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J. DAVID NAVARRO, Clerk
By DEBRA L. PRICE
DEPUTY

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STATE OF IDAHO

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State of Idaho
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IN THE DISTRICT COURT OF THE FOURTH JUDICIAL DISTRICT

OF THE STATE OF IDAHO, IN AND FOR THE COUNTY OF ADA

STATE OF IDAHO, Department of Finance, Plaintiff, vs. Reimar Stuckenbrock, an individual, and German American Investments, LLC, aka GAI, Defendants.	LV OC 9800990D Civil No. **VERIFIED COMPLAINT** Fee Category: Exempt

Comes now the State of Idaho, Department of Finance, Gavin M. Gee, Director, by and through counsel, to complain and allege as follows:

JURISDICTION

1. This action is brought under the provisions of the Idaho Securities Act, Title 30, Chapter 14, Idaho Code, and in particular Idaho Code §30-1442 wherein the Director of the Idaho Department of Finance ("Department") is empowered to bring actions

seeking injunctive and other relief against defendants who have either violated or are about to violate provisions of the Idaho Securities Act or any Rule thereunder.

VENUE

2. The acts and practices alleged herein comprising violations of law by the above-named Defendants occurred in the conduct of trade and commerce in Ada County, and elsewhere in the State of Idaho.

DEFENDANTS

3. Defendant Reimar Stuckenbrock ("Stuckenbrock") is an individual whose last known address is 721 Wyndemere Drive, Boise, Idaho 83702. Stuckenbrock is the "Manager" of German American Investments LLC. Stuckenbrock has never been licensed by the Idaho Department of Finance as a securities salesman.

4. Defendant German American Investments LLC ("GAI") is an Idaho limited liability company located at 721 Wyndemere Drive, Boise, Idaho 83702. GAI was formed to invest in "bank debenture trading programs."

FACTS

"Prime Bank Instrument" Frauds

5. Fraudulent schemes that purport to offer investments in fictitious securities and financial instruments variously termed "prime bank debentures," "prime bank promissory notes," "prime bank guarantees," "standby letters of credit," and, collectively, "prime bank instruments," that allegedly are sold or traded by the "world's 100 prime banks," the "top 50 [or 20] European prime banks," and so forth, have proliferated during the past six years.

6. On October 21, 1993, a "Warning Concerning 'Prime Bank' Notes, Guarantees, and Letters of Credit and Similar Financial Instruments" was issued jointly by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision ("Interagency Advisory"), which alerted financial institutions and the investing public to the existence of "illegal or dubious schemes" involving "'investments' in 'Prime Bank'-type financial instruments and promises of unrealistic returns on multi-million dollar investments." (A true and correct copy of the Interagency Advisory is attached hereto as Exhibit A.) The Interagency Advisory also stated that "the staffs of the federal bank, thrift and credit union regulatory agencies are not aware of any legitimate use of any financial instruments called a 'Prime Bank' note, guarantee, letter of credit, debenture, or similar type of financial instrument."

7. The United States Court of Appeals for the Seventh Circuit, in SEC v. Lauer, 52 F.3d 667, 669 (7th Cir. 1995), found that "Prime Bank Instruments" were "a nonexistent high-yield security." The court of appeals flatly stated, "Prime Bank Instruments do not exist." Id. at 670.

8. As alleged below, the securities offered by the Defendants share many of the characteristics of the bogus securities that are the subject of the regulatory and law enforcement agency warnings and advisories discussed above.

STUCKENBROCK AND GAI SCHEME

9. Beginning on a date uncertain, but at least since April 1997, Defendants have promoted and offered to sell securities to investors in Idaho and possibly elsewhere.

10. The securities offered by Defendants are investment contracts to be managed through GAI and Stuckenbrock. Ultimately, investor funds were to be committed to an international bank debenture trading program, involving prime bank debentures, prime bank guarantees, or prime bank standby letters of credit. In connection with their investment program, Defendants distributed written offering materials explaining the program and the Defendants' proposed activities. (A true and correct copy of these materials is attached as Exhibit B.) Defendants knew or should have known that such instruments or programs did not exist or they could not trade them in the manner that they had represented to the investors.

11. Defendants, in connection with the offer or sale of securities, made untrue statements of material fact and misleading statements. Defendants informed potential investors about "the possible extraordinary profitability of the trading programs," stating that "GAI has offers of between 50 - 400% return p. a. during a forty week trading period." Defendants represented to potential investors that the transaction would be conducted such that "investors collateral is not at risk."

12. Defendants have raised in excess of $200,000 from at least seven persons for investment in a bank debenture trading program.

COUNT ONE

The allegations contained in paragraph 1 through 12 are hereby realleged as if fully set forth.

13. Beginning on a date uncertain but at least since April 1997 Defendants offered for sale, either directly or indirectly, or aided and abetted in the offer, to Idaho residents through printed offering material and oral solicitations, securities.

14. The securities offered by Defendants were not registered with the Department as required by Idaho Code §30-1416.

15. Defendants have violated Idaho Code §30-1416.

COUNT TWO

The allegations contained in paragraphs 1 through 15 are hereby realleged as if fully set forth.

16. At no time have the Defendants been licensed by the Department of Finance as broker-dealers or salesmen to offer for sale securities as required by Idaho Code §30-1406. Therefore, Defendants have either transacted business in this state as a broker-dealer or salesman without having been registered, or have acted as broker-dealers or issuers, and employed a salesman who was not registered under the Act.

17. Defendants have violated Idaho Code §30-1406.

COUNT THREE

The allegations contained in paragraphs 1 through 17 are hereby realleged as if fully set forth.

18. Defendants offered and sold securities to individuals in this state in violation of an antifraud provision of the Idaho Securities Act, Idaho Code §30-1403(2), in that they omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. The omissions of Defendants include, but are not limited to, the following:

A. Failing to disclose to offerees and/or investors that Prime Bank Instruments do not exist.

B. Failing to disclose that trading programs could not operate in the manner that had been represented to offerees and/or investors.

C. Failing to disclose to offerees and/or investors that Stuckenbrock is not registered as a securities salesman in Idaho, as is required by the Idaho Securities Act.

D. Failing to disclose to offerees and/or investors all of the risks associated with an investment in an international bank debenture trading program.

E. Failing to disclose to offerees and/or investors that several state and federal securities regulators have initiated enforcement proceedings against multiple promoters that offered investment programs with substantial similarities to the Defendants' investment program.

F. Failing to disclose to offerees and/or investors that GAI is not registered as a broker-dealer in Idaho, as is required by the Idaho Securities Act.

G. Failing to disclose to offerees and/or investors that the securities offered were not registered in Idaho, as required by the Idaho Securities Act.

19. Defendants have violated Idaho Code §30-1403(2).

COUNT FOUR

The allegations contained in paragraph 1 through 19 are hereby realleged as if fully set forth.

20. Defendants offered and sold securities to individuals in this state in violation of an antifraud provision of the Idaho Securities Act, Idaho Code §30-1403(2), in that they made untrue statements of material facts in connection with the offer and sale of

securities. The misrepresentations of Defendants include, but are not limited to, the following:

A. Representing to offerees in written offering materials distributed by Defendants state that the Federal Reserve Board is "the driving force behind the financial instruments" known as Prime Bank SLCs and Bank Debentures. In fact, the Interagency Advisory issued jointly on October 21, 1993 by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision stated that "the staffs of the federal bank, thrift and credit union regulatory agencies are not aware of any legitimate use of any financial instruments called a 'Prime Bank' note, guarantee, letter of credit, debenture, or similar type of financial instrument."

21. Defendants have violated Idaho Code §30-1403(2).

PRAYER FOR RELIEF

Wherefore, Plaintiff prays for a Judgment in favor of Plaintiff and against Defendants as follows:

A. That Defendants be adjudged to have violated the Idaho Securities Act and Rules thereunder.

B. That Defendants be permanently enjoined from engaging in any acts, practices or omissions which would constitute violations of the Idaho Securities Act, Title 30, Chapter 14, Idaho Code, and in particular, that they be permanently enjoined from:

1. Selling or offering for sale nonexempt securities in any form in the State of Idaho until such time as the securities have been registered with the Idaho Department of Finance in accordance with Title 30, Chapter 14, Idaho Code;
2. Selling or offering for sale nonexempt securities in any form in the State of Idaho until such time as Defendants have registered as broker-dealers or salesmen for a broker-dealer or issuer with the Idaho Department of Finance, in accordance with Title 30, Chapter 14, Idaho Code;
3. While engaged in or in connection with the offer, sale or purchase of any security:
   (a) Employing any device, scheme or artifice to defraud any investors in the securities;
   (b) Making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading;
   (c) Engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.
4. Aiding, abetting, counseling, inducing or causing any other person to engage in any of the types of conduct described in paragraphs 1, 2, or 3, above.

C. That Defendants be prohibited from claiming the availability of, using, or offering or selling securities, under any exemptions under the Idaho Securities Act without receiving the prior written consent of the Director.

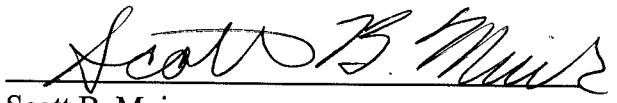
D. That Defendants be ordered to restore to each person in interest any consideration which may have been acquired or transferred in violation of the Idaho Securities Act.

E. That Defendants be ordered to pay a civil penalty to Plaintiff in an amount of $10,000 for each violation of the Idaho Securities Act.

F. That Plaintiff be awarded attorney's fees and costs incurred in the preparation and the prosecution of this action, and if judgment is taken by default herein, that $5,000 is a reasonable attorney's fee.

G. Such other and further relief as this Court may deem equitable and just.

DATED this 20th day of February, 1998.



Scott B. Muir
Deputy Attorney General
Department of Finance

VERIFICATION

STATE OF IDAHO)
) ss:
County of Ada)

MARILYN T. SCANLAN, Bureau Chief of the Securities Bureau of the Idaho Department of Finance, being first duly sworn, deposes and says:

That she has read the foregoing verified complaint; that she knows the contents thereof, and that the same are true to the best of her knowledge.

DATED this 20TH day of February, 1998.

Marilyn T. Scanlan

MARILYN T. SCANLAN

SUBSCRIBED AND SWORN to before me this 20th day of February, 1998.

Virginia L. Lore

NOTARY PUBLIC FOR IDAHO
Residing at: Caldwell
My Commission expires: 4/5/2000

1ST DECISION of Level 1 printed in FULL format.

Federal Deposit Insurance Corporation

FIL-73-93

1993 FDIC Interp. Ltr. LEXIS 78

October 29, 1993

SUBJECT: [*1] Warning Concerning "Prime Bank" Notes, Guarantees, Letters of Credit and Similar Financial Instruments

TEXT:

SPECIAL ALERT

Enclosed is an interagency advisory warning of the increased use of fraudulent "Prime Bank" financial instruments. The advisory is an effort of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Association, the Office of the Comptroller of the Currency and the Office of Thrift Supervision. Please carefully read the attached advisory and circulate it to all appropriate departments of your institution. If you become aware of any transaction involving the subject of this advisory, immediately notify the FDIC at the address listed in the advisory.

Attachment

Distribution: FDIC-Supervised Banks (Commercial and Savings)

Board of Governors of the Federal Reserve System

Federal Deposit Insurance Corporation

National Credit Union Administration

Office of the Comptroller of the Currency

Office of Thrift Supervision

October 21, 1993

Interagency Advisory

WARNING CONCERNING "PRIME BANK" NOTES, GUARANTEES, AND LETTERS OF CREDIT AND SIMILAR FINANCIAL INSTRUMENTS

The enforcement staffs of the [*2] federal financial institutions supervisory agencies, who work with federal law enforcement officials responsible for investigating and prosecuting bank fraud-related matters, have noted an increase in the use, or attempted use, of questionable financial instruments in connection with complex, and possibly illegal, schemes. Many of these schemes have been aimed at defrauding borrowers and investors in the United States and abroad, as well as domestic and foreign banks. The

EXHIBIT

A

questionable instruments are often denominated as "Prime Bank Notes", "Prime Bank Guarantees", or "Prime Bank Letters of Credit". They are also called by such other names as "Prime European Bank Letters of Credit", "Prime World Bank Debentures", or "Prime Insurance Guarantees". n1

n1 These and similar financial instruments were the subject of prior regulatory agency alerts issued by the Office of the Comptroller of the Currency. These included the Office of the Comptroller of the Currency's Banking Circular BC-141, Supplement 2, dated July 14, 1982, several subsequent supplements to BC-141, and BC-243, dated February 7, 1990.

Over the past several years, federal and state law enforcement authorities have [*3] prosecuted, or are presently in the process of investigating, wrongdoers who have defrauded individuals and entities by promising, for example, to arrange loans that would be funded in some manner by "Prime Bank"-types of financial instruments, or would, in some other way, involve such instruments and advance loan fee payments. Many of the illegal or dubious schemes that have been brought to the attention of various regulatory agencies by law enforcement officials, foreign banks, the World Bank, and central banking authorities appear to involve overly complex loan funding mechanisms necessitating the use of "Prime Bank"-type documents. Other suspicious schemes involve "investments" in "Prime Bank"-type financial instruments and promises of unrealistic returns on multi-million dollar investments. In many recent situations, the agencies have been advised that individuals have been improperly using the names of large, well-known domestic and foreign banks, the World Bank, and central banks in connection with their "Prime Bank" schemes. When contacted by potential borrowers, investors or regulators, the institutions had no knowledge about the unauthorized use of their names or the [*4] issuance of anything akin to "Prime Bank"-type financial instruments.

Because the staffs of the federal bank, thrift and credit union regulatory agencies are not aware of any legitimate use of any financial instrument called a "Prime Bank" note, guarantee, letter of credit, debenture, or similar type of financial instrument, you should be alert to the potential dangers associated with any transaction involving these types of instruments. n2 Likewise, you should be attentive to the attempted use of any traditional type of financial instrument -- such as a standby, performance or commercial letter of credit -- that is somehow referred to in an unconventional manner, such as a letter of credit referencing forms allegedly produced or approved by the International Chamber of Commerce. Examples of these include bogus schemes involving the supposed issuance of an "ICC 3034" or an "ICC 3039" letter of credit by a domestic or foreign bank.

n2 There are currently six insured depository institutions with the word "Prime" in their names in the United States. Two of them are commercial banks that operate in Florida, one is a commercial bank in Connecticut, another is a commercial bank in Indiana, and two of them are thrift associations operating in Wisconsin and Pennsylvania, respectively. There is also one bank holding company in Illinois with the word "Prime" in its name. This alert is not associated with any deposit or other type of legitimate debt obligation or financial instrument issued by any of these financial institutions. [*5]

The staffs of the regulatory agencies, in cooperation with the Department of Justice, the Federal Bureau of Investigation, the U.S. Secret Service, and the

Securities and Exchange Commission, want to alert you to this situation and request that, in the event you become aware of any transaction involving any of the aforementioned types of financial instruments, you advise one of the following federal regulatory agency officials:

Board of Governors of the Federal Reserve System

Deputy Associate Director Enforcement and Special Investigations Sections

Division of Banking Supervision and Regulation

Mail Stop 175

Washington, D.C. 20551

(202) 452-2620

(202) 736-5641 (fax)

National Credit Union Administration

Office of the General Counsel

1775 Duke Street

Alexandria, Virginia 22314

(703) 518-6540

(703) 518-6569 (fax)

Federal Deposit Insurance Corporation

Chief

Special Activities Section

Division of Supervision

550 17th Street, N.W.

Washington, D.C. 20429

(202) 898-6750

(202) 898-3627 (fax)

Office of the Comptroller of the Currency

Law Department

Enforcement and Compliance Director

250 E Street, S.W.

German American Investments LLC

721 Wyndemere Drive Boise, Idaho 83702

Investment Contract

EXHIBIT

B

between

German American Investments LLC, an Idaho Company (hereinafter called "GAI")
represented through its "Manager"
Reimar Stuckenbrock,
located at:
721 Wyndemere Drive
Boise, Idaho 83702
Tel.: (208) 891-5458
Fax: (208) 384-5703

and

the Investor (hereinafter called the "Investor")

Name:.....

Address:.....

Telephone:.....

Facsimile:.....

Amount invested $:..... (hereinafter called "Funds")

Date:.....

Initials: (Investor) Initials: (GAI-Manager)

The parties are ready and willing to enter into an agreement under the following terms and conditions:

I. Recitals:

1. Investor is willing to commit his Funds for a period of six (6) months beginning the day of signing this agreement under the terms and conditions stated hereunder.

2. GAI agrees to use these funds only as a collateral to enter a Joint Venture Agreement with a major Fund to access $10 Million or more in order to participate in a successful bank debenture trading program with a major European Bank through another Joint Venture Agreement with a company providing the access. Both Parties acknowledge that a successful and safe trading program requires a minimum investment of $10 Million or more.
(see "Prospectus")

3. Investor acknowledges that GAI presented sufficient documentation and information about the bank debenture trading programs that Investor feels sophisticated enough to to enter into this agreement. GAI delivered a paper called "The Mechanics of Prime Bank SLC's and Guarantees" from an Internet Provider (http://www.vii.com/fj616/trade/tr 00001 html).
Upon Investor's request GAI is also offering a photocopy of a book, which is an extensive investigation into the trading program by the consulting firm Hawthorne-Sterling & Company, 29 Olmstead Hill Road, Wilton CT 06897 (Ian Renert: Standby Letters of Credit: The Private Primary Market, Part One and Two), which is reflecting the special status of this investment program.

4. Due to the special circumstances and the complexity of this investment GAI is obligated to research and investigate every possible aspect before any Joint Venture contracts occur with the provider of the trading capital or the trading bank in Europe and will inform the investor about any deviations from the procedures outlined below.

Therefore the parties agree to act as follows:

5. After having done all the necessary due diligence in this matter, Investor authorizes GAI to use Investor's Funds as a collateral to enter into a Joint Venture Contract with the Provider of the trading capital in order to participate with $10 Million or more in a succesful trading program under the following conditions:

a) GAI is only authorized to enter in a contract with the Provider of the trading capital and the Trading Bank if the bank is able to provide the necessary Guarantee for the Provider

of the trade capital and a guarantee that the trade is successful and the investors collateral is not at risk and will be released as soon as the program is working.

b) GAI promises to inform the Investor about the status of the efforts to enter into the Joint Venture Contract with the different parties necessary to enter the program and to return Investor's Funds as soon as they are released as a collateral to complete the transaction.

c) GAI will keep Investor's Funds in an interest bearing account during the time the funds are not used as a collateral in the anticipated transaction. Interest is due with the return of the principal.

6.) GAI informed Investor about the possible extraordinary profitability of the trading programs. Although it is difficult to determine an exact rate of return before a contract with the trading bank is actually signed and guaranteed, GAI has offers of between 50-400% return p. a. during a forty week trading period. GAI is promising Investor to pay out the average rate of return it receives during the forty trading weeks, which might vary due to the circumstances of the actual conduct of the program (including delays and a possible termination of the program). GAI will inform Investor about the beginning of the program, the payouts of the profits to GAI and the Joint Venture Partners and the agreed rate of return. The profits a due at the latest by the end of the trading period. After having returned the principal, GAI will also inform Investor about possible reinvestments.

7) The Investor obligates himself to treat confidentially the market information given to him by GAI and not to make them accessible to third persons. The Investor furthermore agrees with the duty not to disclose the facts about the program concerning especially the denomination of banks and Joint Venture Partners which are participating in this transaction.

Boise, Idaho .....

....

(GAI - Reimar Stuckenbrock) (Investor)

Initials: (GAI, Manager) Initials: (Investor)

PROSPECTUS

This is a Private Placement under Idaho Code Section 30-1435(1)(I) limited to ten Investors or fewer, which is exempted from registration with the SEC under the Securities Act of 1933 Section 4 (1-6).

German American Investments LLC ("GAI") is offering this special investment opportunity only to sophisticated investors, who are able and willing to educate themselves about the nature of the bank debenture trading program. Investor's funds are only pooled up to $275,000 as a collateral to access up to $10 Million to meet the minimum requirements of this special investment program. GAI will only enter in a Joint Venture Contract with any party, if there is sufficient guarantee that Investor's money is not at risk and will be returned upon completion of the transaction. GAI will inform the Investor's if there is any additional risks involved before it will take any further steps to complete the transaction.

Boise, Idaho April 29th, 1997

.....

(GAI, Reimar Stuckenbrock, Manager)

Initials: R. St. (GAI, Manager) Initials: (Investor)

The following document was written by an unknown Economist/Accountant of a Major US Corporation under direction of its Board of Directors.

THE MECHANICS OF PRIME BANK SLCS AND GUARANTEES

Please note Prime Bank Guarantees or SLCs are shorthand terms and are trade jargon; the proper name for such is BANK DEBENTURES.

1. BACKGROUND

The driving force behind the financial instruments under discussion in this paper is the U.S. Government through its monetary agency, the Federal Reserve Board. The U.S. dollar is the basis of the world's liquidity system since all other currencies base their exchange rate on it. Quite simply this means that the U.S. is the world's central banker. As the world's central banker, the U.S. has an enormous responsibility to maintain stability in the world's monetary system. As well, the U.S. as the most powerful nation has accepted the role as the champion and promoter of democracy in all of its endeavors. While the U.S. has many tools to do this, one in particular s relevant for the purpose of this discussion.

The Federal Reserve Board (Fed) uses two financial instruments to control and utilize the amount of U.S. dollars in circulation internationally: Standby Letters of Credit (SLC) and Prime Bank Guarantees (PBG).

The Fed's domestic tools to control credit creation are interest rate policy, open market operations, reserve ratio policy and moral persuasion. In the domestic context, these tools are not always as effective as the Fed would like them to be. Part of the reason for the less than perfect effectiveness is due to the substantial stock of U.S. dollars in foreign jurisdictions. Several of the Fed's domestic tools cannot be used by it in other countries. For example, the Fed cannot change foreign reserve ratios. Furthermore, a significant amount of credit creation occurs in U.S. dollars in foreign countries, particularly in the Eurodollar market. The Fed cannot control the credit creation in foreign markets through its use of domestic policy instruments. Internationally, the currency of choice is the U.S. dollar as it is considered the safest currency, especially in times of political crisis. Consequently, those holding the dollar do so for reasons which are less sensitive to economic stimuli. Because foreign banks readily accept U.S. dollar deposits, those funds, which in the domestic context are the basis of M1 money supply, in the foreign context, they act more like the near money features of M3. This means they are infinitely more difficult to control. The "offshore market" has grown substantially in the last two decades for a number of reasons. First, huge quantities of U.S. dollars associated with the drug trade slosh around the international monetary system, and second, wealthy individuals concerned about high taxes and preserving their wealth opt to keep their assets in offshore

tax havens. This significant stock of U.S. dollars cannot be effectively controlled by the U.S. with its normal domestic policy tools.

Finally, currency futures markets can be another difficult area to control because of the substantial amount of leverage that is available. For example, for as little as $1,500 dollars, it is possible to short or go long for over $150,000 U.S. dollars versus the D Mark. All other major currencies have a similar leverage on the dollar. This means that someone with $1,500 U.S. dollars can take the other side in a Fed move to stabilize the currency. Since the currency does not have to be delivered, but the contracts are rolled near the expire date, it is possible to create substantial pressure on the dollar in either direction. (The Hunts learned this the hard way when they tried to corner the world silver market.) To control U.S. dollars outside the U.S., the Fed resorts to Standby Letters of Credit or, as they are popularly known, SLCs. In its more familiar domestic form, the SLC is a financial guarantee or performance bond issued by a bank for a fee on behalf of a customer that wishes to borrow funds but is unable to do so cheaply in credit markets. A bank guarantees the borrower's financial performance to the lender by issuing the SLC. Since the bank is in a better position to assess credit risk and demand collateral, the issuance of this form of guarantee is a natural service that a bank provides.

In the international markets the use of SLCs is somewhat different. It simply is a money-raising device where the financial guarantee is almost meaningless. Banks issue these SLCs on behalf of the Fed; in other words, the Fed is the customer of the bank. Obviously there is no credit risk here. The net proceeds from the funds raised are immediately wired to the Fed. Using this method, the Fed can reduce the U.S. dollars in circulation in foreign jurisdictions.

Using a different method, the large stock of expatriated dollars is employed by the Fed to promote U.S. foreign policy. For example, during the G7 meeting in Tokyo in April of 1993, the U.S. committed financial aid to Boris Yeltzin to the tune of $6 billion. These funds do not come from the U.S. Treasury, nor is the merit of the loan debated in the U.S. Congress. Instead, the U.S. taps the international pool of U.S. dollars through an instrument called a Prime Bank Guarantee (PBG). Essentially the instrument has the features of an SLC except it is longer dated with 10 and 20 year maturities. Unlike SLCs, which sell at a discount and bear no interest, PBGs bear a coupon payable annually in arrears. Like the SLC, it is a form of guarantee ensuring the lender will receive interest as is due and be repaid the principal upon maturity.

It is important that the U.S. has these tools to control the dollars that increasingly grow off its borders. The Fed operates its currency stabilization so effectively through the use of SLCs that is seldom resorts to intervening in the foreign exchange markets. Rather than the U S. government tapping the domestic savings pool to assist foreign governments, it is able to tap the international pool of expatriated U.S. dollars that leak away from its shores in hundreds of millions daily.

2. THE INSTITUTIONAL STRUCTURE OF THE SYSTEM

A number of problems must be overcome to make the structure work. Inevitably, the offshore U.S. dollars find their way into the international banking system by way of deposits. Therefore, banks must be the main buyers of any financial instruments that the Fed causes to be issued. However, the rules of the Bank of International Settlement (BIS) prohibit banks from buying the newly issued debt instruments from each other directly. This prohibition exists for obvious reasons. If banks were allowed to fund one another, the probability of system-wide bank failure would be increased. This system of funding is not intended to support weak banks; in fact, the opposite objective is the goal. Therefore, a methodology has been constructed that allows banks to buy each other's newly issued paper.

BIS rules do not prohibit banks from owning other banks' financial obligations as long as they are not purchased from another bank directly, but instead are purchased in the secondary market. The Fed supports a group of intermediaries that have substantial available cash reserves. These intermediaries purchase paper from issuing banks and almost always immediately resell it to other banks. These intermediaries are called "commitment holders."

The Federal Reserve Board "licenses" a small number of commitment holders to participate in a quiet international monetary policy. These commitment holders are identified by confidential, Fed-issued, registration numbers. These numbers are revealed under extremely controlled circumstances, because once revealed, a knowledgeable individual could cause paper to be issued. The commitment holders are few in number, however they are essential to the smooth functioning of the process. Commitment holders often forge relationships with other sources of funds. These relationships are called sub-commitments.

Holding a commitment entails a number of conditions which are extremely important to maintain. First and foremost, there is a demand for utter secrecy. Second, the commitment holder must be able to quickly produce large sums of U.S. dollars, generally in the billions. This explains why commitment holders are prepared to take on sub-licensees to ensure a large supply of readily available funds. Finally, this is a "funds first" business. No one can buy issued Paper on credit. To ensure this happens and not waste time, a commitment holder will not initiate a discussion with anyone unless they can prove cash funds of high quality security of at least 100 million U.S. dollars.

The Fed, as well, identifies a tier of high quality banks, usually in the top 100, which it authorized to deal in the paper. Criteria for being on the Fed's list would include strength in the normal banking ratios as well as countries in which the Fed desires to be active. It is evident that the largest supply of international U.S. dollars is in Europe, which explains the dominance of European banks on the Fed list.

Another aspect of this fund-raising process is the fact that it is conducted entirely off the balance sheets of issuing banks. Both instruments are guarantees and as such, represent contingent liabilities. As contingent liabilities, they are not posted to the balance sheet. However, they do require a risk-adjusted amount of capital reserve as prescribed by BIS rules. By keeping the funding instruments off balance sheets, there is little, if any, disruption of normal financing activities of the banks.

3. ISSUING PAPER

The Federal Reserve decides which banks will issue paper, what kind and how much at any point in time. The United Nations and the World Bank have similar authority with PBGs, but they too must coordinate with the FED.

A commitment holder and a bank work together to operate a trading program. The commitment holder is the source of funds. It establishes lists of banks from which it will accept paper. The lists reflect the preferences of the owners of the funds. Obviously, the strongest banks will appear on the lists with the highest frequency. This causes them to benefit the most from this activity. The strongest banks attract the commitment holders to operate the trading programs within their establishments.

Banks do the actual trading. They inquire through the Fed to determine who is issuing instruments. They are also informed about the banks that wish to acquire paper. They arrange the trades, verify and confirm the securities and clear the trades. The commitment holder is an integral part of the process although it does not have to be present to make it function. The commitment holder simply must leave the required amount of funds at the trading bank in a custody account after all the procedures have been properly executed.

The commitment holder provides the source of funds which is used to purchase the initial issue of paper and immediately resells it to another bank. There is no room in the system for anyone without funds. This is a principal to principal (bank to bank) business only. The trading bank executes the trades and finds buyers for issued paper. Outsiders can access the system only by finding a commitment holder and lodging funds with it or with one of its sub-licenses. The commitment holder spends most of its time finding "investors."

4. WHY THE YIELDS ARE SO HIGH

As of the writing of this paper, SLCs were yielding approximately 13.7% and 10 year PBGs 11.7%. One year U.S. T-bills were yielding 8.49% and 10-year Treasuries were yielding 5.78%. How are these extraordinary yields accounted for in an investment that does not appear to be intrinsically risky?

There are several factors contributing to this market phenomenon. The international market for U.S. Funds is extremely competitive. For example, there are several countries whose desire for U.S. dollars is so high that they will pay annual yields of 20% to 25%,

make monthly interest payments in U.S. dollars and issue debentures whose terms do not exceed one year. These are countries whose risk profile is high even though there is no record of default on their obligations. These borrowers set the benchmark at the high end of the yield spectrum.

At the other end of the spectrum are very low risk sovereign issuers which are able to attract funds at rates competitive with U.S. treasuries.

Earlier it was explained how the institutional side of this process functions. It was pointed out that when an SLC is issued by a foreign bank on behalf of the Fed, it had to establish a capital reserve. Recent changes to BIS rules require off balance sheet entries to be included in the computation of bank assets and capital adequacy ratios. Furthermore, these assets and all other assets must be weighted to reflect their overall risk. Capital adequacy ratios are now all risk adjusted.

SLCs fall into the 100% credit conversion factor rating to convert the off balance sheet item to an on balance sheet equivalent. For there the converted SLC is risk-rated. SLCs, which are the subject of this paper, fall into the 0% risk weight category. Consequently, every dollar of SLC exposure has no risk-weighted asset equivalent. If banking guidelines require the ration of total risk weighted assets not to fall below 8%, then at the margin, the bank would have to reserve capital of 8 cents for every dollar of SLC exposure. If an SLC of $100 million is issued, $5 million of capital must be set aside.

In reality, the capital requirements are no so onerous because there are a number of other factors at work that lower the marginal cost of capital utilization. For purposes of discussion, let us assume this marginal cost of capital utilization is 4%. This is what the issuing bank would demand from the Fed to issue SLCs on its behalf. Therefore, if the purchasing bank is paying 92% of face value for an SLC, the selling bank will retain 4 points for itself to cover its reserve requirements by remitting 88% of face value to the Fed. The issuing bank will also load in a charge for providing the service which could be up to 2 points. As we shall see, the banks are paid their fee at maturity or redemption.

Next there needs to be a yield spread which will motivate large sums of capital to sit in a custody account in U.S. dollars. The spread earned by the owners of capital and the commitment holder could equal another 4 points. This 4 point spread would reflect the costs of fund raising and the economic rent on the capital.

The following table summarizes this discussion.

	% of Face Value	Yield	Spread Earned	Allocation
Issue Price by Selling Bank	**84.00**	**18.0%**	**6 points**	**4pts. to capital 2pts. to fee**
Purchase Price by Commitment Holder	**90.00**	**11.1%**	**4 points**	**2pts. to holder 2pts. to investor**
Purchase Price by Buying Bank	**94.00**	**6.4%**		
Market Price Equivalent U.S. Treasury	**96.60**	**3.5%**		

The figures in the table are not precise, but they are close enough to give a general idea of how the yields work. The issue price yield is a whopping 19% which is what most observers focus on. However, no one earns this maximum yield. When the bank sells the SLC to the commitment holder, it receives 90% of face. If the face value were $100 million, it would receive $90 million. It sends %86 million to the Fed. At this point the yield is 11.1%. The commitment holder sells the note to the purchasing bank for $4 million. At this point the yield has fallen to 6.4% for the purchasing bank. The equivalent U.S. treasury yield is 3.5%. Enough excess yield remains so that the purchasing bank could profitably sell the note which would cause the yield to almost match market yield.

When the note matures, the Fed repays the issuing bank $98 million. Because the issuing bank needed $4 million for capital, it retained /44 million from the amount it sold the note for before sending the rest to the Fed. Since it is charging $2 million for the service, the Fed sends it back $98 million instead of $102 million. Remember, when the note is repaid, the $4 million in capital is released back to the Fed.

The next question is why would the Fed be interested in paying these yields. First, it is not as expensive as it might appear. As noted, when the SLC matures, the capital reserve is released. In other words, the Fed gets $4 million back. More importantly, the value of the process to the Fed should be clearly understood.

Any country which is attempting to stabilize its currency implements one or both of the following policies. The first line of attack is to manipulate interest rates to increase rates to increase or decrease the flow of its currency by altering final demand. If speculation becomes too powerful, which it often does, the next line of attack is to intervene in the currency market by supplying the excess demand or by removing the excess supply. Changing interest rates can be disruptive enough but once the speculators smell a weakening or strengthening currency, it becomes very expensive to smooth a rapid adjustment in value.

The U.S. dollar is the base currency of global commerce. Speculation could occur at a rate that would be mind boggling. The cost to the global economy would be significant, let alone the cost to the Fed of intervention. From this perspective, the manner in which the Fed conducts its activities probably is not expensive. There are countless examples where a central bank has announced it will defend its currency and $15 billion later it gives up as Britain did when it pulled out of the ERM in 1993. That $15 billion goes straight into the pockets of the speculators.

The only perhaps negative aspect of this system is that the Fed is reliant on a group of fund raisers called commitment holders who grow very rich from the service they provide. But this is the only way the Fed can keep the process very confidential and highly selective.

There is an analog in the public markets, NYSE market makers or specialists are a very select club which is extremely difficult to join. Market makers are charged with the responsibility of making a market in their particular stock to maintain the balance between its demand and supply. They are given a monopoly on market order flow information upon which there is no infringement. Market makers bear risk but it is one which most of the time is easily managed. Market making firms have the highest return on capital of any firms involved in the market.

Commitment holders are market makers as well, though of a slightly different sort. They do not bear much risk in making a market. Their "risk" lies in their ability to gather huge amounts of U.S. dollars because unlike equity market makers, they cannot leverage their capital.

The final question is, why does the Fed not issue securities directly to these banks to attract their dollar holdings? First, the Fed is not empowered to issue securities; only the U.S. Treasury Department and other agencies guaranteed by the U.S. government can do that. Secondly, selling bonds would be negatively perceived since they are generally used for deficit financing. This process works as well as it does because it is entirely out of sight.

It should be evident how monetary policy (exchange policy) can be conducted. Only the issuance of an SLC has been discussed so far. The issuance of an SLC is a fiscal move that bids up the price of the dollar. If the Fed were interested, however, in injecting liquidity into the system, it simply repurchases outstanding SLCs in the countries where it desires to lower the exchange value of the dollar. We could call it a "closed" market operation. The domestic analog of this foreign monetary policy is an open market operation.

Prime Bank Guarantees (PBG) are also used in similar ways. They represent a financial guarantee and therefore a contingent liability. Unlike SLCs, PBGs are not used for currency operations. These instruments support loans to countries and to development

agencies which fund projects in LDCs. When a bank issues a PBG, the net proceeds go to the source of the funding commitment.

While PBGs are issued at a deeper discount than SLCs, they in fact have a lower annual yield. The apparent deeper discount is caused by the fact the PBGs bear interest and are longer dated securities. For example, 1 point of discount on an SLC equals 1.3 points of annual yield, while 1 point of discount on a PBG equals .6 points of annual yield. In other words, it takes a larger change in the discount of a PBG to have the same effect on yield as an SLC.

The economic consequences with a PBG are quite different than those associated with an SLC. Dollars are not removed from the economic system. They instead flow to areas where there is a perceived need to be philanthropic, which is no doubt motivated by political considerations. Once a project has been initiated, the recipient of funds begins to import materials and finished products which increases the amount of trade taking place which in turn expands production. Inevitably, a large share of these dollars is spent in the U.S. The PBG then is a method whereby the U.S. can direct the use of its currency without explicitly saying that it is doing so. The alternative would be to make it a budgetary expenditure which would be debated in Congress. If it passed successfully through that process, it would add to the deficit of the country. Such an expenditure would most likely be funded by issuing new government bonds. Therefore, the issuance of PBGs is a most expedient way of accomplishing the same thing with the vast pools of U.S. dollars deposited in European banks instead of using domestic dollars.

The PBG does not appear to have an overt credit creation action. The stock of dollars utilized already exists in the economic system. However, to the extent that a country defaulted on repaying the PBG, the Fed would be called to honor its guarantee to the issuing bank which then would cause credit to be created.

Again the high yields are motivated by the same reasons explained previously. The discount charges will be larger to have the similar effect on the yield as an SLC which also results in the market makers making even more profit on PBG issues.

5. ENTRY INTO A TRADING PROGRAM

This is one of the most difficult areas to invest in that exist. There are plenty of people around who know something about this marketplace, but very, very few know how it truly works. Because enough people know something and the fact that there is significant money to be made, this market attracts many bad players. Two features distinguish these pretenders--they lack financial and investment acumen and they ask for up front fees. From time to time these pretenders attempt to pull off a major fraud with a significant investor. This prompts warnings issued by the Board of Governors of the Federal Reserve System or the Comptroller of the Currency.

These pretenders almost always attempt to set up their fund-raising efforts in the U.S. The Fed, or course, will not have any part of that since the process is designed to control and utilize expatriate dollars, not domestic dollars.

Banks routinely deny the existence of these programs, even the ones operating them. Most bank officers know nothing in any event. The only way into the system is to be able to certify substantial assets to a commitment holder or one of its sub-licensees. Finding either is not a trivial task because there are more pretenders around than legitimate commitment holders. There are very few actual commitment holders. If an investor cannot certify at least $100 million and more likely $500 million, the chances of getting anyone's attention who is genuine are indeed remote. This is why, quite frankly speaking, these offices feel no presumption whatever in jointing for the joint venture, in as much as the funds provided would find it virtually impossible to locate a collateral commitment holder which this program provides on the very highest level.

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last update: 03/29/96
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