	6.5	11.6	15.8	15.9	3.3	7.6	7.5	8.2
b. Public Sector Nonbank borrowers	16.4	19.3	28.7	31.6	10.5	14.3	20.6	22.7	3.1	3.3	4.0	4.3
c. Private Sector Nonbank borrowers	17.6	20.4	32.6	34.0	13.0	14.0	21.2	21.7	2.5	6.0	5.9	6.5
Reporting banks' total assets	717.1	941.3	1,164.5	1,192.4	372.5	486.1	564.6	566.3	145.0	188.1	233.8	241.1
Reporting banks' total capital	40.9	49.9	62.7	66.2	18.4	21.9	26.1	27.1	8.3	10.1	12.2	12.7
Claims as a percent of												
Total assets	6.5	6.6	8.0	8.3	8.1	8.2	10.2	10.6	6.1	6.0	7.4	7.9
Total capital	115	124	148	149	163	182	220	222	106	112	143	150

1/ All U.S. banks reporting the Country Exposure Lending Survey; 167 banks in the survey for June 1982.
Note: Details may not add to totals because of rounding.

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Mrs. Mallardi

Action assigned to Ted Truman (cc: Mike Bradfield)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

1983 MAR 28 AM 9: 10

RECEIVED OFFICE OF THE CHAIRMAN

Congress of the United States

Washington, D.C. 20515

#56

March 23, 1983

The Honorable Paul A. Volcker
Office of the Chairman
Federal Reserve System
20th & 21st Streets, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

We question the wisdom of increasing by $8.5 billion the U.S. commitment to the IMF. Further lending by the IMF to nations in default or verging on default will encourage further lending by private American banks.

It seems illogical to us for the Administration to advocate a heavier debt burden as the salvation of nations whose export surpluses are unlikely to be sufficient to service old debt, much less new debt. It seems illogical to us to advocate further lending to overborrowed nations by overextended American banks as a means of strengthening the balance sheet of our banks.

We suggest that a better alternative is to deny the IMF's $8.5 billion request and let the creditors work out repayment with their debtors. In certain cases, of course, some loans would have to be written off. This would lead to lighter debt service for debtor nations and more realistic bookkeeping by banks, a healthier situation in both cases. U.S. official funding, if any, should be self-liquidating, temporary and preferably bilateral.

If, instead, the U.S. increases its funding of the IMF and thereby pursues a policy of encouraging more lending by overextended banks to over-indebted nations, we foresee a vicious circle. Repeated threats of default will continue exerting constant pressure on the western governments and private lenders to extend ever more credit. The more intense this pressure, the more blatant the disregard for U.S. interests--economic, financial, political, strategic and diplomatic--is likely to be. Transfer of real resources from the United States to debtor nations--by means of direct government credits and lending by private banks or through the IMF--can continue for a certain period of time, as it did on a massive scale in 1982. Ultimately though, if widespread moratoriums are to be averted, the temptation to defuse

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the situation through the time-tested method of inflation may become irresistible. Needless to say, the consequences of such a course of events for the U.S. economy would be calamitous.

It is obvious that the pressures to increase lending to debtor countries are strengthened by the threat of default. Major U.S. banks, and by extension the U.S. government in its capacity as effective guarantor of the integrity of the domestic banking system, have become hostages of their debtors. In this scheme of things, the threat of default has become equivalent to blackmail, requiring us to pay ransom in the form of continuous lending.

The position in which the United States has found itself is, on many grounds, totally unacceptable. Yet current initiatives of the Administration, including most notably its commitment to increase the subscription to the IMF quotas, only make matters worse in the long run. In order to extricate ourselves from the position of a hostage of foreign debtors, it is necessary to take urgent steps toward reducing, instead of increasing, our major banks' foreign exposure relative to their capital.

A policy of gradually reducing the foreign exposure of U.S. banks relative to their capital must begin by recognizing that the banks' portfolios of high interest yielding short- and medium-term loans to foreign governments are in many cases nothing but a fiction. The economic reality is strikingly different; many of these loans are in effect permanent debt (consols) with interest on them being paid by issuance of more permanent debt by the debtors. The first order of business, therefore, must be to bring legal and accounting treatment of foreign loans in line with the economic reality. Such measures would entail legal recognition of economic losses suffered by U.S. lenders, and their equity positions would have to be adjusted accordingly.

We are acutely aware that a <u>gradual</u> reduction of the ratio of the banks' foreign exposure to their equity must not result either in unintended diminution of the banks' ability to extend domestic credit or in a sharp economic contraction in debtor countries. A plan aimed at the resolution of the present debt situation must emphasize the reduction of debtor countries' debt relative to their exports, not further debt accumulation--especially when it involves American taxpayers guaranteeing the repayment of loans extended by private institutions to foreign governments.

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In its broad outline such a plan would allow selected debtor nations to reduce their debt service. This could be done by consolidating their short- and medium-term loans into long-term loans, and by granting them a period of grace on the repayment of the principal. These steps would give the debtors sufficient breathing space to reorient their economies toward generating export surpluses necessary to fully service their debts in future years. Such an orderly adjustment is clearly preferable to the present practice of sporadic hectic scrambling by borrowers for additional funds in exchange for promises to undertake austerity measures that might not be economically rational or politically tolerable. As the economic recovery in industrial countries becomes broad-based and solid, the debtors should find that higher demand for their exports makes it easier to resume repayments of loans.

Since the flow of interest payments on the consolidated debt is to be maintained during the grace period, reported earnings of U.S. banks will suffer only to a limited degree relative to the current fictitious arrangement. The grace period would also enable the banks to start setting aside loan loss reserves commensurate with their foreign exposure. This would require diverting some portion of their earning stream from both domestic and foreign operations toward such reserves at the expense of dividend payments, bonuses for management and tax revenues to the Treasury. It is a good investment that will strengthen the banks and reduce the transfer of U.S. resources to foreign governments.

There is no doubt that projected total pre-tax earnings of major banks would be sufficient to fund such loan loss reserves. In fact, most analysts agree that the outlook for major U.S. banks is very good. Lower rates of inflation are increasing the value of their investment portfolios; declines in interest rates are resulting in widening spreads between their lending rates and cost of funds; deregulation is helping them to reclaim the market share lost to money-market mutual funds. By and large, their earning per share and dividends are expected to grow quite rapidly, especially in an expanding economy. Finally, owing to the improved economic climate, the quality of their domestic loans is bound to improve. The bottom line is that the banking industry will be strong enough to establish over a period of several years reserves for possible losses on its foreign loans.

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The questions remain as to:

* What percentage of foreign loans by U.S. banks would have to be written down to make the remainder serviceable?

* What is the minimum period of time over which the reserve funds should be set aside?

* What would constitute "sufficient" reserves?

* Against which classes of loans are these reserves to be established?

* What should be the length of the grace period during which the repayment of the principal would be suspended?

* What would be the criteria and procedure for absorbing established loan loss reserves into the banks' capital base if and when loans are repaid?

* To what extent U.S. banks or debtor countries can be treated differentially?

These questions cannot be answered without data on individual banks' exposure in individual countries and without data on countries' exports and banks' earning prospects. Since regulation of the nation's banking system is within your domain of responsibility, we urge you to have the above questions explored with some urgency. Numerous policy options have been proposed in conjunction with such a study, and we commend these to your attention. These options include, but are not limited to, the following:

* The grace period is to be denied to Communist countries.

* The grace period is not to extend beyond 4 years.

* Loans are to be consolidated over a period no longer than 12 years following the grace period.

* Debtor nations involved should encompass those whose debt was already rescheduled or is expected to be rescheduled in 1983.

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* Long-term targets for loan loss reserves are to be set for all banks whose total foreign exposure exceeds their total equity; these targets are to be specified in such a way that they apply to all loans to a country in excess of a given percentage of a given bank's equity (such as 10, 20 or 30 percent).

* A fixed percentage (10, 20 or 25 percent, for example) of pre-tax earnings of each bank involved are to be set aside each year until the specified loan loss reserve targets are attained.

Formulating your response with the above options in mind will help us to respond to suggestions being made and to evaluate and determine the proper parameters in which to address this problem. Too much is at stake to allow banks to continue pretending for another year or two that their renegotiated foreign loans, with their outrageous up-front fees and higher interest rates, are profit-yielding, when in fact these profits are entirely a result of dubious bookkeeping rather than cash flows.

For the troubled borrowers to resume economic growth, their debt burden must lighten rather than increase. For U.S. banks, the proportion of their assets in the form of loans to less developed countries and Communist countries must be reduced rather than increased. It is, we firmly believe, a duty of the U.S. government to adopt energetic measures leading to this outcome. Detailed examination of these measures would be a sensible and necessary beginning.

Finally, coming to grips with the symptoms of the International Debt Crisis can make sense only if we simultaneously address its underlying cause -- the breakdown of a stable and workable international monetary system. Unless we do so, all our efforts to assist the transition to a sustainable equilibrium of world growth and stability will be rapidly swallowed up in a new cycle of crisis. This would be the cruelest blow of all both to American citizens and the people of the developing countries who trust us to put an end to their economic misery. So we urge you also to put international monetary reform on the agenda of the leader of the West.

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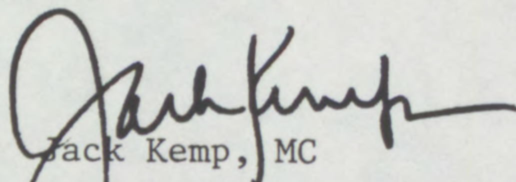
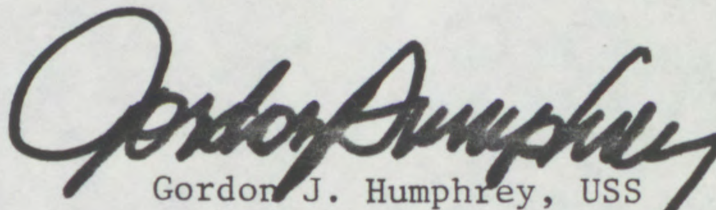
The Honorable Donald T. Regan
March 24, 1983
Page Six

The purpose of this letter is to solicit your evaluation of the plan we have suggested and to request answers to the questions posed. Since this matter is proceeding in Congress, we respectfully request an early reply.

Sincerely,

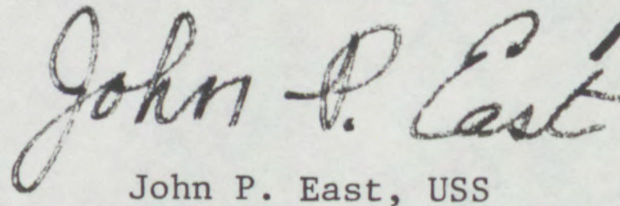


Jack Kemp, MC

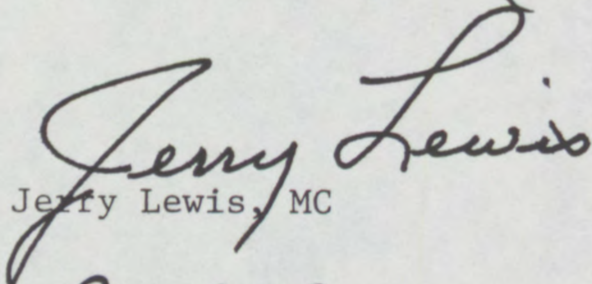


Gordon J. Humphrey, USS

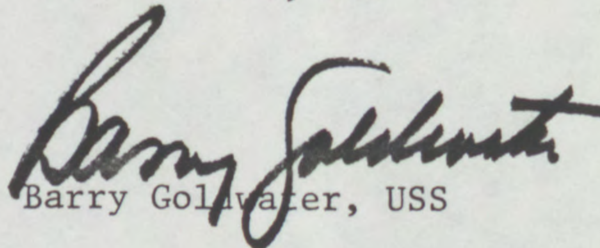
Trent Lott, MC



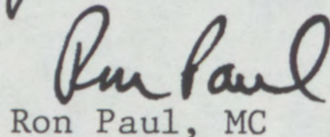
John P. East, USS



Jerry Lewis, MC



Barry Goldwater, USS



Ron Paul, MC

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April 19, 1983

The Honorable Fernand J. St Germain
House of Representatives
Washington, D. C. 20515

Dear Fred:

I appreciate the gavel. It will be a great contribution to the coordination of the Federal Reserve with the House Committee if I can use it with the same intimidating effect in our meetings!

Regards,

PAV:ccm

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225-4247

April 13, 1983

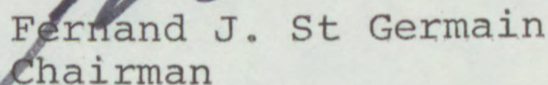
Honorable Paul Volcker
Chairman
Federal Reserve Board
Washington, D. C.

Dear Mr. ~~Chairman~~ Paul:

At our Committee hearing yesterday you seemed to be intimidated by my use of a "man-sized" gavel!

I am delighted to give you the twin of my gavel so that you do not feel neglected.

Sincerely,



Fernand J. St Germain
Chairman

Enclosure

Dear Fred,
I appreciate the gavel.
It will be a great contribution to the coordination of the Federal Reserve with the ~~Federal Reserve~~ House Committee if I can use it with the same intimidating effect in our meetings!
Regards,

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April 19, 1983

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

Thank you for your letter of March 23 enclosing written questions posed by Congresswoman Kaptur in connection with the hearing held on February 2. For your information, I am enclosing a copy of the responses I have sent to Ms. Kaptur.

Sincerely,

S/ Paul

Enclosure

CO:pjt (#V-57)
bcc: Mr. Gemmill
Mrs. Mallardi (2) ✓

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April 19, 1983

The Honorable Marcy Kaptur
House of Representatives
Washington, D.C. 20515

Dear Ms. Kaptur:

In Chairman St Germain's letter to me of March 23, he submitted written questions you had in connection with the hearing on February 2. I am pleased to enclose responses to these questions.

Please let me know if I can be of further assistance.

Sincerely,

S/Paul A. Volcker

Enclosure

CO:pjt (#V-57)
bcc: Mr. Gemmill
Mrs. Mallardi (2)

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Chairman Volcker's responses to written questions from Congressman Kaptur submitted in connection with the hearing held on February 2, 1983.

Question 1: What additional supervisory role could be played by an agency in the United States to "help" the banks avoid overexposure in the future? If the banks do not change their attitude towards loans even with a growth in their current account deficits, what role can a surpervisory group play to force them to take account of these factors?

Answer: There are several ways in which an expanded role for bank supervision could reduce the likelihood that banks would become over exposed on international lending. The bank regulatory agencies submitted a Joint Memorandum to the Senate Banking Committee on April 7 (copy enclosed) that outlines our proposals for improved supervision and regulation.

The basic approach is to require banks' increased attention to the diversification of risk and the maintenance of adequate financial strength.

One element of this approach is to adopt measures that would give banks greater incentives to ensure that loans are priced adequately to cover the risk involved. During the two years to mid-1982 -- a period of substantial growth in bank claims on the main borrowing countries -- lending terms on bank loans tightened only slightly. It has been suggested that changes in banks' accounting and reserving practices could contribute to more realistic pricing of loans, particularly in recognizing the potential risks involved. This approach would

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be more effective, and more compatible with competitive equity, if it were taken on a coordinated basis by supervisors of all countries whose banks are actively involved in international lending.

Another element is to take steps to increase the amount of information made public on the positions of individual banks, and to rely on market discipline to ensure that banks limited their exposure in various markets and to different borrowers to prudent levels.

These elements are not mutually exclusive, and, in fact, U.S. bank supervisors are recommending measures of each type as part of their integrated package.

Question 2: Why do not the banks set up larger risk pools (loan loss reserves) if they want to loan abroad?

Answer: Banks are expected to maintain loan loss reserves adequate to meet future losses on any loans, foreign or domestic, in their portfolios. The exact level of reserves is determined by bank management, and many U.S. banks have increased their loan loss reserves substantially during the past year in recognition of the deterioration in quality of both foreign and domestic loans on their books. One of the recommendations in the banking agencies' proposal is that special reserves be established for certain specified country exposure situations, where a borrower has been unable to service its external debts over a protracted period and the bank has not otherwise recognized the diminished quality of the assets involved.

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Question 3: If a major tightening of regulations on U.S. bank lending abroad is insisted upon in exchange for approving U.S. participation in the move to bolster the IMF, what regulatory policies do you think should be adopted?

Answer: The bank supervisors have now supplied a memorandum giving their views on desirable changes in regulatory policies and practices.

Question 4: How should we insure that money that U.S. banks loans to foreign countries is not used for the support of human rights violations, military build-ups, and foreign political situations which we don't fully understand? What total dollar loan amount can be traced to use for military purposes?

Answer: As a general policy, the United States does not impose restrictions on private trade or financial transactions with foreign countries. The Foreign Assets Control Regulations of the U.S. Treasury are a limited exception. Under these Regulations licenses are required for commercial or financial transactions with Cuba, Kampuchea, North Korea and Viet Nam by banks and other U.S. persons.

In general, countries obtain funds from a wide range of commercial and financial transactions. Because of the fungibility of money, there is not an effective way to trace a particular source of funds to a particular use by a borrowing country.

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Question 5: Mr. Richard Dale, in his testimony on February 9, suggested that the following safeguards are necessary:

a. A mandatory country lending limit equivalent to, say, 25 percent of the lending bank's capital.
b. Fuller and more timely information on individual countries' public and private sector external debt.
c. Active IMF surveillance of the volume, composition and maturity-distribution of member countries' external debt with a view to preventing, prior to payment interruption, both excessive levels of debt and undue reliance on short-term borrowing.
d. New institutional arrangements to provide lender of last resort assistance to country borrowers experiencing a sudden contraction of external credit.

Please comment on all of the above.

Answer:

a. Specific percentage limits relative to capital on bank loans to individual countries might help achieve diversification of portfolios of some banks, but they would inevitably be arbitrary. Because they would not distinguish between the capabilities of individual banks or the size or circumstances of individual borrowing countries they could well raise more problems than they would resolve. If country lending limits were to be set on a case-by-case basis, the supervisory agencies would be put in the position of making controversial, politically- sensitive judgments about other countries, which they are not equipped to do.

b. More complete current information on debt would be useful to lending institutions, as well as to borrowing countries themselves. However, it is also essential that banks make effective use of the considerable information that is already at their disposal.

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c. The IMF can play a significant role in helping ensure that borrowing countries avoid excessive build-ups of debt, particularly short-term debt. The Fund's influence can be exerted as part of the annual consultations that occur between the Fund and member countries, and more specifically in conjunction with stabilization programs that individual countries may sumbit to the IMF for approval. Fund influence could also come through comment on general economic and financial developments in connection with its Annual Report or other public documents. For these reasons, the bank regulators' program calls for a strengthening of the role of the IMF in this area.

d. The Fund is the appropriate international institution to provide external assistance to countries experiencing reductions in external credits. Such a reduction in credit would generally occur as a result of changes in the position of a borrowing country that called for some adjustment of that country's policies, and a program of adjustment could be worked out in conjunction with the Fund. The historical record shows that once a Fund program is in place, private market financing and/or official credits become more readily available.

As an interim measure, some short-term bridge financing may sometimes be required by countries, pending conclusion of an agreed stabilization program and standby arrangement

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with the Fund. In the past, such assistance has been supplied on an ad hoc basis, often through the Bank for International Settlements. The additional new financing that has been requested for the Fund should be sufficient to obviate any need for a new international institution.

Question 6: If the Congress passes the Administration's request as presented, how much difference would the additional loan authority actually make to the countries involved? If the IMF portion is less than 15 percent of a country's need, how will the U.S. contribution make a difference?

Answer: The Fund's contribution to economic stabilization goes far beyond the proportional size of the financial assistance that it provides. As the international institution with major responsiblities for maintaining the stability of the international financial system, the Fund occupies a unique role. Through its surveillance of an individual country's policies, the Fund helps ensure that the policies adopted by that country are appropriate. In this way, Fund surveillance provides the basis for a country to attract commercial bank and other external financing. Through conditions that are attached to use of its resources, the Fund helps limit and reduce the use of exchange restrictions and other policies that may have disruptive or unfair effects on suppliers or creditors.

In addition to these indirect benefits to member countries, the Fund can provide substantial amounts of financing over the course of an agreed stabilization program. The United States has a strong interest in supporting the Fund in these efforts which cannot continue without full U.S. support.

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QUESTION 7: If the Congress agrees to the Administration's request, describe the crowding out of capital that will occur in U.S. capital markets.

Answer: As noted in testimony before the Committee, commitments for increases in Fund quotas and for an increase in the GAB do not immediately require budget outlays, or an increase in borrowing requirements by the U.S. Treasury. However, when a cash transfer to the Fund is needed Treasury borrowing requirements rise. (The Treasury also receives money back and its borrowing requirements are reduced when members pay back the Fund.)

The amounts that might be required from the United States over the next few years cannot be estimated closely, but they are not likely to involve more than a fraction of the U.S. commitment, and in any event could be expected to represent a very small fraction of Treasury cash demands over this period. The disruptive impact on U.S. financial markets that would occur if the role of the Fund were so limited that it could not effectively stabilize the international financial system would be far greater than the market impact of the additional Treasury borrowing that might arise from IMF use of the additional resources that are being proposed.

QUESTION 8: The Interagency Country Exposure Review Committee (ICERC) has failed to achieve its own stated objective which is to ensure adequate diversification of banks' international loan portfolios. What can be done about this?

QUESTION 9: What can be done about the fact that the ICERC either does not make recommendations that excessive exposures be reduced or that such recommendations are ignored?

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QUESTION 10: Do you think that the most important defect of the ICERC approach is the underlying assumption that diversification can itself provide a sufficient safeguard against country risk? What should the underlying assumption be?

Answer: As noted above, the supervisory agencies have reviewed the country exposure system, and have just reported to Congress on the results of this review.

Diversification of portfolios is a generally accepted principle of sound banking and investment, and it underlies the statutory limit on loans to a single borrower by national banks. Diversification rests on the proposition that all risks attached to any given loan or investment cannot be identified in advance and guarded against. Through diversification, a bank is better protected against the likelihood that a large share of its loan portfolio will be adversely affected by changes in the circumstances of a single borrower, or borrowing country. Of course, diversification alone is not enough -- it must be supplemented by sound lending policies, capital structures and liquidity positions. Banks and bank supervisors need to continue to given close attention to emerging difficulties in borrowing countries.

QUESTION 11: There seems to be a boom/bust tendency in the international credit market. What can be done to prevent both excessive expansion and undue contraction of international lending?

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Answer: Wide cyclical variations in spending occur when plans made on the basis of one set of conditions must be revised as the conditions change. This is particularly likely to happen when an economy shifts into or out of an inflationary period. One consequence of inflation is that financing plans are made and loans negotiated on terms that will prove viable only so long as inflation continues. Wide variations in financing flows have occurred in our domestic economy as well as in the international economy. Particularly pronounced swings in credit market flows have resulted from the sharp changes that have occurred in the oil market in recent years. As the question notes, a primary task is to avoid excessive economy expansion; this can be accomplished if overheating in national economies can be avoided.

QUESTION 12: If IMF funding is not increased, what foreign aid alternatives might be good substitutes to ease the internal pain of countries, such as shipments of more U.S. commodities, oil transfers from the glut, etc."

Answer: As noted in the answer to question #6, the contribution of the Fund cannot be measured by the amount of resources that it supplied to member countries in connection with stabilization programs. In the absence of a Fund program, some countries might provide official bilateral assistance to debtor countries in the form of credits or commodities. However, such bilateral assistance by itself may often tend to lead to bilateral trade and financial arrangements; in addition, some debtor countries

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might seek to deal with their financial problems through discriminatory restrictions on payments. Historically the United States has been adversely affected by exchange restrictions and discriminatory trade and payments, and it is highly unlikely that the United States would benefit from a shift from the present cooperative international financial system to one based in considerable measure on bilateral arrangements.

QUESTION 13: If IMF funding is not approved, describe the likely result on any one of the banking institutions involved.

Answer: Failure to approve the IMF funding would signal a breakdown in international financial cooperation, and would lead to increased uncertainty in financial markets here and abroad. Increased uncertainty could pose problems for some individual banks. Banks that were subject to increased uncertainty might experience deposit run-offs; banks subject to uncertainty might also curtail their lending, both domestic and international. In such an environment, recovery in domestic economies and in international trade could be significantly disrupted.

QUESTION 14: Why can not additional funding be obtained through private markets?

Answer: In order for the IMF to continue in its present role in the international financial system, it is important that the principal permanent source of Fund financing be the quota subscriptions of member governments. Because the Fund is not only a source of short-term financing to member countries but is also expected to provide impartial advice to countries on

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their domestic and international financial policies, the multinational inter-governmental character of the Fund should be preserved. The Fund's role as the guardian of the principles of a free and open international monetary and trading system would not be enhanced if it were increasingly to take on the character of a financial intermediary. That observation would not, however, rule out the possibility that the Fund might have very occasional recourse to private market financing as an interim measure when official financing has been agreed but has not yet been made fully available.

QUESTION 15: If the IMF funding is approved, describe the impact on the U.S. export/import market in the relation to the domestic employment situation in the short-term (1983-85) and in the long term (1985-90).

Answer: Approval of the IMF funding will strengthen the role of the Fund, and help ensure preservation of a free multilateral trading and financial system, and it is in this sort of system that U.S. exports are most likely to flourish. Historically, the United States has been adversely affected by exchange restrictions on international trade -- most strikingly in the 1930s.

When the Fund provides temporary financing to countries in weak financial positions, it helps stabilize the pattern of trade. Such stability contributes importantly to an environment conducive to growth of U.S. exports.

The developing countries that are likely to be most dependent on interim Fund financing have become major customers

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of the United States. Support from the Fund will enable them to grow rapidly not only in the short term, but as emerging industrial countries in the longer term. We would expect to benefit from this growth of markets, especially in the Western Hemisphere. The slowdown in these markets last year was an important contributor to the weakness of our exports.

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Mrs. Mallardi

Action assigned to Ted Truman (cc: Mr. Bradfield)

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225-4247

#57

March 23, 1983

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FEDERAL RESERVE SYSTEM
1983 MAR 28 AM 9:11
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OFFICE OF THE CHAIRMAN

Honorable Paul Volcker
Chairman
Board of Governors
Federal Reserve System
Washington, D.C.

Dear Mr. Chairman:

Listed below are questions of Congresswoman Kaptur relating to your testimony of February 2, 1983, on the condition of international financial markets.

1. What additional supervisory role could be played by an agency in the United States to "help" the banks avoid overexposure in the future? If the banks do not change their attitude towards loans even with a growth in their current account deficits, what role can a supervisory group play to force them to take account of these factors?

2. Why do not the banks set up larger risk pools (loan loss reserves) if they want to loan abroad?

3. If a major tightening of regulations on U.S. bank lending abroad is insisted upon in exchange for approving U.S. participation in the move to bolster the IMF, what regulatory policies do you think should be adopted?

4. How should we insure that money that U.S. banks loan to foreign countries is not used for the support of human rights violators, military build-ups, and foreign political situations which we don't fully understand? What total dollar loan amount can be traced to use for military purposes?

5. Mr. Richard Dale, in his testimony on February 9, suggested that the following safeguards are necessary:

   a. A mandatory country lending limit equivalent to, say, 25% of the lending bank's capital.

   b. Fuller and more timely information on individual countries' public and private sector external debt.

   c. Active IMF surveillance of the volume, composition and maturity distribution of member countries' external debt with a view to preventing, prior to payment interruption, both excessive levels of debt and undue reliance on short-term borrowing.

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d. New institutional arrangements to provide lender of last resort assistance to country borrowers experiencing a sudden contraction of external credit.

Please comment on all of the above.

6. If the Congress passes the Administration's request as presented, how much difference would the additional loan authority actually make to the countries involved? If the IMF portion is less than 15% of a country's need, how will the U.S. contribution really make a difference?

7. If the Congress agrees to the Administration's request, describe the crowding out of capital that will occur in U.S. capital markets.

8. The Interagency Country Exposure Review Committee (ICERC) has failed to achieve its own stated objective which is to ensure adequate diversification of banks' international loan portfolios. What can be done about this?

9. What can be done about the fact that the ICERC either does not make recommendations that excessive exposures be reduced or that such recommendations are ignored?

10. Do you think that the most important defect of the ICERC approach is the underlying assumption that diversification can in itself provide a sufficient safeguard against country risk? What should the underlying assumption be?

11. There seems to be a boom/bust tendency in the international credit market. What can be done to prevent both excessive expansion and undue contraction of international lending?

12. If IMF funding is not increased, what foreign aid alternatives might be good substitutes to ease the internal pain of countries, such as shipment of more U.S. commodities, oil transfers from the glut, etc.?

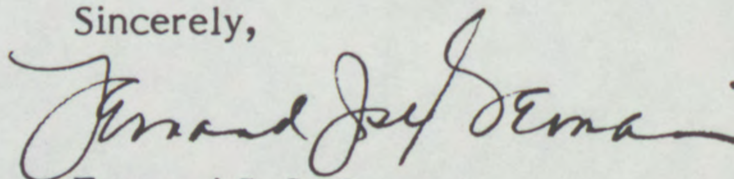
13. If IMF funding is not approved, described the likely result on any one of the banking institutions involved.

14. Why can not additional funding be obtained through private capital markets?

15. If the IMF funding is approved, describe the impact on the U.S. export/import market in relation to the domestic employment situation in the short term (1983-85) and in the long term (1985-90).

Your answers to these questions, and the direct communication of your answers to Congresswoman Kaptur would be appreciated.

Sincerely,



Fernand J. St Germain
Chairman

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 19, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Charles E. Schumer
House of Representatives
Washington, D.C. 20515

Dear Mr. Schumer:

Your letter of April 4 requested my views on H.R. 2378, the International Financial Stability Act, which you have recently introduced. As you know, the bank regulatory agencies have prepared a program for improved supervision and regulation of international lending by U.S. banks. That plan was described in a Joint Memorandum sent to the House Committee on Banking, Finance and Urban Affairs on April 7 and later embodied in a draft bill forwarded to Congress on April 15. Since the regulators' proposal addresses a number of the issues covered in your draft legislation, I believe it would be most useful to compare the two approaches.

Section 3 of your bill directs the U.S. Executive Director of the International Monetary Fund to work with other Fund officials to attempt to convert short-term debt to long-term debt, to limit lending rates (including fees and charges) applied by private banks on such restructured debt to no more than the London Interbank Offer Rate, and to assure that principal and interest payments required of a country are a manageable share of its export earnings. As you know, I believe the IMF has an important role in helpling its members put together viable adjustment programs including their financing from IMF, private and official sources. The Fund's role, however, must be flexible and suited to the particular circumstances of its individual members. From that perspective, I am concerned that your approach is too mechanical and rigid. If the Fund were successful in implementing your approach, it would risk discouraging private lenders from putting up new money in support of IMF-approved adjustment programs. In many cases, new money is necessary to make such programs viable. In addition, in these circumstances private banks would be reluctant to make new loans to any countries in fear that the country would borrow from the IMF and the provisions of your bill would subsequently come into force. On the other hand, if the Fund were unsuccessful in its negotiations and in general other Executive Directors joined the U.S. Executive Director in voting against countries' adjustment programs as required by your bill, the IMF would not be discharging its assigned responsibilities with respect to the smooth functioning of the international monetary system.

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Section 3 of your bill also directs the U.S. Executive Director of the International Monetary Fund to request the IMF to establish an insurance fund financed by a levy against banks and borrowers to ensure repayment of rescheduled debt, and requires him to vote against any IMF loans to countries which have rescheduled if that insurance fund is not operational. This part of the draft legislation is also troublesome. First, the existence of the surcharge, or threat of such a surcharge, would raise the cost of international intermediation and induce banks to reduce their international lending at a time when participation in such lending by a wide range of banks is important. Second, the existence of such a fund could lead to pressures from the banks to use it to dispose of certain loans as well as pressures by borrowers to use it to reduce their indebtedness.

Although I believe these provisions in your draft legislation are flawed and would fail to offer a viable solution to international debt problems, I share your concern that IMF-approved stabilization programs be soundly based. In some cases external debt restructurings are needed as part of such programs. If the terms of such restructurings are excessively burdensome, the program will not be viable. Similarly, the overall external financing of the program needs to be realistic in terms of coverage and burden sharing. However, the situation of each borrowing country is unique, and such arrangements involve many borrowers here and abroad. A program of "forced" restructuring, triggered by a country's approach to the IMF, could well, on balance, discourage private lenders, result in a lower net flow of resources to borrowers during difficult adjustment periods, and force the adoption of more severe adjustment actions. In the present context, such a result would retard, not sustain, the economic recovery here and abroad that all agree is desirable.

The program proposed by the banking regulators stresses the importance of continued international lending by banks. In this connection, it provides for a strengthening of the role of the IMF--including the suggestion of limits under IMF programs on the amount of short-term, public-sector, external borrowing--without excessive intrusion of the Fund into the decisions of private lenders. At the same time, the proposed program aims at ensuring that U.S. banks maintain adequate financial strength to deal with unexpected contingencies and avoid undue concentration risks.

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Section 4 of your bill calls for banks to establish loan loss reserves under certain circumstances. I believe that your provision is substantially similar to the provision in the regulators' proposal that would require the establishment of a system of provisioning against certain country exposures when the borrower has been unable to service its debts over a protracted period of time. In general, it is not feasible to link the conditions for loan loss reserves on international lending to those for loan loss reserves on non-performing domestic loans. Reserves are not mechanically required in the case of non-performing domestic loans. Moreover, international lending, especially to foreign governments, is not subject to the same "market test" of potential insolvency, but it may be subject to transfer risk. I would note that the regulators' proposal recognizes, as does yours, the potential importance of the existence of an IMF program in judging the quality of international loans and whether a reserve should be established against them.

Section 5 of the proposed legislation would require limits on short-term loans by banks to individual countries. As noted in the Joint Memorandum, the bank regulators believe that lending limits, in general, would not adequately distinguish between countries whose situations may be quite different. A system of country lending limits as specified in your proposal would involve the regulators in subjective judgments that they might not be able to exercise with the required foresight or to administer fairly while avoiding political complications. Applying such limits to short-term credit, in addition, might interfere with normal flows of trade credit without placing any effective limits on overall exposure of banks to individual countries.

In your letter you point out the importance of world-wide growth as a precondition for a satisfactory resolution of the present crisis. I believe that the supervisory proposals that have been submitted to Congress, combined with continued efforts on the part of borrowing countries, the international banking community and the International Monetary Fund, and prompt enactment of the IMF legislation now before Congress, will contribute to achieving the objective of dealing with current extraordinary financial pressures and sustainable economic recovery.

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I appreciate the opportunity to comment on your proposals and hope these comments are useful.

Sincerely,

HST:EMT:DJW:pjt (#V-62)
bcc: Mr. Terrell
Mr. Truman
Ms. Brown
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

CHARLES E. SCHUMER
16TH DISTRICT, NEW YORK

COMMITTEES:
BANKING, FINANCE
AND URBAN AFFAIRS
POST OFFICE AND CIVIL SERVICE

Congress of the United States
House of Representatives
Washington, D.C. 20515

126 CANNON HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-6616

2501 AVENUE U
BROOKLYN, NEW YORK 11229
(212) 743-3800

April 4, 1983 #62

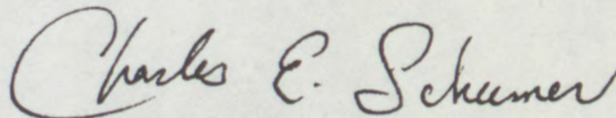
The Honorable Paul A. Volcker
The Federal Reserve Board
Washington, D.C. 20551

Dear Mr. Volcker:

I am enclosing a copy of H.R. 2378, The International Financial Stability Act, which I introduced on March 24. This bill provides a responsible and equitable solution to the international debt crisis. It authorizes the U.S. quota increase for the IMF, distributes the burden equitably between debtor nations, banks, and developed countries, and increases the probability of rapid world-wide growth--the one precondition that everyone agrees is essential for a satisfactory resolution of the current crisis.

I look forward to your comments and cooperation as Congress works toward a satisfactory resolution of the IMF quota legislation.

Sincerely,



CHARLES E. SCHUMER
Member of Congress

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
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98TH CONGRESS
1ST SESSION

H. R. 2378

To authorize an increase in the United States quota in the International Monetary Fund, to require the rescheduling of short-term debt incurred by certain countries, and to impose certain restrictions on financial institutions with respect to their lending to foreign countries.

IN THE HOUSE OF REPRESENTATIVES

MARCH 24, 1983

Mr. SCHUMER introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

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A BILL

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1 *Be it enacted by the Senate and House of Representa-*
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3 SHORT TITLE
4 SECTION 1. This Act may be cited as the "International
5 Financial Stability Act".

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2 SEC. 2. (a) The Bretton Woods Agreements Act (22
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14 (A) by inserting "as amended in accordance
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16 (B) by striking out "$2,000,000,000" and in-
17 serting in lieu thereof "4,250 million Special
18 Drawing Rights, limited to such amounts as are
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20 and

21 (2) in the first sentence of subsection (b), by strik-
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2 SEC. 3. The Bretton Woods Agreements Act (22
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5 "DEBT RESTRUCTURING

6 "SEC. 41. (a)(1)(A) With respect to each country which
7 is experiencing financial difficulties and which may request
8 additional loans from the Fund, the United States executive
9 director of the Fund is directed to work with other officials of
10 the Fund, officials from the central bank of the country in-
11 volved, the finance minister of such country, and representa-
12 tives of private banks which have made loans to such country
13 in order to develop a plan to convert short-term debt which
14 was made at high interest rates into long-term debt at a
15 lower rate of interest.

16 "(B) In no case shall such lower rate of interest, includ-
17 ing all points, restructuring fees, and all other charges im-
18 posed on the borrower, exceed the London Interbank Offer
19 Rate for debt with a maturity of one year.

20 "(2) Each such plan shall assure that the total amount
21 of principal and interest payments required of the country
22 involved are both a manageable and prudent percentage of
23 the annual export earnings of such country.

24 "(3)(A) The United States executive director of the
25 Fund is directed to request the Fund to establish an insur-

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1 ance fund to ensure the repayment of debts which are re-
2 scheduled under a plan developed pursuant to paragraphs (1)
3 and (2).

4 "(B) Such insurance fund shall be financed by a sur-
5 charge, not to exceed one percent, on the outstanding bal-
6 ance of the debt which is rescheduled under this subsection.
7 Such surcharge shall be jointly paid by the country involved
8 and the private banks which have loans outstanding to such
9 country.

10 "(b) The United States executive director of the Fund
11 shall vote against providing any additional loan to any coun-
12 try if—

13 "(1) such loan does not meet the requirements of
14 paragraphs (1) and (2) of subsection (a); and

15 "(2) the insurance fund specified in subsection
16 (a)(3) is not operational on the date on which such loan
17 is to be made.

18 "(c) For purposes of this section, the term 'long-term
19 debt' means any debt with a maturity of not less than 10
20 years.".

21 LOAN LOSS RESERVES

22 SEC. 4. (a) In any case in which a bank has made any
23 loan to a public or private borrower in a foreign country and
24 such loan cannot be repaid according to the original terms
25 and conditions on which such loan was made, the Financial

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1 Institutions Examination Council shall require such bank to
2 increase its loan loss reserves by the same amount that such
3 bank would be required to increase its loan loss reserve if this
4 loan were a nonperforming domestic loan.

5 (b) The Financial Institutions Examination Council shall
6 waive the requirements of subsection (a) with respect to any
7 loan which is restructured under section 41(a) of the Bretton
8 Woods Agreements Act.

9 COUNTRY LENDING LIMITS

10 SEC. 5. (a)(1) The Financial Institutions Examination
11 Council shall establish limits on the total amount of short-
12 term loans which any bank may make to public and private
13 borrowers in any one country. Such limitations shall be ex-
14 pressed as a percentage of a bank's capital.

15 (2) The Financial Institutions Examination Council shall
16 set different limits for specific countries and shall provide
17 transitional provisions to allow banks and their borrowers to
18 have sufficient time to negotiate an orderly conversion of
19 short-term debt into long-term debt.

20 (b) Whenever the Chairman of the Financial Institutions
21 Examination Council determines that additional short-term
22 lending is required in order to preserve the soundness and
23 stability of the world financial system, the Chairman may
24 waive, on a bank-by-bank basis and for not more than one

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1 year at a time, the limitations established under subsection
2 (a).

3 (c) The Chairman of the Financial Institutions Exami-
4 nation Council shall report the limitations established under
5 subsection (a) to the Congress along with the Council's esti-
6 mate of the amount of short-term debt which will have to be
7 converted into long-term debt as a result of the limitations
8 established under subsection (a).

9 (d)(1) The United States executive director of the Inter-
10 national Monetary Fund shall work with other officials of the
11 International Monetary Fund and with bank regulators in
12 other countries in order to establish uniform short-term lend-
13 ing limitations for all banks involved in international lending.

14 (2) The provisions of subsections (a) and (b) shall not
15 take effect until the uniform short-term lending limitations
16 specified in paragraph (1) have been established.

○

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Mrs. Mallardi
(V-62)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 19, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Charles E. Schumer
House of Representatives
Washington, D.C. 20515

Dear Mr. Schumer:

Your letter of April 4 requested my views on H.R. 2378, the International Financial Stability Act, which you have recently introduced. As you know, the bank regulatory agencies have prepared a program for improved supervision and regulation of international lending by U.S. banks. That plan was described in a Joint Memorandum sent to the House Committee on Banking, Finance and Urban Affairs on April 7 and later embodied in a draft bill forwarded to Congress on April 15. Since the regulators' proposal addresses a number of the issues covered in your draft legislation, I believe it would be most useful to compare the two approaches.

Section 3 of your bill directs the U.S. Executive Director of the International Monetary Fund to work with other Fund officials to attempt to convert short-term debt to long-term debt, to limit lending rates (including fees and charges) applied by private banks on such restructured debt to no more than the London Interbank Offer Rate, and to assure that principal and interest payments required of a country are a manageable share of its export earnings. As you know, I believe the IMF has an important role in helping its members put together viable adjustment programs including their financing from IMF, private and official sources. The Fund's role, however, must be flexible and suited to the particular circumstances of its individual members. From that perspective, I am concerned that your approach is too mechanical and rigid. If the Fund were successful in implementing your approach, it would risk discouraging private lenders from putting up new money in support of IMF-approved adjustment programs. In many cases, new money is necessary to make such programs viable. In addition, in these circumstances private banks would be reluctant to make new loans to any countries in fear that the country would borrow from the IMF and the provisions of your bill would subsequently come into force. On the other hand, if the Fund were unsuccessful in its negotiations and in general other Executive Directors joined the U.S. Executive Director in voting against countries' adjustment programs as required by your bill, the IMF would not be discharging its assigned responsibilities with respect to the smooth functioning of the international monetary system.

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Section 3 of your bill also directs the U.S. Executive Director of the International Monetary Fund to request the IMF to establish an insurance fund financed by a levy against banks and borrowers to ensure repayment of rescheduled debt, and requires him to vote against any IMF loans to countries which have rescheduled if that insurance fund is not operational. This part of the draft legislation is also troublesome. First, the existence of the surcharge, or threat of such a surcharge, would raise the cost of international intermediation and induce banks to reduce their international lending at a time when participation in such lending by a wide range of banks is important. Second, the existence of such a fund could lead to pressures from the banks to use it to dispose of certain loans as well as pressures by borrowers to use it to reduce their indebtedness.

Although I believe these provisions in your draft legislation are flawed and would fail to offer a viable solution to international debt problems, I share your concern that IMF-approved stabilization programs be soundly based. In some cases external debt restructurings are needed as part of such programs. If the terms of such restructurings are excessively burdensome, the program will not be viable. Similarly, the overall external financing of the program needs to be realistic in terms of coverage and burden sharing. However, the situation of each borrowing country is unique, and such arrangements involve many borrowers here and abroad. A program of "forced" restructuring, triggered by a country's approach to the IMF, could well, on balance, discourage private lenders, result in a lower net flow of resources to borrowers during difficult adjustment periods, and force the adoption of more severe adjustment actions. In the present context, such a result would retard, not sustain, the economic recovery here and abroad that all agree is desirable.

The program proposed by the banking regulators stresses the importance of continued international lending by banks. In this connection, it provides for a strengthening of the role of the IMF--including the suggestion of limits under IMF programs on the amount of short-term, public-sector, external borrowing--without excessive intrusion of the Fund into the decisions of private lenders. At the same time, the proposed program aims at ensuring that U.S. banks maintain adequate financial strength to deal with unexpected contingencies and avoid undue concentration risks.

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The Honorable Charles E. Schumer
Page Three

Section 4 of your bill calls for banks to establish loan loss reserves under certain circumstances. I believe that your provision is substantially similar to the provision in the regulators' proposal that would require the establishment of a system of provisioning against certain country exposures when the borrower has been unable to service its debts over a protracted period of time. In general, it is not feasible to link the conditions for loan loss reserves on international lending to those for loan loss reserves on non-performing domestic loans. Reserves are not mechanically required in the case of non-performing domestic loans. Moreover, international lending, especially to foreign governments, is not subject to the same "market test" of potential insolvency, but it may be subject to transfer risk. I would note that the regulators' proposal recognizes, as does yours, the potential importance of the existence of an IMF program in judging the quality of international loans and whether a reserve should be established against them.

Section 5 of the proposed legislation would require limits on short-term loans by banks to individual countries. As noted in the Joint Memorandum, the bank regulators believe that lending limits, in general, would not adequately distinguish between countries whose situations may be quite different. A system of country lending limits as specified in your proposal would involve the regulators in subjective judgments that they might not be able to exercise with the required foresight or to administer fairly while avoiding political complications. Applying such limits to short-term credit, in addition, might interfere with normal flows of trade credit without placing any effective limits on overall exposure of banks to individual countries.

In your letter you point out the importance of worldwide growth as a precondition for a satisfactory resolution of the present crisis. I believe that the supervisory proposals that have been submitted to Congress, combined with continued efforts on the part of borrowing countries, the international banking community and the International Monetary Fund, and prompt enactment of the IMF legislation now before Congress, will contribute to achieving the objective of dealing with current extraordinary financial pressures and sustainable economic recovery.

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I appreciate the opportunity to comment on your proposals and hope these comments are useful.

Sincerely,

S/Paul A. Volcker

HST:EMT:DJW:pjt (#V-62)
bcc: Mr. Terrell
Mr. Truman
Ms. Brown
Mrs. Mallardi (2)

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Federal Reserve Bank of St. Louis

Action assigned Mr. Truman; info copy to Mr. Dahl

CHARLES E. SCHUMER
16TH DISTRICT, NEW YORK

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Member of Congress

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98TH CONGRESS
1ST SESSION

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○

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CARROLL HUBBARD
CONGRESSMAN
1ST DISTRICT, KENTUCKY

2182 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C 20515
(202) 225-3115

Congress of the United States
House of Representatives
Washington, D.C. 20515

AT LARGE MAJORITY WHIP

COMMITTEES:
BANKING, FINANCE AND URBAN AFFAIRS

MERCHANT MARINE AND FISHERIES

CHAIRMAN, SUBCOMMITTEE ON PANAMA CANAL/OUTER CONTINENTAL SHELF

April 15, 1983

Hon. Paul A. Volcker
Chairman
Federal Reserve Board
Twentieth Street and Constitution Avenue, NW
Washington, DC 20551

Dear Paul:

Thank you for your letter and the copy of the 69th Annual Report of the Federal Reserve Board covering operations for calendar year 1982, received in my office today.

I appreciate your sending the report to me. I have reviewed the data, and I believe the publication will prove helpful to my staff and me.

Again, many thanks for your correspondence.

With best wishes for you, I am

Sincerely yours,

Carroll Hubbard

Carroll Hubbard
Member of Congress

CH/lll

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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Federal Reserve Bank of St. Louis

April 14, 1983

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

In Chairman Volcker's absence, I am writing to thank you for your letters of April 7 and 13 concerning your Subcommittee's hearing on international lending.

I am looking forward to appearing, on behalf of the Board, on April 21 at 9:30 a.m.

Sincerely,

/S/

J. Charles Partee

CO:pjt (#V-65 & V-68)
bcc: Gov. Partee
Mrs. Mallardi (2) ✓
Mr Truman
Mr. Ryan

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Copies to Governor Partee, Messrs. Truman and Ryan

FERNAND J. ST GERMAIN, R.I., CHAIRMAN
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U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

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DAVID DREIER, CALIF.

#68

April 13, 1983

Honorable Paul Volcker
Chairman
Board of Governors
Federal Reserve System
Washington, D.C.

Dear Mr. Chairman:

In your prepared statement before this Subcommittee on April 21, please include a thorough discussion of the information contained in and copies of the international lending reports published since 1978 by the Bank for International Settlements. This material is needed to assist the Subcommittee in assessing the merits of the fifth component in the Joint Memorandum on international lending and in determining whether international regulators had information at hand regarding the rapid debt buildups in the developing nations.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:gDj

Chairman -
these were sent up on Fri.

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Federal Reserve Bank of St. Louis

Copies sent Messrs. Truman and Ryan

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U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-EIGHTH CONGRESS

WASHINGTON, D.C. 20515

#65

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
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April 7, 1983

Honorable Paul Volcker
Chairman
Board of Governors
Federal Reserve System
Washington, D.C.

Dear Mr. Chairman:

This letter confirms the discussions of our staffs concerning your testimony or that of your designee before this Subcommittee on April 20 or 21, 1983, at 9:30 a.m. in Room 2128 of the Rayburn House Office Building. It would be most helpful if the prepared statement of the Federal Reserve, contained thorough discussions of the issues noted below:

1. What legislative, regulatory, or supervisory actions does the Federal Reserve recommend should be taken to address the international lending problem, particularly with respect to augmenting U.S. bank foreign loan disclosures via the Consolidated Report of Condition and Income, the Country Exposure Lending Survey, or the required reports of the Securities and Exchange Commission; increasing loan loss reserves; preventing undue foreign loan concentrations; changing the manner in which banks account for the fees they charge for loan reschedulings; and strengthening the international examination and supervision practices of the U.S. federal agencies? With respect to each recommendation, please describe in detail the comparable statutory, regulatory, or supervisory requirements in each of the Group of Ten Countries and Switzerland.

2. In recent years, when U.S. banks made decisions to lend to foreign countries, they seem to have had little knowledge about the existing debt structure of the borrowing country. Is this accurate? Do U.S. banks now have the necessary information on which to make sound lending decisions? What does the Federal Reserve know of borrowing country debt structure when the Federal Reserve examines banks? Was that knowledge adequate in past years and is it now adequate? What steps should be taken to provide for better and more timely exchange of information between national regulatory bodies?

3. H.J. Res. 208, the International Recovery Resolution, would require the Reagan Administration to take actions at the Williamsburg Economic Summit to be held in late May, to assure that the assembled nations consider making a multilateral commitment to adopting fiscal and monetary policies that would result in renewed growth and employment, to reducing the financial pressures on the developing nations, and to improving the regulatory programs that govern international safety and soundness. Apart from several suggestions you made when we last

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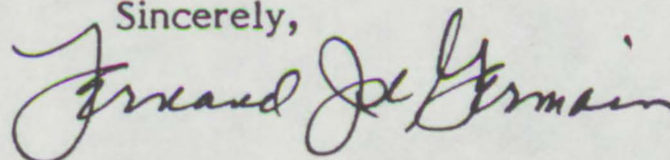
discussed H.J. Res. 208, I trust I have your general support for its eventual passage.

4. In this Subcommittee's 1977 hearings, considerable evidence was provided indicating inconsistencies among practices of the federal regulatory agencies with jurisdiction over international lending. Such inconsistencies were to a significant degree eliminated by the establishment of the Federal Financial Institutions Examination Council; however, responsibility for the actions of U.S. international banks remains in the hands of different agencies with different primary concerns. The result may be that various U.S. international banks are regulated differently depending on which regulator has jurisdiction. What would be the advantages and disadvantages of allocating more of the responsibility for international regulation, examination, and supervision to the Council, for example, as proposed in H.R. 2378, recently introduced by Congressman Schumer?

5. There are several international institutions which apparently are having a growing impact on the safety and soundness and the regulation of U.S. international banks. The International Monetary Fund (IMF) is directly involved in many of the decisions U.S. banks make concerning the amount of credit they extend to developing nations. The Bank for International Settlements (BIS) is becoming an important source of international liquidity for lending banks and borrowing nations alike. The Committee on Banking Regulations and Supervisory Practices of the Group of Ten Countries and Switzerland (also known as the "Basle Committee" or "Cooke Committee") seems to be affecting the evolution of bank regulation and the pattern of central bank lender-of-last-resort responsibility in every member nation. What have been the safety and soundness effects of IMF actions on the banks under the Federal Reserve's jurisdiction? What has been the relationship of the Federal Reserve to the BIS and the Basle Committee? Is the Basle Committee actively considering an international regulatory and lender-of-last-resort agreement that would specify that matters involving the inherent financial strength of a bank (its solvency), should be the responsibility of the central bank authority of the parent bank, and that matters involving the ability of a bank to fund itself (its liquidity), should be the responsibility of the host nation's central bank? If such an agreement were adopted, specifically what would be the responsibilities of the Federal Reserve?

Responses to the issues noted above in addition to any comments you may wish to make regarding the provisions of H.R. 2378, S.502, and Senate Report 98-35, and any other topic you judge appropriate, would be of great assistance to this Subcommittee in its deliberations on regulatory modification proposals. In accordance with Committee rules and to enable the Subcommittee Members an opportunity to study your testimony in advance of the hearing, please deliver 150 copies of your prepared statement 24 hours in advance of your appearance to room B303 Rayburn. I must also ask that you limit the oral presentation of your testimony to 10 minutes to enable all Subcommittee Members sufficient time for questioning. Your prepared statement will be included in its entirety in the hearing record.

Sincerely,



Fernand J. St Germain
Chairman

FJStG:gDj

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 11, 1983

The Honorable Henry M. Jackson
United States Senator
802 United States Courthouse
Seattle, Washington 98104

Dear Senator Jackson:

I am writing on behalf of Chairman Volcker in response to your request for comment on the enclosed inquiry from your constituent, Mr. Marshall B. Miller, III. Mr. Miller expresses concern about the actions taken by the Depository Institutions Deregulation Committee (DIDC) to eliminate interest rate ceilings on deposits of banks and thrift institutions. In particular, Mr. Miller believes that the removal of interest rate ceilings will increase the costs of funds to small banks, which will then be forced to increase the interest rates they charge to borrowers. He also expresses particular concern about a recent proposal that would permit depository institutions to pay interest on transactions balances of business firms.

The DIDC, as you know, is required by the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221) to phase out interest rate ceilings on deposit accounts as soon as possible, consistent with the safety and soundness of depository institutions. This phase-out must be completed by March 31, 1986. As Mr. Miller points out, the purpose of this legislation is to assure that depositors receive a market rate of return on their savings. The deregulation process was given additional impetus in 1982 by the passage of the Garn-St Germain Depository Institutions Act (P.L. 97-320), which required the DIDC to establish a new deposit account that would enable depository institutions to compete directly with money market mutual funds. This new account, which allows a limited number of third party transfers and is available to all depositors, has been an overwhelming success--more than $300 billion is now maintained in these money market deposit accounts (MMDAs). This has resulted in increased funds that are now available for depository institutions to lend.

As a result of the success of the MMDA, the DIDC authorized a Super NOW account--a checking account that requires a minimum balance of at least $2500 and which is not subject to any interest rate ceilings. This account, however, is available only to individuals, certain nonprofit organizations, and governmental entities. This account has also been popular among depositors, and the DIDC has been considering whether a similar account in the form of an MMDA (but without

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any limits on the number of third-party transfers that may be made) should be made available to business organizations so that they can obtain the advantages of earning interest on their checking balances.

A substantial number of comments have been received on this proposal, many of which expressed concerns similar to those of Mr. Miller. In view of these concerns, at its last meeting the DIDC deferred further action on the proposal and requested the staff to provide a more detailed analysis of the issues for a future meeting. Some members of the Committee also suggested that this might be an appropriate issue for the Congress to consider. The staff, in its analysis of the issues raised by the proposal, will give careful consideration to the effect that paying interest on business checking accounts will have upon depository institutions and their customers. It is expected that the Committee may consider this matter again at its June meeting.

I hope that this is helpful to you. Please let me know if I can be of further assistance.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn
Assistant to the Board

Enclosure

GTS:TC:MS:JZ:vcd (V-46)

bcc: Ms. Scanlon
Mr. Curry
Ms. Wing
Mr. Schwartz
Legal Files (2)
Mrs. Mallardi

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United States Senate

COMMITTEE ON ARMED SERVICES
WASHINGTON, D.C. 20510

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March 10, 1983

#46

Paul A. Volcker, Chairman
Depository Institutions Deregulation Committee
20th and Constitution Avenue, Room B-2120
Washington, D. C. 20551

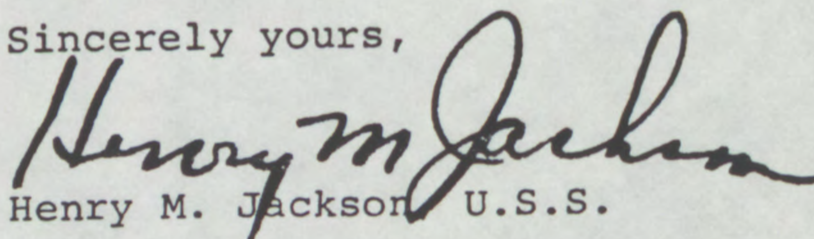
RE: MARSHALL B. MILLER III
inquiry

Dear Mr. Volcker:

The enclosed is respectfully submitted to you for every proper consideration.

Please provide me with a report in duplicate and send your response and the enclosure directly to my Seattle office at 802 United States Courthouse, Seattle, Washington 98104 (telephone 206/442-7476, FTS 399-7476).

Sincerely yours,



Henry M. Jackson, U.S.S.

HMJ: er

Enclosure

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National Bank of Bremerton

P.O. Box 459, Bremerton, WA 98310, Phone (206) 479-5100

February 16, 1983

REC'D MAR 10 1983

The Honorable Henry M. Jackson
United States Senate
137 Russell Office Bldg.
Washington, D. C. 20510

SUBJECT: The Depository Institutions Deregulation Committee (D.I.D.C.)

Dear Senator Jackson:

We are a nationally chartered community bank, whose clientele, primarily, consists of businesses with less than $1,000,000 in sales and consumers. During the past two years, we have been watching the actions of and the reactions to the dissolution of Regulation "Q", which primarily mandates interest rate ceilings that commercial banks can pay to depositors in denominations of less than $100,000.

The federally mandated deregulation of the liability side of the commercial bank's financial statement does, in fact, allow large and small depositors to receive "a fair and competitive rate of interest on their funds". However, state and national usury laws historically have been, and may still be in many parts of the country, restricting a "fair" interest rate charge to borrowers.

The borrowers that are hurt are not the nationally known corporations, but are, in fact, the small, independently owned companies and the wage earners. We believe the D. I. D. C. is poised,at its scheduled March first meeting this year, to further deregulate demand deposits we received from businesses. If this becomes reality, and, for example, a million dollars worth of business checking accounts go from zero interest to, say, eight percent interest, this would virtually, over night increase our cost by $80,000 per $1,000,000 worth of checking accounts. This would represent approximately, for our small community bank, an over night ten percent increase in the total expenses of our bank. How do we compensate for this?

As deposits are liabilities, and loans are assets, I suspect we will, again, look to the borrower, the small business person, the consumer, to pay a higher rate of interest. If that $1,000,000 bloc of funds are converted to an eight percent business interest bearing account, to stay equal, we will be forced

- more -

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to increase our interest rate on the $4,000,000 worth of loans we presently have at least two percent. This means that the consumer loans we are presently offering at 14 and 14½ percent, will increase to 16 and 16½ percent, and that the small business loans that we are offering at between 12 and 15% will also be "inappropriately" increased.

Sir, national inflation rate of 4-6 percent; Kitsap County unemployment rate of 8.4%; Washington State unemployemnt rate of nearly 13% really has little to do with our costs of funds and what we have to charge to be a profitable organization.

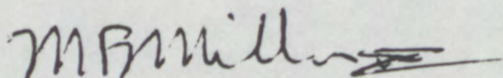
We know the D.I.D.C. is looked favorably upon by the very large multi-bank, multi-national financial institutions, but how many problem loans do community banks have to Mexico, Brazil, Argentina, or the Communist block countries? And how many of these small community banks will be looking towards the federal government and our tax dollars to keep them afloat when Brazil, Mexico, and other countries cannot even pay back interest, let alone begin to repay the principal that they have received?

We believe the actions of the D.I.D.C. are hurting, and will continue to hurt, the community banks of our area, state and nation.

I urge you to please review what this committee is doing and to review facts and figures, as presented by the Independent Bankers' Association of America.

Thank you for your time and concern.

Sincerely,



MARSHALL B. MILLER, III
Senior Vice President

MBM:ns

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Federal Reserve Bank of St. Louis

April 11, 1983

The Honorable Charles H. Percy
Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C. 20510

Dear Chairman Percy:

I thought you might like to have a copy of my testimony today before the Senate Banking Committee on the IMF legislation, including the amendments added by the Foreign Relations Committee. I am also enclosing the supervisory proposals recommended by the bank regulators.

Sincerely,

S/Paul A. Volcker

Enclosures (Chrmn. Volcker's statement of 4/11/83 & ltr. dtd. 4/7/83 to Chrmn. Garn)

DJW:pjt
bcc: Mrs. Mallardi (2)

Identical letter also sent to: Chrmn. Mathias (Sub. on International Economic Policy of Senate Foreign Relations)

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BOARD OF GOVERNORS
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WASHINGTON, D. C. 20551

April 8, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D. C. 20515

Dear Chairman St Germain:

Your letter of March 2 asked for my comments on House Joint Resolution 208 which you introduced to focus attention at the Williamsburg Summit on the need to bring about a sustainable worldwide recovery and to structure a safe and sound international banking system. As you know, I share your general concerns in these areas, and an appropriate resolution could be a vehicle for indicating broad Congressional interest and support. From that perspective, I would like to offer a few comments on the provisions in the resolution.

First, your letter to me emphasizes the importance of sustainable recovery--I underline the "sustainable" part because I believe that is the key. That, I believe, requires that we integrate policies for recovery with continued attention to the inflationary danger, and I believe any resolution should, in effect, indicate the urgency of "sustainable, non-inflationary" recovery.

That theme seems to me appropriate for the United States and other countries, including countries not represented at Williamsburg. The point is only if inflation, which has been significantly lowered in this country, is generally reduced and remains low, can we expect interest rates, financial markets, and other economic factors to be consistent with a lasting recovery in the world economy.

Second, the proposed resolution calls for the establishment of a plan to extend the maturity of foreign debt owed by developing countries. I am not certain what you mean to convey by that provision. I would note that in important cases, as part of comprehensive, IMF-approved, external financial and economic stabilization programs, lenders have negotiated a stretchout of existing loans. Such arrangements are appropriate when they contribute to a viable overall solution; in that sense I sympathize with the apparent intent of the section. However, such arrangements involve private creditors here and abroad and need to be considered on a case-by-case basis; the situation of

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each borrowing country is unique. Moreover, a generalized "forced" program of restructuring debts could well, on balance, discourage private lenders and result in a lower net flow of resources during this difficult period than would be necessary to sustain recovery and adjustment. In the light of the ambiguities in meaning of the section as drafted, I would suggest its deletion.

Third, the resolution calls for a commitment to correct any lack of uniformity or deficiencies which now exist in the regulation and supervision of international banking. While this subject is rather technical, would be somewhat unusual for a Summit agenda, and necessarily involves authorities in a much larger group of countries, I would welcome your recognition of the importance and relevance of the issue. As you know, I have devoted considerable attention to this area in recent months and one key problem is, indeed, the need to insure even-handed treatment of banks that are subject to differing treatment by their respective national authorities. There are great complexities, and supervisors have been working on them for some time. Additional impetus that might be supplied by the proposed resolution could be useful.

I hope that you find these comments helpful.

Sincerely,

S/Paul A. Volcker

PAV:EMT:vcd (V-52)

bcc: Mr. Truman
Mr. Dahl
Mrs. Mallardi (2)

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225-4247

#52

March 22, 1983

Honorable Paul Volcker
Chairman
Board of Governors
Federal Reserve System
Washington, D.C.

Dear Mr. Chairman:

Though in recent weeks there have been occasional signs of improvement in the international economic and financial situation, I remain deeply concerned about the longer term outlook. In my judgment, on an international basis, every effort must be made to bring about a sustainable worldwide recovery and to structure a safe and sound international banking system. To encourage the multilateral efforts I feel are so vitally necessary, I have introduced H.J. Res. 208, the **International Recovery Resolution**, and written to President Ronald Reagan urging his support of the resolution.

H.J. Res. 208 would require the U.S. Representative to the Summit of Industrialized Nations scheduled to meet in Williamsburg, Virginia in late May, 1983, to take whatever actions are necessary to assure that multilateral fiscal, monetary, and regulatory reforms are included on the Summit agenda. Copies of H.J. Res. 208, my House Floor remarks upon its introduction, and my letter to the President are enclosed.

It is my hope that I will have your support in the coming weeks as I seek to obtain passage of H.J. Res. 208.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:gDj

Enclosures

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H1381-82

United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 98th CONGRESS, FIRST SESSION

Vol. 129 WASHINGTON, THURSDAY, MARCH 17, 1983 No. 34

H.J. Res. 208

INTERNATIONAL RECOVERY RESOLUTION

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Rhode Island (Mr. ST GERMAIN) is recognized for 10 minutes.

● Mr. ST GERMAIN. Mr. Speaker, as your know, the House Banking Committee recently completed 4 days of hearings on the international lending problem, the U.S. economy, and the IMF quota increase. At those hearings, we heard the testimony of Treasury Secretary Donald Regan, Federal Reserve Chairman Paul Volcker, representatives of Citibank, Chase Manhattan Bank, and Bank of America, and numerous experts on economics and international banking. We also recently completed 2 days of hearings on the rising trend of mortgage foreclosures in the United States. The testimony of hard-working men and women who had never been unemployed in their lives until this recession and who have lost or are about to lose their homes or farms through foreclosure had a profound impact on me and my committee colleagues. The committee acted promptly and passed H.R. 1983, the Emergency Housing Assistance Act, which will be considered by the House next week. Admittedly there are signs of improvement in the American economy, but from what I am hearing about unemployment, forced home and farm sales, small business bankruptcies and the like, our economy is a laong way from being what it could and should be.

From all that I heard in those many days of hearings, four facts became clear to me. First, our primary concern has to be for the well-being of citizens in our country. Second, if there is going to be any hope at all of solving the international debt problem, we clearly need to have a strong and sustained recovery here in the United States and in the other industrialized nations of the world. Third, the large American money center banks did not exercise the judgment they should have in their foreign lending activities, and ultimately significant international bank regulatory reform will be needed if we are to avoid similar situations in the future. And fourth, increasing the U.S. commitment to the International Monetary Fund is an essential element in maintaining world economic stability, and because the U.S. economy is critically dependent on world economic growth and prosperity, the increase will enhance the economic outlook for the United States.

One of the major obstacles to a sustained recovery is the potential for another flip-flop by the Federal Reserve Board excessively concerned about inflation and forcing interest rates back up. A return to the high rate policies of the first 2 years of the Reagan administration is a prescription for disaster. We must not allow the Federal Reserve to shift once more. For the sake of our own domestic economy and for the economic well-being of the world, it is imperative that we implement monetary and fiscal policies that will bring about interest rate reductions and a return of sound economic growth.

Another potential obstacle to a strong recovery is the mounting international debt crisis. Many developing countries are faced with debt payments that they cannot afford, due to the worldwide recession, and high interest rates. In fact, some of these struggling nations are actually unable to afford even the interest payments on their debts. The danger of a default snowballing into international financial disaster grows each day. To free up resources in the developing nations for growth, we must begin discussions toward a multilateral plan to stretch-out foreign debt for developing nations.

We have a golden opportunity to express our commitment to a strong and growing domestic economy and a restoration of global economic growth. In late May, representatives of the largest industrial nations in the world will gather for an economic summit in Williamsburg, Va. Mr. Speaker, I strongly urge that the United States should not repeat the Toronto mistake of having no agenda and refusing to acknowledge our problems, but instead we should use the Williamsburg summit to announce our commitment to lower interest rates, lower deficits, and a strong recovery around the world. In addition, I urge that we take whatever actions are necessary to assure that the agenda of the economic summit includes consideration of multilateral agreements to extend the maturity of the foreign debt of the developing nations and to correct the deficiencies which now exist in the regulation and supervision of international banking.

To assure that this opportunity is not missed, Mr. Speaker, I am introducing the international recovery resolution, a House joint resolution, expressing the sense of the House that the United States should use the upcoming economic summit to make clear its willingness to pursue monetary and fiscal policies and take those international financial actions which will contribute to world economic recovery.

Mr. Speaker, action on the international recovery resolution is needed because for many nations, short-term loans, lasting only a few years, are a convenient fiction. Neither the banks nor the nations believe that the loans will ever be repaid. Instead, the loans will be rescheduled when the payments come due. For banks this is convenient, since they collect large sums of cash up front as rescheduling fees, and then continue to pretend that their loans will be paid. Meanwhile, debtor nations find themselves borrowing more money simply to make the interest payments on previous loans. I am fearful that this may prove to be simply a giant, international Ponzi scheme; an international house of cards that must collapse of its own weight.

Sooner or later, rationally or in a panic, we must face facts. The developing country debt problem is serious, and getting worse. As nations borrow to make interest payments on earlier loans, the problem simply spirals. Recent declines in oil prices will hurry this process as OPEC nations pull their liquid investments out of western nations, and retrench on lending to their nonoil exporting neighbors.

Fortunately, there is still time for a rational appraisal of this debt problem. There is still time for negotiations toward a multilateral stretchout of the existing loans. By converting them to more manageable long-term debt, there is a good chance they can be repaid. But that process must begin soon, and the Williamsburg summit in May is the right place at the right time. We cannot let this opportunity slip by.

If a few nations defaulted, there would be increased pressure for banks to pad their bad debt reserves further, and force rates even higher. Higher rates could force other countries into default as their payments increased. The upward spiral of rates, and downward spiral of international solvency has only one end: an international depression.

The keys to preventing this disasterous chain of events are low interest rates and a rational reordering of developing nations' debt. Lower U.S. interest rates will reduce payment for debtor nations as the dollar falls from its overpriced level on international markets.

But lower interest rates will only come from a monetary policy that allows a strong recovery, and from tax and spending changes that reduce budget deficits, in the future. The United States should clearly announce that we are ready to lead the way to a worldwide recovery. The time for retrenchment, high interest rates and recession is past. This message would reassure our 11 million unemployed citizens, and would be a great relief to the millions of unemployed people across the world for whom recovery means jobs, adequate food, and renewed dignity.

The international recovery resolution will put the Congress firmly on record in favor of recovery policies by our Nation and other developed countries. It will help assure that the most

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urgent problem of international debt rescheduling is discussed at the nearest appropriate international meeting—the Williamsburg summit. Finally, it will send a strong signal to our constituents, and to our allies that the United States is ready to assume its rightful mantle of leadership in these troubled economic times.

H.J. Res. 208

Whereas the economic well-being of all Americans depends on world economic growth and prosperity;

Whereas millions of American jobs have been lost through worldwide recession, and 35 per centum of our GNP decline in the 1981–82 recession was due to a sharp drop in exports;

Whereas world economic recovery is being retarded by high United States interest rates, and by the overwhelming magnitude and short maturity of the developing nations' foreign debt;

Whereas if the time allowed for developing nations to repay their debts were lengthened, the international debt crisis would be substantially eased, and financial resources within these countries could be turned to expanding growth;

Whereas expanded growth of developing countries will help to restore American export markets lost in the worldwide recession, and bring back millions of American jobs;

Whereas bank regulation in individual nations which was designed to meet internal, rather than international needs, lacks uniformity from nation to nation, and may have contributed significantly to the current international debt crisis: Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That it is the sense of the Congress of the United States that the United States should use the upcoming economic summit meetings in Williamsburg, Virginia, to indicate its willingness to pursue monetary and fiscal policies necessary to stimulate growth in this country, and to help lead a world economic recovery by taking such actions as are necessary to assure that the agenda of the economic summit meetings will include: (1) consideration of a multilateral agreement to adopt national fiscal and monetary policies designed to bring about a prompt reduction in worldwide unemployment, and interest rates; (2) inauguration of a plan to extend the maturity of foreign debt owed by developing nations; and (3) commitment to correct any lack of uniformity or deficiencies which now exist in the regulation and supervision of international banking.●

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225-4247

March 22, 1983

The President
The White House
Washington, D.C. 20500

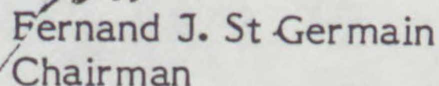
My dear Mr. President:

I feel strongly that every effort must be made, domestically and internationally, to bring about a sustainable worldwide economic recovery and to structure an international banking system that can finance that recovery in a safe and sound manner. This effort will require multilateral commitments to fiscal and monetary policies that will result in renewed growth and employment, to reductions in the financial pressures on the developing nations, and to improvements in the regulatory programs that govern international banking safety and soundness. The United States has a great opportunity to take the lead in this effort at the Summit of the Industrialized Nations scheduled to meet in Williamsburg in late May, 1983.

To encourage U.S. leadership at the Williamsburg Economic Summit, I have introduced H.J. Res. 208, the **International Recovery Resolution.** H.J. Res. 208 would require the U.S. representative to take whatever actions are necessary to assure that fiscal, monetary and regulatory reforms are included on the Summit agenda for consideration by the assembled nations. A copy of that resolution is enclosed.

Mr. President, I respectfully urge your support of H.J. Res. 208. In addition to the clear need for substantive improvements in international bank supervision and in worldwide economic conditions, I am convinced that the climate for your request for increased contributions to the International Monetary Fund would be enhanced by a positive response from your Administration to H.J. Res. 208.

Sincerely,



Fernand J. St Germain
Chairman

Enclosure

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April 7, 1983

The Honorable Walter E. Fauntroy
Chairman
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D. C. 20515

Dear Chairman Fauntroy:

Thank you for your letter of April 6 concerning your Subcommittee's hearings on the structure and function of domestic institutions engaged in the purchase and sale of United States government debt instruments.

As you are aware, I have asked Mr. Anthony M. Solomon, President of the Federal Reserve Bank of New York, to appear before your Subcommittee on behalf of the Board on Monday, April 25.

Sincerely,

S/ Paul

CO:vcd (V-63)

bcc: President Solomon
Mr. Axilrod
Mrs. Mallardi (2)

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President Solomon will testify accompanied by Messrs. Sternlight and Geng

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H2-109, ANNEX NO. 2
WASHINGTON, D.C. 20515
(202) 226-7315

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-EIGHTH CONGRESS
WASHINGTON, D.C. 20515

April 6, 1983

#63

The Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Paul:

On Monday, April 25, 1983 the Subcommittee on Domestic Monetary Policy in exercise of its oversight authority will meet to take testimony on the structure and function of those domestic institutions engaged in the purchase and sale of United States government debt instruments. This has been a matter which has previously been studied by this Subcommittee and this hearing continues my deep interest and concern about the safety, soundness, function, and structure of our debt markets.

I understand that the Federal Reserve Bank of New York has increased its regulatory efforts in this area since the failures of Drysdale Government Securities, Inc. and Lombard-Wall Inc. last year, and that additional regulatory schemes are being contemplated. I also understand that both this regulatory effort and any subsequent schemes would be applied first, and only directly, to the 36 dealers with whom the New York Bank has a specific relationship with the further effectiveness of any regulatory effort occuring through the insistence by this group that the same standards be followed by other dealers with whom they maintain business relationships.

I would like you or your designee to testify on this date to these matters. Specifically, I hope your testimony will address the following questions:

1. What concerns are held by the System with respect to the conditions of firms engaged in the purchase and sale of government securities including both financial and operational matters?

2. Whether the size of the pending government deficit will have an adverse effect on the ability of the market to absorb the deficit without undue upward pressures on interest rates and the safety and soundness of government security firms.

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3. Whether the number of dealers with whom the Federal Reserve has a direct relationship should be expanded, how this might be accomplished, and whether there should be changes in the standards governing those who are engaged in the purchase and sale of government securities;

voluntary lesser frequency reporting by wider panel.

4. Whether direct regulation of all government security firms by the Federal Reserve should be undertaken and what legislative changes might be required to implement such a scheme;

5. Exemptions from certain provisions of the bankruptcy law controlling assets when those assets are repurchase agreements.

I am also very much interested in discussions which have been ongoing at the Federal Reserve Bank of New York related to the possible imposition of capital ratios. I would like a thorough discussion of the issues surrounding this matter which should include the advantages such a rule could conceivably bring and the disadvantages such as a narrowing of the number of qualified dealers.

I realize that the System has not yet finalized any proposal or suggestion. I am not looking for any finalized version of any potential regulatory scheme. Rather, I want to be sure that all of the issues are being fully examined and discussed. Towards that end, I will be holding further hearings on this matter. There will not, however, be any other witnesses at this hearing since I have determined that it would not be useful to engage in any debate before there has been adequate time to assess Federal Reserve System comments or concepts. The industry will be given adequate time to comment on a subsequent date.

The hearing will commence at 1:00 p.m. on Monday, April 25, 1983 in Room 2128 of the Rayburn House Office Building. Committee Rules provide that witnesses should provide 100 copies of their testimony at least 24 hours before the hearing. Witnesses should also bring with them additional copies if they want to be sure that members of the press and the public who may be in attendance are to be provided with copies of their testimony.

Any questions concerning this oversight hearing should be directed to the Staff Director of the Subcommittee, Howard Lee, who may be reached at 226-7315.

Sincerely yours,

Walt

Walter E. Fauntroy
Chairman

Paul, I understand that Tony Solomon has been designated by you to testify on this matter and that he will be accompanied by other officials of the New York Fed. That is an acceptable arrangement and I am most pleased to extend to him my welcome.

W.

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NOT FOR RELEASE UNTIL MONDAY, APRIL 11, 1983
10 a.m.

April 7, 1983

The Honorable John Heinz
Chairman
Subcommittee on International Finance
and Monetary Policy
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Chairman Heinz:

As you know, the bank regulators have been working together to review the regulatory framework and supervisory approaches relating to foreign lending by U. S. banks. Enclosed please find a Joint Memorandum on international lending which summarizes our proposals on the subject. Along with the Joint Memorandum are four appendices covering some topics in greater detail.

We appreciate the opportunity for public discussion which Congressional hearings on this subject provide, and we look forward to any further consideration that the Congress and other interested parties put forward. We appreciate the urgency of action in this area in connection with the IMF legislation, and we will, of course, continue to work with you in the effort to improve public policies on foreign lending by U. S. banks.

Sincerely,

C. T. Conover   William M. Isaac   Paul A. Volcker

Enclosures

IDENTICAL LETTERS TO CHAIRMAN GARN, SENATOR PROXMIRE, CHAIRMAN ST GERMAIN AND CONG. WYLIE

EMT:vcd
bcc: Mr. Truman
Ms. Jacklin
Mrs. Mallardi (2)

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April 7, 1983

Joint Memorandum

Subject: Program for Improved Supervision and Regulation of Internationnal Lending

In recent years, the banking systems in the United States and abroad have extended large amounts of credit to foreign borrowers, including foreign governments. As a result of strained economic conditions worldwide, a number of countries, particularly in Latin America, have simultaneously experienced reduced foreign exchange earnings and external financing problems, thus helping to precipitate problems in servicing debt burdens built up over a number of years. As part of the necessary readjustment, many of the major borrowers have adopted economic stabilization programs approved by the IMF and involving, in addition to important domestic measures, both the restructuring of existing bank credits and the extension of a limited amount of new credit. This situation has raised concern that there should be in place strengthened supervisory and regulatory practices aimed at avoiding excessive concentrations of credit in foreign countries.

In response to these problems, the federal bank regulators have reviewed a number of suggestions for strengthening supervision and regulation of United States depository institutions engaged in foreign lending. Some foreign lending (e.g., that to private companies abroad) includes elements of credit risk analogous to domestic lending -- elements relating to the capacity and willingness of borrowers to generate resources from operations to repay debts. Lending to foreign governments (i.e., "sovereign lending"), while not entirely free of credit risk, is not subject to the same "market test" of potential insolvency. However, all foreign lending must take account of risks not present in domestic private or public lending, that is "transfer risk." Thus, overall "country exposure" is also a relevant concept for assessing the risks involved in foreign lending.

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"Transfer risk" means the possibility that a borrower may not be able to maintain debt servicing in the currency in which the debt is to be paid because of a lack of foreign exchange. A bank's "country exposure" is defined as all cross-border and cross-currency claims and contingent claims on residents of the country, plus other credits guaranteed by residents of the country, less credits guaranteed by residents of other countries and net local currency assets of the bank's offices in the country.

As result of our review of the supervision and regulation of foreign lending, a five-point program has been developed. The objective of the program is to encourage prudent private decision-making in foreign lending that appropriately recognizes the risks while permitting the exercise of lender discretion in the funding of creditworthy borrowers both here and abroad. The proposed procedures reinforce two of the basic principles of sound banking — diversification of risk and maintenance of adequate financial strength to deal with unexpected contingencies. The program will help assure earlier recognition of potential international payments problems, encourage orderly responses to these problems, and provide for stronger reserves to meet adverse conditions when they infrequently, but inevitably, arise.

The five-point program consists of the following elements:

1. Strengthening of the existing program of country risk examination and evaluation;

2. Increased disclosure of banks' country exposures;

3. A system of special reserves;

4. Supervisory rules for accounting for fees; and

5. Strengthening international cooperation with foreign banking regulators and through the International Monetary Fund.

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The program constitutes an integrated package -- none of the elements alone could accomplish the intended objectives. This memorandum summarizes the principal aspects of the five points. Separate appendices have been attached providing elaboration for some of them.

This program has been designed to create incentives for prudent lending but without establishing arbitrary obstacles to international capital movements or preventing the continuation of credit flows to credit-worthy borrowers. Depending upon particular circumstances, continued capital flows to basically credit-worthy countries in current strained economic conditions remains appropriate -- especially in the context of IMF-approved economic stabilization programs — in order to encourage appropriate adjustment by borrowers to their problems, to maintain their capacity to service their outstanding debt, and therefore to preserve the integrity of existing bank assets. These considerations are, of course, not unique to international lending, but the scale of the lending to particular foreign borrowers means that broader considerations of the stability of the international financial and economic system are at stake as well; this fact is reflected in the role of the IMF and other official lending. The five-point program set forth in looking toward the future is designed to recognize these circumstances.

1. Strengthening of Country Risk Examination and Evaluation

As a first step, the federal banking regulators intend to strengthen their present program of country risk examination and evaluation basically established in its present form in 1979. Our review of the operation of this system indicates that increases in banks' country exposure have not in all cases been brought to the attention of high level management as explicitly and forcefully as they probably should have been. This

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procedure can be made more effective by establishing clearer guidelines for examiners in formulating exposure warnings and for assuring that these warnings are considered at the policy-making level within bank management. Its more effective use should help to avoid risk concentration and to increase risk diversification.

As a separate part of country risk examination and evaluation, the federal banking regulators will also analyze a bank's capital adequacy in relationship to the level of diversification of the bank's international portfolio. Those institutions with relatively large concentrations of credit in particular countries will be expected to maintain generally higher overall capital ratios than those institutions that are well diversified. As part of this process, the banking regulators will further develop, as a reference point, standards for country exposure concentration as it relates to capital adequacy. Because banks vary in their current capital positions and other elements of risk exposure, the implications for the capital adequacy of any particular bank would have to be evaluated on a case-by-case basis.

In general, the characteristics of a bank's country exposure will be considered a factor to be weighed in the application of the capital adequacy guidelines used by the federal banking agencies. Thus, recommendations on capital levels as a function of country exposure concentrations will form an integral part of the overall supervision and regulation process. In accordance with their recommendations in this regard, the banking regulators will expect appropriate corrective action as necessary to conform to safe and sound banking practices, taking full account of the need for flexibility in some circumstances for responding to needs for additional credit as part of well-considered adjustment programs.

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Additional details on the federal bank regulators' development of procedures to strengthen the supervision of country risk are contained in Appendix A.

2. Additional Disclosure

Experience suggests that the identification of increased country exposure and transfer risk based on a subjective analysis of economic factors, particularly in cases of larger countries, may not always take place at a sufficiently early stage so as to make adjustment in banks' lending feasible without jeopardizing service of existing debts or, indeed, disruptions of the financial system more generally. Disclosure triggered by subjective risk evaluation may aggravate the problem. However, more routine disclosure, centered around the concept of concentration, may strengthen other approaches, helping to bring appropriate marketplace discipline to bear on lending decisions.

Depositors and investors, through their individual decisions, will have the information to assess better the prudence of foreign lending and require greater risk diversification and adequate reserves as the condition for their increased deposits and investments in banks' equity and other securities. Banks will need to be prepared to defend policies leading to large and concentrated country exposure as a consequence of their continuing reporting requirements, and indeed considerable movement has been made in that direction by some institutions. The best current practice should be made more uniform. To that end, individual banks should make public disclosure of all concentrations of country exposure that are material.

Another step toward better analysis of developing trends in international lending is more frequent and earlier availability of aggregate data. To this end, reports on material country exposure should be submitted

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to the banking supervisors quarterly, instead of semiannually as at present. In this connection, the banking supervisors will require that the reports be submitted more promptly than in the past so that the aggregate information on lending by U.S. banks can be made available to the public on a more current basis.

Additional details on the proposed reporting and disclosure requirements are contained in Appendix B.

3. Special Reserves

Another incentive for risk diversification and increased financial strength can be created through establishment of a system of provisioning against certain country exposures. When a borrower has been unable to service its debts over a protracted period of time, whether or not that borrower is a sovereign, it is appropriate to recognize the risks and the diminshed quality of the assets represented by these loans. Indeed, to the extent interest has not been paid, that by itself diminishes the value of the underlying asset.

It is prudent that the lending institutions establish specific provisions against such assets in order to reflect more accurately the current condition of the asset. Although some banks now make reserve provisions for such purposes, this approach should be more systematic. Such provisions would be deducted from current earnings and, to the extent required by regulation, would not be included in capital for regulatory and accounting purposes. The prospective requirement for reserving, with its attendant bottom-line earnings impact, should act as a cautionary element when the initial decision to lend is being made. Such reserve provisions would not apply to lending to a country where the terms of any restructuring of debt were being met, where interest payments were being made and where

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the borrowing country is complying with the terms of an IMF-approved stabilization program.

Appendix C contains additional details on the proposed reserve provisioning for credits to countries with severe and protracted debt servicing problems.

4. Accounting For Fees

This program element would establish rules for accounting for fees charged in connection with international lending. Some concern has been expressed that so-called front-end fees, when taken into income in the quarter or year in which they are charged, provide an added incentive to seek out international loans in order to boost earnings immediately and, once this has occurred, to sustain past earnings levels. The general practice in the industry is, apparently, to treat a portion of these loan fees -- that part which is paid to all participating lenders -- as interest to be taken into earnings over the maturity of the credit and the remainder -- syndication fees -- as current income. However, specific practice apparently varies, and the more conservative practices may not prevail generally. Therefore, it would be desirable to assure uniform rules so that artifical incentives are not created for foreign lending. To this end, the regulators are prepared to establish rules to require that front-end fees be treated as interest except when they are identifiable as reimbursement of direct costs.

Appendix D contains an analysis of accounting for fees on syndicated international credits and an explanation of the proposed guidelines for such fees.

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5. International Cooperation

Present problems in foreign lending are international in scope, and an effective program for limiting the potential scope for such problems in the future must be coordinated with bank supervisors abroad and with the activities and operations of the International Monetary Fund.

Coordination with overseas bank supervisors can help to avoid competitive inequalities, to assure equal treatment of lenders and borrowers, and to reinforce the effectiveness of U.S. programs. The bank regulatory agencies will seek understandings with foreign bank authorities to help achieve the objectives of risk diversification and strengthened financial condition that we have set for ourselves.

Similarly, the IMF can play a major role, particularly with borrowers, in avoiding situations involving excessive build-ups of credit, especially short-term credit. We intend to work in the following areas to improve information flows and to ensure a more effective IMF surveillance process:

1. In its consultations with member governments on their economic policies, the Fund should intensify its examination of the trend and volume of external indebtedness of private and public borrowers in the member country and comment to the country and in its reports to the Executive Board on such borrowing from the viewpoint of its contribution to the economic stability of the borrower. The IMF might also consider the extent or form that these comments might be made available to the international banking community and the public.

2. As part of any member's stabilization program approved by the IMF, the Fund should place limits on public sector external short- and long-term borrowing; and

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3. As a part of its Annual Report, and at such times as it may consider desirable, the Fund should publish information on the trend and volume of international lending in the aggregate as it affects the economic situation of lenders, borrowers and the smooth functioning of the international financial system.

Consideration of Lending Limits

The foregoing program does not include the establishment of country lending limits. It was concluded that lending limits based upon objective criteria are likely to be too rigid. Such limits would fail to distinguish between countries capable of carrying substantial debt without significant transfer risk and countries where smaller amounts of debt still raise large transfer risk problems. On the other hand, lending limits based on subjective judgments that change over time are likely to have capricious and abrupt effects on flows of credit, imply a degree of foresight on the part of the regulators that may not be realistic, and be difficult to administer fairly while avoiding political complications. Finally, in view of the substantial exposures already incurred, a program of lending limits would not be workable except with a very long transition period that would tend to vitiate its credibility.

The problem that is before the international financial community today is one of maintaining a reasonable flow of international credit to allow time for orderly adjustment. As for the future, as levels of exposure decrease over time, the program of intensified regulatory surveillance and evalution of country exposures, additional disclosure, special reserves, rules for fee accounting, and improved international cooperation should prove sufficient to deal with build-ups of concentrations of international credit that might threaten a sound banking system.

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Implementation Authority

The bank regulatory agencies' authority to define and prevent unsafe and unsound banking practices under their enabling statutes and the Financial Institutions Supervisory Act of 1966 could be used to implement the program outlined above insofar as they require regulatory action. A number of similar measures have been taken in the past utilizing this authority and the courts have generally sustained the banking agency actions. To be effective, the banking agencies must demonstrate a clear link between the established prudential practice and the safety and soundness of depository institutions -- a relationship that past experience indicates can be established in the area of international lending. In view of the existence of this authority it would not be desirable to establish rigid or inconsistent legislative rules that could limit the ability of the banking regulators to adapt the program as they gain experience with its implementation and could have the unwarranted and unintended effect of discouraging the international lending necessary to support world trade and economic recovery.

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APPENDIX A

PROPOSED REVISIONS TO EXAMINATION PROCEDURES TO STRENGTHEN SUPERVISION OF COUNTRY RISK

In 1979, the bank regulatory agencies put in place new examination procedures for supervising country risk in U. S. bank portfolios. In retrospect, it is clear that these procedures did not have sufficient impact to temper adequately the buildup of concentrations of credit to foreign countries that were potentially vulnerable to external debt service problems. The proposed changes are designed to integrate more fully country risk considerations into the examiners' overall rating of the condition of a bank, to identify problem credits at an earlier stage, to include more specifically transfer risk in the analysis of the adequacy of a bank's capital, and to improve the presentation to a bank's management and directors of concerns of the banking agencies about large concentrations of country exposure.

Changes would be made along the following lines:

(1) New categories will be employed for identifying credits that are not performing because of a country's debt service problems. These categories will replace the traditional classification categories originally designed for evaluating commercial risk, but also currently used for transfer risk, and would more clearly reflect the types of problems that arise due to transfer risk.

(2) Credits in these new categories will be factored into the agencies' evaluation of a bank's asset quality and other measures of financial soundness.

(3) Examiners will be required, under guidelines to be developed, to highlight certain large concentrations of credit in the examination report and in communications with the bank's directors.

(4) Concentrations of country exposure subject to comment will be factored into the evaluation of a bank's capital adequacy. Banks with large concentrations of country exposure will be expected to have extra capital to support those exposures.

(5) Bank managements will be expected to make systematic reports to their boards of directors on country exposures and country conditions.

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New Categories for Reflecting Credits Adversely Affected by Transfer Risk

The traditional categories that were originally designed for evaluating commercial risk, i.e., substandard and doubtful, have not proved suitable for evaluating transfer risk. The following categories are designed to reflect more closely the types of problems that arise due to transfer risk.

The new categories and the definitions for each are:

Loss -- Indebtedness considered uncollectible and of such little value that its continuance as a bankable asset is not warranted--for example, repudiated debt. Such indebtedness shall be charged off and no longer be carried on the books of the bank.

Reservable -- This classification would apply when a country had demonstrated protracted debt service problems. Evidence to that effect would include such factors as (a) full interest payments on indebtedness to banks had not been made for more than six months, (b) the terms of restructured indebtedness had not been met for over one year, (c) IMF or other suitable adjustment programs had not been complied with and there is no immediate prospect for such compliance, or (d) no definite prospects exist for the orderly restoration of debt service in the near future.

Debt Service Impaired -- This classification would apply when (a) a country has been unable to meet its external debt service obligations and it has not yet adopted viable policies for restoring its debt service capabilities (or is not in the process of doing so), but is generally making required interest payments, (b) there is no evidence that the country will be able to negotiate a successful rescheduling with its creditors in the near future, and (c) the country has not adopted an IMF or other suitable economic adjustment program or is not adhering adequately to such a program.

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Other Changes in Supervisory Procedures

The other changes under active consideration to strengthen supervisory procedures on international lending are: (1) the incorporation into a bank's asset quality rating of credits that fall within the categories just described; (2) the more forceful conveyance in examination reports of concentrations of exposure; and of credits to countries currently experiencing liquidity difficulties that have adjustment programs in place; and (3) the inclusion of concentrations of country exposure in the assessment of capital adequacy.

Implementation of these changes is complex and requires consideration of many technical factors. Details of these changes, including the criteria to be employed and the guidelines to be followed, are as a result still being developed and refined by the banking agencies. In addition, supervisory policies are being developed to insure that boards of directors are adequately reviewing and more fully supervising the international lending policies and decisions of their banks.

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APPENDIX B

REPORTING AND PROPOSED DISCLOSURE OF COUNTRY EXPOSURE

Reporting

The federal banking agencies have required U.S. banks since 1977 to file a Country Exposure Report semi-annually for federal supervisory purposes. This report, which is published in aggregate, has proved to be very useful both for the bank supervisors and the banks themselves. Other countries have used it as a model for their own consolidated reporting systems for the country exposure of their banks. The growth of international lending and the increased number of short-term international liquidity problems suggests the desirability of more frequent reporting for supervisory purposes. Therefore, the federal banking agencies propose to require U.S. banks to file the Country Exposure Report quarterly rather than semi-annually, and on a tighter time schedule than is now required. The aggregate data would continue to be published by the supervisors.

Disclosure

Disclosures of concentration of country exposure in U.S. banks need to be more uniform, complete and timely. To this end, the Country Exposure Report (FFIEC Form 009) would be amended to include a disclosure section which the agencies would make available on request. The disclosure section would indicate concentrations of country risk. A sample form is attached. Country exposures exceeding one percent of bank's total assets would be profiled to detail risk. The profile would show exposure on a gross basis and adjusted for third-country guarantees and would show the exposure by sector and maturities. Country exposures between three quarters and one percent of a bank's total assets would also be indicated, but not profiled.

Attachment

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REPORT OF CONCENTRATIONS OF TRANSFER RISK

(This report is being collected for public disclosure purposes and will be made available to the public upon request)

A. Exposures Exceeding One Percent of Total Assets

Country	Credit outstanding after mandated adjustments for transfers of exposure (1)	Credit outstanding before adjustments (2)	Distribution of outstandings reported in col. 2: To banks (3)	To public sector (4)	To others (5)	Maturing in less than one year (6)	Maturing in more than one year (7)	Total commitments to provide credit, after adjustments for guarantees (8)

B. Exposure Between Three-quarters of One Percent and One Percent of Total Assets

Total number of countries	Credit outstanding after mandated adjustments for transfers of exposure	List Individual Countries

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GENERAL INSTRUCTIONS FOR REPORT OF CONCENTRATIONS OF TRANSFER RISK

A. Exposures Exceeding One Percent of Total Assets

The data required for this section must be submitted for each country where "credit outstanding after mandated adjustments for transfers of exposure," exceed 1 percent of a bank's total assets as of the reporting date.

Col 1 - Credit outstanding after mandated adjustments for transfer of exposure. Report the sum of the following columns from the Country Exposure Report ("CER")--Cols. 4-9 + 10-11 + 12 + (18-19 provided greater than 0).

Col 2 - Col 4 of CER
Col 3 - Col 1 of CER
Col 4 - Col 2 of CER
Col 5 - Col 3 of CER
Col 6 - Col 5 of CER
Col 7 - Sum of Cols. 6, 7, & 8 of CER
Col 8 - Cols. 14 + 15-16 + 17 of CER

B. Exposures Between Three-Quarters of One Percent and One Percent of Total Assets

Show in this section the total number of countries in which the bank's "credit outstanding in each country after mandated adjustments for transfers of exposure", as computed above, range between three-quarters of one percent and one percent of total assets as of the reporting date. Also show the aggregate amount of all credit to those countries. Finally, list the names of each country.

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APPENDIX C

PROPOSED RESERVE PROVISIONING FOR CREDITS TO COUNTRIES WITH SEVERE AND PROTRACTED DEBT SERVICING PROBLEMS

BACKGROUND

As part of the review of their procedures for supervising transfer risk in U. S. banks, the bank regulatory agencies have examined the methods used by banks to account for loans to countries with severe and protracted external payments problems. In the opinion of the agencies, present procedures do not always reflect the reduced quality of the credits to such countries and there is no uniformity among banks in their accounting for these credits.

Under current procedures, banks are required to review their credits to determine whether all or parts of particular loans should be declared "loss" and charged off or whether additional provisions should be made to the allowance for possible loan losses in light of such credits. This process has not worked well for credits that have been adversely affected due to country risk. In part, this has been because countries, unlike companies, do not declare bankruptcy and there are no established liquidation procedures to provide a valuation basis for such credits. Although some banks have made special provisions to the allowance for possible loan losses because of such credits, the treatment among banks has been uneven, indicating the need for a more systematic approach.

Even though credits to a country, absent repudiation, are not "loss" in the traditional sense, transfer risk problems can seriously impair the liquidity and earning power of an asset. Indeed, to the extent interest has not been paid that, by itself, diminishes the value of the underlying asset. The bank regulatory agencies believe that when the servicing of bank credits has been adversely affected over a protracted period of time due to a country's inability or unwillingness to service its international debts, the net carrying value of the affected assets should be adjusted in a bank's financial statements through charges to earnings and balance sheet provisions.

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Since present procedures seem inadequate in this regard, the agencies propose to require banks to make special allocated provisions against certain assets that are found to be severely affected by transfer risk problems. The "allocated transfer risk provisions" (ATRP) would be separate from the general allowance for loan losses and would not be regarded as capital by the agencies. The reserves would be established by a provision against income. In the alternative, a bank would have the option to write off all or part of the loans that are subject to the special reserves and, consequently, reduce the amount of special provisions and reserve balances that would otherwise be required.

In connection with consideration of the special allocated provision proposal, the bank regulatory agencies also reviewed the agreement in 1978 for the examination of transfer risk in U. S. banks. This agreement created an interagency committee, the Interagency Country Exposure Review Committee ("ICERC"), to determine when assets should be classified due to transfer risk, and it provided guidelines to be followed in making those determinations. Experience in applying the procedures indicates a need to clarify and revise the categories and definitions used to identify credits adversely affected by transfer risk. The designation of assets experiencing debt service problems as "substandard" and "doubtful" will no longer be used in characterizing credit problems due to transfer risk. New designations to be used include a category termed "reservable." A "reservable" categorization would trigger the requirement for the ATRP.

An example of the proposed changes in the call report to implement these procedures is attached (Attachment A). A new "provision" item would be added to the balance sheet. The amount of the reserve item would be deducted from "gross loans" to arrive at "net loans." The reserve would be created by a charge ("provision") against income.

PROPOSED PROCEDURES FOR PROVISIONS ON CREDITS TO COUNTRIES CATEGORIZED AS "RESERVABLE"

(1) The new category "reservable" adopted by the banking agencies is defined as follows: A "reservable" categorization is warranted when a country has demonstrated protracted debt service problems. Evidence

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to that effect would include such factors as (a) full interest payments on indebtedness to banks had not been made for more than six months, (b) the terms of restructured indebtedness had not been met for over one year, (c) IMF or other suitable adjustment programs had not been complied with and there is no immediate prospect for such compliance, or (d) no definite prospects exist for the orderly restoration of debt service in the near future.

(2) An Allocated Transfer Risk Provision ("ATRP") is required for assets categorized as "reservable." The provisions are to be established by a charge to earnings. The ATRP is to be separate from the general Allowance for Possible Loan Losses and will not be included as part of the bank's capital funds.

(3) No ATRP provisions are required if the bank has already written down the credit by the requisite amount.

(4) Senior executives of the OCC, FRB and FDIC will jointly determine the amount and timing of the provisions after reviewing the report of the ICERC on the "reservable" categorization. The initial provision will normally be 10 percent. The transfer risk will be reviewed annually. Depending on the circumstances, additional reserves may be required. Additional provisions, if warranted, will normally be in 15 percent increments.

(5) The ATRP may be reversed when a credit is no longer categorized as being adversely affected by transfer risk.

(6) Any payment of interest on credits categorized "reservable" should be applied to reduce principal (or credited to ATRP) and not credited to income. The amount of the mandated ATRP may be reduced by the amount of any interest previously applied to principal.

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ATTACHMENT A CDF 2

Domestic and Foreign Consolidated Report of Condition of ____________

Legal Title of Bank

at close of business on ______________ 19__

Dollar Amount in Thousands | Bil | Mil | Thou

Assets

1. Cash and due from depository institutions (From Schedule C, item 8, Column A) .... 1.
2. U.S. Treasury securities .... 2.
3. Obligations of other U.S. Government agencies and corporations .... 3.
4. Obligations of States and political subdivisions in the United States .... 4.
5. Other bonds, notes, and debentures .... 5.
6. Federal Reserve stock and corporate stock .... 6.
7. Trading account securities .... 7.
8. Federal funds sold and securities purchased under agreements to resell in domestic offices of bank and of its Edge and Agreement subsidiaries .... 8.
9. a. Loans, Total (excluding unearned income) (From Schedule A, item 10, Column A) .... 9.a.
   b. Less: allowance for possible loan losses .... 9.b.
   Less: Allocated Transfer Risk Provision
   c. Loans, Net .... 9.c.
10. Lease financing receivables .... 10.
11. Bank premises, furniture and fixtures, and other assets representing bank premises .... 11.
12. Real estate owned other than bank premises .... 12.
13. Investments in unconsolidated subsidiaries and associated companies .... 13.
14. Customers' liability to this bank on acceptances outstanding .... 14.
15. Other assets (From Schedule G, item 3) .... 15.
16. TOTAL ASSETS (sum of items 1 thru 15) .... 16.

Liabilities

ITEMS 17 THROUGH 24.a(2). REFER ONLY TO DEPOSITS IN DOMESTIC OFFICES OF THE BANK

17. Demand deposits of individuals, partnerships, and corporations (From Schedule F, item 1e, Column A) .... 17.
18. Time and savings deposits of individuals, partnerships, and corporations (From Schedule F, item 1e, Columns B and C) .... 18.
19. Deposits of United States Government (From Schedule F, item 2, Columns A & B & C) .... 19.
20. Deposits of States and political subdivisions in the United States (From Schedule F, item 3, Columns A & B & C) 20.
21. Deposits of foreign governments and official institutions (From Schedule F, item 4, Columns A & B & C) .... 21.
22. Deposits of commercial banks (From Schedule F, items 5 & 6, Columns A & B & C) .... 22.
23. Certified and officers' checks (From Schedule F, item 7, Column A) .... 23.
24. a. TOTAL DEPOSITS IN DOMESTIC OFFICES (sum of items 17 thru 23) .... 24.a.
    (1). Total demand deposits (From Schedule F, item 8, Column A) .... 24.a(1)
    (2). Total time and savings deposits (From Schedule F, item 8, Columns B & C) .... 24.a(2)
    b. TOTAL DEPOSITS IN FOREIGN OFFICES AND EDGE AND AGREEMENT SUBSIDIARIES (Schedule F/F, item 8) .... 24.b.
    c. TOTAL DEPOSITS (sum of items 24a and 24b) .... 24.c.
25. Federal funds purchased and securities sold under agreements to repurchase in domestic offices of bank and of its Edge and Agreement subsidiaries .... 25.
26. a. Interest-bearing demand notes (note balances) issued to the U.S. Treasury .... 26.a.
    b. Other liabilities for borrowed money .... 26.b.
27. Mortgage indebtedness and liability for capitalized leases .... 27.
28. Bank's liability on acceptances executed and outstanding .... 28.
29. Other liabilities (From Schedule H, item 4) .... 29.
30. TOTAL LIABILITIES (excluding subordinated notes and debentures) (sum of items 24c thru 29) .... 30.
31. Subordinated notes and debentures .... 31.

Equity Capital

32. Preferred stock a. No. shares outstanding ______ .... (par value) 32.
33. Common stock a. No. shares authorized ______ b. No. shares outstanding ______ .... (par value) 33.
34. Surplus .... 34.
35. Undivided profits .... 35.
36. Reserve for contingencies and other capital reserves .... 36.
37. TOTAL EQUITY CAPITAL (sum of items 32 thru 36) .... 37.
38. TOTAL LIABILITIES AND EQUITY CAPITAL (sum of items 30, 31 and 37) .... 38.

Memoranda

1. Amounts outstanding as of report date: Memo
   a(1). Standby letters of credit, total .... 1.a(1)
      (a). To U.S. addressees (domicile) .... 1.a(1)
      (b). To non-U.S. addressees (domicile) .... 1.a(1)
   a(2). Amount of standby letters of credit in Memo item 1a(1) conveyed to others through participations .. 1.a(2)
   b. Time certificates of deposit in denominations of $100,000 or more in domestic offices (included in

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Section A - Sources and Disposition of Income

Dollar Amount in Thousands	Year-to-date Mil	Year-to-date Thou	
1. OPERATING INCOME:			
a. Interest and fees on loans			1.a
b. Interest on balances with depository institutions			1.b
c. Income on Federal funds sold and securities purchased under agreements to resell in domestic offices of the bank and of its Edge and Agreement subsidiaries			1.c
d. Interest on U.S. Treasury securities			1.d
e. Interest on obligations of other U.S. Government agencies and corporations			1.e
f. Interest on obligations of States and political subdivisions in the U.S.			1.f
g. Interest on other bonds, notes, and debentures			1.g
h. Dividends on stock			1.h
i. Income from lease financing			1.i
j. Income from fiduciary activities			1.j
k. Service charges on deposit accounts in domestic offices			1.k
l. Other service charges, commissions, and fees			1.l
m. Other operating income (from Section D, item 4)			1.m
n. TOTAL OPERATING INCOME (sum of items 1a thru 1m)			1.n
2. OPERATING EXPENSES.			
a. Salaries and employee benefits			2.a
b. Interest on time certificates of deposit of $100,000 or more issued by domestic offices			2.b
c. Interest on deposits in foreign offices			2.c
d. Interest on other deposits			2.d
e. Expense of Federal funds purchased and securities sold under agreements to repurchase in domestic offices of the bank and of its Edge and Agreement subsidiaries			2.e
f. (1) Interest on demand notes (note balances) issued to the U.S. Treasury			2.f
(2) Interest on other borrowed money			2.f
g. Interest on subordinated notes and debentures			2.g
h. (1) Occupancy expense of bank premises, Gross			2.h
(2) Less: Rental income			2.h
(3) Occupancy expense of bank premises, Net			2.h
i. Furniture and equipment expense			2.i
j. Provision for possible loan losses (from Section C, item 4)			2.j
X Provision for Allocated Transfer Risk			
k. Other operating expenses (from Section E, item 3)			2.k
l. TOTAL OPERATING EXPENSES (sum of items 2a thru 2k)			2.l
3. INCOME BEFORE INCOME TAXES AND SECURITIES GAINS OR LOSSES (item 1n minus 2l)			3.
4. APPLICABLE INCOME TAXES			4.
5. INCOME BEFORE SECURITIES GAINS OR LOSSES (item 3 minus 4)			5.
6. a. SECURITIES GAINS (losses), GROSS			6.
b. APPLICABLE INCOME TAXES			6.
c. SECURITIES GAINS (losses), NET			6.
7. NET INCOME (item 5 plus or minus 6c)			7.
OR			
7. INCOME BEFORE EXTRAORDINARY ITEMS			7.
8. EXTRAORDINARY ITEMS, NET OF TAX EFFECT (From Section F, item 2c)			8.
9. NET INCOME (item 7 plus or minus 8)			9.

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APPENDIX D

PROPOSED SUPERVISORY GUIDELINES FOR ACCOUNTING FOR FEES ON SYNDICATED INTERNATIONAL CREDITS

A. Description of types of fees and recent practices

In addition to the stated interest on international syndicated[1/] loans (including stated interest adjustments for late payments), banks often require payment of certain fees in connection with these credits. These fees are identified by a variety of terms, and are intended for a variety of purposes: for example, a flat fee added specifically to increase the yield of the loan; a fee designed to cover costs associated with syndicating a loan (e.g., for structuring and negotiating a loan package, underwriting a syndicated loan, advising the borrower); a fee to cover the costs of committing funds on the prescribed terms for a fixed period of time; or a fee for serving as agent in administering a syndicated credit. In addition, banks frequently provide in the loan agreement that the managing bank(s) is to be reimbursed for all out-of-pocket expenses incidental to the arrangement of a credit facility, as well as collection or enforcement costs. (A glossary of terminology and description of the principal fees associated with the extension of international credits by commercial banks is attached.)

A survey of a sample of international syndicated loan agreements, concluded between 1978 and 1983, for borrowers in those countries recently experiencing balance of payments difficulties indicates the following:

1/ "Syndication" is the process of arranging a Multi-bank Credit Facility and is characterized by the formation of a Management Group, assumption of "Underwriting Commitments" and participation of various Lending Banks.

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-- Over this period, commitment fees have ranged generally between 1/4 to 1/2 percent on the undrawn amounts of the loan during the availability period. Agency fees have varied for example from $7,500 per year to $300,000, with the variations perhaps related to the size and complexity of the loans. Practically all the agreements surveyed had detailed provisions relating to reimbursement of expenses.

-- The stated interest rates on the loans surveyed by-and-large ranged around 1% to 1-5/8% above LIBOR, with only a few notable exceptions.

-- Management and other front-end fees were unstated in the loan documents in the majority of cases, with the fees established by a side agreement. It is not clear the extent to which these fees are disclosed to other participants in the syndicate. Where the front-end fees were stated, they ranged from 3/4% to 1-1/2%.

B. Current accounting rules and practices applicable to nonrefundable fees

We understand that there are differences in the manner in which banks account for the nonrefundable fees associated with international loans. The major difference is the extent to which the fees are amortized over the life of the loan, as an adjustment to the interest yield on the loan, or instead are taken into income at the time the fees are received. Currently, neither generally accepted accounting principles nor regulatory policy definitively specify the manner in which fee income to the bank should be recognized.

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Existing guidance on the timing of recognition of revenues is provided in Accounting Principles Board (APB) Statement No. 4, Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises that states the following realization principle:

> Revenue from services rendered is recognized under this principle when services have been performed and are billable. Revenue from permitting others to use enterprise resources, such as interest, rent, and royalties is also governed by the realization principle. Revenue of this type is recognized as time passes or as the resources are used.

Thus, under these accounting principles, each activity for which nonrefundable fees are received must be analyzed to consider whether the activity provides services and constitutes a separate earning process or is an integral part of the entity's central operations.

The American Institute of Certified Public Accountants (AICPA) Industry Audit Guide, Audits of Banks ("Bank Audit Guide") (1983) at pages 52-55, provides very general guidance as to accounting recognition of fees. As to commitment fees, the Bank Audit Guide in part states:

> "Banks have recorded income from commitment fees in a variety of ways including recognition:
> (a) in full when received.
> (b) when the commitment period has expired or the loan has been drawn down.
> (c) ratably over the commitment period.
> (d) ratably over the combined commitment and loan period.
>
> "The accounting for recognition of income from commitment fees should be based on the nature and substance of the transactions. However, a bank's method of accounting should ensure that any income that represents an adjustment to the interest yield is deferred until the loan is drawn down and then amortized over the expected life of the loan in relation to the outstanding balance.
>
> "Fees representing compensation for a binding commitment or for rendering a service in issuing the commitment should be deferred and amortized over the commitment period using the straight-line method."

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The Guide does not directly address questions of front-end fees in syndicated international credits, but discusses "origination fees" as follows:

> "Banks also receive fees for originating loans in-house. The normal origination fee (generally referred to as points) is essentially a reimbursement for the expenses of the underwriting process, that is, processing the loan application, reviewing legal title to the collateral, obtaining appraisals, and other procedures. Origination fees, to the extent they are a reimbursement for such costs, should be recognized as income at the time of loan closing. Loan origination fees that are not reimbursements of such costs should be amortized to income over the expected loan period by application of the interest method."

Thus, existing accounting principles allow for a substantial exercise of discretion and so disparity in practice for accounting for front-end and other fees associated with syndicated international credits. Indeed, the accounting profession has recognized that clearer guidance is needed with respect to accounting for nonrefundable fees by financial institutions on all forms of credits. The AICPA has, for this reason, formed a task force to prepare an issues paper addressing the diversity in accounting practice. The study has been underway for several months and no recommendations have as yet been made.

C. Proposed supervisory guidelines for accounting for fees on syndicated international credits

There has developed an increased use of fees to cover a number of different purposes including additions to the yield of international syndicated credits. In view of the present diversity in accounting practice as to those fees among banks, and paucity of definitive guidance as to the appropriate accounting for the wide range of fees that has developed, the federal bank regulatory agencies consider that to achieve conformity and uniformity in accounting for fees the following guidelines should be established.

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PROPOSED GUIDELINES

1. Front-end fees in most instances represent an adjustment to the interest yield and shall be deferred until the loan is issued, and then amortized over the expected life of the loan in relation to the outstanding loan balance using the interest method. Front-end fees, or the portion thereof, that are identifiable as reimbursement of direct costs shall be recognized as income at the time of the loan closing or restructuring.

2. Fees for guaranteeing the funding of a loan (i.e., commitment fees) shall be recognized as revenue over the combined commitment and loan period. Reimbursement of any direct loan processing costs will be recognized as income at closing. Then the straight line method, based on the combined life of the commitment and loan period, shall be applied to the remaining fee to recognize income during the commitment period. When the loan is disbursed, the interest method shall be applied to the balance of the fee to recognize income over the life of the loan. If the loan in fact is not funded, unamortized commitment fees will be recognized as income at the end of the commitment period.

3. Agency fees and advisory fees should be recorded as income when received to the extent they represent reimbursements for identifiable, direct costs, otherwise they should be amortized over the expected period of the loan.

COMMENTARY

A. In a syndicated credit, it is often difficult to determine what share of the front-end fees represent a reimbursement of direct costs of the Managing Bank(s) and what share represents an adjustment to the interest

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yield. A reasonable presumption is that a Managing Bank should recognize a portion of the fee as an adjustment to interest yield based upon the other Participating Banks' share of the fee. Hence, it may be appropriate to consider the portion equal to the largest of any Participating Bank's*/ share of the front-end fee as an interest yield adjustment. The balance of a Managing Bank's share of a front-end fee, or some portion thereof, may be considered as reimbursement of direct costs if such costs are identifiable.

B. Proposed Guideline #2 reflects a presumption that commitment fees often embody three elements -- reimbursement of direct processing costs, remuneration from services in making commitments (such as assumption of risk of adverse changes in market interest rates over the commitment period), and a component that represents a yield adjustment. Determining the amount of each component may be difficult. When the separate components of the fees cannot reasonably be identified, the foregoing guideline provides a reasonable solution for recognizing the total fees over the combined commitment and expected loan period, and is the approach currently recommended in the Bank Audit Guide. The guideline also presumes that it is difficult to determine at the outset of a loan whether the loan in fact will need to be funded. Accordingly, a commitment fee should be accounted for over the combined life unless the loan is not actually funded.

---

*/ A "Participating Bank" is not included in the Management Group for the credit nor does it assume any underwriting risk, i.e., the bank does not commit to lending obligations in excess of the amount it intends to lend in the transaction.

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Glossary of Fees

1. Front End Fee: A flat fee paid by the Borrower to the Lending Bank(s). The fee is generally expressed as a percentage of the amount of the Credit Facility and is paid on the signing or disbursement dates of the Credit Facility. This fee is also sometimes referred to as a commission, financing fee, or flat fee.

   a. Management Fee: The portion of the Front End Fee which is distributed to Lending Banks (in a Multi-bank Credit Facility) in differing amounts depending on their roles in the transaction (i.e. Managing Bank, "Underwriting Bank," Participant, etc.) and participation amount. Managing Banks normally receive a larger share of the Front End Fee than do Participants. There are numerous alternatives for payment of the Management Fee to accomplish different structure and pricing objectives. The Management Fee normally represents an interest yield paid in fee form and, in the case of Multi-bank Credit facilities, frequently includes an element of compensation for additional service provided or "underwriting risk" assumed.

   b. Praecipuum: The portion of the Front End Fee which is distributed to one or more of the Lending Banks (generally Managing Banks) in a Multi-bank Credit Facility. This allocation of the Front End Fee serves as compensation for handling a disproportioniate share of the responsibility for arranging a Credit Facility or assuming an underwriting risk.

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c. <u>Pool</u>: The residual amount resulting from the payment of Participating Banks in Multi-bank Credit Facilities of a less than full share of the Front End Fee. The Pool amount, which may or may not exceed the Praecipuum, is normally apportioned among Managing Banks on some preagreed upon formula and represents a form of compensation for the additional service provided by the Managing Bank(s) during the arrangement of the transaction.

2. <u>Agency Fee</u>: An annual fee paid to the Agent Bank by the Borrower and is normally intended to reimburse the Agent Bank for out-of-pocket expenses incurred in the performance of its administrative duties. Such expenses normally include telex, telephone, postage, printing, and travel. The amount of Agency Fee is generally fixed at the time of the signing of the Credit Agreement and varies in amount depending upon the number of Lending Banks participating in the Credit Facility, the complexity of the transaction and the frequency of communication with the Lending Banks.

3. <u>Commitment Fee:</u> This fee is paid by the Borrower and compensates Lending Banks for legally committing to lend to a Borrower at agreed upon terms and conditions at some future time. This fee is sometimes referred to as a Reservation Fee. This annual fee is customarily expressed as a percentage of the unused commitment from the Lending Bank and is normally paid quarterly in arrears.

4. <u>Advisory Fee</u>: A fee paid by a Borrower to compensate a bank(s) for a specific advisory service provided in relation to a transaction, such as a complex project loan. The advice may relate to the structure of the transaction or its arrangement and execution. This fee often is not listed in the loan agreement.

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5. Expense Reimbursement: It is customary for a Borrower to reimburse banks active in arranging multi-bank or direct (i.e. one-bank) Credit Facilities for out-of-pocket expenses incidental to the arrangement of such facility. Normally these expenses include legal, telecommunications, travel and other expenses incurred during the arrangement of the Credit Facility and collection or enforcement costs.

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April 6, 1983

The Honorable Doug Barnard
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Chairman Barnard:

Thank you for your letter of March 10. I am pleased to enclose the updated tables you requested. Please note that some of the earlier figures we had furnished have also been revised.

I hope this information is useful to your Subcommittee.

Sincerely,

S/Paul A. Volcker

Enclosures

RFG:CO:vcd (V-48)

bcc: Mr. Gemmill
Mr. Truman
Mrs. Mallardi (2)

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TABLE 1

FOREIGN OFFICIAL RESERVES OF FOREIGN EXCHANGE
(billions of dollars)

	December 1970	1973	1977	1978	1979	1980	1981	1982
I. Total Holdings	45.4	125.0	249.7	294.1	337.5	387.9	363.2	331.7
A. OPEC countries	3.6	12.4	67.3	52.4 1/	67.3 1/	85.3 1/	83.7 1/	72.4 1/
1. Middle Eastern 2/	2.5	8.5	52.4	34.4 1/	42.1 1/	39.2 1/	43.5 1/	35.9 1/
2. African 3/	0.3	1.3	5.3	3.2	7.5	13.2	6.7	3.7
3. Other 4/	0.7	2.6	9.6	8.1	10.9	11.6	12.2	8.3
B. All other countries	41.8	112.6	182.4	241.7	270.2	301.6	279.5	259.3
II. Holdings in the United States	23.8	67.4	131.2	162.6	155.1	170.9	173.9	174.5
A. Treasury bills and certificates	13.5	32.5	47.8	67.7	47.8	56.2	52.4	46.7
1. OPEC countries 5/	n.a.	n.a.	4.2	3.3	6.6	8.0	7.5	7.8
2. Other countries	n.a.	n.a.	43.6	64.4	41.2	48.2	44.9	38.9
B. Marketable Treasury bonds and notes	0.3	5.7	32.2	35.9	37.6	41.4	53.2	67.7
1. OPEC countries 5/ (approximate)	n.a.	n.a.	11.0	9.0	7.5	15.6	26.5	33.3
2. Other countries	n.a.	n.a.	21.2	26.9	30.1	25.8	26.7	34.4
C. Nonmarketable Treasury bonds and notes 6/	3.4	15.5	20.4	21.0	22.7	21.1	15.9	10.5
D. Other U.S. securities	0.7	1.3	12.8	14.9	16.5	21.8	25.8	24.8
E. Banking and money market assets 7/	5.9	12.4	18.0	23.1	30.5	30.4	26.6	24.8
1. OPEC countries	n.a.	n.a.	9.6	10.2	8.6	6.6	4.7	4.6
2. Other countries	n.a.	n.a.	8.4	12.8	21.9	23.8	21.9	20.2
III. Holdings at Foreign Branches of U.S. Banks	4.2	10.3	28.1	31.9	35.7	32.5	26.0	19.6
OPEC countries 5/ 8/	n.a.	n.a.	19.1	20.1	29.2	30.1	27.2	20.8

See following page for footnotes.

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Footnotes:

1/ Beginning April 1978 data exclude Saudi Arabian foreign exchange cover against the note issue (amounting to about $5.3 billion in March 1978.) The figures on the line for "Middle Eastern countries" also exclude Iraq (beginning December 1978), Iran (beginning December 1980), and Qatar and United Arab Emirates (December 1982). However, estimates for these countries and dates are included in the figures for "OPEC countries."

2/ Iran, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, United Arab Emirates.

3/ Algeria, Gabon, Nigeria.

4/ Ecuador, Venezuela, Indonesia.

5/ Also includes Bahrain and Oman.

6/ None held by OPEC.

7/ Principally bank deposits, CDs, repurchase agreements, bankers acceptances, and commercial paper.

8/ Including private holdings.

Sources I.: International Monetary Fund, International Financial Statistics.

II.: U.S. Treasury.

III.: Federal Reserve System.

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TABLE 2

FOREIGN OFFICIAL HOLDINGS OF MARKETABLE U.S. TREASURY SECURITIES, SELECTED DATES

	Amount ($ billions)			Percentage of total outstanding		
	Bills	Bonds & Notes	Total	Bills	Bonds & Notes	Total
1968 - November	6.5	.5	7.0	8.9	0.3	3.0
1969 - June	3.8	.5	4.3	5.6	0.3	1.9
1973 - March	37.6	6.9	44.5	35.8	4.2	16.5
1974 - January	29.2	5.2	34.4	27.1	3.2	12.7
1979 - January	68.4	36.0	104.4	42.1	10.8	21.0
- April	51.6	36.2	87.8	31.5	10.6	17.4
1980 - January	48.9	38.1	87.0	27.9	10.6	16.2
1981 - January	56.5	42.3	98.8	25.6	10.4	15.7
1982 - December	46.7	67.7	114.4	15.0	11.9	13.0

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TABLE 3

DEPOSITS OF MIDDLE EAST OIL PRODUCING COUNTRIES IN FOREIGN BRANCHES OF LARGE U.S. BANKS
(billions of dollars)

	December 1975			March 1979			March 1981			December 1981			December 1982		
	Six Largest Banks	Second Largest Six Banks	Next Nine Banks	Six Largest Banks	Second Largest Six Banks	Next Nine Banks	Six Largest Banks	Second Largest Six Banks	Next Nine Banks	Six Largest Banks	Second Largest Six Banks	Next Nine Banks	Six Largest Banks	Second Largest Six Banks	Next Nine Banks
(1) Total deposits (consolidated)	197.5	76.3	49.9	273.8 1/	99.9 1/	68.4 1/	328.5	126.5	85.2	338.4	136.2	89.5	342.0	143.6	94.3
(2) Deposits of Middle East Oil Producing Countries 2/	9.8	1.2	0.7	15.3	1.7	0.5	14.8	2.7	0.9	11.5	3.3	1.2	9.8	2.1	1.2
(3) Line (2) as percent of line (1)	5.0	1.6	1.4	6.0	1.7	0.7	4.5	2.1	1.0	3.4	2.4	1.3	2.9	1.5	1.3

Note: Deposits in foreign branches represent more than 75 percent of total deposits of Middle East oil producers in all U.S. banks.

1/ Deposits as of Dec. 1978.
2/ Includes Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Six largest banks

Bank of America
Chase Manhattan
Chemical Bank
Citibank
Manufacturers Hanover
Morgan Guaranty

Second largest

Bankers Trust
Continental Illinois
Crocker National Bank
First National Bank of Chicago
Security Pacific
Wells Fargo

Next nine

European American Bank & Trust
First National Bank of Boston
Interfirst Bank Dallas
First National Bank of Detroit
Irving Trust
Marine Midland
Mellon
Republic Bank Dallas
First Interstate Bank of California

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TABLE 4

NUMBER OF U.S.-CHARTERED BANKS REPORTING LIABILITIES TO OPEC COUNTRIES AT FOREIGN BRANCHES

	Dec. 1975 r/	Dec. 1978 r/	Dec. 1981	Dec. 1982
Ecuador	8	13	26	22
Venezuela	28	32	44	38
Indonesia	10	17	24	22
Iran	17	26	19	21
Iraq	5	11	13	12
Kuwait	24	22	28	21
Qatar	4	9	9	7
Saudi Arabia	18	29	42	41
United Arab Emirates	13	20	22	19
Algeria	14	20	17	15
Gabon	0	1	1	2
Libya	5	10	11	7
Nigeria	4	6	11	12

r/ Revised.

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Liabilities of U.S. Banks to OPEC Countries[1/]
(billions $)

	3/31/79	3/31/81	12/31/81	12/31/82
Six largest U.S. banks	19.4	19.8	13.3	11.9
Second largest six	2.1	3.0	3.6	2.3
Next nine banks	0.8	1.2	1.4	1.4

1/ Data are for foreign branches and domestic offices of the banks.

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RONALD D. COLEMAN, TEX.
JOHN M. SPRATT, JR., S.C.
JOHN CONYERS, JR., MICH.
ELLIOTT H. LEVITAS, GA.
HENRY A. WAXMAN, CALIF.

NINETY-EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377
WASHINGTON, D.C. 20515

JUDD GREGG, N.H.
WILLIAM F. CLINGER, JR., PA.
TOM LEWIS, FLA.

MAJORITY—(202) 225-4407

#48

March 10, 1983

Hon. Paul Volcker
Chairman
Federal Reserve Board
Washington, D.C. 20551

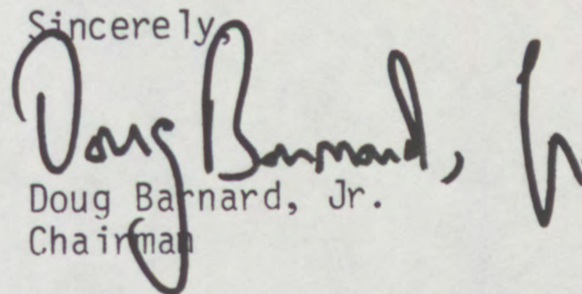
Dear Chairman Volcker:

In September 1981, the Subcommittee on Commerce, Consumer, and Monetary Affairs held two days of hearings on the nature and extent of OPEC country surpluses worldwide and investments in the United States and the U.S. Government's response to such investment. To update information we received at that time, we require current statistical information on the extent of OPEC country holdings, reserves, and bank deposits as of December 31, 1982.

I therefore request that certain data furnished in tabular form by the Federal Reserve Board during the September 1981 hearings and printed on the following hearing transcript pages, be updated: pages 246 through 250. (Attached are copies of the tables involved.)

We would like this information by March 28, 1983. If your staff have any questions, they should contact subcommittee counsel Stephen R. McSpadden.

Sincerely,



Doug Barnard, Jr.
Chairman

DB:srm:v

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Federal Reserve Bank of St. Louis

TABLE 1

FOREIGN OFFICIAL RESERVES OF FOREIGN EXCHANGE
(billions of dollars)

	December 1970	December 1973	December 1977	December 1978	December 1979	December 1980	Mar. 1981
I. Total Holdings	45.4	122.4	243.0	283.3	318.6	382.4	371.5
A. OPEC countries	3.6	12.6	67.9	53.0 1/	65.9 1/	87.4 1/	91.9 1/
1. Middle Eastern 2/	2.5	8.5	52.4	41.7 1/	41.9 1/	40.8 1/	41.4 1/
2. Africa 3/	0.3	1.3	5.3	3.2	7.4	13.4	12.2
3. Other 4/	0.7	2.6	9.6	8.1	10.7	11.8	n.a.
B. All other countries	41.8	109.8	175.1	230.3	252.7	295.0	279.6
II. Holdings in the United States	23.8	66.9	131.1	162.4	162.0	177.0	182.2
A. Treasury bills and certificates	13.4	31.5	47.8	67.7	47.8	56.5	60.6
1. OPEC countries 5/	n.a.	n.a.	4.2	3.3	6.6	8.0	8.2
2. Other countries	n.a.	n.a.	43.6	64.4	41.2	48.5	52.4
B. Marketable Treasury bonds and notes	0.3	5.7	32.2	35.9	43.0	46.0	49.7
1. OPEC countries 5/ (approximate)	n.a.	n.a.	11.0	9.0	8.2	16.3	19.3
2. Other countries	n.a.	n.a.	21.2	26.9	34.8	29.7	30.4
C. Nonmarketable Treasury bonds and notes 6/	3.4	15.5	20.4	21.0	22.7	21.1	20.7
D. Other U.S. securities	0.7	1.7	12.7	14.7	15.7	21.0 e/	22.3 e/
E. Banking and money market assets 7/	5.9	12.4	18.0	23.1	32.8	32.4	28.9
1. OPEC countries	n.a.	n.a.	9.6	10.2	8.6	6.6	7.6
2. Other countries	n.a.	n.a.	8.4	12.8	24.2	25.8	21.3
III. Holdings at Foreign Branches of U.S. Banks	4.2	10.3	28.1	31.9	35.7	32.4	29.9
A. OPEC countries 5/8/	n.a.	n.a.	19.1	20.1	29.2	30.1	29.3
B. Other countries	n.a.	n.a.	9.0	11.8	6.5	2.3	.6

1/ Beginning April 1978 data exclude Saudi Arabian foreign exchange cover against the note issue (amounting to about $5.3 billion in March 1978). The figures on the line for "Middle Eastern countries" also exclude Iraq (beginning December 1978), Iran and Qatar (beginning December 1980), and Kuwait (for March 1981). However, estimates for these countries and dates are included in the figures for "OPEC countries."
2/ Iran, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, United Arab Emirates.
3/ Algeria, Gabon, Nigeria.
4/ Ecuador, Venezuela, Indonesia.
5/ Also includes Bahrain and Oman.
6/ None held by OPEC.
7/ Principally bank deposits, CDs, repurchase agreements, bankers acceptances, and commercial paper.
8/ Including some private holdings.
e/ Estimated from Treasury and Commerce Department data.

Sources I.: International Monetary Fund, *International Financial Statistics*.
II.: U.S. Treasury.
III.: Federal Reserve System.

TABLE 2

FOREIGN OFFICIAL HOLDINGS OF MARKETABLE U.S. TREASURY SECURITIES, SELECTED DATES

	Amount ($ billions)			Percentage of total outstanding		
	Bills	Bonds & Notes	Total	Bills	Bonds & Notes	Total
1968 - November	6.5	.5	7.0	8.9	0.3	3.0
1969 - June	3.8	.5	4.3	5.6	0.3	1.9
1973 - March	37.6	6.9	44.5	35.8	4.2	16.5
1974 - January	29.2	5.2	34.4	27.1	3.2	12.7
1979 - January	68.4	36.0	104.4	42.1	10.8	21.0
- April	51.3	36.3	87.6	31.3	10.7	17.4
1980 - January	49.0	44.1	93.1	27.9	12.2	17.4
1981 - January	56.6	46.8	103.4	25.7	11.5	16.5

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TABLE 3

DEPOSITS OF MIDDLE EAST OIL PRODUCING COUNTRIES
IN FOREIGN BRANCHES OF LARGE U.S. BANKS
(billions of dollars)

	December 1975			March 1979			March 1981		
	Six Largest Banks	Second Largest Six Banks	Next Nine Banks	Six Largest Banks	Second Largest Six Banks	Next Nine Banks	Six Largest Banks	Second Largest Six Banks	Next Nine Banks
(1) Total deposits (consolidated)	197.5	76.3	49.9	273.8 1/	99.9 1/	68.4 1/	328.5	126.5	85.2
(2) Deposits of Middle East Oil Producing Countries 2/	9.8	1.2	0.7	15.3	1.7	0.5	14.8	2.7	0.9
(3) Line (2) as percent of line (1)	5.0	1.6	1.4	6.0	1.7	0.7	4.5	2.1	1.0

Note: Deposits in foreign branches represent more than 75 percent of total deposits of Middle East oil producers in all U.S. banks.

1/ Deposits as of Dec. 1978.
2/ Includes Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Six largest banks

Bank of America
Chase Manhattan
Chemical Bank
Citibank
Manufacturers Hanover
Morgan Guaranty

Second largest

Bankers Trust
Continental Illinois
Crocker National Bank
First National Bank of Chicago
Security Pacific
Wells Fargo

Next nine

European American Bank & Trust
First National Bank of Boston
First National Bank of Dallas
First National Bank of Detroit
Irving Trust
Marine Midland
Mellon
Republic National Bank, Dallas
United California Bank

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TABLE 4

NUMBER OF U.S.-CHARTERED BANKS REPORTING LIABILITIES TO OPEC COUNTRIES AT FOREIGN BRANCHES

	Dec. 1975	Dec. 1976	Dec. 1977	Dec. 1978	Dec. 1979	Dec. 1980
Ecuador	31	36	46	45	45	60
Venezuela	80	82	89	81	88	92
Indonesia	48	52	50	43	39	36
Iran	40	50	53	50	43	41
Iraq	11	23	24	13	14	14
Kuwait	28	30	33	29	34	33
Qatar	17	8	15	17	16	9
Saudi Arabia	18	30	31	33	40	43
United Arab Emirates	19	24	34	38	40	27
Algeria	36	44	45	51	54	54
Gabon	16	19	26	19	20	17
Libya	9	15	14	12	13	11
Nigeria	11	14	13	19	23	26

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PAUL A. VOLCKER
CHAIRMAN

July 10, 1981

CONGRESSMAN BEN ROSENTHAL
STAFF
PARA:
COMMENTS:
FILE CODE:

The Honorable Benjamin S. Rosenthal
Chairman
Subcommittee on Commerce, Consumer
and Monetary Affairs
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Chairman Rosenthal:

Following up my letter of July 1, I am herewith transmitting to you the data on the liabilities to Middle East oil-exporting countries of both the domestic offices and the foreign branches of three groups of large U. S. banks. The latest data, which are for March 31, 1981, are shown below, together with the earlier data for March 31, 1979, that were transmitted to you by Governor Coldwell in August 1979. The figures are as follows (in billions of dollars):

	3/31/79	3/31/81
Six largest U. S. banks	19.4	19.8
Second largest six	2.1	3.0
Next nine banks	0.8	1.2

The information on the liabilities of the domestic offices has been supplied by the U. S. Treasury and include the liabilities of all Edge Act and other domestic subsidiaries as well as those of the parent bank itself.

Sincerely,

Paul A Volcker

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 5, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Richard J. Durbin
House of Representatives
Washington, D.C. 20515

Dear Mr. Durbin:

Your letter of March 9 raises important questions about the interaction of monetary and fiscal policies. In particular you ask if certain specified growth rates in M1 over the next three years (declining from 5.3 percent in 1983 to 4.6 percent by 1985) are "advisable or achievable" if Phase III of the tax cut were eliminated.

Because of the substantial institutional changes that have taken place in recent years and are in process now (e.g., the introduction of nationwide NOW accounts at the beginning of 1981 and of money market deposit accounts and Super-NOWs in late 1982 and early 1983), it is difficult, and probably inadvisable, to provide very precise estimates of the future course of the monetary aggregates as a group, including particularly M1. For 1983, the Federal Open Market Committee set a relatively wide target band of M1 growth in a 4 to 8 percent range.

Growth toward the upper end would be acceptable should the considerable and unusual increase in the demand for M1 relative to GNP in 1982--evident in the sharp decline in the velocity of M1 last year--tend to continue. This increase in demand occurred in part because of precautionary demands for liquidity stemming from the economic uncertainties of the period and in part because of the decline in short-term market interest rates last year, which made it relatively less costly to hold NOW accounts as well as other savings deposits. Should short-term interest rates remain around current levels--or drop further--demand for M1 might be expected to continue to be relatively strong. On the other hand, in a period of economic recovery--which can be expected in 1983--the public often spends more actively out of existing cash balances as attitudes become more optimistic, and the demand for M1 relative to GNP weakens--that is, its velocity rises. If this were to occur, growth of M1 more nearly toward the lower end of the FOMC's range, and more in line with the figure cited in your letter, would be appropriate.

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The FOMC has not yet looked beyond 1983 for establishing growth ranges. However, the general thrust of our policy is to seek behavior of monetary aggregates over time consistent with reasonable price stability. This would generally involve a slowing of money growth rates, but the pace may not be smooth and will depend on institutional changes and the public's adaptation to them.

Our evaluation of the appropriate behavior of the monetary aggregates in 1983 assumed that Congress and the Administration will make progress in reducing federal deficits in the coming years. If that progress were to include elimination of Phase III of the tax cut, it need not necessarily involve a substantially different outlook for M1 than I have described above. That would depend in part on effects of the fiscal action on business and investor confidence, actual spending, and on credit market conditions as influenced to a degree by expectations. For example, a reduction in the fiscal deficit would in a sense be "self-rewarding" if it were accompanied by reductions in market interest rates, particularly for longer-term rates.

Just how the deficit is reduced--as you well know--is itself a widely controversial issue, beyond the competence of the Federal Reserve. I would point out that the benefits for the market of higher taxes are dependent on a view that those taxes would not lead to still higher spending over time. Moreover, from the standpoint of incentives and savings, the argument has been made that alternative means of recouping revenues would be preferable.

But to repeat the general point, significant progress in reducing federal deficits will take pressure off credit markets, and contribute to a further weakening of inflationary expectations. It would provide an environment in which monetary policy designed to restrain money growth over time to rates consistent with price stability can be more effectively implemented, with less risk to investment and interest rates over a transitional period.

Sincerely,

S/Paul A. Volcker

SHA:PAV:pjt (#V-45)
bcc: Mr. Axilrod
Mrs. Mallardi (2)

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Action assigned Mr. Axilrod; info copy to Mr. Prell

RICHARD J. DURBIN
20TH DISTRICT, ILLINOIS

COMMITTEES:
AGRICULTURE
SCIENCE AND TECHNOLOGY

WASHINGTON OFFICE:
417 CANNON BUILDING
WASHINGTON, D.C. 20515
(202) 225-5271

Congress of the United States
House of Representatives
Washington, D.C. 20515

IN SPRINGFIELD:
1307 S. 7TH ST., 62703
(217) 492-4062 OR
P.O. BOX 790 62705

IN DECATUR:
ROOM 110, 363 S. MAIN ST., 62523
(217) 428-4745 OR
P.O. BOX 1506 62525

IN QUINCY:
ROOM 305, 531 HAMPSHIRE ST., 62301
(217) 228-1042

#45

March 9, 1983

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OFFICE OF THE CHAIRMAN

Honorable Paul A. Volcker
Federal Reserve System
20th Street and Constitution Ave. N.W.
Washington, D.C. 20551

Dear Mr Chairman:

We are presently debating the future and fate of Phase III of the Economic Recovery Tax Act which is scheduled to be implemented on July 1 of this year.

Information received from the Congressional Research Service indicates that it would be far more beneficial to overall economic recovery if we coupled elimination of the July 1 tax cut with an increase in bank reserves to hold the growth rates of the money supply (M1) sufficient to cause a percentage change in the money supply of 5.3 percent in 1983; 5.0 percent in 1984; and 4.6 percent in 1985. (I would refer you to Mini Brief No. MB83201 published by the Congressional Research Service in January of 1983 for particulars.)

Although I know this inquiry places you in a difficult position, I am attempting to formulate a position on this tax cut based on available alternatives.

Thus, I would most appreciate it if you would indicate whether or not the monetary policy suggested above would be advisable or achievable in your opinion in the event that we would eliminate Phase III.

I look forward to hearing from you at your earliest opportunity.

Very truly yours,

Dick Durbin

Richard J. Durbin
Member of Congress

RJD:kb

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Federal Reserve Bank of St. Louis

April 4, 1983

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

Thank you for your letter of March 28 inviting the Board to appear before your Committee at hearings on S. 730, the "Credit Deregulation and Availability Act of 1983."

I am pleased to let you know that Governor J. Charles Partee is looking forward to appearing on behalf of the Board on Tuesday, April 12, at 9:00 a.m.

Sincerely,

S/Paul A. Volcker

CO:pjt (V-59)
bcc: Gov. Partee
Dan Laufenberg
Mrs. Mallardi (2)

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JAKE GARN, UTAH, CHAIRMAN

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M. DANNY WALL, STAFF DIRECTOR
KENNETH A. McLEAN, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

March 28, 1983

BOARD OF GOVERNORS
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FEDERAL RESERVE SYSTEM
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OFFICE OF THE CHAIRMAN

#54

Honorable Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
20th and Constitution Ave., N.W.
Washington, D.C. 20551

Partee

Dear Chairman Volcker:

This letter confirms the invitation of the Senate Committee on Banking, Housing and Urban Affairs for you to appear as a witness to offer testimony on S. 730, the "Credit Deregulation and Availability Act of 1983". The hearing will be held on Tuesday, April 12, 1983 in Room SD-538 and it will be conducted in two segments; the first beginning at 9:00 a.m. and the second at 2:30 p.m. A member of my staff will be in contact with your office prior to the hearing to arrange the specific scheduling of your witness for the morning or afternoon session.

A copy of the Committee's guidelines for witnesses is enclosed for your reference and I would appreciate careful adherence to the rules regarding submission of written testimony. In addition, I am requesting all witnesses to attempt to limit their oral presentations to 5 minutes. Since we have a very extensive record from the 97th Congress on an almost identical bill and a large number of witnesses are scheduled to testify on the 12th, I would like the oral statements to be fairly short in order to leave more time for questioning.

Thank you for agreeing to appear at the hearing on S. 730. I look forward to your testimony.

Sincerely,

Jake Garn

Jake Garn
Chairman

Enclosure

JG:bck

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

April 4, 1983

PAUL A. VOLCKER
CHAIRMAN

The Honorable Jim Leach
House of Representatives
Washington, D.C. 20515

Dear Jim:

In your letter of March 1, you asked for views on a possible legislative directive to the Federal Reserve to enter into negotiations with other central banks in order to establish common capital standards for banks engaged in international lending.

International bank lending practices, especially pricing practices, have been questioned by some for a number of years for not adequately reflecting the need to provide an adequate return on capital in the light of the various risks involved. The competitive pressures that are reflected in pricing practices in turn owe something to differences in capital requirements or practices among countries. They also reflect, of course, differences in performance standards such as earnings, desires to expand market shares and, more generally, appraisals of country risk and expectations about the world economy and its management. Hence, while your focus on capital is important and appropriate, that focus (as I am sure you realize) needs to be considered in a larger framework.

Capital standards within and among national banking systems are not easy to determine. Internationally, definitions of capital vary, accounting standards are not uniform, and national capital requirements cannot readily be equated. Overcoming those difficulties as best one can, it seems that the capital ratios of the large U.S. banks stand somewhere in the middle together with the British banks. At the higher end of the spectrum are the Swiss banks and, at the lower end, the French and the Japanese.

There is already some work at the international level to achieve, if not harmonization, greater convergence of approaches to the question of bank capital. These efforts are being made as part of the work of the Committee on Banking Regulations and Supervisory Practices of the Bank for International Settlements. I believe there is some sense of agreement among the leaders of the central banks of the countries represented on the Committee, that this is an important subject; that, as a generalization, capital ratios of the international banks should be improved over time; and that greater homogeneity in the capital levels of those banks is desirable. Work is currently underway on the technical problems of definitions and

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The Honorable Jim Leach
Page Two

measurement of capital adequacy as part of the groundwork for further examination and operative conclusions.

Work is continuing, too, at the international level on other methods of improving international lending standards. These include developing better data on international bank lending and improving techniques for management of country risk in bank portfolios.

All of this parallels, and is partly dependent upon, efforts among the U.S. supervisors on developing standards within the U.S. As you know, the agencies set out more specific capital standards for smaller- and medium-sized banks in the U.S. some time ago, but, while efforts are being made to encourage larger capital by the multinational U.S. banks, the approach is developed more on a case-by-case basis. Because of international competition, that progress is, in turn, partly dependent on attitudes and developments abroad.

All this is a long way of indicating sympathy with the concerns motivating your legislative proposal. At the Federal Reserve, we are already committed to work with the other Federal bank regulatory agencies to strengthen the capital position of the U.S. banking system, and particularly that of the larger banks. We are also committed to continue pressing standards on a worldwide basis. Thus, I do not see that a legislative prescription is necessary in this area, and I do not believe any such prescription should be so specific (in terms of prescribing a need for specific numerical ratios) as your language may suggest. However, a general expression of Congressional encouragement and support for prudential concerns could be reasonable and useful. On a nit-picking point, it would be unrealistic to expect much in the way of a progress report on international efforts within 180 days of passage of such legislation as your draft on international efforts suggests.

Sincerely,

FRD:HCW:PAV:pjt (#V-38)
bcc: Gov. Wallich
Mr. Dahl
Mr. Truman
Mrs. Mallardi (2)
Mr. Ryan

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Action assigned Fred Struble

DAN GLICKMAN
FOURTH DISTRICT—KANSAS

COMMITTEES:
AGRICULTURE
JUDICIARY
SCIENCE AND TECHNOLOGY

CHAIRMAN: SUBCOMMITTEE ON
TRANSPORTATION, AVIATION AND MATERIALS

MYRNE ROE
ADMINISTRATIVE ASSISTANT
SCOTT FLEMING
LEGISLATIVE STAFF DIRECTOR

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

1507 LONGWORTH BUILDING
WASHINGTON, D.C. 20515
(202) 225-6216

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WICHITA, KANSAS 67201
(316) 262-8396

407 WOLCOTT BUILDING
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HUTCHINSON, KANSAS 67501
(316) 669-9011

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
1983 MAR 21 AM 9:46
RECEIVED
OFFICE OF THE CHAIRMAN

March 17, 1983

#51

Honorable Paul A. Volcker
Chairman
Federal Reserve Board
Twentieth Street and Constitution Ave. N.W.
Washington, D.C. 20551

Dear Chairman Volcker:

We are advised that, to date, little progress has been made in initiating the study mandated under Section 23(a) of the Futures Trading Act of 1982. As you know, this section directs the Federal Reserve to take the lead in conducting a study of the effects on the economy of trading in futures and options contracts. We urge you to move ahead as expeditiously as possible in getting the study underway.

The spectacular growth that has occurred in this industry in recent years makes it important for us to carefully consider the effect of this industry on the economy at large. We regard this study as being an important tool for the Congress to have in considering the role that futures and options trading play in the economy, and for determining how this industry can be most productively and responsibly regulated. We are, therefore, very anxious to see that the study is begun soon to insure that a comprehensive and well organized report will be forthcoming.

We will appreciate your prompt attention to this matter and request that you make available to us, as soon as possible, a comprehensive draft of your plans for organizing and carrying out the study.

With best regards,

Ed Jones

Dan Glickman

DG:mm

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Federal Reserve Bank of St. Louis

BARBER B. CONABLE, JR.
NEW YORK, 30TH DISTRICT

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WAYS AND MEANS
STANDARDS OF OFFICIAL CONDUCT
JOINT COMMITTEE ON TAXATION

Congress of the United States
House of Representatives
Washington, D.C. 20515

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237 CANNON HOUSE OFFICE BUILDING
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#64

April 4, 1983

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1983 APR -8 AM 8:57
RECEIVED
OFFICE OF THE CHAIRMAN

The Honorable Paul A. Volcker, Chairman
Board of Governors of the Federal Reserve System
20th St. at Constitution Ave.
Washington, D. C. 20551

Dear Mr. Chairman:

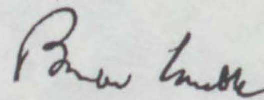
I would like to recommend for your consideration the appointment of John R. Riedman of Rochester, New York, as a member of the Board of Directors of the Buffalo Branch of the Federal Reserve Bank of New York.

John Riedman is one of the outstanding business and community leaders in western New York. As president of the Riedman Corporation he directs one of the nation's leading independent insurance marketing firms, and has developed major office buildings in downtown Rochester. He is a director of the Security New York Corporation; a former president of the Rochester Chapter, Chartered Property and Casualty Underwriters; was a delegate to the White House Conference on Small Business and a member of the President's Commission on Personnel Interchange.

Among his community activities, he is a director of the Rochester Museum and Science Center, a member of the Board of Overseers of Strong Memorial Hospital, and a director of Downtown Development Corporation of Rochester.

I have known John Riedman for about twenty years and have the highest regard for his personal qualities of competence, reliability and integrity. He is well acquainted throughout the western New York business and banking community and would make a substantial contribution to the Board in western New York.

Very truly yours,



Barber B. Conable, Jr.

C/nm

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April 1, 1983

The Honorable Ed Jones
House of Representatives
Washington, D. C. 20515

Dear Mr. Jones:

Thank you for your letter of March 17 urging the Federal Reserve to move ahead as expeditiously as possible with the study of futures and options markets that was mandated under Section 23(a) of the Futures Trading Act of 1982.

We have already commenced general discussions with other agencies designated by the Act to participate in the study. These discussions have focused on information to be collected and analyses to be conducted in order to address fully the issues of concern to the Congress--as indicated by the questions outlined in the Act and the discussions that preceded its passage. In addition, we have also discussed in a general way the assignment of agency responsibilities for carrying out this work. We expect to formulate a specific plan for the study that will be agreeable to all participating agencies in the near future.

Let me assure you that we are fully aware of the Congress' interest in this study and that we have every intention to carry out our responsibilities so that a comprehensive, well-organized report--one that addresses all of the issues of concern to the Congress--is submitted within the time frame specified in the Act.

Sincerely,

S/Paul A. Volcker

IDENTICAL LETTER TO CONG. DAN GLICKMAN

FMS:NS:vcd (V-51)
bcc: Fred Struble
Mrs. Mallardi (2) ✓

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April 1, 1983

The Honorable Benjamin A. Gilman
House of Representatives
Washington, D. C. 20515

Dear Mr. Gilman:

I am pleased to inform you that the Board is submitting the name of Robin Fenner for the Congressional Award for Exemplary Service to the Public. Ms. Fenner, a Senior Consumer Affairs Specialist, has rendered outstanding service to consumers in helping to resolve bank-related problems and in supplying information concerning their financial rights and responsibilities.

We fully support the goals and objectives of this very worthwhile program and share with you the belief that the important contributions that many federal employees are making on behalf of the American public should be recognized.

Thank you for your consideration. We look forward to participating in this program again.

Sincerely,

S/Paul A. Volcker

IDENTICAL LTR. TO CONG. ELLIOTT H. LEVITAS

JRW:vcd (V-29)

bcc: Mr. Weis
Mrs. Mallardi (2) ✓

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#29

Congress of the United States
House of Representatives
Washington, D.C. 20515

BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
1983 FEB 17 AM 11:40
RECEIVED
OFFICE OF THE CHAIRMAN
FEB 10 1983

The Honorable Paul Volcker
Chairman
Board of Governors of the Federal
Reserve System
20th & Constitution Ave., N.W., Room 2046
Washington, D.C. 20551

Dear Mr. Chairman:

Our strong convictions about the importance of courtesy and responsiveness by those who serve the public as Federal civil servants led to the establishment of the Congressional Award for Exemplary Service to the Public during 1980. This annual honor awards program is intended to highlight the very important contributions that many civil servants are making on behalf of the American public. By recognizing a select few each year, this program emphasizes the interest and value that the President, the Congress, and the people of our Nation place on courteous and responsive public service and helps to dispel some of the negative attitudes about Government employees which all too frequently are prevalent among our citizens.

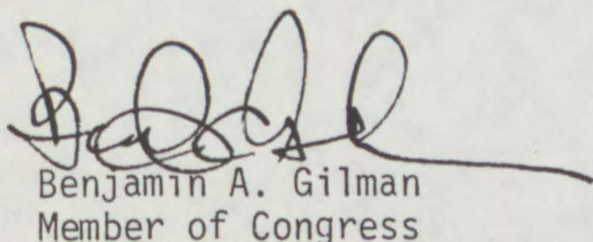
During the first two years, this program has generated a great deal of interest. Forty departments and agencies participated in the program last year, each nominating truly outstanding employees. We would like, once again, to invite your agency to participate in this program by nominating that one individual in your organization who, through his or her actions and dedicated efforts, best represents the highest ideals of public service.

If the field cannot be narrowed to one employee, a maximum of two employees may be nominated. Our experience has shown that, although many employees frequently are worthy of nomination from any one agency, it is that agency's own personnel who are best able to determine which nominations represent the agency's most exemplary employees.

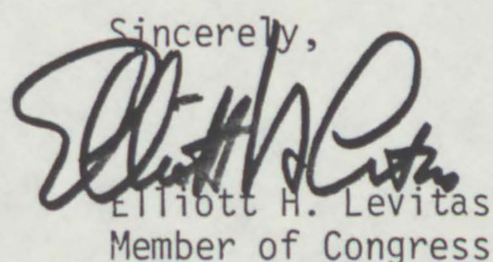
The U.S. Office of Personnel Management is again this year providing assistance in our sponsorship of this Congressional award. Nominations may be directed to: U.S. Office of Personnel Management: Incentive Awards Branch: Room 6H34; 1900 E Street, N.W.; Washington, D.C. 20415.

Nominations are due March 25, 1983. Enclosed is information concerning the award, the criteria, and the format for nominations. We very much look forward to receiving your nominations and wish to express our appreciation for your interest and support.

Sincerely,



Benjamin A. Gilman
Member of Congress



Elliott H. Levitas
Member of Congress

Enclosure

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CONGRESSIONAL AWARD FOR EXEMPLARY SERVICE TO THE PUBLIC

Background

The nature and quality of the contacts citizens have with Federal personnel at all levels strongly influence the way Americans think and feel about their Government.

The Civil Service Reform Act of 1978 reflects the concern of the President and the Congress for ensuring that high standards for courtesy and responsiveness are maintained in the Government's delivery of services to the public.

Congressman Elliott H. Levitas' particular interest in this matter prompted him to author a provision in the Act, supported by Congressman Benjamin A. Gilman, that permits performance standards for Federal employees to address the degree to which employees demonstrate courtesy to the public.

As the Federal agency responsible for providing leadership to the program to improve courtesy to the public throughout Government, the U. S. Office of Personnel Management was requested to assist Congressmen Levitas and Gilman in establishing a program of recognition for Government personnel who provide exemplary and courteous service to the public.

Objectives

To recognize and publicize exemplary and courteous service to the public, to encourage a concerned and responsible attitude toward the public among Government personnel, and to underscore the interest of the President and the Congress in the importance of courtesy throughout Government.

Eligibility

Individual Federal civilian employees.

Criteria

The nominee must have demonstrated a degree of courtesy in dealing with the public that clearly exceeds normal expectations,

For purposes of this award, "public," means (a) the general public, and (2) other organizations or groups, including governmental organizations, served by Federal personnel.

"Courtesy that clearly exceeds normal expectations" is demonstrated by unusual promptness in responding to requests for assistance or information, willingness to "go the extra step," and a desire to reflect a favorable image of the Government generally and of the employee's own organization. Consideration for nomination should be given those employees who have:

(more)

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Congressional Award for Exemplary Service to the Public

Nomination Format

Name of Nominee: ____
(surname, first name, middle initial)

Job Title: ____ Grade or Rank: __________

Employing Agency: ______________________ Organization: ________________

Mailing Address: ____

____

Brief description of employee's exemplary service to the public:

Suggested citation describing the achievement (not to exceed 75 words):

____
Signature of Agency Head
(or designee)

Name of person to contact
regarding nomination: ________________________ Phone number: __________

Nominations should be submitted to: U.S. Office of Personnel Management
Incentive Awards Branch, Room 6H34
1900 E Street, NW
Washington, D.C. 20415
(Due C.O.B. 3/25/83)

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