FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 72-17
January 31, 1972

AMENDMENT TO REGULATION Y
(Investment or Financial Adviser)

INTERPRETATION OF REGULATION Y

POSTPONEMENT OF HEARING DATE - REGULATION Y
(Armored Car or Courier Services)

To All Member Banks and Others Concerned
in the Eleventh Federal Reserve District:

The Board of Governors has amended Section 225.4(a)(5) of Regulation Y effective February 1, 1972, to add to the list of activities that it has determined to be so closely related to banking or managing or controlling banks, the following: "serving as investment adviser, as defined in Section 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act." In addition, the Board has issued an interpretation that expresses the Board's views on several questions that arose during consideration of this matter as to the scope of such activity. Enclosed is a copy of the amendment and interpretation.

On November 29, 1971 and December 16, 1971, there was transmitted to you under Circulars No. 71-284 and 71-290 information pertaining to a proposed amendment to Regulation Y to permit bank holding companies to engage in armored car or courier services. In a separate action the Board has postponed, until February 10, 1972, a hearing to consider the issues involved in this proposal. A copy of the press release pertaining to the scheduled hearing is printed on the reverse.

Yours very truly,

P. E. Coldwell,

President

Enclosures

FEDERAL RESERVE
press release

For immediate release January 20, 1972

The Board of Governors of the Federal Reserve System today scheduled a hearing to commence February 10 on whether armored car and courier services are closely related to banking under the 1970 amendments to the Bank Holding Company Act. A hearing on this proposal had previously been scheduled for January 19.

The hearing, to be conducted by a hearing officer appointed by the Board, will begin at 10 a.m. in Room 1202 of the Federal Reserve Building in Washington.

Courier service will be considered first at the hearing, followed by consideration of armored car service. The Board has authorized the hearing officer to resolve all matters relating to the number and identity of participants, time to be accorded each witness, the receipt of evidence, expert opinion, rebuttal, written and oral arguments.

The Board on January 13 announced postponement of a hearing that had been scheduled for January 19 before available members of the Board, to consider the question of armored car and courier services as closely related to banking.

In addition to rescheduling the hearing, the Board denied requests for a formal hearing before a hearing examiner and for access to intra-agency memoranda considered by the Board in deciding to propose that Bank Holding Companies be allowed to engage in armored car and courier services.

A copy of the Board's order rescheduling the hearing is attached.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BANK HOLDING COMPANIES

AMENDMENT TO REGULATION Y

Effective February 1, 1972, section 225.4(a) is amended to read as follows:

SECTION 225.4—NONBANKING ACTIVITIES

(a) **Activities closely related to banking or managing or controlling banks.** * * * The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:

* * * * *

(5) acting as investment or financial adviser, including (i) serving as the advisory company for a mortgage or a real estate investment trust; (ii) serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act; and (iii) furnishing economic or financial information;**

**For an interpretation relating to the scope of the activity described in (ii) see 12 CFR 225.125. Acting as a management consultant is not regarded by the Board as within this activity (5). Whether to propose expanding activity (5) to include management consulting is under consideration by the Board.

INTERPRETATION OF REGULATION Y

SECTION 225.125—INVESTMENT ADVISER ACTIVITIES.

(a) Effective February 1, 1972, the Board of Governors amended § 225.4(a) of Regulation Y to add "serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act" to the list of activities it has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. During the course of the Board's consideration of this amendment several questions arose as to the scope of such activity, particularly in view of certain restrictions imposed by sections 16, 20, 21 and 32 of the Banking Act of 1933 (12 U.S.C. 24, 377, 378, 78) (sometimes referred to hereinafter as the "Glass-Steagall Act provisions") and the United States Supreme Court's decision in **Investment Company Institute v. Camp,** 401 U. S. 617 (1971). The Board's views with respect to some of these questions are set forth below.

(b) It is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760) that the Glass-Steagall Act provisions were not intended to be affected thereby. Accordingly, the Board regards the Glass-Steagall Act provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment adviser. Consistently with the spirit and purpose of the Glass-Steagall Act, this interpretation applies to all bank holding companies registered under the Bank Holding Company Act irrespective of whether they have subsidiaries that are member banks.

(c) Under § 225.4(a)(5), as amended, bank holding companies (which term, as used herein, includes both their bank and nonbank subsidiaries) may, in accordance with the provisions of § 225.4(b), act as investment advisers to various types of investment companies, such as "open-end" investment companies (commonly referred to as "mutual funds") and "closed-end" investment companies. Briefly, a mutual fund is an investment company which, typically, is continuously engaged in the issuance of its shares and stands ready at any time to redeem the securities as to which it is the issuer; a closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares.

(d) The Board intends that a bank holding company may exercise all functions that are permitted to be exercised by an "investment adviser" under the Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter.

(e) The Board recognizes that presently most mutual funds are organized, sponsored and managed by investment advisers with which they are affiliated and that their securities are distributed to the public by such affiliated investment advisers, or subsidiaries or affiliates thereof. However, the Board believes that (i) the Glass-Steagall Act provisions do not permit a bank holding company to perform all such functions, and (ii) it is not necessary for a bank holding company to perform all such functions in order to engage effectively in the described activity.

(f) In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U. S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund. However, the Board does not believe that such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. In no case, however, should a bank holding company act as investment adviser to an investment company which has a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks.

(g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not (i) purchase for their own account securities of any investment company for which the bank holding company acts as investment adviser; (ii) purchase in their sole discretion, any such securities in a fiduciary capacity (including as managing agent); (iii) extend credit to any such investment company; or (iv) accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.

(h) A bank holding company should not engage, directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser. Prospectuses or sales literature should not be distributed by the holding company, nor should any such literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regarding any investment company for which the bank holding company acts as investment adviser may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor. Further, a bank holding company should not act as investment adviser to a mutual fund which has offices in any building which is likely to be identified in the public's mind with the bank holding company.

(i) Acting in such capacities as registrar, transfer agent, or custodian for an investment company is not a selling activity and is permitted under § 225.4(a)(4) of Regulation Y. However, in view of potential conflicts of interests, a bank holding company which acts both as custodian and investment adviser for an investment company should exercise care to maintain at a minimal level demand deposit accounts of the investment company which are placed with a bank affiliate and should not invest cash funds of the investment company in time deposit accounts (including certificates of deposit) of any bank affiliate.

1/20/72

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FEDERAL RESERVE SYSTEM

[12 CFR Part 225]

BANK HOLDING COMPANIES

Hearings Regarding Courier and Armored Car Services

On January 12, 1972, the Board of Governors announced postponement of a scheduled January 19 hearing to consider whether armored car and courier services are closely related to banking under the 1970 Amendments to the Bank Holding Company Act. The hearing has been rescheduled to commence at 10:00 a.m., Thursday, February 10, 1972, in Room 1202 of the Federal Reserve Building, Washington, D. C., before a hearing officer to be appointed by the Board.

In addition to rescheduling the hearing, the Board acted upon three motions by parties who have asked to appear at the hearing. Those motions and the Board's determinations with respect to them are as follows:

Separation of issues. On December 13, 1971, Wachovia Corporation and Wachovia Courier Corporation filed a "Motion to Provide Separate Consideration of Armored Car and Courier Services Proposed Amendment". The Board believes that separate consideration will facilitate a sharpening of the issues and avoid possible confusion that might otherwise result from a joint consideration. Accordingly, separate but consecutive hearings will be held. The subject of courier services will be considered beginning at 10:00 a.m. on February 10; the subject of armored car services will be considered following completion of the consideration of courier services.

Type of hearing. On December 14, 1971, the National Courier Association and the National Armored Car Association filed a petition for reconsideration by the Board of its denial of a request that these hearings be conducted under §§ 556 and 557 of Title 5, United States Code. (For the Board's order denying the original request, see 36 F.R. 23256.) On January 11, 1972, the Independent Bankers Association of America also requested the Board to conduct the hearing under §§ 556 and 557.

The Board is authorized by § 4(c)(8) of the Bank Holding Company Act to permit bank holding companies to engage in an activity that "the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the Board is required to consider whether performance of the activity by an affiliate of a holding company can reasonably be expected to produce benefits to the public that outweigh possible adverse effects.

In the subject hearings, the Board proposes to determine whether courier services and/or armored car services are closely related to banking, and, if so, whether the usual procedures of § 225.4(b)(1) and (2) of Regulation Y for entry by a holding company into activities on the list of activities specified in § 225.4(a) should apply to those services. The Board will not decide in these hearings whether any particular holding company may engage in courier or armored car services.

In the Board's judgment, the regulatory actions under consideration in the subject proceedings do not constitute an order subject to the judicial review provisions of section 9 of the Bank Holding Company Act. Further, the Holding Company Act does not require a formal hearing on the record with respect to such regulatory actions; and no considerations or arguments have been presented to the Board that, in the Board's judgment, warrant a formal hearing on the issues involved in the hearings, as a matter of Board discretion. Accordingly, the motions for formal hearings are denied.

Access to memoranda. The National Courier Association, the National Armored Car Association, and the Independent Bankers Association have also requested access to intra-agency memoranda considered by the Board in deciding to announce its proposed rulemaking regarding courier and armored car services.

Section 552 of Title 5 specifically exempts from public inspection "inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency". The Board believes that the staff memoranda involved would not be available to the Associations in the event of litigation. Moreover, the Board's knowledge and experience in economics, the payments mechanism, banking, and supervision of banks are reflected in the Board's proposal but are not reflected in said staff memoranda, so that such memoranda cannot be considered to be the basis for the Board's announced proposal for rulemaking.

In these circumstances, the Board believes that there is no legal requirement compelling production and that petitioners' access to the staff memoranda would not contribute to their knowledge of

relevant facts or to their understanding of the Board's rationale in this matter. Accordingly, the requests for access to them are denied.

Other matters. Although the hearing will not be conducted under §§ 556 and 557 of Title 5, it will be a more formal type proceeding than if conducted as previously announced before available members of the Board. The hearing officer will have legal training and skills. He will be qualified to establish orderly procedures; limit presentations in an appropriate manner; exclude irrelevant, immaterial, repetitious, or cumulative material; distinquish between fact and opinion evidence; and accord appropriate weight to material presented.

Accordingly, the Board has authorized the hearing officer to resolve all matters relating to the number and identity of participants, time accorded to participants, the receipt of evidence, expert opinion, rebuttal, written and oral arguments and other presentations, and the desirability and use of a pre-hearing conference.

The hearing officer will make recommendations to the Board, with supporting findings and reasons, on the basis of the subject hearings and material filed in the proceedings. However, the Board will make the final determinations whether, and for what reasons, to adopt its proposal or any modification thereof.

By order of the Board of Governors, January 12, 1972.

(Signed) Tynan Smith

Tynan Smith
Secretary of the Board

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