FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

June 4, 1985

DALLAS, TEXAS 75222

Circular 85-74

TO: The Chief Executive Officer of all
member banks, bank holding companies
and others concerned in the
Eleventh Federal Reserve District

SUBJECT

Request for public comment -- permissibility of certain nonbanking activities

DETAILS

The Board of Governors of the Federal Reserve System has requested public comment on issues presented in an application filed by Citicorp to engage through a wholly-owned subsidiary in underwriting and dealing in, to a limited extent, municipal revenue bonds (including certain industrial development bonds), mortgage-related securities, and consumer receivable-related securities.

The Board indicated that the notice was being published solely for public comment on issues presented by the proposal under the Glass-Steagall Act and the Bank Holding Company Act and that publication did not represent any Board determination that the proposal would be consistent or inconsistent with these acts.

Any comments on the proposal must be submitted in writing and received no later than July 22, 1985. All correspondence should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

ATTACHMENTS

The Board's notice as published in the Federal Register is attached.

MORE INFORMATION

Questions pertaining to the nonbank activities addressed in this proposal may be directed to Basil J. Asaro at (214) 698-4345 or Gayle Teague at (214) 651-6481.

Sincerely yours,

William H. Wallace

FEDERAL RESERVE press release

For immediate release May 13, 1985

The Federal Reserve Board today requested public comment on an application by Citicorp to engage through a wholly-owned subsidiary in underwriting and dealing in, to a limited extent: municipal revenue bonds (including certain industrial development bonds), mortgage-related securities, and consumer receivable-related securities. The Board has not previously found the proposed activities to be permissible for bank holding companies under the Bank Holding Company Act.

The Board requested comment by July 22, 1985.

The Board indicated that notice was being published solely for public comment on issues presented by the proposal under the Glass-Steagall Act and the Bank Holding Company Act, and that publication did not represent any Board determination that the proposal would be consistent or inconsistent with these Acts.

The Citicorp application represents a substantial modification of an earlier application withdrawn on February 25, 1985, before the Board had reached a final decision whether to seek public comment on the proposal.

The Board's notice is attached.

Attachment

225.23(a)(3)), for permission to engage through its wholly-owned subsidiary, Citicorp Securities, Inc. ("CSI"), in the activities of underwriting and dealing in, to a limited extent, the following securities (hereinafter "ineligible securities"):

(1) Municipal revenue bonds, including certain industrial development bonds;

(2) mortgage-related securities (obligations secured by or representing an interest in residential real estate); and

(3) consumer receivable-related securities (obligations secured by or representing an interest in loans or receivables of a type generally made to or due from consumers) ("CRRs").

CSI currently underwrites and deals in securities that national and state member banks are permitted to underwrite and deal in under the Glass-Steagall Act ("eligible securities") (principally U.S. government securities, general obligations of states and municipalities and certain money market instruments), as permitted by § 225.25(b)(16) of Regulation Y (12 CFR § 225.25(b)(16)).

Citicorp also proposes that CSI arrange private placements and provide certain investment advisory services or brokerage services to its customers as activities that should be considered incidental to the proposed underwriting and dealing activities.

The activities would be conducted in the United States through offices of CSI located in New York, Houston, San Francisco, Miami and Chicago.

The Board has not previously determined that the proposed underwriting and dealing activities are permissible for bank holding companies under the Bank Holding Company Act. Citicorp's application also presents issues under section 20 of the Glass-Steagall Act (12 U.S.C. 377). Section 20 of the Glass-Steagal Act prohibits the affiliation of a member bank such as Citibank, N.A., with a firm that is "engaged principally" in the "underwriting, public sale or distribution" of securities. In applicant's opinion, it would not be "engaged principally" in these activities on the basis of a test that would limit the volume of CSI's underwriting and dealing in ineligible securities.

This application represents a substantial modification of an earlier application under which Citicorp proposed that CSI underwrite and deal in corporate debt securities as well as the securities covered by this application. In that application, Citicorp proposed to limit CSI's underwriting and dealing activities to 20 percent of CSI's total underwriting and dealing of eligible and ineligible securities, including CSI's underwriting and dealing in U.S. government securities. On February 25, 1985, Citicorp withdrew the application before the Board had reached a final decision whether to seek public comment on the the proposal. In connection with the withdrawal, the Board issued a statement that its preliminary analysis indicated the proposal was inconsistent with the Glass-Steagall Act and that Congress is the appropriate forum for proposals, such as that submitted by Citicorp, that would dramatically alter the framework established by Congress in the Glass-Steagall Act for the conduct of the commercial banking and investment banking businesses. The Board urged prompt Congressional consideration of legislation that would authorize bank holding companies to underwrite and deal in municipal revenue bonds, commercial paper and 1–4 family residential mortgage-related securities, as well as to sponsor, control and distribute the securities of mutual funds.

Citicorp's amended application eliminates corporate debt securities from the proposal and substantially reduces the volume of underwriting and dealing activities proposed by CSI. Under the proposed test, CSI will limit its underwriting of municipal revenue bonds (including industrial development bonds) in any calendar year to 3 percent of the total amount of such securities underwritten domestically by all firms during the previous calendar year and its underwriting of mortgage-related securities and CRRs to 3 percent of the total amount of all such securities underwritten domestically by all firms during the previous calendar year. CSI will limit its dealing activities so that at no time will CSI hold for dealing municipal revenue bonds (including industrial development bonds) in excess of 3 percent of the total amount of such securities underwriter domestically by all firms during the previous calendar year or hold for dealing mortgage-related securities and CRRs in excess of 3 percent of the total amount of such securities underwritten domestically by all firms during the previous calendar year.[1]

Citicorp; Proposal To Underwrite and Deal in Certain Securities to a Limited Extent

Citicorp, New York, New York, has applied, pursuant to section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and § 225.23(a)(3) of the Board's Regulation Y (12 CFR

[1] In addition, as a further limit on CSI's activities, CSI would limit its underwriting of ineligible securities during the first year so as to not exceed 5 percent of the gross sales price of all eligible and ineligible securities underwritten by CSI. CSI would limit its dealing in ineligible securities during the first year so as not to exceed 5 percent of the gross sales price of all eligible and ineligible securities underwritten by CSI. During the second year the percentage limitation would be 7 percent; thereafter, the precentage limitation would be 10 percent.

Section 4(c)(8) of the Bank Holding Company Act provides that a bank holding company may, with Board approval, engage in any activity "which 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 an activity is a proper incident to banking, the Board must consider whether the proposal may "reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."

While the Board has decided to publish Citicorp's amended proposal for comment, the Board does not thereby take any position on the issues raised by the proposal under the Glass-Steagall Act or the Bank Holding Company Act. Publication of the proposal has been ordered by the Board solely in order to seek the views of interested persons on the issues presented by the application and does not represent a determination by the Board that the proposal is consistent or inconsistent with the Glass-Steagall Act or that the proposal meets or is likely to meet the standards of the Bank Holding Company Act.

The Board requests the written views of interested persons with respect to:

(1) Whether for purposes of the Glass-Steagall Act the proposed activities would constitute CSI being "engaged principally in the issue, flotation, underwriting, public sale, or distribution * * *" of ineligible securities within the meaning of section 20 of the Glass-Steagall Act; and

(2) whether for purposes of section 4(c)(8) of the Bank Holding Company Act the proposed activities are "so closely related to banking or managing or controlling banks as to be a proper incident thereto."

In this connection, the Board is seeking comments specifically addressed to the following matters:

Glass-Steagall Act

Comments are requested on the scope of activity permitted by the phrase "engaged principally" under the Glass-Steagall Act, including whether the phrase contemplates the type of tests proposed by Citicorp, which are based on a percentage of the affiliate's total business activities and of the total underwriting volume of the particular type of securities involved by firms domestically. The Board also seeks comment on whether the term "engaged principally" in section 20 would preclude a member bank affiliate from engaging in underwriting or dealing in ineligible securities on a substantial and regular or non-incidental basis and without regard to the volume of other activities conducted by the affiliate.

Bank Holding Company Act

A. *Closely Related to Banking Issue.* Comment is requested concerning whether underwriting and dealing in each of the proposed types of "investment securities" is closely related to banking on the basis that: (1) Banks have generally in fact provided the proposed services; (2) banks generally provide services that are so similar to the proposed services as to equip them particularly well to provide the proposed services; or 3) banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

Thee guidelines for determining whether an activity is closely related to banking are set out in *National Courier Association* v. *Board of Governors of the Federal Reserve System,* 516 F.2d 1229 (D.C. Cir. 1975). In addition, the Board may consider any other basis that may demonstrate that the activity has a reasonable or close relationship to banking or managing or controlling bank. Board Statement regarding Regulation Y, 49 FR 813 (1984).

B. *Proper Incident to Banking Issue.* Comment is requested on whether the proposal would be a proper incident to banking, that is, whether the performance of the activity may reasonably be expected to produce public benefits that outweight possible adverse effects. The board also requests comment on whether the proposal may result in the abuses or hazards that the United States Supreme Court has identified as motivating Congress in enacting the Glass-Steagall Act.[2] These include conflicts of interest, such as the distribution of a company's securities for the purpose of repaying extensions of credit to the company by an affiliate of the underwriter, unsound banking practices, such as the imprudent investment of a bank's funds in securities underwritten by an affiliate or in imprudent extensions of credit to customers of the affiliated underwriter, damage to the bank's reputation or the confidence of its customers in the bank, or adverse effects on the impartiality of an affiliate bank in he credit-granting process or the conduct of its fiduciary activities (including the provision of investment advice to customers) as a result of a "salesman's stake" in the securities underwritten or dealt in by an affiliate.

Comment is requested on whether conditions should be established to ameliorate any possible adverse effects, including appropriate capital or other financial requirements, or limitations on: transactions between CSI and its bank affiliates; the use of a name or logo that would be associated with the Applicant or its subsidiary banks; lending by any CSI affiliate (bank or nonbank) to a person for the purpose of purchasing securities from CSI, or to an entity the securities of which are underwritten or dealt in by CSI or for the benefit of which such securities are issued; the purchase by a CSI affiliate, for its own account or as a fiduciary, of securities underwritten or dealt in by CSI; the offering or marketing of CSI's services by its bank affiliates; the access of CSI to information from its bank affiliates; common personnel or other interlocking relationships between CSI and its bank affiliates; or the maintenance of common offices with CSI affiliate.

Upon the expiration of the public comment period, depending upon the comments received, the Board may wish first to consider the legal issue presented by the application under the Glass-Steagall Act in order to determine whether there is a legal basis for considering whether the activities could be permitted for a bank holding company under the Bank Holding Company Act.

Any request for a hearing must, as required by § 262.3(e) of the Board's Rules of Procedure (12 CFR § 262.3(e)), be accompanied by a statement of the reasons why a written presentation would not suffice in lieu of a hearing, indentifying specifically any questions of fact that are in dispute, summarizing the evidence that would be presented at a hearing, and indicating how the party commenting would be aggrieved by approval of the proposal.

The application may be inspected at the offices of the Board of Governors of the Federal Reserve Bank of New York.

Any views of requests for hearing should be submitted in writing and received by William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, not later than July 22, 1985.

Board of Governors of the Federal Reserve System, May 14, 1984.

William W. Wiles,

Secretary of the Board.

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[2] These possible adverse effects are discussed by the United States Supreme Court in *Investment Company Institute* v. *Camp,* 401 U.S. 617, 630-633 (1971), and *Securities Industry Ass'n* v. *Board of Governors of the Federal Reserve System,* 104 S.Ct. 2979, 2984-2985 (1984).