

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

To Board of Governors

From Division of Supervision
and Regulation

JW

REC'D RECORDS SECTION
MAR 2 1970
Date February 3, 1970.

Subject: With further reference to applications by Bank of California International and Irving International Financing Corporation to continue to hold stock in China Trade and Development Corporation ("CTD").

*Bank of Calif
Intl
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This memorandum supplements the Division's memorandum of December 19, 1969.

The issues in the present applications are: first, whether the proposed activities of the American subsidiary of CTD constitute being engaged in the "general business of buying or selling goods, wares, merchandise or commodities in the United States"; and second, conditional on a negative finding on the first issue, whether the proposed activities are "incidental" to CTD's international or foreign business.

The same issues were confronted in the Balthex case, which involved an investment in a domestically-chartered combination export manager. When the Board first discussed the present applications, the staff was asked to bring back to the Board the relevant documentation dealing with that earlier case. Attached to this memorandum are excerpts from the Board's minutes of the pertinent portions of the Board's discussion of the Balthex case (Attachment A), a copy of Mr. Forrestal's memorandum of October 27, 1966 (Attachment B), and a copy of the Annex to the Division's memorandum of March 7, 1967, which discussed the Balthex case in the light of general policy considerations. (Attachment C)

filed FBC 3 Serial 1014: Fidelity Shell Corp

Mr. Forrestal's memorandum discusses the issues set out above as they applied in the Balthex case. In both that memorandum and Attachment C, reference is also made to a still earlier decision regarding activities in the United States of Balfour-Williamson, a subsidiary of Bank of London & South America ("BOLSA"). In both those cases, the companies involved acted as intermediaries in arranging export sales and shipments from the United States for foreign clients, and only placed orders in the United States against offsetting firm orders from their foreign clients. The companies maintained no inventory of unsold merchandise. It was on the basis that those companies were essentially acting only as a broker or agent for foreign clients in making purchases from the United States that the Board concluded that the companies were not "engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States. . . ." The closeness of the question in the Balthex case was explicitly recognized in the published interpretation that accompanied the Board's decision. (A copy of the interpretation is included in Attachment A.)

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During Intl Line Corp*

*See Minutes
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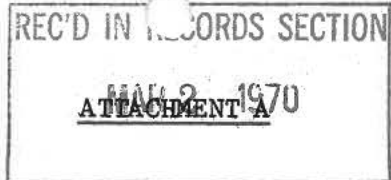
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The facts in the present applications closely parallel those in the Balthex case with two differences: first, CTD's American subsidiary would act as an intermediary for its foreign parent, and possibly other foreign concerns, in arranging sales to as well as purchases from the United States; second, CTD's American subsidiary would be part of an international group of companies rather than a domestically-owned and domestically-chartered corporation. In both these respects, the situation is more analagous to the BOLSA-Balfour Williamson case.

As noted in the Division's memorandum of December 19, 1969, it is not believed that the proposed activities of CTD's American subsidiary are fundamentally distinguishable from the earlier cases, either as regards engaging in "commercial" activity in the United States or as regards the question of being "incidental" to CTD's international or foreign business.

Attachments.



EXCERPTS FROM BOARD MINUTES DEALING WITH BALTHER CASE

The Balthex case was discussed by the Board on the dates indicated below. Some of the minutes of those discussions have not been included in this attachment; the gist of those excluded are parenthetically indicated.

October 24, 1966	(asked for memorandum from Legal Division)
November 8, 1966	(asked for further staff study of legal and policy considerations)
March 13, 1967	
March 20, 1967	
April 10, 1967	(deferred consideration until next day)
April 11, 1967	
April 13, 1967	

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM ON MARCH 13, 1967

Application of Company for Investing Abroad. After discussion on November 8, 1966, of the application of The Company for Investing Abroad, Philadelphia, Pennsylvania, a section 25(a) corporation, for consent to purchase between 20 and 35 per cent of the stock of Balthex International, Inc., also of Philadelphia, the Board requested the staff to analyze the policy aspects of the application. The general policy question was to what extent it was appropriate for United States banks, through Edge and agreement corporations, to invest in companies

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engaged directly or indirectly in nonfinancial activities in the United States.

There had now been distributed a memorandum dated March 7, 1967, from the Division of Examinations reviewing the experience of Edge and agreement corporations in acquiring interests in nonfinancial enterprises, the relevant statutory and regulatory provisions, and certain general considerations bearing on the activities of the corporations. This background material was followed by an examination of the policy issues implicit or inherent in direct investments or in indirect acquisitions of interests in nonfinancial enterprises by Edge and agreement corporations. The principal conclusions regarding the policy issues were as follows:

1. The acquisition of a majority interest in such a company is, as a rule, not appropriate for a corporation. Such interests are not normally necessary to the conduct of a United States bank's international business and such interests might tend to lessen the intended financial character of the corporations. The specific consent of the Board should be required prior to such an acquisition.
2. The acquisition of a minority interest in a non-financial enterprise operating abroad is clearly an appropriate exercise of a corporation's powers. Such an acquisition accords with the broad public purposes to be served by the corporations.
3. The acquisition of a minority interest in a foreign company engaged through an office or subsidiary in nonfinancial activities in the United States is appropriate so long as the statutory tests are satisfied. (The statute prohibited investments in companies engaged in the general business of buying or selling goods, wares, merchandise, or commodities in the United States. Thus, investments in companies operating in the United States were limited to companies providing

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financial and commercial services in the United States. The services provided in the United States must meet the further statutory test of being, in the judgment of the Board, incidental to the international or foreign business of the company.)

4. The acquisition of a minority interest in a domestic company engaged in nonfinancial activities in the United States would be appropriate where the statutory tests appeared satisfied and where the activities were of the sort often associated with a bank's international department. Close scrutiny should be given to companies engaged in other activities as to (1) whether the focus of those activities was indeed international, and (2) whether a proposed investment in a domestic company was likely to produce benefits to the foreign commerce of the United States that could outweigh the consequences of possibly placing corporations in competition with domestic commercial companies.

An annex to the memorandum set forth the essential facts regarding the activities of Balthex International, with arguments for and against granting consent to the proposed investment by The Company for Investing Abroad.

After introductory comments by Mr. Dahl, Governor Robertson asked the Legal Division to review the basis for its conclusion, set forth in a memorandum distributed prior to the discussion in November, that approval of the application could be justified.

Mr. Shay observed that Balthex was not engaged in buying and selling merchandise in this country as a general business, but only in filling orders for customers abroad, an activity that seemed essentially related to international operations. Whether or not that activity was incidental to international operations involved a question of interpretation. While that was debatable, he believed that to hold that as a

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technical, legal matter it was not incidental would amount to taking a narrow view.

Mr. Forrestal commented further on the Division's view that the activities of Balthex could be regarded as incidental to international operations, and on similarities between this situation and the one involved in a 1965 application by Mellon Bank International to acquire shares of Bank of London & South America, London, England, which the Board had approved. Mr. Forrestal added that if the Board should consider that from the policy standpoint the activities of Balthex made an investment in that company not appropriate for Edge corporations, a denial of the application could be supported from the legal point of view.

Governor Robertson asked if it was correct to say that the Legal Division had based its conclusion largely on the action taken by the Board in the Mellon case. Mr. Forrestal replied that the Legal Division had not used the Mellon case simply as a precedent but thought the action taken was supportable legally. Mr. Shay expressed the opinion that, while it was possible to decide the current question either way, the liberal view was probably easier to support.

Governor Brimmer noted that the subsidiary of Bank of London & South America had discontinued some of the activities in the United States that had been in question, and the ensuing discussion brought out that it was not known definitely why it had done so.

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Governor Brimmer then observed that a distinction had been drawn in that the subsidiary in question in the Mellon case had offices abroad, whereas Balthex dealt through agents. He asked if the question of dealing through offices or agents was considered significant in judging the appropriateness of an investment.

Mr. Shay responded that it was difficult to differentiate according to the letter of the law between the acceptability of an investment in a State-chartered corporation conducting its business through agents and one in a foreign corporation that conducted operations through agents in the United States.

Mr. Dahl expressed the view that there might be a possible distinction between conducting business abroad through the company's own units and through casual agents or distributors.

Chairman Martin said it was his feeling that if a case like the present one was not prohibited by law, it would be better for the Board to give consent than to deny the application. If the proposal of The Company for Investing Abroad would encourage additional exports, that would be in the public interest.

Governor Maisel remarked that he had found the staff analysis of the policy issues valuable. In his mind the critical question was whether U.S. banks, through Edge and agreement corporations, should be allowed to have a special relationship with firms with which they would not otherwise be permitted to be affiliated.

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Mr. Shay responded that the Legal Division would regard it as improper for an Edge or agreement corporation to acquire a majority of the stock of a U.S. nonbank, nonfinancial organization. The corporations were formed for the purpose of engaging in foreign banking and financing. They should not be permitted to get into an ownership-management position in nonfinancial businesses.

Governor Maisel stated that Mr. Shay's remarks made him feel even more strongly that Edge and agreement corporations would not seek investment in domestic corporations except to allow their parent banks to participate in management and operations that would be prohibited if the relationship were direct. In his view, such an acquisition could not be regarded as merely an investment.

Governor Mitchell commented that the Balthex situation appeared to be one in which the parent bank, having a number of industrial customers, wanted to finance their exports and wished to encourage them to enter the export market by putting them in touch with an export agent.

Governor Maisel expressed the view that the export agent, Balthex, would thus be given an important competitive advantage over other export agents. It was his feeling that such an advantage should not be allowed.

Governor Brimmer stated that he believed the proposed arrangement was one that would promote exports and therefore was probably the kind of experiment the Board ought to encourage rather than discourage. Many export potentials had probably been lost because manufacturers

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needed additional expertise, and this proposal might be a useful device. Moreover, he would be pleased if additional banks entered into such arrangements. He was persuaded by the reasons presented by the staff for granting consent. If the Board approved the application, it should recognize that this was a new and basic policy decision, and therefore one that it would seem desirable to make known publicly.

Governor Robertson read pertinent parts of the statute and expressed the view that the activities of Balthex in the United States apparently were not incidental to international business but were its entire business; Balthex was merely a conduit between manufacturers in the United States and purchasers abroad. In response to an observation by Governor Brimmer that Balthex did not act as a conduit for shipment of goods between points in the United States and there was always a foreign point of origin of orders, Governor Robertson commented that Balthex appeared to have no foreign business to which its domestic business could be incidental.

After further exchanges of views regarding the determination of an incidental relationship, Governor Brimmer requested comments from Mr. Sammons in regard to the possible merit of the proposal in terms of promoting exports.

Mr. Sammons stated that although he had difficulty in arriving at a conclusion, he thought that at least in a sense the business of Balthex was purely domestic and that to approve the proposal would open

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a wide gate. Although the proposed relationship might be an aid to exports, the statute did not cite promotion of exports as a basic purpose of Edge and agreement corporations. Mr. Sammons noted also that Internal Revenue Service gave weight in judging tax questions to whether sources of income were domestic or foreign; under that test, he thought Balthex would be considered domestic, since all of its income arose within the United States.

Asked what potential danger he saw in allowing The Company for Investing Abroad to use Balthex as a conduit, Mr. Sammons replied that the danger applied to circumvention of the public policy of separating banks from commercial business. The Legal Division assigned weight to whether the investment represented a majority interest or not, but Mr. Sammons felt that even a minority investment was likely to carry with it an active interest in management.

Mr. Shay commented that the test differentiating between ownership and investment was whether control could be exercised. If control existed, even though the percentage of stock owned was less than 50 per cent, the investing company was itself engaged in the business.

In response to a question by Governor Brimmer, Mr. Dahl said he thought it was problematic whether the Balthex arrangement would promote exports. The arrangement was an experiment on the part of The Company for Investing Abroad, and the outcome was uncertain. The parent bank indicated that it had tried various ways to get some of its manufacturing

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customers into exports and had found it difficult. It was not known how successful the proposed arrangement would be in producing orders for those manufacturers. Therefore, it was difficult to judge whether a positive contribution to promotion of exports would result.

In continuing discussion several members of the Board mentioned particular facets of the problem that they would like to have explored as a basis for further discussion. Interest was expressed in particular in the role played by export agents in assisting manufacturers.

It was understood that the staff would prepare additional materials along the lines that had been described.

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM ON MARCH 20, 1967

Application of Company for Investing Abroad. On March 13, 1967, on the basis of an analysis of the policy issues prepared by the staff, the Board discussed the application of The Company for Investing Abroad, Philadelphia, Pennsylvania, a section 25(a) corporation, for consent to purchase between 20 and 35 per cent of the stock of Balthex International, Inc., also of Philadelphia. At the conclusion of the discussion the staff was requested to prepare additional materials, bearing especially on the role of export agents in assisting manufacturers in the United States.

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There had now been distributed a memorandum dated March 17, 1967, from Mr. Sammons reporting information he had obtained from the Department of Commerce regarding the operations of manufacturers' export representatives, generally known as Combination Export Managers (CEM's). There were about 225 such firms in the United States, excluding firms that were also engaged in production or trade. About half of them were located in the New York area, the rest mainly in seaport towns but also in other industrial centers. Over 70 per cent of these firms reported annual export sales of less than \$1 million, and only 4 firms reported sales in excess of \$10 million. In general, they tended to specialize in particular lines, such as foods, steel products, automobile products, etc. Traditionally, their method of operation had been merely to act as agent for manufacturers in handling export sales, usually for a commission. Terms of payment, including any extensions of credit, and prices were usually fixed by the manufacturer. A Commerce Department expert regarded the CEM's as an important factor in persuading individual manufacturers to go into the export business. A CEM's ability to obtain additional manufacturers to represent was a major factor in the success of his operations.

The memorandum continued by saying that the Department expert had observed that in recent years the CEM's themselves more and more had to provide the financing for the export sales they handled, in order to relieve the manufacturers of the burden of providing the export

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financing, particularly in the face of a booming domestic demand that had reduced the incentive to export. It was not known exactly how the financing was handled by the CEM's, but presumably it was done both by direct extension of credit and by obtaining bank financing on behalf of either the exporter or, more likely, the foreign importer. The view had been expressed that tight money and rising interest rates last year had made things difficult for the CEM's. Probably most of their sales customarily involved payment in 30 to 90 days, and the interest cost of supplying credit for that length of time had to come out of commission earnings.

Governor Brimmer noted that his assumption in suggesting that the role of export agents be explored was that they played an important role in encouraging exports, particularly in the case of smaller manufacturers. He had also been concerned that the CEM's were having problems in obtaining financing, and had thought it might be useful to study the matter with a view to a possible Board policy decision that would clear the way for banks to enter into arrangements with CEM's. It was his hope that today's discussion might lead back to that point.

Governor Maisel expressed the view that the information obtained by Mr. Sammons raised anew the question whether an affiliation between export agents and a bank constituted unfair competition with other export agents and contravened the purpose of the statutory prohibition of engagement by banks in commercial business.

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Governor Robertson expressed agreement with Governor Maisel's point. He thought it was inappropriate for a bank to have an interest in a domestic corporation involved in selling abroad the products of particular American manufacturers. He believed banks should distribute credit on the basis of credit-worthiness and not because the borrower had special ties to an affiliate of the bank. In such a situation, manufacturers not linked to the affiliate might experience difficulty in obtaining bank credit.

Governor Mitchell remarked that although he was inclined toward Governor Maisel's position, he did not have any strong conviction. He did not know exactly what further information could be obtained that would help to resolve his doubts.

Governor Daane observed that he had not participated in the preceding discussion and asked Governor Brimmer to summarize his views. The latter replied that the Legal Division had concluded that the law did not preclude approval of the application of The Company for Investing Abroad; whether or not the proposed arrangement should be permitted was a matter of policy. It was Governor Brimmer's view that as a matter of policy the application should be approved because it appeared to him that the business of Balthex was basically the promotion of exports. It was easier for him to see a basis for approval than denial.

Governor Robertson expressed the view that the basis for denial was clear, namely, the statutory separation of banking from commerce.

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The proposal here was that a bank have an indirect equity interest in Balthex. Its profits on that investment would be directly related to the financing of the particular manufacturers who were clients of Balthex. Carried to an extreme, if Balthex represented only one manufacturer rather than a group, it would not be to the interest of the bank to extend credit to other manufacturers who applied for export financing because competition with the Balthex client would thereby be aided and the profits of Balthex correspondingly reduced. From this point of view, he believed the proposal was not necessarily conducive to expansion of U.S. exports but instead might deter them.

There ensued a discussion of the areas of operation permissible to Edge and agreement corporations under the statute, and the bearing upon those operations of the principle of separation of banking from commercial business. Comments were made especially on the basis for determining whether or not a particular type of domestic activity was "incidental" to an international business.

Governor Daane then asked if he correctly understood the Legal Division to hold that if The Company for Investing Abroad were acquiring an equity interest in a foreign corporation that was stimulating exports in the United States, the arrangement would be clearly permissible. Upon an affirmative response from Mr. Forrestal, Governor Daane said that he found himself substantially in agreement with Governor Brimmer. If the Board legally had the option of encouraging this

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particular flexibility in export financing, he saw no reason to discourage it.

Mr. Forrestal commented that if Balthex were incorporated in England and had an office in Philadelphia or New York, he did not believe the Board would have any difficulty in holding that its business in this country was of an "incidental" character. Although Balthex was incorporated in the United States, the Edge Act provides for investments by Edge corporations in domestic as well as foreign corporations and for financing by Edge corporations of exports or imports of goods into or out of the United States. In his view, Balthex was conducting an international business and he could see no legal impediment.

Governor Mitchell said he thought there was some justification for allowing the Balthex arrangement as an experiment, although at the moment he could not see how to reverse direction if the experiment appeared to be getting out of hand.

Governor Brimmer said that he too was cognizant of the risk, but he believed the Board should do what it could to encourage exports. If the situation threatened to get out of hand, he assumed a way could be found to take remedial action.

Governor Robertson observed that approval of the present application would clearly represent a precedent. While there might be some basis for approval of the application if there was a demonstrated lack

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of financing for exports, it did not appear that such financing had been or was unavailable to the extent of constituting any serious impediment to U.S. exports.

Governor Maisel expressed the opinion that the only reason a bank would seek to obtain an interest in a domestic corporation such as Balthex would be to share in its profits. It seemed to him that the real question was not what sort of financing package was put together but why the bank sought this indirect equity interest and whether the proposal was not of the sort prohibited under the statutory principle of separation of banking and commercial business.

Governor Brimmer observed that the parent bank of The Company for Investing Abroad could operate such a scheme out of its own international department, which raised the question why the bank should not be permitted to conduct the operation through its subsidiary.

In response to an inquiry by Governor Daane as to whether he saw a risk that the kind of relationship contemplated might become widespread, Mr. Sammons said he thought there was such a risk. He believed that in the layman's view the business of Balthex would be generally thought of as domestic activity. He would think that many exporters could either qualify as CEM's or create subsidiaries owned by the same stockholders. Almost any activity now handled on a commission basis could be placed in a firm that then could be owned by a bank. In essence, his feeling was that there was considerable risk in the direction of combining banking with manufacturing.

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Mr. Dahl commented that a question was involved on which judgments could differ. The risks attendant upon a bank's participating in this kind of activity had to be weighed against the possible benefits to the foreign commerce of the United States. Although the question was borderline, he placed somewhat greater weight on the possible benefits to foreign commerce and to U.S. exports in particular, although perhaps his judgment was swayed by his experience with balance of payments problems. As for the chances of expansion, the Division of Examinations had pointed out that it was known that one other bank was prepared to file a similar application if this one were approved.

Governor Shepardson asked the Legal Division what recourse there might be if the application were approved and such activity threatened to expand beyond a point the Board thought appropriate.

Mr. Forrestal replied that Regulation K (Corporations Engaged in Foreign Banking and Financing under the Federal Reserve Act) provides that an Edge corporation shall divest itself of any investment deemed by the Board to be inappropriate. The Board had never had occasion to invoke that provision, and the word "inappropriate" had never been defined in that context, but the provision might furnish a vehicle for remedial action.

Governor Shepardson then said it seemed to him that the possible necessity of a reversal if the practice became widespread provided a clue to the basic issue. If the Board did not think the proposal was

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permissible for a dozen institutions, then it seemed hardly permissible for the first to propose it.

Governor Daane stated that the principal favorable argument appeared to be that assistance might be given to U.S. exports. It was problematical whether or not the device would be helpful for that purpose, but his own evaluation was that it probably would be. As for the potential dangers that had been cited, there appeared to be means of prevention at the Board's disposal.

There followed discussion of a suggestion that a survey of manufacturers' export financing needs might be conducted, and several problems that might be involved in conducting and interpreting the results of such a survey were mentioned.

Governor Brimmer then suggested that the staff prepare a rationale for approval of the Balthex application by the Board. Other members of the Board suggested that it would be desirable to have two such statements, one supporting approval and one in support of denial, to assist the Board in debating the merits of the two positions.

At the conclusion of the discussion it was understood that the staff would prepare material along the lines suggested.

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM ON APRIL 11, 1967

Balthex matter. At previous meetings the Board had considered
an application by The Company for Investing Abroad (subsequently renamed

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Fidelity International Corporation), Philadelphia, Pennsylvania, for permission to invest in Balthex International, Inc., a United States corporation engaged essentially in providing export management services. In connection with these discussions, there had been distributed for the Board's consideration a series of staff memoranda.

There had now been distributed a draft of letter prepared by the Legal Division, dated April 10, 1967, incorporating comments and suggestions offered at the Board meeting of that date, granting consent for the proposed transaction.

Mr. Forrestal noted that the basic issue involved was whether Balthex was engaged essentially in international or domestic business and, if the former, whether its domestic activities were merely incidental to its international or foreign business. If so, the requisite criteria under section 25(a) of the Federal Reserve Act for Board consent to the desired investment were present.

In response to a question from Governor Daane concerning the number of corporations such as Balthex that were combination export managers, Mr. Forrestal replied that apparently there were approximately 225 firms engaged in this kind of business.

Governor Brimmer observed, however, that in the event the present consent were to be granted it was unlikely the Board would receive any substantial number of similar applications. According to his information, about 70 per cent of the combination export manager firms had

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total sales of under \$1 million, and only four had sales of over \$10 million. Furthermore, he thought that a number of the firms included in the 225 figure cited by Mr. Forrestal probably were either inactive or had a more predominantly domestic flavor to their operations than was the case with Balthex.

Governor Shepardson noted that the problem involved in this case had been studied and discussed at length. The proposed draft letter seemed to him to reflect accurately the suggestions made yesterday, and he would favor its approval.

Governor Mitchell commented that his judgment about the matter had changed somewhat as a result of the March 7 memorandum from the Division of Examinations concerning policy issues involved in the pending application, in which various nonfinancial service activities were assessed in light of their compatibility with a literal reading of the statutory tests set forth in section 25(a) of the Federal Reserve Act. He now leaned toward a more liberal point of view than he had held before and was inclined to favor approval of the pending request. However, he believed it would be desirable to emphasize the borderline nature of this case in the letter of approval and to make clear that the Board would keep the activities involved under close surveillance.

Governor Daane indicated that he, too, would favor approval of this application. While agreeing with Governor Mitchell that it was probably a borderline case, he felt the possible encouragement of export

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business was worth taking the moderate risk involved in consenting to the proposed investment. With respect to the text of the letter, he wondered whether, if reference were to be made to the marginal nature of this case, something on the plus side regarding benefits that might accrue should not also be added.

At this point Mr. Shay raised the question whether or not the Board would want to publish its decision. A decision could always be made on an ad hoc basis in light of the particular facts in a given application and, since the Board appeared to feel that the propriety of the proposed investment was a close question, it might be preferable not to publish the decision.

After some discussion of this point, Governor Maisel said that upon further careful study he continued to feel that the application should be denied. He referred to a paragraph, as follows, from a legal interpretation that had been drafted at the Board's request for use in the event of disapproval and said that it reflected his conclusions:

From the facts presented, it appears that the activities of the company in the United States and its relationships with domestic companies form the core of its business. The company is but an arm of each manufacturer it represents for the purpose of conducting that manufacturer's foreign business. The company acts as exclusive export sales agent solely for domestic companies and maintains no offices abroad. On the basis of these considerations, it is the Board's judgment that the company is engaged in a commercial business within the United States and that its activities in the United States are not "incidental to its international or foreign business."

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However, if the application were approved, Governor Maisel felt that the decision should be published in fairness to others who might want to consider entering into similar relationships.

Governor Brimmer expressed himself as favoring approval of the proposed investment and recommended that a statement be published in the Federal Register and the Federal Reserve Bulletin. He thought the matter was of sufficient interest that other prospective applicants should know of it; indeed, he understood that at least one other banking organization proposed to submit a similar application if the Board's decision in this case was favorable. The published statement could make it clear that each subsequent case would be judged on its own merits.

With respect to the matter of publication, Mr. Hackley observed that there were two considerations involved; one was legal in nature and the other involved Board policy. Since the proposed action was approval of an individual application, the Board did not have a legal obligation to publish it in the Federal Register. On the other hand, since the decision did involve interpretation of a statute administered by the Board, he thought publication of a general statement would be desirable, with an indication that each case would necessarily have to stand on its own merits.

Mr. Goodfellow noted that under certain circumstances investments in a combination export manager firm might technically fall within the general consent provisions of Regulation K (Corporations Engaged in

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Foreign Banking and Financing under the Federal Reserve Act). Publication of an interpretation might serve to put interested parties on notice that before undertaking such investments they should nevertheless request an opinion from the Board as to the propriety of the transaction.

Mr. Forrestal, on the other hand, expressed doubt that much would be gained through publishing an interpretation. It seemed to him that the action would become a matter of general knowledge in a short time in any event. Publication might only becloud the fact that the Board wanted to pass individually upon cases of this kind; Edge corporations might read the interpretation to mean that they could go ahead with various investments under the general consent provisions of Regulation K.

Governor Brimmer disagreed. He considered the ruling in this case to be a major policy decision, predicated basically upon a desire to aid United States export trade. In order to make the policy decision effective, he thought it was necessary that the ruling be published.

Governor Mitchell commented that one could not predict what consequences might result from action to approve this application. Pending assessment of developments, it seemed prudent for the Board to move cautiously. Publication in the Federal Register might create a fanfare that would attract the interest of a number of other banks having Edge Act subsidiaries and cause a vigorous effort on their part to establish similar relationships. This could complicate the picture undesirably.

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If there was to be an announcement, therefore, he would counsel limiting it to a modest statement in the Federal Reserve Bulletin.

Governor Brimmer indicated that that would be agreeable to him.

Governor Maisel expressed the opinion that since this ruling involved a statutory interpretation it was incumbent upon the Board to publish it in the Federal Register. He believed this was the kind of disclosure that the Freedom of Information Act was designed to require. The public should be adequately informed about Board policy on matters within its jurisdiction, and publication in the Federal Register was the normal procedure.

Mr. Hackley pointed out that it might not be legally necessary for the ruling on this application to be published in the Federal Register either under the new law or present law. Publication was required only of rules of general applicability, whereas the present case would fall within the category of adjudication. On the other hand, the Freedom of Information Act would require the maintenance of an index to Board actions to which the public would have access in order to determine precedents. Since the present case involved an important precedent, it could be published in the Federal Register on the theory that it included an interpretation of law. However, future cases of a similar nature would still be subject to Board approval on an individual basis.

Governor Daane expressed some reservations about publishing the action in the Federal Register if future cases would still be subject

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to Board approval, because in his view such publication carried with it the implication of general applicability.

Governor Robertson said that in his opinion it would be a mistake to approve this application since that would violate a long-standing policy of maintaining separation between banking and commercial business activities. The proposed action would also be undesirable because, upon acquisition of stock in a combination export manager firm by an Edge Act subsidiary, the parent bank would have a special interest in financing the business of that firm exclusively. A proliferation of such relationships would therefore have an anticompetitive effect. In substance, he did not see how the statute could be interpreted to permit the proposed investment, nor did he feel that the Board should do so as a matter of policy. However, if the Board approved the proposed investment, that action should be published so that other institutions would be aware of it and have an equal opportunity to establish similar relationships. The applicant in this case should not be permitted to obtain a competitive advantage.

Chairman Martin agreed that all institutions having a potential interest in the matter should be made aware of the Board's decision. On the question of approval or disapproval, he observed that it was clearly a matter of judgment whether the domestic activities of Balthex were or were not incidental to its international or foreign business. Thus, the proposed letter to the applicant would state that: "Accordingly, it is

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the Board's judgment that Balthex is not engaged in the general business of buying or selling goods, merchandise, or commodities in the United States, and that the activities of Balthex in the United States are incidental to its international or foreign business within the meaning of section 25(a) of the Federal Reserve Act." In his opinion that sentence stated the matter satisfactorily.

Governor Robertson commented that the evidence indicated that Balthex was engaged in the business of buying goods in this country. The question of judgment was whether such activity was or was not incidental to the company's international or foreign business. In his opinion, if the application was approved, the sentence referred to by the Chairman preferably should read: "Accordingly, it is the Board's judgment that the activities of Balthex in the United States are incidental to its international or foreign business. . . ."

Mr. Shay pointed out that if the Board approved the application it must be presumed to have made a finding that Balthex was not engaged in the general business of buying or selling goods, merchandise, or commodities in the United States. If it was so engaged, the Board would have been forced to turn down the application.

Governors Daane and Brimmer expressed the view that the language in the draft letter was satisfactory.

The application of Fidelity International Corporation to acquire up to 35 per cent of the common shares of Balthex was then approved, Governors Robertson and Maisel dissenting.

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With regard to the publication of an interpretation based on the Board's action on this application, it was understood that a further draft reflecting certain suggestions that had been made would be submitted to the Board for review.

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM ON APRIL 13, 1967

Application of Fidelity International Corporation (Items 9-10).

Pursuant to the understanding at the meeting on April 11, 1967, there had been distributed (1) a revised draft of letter to The Fidelity International Corporation, Philadelphia, Pennsylvania, a section 25(a) corporation, granting consent to its application to acquire up to 35 per cent of the common shares of Balthex International, Inc., also of Philadelphia; and (2) a draft of an interpretation concerning the matter that could be published in the Federal Register and the Federal Reserve Bulletin.

The transmittal of the letter to Fidelity International Corporation was authorized, together with publication of the interpretation. Copies of the letter and interpretation are attached as Items 9 and 10, respectively.

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

Item No. 9
4/13/67

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 13, 1967.

The Fidelity International Corporation,
The Fidelity Building,
Philadelphia, Pennsylvania.

Gentlemen:

This is in reference to your letter of July 20, 1966, requesting the Board's consent for your Corporation to purchase and hold up to 35 per cent of the common shares of Balthex International, Inc. ("Balthex"), Philadelphia, Pennsylvania, at a cost of approximately \$70,000.

The subject application has presented the Board with serious and difficult questions concerning the appropriateness of the proposed investment under section 25(a) of the Federal Reserve Act, and the implications of such investment for future acquisitions by Edge Corporations in related situations. The Board has carefully reviewed the material submitted in support of your application and, although this is a close case, has concluded that the investment conforms to the requirements of section 25(a) of the Federal Reserve Act and would otherwise be likely to further the foreign commerce of the United States.

From the facts presented it appears that, while the activities of Balthex are closely related to those of companies engaged in a commercial business in the United States, the sole business of the company is to act as an intermediary between domestic manufacturers and foreign consumers and that it maintains no inventories of unsold merchandise and makes no sales in the United States. Moreover, it is understood that Balthex is exclusively concerned with the effecting of international transactions and its activities in the United States are entirely directed to that end. Accordingly, it is the Board's judgment that Balthex is not engaged in the general business of buying or selling goods, wares, merchandise, or commodities in the United States, and that the activities of Balthex in the United States are incidental to its international or foreign business within the meaning of section 25(a) of the Federal Reserve Act.

The Fidelity International
Corporation

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Therefore, the Board grants its consent to the above-described acquisition and holding of stock of Balthex, subject to continuing observation and review, provided that such stock is acquired within one year from the date of this letter, and that Balthex's business will continue to be that outlined in your application, particularly as to the type and extent of its operations in the United States.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

TITLE 12 - BANKS AND BANKING

Item No. 10

4/13/67

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. K]

PART 211--CORPORATIONS ENGAGED IN FOREIGN BANKING
AND FINANCING UNDER THE FEDERAL RESERVE ACT

Stock Acquisitions

§ 211.103 Acquisition of stock of combination export manager.

(a) The Board of Governors has been presented with the question whether a corporation organized under section 25(a) of the Federal Reserve Act (an "Edge corporation") may acquire and hold a non-controlling stock interest in a company engaged in the United States in the business of combination export manager.

(b) The company and the clients for which it acts as export sales manager are located in the United States. Through designated agents and distributors abroad, the company obtains foreign orders for its clients in the United States or, against firm orders from abroad, itself purchases merchandise from them and reinvoices it for export. In no case does the company maintain inventories of unsold merchandise, nor does it make any sales in the United States.

(c) The eighth paragraph of section 25(a) of the Federal Reserve Act (12 U.S.C. 615) authorizes an Edge corporation, with the consent of the Board, "to purchase and hold stock or other certificates of ownership in any other corporation organized . . . under the laws of any foreign country or a colony or dependency thereof, or under the laws

of any State, dependency, or insular possession of the United States, but not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States, and not transacting any business in the United States except such as in the judgment of the Board . . . may be incidental to its international or foreign business".

(d) The Board recognized the closeness of the question whether the company is engaged in the general business of buying or selling goods in the United States. It concluded, however, that the activities of the company in acting as agent or broker for foreign clients where there is no market risk on the part of the company, or in acting as principal where there are offsetting firm orders for foreign clients, would not cause it to be "engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States . . .".

(e) While the activities of the company are closely related to those of companies engaged in a commercial business in the United States, the sole business of the company is to act as an intermediary between domestic manufacturers and foreign consumers. Moreover, the company is exclusively concerned with the effecting of international transactions and its activities in the United States are entirely directed to that end. Accordingly, it was the judgment of the Board that the activities of the company in the United States are "incidental to its international or foreign business".

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(f) Inasmuch as the activities of the company in the United States conform to the requirements contained in the eighth paragraph of section 25(a) of the Federal Reserve Act, and the acquisition of a stock interest therein by an Edge corporation would otherwise be likely to further the foreign commerce of the United States, the Board concluded that such an acquisition and holding would be permissible and appropriate.

(g) In view of the serious and difficult questions presented by the foregoing application, the Board emphasized that its decision was based on the particular facts of this case, and that applications by Edge corporations for permission to make similar acquisitions will necessarily be decided on their own merits. Because of the closeness of this case, the Board also stated that Edge corporations may wish to obtain the prior specific consent of the Board before making investments of the kind described herein, even though a proposed investment technically might fall within the general consent provisions of section 211.8(a) of this part.

(12 U.S.C. 615. Interprets or applies 12 U.S.C. 615.)

Dated at Washington, D. C., this 13th day of April, 1967.

By order of the Board of Governors.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

ANNEXThe Comina-Balthex Case

The essential facts on the activities of Balthex International, in which Comina seeks to acquire a 20-35 per cent interest, are:

1. Balthex is a domestic corporation located in Philadelphia and chartered under the laws of Maryland, which acts as an export sales manager for a number of U.S. companies.
2. Through agents and distributors in 30 countries abroad, Balthex obtains export sales orders for its domestic customers. The sales orders are either passed on directly to the domestic manufacturer who pays separately a commission to Balthex; or Balthex against a firm sales order purchases the goods from the domestic manufacturer and completes the transaction adding its commission to the price at which it purchased the merchandise.
3. At no time does Balthex hold inventory or title to unsold goods - that is, Balthex takes no position itself in merchandise.

(b) (5)

(b) (5)

There are several respects in which the Comina-Balthex case may be differentiated from the Mellon-BOLSA case. First, Comina proposes to make a direct investment in Balthex whereas MBI made a direct investment in BOLSA and in the process acquired an indirect interest in Balfour, Williamson. Secondly, Comina, in its application and otherwise, has indicated that through

this affiliation with Balthex it would attempt to develop its export financing business by offering the services of Balthex to its customers, particularly those in the Philadelphia area. MBI's investment in BOLSA was prompted by a desire to establish a close working relationship with a major international bank rather than Balfour, Williamson, Inc. Thirdly, Balthex is a domestically-chartered company with agents and distributors but no offices abroad, whereas Balfour, Williamson, Inc. is part of an international group of companies.

A change in the activities of Balfour, Williamson, Inc. has recently occurred which the Board may wish to take into account in its further consideration of Comina's application to invest in Balthex. In effect, Balfour, Williamson, Inc. has discontinued its agency functions in the export and import trade which were comparable to those of Balthex. In a letter dated January 20, 1967, addressed to the Federal Reserve Bank of New York, MBI stated that these activities of Balfour, Williamson, Inc. had been sold and that Balfour, Williamson, Inc. now engages in only the following activities in the United States: supervising for Balfour, Williamson & Co. Ltd. and several of its subsidiaries the confirmation of credits for purchases in the U.S. for shipment abroad, confirming the credit to the U.S. exporter and handling the documentation; and temporarily financing foreign importers who purchase goods in the U.S. for shipment abroad or for third country transactions, and handling the documentation therewith.

The background paper on "Investments in Nonfinancial Enterprises", to which this note is annexed, distinguished between investments in "foreign" and "domestic" companies. It was concluded that the acquisition of minority interests in "foreign" companies engaged in activities in the United States was appropriate for the Corporations so long as those activities satisfied the statutory tests. It was further concluded, however, that the long-standing public policy of separating banking and commercial activity in the United States justified additional and closer scrutiny of proposed investments in "domestic" companies. It was suggested that in these cases attention be directed to (1) the compatibility of the activities of the domestic company with those usually associated with banks; (2) the "international character" of the activities of the domestic company even when those activities appeared to satisfy the statutory tests contained in Section 25(a); and (3) the benefits to the foreign commerce of the United States that might reasonably be expected to result from the investment. It was recognized that the results of such an examination would not necessarily be conclusive in all cases. It was nevertheless believed that this approach might serve as a useful starting point in resolving cases where a possible conflict existed between the public interests in facilitating the international operations of U.S. banks and in preserving in the United States the financial character of the banking system.

Examining the Comina-Balthex case in the light of those conclusions, it is clear that the activities of Balthex are not those normally associated with a bank. The appropriateness of the investment therefore turns on judgments as to the "international" focus of Balthex' activities

and the foreign commerce benefits of the investment. In reaching a decision on the application, the Board may wish to consider and weigh the arguments that can be marshalled pro and con with particular regard to these points. These arguments are summarized in the following paragraphs.

For consent to the investment are:

(1) The Corporations were intended to provide needed additional flexibility to U.S. banks in conducting their international business, in particular through the power to make equity investments in foreign and domestic companies. While there may be elements of "domestic" business in Balthex' activities, the statutory tests provide sufficient protection to the continued public interest in separating banking from commercial activity in this country. Very few commercial activities in the United States would qualify under those tests, of which activities like those of Balthex are perhaps the principal ones in which banks would be interested. The investment in Balthex would provide Comina and its parent bank with an additional means of assisting customers in their international business.

(2) The proposed investment would probably help to promote the foreign commerce of the United States, and exports in particular. Comina and its parent bank intend to use this affiliation as a means of interesting and encouraging more medium-sized companies in the bank's service area in export possibilities; they believe this can be done by offering export sales management and export finance as a package service to existing and prospective customers of the parent bank. Previous efforts to encourage such companies to develop export markets are reported by Comina as not very successful, in large part because of the companies' lack of export sales experience. This admittedly experimental foray into this service area by Comina should be welcomed in view of the public interest in strengthening U.S. exports and export markets.

Against consent to the investment are:

(1) Balthex is a domestic corporation with no offices or affiliates abroad, whose operations in foreign countries are conducted solely through designated agents and distributors. The export sales services of Balthex are limited to domestic companies. In this sense, the focus of its business is more "domestic" than "international."

(2) Many firms exist in the United States that perform the same or related services for U.S. companies. Consent of the Board to this investment could conceivably open the gates to affiliations of many of these firms with U.S. banks. It is known, for example, that should the Board consent to this investment, another bank located outside Philadelphia is interested in establishing through its Corporation an affiliation with one of Balthex' sister companies in Philadelphia. The forces of competition in the international side of American banking are strong today with each bank striving

to provide equivalent or better services than its competitors. Though perhaps remote, the possibility exists that a process may be initiated whereby one bank after another would seek to establish one or more affiliations of this kind. Should this occur, a larger breach could be made in the traditional separation of banking and commerce in this country than was envisaged by the legislation and than is in the public interest.

(3) The benefits to the foreign commerce of the United States are problematic.