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September 27, 1988

BY HAND

Richard S. Carnell
Counsel
Committee on Banking, Housing
and Urban Affairs
U.S. Senate
Senate Dirksen Office Building; Room 534
Washington, D.C. 20510

Dear Rick:

Following up on our telephone conversation earlier today, enclosed is an expanded version of our paper highlighting changes to existing bank authority imposed by the Energy and Commerce Committee amendments to H.R. 5094. We will deliver to you shortly a package of background materials and precedents on these points as you suggested.

Sincerely,

Scott N. Benedict

cc: William Mattea

September 27, 1988

Energy and Commerce Committee Amendments to H.R. 5094

Restrictions on Current Activities

The Energy and Commerce Committee amendments to H.R. 5094 provide few powers beyond already existing authority for banks and bank holding companies, cut back on many existing activities, and effectively overturn final court decisions under the Glass-Steagall Act. Attacks on existing authority include the following:

-- Definitions. By inserting securities law definitions and concepts into the banking laws definitions the Energy and Commerce Committee would open to uncertainty and litigation areas of long-settled practice and established precedent under existing laws (e.g., potentially treating bank CD's as securities; treating certain asset-backed securities as equities; treating obligations of certain state and international corporate instrumentalities as corporate debt). [§§ 102(c), 102(d); new BHC Act §§ 5(a)(2)(A), 2(o)(2)-(5)]

-- Mutual Fund Sales. Banks today are permitted to sponsor, organize and control closed-end investment companies, act as investment advisers to both closed- and open-end investment companies, offer customers information about mutual funds and other investment companies, and serve as agent for customers in purchasing mutual fund shares and other investment company securities. The Energy and Commerce Committee would eliminate the ability of banks and their affiliates to sponsor, organize or control closed-end funds, and would restrict even newly-authorized securities subsidiaries to distributing securities of only unaffiliated investment companies. [§ 102(c); new BHC Act §§ 5(a)(1)(E), 5(a)(2)(A)(ii)]

-- Asset-backed Securities. The Energy and Commerce Committee would modify current authorized practices (and make such modified authorization unworkable) by requiring securities firms to be joint underwriters in asset-backed securities offerings of banks and affiliates. Third-party securities firms, rather than the issuers, would set the prices of such offerings and investment grade ratings would be required. [§§ 201, 211; new BHC Act § 9(h) and new 1934 Act § 15D(9)(h)]

-- Private Placement Activities. Banks that establish holding company securities subsidiaries would be prohibited from engaging directly in traditional private placement activities upheld under settled judicial precedent. Moreover, even newly-authorized securities subsidiaries would not be permitted to act as placement agent for corporate debt and equity securities, overturning long-standing banking law. [§ 102(c); new BHC Act § 5(a)(2)(A)(i)]

-- Commercial Paper. The Energy and Commerce Committee amendments restrict commercial paper activities previously approved by the Federal Reserve Board and the Supreme Court. [§§ 102(d), 103(b); new BHC Act § 2(o)(2) and revised § 5136(b)(7) of the National Bank Act]

-- Revenue Bond Underwriting. By adding a restrictive definition of "qualified municipal securities", the Energy and Commerce Committee would prohibit the underwriting of certain private activity municipal revenue bonds, including those of agencies and instrumentalities -- an activity permitted to bank holding companies by the Federal Reserve Board and the Supreme Court. [§ 102(d); new BHC Act § 2(o)(6)]

-- Trust Department Activities. The Energy and Commerce Committee would deny bank trust departments the traditional activity of acting as managing agent for customer accounts. [Changes throughout bill, including § 102(c); new BHC Act § 5(a)(2)(B)(ii)]

-- Brokerage Activities. Current full service brokerage (including investment advice) would be prohibited both for banks and existing bank holding company subsidiaries, overturning a major court case. [§ 102(c); new BHC Act § 5(d)(2)]

-- Clearing and Other Services. The Energy and Commerce Committee has adopted a restriction that could require banks to make available their private, in-house clearing and other services to securities firms. [§ 201; new BHC Act § 9(k)]

-- International Activities. The Energy and Commerce Committee would prohibit federal banking regulators from permitting banks and existing affiliates from continuing to engage in the United States in any "securities activities," including activities incidental to foreign business. Foreign-related securities activities in the United States could be conducted only in a new bank holding company securities subsidiary and only if "necessary" to its international business. [§ 102(c); new BHC Act §§ 5(c)(2)(E), 5(c)(4)]

Moreover, the Energy and Commerce Committee amendments would restrict all securities activities of other bank holding company subsidiaries (whether or not conducted in the United States) to activities that are both incidental and "necessary" to international business. This would effectively extend the Glass-Steagall Act for the first time to overseas activities and affiliates. [§ 102(c); new BHC Act § 5(d)(3)]