The original documents are located in Box K41, folder "Wriston, Walter B. (1)" of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

January 12, 1978

Walter B. Wriston
Chairman
Citibank, N.A.
399 Park Avenue
New York, New York 10022

Dear Walter:

Thank you for your letter supplementing Citicorp's original comments with regard to the Board's proposal to authorize the automatic transfer of funds from savings to checking accounts.

As you may know, the Board is currently reexamining this proposal and I can assure you that your additional comments will be of significant value to the Board in its review of this matter.

Sincerely yours,

Arthur F. Burns

ALR:iks

CO#1951

CITIBANK

nk, N.A.
ark Avenue
York, N.Y.

Walter B. Wriston
Chairman

FEDERAL RESERVE
1977 DEC 30 AM 9:28
RECEIVED
OFFICE OF THE CHAIRMAN

to JL
Allison
Raiken
1/12 by
3pm

#1951

December 27, 1977

Honorable Arthur F. Burns
Chairman
Board of Governors of the
Federal Reserve System
Constitution Avenue, Northwest
Washington, D.C. 20551

Dear Dr. Burns:

On June 14, 1976, John S. Reed, Executive Vice President of Citibank, forwarded to the Board Citicorp's comments on a proposed amendment to Section 217.5 (c) (2) of Regulation Q regarding automatic transfers from savings to checking accounts. The purpose of this letter is to supplement the original Citicorp response and to reaffirm our support for the amendment.

Citicorp supports the amendment which we feel will benefit consumers, merchants, and banks by greatly reducing the amount of checks drawn on insufficient funds. However, there are three areas of the proposal on which we would like to take this opportunity to express our opinions to the Board.

First, the provision requiring transfers in $100 increments makes no economic sense. We see no reason to penalize a customer who makes an accidental One Dollar overdraft as if he made a $100 overdraft. Many banks, including Citibank, currently offer an analogous service whereby they lend the customer the exact amount of the overdraft. Requiring $100 units for automatic transfers but not for overdraft loans would be unnecessarily inconsistent and confusing.

Second, the provision mandating an interest penalty of forfeiture of thirty days interest amounts to price fixing by the Board. Currently some banks charge explicitly for each service and some banks package their services as they see fit. This freedom offers consumers a broad range of choices

Dr. Arthur F. Burns
Washington, D. C.

December 27, 1977

thereby increasing competition and driving down costs. Under the current proposal, the price of this service, as set by the Board, would likely become the competitive floor. Additionally, corporations have been receiving overdraft services from banks on a competitive basis for years and it is only fair that consumers now be offered the same option.

The third area of the proposal with which we would like to express our opinion is that of competitive equality. Savings banks in New York and other states currently have checking account powers. Once the FDIC joins the Board in approving the amendment, the commercial banks in these states will be put at a severe competitive disadvantage because of the Regulation Q interest differential. This potential competitive inequality has already been noted twice: First, Congress has mandated a uniform NOW interest rate for all institutions in New England; and second, the Federal Reserve has allowed commercial banks to pay interest on IRA/Keogh accounts at the higher thrift rates. We feel the same consideration should apply here and the savings transfer account should have a uniform rate ceiling for all institutions.

In conclusion, we strongly support the Board's attempt to offer consumers this new service although we hope the proposal will be modified so it does not impose undue restrictions on consumers and penalize customers of commercial banks. We trust our comments have been helpful.

Sincerely yours,

W. B. Wriston

Walter B. Wriston
Chairman

November 7, 1977

Mr. Walter B. Wriston
Chairman
Citicorp
399 Park Avenue
New York, New York 10022

Dear Mr. Wriston:

Thank you for your letter to Chairman Burns of October 31 commenting on the application by Citicorp for retention of Advance Mortgage Corporation.

I have given your letter to members of our staff who will be preparing an analysis of the application, and it will be brought to the attention of the Board when the application comes before it.

Sincerely yours,

(signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

TEAllison:red
#1537

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1977 NOV -3 AM 11:45

RECEIVED
OFFICE OF THE CHAIRMAN

October 31, 1977

Citicorp
399 Park Avenue
New York, N.Y.
10022

Walter B. Wriston
Chairman

#1537

The Honorable Arthur F. Burns
Chairman
Board of Governors of the
Federal Reserve System
Constitution Avenue, N.W.
Washington, D. C. 20551

Dear Dr. Burns:

I am writing to call your attention to - and urge your approval of our application to the Board of Governors for retention of the Advance Mortgage Corporation which has been submitted through the Federal Reserve Bank of New York last Friday, October 28th.

As you may recall, Citicorp acquired Advance Mortgage Corporation prior to the enactment of the one-bank holding company legislation. We applied for permission to retain our ownership but were turned down by the Board in December 1973. The denial resulted from the Board's feeling that expected public benefits did not outweigh the potential negative competitive effects of our ownership. The Board did indicate that we could re-apply. The years have gone by and in our view the record is reasonably clear: (1) Citicorp's ownership of Advance is important to us because it is a key element in our commitment to provide financial services to the American consumer and more specifically to the housing market; (2) our ownership has permitted Advance to maintain this commitment even when the industry was retrenching during periods of tight money; (3) neither our management nor ownership has had the effect of diminishing competition in the industry - if anything, the contrary is true; (4) the role of one-bank holding companies in the financial service business seems much more clear - and is hardly the threat once imagined - at the same time the company is now profitable and well managed, hence, is not a drain on Citicorp; (5) the involvement of a major financial institution such as Citicorp in the government's FHA-VA programs, while not without its problems, is a net benefit; and (6) our social commitment to provide financing for the rehabilitation of inner city housing is growing and we commit ourselves to further expansion.

You may also recall that Advance was criticized by HUD for some origination and foreclosure practices at specific offices with the result that we joined in a consent agreement. I feel that the record indicates that while there was legitimacy to this criticism and a sense of frustration on our part in reaction to the complexities of acting as an agent for the Federal Government's changing housing programs, there was also a clear

The Honorable Arthur F. Burns
Chairman
Board of Governors of the
Federal Reserve System
Page 2
October 31, 1977

and prompt response to the problem. We wasted little time and spent a significant sum of our stockholders money to correct the deficiencies. Today, we feel that we are one of the top performers within the federal housing program. This responsiveness and sensitivity is a direct benefit of permitting a major bank holding company to participate in the mortgage banking business.

Finally you should understand that two years ago after specific study Citicorp made a business decision to significantly increase our commitment to the consumer section of the financial service business. These activities now fall within the responsibility of a newly created organizational unit - the Consumer Services Group. Advance Mortgage is viewed as being core to our commitment to provide housing finance and as part of the Consumer Services Group will be developed within the framework of a more general commitment to provide a full set of financial services in response to the needs of the average household.

I trust that an examination of this application will persuade you as it has us that our retention of Advance Mortgage is indeed of benefit to the public.

Sincerely,

Walter B. Wriston
Chairman

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Wriston

Office Correspondence

Date November 4, 1977

To Chairman Burns

From Normand Bernard N.B.

Subject: Conversation with Mr. Angermueller, General Counsel of Citibank regarding Letters of Credit and the Arab Boycott

At the request of Mr. Walter Wriston following today's meeting of the FAC with the Board, Mr. Angermueller called to provide information on the impact that certain recent actions of the Treasury may have on banks such as Citibank that issue letters of credit to the Middle East. Mr. Angermueller explained that in November 1976, the Treasury issued certain guidelines pursuant to the Ribicoff Amendments to the Tax Reform Act of 1976. The Amendments provided that any U.S. person who refuses to deal with another U.S. person in observance of a foreign boycott agreement would be subject to certain tax penalties, including loss of foreign tax credits, rights to defer certain income, and benefits under DISC legislation. According to the guidelines, letters of credit issued or confirmed by U.S. banks would not be a kind of agreement that would violate the strictures of the Ribicoff Amendment. In August of this year, the Treasury proposed new guidelines which would reverse the above position with regard to letters of credit. Citibank dispatched a team to present the affected banks' point of view before the new guidelines became effective. The Treasury agreed to hold public hearings on October 25 and to defer the effective date to November 16, 1977.[1/] At the hearing a Treasury spokesman indicated that letters of credit issued before November 16, 1977, would not be considered a violation of the final guidelines which the Treasury proposed to issue on or before January 19, 1978.

The problem, Mr. Angermueller said, was that for the period from November 16, 1977, until the final guidelines were issued, banks would not know where they stood. Those involved had met with Treasury representatives and asked them to extend the grandfather provision so that it would run until the new guidelines were issued--an extension of up to about two months. The Treasury

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1/ Mr. Angermueller represented the New York Clearinghouse Association at those hearings and Mr. John Hofman (Houseman?) of Sterling Hayden (who also participated in today's telephone conversation) represented the Business Roundtable.

replied that such an extension was technically feasible but that it would raise political problems. The bankers replied that in the absence of the extension, they might have to suspend their affected letter of credit business until the final guidelines were issued and they argued that in the circumstances an extension was desirable despite the political problem.

CITIBANK

Citibank, N.A.
399 Park Avenue
New York, N.Y.
10022

Walter B. Wriston
Chairman [redacted]

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1977 NOV -3 AM 11: 46

RECEIVED
OFFICE OF THE CHAIRMAN

October 31, 1977

The Honorable Arthur F. Burns
Chairman
Board of Governors of the Federal Reserve System
Washington, D. C. 20551

Dear Arthur:

Upon my return from Paris this morning I was pleased to find a copy of your speech on "The Need for Better Profits." It is certainly something that needs to be said and, as usual, you said it extremely well. I sincerely hope that the Administration will take to heart the importance of the need to promote, rather than impede, the formation of capital.

It looks as if some progress is being made with the withdrawal by the President of an early consideration of his tax bill.

Sincerely yours,

October 25, 1977

Dear Walter and Kathy:

Helen and I very much enjoyed the dinner that you hosted at the Kennedy Center. She joins me in expressing our thanks.

With kindest regards,

Sincerely yours,

Arthus F. Burns

Mr. Walter B. Wriston
Chairman
Citibank, N.A.
399 Park Avenue
New York, New York 10022

NB:slc

Citibank

CITIBANK

Citibank, N.A.
399 Park Avenue
New York, N.Y.
10022

Walter B. Wriston
Chairman

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1977 JUN -3 PM 12:57

RECEIVED
OFFICE OF THE CHAIRMAN

May 31, 1977

Mr. Arthur F. Burns
Chairman
Board of Governors
The Federal Reserve System
Washington, D. C. 20551

Dear Arthur:

Whenever the World Bank and International Monetary Fund Annual Meetings are held in Washington, Citibank likes to gather together informally some of its friends and colleagues in international finance and banking. This year my wife and I are hosting a dinner on Monday, September 26, at 7:30 p.m. in the Atrium of the John F. Kennedy Center.

Since this will be the only dinner Citibank is hosting, I especially hope you and your wife, if she is accompanying you, will be able to attend.

I realize that it is a bit early and your plans to attend the Meetings may not yet be firm. However, it would be helpful for our planning to know whether you expect to be able to join us.

A formal invitation will be sent to you later, but I look forward to hearing from you in the meantime.

Sincerely,

Walter B. Wriston

559-4883

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

STEPHEN S. GARDNER
VICE CHAIRMAN

AUG 30 1977

Mr. Richard D. Hill, President
Federal Advisory Council
c/o First National Bank of Boston
100 Federal Street
Boston, Massachusetts 02110

Dear Mr. Hill:

Mr. Walter B. Wriston, Chairman of Citibank N.A. and a member of the Federal Advisory Council, has written the Board in favor of the establishment by domestic commercial banks of international banking branches in the United States. Such facilities would be used by U.S. banks to receive foreign deposits and make foreign loans without being subject to reserve requirements or interest rate ceilings.

Several years ago, the Board asked the Council for its views on a similar proposal. Following a brief discussion of the issue at the February 1974 meeting, questions regarding the possible benefits and problems associated with the operation of this type of facility were formulated and sent by President Storrs to the members of the Council with a request for their individual comments. Subsequently, the Board concluded that the advantages of such a proposal were outweighed by its negative implications for the control of domestic money and credit.

Since then there have been significant increases in the volume of international loans and deposits both at U.S. offices and at overseas branches of our banks, and our banking system is undergoing important changes. It therefore seems appropriate to undertake another evaluation of this proposal.

We believe that it would be useful once again to ascertain the views of the Council, and as a result, we plan to suggest such a discussion topic for the Council's November meeting. It would be especially helpful to the Board if the Council's expression of views on this matter could include specific consideration of the enclosed set of questions that has been drafted by the staff.

In order that the individual Council members may have adequate time to study the issue prior to the November meeting, you may wish to let them know that we plan to raise the question at that time. You may also wish to distribute to the Council members copies of the enclosed material that was furnished me by Mr. Wriston.

Sincerely yours,

/S/

Stephen S. Gardner

Enclosures

cc: Mr. Herbert Prochnow, Secretary, Federal Advisory Council
Mr. William Korsvik, Associate Secretary, Federal Advisory Council

bcc: Mr. Gemmill
Mr. Truman
Mr. Axilrod
Mr. Lawrence
Mr. Hogwood
Mr. Allison
Mrs. S. Connor ✓

AWH/TEAllison:red
8/30/77

Questions for Federal Advisory Council

Various suggestions have been made from time to time by U.S. bankers that their banks be permitted to conduct international operations out of U.S. offices under rules similar to those that apply to foreign branches. For example, it has been proposed that deposits owned by foreign entities be exempt from reserve requirements, Regulation Q ceilings, and the prohibition of payment of interest on time deposits with maturities under 30 days. The amount of foreign deposits that would be given special treatment would be limited, at the maximum, to the amount of a bank's foreign loans and investments in foreign securities.

The Board would appreciate the Council's views on the following questions:

1. Should such "freeport" facilities for international banking be permitted?

2. What, if any, advantages, corporate and public, would likely ensue if banks engaged in international lending and deposit-gathering had such facilities? Would adoption of the proposal obviate the need for "shell" branches? Would it tend to reduce the amount of business conducted through full service branches in foreign financial centers, perhaps with some substitution of representative offices for such branches?

3. Would the Council expect the use of such facilities to increase the total amount of international business done by U.S. banks? Would deposits in such "freeport" facilities located in the U.S. be more useful to customers than deposits in "shell" branches or foreign branches?

4. Would the Council expect the existence of such facilities to result in a shift of deposits and borrowing of multinational concerns away from domestic deposit and loan accounts and into the freeport facilities? Would such shifts have potential adverse effects on the conduct of domestic monetary policy?

5. Would the existence of "freeports" tend to discriminate against U.S. customers with no foreign subsidiaries?

6. Does the Council believe that the kinds of reports needed for regulatory policing of such "privileged" operations would raise serious compliance problems? Would it be desirable to segregate the privileged activity into a separate subsidiary of the bank, with separate bookkeeping?

7. Would adoption of such a policy lead to a more equitable system of competition for international business between small and large banks? Would it create an undesirable incentive for inexperienced banks to enter the field of international banking?

8. If such facilities were permitted, how might the problem of phasing-in be handled? (Presumably a very substantial amount of foreign deposits would suddenly become eligible for favored treatment, creating at least transitional problems for the conduct of monetary policy.)

on FAC agenda

July 27, 1977

Mr. Walter B. Wriston
Chairman
Citibank, N.A.
399 Park Avenue
New York, New York 10022

Dear Walter:

Thank you for your letter proposing the establishment of international banking branches in the United States. Several years ago, the Board evaluated a similar proposal. At that time, it concluded that the advantages of such a proposal were outweighed by its negative implications for the control of domestic money and credit. Since then, there have been significant increases in the volume of international loans and deposits both at U.S. offices and at overseas branches of our banks, and our banking system is undergoing important changes. It may, therefore, be appropriate to undertake another evaluation of this proposal.

A useful first step would be to ascertain how other banks now would regard such a proposal, and what they would envision might result from the statutory and other changes you propose. I therefore plan to ask the Federal Advisory Council for its views as we did in early 1974.

Sincerely yours,

Arthur F. Burns

RFG/FRD:aw
#1006
cc: Bob Gemmill, J. Dahl
Drew Hogwood
Ted Allison

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

STEPHEN S. GARDNER
VICE CHAIRMAN

July 27, 1977

NOTE TO THE CHAIRMAN

Walter Wriston has written suggesting that we reconsider permitting international branches of U.S. banks to be established in U.S. enclaves. He has submitted a technical paper advocating the plan with supporting appendices.

These issues, of course, have been raised before and we submitted such a question to the Federal Advisory Council in February 1974. The idea has some merit but many problems. Principal among the problems is the difficulty of preventing shifts of domestic business to such enclave branches and freeing them from reserve requirements.

I recommend we reconsider the proposal and review the question again with the Federal Advisory Council and our staff. A sufficient amount of time has elapsed since early 1974 to justify a reappraisal.

The attached letter acknowledges Wriston's letter and indicates we will follow the proposed course. I would also ask International, Supervision and Regulation and Legal to prepare the review since they have participated in developing this draft reply.

S. G.

OFFICE OF THE CHAIRMAN
RECEIVED
1977 JUL 27 PM 4:57
BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

nk, N.A.
ark Avenue
York, N.Y.

Walter B. Wriston
Chairman

CITIBANK

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1977 JUL 22 AM 11: 33

RECEIVED
OFFICE OF THE CHAIRMAN

July 15, 1977

#1006

The Honorable Arthur F. Burns
Chairman
Federal Reserve System
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20051

Dear Arthur:

We have been considering ways to help the United States--and specifically New York City--regain position as the financial center of the world. One way which we believe this could be done is to attract back to this country those truly international banking transactions which, because of the adverse impact of domestic Federal regulations and local laws, are currently being booked in various off-shore locations outside the United States.

Attached is a proposal which, through some relatively simple amendments to current laws and the promulgation of appropriate regulations, would provide for the establishment within the United States of International Banking Branches of U.S. banks. With the establishment of these branches, transactions of the type now being booked by American banks outside the United States could instead be booked within the United States.

This is not a wholly novel idea, but one which is, in my judgment, timely. I am enclosing for your consideration and comment a document generally outlining the proposal for the establishment of such International Banking Branches as well as a somewhat more detailed and technical memorandum entitled "A Background Paper on International Dollar Banking by U.S. Banks". I am concurrently sending copies of these documents to Paul A. Volcker, President, Federal Reserve Bank of New York and Governor Hugh L. Carey of New York for their consideration and review.

If you and your associates believe this proposal has merit, I would be most pleased to cooperate in pushing this proposal forward toward its implementation. Personally, I believe the implementation of such proposals would result in not only strengthening the role of the United States but also, specifically, New York City, as the world's leading financial center.

I look forward to your reaction.

Sincerely,

A Proposal To Establish
International Banking Branches
In The United States

In a time when efforts are being made to revitalize New York's declining economic position, we would like to propose a simple, logical approach to help New York regain its once preeminent role as an international money center -- a monetary free trade zone.

Most people are familiar with the free trade zones that countries set up for imports and exports of goods which are never actually sold in the domestic market. The basic principle is that imports into a free zone are not subject to customs duties if the goods flow back into international trade. If, however, the trade goods leave the free zone and flow into domestic commerce, they would be taxed accordingly.

In our country the zones have a long history and a wide geography. The Foreign Trade Zones Board was established by Congress in 1934 and oversees 19 free zones which extend from the Brooklyn Navy Yard to Honolulu. The zones are designed so that goods which are not intended for sale or use in the United States may be imported, stored, assembled or manufactured by domestic firms and labor without being burdened by United States import duties.

The same principle could be applied to banking operations not involving the domestic markets. If loans and deposits of purely international origin and destination could be transacted free of the regulatory and legislative constraints and taxes designed to apply to domestic operations, they would be maintained and serviced in the United States using domestic bank personnel and expertise. In effect, banks would be allowed to establish specifically designated branches which would deal only in international transactions. The concept already exists in many foreign cities and countries which, as a result, have become international banking centers at the expense of the United States and, more specifically, New York.

In such designated "International Banking Branches", located within the United States, banks could accept non-U.S. deposits free of the burden of non-earnings reserves and interest rate restrictions imposed by Congress and the Federal Reserve and make loans to foreign borrowers. The location of such branches would be subject to existing limitations on interstate banking, i.e. New York banks would be limited to a New York location, Chicago banks to Chicago, etc. There would be no State or City taxes applied to the earnings of these International Branches. There would be no loss of local tax revenues because these operations are not presently conducted in the United States.

Just as in the case of existing free trade zones for goods, in these International Branches the absence of domestic restrictions would apply only to foreign transactions--deposits from and loans to non-residents. Any financial transactions between the

International Branches and other domestic offices or resident customers would be subject to the same restrictions, regulations, and taxes which presently exist on transactions between United States domestic banks and their foreign branches. Federal and/or State supervisory authorities would authorize and oversee the operations of such International Branches.

Background

While International Banking Branches could be set up anywhere in the United States, New York would particularly benefit because of the size and international scope of New York headquartered banks and the large number of foreign banks already located here. New York has all of the foundations necessary for an international banking center -- excellent world communications and transportation; a vast pool of experienced financial analysts, legal counselors and skilled banking personnel; and available office space. New York was the world's primary banking center until the early 1960s. At that time, balance of payments considerations led the U.S. Government to impose regulations -- Interest Equalization Tax (IET), Voluntary Foreign Credit Restraints (VFCR), Office of Foreign Direct Investment regulations (OFDI) -- which served to stimulate corporate funding outside the United States, motivated banks to set up or expand foreign branches, and spurred the growth of the Eurodollar markets.

During the time the IET, VCR, and OFDI restrictions were in effect London's position as an international banking center had been vastly expanded and several new international financial centers had developed. New York City's preeminence had been seriously eroded not only by London, but by Singapore, Hong Kong, the Bahamas, Cayman Islands, Panama and, more recently, Bahrain. Moreover, in the three years since the removal of United States balance of payments restrictions, foreign international money centers have continued to grow dramatically.

The growth of these overseas financial centers is a logical result of the nature of the Eurodollar business. In global financial transactions, it is not a simple matter to decide where negotiations really take place and thus on which branch locations books a loan shall be entered. If a loan is made to the Brazilian subsidiary of a German company, people may become involved in its negotiation in Brazil, the United States, Germany, and various other places. Claims on people's time and other expenses may well be incurred in half a dozen countries. These loans could be booked in any number of places where a bank has a branch, including New York for New York headquartered institutions; but, because of domestic reserve requirements and restrictions on interest payments, the loans tend to be placed in branches in money centers outside the United States.

When American banks book Eurodollar loans in the United States, the deposits necessary to fund the loans are subject to reserve requirements (these reserves represent a non-earning asset), and Regulation Q which forbids payment of interest on deposits under 30 days. Since foreign banks have access to Eurodollars, are not subject to reserve requirements, and can pay interest on short-term deposits, United States banks have to find ways to remain competitive. This can only be done, under existing Federal Reserve regulations, by establishing a Eurodollar center outside the United States.

Advantages of United States International Banking Branches

The establishment of International Banking Branches in New York City, and elsewhere, free from domestic restrictions, would enable United States banks to conduct much of their international deposit gathering and international lending in a domestic location rather than in offshore booking centers. It would benefit New York City, other major cities in this country, United States banks, the Treasury and the Federal Reserve.

The advantages for New York City could be significant. It would help New York regain its lost prestige in the world financial community not only in banking, but in the investment industry as well. Wall Street, once the foremost securities center, now has only a fraction of the Eurobond underwriting while London has become the center for international bond financing. If international banking returns to New York, at least some portion of the Eurobond underwriting activities should return as well.

The return of the international financial services business should have a significant positive impact on New York City employment both in terms of direct employment and in expanded need for support services; it would help the occupation of under-utilized office space; it would attract to New York commercial and industrial users of international banking. In sum, it would generally aid the revitalization of New York City and result in a net increase in tax revenues due to more jobs and more spending by visitors, etc., even though the international banking activity itself would not be taxed.

The proposal would be advantageous to United States banks because it would permit easier, more effective control and audit of operations which are now spread out in many foreign branches. It would result in a reduction of costs for American banks which could be particularly important to medium size banks.

It would also promote international banking by many smaller United States banks which are presently restricted from international banking operations by the high costs and control risks of separate branch operations. The Federal Reserve has tried to accommodate these smaller banks by approving some eighty "shadow branches" in the Bahamas and the Cayman Islands which are not fullfledged branches but have enabled the smaller banks to enter the international market. A domestic location would be a more effective solution.

The establishment of International Banking Branches in the United States would also return more tax revenues to the Treasury. Tax payments which are paid on foreign branch profits to foreign governments are presently offsetting the Federal taxes paid on the same income. Profits of the proposed International Branches would be made in the United States rather than abroad and, therefore, would not be subject to foreign taxation. More taxes would be paid to the Federal Government because the offsets, or credits, would be reduced.

Finally, establishment of these Branches would improve the ability of the Federal supervisory agencies to examine international operations more efficiently and effectively.

Necessary Legislative/Regulatory Changes

The key components for establishing International Banking Branches within the United States are to create a legal/regulatory environment which will preserve for non-residents substantially all of the benefits they now enjoy through the use of off-shore booking centers of American banks and, in addition, extend to such non-residents the economic, political and social stability which has traditionally been associated with the United States.

In order to achieve such a legal/regulatory environment, essentially two steps must be taken:

(1) State and Municipal laws imposing tax and other local risks within the jurisdiction where such International Banking Branches are to be located must be amended so as to be inapplicable to income derived from non-residents dealing with such Branches and

(2) Federal Reserve regulations must be promulgated to remove reserve requirements and interest rate restrictions on all, or substantially all, foreign source deposits made in an International Branch by non-residents dealing with such Branch.

Specifically, the Federal Reserve would have to amend Regulation D to remove reserve requirements on foreign deposits in the International Banking Branches. In addition, the Federal Reserve would have to amend Regulation Q to remove the restriction forbidding the payment of interest on foreign deposits of less than 30 days and to allow market rates of interest to be paid on time deposits held by foreign persons in such International Branches. Part of this requirement is already accomplished. There are presently no rate limits on time deposits held by certain foreign depositors such as foreign governments, foreign monetary authorities, or international financial institutions. However, it would be better to base the exemption for the International Branches on the general foreign character of the depositor, both to free the market and build overall non-resident depositor confidence in this freedom.

The Federal Reserve may already have sufficient regulatory power to remove reserve requirements and interest rate restrictions with respect to all foreign deposits which might be held by International Banking Branches other than those deposits which are literally payable without notice and immediately on "call" or "demand". As a practical matter, the vast preponderance of prospective non-resident depositors utilizing International Branches would probably be willing to deposit funds subject to some, albeit very short, notice period (e.g. one, two or three days) in order to avoid foreign "country risk".

If, however, the Federal Reserve felt it necessary or advisable it would, of course, seek Congressional authorization to remove reserve requirements and interest rate restrictions with respect to <u>all</u> non-resident deposits which might be held in International Banking Branches. Such Congressional authorization could take the form of a relatively simple amendment to Sec. 19 of the Federal Reserve Act.

In the past, concern has been expressed over potential for misuse, a weakening of monetary policy control, and the need for new and elaborate regulatory apparatus if existing regulations and restrictions were removed on international transactions and International Banking Branches authorized. The adequacy of existing regulatory controls and available evidence on the limited impact of the already large foreign dollar market on U.S. monetary control indicate those concerns are overstated. Simply stated, United States International Banking Branches would not create new opportunities for misuse; they would allow American banks to conduct the same international operations in the United States that they presently conduct in off-shore locations. It makes little sense to define reserve requirements and interest rate limitations in such a way that international dollar banking cannot be conducted in the home country of the dollar.

If the Federal Reserve were to open the way for the establishment of designated International Banking Branches pursuant to Federal Reserve Act amendments and/or new regulations, then it would be necessary for New York State and City (if this is where the Branches were to be located) to eliminate an excessive tax burden in order to make New York an attractive site for these Branches. This represents no revenue loss to the local taxing authorities as these activities are not now taking place in the United States. The level of New York taxes, combined with Federal taxes, remains an obstacle in attracting international banking. Federal, State and City income taxes on New York banking operations are now 62.3%, a level far above London at 52%. Even with a 52% rate, in the past few years London has been losing its relative share of international banking to lower-taxed centers.

In addition, New York State should: a) remove its reserve requirements on State chartered non-member banks that wish to establish similar International Branches (in line with the Federal Reserve's move for its members), and b) change the New York State escheat law, better known as the Abandoned Property Law, to exclude non-resident owned deposits or at least to lengthen the period to a more reasonable 15 to 20 years. This law now requires inactive deposits to be turned over to the State after five years.

<u>Conclusion</u>

The United States is the most attractive country in the world from the point of view of economic, political and business stability. It is a natural locus of international finance. However, the impact of reserve requirements and interest rate ceilings coupled with exposure to local tax and simlar laws tends to deter non-residents from making deposits in the domestic branches of U.S. banks. Were these deterrents eliminated, such non-residents could effectively obtain all of the benefits and protection which they now enjoy by utilizing foreign branches of United States banks and still, at the same time, avoid the sovereign risks implicit in foreign laws and regulations.

No overriding policy requires that reserve requirements and interest rate limitations imposed for domestic reasons be so structured that United States banks are caused to carry on international banking primarily through foreign branches and that medium and smaller banks, unable to justify foreign branches, be largely excluded from receiving deposits from and making loans to non-residents. This largely accidental effect of the present structure of regulation has penalized United States cities by excluding them from developing international banking with its advantages in employment, economic activity, and creation of competitive knowledge resources, and served to create vigorous dollar banking centers in foreign cities. It has increased the difficulties of inspection by United States regulatory agencies and raised the costs and risks for United States banks.

With all the natural competitive advantages that the United States offers, efforts should be made immediately to remove the legislative/regulatory obstacles so that the United States can once again become the international financial center of the world.

New York, as the major financial center of the United States, has much to gain in seeing this proposal implemented. By encouraging Federal Reserve action and being prepared to implement the required changes in State and City tax regulations, the City can move to reestablish its reputation as <u>the</u> leading international financial center.

Citibank
July 13, 1977

APPENDIX I

Proposed New York Legislative Amendments for a Domestic International Banking Zone in New York City

Taxes on Banking Corporations
A. New York State

The statutory provision dealing with allocation of a bank's net income to branches outside New York, thus removing this income from taxation by New York, is very brief (New York Tax Law, Article 32)

> "§1454. Allocation of Entire Net Income
>
> If the taxpayer's entire net income is derived from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be allocated under rules and regulations prescribed by the tax commission."

If the income attributable to the proposed New York City international banking facilities is to be excluded from taxation by New York State, the following sentence should be added to that section:

> "For the purposes of this section a segregated international banking facility maintained within the state for the purpose of receiving deposits from non-residents of the United States and making loans to non-residents of the United States shall be deemed to be business carried on without the state and the portion of entire net income allocated to such facility under rules and regulations prescribed by the tax commission shall not be treated as derived from business carried on within the state."

B. New York City

The provision in New York City law imposing taxes on banking institutions (New York City Administrative Code, Title R, Part III, Subject 4) which deals with the allocation of net income (§R46-37.4) is identical to §1454 of the New York State tax law. Therefore a similar amendment would accomplish the same result:

> "For purposes of this section a segregated international banking facility maintained within the city for the purpose of receiving deposits from non-residents of the United States and making loans to non-residents of the United States shall be deemed to be business carried on without the city and the portion of entire net income allocated to such facility under rules and regulations prescribed by the finance administrator shall not be treated as derived from business carried on within the city."

This amendment must be enacted by the New York City Council. No change is required in the New York State Enabling Act under which the City is authorized to tax banks (L.1966, Ch. 772, §1), so long as the amendment to Article 32 (§1454, above) is first enacted.

Abandoned Property

At present New York State has an extraordinarily short escheat period for unclaimed property held or owned by banking organizations - five years - which may inhibit the placing of deposits by non-residents. The solution lies in either extending this period to the former (prior to 1976) ten years for deposits or providing that deposits payable only at an international banking facility as defined would fall within the present exemption for deposits payable only at foreign branches. In view of the fact that a general lengthening of the period would delay revenue, just as the 1976 amendment, as intended, accelerated state revenue, the exemption method would be preferable.

Abandoned Property Law

> "300(a)...exception (iv) any such amount payable only at or by a branch office located in a foreign country, or at or by a segregated international banking facility maintained and operated in New York for the purpose of receiving foreign deposits and making foreign loans, or payable in currency other than United States currency, or"

July 13, 1977

A Background Paper On
International Dollar Banking By U.S. Banks

he Size of Off-Shore Banking

atest data show that, as of December, 1975, 97 national banks operated 674 branches utside the United States, and 29 State member banks operated 88 such foreign branches.[1])ver 34 percent of these branches, or 265 in total, were located in "off-shore" centers or international dollar banking such as the Bahamas, Cayman Islands, Bahrain, Panama, ingapore, and the United Kingdom.[2] As of December, 1976, member bank branches n the U.K., Bahamas, and the Cayman Islands, held $125 billion in U.S. dollar assets ut of a total of $167 billion in U.S. dollar assets of all foreign branches, or just under 5 percent of foreign branch dollar assets.[3] In contrast, U.S. offices of all banks in ne U.S. held at end December, 1976, $78 billion of dollar claims on foreigners, of hich $32 billion were claims other than loans, mostly claims on foreign branches and gencies of those U.S. banks.[4] Why should foreign branches of member banks hold I.S. dollar assets equal to more than double the total of dollar claims on foreigners of ll U.S. banks?

low Did This Come About?

: is clear that the tremendous growth of foreign branch dollar banking was caused in arge part by, and coincided with, implementation of the various parts of the U.S. alance of payments programs from 1963 to 1973. The Interest Equalization Tax, the 'ederal Reserve Voluntary Foreign Credit Restraint program, and the Office of Foreign)irect Investment regulation combined to discourage and partially prohibit persons ithin the United States from lending to persons outside the United States and from nvesting domestic source funds abroad, while at the same time encouraging the development of funds gathering capability abroad, particularly the creation of foreign banking ranches. On April 30, 1976, former Federal Reserve Board Governor Andrew F. Brimmer presented to a conference on "New York: World Financial Center" at the Valdorf Astoria, a comprehensive view of the growth of foreign branches of U.S. banks, oth during the period of the balance of payments program prior to early 1974, and in ne two years following the termination of the program. Table I of former Governor Brimmer's presentation (attached) summarized the history of growth of foreign branches n relation to credit extended to foreigners by U.S. offices from 1960 to end 1975. Up o 1966 credits to foreigners by U.S. branches were greater than the assets of foreign ranches. Starting in 1966 foreign branch assets grew precipitously until the relationhips were reached described at the beginning of this paper. And the proportional mportance of foreign branches has continued to grow even after termination of the alance of payments programs at end 1973. Governor Brimmer reported:

> "At the end of last December, U.S. commercial banks had $29.5 billion of loans to foreigners outstanding on the books of their head offices. At the same time, their foreign branches had total assets of $165.0 billion. Of this total of $194.5 billion, the head offices held 15 percent, and the remainder was held

by the branches. In contrast, in 1973 (prior to the termination of restraints on bank lending abroad from their head offices), the head offices in the United States held 13 percent of the combined foreign assets, and the branches held the remainder. So, partly in response to capital constraints imposed by the Federal Government, American banks had come to rely primarily on their foreign branches as vehicles through which to conduct the bulk of their international lending activities. This is still the case today."

Vhy Off-Shore Banking Today?

To understand this phenomenon it is necessary to realize that while the balance of ayments programs was the primary impetus for U.S. banks to move international lollar banking to foreign branches, other factors sustain this movement today. These factors are 1) freedom from deposit reserve requirements in foreign centers, nd 2) freedom in those foreign centers to pay market rates of interest on demand nd time deposits. While taxes on bank branch profits are also sometimes mentioned s incentives to carry on dollar banking in foriegn branches, this is true only to a ery limited extent, as will be discussed below. If these two competitive advantages ffered by foreign dollar centers were also available in U.S. centers it is fairly ertain that a large part of foreign branch dollar banking would be returned to domestic ffices. Are there any sound policy reasons for the U.S. to continue to create ompetitive advantages for dollar banking in foreign centers to the detriment of U.S. ities?

he response to this question may rest either on inquiry into the need for deposit eserves and restrictions on deposit interest payment in general, or on inquiry into he appropriateness and administrative feasibility of removing foreign-source, or nternational deposits held in domestic offices from the constraints of deposit reserves nd limitations on interest payments.

eposit Reserves and Limitations on Interest Applied to Deposits From Foreigners n Domestic Banking Offices.

Vhile some economists argue that reserve requirements have relatively little value s a monetary policy mechanism, it is not the purpose of this paper to deal with that ssue. We will assume, for purposes of this presentation, that deposit reserves and imitations on deposit interest will continue as instruments of monetary management f the domestic economy. Therefore, in order to respond to the basic question, it is ecessary to examine whether such requirements should be applied to deposits held in omestic banking offices by foreign persons and entities.

Jnder present regulation, dollar funds held by foreigners can be deposited in domestic anking offices at rates competitive with free Euromarket rates only if the size and erm of the deposit is such that it is free from limitations on interest payments, and he market power of the depositor is such that the bank can be persuaded to absorb he cost of required reserves. Thus, it can be assumed that the great bulk of dollar unds held by non-residents of the United States will be deposited in foreign branches f U.S. banks or in foreign banks outside the United States. These foreign held ollar funds, placed in banks abroad, can exercise an influence on domestic monetary markets only through the following banking channels; A) advances in any form by foreign branches of U.S. banks to their domestic offices; B) extensions of credit by such foreign branches to domestic borrowers for use in the U.S.; C) advances by foreign banks to their domestic offices; and D) extensions of credit by foreign banks to domestic borrowers for use in the United States. The Federal Reserve Board has controlled channels A) and B), where it has imposed reserves based on advances or extensions of credit by member banks' foreign branches. However, claims by foreign branches on U.S. persons, other than their domestic offices, have been very small, as a percentage of their assets. From 1973 to end 1976 the total has never exceeded 2.6% of total uses of foreign branch funds, and the amounts have been more than offset by the liabilities of these branches to U.S. depositors.[5] In addition, advances by foreign branches to their domestic offices have been relatively unimportant.

Since 1973 they have never exceeded 3.3% of total foreign branch fund uses, and since December, 1974, have been offset by advances by the U.S. offices to foreign branches.[6] Even in 1969, prior to imposition of the Reg. M reserves, the total advances by foreign branches to domestic offices, in the face of severe restraints on U.S. money markets, represented only 31% of the assets of foreign branches, or more significantly only 2.4% of the total assets of all U.S. commercial banks.[7]

It is difficult to assess the total amount of U.S. dollar funds held by foreign banks, as opposed to foreign branches of U.S. banks, because statistics are either not compiled in various centers on different bases. For London, however, statistics published by the Bank of England do permit some estimates. As of December 31, 1975, for example, total U.S. currency liabilities of U.K. banks were about $104 billion, while those of branches of U.S. banks in the U.K. were about $58 billion. On the other side total U.S. currency assets of U.K. banks at that date were $97 billion, and those of U.S. bank branches there were $57 billion. Thus, non-U.S. banks in the U.K. held sizeable totals of U.S. dollar liabilities and assets although the larger part of the totals for all U.K. banks were those of branches of U.S. banks. These dollar operations of foreign banks outside the United States are not subject, either actually or potentially, to control by U.S. authorities. At the same time, the Bank of England data indicate that only a small part of these U.S. currency liabilities and assets of U.K. banks were to U.S. persons (9.4%) or due from U.S. persons (6.9%).[8] Thus, given both the substantial U.S. dollar operations of foreign banks and the small portion of these operations which involve transactions with persons in the United States, it is at least questionable whether the present program under Reg. M is necessary or appropriate.

Moreover, available evidence suggests that conditions in the "uncontrolled" foreign dollar markets are, in fact, dictated by conditions in the U.S. markets. Eurodollar interest rates move in a quite close relationship with U.S. domestic interest rates, and even the fluctuations in the growth of the Eurodollar market appear to be predictably related to the growth in U.S. monetary aggregates, notably the monetary base. Thus there is much stronger influence running from the U.S. economy to the foreign dollar centers than in the opposite direction. The imposition of Regulation M reserve requirements in order to strengthen the Federal Reserve's control over U.S. monetary conditions, therefore, may be unnecessary.

Domestic International Banking Offices

But if there is a need to apply reserve requirements in order to isolate foreign dollar markets from domestic markets, there is no convincing reason to do this in a way which encourages U.S. banks to carry on their dollar operations with non-residents primarily in foreign locations. U.S. banks could be permitted to create international banking facilities at domestic locations for the receipt of deposits from non-residents and the making of loans to non-residents just as they do today in foreign branches. There is no reason why the regulation of such facilities to control their effect on domestic markets should be more difficult or burdensome than the regulation of foreign branches. In fact, the location of such facilities in domestic cities would make the task of supervision easier than is the case with widespread foreign branches.

If such controls were needed, essential to their implementation would be 1) a definition of such domestic international facilities, 2) definitions of those deposits which such facility would be empowered to accept, free of reserve requirements and restrictions on interest payments, and 3) provisions for reserve requirements to apply where such a facility makes funds available to other domestic offices (such domestic offices could be required to maintain ordinary reserves on such funds received from the facility) of the bank or to domestic borrowers for use in the United States. While the Federal Reserve Board has, through former Governor George Mitchell, taken the position that these regulations would, of necessity, be costly and burdensome [9] this does not appear to be the case.

If the domestic international banking facility were required to keep separate books of account, and be maintained as a separate unit, just as if it were a foreign branch, limited to certain categories of transactions (receipt of despoits from "non-residents" and making loans to "non-residents") its regulation should be no more difficult or costly than is the regulation of Edge Act corporations.

A definition of non-residents is already contained in the pertinent provisions of Reg. M. (These provisions (§213.7 of Reg. M) still reflect the OFDI requirements and, if continued, are in need of revision.) The term "non-residents" should be so adapted so as to include domestic international banking facilities of other banks so that an inter-bank international market in non-resident source funds could develop.

The Federal Reserve may already have current regulatory power to remove reserve requirements and interest rate restrictions with respect to all foreign deposits which might be held by domestic international banking facilities other than those deposits which are literally payable without notice and immediately on "call" or "demand". As a practical matter, the vast preponderance of prospective non-resident depositors utilizing such facilities would probably be willing to deposit funds subject to some, albeit very short, notice period (e.g. one, two or three days) in order to avoid foreign "country risk". Nevertheless, should the Federal Reserve deem it appropriate, it could seek specific legislative authorization from Congress to remove reserve requirements and interest rate restrictions with respect to such non-resident deposits as might be held in domestic international banking facilities. Such Congressional authorization could take the form of a relatively simple amendment to Sec. 19 of the Federal Reserve Act. (See the attached text of a possible amendment to Sec. 19.)

Taxation

Congress took a major step towards attracting non-resident deposits to United States banks by making the exemption from withholding taxes applicable to interest on bank deposits a permanent part of the Internal Revenue Code in 1976, although the expected transfer of foreign held deposits from off-shore centers to U.S. offices will not be realized unless other impediments to domestic deposits are removed.

On the level of taxation of bank profits, rather than on depositors, it is commonly thought that the lack of local income taxes, or low rates of such taxes, in some off-shore centers is an incentive to carry on international banking in those centers rather than at domestic U.S. locations. As far as the federal income tax is concerned, this is not the case. A U.S. bank is subject to federal tax on its world-wide income, whether this is earned in domestic locations or foreign branches, and it may credit foreign income taxes which it pays against its liability for federal tax, but not more than that proportion of the federal tax which equals the proportion of the bank's total taxable income which is from foreign sources. Thus the bank's tax burden, foreign and federal, will be at least 48 percent of foreign income and will exceed 48 percent only if foreign source income is subject to foreign taxes in excess of 48 percent. Income earned in a low-tax foreign center is subject to the same federal tax as is income earned in a domestic branch.

Many off-shore centers, London (52 percent), Bahrain (20 percent), Singapore (10 percent) levy income taxes. To the extent that income earned in branches in these centers were earned instead in domestic locations, more taxes would be paid to the federal treasury because creditable foreign taxes would be reduced.

Many loans to foreign borrowers are subject to withholding taxes levied at the source on interest, in addition to the income taxes assessed on foreign branches where these loans are made. As between foreign banking centers, the lower taxed centers are more attractive because the total foreign tax burden on such loans is thereby reduced and the risk is diminished that the total amount of such foreign taxes may exceed the maximum credit permitted. If loans to foreign borrowers were made from domestic offices the same effect would be achieved as making such loans from lower taxed foreign centers since one layer of foreign tax would be eliminated. Thus, except for state and local taxes, domestic locations can compete on the tax level with no-tax or low-tax foreign centers in attracting foreign loans out of higher-taxed foreign centers.

State and local taxes on branch operations do represent an obstacle to location of operations which are carried on in foreign centers, because these taxes are not creditable against the federal tax, but are deductible. Due to reserve requirements and limitations on interest payments, however, domestic locations do not at present attract international operations, and there is some hope that states may eliminate profits taxes on international operations or reduce the burden in order to gain such international operations and the additional employment, expertise and economic benefits which international banking could bring. This is especially true of states with cities equipped to be international centers of considerable size.

:onclusion

Io overriding policy requires that reserve requirements and interest rate limitations mposed for domestic reasons be so structured that U.S. banks are caused to carry n international banking primarily, if not exclusively, through foreign branches, nd that midsize and smaller banks, unable to justify foreign branches, are largely xcluded from receiving deposits from and making loans to non-residents. This argely accidental effect of the present structure of regulation has penalized United tates cities by excluding them from developing international banking with its dvantages in employment, economic activity, and creation of competitive knowledge esources, and by creating vigorous dollar banking centers in foreign cities. The isadvantages of this regulatory structure include also increased difficultities and osts of examination by U.S. regulatory agencies and greater costs and risks for '.S. banks. Therefore, amendment of the applicable laws and regulations to permit '.S. banks to carry on international banking in the United States, and to permit nany banks unable to maintain foreign branches to compete in this business with arger banks, is warranted now.

:itibank
uly 13, 1977

NOTES

1) 62nd Annual Report, 1975, Board of Governors of the Federal Reserve System, pp. 303-4.

2) Ibid, table, p. 304

3) Federal Reserve Bulletin, March, 1977, p. A62.

4) Ibid, p. A61, Tables 3.19, 3.20

5) Federal Reserve Bulletin, April, 1977, pp. A62-A63.

6) Ibid.

7) See table I, presented by Mr. Brimmer, attached.

8) Federal Reserve Bulletin, January, 1977, pp. A62-A63; Bank of England Quarterly Report, Vol. 16, September, 1976, Table 21. These data also show that, from December, 1975, to June, 1976, non-U.S. banks in the U.K. used only ten percent of their dollar resources to acquire claims on the U.S., even though the amounts of those U.S. claims exceeded those of U.S. bank branches in the U.K. During the period, the amount of all U.K. banks' liabilities to U.S. persons exceeded the amount of their claims on U.S. persons.

9) Financial Institutions and the Nation's Economy "Discussion Principles". Hearings before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House of Representatives, December 11, 12, 16, and 17, 1975, Statement of Hon. George W. Mitchell, at pp. 1035-6, Vol. 2

TABLE 1

International Operations of U.S. Banks: Selected Indicators, 1960-1975
(Monetary Magnitudes are in Billions of Dollars)

	CATEGORY	1960	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
I.	U.S. Offices[1]													
	Bank Credit to Foreigners[2]	$4.2	9.4	9.7	9.6	9.8	9.2	9.3	9.7	12.1	13.4	17.2	29.0	29.5
	Foreign Deposits[2,3] (other than Due to Foreign Branches)	$9.1	13.4	13.6	12.6	14.4	14.7	16.5	16.5	17.1	17.4	21.8	24.2	24.1
	Due to Foreign Branches[4]	$--	1.2	1.3	4.0	4.2	6.0	12.8	7.7	0.9	1.4	2.5	4.5	4.1
II.	Overseas Branches of Banks[5]													
	Number of Banks with Overseas Branches	8	11	13	13	15	26	53	79	91	108	125	125	126
	Number of Overseas Branches	131	181	211	244	295	375	459	536	583	627	699	732	762
	Assets of Overseas Branches[6]	$3.5	6.9	9.1	12.4	15.7	23.0	41.1	52.6	67.1	77.4	118.0	151.9	165.0
III.	Edge and Agreement Corporations													
	Number	15	38	42	49	53	63	71	77	85	92	104	114	116
	Assets	$N.A.	0.9	1.0	1.4	1.5	2.5	3.5	4.6	5.5	6.0	6.9	10.1	NA
MEMORANDUM:	All Insured Commercial Banks in U.S.													
	Total Assets	$255.7	343.9	374.1	401.4	448.9	498.1	527.6	576.2	640.3	732.5	827.1	906.3	912.0 S
	Total Deposits	228.4	305.1	330.3	351.4	394.1	432.7	434.1	480.9	537.9	612.8	677.4	741.7	741.8 S

NOTE: N.A. Not Available. Data are for end of year, except subscript S - September, 1975.
p.e. Partly Estimated.

1. All data for U.S. offices are on a balance of payments basis.
2. Bank credit to foreigners and foreign deposits relate to all commercial banks reporting on the Treasury foreign exchange forms, and include credits and deposits of branches and agencies of foreign banks as well as U.S. banks. Bank credit includes short- and long-term loans and acceptance credits denominated in dollars; for 1960, some other short- and long-term claims are also included. Data for 1972 through 1974 do not include claims on U.S. banks or their foreign branches or claims of U.S. agencies and branches of foreign banks on their head offices.
3. Foreign deposits include demand and time deposits of one-year or less maturity, and beginning in 1964, include negotiable certificates of deposit issued to foreigners and international institutions.
4. Due to branches refers to the gross liabilities due to foreign branches of large U.S. weekly-reporting banks.
5. Overseas branches include branches of member banks in U.S. possessions and territories as well as in foreign countries.
6. Branch assets include interbranch balances.

Sources: Treasury Forms B-2 and B-3; Federal Reserve Board.

Proposed Legislative Amendment to Effect the Establishment of Domestic International Banking Facilities of Member Banks

Federal Reserve Act

Section 19(a) of the Federal Reserve Act (12 U.S. Code 461) is amended by adding the following sentence thereto:

> "The Board may by regulation on such basis as it may deem reasonable authorize the creation by member banks of international banking facilities at such locations where such banks are authorized to conduct business within the United States for the purpose of receiving deposits from foreign governments, their agencies, persons conducting business outside the United States, foreign branches of United States business entities, and from individuals not resident in the United States, and for making loans to such foreign persons and entities for use outside the United States and such other purposes concerning foreign banking as may be determined by the Board by regulation, and the Board may by the affirmative vote of not less than four members of the Board exempt from any of the provisions of this section any one or more of the types of deposits authorized to be held by such international banking facility."

Alternatively, the foregoing sentence could, as a technical matter, equally well be added as a new Section 19(k).

July 27, 1977

Mr. Walter B. Wriston
Chairman
Citibank, N.A.
399 Park Avenue
New York, New York 10022

Dear Walter:

7/15/77

Thank you for your letter proposing the establishment of international banking branches in the United States. Several years ago, the Board evaluated a similar proposal. At that time, it concluded that the advantages of such a proposal were outweighed by its negative implications for the control of domestic money and credit. Since then, there have been significant increases in the volume of international loans and deposits both at U.S. offices and at overseas branches of our banks, and our banking system is undergoing important changes. It may, therefore, be appropriate to undertake another evaluation of this proposal.

A useful first step would be to ascertain how other banks now would regard such a proposal, and what they would envision might result from the statutory and other changes you propose. I therefore plan to ask the Federal Advisory Council for its views as we did in early 1974. See 2/1/74

Sincerely yours,

Arthur F. Burns

FOR FILES
S. Connor

RFG/FRD:aw
#1006 N.B.

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July 26, 1977 421.2

Governor Gardner

Messrs. Gemmill, Dahl, Tuttle

Wriston letter on international banking facilities

7/26/77

The attached draft reply is about as forthcoming as we would want to be on this issue at the present time. Among the considerations we have taken into account in framing this reply are the following:

1) While the proposal is described as one that would merely substitute deposits and loans in international banking branches located in the United States for deposits and loans in overseas branches of U.S. banks, it has the potential for substituting for lending and deposit business already occurring at domestic banking offices.

a) Roughly $30 billion of foreign-owned demand and time deposits (including CD's) might become eligible for shifting to the new facilities, should they be established as proposed;

b) U.S. corporations with overseas affiliates might well shift their deposit business from U.S. banking offices by having their foreign branches or subsidiaries conduct the same business (free of regulation) through the newly-created international banking branches.

2) It would be awkward for the Board to endorse a proposal that could remove such a volume of deposits from reserve requirements at a time when the Board is vigorously advocating subjecting foreign banks in the United States to monetary controls.

3) It is not clear that substantial benefits to employment and income in New York (and other cities) would result from the new facility. All the administrative work and bookkeeping for Nassau branches is already taking place in New York. And to the extent that foreign business now being done in New York would be done in the new facilities, New York City and State tax revenues would be reduced.

These issues were raised in the questions submitted by the Board to the Federal Advisory Council in February. (A copy of those questions is attached.) We would propose to revise these questions as needed and then send them to the present members of the FAC.

For your information there is also attached a copy of Governor Mitchell's statement on this question for the FINE study.

Attachment

FRD:dac

D R A F T
RFG/FRD
6-26-77

Mr. Walter B. Wriston, Chairman
Citibank, N.A.
399 Park Avenue
New York, New York 10022

Dear Walter:

Thank you for your letter proposing the establishment of international banking branches in the United States. Several years ago, the Board evaluated a similar proposal. At that time, it concluded that the advantages of such a proposal were outweighed by its negative implications for the control of domestic money and credit. Since then, there have been significant increases in the volume of international loans and deposits both at U.S. offices and at overseas branches of our banks, and out banking system is undergoing important changes. It may, therefore, be appropriate to undertake another evaluation of this proposal.

A useful first step would be to ascertain how other banks now would regard such a proposal, and what they would envision might result from the statutory and other changes you propose. I therefore plan to ask the Federal Advisory Council for its views as we did in early 1974.

Sincerely yours,

Arthur F. Burns

Questions for Federal Advisory Council

Various suggestions have been made from time to time by U.S. bankers that their banks be permitted to conduct international operations out of U.S. offices under rules similar to those that apply to foreign branches. For example, it has been proposed that deposits owned by foreign entities be exempt from reserve requirements, Regulation Q ceilings, and the prohibition of payment of interest on time deposits with maturities under 30 days. The amount of foreign deposits that would be given special treatment would be limited, at the maximum, to the amount of a bank's foreign loans and investments in foreign securities.

The Board would appreciate the Council's views on the following questions:

1. Should such "freeport" facilities for international banking be permitted?

2. What, if any, advantages, corporate and public, would likely ensue if banks engaged in international lending and deposit-gathering had such facilities? Would adoption of the proposal obviate the need for "shell" branches? Would it tend to reduce the amount of business conducted through full service branches in foreign financial centers, perhaps with some substitution of representative offices for such branches?

3. Would the Council expect the use of such facilities to increase the total amount of international business done by U.S. banks? Would deposits in such "freeport" facilities located in the U.S. be more useful to customers than deposits in "shell" branches or foreign branches?

4. Would the Council expect the existence of such facilities to result in a shift of deposits and borrowing of multinational concerns away from domestic deposit and loan accounts and into the freeport facilities? Would such shifts have potential adverse effects on the conduct of domestic monetary policy?

5. Would the existence of "freeports" tend to discriminate against U.S. customers with no foreign subsidiaries?

6. Does the Council believe that the kinds of reports needed for regulatory policing of such "privileged" operations would raise serious compliance problems? Would it be desirable to segregate the privileged activity into a separate subsidiary of the bank, with separate bookkeeping?

7. Would adoption of such a policy lead to a more equitable system of competition for international business between small and large banks? Would it create an undesirable incentive for inexperienced banks to enter the field of international banking?

8. If such facilities were permitted, how might the problem of phasing-in be handled? (Presumably a very substantial amount of foreign deposits would suddenly become eligible for favored treatment, creating at least transitional problems for the conduct of monetary policy.)

all parties and their responsibilities through the maintenance at U.S. head offices of adequate information for examination purposes.

It is proposed in Title VII that U.S. banks should not be allowed to operate in such bank secrecy countries. That proposal does not give sufficient weight to the importance of facilities in these countries to the over-all international operations of the banks in question. Nor does it give enough weight to the evolutionary process of arriving at the proper type of supervision for bank facilities in those countries.

Multinational Cooperation on Bank Supervision

Problems associated with the growth of international banking are common to bank supervisors everywhere. As a result of this experience and events of the past year or so, there is now a far greater awareness of the mutuality of interests among the banking authorities of various countries.

It is well known that under the aegis of the Bank for International Settlements a committee has been set up to serve as a forum for exchanging information and views on problems of bank supervision in the major industrial countries. The Federal Reserve is participating in the work of that committee. Already that committee is proving useful as a means of sharing experiences of dealing with such problems as capital, liquidity, supervision of foreign exchange operations, and so forth. Hopefully, it will serve as part of an international early warning system to alert banking authorities to emerging problems in international banks. It is too early to say how this will all work, but one can be hopeful that this cooperation among banking authorities will lead to better supervision of the international banking system.

The Foreign Window

In principle 2 of Title VII, it is stated that in order to promote competition among banks of different sizes in international financial markets, U.S. banks should be able to establish overseas departments in their domestic offices. These offices would be allowed to engage in the same activities as foreign branches and would not be subject to the restrictions placed on the domestic activities of U.S. banks.

About a year and a half ago, our staff reviewed the possible advantages and disadvantages of establishing at U.S. offices of U.S. banks a new "foreign window", or overseas department, that would be segregated from domestic accounts, and through which U.S. banks could conduct business with foreign customers free of regulations that are applied to domestic banking transactions. Although such foreign windows could provide some cost advantages, and might promote international banking by smaller banks, it was concluded that the regulatory disadvantages outweighed any potential benefits.

A poll of banks taken at the time indicated that foreign windows would not serve as substitutes for full-service branches abroad, and for many banks would not provide significant cost or other operational advantages over "shell" branches abroad. An important consideration in banks' decisions about any substitution of foreign windows for foreign branches would doubtless be the tax status of the window, and on this issue the Committee may want to consider the status of any such window under municipal and State taxes as well as under federal taxes.

Our reservations concerning the window arise mainly because of the scope for misuse of the window to conduct essentially domestic business. U.S. corporations--using foreign subsidiaries as intermediaries--might shift substantial amounts of their domestic U.S. banking transactions to the foreign window to take advantage of the special advantages offered by the window (e.g., higher rates on deposits, reflecting the absence of interest rate limitations and reserve requirements). If the Federal Reserve were unable to control such shifts, there could be a serious weakening of the System's influence over domestic monetary and credit conditions. An extensive and cumbersome system of regulation would thus be needed in order to control the use of any foreign window. The administrative and other costs of establishing such a system of regulation in order to prevent any potential weakening of the System's influence over domestic monetary policy would appear to outweigh any potential benefits.

Discount of Foreign Paper--Principle 5

In order to discuss the ramifications of the proposal to restrict access to the Federal Reserve discount window to borrowings secured by "domestic paper", it would be necessary to understand exactly what is meant to be included within the term "domestic paper" and what considerations led to cc: [illegible]

CITIBANK

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Walter B. Wriston
Chairman

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
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The Honorable Arthur F. Burns
Chairman
Federal Reserve System
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20051

Dear Arthur:

We have been considering ways to help the United States--and specifically New York City--regain position as the financial center of the world. One way which we believe this could be done is to attract back to this country those truly international banking transactions which, because of the adverse impact of domestic Federal regulations and local laws, are currently being booked in various off-shore locations outside the United States.

Attached is a proposal which, through some relatively simple amendments to current laws and the promulgation of appropriate regulations, would provide for the establishment within the United States of International Banking Branches of U.S. banks. With the establishment of these branches, transactions of the type now being booked by American banks outside the United States could instead be booked within the United States.

This is not a wholly novel idea, but one which is, in my judgment, timely. I am enclosing for your consideration and comment a document generally outlining the proposal for the establishment of such International Banking Branches as well as a somewhat more detailed and technical memorandum entitled "A Background Paper on International Dollar Banking by U.S. Banks". I am concurrently sending copies of these documents to Paul A. Volcker, President, Federal Reserve Bank of New York and Governor Hugh L. Carey of New York for their consideration and review.

The Honorable Arthur F. Burns
Page 2
July 15, 1977

If you and your associates believe this proposal has merit, I would be most pleased to cooperate in pushing this proposal forward toward its implementation. Personally, I believe the implementation of such proposals would result in not only strengthening the role of the United States but also, specifically, New York City, as the world's leading financial center.

I look forward to your reaction.

Sincerely,

A Proposal To Establish
International Banking Branches
In The United States

In a time when efforts are being made to revitalize New York's declining economic position, we would like to propose a simple, logical approach to help New York regain its once preeminent role as an international money center -- a monetary free trade zone.

Most people are familiar with the free trade zones that countries set up for imports and exports of goods which are never actually sold in the domestic market. The basic principle is that imports into a free zone are not subject to customs duties if the goods flow back into international trade. If, however, the trade goods leave the free zone and flow into domestic commerce, they would be taxed accordingly.

In our country the zones have a long history and a wide geography. The Foreign Trade Zones Board was established by Congress in 1934 and oversees 19 free zones which extend from the Brooklyn Navy Yard to Honolulu. The zones are designed so that goods which are not intended for sale or use in the United States may be imported, stored, assembled or manufactured by domestic firms and labor without being burdened by United States import duties.

The same principle could be applied to banking operations not involving the domestic markets. If loans and deposits of purely international origin and destination could be transacted free of the regulatory and legislative constraints and taxes designed to apply to domestic operations, they would be maintained and serviced in the United States using domestic bank personnel and expertise. In effect, banks would be allowed to establish specifically designated branches which would deal only in international transactions. The concept already exists in many foreign cities and countries which, as a result, have become international banking centers at the expense of the United States and, more specifically, New York.

In such designated "International Banking Branches", located within the United States, banks could accept non-U.S. deposits free of the burden of non-earnings reserves and interest rate restrictions imposed by Congress and the Federal Reserve and make loans to foreign borrowers. The location of such branches would be subject to existing limitations on interstate banking, i.e. New York banks would be limited to a New York location, Chicago banks to Chicago, etc. There would be no State or City taxes applied to the earnings of these International Branches. There would be no loss of local tax revenues because these operations are not presently conducted in the United States.

Just as in the case of existing free trade zones for goods, in these International Branches the absence of domestic restrictions would apply only to foreign transactions-- deposits from and loans to non-residents. Any financial transactions between the

International Branches and other domestic offices or resident customers would be subject to the same restrictions, regulations, and taxes which presently exist on transactions between United States domestic banks and their foreign branches. Federal and/or State supervisory authorities would authorize and oversee the operations of such International Branches.

Background

While International Banking Branches could be set up anywhere in the United States, New York would particularly benefit because of the size and international scope of New York headquartered banks and the large number of foreign banks already located here. New York has all of the foundations necessary for an international banking center -- excellent world communications and transportation; a vast pool of experienced financial analysts, legal counselors and skilled banking personnel; and available office space. New York was the world's primary banking center until the early 1960s. At that time, balance of payments considerations led the U.S. Government to impose regulations -- Interest Equalization Tax (IET), Voluntary Foreign Credit Restraints (VFCR), Office of Foreign Direct Investment regulations (OFDI) -- which served to stimulate corporate funding outside the United States, motivated banks to set up or expand foreign branches, and spurred the growth of the Eurodollar markets.

During the time the IET, VCR, and OFDI restrictions were in effect London's position as an international banking center had been vastly expanded and several new international financial centers had developed. New York City's preeminence had been seriously eroded not only by London, but by Singapore, Hong Kong, the Bahamas, Cayman Islands, Panama and, more recently, Bahrain. Moreover, in the three years since the removal of United States balance of payments restrictions, foreign international money centers have continued to grow dramatically.

The growth of these overseas financial centers is a logical result of the nature of the Eurodollar business. In global financial transactions, it is not a simple matter to decide where negotiations really take place and thus on which branch locations books a loan shall be entered. If a loan is made to the Brazilian subsidiary of a German company, people may become involved in its negotiation in Brazil, the United States, Germany, and various other places. Claims on people's time and other expenses may well be incurred in half a dozen countries. These loans could be booked in any number of places where a bank has a branch, including New York for New York headquartered institutions; but, because of domestic reserve requirements and restrictions on interest payments, the loans tend to be placed in branches in money centers outside the United States.

When American banks book Eurodollar loans in the United States, the deposits necessary to fund the loans are subject to reserve requirements (these reserves represent a non-earning asset), and Regulation Q which forbids payment of interest on deposits under 30 days. Since foreign banks have access to Eurodollars, are not subject to reserve requirements, and can pay interest on short-term deposits, United States banks have to find ways to remain competitive. This can only be done, under existing Federal Reserve regulations, by establishing a Eurodollar center outside the United States.

Advantages of United States International Banking Branches

The establishment of International Banking Branches in New York City, and elsewhere, free from domestic restrictions, would enable United States banks to conduct much of their international deposit gathering and international lending in a domestic location rather than in offshore booking centers. It would benefit New York City, other major cities in this country, United States banks, the Treasury and the Federal Reserve.

The advantages for New York City could be significant. It would help New York regain its lost prestige in the world financial community not only in banking, but in the investment industry as well. Wall Street, once the foremost securities center, now has only a fraction of the Eurobond underwriting while London has become the center for international bond financing. If international banking returns to New York, at least some portion of the Eurobond underwriting activities should return as well.

The return of the international financial services business should have a significant positive impact on New York City employment both in terms of direct employment and in expanded need for support services; it would help the occupation of underutilized office space; it would attract to New York commercial and industrial users of international banking. In sum, it would generally aid the revitalization of New York City and result in a net increase in tax revenues due to more jobs and more spending by visitors, etc., even though the international banking activity itself would not be taxed.

The proposal would be advantageous to United States banks because it would permit easier, more effective control and audit of operations which are now spread out in many foreign branches. It would result in a reduction of costs for American banks which could be particularly important to medium size banks.

It would also promote international banking by many smaller United States banks which are presently restricted from international banking operations by the high costs and control risks of separate branch operations. The Federal Reserve has tried to accommodate these smaller banks by approving some eighty "shadow branches" in the Bahamas and the Cayman Islands which are not fullfledged branches but have enabled the smaller banks to enter the international market. A domestic location would be a more effective solution.

The establishment of International Banking Branches in the United States would also return more tax revenues to the Treasury. Tax payments which are paid on foreign branch profits to foreign governments are presently offsetting the Federal taxes paid on the same income. Profits of the proposed International Branches would be made in the United States rather than abroad and, therefore, would not be subject to foreign taxation. More taxes would be paid to the Federal Government because the offsets, or credits, would be reduced.

Finally, establishment of these Branches would improve the ability of the Federal supervisory agencies to examine international operations more efficiently and effectively.

Necessary Legislative/Regulatory Changes

The key components for establishing International Banking Branches within the United States are to create a legal/regulatory environment which will preserve for non-residents substantially all of the benefits they now enjoy through the use of off-shore booking centers of American banks and, in addition, extend to such non-residents the economic, political and social stability which has traditionally been associated with the United States.

In order to achieve such a legal/regulatory environment, essentially two steps must be taken:

(1) State and Municipal laws imposing tax and other local risks within the jurisdiction where such International Banking Branches are to be located must be amended so as to be inapplicable to income derived from non-residents dealing with such Branches and

(2) Federal Reserve regulations must be promulgated to remove reserve requirements and interest rate restrictions on all, or substantially all, foreign source deposits made in an International Branch by non-residents dealing with such Branch.

Specifically, the Federal Reserve would have to amend Regulation D to remove reserve requirements on foreign deposits in the International Banking Branches. In addition, the Federal Reserve would have to amend Regulation Q to remove the restriction forbidding the payment of interest on foreign deposits of less than 30 days and to allow market rates of interest to be paid on time deposits held by foreign persons in such International Branches. Part of this requirement is already accomplished. There are presently no rate limits on time deposits held by certain foreign depositors such as foreign governments, foreign monetary authorities, or international financial institutions. However, it would be better to base the exemption for the International Branches on the general foreign character of the depositor, both to free the market and build overall non-resident depositor confidence in this freedom.

The Federal Reserve may already have sufficient regulatory power to remove reserve requirements and interest rate restrictions with respect to all foreign deposits which might be held by International Banking Branches other than those deposits which are literally payable without notice and immediately on "call" or "demand". As a practical matter, the vast preponderance of prospective non-resident depositors utilizing International Branches would probably be willing to deposit funds subject to some, albeit very short, notice period (e.g. one, two or three days) in order to avoid foreign "country risk".

If, however, the Federal Reserve felt it necessary or advisable it would, of course, seek Congressional authorization to remove reserve requirements and interest rate restrictions with respect to all non-resident deposits which might be held in International Banking Branches. Such Congressional authorization could take the form of a relatively simple amendment to Sec. 19 of the Federal Reserve Act.

In the past, concern has been expressed over potential for misuse, a weakening of monetary policy control, and the need for new and elaborate regulatory apparatus if existing regulations and restrictions were removed on international transactions and International Banking Branches authorized. The adequacy of existing regulatory controls and available evidence on the limited impact of the already large foreign dollar market on U.S. monetary control indicate those concerns are overstated. Simply stated, United States International Banking Branches would not create new opportunities for misuse; they would allow American banks to conduct the same international operations in the United States that they presently conduct in off-shore locations. It makes little sense to define reserve requirements and interest rate limitations in such a way that international dollar banking cannot be conducted in the home country of the dollar.

If the Federal Reserve were to open the way for the establishment of designated International Banking Branches pursuant to Federal Reserve Act amendments and/or new regulations, then it would be necessary for New York State and City (if this is where the Branches were to be located) to eliminate an excessive tax burden in order to make New York an attractive site for these Branches. This represents no revenue loss to the local taxing authorities as these activities are not now taking place in the United States. The level of New York taxes, combined with Federal taxes, remains an obstacle in attracting international banking. Federal, State and City income taxes on New York banking operations are now 62.3%, a level far above London at 52%. Even with a 52% rate, in the past few years London has been losing its relative share of international banking to lower-taxed centers.

In addition, New York State should: a) remove its reserve requirements on State chartered non-member banks that wish to establish similar International Branches (in line with the Federal Reserve's move for its members), and b) change the New York State escheat law, better known as the Abandoned Property Law, to exclude non-resident owned deposits or at least to lengthen the period to a more reasonable 15 to 20 years. This law now requires inactive deposits to be turned over to the State after five years.

Conclusion

The United States is the most attractive country in the world from the point of view of economic, political and business stability. It is a natural locus of international finance. However, the impact of reserve requirements and interest rate ceilings coupled with exposure to local tax and simlar laws tends to deter non-residents from making deposits in the domestic branches of U.S. banks. Were these deterrents eliminated, such non-residents could effectively obtain all of the benefits and protection which they now enjoy by utilizing foreign branches of United States banks and still, at the same time, avoid the sovereign risks implicit in foreign laws and regulations.

No overriding policy requires that reserve requirements and interest rate limitations imposed for domestic reasons be so structured that United States banks are caused to carry on international banking primarily through foreign branches and that medium and smaller banks, unable to justify foreign branches, be largely excluded from receiving deposits from and making loans to non-residents. This largely accidental effect of the present structure of regulation has penalized United States cities by excluding them from developing international banking with its advantages in employment, economic activity, and creation of competitive knowledge resources, and served to create vigorous dollar banking centers in foreign cities. It has increased the difficulties of inspection by United States regulatory agencies and raised the costs and risks for United States banks.

With all the natural competitive advantages that the United States offers, efforts should be made immediately to remove the legislative/regulatory obstacles so that the United States can once again become the international financial center of the world.

New York, as the major financial center of the United States, has much to gain in seeing this proposal implemented. By encouraging Federal Reserve action and being prepared to implement the required changes in State and City tax regulations, the City can move to reestablish its reputation as <u>the</u> leading international financial center.

Citibank
July 13, 1977

APPENDIX I

Proposed New York Legislative Amendments for a Domestic International Banking Zone in New York City

Taxes on Banking Corporations
A. New York State

The statutory provision dealing with allocation of a bank's net income to branches outside New York, thus removing this income from taxation by New York, is very brief (New York Tax Law, Article 32)

> "§1454. Allocation of Entire Net Income
>
> If the taxpayer's entire net income is derived from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be allocated under rules and regulations prescribed by the tax commission."

If the income attributable to the proposed New York City international banking facilities is to be excluded from taxation by New York State, the following sentence should be added to that section:

> "For the purposes of this section a segregated international banking facility maintained within the state for the purpose of receiving deposits from non-residents of the United States and making loans to non-residents of the United States shall be deemed to be business carried on without the state and the portion of entire net income allocated to such facility under rules and regulations prescribed by the tax commission shall not be treated as derived from business carried on within the state."

B. New York City

The provision in New York City law imposing taxes on banking institutions (New York City Administrative Code, Title R, Part III, Subject 4) which deals with the allocation of net income (§R46-37.4) is identical to §1454 of the New York State tax law. Therefore a similar amendment would accomplish the same result:

"For purposes of this section a segregated international banking facility maintained within the city for the purpose of receiving deposits from non-residents of the United States and making loans to non-residents of the United States shall be deemed to be business carried on without the city and the portion of entire net income allocated to such facility under rules and regulations prescribed by the finance administrator shall not be treated as derived from business carried on within the city."

This amendment must be enacted by the New York City Council. No change is required in the New York State Enabling Act under which the City is authorized to tax banks (L.1966, Ch. 772, §1), so long as the amendment to Article 32 (§1454, above) is first enacted.

Abandoned Property

At present New York State has an extraordinarily short escheat period for unclaimed property held or owned by banking organizations - five years - which may inhibit the placing of deposits by non-residents. The solution lies in either extending this period to the former (prior to 1976) ten years for deposits or providing that deposits payable only at an international banking facility as defined would fall within the present exemption for deposits payable only at foreign branches. In view of the fact that a general lengthening of the period would delay revenue, just as the 1976 amendment, as intended, accelerated state revenue, the exemption method would be preferable.

Abandoned Property Law

"300(a)...exception (iv) any such amount payable only at or by a branch office located in a foreign country, or at or by a segregated international banking facility maintained and operated in New York for the purpose of receiving foreign deposits and making foreign loans, or payable in currency other than United States currency, or"

July 13, 1977

A Background Paper On
International Dollar Banking By U.S. Banks

The Size of Off-Shore Banking

Latest data show that, as of December, 1975, 97 national banks operated 674 branches outside the United States, and 29 State member banks operated 88 such foreign branches.[1] Over 34 percent of these branches, or 265 in total, were located in "off-shore" centers for international dollar banking such as the Bahamas, Cayman Islands, Bahrain, Panama, Singapore, and the United Kingdom.[2] As of December, 1976, member bank branches in the U.K., Bahamas, and the Cayman Islands, held $125 billion in U.S. dollar assets out of a total of $167 billion in U.S. dollar assets of all foreign branches, or just under 75 percent of foreign branch dollar assets.[3] In contrast, U.S. offices of all banks in the U.S. held at end December, 1976, $78 billion of dollar claims on foreigners, of which $32 billion were claims other than loans, mostly claims on foreign branches and agencies of those U.S. banks.[4] Why should foreign branches of member banks hold U.S. dollar assets equal to more than double the total of dollar claims on foreigners of all U.S. banks?

How Did This Come About?

It is clear that the tremendous growth of foreign branch dollar banking was caused in large part by, and coincided with, implementation of the various parts of the U.S. balance of payments programs from 1963 to 1973. The Interest Equalization Tax, the Federal Reserve Voluntary Foreign Credit Restraint program, and the Office of Foreign Direct Investment regulation combined to discourage and partially prohibit persons within the United States from lending to persons outside the United States and from investing domestic source funds abroad, while at the same time encouraging the development of funds gathering capability abroad, particularly the creation of foreign banking branches. On April 30, 1976, former Federal Reserve Board Governor Andrew F. Brimmer presented to a conference on "New York: World Financial Center" at the Waldorf Astoria, a comprehensive view of the growth of foreign branches of U.S. banks, both during the period of the balance of payments program prior to early 1974, and in the two years following the termination of the program. Table I of former Governor Brimmer's presentation (attached) summarized the history of growth of foreign branches in relation to credit extended to foreigners by U.S. offices from 1960 to end 1975. Up to 1966 credits to foreigners by U.S. branches were greater than the assets of foreign branches. Starting in 1966 foreign branch assets grew precipitously until the relationships were reached described at the beginning of this paper. And the proportional importance of foreign branches has continued to grow even after termination of the balance of payments programs at end 1973. Governor Brimmer reported:

> "At the end of last December, U.S. commercial banks had $29.5 billion of loans to foreigners outstanding on the books of their head offices. At the same time, their foreign branches had total assets of $165.0 billion. Of this total of $194.5 billion, the head offices held 15 percent, and the remainder was held

by the branches. In contrast, in 1973 (prior to the termination of restraints on bank lending abroad from their head offices), the head offices in the United States held 13 percent of the combined foreign assets, and the branches held the remainder. So, partly in response to capital constraints imposed by the Federal Government, American banks had come to rely primarily on their foreign branches as vehicles through which to conduct the bulk of their international lending activities. This is still the case today."

Why Off-Shore Banking Today?

To understand this phenomenon it is necessary to realize that while the balance of payments programs was the primary impetus for U.S. banks to move international dollar banking to foreign branches, other factors sustain this movement today. These factors are 1) freedom from deposit reserve requirements in foreign centers, and 2) freedom in those foreign centers to pay market rates of interest on demand and time deposits. While taxes on bank branch profits are also sometimes mentioned as incentives to carry on dollar banking in foriegn branches, this is true only to a very limited extent, as will be discussed below. If these two competitive advantages offered by foreign dollar centers were also available in U.S. centers it is fairly certain that a large part of foreign branch dollar banking would be returned to domestic offices. Are there any sound policy reasons for the U.S. to continue to create competitive advantages for dollar banking in foreign centers to the detriment of U.S. cities?

The response to this question may rest either on inquiry into the need for deposit reserves and restrictions on deposit interest payment in general, or on inquiry into the appropriateness and administrative feasibility of removing foreign-source, or international deposits held in domestic offices from the constraints of deposit reserves and limitations on interest payments.

Deposit Reserves and Limitations on Interest Applied to Deposits From Foreigners in Domestic Banking Offices.

While some economists argue that reserve requirements have relatively little value as a monetary policy mechanism, it is not the purpose of this paper to deal with that issue. We will assume, for purposes of this presentation, that deposit reserves and limitations on deposit interest will continue as instruments of monetary management of the domestic economy. Therefore, in order to respond to the basic question, it is necessary to examine whether such requirements should be applied to deposits held in domestic banking offices by foreign persons and entities.

Under present regulation, dollar funds held by foreigners can be deposited in domestic banking offices at rates competitive with free Euromarket rates only if the size and term of the deposit is such that it is free from limitations on interest payments, and the market power of the depositor is such that the bank can be persuaded to absorb the cost of required reserves. Thus, it can be assumed that the great bulk of dollar funds held by non-residents of the United States will be deposited in foreign branches of U.S. banks or in foreign banks outside the United States. These foreign held dollar funds, placed in banks abroad, can exercise an influence on domestic monetary kets only through the following banking channels; A) advan... in any form by ign branches of U.S. banks to their domestic offices; B) extensions of credit uch foreign branches to domestic borrowers for use in the U.S.; C) advances oreign banks to their domestic offices; and D) extensions of credit by foreign s to domestic borrowers for use in the United States. The Federal Reserve rd has controlled channels A) and B), where it has imposed reserves based on ances or extensions of credit by member banks' foreign branches. However, ms by foreign branches on U.S. persons, other than their domestic offices, e been very small, as a percentage of their assets. From 1973 to end 1976 the l has never exceeded 2.6% of total uses of foreign branch funds, and the amounts e been more than offset by the liabilities of these branches to U.S. depositors.[5] ddition, advances by foreign branches to their domestic offices have been atively unimportant.

ce 1973 they have never exceeded 3.3% of total foreign branch fund uses, and ce December, 1974, have been offset by advances by the U.S. offices to foreign nches.[6] Even in 1969, prior to imposition of the Reg. M reserves, the total ances by foreign branches to domestic offices, in the face of severe restraints U.S. money markets, represented only 31% of the assets of foreign branches, or re significantly only 2.4% of the total assets of all U.S. commercial banks.[7]

s difficult to assess the total amount of U.S. dollar funds held by foreign banks, opposed to foreign branches of U.S. banks, because statistics are either not npiled in various centers on different bases. For London, however, statistics olished by the Bank of England do permit some estimates. As of December 31, 75, for example, total U.S. currency liabilities of U.K. banks were about $104 lion, while those of branches of U.S. banks in the U.K. were about $58 billion. the other side total U.S. currency assets of U.K. banks at that date were $97 lion, and those of U.S. bank branches there were $57 billion. Thus, non-U.S. nks in the U.K. held sizeable totals of U.S. dollar liabilities and assets although e larger part of the totals for all U.K. banks were those of branches of U.S. banks. iese dollar operations of foreign banks outside the United States are not subject, ther actually or potentially, to control by U.S. authorities. At the same time, the nk of England data indicate that only a small part of these U.S. currency liabilities d assets of U.K. banks were to U.S. persons (9.4%) or due from U.S. persons .9%).[8] Thus, given both the substantial U.S. dollar operations of foreign banks d the small portion of these operations which involve transactions with persons in e United States, it is at least questionable whether the present program under eg. M is necessary or appropriate.

loreover, available evidence suggests that conditions in the "uncontrolled" foreign ollar markets are, in fact, dictated by conditions in the U.S. markets. Eurodollar iterest rates move in a quite close relationship with U.S. domestic interest rates, nd even the fluctuations in the growth of the Eurodollar market appear to be preictably related to the growth in U.S. monetary aggregates, notably the monetary ase. Thus there is much stronger influence running from the U.S. economy to ie foreign dollar centers than in the opposite direction. The imposition of Regulation M reserve requirements in order to strengthen the Federal Reserve's control over U.S. monetary conditions, therefore, may be unnecessary.

But if there is a need to apply reserve requirements in order to isolate foreign dollar markets from domestic markets, there is no convincing reason to do this in a way which encourages U.S. banks to carry on their dollar operations with non-residents primarily in foreign locations. U.S. banks could be permitted to create international banking facilities at domestic locations for the receipt of deposits from non-residents and the making of loans to non-residents just as they do today in foreign branches. There is no reason why the regulation of such facilities to control their effect on domestic markets should be more difficult or burdensome than the regulation of foreign branches. In fact, the location of such facilities in domestic cities would make the task of supervision easier than is the case with widespread foreign branches.

If such controls were needed, essential to their implementation would be 1) a definition of such domestic international facilities, 2) definitions of those deposits which such facility would be empowered to accept, free of reserve requirements and restrictions on interest payments, and 3) provisions for reserve requirements to apply where such a facility makes funds available to other domestic offices (such domestic offices could be required to maintain ordinary reserves on such funds received from the facility) of the bank or to domestic borrowers for use in the United States. While the Federal Reserve Board has, through former Governor George Mitchell, taken the position that these regulations would, of necessity, be costly and burdensome [9] this does not appear to be the case.

If the domestic international banking facility were required to keep separate books of account, and be maintained as a separate unit, just as if it were a foreign branch, limited to certain categories of transactions (receipt of despoits from "non-residents" and making loans to "non-residents") its regulation should be no more difficult or costly than is the regulation of Edge Act corporations.

A definition of non-residents is already contained in the pertinent provisions of Reg. M. (These provisions (s213.7 of Reg. M) still reflect the OFDI requirements and, if continued, are in need of revision.) The term "non-residents" should be so adapted so as to include domestic international banking facilities of other banks so that an inter-bank international market in non-resident source funds could develop.

The Federal Reserve may already have current regulatory power to remove reserve requirements and interest rate restrictions with respect to all foreign deposits which might be held by domestic international banking facilities other than those deposits which are literally payable without notice and immediately on "call" or "demand". As a practical matter, the vast preponderance of prospective non-resident depositors utilizing such facilities would probably be willing to deposit funds subject to some, albeit very short, notice period (e.g. one, two or three days) in order to avoid foreign "country risk". Nevertheless, should the Federal Reserve deem it appropriate, it could seek specific legislative authorization from Congress to remove reserve requirements and interest rate restrictions with respect to such non-resident deposits as might be held in domestic international banking facilities. Such Congressional authorization could take the form of a relatively simple amendment to Sec. 19 of the Federal Reserve Act. (See the attached text of a possible amendment to Sec. 19.)

9.

Taxation

Congress took a major step towards attracting non-resident deposits to United States banks by making the exemption from withholding taxes applicable to interest on bank deposits a permanent part of the Internal Revenue Code in 1976, although the expected transfer of foreign held deposits from off-shore centers to U.S. offices will not be realized unless other impediments to domestic deposits are removed.

On the level of taxation of bank profits, rather than on depositors, it is commonly thought that the lack of local income taxes, or low rates of such taxes, in some off-shore centers is an incentive to carry on international banking in those centers rather than at domestic U.S. locations. As far as the federal income tax is concerned, this is not the case. A U.S. bank is subject to federal tax on its world-wide income, whether this is earned in domestic locations or foreign branches, and it may credit foreign income taxes which it pays against its liability for federal tax, but not more than that proportion of the federal tax which equals the proportion of the bank's total taxable income which is from foreign sources. Thus the bank's tax burden, foreign and federal, will be at least 48 percent of foreign income and will exceed 48 percent only if foreign source income is subject to foreign taxes in excess of 48 percent. Income earned in a low-tax foreign center is subject to the same federal tax as is income earned in a domestic branch.

Many off-shore centers, London (52 percent), Bahrain (20 percent), Singapore (10 percent) levy income taxes. To the extent that income earned in branches in these centers were earned instead in domestic locations, more taxes would be paid to the federal treasury because creditable foreign taxes would be reduced.

Many loans to foreign borrowers are subject to withholding taxes levied at the source on interest, in addition to the income taxes assessed on foreign branches where these loans are made. As between foreign banking centers, the lower taxed centers are more attractive because the total foreign tax burden on such loans is thereby reduced and the risk is diminished that the total amount of such foreign taxes may exceed the maximum credit permitted. If loans to foreign borrowers were made from domestic offices the same effect would be achieved as making such loans from lower taxed foreign centers since one layer of foreign tax would be eliminated. Thus, except for state and local taxes, domestic locations can compete on the tax level with no-tax or low-tax foreign centers in attracting foreign loans out of higher-taxed foreign centers.

State and local taxes on branch operations do represent an obstacle to location of operations which are carried on in foreign centers, because these taxes are not creditable against the federal tax, but are deductible. Due to reserve requirements and limitations on interest payments, however, domestic locations do not at present attract international operations, and there is some hope that states may eliminate profits taxes on international operations or reduce the burden in order to gain such international operations and the additional employment, expertise and economic benefits which international banking could bring. This is especially true of states with cities equipped to be international centers of considerable size.

Conclusion

No overriding policy requires that reserve requirements and interest rate limitations imposed for domestic reasons be so structured that U.S. banks are caused to carry on international banking primarily, if not exclusively, through foreign branches, and that midsize and smaller banks, unable to justify foreign branches, are largely excluded from receiving deposits from and making loans to non-residents. This largely accidental effect of the present structure of regulation has penalized United States cities by excluding them from developing international banking with its advantages in employment, economic activity, and creation of competitive knowledge resources, and by creating vigorous dollar banking centers in foreign cities. The disadvantages of this regulatory structure include also increased difficultities and costs of examination by U.S. regulatory agencies and greater costs and risks for U.S. banks. Therefore, amendment of the applicable laws and regulations to permit U.S. banks to carry on international banking in the United States, and to permit many banks unable to maintain foreign branches to compete in this business with larger banks, is warranted now.

Citibank
July 13, 1977

4

NOTES

1) 62nd Annual Report, 1975, Board of Governors of the Federal Reserve System, pp. 303-4.

2) Ibid, table, p. 304

3) Federal Reserve Bulletin, March, 1977, p. A62.

4) Ibid, p. A61, Tables 3.19, 3.20

5) Federal Reserve Bulletin, April, 1977, pp. A62-A63.

6) Ibid.

7) See table I, presented by Mr. Brimmer, attached.

8) Federal Reserve Bulletin, January, 1977, pp. A62-A63; Bank of England Quarterly Report, Vol. 16, September, 1976, Table 21. These data also show that, from December, 1975, to June, 1976, non-U.S. banks in the U.K. used only ten percent of their dollar resources to acquire claims on the U.S., even though the amounts of those U.S. claims exceeded those of U.S. bank branches in the U.K. During the period, the amount of all U.K. banks' liabilities to U.S. persons exceeded the amount of their claims on U.S. persons.

9) Financial Institutions and the Nation's Economy "Discussion Principles". Hearings before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House of Representatives, December 11, 12, 16, and 17, 1975, Statement of Hon. George W. Mitchell, at pp. 1035-6, Vol. 2

TABLE 1

International Operations of U.S. Banks: Selected Indicators, 1960-1975
(Monetary Magnitudes are in Billions of Dollars)

CATEGORY	1960	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
I. U.S. Offices[1]													
Bank Credit to Foreigners[2]	$4.2	9.4	9.7	9.6	9.8	9.2	9.3	9.7	12.1	13.4	17.2	29.0	29.5
Foreign Deposits[2,3] (other than Due to Foreign Branches)	$9.1	13.4	13.6	12.6	14.4	14.7	16.5	16.5	17.1	17.4	21.8	24.2	24.1
Due to Foreign Branches[4]	$--	1.2	1.3	4.0	4.2	6.0	12.8	7.7	0.9	1.4	2.5	4.5	4.1
II. Overseas Branches of Banks[5]													
Number of Banks with Overseas Branches	8	11	13	13	15	26	53	79	91	108	125	125	126
Number of Overseas Branches	131	181	211	244	295	375	459	536	583	627	699	732	762
Assets of Overseas Branches[6]	$3.5	6.9	9.1	12.4	15.7	23.0	41.1	52.6	67.1	77.4	118.0	151.9	165.0
III. Edge and Agreement Corporations													
Number	15	38	42	49	53	63	71	77	85	92	104	114	116
Assets	$N.A.	0.9	1.0	1.4	1.5	2.5	3.5	4.6	5.5	6.0	6.9	10.1	NA
MEMORANDUM:													
All Insured Commercial Banks in U.S.													
Total Assets	$255.7	343.9	374.1	401.4	448.9	498.1	527.6	576.2	640.3	732.5	827.1	906.3	912.0_S
Total Deposits	228.4	305.1	330.3	351.4	394.1	432.7	434.1	480.9	537.9	612.8	677.4	741.7	741.8_S

NOTE: N.A. Not Available. Data are for end of year, except subscript S - September, 1975.
p.e. Partly Estimated.

1. All data for U.S. offices are on a balance of payments basis.
2. Bank credit to foreigners and foreign deposits relate to all commercial banks reporting on the Treasury foreign exchange forms, and include credits and deposits of branches and agencies of foreign banks as well as U.S. banks. Bank credit includes short- and long-term loans and acceptance credits denominated in dollars; for 1960, some other short- and long-term claims are also included. Data for 1972 through 1974 do not include claims on U.S. banks or their foreign branches or claims of U.S. agencies and branches of foreign banks on their head offices.
3. Foreign deposits include demand and time deposits of one-year or less maturity, and beginning in 1964, include negotiable certificates of deposit issued to foreigners and international institutions.
4. Due to branches refers to the gross liabilities due to foreign branches of large U.S. weekly-reporting banks.
5. Overseas branches include branches of member banks in U.S. possessions and territories as well as in foreign countries.
6. Branch assets include interbranch balances.

Sources: Treasury Forms B-2 and B-3; Federal Reserve Board.

Proposed Legislative Amendment to Effect the Establishment of Domestic International Banking Facilities of Member Banks

Federal Reserve Act

Section 19(a) of the Federal Reserve Act (12 U.S. Code 461) is amended by adding the following sentence thereto:

> "The Board may by regulation on such basis as it may deem reasonable authorize the creation by member banks of international banking facilities at such locations where such banks are authorized to conduct business within the United States for the purpose of receiving deposits from foreign governments, their agencies, persons conducting business outside the United States, foreign branches of United States business entities, and from individuals not resident in the United States, and for making loans to such foreign persons and entities for use outside the United States and such other purposes concerning foreign banking as may be determined by the Board by regulation, and the Board may by the affirmative vote of not less than four members of the Board exempt from any of the provisions of this section any one or more of the types of deposits authorized to be held by such international banking facility."

Alternatively, the foregoing sentence could, as a technical matter, equally well be added as a new Section 19(k).