

**FEDERAL RESERVE BANK  
OF NEW YORK**

[ Circular No. 10303 ]  
June 29, 1989 ]

**BANK HOLDING COMPANIES**  
**Comment Invited by July 20 on Proposals Regarding**  
**Dealing in Affiliate Securities Under Section 20**  
**of the Glass-Steagall Act**

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

The Board of Governors of the Federal Reserve System has proposed two changes in its rules regarding underwriting or dealing in certain securities by bank holding company subsidiaries. Following are the texts of the Board's statements announcing these proposals:

**Proposal to increase the revenue limit on bank-ineligible securities**

The Federal Reserve Board is seeking public comment on whether to increase from 5 percent to 10 percent the revenue limit established by the Board in its orders authorizing bank holding company subsidiaries to underwrite and deal in bank-ineligible securities consistent with section 20 of the Glass-Steagall Act.

Comment must be submitted to the Board by July 20, 1989.

In its orders the Board stated that underwriting and dealing within a range of 5 to 10 percent of revenues would not violate section 20. The Board set an initial limit of 5 percent and stated it would review whether to increase the limit up to 10 percent after one year of operation.

**Proposal to modify restriction on asset-based securities**

The Federal Reserve Board is seeking public comment on whether to modify a restriction on underwriting asset-based securities of affiliates in the Board's orders under section 20 of the Glass-Steagall Act.

Comment must be submitted to the Board by July 20, 1989.

The modification would allow underwriting of affiliates' securities if they are:

- rated by a non-affiliated nationally recognized rating agency; or
- issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association, or represent interests in such obligations.

Printed on the reverse side is the text of the Board's proposals, which have been reprinted from the *Federal Register* of June 26. Comments thereon should be submitted by July 20, 1989, and may be sent to the Board of Governors, as specified in the proposals, or to our Domestic Banking Applications Division.

E. GERALD CORRIGAN,  
*President.*

(OVER)

## FEDERAL RESERVE SYSTEM

### Review of Revenue Limit on Securities Underwriting Subsidiaries

The Board is considering whether to increase from 5 to 10 percent the revenue limit established by the Board in its Section 20 Orders authorizing bank holding company subsidiaries to underwrite and deal in bank-ineligible securities. See, e.g., *Citicorp, J.P. Morgan & Co. Incorporated, and Bankers Trust New York Corporation*, 73 Federal Reserve Bulletin 473, 485 (1987), *affirmed sub nom. Securities Industry Association v. Board of Governors of the Federal Reserve System/Citicorp, J.P. Morgan & Co. Incorporated, Bankers Trust New York Corporation*, 839 F.2d 47 (2d Cir. 1988), *cert. denied*, 108 S.Ct. 2830 (1988). See also *Securities Industry Association v. Board of Governors of the Federal Reserve System/The Chase Manhattan Corporation*, 847 F.2d 890 (D.C. Cir. 1988).

In those Orders, the Board determined that a bank holding company subsidiary would not be "engaged principally" in securities underwriting activity in violation of section 20 of the Glass-Steagall Act (12 U.S.C. 377), if the subsidiary's gross revenue from bank-ineligible underwriting and dealing did not exceed a range of between 5 and 10 percent of its total gross revenues. Initially, the Board established a 5 percent limit on the amount of revenues received by a section 20 subsidiary from bank-ineligible activity for the first year of operation.

The Board stated that it would review after one year of operation under the Orders whether to increase the limit to 10 percent. In this connection, a number of bank holding companies have filed requests for an increase of the revenue limit to the 10 percent level.

Any comments regarding this matter should be submitted in writing and

received by William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, not later than July 20, 1989.

Board of Governors of the Federal Reserve System, June 20, 1989.

Jennifer J. Johnson,

*Associate Secretary of the Board.*

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### Request for Modification of Restriction on Section 20 Subsidiaries' Underwriting of Asset-Backed Securities of Affiliates

The Board is considering whether to modify a provision in the Board's Section 20 Orders which prohibits securities subsidiaries of bank holding companies from underwriting or dealing in bank-ineligible securities issued by affiliates or representing interests in, or secured by, obligations originated or sponsored by affiliates ("affiliate securities"). This restriction was established by the Board in its initial Orders under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) authorizing the establishment of subsidiaries that underwrite and deal in bank-ineligible securities to a limited extent consistent with section 20 of the Glass-Steagall Act (12 U.S.C. 377). The prohibition was adopted by the Board as a precautionary measure to address the Board's specific concern that a Section 20 subsidiary might be tempted to securitize the affiliates' least creditworthy assets. See, e.g., *Citicorp, J.P. Morgan & Co. Incorporated, and Bankers Trust New York Corporation*, 73 Federal Reserve Bulletin 473, 499, 504 (1987).

Subsequent to the Board's initial Orders, the U.S. Senate and Committees of the U.S. House of Representatives voted in favor of legislation to permit

bank holding company subsidiaries to underwrite and deal in affiliate securities that are: (1) Rated by an unaffiliated, nationally recognized rating organization, or (2) issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association, or represent interests in such obligations.<sup>1</sup> The Board has received requests from bank holding companies to modify the prohibition on underwriting affiliate securities to permit such underwriting and dealing if the requirements listed above are met.

In approving the initial establishment of section 20 subsidiaries, the Board stated it would review the continued appropriateness of the limitations established initially, and reserved the right to amplify or modify them from time to time as the Board deems necessary to ensure the standards of the Bank Holding Company Act are met. The Board requests comment on whether replacing the existing prohibition on underwriting affiliate obligations with a test based on the above-stated requirements would be appropriate to address the Board's concern.

Any comments regarding the requested relief should be submitted in writing and received by William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, not later than July 20, 1989.

Board of Governors of the Federal Reserve System, June 20, 1989.

Jennifer J. Johnson,

*Associate Secretary of the Board.*

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<sup>1</sup> S. 1886, section 102, 100th Cong., 2d Sess. (1988); H.R. 5094, section 201, 100th Cong., 2d Sess. (1988).