



FEDERAL RESERVE BANK  
OF DALLAS

ROBERT D. McTEER, JR.  
PRESIDENT  
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS  
75265-5906

June 5, 1998

**Notice 98-40**

**TO:** The Chief Executive Officer of each  
financial institution and others concerned  
in the Eleventh Federal Reserve District

**SUBJECT**

**Clarification of the Board's  
Section 20 Orders**

**DETAILS**

The Board of Governors of the Federal Reserve System has issued a clarification to one of the operating standards established in its decisions under the Bank Holding Company Act and section 20 of the Glass-Steagall Act permitting a nonbank subsidiary of a bank holding company to underwrite and deal in securities. The Board is modifying the customer disclosure operating standard to make clear that a section 20 subsidiary operating off bank premises may satisfy the standard by providing a one-time disclosure in writing when an investment account is opened.

**ATTACHMENT**

A copy of the Board's notice as it appears on pages 14803-04, Vol. 63, No. 59 of the *Federal Register* dated March 27, 1998, is attached.

**MORE INFORMATION**

For more information, please contact Rob Jolley at (214) 922-6071. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

A handwritten signature in black ink that reads "Robert D. McTeer, Jr." with a stylized flourish at the end.

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For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

# Rules and Regulations

Federal Register

Vol. 63, No. 59

Friday, March 27, 1998

## FEDERAL RESERVE SYSTEM

### 12 CFR Part 225

[Regulation Y; Docket No. R-1010]

#### Bank Holding Companies and Change in Bank Control; Clarification to the Board's Section 20 Orders

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final Conditions to Board Orders.

**SUMMARY:** The Board is clarifying one of the operating standards established in its decisions under the Bank Holding Company Act and section 20 of the Glass-Steagall Act permitting a nonbank subsidiary of a bank holding company to underwrite and deal in securities. The Board is modifying the customer disclosure operating standard to make clear that a section 20 subsidiary operating off bank premises may satisfy the standard by providing a one-time disclosure in writing when an investment account is opened.

**EFFECTIVE DATE:** March 27, 1998.

**FOR FURTHER INFORMATION CONTACT:** Thomas Corsi, Senior Counsel, (202) 452-3275, *Legal Division*; Michael J. Schoenfeld, Senior Supervisory Financial Analyst, (202) 452-2781, *Division of Banking Supervision and Regulation*; for the hearing impaired only, Telecommunications Device for the Deaf (TDD), Diane Jenkins, (202) 452-3544.

**SUPPLEMENTARY INFORMATION:** In August 1997 the Board approved a substantial revision to the prudential limitations governing the activities of section 20 subsidiaries of bank holding companies.<sup>1</sup> The Board removed all of the existing firewalls and adopted in

their place 8 operating standards.<sup>2</sup> Operating standard 4(i) mandates that a section 20 subsidiary provide its retail customers with the same oral and written disclosures that are required of depository institutions by the Interagency Statement on the Retail Sale of Nondeposit Investment Products (Interagency Statement),<sup>3</sup> even when the section 20 subsidiary is operating off bank premises.<sup>4</sup>

The Interagency Statement generally applies to retail sales of securities and other nondeposit investment products on the premises of depository institutions, and requires that customers be informed that the products being sold are not FDIC-insured, are not deposits of or guaranteed by any depository institution, and are subject to investment risks, including possible loss of principal. The Statement requires that these disclosures be given orally during sales presentations, in connection with investment advice, and when an investment account is opened. Written disclosures also are required when an investment account is opened.<sup>5</sup> Disclosures are generally required in advertisements and promotional materials as well as in customer confirmations and account statements.

A section 20 subsidiary, like any affiliated or unaffiliated broker, operating on the premises of a depository institution is subject to the provisions of the Interagency Statement. The operating standards extend the disclosure requirements of the Interagency Statement to apply even when a section 20 subsidiary is operating off the premises of a depository institution.

The Board recently received a request from several bank holding companies that control section 20 subsidiaries to clarify the operating standard on disclosures. These holding companies believe that requiring a section 20 subsidiary to comply with the oral disclosures mandated by the Interagency Statement when operating off the premises of a depository institution is excessively burdensome. The holding companies contend that it

is not unusual for customers to call a broker several times a day to solicit the broker's views on a particular security. The companies believe that requiring brokers to provide oral disclosures to customers in every instance is potentially damaging to customer relationships and serves no purpose.

The Board retained a disclosure requirement as one of the section 20 operating standards to avoid customer confusion regarding whether products sold by a section 20 subsidiary are federally insured or guaranteed by an affiliated bank. The Board sought to limit the burden of the disclosure requirement on section 20 subsidiaries by requiring only disclosures to retail customers, and requiring the disclosures in the Interagency Statement, which are familiar to banking organizations. The Board stated that the disclosure requirement provides some benefit at minimal cost.

The requesting bank holding companies are now stating that the cost of complying with the disclosure requirement is higher than anticipated when the Board adopted the operating standards. The cost has become particularly apparent in view of the large numbers of registered representatives employed by broker-dealers that have been acquired by bank holding companies in recent months. The burden on large numbers of brokers in complying with the oral disclosure requirement, and the burden on institutions of monitoring compliance with the requirement does not appear to be offset by a corresponding benefit. The potential for customer confusion regarding the nature of products being purchased should be less when a section 20 subsidiary is not operating on bank premises. Accordingly, it appears appropriate to reduce the regulatory burden on bank holding companies in these instances.

When a section 20 subsidiary is operating off bank premises, the concern regarding customer confusion should be adequately mitigated if, when a retail customer opens an investment account, the subsidiary provides the customer with the written disclosures required by the Interagency Statement in that situation. None of the other provisions of the Interagency Statement would apply to a section 20 subsidiary unless it is engaged in activities through arrangements with a bank that are

<sup>2</sup> These operating standards are set out at 12 CFR 225.200.

<sup>3</sup> 1 FRRS ¶ 3-1579.51.

<sup>4</sup> 12 CFR 225.200(b)(4)(i).

<sup>5</sup> The Interagency Statement states that customers should sign a statement acknowledging that they understand the written disclosures that they receive.

<sup>1</sup> 62 FR 45295 (August 27, 1997). Section 20 subsidiaries are companies that underwrite and deal in, to a limited extent, securities that a member bank may not underwrite or deal in.

covered by the Interagency Statement. This revised requirement should relieve some of the compliance burden on section 20 subsidiaries while continuing to mitigate the concerns expressed by the Board in adopting the disclosure requirement.

#### Public Comment and Deferred Effective Date

The Board does not believe that the notice, public comment and delayed effective date requirements of the Administrative Procedure Act at 5 U.S.C. 553 apply with respect to this action. The requirements of section 553 do not apply when an agency finds that notice and public procedure thereon are "impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. 553(b). Similarly, a delayed effective date is not required with respect to agency action that relieves a restriction. 5 U.S.C. 553(d)(1).

The Board believes that notice, public procedure and a delayed effective date are unnecessary in connection with this action. The Board recently amended this restriction after providing notice and seeking public comment. Furthermore, this action would relieve a restriction on bank holding companies that operate section 20 subsidiaries. Accordingly, the Board concludes that the requirements of section 553 do not apply to this action.

#### List of Subjects in 12 CFR Part 225

Administrative practice and procedure, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Board amends 12 CFR Part 225 as follows:

#### PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

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

**Authority:** 12 U.S.C. 1817(j)(13), 1818, 1831i, 1831p-1, 1843(c)(8), 1844(b), 1972(l), 3106, 3108, 3310, 3331-3351, 3907, 3908, and 3909.

2. Section 225.200 is amended by revising paragraph (b)(4)(i) to read as follows:

#### § 225.200 Conditions to Board's section 20 orders.

\* \* \* \* \*

(b) *Conditions.* \* \* \*

(4) *Customer disclosure—(i)*

*Disclosure to section 20 customers.* A section 20 subsidiary shall provide, in

writing, to each of its retail customers,<sup>4</sup> at the time an investment account is opened, the same minimum disclosures, and obtain the same customer acknowledgment, described in the Interagency Statement on Retail Sales of Nondeposit Investment Products (Statement) as applicable in such situations. These disclosures must be provided regardless of whether the section 20 subsidiary is itself engaged in activities through arrangements with a bank that is covered by the Statement.

\* \* \* \* \*

By order of the Board of Governors of the Federal Reserve System, March 23, 1998.

**William W. Wiles,**

*Secretary of the Board.*

[FR Doc. 98-7972 Filed 3-26-98; 8:45 am]

**BILLING CODE 6210-01-P**