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To Board of Governors

From Division of Supervision
and Regulation

Subject: Allied Bank International
New York: International operation
stockholding banks.



This memorandum presents two questions on the international operations of banks relating to their membership as a stockholder in ABI. The questions are separate but they are also related in that they are part of the broader issue of the competitive aspects of multibank ownership of Edge Corporations. The first question concerns the resolution of the proposed participation of United States National Bank of Oregon as a stockholder of ABI. The second concerns the proposed establishment by stockholding banks of ABI of their own branches in Nassau.

I. United States National Bank of Oregon as a stockholder of ABI.

Background.

Earlier this year, ABI requested the Board's permission to add certain banks as stockholders. When the request was first considered by the Board, questions were raised about the appropriateness of the participation of three banks, mainly because of their size: Valley National Bank, Phoenix, with total assets of \$1.4 billion; United States National Bank of Oregon, with total assets of \$1.7 billion; and First National Bank of St. Paul, though with total assets of less than \$800 million, as one of two lead banks in First Bank System, a \$3.8 billion registered bank holding company. The original stockholding banks of ABI had had total assets generally in the range of \$500 million to \$1 billion.

In response to those questions, the Division prepared a memorandum dated June 4, 1969, addressed to the question of size as a criteria for determining membership in ABI. The memorandum admitted a correlation between the size of a bank and a bank's ability independently to develop international banking capabilities. However, it was observed that:

". . . there is little in experience to suggest the existence of a 'critical' or 'threshold' size beyond which the actual development of such capabilities becomes inevitable. Rather, it would appear that other elements such as the existing character of a bank's business, the economic interests served in a bank's primary marketing area, and the nature of the competition faced by the bank from both within and without its primary marketing area, are more compelling in decisions to develop international banking services."

*See Minutes
12/17/89 89*

As an indication of the character of the business of the banks in question, an analysis was made of their deposit structures. That analysis suggested that despite the over-all size of the banks involved, they were not significant competitors--generally or with one another--in the national banking market. The deposit characteristics of Valley National Bank and United States National Bank of Oregon, in particular, reflected the fact that these banks operate Statewide branching systems.

The Division recommended approval of the three banks as stockholders of ABI on the following grounds:

- (1) The absolute size of a bank is not a sufficient criteria in itself for determining its inclusion or exclusion from a joint venture such as ABI. Other important elements to consider are the geographic location of the bank and the nature of its business, especially its international business, as indicative of the bank's position as an actual or potential competitor in international banking.
- (2) None of the three banks was a significant competitor in the international banking business. Foreign claims of the three banks under the FCRP were approximately as follows: Valley National--\$18 million; United States National--\$4 million; and First National of St. Paul--\$7 million. These amounts were all negligible, both absolutely and in relation to the size of the banks; the largest (Valley's) was mainly in connection with Mexican border traffic. None of the three banks had foreign branches or ownership interests in foreign institutions. United States National Bank of Oregon had a recently-established Edge Corporation, co-located with the bank, but the Corporation was dormant.
- (3) The three banks were not major competitors in the national banking market, as indicated by the analysis of their deposit structures.
- (4) The three banks were geographically separate and were not direct general competitors with one another or with existing shareholders of ABI.

When the request was considered further by the Board on June 25, 1969, the participation in ABI of Valley National Bank and First National Bank of St. Paul was approved. However, since United States National Bank of Oregon was not only large but had already established an Edge Corporation, the request to add that bank as a shareholder of ABI was held in abeyance pending further indications of the bank's intentions for its Edge Corporation.

ABI was subsequently informed of the Board's concern regarding the participation of United States National Bank of Oregon as a shareholder of the Corporation. As elements of that concern, mention was made of the size of United States National and the existence of its own Edge Corporation. In a letter dated August 28, 1969, ABI has put forward additional arguments in support of its request. (Attachment A.) ABI has also furnished a copy of a letter dated October 8, 1969, from Mr. Leroy Staver, Chairman of the Board of United States National Bank of Oregon, to Mr. Jacques Stunzi, President of ABI, regarding the formation and utilization of United States National Bank of Oregon International Corporation. (Attachment B.) The remainder of this section reviews the attributes of "in-house" Edge Corporations, the additional material supplied by ABI, and the general question involved in the request.

"In-house" Edge Corporations.

Of the 65 Edge and Agreement Corporations that are subsidiaries of member banks, some 47 are "in-house" Corporations--that is, co-located with their parent bank. For all practical purposes, these Corporations are but separately incorporated sections of the parent banks' international departments.

The sole advantage of an "in-house" Corporation over a bank's international department is the ability of the former to acquire and hold equities. The large banks that not only conduct a sizable international business but also have been building an overseas banking and financing organization have used such Corporations as vehicles to hold the stock of foreign subsidiaries and to acquire minority positions in foreign financial institutions. For other banks, the principal use of such Corporations has been to take equity positions in foreign companies in connection with loan and financing operations. A number have participated in financing transactions sponsored by the International Finance Corporation which have involved equity-loan packages. Also, some have been used to handle especially complicated foreign loans.

On the whole, the activities and operations of these "in-house" Corporations have reflected the general position and posture of their parent banks in international banking. The most active Corporations have been the subsidiaries of the strongly internationally oriented banks. The others have generally remained small and have been used intermittently by their parent banks. In fact, several would appear to have been organized for local competitive or prestige reasons and have been little used.

Applicant's additional submissions (Attachments A and B).

ABI's letter does not add materially to the information available to the Board on the issue raised by the application. It reviews the general concept underlying the formation of the Corporation, emphasizing the pro-competitive aspects of ABI--namely, as a Corporation owned by a consortium of regional banks and of sufficient size to compete effectively with the large New York banks. According to the applicant, if ABI is to have representation from the Pacific Northwest region among its shareholders, there is no alternative to United States National; the other banks of any size in Oregon are already established, directly or indirectly, in the field of international banking. Similarly, United States National's participation in ABI would assist that bank in being a more effective alternative source of international banking services to customers in that region. On the question of size, the letter notes that United States National operates on a Statewide basis; if only the bank's deposits at head office and branches in Portland were considered, the total would be less than \$700 million.

Mr. Staver's letter to Mr. Stunzi provides additional information on the genesis of United States National's Edge Corporation, confirms that the Corporation is now dormant, and states that there are no immediate plans for using the Corporation. According to Mr. Staver, the Corporation would be used as and when needed in conjunction with the operation of the bank's international division--possible through an equity participation in connection with a loan to a customer. Such usage would parallel the operations of a number of existing "in-house" Corporations, as described above.

Discussion.

The key question regarding a particular bank's participation in a joint venture such as ABI is whether that participation diminishes to a significant degree existing or potential competition among United States banks, notably in the provision of international banking services.

The competitive aspects of multi-bank Edge Corporations were explored in the Division's memorandum of March 14, 1968, when the formation of ABI was under consideration by the Board. The discussion in that memorandum started from the premise that all substantial banks (especially those with, say, total resources of \$500 million or more) need be considered as potential competitors in the market for international banking services, and that their participation in a jointly-owned New York Edge Corporation necessarily reduces the potential entry of banks into New York City through separate Edge Corporations. However, it concluded:

- "1. Possible adverse effects of such joint ventures on potential competition in New York City would be minimal in view of the highly developed market for international banking services already in existence and dominated by the large New York City banks. Existing competition would probably be enhanced and be more effective by the entry now of a single and larger entity.
- "2. Potential competition among participating banks for the international business of foreigners and large national corporate customers would be diminished by such a joint venture. However, since most of the banks to which a jointly-owned Edge Corporation would appeal do not presently conduct a sizable international business, they cannot be said now to be significant competitors, either among themselves or in the overall market for that business. It may, therefore, be doubted whether in most cases the reduction in potential competition for that business, risked in permitting such joint ventures, would be significant. If the participants in a joint venture included banks serving the same local banking market, a prima facie case would exist that existing and potential competition in that market would be adversely affected.
- "3. Existing and potential competition in the market for international banking services could be adversely affected if existing joint ventures, through the number and composition of their participants, restricted possibilities for nonparticipating banks to form competing jointly-owned corporations."

The memorandum also suggested that the "size of the existing international business and the location of the participating banks would seem the principal points of departure in the Board's consideration of the competitive implications of a particular venture."

At the time, the Board also requested and obtained the views of the Department of Justice as to any antitrust issues raised by such joint ventures. The Justice Department responded as follows:

"The only significant antitrust issue which we see in the formation of jointly-owned Edge Act corporations is that such joint ventures might in some circumstances unduly limit the number of competitors engaged in international banking and financial operations. This might occur if the number of banks participating in such a joint venture was unduly large

"or if it included banks already having competing Edge Act subsidiaries or other international banking operations. While we might question whether the proposed 'American Overseas Banking Corporation' in fact needs the number of banks presently proposed as shareholders in order to conduct effective international banking operations, we are not in a position to resolve this question or to conclude that the participation of this number of banks in a single Edge Act corporation is likely to unreasonably limit the number of such corporations which are likely to be formed.

"With the exception of the possible problem mentioned above, we conclude that the formation of the proposed corporations, with the shareholders listed herein, would probably not raise significant issues under the antitrust laws. We are influenced in reaching this conclusion by the fact that none of the banks involved in the formation of the proposed corporations appears to be a major factor in the foreign banking and financing field or has an office located outside the United States, and that since no two of the banks are located in the same city, the formation of these joint ventures will not reduce the number of locally available foreign banking alternatives in any community."

The conclusions reached in both the Justice Department's letter and the Division's memorandum rested essentially on a judgment as to whether proposed participants are a "major factor in the foreign banking or financing field." In making such a judgment, the Division's memorandum did not focus explicitly on the organizational framework in which a bank's international business is conducted. The Justice Department's letter did mention banks with "competing Edge Corporations" or "an office located outside the United States."

In the context in which the Justice Department's comment on "competing Edge Corporations" was made, it is clear that the emphasis intended was on the word "competing" and in the sense of "competing" in a geographical area. For, as will be recalled, the Justice Department's views covered not only the formation of ABI but also the establishment of American International Bank. The latter was to be formed in New York by The Fidelity Bank, Philadelphia, and Wachovia Bank and Trust Company, National Association, Winston-Salem, with each to hold a 35 per cent interest. At the time, both banks already had "in-house" Edge Corporations, through which they jointly controlled a French bank, and each of which had a modest number of minority equity investments. (Ownership of the French bank has since been transferred to American International Bank.) The Department did not find the existence and activities of these "in-house" Edge Corporations formed an impediment to the establishment of American International Bank.

Against the foregoing background and discussion, the arguments for denial and for approval of the application may be summarized as follows:

Arguments for denial. United States National Bank of Oregon is the 31st largest bank in the United States. With total assets of \$1.7 billion, the bank has sufficient resources to develop independent capabilities to provide international banking services and consequently to be considered a potentially significant competitor in this field. The bank has already established an Edge Corporation which, though now inactive, indicates the bank's interest in developing its international capabilities. Approval of the application would tend to diminish any incentive for United States National to enter independently into the New York international banking market.

Arguments for approval. United States National Bank of Oregon, though large, is essentially a regional bank. It is not a significant factor in the national banking market nor is it a significant factor in the international banking business of United States banks. Its foreign lending has been negligible, it has no overseas banking offices, and its Edge Corporation not only has been inactive but also is of the limited "in-house" variety. An "in-house" Corporation is only part of a bank's international department--essentially only a means of gaining authority to hold equities--and its narrow function should be considered as part of the assessment of the overall scope of a bank's international activities. By itself, the existence of such a Corporation does not evidence significant international banking capabilities, either actually or potentially, a conclusion shared by the Justice Department in another and comparable situation.

The Division continues to believe that the arguments in favor of approval are the more persuasive.

II. Nassau branches for shareholding banks of ABI.

The Board has received applications for permission to establish limited branch facilities in Nassau from the following banks, all shareholders of ABI: Valley National Bank, Phoenix; Liberty National Bank and Trust Company, Oklahoma City; Hartford National Bank and Trust Company; and First National Bank of St. Paul. It is understood that other shareholding banks have similar facilities under active consideration.

In addition, the Board has received an application for a Nassau branch from The First National Bank of Minneapolis. While not a direct stockholder in ABI, the bank is part of First Bank System whose other leading bank, located in St. Paul, is a shareholder in ABI.

Furthermore, ABI itself has applied to the Board for a Nassau branch. ABI already has a London branch and the incentive for a Nassau office is to avoid double taxation on income from loans to United States corporations. (Avoidance of taxation on such income by both the British and United States revenue services was the basic reason for the establishment of Nassau facilities by Chemical Bank and Marine Midland Grace Trust Company, and underlies the practice of Chase Manhattan, for example, of booking such loans in its long-established Nassau branch rather than in London.) It is understood that if ABI's application were approved and also the applications of ABI's shareholders, ABI's Nassau branch would probably provide the office space, bookkeeping services, etc., for the facilities of its shareholding banks in much the same way as such services are presently furnished to Nassau branches of other banks by institutions such as World Banking Corporation (an affiliate of Bank of America), Arawak Trust Company, and Deltec Banking.

The principal reason given by the applicants for a Nassau facility is that it would provide them with access to Eurodollars that could be used outside their FCRP guidelines to meet the foreign financing needs of their local customers. All the shareholding banks of ABI have relatively small guideline ceilings; ceilings that have been diminished for their own operations by transfers of portions to ABI.

An existing full-service foreign branch would presumably weigh against permitting a bank to become a shareholder of ABI on the grounds that such a branch would indicate sufficiently developed international banking capabilities for the bank to be considered, at least potentially if not actually, a significant competitive factor in the international banking market. The question posed by the present applications is the appropriateness of banks, once they are shareholders of ABI, establishing their own Nassau branch facilities.

ABI was established on the basis that it would enable a consortium of banks, lacking international banking capabilities, to construct and to have access to an international banking organization operating in New York and abroad. Such an organization would provide an effective alternative to the international banking and financial facilities concentrated in the giant banks, especially in New York. The pro-competitive aspects of the concept were considered to outweigh the risks entailed of limiting potential competition in this field among United States banks. Approval of the participation of individual

banks in the venture was on the basis of a judgment that they were not at present, and were unlikely to become, significant competitors in the market for international banking services. In these circumstances, for an ABI shareholding bank to seek to establish a full-service foreign branch dealing with the public in a major center abroad would seem to raise questions as to whether such an operation would be consistent with its continued participation in ABI. However, the present applications are for Nassau facilities through which only limited banking services are offered, in which there are no dealings with the public as such, and where all transactions are effected by head office decisions. Like the Nassau facilities of most other banks, the proposed branches would be simply devices enabling banks to extend foreign credits outside the FCRP guidelines, employing funds obtained abroad, credits that otherwise would be made from domestic offices. These facilities can be viewed as really but a part of the banks' international departments and not as separate offices for conducting banking business abroad, such as would be indicative of an independent capacity to compete significantly in international banking. Permission to become shareholders in ABI was not intended to preclude the growth and development of the international banking business conducted independently by the participating banks at their domestic offices nor of their ability to provide international banking services to their local customers. That growth and development is at present impeded by the restraints of the FCRP, which other banks (including local competitors of some of the applicants) have sought to surmount through the establishment of Nassau branches.

The Board earlier approved a Nassau branch for The Fidelity Bank and a Nassau subsidiary for The Fidelity Bank's Edge Corporation. Approval was also given for a comparable subsidiary in the Cayman Islands to the Edge Corporation of Wachovia Bank and Trust Company. The Fidelity Bank and Wachovia Bank and Trust Company are shareholders in the American International Bank, an Edge Corporation located in New York.

In view of the special character and limited nature of Nassau branch facilities, the Division does not believe that the proposed establishment of such facilities by existing shareholders in ABI raises serious anticompetitive questions. In fact, they might help to maintain a competitive environment between the participating banks and ABI. On this basis, the Division would recommend approval of the applications.

If the Board agrees with the foregoing recommendation on the general question, the individual applications will be presented to the Board in accordance with the usual procedure, following review by the respective Reserve Banks and by the Division.

Attachments.