FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10763**
January 13, 1995]

BANK HOLDING COMPANIES

Proposed Amendment to an Interpretative Rule Regarding Investment Adviser Activities

Comments Invited by January 30

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

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

> The Federal Reserve Board has requested public comment on a proposal to amend a restriction in its interpretive rule on investment adviser activities of bank holding companies. The current restriction requires that a bank holding company and its bank and nonbank subsidiaries not purchase, in its sole discretion in a fiduciary capacity, any securities of an investment company advised by the bank holding company. The Board now proposes to modify the interpretive rule to provide that a bank holding company and its bank and nonbank subsidiaries may purchase in a fiduciary capacity, securities of an investment company advised by the bank holding company if the purchase is specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.
>
> Comment is requested by January 30, 1995.

Printed on the following pages is the text of the proposal, as published in the *Federal Register*. Comments thereon should be submitted by January 30, 1995, and may be sent to the Board, as indicated in the notice, or to our Banking Applications Department.

WILLIAM J. MCDONOUGH,
President.

Federal Register
Vol. 59, No. 250
Friday, December 30, 1994

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R–0868]

Bank Holding Companies and Change in Bank Control; Investment Adviser Activities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board seeks public comment on a proposal to revise its interpretive rule regarding investment adviser activities of bank holding companies to allow a bank holding company and its bank and nonbank subsidiaries to purchase in their sole discretion in a fiduciary capacity, securities of an investment company advised by the holding company if this purchase is specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.

DATES: Comments must be received on or before January 30, 1995.

ADDRESSES: Comments should refer to Docket No. R–0868, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B–2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP–500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

FOR FURTHER INFORMATION CONTACT: Scott G. Alvarez, Associate General Counsel (202/452–3583), Thomas M. Corsi, Senior Attorney (202/452–3275), or Timothy Byrne, Attorney (202/452–3565), Legal Division, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION:

I. Background

In 1972, the Board permitted bank holding companies to serve as an investment adviser to mutual funds and other registered investment companies. See 12 CFR 225.25(b)(4). When the Board added this activity to Regulation Y, it also published an interpretive rule that placed certain prudential and other limitations on the manner in which bank holding companies could conduct the activity. 12 CFR 225.125.

Among the restrictions in the interpretive rule is a requirement that a bank holding company and its bank and nonbank subsidiaries should not purchase, in its sole discretion in a fiduciary capacity, any securities of an investment company advised by the bank holding company. 12 CFR 225.125(g). The Board adopted the restriction because of concern that a bank holding company might use its position as a fiduciary to support an investment company that the bank holding company advised, to increase the asset size of the investment company or as a means of increasing advisory fees.

A number of bank holding companies have recently indicated that a mutual fund advised by the bank holding company is often the most cost-effective method of providing investment advice to customers and is increasingly attractive to customers because a mutual fund provides customers with a readily marketable and easily valued investment product.[1] These bank holding companies point out that a number of statutory and regulatory developments have occurred since 1972 that address the concerns that originally prompted the Board to adopt its prohibition on fiduciary purchases by a bank holding company of shares of a mutual fund advised by the bank holding company. In light of these developments, several bank holding companies have requested that the Board modify its current interpretive rule to permit bank holding companies to purchase, on behalf of fiduciary customers, shares of mutual funds advised by the bank holding company.

Since the Board adopted its investment advisory interpretive rule, Congress enacted section 23B of the Federal Reserve Act, which specifically permits a bank or its subsidiary to purchase securities, as a fiduciary, from an affiliate if such purchases are permitted by the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction governing the fiduciary relationship. In addition, in an analogous area, the Board since permitted fiduciary purchases of securities that are underwritten by a section 20 affiliate if the purchase was specifically authorized under the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.[2]

Both the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have recently permitted the banks that they regulate to purchase, in a fiduciary capacity, securities of an investment company advised by an affiliate of the bank if the purchase is specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by local law.[3] Moreover, many states have amended their laws to allow banks to engage in these types of transactions.[4]

The Board now proposes to modify its investment advisory interpretive rule to provide that a bank holding company and its bank and nonbank subsidiaries may purchase in their sole discretion in a fiduciary capacity, securities of an investment company advised by the bank holding company if this purchase

[1] See Letter, dated August 12, 1994, to Chairman Greenspan from Edward L. Yingling, Executive Director Government Relations, American Bankers Association.

[2] *Citicorp, J.P. Morgan & Company Incorporated, and Bankers Trust New York Corporation*, 73 Federal Reserve Bulletin 473 (1987) (1987 Section 20 Order), *aff'd sub nom. Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, 839 F.2d 47 (2d Cir. 1988), *cert. denied*, 486 U.S. 1059 (1988).

[3] See OCC Trust Interpretations No. 234 (September 21, 1989); 12 CFR 9.12; 12 CFR 337.4(e). See also Letter dated May 4, 1994, from Frank Maguire, Senior Deputy Comptroller for Corporate Activities and Policy Analysis, OCC, to Michael E. Bleier, General Counsel, Mellon Bank, N.A. (regarding Mellon Bank's acquisition of The Dreyfus Corporation).

[4] See Mich. Comp. Laws § 487.485 (1992) (amended in 1992); Md. Code Ann., Est. & Trusts § 15–106 (1993) (amended in 1991); Ind. Code Ann. § 28–1–12–3 (Burns 1993).

is specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered. To assure that fiduciary customers are aware of the potential conflicts of interest that may arise, the proposed change would contain a requirement that the bank holding company disclose, in writing at the time that the fiduciary relationship is created, to its fiduciary customer, that it, or an affiliate, serves as investment adviser to the investment company whose shares are purchased in a fiduciary capacity. These purchases would also be governed by fiduciary principles that require the purchase to be made on market terms. The Board seeks comment on the proposed disclosure requirement and whether it is adequate to assure that fiduciary customers are aware of potential conflicts of interest. In particular, the Board seeks comment on whether the required written disclosure should be given to a fiduciary customer immediately prior to each initial investment in an investment company advised by the bank holding company.

II. 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 the proposed regulation will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation. This revision will not place additional burdens on any bank holding company. It will clarify the rules as they currently apply to all bank holding companies.

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, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)), the Board proposes to amend 12 CFR part 225 as set forth below:

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

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

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

2. Section 225.125 is amended by revising paragraph (g) to read as follows:

§ 225.125 Investment adviser activities.

* * * * *

(g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not:

(1) Purchase for their own account securities of any investment company for which the bank holding company acts as investment adviser;

(2) Purchase any such securities in a fiduciary capacity (including as managing agent) unless the purchase is specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered; [1]

(3) Extend credit to any such investment company; or

(4) Accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.

* * * * *

By order of the Board of Governors of the Federal Reserve System, December 22, 1994.

William W. Wiles,

Secretary of the Board.

[FR Doc. 94–32053 Filed 12–29–94; 8:45 am]

Billing Code 6210–01–P