

MEMO# 9418

November 17, 1997

HOUSE FAILS TO ACT ON FINANCIAL SERVICES MODERNIZATION BILL; MOVES ACTION TO EARLY 1998

1 See Memorandum to Board of Governors No. 39-97, Federal Legislation Members No. 10-97, Primary Contacts - Member Complex No. 41-97, and Public Information Committee No. 21-97, dated June 24, 1997. [9418] November 17, 1997 TO: BOARD OF GOVERNORS No. 61-97 FEDERAL LEGISLATION MEMBERS No. 13-97 PRIMARY CONTACTS - MEMBER COMPLEX No. 76-97 PUBLIC INFORMATION COMMITTEE No. 32-97 RE: HOUSE FAILS TO ACT ON FINANCIAL SERVICES MODERNIZATION BILL; MOVES ACTION TO EARLY 1998

Shortly before Congress adjourned on November 14, the House Commerce Committee approved by a vote of 33-11, H.R. 10, the "Financial Services Act of 1997." The bill would amend the Bank Holding Company Act to permit unlimited affiliation among financial services companies and limited investment in nonfinancial enterprises through "financial holding companies." As reported, the legislation differs significantly from that approved in June by the House Banking and Financial Services Committee.¹ Despite a significant effort, the House Leadership failed to reach consensus on a compromise between the House Banking and House Commerce Committee versions of the legislation before Congress adjourned. Discussions are to continue during adjournment, with the expectation that compromise legislation may be brought to a vote in the House early in the next session of Congress, which is scheduled to begin on January 27, 1998. Those matters in the Commerce Committee legislation that are of the greatest importance to Institute members include: Holding Company Regulation Under H.R. 10 as approved by the Commerce Committee, the Federal Reserve Board would remain the consolidated or "umbrella" regulator of bank holding companies (including financial holding companies). However, unlike the House Banking Committee provisions which are opposed by the Institute the Federal Reserve 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 Federal Reserve 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, under the Commerce Committee bill, the Federal Reserve 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. This bill also states that the SEC would be the sole examining regulator of registered investment companies that are not bank holding companies. Under the Commerce Committee bill, the Federal Reserve 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. Similarly, the Federal Reserve 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. Permissible Financial and Commercial Activities The Commerce Committee legislation provides for a five-percent "basket" of commercial activities as compared to the 15-percent basket provided in the House Banking Committee version. Specifically, the Commerce Committee bill would allow a financial holding company to engage in nonfinancial activities, provided that such activities do not comprise more than five percent of the holding company's consolidated annual revenues (up to a maximum of \$500 million) and that the nonfinancial-commercial subsidiary of the holding company has less than \$750 million in consolidated assets. The bill also contains a grandfather clause that would permit a financial holding company to retain a limited amount of nonfinancial investments and activities that it held or engaged in as of September 30, 1997. Securities Transaction Regulation The Commerce Committee legislation would narrow the specific exemptions (included in the Banking Committee bill) that would allow a bank to engage in the business of buying and selling securities without requiring the bank to register as a broker or dealer. For example, the legislation would allow for the existence of dual bank/broker or dealer employees in third- party networking arrangements, but generally would limit to clerical or ministerial functions the brokerage activities of unregistered bank employees. Investment Company Act Amendments H.R. 10, as approved by the Commerce Committee, would 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, lends money to an affiliated fund, or causes an affiliated fund to purchase securities issued by a company of which the bank is a major creditor. 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. We will keep you informed as developments occur. Matthew P. Fink President

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