FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10314**
October 24, 1989]

BANK HOLDING COMPANIES

Modifications Regarding Securities Underwriting and Dealing 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 recently announced modifications 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.

The following is quoted from the text of the Board's announcement:

The modifications:

- raise from 5 to 10 percent the revenue limit on the amount of total revenues a section 20 subsidiary may derive from ineligible securities underwriting and dealing activities; and,

- permit underwriting and dealing in securities of affiliates if the securities are rated by a non-affiliated nationally recognized rating organization; or are issued or guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association, or represent interests in such obligations.

Enclosed—for bank holding companies and foreign banking organizations operating in this District—is the text of the Board's order. Copies will be furnished to others upon request directed to our Circulars Division (Tel. No. 212-720-5215 or 5216). Questions on this matter may be directed to our Domestic Banking Applications Division (Tel No. 212-720-5861).

E. GERALD CORRIGAN,
President.

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

ORDER APPROVING MODIFICATIONS TO SECTION 20 ORDERS

I. Introduction.

On June 26, 1989, the Board requested public comment[1] on proposed modifications to two of the limitations in the Board's prior Orders authorizing bank holding companies to underwrite and deal in ineligible securities[2] to a limited extent consistent with section 20 of the Glass-Steagall Act (12 U.S.C. § 377) and section 4(c)(8) of the Bank Holding Company Act ("BHC Act")(12 U.S.C. § 1843(c)(8)).

The proposed modifications would (1) raise from 5 to 10 percent the revenue limit on the amount of total revenues the holding company subsidiary ("section 20 subsidiary") may derive from ineligible securities underwriting and dealing activities; and (2) permit underwriting and dealing in securities of affiliates where the securities are rated by an unaffiliated, nationally recognized statistical rating organization or are issued or guaranteed by the Federal National Mortgage

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[1] 54 Federal Register 26840.

[2] Ineligible securities are securities that member banks may not underwrite and deal in under the Glass-Steagall Act. 12 U.S.C. §§ 24(Seventh) and 335.

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Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association ("FNMA, FHLMC or GNMA"), or represent interests in securities issued or guaranteed by the agencies.

In 1987, the Board authorized bank holding companies for the first time to underwrite and deal in certain limited types of ineligible securities. Citicorp, J.P. Morgan & Co. Incorporated and Bankers Trust New York Corporation, 73 Federal Reserve Bulletin 473 (1987)("Citicorp/Morgan/Bankers Trust").[3] In 1989, the Board expanded the scope of securities that could be underwritten and dealt in to include all types of debt and equity securities. J.P. Morgan & Co. Incorporated, The Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp and Security Pacific Corporation, 75 Federal Reserve Bulletin 192 (1989)("J.P. Morgan & Co., et al.").[4] In the Board's previous decisions, the Board determined that a company would not be "engaged principally" in underwriting or dealing in ineligible

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[3] The Board's Order authorized underwriting and dealing in ineligible municipal revenue bonds, 1-4 family mortgage-backed securities and commercial paper. The Board subsequently approved underwriting and dealing in consumer-receivable-related securities in Chemical New York Corporation, The Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp, Manufacturers Hanover Corporation and Security Pacific Corporation, 73 Federal Reserve Bulletin 731 (1987) ("Chemical New York Corporation").

[4] The Board required that underwriting and dealing in equity securities be delayed for at least one year to permit the Board to review whether the underwriting subsidiaries have in place an adequate operational and managerial infrastructure for this activity.

securities in violation of section 20 of the Glass-Steagall Act if the revenues the company derives from this activity are limited to between 5 and 10 percent of the total revenues of the subsidiary.[5] The Board established the 5 percent revenue limit as a conservative approach to allowing ineligible securities underwriting and dealing activity initially. The Board stated, however, that it would review the revenue limit within one year, after the Applicants had gained experience operating underwriting subsidiaries, to determine whether higher levels of activity up to 10 percent would be permissible.[6]

In addition to the revenue limitation, the Board established a number of prudential limitations on the conduct of the activity. These limitations included the prohibition against the section 20 subsidiary's underwriting and dealing in ineligible securities issued by its affiliates or representing interests in, or secured by, obligations originated or sponsored by its affiliates. The Board stated that it would review from time to time the continued appropriateness of particular limitations, such as the affiliate underwriting prohibition, based on the record of experience of underwriting subsidiaries.[7]

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[5] Section 20 prohibits the affiliation of a member bank with a company that is "engaged principally" in underwriting and dealing in ineligible securities. 12 U.S.C. § 377.

[6] Citicorp/Morgan/Bankers Trust, 73 Federal Reserve Bulletin at 475-76, 485.

[7] Citicorp/Morgan/Bankers Trust, 73 Federal Reserve Bulletin at 499, 504.

The Board has received requests from bank holding companies to permit underwriting and dealing in affiliates' securities in light of the fact that, after the Board's initial section 20 decision, the full Senate and the House Banking Committee approved legislation to permit underwriting of affiliate securities under the proposed conditions.[8]

II. Summary of Public Comments.

In response to the request for comments, the Board received letters from numerous banking organizations, securities industry trade associations, the OCC and other members of the public. Most of the commenters favored increasing the revenue limit as well as permitting underwriting and dealing in affiliate securities, on the basis of their views that the modifications would expand the ineligible securities underwriting and dealing activities of section 20 subsidiaries, thereby fostering increased competition, and would not violate the Glass-Steagall Act or the BHC.

The Securities Industry Association ("SIA"), the Investment Company Institute ("ICI"), and two smaller banking organizations commented in opposition to the proposals, on the basis of their views that the modifications would be inconsistent with the intent of the Glass-Steagall Act or would increase the potential for adverse effects that these commenters believe are

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[8] S. 1886, 100th Cong., 2d Sess., 134 Cong. Rec. S3362 (daily ed. March 30, 1988); H.R. 5094, 100th Cong., 2d Sess. § 201 (1988), as set out in H. Rep. No. 822, Part 1, 100th Cong., 2d Sess. 18-19.

associated with securities underwriting and dealing activities conducted by banking organizations.

III. Revenue Limit.

The Board has carefully considered the submissions of the commenters for and against the proposed increase in the revenue limit to 10 percent as well as other facts of record. Based upon this review, the Board has concluded that this modification would be consistent with the Glass-Steagall Act and the standards the Board is required to apply to nonbanking activities under section 4(c)(8) of the BHC Act.

A. Compliance with Section 20 of the Glass-Steagall Act. As the Board determined in its initial section 20 decisions, revenues received by an underwriting subsidiary from ineligible securities underwriting and dealing in a range of 5 to 10 percent of total revenues do not violate section 20 of the Glass-Steagall Act. The U.S. Court of Appeals for the Second Circuit upheld the Board's ruling in Securities Industry v. Board of Governors of the Federal Reserve System, 839 F.2d 47, 62, 67 (2d Cir. 1988), cert. denied, 108 S.Ct. 2830 (1988)("SIA v. Board").[9]

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[9] The Second Circuit Court of Appeals stated:

> [W]e defer to the Board's determination that § 20 allows an affiliate to engage in bank-ineligible securities activities so long as those activities do not exceed five to ten percent of the affiliate's gross revenue. This range is both reasonable and consistent with the statute. SIA v. Board, 839 F.2d at 67.

-- SIA's Glass-Steagall Act Contentions.

In reaching the decision to increase the revenue limit to 10 percent, the Board has carefully considered the comments opposing a 10 percent limit from the SIA, which contended that this limit would be inconsistent with the intent of the Glass-Steagall Act by allowing affiliations between banks and the nation's largest investment banking firms.[10] As noted, however, the Board and the U.S. Court of Appeals for the Second Circuit have ruled that the 5 to 10 percent of revenue range is consistent with both the literal terms of section 20 and the intent of Congress underlying the Glass-Steagall Act.[11]

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[10] The SIA commented that the section 20 subsidiaries may be able to manipulate sales data and thus the revenue limit and argued that a 10 percent limit would allow a section 20 subsidiary to match or exceed the average percentage level of underwriting revenues of members of the securities industry. The SIA requested the Board to reconsider the SIA's previous request for a 5 percent capital limit on ineligible activity. The Board previously considered similar arguments of the SIA in other cases in arriving at the revenue limit, which applies to both underwriting and dealing, and the prudential limitations applicable to section 20 subsidiaries.

[11] SIA V. Board, 839 F.2d at 58, 62-67. The Second Circuit U.S. Court of Appeals noted that the Congress that enacted the Glass-Steagall legislation rejected the suggestion that affiliates be abolished and stated that the "inference following from [the section 20] terminology is obvious: § 20 applies a 'less stringent standard' than the absolute bar between commercial and investment banking laid down by §§ 16 and 21." 839 F.2d at 58. See also Securities Industry Association v. Board of Governors of the Federal Reserve System, 847 F.2d 890, 895 (D.C. Cir. 1988)(upholding the 5 percent revenue limit at

(continued...)

Accordingly, the Board does not believe a decision to increase the revenue limit to 10 percent would be inconsistent with the Glass-Steagall Act.[12]

B. Section 4(c)(8) of the BHC Act. The Board also believes that increasing the revenue limit would be consistent with the nonbanking standards the Board is required to apply under section 4(c)(8) of the BHC Act. Section 4(c)(8) requires the Board to determine whether the proposed nonbanking activities are "closely related to banking or managing or controlling banks." In addition, the Board must find that the conduct of the activities by a bank holding company would be a "proper incident" to banking or managing or controlling banks, i.e., that the performance of the activities by an affiliate of a holding company "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects."[13]

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[11](...continued)
issue in the case).

[12] The Board also received comments from banking organizations that believe the Board should leave the door open to additional interpretation of section 20 to permit ineligible activity at higher levels up to 25 percent of revenues or more. In its proposal, the Board asked for comment on whether, consistent with its statement in its original decision, the revenue limit should be raised to 10 percent within the range found permissible by the U.S. Court of Appeals for the Second Circuit. The question of whether to increase the revenue limit above 10 percent is not before the Board.

[13] 12 U.S.C. § 1843(c)(8).

1. Closely Related to Banking Requirement. The Board determined in its prior section 20 decisions that underwriting and dealing in ineligible securities is closely related to banking on the basis that banks and their subsidiaries conduct securities underwriting and dealing activities and other services that are operationally and functionally similar to underwriting and dealing in ineligible securities. Increasing the revenue limit on ineligible activity will not alter the fundamental nature of the activities of the section 20 subsidiary or, consequently, the basis for the Board's finding regarding the closely-relatedness of the activity. Accordingly, the Board concludes that the activities of section 20 subsidiaries would continue to meet the closely related to banking standard under section 4(c)(8) after increasing the revenue limit on the amount of ineligible underwriting and dealing activity to 10 percent.

2. Proper Incident to Banking Requirement. The Board also believes that increasing the revenue limit would be consistent with the Board's previous determination that ineligible securities underwriting and dealing is a "proper incident" to banking within the meaning of section 4(c)(8).

-- Public Benefits. Increasing the revenue limit would not adversely affect the public benefits of increased competition, greater convenience to customers and enhanced efficiency in the provision of services that the Board previously found could reasonably be expected to result from a bank holding company's underwriting and dealing in ineligible securities. A

10 percent limit, which the U.S. Court of Appeals for the Second Circuit has held would not violate section 20 of the Glass-Steagall Act, would also provide greater leeway to section 20 subsidiaries to enter the market and to compete in the various aspects of the underwriting and dealing business.

-- Possible Adverse Effects. In the Board's view, increasing the revenue limit to 10 percent also would not result in any additional adverse effects under section 4(c)(8) of the BHC Act. In reaching the conclusion that ineligible securities underwriting and dealing would not lead to significant adverse effects, the Board generally has relied, not on quantitative limits, but rather on a framework of prudential limitations that operate by addressing directly practices, transactions or relationships that have the potential to be associated with conflicts of interest, unsound banking practices, unfair competition or other possible adverse effects.[14] The basic approach of these limitations is to require ineligible securities activities to be conducted in a separate holding company subsidiary subject to firewalls intended to insulate affiliated banks from the potential for risk in the activity and minimize the potential for other adverse effects. In general, the firewalls:

1. require that equity investments and loans qualifying as regulatory capital in the underwriting subsidiary not be counted toward

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[14] Citicorp/Morgan/Bankers Trust, 73 Federal Reserve Bulletin at 502-04; J.P. Morgan & Co., et al., 75 Federal Reserve Bulletin at 214-17.

the holding company's consolidated capital for regulatory purposes;

2. prohibit credit extensions to or for the benefit of the underwriting subsidiary, including credit enhancements of securities and purchases of financial assets from the subsidiary;

3. require separate offices for the underwriting subsidiary and limit employee, officer and director interlocks and communication of confidential customer information between the underwriting subsidiary and affiliated banks; and

4. require disclosure that the underwriting subsidiary is separate from any affiliated banks and that securities offered, sold or recommended are not FDIC-insured.

These prudential requirements would remain in place under a 10 percent revenue limit. Moreover, the Board has concluded as a general matter, and in endorsing legislation to permit bank holding company subsidiaries to engage in an unlimited amount of ineligible underwriting and dealing activity, that this type of framework is preferable for addressing possible adverse effects.[15] The Board notes that the effectiveness of this framework has not been called into question by experience.

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[15] Legislative Proposals to Restructure our Financial System: Hearings on S. 1886, S. 1891, and S. 1905 Before the Senate Comm. on Banking, Housing and Urban Affairs, 100th Cong., 1st Sess. 97-98 (December 1, 1987)(Statement of Chairman Greenspan), reprinted in 74 Federal Reserve Bulletin 91 (1988); Hearings Before the Subcomm. on Financial Institutions Supervision , Regulation and Insurance of the House Comm. on Banking, 100th Cong., 1st Sess. (November 18, 1987)(Statement of Chairman Greenspan), reprinted in 74 Federal Reserve Bulletin 20 (1988).

-- SIA's Section 4(c)(8) Contentions.

The SIA contends that the Board should not consider an increase in the revenue limit unless it provides public access to compliance reports or related data concerning section 20 subsidiaries. The Board does not believe that informed public comment on the proposal to increase the revenue limit requires disclosure of confidential examination and inspection information. As discussed above, the revenue limit was established as a Glass-Steagall Act restriction. Disclosure of confidential compliance information would not assist the SIA in addressing the requirements of the Glass-Steagall Act.

Moreover, the Board previously denied a similar request by the SIA for confidential financial information concerning the Applicants in Citicorp/Morgan/Bankers Trust on the basis of the possible harm to the competitive position of the Applicants and the public availability of sufficient information to comment.[16] In the Board's view, those reasons also apply here.

The SIA also contends that increasing the revenue limit would increase the potential for unfair competition between section 20 subsidiaries and securities firms that are not affiliated with banks. The Board previously analyzed the SIA's contentions with regard to possible unfair competition in Citicorp/Morgan/Bankers Trust and J.P. Morgan & Co., et al. and determined that existing regulations and prudential limitations

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[16] 73 Federal Reserve Bulletin at 505 n.104.

established under the Orders would be effective to address this concern.

The SIA also maintains that Board action to increase the revenue limit is not warranted at this time because, in its view, the section 20 subsidiaries have not had sufficient experience, particularly in corporate debt securities underwriting and dealing authorized in 1989. The Board has considered, however, the experience of the section 20 subsidiaries that received approval in 1987 to engage in ineligible securities activities and that have been operating for a year or more. In the Board's view, there is an adequate record of experience upon which the Board has been able to reach a decision to increase the revenue limit.

Based on the foregoing and other facts or record, the Board has determined to adopt the proposed modification of the revenue limit to permit section 20 subsidiaries to derive up to 10 percent of total revenues from ineligible underwriting and dealing activity. In addition, the Board has determined to apply the increased revenue limit to all section 20 subsidiaries, including those that have not been operating for more than one year and those that recently received expanded authority to underwrite and deal in corporate debt securities. In this regard, the Board notes that the Citicorp/Morgan/Bankers Trust Order does not contemplate that the Board would apply any decision raising the revenue limit to only those section 20 subsidiaries that have been in operation for one year.

IV. Underwriting and Dealing in Affiliate Securities.

The Board also has carefully considered the submissions of the public commenters for and against the proposed modification to permit underwriting and dealing in affiliates' securities under certain conditions. The Board in Citicorp/Morgan/Bankers Trust established the prohibition against underwriting and dealing in ineligible securities and obligations of affiliates not because the Board believed this activity would violate section 20 of the Glass-Steagall Act, but as a precautionary measure to guard against possible conflicts of interest under section 4(c)(8) of the BHC Act. In particular, the Board was concerned about and adopted the prohibition to address the possible temptation that a bank holding company might use its section 20 subsidiary as a mechanism to dispose of uncreditworthy assets of affiliates. As discussed below, based upon review of the comments and other facts of record, the Board believes it would be consistent with section 4(c)(8) of the BHC Act to modify this prohibition to permit underwriting and dealing in ineligible securities issued by (or representing interests in, or secured by, obligations of) affiliates provided the securities are 1) rated by an unaffiliated, nationally recognized statistical rating organization, or 2) issued or guaranteed by FNMA, FHLMC or GNMA (or represent interests in securities issued or guaranteed by FNMA, FHLMC or GNMA).

1. Public Benefits. There is no evidence that permitting section 20 subsidiaries to underwrite and deal in

affiliate obligations to the limited extent described above would remove any of the public benefits of increased competition, greater convenience and enhanced efficiency that the Board previously determined could be expected from bank holding companies' entry into underwriting and dealing activities, particularly in the newer market for asset-backed securities.[17]

Moreover, it is reasonable to expect that public benefits may result from allowing banking organizations to participate to a greater degree in the growing market in securitized banking assets. The commenters noted that securities firms that are not affiliated with banks currently underwrite and deal in securities of affiliates. Thus, permitting section 20 subsidiaries to engage in similar activity could be expected to increase competition. In addition, approval of the proposed modification would allow a bank holding company to participate in the various steps in the securitization process by which loans of affiliates may be made available for sale as securities, performing the functions of originator, trustee for a pool of assets, issuer, underwriter and dealer. In the Board's view, the combination of these services in a bank holding company, subject to requirements placed on the section 20 subsidiary to avoid adverse effects, could be expected to result in public benefits in the form of increased efficiency, reduced financing costs,

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[17] See Chemical New York Corporation, 73 Federal Reserve Bulletin 731, 734 (1987).

increased availability of services to issuers and investors, and market innovation.

2. Possible Adverse Effects. In Citicorp/Morgan/Bankers Trust, the Board expressed concern regarding potential conflicts of interest that might arise if a section 20 subsidiary underwrites or deals in securities of affiliated entities, particularly those that may be experiencing financial difficulties.[18] As noted, the Board was concerned that a bank holding company with an underwriting affiliate might be tempted to securitize the less creditworthy assets of subsidiary banks or other subsidiaries for sale to the public through the underwriting affiliate. As a precautionary measure in authorizing the initial establishment of underwriting subsidiaries, the Board addressed this concern by prohibiting a section 20 subsidiary from underwriting and dealing in affiliates' securities or obligations. The Board noted that this would require the bank holding company to obtain an independent underwriter to make an impartial credit judgment as to the quality of the assets.

The Board believes that the modification would be effective to address the Board's initial concerns because it would ensure that an impartial credit judgment is made concerning the securities. Under the modification, the unaffiliated rating agency or the relevant government or government-sponsored agency

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[18] 73 Federal Reserve Bulletin at 499.

would impose its credit standards and review the issue. The rating agency would provide independent credit analysis similar to that available from an unaffiliated underwriter. The same would be true in the case of securities issued or guaranteed by FNMA, FHLMC or GNMA, since any loans of affiliates that were securitized and sold by a section 20 subsidiary would be subject to the underwriting criteria and independent credit standards of the agencies.[19] In addition, the pools into which the loans would be placed would all be guaranteed as to interest and principal by FNMA, FHLMC or GNMA.

The Board also notes that in the proposed securities legislation considered during the 100th Congress, the full Senate and the House Banking Committee approved unlimited underwriting of affiliate securities provided that the same requirements contained in the modification were satisfied.[20] The Board

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[19] FNMA, GNMA and FHLMC have established standards in such areas as type of real estate, loan to value ratios, maximum loan amounts, title and casualty insurance coverage, property appraisal and minimum levels of equity in the issuing entity. These standards make is unlikely that an affiliate could "dump" uncreditworthy assets through the Section 20 affiliate.

[20] S. 1886, 100th Cong., 2d Sess. § 102 (proposed Bank Holding Company Act section 4(c)(15)(F)(x)), and H.R. 5094, 100th Cong., 2d Sess. § 201 (proposed Bank Holding Company Act section 9(i)).

As stated in the Senate Report accompanying the bill:

> The rating requirement ensures that the investing public will have the benefit of an impartial third party's evaluation of any such securities that are being underwritten or distributed by the securities affiliates.

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endorsed this legislation and testified in favor of the specific provision to allow underwriting in affiliates' obligations.[21]

-- SIA and ICI Contentions.

The SIA and the ICI opposed allowing any underwriting and dealing in affiliates' securities on the grounds that the proposed modification would not be adequate to address possible adverse effects. In the ICI's view, rating by an independent agency or backing by FNMA, FHLMC or GNMA would not be effective to ensure that there would be an impartial credit judgment with regard to an offering of affiliate obligations. In particular, the ICI maintained that a rating agency, unlike a separate

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[20](...continued)
S. Rep. No. 305, 100th Cong., 2d Sess. 54 (1988).

With regard to the modification for FNMA, FHLMC or GNMA obligations, the Senate Report also noted:

> Each agency has standards for mortgages underlying the asset-related securities that it issues or guarantees. Moreover, the agency itself is responsible for paying the principal of and interest on the securities, regardless of how the mortgages perform. The agency's mortgage evaluation standards and direct responsibility give investors protection that is at least equivalent to that of a rating. Id.

[21] Legislative Proposals to Restructure our Financial System: Hearings on S. 1886, S. 1891, and S. 1905 Before the Senate Comm. on Banking, Housing and Urban Affairs, 100th Cong., 1st Sess. 97-98 (December 1, 1987)(Statement of Chairman Greenspan), reprinted in 74 Federal Reserve Bulletin 91, 98-99 (1988).

underwriter, does not have securities law liability for disclosure of material information relating to the creditworthiness of an issue and thus would not be as thorough as an independent underwriter. While not endorsing the grant of authority to a section 20 subsidiary to underwrite affiliate obligations, the ICI maintained that allowing such underwriting only if the securities are priced by an independent underwriter would be preferable to the language proposed in the Board's Federal Register notice, which was based on the Senate and House Banking Committees' bills.[22]

The SIA and the ICI did not, however, provide a factual basis to support their views that a separate, unaffiliated underwriter is necessary to avoid conflicts of interest. Securities firms and their affiliates currently participate in the securitization process, performing the roles of both issuer and underwriter. Like the section 20 affiliates, such firms are subject to the requirements of the securities laws and regulations thereunder that, through disclosure, anti-fraud and other provisions, tend to discourage any temptation to pass off potentially nonperforming assets on investors.[23] The additional

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[22] This request for pricing by an independent underwriter was contained in the bill considered by the House Energy and Commerce Committee during the 100th Congress.

[23] In addition, Schedule E to the NASD By-Laws imposes a series of safeguards against conflicts of interest in an underwriter's sale of securities of its affiliates.

requirements placed on section 20 subsidiaries under the modification, together with the firewall provisions the Board has established for the subsidiaries and the requirements of sections 23A and 23B of the Federal Reserve Act, would in the Board's view effectively minimize the possibility of significant adverse effects.

The SIA and the ICI also have not provided a factual basis for their argument that the modification would lead to undue risk, and the record before the Board does not indicate that increased risk would result. To the contrary, the Board received comments from members of the banking industry maintaining that fuller participation in the securitization process could lead to a reduction of risks to banks, as a result of improved capital ratios and return on assets, freeing of balance sheets for additional activities, elimination of interest rate and prepayment risks, and diversification of credit risk.

In addition, the Board believes that permitting section 20 subsidiaries to underwrite and deal in affiliates' securities would be consistent with the ruling by the U.S. Court of Appeals for the Second Circuit in Securities Industry v. Clarke, Nos. 89-6027 and 87-6029, slip op. (2d Cir. September 8, 1989), which upheld an interpretation by the Comptroller of the Currency that similar activity is permissible for national banks. In that decision, the court held that the Comptroller of the Currency had properly determined that securitization activity conducted by Security Pacific National Bank was within the "business of

banking" under the National Bank Act. By allowing the activity in the holding company subject to the rating (or the FNMA, FHLMC or GNMA) requirements and the prudential limitations established in the Section 20 Orders, the Board's decision should permit reduction of risks to banks and to the federal safety net and provide additional protections against conflicts of interest or potential adverse effects.[24]

V. Conclusions.

Accordingly, for the reasons and subject to the conditions set forth in this Order, the Board concludes that the proposed modifications are consistent with section 20 of the Glass-Steagall Act and section 4(c)(8) of the Bank Holding Company Act and are hereby adopted. The Board's approval extends only to the ineligible securities underwriting and dealing activities previously approved for individual bank holding companies and does not expand the types of securities any applicant has previously received authority to underwrite and deal in. The Board's determination to raise the revenue limit is subject to the requirement that the percentage revenue limit be

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[24] Some commenters from the banking industry requested additional underwriting and dealing authority, such as authority to underwrite and deal in all securities that are guaranteed as to interest and principal by any U.S. government or U.S. government-sponsored agency (or backed by such securities), or authority to deal in affiliate securities without limitation. Requests to extend affiliate underwriting and dealing authority beyond that proposed for public comment may raise additional risk considerations that have not been fully explored. Accordingly, the Board has not considered the requests for broader authority at this time.

calculated in accordance with the clarification set forth in J.P. Morgan & Co., et al.,[25] except that the applicable limit will hereafter be 10 percent. The Board's Order applies to all section 20 subsidiaries of bank holding companies and is effective immediately. Approval of the modifications is subject to the Board's continuing authority to reexamine limitations established on section 20 subsidiaries as provided in the Citicorp/Morgan/Bankers Trust and J.P. Morgan & Co., et al. Orders.

By order of the Board of Governors,[26] effective September 21, 1989.

William W. Wiles
Secretary of the Board

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[25] 75 Federal Reserve Bulletin at 196.

[26] Voting for this action: Chairman Greenspan and Governors Johnson, Seger, Angell, Kelley, and LaWare.