

Edge act and agreement corporations: mediums for international banking

Neil Pinsky

Expansion of the international activities of U.S. banks has been one of the most remarkable developments in American banking over the past 20 years.¹ The most "visible" sign of this expansion has been the growth of foreign assets of U.S. banks. From just over \$6 billion in 1957, these assets had increased to almost \$350 billion at the end of 1977. Less visible but equally remarkable has been the institutional adaptability of banks, which facilitated the expansion.

One sign of this adaptability has been the rapid growth in recent years of special corporate entities known as Edge Act and agreement corporations. Authorized by federal banking laws as channels for conducting international activities, these corporations increased in number from 38 in 1964 to 122 in 1977. By the end of 1976, the last year for which detailed figures are available, their total assets reached \$11.6 billion.

Initially, Edge Act and agreement corporations made it possible for U.S. banks to engage in international banking and finance activities from which they had been barred. In recent years, these corporations have become the main vehicle for banks to establish international banking offices in financial centers outside their home states.

Legal foundations

Banks in the United States were slow to engage in international activities. Even though international trade and foreign in-

flows of capital had always been integral to the country's economic development, the provision of financial and banking services that typically underlie such transactions remained in the hands of European banks.

Much of this was due to the strong domestic orientation of most U.S. banks. In part, however, it was also due to the legal restrictions the government placed on the international activities of banks. Until 1913, national banks were barred from financing foreign trade through bankers' acceptances. They were also barred from establishing branches overseas.

At the turn of the century, as the United States was becoming a major industrial power, attitudes toward international banking began to change. In 1913, the Federal Reserve Act lowered the legal barriers to participation in international banking by national banks. National banks with \$1 million in capital and surplus could establish branches in foreign countries, subject to approval of the Federal Reserve Board, "... for the furtherance of the foreign commerce of the United States, and to act, if required to do so, as fiscal agents of the United States."²

Support for the legislation came from the belief that expansion of the authority of banks to conduct business abroad would help in the promotion of U.S. exports and the extension of credit to European governments.

Over the next three years, only one bank—one of the country's largest—took advantage of the new authority. The costs and risks of expanding abroad were apparently perceived as too great for any but the largest banks to bear alone. To broaden the base of

¹For a historical perspective on this development, see "Banking goes international," *Business Conditions*, Federal Reserve Bank of Chicago, April 1967. For a more recent survey, see "International banking: Part I," *Business Conditions*, Federal Reserve Bank of Chicago, September 1975.

²The same authority was extended in 1933 to include state banks that were members of the Federal Reserve.

banks that might be willing to engage in international banking, the Federal Reserve Act was amended in 1916 to allow national banks with capital of \$1 million or more to invest, individually or together with other banks, up to 10 percent of their capital and surplus in institutions chartered by state banking authorities for the sole purpose of conducting international banking business. This authority required that the institution enter into an agreement with the Federal Reserve Board to observe any restrictions that might be imposed. These institutions became known as *agreement corporations*.

Despite the liberal terms of the charters—there is no minimum required capitalization, for example, and no restriction on the nationalities of owners or directors of the corporations—only three agreement corporations were chartered over the next two years.

In a further effort to increase the international activities of American banks, the Federal Reserve Act was amended again in 1919 to allow the Federal Reserve Board to charter corporations to engage in international banking. The amendment was called the Edge Act, after its sponsor, Senator Walter Edge of New Jersey, and corporations chartered under the act became known as *Edge Act corporations*, or simply as Edges.

The International Banking Act of 1978, which was recently enacted, contains significant revisions to the Edge Act. This legislation recognizes the need to improve the competitive position of Edges relative to foreign banks in the United States and elsewhere, end discrimination against the ownership of Edges by foreign-owned banking institutions, and foster the ownership of Edge Act corporations by regional and smaller banks throughout the United States. The expansion and increased competition in international banking that are expected should promote international trade, especially U.S. exports, by bringing international trade financing opportunities to small as well as large farms and businesses.

To facilitate these objectives, the section of the 1978 legislation pertaining to Edges

Regulating Edge Act and agreement corporations

Laws and regulations affecting Edge Act and agreement corporations, contained generally in Sections 25 and 25(a) of the Federal Reserve Act and in Federal Reserve Regulation K, provide the following:

- National banks can invest up to 10 percent of their capital in Edge Act and agreement corporations.

- Edges have a minimum capital requirement of \$2 million. There is no minimum capital requirement for agreement corporations.

- Under the International Banking Act of 1978, the requirement that directors of Edge Act corporations be U.S. citizens is removed. Foreign-owned banking institutions are authorized for the first time to acquire majority control of an Edge. Agreement corporations were never subject to these restrictions on foreign ownership or directors.

- The International Banking Act of 1978 will eliminate the limitation on Edge Act liabilities upon debentures, bonds and promissory notes in excess of ten times its capital and surplus.

- Deposits of Edge Act and agreement corporations are subject to the same reserve requirements as deposits at banks that are members of the Federal Reserve System. The International Banking Act of 1978 eliminates the statutory minimum reserve ratio of 10 percent on aggregate deposits.

- Interest payments on deposits are also subject to the same restrictions as at member banks.

The original act authorizing Edge corporations provided for two types: investment (or financing) Edges and banking Edges. This distinction was largely eliminated in 1963, when Regulation K was revised to allow Edge Act corporations to engage in both types of activities. The only distinction remaining relates to lending limits. An Edge Act corporation is "engaged in banking" when its aggregate demand deposits and acceptance liabilities exceed its capital and surplus. As a banking Edge, it can grant credit to any one customer only up to 10 percent of its capital and surplus. An Edge not "engaged in banking" is commonly called an investment Edge. It can lend as much as 50 percent of its capital and surplus to a single customer.

eliminates or modifies many of the restrictive provisions of the original Edge Act and requires the Federal Reserve Board to revise its regulation of Edges.

Nature of operations

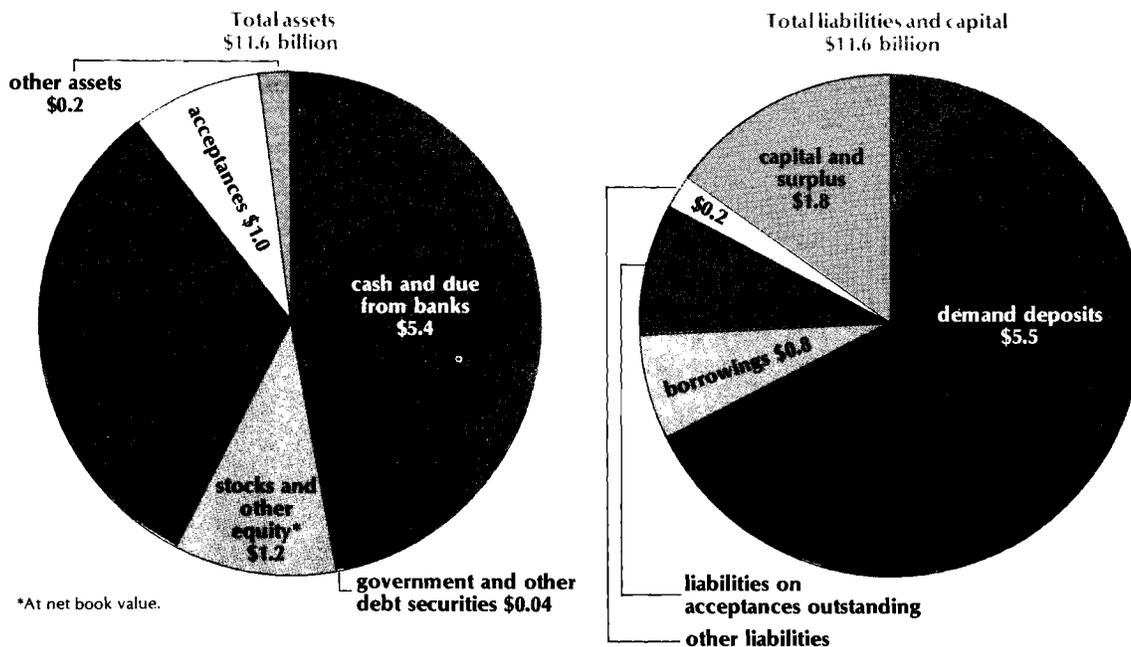
Edge Act and agreement corporations can engage in an array of international banking and financing activities, including trading in foreign currencies, foreign lending, acceptance financing, and foreign collections. They can accept demand and time deposits (but not savings deposits) in the United States as long as the deposits are related to identifiable international transactions. They can accept deposits from foreigners, including foreign governments, and businesses operating primarily abroad, provided the deposits are not used to pay purely domestic expenses.

Originally, the main advantage of an Edge or an agreement corporation to its parent bank was its unique authority to make

equity investments in foreign corporations.³ While U.S. banks could not ordinarily make equity investments, with an Edge or agreement corporation, they could legally undertake such investments in foreign corporations. This ability put U.S. banks in an improved competitive position relative to banks in other countries, which were typically permitted by their laws to make such investments. The ability of Edges and agreement corporations to provide medium and long-term debt financing as well as equity financing gave banks a useful complement to

³Edges have the "general consent" of the Board of Governors of the Federal Reserve System to make an equity investment of up to \$500,000 in foreign corporations not doing business in the United States, provided they hold no more than 25 percent of the voting shares of the corporation. Otherwise, prior consent of the board is required, unless the purchase of the stock is necessary to prevent loss on an existing loan. Without specific approval of the Board of Governors, no more than 10 percent of an Edge's capital and surplus can be invested in a corporation other than a bank and no more than 15 percent can be invested in a banking corporation.

Edge Act and agreement corporations composite balance sheet, December 31, 1976



their primary role as short-term lenders. This was particularly true in the case of corporate customers in countries with poorly developed capital markets.⁴

The authority to make equity investments was especially important when Edges and agreement corporations were the only means U.S. banks had of investing in foreign banks in countries where they were barred from establishing branches. In 1966, however, the Federal Reserve Act was amended to allow national banks, with approval of the Federal Reserve Board, to invest directly in foreign banks doing no substantive business in the United States.

The advantage of Edges and agreement corporations as a unique channel for equity investment by American banks was further diminished in 1970, when the Bank Holding Company Act was amended to allow *bank holding companies* to make the same equity investments in foreign corporations that Edges could make.

Edges and agreement corporations, however, still have one investment advantage over other forms of international banking organization. Since they are exempt from some of the restrictions on loans to foreign affiliates and investments in them, Edge corporations are now commonly used by banks as “holding companies” for their foreign subsidiaries and affiliated companies. Edges engaged in equity investments are commonly called investment Edges. They are usually located in the same city as their parent bank.

Edge and agreement corporations can be located anywhere in the United States. This is an important advantage, for banks themselves are prohibited from establishing branches outside their own state, and they are not usually allowed to own banks in other states.

⁴Some Edge Act corporation investments have been a hybrid of debt and equity—loans that can be converted into stock at the discretion of the Edge or loans that give the Edge the option of buying an equity interest in the borrowing corporation. Through such hybrid investments by their subsidiaries, banks could increase their return on loans to foreign corporations, especially in the early stages of a customer’s corporate development.

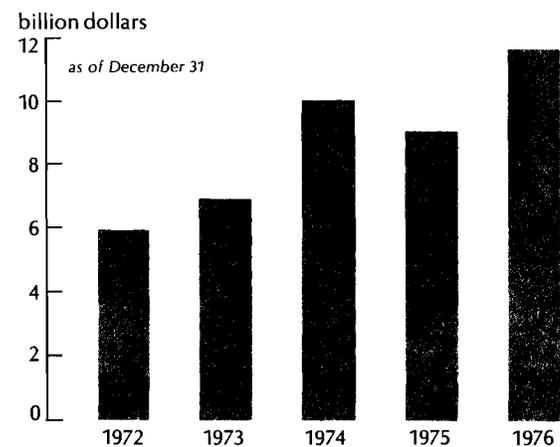
Therefore, Edge and agreement corporations can serve as a vehicle for banks to establish offices outside their home state for purposes of engaging in international banking. With offices in other cities, banks can better serve the trade financing and other international banking needs of their customers. Although they cannot make domestic loans, their presence in other financial centers can be helpful to parent banks in competing for domestic business far from their home offices. Most Edges located outside the parent’s home state primarily engage in international banking rather than in investing in foreign corporations.

Patterns of growth

Despite the advantages of Edge Act and agreement corporations, banks were slow to make use of them. Only 20 Edge and agreement corporations were chartered by 1932. Since they were buffeted by the same forces that caused some 15,000 bank failures in the United States between 1920 and 1933, only five were still in operation by 1934.

Growth of international banking was stymied by the worldwide recession in the thirties, and the war and reconstruction in the forties. Only two Edges and one agreement

Total assets of Edge Act and agreement corporations almost doubled in four years



corporation were chartered between 1932 and 1956.

By the late fifties, however, with world trade expanding and American business increasing its investment abroad, the demand for international banking services increased. Edge Act and agreement corporations were

channels through which American banks could meet the demand.

Some banks used Edges to complement the operations of branches overseas and international departments at their head offices. Others used them as a means of establishing a presence in New York, the country's main

Edge Act and agreement corporations operating in
the Seventh Federal Reserve District

as of December 31, 1976

<u>Name</u>	<u>Parent bank</u>	<u>Location</u>	<u>Year estab- lished</u>	<u>Capital</u> <i>(thousands)¹</i>
American Natl. Overseas Corp.	American Natl. Bank & Tr. Co. (Chicago)	Chicago	1968	\$ 2,341
Bank of America Intl. (Chicago)	Bank of America NT & SA (San Francisco)	Chicago	1971	9,481
Bankers Trust Intl. (Midwest) Corp.	Bankers Trust Co. (New York)	Chicago	1974	3,100
Chase Bank Intl. (Chicago)	Chase Manhattan Bank NA (N.Y.)	Chicago	1974	2,792
Chemical Bank Intl. (Chicago)	Chemical Bank (New York)	Chicago	1974	2,281
Citibank Intl. (Chicago)	Citicorp (New York)	Chicago	1972	2,359
Continental Intl. Finance Corp.	Continental Ill. Natl. Bank & Tr. (Chgo.)	Chicago	1962	34,406
Crocker Bank Intl. (Chicago)	Crocker Natl. Bank (San Francisco)	Chicago	1973	4,717
European-American ² (Chicago) Corp.	European American Bancorp (N. Y.)	Chicago	1977	Not open
Exchange-Israel ² Corp. (Chicago)	Exchange Natl. Bank (Chicago)	Chicago	1973	³
First Chicago Intl., Fin. Corp.	First National Bank (Chicago)	Chicago	1962	23,122
Detroit Bank and Trust Intl.	Detroit Bank & Trust Co.	Detroit	1969	20,897 ⁴
Intl. Bank of Detroit	National Bank of Detroit	Detroit	1963	26,072
Manufacturers-Detroit Intl. Corp.	Manufacturers Natl. Bank (Detroit)	Detroit	1963	4,387
Indiana Natl. Overseas Corp.	Indiana Natl. Bank (Indianapolis)	Indian- apolis	1971	2,410

¹December 31, 1976.

²Agreement corporation.

³Exchange-Israel Corporation is an inactive but chartered agreement corporation.

⁴Total consolidated capital for home office and foreign branches.

**Edge Act and agreement corporations of banks domiciled in
the Seventh Federal Reserve District**
(December 31, 1977)

<u>Name</u>	<u>Parent bank</u>	<u>Location</u>	<u>Year estab- lished</u>	<u>Capital</u> (thousands) ¹
Allied Bank ² Intl.	American Fletcher Natl. Bank & Trust Michigan Natl. Bank of Lansing	New York	1968	\$42,947
American Natl. Overseas Corp.	American Natl. Bank & Tr. Co.	Chicago	1968	2,341
Continental Bank Intl.	Continental Ill. Natl. Bank & Tr. Co.	New York	1962	36,879
Continental Bank Intl. (Pacific)	Continental Ill. Natl. Bank & Tr. Co.	Los Angeles	1972	11,116
Continental Bank Intl. (Texas)	Continental Ill. Natl. Bank & Tr. Co.	Houston	1973	5,312
Continental Intl. Finance Corp.	Continental Ill. Natl. Bank & Tr. Co.	Chicago	1962	34,406
Detroit Bank & Tr. Intl.	Detroit Bank & Trust Company	Detroit	1969	20,897 ³
Exchange-Israel ⁴	Exchange Natl.	Chicago	1973	3
First Chicago Intl. Banking Corp.	First Natl. Bank of Chicago	New York	1962	12,523
First Chicago Intl. Finance Corp.	First Natl. Bank of Chicago	Chicago	1962	23,122
First Chicago Intl. (Los Angeles)	First Natl. Bank of Chicago	Los Angeles	1973	5,409
First Chicago Intl. (San Francisco)	First Natl. Bank of Chicago	San Francisco	1973	5,933
First Wisconsin Intl. Bank	First Wisconsin Natl. Bank Corp.	New York	1972	2,532
Harris Bank Intl. Corp.	Harris Trust & Savings Bank	New York	1971	5,517
Indiana Natl. Overseas Corp.	Indiana Natl. Bank	Indian- apolis	1971	2,410
Manufacturers-Detroit Intl. Corp.	Manufacturers Natl. Bank	Detroit	1963	4,387
Intl. Bank of Detroit	Natl. Bank of Detroit	Detroit	1963	26,072
Northern Trust Interamerican Bk.	Northern Trust Co.	Miami	1974	2,505
Northern Trust Intl. Banking Corp.	Northern Trust Co.	New York	1968	6,702

¹December 31, 1976.

²Allied Bank International is owned by 18 regional banks, including American Fletcher National Bank (Indianapolis) and Trust Company and Michigan National Bank of Lansing.

³Total consolidated capital for home office and foreign branches.

⁴Exchange-Israel Corporation is an inactive but chartered agreement corporation.

center for international finance. By 1966, there were 36 Edge Act corporations, 18 of them in New York.

In the late sixties and early seventies, there was an apparent movement toward decentralization of international activities. In recognition of the growing importance of cities other than New York as international banking centers, banks began opening Edge Act and agreement corporations in financial centers across the country. There were 116 Edges and six agreement corporations last year, and their dispersal across the country allowed banks to offer an array of international banking services nationwide. Thirty-eight were in New York. Other heavy concentrations were in Los Angeles (12), Chicago (11), Miami (ten), and Houston (nine).

Edges in the Seventh District

There are 13 Edge and 2 agreement corporations operating in the Seventh Federal Reserve District.⁵ That number, the largest in any district except the Second (New York) and Twelfth (San Francisco), reflects both the significance of Seventh District states in world trade and the importance of Chicago as an international financial center.

Thirteen banks headquartered in the Seventh District own interests in 19 international banking subsidiaries—18 Edges and one agreement corporation. Of these, eight are in the district, six are in New York, and two are in Los Angeles. The rest are in San Francisco, Houston, and Miami.

The establishment of both the Edge cor-

⁵One of the two agreement corporations, European-American Corporation (Chicago), is a subsidiary of a foreign-owned bank based in New York State.

porations in the district and Edge subsidiaries of banks headquartered in the district reflects the pattern of growth in international banking corporations nationwide. Banks in the district established ten Edges in the sixties. Of these, four were “banking” Edges in New York. The rest were investment Edges in each bank’s home city.

In the seventies, five of the nine international banking subsidiaries established by the banks in the Seventh District were Edges located outside New York. In 1971, the California-based Bank of America opened an Edge in Chicago. That was the first Edge in the district set up by a bank from outside the district. Others followed shortly. Six banks from outside the district have Edges in Chicago, and one has an agreement corporation.

Summary and conclusions

Edge Act and agreement corporations have added an important dimension to the expansion of international banking services. Their growth over the past 20 years attests to the advantages they offer banks. The license of Edges to make equity investments in foreign corporations and their exemption from some of the restrictions on banks makes them an attractive vehicle for holding a bank’s foreign subsidiaries. The ability of Edges to establish offices in states other than that of the parent bank makes it possible for banks to serve the international banking needs of their customers nationwide.

Because of these advantages, and revised regulations that will result from the International Banking Act of 1978, Edge Act and agreement corporations can be expected to continue playing an important role in the international activities of U.S. banks.