The Legal and Economic Impact of the Federal Reserve Board's Ruling to Allow U.S. Depository Institutions to Accept Foreign Currency Deposits

Dean C. Alexander

Follow this and additional works at: https://scholarship.law.unc.edu/ncilj

Part of the Commercial Law Commons, and the International Law Commons

Recommended Citation
Available at: https://scholarship.law.unc.edu/ncilj/vol14/iss3/6

This Comments is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Journal of International Law by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.
The Legal and Economic Impact of the Federal Reserve Board’s Ruling to Allow U.S. Depository Institutions to Accept Foreign Currency Deposits

I. Introduction

Prior to December 23, 1988, the Federal Reserve Board (FED) maintained a policy discouraging U.S. depository institutions from accepting foreign currency deposits. This policy, though not required by federal statute or regulation, resulted from the FED’s concern that large deposits of foreign currency in the United States would adversely affect the value of the U.S. dollar. Most banks complied with the FED’s policy, but several depository institutions accepted foreign currency deposits and made foreign currency loans. Other U.S. banks limited their foreign currency services to international banking facilities and eurocurrencies, available only to non-


3 Telephone Interview with Larry Promisel, Senior Associate Director, Division of International Finance, Board of Governors (BOG) of Federal Reserve System (Jan. 24, 1989).

4 Some foreign-owned banks and agencies of foreign banks located in California accepted foreign currency deposits and offered foreign currency loans in 1977. Letter from Kent Sims, Senior Vice President of the Federal Reserve Bank of San Francisco, to John Ryan, Division of Bank Supervision and Regulation, BOG (July 20, 1977) [hereinafter Sims-BOG letter] (this letter and all correspondence infra provided by Office of Secretary of BOG, Washington, D.C.); see also infra notes 100-02 and accompanying text.


6 See infra notes 29-33, 36-40 and accompanying text.
U.S. resident customers.\(^7\)

The FED’s policy differed from that of many other developed countries, which allowed banks to accept foreign currency deposits and to offer foreign money loans to resident customers.\(^8\) Furthermore, despite the FED’s position, U.S. residents could still deal in foreign currency: they could transfer foreign currency denominations abroad in connection with an international financing transaction;\(^9\) they could obtain checks denominated in a foreign currency from a domestic bank in order to conduct payment abroad;\(^10\) they could use foreign currency travelers checks;\(^11\) or they could conduct transactions in foreign exchange markets.

In a significant reversal of policy, the FED ruled on December 23, 1988, that it would no longer discourage U.S. depository institutions from offering foreign currency deposits.\(^12\) According to the FED, globalization and innovation of financial markets warranted this change in regulation.\(^13\) The FED also predicted that the growth of foreign denominated deposits will be small due to the availability of competing instruments\(^14\) and the probability that reserve requirements would attach to these funds.\(^15\)

This Comment discusses the legal and economic impact of the

\(^7\) Plaut, The Case For Domestic Eurobanking, J. RETAIL BANKING, Spring 1988, at 25. These services are more specialized and restrictive than basic foreign currency deposit accounts, which can often be opened without significant minimum deposits.

\(^8\) Id. Foreign currency deposits are available in many developed countries including Canada, Belgium, Luxembourg, and Hong Kong. P. Bentley, A WORLD GUIDE TO EXCHANGE CONTROL REGULATION 1986/87 57, 82, 178 (1986). Due to the instability and weakness of their national currencies, developing nations, including Peru, Mexico, and Egypt, have experienced a rapid rise in foreign currency deposits. In Peru, for example, foreign currency deposits increased from 31% of the total financial sector liabilities in 1980 to approximately 50% in 1984. El-Erian, Foreign Currency Deposits in LDCs, FIN. & DEV., Dec. 1987, at 38, 40. Cf. Greenhouse, France, Citing Stable Franc, Is Ending Currency Controls, N.Y. Times, Mar. 10, 1989, at D4, col. 4 (French residents may not hold non-franc deposits in France or abroad); P. Bentley, supra, at 92, 162, 182, 207, 226 (residents of Japan, West Germany, Italy, Ireland, and Denmark face restrictions on foreign currency deposits).

\(^9\) Interview with Gary Cunningham, Division of Research and Statistics, BOG (Feb. 17, 1989) (stating that foreign funds may be transferred into the U.S. by means of electronic transfers) [hereinafter Cunningham interview]; interview with Gary Welsh, Esq., representing Bankers’ Association for Foreign Trade (Feb. 17, 1989) [hereinafter Welsh interview].

\(^10\) Welsh interview, supra note 9.

\(^11\) Interview with Paul Smith, Esq., American Bankers Association (Jan. 30, 1989) [hereinafter Smith interview].


\(^13\) BOG-Keehn letter, supra note 12.

\(^14\) Id.

\(^15\) Id. For FED requirements, see generally 12 C.F.R. §§ 204.1-131 (1988).
FOREIGN CURRENCY DEPOSITS IN U.S.

FED's policy reversal. Part II describes the globalization of world financial markets and discusses the FED's role in regulating the value of U.S. currency. Part II also explains the manner in which increased currency substitution heightens pressure on the exchange rate of national currency. Part III summarizes the legal background surrounding the FED's foreign currency deposit policy and focuses on the substance of the FED's policy reversal. Part IV critically analyzes the basis of the FED's ruling and discusses several issues that will arise when depository institutions begin accepting foreign currency deposits. Part V concludes that significant currency substitution in the United States, due to the FED's new policy, will impair the FED's ability to respond to fluctuations in the dollar's value.

II. Economic Background: Globalization of World Financial Markets

World financial markets include eurocurrencies, international bond markets, and foreign exchange markets. Foreign currency trading in these markets, conducted through advanced telecommunications networks, operates twenty-four hours a day. The major foreign exchange trading centers are London, New York, and Tokyo. In addition, Chicago has grown into a leading market for futures and options.

There are various types of transactions in the foreign exchange market. For example, spot transactions are based on a price set each day and delivery of the currency occurs immediately. In forward

---

16 See infra notes 41-61 and accompanying text.
17 See infra notes 62-66 and accompanying text.
18 See infra notes 67-101 and accompanying text.
19 See infra notes 102-15 and accompanying text.
20 See infra notes 115-85 and accompanying text.
21 Automated trading in the financial futures industry results in orders being entered, matched, and cleared via computer keyboard, thus practically eliminating the prior practice of trading over phones and in back offices. See, e.g., Futures Markets Will Let Their Fingers Do the Dealing, THE ECONOMIST, Mar. 19-26, 1988, at 77-78 [hereinafter Futures Markets]; Commins, Futures and Options—Will Goliath Defeat the Davids?, EUROMONEY CORP. FIN. SUPP., Nov. 1987, at 12-13 [hereinafter Commins II].
24 CFTC, supra note 23, at 145; J.O. GRABBE, supra note 22, at 64.
transactions foreign currency is delivered at a specified time in the future at a price quoted at the time of the offer or at the time of delivery. In swap transactions different currencies are bought and sold simultaneously, yet delivery dates for the purchase and sale are different. A futures transaction involves an agreement to purchase or sell a foreign currency at a specific price, with delivery to occur in the future. Finally, option transactions involve a contract right to sell or buy foreign currencies at a specific price on a specific date (European option) or within a specific time (U.S. option).

Eurocurrencies are deposits in a bank located outside of the territory in which the currency is the national currency. The


26 H. Riehl & R. Rodriguez, Foreign Exchange and Money Markets 104 (1983); CFTC, supra note 23, at 146. A swap is a pair of spot and forward transactions in which the forward transaction offsets or unwinds the spot transaction. M. Stigum, The Money Market: Myth, Reality, and Practices 134 (1978). For example, a six-month forward purchase of Japanese yen for U.S. dollars would be offset by a matching spot market transaction to occur immediately. See H. Riehl & R. Rodriguez, supra, at 104. Swap transactions are categorized as pure, in which one party closes both the purchase and sale, or engineered, in which a different party closes each transaction. Id. at 106.

27 See J.O. Grabbe, supra note 22, at 93-95; H. Riehl & R. Rodriguez, supra note 26, at 272-74, 346. A futures contract is also defined as an agreement to purchase or sell a commodity for delivery in the future: (1) at a price that is determined at initiation of the contract; (2) which is normally traded on a board of trade by members of the exchange; (3) which is used to assure or shift price risk; and (4) which obligates each party to the contract, either into an opposite transaction.

CFTC, supra note 23, at 132. See Goldstein, supra note 25, at 8 (describing arbitrage in foreign currencies futures exchange rate).

28 J.O. Grabbe, supra note 22, at 113-14; H. Riehl & R. Rodriguez, supra note 26, at 440. A commodity option is a bilateral contract which gives the buyer the right to buy or sell specified quantities of a commodity at a specific price within a specified period of time, regardless of the market price of that commodity. CFTC, supra note 23, at 139. A call option provides the right to purchase the foreign currency, while a put option confers a right to sell the foreign currency. Chrystal, supra note 23, at 12. It is important to underscore that the buyer of an option may determine not to exercise his right specified under the contract, although the seller of the option must do so. As a result, the buyer of the option must furnish the seller with adequate compensation, the option price. The price at which the option is exercised is termed the strike or exercise price. Id.

At the Philadelphia Stock Exchange, options on the spot foreign exchange include German marks, Swiss francs, Canadian dollars, British pounds, and Japanese yen. Id. at 10. In Chicago, options on the futures foreign exchange are available in the same currencies. CFTC, supra note 23, at 106. Over-the-counter currency options, without the benefit of a central market to enhance competitiveness, still provide a large market with approximately $15 billion settled daily. Id. For further discussion of foreign exchange option contracts, see generally Harding, Some Practical and Legal Aspects of Financial Futures, 1 Butterworth J. Int'l Banking & Fin. L. 30 (1986) (addressing foreign exchange option contracts in London); Giddy, Foreign Exchange Options, J. Futures Markets, Summer 1983, at 143 (providing an overview of foreign currency options).

euromarket is an amalgamation of the international money market and the international credit market for short- and medium-term bank and non-bank funds.\textsuperscript{30} Eurocurrency credits and eurobonds are the two primary methods for obtaining funds in the eurocurrency market. Eurocurrencies are found throughout the world, but are concentrated in the principal euromarket centers,\textsuperscript{31} such as London and Singapore. Although some domestic banks are active in the eurocurrency market,\textsuperscript{32} the main participants are subsidiaries and branches of well-known commercial banks located at the eurocenter.\textsuperscript{33}

The international bond market consists of foreign bonds and eurobonds. Foreign bonds are issued by foreign or international borrowers in a nation's domestic capital market and denominated in the nation's domestic currency.\textsuperscript{34} Foreign bond trading exists in numerous currencies including U.S. dollars, German marks, and Japanese yen; and occurs in many markets such as New York, Frankfurt, and Tokyo.\textsuperscript{35} In contrast, eurobonds are denominated in a particular currency and are issued simultaneously in the capital markets of nations outside the country of the borrower.\textsuperscript{36} Eurobonds may be issued in a particular currency or in mixtures of currencies such as European Currency Units, Arab Currency Units, and Special Drawing Rights drawn on the International Monetary Fund.\textsuperscript{37}

The size of Eurobond issues has varied from $10 million to $500


\textsuperscript{32} OECD, supra note 30, at 132.

\textsuperscript{33} R.B. Johnston, supra note 29, at 4; see OECD, supra note 30, at 132.

\textsuperscript{34} J.O. Grabbe, supra note 22, at 271.

\textsuperscript{35} Id.

\textsuperscript{36} See id. at 273-75. Generally, eurobonds are in bearer form, the identity of the beneficial owner is not disclosed, and the bond may be transferred on delivery. Beller & Berney, Eurobonds, SEC. & COMMODITIES REG., Feb. 19, 1986, at 39, 40. Although there is no registration requirement in a eurobond issue, a majority of eurobonds are listed on the Luxembourg of London Stock Exchanges. H. Bloomenthal, 10 International Capital Markets and Securities Regulation § 1.02[5] (1986). One benefit of eurobonds is that interest payments on these investments are free of withholding tax. Beller & Berney, supra, at 40.

Public borrowers such as governments, nationalized industries, and industrial institutions as well as large private borrowers such as large companies and banks, are generally well known names to investors. Because these bond issuers are so familiar, the risk of these obligations is decreased. Eurobond investors include private individuals and institutional investors such as government agencies, central banks, bank trust companies, and insurance companies.

The globalization of world financial markets is evidenced by several significant trends. First, some nations have enacted more expansive laws regarding quantitative limits and ceilings on foreign currency deposits and interest rates. For example, France has allowed issuance of European Currency Unit Certificates of Deposit; and the United States has opened international banking facilities to repatriate dollars transferred to eurocurrency markets. Japan has also eased banking restrictions. Second, national monetary authorities have liberalized capital inflow and outflow regulations. For example, Great Britain and Japan have eliminated exchange controls on capital outflows. In addition, West Germany has stimulated financial markets by loosening capital inflow restrictions. More recently, France, which since 1968 had maintained foreign exchange controls, will reduce such controls on all individuals by July 1, 1990. Foreign exchange controls on French corporations would occur at once. Third, foreign banks now occupy larger roles in previously protected national financial markets. Fourth, legal barriers separating domestic and international sectors of securities markets no longer exist in many national markets. Fifth, many countries have relaxed regulations concerning nonresident participation in domestic financial markets.

---

38 Swiss Bank, supra note 37, at 5-6.
39 Id. at 4.
41 Id., at 149-50.
42 Id.; see also Comment, Offshore Banking, supra note 5, at 61.
43 Id. at 149-50.
45 Id., at 149-50.
46 Id.
47 Greenhouse, supra note 8, at D4.
48 Id., at 150; Llewellyn, supra note 45, at 255; Pandemic, supra note 42, at 21.
49 Group, supra note 41, at 150; Llewellyn, supra note 45, at 255.
50 In the United Kingdom, for example, the 1979 Banking Act abolished the 1947
FOREIGN CURRENCY DEPOSITS IN U.S.

The globalization of financial markets is particularly evident in the futures and options exchanges. U.S. markets, for example, have extended trading periods in order to compete with Asian exchanges. The Chicago Mercantile Exchange (CME) has agreed with Reuters to broadcast after-hours trading in the futures and options market. The globalization of financial products can also be witnessed at the London International Financial Futures Exchange (LIFFE), where U.S. Treasury bond and German government bond contracts are traded. Furthermore, both LIFFE and the Chicago Board of Trade (CBOT) permit traders to initiate positions on one exchange and liquidate on the other.

Similarly, the movement of Japanese government bonds abroad illustrates the integration of Asia into the futures market. In addition, the Commodity Futures Trading Commission recently allowed the CBOT to trade futures on Japanese government bonds and the CME to trade on the Nikkei 225. In addition, the CME has received permission to trade on the European, Australian, and Far East stock index (EAFE) and the CBOT has agreed to trade futures on Topix, the index for the Tokyo Stock Exchange. Options on fifty foreign stocks will be available when the New York Coffee, Sugar & Cocoa Exchange, in unison with the American Stock Exchange, trades its International Market Index, comprised of fifty foreign stocks. Finally, the Tokyo Financial Futures Exchange (TFFE) will

---

Exchange Control Act and allowed banks to offer foreign currency deposits or to raise foreign currency credits for use in subsequent Eurocurrency transactions. OECD, supra note 30, at 107.

52 See, e.g., J.O. Grabbe, supra note 22, at 116.

53 Commins II, supra note 21, at 13.

54 See Kanji, Capital Markets: Last of the Dinosaurs?, THE BANKER, Oct. 1987, at 94-95. The agreement to form an electronic automated system is known as post market trading. Futures Markets, supra note 21, at 77-78. The proposed CME linkage with Reuters, also dubbed Globex, was slated to commence on a limited basis in late 1989 or early 1990 in New York, Chicago, and London. Tokyo officials have been slow to approve Globex, however, perhaps because of the Tokyo Financial Futures Exchange's slow start. Murray & Kanabayashi, Chicago Merc Futures Venture Slowed by Japan, Wall St. J., Sept. 26, 1989, at C9, cols. 5-6; see Campbell, Suspicion Lingers in the Pit, Fin. Times, Mar. 8, 1989, § III, at II, col. 3.

55 Crabbs, LIFFE'S Financial Future, EUROMONEY, July 1988, at 102-03; see also Kanji, supra note 54, at 94.

56 Kanji, supra note 54, at 94. Additionally, cooperation between the U.S. Commodity Futures Trading Commission and the U.K. Securities and Investment Board has resulted in an agreement permitting commodity firms from each nation to operate in the other. Cohen, The Bad Apple in the Other Guy's Barrel, Fin. Times, Mar. 8, 1989, § III, at IV, col. 4.


59 Id.

60 Id.
soon commence trading in eurodollar interest rate futures as well as yen-dollar currency futures.61

III. Legal Background

A. The FED's Role in Influencing the Value of U.S. Currency

The Federal Reserve Bank of New York carries out the FED's foreign exchange operations and thereby influences the market demand and supply of the dollar.62 For example, if the dollar is believed to be overvalued, the Federal Reserve Bank of New York can purchase German marks with its dollar reserves, thereby increasing the supply of dollars available in the market and lowering the dollar's value. On the other hand, to increase demand for dollars and their value, the FED may conduct swap transactions63 to obtain foreign currency with which it purchases dollars in foreign exchange markets.64 The FED may also influence the value of the dollar through explicit coordination with other central banks.65 Generally, FED intervention is limited to smoothing out temporary swings in the exchange-rate fluctuations of the dollar.

The FED's role in stabilizing exchange rates and the value of the dollar has been a significant factor in the approach taken towards foreign currency deposits. When implementing monetary policies, the FED must keep in mind the effect of increased mobility of capital in the international financial markets on exchange rates.66 Failure to do so will lead to ineffective policies.


64 Cross, supra note 63, at 60.

65 Id. at 57; see Deane, At Quiet Bank-Fund Meetings, Thoughts of Monetary System, FINANCIER, Nov. 1988, at 13-16 (providing overview of U.S.-Japan agreement whereby United States buys yen with SDRs in order to finance participation in coordinated exchange-rate interventions by the two countries); Hampage, Intervention and the Dollar, FED. RESERVE BANK CLEVELAND ECON. COMMENTARY, Sept. 1988, at 1-4 (arguing that successful intervention is more likely with coordination among central banks).

B. The Evolution of the FED's Policy on Foreign Currency Deposits

U.S. depository institutions have long expressed interest in offering foreign currency deposits, but this interest was almost always met with opposition by the FED. In 1969, the FED also discouraged foreign branches of FED-member banks from accepting deposits from U.S. residents unless such deposits "serve[d] a definite, necessary purpose outside the United States." The FED wanted to prevent these foreign branches from competing with domestic banking facilities.

In 1973, the Bank of America formally sought to determine whether U.S. depository institutions could extend foreign currency loans and accept foreign money deposits in the United States. While the FED's Division of International Finance expressed some reluctance in permitting such accounts, the Treasury Department and the Federal Reserve Bank of New York opposed domestic offerings of foreign currency deposits. FED Chairman Arthur Burns noted two factors underlying his eventual opposition to allowing banks to accept foreign currency deposits in the United States. First, U.S. companies would be able to hold foreign currency assets above the amounts permitted by the capital restraint program. Second, the U.S. market would recapture foreign denominated funds normally deposited abroad or traded in the forward market. Ultimately, however, Burns concluded that these two factors might threaten the stability of the dollar and he decided that the Bank of America, as well as other institutions in the United States, should not accept foreign currency deposits.

In 1974, citing a stronger dollar and the termination of capital

---

67 Stephen Shock, Vice President of MNC Financial, interviewed in Hinden, supra note 12, at C3, col. 3; telephone interview with Fred Grede, Vice President of CBOT (Feb. 23, 1989) (stating that commodity exchanges have urged the FED to remove its disapproval of U.S. residents' holding foreign currency deposits) [hereinafter Grede interview]; telephone interview with Barbara Wierzynski, Esq., representing Futures Industry Association (Feb. 21, 1989) [hereinafter Wierzynski interview].
68 Letter from BOG to all FED member banks with foreign branches (June 3, 1969).
69 See id. Additionally, in July 1975, the FED argued that the role of international banks was to offer services to foreign customers, rather than serve as alternatives to domestic banking services. Letter from Arthur Burns, Chairman of BOG of FED, to all FED member banks with foreign branches (July 21, 1975).
70 See letter from John J. Balles, President of Federal Reserve Bank of San Francisco, to BOG (Apr. 4, 1977) [hereinafter Balles-BOG letter].
71 Id.
72 Letter from Arthur Burns, Chairman of BOG of FED, to A.W. Clausen, President of Bank of America (Oct. 23, 1973) [hereinafter BOG-Clausen letter].
73 Id.; see also letter from A.W. Clausen, President of Bank of America, to John Balles, President of Federal Reserve Bank of San Francisco (Jan. 9, 1974) (suggesting U.S. balance of payment problems and international monetary reform efforts in 1973 made Bank of America's request to offer foreign currency deposits inopportune) [hereinafter Clausen-Balles letter].
74 BOG-Clausen letter, supra note 72.
75 Id.
restraint programs, the Bank of America approached the Federal Reserve Bank of San Francisco to request a reversal of the FED's position on foreign currency deposits.\textsuperscript{76} After a thorough study of the issue, the FED reasserted its fear that allowing U.S. banks to accept foreign currency deposits would destabilize the dollar to the detriment of the public interest.\textsuperscript{77}

In March 1977, the Bank of America requested from the Board of Governors a reconsideration of the foreign currency deposit policy.\textsuperscript{78} Bank of America argued that significant changes in the world financial system provided sufficient justification to relieve the FED's concern over the dollar's stability.\textsuperscript{79} In particular, Bank of America pointed to a healthy floating exchange rate system that allowed the FED to intervene in order to maintain the value of the dollar.\textsuperscript{80} Bank of America also argued that public access to foreign currency deposits and loan facilities would be beneficial.\textsuperscript{81} First, such accounts would facilitate international transactions by U.S. firms who contract for payment in foreign currencies.\textsuperscript{82} Second, foreign currency deposits would enable U.S. businesses to borrow funds in a foreign currency while guarding against foreign exchange fluctuations.\textsuperscript{83} Bank of America recognized that similar transactions could be carried out abroad, but suggested that doing so presented both political and transfer risks.\textsuperscript{84} Third, denial of foreign currency deposits in the United States forces those funds to be deposited in foreign accounts, thereby reducing business by U.S. banks.\textsuperscript{85} Finally, development of foreign currency deposits in U.S. banks would increase use of foreign currencies and relieve some of the pressure on the dollar from its use as an international currency.\textsuperscript{86}

The Federal Reserve Bank of San Francisco agreed with Bank of America's position and noted that previous FED objections to foreign currency deposits were no longer relevant.\textsuperscript{87} John J. Balles, President of the Federal Reserve Bank of San Francisco, argued that

\textsuperscript{76} Clausen-Balles letter, supra note 73.
\textsuperscript{77} Letter from Theodore Allison, Secretary of BOG, to John Balles, President of Federal Reserve Bank of San Francisco (Jan. 8, 1975) (regarding Clausen's request). The FED also expressed its position on foreign currency deposits to the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Letter from Theodore Allison, Secretary of BOG, to James Smith, Comptroller of the Currency (Jan. 14, 1975); letter from Theodore Allison, Secretary of BOG, to Frank Wille, Chairman of FDIC (Jan. 14, 1975).
\textsuperscript{78} Letter from A.W. Clausen, President of Bank of America, to BOG (Mar. 28, 1977) [hereinafter Clausen-BOG letter].
\textsuperscript{79} Id. at 2.
\textsuperscript{80} Id.
\textsuperscript{81} Id.
\textsuperscript{82} Id.
\textsuperscript{83} Id. at 3.
\textsuperscript{84} Id. at 2.
\textsuperscript{85} Id. at 3.
\textsuperscript{86} Id.
\textsuperscript{87} "[I]t is my recommendation that the Board remove its objections to Bank of
the recognized U.S. policy of a stronger and more flexible exchange rate monetary system and a reduction of governmental barriers to international finance and trade justified a reversal in policy.\(^8\) Additionally, Balles pointed out that termination of the foreign credit restraint program and the current strength of the dollar supported the establishment of foreign denominated accounts in U.S. banks.\(^9\) Despite these arguments, staff of the FED responded without much discussion that the dollar's present depreciation made currency deposit reform unlikely.\(^10\)

In November 1977, Dominion National Bank urged the FED to allow U.S. banks to provide foreign currency facilities.\(^11\) Dominion highlighted the benefits that smaller banks would receive from joining the international finance market.\(^12\) Foreign currency accounts in the United States could attract deposits from U.S. foreign banks to U.S. resident depository institutions.\(^13\) With experience in operating foreign currency facilities small banks could open foreign branches.\(^14\) Despite these benefits, the FED continued to refuse to allow foreign currency deposits at U.S. banks.\(^15\)

In February 1980, the FED's position weakened slightly as a member bank was permitted to establish a demand account denominated in Canadian dollars.\(^16\) However, due to the limited purpose of the account, serving to ease the administration of a union pension fund, no modification of FED policy was announced.\(^17\) Instead, the

\(^{88}\) America's proposal to accept foreign currency deposits and to extend foreign currency loans in the U.S. Balles-BOG letter, supra note 70, at 2.

\(^{89}\) Id.

\(^{90}\) See Letter from Fredrick Dahl, BOG, to Kent Sims, Senior Vice President of Federal Reserve Bank of San Francisco (Dec. 22, 1977).

\(^{91}\) Letter from George Pinckney, Assistant Branch Manager of Dominion National Bank of Richmond, to BOG (Nov. 22, 1977) [hereinafter Pinckney-BOG letter]; see also Pinckney, Time Deposits In Foreign Currencies (Oct. 29, 1977) (unpublished paper accompanying letter) [hereinafter Foreign Deposits Paper].

\(^{92}\) Specifically, Dominion noted that:

By allowing member banks to issue foreign currency time deposits, the Federal Reserve will be: increasing national competition by allowing smaller banks to enter the international field; better protecting the nation’s depositors by allowing them service at home at a regulated bank and not overseas; strengthening the dollar by free market competitive forces to which even the Congress must heed; and increasing international trade.

Pinckney-BOG letter, supra note 91. See also Foreign Deposits Paper, supra note 91, at 3-5.

\(^{93}\) Foreign Deposits Paper, supra note 91, at 3.

\(^{94}\) Id. at 4.

\(^{95}\) See letter from Gilbert Schwartz, Assistant General Counsel, and Anthony Cole, Senior Attorney, of BOG, to (name of bank not disclosed) (Feb. 19, 1980).

\(^{96}\) Id.

\(^{97}\) Id.

The qualified pension fund maintained by the union includes a limited number of Canadian participants who submit contributions to the fund in Canadian dollars. These contributions are presently handled by [name not disclosed] in Canada. The fund accrues benefits for the participants at a rate of 2 1/2 per cent a year. . . . [Undisclosed bank] proposes to establish a
FED underscored that its policy of discouraging U.S. depository institutions from accepting foreign currency deposits would remain in effect.98

From 1980 to early 1988, the FED did not formally consider the issue of foreign currency accounts.99 In April 1988, however, the issue resurfaced before the Federal Reserve Bank of Chicago.100 With respect to one particular foreign currency transaction proposed by the petitioning banks, Silas Keehn, President of the Federal Reserve Bank of Chicago, suggested that the FED's earlier apprehensions concerning foreign currency facilities were inapplicable.101 Keehn concluded that numerous mechanisms affect foreign currency positions and no substantive effect on the dollar's exchange rate due solely to the existence of foreign currency deposits was foreseeable.102 Keehn also observed that denial of these deposits harms U.S. resident banks because the foreign currency funds are redirected to foreign accounts.103

On December 27, 1988, the FED agreed with Keehn's arguments and reversed its longstanding reluctance to permit U.S. depository institutions to accept foreign denominated deposits.104 The FED asserted that innovation in globalized financial markets was one factor warranting the policy reversal.105 In addition, the FED reasoned that growth of these deposits would be limited because foreign currency accounts would be subjected to reserve requirements and because competing financial facilities already exist.106

C. Substance of FED's New Ruling

Other than setting out the basis for its decision and pointing out its ramifications, the FED's ruling was not very instructive. Addition-
ally, the FED did propose a reporting mechanism to compile weekly averages of the amounts of outstanding foreign exchange deposits at depository institutions in the United States.\textsuperscript{107} This new form, FR 2915,\textsuperscript{108} containing the dollar equivalent of foreign currency deposits, would be included in the Report of Transaction Accounts, Other Deposits, and Vault Cash (FR 2900).\textsuperscript{109} FR 2915 is useful because it segregates the foreign exchange deposits from conventional monetary measurements. For example, levels of foreign currency deposits will not be included in M1 money aggregates.\textsuperscript{110} Also, the exchange rate used for valuing FR 2900 and FR 2915 will be the rate quoted every Tuesday at ten o’clock in the morning (or noon) for major currencies by the Federal Reserve Bank of New York.\textsuperscript{111} Establishing uniform guidelines for valuation of foreign currency deposits will encourage accurate monitoring of these accounts.\textsuperscript{112}

IV. Analysis of the Basis for the FED’s New Policy

A. The Demand for Foreign Currency Deposits in the United States

The FED based its new policy, at least in part, on the assumption that demand for foreign currency deposits will not be great. A corollary to this assumption is that the impact of foreign currency deposits on the economy and on financial markets will be marginal. The FED asserted two factors justifying this assumption. First, the FED believes that these accounts will not be very popular because they will be subject to reserve requirements.\textsuperscript{113} Second, the FED submits that there are alternative financial instruments available that can provide equal or better protection from currency fluctuations.\textsuperscript{114} For instance, investors may speculate in foreign stocks as well as futures and options in foreign exchange.\textsuperscript{115}

The facts cited by the FED in support of their assumption of low demand are reasonable, but there are many other factors that point to a large demand for foreign currency deposits. First, the availability of foreign currency deposits in the United States is beneficial both

\textsuperscript{107} See BOG, Agency Forms Under Review 3 (Dec. 23, 1988) [hereinafter Agency Form].


\textsuperscript{109} Agency Form, supra note 107, at 2.

\textsuperscript{110} Welsh interview, supra note 9.

\textsuperscript{111} Id.

\textsuperscript{112} However, though they will compile values of nonmajor foreign currencies for FR 2900 and FR 2915, banks will not be forced to use the exchange rate quoted by the Federal Reserve Bank of New York. Thus, an accurate dollar valuation of these funds will be difficult to determine. Id.

\textsuperscript{113} BOG-Keehn letter, supra note 12.

\textsuperscript{114} Id.

\textsuperscript{115} Telephone interview with Harry Jorgansen, Esq., Legal Division, BOG (Feb. 14, 1989).
to depository institutions and their clients.\textsuperscript{116} The offerors of such accounts, gaining flexibility and diversification in their operations, will likely attract new clients.\textsuperscript{117} Foreign currency deposits allow bank clients to hedge against foreign exchange risk, decrease business costs, and increase investment flexibility.\textsuperscript{118} Foreign currency deposits provide importers and exporters with hedging capabilities that are often cheaper and more flexible than forward contracts.\textsuperscript{119} U.S. manufacturers who import component parts could also reduce exposure to exchange rate volatility by holding foreign currency deposits.\textsuperscript{120} In addition, institutional investors holding significant amounts of foreign currency overseas could eliminate country risk, such as inconvertibility, by depositing the funds in the United States.\textsuperscript{121}

Second, significant growth in foreign currency deposits may result if small investors use these accounts.\textsuperscript{122} Tourists who travel frequently may wish to hold a stable, strong currency in order to earn interest and avoid the transaction cost of multiple conversions.\textsuperscript{123} Also, foreign currency deposits provide small investors with another method for portfolio diversification.\textsuperscript{124} Other potential foreign currency depositors might include the following: retail customers looking toward investments in foreign pension funds;\textsuperscript{125} households planning to purchase an automobile abroad;\textsuperscript{126} and other depositors with unpredictable foreign exchange transaction dates who would otherwise be subject to the rigidity of futures foreign currency contracts.\textsuperscript{127}

The availability of foreign currency deposits benefits not only the offering institutions and their clients, but it also benefits U.S. foreign exchange markets. Historically, foreign exchange contracts traded in the United States were denominated in dollars.\textsuperscript{128} Consequently, actual delivery of foreign exchange had to occur either

\textsuperscript{116} Plaut, \textit{supra} note 7, at 27; Grede interview, \textit{supra} note 67; Wierzynfki interview, \textit{supra} note 67.

\textsuperscript{117} For example, the FED could deposit into U.S. banks its approximately $18 billion held abroad in foreign currencies. \textit{See} Plaut, \textit{supra} note 7, at 27.

\textsuperscript{118} The American Bankers Association states "that any kind of increased flexibility like [permitting U.S. depositories to accept foreign currency deposits] is a good thing." James McLaughlin, American Bankers Association, as quoted in \textit{Murray & Duke, supra} note 12, col. 3; Smith interview, \textit{supra} note 11.

\textsuperscript{119} Smith interview, \textit{supra} note 11.

\textsuperscript{120} Plaut, \textit{supra} note 7, at 25.

\textsuperscript{121} Wierzynfki interview, \textit{supra} note 67; Grede interview, \textit{supra} note 67.

\textsuperscript{122} Foreign exchange contracts are characteristically large scale transactions with odd maturity dates, and may not be practical for small investors. Plaut, \textit{supra} note 8, at 26-27.

\textsuperscript{123} \textit{Id.} at 26.

\textsuperscript{124} \textit{Id.}

\textsuperscript{125} \textit{Murray & Duke, supra} note 12, col. 4.

\textsuperscript{126} Plaut, \textit{supra} note 8, at 26.

\textsuperscript{127} \textit{Id.} at 26-27.

\textsuperscript{128} Wierzynfki interview, \textit{supra} note 67; Grede interview, \textit{supra} note 67.
outside the United States or within the United States in dollar equivalents.\textsuperscript{129} The new FED policy will expedite foreign financial instrument trading because the asset can now be denominated in its native currency.\textsuperscript{130} Foreign currency instruments, such as Japanese government bonds, previously were subject to currency fluctuation in the dollar-denominated yen product as well as to changes in the underlying instrument. Now these instruments will be subject only to the instability of the underlying instrument.\textsuperscript{131} This factor alone creates the potential for growth in foreign currency deposits.\textsuperscript{132}

The commodity futures and options market might also create a large pool of foreign denominated deposits in the United States. Prior to the FED’s policy change, the payment of margin\textsuperscript{133} by a domestic client to a futures commission merchant\textsuperscript{134} to secure a transaction was made in dollars.\textsuperscript{135} Domestic customers who wanted to cover their margin with a payment of a foreign currency had to pay through a foreign depository institution.\textsuperscript{136} Now, however, such margin payments will be available domestically.\textsuperscript{137} Initial margin

\textsuperscript{129} Grede interview, supra note 67.

\textsuperscript{130} Id.; Wierzynfki interview, supra note 67.

\textsuperscript{131} One commentator notes: “If you have a dollar-denominated deutsche mark product, a trader is constantly exposed to currency fluctuations as well as changes in the underlying instrument. . . . If the product is denominated in deutsche marks, the trader doesn’t have to factor in currency risk on a constant basis.” Commins I, supra note 12, cols. 2-3. For example, futures on the Nikkei 225, Topix, as well as Japanese government bonds, all priced and settled in the underlying foreign currency, will benefit from the FED’s ruling. Hargreaves, supra note 58, col. 1.

\textsuperscript{132} Commins I, supra note 12, col. 2.

\textsuperscript{133} Margin is “[t]he amount of money or collateral deposited by a customer with his broker . . . for the purpose of insuring the broker or clearing house against loss on open futures contracts. The margin is not partial payment on a purchase.” CFTC, supra note 25, at 137.

\textsuperscript{134} Futures Commission Merchants (FCMs) include: individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property . . . to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

\textsuperscript{135} Financial and Segregation Interpretation No. 12—Deposit of Customer Funds in Foreign Depositories, Comm. Fut. L. Rep. (CCH) ¶ 7122 (Nov. 16, 1988), modifying Commodity Exchange Authority Administrative Determination No. 238 (Sept. 4, 1974).

\textsuperscript{136} Id. The ability of domestic customers to deposit funds in foreign depositories is a recent phenomenon. Id. The CFTC determined that, in light of internationalization and significant changes in the futures and options market, domestic customers should have such privileges. Id. ¶¶ 7126-27. Prior to this agency determination, only foreign domiciled customers could hold funds with a FCM outside the United States. Id. ¶ 7126. The CFTC policy statement was intended to reduce the insecurity of holding customer funds abroad (foreign sovereign risk) as well as to decrease the abatement of customer funds segregation in the United States. See id. ¶¶ 7126-27.

\textsuperscript{137} Moreover, margins denominated in foreign currencies may be forwarded to a FCM, who then deposits these funds in a foreign currency account at a U.S. depository institution. Telephone interview with Alan Seifert, Deputy Director, Trading and Markets Division, CFTC (Feb. 22, 1989). In light of the FED’s new policy, the CFTC will need to
payments from five to fifteen percent of the total value of the commodity,\textsuperscript{138} may generate growth in foreign currency denominated margins and foreign currency bank deposits.\textsuperscript{139}

To reiterate, because financial institutions, commodities markets, business, government, and the public will readily use foreign currency facilities made possible by the FED's change in policy regarding foreign currency deposits, the scope and breadth of these accounts will be larger than the FED originally predicted. Indeed, this conversion of dollar holdings into foreign currencies, coupled with increased international capital mobility will augment pressure on the exchange rate of the dollar. In turn, the ramification of this substitution, will be an interference with the FED's dollar exchange rate targets.

B. Currency Substitution

A second ground for criticism of the FED's new policy is that increased demand for foreign deposits could lead to greater currency substitution and, therefore, less control by the FED over the stability of U.S. foreign exchange. Currency substitution occurs when an expected rise in the value of a foreign currency, vis-a-vis the domestic currency, induces domestic residents to hold more of this foreign asset.\textsuperscript{140} Thus, national currency substitution is based on the relative rates of return of each currency.\textsuperscript{141} For example, it is expected that a depreciating dollar, vis-a-vis the Japanese yen, will result in increased conversion of U.S. dollars into Japanese yen.\textsuperscript{142} Varying demand and supply of substitute monies can lead to instability in the exchange rate of home currency.\textsuperscript{143} If the currency of one

\textsuperscript{138} These levels of margin are established by the exchanges. Generally, the CFTC, pursuant to § 5(a)(12) of the Commodity Exchange Act (CEA), may not review the margin levels which the exchanges establish. Yet, during a market emergency, the CFTC may, as § 8a(9) of the CEA stipulates, establish margin levels. T. Russo, \textit{Regulation of the Commodities Futures and Options Markets} § 1.20 (1989). The CBOT and the CME, for example, issue rules regarding sufficient amounts for initial margin.

\textsuperscript{139} See Hargreaves, \textit{supra} note 58, col. 1.


\textsuperscript{142} Bordo & Choudhri, \textit{supra} note 141, at 48-49.

\textsuperscript{144} Zilberfarb, \textit{The Effects of Foreign Exchange Risk and Return on the Demand for Domestic Balances}, 52 Eur. Econ. Rev. 1359, 1359-60 (1988). Note also El-Erian's discussion of the effect of foreign currency deposits upon exchange rate volatility. El-Erian, \textit{supra} note 8, at 58. Increased capital mobility and integration of finance can also
nation is a ready substitute for another, as is the case when foreign currency deposits are available, slight shifts in the money supply of one currency can create significant variance in the exchange rate of the other.\textsuperscript{144}

Currency substitution destabilizes the demand for a particular currency, thereby interfering with the central bank's efforts to formulate effective monetary policy unconstrained by foreign influence.\textsuperscript{145} Therefore, currency substitution due to large influxes of foreign currency decreases the capacity of monetary authorities to control credit and money supply.\textsuperscript{146} This fact is particularly troublesome if countries pursue monetary policy while presuming that their domestic currency is unaffected by finance changes abroad.\textsuperscript{147}

\section*{C. Issues Not Addressed by the FED}

The FED's new ruling provided little guidance for its ultimate implementation and failed to address several important issues.\textsuperscript{148} First, the reporting requirements of FR 2900 seem inadequate. Because the FED estimated that foreign money deposits in U.S. depository institutions will be slight, the regulations require weekly rather than daily totals.\textsuperscript{149} This might give rise to confusion over when and how much foreign currency a bank client holds. Also, the regulations require depository institutions to convert the value of foreign currency accounts into dollars on FR 2915; there will be no indica-

\textsuperscript{144} Bordo & Choudhri, supra note 141, at 48.

Likewise, in developing countries, currency substitution arising from foreign currency deposits has clearly affected the ability of national monetary authorities to implement exchange rate policies. Specifically, currency substitution makes a country's currency devaluation less effective at reducing domestic income. Currency substitution also loosens governmental control over domestic liquidity, increases the possibilities for tax avoidance, and reduces seigniorage. El-Erian, supra note 8, at 38; see also Ramirez-Rojas, Monetary Substitution in Developing Countries, FIN. & DEV., June 1986, at 36-37 (proposing that currency substitution aggravates monetary authorities' ability to stabilize national currency).

\textsuperscript{146} Ramirez-Rojas, supra note 145, at 35; El-Erian, supra note 8, at 40. The degree of interference with monetary authorities depends upon the degree of currency substitution. The larger the degree of currency substitution, the greater the amount of fluctuation and variability in the foreign exchange. Cox & Parkin, supra note 145, at 2-3, 9; Willet, supra note 143, at 81.

\textsuperscript{147} Id.; Batten & Hafer, supra note 145, at 7. See Daniel & Fried, supra note 140, at 613.
\textsuperscript{148} Cunningham interview, supra note 9 (admitting additional information and guidance by FED is necessary before the policy goes into effect).
\textsuperscript{149} See id.; see also Supporting Statement, supra note 108, at 3.
tion of which currencies are deposited. Without a record indicating which foreign currencies are deposited the FED may not have the data necessary to assess fully the effect of currency substitution on the dollar’s value. A revised FR 2915 detailing the five largest holdings of foreign currency deposits would increase the FED’s ability to understand the scope and nature of currency substitution occurring in the United States.

Second, the FED does not restrict the types of depository institutions permitting foreign currency deposits, and there is no requirement that any institutions must offer such accounts. The FED estimates that approximately one hundred banks will be interested in offering foreign currency deposits. The types of depository institutions and the specific geographical regions that will be interested in the new accounts is entirely speculative.

Some bankers believe that large international banks and U.S. subsidiaries of foreign banks will offer foreign currency deposits in order to be more competitive and flexible. Other bankers believe that these deposits will be popular in all areas of the country, particularly where international trade is active. Some attorneys believe that client needs and banking goals, rather than bank asset totals or geographic location, will be the principle factors. Likewise, commodities authorities at the CBOT, CME, and the Futures Industry Association predict that banks whose clients include commodity exchanges will offer foreign currency deposits.

Third, the new policy makes all foreign currencies eligible for deposit, but banks may themselves decide to limit deposits to certain currencies. Banks will probably prefer to offer only currencies that perform well against the dollar, such as the Japanese yen, German mark, British pound, and Swiss franc. Large deposits of weak

---

150 See BOG-Keehn letter, supra note 12; Cunningham interview, supra note 9.
152 Smith interview, supra note 11; Cunningham interview, supra note 9; Welsh interview, supra note 9; Jorgansen interview, supra note 115.
153 Jorgansen interview, supra note 115; Welsh interview, supra note 9.
154 Cunningham interview, supra note 9 (suggesting recent U.S.-Canada Free Trade Agreement could result in significant deposits of Canadian dollars). See generally Koh, The Legal Markets of International Trade: A Perspective on the Proposed United States-Canada Free Trade Agreement, 12 YALE J. INT’L L. 195 (1987); Fried, Barriers to United States-Canadian Trade: Problems and Solutions, The Canadian Perspective, 19 GEO. WASH. J. INT’L L. & ECON. 433 (1985). Due to a high volume of international trade Florida, Texas, and California are likely host for foreign currency deposits. But despite significant trade between the United States and Mexico, large peso deposit accounts are unlikely because of the instability and weakness of Mexican currency. Smith interview, supra note 11.
155 Smith interview, supra note 11.
156 CommIs I, supra note 12, cols. 2-3; Grede interview, supra note 67; Wierzyński interview, supra note 67.
157 BOG-Keehn letter, supra note 12; see Supporting Statement, supra note 108, at 3 (all foreign currencies are to be used in calculating FR 2915 dollar equivalent totals).
158 Cunningham interview, supra note 9; Welsh interview, supra note 9; see also CFTC, supra note 23, at 103 (only strong currencies are normally traded on futures or options.
currencies would be unlikely because of consistent depreciation vis-a-vis the dollar. In addition, banks probably will not accept foreign monies subject to restrictive exchange rate controls. The Canadian dollar, the currency of the United States' largest trading partner, will probably occupy a significant amount of the total foreign currency deposits.

Fourth, the FED did not discuss how foreign deposit holders will obtain foreign currency funds or what interest rates will be offered by the depository institutions. If both the purchase and deposit of foreign currency occur at the same bank, the client will probably receive a better exchange rate than if separate banks are used. The interest rates offered on foreign currency deposits may be comparable with the rates offered on domestic deposit accounts or they may follow rates in the currency's home country. Two additional factors will influence the interest rate offered on foreign currency deposits. First, the interest rate will depend on whether the accounts are demand or time deposits. Demand deposits often provide a lower interest rate than time deposits. Many sectors in international finance and trade as well as commodities trading conduct numerous transactions and would probably prefer demand deposits. On the other hand, small investors and overseas travelers would make infrequent deposits and withdrawals and so would probably

---


Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement, shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making exchange control regulations of either member more effective . . . .

Id. 159


161 Hinden, supra note 12, col. 3, citing Stephen Shock, Vice President of MNC Financial.

162 Cunningham interview, supra note 9.

163 Welsh interview, supra note 9; see also Hinden, supra note 12, col. 4. Foreign denominated deposits in the United States provide an alternative to deposits of the same currency in the home country. Interest rates may reflect this situation.

164 Cunningham interview, supra note 9; Welsh interview, supra note 9.

choose time deposits. The second factor affecting the interest rate on a foreign currency deposit is the strength of the foreign currency itself against the dollar. Strong currencies receive lower interest rates than weaker currencies. To equalize the net interest earnings, a strong currency requires only a marginal interest rate as compared to a weak currency.

Fifth, the FED did not determine whether clients holding foreign currency deposits will be able to write checks on their account. Many current domestic accounts do allow check-writing, but foreign currency checks may present special problems. Difficulties may arise when a foreign currency account holder writes a check to someone without an account in the same currency. Another complication arises if one bank permits foreign currency checking and other banks do not honor the negotiable instruments. Furthermore, it is unclear whether the check will be valued in U.S. dollars at the time it was written or at the time it is received by another bank. This is an important issue if the foreign currency supporting the check is significantly appreciating or depreciating vis-a-vis the U.S. dollar. Yet, one could argue that any subsequent conversion of the foreign denominated check would occur regardless of the exchange rate when the check was written and apply the exchange rate when the foreign currency is withdrawn from the checking account.

The capacity to write checks in a foreign currency as well as to receive payment in this currency is especially beneficial for those U.S. residents who purchase and sell products from abroad and for U.S. resident businesses seeking to be more efficient by decreasing costs. For example, importers could make payments for the foreign goods they purchase in the exporting country’s currency. The importer will avoid the costs of multiple conversion by being able to send payment for goods in a foreign denominated check. Similarly, exporters could pay foreign fees and taxes associated with selling a

---

166 Cunningham interview, supra note 9.
167 Id.; Welsh interview, supra note 9.
168 Jorgansen interview, supra note 115 (noting only U.S. dollars are legal tender in the United States for settlement of debt); Welsh interview, supra note 9; Cunningham interview, supra note 9.
169 This problem is similar to the process of determining what conversion rate must be given to legal judgments arising from disputes involving foreign currencies. Courts have used three approaches. First, the judgment day rule requires conversion of foreign denominated obligations to the currency of the court’s forum at the exchange rate that applies on the date of the judgment. MANN, THE LEGAL ASPECT OF MONEY 307-08 (2d ed. 1953). Second, the breach day rule calls for conversion at the exchange rate prevailing on the day the tort occurred or the contract was breached. Gylfe v. Trujillo, 209 F.2d 386, 387 (2d Cir. 1954); Taubenfeld v. Taubenfeld, 198 Misc. 108, 97 N.Y.S.2d 158 (N.Y. Sup. Ct. 1950). Last, federal courts use the judgment day rate of conversion when the contract requires payment in a foreign nation, and the breach date rate when payment is to be made in the United States. Zimmerman v. Sutherland, 274 U.S. 253 (1927); Sutherland v. Mayer, 271 U.S. 272 (1926).
product abroad in the importing country's currency. Also, persons who speculate on commodity futures and options could send a foreign denominated check to a futures commission merchant to cover the margin of a transaction.

Sixth, because the value of a foreign currency deposit is subject to exchange rate volatility, the FED may require depository institutions offering such accounts to follow strict guidelines regarding disclosure, advertising, and other consumer protections, yet the FED failed to indicate how or if this would be accomplished. Consumer protection requirements could parallel or be subsumed under present FED regulations compelling banks to explain to their clients the terms and costs of their loan. Presently, banks must inform the borrower when finance charges on a loan begin as well as the annual interest rate to be charged. Additionally, a creditor must provide the borrower with an annual statement, a form listing payments made, and a notation of the amount of the outstanding loan. In the case of foreign currency deposits, FED regulations could insist that depository institutions describe to the client the interest rate depositors earn on their account and provide the terms of the depository account, the minimum balance, and charge per check.

If disclosure statements are required some policy will be needed to determine which language will be used. Translation of the disclosure statements will probably not occur because U.S. residents or agents of nonresidents who use foreign currency deposits will presumably understand English.

The FED may also set advertising standards for foreign currency deposits. Presently, FED regulations ensure that any advertisement describing specific credit terms must be clear and comprehensible. Banks offering foreign currencies could also be held to comparable responsibilities.

Future FED advertisement requirements could also include disclosure by depository institutions of whether withdrawal of funds is possible in currencies other than those originally deposited. For example, if the bank fails to maintain enough funds in a particular for-

---

170 See Plaut, supra note 8, at 27.
171 Welsh interview, supra note 9. Because bank clients have dealt primarily with domestic dollar currency deposits, some guidance regarding foreign currency deposits may be helpful for both the client and bank. Such consumer protection measures will enable banks to protect themselves from suits arising from misinterpretation.
173 Id.
174 It would also be important for the investor to know if the minimum deposit were calculated by the foreign currency or by a dollar conversion rate. If the latter applied, the investor would likely also be interested in what exchange rate guidelines will be quoted.
eign currency; the deposit account agreement might have stipulations similar to currency availability clauses (i.e., if there is scarcity of a currency, the lender has the option to switch loan payment into a different currency) and multicurrency clauses (allowing the borrower to request a change in currency payment). The FED could also require banks to keep a portion of their assets in a particular foreign currency.

The FED may also attempt to ensure that depository institutions do not solicit foreign currency deposits unfairly or deceptively. To this end, the FED could require that banks provide information to potential customers of the difference between foreign currency deposit risks and domestic dollar deposit risks. A bank might also warn that foreign currency deposits are not the most effective way to hedge against foreign currency fluctuations.

Finally, the FED has not addressed how banks should deal with money launderers who may resort to using these new accounts. The Money Laundering Control Act of 1986, coupled with the Currency and Foreign Transactions Reporting Act, require banks to respond promptly and diligently when conducting unusual or suspicious fund transfers. In light of the FED's ruling, awareness and attention by banks concerning suspicious foreign currency deposits should be heightened. No new regulations geared at countering foreign currency laundering are envisioned, since the statutes and regulations discussed above could be applied both to dollars and foreign currencies.

V. Conclusion

In essence, the FED's decision no longer to discourage U.S. depository institutions from accepting foreign currency deposits crys-

178 Id.; see R.B. Johnston, supra note 29, at 29.
180 Welsh interview, supra note 9.
181 Smith interview, supra note 11; see supra notes 24-28 and accompanying text; Little, Financial Futures and Immunization, 9 J. Fin. Res. 1 (1986) (relating capacity of financial futures to hedge unexpected movement in interest rates).
182 Money laundering occurs when persons or financial institutions conduct transactions with proceeds known to have been gained through certain unlawful activities. See 18 U.S.C. § 1956 (1988).
185 Cunningham interview, supra note 9.
talizes the tension between the gains to the domestic public of integrated international financial markets and the FED's objective to manage the exchange rate of national currency. This new policy anticipates marginal growth of nondollar deposits at U.S. banks. However, there are significant benefits from these new accounts both to banks and their clients, and it is quite probable that demand for these accounts will be large. As the demand by U.S. residents for foreign currencies rises, substitution of dollar deposits into foreign currencies will increase, thereby destabilizing the exchange rate of the dollar. Permitting this uncertainty in the value of the dollar undermines the FED's goal to maintain efficient control over the nation's financial markets.

DEAN C. ALEXANDER