FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10576**
September 28, 1992]

BANK HOLDING COMPANIES

Addition of Full-Service Brokerage and Financial Advisory Services as Permissible Nonbanking Activities

Effective September 10, 1992

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

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

The Federal Reserve Board has announced that it has amended the Board's Regulation Y to permit the provision of financial advisory services to financial and nonfinancial institutions and high net worth individuals under certain conditions, and the offering of investment advisory and securities brokerage services on a combined basis under certain conditions. Applications by bank holding companies to engage in these activities now may be processed by the Federal Reserve Banks under expedited procedures pursuant to authority delegated by the Board.

The amendments are effective September 10, 1992.

Enclosed, for bank holding companies and others who maintain sets of the Board's regulations, is the text of the amendments to Regulation Y, as published in the *Federal Register* of September 10. Additional, single copies may be obtained at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling our Circulars Division (Tel. No. 212-720-5215 or 5216).

Questions on this matter may be directed to Jay Bernstein, Staff Director of our Domestic Banking Applications Division (Tel. No. 212-720-5861).

E. GERALD CORRIGAN,
President.

Federal Register

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Amendments to Regulation Y

Docket No. R-0706

Permissible Nonbanking Activities

Effective September 10,1992

[Enc. Cir. No. 10576]

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R-0706]

RIN 7100-AB09

Bank Holding Companies and Change in Bank Control

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending its Regulation Y to augment the list of permissible nonbanking activities for bank holding companies to include the provision of full service securities brokerage under certain conditions; and the provision of financial advisory services under certain conditions. The Board has by order previously approved these activities. 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.

EFFECTIVE DATE: September 10, 1992.

FOR FURTHER INFORMATION CONTACT: Scott G. Alvarez, Associate General Counsel (202/452-3583), or Thomas M. Corsi, Senior Attorney (202/452-3275), Legal Division. For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

The Bank Holding Company Act of 1956, as amended (the "BHC Act"), 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's Regulation Y (12 CFR part 225) sets forth 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. 12 CFR 225.25. Applications by bank holding companies to engage in activities listed in Regulation Y as permissible nonbanking activities may be processed by the Reserve Banks under expedited procedures pursuant to delegated authority.

The Board has previously determined, by order, that full service securities brokerage activities, *i.e.*, the provision of securities brokerage services and investment advisory services together by the same company to its customers, is closely related to banking and a proper incident thereto for purposes of section 4(c)(8) of the Bank Holding Company Act. The Board has also previously determined, by order, that the provision of the following financial advisory services is an activity that is closely related to banking and a proper incident thereto: (1) Providing financial advice to foreign governments and their municipalities and agencies, such as with respect to the issuance of their securities; (2) providing financial and transaction advice to institutional customers with respect to structuring, financing and negotiating mergers, acquisitions, divestitures, joint ventures, leveraged buyouts, recapitalizations, capital structurings, structuring and arranging loan syndications, financing and other corporate transactions (including private and public financings), rendering fairness opinions, providing valuation services, and conducting feasibility studies; and, (3) providing financial and transaction advice to institutional customers regarding the structuring and arranging of swaps, caps, and similar transactions relating to interest rates, currency exchange rates or prices, and economic and financial indices.

The Board has invited public comment on a proposal to amend its Regulation Y to add these activities to the Board's regulatory list of permissible nonbanking activities. 55 FR 36282, September 5, 1990.

In connection with this action, the Board proposed to modify certain restrictions previously imposed by order on bank holding companies engaged in full service securities brokerage activities. The Board also requested public comment on the appropriateness of modifying limitations imposed by order on financial advisory activities, and proposed to amend Regulation Y to include a definition of institutional customer applicable to full service securities brokerage services.

Description of the Final Rule

The Board has determined to add full service securities brokerage and financial advisory services to the regulatory list of permissible nonbanking activities. The final rule as adopted generally simplifies the conditions previously imposed by the Board on the conduct of full service securities brokerage activities and on financial advisory activities. Pursuant to the final rule, bank holding companies seeking to conduct these activities or acquire companies engaged in these activities will be able to take advantage of a number of streamlined procedures relating to listed nonbanking activities. These procedures substitute a notice period in lieu of an application procedure for companies seeking to engage *de novo* in these activities, and permit Reserve Banks to review proposals to conduct these activities under expedited procedures.

Full Service Securities Brokerage

The Board's regulations currently permit bank holding companies to provide securities brokerage and investment advisory services separately.[1] 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.[2]

In its orders permitting bank holding companies to engage in full service securities brokerage activities, the Board established a framework for the conduct of the activity that was designed to address potential adverse effects, including conflicts of interests, that may result from the combination of investment advisory and securities brokerage activities.[3] This framework included requirements that:

- A majority of the brokerage company's board of directors not be officers or directors of any affiliated bank.
- The brokerage company hold itself out as a separate and distinct corporation with its own properties, assets and liabilities, capital, books and records and maintain separate operations from affiliated banks. The Board

[1] See 12 CFR 225.25(b)(4) (investment advice); and 225.25(b)(15) (securities brokerage). Bank holding companies may still seek approval to engage separately in these activities, or to engage only in one of the activities.

[2] 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, 484 U.S. 1005 (1988). See also PNC Financial Corp., 75 Federal Reserve Bulletin 396 (1989); Bank of New England Corporation, 74 Federal Reserve Bulletin 700 (1988) (combined services offered to institutional and retail customers); Manufacturers Hanover Corp., 73 Federal Reserve Bulletin 930 (1987).

[3] Id.

has permitted brokerage companies to share certain back-office employees with affiliated banks, where the employees do not have contact with the public or participate in the sales activities of the brokerage company.

- All of the brokerage company's notices, advice, confirmations, correspondence and other documentation clearly indicate the company's separate identity.
- The brokerage company specify in all customer agreements that it is solely responsible for its contractual obligations and commitments.
- Any back office services provided to the brokerage company by bank affiliates and research or investment advice purchased from affiliates be compensated for in accordance with section 23B of the Federal Reserve Act.
- The brokerage company provide discretionary investment management services only to institutional customers (as defined).
- The brokerage company provide notice to its customers that an affiliated bank may be a lender to an issuer of securities.
- The brokerage company not receive referrals from affiliates and not exchange customer lists or confidential information regarding customers with affiliates, except with the customers' consent.
- As required by section 23B of the Federal Reserve Act, no bank affiliated with the brokerage company engage in advertising for the brokerage company stating or suggesting that an affiliated bank is responsible for the brokerage company's obligations, or enter into any agreement so stating or suggesting.
- The brokerage company's offices either be separate from those of other affiliates or, in the case of offices established in a building in which another affiliate also has offices, in areas separate from areas utilized by such affiliate.
- The brokerage company not transmit advisory research or recommendations to the commercial lending department of any bank affiliate. The brokerage company may make available to affiliated banks the investment recommendations and research that it makes available to unaffiliated investor clients or that are non-confidential. The brokerage company may not be provided with position reports regarding the securities affiliates may hold in inventory.[4]
- If the brokerage company obtains customer lists from affiliates, it use such lists for general advertising purposes only (such as mass mailings) and not to solicit individual customers of its affiliates.
- The brokerage company charge fees only for transactions executed for the customer (and not separately for advice).[5]

In addition to these requirements imposed by the Board, the full service securities brokerage subsidiaries of bank holding companies are subject to the requirements applicable to broker-dealers under the Securities Exchange Act of 1934, as well as to applicable provisions of the Investment Advisers Act of 1940, applicable state securities laws, the general anti-fraud provisions of the securities laws, and a duty to deal fairly with customers.[6]

The Board proposed eliminating most of the restrictions noted above as part of this proposal. After careful review of the comments and the Board's experience in supervising the full service brokerage activities of bank holding companies, the Board has determined to eliminate duplication between the restrictions imposed by the Board on the conduct of this activity and the restrictions imposed under the securities laws or other applicable laws. In addition, the Board has determined to remove the other restrictions noted above, with three exceptions. First, the rule retains the limitation under current Board orders that a full service securities brokerage subsidiary may provide discretionary investment management services only to institutional customers.[7] Second, the rule retains in large part the Board's current disclosure requirements.[8] Third, the rule retains the restriction that prevents a brokerage company from exchanging confidential customer information with any affiliate without the customer's consent.

The final rule does not include the other restrictions listed above that were previously imposed by order on a bank holding company's conduct of full service securities brokerage. Bank holding companies and their subsidiaries engaged in full service brokerage activities will, of course, continue to be subject to all of the requirements imposed by federal and state securities laws, as well as to the other restrictions imposed by applicable statutes, including the prohibitions on tying products and services with bank products and services, and restrictions on transactions with affiliated banks imposed by other statutes. In addition, while the Board has determined not to retain all of the above noted restrictions in its final regulation, the Board believes that bank holding companies should, as a matter of sound practice and in order to obtain the benefits of the legal doctrine of corporate separateness, continue to operate full service brokerage subsidiaries as a distinct and separate corporation with separate books and records, capital, assets, liabilities, and management.

The Board believes that the restrictions it has retained in its regulation together with federal securities laws and regulations and federal banking statutes, particularly the affiliate transactions restrictions of sections 23A and 23B of the Federal Reserve Act, are adequate to address the potential conflicts of interests and other adverse effects that may be associated with the conduct of full service securities brokerage activities by a subsidiary of a bank holding company. In addition, the Board believes that under these conditions, this revision will benefit the public by providing increased customer convenience and increased efficiencies for bank holding companies that provide full service brokerage services.

Public Comments Regarding Full Service Securities Brokerage Activities

The Board received over 70 public comments in response to its request for comments on the proposal to add full service securities brokerage to the Regulation Y list of permissible nonbanking activities. No commenter opposed the addition of this activity to the Regulation Y list. The commenters included forty-five individuals; fifteen bank holding companies, including large national and regional companies; six small banks; several brokerage subsidiaries of bank holding companies; five trade associations; a law firm; and several Federal Reserve Banks. Although every commenter favored the addition of full service securities brokerage to the Regulation Y list of

[4] The company may, at the time a research report is being released, disclose to customers its affiliates' positions in securities that are the subject of the research report.

[5] See, *e.g.*, Bank of New England Corporation, 74 Federal Reserve Bulletin 700 (1988).

[6] See, *e.g.*, 17 CFR 240.15c1-2 (anti-fraud rule).

[7] The Board has previously defined an "institutional customer." See The Chase Manhattan Corporation, 74 Federal Reserve Bulletin 704 (1988). The final rule amends Regulation Y to incorporate this definition. The final rule also retains the requirements that a brokerage company offering discretionary management services comply with applicable law, including fiduciary principles, and that it obtain the consent of its customer before engaging in discretionary securities transactions with itself or an affiliate. See J.P. Morgan & Co., Incorporated, 73 Federal Reserve Bulletin 810 (1987).

[8] The final rule requires specifically that the brokerage company disclose to all of its customers that the brokerage company is solely responsible for its contractual obligations and commitments; that the brokerage company 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 insured by the FDIC, and are not obligations of, or endorsed or guaranteed by, any bank, unless such is the case. The final rule requires that these disclosures be made before the brokerage company provides any brokerage or advisory services to its customers and, in the case of the statement that the brokerage company is solely responsible for its contractual obligations and commitments, again in each statement of accounts to customers. The initial disclosure may be oral provided that a written disclosure is provided immediately thereafter.

permissible nonbanking activities, various commenters addressed specific features of the proposal, especially the topics of discretionary investment management for retail customers and the disclosure requirements.

1. Need for Restrictions Generally

A number of commenters argued that many of the restrictions imposed by the Board on full service brokerage activities are not necessary. First, commenters argue that the Board need not duplicate restrictions contained in the securities laws because the securities brokerage subsidiaries of bank holding companies remain subject to state and federal securities laws and regulations. A number of the restrictions imposed by the Board are similar to the existing requirements of federal and state securities laws, or incorporate requirements contained in other statutory provisions (such as section 23B of the Federal Reserve Act). The commenters also note that the experience of the OCC has not indicated that the simpler framework used by the OCC that relies primarily on the securities laws adds significant risk to the conduct of the activity.[9]

2. Discretionary Investment Management

Thirteen commenters, including large national and regional bank holding companies and trade associations, suggested that the Board broaden the scope of authorized full service securities brokerage to permit discretionary investment management for retail customers. The commenters offered several reasons for permitting bank holding companies to offer discretionary investment management to retail customers through full service securities brokerage affiliates. In particular, the commenters argued that:

1. Brokerage companies affiliated with bank holding companies would be registered as broker-dealers with the Securities and Exchange Commission and the National Association of Securities Dealers, and customers would be protected by existing securities and common law requirements and duties.

2. Customers are generally free to limit a broker's exercise of discretion.

3. Retail customers have sufficient resources and incentive to monitor closely their account activities in order to identify possible abuses.

4. Prohibiting such a service would disadvantage the brokerage companies that are affiliates of bank holding companies relative to those that are not affiliates of bank holding companies.

In determining in 1987 to limit discretionary account activities to institutional customers, the Board reasoned that institutional customers are generally financially sophisticated, less likely in general than retail customers to place undue reliance on investment advice, and better able to monitor the activities of, and potential conflicts of interests arising from, a brokerage company that provides discretionary investment management services.[10] The Board noted in particular that institutional customers would be better able than retail customers to detect account churning or unsuitable investments made on behalf of the customer by a brokerage firm.

Four commenters stated that the existing restriction on discretionary account activities should be retained. Two large regional bank holding companies supported retention of the existing limitation on the ground that the trust departments of banks are better suited than brokerage companies to providing discretionary investment management to retail customers.

The OCC also has recognized the possibility of abuses in connection with discretionary investment management services. Accordingly, the OCC has not to date permitted national banks to offer such services to retail brokerage customers other than through a trust department or trust company operations subsidiary. These entities operate under a number of restrictions to which the nonbank subsidiaries of bank holding companies are not subject, including the OCC's comprehensive rules governing trust activities.[11]

The final rule retains the prohibition on providing discretionary investment management services to retail customers. The Board believes this limitation is appropriate in light of the potential for abuse and conflicts of interest in connection with providing discretionary investment management services. However, because institutional customers are likely to be financially sophisticated and able to detect potential abuses and conflicts of interest, the Board continues to believe that these potential adverse effects are substantially mitigated in the case of the provision of discretionary investment management service to institutional customers. In addition, a prohibition on the provision of discretionary investment management services to retail customers through a full service securities brokerage company subsidiary would not preclude bank holding companies from offering the service through other appropriate means. Bank holding companies may provide such services to retail customers through a trust company subsidiary or the trust department of a bank, where specific fiduciary responsibilities govern the bank or trust company's actions.

3. Definition of Institutional Customer

Two commenters specifically addressed the Board's proposed definition of "institutional customer." As proposed, the definition of "institutional customer" included individuals whose net worth (or joint net worth with spouse) exceeds $1 million. The proposed definition also included broker-dealers and option traders registered under the Securities Exchange Act of 1934, as well as other securities professionals.

One commenter proposed adding to this list investment or banking professionals. The Board has previously determined that including investment and banking professionals within the definition of institutional customer is consistent with the purpose of the definition, which is to limit the provision of certain services to financially sophisticated customers, and would not materially increase the likelihood of significant adverse effects. Bankers Trust New York Company, 74 Federal Reserve Bulletin 695 (1988). Accordingly, the Board has adopted this suggestion in the final rule.

Another commenter suggested including all "accredited investors" as defined in Regulation D of the Securities and Exchange Commission within the definition of institutional customer.[12] The SEC's definition of accredited investor differs in a number of respects from the Board's definition of institutional customer. For example, to qualify as an accredited investor a corporation must meet a higher $5 million asset test than the $1 million asset test adopted in the board's definition of institutional customer; on the other hand, a natural person with income in excess of $200,000 in each of the two most recent years may qualify as an accredited investor, while the Board's definition of institutional customer includes only individuals with a net worth in excess of $1 million.

The definition of the term accredited investor was developed in the context of

[9] *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 OCC also has limited national banks to providing discretionary investment management only through the trust department of the bank.

[10] J.P. Morgan & Co., Incorporated, 73 Federal Reserve Bulletin 810 (1987).

[11] 12 CFR part 9.

[12] 17 CFR 230.215.

other safeguards and limitations imposed by the federal securities laws on the sale of unregistered securities. These include specific written disclosure requirements that must be made prior to each transaction. The definition of institutional customer on the other hand, is used in the context of the provision of discretionary management investment services, which, by definition, do not require detailed prior disclosures in connection with each investment. Because of these differences, the Board does not believe that it is appropriate to modify the definition of institutional customer to conform with the SEC's definition of accredited investor.

4. Disclosure Requirements

Seven commenters supported the disclosure requirements as proposed. Six commenters suggested a variety of changes intended to reduce the frequency and increase the efficiency of any required disclosure.

The proposal would have required that the brokerage company disclose in writing to all of its customers that the brokerage company is solely responsible for its contractual obligations and commitments. The proposed rule required that the disclosure be made before the brokerage company provides any brokerage or advisory services to its customers and again in its statements of accounts to customers. The rule as proposed also required that the bank holding company make a one-time written disclosure at the start of the customer relationship that the brokerage company 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 insured by the FDIC, and are not guaranteed by, or an obligation of, any bank, unless such is the case.

In a comment representative of those suggesting changes to the proposed disclosure requirements, a bank holding company argued that the regulation should allow each holding company to exercise discretion, within the limits established by the securities laws, to decide the timing and manner for providing the required disclosures. The commenter noted that the securities laws, for example, generally do not require pre-relationship disclosure. In certain instances when the securities laws do require pre-relationship disclosure, the rules permit oral disclosure, provided a written disclosure is made prior to the completion of the relevant contract.[13] Similarly, another commenter suggested that the brokerage company be granted discretion to deliver any required periodic written disclosure in the manner it finds most efficient, whether by order confirmations, customer statements or separate customer mailings. Another bank holding company proposed requiring written disclosures only in the brokerage company's initial written communication with a customer (for example, in a statement of account terms).

With respect to the substance of any required disclosure, one bank holding company suggested alternatives for certain aspects of the proposed disclosure language. This commenter stated that it is unnecessary to require the brokerage company to disclose that it is solely responsible for its obligations because the brokerage company is already required to state that it is separate from affiliated depository institutions.

The final rule continues to require that a full service securities brokerage subsidiary of a bank holding company provide the mandated disclosure to each customer before providing any brokerage or advisory service. The proposal has been amended, however, to permit the brokerage company to make the initial disclosure orally, provided that written disclosure is given to the customer promptly thereafter and that the disclosure complies with any securities law requirements. The final rule otherwise provides bank holding companies with discretion to include the mandated disclosures in the customer agreement required under NASD rules or in any other vehicle, including in a separate written statement provided to the customer.[14]

The final rule retains the content of the current disclosure requirements without modification. The Board believes at this time that these disclosures are appropriate for a brokerage company that is affiliated with a bank in order to ensure that customers understand that the brokerage company is separate from the bank and that securities sold, offered, or recommended are not FDIC-insured and are not obligations of a bank (unless such is the case). The Board continues to believe that these disclosures decrease the likelihood that customers will associate the advice received from full service brokerage subsidiaries of bank holding companies, or the financial strength of these brokerage subsidiaries, with their affiliated banks. The OCC requires national banks that provide full service brokerage services to make similar disclosures.

5. Restriction on Certain Interlocks With Bank Affiliates

Fourteen commenters, including bank trade associations and large national and regional bank holding companies, supported fully the proposed elimination of the restriction on director, officer, and employee interlocks between a brokerage company and affiliated banks. Two bank holding companies noted that the elimination of the interlock restriction would permit regional bank holding companies to offer full service securities brokerage without costly duplication of existing management structures.

The Board believes that existing requirements of federal and state securities laws are sufficient to address potential adverse effects that may be associated with officer and director interlocks between a bank and its securities brokerage affiliate. Moreover, the Board notes that the OCC and many states permit national and state banks to provide full service brokerage services directly within the bank. The experience of the OCC in permitting national banks directly to provide full service brokerage services to their customers has not indicated a need for the requirement imposed by the Board that limits officer, director and employee interlocks between a brokerage company and its affiliated bank. In this regard, the Board notes that any subsidiary of a bank holding company that provides full service brokerage services is subject to prohibitions on tying these services to services offered by an affiliated bank. 12 U.S.C. 1972; 12 CFR 225.4(d). Moreover, a full service brokerage affiliate is required to make the disclosures discussed above when providing full service brokerage services to a customer.

Thus, the final rule eliminates the restriction on interlocks between a bank and an affiliated full service securities brokerage company. This action does not remove the restriction currently imposed by the Board on interlocks between a bank and an affiliate that conducts securities underwriting and dealing activities permitted under

[13] See, *e.g.*, 17 CFR 240.15c1-5; National Association of Securities Dealers, Rules of Fair Practice, Art. III, sec. 13.

[14] Later disclosures that are required to be included in the company's statements of accounts to its customers are more limited. These disclosures include statements that the brokerage company is a separate and distinct corporation, and reinforce that the bank affiliate is not responsible for, and does not provide any financial guarantee regarding, the investments recommended by the brokerage affiliate.

section 20 of the Glass-Steagall Act, or any limitations imposed by section 32 of the Glass-Steagall Act and Board Regulation R.

6. Restrictions on Brokering or Recommending Certain Securities

One bank holding company requested that the Board modify certain restrictions on a brokerage firm's ability to recommend or broker securities underwritten by an affiliate or distributed by an investment company advised by an affiliate. These restrictions arise from the section 20 firewalls applicable to affiliates that underwrite and deal in securities, and from the Board's interpretive rule governing investment advisory activities (12 CFR 225.125).

The Board has recently revised the interpretive rule to permit bank holding companies or their subsidiaries to provide advice with respect to, and broker securities issued by, investment companies advised by the holding company or its nonbanking affiliates.[15] As noted above, the Board did not, in connection with these modifications, propose any revisions to either the section 20 firewalls applicable to companies with subsidiaries that underwrite or deal in bank-ineligible securities or the Board's interpretive rule governing investment advisory activities.

7. Cross-Marketing

Another bank holding company proposed that the Board permit cross-marketing activity between full service brokerage companies and bank affiliates, including allowing bank affiliates to act as agent for, or engage in marketing on behalf of, affiliated brokerage companies. Current restrictions regarding such cross-marketing activity derive from the section 20 firewalls and apply only to bank holding companies with subsidiaries that underwrite and deal in bank-ineligible securities. As noted, the rule does not modify this restriction or any of the other section 20 firewalls. The Board has proposed modifying the cross-marketing restrictions in other rulemaking and will consider this comment in that context.

Relief From Prior Restrictions

Bank holding companies that have received Board approval by order to conduct full service securities brokerage activities subject to the restrictions discussed above are relieved of their commitments to the Board to conduct full service brokerage activities within the restrictions discussed above, except as noted, and may conduct full service brokerage activities subject to the limitations retained in this final rule and to other applicable laws.

The Board's action in this rule does not affect the framework governing bank holding company subsidiaries that underwrite or deal in bank-ineligible securities consistent with section 20 of the Glass-Steagall Act. A holding company affiliate engaged in such bank-ineligible securities underwriting or dealing continues to be bound by the restrictions imposed on those activities by the Board.[16] In addition, a bank holding company that operates a section 20 affiliate and conducts full service brokerage activities, either within the section 20 affiliate or in a separate subsidiary, is not relieved of commitments or conditions governing brokering or recommending securities underwritten by the section 20 company.[17]

The final rule does not expand the scope of full service securities brokerage activities beyond the scope previously approved by the Board by order. In addition, the final rule does not modify the Board's interpretive rule regarding the investment advisory activities of bank holding companies. See 12 CFR 225.125 as amended at 57 FR 30387, July 9, 1992.

Financial Advisory Services

The Board has previously determined by order that the provision of several types 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, joint ventures, reorganizations, recapitalizations, financing transactions, and the structuring of leveraged buyouts and capital raising vehicles, including providing valuations and fairness opinions in connection with mergers, acquisitions, and similar transactions; and
- Advice regarding the structuring of and arranging for loan syndications, interest rate swaps, interest rate caps, and similar transactions.

The Board has also permitted bank holding companies to conduct feasibility studies for corporations.[18] In making these determinations, the Board has 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 do not exert undue control over the operations of the client institution through the provision of financial advisory services.[19]

Comments Regarding Financial Advisory Activities

No commenter opposed the addition of the proposed financial advisory activities to the Regulation Y list of permissible nonbanking activities. Various commenters suggested modifications to, or clarifications of, certain specific features of the proposal, including removal of the limitations on this activity. No commenter suggested that restrictions more rigorous than those proposed would be appropriate.

The final rule adds the provision of the financial advisory services listed

[15] 57 FR 30387, July 9, 1992.

[16] For example, the Board's action does not relieve a bank holding company subsidiary that engages in underwriting and dealing activities consistent with section 20 of the Glass-Steagall Act as well as full service brokerage activities from the restrictions imposed on having interlocking officers, directors or employees with an affiliated bank.

[17] For example, in conducting securities brokerage activities, the company conducting securities brokerage activities must disclose to any customer that it advises any interest of the company or affiliate as underwriter or market maker in the securities being purchased or recommended. In addition, this rule does not relieve any insured depository institution of the restriction imposed by Board order on expressing an opinion on the value or advisability of the purchase or sale of ineligible securities underwritten or dealt in by an affiliate without appropriate disclosure. J.P. Morgan & Co. Incorporated, The Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp, Security Pacific Corporation, 75 Federal Reserve Bulletin 192, 215 (1989).

[18] See, *e.g.*, SunTrust Banks, Inc., 74 Federal Reserve Bulletin 256 (1988) (provision of financial advisory services to nonaffiliated institutions in connection with mergers, acquisitions, divestitures, and the structuring of and arranging for loan syndications, interest rate swaps, caps, and similar transactions, and conducting feasibility studies for corporations); Skandinavian Bank Group plc, 75 Federal Reserve bulletin 311 (1989) (provision of financial advisory services concerning joint ventures and the structuring of leveraged buyouts and capital raising vehicles); First Regional Bancorp, Inc., 76 Federal Reserve Bulletin 859 (1990) (provision of financial advisory services in connection with reorganizations and recapitalizations); Banc One Corporation, 76 Federal Reserve Bulletin 756 (1990) (provision of financial advisory services to high net worth individuals).

[19] The limitations are the following:

1. The advisor's financial advisory activities will not encompass the performance of routine tasks or operations for a client on a daily basis;

2. Disclosure will be made to each potential client of the advisor that the advisor is an affiliate of its parent bank holding company and affiliated banks.

3. Advice rendered by the advisor on an explicit fee basis will be rendered without regard to correspondent balances maintained at the advisor's depository institution affiliates;

4. The advisor will not make available to its parent bank holding company or to any of its affiliates confidential information received by a client, except with the client's consent.

above to the regulatory list of activities permissible for bank holding companies, thereby simplifying the process under which bank holding companies obtain approval to conduct these activities. While the Board previously has permitted bank holding companies to provide feasibility studies only for corporations, the final rule permits bank holding companies to conduct feasibility studies for high net worth individuals, as well as corporations, and financial and nonfinancial institutions.

The rule retains two limitations on the conduct of financial advisory activities. First, the rule prohibits bank holding companies that provide financial advisory activities from performing routine tasks or operations for a financial advisory customer on a daily or continuous basis. The Board believes it is appropriate to retain this limitation at this time in order to assure that bank holding companies do not exercise daily control over companies under the guise of providing financial advisory services.[20] Second, the rule prohibits a financial advisor from making available to any of its affiliates confidential information regarding a customer or other party obtained in the course of providing any of the financial advisory services, except with the consent of the customer or party.

The Board's experience in supervising bank holding companies that conduct financial advisory services has not indicated that the other restrictions imposed by the Board by order are necessary to prevent adverse effects in the conduct of this activity. Of course, holding company affiliates that provide financial advisory services are bound by the restrictions against tying of products and services contained in section 106 of the Bank Holding Company Act Amendments of 1970. Accordingly, the final rule does not retain these restrictions and bank holding companies that conduct financial advisory services subject to these restrictions are granted relief from these two requirements.

The final rule reflects several revisions to the published proposal in response to suggestions made by commenters. In particular, at the request of commenters, the rule has been clarified to indicate that the provision of financial advice with respect to joint ventures, the structuring of leveraged buyouts and capital raising vehicles, restructurings, reorganizations, interest rate collars, and interest rate floors is permissible. The proposal has also been expanded at the request of several commenters to add references to providing financial advice regarding swaps, caps and similar transactions relating to currency exchange rates or prices, and economic and financial indices. Finally, the rule has been amended in response to comments to add the activity of providing financial advice to foreign governments, including foreign municipalities and agencies of foreign governments. The Board has previously determined by order that each of these activities is closely related to banking for purposes of section 4(c)(8) of the BHC Act in connection with proposals to conduct other financial advisory activities.[21]

Final Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 95–354, 5 U.S.C. 601 *et seq.*), the Board of Governors of the Federal Reserve System certifies that adoption of this final rule will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation.

This amendment will add to the list of permissible bank holding company activities in the Board's Regulation Y activities that have been previously approved for bank holding companies by order. The addition will have the effect of reducing the burden on bank holding companies, including small bank holding companies, that wish to conduct these activities by simplifying the regulatory review process. The amendment does not impose more burdensome requirements on bank holding companies than are currently applicable.

Effective Date

The provisions of 5 U.S.C. 553(d) generally prescribing 30 days prior notice of the effective date of a rule have not been followed in connection with the adoption of this amendment because adoption of the rule reduces a regulatory burden. Section 553(d)(1) grants a specific exemption from the deferred effective date requirements in these instances.

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 forth in the preamble, the Board is amending 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.

In part 225, the footnotes are redesignated as shown below:

Section and paragraph	Current footnote number	New footnote number
§§ 225.25(b)(5)(i)(C)	3	4
(b)(5)(i)(D)	4	5
	5	6
(b)(5)(i)(F)	6	7
(b)(5)(ii)(D)	7	8
(b)(8)(i)(B)	8	9
(b)(8)(ii) (introductory text)	9	10
(b)(8)(ii)(B)	10	11
(b)(8)(iv) (introductory text)	11	12
	12	13
(b)(10)(ii)	13	14
(b)(11) (introductory text)	14	15
(b)(11)(iv)	15	16

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

§ 225.2 Definitions

* * * * *

(g) *Institutional customer* means:

(1) A bank (acting in an individual or fiduciary capacity); a savings and loan association; an insurance company; an investment company registered under the Investment Company Act of 1940; or

[20] Two commenters addressed specifically the proposed prohibition on providing financial advice on a daily or continuous basis. One bank holding company opposed the limitation, on the ground that certain of the financial advisory services lend themselves to recurring or regular provision, especially those involving long-standing clients with ongoing advisory requirements. The commenter argued that the limitation would unnecessarily restrict the ability of a bank holding company to advise its clients. By contrast, another bank holding company supported the proposed limitation, noting, as has the Board in its orders approving the provision of these services, that daily or continuous advice could involve the bank holding company in the direct management of its client, thereby resulting in a possible control relationship. The Board has previously determined that the performance of management consulting services other than for depository institutions pursuant to Regulation Y (12 CFR 225.25(b)(11)) is not so closely related to banking or managing or controlling banks as to be a proper incident thereto. 12 CFR 225.126(f); First Commerce Corporation, 58 Federal Reserve Bulletin 674 (1972).

[21] See, *e.g.*, The Dai-Ichi Kangyo Bank, Ltd., 77 Federal Reserve Bulletin 184 (1991) (advice regarding joint ventures, leveraged buyouts, restructurings, recapitalizations, and other corporate transactions, and advice regarding the structuring and arranging of swaps, caps and similar transactions relating to interest rates, currency exchange rates and prices, and economic and financial indices); The Bank of Tokyo, Ltd., 76 Federal Reserve Bulletin 654 (financial advice to foreign governments).

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 a spouse) at the time of receipt of the brokerage, advisory, or other relevant service exceeds $1,000,000;

(4) A broker-dealer or option trader registered under the Securities Exchange Act of 1934, or other securities, investment or banking 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), paragraph (b)(4)(v) is revised, a new paragraph (b)(4)(vi) is added, and paragraph (b)(15) is revised to read as follows:

§ 225.25 List of permissible nonbanking activities.

* * * * *

(b) * * *

(4) * * *

(v) Providing financial advice to state and local governments and foreign governments (including foreign municipalities and agencies of foreign governments), such as with respect to the issuance of their securities; and

(vi) (A)(*1*) Providing advice, including rendering fairness opinions and providing valuation services, in connection with mergers, acquisitions, divestitures, joint ventures, leveraged buyouts, recapitalizations, capital structurings, and financing transactions (including private and public financings and loan syndications); and conducting financial feasibility studies; [3] and,

(*2*) Providing financial and transaction advice regarding the structuring and arranging of swaps, caps, and similar transactions relating to interest rates, currency exchange rates or prices, and economic and financial indices, and similar transactions.

(B) The financial advisory services described in this subparagraph may be provided only to corporations, to financial and nonfinancial institutions, and to natural persons whose individual net worth (or joint net worth with a spouse) at the time the service is provided exceeds $1,000,000.

(C) Financial advisory activities under this subparagraph may 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 affiliates confidential information regarding a party obtained in the course of providing any financial advisory services except as authorized by the party.

* * * * *

(15) *Securities brokerage.* (i) Providing securities brokerage services, related securities credit activities pursuant to the Board's Regulation T (12 CFR Part 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) Providing 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 [17] subject to the following requirements:

(A) The company must prominently disclose in writing [18] to each customer before providing any brokerage or advisory services, and, in the case of disclosures required under paragraph (b)(15)(ii)(A) (*1*) of this section, again in each customer account statement, that:

(*1*) The company is solely responsible for its contractual obligations and commitments;

(*2*) The company is not a bank and is separate from any affiliate bank; and

(*3*) The securities sold, offered, or recommended by the company are not insured by the Federal Deposit Insurance Corporation, and are not obligations of, or endorsed or guaranteed in any way by, any bank, unless this is the case; and

(B) The company and its affiliates may not share any confidential information concerning their respective customers without the consent of the customer.

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By order of the Board of Governors of the Federal Reserve System, August 31, 1992.

William W. Wiles,

Secretary of the Board.

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[3] Feasibility studies do not include assisting management with the planning or marketing for a given project or providing general operational or management advice.

[17] Investment advisory services authorized under paragraph (b)(4) include the exercise of discretion in buying and selling securities on behalf of a customer provided that investment discretion is exercised only on behalf of institutional customers and only at the request of the customer. A bank holding company or its subsidiary providing these discretionary investment management services must comply with applicable law, including fiduciary principles, and obtain the consent of its customers before engaging, as principal or as agent in a transaction in which an affiliate acts as principal, in securities transactions on the customer's behalf.

[18] These disclosures may be made orally provided that a written disclosure is provided to the customer immediately thereafter.