FEDERAL RESERVE BANK OF NEW YORK

[Circular No. 7980
October 29, 1976]

BANK HOLDING COMPANIES

Deferral of Action on Proposal to Permit Underwriting and Dealing in Government Securities by Bank Holding Companies

*To All Bank Holding Companies, and Others Concerned,
in the Second Federal Reserve District:*

Following is the text of a statement issued October 20 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today deferred action on a proposal to make underwriting and dealing in Federal Government securities and general obligations of States or their subdivisions (municipal securities) a permissible activity for bank holding companies.

The Board also suspended further consideration of applications by bank holding companies to engage in the activity, and announced in consequence that it was deferring action on an application from United Bancorp of Roseburg, Oregon.

Action was deferred for 12 months unless before that time actions by the Municipal Securities Rulemaking Board—created by Congress in 1975 to regulate the municipal securities field—make reconsideration appropriate in the Board's judgment.

The Board proposed on April 2, 1974 to add to the list of permissible bank holding company activities underwriting and dealing in obligations of the United States, general obligations of any State and of any political subdivision thereof, and other obligations that State member banks are authorized to underwrite and deal in. Underwriting and dealing in U.S. Government securities and municipals is common among banks.

Printed below is the text of the Board of Governors' Order deferring action on the proposal. Questions regarding this matter may be directed to our Domestic Banking Applications Department. Additional copies of this circular will be furnished upon request.

PAUL A. VOLCKER,
President.

(Reg. Y)

BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

By notice of proposed rulemaking published in the *Federal Register* on April 10, 1974 (39 F.R. 13007), the Board of Governors proposed, in connection with an application filed pursuant to § 4(c)(8) of the Bank Holding Company Act (12 U.S.C. § 1843(c)(8)) and § 225.4(b)(2) of the Board's Regulation Y (12 CFR § 225.4(b)(2)), to add to the list of activities that it has determined to be closely related to banking or managing or controlling banks (§ 225.4(a) of Regulation Y) the following:

> underwriting and dealing in such obligations of the United States, general obligations of any State and of any political subdivision thereof, and other obligations that State member banks of the Federal Reserve System may from time to time be authorized to underwrite and deal in.

The Board has considered all comments received. After considering all relevant aspects of the proposal to add the above activity to the list of permissible activities for bank holding companies, the Board has determined not to adopt the proposed amendment at the present time and to suspend further consideration of the activity at this time.

In order for the Board to approve an activity as permissible for a bank holding company under § 4(c)(8) of the Bank Holding Company Act, the Board must find that the activity satisfies two distinct tests. The activity must be determined (1) to be closely related to banking or managing or controlling banks; and (2) to be a proper incident thereto. The second test involves a weighing of public benefits that may be expected to flow from a bank holding company engaging in the activity against the possible adverse effects.

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On the basis of the information in the record, the Board believes that there is support for a determination that the activity is "closely related to banking." National banks and State member banks are specifically authorized under 12 U.S.C. §§ 24, Paragraph Seventh and 335, to engage in the activity directly and many banks do, in fact, engage in the activity. At the present time, banks are a major competitive factor in the industry. To date, only two courts have considered the "closely related" language in section 4(c)(8) of the Act, and both courts concluded, *inter alia,* that an activity generally engaged in by banks directly would seem to qualify as "closely related" to banking or managing or controlling banks within the meaning of the statute.[1] Accordingly, the Board is of the view that the proposed activity is "closely related" to banking.

Notwithstanding the foregoing conclusion, the Board believes that developments occurring since the issuance of the proposed rulemaking in this matter warrant deferral of a decision to adopt the proposed amendment to Regulation Y. In 1975, subsequent to the notice of the proposed rulemaking in this matter, Congress amended the Securities Exchange Act of 1934 to subject, for the first time, municipal securities dealers to extensive regulation. As part of a comprehensive scheme of regulation, the 1975 Amendments created the Municipal Securities Rulemaking Board ("MSRB") and authorized it to promulgate rules governing the activities of bank and nonbank municipal securities dealers. Under the statute, the MSRB is required, among other things, to propose and adopt rules that:

> "[are] designed . . . to promote just and equitable principals of trade . . . to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest [and must] not be designed to permit unfair discrimination between customers . . . [and that] establish the terms and conditions under which any municipal securities dealer may sell, or prohibit any municipal securities dealer from selling, any part of a new issue of municipal securities to a municipal securities portfolio during the underwriting period." [2]

The MSRB is currently in the process of promulgating regulations governing the conduct of municipal securities dealers. Without the benefit of a thorough consideration of the impact that the MSRB's actions may have on the municipal securities industry and in light of the specific Congressional mandate that the MSRB has received to act in this area, the Board believes that action by it to adopt the proposed amendment at this time would be premature.

Possible regulatory changes that may be brought about by actions of the Municipal Securities Rulemaking Board may significantly alter present practices and operations of bank-related and nonbank-related municipal securities underwriters and dealers. In light of this uncertainty, any findings of public benefits deriving from bank holding company performance of the instant activity or of possible adverse effects of such performance would necessarily be speculative at best. Application of the balancing test necessary to determine that the instant activity is a proper incident to banking or managing or controlling banks would be even more uncertain at this time.

For the foregoing reasons, the Board has determined not to adopt the proposed amendment at this time, and to suspend further consideration of the activity, either by order or by regulation, as permissible for bank holding companies, for a period of twelve months, unless prior to that time actions of the Municipal Securities Rulemaking Board lead the Board in its judgment to reconsider the deferral of action on this matter.

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[1] *National Courier Association v. Board of Governors of the Federal Reserve System,* 516 F. 2d 1229 (D.C. Cir. 1975); and *Alabama Association of Insurance Agents v. Board of Governors of the Federal Reserve System,* 533 F. 2d 224 (5th Cir. June 10, 1976).

[2] Section 15(b)(2)(C) and (K) of the Securities Exchange Act of 1934, as amended.

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