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DIRECTORATE OF
INTELLIGENCE

Intelligence Report

Soviet-Owned Banks in the West

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1969

INTELLIGENCE REPORT

Soviet-Owned Banks in the West

Introduction

The rapid growth of East-West trade since the late 1950's and the concomitant rise in requirements for convertible currency to finance it have been instrumental in the expansion of Soviet banking activities and institutions in the West. This report examines the role of Western-based Soviet-owned banks in the financing of East-West trade, their operations in Western money markets, and the growth of these banks in recent years.

Note: This report was produced solely by CIA. It was prepared by the Office of Economic Research.

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Background and Recent Growth

1. Since the return to convertibility in Western Europe in 1959, Soviet-owned banks in the West have played an increasingly important role in the development of East-West trade,* which increased from about \$5.7 billion to roughly \$15.7 billion in the period 1958-68. Moscow Narodny Bank (MNB) in London and Banque Commerciale pour l'Europe du Nord (BCEN)** in Paris -- both relatively small in the pre-World War II era -- have developed into large and diversified banking institutions. MNB opened a branch in Beirut in 1963. Another bank, Wozchod Handelsbank, A.G., was added in Zurich in 1966.*** The total assets of the Soviet-owned banks exceeded \$1.6 billion at the end of 1968, compared with about \$220 million a decade earlier (see the table).

Assets of Soviet-Owned Banks in the West

Million US \$ ^{a/}				
<u>Year</u>	<u>MNB</u>	<u>BCEN</u>	<u>Wozchod</u>	<u>Total</u>
1958	24	198		222
1959	151	380		531
1960	156	360		516
1961	219	426		645
1962	291	503		794
1963	520	550		1,070
1964	573	570		1,143
1965	653	632		1,285
1966	702	662	9 <u>b/</u>	1,373 <u>b/</u>
1967	719	774	42	1,535
1968	775	800 <u>b/</u>	61	1,636 <u>b/</u>

a. *Converted from national currencies to US dollars at appropriate exchange rates.*

b. *Estimated.*

* *Trade of the USSR, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania with the non-Communist world.*

** *BCEN is commonly known by its cable address, Euro-bank.*

*** *The Russo-Iranian Bank in Teheran had already been established in 1923. It is not concerned with East-West trade per se. For a description of its history and functions, see Appendix A.*

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2. The handling of East-West trade could be left entirely to Western banks, but the presence of these Soviet-owned banks in the West offers certain advantages to the USSR. Their successful development, for example, has enhanced the ability of the USSR to gather commercial intelligence, to enter the foreign exchange and Eurocurrency markets, to tap outside sources of funds, and to maintain a degree of secrecy in its convertible currency dealings. Moreover, in recent years MNB and BCEN have been profitable operations, each earning a return on capital of 10 percent or more. Profits of the Soviet-owned banks combined exceeded \$4 million in 1968. In addition, these banks, in their capacity as overseas representatives of the USSR, give the Soviet authorities a measure of control over the credit made available to other Communist countries and even to some less developed countries.

3. The State Bank of the Soviet Union (Gosbank) and the Foreign Trade Bank of the Soviet Union (Vneshtorgbank) are the major shareholders of the Soviet-owned banks in the West, and the general policies of the Western-based Soviet banks are under the direction of Soviet authorities. Soviet citizens generally occupy the key top posts, but the banks otherwise are staffed by local nationals who are hired for their banking expertise rather than ideological commitments. The bank managements adhere to the laws and customs of the countries in which they are incorporated and are largely autonomous in operational matters, especially in fields where their activities are prescribed by commercial considerations or accepted Western practice.

4. These banks provide banking services and financing of Western trade for the USSR and other Communist countries (particularly in Eastern Europe). To an increasing extent they have become involved in financing trade of non-Communist countries as well. Aside from foreign trade activities they act as agents for Soviet (and occasionally East European) gold sales in the West, handling gold contracts and deliveries. The Soviet-owned banks also offer banking services to local customers, including the maintenance of current and time deposit accounts and the provision of short-term loans to private companies.

Some of the activities of the Soviet-owned banks may be ascribed to a desire for their own institutional growth and profits rather than the promotion of East-West trade, but by expanding and diversifying their operations these banks have enhanced their ability to provide financing and banking services for East-West trade and have helped to build the financial reputation of the Communist countries. By developing local customer relations, these banks have increased their deposits of Western currencies and have expanded the possibilities for the profitable use of their funds.

Moscow Narodny Bank

5. MNB was originally established in London in 1916 as an agency of the Moskovskiy Narodny Bank of Moscow. In 1919, after the revolution, it was re-created as a separate legal entity. By 1929, MNB had assets of about \$40 million and branch offices in Paris, Berlin, and New York. With the depression, World War II, and finally the cold war, however, business fell off, branches were closed, and assets plunged. As late as 1952, MNB's assets were less than \$17 million, and its business was to remain slack for a few more years. Since 1958, however, its resources have expanded rapidly and its activities have taken on new dimensions.

6. MNB's assets at the end of 1968 were \$775 million, some 32 times greater than the 1958 level. About two-thirds* of its assets consist of advances and loans; less than one-third are in the form of balances held with banks and correspondents. The increase in MNB's resources over the years has come about largely through the increases in balances held with it by banks and correspondents, both Western and Communist.** These balances, totaling \$640 million in 1967, comprised almost 90 percent of MNB's total resources, and about half are Communist held. MNB's resources also have been supplemented by the

* Based on 1967 data, the latest year for which detailed data are available. For further details, see Appendix B.

** MNB has about 150 correspondents in 50 countries.

use of rediscount facilities in London, where MNB acceptances command the most favorable rates, and from successive increases in capital and reserves, which increased from less than \$2 million in 1958 to about \$15 million in 1967. Net profits also have risen, reaching almost \$2 million in 1968 compared with about \$100,000 in 1958.

7. In addition to promoting and financing East-West trade, MNB provides some financing for Western exports to less developed countries. MNB also is active in foreign exchange and Eurocurrency markets, as both borrower and lender. Since 1967, MNB has been a principal in the sale of Eurodollar Certificates of Deposit (CD's) and, since 1968, of sterling CD's.

8. In October 1963, MNB opened a branch in Beirut, Lebanon. The primary motive for the move into this important financial center evidently was the need to facilitate banking operations in an area where Communist trade was growing rapidly. The emphasis in the Beirut branch, according to its head office, is on the financing of East-West trade, said to be the largest single type of finance extended by the Beirut office. It is also involved in foreign exchange operations. The London office claims that the Beirut branch is "foremost among the banks operating in Lebanon." Its assets (included in the total for MNB) may be \$100 million or more. There is no recent information on its profits, but they probably have grown since 1964, when they were stated to be about \$250,000.

Banque Commerciale pour l'Europe du Nord

9. BCEN was founded in Paris in 1921 by a group of wealthy Russian emigres, who sold out to Soviet interests in 1925. Unlike MNB, BCEN experienced rapid growth in the immediate post-World War II period. In 1948, BCEN had assets of less than \$7 million, or only 10 percent of MNB's total assets at the time. By 1958, BCEN's assets had reached roughly \$200 million -- eight times those of MNB. This more rapid growth apparently was related to the confidence that

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Moscow had in the BCEN manager at that time, Charles Hilsum,* prompting it to make funds available to (and channel business through) BCEN rather than MNB.

10. BCEN's assets at the end of 1967 (1968 data are not available) were \$774 million, roughly the same as MNB and about four times those of 1958. Unlike MNB, the largest proportion -- almost 80 percent -- of BCEN's assets were in the form of cash, mainly deposits with banks and correspondents.** Only about one-fifth were allocated to advances and loans -- that is, for the direct financing of trade. On the opposite side of the ledger, virtually all of BCEN's resources -- more than 97 percent -- came from deposits by banks and correspondents, most of the remainder from capital and reserves. BCEN's net profit of \$2.1 million in 1967 compares favorably with MNB's profit of \$2 million in 1968.

11. The high proportion of cash on the assets side and the correspondingly small proportion used for commercial loans and advances indicates that BCEN does relatively little direct trade financing. Instead, it has induced a number of its Western correspondent banks to provide such trade credit. A considerable proportion of BCEN's deposits with its Western correspondents have served to secure lines of credit at these banks, primarily for Communist imports from the country in which the Western bank is located. Serving basically as a financial intermediary -- as opposed to the direct financing of East-West trade -- BCEN is probably even more actively involved in Eurocurrency markets than is MNB.

Wozchod Handelsbank, A.G.

12. In October 1966, Wozchod Handelsbank, the newest of the Soviet-owned banks in the West, was

* Hilsum, a naturalized Frenchman of Russian origin, was closely associated with the French Communist Party.

** See Appendix B. BCEN has roughly 200 correspondents.

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established in Zurich, Europe's chief financial center. One of the major motivations for Wozchod's establishment may have been the Soviet desire to tap a new and major source of Eurocurrency funds; another motive may have been the greater secrecy in monetary operations, including sales of gold, in Switzerland.

13. Wozchod Handelsbank has grown rapidly since its establishment in 1966. Its initial capital of about \$2 million increased to about \$9 million in 1968. By the end of 1968 the bank's assets exceeded \$60 million, a 45-percent increase over 1967. Wozchod's net profits in 1968, about \$160,000, were three times those of 1967.

Role of the Banks in East-West Trade

14. The primary stated function of the Soviet-owned banks in the West is to facilitate Soviet trade with Western countries. The charters of BCEN and Wozchod Handelsbank specifically state that their purpose is to develop Soviet trade with France and Switzerland, respectively. MNB, however, refers to itself more generally by its "second name," "the Bank for East-West Trade." In practice all three banks provide their services to other Communist countries, including Yugoslavia, as well as to some of the less developed countries. The services are the same as those generally provided by Western banks specializing in international payments and include such items as making and collecting payments, direct financing, rediscounting, and processing trade documents. The Soviet-owned banks also provide the Communist countries with general commercial intelligence, particularly that pertaining to East-West trade. Through their credit departments and contacts with their Western correspondent banks, they can obtain current credit information on Western importers and exporters that normally would not be available to Communist foreign trade firms and banks.

15. The trade financing offered by the Soviet-owned banks is similar to that offered by any large Western bank handling international payments. Although loans are primarily for periods of six months or less, some longer term financing is offered, especially

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for trade in capital equipment. Because of their limited resources, however, the Soviet-owned banks are largely restricted to short-term financing. Consequently, the USSR and East European countries have had to turn increasingly to Western sources to obtain the medium- and long-term loans required for their expanding imports of machinery and equipment from the West. Over the past decade they have borrowed several billion dollars from the West -- chiefly in the form of government-guaranteed supplier credits and other tied loans. According to NATO sources, East European medium- and long-term indebtedness to the West is now about \$2 billion. Soviet indebtedness is estimated at about \$700 million.

16. The credit facilities available to the USSR and Eastern Europe do not, however, provide for all contingencies. During the past decade the hard currency payments positions of a number of these countries have from time to time required some of them to cut back on imports of equipment and materials required for industrialization programs and, in the case of the USSR, have resulted in a severe drain on gold reserves. The current interest being shown by the USSR and other European Communist countries in the International Monetary Fund (IMF) might indicate that they are seeking the additional flexibility in international payments that membership in IMF would provide. The likelihood of their seeking membership under present conditions is virtually nil, however -- if only because these countries would be loath to reveal data on their financial reserves, such data being a state secret.

Involvement in Western Money Markets

17. MNB and BCEN (and presumably Wozchod Handelsbank), being located in the leading European financial centers, are active participants in both foreign exchange and Eurocurrency markets. BCEN became active in European foreign exchange markets before MNB, apparently because of its earlier post-World War II development into a sizable international bank and its extensive relations with Western correspondents, many of which provide trade credits in foreign currencies. MNB began to play an active role in the foreign exchange market only in 1961.

18. MNB and BCEN were among the first European banks to become involved in Eurodollar transactions, in the early 1950's. At first they were primarily lenders -- a result of the unwillingness of their Communist correspondent banks (Gosbank, Vneshtorgbank, and the central banks of special foreign trade banks of the Communist countries) to hold more than working balances in US banks, apparently feeling that if East-West relations deteriorated, their Western currency balances in European banks would be safer (that is, less likely to be blocked by government authorities) than balances held in the United States. The Communist countries, however, were unwilling to exchange their dollar balances for the then less convertible Western European currencies. As a result, Soviet and East European banks began to hold some of their dollar balances in MNB and BCEN, which in turn lent them at profitable rates of interest in the Eurodollar market. The liberalization of exchange controls in Europe in 1958 increased the flexibility of the Eurodollar operations and allowed the development of active markets in European currencies as well as US dollars.

19. The position of MNB and BCEN in Eurocurrency markets gives the USSR and East European countries additional flexibility in financial relations with the West. By building up their credit standing, MNB and BCEN have been able, when necessary, to become net borrowers in Eurocurrency markets. The ability to borrow in these markets serves both to augment the trade credit otherwise obtainable in the West and to cushion the disruptive effects of large emergency withdrawals by Communist or Western correspondents. In addition, the excellent reputations that MNB and BCEN have established in Western currency markets enable them to attract Eurocurrency deposits at prime rates -- a factor of great importance for profitable operations. By building these reputations, MNB and BCEN have also been instrumental in establishing the credit-worthiness of the Communist countries and institutions associated with them. Wozchod Handelsbank, the newest Soviet entry in the Western banking world, undoubtedly will share in the confidence earned by MNB and BCEN.

Gold Sales

20. In addition to normal banking duties, the Soviet-owned banks in the West act as agents for the USSR and, occasionally, for other Communist countries for sales of gold in the West. In the past, London was the major gold market in the world because of the special role of the Bank of England both in the Gold Pool and in acting as agent for sales of South African gold. Accordingly, most Soviet gold was sold in London, with smaller quantities sold in Switzerland and Paris. Because the central banks of the Group of Ten maintained the price of gold at \$35 per ounce,* the USSR had to accept this price to be able to sell in large lots. Smaller markets -- for example, Beirut or Hong Kong, with their higher prices -- would not have been able to absorb Soviet sales. Under the present two-tier system, the USSR can obtain higher prices -- \$40-\$42 per ounce -- on the free gold market, but large lot sales might depress the price of gold. Under the old system the USSR received only \$35 an ounce, but that price was guaranteed. Now the USSR, if it desired to sell gold, would have to be more circumspect and sell smaller amounts -- in London, Zurich, Paris, and Beirut** -- to avoid putting a downward pressure on the market.

Initiatives for New Banking Facilities

21. Over the last four or five years, Soviet banking officials have indicated an interest in the establishment of a banking facility in New York. The present volume of US trade with the USSR clearly does not call for a Soviet bank in the United States, the present business being handled by US correspondents of Soviet banks. Certain advantages would accrue to the USSR, however, if it were to establish a banking facility in the United States. It could, for example,

* Plus a small markup on forward sales.

** The major world gold markets are, in order of importance, Zurich, London, Paris, Frankfurt, Beirut, and Hong Kong-Macao.

make use of the New York money market as a supplement or alternative to the Eurocurrency market. This market also could be a source of additional dollars should Soviet dollar-financed trade, say with Latin America and Africa, be expanded. In addition, there is the prestige of having a bank facility in a city which, many experts believe, will become the financial center of the world. Finally, there is the additional secrecy which would be imparted to the USSR's banking operations in the United States with funds being channeled through its own facility rather than a US bank correspondent.

22. As late as 1967 the establishment of a Frankfurt branch of MNB appeared imminent. Applications were filed, directors were named, and official West German permission was expected. An impasse apparently developed, however, and the branch office was never established, thus ending negotiations which had been in the works for several years. A Soviet banking facility in Frankfurt would provide the USSR with another money market to tap, as well as a location in the only major world gold market where it does not now have one. While past efforts for the placement of a bank in Frankfurt have not been fruitful, the possibility of an eventual establishment of such a facility should not be written off.

Conclusions

23. Soviet-owned banking facilities in the West have flourished in the past decade with the growth of East-West trade. These banks have developed into diversified banking institutions and together have assets in excess of \$1.6 billion. Through close adherence to sound Western banking practice and generally prompt payment of obligations, they have helped to build their financial reputation. To a considerable degree, this reputation has enabled them to attract Western deposits. These banks have developed correspondent relations with a large number of Western banks as well as with banks of the Communist countries. The growth in the financial resources of the Soviet-owned banks has come in large part from the deposits of banking correspondents -- both Western and Communist -- rather than from a growth in equity capital provided by the USSR.

24. The chief function of the Soviet-owned banks is to facilitate East-West trade and, in this capacity, they collect and make trade payments and provide trade financing, largely short-term. MNB furnishes a large volume of short-term credits, but BCEN provides only limited short-term financing of trade, holding most of its resources as deposits with correspondent banks. A share of these deposits with Western correspondents serves to secure lines of credit provided to BCEN by these banks for the financing of East-West trade. The Soviet-owned banks perform a number of other functions, including the provision of banking services to local customers. They also act as agents in the sale of gold by the USSR and other Communist countries.

25. The Soviet-owned banks are active participants in the foreign exchange and Eurocurrency markets, where they are both borrowers and lenders. Access to the Eurocurrency market provides additional flexibility in furnishing funds to the banks' Communist customers. The Soviet-owned banks are largely restricted to short-term financing, although a small amount of longer term financing has been made available to Communist countries to purchase machinery and equipment. To obtain the medium- and long-term financing required for increasing imports of capital equipment, the Communist countries have had to go to Western sources. Over the past decade the USSR and East European countries have borrowed several billion dollars from the West -- chiefly government-guaranteed supplier credits -- and now have an outstanding indebtedness of about \$2 to \$3 billion. The demand of these Communist countries for credit reflects chronic difficulties in their hard currency balance of payments. The current interest being shown by the USSR and other European Communist countries in the IMF might indicate that they are seeking the additional flexibility in international payments that membership in the IMF would provide.

26. In recent years the USSR has shown some interest in opening banks in Frankfurt and in New York, the two remaining major Western financial markets where there are no Soviet-owned banks. The rationale for opening branches at these locations would be the same as for the others. Having its own facilities in the West has provided certain advantages to the

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USSR, including the ability to gather commercial intelligence, to tap outside sources of funds, to engage in and profit from foreign exchange and Euro-currency markets, and to maintain a degree of secrecy in its financial transactions.

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APPENDIX A

The Russo-Iranian Bank

The Russo-Iranian Bank (RIB) was established under joint Soviet-Iranian ownership in Teheran in 1923. In 1954 the USSR assumed complete ownership, with Vneshtorgbank holding an 84-percent interest and Gosbank holding the remainder. Originally, RIB was called the Banque Russo-Persane and had branches throughout Iran. This was a period of extensive Soviet-Iranian economic cooperation. By 1934, RIB was one of the largest banks in Iran, with a capital of about \$5 million. By way of comparison, the National Bank of Persia had a paid-up capital of slightly more than a half-million dollars in that year. RIB's capital by 1939 had grown to about \$32 million.

No information is available on RIB's assets in this early period, but the size of its capital suggests that it was at least as large as MNB, whose total assets (not merely capital) were valued at about \$40 million in 1929, before its business began falling off. With the cessation of Iran's foreign trade during World War II and later during the cold war period, RIB's capitalization -- and presumably its business, too -- fell.

In 1944 RIB's capital was valued at \$200,000; during 1948-51 it stood at about \$250,000. For about 15 years, little was reported about the bank's activities or existence. In March 1967, RIB's total assets were valued at \$14.4 million and its paid-up capital was valued at \$1.3 million. By March 1968, RIB's total financial resources increased to about \$15.8 million, due primarily to the tripling of equity capital which grew to almost \$4 million. The increase in the bank's equity capital coincides with the return to closer Soviet-Iranian economic relations, and RIB may well play a more active role in the financing of future Soviet as well as East European trade with Iran.

RIB maintains correspondent relations with the Deutsche Bank in Hamburg and with the Irving Trust Company and the Chase Manhattan Bank in New York. Chase Manhattan has been a correspondent since at least the early 1930's.

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APPENDIX B

Balance Sheets of Moscow Narodny, Limited,
and Banque Commerciale pour l'Europe du Nord
as of 31 December 1967 a/

	<u>MNB</u>		<u>BCEN</u>	
	<u>Million</u> <u>US \$</u>	<u>Percent</u>	<u>Million</u> <u>US \$</u>	<u>Percent</u>
<i>Liabilities</i>	718.8	100.0	774.1	100.0
Capital	9.6	1.3	18.2	2.3
Reserves	5.6	0.8	2.2	0.3
Correspondent and other deposits	640.5	89.1	753.7	97.4
Bills rediscounted	42.1	5.9		
Other	21.0	2.9		
<i>Assets</i>	718.8	100.0	774.1	100.0
Cash and banks a/	201.1	28.0	613.8	79.3
Advances and loans	459.1	63.9	147.9	19.1
Securities	32.7	4.5	4.4	0.6
Other	25.9	3.6	8.0	1.0

a. Categories are not entirely comparable. The MNB balance sheet has a category called "short-term deposits" not included in the BCEN balance sheet. This category is lumped into "cash and banks."

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