

MEMO# 10322

September 24, 1998

SENATE BANKING COMMITTEE APPROVES FINANCIAL SERVICES REFORM LEGISLATION

1 See Memorandum to Board of Governors No. 35-98, Federal Legislation Members No. 10-98, Primary Contacts - Member Complex No. 43-98 and Public Information Committee No. 19-98, dated May 22, 1998. [10322] September 24, 1998 TO: BOARD OF GOVERNORS No. 60-98 FEDERAL LEGISLATION MEMBERS No. 23-98 PRIMARY CONTACTS - MEMBER COMPLEX No. 80-98 PUBLIC INFORMATION COMMITTEE No. 41-98 RE: SENATE BANKING COMMITTEE APPROVES FINANCIAL SERVICES REFORM LEGISLATION

The Senate Banking, Housing, and Urban Affairs Committee recently approved H.R. 10, the "Financial Services Act of 1998," by a vote of 16-2. The House approved H.R. 10 by a one- vote margin in May. The Senate Banking Committee vote represents historic progress for financial modernization legislation, which has been considered in Congress for over twenty years, but has never advanced so far in the legislative process. The full Senate is expected to consider the legislation before mid-October. As approved by the Senate Banking Committee, the legislation would amend the Bank Holding Company Act to permit affiliations among financial services companies, including banks, registered investment companies, securities firms and insurance companies. While the bill is substantially similar to that approved by the House in May,¹ several changes represent an improvement in the bill for registered investment companies. Holding Company Regulation Under H.R. 10 as approved by the Senate Banking Committee, the Federal Reserve Board would be designated the "umbrella" regulator of bank holding companies (including the new financial holding companies). However, neither the Board, the Comptroller of the Currency, nor the Office of Thrift Supervision would be able to exercise its authority to regulate, examine or take enforcement actions against functionally regulated non-bank subsidiaries of the holding company such as investment advisers, broker/dealers and insurance companies. Exceptions would be permitted only if the agency determined that there exists a material risk to an affiliated bank 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 federal regulator with authority to examine registered investment companies that are not bank holding companies. The Board also would 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 taking into account the activities, operations or investments of an affiliated investment company in determining holding company capital requirements, unless the investment company is a bank holding company or a bank holding

company owns 25 percent or more of the shares of the investment company. Community Reinvestment Obligations The Senate bill limits coverage of the Community Reinvestment Act (CRA) from that in the House-approved version of H.R. 10 to include only wholesale financial institutions (WFIs) that are affiliated with insured banks (the House bill included all WFIs). The bill also deletes the application of CRA to foreign banks and eliminates a provision contained in the House bill that would have required the Treasury Department to conduct a study of depository institutions now covered under CRA. Permissible Commercial Activities As approved by the Senate Banking Committee, H.R. 10 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 commercial 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. At the end of the grandfathered period, all financial services holding companies would be required to divest or cease commercial operations. Existing unitary thrift holding companies are exempted from the restrictions on commercial activities subject to certain conditions, including a prohibition on any other commercial company acquiring control of a grandfathered thrift holding company. Privacy of Information The Senate bill includes a provision that would make it a federal crime to obtain fraudulently customer information from banks or other financial institutions. However, this privacy provision would place no new disclosure or consent requirements on financial institutions to protect customers' financial information. The term "financial institution" in this provision is defined to specifically include depository institutions, finance companies, credit card issuers and consumer reporting agencies, and may include other institutions that maintain a credit, deposit, trust or other financial account or relationship as determined by the Federal Reserve Board. The House version of H.R. 10 does not contain this provision, although a similar measure (H.R. 4321) has been separately approved by the House Banking Committee and has strong support in the full House. Investment Company Act Amendments The Senate Banking Committee version of 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 Institute supports this legislation and will continue to work with Senate and House leaders to see that the bill is approved in this session of Congress. We will keep you informed of further developments. Matthew P. Fink President