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The Edge Act: Will Recent Changes Give Banks with Interstate Subsidiaries an Edge in Domestic as Well as International Banking

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The Edge Act: Will Recent Changes Give Banks with Interstate Subsidiaries an Edge in Domestic As Well As International Banking?

The Edge Act international banking subsidiary (EAS) is a unique form of banking organization. By establishing an EAS a parent bank is able to open a deposit-taking branch in another state, provided the branch engages solely in international business. There exist no other direct methods by which a parent may establish such an interstate presence. Although first created by Congress in 1919, the Edge Act subsidiary, a federally chartered banking organization, has enjoyed considerable attention only in recent years. In the past decade major and regional banks alike have established many new Edge Act offices, mostly in trading centers,[1] across the country. This note proposes to take a closer look at the EAS phenomenon, in particular to examine the structure and permissible activities of an Edge Act subsidiary and to review some recent changes in the Edge Act itself. Finally, the motivations and expectations of some banks which have elected to expand their international operations by investing in an EAS will be explored.

I. Legislative and Regulatory History

A. Evolution of the Edge Act

By the time Congress formulated and passed the Federal Reserve Act of 1913,[2] the United States was on the verge of assuming an important if not dominant position in international trade.[3] Perhaps recogniz-

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[1] For general information on the Edge Act subsidiary trend over the past ten or so years, *see The Barriers Are Falling Fast*, FORBES, July 1, 1976, at 50-52; Leff, *The Edge Act—A Case for Joint Ventures*, 123 THE BANKER 1043 (1973).

[2] 12 U.S.C. §§ 221 *et seq.* (1976).

[3] In the words of one commentator:

> Soon after the outbreak of the [First] World War, the belligerent nations of Europe began borrowing in the United States to help finance their purchases of war materials. They borrowed from American bankers and the American public until the United States declared war, April 6, 1917. Thereafter they obtained funds directly from the United States government, until government lending practically came to an end in 1920. By 1919 American financing of foreign borrowers was back in the hands of private agencies, but it was 1921 before any great volume of lending developed.

C. LEWIS, AMERICA'S STAKE IN INTERNATIONAL INVESTMENTS 351 (1938). At the same time, "by 1920 exports (from the United States) had increased twentyfold and imports had increased

ing the promising international potential of U.S. business, as well as the need to support trade expansion with a complementary growth in international banking and financial services, Congress included section 25 of the Act which authorized qualified U.S. banks to establish foreign branches.[4]

Within three years of passing the Federal Reserve Act, Congress amended section 25 to enable smaller banks to cooperate and establish a domestic, jointly owned banking subsidiary in any state of the United States; this subsidiary could in turn own or control stock in a financial institution organized under the laws of a foreign country or undertake directly to meet international business' commercial banking needs. More specifically, the 1916 amendment[5] provided that any national bank possessing surplus and capital in excess of $1,000,000 could invest up to ten percent of its paid-in capital and surplus in a domestic subsidiary principally engaged in international banking. Furthermore,

> Before any national bank shall be permitted to purchase stock in any such corporation the said corporation shall enter into an *agreement* or undertaking with the Board of Governors of the Federal Reserve System to restrict its operations or conduct its business in such a manner or under such limitations and restrictions as the said board may prescribe . . . .[6]

Banking subsidiaries established under the amendment's provisions, founded primarily in order to hold stock in foreign financial ventures, came to be known as "agreement" corporations.[7]

By 1919, however, it became clear to many that some type of federal sponsorship was needed to encourage the formation of more international banking corporations. In response, Senator Walter Edge of New Jersey proposed yet another change in section 25 of the Federal Reserve Act. The Edge amendment passed on December 24, 1919 and authorized the Board of Governors of the Federal Reserve to charter corporations "for the purpose of engaging in international or foreign banking . . . either directly or through the agency, ownership or control of local institutions in foreign countries . . . ."[8]

The Edge Act, as it became known, made international banking subsidiaries far more accessible to U.S. banks. Henceforth, bankers did not need to employ state law to organize new international banking subsidiaries; such subsidiaries could be chartered under federal law in any state of the United States. In addition, Edge corporations could conduct international banking not only through stock ownership in a foreign financial institution. A federally chartered Edge Act subsidiary could

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fourteen times over the past sixty years." *See* J. BAKER & M. BRADFORD, AMERICAN BANKS ABROAD, EDGE ACT COMPANIES AND MULTINATIONAL BANKING 20 (1974).

[4] 12 U.S.C. § 601 (1976).

[5] *Id.* §§ 601-604.

[6] *Id.* § 603.

[7] J. BAKER & M. BRADFORD, *supra* note 3, at 26.

[8] 12 U.S.C. § 611 (1976). The amendment can be found at *id.* §§ 611-631.

also engage directly in commercial banking activities of an international character.[9]

On the other hand, the amendment embodied in section 25(a) also specified several limitations on the organization and operation of the EAS. Most importantly, the word "principally" contained in section 601 was missing in section 611 of the new amendment.[10] This suggested that the new EAS could not just participate "principally" in international banking; it had to be *solely* engaged in international banking. Other restrictions included a requirement that the EAS be capitalized at a minimum level of $2,000,000[11] and that only U.S. nationals or corporations with U.S. shareholders in the majority[12] control the EAS. Finally, instead of relying on "agreement" with the Federal Reserve to limit the activities of an EAS, Congress, by providing for organization under federal charter only with the approval of the Federal Reserve, established the means for closer control of the direction and day to day activities of Edge international banking subsidiaries.[13]

B. Regulation K: The Federal Reserve's Rules Governing the EAS

Under mandate of the Edge Act, the Federal Reserve issued Regulation K in 1920. Its provisions further delineated what services an EAS could and could not render to its customers and to its parent. Like the evolution of section 25(a), Regulation K too has undergone some major changes over the years. The original 1920 version failed to distinguish between the EAS's direct participation in international banking as opposed to activities conducted "through the agency, ownership or control of local institutions in foreign countries."[14] Therefore, any EAS could offer its customers normal international commercial banking services[15] as well as hold investments in foreign financial institutions.

The Federal Reserve severely limited the scope of operation of EASes in 1957 when it "drew a sharp line between commercial banking corporations created under the Act, which could take deposits and accept drafts connected with international business, and investment banking corporations which were permitted . . . to invest in foreign banking

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[9] *Id.* §§ 611, 615. Among the activities § 615 authorizes the Edge subsidiary to engage in are documentary business, international lending and deposit solicitation. *See* Section II *infra* for a discussion which explicates the limitations on these activities.

[10] *Id.* §§ 601, 611. By way of clarification, paragraph three of § 601 speaks of corporations "principally engaged in international or foreign banking." In contrast, paragraph one of § 611 refers to only "corporations to be organized for the purpose of engaging in international or foreign banking." *See* Brunsden, *The Edge Act in U.S. Banking*, 123 THE BANKER 143, 144 (1973).

[11] 12 U.S.C. § 618 (1976).

[12] *Id.* § 619.

[13] *Id.* § 615.

[14] *Id.* § 611.

[15] *See* discussion in text *infra* for what is included in the term "international commercial banking."

companies."[16] Because of the 1957 revision, a single Edge Act subsidiary could no longer engage in both international commercial banking and investment activities.

The election the 1957 version of Regulation K compelled each EAS to make was shortlived, however. In 1963 the Federal Reserve changed Regulation K once again to permit all EASes to operate as both international commercial banks and investors. Nevertheless in practice the Federal Reserve continued to distinguish between the banking and investment activities of the EAS. Accordingly, if an EAS's aggregate demand deposits and acceptance liabilities exceeded its gross capital and surplus, the EAS was deemed "to be engaged in banking" and was limited to lending no more than ten percent of its capital and surplus to any one borrower.[17] On the other hand, the EAS not "engaged in banking" under the test just outlined, could lend up to a level of fifty percent of its capital and surplus to any single borrower.[18]

In 1969[19] a new version of Regulation K authorized an EAS to establish its own foreign subsidiaries or branches[20] and also to participate directly in international banking activities.[21] Furthermore, the Federal Reserve renewed its general permission to allow an EAS to invest up to $500,000 or acquire up to twenty-five percent control in a foreign financial institution not doing business in the United States.[22] The 1969 version retained the different ceilings on the permissible levels of loans to a single borrower, depending on whether the EAS were primarily engaged in banking or investment.[23] Similarly, total liabilities of the EAS at any one time were limited to ten times the EAS's net worth, unless special permission was granted by the Federal Reserve.[24] As of this writing, Congress has ordered the Federal Reserve to conduct a review and to revise Regulation K, the details of which will be explored in Section III.

II. Current Legislative and Regulatory Provisions Governing the Organization and Operation of an EAS[25]

Any national banking association may apply to the Federal Reserve for permission to establish an EAS.[26] The application form must be pro-

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[16] Brunsden, *supra* note 10, at 146.

[17] Whether this restriction will survive the upcoming review of Regulation K is uncertain. *See* Section III *infra* for more details.

[18] *Id.*

[19] 12 C.F.R. § 211 (1978).

[20] *Id.* § 211.6. Of course, such plans were subject to the approval of the Federal Reserve.

[21] *Id.* § 211.1(2).

[22] *Id.* § 211.8(a).

[23] *Id.* § 211.9(b).

[24] *Id.* § 211.9(c).

[25] Section III *infra* outlines what changes the International Banking Act of 1978 has made in the Edge Act. The framework outlined here will probably still be applicable to the formation and operation of an EAS, however. Changes appear to focus on such things as what parties may organize an EAS and at what levels the EAS may incur liabilities.

[26] In theory, a party need not be a national bank with sizable capital and surplus to

cured in the district where the proposed subsidiary is to be located.[27] The investment by the parent may not exceed ten percent of its paid-in capital and surplus.[28] Furthermore, the EAS may be organized as a wholly or jointly owned venture.[29] Before any EAS may proceed to organize and do business, the Federal Reserve bank in its district must issue a preliminary permit approving the name,[30] articles of association, organizational certificate and proposed capitalization of the EAS.[31] After procuring this permit, the promoters of the EAS may complete its organization and seek a final permit in order to begin to do business.[32]

Once the Federal Reserve has authorized an EAS to do business, section 25(a) of the Federal Reserve Act provides that it may engage in the following types of banking activities:

> (a) To purchase, sell, discount, and negotiate, with or without its endorsement or guaranty, notes drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness; to purchase and sell, with or without its endorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided; to accept bills or drafts drawn upon it subject to such limitations and restrictions as the Board of Governors of the Federal Reserve System may impose; to issue letters of credit; to purchase and sell coin, bullion, and exchange; to borrow and to lend money; to issue debentures, bonds, and promissory notes under such general conditions as to security and such limitations as the Board of Governors of the Federal Reserve System may prescribe . . . ; to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to or for the

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participate in an EAS. 12 U.S.C. § 611 (1976) provides that an EAS "may be formed by any number of natural persons, not less in any case than five." Furthermore, 12 U.S.C. § 613 (1976) stipulates that the organization certificate should be made "to enable the persons subscribing to the same, and all other *persons, firms, companies* and *corporations*, who or which may thereafter subscribe to or purchase shares of the corporate stock of such corporation, to avail themselves of the advantage of this section." (emphasis added) No other section of the Edge Act or Regulation K contains any further specification about who may own stock in an EAS. In practice, however, all Edge Act subsidiaries are owned by banking institutions. S. REP. NO. 1073, 95th Cong., 2nd Sess. 5 (1978), *reprinted in* [1978] 9 U.S. CODE CONG. & AD. NEWS 2831. Whether this is due to Federal Reserve design, *i.e.*, that no application to form an EAS by a non-banking concern has ever been approved by the Fed, or because a non-banking concern has never applied to the Federal Reserve to form an EAS is unclear. The practice may have come about because of tradition; agreement corporations, which preceded EASes were only available to national banking corporations possessing capital and surplus of $1,000,000. 12 U.S.C. § 601 (1976).

[27] 12 C.F.R. 211.3(a) n.1 (1978).

[28] 12 U.S.C. § 601 (1976).

[29] Despite the fact that any EAS may be jointly owned, there is only one joint venture EAS in existence at this time, the Allied International Bank in New York, which is owned by more than twenty member banks. Other banks apparently prefer to establish and wholly own their EASes. *See* J. BAKER & M. BRADFORD, *supra* note 3, at 74. Updated information was obtained in personal interviews.

[30] 12 C.F.R. § 211.3(a) (1978). This section also stipulates that the name of each EAS shall include "international," "foreign," "overseas," or a similar word.

[31] 12 U.S.C. § 618 (1976) provides that an EAS must have a minimum capitalization of $2,000,000.

[32] *Id.* § 614.

> purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States; and generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Board of Governors of the Federal Reserve System, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein.[33]

In sum, under 12 U.S.C. § 615(a), the EAS may transact documentary business, purchase and sell government obligations as well as deal in some limited securities transactions, take a position in the gold and foreign exchange markets, provided the activity is not too speculative, make loans and, finally, accept deposits, provided all involve international transactions.

Sections 615(b) and (c) also empower an EAS, with the permission of the Federal Reserve, to establish foreign branches and within certain limitations to invest in the stock of other corporations organized under the laws of a foreign country. The latter is permitted only when the foreign corporation transacts no business in the United States except as may be incidental to international business.[34]

Concerning the ability of an EAS itself to open branch offices, Regulation K clearly proscribes any domestic branching by an EAS.[35] However, an EAS may establish agencies presumably for such purposes as business promotion.[36] Of course, no banking transactions may be booked on the premises of these agencies.

While an EAS has formidable banking powers, it must at the same time operate within considerable limitations. Both section 25(a) and Regulation K enumerate the restrictions on EAS activities. The most important of these is the general prohibition against carrying on any part of EAS business in the United States except as may be incidental to international transactions.[37] Regarding specific banking activities, the regulations provide that an EAS may accept no deposits in the United States which its customers will use to pay domestic (U.S.) expenses.[38] With respect to bankers' acceptances[39] held by the EAS, there are also requirements that fifty percent of those acceptances exceeding the EAS's capital and surplus and all those exceeding two times capital and surplus and all those acceptances for any one customer exceeding ten percent of

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[33] *Id.* § 615, *as amended by* Act of September 17, 1978, Pub. L. No. 95-369, § 3; codified at 12 U.S.C. 3101 (1978).

[34] *See id.* at §§ 615(b) and (c) for more details.

[35] 12 C.F.R. § 211.6 (1978).

[36] *Id.*

[37] 12 U.S.C. § 616 (1976).

[38] 12 C.F.R. § 211.7(c) (1978). Apparently this limitation is strictly enforced. Several EAS officers interviewed in 1977 noted that Federal Reserve inspectors had reviewed random samples of the EAS's demand deposit records in order to make sure no customers had written checks for domestic expenses.

[39] A banker's acceptance is a draft accepted by a bank on which that bank guarantees payment on maturity; such commercial paper is often marketable.

capital and surplus must be fully secured by the EAS. The single exception to this rule is that if the acceptances falling within these categories pertain to the international movement of goods *and* are guaranteed through primary obligations by banks or bankers, they need not be fully secured.[40]

Another interesting restriction on EAS activities concerns commodities trading. Section 25(a) contains a strongly worded prohibition against both dealing in and price manipulation of transactions directly involving commodities trading.[41] However, at least one exception to this general prohibition exists in 12 U.S.C. § 615, which suggests that an EAS will be permitted to trade and take a position in precious metals.[42]

An EAS's use of funds not currently employed in its business transactions is also strictly regulated. Such assets shall be held only in the liquid form of cash, deposits with banks, bankers' acceptances, and government or government affiliated obligations.[43] Other restrictions, such as those on aggregate liabilities and credit to a single borrower have been altered by the International Banking Act.[44]

III. The International Banking Act of 1978 and its Effect on Edge Act Subsidiaries

While the International Banking Act of 1978 (IBA)[45] focuses primarily on the regulation of foreign banking in the United States, section three of the Act deals solely with Edge Act subsidiaries. In the IBA Congress reiterated its desire to promote international banking under federal supervision and to improve the competitive position of American banks *vis à vis* foreign financial institutions.[46] Furthermore, Congress hinted

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[40] 12 C.F.R. § 211.9 (1978).

[41] 12 U.S.C. § 617 (1976) provides in part that "[no] corporation organized under this subchapter shall engage in commerce or trade in commodities except as specifically provided in this subchapter, nor shall it, either directly or indirectly, control or fix or attempt to control or fix the price of any such commodities."

[42] *Id.* § 615.

[43] 12 C.F.R. § 211.7(b) (1978).

[44] *See* Section III *infra*.

[45] The International Banking Act of 1978, Pub. L. No. 95-369, 92 Stat. 607 (to be codified in scattered sections of 12 U.S.C. (1976)).

[46] *Id.* § 3(a). *See also* S. REP. NO. 1073, 95th Cong., 2d Sess. 4 (1978). In the International Banking Act, § 3(b) the Congress included the following policy statement:

> The Congress hereby declares that it is the purpose of this section to provide for the establishment of international banking and financial corporations operating under Federal supervision with powers sufficiently broad to enable them to compete effectively with similar foreign-owned institutions in the United States and abroad; to afford to the United States exporter and importer in particular, and to the United States commerce, industry, and agriculture in general, at all times a means of financing international trade, especially United States exports; to foster the participation by regional and smaller banks throughout the United States in the provision of international banking and financial services to all segments of United States agriculture, commerce and industry, and in particular small business and farming concerns; to stimulate competition in the provision of international banking and financial services throughout the United States; and, in conjunction with each of the preceding purposes, to facilitate and stimulate the

that it wished to provide new opportunities for U.S. exporters and importers to finance international trade.[47]

The most specific changes made by Congress in section 25(a) of the Federal Reserve Act, the Edge Act, relate to:

(1) the requirement that directors of an EAS all be citizens of the United States;[48]

(2) the stipulation that the majority of shares of an EAS shall at all times be held and owned by U.S. citizens or corporations in which the controlling interest is held by U.S. nationals;[49]

(3) the overall liability limit of ten times capital and surplus which controls EAS activities;[50]

(4) the ten percent floor on the required reserve ratio for deposits received by the EAS;[51] and

(5) the modification of Regulation K by the Federal Reserve Board.[52]

Accordingly, in section 3(c) of the International Banking Act, Congress removed the requirement that all EAS directors be U.S. citizens.[53] Furthermore, in section 3(f) Congress deleted the requisite that a majority of EAS stockholders be U.S. nationals[54] and specifically provided for the establishment of Edge Act subsidiaries by foreign banks.[55] These changes represent a basic policy trade-off made by Congress; it decided to permit foreign banks to participate in interstate banking under the Edge Act, while no longer allowing them to establish domestic deposit-taking branches even where permitted by state law.[56]

In an effort to ease the relatively stringent regulations on the operations of Edge Act subsidiaries, Congress also lifted both the EAS's liability ceiling of ten times its net worth[57] as well as its ten percent of net

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export of United States goods, wares, merchandise, commodities and services to achieve a sound United States international trade position. The Board of Governors of the Federal Reserve System shall issue rules and regulations under this section consistent with and in furtherance of the purposes described in the preceding sentence . . . .

[47] International Banking Act, § 3(b). The Act is unclear as to whether this means that international businesses will be encouraged to invest directly in Edge Act subsidiaries.

[48] 12 U.S.C. §§ 614, 618 (1976), *as amended by* International Banking Act, § 3(d).

[49] 12 U.S.C. § 619 (1976), *as amended by* International Banking Act, § 3(f).

[50] 12 U.S.C. § 615(a) (1976), *as amended by* International Banking Act, § 3(c).

[51] 12 U.S.C. § 615(a) (1976), *as amended by* International Banking Act, § 3(e).

[52] *See* International Banking Act, § 3(a).

[53] 12 U.S.C. § 614 (1976), *as amended by* International Banking Act, § 3(c).

[54] 12 U.S.C. § 619 (1976), *as amended by* International Banking Act, § 3(f).

[55] International Banking Act, § 3(f).

[56] This regulation affects only new domestic deposit-taking branches that foreign banks might wish to establish in the United States and only those opened after the foreign bank has made an initial entry into a "home state." *See* International Banking Act, § 5(b).

[57] International Banking Act, § 3(d). Because it is sometimes difficult for an EAS to estimate when deals will clear and therefore what its liability position will be at day's end, this ceiling of ten times net worth has been sometimes a difficult one for the EASes to work within. This has been particularly true if the EAS were conservatively capitalized, in the $2 to $5 million range.

worth limitation on a single borrower for an EAS "engaged in banking."[58] What types of liability restrictions, if any, the Federal Reserve will impose on EAS operations in the future is unclear. The new regulations which the Federal Reserve must produce by mid-February 1979[59] will probably clarify these remaining questions.

Another requirement an EAS need no longer observe under the IBA is the reserve floor of ten percent of deposits.[60] In place of this specially prescribed minimum the Act provides that the reserve ratio of an EAS will be regulated as are those of member banks of the Federal Reserve System.[61] For most Edge Act subsidiaries operating in urban centers, this will probably mean an eased reserve requirement.

Under the International Banking Act, not only must the Federal Reserve revise Regulation K within 150 days of the Act's becoming law, but the Fed must also review any regulations issued concerning EASes at least once every five years in the future.[62] In enacting these provisions, Congress had several goals in mind. It wanted to eliminate both those provisions which discriminated against foreign banks and those which hampered domestic banks from competing with foreign banks. Additionally, in the words of the Senate Committee Report, "the antiquated statutory and regulatory framework"[63] needed regular, periodic attention. Congress, in providing for reexamination at five year intervals, clearly wished to avoid such stagnation in the future regulation of Edge Act subsidiaries.[64]

These changes in EAS law reflect Congress' recognition that the restrictions on Edge Act banking needed liberalizing. They also represent a decision by Congress to use the unique attributes of the EAS to curtail the freedom of foreign banking operations in the United States while at the same time granting foreign bankers a valuable new privilege. One can only guess as to whether the changes in EAS regulation by the Federal Reserve will permit domestic banks to offer a wider range of interstate banking services in the short term,[65] thus perhaps moving the domestic banking system at large one step closer to full-scale interstate branch banking.

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58 *Id.*

59 *Id.* § 3(a). *See also* Afterword.

60 *Id.* § 3(e).

61 *Id.*

62 *Id.* § 3(b).

63 S. REP. NO. 1073, 95th Cong., 2d Sess. 4 (1978).

64 This sudden and close attention to Edge Act subsidiaries may be motivated by two factors. First, Congress is concerned about promoting U.S. institutions in international banking. Second, Congress may wish to monitor Edge Act banking regulation as a trial for the regulation of full-scale interstate branching. *See id.* at 7-12.

65 For example, will the Federal Reserve permit parent banks to use EAS offices for domestic loan production as a part of the mandated liberalization?

IV. The Edge Act Subsidiary in Perspective

The EAS was not an unpopular form of banking organization before Congress ordered its liberalization and made it available to foreign banks on September 17, 1978. By mid-1977 there were at least thirty-five such subsidiaries in New York City alone, roughly thirteen in Miami and a handful scattered among Philadelphia, Houston, New Orleans and the West Coast.[66] Many of these offices had been in operation for fewer than ten years.[67]

The question arises, why establish an EAS if a parent bank could presumably perform any service an Edge Act subsidiary could provide through the bank's international department? The single, most important response must be that in most cases an EAS can offer such services in places where the parent cannot. For example, consider a southeastern regional bank that finds itself faced with a growing local market for international trade services.[68] In accommodating that growth, the bank may consider it feasible to render services relying more and more on its own network rather than always using big New York banks to act as financial intermediaries, *e.g.*, to clear international transactions for the regional bank. If the regional bank wants to do more clearing on its own, it needs to hold more clearing balances.[69] Foreign banks are more likely to keep such balances with U.S. banks if these banks are in New York City, the place perceived by foreigners as the unchallenged international banking center of the United States. Therefore, it becomes logical for the regional bank to consider establishing its own deposit-taking branch in New York City.[70]

Moreover, concomitant with this growth in trade servicing come revenues which the international department of the regional bank wishes to place in a profitable loan portfolio. A presence in the New York market through an EAS can often lead to more loan opportunities, both in a managing as well as a participating position. Furthermore, a New York location is also of prestige value to a regional bank; in many parts of the world a calling card with a New York address will often be better received and evoke more recognition than one from a less well-known state.

A slightly different set of factors would motivate a big New York bank to establish an EAS. For example, a major bank eyeing the Latin

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[66] *See The Edge is Off the Edge Act Banks*, BUSINESS WEEK, April 7, 1975, at 42-43.

[67] The Federal Reserve provides current data on Edge Act banking in the United States on request. These data were compiled on the basis of material provided by the New York Federal Reserve and personal interviews with several N.Y. Edge Act banks conducted during July 1977.

[68] International trade services include providing export and import financing and foreign exchange.

[69] Clearing balances are deposits held by a bank on behalf of another bank. These balances are used to accommodate the constant flow of transactions between the customers of the holding bank and the customers of the depositing bank.

[70] Since clearing involves a deposit-taking activity, the EAS is the only direct way to establish an interstate presence which can accept deposits.

American market may be fully capable of rendering a full range of services from its New York offices. Yet substantial advantages may accrue from opening an office in Miami to handle a portion of that business. First, Miami is closer to Latin America. Loan officers can make more frequent calls on big clients accustomed to doing business with the parent.[71] Big clients and their families, in return, are more apt to make frequent trips to Miami on personal as well as professional business. Accordingly, they may choose to keep their personal as well as business demand accounts at the EAS for convenience. This would result in the EAS's receiving a larger pool of potential lending funds. Second, to some extent the Miami tax environment is less onerous than that of New York City.[72] Thus, any revenues earned in a loan portfolio situated in Miami will result in larger profits after tax than equal revenues derived from a New York portfolio. This differential has certainly not escaped the tax planners of the big New York banks.[73]

The final aspect of EAS banking to be discussed involves its repercussions for interstate banking at large. Prior to the 1978 reforms, bankers viewed the Edge Act as an important exception to the McFadden Act's overall prohibition of interstate banking.[74] Often domestic banking organizations, to the extent allowed by the Federal Reserve, would try to utilize their Edge Act offices indirectly for the promotion of domestic services. This could be accomplished by making sure the EAS's name contained that of the parent, by urging the EAS staff to refer to domestic services available from the parent and, under strict limitations, by using some Edge Act office facilities or adjacent premises as loan production offices for domestic lending activities.

Most bankers welcome the liberal changes in EAS law and regulation brought about by the IBA as another milestone on the road to general interstate domestic banking.[75] Whether the Edge Act changes actually do encourage this trend will be, in part, a function of what impact increased EAS operations have on the national banking scene.

V. Conclusion

In the near future, it is likely that many more Edge Act subsidiaries

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[71] Smaller accounts are often served by the local branches of the big banks in Latin American countries.

[72] In 1977 there was roughly a ten percent difference in the effective tax rates in New York City and Florida. *See* [1977] State Tax Handbook [CCH] at 492, 569 and 672 for the relevant data.

[73] While strictly speaking, banks would not be permitted to take revenue-producing business out of New York City to avoid taxes, they may develop new business in other parts of the country and hold the profits at the out-of-state subsidiary, until the directors of the subsidiary declare a dividend to the parent. On this basis the New York banks are theoretically able to take advantage of the lower Miami tax environment.

[74] 12 U.S.C. § 36 (1976).

[75] This view was expressed in informal interviews with private commercial bankers conducted by the author in December 1978.

will open in the banking centers as well as in other cities. This will occur, first, due to the new restrictions placed on interstate branching by foreign banks in the United States.[76] The second motivation for such growth in the short-term is that as a result of the weakened dollar, foreign banks[77] and businesses can currently invest very cheaply in the United States. Finally, regional and major banks alike have a vested interest in expanding their international operations, since in recent years their international operations have been among their most profitable activities.

The new regulations the Federal Reserve is under mandate to produce in 1979 will also have an important impact on the desirability of investing in an EAS. Most likely the new Regulation K will make it easier than ever to organize and operate an EAS. However, it remains to be seen to what extent the regulations will open up new domestic opportunities for EASes to enable them to compete more effectively with foreign banks. Thus, 1979 may be remembered as the year a new era in Edge Act subsidiary banking began.

—MARY PATRICIA AZEVEDO

Afterword

As this issue goes to press, a draft version of the new Regulation K has been forthcoming from the Federal Reserve. However, no final action has been taken. Later issues of this Journal will carry an update on the new version of Regulation K.

M.P.A.

[76] International Banking Act, § 4.

[77] Especially Japanese, German and Swiss banks.