INVESTMENT COMPANY INSTITUTE
The Asset Management Industry SERVING INDIVIDUAL INVESTORS

**MEMO# 13706**

July 9, 2001

# INSTITUTE MEETING WITH FEDERAL RESERVE BOARD REGARDING FUNDS' INVESTMENTS IN BANKING ORGANIZATIONS

[13706] July 9, 2001 TO: COMPLIANCE ADVISORY COMMITTEE No. 29-01 SEC RULES COMMITTEE No. 53-01 INVESTMENT IN BANK SECURITIES WORKING GROUP RE: INSTITUTE MEETING WITH FEDERAL RESERVE BOARD REGARDING FUNDS' INVESTMENTS IN BANKING ORGANIZATIONS The Institute recently sent a letter to the Federal Reserve Board (a copy of which is attached) discussing certain problems that arise for registered investment companies when investing in securities issued by state member banks or bank holding companies ("banking organizations") and requesting a meeting with Board staff to discuss this issue. On June 5, the Institute and several members met with Board staff. At the meeting, we discussed the difficulties caused by the manner in which the Board applies the presumption of control provision of Regulation Y1 to investment companies.2 We explained that these difficulties arise because the Board does not distinguish between passive and non-passive investors in applying the presumption of control provision. Also, holdings of securities of a banking organization by entities that are affiliated with one another generally must be aggregated, even where the entities in question are separately managed business units within an organization that have no intent to exercise control or influence the management of the banking organization. In order to remedy this problem, we suggested to Board staff that they distinguish between passive and non-passive investors in applying the presumption of control provision of Regulation Y (as other federal agencies have done) and that the Board not require the aggregation of securities of a banking organization in certain situations, such as when affiliated entities exercise voting and investment powers independently of one another. 1 Under Regulation Y, a person is presumed to have acquired control of a banking organization if the acquiring person (or persons acting in concert) owns, controls or holds the power to vote ten percent or more of any class of voting securities of the institution. 2 In particular, we explained that the presumption of control provision severely limits the ability of investment companies to effectively invest in a banking organization, discourages investments in banking organization securities, and imposes unnecessary operating constraints on investment companies as they must constantly monitor their aggregate position in each banking organization security to avoid crossing the ten percent threshold. 2The Board staff present at the meeting stated that they are willing to consider fund groups' requests for relief in this area, based on the specific facts and circumstances of each case. In addition, the Board staff informed us that they had recently provided relief to one fund group, subject to a series of negotiated conditions. The staff provided us with a redacted version of their letter documenting the

terms of the relief. A copy of the letter is attached. If you are interested in pursuing this type of relief, we recommend that you contact Scott Alvarez, Federal Reserve Board Associate General Counsel, at 202-452-3583. The conditions outlined in the attached letter are a good starting point to examine the types of commitments the Board may impose in order to provide relief. Members should keep in mind, however, that obtaining relief from the Board may be a lengthy process. The fund group that entered into the attached agreement with the Board informed us that it took almost a year for the entire process to be completed. In addition, we understand that many states also have presumption of control provisions, and the need to obtain relief from them may add more time to the process. If you have any questions, please contact the undersigned by phone at (202) 371-5408 or by e-mail at aburstein@ici.org. Ari Burstein Associate Counsel Attachments Attachment no. 1 (in .pdf format)

---