The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 9962

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HOUSE APPROVES FINANCIAL SERVICES MODERNIZATION BILL; SENATE SCHEDULES JUNE 17 HEARING

1 See Memorandum to Board of Governors No. 61-97, Federal Legislation Members No. 13-97, Primary Contacts - Member Complex No. 76-97 and Public Information Committee No. 32-97, dated November 17, 1997. [9962] May 22, 1998 TO: BOARD OF GOVERNORS No. 35-98 FEDERAL LEGISLATION MEMBERS No. 10-98 PRIMARY CONTACTS - MEMBER COMPLEX No. 43-98 PUBLIC INFORMATION COMMITTEE No. 19-98 RE: HOUSE APPROVES FINANCIAL SERVICES MODERNIZATION BILL; SENATE SCHEDULES JUNE 17 HEARING

_____ On May 13, the House approved H.R. 10, the "Financial Services Act of 1998," by a vote of 214-213. The bill would amend the Bank Holding Company Act to permit affiliation among financial services companies, including banks, registered investment companies, securities firms and insurance companies. This legislation differs somewhat from that approved by the House Commerce Committee last October.1 Holding Company Regulation Under H.R. 10, the Federal Reserve Board is the designated consolidated or "umbrella" regulator of bank holding companies (including financial holding companies). However, the Board would not be able to regulate, examine or take enforcement actions against functionally regulated non-bank subsidiaries (such as investment advisers, broker/dealers and insurance companies) of the holding company, except or unless the Board believes that there is a material risk to a bank within the holding company or to the domestic or international payments system. In addition, the Board would be permitted to act with regard to investment advisers, broker/dealers or insurance companies that it believes are not in compliance with the Bank Holding Company Act. The SEC would be the sole examining regulator of registered investment companies that are not bank holding companies. As under current law, the Board would also be prohibited from imposing capital requirements on broker/dealers and insurance companies that already meet capital requirements imposed by a federal or state regulator. Likewise, the Board would be prohibited from imposing capital requirements with respect to the investment advisory activities of investment advisers, unless the adviser is also a bank holding company. Community Reinvestment Obligations In the weeks before H.R. 10 went to the floor, legislative efforts surfaced to impose bank-like community reinvestment obligations on mutual funds, securities firms and insurance companies. However, the efforts were not successful. Subsequently, an amendment that would require a study of depository institutions now covered under the Community Reinvestment Act (CRA) was approved; the study does not cover mutual funds, securities firms or insurance companies. The bill directs the Treasury Department, in conjunction with the federal banking agencies and the Securities and Exchange Commission, to conduct a study of the extent to which the enactment of the bill

would affect the provision of services by CRA- covered institutions, especially in low- and moderate-income communities. Treasury must report its findings to Congress within two years. The report is also to include any legislative or regulatory recommendations deemed appropriate for only those institutions currently subject to CRA. Permissible Commercial Activities As approved by the House, H.R. 10 contains a significant change with regard to its treatment of permissible commercial activities. Unlike previous versions, the bill now would bar financial holding companies from deriving revenues from nonfinancial activities. However, the bill contains a limited "grandfather" clause that would allow securities firms and insurance companies to continue to engage in existing nonfinancial activities for 10 years, provided those activities do not generate more than 15 percent of the company's consolidated annual revenues, excluding those from subsidiary banks. After 10 years, all financial services holding companies would be required to divest or cease commercial operations. The 10-year period could be extended by up to five years with approval of the Federal Reserve Board, provided the extension "would not be detrimental to the public interest." Investment Company Act Amendments H.R. 10 would also amend the Investment Company Act to add several provisions tailored to bank-advised mutual funds. These provisions address situations when a bank serves as custodian for an affiliated fund or lends money to an affiliated fund. The bill would grant the SEC rulemaking authority to require certain disclosures in connection with the sale of bank-affiliated funds. H.R. 10 also would require that similar regulatory safeguards be established under current banking law. Additionally, a bank (or a separately identifiable division of the bank) that advises an investment company would be required to register as an investment adviser. * * * The legislation faces an uncertain future in the Senate. Senate Banking Committee Chairman Alfonse D'Amato (R-NY) and Ranking Member Paul Sarbanes (D-MD) have scheduled a hearing on H.R. 10 for June 17. Although the Senate has less than 30 legislative days remaining to conclude its business for the year, Senators D'Amato and Sarbanes indicated that they may be preparing for final action on the legislation. "The policy issues involved in this legislation are of enormous importance to our financial services industry and our nation as a whole . . . Financial services legislation to revise legal constraints no longer appropriate to our financial institutions is needed," they said in a statement. We will keep you informed as developments occur. Matthew P. Fink President

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