



FEDERAL RESERVE BANK OF DALLAS

Station K, Dallas, Texas 75222

Circular No. 84-126
December 27, 1984

TO: All member banks, bank holding companies and others concerned in the Eleventh Federal Reserve District

ATTENTION: Chief Executive Officer

SUBJECT: **Board's press release concerning possible violation of the Glass-Steagall Act by Bankers Trust Company**

SUMMARY: The Board of Governors of the Federal Reserve System has recently advised Bankers Trust Company that it has substantial reason to believe that the bank's method of placing third party commercial paper violates the Glass-Steagall Act. Bankers Trust Company has been requested to respond to the allegations within 45 days. Interested parties will be given an opportunity to comment on Bankers Trust Company's response for 45 days thereafter.

ATTACHMENTS: Board's press release, including a copy of the Board's letter to Bankers Trust Company

MORE INFORMATION: Legal Department, Extension 6171

ADDITIONAL COPIES: Public Affairs Department, Extension 6289

FEDERAL RESERVE press release



immediate release

December 4, 1984

The Federal Reserve Board today advised Banker's Trust Company, in the attached letter, that it has substantial reason to believe that the method of placing third party commercial paper used by the bank constitutes "selling" and "underwriting" of commercial paper in violation of the Glass-Steagall Act.

The Board acted in response to a court action directing the Board to resolve the issue -- whether Banker's Trust's method of placing commercial paper with third parties violates certain provisions of the Glass-Steagall Act -- left undecided by a recent decision of the Supreme Court.

The Board's letter asked Banker's Trust to provide information concerning its methods of placing commercial paper with third parties.

The Board established the following schedule for final resolution of the issue:

- Banker's Trust should within 45 days of the date of the Board's letter provide the Board with a description of its current, or planned, commercial placement activities and legal arguments justifying them.
- The Board will accept comment from interested parties on the response by Banker's Trust for 45 days thereafter.
- Within 30 days following the end of the comment period, the Board's staff will present the matter to the Board for final decision.

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Attachment



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 3, 1984

James Baechle, Esq.
Executive Vice President
and General Counsel
Bankers Trust Company
280 Park Avenue
New York, New York 10015

Re: A.G. Becker, Inc. v. Board of Governors,
No. 80-2614; Securities Industry Association
v. Board of Governors, No. 80-2730 (D.D.C.)

Dear Mr. Baechle:

This letter is in reference to the order, dated October 19, 1984, of the United States District Court for the District of Columbia remanding the above-captioned cases to the Board for resolution of the issue not decided by the opinion of the Supreme Court in these cases. The Supreme Court overturned the Board's September 1980 ruling that the third party commercial paper being placed by Bankers Trust Company is not a "security" for purposes of the Glass-Steagall Act, but expressed no opinion on whether the methods employed by Bankers Trust to place the commercial paper constitute "issuing," "underwriting," "selling," or "distributing" within the meaning of the Act, leaving this issue to be decided on remand. Securities Industry Association v. Board of Governors, No. 82-1766, Slip op. at 22 n.12.

In order to comply with the court's remand order, the record related to the Board's September 1980 ruling has been carefully reviewed. Although this ruling expressed no opinion on whether Bankers Trust's method of placing commercial paper constitutes "underwriting," this question was examined by the staff and was addressed by the parties when the matter was pending before the Board. The Board made no detailed findings on the nature of Bankers Trust's placement methods, but the record indicates that the bank's placement activities operate essentially as follows.

The bank provides financial advice to issuers of commercial paper and solicits purchasers for the commercial paper of these issuers, usually from among the bank's established list of institutional customers that regularly purchase other short-term money market instruments. The bank does not purchase the commercial paper from the issuer and resell it, but solicits purchasers as the agent of the issuer. On some occasions, Bankers Trust extends short-term credit (without any prior commitment) at or near the commercial paper rate of interest to the issuers of commercial paper being placed by the bank in an amount equivalent to part of the unsold portion of the issue sought to be placed and takes back commercial paper notes. The commercial paper representing these transactions may then be resold.

Based on this general description of Bankers Trust's activities as conducted in 1980, the Board has substantial reason to believe that the marketing activity described above constitutes the "selling" and "underwriting" of commercial paper securities within the meaning of the Glass-Steagall Act. Because this tentative conclusion is premised on a relatively general description of Bankers Trust's activities as conducted in 1980, the Board believes that Bankers Trust should be provided an opportunity to provide additional or more detailed information concerning its current commercial paper placement activities. The Board also believes that it is appropriate to afford Bankers Trust and the securities industry representatives that petitioned the Board to halt Bankers Trust's activities an opportunity to provide the Board with additional or supplemental legal arguments.

As the Supreme Court's opinion in these cases makes clear, the permissible scope of Bankers Trust's activities with respect to securities is governed by sections 16 and 21 of the Act. Section 16 (12 U.S.C. § 24 Seventh), in relevant part, provides that the business of dealing in securities by a national bank shall be limited to purchasing and selling securities "solely upon the order, and for the account of customers, and in no case for its own account." Section 16 further provides that a national bank "shall not underwrite any issue" of securities. State member banks are subject to the limitations of section 16 with respect to dealing in securities. 12 U.S.C. § 335. Section 21 (12 U.S.C. § 378) prohibits any organization engaged in the business of receiving deposits from engaging at the same time in the business of "issuing, underwriting, selling, or distributing" securities.

For purposes of the Glass-Steagall Act, the term "underwriter" has been interpreted as referring to a person who purchases securities from an issuer for the purpose of selling them to third parties or who agrees to use his best efforts to achieve a sale of the issue to third parties.^{1/} The definition of "underwriter" for purposes of the federal securities laws has been limited to persons who are involved in a "distribution," i.e., a public offering, of securities.^{2/} The Board staff's Private Placement Study concluded that bank private placement services, which involve a negotiated placement of securities with a limited number of sophisticated investors, do not constitute "underwriting" or "distributing" securities, provided that the bank does not offer the securities to the public and does not use bank funds to purchase the securities to be placed from the issuer.

With respect to the "selling" of securities for purposes of section 21 of the Act, the term has been interpreted as encompassing a bank's activities as a principal, such as selling securities owned by the bank or for the bank's own account.^{3/} Similarly, section 16 authorizes a bank to engage in the business of "selling" securities on the order of and for the account of customers, but not for the bank's own account.

Applying these principles to the general description of Bankers Trust's commercial paper placement activities as conducted in 1980, the Board believes that such activities appear to constitute the "selling" of securities prohibited by the Act. The fact that the bank from time to time extends short-term credit to issuers of commercial paper to cover any

^{1/} E.g., 1 L. Loss, Securities Regulation 159-72 (2d ed. 1961); Securities Act of 1933, § 2(11), 15 U.S.C. § 77b(11); Dale v. Rosenfeld, 229 F.2d 855 (2d Cir. 1956); Federal Reserve Board Staff, Commercial Bank Private Placement Activities 87-89 (June 1977) [hereinafter cited as Private Placement Study].

^{2/} 1 L. Loss, supra, at 547, 654; Private Placement Study 88-91; see 15 U.S.C. § 77d(2).

^{3/} 20 Fed. Res. Bull. 393; Private Placement Study 91-2; see also Securities Industry Ass'n v. Board of Governors (Schwab), 104 S. Ct. 3003, 3010 (1984) ("public sale" as used in section 20 of the Glass-Steagall Act should be read to refer to securities activities in which a bank affiliate "normally acts as principal").

unsold portion of the issue at or near the rate of interest of the commercial paper, takes back a commercial paper note, and then sells that commercial paper appears, in the Board's view, to be the economic equivalent of the bank's buying some of the unsold issue with its own funds with a view to subsequent resale, a method of marketing that would be deemed to constitute "selling" for purposes of the Act. Although the bank's extensions of credit to commercial paper issuers have been described as loans and not the outright purchase of commercial paper, the fact that these loans bear interest at or near the commercial paper rate and that the amount of credit extended is linked to the amount of commercial paper the bank is unable to place indicate that in effect the bank is purchasing a portion of the commercial paper issue the bank has agreed to place, not a note representing a loan independent of the bank's placement activity.

To the extent that the bank's funds are committed to support its placement activity, the bank is acting as principal and for its own account in its commercial paper activities, and the exception in section 16 for sales of securities as the agent for, and on the account of, customers does not appear to apply. Moreover, because the bank is in effect purchasing commercial paper from the issuer for resale, the bank's activity supports the conclusion that it is engaged in "underwriting" in the ordinary, conventional sense of that term.

The Board expresses no opinion at this time with respect to whether Bankers Trust's activities are exempt from the Act's prohibitions against underwriting because no public offering is involved. However, even absent any use of bank funds to meet funding shortages occasioned by unsold commercial paper, there is a question as to whether Bankers Trust's commercial paper activities may be viewed as falling within the private placement exemption from the Glass-Steagall Act recognized in the Private Placement Study. Bankers Trust is requested to provide information with respect to whether its method of placing commercial paper would comply with Regulation D of the Securities and Exchange Commission (17 C.F.R. §§ 230.501-506) and a discussion on the relevance of the requirements of Regulation D for purposes of the Glass-Steagall Act.

The Board recognizes that Bankers Trust may have modified its commercial paper operations since 1980. In addition, because the Board's inquiry in connection with its 1980 ruling to a large extent focused on the status of commercial paper as a security and its resemblance to traditional banking functions, it is possible that the record does not contain all of the relevant facts necessary to resolve whether the bank's method of placing commercial paper constitutes "underwriting," "distributing," or "selling" for purposes of the Act. Accordingly, the Board believes that

Bankers Trust should be permitted an opportunity to provide the Board with a comprehensive description of its current or proposed commercial paper placement activities. The Board's conclusions expressed in this letter will be reviewed in light of any relevant additional facts submitted.

In addition, the Board notes that the Supreme Court's opinion on commercial paper, although expressing no conclusion on the "underwriting" issue, noted that Bankers Trust's placing of commercial paper may give rise to some of the concerns that prompted the passage of the Act. (Slip op. at 17-18). For example, the Supreme Court found that commercial paper activities might impair the bank's ability to serve as an impartial source of credit, since the bank might be under pressure to extend back-up lines of credit to the issuer to enhance the creditworthiness of a particular commercial paper issue. (Slip op. at 17). The Court also stated that a bank might be tempted to purchase unsold notes in order to demonstrate the reliability of its distribution system, even if the paper does not meet the bank's usual credit standards. (*Id.*). The Court also identified the possible danger that confidence in a bank could be jeopardized in the event of a default if the bank sold commercial paper to large bank depositors. (*Id.*). Finally, the Court's opinion finds an especially acute conflict of interest if the bank were to sell commercial paper the proceeds of which will be used to retire a debt owed by the issuer to the bank. (Slip op. at 18). The Board requests Bankers Trust to address these concerns of the Supreme Court.

Any description by Bankers Trust of its current commercial paper activities or of any proposed modifications in its current activities should at a minimum address all of the aspects of the bank's activity examined by the Board's staff during the initial consideration of this matter. However, particular aspects of the bank's activity may be described in general terms, and individual transactions, particular customers, the amount of revenue derived from the activity, and other information generally regarded as confidential business data need not be provided. If deemed appropriate, earlier submissions by Bankers Trust may be incorporated by reference.

In remanding this case to the Board, the district court confirmed the need for an expeditious resolution of the matters left undecided by the Supreme Court's opinion. Accordingly, Bankers Trust should provide to the Secretary of the Board any description of its current commercial paper placement activities and accompanying legal justification within 45 days from the date of this letter. The Board will consider written comments on Bankers Trust's response submitted by the interested parties within 45 days thereafter. Within 30 days after the deadline for submission of comments, the staff

James Baechle, Esq.

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will present the matter to the Board for a final decision, which in the ordinary course of business should be forthcoming shortly thereafter. The Board expects that Bankers Trust will conform its commercial paper placement activities to the final decision of the Board in this matter.

Very truly yours,

A handwritten signature in black ink, appearing to read "William W. Wiles". The signature is written in a cursive style with a large, prominent initial "W".

William W. Wiles
Secretary of the Board

cc: John B. Liftin, Esq.
Harvey L. Pitt, Esq.