APPLICATION REQUIRING BOARD ACTION

Date December 5, 1969.

Federal Reserve District 2.

By: Allied Bank International ("ABI"), New York, New York, a Section 25(a) Corporation.

For: A - Permission to issue, either directly or through its wholly-owned subsidiary, Allied International N.V. ("AINV"), Curacao, Netherlands Antilles, medium- and long-term obligations up to $100,000,000.

B - A ruling that guarantees by ABI of such obligations issued by AINV do not come within the limitations in Sections 211.9(b) and (c) of Regulation K.

C - Prior Board permission to exclude such obligations in applying the limitation on aggregate liabilities in Section 211.9(c) of Regulation K.

Recommendations

Federal Reserve Bank: A - Approval, but for only $50,000,000.
B - Approval.
C - Denial.

Division of Supervision and Regulation: Same as Federal Reserve Bank.

Review Examiner

Assistant Director

Data Regarding Applicant
(Amounts in Millions)

As of June 30, 1969	London	New York	Total
Cash and due from banks	$15.2	$ 46.1	$ 61.3
Due from Head Office/Branch	-	2.0	-
Loans	1.4	46.9a/	48.3
Customers' liability on acceptances	.1	1.7	1.8
Fixed assets	*	1.9	1.9
Other assets	*	2.5	2.5
TOTAL ASSETS/LIABILITIES	$16.7	$101.1	$115.8
Deposits	.1	48.6	48.7
Borrowings	14.5	13.9	28.4
Liability on acceptances	.1	1.7	1.8
Other Liabilities	.1	4.6	4.7
Due to Head Office/Branch	2.0	-	-
Capital and Surplus	-	32.2	32.2
Other Capital accounts	(.1)	.1	-

* Less than fifty thousand dollars.
a/ After Reserve for Loans of $.1.

A - The Issuance of Obligations

Statutory and Present Regulatory Provisions

Section 25(a) of the Federal Reserve Act grants to Corporations the power, among others, "to borrow and to lend money; to issue debentures, bonds, and promissory notes under such general conditions as to security and such limitations as the Board . . . may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times its capital stock and surplus; . . . ."

Section 211.4 of Regulation K, as revised September 1, 1963, provides that a Corporation must receive prior Board approval to "issue or have outstanding any debentures, bonds, promissory notes (other than notes due within one year), or similar obligations."

Utilization by the Corporations

Since the 1920's no Corporation has directly issued debt obligations which have been sold to the public. However, in the past few months the Board has approved the issuance of promissory notes to the Export-Import Bank by several Corporations engaged in banking, but these would appear to be more in the nature of borrowings, rather than the issuance of debt obligations of a Corporation. Additionally, there have been instances where the Board has approved the issuance of obligations by subsidiaries of Corporations which were sold outside the United States. These obligations were guaranteed either by the parent bank or bank holding company and sometimes included rights to convert into stock of the holding company. None of the subsidiaries issuing these obligations have been deposit-taking institutions, nor have the obligations issued been secured by assets of the issuer or guarantor. In no instance was the issuance of these obligations subject to any special conditions by the Board other than some relating to the foreign credit restraint program.

ABI and its application

ABI was organized to engage in a general international banking business in New York, including the receipt of deposits. It was granted a preliminary permit on April 10, 1968, a final permit on October 4, 1968, and opened for business on October 21, 1968, but did not really begin full operations until the first quarter of 1969. ABI has not yet been examined due to the recent commencement of operations, but will be examined prior to the end of this year.1/ As of June 30, 1969, ABI had capital stock and surplus of $32.2 million; its statutory limit for the issuance of obligations is therefore $322 million and the request is well within that limitation.

1/ Examination commenced December 1, 1969.

Mr. Stunzi, President of ABI, has stated that ABI does not intend to issue the proposed obligations at one time, but instead over a period of two years or more. Also, the application states:

> "In the event the Board should be reluctant to grant the $100,000,000 ceiling herein requested, we respectfully suggest and request that such $100,000,000 ceiling be granted subject to appropriate condition that we will not exceed, say, $50,000,000, until after reporting to some delegated authority within the Board, and receiving permission of such delegate with respect to the excess over such $50,000,000."

Recommendation of the Federal Reserve Bank of New York

> ". . ., we do not believe that ABI should be given a 'blank check' to issue such a large amount of obligations at this juncture of its existence. While we are willing to concede that the management and sponsorship of ABI are highly regarded in both the domestic and international banking fields, the fact remains that the Corporation has been in business for only a few months and we have not yet had an opportunity either to examine or to evaluate its operations. Therefore, until such time as we are able to properly evaluate the functioning of this relatively new organization and ascertain the need for it to have such a large block of outstanding obligations, we would consider permitting ABI to issue, perhaps, up to $50 million in medium and long-term obligations, at this time, with the understanding that we would consider a request for an additional authorization when the actual need is demonstrated in the future."

The Division of Supervision and Regulation believes that the position taken by the Federal Reserve Bank of New York is generally appropriate. However, it is felt that in acting on the application the Board should be aware of the history of the regulatory provision involved in this question.

History of the Regulatory Provisions governing the Issuance of Obligatio

Prior to the 1963 revision, Regulation K did not require prior Board approval for the issuance of medium- and long-term obligations, but placed a number of conditions on their issuance, and restrictions on the Corporation issuing them. Corporations accepting deposits and/or creating acceptances were precluded from issuing such obligations. Other Corporations could issue secured obligations; and after 1954 were allowed also to issue unsecured obligations.

However, a Corporation's issuance of unsecured obligations was subject to certain conditions: not to have outstanding loans or other credits with maturities exceeding 10 years; not to subject any assets to liens, except with the approval of all holders of obligations; not to dispose of all or substantially all of its assets; and not to pay any dividends, except certain stock dividends. The Regulation also provided that a Corporation issuing obligations should ". . . carry on its business in accordance with sound financial policies, including, among other considerations, a proper regard to the relationship between its assets and the maturities of its obligations . . .."

In addition to the foregoing, the Regulation required prior to 1963 that any prospectus or advertisements relating to the issuance of such obligations clearly indicate that the obligations had in no way been approved by the Board. The Corporations were also required to file with the Board copies of prospectuses and certain other information in connection with the issuance of such obligations.

The original proposed revision of Regulation K in 1963 made no basic changes in the foregoing provisions. However, the version that was subsequently adopted removed all the detailed conditions and substituted the present simpler provisions--namely, that prior Board approval shall be obtained before the issuance of such obligations. The substitution was prompted in large part by the fact that the Corporations had not issued such obligations. The implication of the decision was that the requirement for prior Board approval would permit the Board to attach such conditions as it considered appropriate to the issuance of such obligations.

The conditions and requirements attached to the issuance of obligations in earlier versions of Regulation K appear to have been unnecessarily restrictive, if not in retrospect at least in light of current practices. The attachment of comparable conditions or requirements to Board approval of the issuance of obligations would appear equally unnecessary.1/ The Corporations are examined annually, affording an opportunity to review the terms and conditions of any such borrowings and to assure that the issuing Corporations are being operated in such a way as to be able to meet all their liabilities. Any such obligations issued in the United States would be subject to the requirements of the SEC. However, the Board might wish in authorizing the issuance

1/ The Comptroller of the Currency reportedly does not impose any special conditions when authorizing the issuance of capital notes by national banks. The agreement is reviewed, primarily as to voting rights granted in cases of mergers or consolidations. Recently, the Office of the Comptroller has encouraged short maturities on such notes because of present high interest rates.

of such obligations to emphasize that such authorization does not indicate Board approval of the obligations and that nothing to that effect is to be conveyed or implied to any purchaser or would-be purchaser of the obligations.

Recommendation

The Division recommends the following:

(1) That the Board approve the issuance of up to $50 million in debt obligations by ABI and/or AINV;

(2) That, to avoid an open-ended authorization and to afford an occasion for subsequent review, the approval be limited to obligations issued within the next five years;

(3) That no other restrictions or conditions be attached to the approval, except the requirements that no preference be given over depositors through the pledge of assets, and that there is to be no implication that the obligations themselves are approved by the Board; and

(4) That there be no delegation for approval of the issuance of more than $50 million, as it would appear inappropriate to have special delegations for a single application.

B - Applicability of Limitation on Guarantees

Regulation K states in part:

Section 211.7(d) . . . It will ordinarily be considered incidental to the international or foreign business of a Corporation for it to engage in the following transactions in the United States: . . .
(3) Guarantee customers' debts or otherwise agree for their benefit to make payments on the occurrence of readily ascertainable events . . .. [emphasis added]

Section 211.9(b) Liabilities of one borrower. - Except as the Board may otherwise specify, the total liabilities to a Corporation of any person shall at no time exceed 50 per cent of the Corporation's capital and surplus, or 10 per cent thereof if it is engaged in banking. In this paragraph "liabilities" includes: . . . unsecured liabilities resulting from issuance by the Corporation of guarantees or similar agreements (described in Section 211.7(d)(3)), the aggregate of which liabilities incurred for any person may in no event exceed 10 per cent of any Corporation's capital and surplus; . . .

(c) Aggregate liabilities. Except with prior Board permission, a Corporations' aggregate outstanding liabilities on account of acceptances, monthly average deposits, borrowings, guarantees, endorsements, debentures, bonds, notes, and other such obligations shall not exceed ten times its capital and surplus; provided that aggregate outstanding unsecured liabilities under guarantees or similar agreements (described in Section 211.7(d)(3)) may in no event exceed 50 per cent of its capital and surplus. In this paragraph "liabilities" does not include endorsements of bills having not more than six months to run, drawn, and accepted by others.

The New York recommendation states:

> "We concur in the conclusion stated by Counsel that the Board has defined the term 'guarantees' for purposes of the proviso of Section 211.9(c) to include only customers' guarantees, and not to include any guarantee relationships between an Edge Act Corporation and its controlled subsidiary. Accordingly, we would agree that there is no basis for making any guarantees by ABI of obligations issued by AINV subject to the 50 per cent limitation contained in Section 211.9(c) of Regulation K."

The Division of Supervision and Regulation agrees with the New York recommendation.

C - Exception to Limitation on Aggregate Liabilities

As noted in part A of this memorandum, the statute limits a Corporation's liabilities on bonds and debentures to ten times its capital and surplus. The statute also provides, "Nothing contained in this section shall be construed to prohibit the Board . . ., under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the Corporation and outstanding at any one time."

As set forth in part B of this memorandum, Section 211.9(c) of Regulation K also limits the amount of aggregate liabilities (including bonds and debentures) to ten times a Corporation's capital and surplus.

Applicant states:

"The 10 times capital and surplus limitation of Section 211.9(c) applicable to the aggregate outstanding liabilities of the kind therein described (which is more stringent and inclusive than the statutory limitation) is more restrictive than the actual ratios maintained by many U. S. banks. Based upon the 1968 annual reports of the 12 largest banks in the United States, the ratio of total liabilities (exclusive of capital funds) to capital and surplus ranges from 27.4 to 1, to 14.1 to 1 (with mean being 20.8 to 1); and the ratio of total liabilities (exclusive of capital funds, and less cash and due from banks) to capital and surplus ranges from 11.0 to 1, to 22.3 to 1 (with the mean being 15.3 to 10). (See chart attached.) As is well known, the liability-capital ratio of foreign banks is generally even higher.

"We respectfully submit, therefore, that, particularly in the case of Allied Bank International, whose stockholder banks represent a broad base of some 17 important regional banks, and whose Board of Directors consists of a chief executive officer of each of those banks, it is unnecessary and unduly restrictive, to have such debentures, bonds and notes (used for capital purposes) included with the other categories of liabilities in Section 211.9(c) in establishing a regulatory ceiling of 10 times capital and surplus."

The New York Federal Reserve Bank's recommendation states:

"According to ABI's letter, its capital and surplus accounts amount to $34 million (assuming that all pending proposals to acquire additional shareholder banks are approved) which, in accordance with the provisions of Section 211.9(c) of Regulation K, would permit ABI to have aggregate outstanding liabilities, including debentures, bonds and promissory notes, equal to $340 million. Thus, ABI and/or AINV could issue, with Board approval, the proposed $100 million in medium and long-term obligations well within the ten times capital and surplus limitation of Section 211.9(c), leaving approximately $240 million for other classes of liabilities . . ..
[Reasons for limiting issue to $50,000,000 quoted in part A of this memorandum]

"Under these particular circumstances and in the absence of other compelling reasons, it is our view that obligations of the types which ABI contemplates issuing should remain subject to the ten times capital and surplus limitation of Section 211.9(c) of Regulation K."

While it may be desirable to review possible changes in this provision in conjunction with a general revision of Regulation K, the Division of Supervision and Regulation does not believe that a review is necessary at this time, and agrees with the recommendation of the Federal Reserve Bank of New York.

Attachment - Proposed letter.

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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

Allied Bank International,
116 East 55th Street,
New York, New York. 10022

Gentlemen:

This is in response to the letter of June 25, 1969, from your Corporation ("ABI") which contained several requests relating to the issuance of medium- and long-term obligations (i.e., having maturities of more than one year) by either ABI or your wholly-owned subsidiary, Allied International N.V. ("AINV"), Willemstad, Curacao, Netherlands Antilles, in accordance with Section 211.4 of Regulation K and the Board's consent of May 2, 1969, for ABI to purchase and hold all of the stock of AINV.

In reviewing your requests, the Board took into consideration the relative newness of your Corporation and its operations, and the diversity of the ownership of your stock. In the light of these factors, and in view of the indication in the last paragraph of your letter, the Board concluded (1) that the issuance of such obligations should be limited to an amount reasonably necessary for ABI's operations within the near future; (2) that there is no showing of any present need by ABI for exceptions from the limitations of Section 211.9(c) of Regulation K on aggregate liabilities; and (3) that, in accordance with its established procedures, the Board will consider the issuance of a larger amount of obligations and the application of the limitations in Section 211.9(c) of Regulation K should your Corporation reapply in the light of then current needs.

Accordingly, the Board of Governors grants its approval, for a period of five years from the date of this letter, for ABI to issue obligations with maturities in excess of one year and/or to continue to hold the stock of AINV after AINV issues such obligations, provided that the total of such obligations issued by ABI and AINV shall not exceed $50,000,000, and that neither ABI nor AINV shall pledge any of their assets to secure the obligations issued. Approval is granted on the condition that your Corporation make no implication

that such obligations carry any sanction of the Board of Governors. The Board should be advised, through the Federal Reserve Bank of New York, of the issuance of these obligations, including information as to the amount and terms.

As to your inquiry regarding the applicability of the limitations on guarantees set forth in Sections 211.9(b) and (c) of Regulation K, those limitations apply only to the guarantees described in Section 211.7(d)(3) of the Regulation--namely, guarantees of "customers' debts." Guarantees of the obligations of a Corporation's subsidiary are not subject to those limitations.

Your inquiry and requests indicate that ABI may guarantee payment of any obligations issued by AINV, thus making them direct, primary obligations of ABI payable at its office in New York, and that the proceeds thereof will be used by ABI in the ordinary course of its banking business. In these circumstances, such obligations would be "deposits" of ABI under Sections 204.1(f) of Regulation D and 217.1(f) of Regulation Q. Such notes would therefore be subject to the requirements and restrictions of those Regulations unless one of the exceptions specified in those Sections were applicable or unless both the notes and the guarantee were expressly made payable only outside the United States. Of course, any obligations issued by ABI and payable in the United States would be similarly subject to the provisions of Regulations D and Q unless one of the aforementioned exceptions were applicable.

Very truly yours,

Robert P. Forrestal,
Assistant Secretary.