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EDGE ACT CO
AND INTERNATION

Commercial banking in the United States has undergone almost revolutionary changes in the last decade. These include a growth of more than 80% in total assets, immense changes in the structure of assets and liabilities, and the development of new sources and outlets for funds. One of the more interesting developments during this period, however, has been the growth of international operations.

Several methods are available to United States banks for conducting business abroad, with the method chosen by a particular bank depending upon the size of the bank, the type of operations engaged in, and conditions in the countries in which business is conducted. Many banks use the services of correspondents, some establish foreign branches, while some find special subsidiary institutions to be especially suitable to certain types of operations or to operations in certain areas of the world. A few banks have large foreign departments and extensive overseas branch operations as well as special subsidiaries. This article discusses certain aspects of foreign banking and financing subsidiaries, or what are known as Edge Act and agreement corporations.

The Background United States commercial banks are relative newcomers to the field of international banking and finance. Prior to World War I, a large part of world trade was financed in sterling by London banks. Until the enactment of the Federal Reserve Act in 1913, national banks could not establish branches abroad nor were they authorized to create bankers' acceptances, the chief method of financing foreign trade. Several state banks did establish foreign branches, however, and by 1914 two foreign banking corporations were operating branches overseas.

The Federal Reserve Act authorized national banks to establish foreign branches, subject to approval by the Federal Reserve Board, and to accept drafts. This action contributed to a rapid increase in the number of foreign branches of U. S. banks during and after World War I, but soon after passage of this legislation concern was expressed over the inability of small banks to establish branches abroad. The idea was advanced that small banks could participate in foreign branching by joining with other banks in establishing special foreign banking corporations. Such participation was made possible in 1916 when Congress amended Section 25 of the Federal Reserve Act to authorize national banks with capital and surplus of $1 million or more to invest up to 10% of their capital and surplus in

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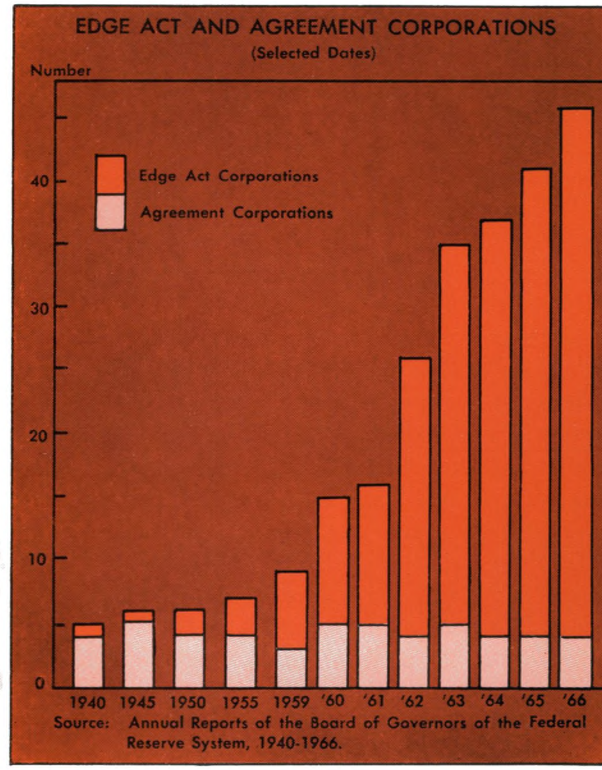

Source: Annual Reports of the Board of Governors of the Federal Reserve System, 1940-1966.

the stock of corporations chartered "under the laws of the United States or of any state thereof, and principally engaged in international or foreign banking. . ." The law did not provide for Federal chartering of the corporations, however, so the only corporations to which the amendment applied were those established under state laws.

Before any national bank would be permitted to buy stock of such corporation, the corporation had to enter into an agreement with the Federal Reserve Board to conduct its business in such manner or under such limitations and restrictions as the Board might prescribe. Because of this requirement, these came to be known as "agreement corporations."

World War I brought fundamental alterations in the international financial and trade position of the United States which contributed to the emergence of a sentiment in favor of a much more aggressive role for the United States in the world economy. The amendment of the Federal Reserve Act in 1919 by the addition of Section 25 (a) was partly a reflection of this development. A primary objective of this section, commonly known as the Edge Act after its sponsor, Senator Edge of New Jersey, was to encourage the expansion of U. S. exports by providing credit to European buyers.

Section 25 (a) authorized the Federal Reserve Board to charter corporations 'for the purpose of engaging in international or foreign banking or other international or foreign financial operations. . . either directly or through the agency, ownership, or control of local institutions in foreign countries. . ." The Act required a minimum capital of $2,000,000 and provided that a majority of the shares of such corporations shall at all times be held and owned by citizens of the United States or by corporations or firms the controlling interest of which is owned by citizens of the United States.

The corporations were granted certain powers, subject to such rules and regulations as the Federal Reserve Board might prescribe. Regulation K, first issued by the Board in 1920 and revised several times since, sets forth general rules governing the operations of Edge corporations. This regulation was most recently revised in 1963. Thus, the chartering and regulation of Edge corporations was placed in the hands of the Federal Reserve Board.

Early Activities The passage of the legislation described above, the altered position of the United States in the international economy, and the growth of foreign trade and investment resulted in a rapid expansion of foreign banking and financing corporations in the decade following World War I. Between 1919 and 1929, 18 corporations were organized, of which 15 were agreement corporations operating under state charters and three were Edge corporations chartered by the Board of Governors.

For the most part, the corporations formed in this period were concerned with general foreign banking, and they established numerous branches in Europe, Latin America, and Asia. A few of the corporations were wholly-owned by large United States banks, but in a number of cases large banks in financial centers shared ownership with their domestic correspondents. Stockholders of one New York based corporation included more than 30 banks located in 20 odd states. A few were jointly owned with foreign interests. Some were designed to facilitate certain types of exports by providing better credit facilities. An example of this type was a corporation based in New Orleans and owned by banks in the South and Southwest. Its major objective was to provide better credit facilities for the export of cotton, tobacco, and lumber.

The history of these early ventures was not a particularly happy one. By the early thirties, most of those established in the postwar decade had been liquidated or absorbed by other corporations or by banks. Many of the liquidations involved losses to stockholders.

A number of developments contributed to the lack of success of the Edge Act and agreement corporations in this early period. A desire to get in on a new thing may have contributed to the establishment of more corporations than were called for by conditions in world trade and finance, while at the same time U. S. banks were expanding their foreign departments and adding to the competition for foreign business. A lack of personnel experienced in this type of operation also contributed to the unfavorable performance. Finally, many corporations were chartered shortly before or during the decline in world trade that accompanied the economic recession of 1920-21. This was followed by a period of unusual instability in world prices in the 1920's and the worldwide depression and breakdown of international economic relations in the 1930's.

Whatever the causes, by the early 1930's foreign banking through the establishment of Edge Act and agreement corporations had entered an hiatus that lasted until the late 1950's. As the accompanying chart shows, only one Edge corporation and 4 agreement corporations were in operation at the end of 1940. Three Edge corporations had been formed in the 1920's, but the last of these was liquidated in 1933, and the only one remaining in 1940 was an affiliate of Chase National Bank that had been chartered in 1930.

Recent Growth The rebirth of interest in foreign banking and financing affiliates, like so many of the major changes in international trade and finance since World War II, did not come about until after the general movement toward currency convertibility by the world's major nations in 1958. As late as 1959, for example, there were only 9 Edge Act and agreement corporations, as compared with a total of 6 in 1945. In 1960 the number more than doubled, and by the end of 1966 it had risen to 46. Growth since 1962 has been very rapid and all of the increase has been in Edge Act corporations.

This does not mean, of course, that the return to convertibility on current transactions was the cause of the rebirth of interest in foreign banking and financing subsidiaries. This move, while symbolic of a "return to normalcy" in international financial affairs after a quarter century of restrictions and controls, was only one of a number of developments contributing to the remarkable expansion of foreign operations of U. S. banks. Among these were the creation of a new monetary order, based on the International Monetary Fund, with the U. S. dollar occupying the position of key reserve and trading currency. Closely related to this was the emergence of the "Euro-dollar market," a true international money market in United States dollars. In addition, the creation of the Common Market in Europe and the drive toward economic development in many of the world's underdeveloped areas contributed to the doubling of world trade in the last decade, as well as the tremendous increase in the flow of investment funds from the United States to countries all over the world.

These developments required financing, and since the U. S. dollar was the world's chief trading and reserve currency, much of the financing was done through U. S. banks. Moreover, the rapidly expanding operations of United States businesses in foreign markets created a growing demand on the part of bank customers for advice concerning foreign markets and foreign laws and regulations. Many of these services were provided through expanded correspondent relationships and branch operations, but some banks elected to enter the foreign field through an Edge Act subsidiary.

Operations of Corporations From time to time there have been attempts to separate the banking and financing operations of Edge corporations.

Regulation K, as revised in 1957, required Edge corporations to operate as either banking or financial subsidiaries, with important differences in the powers enjoyed by each type. Because of these differences, some banks formed one of each. The 1963 revision of the Regulation eliminated the formal distinction between the two types, however, although there are still certain differences between the powers and privileges of corporations "engaged in banking" and those that are not.

Corporations enjoy rather broad powers under Section 25 (a) and Regulation K. They may acquire and hold shares of a foreign corporation if such acquisition is incidental to the extension of credit to the corporation, if the acquisition consists of shares in a foreign bank, or is otherwise likely to further the development of U. S. foreign commerce. Prior consent of the Board of Governors is required, however, if the acquisition results in the corporation holding 25% or more of the voting shares of a foreign bank or if the aggregate amount invested in the shares of another corporation exceeds $200,000.

Corporations are empowered to receive deposits outside the United States as well as demand and time (but not savings) deposits in the United States, if the latter are incidental to or for the purpose of carrying out transactions in foreign countries. They may issue letters of credit, accept bills and drafts drawn upon them, trade in foreign exchange, and in general carry on a banking business as it relates to foreign operations.

Actual operations of foreign subsidiaries vary considerably. Some carry on banking operations comparable to those of the foreign department of a large commercial bank. These include the acceptance of deposits, issuance of letters of credit, extension of loans, collections, and other banking operations. Such operations may be carried on directly or through ownership of foreign commercial banks. Other corporations go beyond the provision of short-term commercial bank credit and to an increasing extent in recent years they have served as holding companies for the stock of foreign nonbank corporations. The latter have consisted primarily of financial institutions, such as underwriting and brokerage firms, factors, and trust affiliates. Commercial and industrial concerns with activities ranging from steel to shipbuilding to electrical appliances have also been included, but these have been relatively unimportant, amounting to only about 5% of total investment.

Reasons for Revival It is easy to attribute the recent revival of interest in Edge corporations to the substantial growth in foreign trade and investment in the last decade. But this does not explain why banks chose to expand foreign operations through Edge corporations rather than through correspondent or branch operations.

The foregoing discussion of the operations of Edge corporations should indicate some of the advantages enjoyed by these affiliates. The fact of the matter is that United States banks can do a number of things through Edge affiliates that they cannot do directly. The most obvious of these is the ability to own equity shares in foreign banking or nonbank subsidiaries. This is particularly advantageous in carrying on banking operations in countries where foreign banks are not permitted to operate branches. This advantage of Edge corporations was somewhat reduced, however, by the recent revision of Regulation M which permits member banks, within certain limits and with prior approval of the Board of Governors, to purchase stock of foreign banks directly.

An Edge corporation's ability to acquire an equity interest in nonbank financial institutions and to engage in a variety of financing activities adds greatly to its flexibility. A type of operation of growing importance in recent years has been the joint venture, where the Edge corporation acquires a portion (and sometimes less than a controlling interest) of a foreign corporation in partnership with one or more foreign interests. In some instances two or more Edge corporations may join together to acquire part or all of the shares of a foreign corporation.

Another reason for using the Edge method of expanding foreign operations derives from the inability of commercial banks in the United States to establish branches outside the state in which the head office is located. Thus, a bank operating in North Carolina would not be able to establish a branch in New York City for the purpose of conducting foreign operations, but it could acquire such an office through the formation of an Edge Act subsidiary. Many banks have used this device for precisely this purpose.

The historical section of this article draws heavily on "United States Banking Organization Abroad" by Frank M. Tamagna and Parker B. Willis in the *Federal Reserve Bulletin,* December 1956.

■ Coal mining operations in the Fifth District date back to the eighteenth century. As early as 1725, settlers in the backcountry of Virginia and Maryland were aware of the existence in those areas of sizable deposits of bituminous. Because of limited commercial demand and high transportation costs, however, these deposits were not exploited until much later in the century. The first commercial mining of soft coal in North America began in 1750, with the discovery of an unusually rich vein in the Richmond area of Virginia. By the end of the century, commercial operations were under way in Western Maryland and in what is now West Virginia. ■ Domestic demand for coal soared with the industrial development of the country in the Civil War and post-Civil War period. Early industrial users of coal preferred anthracite to bituminous because anthracite contained less volatile matter and hence produced much less smoke. The great anthracite strike of 1902, however, encouraged industrial users to seek substitutes. It was at this time that the "smokeless coal" fields of West Virginia were developed. These coal fields yielded a low volatility bituminous coal, which was a reasonably close substitute for anthracite. From that time, West Virginia has been a major coal-producing state and today produces more than any other state. Virginia ranks sixth. ■ Coal was first transported from the mines to industrial sites by flat boats and barges. By the middle of the nineteenth century, however, railroads were being run to the mines and by the turn of the century accounted for the bulk of coal transportation. Today 73 per cent of all domestic coal production is shipped by rail, with the remainder carried chiefly by water transportation and by truck. ■ Coal production in the District centers in the Appalachian Coal Field, which extends through Western Maryland, Southwest Virginia, West Virginia, and the northwest corner of Georgia. The coal found in this area is bituminous or soft coal and is used widely by industry and for home heating. Coal of this type is also found in smaller quantities in North Carolina. ■ Mining techniques have made rapid strides in the last several decades. Modern machinery and technology have increased output from six tons per day per miner in 1945 to about 16 tons in 1964. Safety standards and equipment also have been improved vastly. ■ Coal production today is complementary to many major industries, including transportation, steel and other metals, and electric power production. In recent years it also has emerged as an increasingly important raw material for the chemical industry. It has also assumed increasing significance as an export commodity.

CREDIT: The National Coal Association