

MEMO# 10810

March 18, 1999

SENATE BANKING COMMITTEE APPROVES FINANCIAL SERVICES REFORM LEGISLATION

1[10810] March 18, 1999 TO: BOARD OF GOVERNORS No. 17-99 FEDERAL LEGISLATION
MEMBERS No. 7-99 PRIMARY CONTACTS - MEMBER COMPLEX No. 27-99 PUBLIC
INFORMATION COMMITTEE No. 8-99 RE: SENATE BANKING COMMITTEE APPROVES
FINANCIAL SERVICES REFORM LEGISLATION

The Senate Banking, Housing, and Urban Affairs Committee recently approved legislation to modernize the nation's financial services laws. The bill was passed 11-9 on a straight party line vote. The Senate bill would repeal the Glass-Steagall Act's provisions that restrict bank and securities firm affiliations. The bill would amend the Bank Holding Company Act to permit affiliations among financial services companies, including banks, registered investment companies, securities firms and insurance companies. The provisions that would have the greatest affect on investment companies are summarized below. Holding Company Regulation Under the Senate Banking Committee's bill, the Federal Reserve Board (FRB) would remain the "umbrella" regulator of bank holding companies (BHCs), which would be given expanded authority to engage in activities that are "financial in nature." As the Institute recommended, the existing authority of the FRB when exercising its general supervisory authority to regulate, examine or take enforcement action against regulated, non-bank subsidiaries of the holding company—such as investment advisers, broker/dealers and insurance companies—has been carefully prescribed and would require a determination by the FRB that actions by a regulated subsidiary within the holding company pose a material risk to an affiliated bank or the domestic or international payments system. Importantly, these provisions also apply to general supervisory authority of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. Finally, the Senate legislation continues the Securities and Exchange Commission's primary examination authority over investment companies. Community Reinvestment Act The bill contains no provisions to extend the Community Reinvestment Act (CRA) to investment companies or other non-bank entities. Rather, the legislation loosens CRA requirements somewhat and would completely exempt from CRA requirements banks with less than \$100 million in assets that are outside of metropolitan areas. The Administration remains staunchly opposed to these provisions. 2Commercial Affiliations The Senate Banking Committee bill would not directly allow bank holding companies to engage in nonfinancial, commercial activities and it contains no provisions to allow for the grandfathering of existing commercial activities. It would, however, now permit the FRB to authorize activities that are complementary to financial activities or any other service that does not pose a substantial safety and soundness risk. Also, the Senate

bill does include expanded “merchant banking” authority for bank holding companies which would permit investments in nonfinancial companies as part of “bona fide underwriting or merchant banking activity.” The limitations related to the holding period and management of these investments in H.R. 10 are removed in the Senate bill. Unitary Savings and Loan Holding Companies Under existing law, without activity restrictions, any commercial company may control a single thrift, as a unitary savings and loan holding company (USLHC). However, the Senate bill would change that, by barring any company engaged in commercial or nonfinancial activities from owning a thrift. Any commercial company that was a USLHC or applied to control a unitary thrift before February 28, 1999 would be allowed to continue operations under a grandfather provision. In addition, a grandfathered USLHC would be allowed to sell its thrift operation without restriction. Bank Securities Activities The Senate Banking Committee bill would amend the various exemptions for banks and their activities under the Investment Company and Investment Advisers Acts of 1940 and the Securities Exchange Act of 1934. Thus, certain bank activities that were previously exempt would now be required to be conducted in a broker-dealer. Also, banks will be required to register as investment advisers to investment companies. * * * * *

Banking Committee Chairman Gramm expects the bill to be considered in the full Senate in early April. President Clinton has clearly stated that he will veto the legislation unless certain provisions of the bill are amended—particularly those affecting the CRA. In the meantime, the House Banking and Financial Services Committee approved its financial modernization bill, H.R. 10, on March 11. That bill now moves to the House Commerce Committee, which has indicated that it may begin hearings on financial services modernization in April. A separate memo will follow describing the final House Banking Committee bill. We will keep you informed of further developments. 3Matthew P. Fink
President