

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 83-41
March 17, 1983

REGULATION Y

BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

(Amendment to Policy Statement)

TO ALL MEMBER BANKS,
BANK HOLDING COMPANIES
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System has amended its policy statement regarding futures, forward and options contracts on U.S. Government and Agency securities and money market instruments. The original policy statement was issued by Circular No. 80-179, dated September 23, 1980. This policy statement is being amended primarily to request that bank holding companies furnish written notification to their Federal Reserve Bank if such contract activities are commenced by either the parent company or one of its nonbank subsidiaries. Companies which are already engaging in these activities are requested to notify the appropriate Federal Reserve Bank by March 31, 1983. In addition, the policy statement is amended to clarify that it encompasses futures and options contracts on money market instruments, U.S. Government and Agency securities, exchange traded options contracts and standby contracts.

A copy of the Board's notice as published in the Federal Register is printed on the following pages. A press release will not be issued regarding this action.

Questions regarding the contents of this circular should be directed to David W. Dixon, Holding Company Supervision Department, Extension 6182.

Additional copies of this circular will be furnished upon request to the Public Affairs Department, Extension 6289.

Sincerely yours,



William H. Wallace
First Vice President

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

Rules and Regulations

Federal Register

Vol. 48, No. 38

Thursday, February 24, 1983

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Docket No. R-0456]

Regulation Y; Bank Holding Companies; Futures, Forward and Options Contracts on U.S. Government and Agency Securities and Money Market Instruments

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Amended policy statement.

SUMMARY: On August 21, 1980, the Board of Governors adopted a policy statement with respect to the use by bank holding companies of futures, forward and standby contracts on U.S. government and agency securities. The policy statement is being amended at this time, principally to request that bank holding companies furnish written notification to their District Federal Reserve Bank if such contract activities are undertaken by a parent bank holding company or a nonbank subsidiary. In addition, the policy statement is amended to clarify that it encompasses futures and options contracts on money market instruments, as well as U.S. government and agency securities, and exchange traded options contracts, as well as "standby" contracts.

EFFECTIVE DATE: March 1, 1983.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, or Michael J. Schoenfeld, Senior Securities Regulation Analyst, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2781).

SUPPLEMENTARY INFORMATION: In March, 1980, the three federal bank regulatory agencies adopted revised guidelines for banks engaging in futures,

forward and standby contracts on U.S. government and agency securities.¹ After questions arose concerning the application of the joint bank policy statements to bank holding companies contemplating similar practices, the Board adopted a statement setting forth its policy with respect to bank holding company participation in forward placement or delayed delivery contracts and interest rate futures contracts (collectively referred to as "financial contracts"), pursuant to sections 5(b) and 8 of the Bank Holding Company Act (12 U.S.C. 1844 and 1847) and section 8(b) of the Financial Institutions Supervisory Act (12 U.S.C. 1818(b)).² Subsequent to the commencement of futures trading specifying delivery of domestic bank certificates of deposit, the Board issued a final interpretation to clarify that the financial contracts policy statement also applies to newer interest rate futures contracts which specify delivery of money market instruments, as well as government or agency securities.³ Hence, this amended policy statement includes money market instruments in its title, and also reflects the fact that since the issuance of the policy statement, exchange trading has begun in options specifying delivery of debt securities, money market instruments, or futures contracts specifying delivery of debt securities.

The principal purpose of this amendment to the policy statement is to incorporate a revised paragraph (f), Federal Reserve Bank Notification. Revised paragraph (f) requests that bank holding company management notify the appropriate District Reserve Bank when the parent bank holding company or a nonbank subsidiary has begun to engage in financial contract transactions. Holding company systems already engaged in financial contract transactions are requested to notify the appropriate Federal Reserve Bank of the activity by March 31, 1983.

This notification is intended to aid District Reserve Banks in monitoring such activities. Since the federal bank regulatory agencies will begin to receive Supplemental Call Report data with respect to financial contract activities as of June 30, 1983, specific notification by State member banks does not appear necessary at this time.

¹ See 45 FR 18116 (March 20, 1980); 45 FR 18120 (March 20, 1980); Comptroller of the Currency, Banking Circular 79 (2nd Rev.).

² See 45 FR 61595 (September 17, 1980); 12 CFR 225.142.

³ See 46 FR 46386 (September 18, 1981).

List of Subjects in 12 CFR Part 225

Banks, banking, Holding companies, Securities, Reporting and recordkeeping requirements.

PART 225—[AMENDED]

Accordingly, pursuant to sections 5(b) and 8 of the Bank Holding Company Act (12 U.S.C. 1844 and 1847) and section 8(b) of the Financial Institutions Supervisory Act (12 U.S.C. 1818(b)) the Board hereby amends its policy statement at 12 CFR § 225.142 to read in its entirety as follows:

§ 225.142 Statement of policy concerning bank holding companies engaging in futures, forward and options contracts on U.S. government and agency securities and money market instruments.

(a) *Purpose of Financial Contract Positions.* In supervising the activities of bank holding companies, the Board has adopted and continues to follow the principle that bank holding companies should serve as a source of strength for their subsidiary banks. Accordingly, the Board believes that any positions that bank holding companies or their nonbank subsidiaries take in financial contracts should reduce risk exposure, that is, not be speculative.

(b) *Establishment of Prudent Written Policies, Appropriate Limitations and Internal Controls and Audit Programs.* If the parent organization or nonbank subsidiary is taking or intends to take positions in financial contracts, that company's board of directors should approve prudent written policies and establish appropriate limitations to insure that financial contract activities are performed in a safe and sound manner with levels of activity reasonably related to the organization's business needs and capacity to fulfill obligations. In addition, internal controls and internal audit programs to monitor such activity should be established. The board of directors, a duly authorized committee thereof or the internal auditors should review periodically (at least monthly) all financial contract positions to insure conformity with such policies and limits. In order to determine the company's exposure, all open positions should be reviewed and market values determined at least monthly, or more often, depending on volume and magnitude of positions.

(c) *Formulating Policies and Recording Financial Contracts.* In formulating its policies and procedures, the parent holding company may consider the interest rate exposure of its nonbank subsidiaries, but not that of its bank subsidiaries. As a matter of policy, the Board believes that any financial

contracts executed to reduce the interest rate exposure of a bank affiliate of a holding company should be reflected on the books and records of the bank affiliate (to the extent required by the bank policy statements), rather than on the books and records of the parent company. If a bank has an interest rate exposure that management believes requires hedging with financial contracts, the bank should be the direct beneficiary of any effort to reduce that exposure. The Board also believes that final responsibility for financial contract transactions for the account of each affiliated bank should reside with the management of that bank.

(d) *Accounting.* The joint bank policy statements of March 12, 1980 include accounting guidelines for banks that engage in financial contract activities. Since the Financial Accounting Standards Board is presently considering accounting standards for contract activities, no specific accounting requirements for financial contracts entered into by parent bank holding companies and nonbank subsidiaries are being mandated at this time. The Board expects to review further developments in this area.

(e) *Board to Monitor Bank Holding Company Transactions In Financial Contracts.* The Board intends to monitor closely bank holding company transactions in financial contracts to ensure that any such activity is consistent with maintaining a safe and sound banking system. In any cases where bank holding companies are found to be engaging in speculative practices, the Board is prepared to institute appropriate action under the Financial Institutions Supervisory Act of 1966, as amended.

(f) *Federal Reserve Bank Notification.* Bank holding companies should furnish written notification to their District Federal Reserve Bank within 10 days after financial contract activities are begun by the parent or a nonbank subsidiary. Holding companies in which the parent or a nonbank subsidiary currently engage in financial contract activity should furnish notice by March 31, 1983.

Board of Governors of the Federal Reserve System, February 17, 1983.

William W. Wiles,
Secretary of the Board.

[FR Doc. 83-4673 Filed 2-23-83; 8:45 am]

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