FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

September 20, 1990

Circular 90-69

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Regulation Y (Bank Holding Companies and Change in Bank Control)

DETAILS

The Federal Reserve Board has requested public comment on a proposal to revise the Board's Regulation Y to permit the provision of financial advisory services to financial and nonfinancial institutions and high net worth individuals and to permit the offering of investment advice and securities brokerage activities on a combined basis.

Comments should be received by the Board by October 22, 1990, and should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0706.

ATTACHMENT

The Board's notice is attached.

MORE INFORMATION

Questions concerning the Board's proposal should be addressed to Gayle Teague at (214) 744-7312. If you would like to receive additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

William H. Wallace

Federal Reserve System

12 CFR Part 225

[Regulation Y; Docket No. R-0706]

Bank Holding Companies and Change in Bank Control; Nonbanking Activities and Acquisitions by Bank Holding Companies;

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is seeking public comment on a proposal to amend the provisions in Regulation Y implementing the Bank Holding Company Act (the "BHC Act") to add to the regulatory list of nonbanking activities generally permissible for bank holding companies certain financial advisory activities and the provision of full service securities brokerage services. The Board has previously determined by order that, subject to certain restrictions, these activities are so closely related to banking as to be a proper incident thereto for purposes of section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)). The proposal would modify some of the restrictions on these activities previously imposed by order.

DATE: Comments must be received by October 22, 1990.

ADDRESS: Comments, which should refer to Docket No. R-0706, may be mailed to the Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551, to the attention of Mr. William W. Wiles, Secretary; or delivered to room B-2223, Eccles Building, between 8:45 a.m. and 5:15 p.m. Comments may be inspected in room B-1122 between 9:00 a.m. and 5:00 p.m., except as provided in section 261.8 of

the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Scott G. Alvarez, Assistant General Counsel (202/452-3583), Andrew T. Karp, Attorney (202/452-3554), or Brendan T. Gormley, Attorney (202/452-3721), Legal Division; or Sidney M. Sussan, Assistant Director (202/452-2638), Division of Banking Supervision and Regulation, Board of Governors. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

The Bank Holding Company Act of 1956, as amended, generally prohibits a bank holding company from engaging in nonbanking activities or acquiring voting securities of any company that is not a bank. Section 4(c)(8) of the BHC Act provides an exception to this prohibition where the Board determines after notice and opportunity for hearing that the activities being conducted are "so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. 1843(c)(8). The Board is authorized to make this determination by order in an individual case or by regulation.

The Board has included in its Regulation Y a list of nonbanking activities that the Board has determined to be closely related to banking under section 4(c)(8) of the BHC Act and,

therefore, generally permissible for bank holding companies. Applications by bank holding companies to engage in activities included on the Regulation Y list of permissible nonbanking activities may be processed by the Reserve Banks under expedited procedures pursuant to delegated authority.

Proposed Nonbanking Activities

The Board is seeking public comment regarding whether the Regulation Y list of nonbanking activities permissible for bank holding companies (12 CFR 225.25) should be amended to add so-called full service securities brokerage activities, and financial advisory activities previously approved by order.

Full Service Securities Brokerage

The Board's regulations permit bank holding companies to provide securities brokerage and investment advisory activities separately. See 12 CFR 225.25(b)(4) (investment advice), 225.25(b)(15) (securities brokerage). In addition, the Board has previously determined by order that bank holding companies may provide these services on a combined basis to institutional and retail customers pursuant to section 4(c)(8) of the BHC Act. See, e.g., National Westminster Bank PLC, 72 Federal Reserve Bulletin 584 (1986), affirmed Securities Industry Ass'n v. Board of Governors, 821 F.2d 810 (D.C. Cir. 1987), cert. denied, 108 S.Ct. 697 (1988); Bank of New England Corporation, 74 Federal Reserve Bulletin 700 (1988) (combined services offered to institutional and retail customers).

In its orders permitting bank holding companies to engage in full service brokerage activities, the Board established a framework that includes certain limitations and disclosure requirements that were designed to address potential adverse effects, including conflicts of interests, that may result from combining investment advisory and securities brokerage activities. See, e.g., Bank of New England Corporation, 74 Federal Reserve Bulletin 700 (1988). Many of the restrictions imposed by the framework established in these previous Board orders are similar to the existing requirements of federal and state securities laws. In this regard, the brokerage subsidiaries of bank holding companies are required by federal securities laws to be registered with the Securities and Exchange Commission (the "SEC") and the National Association of Securities Dealers, Inc. and are subject to various federal and state securities laws in conducting these brokerage activities. Brokers are also subject to the general anti-fraud provisions of the securities laws and to a duty, expressed in numerous SEC and judicial decisions, to deal fairly with customers. See, e.g., 17 CFR 240.15c1-2 (SEC anti-fraud rule specifically applicable to broker-dealers).

The Board also requires that a holding company that engages, directly or indirectly, in combined securities brokerage and advisory services make certain disclosures to its customers. Since the Board's initial decision in this area, the Office of the Comptroller of the Currency has authorized operations

subsidiaries of national banks to offer full service brokerage activities within the framework established by the relevant securities laws, and with similar disclosure requirements. See, e.g., O.C.C. Interpretive Letter 403, reprinted in [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627 (December 9, 1987).

The Board proposes to add the conduct of full service securities brokerage activities to its regulatory list of permissible nonbanking activities with a requirement that the brokerage company disclose to all of its customers that the brokerage company is solely responsible for its contractual obligations and commitments; that it is not a bank or insured institution, and is separate from any affiliated bank or insured institution; and that the securities sold, offered, or recommended by the brokerage company are not deposits, are not insured by the FDIC, and are neither endorsed nor guaranteed by, nor constitute an obligation of, any bank. The proposal requires that these disclosures be made prominently and in writing before the brokerage company provides any brokerage or advisory services to its customers and again in its statements of accounts to customers. The brokerage company would, of course, continue to be subject to applicable federal and state securities laws.

The Board also proposes to retain the limitation that combination of discretionary investment management services with brokerage services be available only for institutional customers. J.P. Morgan & Co., Incorporated, 73 Federal Reserve Bulletin 810

(1987). The Board requests comments on whether it is appropriate to permit bank holding companies to provide these discretionary investment services to retail customers as well as institutional customers. In this regard, the Board notes that national banks may not offer these services unless the national bank has been authorized to offer trust services directly or through an operations subsidiary, pursuant to 12 U.S.C. § 92a. See, 12 CFR Part 9, Trust Banking Circular No. 23 (October 4, 1983), reprinted in, Fed. Banking L. Rep. (CCH) ¶ 60,575, and O.C.C. Interpretative Letter No. 353, reprinted in, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,523. The Board has previously defined an "institutional customer." See, The Chase Manhattan Corporation, 74 Federal Reserve Bulletin 704 (1988). The Board proposes to amend Regulation Y to reflect this definition.

In its actions approving the combination of investment advice with brokerage services, the Board has limited director, officer, and employee interlocks between a bank and a securities brokerage affiliate.[1/] The Board is not proposing to retain restrictions on interlocks between a bank and an affiliated full-service brokerage company.

The Board requests public comment on whether other restrictions are necessary to address potential adverse effects, including conflicts of interests and unsafe and unsound banking

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1/ Signet Banking Corporation, 75 Federal Reserve Bulletin 34 (1989).

practices, that may be associated with full service brokerage services.

The proposed regulation would not expand the securities brokerage and investment advisory authority of bank holding companies beyond that which is currently authorized by order. The Board notes that the proposed regulation would not affect the framework governing bank holding company subsidiaries that underwrite or deal in bank-ineligible securities. In addition, this proposal is not intended to modify the Board's interpretive rule regarding the investment advisory activities of bank holding companies. See 12 CFR 225.125; 55 Federal Register 25,849 (June 25, 1990) (proposed revision to interpretive rule).

Financial Advisory Services

The Board has previously determined by order that the provision of financial advisory services is closely related to banking for purposes of section 4(c)(8) of the BHC Act. Specifically, the Board has by order permitted bank holding companies to provide advice to financial and nonfinancial institutions and high net worth individuals with respect to mergers, acquisitions, divestitures, financing transactions, structuring and arranging loan syndications, interest rate swaps, interest rate caps, and similar transactions, including rendering fairness opinions and providing valuation services; and conducting feasibility studies for corporations. See, e.g., SunTrust Banks, Inc., 74 Federal Reserve Bulletin 256 (1988); Banc One Corporation, 76 Federal Reserve Bulletin ___ (Order

dated July 16, 1990) (approving provision of financial advisory services to high net worth individuals). In making this determination, the Board relied on several limitations designed to mitigate the effects of possible conflicts of interests that could arise from the activity, and to ensure that bank holding companies and their nonbanking subsidiaries would not exert significant control over the operations of the client institution through the provision of financial advisory services.

The Board also proposes to permit bank holding companies to conduct feasibility studies for nonfinancial and financial institutions and high net worth individuals. The Board has permitted bank holding companies to provide feasibility studies only for corporations.

The Board proposes to add the provision of financial advisory services to its regulatory list of activities permissible for bank holding companies. The proposal would not permit bank holding companies that provide financial advisory activities to perform routine tasks or operations for a customer on a daily or continuous basis. In addition, the proposal would not permit a financial advisor to make available to any of its affiliates confidential information regarding a party received in the course of providing any of the financial advisory services, except as authorized by the party. The Board seeks public comment on these requirements as well as on whether other requirements may be appropriate to address possible conflicts of

interests, unsafe and unsound banking practices, or other potential adverse effects.

Section-by-section analysis

Section 225.25(b)(4)(i)-(v): The proposed amendment retains in full the existing investment and financial advisory provisions of subsection 225.25(b)(4)(i)-(v).

Section 225.25 (b)(4)(vi): The proposed amendment adds paragraph (vi) to subsection 225.25(b)(4). This paragraph authorizes bank holding companies to engage in additional varieties of financial advisory activities subject to the limitations set forth in that subsection.

Section 225.25(b)(15): The proposed amendment retains in full the existing securities brokerage provisions and modifies the subsection to authorize nonbank subsidiaries of bank holding companies to engage, subject to certain disclosure requirements, in securities brokerage in combination with investment advisory services permissible under section 225.25(b)(4) of Regulation Y.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. No. 95-354, 5 U.S.C. 601 et seq.), the Board of Governors of the Federal Reserve System certifies that this notice of proposed rulemaking, if adopted as a final rule, will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation.

List of Subjects in 12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this notice, and pursuant to the Board's authority under sections 4(c)(8) and 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1843(c)(8), 1844(b)), the Board proposes to amend 12 CFR Part 225 as follows:

PART 225 - BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority citation for Part 225 continues to read as follows:

AUTHORITY: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1843(c)(8), 1844(b), 3106, 3108, 3907, 3909, 3310, and 3331-3351.

2. In Part 225, the footnotes are redesignated as shown below:

Section and Paragraph	Current Footnote Number	New Footnote Number
§§ 225.25(b)(5)(iii)	3	4
(b)(5)(iv)	4	5
	5	6
(b)(5)(vi)	6	7
(b)(8)(i)(B)	7	8
(b)(8)(ii)	8	9
(b)(8)(ii)(B)	9	10
(b)(8)(iv)	10	11
	11	12
(b)(10)(ii)	12	13
(b)(11)	13	14
(b)(11)(iv)	14	15

3. In § 225.2, paragraphs (g) through (o) are redesignated as paragraphs (h) through (p) and new paragraph (g) is added to read as follows:

(g) "Institutional customer" means:

(1) A bank (acting in an individual or fiduciary capacity); a savings and loan association; an insurance company; a registered investment company under the Investment Company Act of 1940; or a corporation, partnership, proprietorship, organization or institutional entity with net worth exceeding $1,000,000;

(2) An employee benefit plan with assets exceeding $1,000,000, or whose investment decisions are made by a bank, insurance company or investment advisor registered under the Investment Advisors Act of 1940;

(3) A natural person whose individual net worth (or joint net worth with his or her spouse) at the time of receipt of the investment advice or brokerage services exceeds $1,000,000;

(4) A broker-dealer or option trader registered under the Securities Exchange Act of 1934, or other securities professional; or

(5) An entity all of the equity owners of which are institutional customers.

4. In § 225.25, the word "and" is removed at the end of paragraph (b)(4)(iv); the period at the end of paragraph (b)(4)(v) is removed and "; and" is added; and new paragraph (b)(4)(vi) is added to read as follows:

§ 225.25 List of permissible nonbanking activities.

* * * * *

(b) * * *

(4) * * *

(vi) (A) Providing advice to financial and nonfinancial institutions and high net worth individuals[3/] with respect to mergers, acquisitions, divestitures, financing transactions, structuring and arranging loan syndications, interest rate swaps, interest rate caps, and similar transactions, including rendering fairness opinions, providing valuation services, and conducting feasibility studies;

3/ High net worth individual means for purposes of this paragraph an individual whose net worth (or joint net worth with a spouse) exceeds one million dollars.

(B) Financial advisory activities under paragraph (b)(4)(vi)(A) of this section shall not encompass the performance of routine tasks or operations for a customer on a daily or continuous basis, and, the financial advisor shall not make available to any of its subsidiaries confidential information regarding a party obtained in the course of providing any financial advisory services except as authorized by the party.

* * * * *

5. In § 225.25, paragraph (b)(15) is revised to read as follows:

(15) Securities brokerage.

(i) Providing securities brokerage services, related securities credit activities pursuant to the Board's Regulation T (12 CFR 220), and incidental activities such as offering custodial services, individual retirement accounts, and cash management services, if the securities brokerage services are restricted to buying and selling securities solely as agent for the account of customers and do not include securities underwriting or dealing; and

(ii) A bank holding company or its nonbank subsidiary may provide securities brokerage services under paragraph (b)(15)(i) of this section in combination with investment advisory services permissible under paragraph (b)(4) of this

section[16/] if the brokerage company prominently discloses to each customer in writing before providing any brokerage or advisory services and again in any customer account statements that:

(A) The brokerage company is solely responsible for its contractual obligations and commitments;

(B) The brokerage company is not a bank and is separate from any affiliated bank; and

(C) The securities sold, offered, or recommended by the brokerage company are not deposits, are not insured by the Federal Deposit Insurance Corporation, do not constitute obligations of any bank, and are not endorsed or guaranteed by any bank, unless this is the case.

16/ A bank holding company or its subsidiary that provides investment advisory services under paragraph (b)(4) of this section in combination with securities brokerage services under this subparagraph may exercise discretion in buying and selling securities solely on behalf of institutional customers, and solely at the request of the customer. A bank holding company or its subsidiary providing these services must comply with applicable law, including fiduciary principles, and obtain the consent of its customer before engaging, as principal or with an affiliate, in securities transactions on the customer's behalf.

Board of Governors of the Federal Reserve System,

August 29, 1990.

(signed) Jennifer J. Johnson

Jennifer J. Johnson
Associate Secretary of the Board