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Part 2

# DEPOSITORY INSTITUTIONS ACT OF 1988

SEPTEMBER 27, 1988.—Ordered to be printed

Mr. DINGELL, from the Committee on Energy and Commerce, submitted the following

# REPORT

together with

## ADDITIONAL, SUPPLEMENTAL, AND DISSENTING VIEWS

[To accompany H.R. 5094]

[Including cost estimate of the Congressional Budget Office]

The Committee on Energy and Commerce, to whom was referred the bill (H.R. 5094) to strengthen the competitiveness and protect the safety and soundness of depository institutions, to provide additional benefits to and protections for consumers of financial services, to strengthen the enforcement authority of depository institutions regulatory agencies, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

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The amendments (stated in terms of the page and line numbers of the reported bill) are as follows:

Page 3, strike out line 5 and all that follows through the end of title I and insert the following:

# TITLE I—SECURITIES ACTIVITIES OF NATIONAL BANKS AND BANK HOLDING COMPANY SUBSIDIARIES

### SEC. 101. AMENDMENT TO THE BANKING ACT OF 1933.

(a) IN GENERAL.—Section 20 of the Banking Act of 1933 (12 U.S.C. 377) is amended—

(1) by striking out "principally" in the first paragraph of such section; and

(2) by adding at the end thereof the following new paragraph:

"Notwithstanding any other provision of this section, a member bank may be an affiliate (as defined in section 2(k) of the Bank Holding Company Act of 1956) of a qualified securities subsidiary (as defined in section 2(n)(1) of such Act).".

(b) TRANSITION RULE.—The amendment made by subsection (a) shall not apply so as to prohibit a nonbank subsidiary of a bank holding company described in section 5(d) of the Bank Holding Company Act of 1956 (as added by section 102(c) of this Act) from engaging in activities referred to in the first paragraph of section 20 of the Banking Act of 1933 before the date required under such section 5(d).

### SEC. 102. AUTHORIZATION FOR BANK HOLDING COMPANIES TO ESTABLISH SECURITIES SUBSIDIARIES.

(a) SECURITIES SUBSIDIARY OF BANK HOLDING COMPANY ALLOWED.—Section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)) is amended—

(1) by inserting after paragraph (14) the following new paragraph:

"(15) The shares of any qualified securities subsidiary."; and

(2) by striking "or" at the end of paragraph (13).

(b) SECURITIES SUBSIDIARIES DEFINED.—Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended by adding at the end thereof the following new subsection:

"(n) SECURITIES SUBSIDIARIES DEFINED.—For purposes of this Act—

"(1) QUALIFIED SECURITIES SUBSIDIARY.—The term 'qualified securities subsidiary' means any company—

"(A) which—

"(i) is a subsidiary of a bank holding company;

"(ii) is not a bank or insured institution or a subsidiary of a bank or insured institution;

"(iii) engages, in the United States, in securities activities; and

"(iv) is registered as a broker or dealer, government securities broker or government securities dealer, or municipal securities dealer as required by the Securities Exchange Act of 1934 or as an investment adviser as required by the Investment Advisers Act of 1940; and

"(B) the formation or acquisition of which by the bank holding company has been approved by the Board under section 5(b).

"(2) SECURITIES SUBSIDIARY.—The term 'securities subsidiary' means—

"(A) any qualified securities subsidiary; and

"(B) any subsidiary of any qualified securities subsidiary.".

(c) ESTABLISHMENT AND ACTIVITIES OF QUALIFIED SECURITIES SUBSIDIARY.—The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by inserting after section 4 the following new section:

"SEC. 5. SECURITIES ACTIVITIES.

"(a) AUTHORIZED ACTIVITIES FOR QUALIFIED SECURITIES SUBSIDIARY.—

"(1) ACTIVITIES AUTHORIZED FOR QUALIFIED SECURITIES SUBSIDIARY.—A qualified securities subsidiary may—

"(A) engage in underwriting, distributing, or dealing in any obligation which is—

"(i) described in section 5136(b)(6) of the Revised Statutes;

"(ii) a qualified municipal security;

"(iii) commercial paper; or

"(iv) an asset-backed security;

"(B) engage in securities brokerage, investment advisory services, financial advisory services, and such additional securities activities that are not prohibited by paragraph (2)(A) and that are permitted for brokers or dealers registered under the Securities Exchange Act of 1934 or for investment advisors registered under the Investment Advisers Act of 1940;

"(C) engage in buying and selling foreign currency, coin, and bullion and engage in interest rate and currency swaps;

"(D) engage in, or acquire the shares of any company engaged in, any activity which is not described in subparagraph (A), (B), or (C) of this paragraph if—

"(i) a provision of section 4 of this Act allows a bank holding company or any subsidiary of a bank holding

company to engage in, or acquire the shares of any company engaged in, such activity; and

"(ii) either—

"(I) the Board permits the bank holding company to engage in, or acquire the shares of a company engaged in, such activity; or

"(II) such provision of section 4 allows the bank holding company or any subsidiary of a bank holding company to engage in, or acquire the shares of a company engaged in, such activity without the Board's approval; and

"(E) engage in distributing securities issued by an investment company—

"(i) that is registered pursuant to section 8 of the Investment Company Act of 1940;

"(ii) that is not promoted, sponsored, or controlled by any affiliate of the qualified securities subsidiary; and

"(iii) for which neither the qualified securities subsidiary nor any affiliate of the qualified securities subsidiary acts as investment adviser.

"(2) LIMITATIONS ON SECURITIES SUBSIDIARY ACTIVITIES.—

"(A) IN GENERAL.—Notwithstanding paragraph (1) of this subsection, no securities subsidiary may—

"(i) underwrite (except as agent), distribute, or deal in any corporate debt security not specifically described in paragraph (1)(A) of this subsection;

"(ii) underwrite, distribute, place, or deal in any equity security (as defined in section 3(a)(11) of the Securities Exchange Act of 1934), other than an asset-backed security;

"(iii) underwrite, distribute, place, or deal in any derivatives or variants of such debt or equity security; or

"(iv) act as promoter or sponsor of any open-end investment company, or as underwriter to any investment company, registered or required to register under the Investment Company Act of 1940.

"(B) LIMITATION ON BOARD AUTHORITY.—The Board may not issue any regulation, order, or interpretation authorizing or permitting a securities subsidiary to engage in the United States in any securities activities other than—

"(i) activities specifically described in subparagraph (A), (B), or (C) of paragraph (1) of this subsection that are not prohibited by subparagraph (A) of this paragraph; or

"(ii) securities activities in a capacity as a trustee, executor, administrator, custodian, or guardian of estates.

"(b) FORMATION OF QUALIFIED SECURITIES SUBSIDIARY.—

"(1) BOARD APPROVAL REQUIRED.—No bank holding company may form a company, or acquire any shares of any existing company, for the purpose of establishing a qualified securities subsidiary unless the Board approves a written application (containing such information with respect to such formation or

acquisition as the Board may prescribe by regulations) by the bank holding company.

"(2) PROHIBITION ON APPROVAL UNDER CERTAIN CIRCUMSTANCES.—The Board shall not approve any application under paragraph (1) with respect to the proposed establishment of a qualified securities subsidiary by a bank holding company if the Board determines that any of the following conditions exist or would likely result from the approval of the application:

"(A) ADVERSE EFFECT ON HOLDING COMPANY RESOURCES TO THE DETRIMENT OF DEPOSITORY INSTITUTION SUBSIDIARIES.—The establishment of a qualified securities subsidiary would affect the managerial or financial resources of the bank holding company to such an extent that the establishment would likely—

"(i) have an adverse impact on the safety and soundness of any depository institution subsidiary of the bank holding company; or

"(ii) impair or diminish the bank holding company's ability to act as a source of strength for any depository institution subsidiary of the bank holding company.

"(B) UNDUE CONCENTRATION OF RESOURCES.—The Board determines that disapproval of the application is required under subsection (e) of this section.

"(C) INCOMPLETE APPLICATION.—The applicant bank holding company has failed to provide information required by regulations prescribed pursuant to paragraph (1) or such additional information as the Board may require the bank holding company to submit in connection with the application.

"(D) COMMUNITY BENEFITS.—The Board determines that disapproval of the application is required under section 11.

"(E) MINIMUM RISK-BASED CAPITAL REQUIREMENT.—The Board determines that any bank subsidiary of such bank holding company fails, at the time of such application, to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.

"(F) PUBLIC BENEFIT.—The Board determines that the establishment and operation of a qualified securities subsidiary cannot reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

"(3) OPPORTUNITY FOR COMMENT.—The Board shall provide for public notice and opportunity for comment before making any determination with respect to any application under paragraph (1).

"(c) TRANSFER OF SECURITIES ACTIVITIES FROM DEPOSITORY INSTITUTION SUBSIDIARIES.—

"(1) IN GENERAL.—If any bank holding company establishes a qualified securities subsidiary, no bank or insured institution

subsidiary of the bank holding company, and no subsidiary of any such bank or insured institution, may engage in the United States in any securities activities as of the date such qualified securities subsidiary commences operations.

"(2) CERTAIN ACTIVITIES NOT INCLUDED.—Paragraph (1) of this subsection shall not apply so as to prohibit any bank or insured institution subsidiary of a bank holding company, or any subsidiary of any such bank or insured institution, from—

"(A) buying or selling, as principal or agent, or underwriting any security issued by the Secretary of the Treasury under chapter 31 of title 31, United States Code;

"(B) engaging in any activity or transaction described in paragraph (5) or (8) of section 5136(b) of the Revised Statutes;

"(C) buying or selling, without recourse, any security in such subsidiary's capacity as trustee, executor, administrator, custodian, or guardian of estates with respect to the account of a customer;

"(D) securities activities described in section 2(o)(5)(B) of this Act; or

"(E) engaging in activities—

"(i) that are necessary and incidental to the international or foreign business of the subsidiary; or

"(ii) through a subsidiary established or acquired pursuant to section 302(b) of the Small Business Investment Act of 1958.

"(3) LIMITED EXTENSION IN CASE OF HARDSHIP.—If the Board determines that the requirement that any subsidiary referred to in paragraph (1) of this subsection shall cease any activity described in such paragraph as of the date the qualified securities subsidiary commences operation would cause—

"(A) undue hardship to the subsidiary; or

"(B) excessive disruption in the operations of the bank holding company while such activities are being transferred from such subsidiary,

the Board may authorize such subsidiary to continue to engage in an activity described in such paragraph after such date for a period not to exceed 1 year.

"(4) LIMITATION ON REGULATORY AGENCY AUTHORITY.—No appropriate Federal depository institutions regulatory agency may issue any regulation or order authorizing or permitting any bank or insured institution affiliate of a qualified securities subsidiary or any affiliate of such bank or insured institution (other than a securities subsidiary) to engage in the United States in securities activities other than activities specifically described in subparagraph (A), (B), (C), (D), or (E) of paragraph (2) of this subsection.

"(d) SECURITIES ACTIVITIES OF OTHER BHC NONBANK SUBSIDIARIES.—

"(1) CERTAIN SECURITIES ACTIVITIES PROHIBITED AFTER TRANSITION.—Notwithstanding any other provision of this section or section 4, no bank holding company and no nonbank subsidiary of a bank holding company (other than a qualified securities

subsidiary) may engage in the United States in securities activities after the earlier of—

"(A) the date a qualified securities subsidiary of such bank holding company commences operations; or

"(B) the end of the 2-year period beginning on the date of the enactment of the Depository Institutions Act of 1988.

"(2) EXCEPTION FOR AVISORY SRVICES OR DISCOUNT BROKERAGE.—Notwithstanding paragraph (1), a nonbank subsidiary of a bank holding company may engage in either (but not both) of the following:

"(A) securities activities described in section 2(o)(5)(B) of this Act; or

"(B) buying and selling securities—

"(i) for the account of a customer;

"(ii) upon the order of the customer; and

"(iii) without recourse.

"(3) EXCEPTION WITH RESPECT TO INTERNATIONAL OR FOREIGN BUSINESS.—Paragraph (1) shall not prohibit any bank holding company or any nonbank subsidiary of a bank holding company from engaging in activities that are necessary and incidental to the international or foreign business of such company or subsidiary.

"(4) EXCEPTION FOR PRIMARY DEALERS.—Notwithstanding paragraph (1), a nonbank subsidiary of a bank holding company that is a government securities broker or government securities dealer registered under section 15C of the Securities Exchange Act of 1934 may engage in securities activities as a primary dealer recognized by the Federal Reserve Bank of New York.

"(e) AFFILIATIONS WHICH WOULD RESULT IN UNDUE CONCENTRATION OF RESOURCES PROHIBITED.—

"(1) IN GENERAL.—No bank holding company may establish a qualified securities subsidiary through the acquisition of an existing securities firm if—

"(A) the establishment of the qualified securities subsidiary would result in the affiliation of—

"(i) a bank holding company or bank which—

"(I) is, as of the latest report of financial condition date (before such affiliation); or

"(II) was, as of the end of any of the 8 calendar quarters preceding such report of financial condition date,

among the 15 largest banking organizations in the United States in terms of total consolidated assets; with

"(ii) a securities firm which—

"(I) is, as of the latest quarterly report of financial condition (before such affiliation); or

"(II) was, as of the end of any of the 8 calendar quarters preceding such date of report of financial condition,

among the 15 largest securities firms in the United States in terms of total consolidated assets;

"(B) the establishment of the qualified securities subsidiary would result in the affiliation of—

"(i) a bank holding company or bank which has, or had on average during any of the 8 calendar quarters preceding the date of application to establish such securities subsidiary, total worldwide consolidated assets of more than $30,000,000,000; with

"(ii) a securities firm described in subparagraph (A)(ii); or

"(C) the establishment of the qualified securities subsidiary would result in the affiliation of—

"(i) a securities firm which has, or had on average during any of the 8 calendar quarters preceding the date of application to establish such securities subsidiary, total worldwide consolidated assets of more than $15,000,000,000; with

"(ii) a bank holding company or bank described in subparagraph (A)(i).

"(2) ANNUAL ADJUSTMENT FOR INFLATION.—The dollar amounts of assets referred to in clause (i) of paragraph (1)(B) and clause (i) of paragraph (1) shall be increased by the Board at the end of each calendar year beginning after December 31, 1988, by the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics.

"(f) DIVESTMENT REQUIRED IF RISK-BASED CAPITAL REQUIREMENTS ARE NOT MET.—In the case of any bank holding company which controls a qualified securities subsidiary, the Board may order such bank holding company to cease conducting any securities activities other than activities in which a national bank may engage under section 5136(b) of the Revised Statutes if any bank subsidiary of such bank holding company fails to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.

"(g) RULE OF CONSTRUCTION.—No provision of this section or section 9 shall be construed as—

"(1) superseding or limiting any provision of any Federal securities law or regulation or limiting the authority of the Securities and Exchange Commission; or

"(2) limiting the authority of the Board—

"(A) under section 12, to—

"(i) prescribe regulations and issue orders to carry out the purposes of this Act and to prevent evasions of the requirements of this Act or any such regulation or order; and

"(ii) require reports and make examinations for the purposes referred to in clause (i),

with respect to any qualified securities subsidiary of a bank holding company; or

"(B) under any other provision of this Act, the Federal Reserve Act, the Federal Deposit Insurance Act, or any other provision of law, to regulate bank holding companies and bank holding company subsidiaries, including non-

bank subsidiaries, and the transactions between or among bank holding companies and bank and nonbank subsidiaries of such companies.".

(d) ADDITIONAL DEFINITIONS.—Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended by inserting after subsection (n) (as added by subsection (b) of this section) the following new subsections:

"(o) ADDITIONAL DEFINITIONS RELATING TO SECURITIES ACTIVITIES.—

"(1) ASSET-BACKED SECURITY.—The term 'asset-backed securities' means securities which represent interests in, or are secured by, notes, drafts, acceptances, loans, leases, receivables, other obligations, or pools of any such obligations, if the securities provide for payment obligations in the aggregate no greater than the underlying payment obligations, but does not include a security issued by an investment company registered or required to register under section 8 of the Investment Company Act of 1940.

"(2) COMMERCIAL PAPER.—The term 'commercial paper' means a security which is exempted from registration under section 3(a)(3) of the Securities Act of 1933 or such other similar instrument as the Securities and Exchange Commission determines, by rule or order, to be commercial paper.

"(3) SECURITY.—The term 'security' means a security within the meaning of section 3(a)(10) of the Securities Exchange Act of 1934 or commercial paper.

"(4) CORPORATE DEBT SECURITY.—The term 'corporate debt security' means any security that is not an equity security (as defined in section 3(a)(11) of the Securities Exchange Act of 1934).

"(5) SECURITIES ACTIVITIES.—The term 'securities activities' means—

"(A) the underwriting, distribution, dealing or making markets in, private placement, or purchase or sale for the account of others of any security;

"(B) investment advisory services with respect to securities, or financial advisory services relating to mergers, acquisitions, restructurings, or reorganizations; and

"(C) any other activities determined by the Securities and Exchange Commission, after consultation with the Board, to be securities activities.

"(6) QUALIFIED MUNICIPAL SECURITIES.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'qualified municipal securities' means obligations issued by, or on behalf of, or guaranteed as to principal and interest by any State, any political subdivision of any State, or any agency or instrumentality of any State or political subdivision.

"(B) EXCEPTION.—The term 'qualified municipal securities' does not include any private activity bond (as defined in section 141 of the Internal Revenue Code of 1986) unless—

"(i) the interest on such bond is excludable from gross income under section 103 of the Internal Revenue Code of 1986 and all the property to be financed

by the net proceeds of such bond is owned, for Federal income tax purposes, by a governmental unit; or

"(ii) any State or any political subdivision of any State has pledged such State or political subdivision's full faith and credit for the payment of all principal and interest on such bond.

"(C) STATE.—For purposes of this paragraph, the term 'State' includes the District of Columbia and any possession of the United States.

"(p) BRANCHES AND AGENCIES OF FOREIGN BANKS TREATED AS BANKS FOR CERTAIN PURPOSES.—Notwithstanding section 8(d) of the International Banking Act of 1978, any branch or agency of a foreign bank (as such terms are defined in section 1(b) of such Act) shall be considered to be a bank for purposes of sections 5 and 9 of this Act.".

SEC. 103. BANK SECURITIES AND INVESTMENT ACTIVITIES.

(a) RESTATEMENT AND REORGANIZATION OF SECTION 5136 OF THE REVISED STATUTES.—

(1) IN GENERAL.—Section 5136 of the Revised Statutes (12 U.S.C. 24) is amended to read as follows:

"SEC. 5136. CORPORATE POWERS OF NATIONAL BANKS.

"(a) GENERAL POWERS.—Upon filing articles of association and an organization certificate, a national bank shall become, as of the date of the execution of such organization certificate, a corporation which shall have, in the name designated in such certificate, the following powers:

"(1) To adopt and use a corporate seal.

"(2) To have succession from February 25, 1927, or from the date of the execution of such organization certificate (if such date is later than February 25, 1927) until—

"(A) such time as the bank is dissolved by the act of shareholders owning not less than 2/3 of the stock of such bank;

"(B) the franchise is forfeited by reason of violation of law;

"(C) the franchise is forfeited by a general or special Act of Congress; or

"(D) the affairs of the bank are placed in the control of the Federal Deposit Insurance Corporation, as receiver, and finally wound up by such Corporation.

"(3) To enter into contracts.

"(4) To sue and be sued in its corporate capacity, and to complain and defend in any action brought against the national bank in any court of competent jurisdiction.

"(5) To elect or appoint directors to the board of directors of the bank and, by such board of directors, to—

"(A) appoint a president, vice president, cashier, and other officers;

"(B) define the duties of officers;

"(C) require bonds of such officers and fix the penalty of such bonds; and

"(D) dismiss any officer at the pleasure of the directors and appoint another to fill the position.

"(6) To prescribe, by the board of directors, bylaws not inconsistent with law regulating the manner in which—

"(A) stock of the bank may be transferred;

"(B) the directors of the bank are appointed or elected;

"(C) the officers of the bank may be appointed;

"(D) the property of the bank may be transferred;

"(E) the general business of the bank may be conducted; and

"(F) the privileges granted to the bank by law may be exercised and enjoyed.

"(7) To exercise, by the board of directors or officers or agents authorized by such board and subject to any other provision of law, all such incidental powers as shall be necessary to carry on the business of banking, including, but not limited to—

"(A) discounting and negotiating promissory notes, drafts, bills of exchange, and other evidence of debt;

"(B) receiving deposits;

"(C) buying and selling exchange, coin, and bullion;

"(D) loaning money on personal security; and

"(E) obtaining, issuing, and circulating notes according to the provisions of this title.

"(8) To contribute to community funds or charitable, philanthropic, or benevolent instrumentalities conducive to the public welfare, such sums as the board of directors may determine to be expedient and in the interests of the national bank if such bank is not located in a State the laws of which expressly prohibit State banks from contributing to such funds or instrumentalities.

"(9) To invest in tangible personal property, including, without limitation, vehicles, manufactured homes, machinery, equipment, or furniture, for lease financing transactions on a net lease basis, but such investment may not exceed 10 percent of the assets of the national bank.

"(b) POWERS RELATING TO SECURITIES ACTIVITIES AND COMMERCIAL PAPER.—

"(1) SECURITIES UNDERWRITING PROHIBITED.—Except as otherwise provided in this subsection or any other provision of law, no national bank may underwrite any issue of securities.

"(2) BUYING AND SELLING SECURITIES PROHIBITED EXCEPT AS AGENT FOR CUSTOMER.—Except as otherwise provided in this subsection or any other provision of law, no national bank may buy or sell any security unless the purchase or sale is made—

"(A) for the account of a customer;

"(B) by the bank—

"(i) upon the order of the customer; or

"(ii) in the bank's capacity as trustee, executor, administrator, custodian, or guardian of estates with respect to the account of the customer; and

"(C) without recourse.

"(3) ISSUANCE AND SALE OF CERTAIN GNMA GUARANTEED SECURITIES.—Notwithstanding paragraph (2) or any other provision of this section, a national bank may issue and sell securities

which are guaranteed by the Government National Mortgage Association under section 306(g) of the National Housing Act.

"(4) EXCEPTION FOR BANK-ELIGIBLE SECURITIES.—Paragraphs (1) and (2) shall not apply with respect to any bank-eligible security, except that subsection (c)(3)(B) shall apply with respect to the aggregate amount of bank-eligible securities described in subparagraph (N), (O), (P), or (Q) of paragraph (6) which may be held by any national bank at any time.

"(5) EXCEPTION FOR CERTAIN BANK SECURITIES AND BANK INVESTMENTS FOR THE BANK'S OWN ACCOUNT.—Paragraph (2) shall not apply to the purchase or sale by a national bank of—

"(A) any security of which the national bank is the issuer; or

"(B) any investment security or other security which the bank is purchasing or has purchased for the bank's own account for investment in accordance with subsection (c).

"(6) BANK-ELIGIBLE SECURITY DEFINED.—For purposes of this section, the term 'bank-eligible security' means any of the following investment securities:

"(A) Obligations of the United States.

"(B) General obligations of any State or any political subdivision of any State.

"(C) Obligations of the Washington Metropolitan Area Transit Authority which are guaranteed by the Secretary of Transportation under section 9 of the National Capital Transportation Act of 1969.

"(D) Obligations issued—

"(i) under authority of the Federal Farm Loan Act; or

"(ii) by the thirteen banks for cooperatives, any bank for cooperatives, or the Federal Home Loan Banks.

"(E) Obligations insured by the Secretary of Housing and Urban Development under title XI of the National Housing Act.

"(F) Obligations insured by the Secretary of Housing and Urban Development pursuant to section 207 of the National Housing Act if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States.

"(G) Obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association.

"(H) Mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to section 305 or section 306 of the Federal Home Loan Mortgage Corporation Act.

"(I) Obligations of the Federal Financing Bank.

"(J) Obligations of the Environmental Financing Authority.

"(K) Obligations or other instruments or securities of the Student Loan Marketing Association.

"(L) Such obligations of any local public agency (as defined in section 110(h) of the Housing Act of 1949) as are

secured by an agreement between the local public agency and the Secretary of Housing and Urban Development in which the local public agency agrees to borrow from the Secretary, and the Secretary agrees to lend to such local public agency, moneys in an aggregate amount which (together with any other moneys irrevocably committed to the payment of interest on such obligations) will suffice to pay, when due, the interest on and all installments (including the final installment) of the principal of such obligations, which moneys under the terms of said agreement are required to be used for such payments.

"(M) Such obligations of a public housing agency (as defined in the United States Housing Act of 1937) as are secured—

"(i) by an agreement between such agency and the Secretary of Housing and Urban Development in which the agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the agency, prior to the maturity of such obligations, moneys in an amount which (together with any other moneys irrevocably committed to the payment of interest on such obligations) will suffice to pay the principal of such obligations with interest to maturity thereon, which moneys under the terms of said agreement are required to be used for the purpose of paying the principal of and the interest on such obligations at their maturity;

"(ii) by a pledge of annual contributions under an annual contributions contract between such agency and the Secretary of Housing and Urban Development if such contract contains the covenant by the Secretary which is authorized by section 6(g) of the United States Housing Act of 1937, and if the maximum sum and the maximum period specified in such contract pursuant to such section 6(g), shall not be less than the annual amount and the period for payment which are requisite to provide for the payment when due of all installments of principal and interest on such obligations; or

"(iii) by a pledge of both annual contributions under an annual contributions contract containing the covenant by the Secretary of Housing and Urban Development which is authorized by section 6(g) of the United States Housing Act of 1937, and a loan under an agreement between such agency and the Secretary in which the agency agrees to borrow from the Secretary and the Secretary agrees to lend to the agency, prior to the maturity of the obligations involved, moneys in an amount which (together with any other moneys irrevocably committed under the annual contributions contract to the payment of principal and interest on such obligations) will suffice to provide for the payment when due of all installments of principal and interest on such obligations, which moneys under

the terms of the agreement are required to be used for the purpose of paying the principal and interest on such obligations at their maturity.

"(N) Obligations issued by the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, or the Inter-American Investment Corporation.

"(O) Obligations issued by any State or political subdivision or any agency of a State or political subdivision for housing, university, or dormitory purposes, which are at the time eligible for purchase by a national bank for its own account.

"(P) Obligations issued by the Tennessee Valley Authority.

"(Q) Obligations issued by the United States Postal Service.

"(c) PURCHASE OF INVESTMENT SECURITIES FOR THE BANK'S OWN ACCOUNT.—

"(1) LIMITED AUTHORITY TO BUY FOR BANK'S OWN ACCOUNT FOR INVESTMENT.—The authority of any national bank under this section to buy investment securities or other securities for the bank's own account shall be subject to the following limitations:

"(A) CORPORATE STOCK.—Except as provided in any other provision of law, the bank may not buy, for the bank's own account, any share of stock of any corporation (other than shares of a corporation described in any other paragraph of this subsection).

"(B) MAXIMUM INVESTMENT AMOUNT FOR SECURITIES ISSUED BY ANY SINGLE ISSUER.—The total amount of investment securities held by the bank (for the bank's own account) which were issued by any 1 person, or for which such person is the obligor, may not exceed at any time the amount which is equal to the sum of—

"(i) 10 percent of the capital stock of the bank which is actually paid in and unimpaired; and

"(ii) 10 percent of the bank's unimpaired surplus fund,

except that this subparagraph shall not require any bank to dispose of investment securities lawfully held by the bank on August 23, 1935.

"(2) BANKERS' BANKS.—

"(A) ACQUISITION OF SHARES ALLOWED.—Paragraph (1) shall not apply to the purchase by a national bank, for the bank's own account, of shares of an insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act) or a bank holding company (as defined in section 2(a) of the Bank Holding Company Act of 1956), if—

"(i) the outstanding shares of such bank or company are owned exclusively (except to the extent of directors' qualifying shares required by law) by depository institutions (as defined in clauses (i) through (vi) of

section 19(b)(1)(A) of the Federal Reserve Act) or depository institution holding companies; and

"(ii) such bank or company, and all subsidiaries of such bank or company, are engaged exclusively in providing services for other depository institutions and officers, directors, and employees of depository institutions.

"(B) MAXIMUM INVESTMENT AMOUNT.—The total amount of stock held by any national bank in any bank or holding company referred to in subparagraph (A)—

"(i) may not exceed, at any time, 10 percent of the national bank's capital stock and paid in and unimpaired surplus; and

"(ii) may not include more than 5 percent of any class of voting securities of such bank or company.

"(3) BANK-ELIGIBLE SECURITIES.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to the purchase by a national bank, for the bank's own account, of bank-eligible securities.

"(B) MAXIMUM INVESTMENT AMOUNT IN THE CASE OF CERTAIN SECURITIES.—The total amount of bank-eligible securities described in subparagraph (N), (O), (P), or (Q) of subsection (b)(6) which may be held by any national bank at any time—

"(i) in connection with being an underwriter of such securities or buying and selling, as principal, such securities under subsection (b); or

"(ii) for the bank's own account,

shall not exceed an amount equal to the sum of 10 percent of the capital stock of the national bank actually paid in and unimpaired and 10 percent of the bank's unimpaired surplus fund.

"(C) SPECIAL RULE FOR CERTAIN COMMITMENTS.—For purposes of subparagraph (B), any bank-eligible securities referred to in such subparagraph as to which any national bank is under a commitment shall be deemed to be held by such national bank.

"(4) MORTGAGE RELATED SECURITIES.—

"(A) PARAGRAPH (1) DOES NOT APPLY.—Paragraph (1) shall not apply to the purchase by a national bank, for the bank's own account, of any of the following securities:

"(i) Securities offered and sold pursuant to section 4(5) of the Securities Act of 1933.

"(ii) Mortgage related securities (as defined in section 3(a)(41) of the Securities Exchange Act of 1934).

"(B) REGULATIONS.—Any purchase by a national bank of securities described in subparagraph (A) shall be subject to such limitations and restrictions as the Comptroller of the Currency may prescribe by regulation, including regulations prescribing—

"(i) the minimum size of the issue (at the time of initial distribution) with respect to any such security; and

"(ii) minimum aggregate sales prices with respect to any such security,

which must be met or exceeded in order for a national bank to be eligible to purchase such securities without limitation pursuant to subparagraph (A).

"(5) SAFE-DEPOSIT BUSINESS.—

"(A) ACQUISITION OF SHARES ALLOWED.—Paragraph (1) shall not apply to the purchase by a national bank, in connection with the bank's carrying on the business commonly known as the safe-deposit business, of capital stock of a corporation organized under the law of any State to conduct a safe-deposit business.

"(B) MAXIMUM INVESTMENT AMOUNT.—The total amount of stock held by any national bank in any corporation referred to in subparagraph (A) shall not exceed an amount equal to the sum of—

"(i) 15 percent of the capital stock of the national bank actually paid in and unimpaired; and

"(ii) 15 percent of the bank's unimpaired surplus fund.

"(6) ACQUISITION OF SHARES OF NATIONAL HOUSING CORPORATIONS ALLOWED; ETC.—Paragraph (1) shall not apply with respect to the following:

"(A) The purchase by a national bank, for the bank's own account, shares of stock issued by a corporation authorized to be created pursuant to title IX of the Housing and Urban Development Act of 1968.

"(B) Investments by a national bank in a partnership, limited partnership, or joint venture formed pursuant to section 907(a) or 907(c) of such Act.

"(7) STATE HOUSING CORPORATIONS.—

"(A) ACQUISITION OF SHARES AND OTHER INVESTMENTS ALLOWED.—Paragraph (1) shall not apply with respect to the following:

"(i) The purchase by a national bank, for the bank's own account, shares of stock issued by any State housing corporation incorporated in the State in which the national bank is located.

"(ii) Investments by a national bank in loans and commitments for loans to any such corporation.

"(B) MAXIMUM INVESTMENT AMOUNT.—The total amount of stock held by a national bank in any corporation referred to in subparagraph (A) and the amount of investments in loans and commitments for loans to such corporation by the bank shall not exceed an amount equal to the sum of—

"(i) 5 percent of the national bank's capital stock actually paid in and unimpaired; and

"(ii) 5 percent of the bank's unimpaired surplus fund.

"(8) AGRICULTURAL CREDIT CORPORATIONS.—

"(A) ACQUISITION OF SHARES AND OTHER INVESTMENTS ALLOWED.—Paragraph (1) shall not apply to the purchase by a national bank, for the bank's own account, of shares of

stock issued by a corporation organized solely for the purpose of making loans to farmers and ranchers for agricultural purposes, including the breeding, raising, fattening, or marketing of livestock.

"(B) MAXIMUM INVESTMENT AMOUNT.—Unless the national bank owns at least 80 percent of the stock of an agricultural credit corporation described in subparagraph (A) the total amount of stock held by the national bank in any such corporation shall not exceed an amount equal to 20 percent of the unimpaired capital and surplus of the national bank.

"(9) ADDITIONAL LIMITATIONS PRESCRIBED IN REGULATIONS.—The authority of any national bank under this section to buy investment securities for the bank's own account shall be subject to such additional limitations and restrictions as the Comptroller of the Currency may prescribe by regulation.

"(10) INVESTMENT SECURITIES DEFINED.—For purposes of this section, the term 'investment securities' means marketable obligations, evidencing indebtedness of any person, copartnership, association or corporation in the form of bonds, notes, and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency.".

(2) RULE OF CONSTRUCTION.—The amendment made by paragraph (1) to section 5136 of the Revised Statutes—

(A) may not be construed as making any substantive change in the meaning of any provision of such section (as in effect on the day before the effective date of such amendment); and

(B) shall not modify, affirm, or otherwise affect any regulation prescribed, any order issued, or any action taken before the effective date of such amendment under or pursuant to such section (as in effect on the day before such date).

(b) ADDITIONAL AMENDMENTS TO SECTION 5136 OF THE REVISED STATUTES.—Section 5136 of the Revised Statutes (as amended by subsection (a)(1) of this section) is amended—

(1) in subsection (b)(1), by inserting before the period ", including asset-backed securities (as defined in section 2(o)(1) of the Bank Holding Company Act of 1956)";

(2) in subsection (b), by adding at the end thereof the following new paragraphs:

"(7) BUYING AND SELLING COMMERCIAL PAPER ALLOWED.—Any national bank may buy and sell commercial paper, as such term is defined in section 2(o)(2) of the Bank Holding Company Act of 1956.

"(8) CERTAIN INFORMATION PROCESSING AND CLEARING FUNCTIONS.—No provision of this subsection shall be construed as prohibiting a national bank from performing the functions described in the second sentence of paragraph (22)(A) or paragraph (23)(B)(iii) of section 3(a) of the Securities Exchange Act of 1934 to the extent allowed under any such paragraph.

"(9) FEDERAL RESERVE BOARD AUTHORITY TO PROHIBIT SECURITIES ACTIVITIES OF NATIONAL BANKS.—Notwithstanding any other provision of this section or any other law, the Board of Governors of the Federal Reserve System may—

"(A) prohibit any activity of a national bank which would be a securities activity if engaged in by any person other than a bank; and

"(B) prescribe such regulations as the Board determines to be necessary or appropriate to prevent any evasion of the requirements of this subsection, the 20th paragraph of section 9 of the Federal Reserve Act, and section 21 of the Banking Act of 1933.";

(3) in subsection (b)(6), insert after subparagraph (Q) the following new subparagraphs:

"(R) Shares issued by and securities guaranteed by the Federal Agricultural Mortgage Corporation.

"(S) Obligations of the Financing Corporation.";

(4) in subsection (c)(2)(A)(ii), by inserting "or depository institution holding companies" after "depository institutions" each place such term appears; and

(5) by adding at the end thereof the following new subsections:

"(d) MUNICIPAL SECURITIES AND MUTUAL FUND POWERS FOR BANKS WITH ASSETS OF NOT MORE THAN $500,000,000.—

"(1) MUNICIPAL SECURITIES.—Notwithstanding any provision of subsection (b), a national bank which—

"(A) is not controlled by a bank holding company (as defined in section 2(a) of the Bank Holding Company Act of 1956); and

"(B) has total banking assets of not more than $500,000,000,

may buy and sell, as principal or agent, and underwrite qualified municipal securities (as defined in section 2(o)(6) of the Bank Holding Company Act of 1956).

"(2) MUTUAL FUNDS.—Notwithstanding subsection (b), a national bank that has total banking assets of not more than $500,000,000 may distribute securities of an investment company—

"(A) that is registered pursuant to section 8 of the Investment Company Act of 1940;

"(B) that is not organized, sponsored, managed, or controlled by the bank or any affiliate of the bank; and

"(C) for which neither the bank nor any affiliate of the bank acts as investment adviser.

"(e) RISK-BASED CAPITAL REQUIREMENTS.—No national bank may engage in any activity after the date of the enactment of the Depository Institutions Act of 1988 in which such bank could not engage before such date if such bank fails to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.

"(f) LIMITATIONS ON BANK ACTIVITIES RELATING TO OPEN-END INVESTMENT COMPANIES.—Notwithstanding any other provision of law, no national bank may act as promoter or sponsor of, or under-

writer to, any open-end investment company registered or required to register under the Investment Company Act of 1940, other than a common trust fund or common investment fund which—

"(1) is registered under the Investment Company Act of 1940;

"(2) is used solely for the investment of individual retirement account assets; and

"(3) is maintained in accordance with the requirements of section 408 of the Internal Revenue Code of 1986.".

(c) LIMITATION ON SECURITIES AFFILIATIONS OF INSURED BANKS.—Section 18(j)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)(3)) is amended—

(1) by striking out subparagraph (A) and inserting in lieu thereof the following new subparagraph:

"(A) IN GENERAL.—Except as provided in section 5 of the Bank Holding Company Act of 1956, no insured bank may be an affiliate of any company which engages, directly or indirectly, in the United States in securities activities (as such term is defined in section 2(o)(5) of the Bank Holding Company Act of 1956) other than activities in which a national bank may engage under subsection (b) or (d) of section 5136 of the Revised Statutes.";

(2) by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraph:

"(B) CONTINUATION OF CERTAIN AFFILIATIONS AND ACTIVITIES.—This paragraph shall not prohibit any company that was engaged directly or indirectly in any securities activities (as such term is defined in section 2(o)(5) of the Bank Holding Company Act of 1956) on March 1, 1988, and that was affiliated with an insured bank on such date, from continuing to be affiliated with such insured bank in the same or any other manner, and, in the case of any such company which is also a company described in section 4(f)(1) of the Bank Holding Company Act of 1956, shall not prohibit such company from directly or indirectly establishing, organizing, sponsoring, acquiring, managing, or controlling additional affiliates engaged directly or indirectly in such securities activities.";

(3) by striking out subparagraph (C) and inserting in lieu thereof the following new subparagraph:

"(C) TRANSITION RULE.—Notwithstanding subparagraph (A), any affiliation of an insured bank with any company which is prohibited under such subparagraph may continue until the earlier of—

"(i) the date a qualified securities subsidiary (as defined in section 2(n)(1) of the Bank Holding Company Act of 1956) which is an affiliate of such bank commences operations; or

"(ii) the end of the 2-year period beginning on the date of the enactment of the Depository Institutions Act of 1988.";

(4) in subparagraph (E)—

(A) by inserting "or section 20 of the Banking Act of 1933" after "paragraph"; and

(B) by inserting "(H)," after "(F),"; and

(5) by striking out subparagraph (F) and inserting in lieu thereof the following new subparagraph:

"(F) DEFINITIONS.—For purposes of this paragraph—

"(i) AFFILIATE.—The term 'affiliate' has the meaning given to such term in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

"(ii) COMPANY.—The term 'company' has the meaning given to such term in section 2(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(b)).".

(d) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 335) is amended by striking out "paragraph 'Seventh' of" and inserting in lieu thereof "subsections (b), (c), (d), (e), and (f) of".

(2) Section 514 of the National Housing Act (12 U.S.C. 1733) is amended by striking out "paragraph seventh of" and inserting in lieu thereof "subsections (b) and (c) of".

(3) Section 4(g)(1) of the International Banking Act of 1978 (12 U.S.C. 3102(g)(1)) is amended by striking out "paragraph 'Seventh' of" and inserting in lieu thereof "subsection (c) of".

(4) Section 3(q)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)) is amended—

(A) by adding at the end thereof the following new subparagraph:

"(F) in the case of national banks with respect to the activities of such banks which are subject to regulation and enforcement by such Board under section 5136(b)(9) of the Revised Statutes,";

(B) by striking out "and" at the end of subparagraph (D); and

(C) by inserting "and" after the comma at the end of subparagraph (E).

(5) Section 18(j)(4)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)(4)(A)) is amended by striking out "or any provision of section 20 of the Banking Act of 1933" and inserting in lieu thereof "or any provision of paragraph (3) of this subsection".

SEC. 104. EFFECT ON CERTAIN STATE LAWS.

Section 13 of the Bank Holding Company Act of 1956 (12 U.S.C. 1846) (as redesignated by section 2(b) of this Act) is amended—

(1) by striking out "No provision of this Act" and inserting in lieu thereof "(a) IN GENERAL.—No provision of this Act"; and

(2) by adding at the end thereof the following new subsection:

"(b) EXCEPTION ALLOWING STATE BANK AFFILIATION WITH SECURITIES SUBSIDIARIES.—No State may prohibit the affiliation of a bank or prohibit the affiliation of a bank holding company with a qualified securities subsidiary solely because the securities subsidiary is engaged in activities described in section 5(a) of this Act.".

SEC. 105. BANK HOLDING COMPANY FORMATION THROUGH REORGANIZATIONS.

(a) EXCEPTION TO APPROVAL REQUIREMENTS IN CONNECTION WITH CERTAIN BANK REORGANIZATIONS.—The second sentence of section 3(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(a)) is amended—

(1) by striking out "or (B)" and inserting in lieu thereof "(B)"; and

(2) by inserting before the period at the end thereof the following: "; or (C) the acquisition by a company of control of a bank in connection with a reorganization described in paragraph (1) of subsection (h) if the requirements of such subsection are met".

(b) EXPEDITED PROCEDURES FOR CERTAIN REORGANIZATIONS OF BANKS INTO HOLDING COMPANIES.—Section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842) is amended by adding at the end thereof the following new subsection:

"(h) EXPEDITED PROCEDURES FOR CERTAIN REORGANIZATIONS OF BANKS INTO HOLDING COMPANIES.—

"(1) REORGANIZATION DESCRIBED.—For purposes of subparagraph (C) of the second sentence of subsection (a), a reorganization is described in this paragraph if—

"(A) any person or any group of persons exchange the shares of a bank which are held by any such person for shares of a newly formed bank holding company;

"(B) each such person holds, after such exchange, substantially the same proportionate interest in the bank holding company as each such person held in the bank before such exchange other than any change in the shareholders' proportionate interest in such holding company which resulted from the exercise of dissenting shareholders' rights under State or Federal law; and

"(C) immediately following the reorganization, the resulting bank holding company meets the capital and other financial standards prescribed by the Board by regulation for a bank holding company.

"(2) EXPEDITED PROCEDURE.—The exception provided by subparagraph (C) of the second sentence of subsection (a) to the approval requirement of such subsection shall apply with respect to a reorganization described in paragraph (1) of this subsection, if—

"(A) the bank referred to in paragraph (1)(A) provides notice to the Board of such reorganization at least 30 days before the date on which such reorganization is scheduled to begin; and

"(B) the Board has not—

"(i) issued an order before such date disapproving such reorganization; or

"(ii) issued a notice before such date that the provisions of this subsection are not applicable to such reorganization by reason of paragraph (3).

"(3) EXCEPTION IN CASE OF CERTAIN NONBANKING ACTIVITIES.—This subsection shall not apply to any reorganization described in paragraph (1) if, as a result of such reorganization,

the bank holding company would be engaging in any activity other than banking or managing and controlling banks.

"(4) CAPITAL REQUIREMENT.—In promulgating regulations pursuant to this subsection, the Board shall not require more capital for the subsidiary bank resulting from a reorganization described in paragraph (1) of this subsection immediately following such reorganization than is required for a similarly sized bank that is not a subsidiary of a bank holding company.".

SEC. 106. EXPEDITED PROCEDURES FOR BANK HOLDING COMPANIES TO SEEK APPROVAL TO ENGAGE IN CERTAIN NONBANKING ACTIVITIES.

(a) IN GENERAL.—Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843) is amended by adding at the end thereof the following new subsection:

"(i) EXPEDITED APPROVAL FOR NONBANKING ACTIVITIES.—

"(1) NOTICE REQUIREMENT.—Except as provided in paragraph (2), no bank holding company shall engage, directly or indirectly, in any activity or acquire the shares of any company pursuant to any paragraph of subsection (c) which requires an application or notice to the Board, other than paragraph (15), either de novo or by an acquisition, in whole or in part, of a going concern, unless—

"(A) the Board has been given 60 days prior written notice of such company's intention to engage in such activity or acquire such shares; and

"(B) within the 60-day period described in subparagraph (A), the Board has not issued an order—

"(i) disapproving the proposal; or

"(ii) extending the period within which the Board may disapprove the proposal in accordance with paragraph (5).

"(2) EXCEPTIONS.—

"(A) BOARD NOTICE OF INTENT BEFORE END OF DISAPPROVAL PERIOD.—An acquisition may be made prior to the expiration of the period described in paragraph (1)(A) (or extended in accordance with paragraph (5)) for disapproving such acquisition if the Board issues a written statement that the Board does not intend to disapprove the proposal.

"(B) BOARD EXCEPTION FOR EMERGENCY ACQUISITIONS.—The Board may provide, by regulation or order, for no notice under this subsection, or notice for a shorter period of time, with respect to—

"(i) a notice under paragraph (1) involving a thrift institution if—

"(I) the Board determines an emergency exists; and

"(II) the primary Federal regulator of such thrift institution concurs in the Board's determination; or

"(ii) nonbanking activities involved in an acquisition pursuant to section 13(f) of the Federal Deposit Insurance Act.

"(C) CHANGE IN METHOD OF ENGAGING IN PREVIOUSLY AUTHORIZED ACTIVITIES.—No notice under this paragraph is required for a bank holding company to establish de novo an office to engage in any activity previously authorized for that bank holding company under this paragraph or to change the location of an office engaged in that activity.

"(3) CONTENTS OF NOTICE.—The notice submitted to the Board shall contain such information as the Board shall prescribe by regulation.

"(4) ADDITIONAL INFORMATION.—The Board may, by specific request in connection with a particular notice, require additional information with respect to such notice, except that the Board may require only such information as may be relevant to—

"(A) the nature and scope of the proposed activity or acquisition; and

"(B) the Board's evaluation of the notice under the criteria specified in paragraph (6).

"(5) EXTENSION OF DISAPPROVAL PERIOD.—If, in connection with a particular notice, the Board requests additional relevant information pursuant to paragraph (4), the Board may by order provide that the Board shall have an additional period (not to exceed 60 days beginning on the date the Board receives such information) within which to disapprove the proposed activity or acquisition.

"(6) CRITERIA FOR DISAPPROVAL.—In considering a notice under this subsection, the Board shall consider (in addition to the requirements contained in the applicable paragraph of subsection (c) or any applicable provision of section 6 or 7) whether the performance of the activity or the acquisition described in the notice by a bank holding company, or a subsidiary of such holding company, can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

"(7) DIFFERENTIATION BETWEEN ESTABLISHMENT DE NOVO AND ACQUISITION OF ONGOING CONCERN.—In issuing orders and prescribing regulations under subsection (c) with respect to activities or acquisitions referred to in paragraph (1) of this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern.".

(b) TECHNOLOGICAL ADVANCES TO BE CONSIDERED IN SECTION 4(c)(8) DETERMINATIONS.—Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by inserting ", after taking into account technological and other innovations in the provision of banking products or services" before "as to be a proper incident thereto,".

SEC. 107. MONITORING OF FOREIGN EXCHANGE OPERATIONS OF BANK HOLDING COMPANIES.

Section 12 of the Bank Holding Company Act of 1956 (as redesignated by section 2(b) of this Act) is amended by adding at the end thereof the following new subsection:

"(g) MONITORING AND SUPERVISION OF FOREIGN CURRENCY OPERATIONS WITHIN BANK HOLDING COMPANIES.—

"(1) MONITORING REQUIRED.—

"(A) IN GENERAL.—The Board shall monitor and, as appropriate, supervise on an ongoing basis the foreign currency exchange operations, including currency swap transactions, of bank holding companies and nonbank, bank, and insured institution subsidiaries of bank holding companies, including subsidiaries of such subsidiaries.

"(B) REPORTS AND EXAMINATIONS AUTHORIZED.—The Board may require such reports to be made by, and such examinations to be conducted of, bank holding companies and subsidiaries of bank holding companies as the Board may determine to be appropriate to carry out the purposes of this subsection.

"(C) CERTAIN FACTORS TO BE CONSIDERED.—In carrying out this subsection, the Board shall consider the following factors:

"(i) The extent of the exposure to risks associated with foreign currency operations.

"(ii) The extent to which the exposure to such risks is minimized through risk diversification.

"(iii) Operational capabilities.

"(iv) Managerial expertise.

"(2) PROTECTION OF SAFETY AND SOUNDNESS OF BANKS AND INSURED INSTITUTIONS.—The Board may, after consultation with the Securities and Exchange Commission, limit the extent to which any bank holding company may, directly or indirectly, engage in foreign currency exchange operations, including currency swaps, whenever such limitations are appropriate to protect the safety and soundness of any bank or insured institution subsidiary of a bank holding company from the risks associated with such operations.

"(3) PROMOTION OF SOUND FOREIGN CURRENCY EXCHANGE OPERATIONS.—The Board, after consultation with the Comptroller of the Currency and the Securities and Exchange Commission, may require such changes in the manner in which any foreign currency exchange operations are conducted by any bank holding company or by any subsidiary of any bank holding company as may be necessary to—

"(A) limit exposure to risks associated with foreign currency operations;

"(B) achieve further risk diversification;

"(C) increase operational capabilities; or

"(D) improve the managerial expertise involved in conducting such operations.".

SEC. 108. REGULATIONS; EFFECTIVE DATE.

(a) REGULATIONS.—

(1) IMPLEMENTATION REPORT TO CONGRESS.—The Board of Governors of the Federal Reserve System and the Comptroller of the Currency shall each submit a report to Congress containing proposed regulations required to be prescribed by such Board or the Comptroller of the Currency to implement the amendments made by this title to the Bank Holding Company Act of 1956 and to section 5136 of the Revised Statutes before the end of the 90-day period beginning on the date of the enactment of this title.

(2) FINAL REGULATIONS.—The final regulations required to implement the amendments made by this title to the Bank Holding Company Act of 1956 and section 5136 of the Revised Statutes shall be prescribed and published before the end of the 150-day period beginning on the date of the enactment of this Act.

(b) EFFECTIVE DATE.—The amendments made by this title shall take effect at the end of the 180-day period beginning on the date of the enactment of this Act.

Page 57, beginning on line 6, strike out all of title II through page 82, line 5, and insert the following:

# TITLE II—SAFEGUARD PROVISIONS FOR BANK SAFETY, INVESTOR AND CONSUMER PROTECTION, AND FAIR COMPETITION

## PART A—SAFEGUARD PROVISIONS ENFORCED BY FEDERAL DEPOSITORY INSTITUTIONS REGULATORY AGENCIES

### SEC. 201. BANK SAFETY AND SOUNDNESS.

The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by inserting before section 12 (as redesignated by section 2(b) of this Act) the following new section:

"SEC. 9. SAFEGUARD PROVISIONS AND OTHER REQUIREMENTS APPLICABLE IN THE CASE OF BANK HOLDING COMPANIES WITH SECURITIES SUBSIDIARIES.

"(a) CERTAIN FINANCIAL TRANSACTIONS INVOLVING BANKS, ETC., AND SECURITIES AFFILIATES PROHIBITED.—In the case of a bank holding company which controls a securities subsidiary, no bank or insured institution subsidiary of such bank holding company, and no subsidiary of any such bank or insured institution, may engage, directly or indirectly, in any of the following transactions involving any securities subsidiary which is an affiliate of such bank, insured institution, or subsidiary:

"(1) Except as provided in subsection (j) of this section, extend credit in any manner to the securities subsidiary.

"(2) Issue a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, for the benefit of the securities subsidiary.

"(3) Purchase for the bank or insured institution's own account, or the account of any subsidiary of the bank or insured institution, any asset of the securities subsidiary.

"(4) Purchase for the bank or insured institution's own account, or the account of any subsidiary of the bank or insured

institution, any security of which the securities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period.

"(5) Purchase, in the bank's, insured institution's, or subsidiary's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates with respect to the account of a customer, any security of which the securities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period, except at the express request of the customer.

"(6) Purchase, in the bank, insured institution, or subsidiary's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates, any security—

"(A) which is issued by an investment company for which such bank, insured institution, or subsidiary acts as investment adviser, or

"(B) which is issued by an investment company and which is distributed by such bank, insured institution, or affiliate,

except that the Securities and Exchange Commission may, by rule or order, grant such exemptions from this paragraph as it considers necessary or appropriate in the public interest or for the protection of investors.

"(7) Extend credit in any manner to any investment company—

"(A) for which the securities subsidiary, bank, insured institution, or subsidiary of the bank or insured institution acts as investment adviser; or

"(B) whose securities are distributed by the securities subsidiary, bank, insured institution, or subsidiary of the bank or insured institution;

except as permitted pursuant to section 18(f)(3) of the Investment Company Act of 1940.

"(8) Except as provided in subsection (h) of this section, sell any asset of the bank, insured institution, or subsidiary to the securities subsidiary or to any investment company for which the securities subsidiary acts as investment adviser.

"(9) Extend credit to an issuer of securities of which the securities subsidiary is an underwriter—

"(A) for the purpose of paying, in whole or in part, the principal of, or any interest or dividends on, those securities; or

"(B) providing terms, conditions, or maturities that are substantially similar to those of the underwritten securities.

"(10) Extend credit, arrange for the extension of credit, or issue or enter into a standby letter of credit, asset purchase agreement, indemnity, guarantee, insurance, or other instrument or facility, for the purpose of enhancing the marketability of, or in connection with, the issuance of any security of which the securities subsidiary is an underwriter or member of a selling group.

"(11) Accept, as collateral for any extension of credit to any person, securities issued by the securities subsidiary or by an investment company for which the securities subsidiary acts as investment adviser.

"(b) CERTAIN FINANCIAL TRANSACTIONS DURING DISTRIBUTION PERIOD FOR CERTAIN NEW ISSUES PROHIBITED.—No bank holding company and no subsidiary of any bank holding company (other than a securities subsidiary) may, directly or indirectly, knowingly extend credit or arrange for the extension of credit, to any person, which is secured by or which is extended for the purpose of purchasing any security during the period, and for 30 days after the end of the period, in which such security is the subject of a distribution in which a securities subsidiary of such bank holding company participates as an underwriter or a member of a selling group.

"(c) ARMS-LENGTH TRANSACTIONS BETWEEN BANKS, ETC., AND CUSTOMERS OF SECURITIES AFFILIATE REQUIRED.—

"(1) IN GENERAL.—A bank or insured institution subsidiary of a bank holding company, and any subsidiary of any such bank or insured institution, may provide products or services to any customer of a securities subsidiary of such bank holding company only if such products or services are provided on terms and under circumstances (including credit and similar standards) which meet the following requirements:

"(A) The products or services are provided to customers of the securities subsidiary on terms and under circumstances (including credit and similar standards) which are substantially the same as, or at least as favorable to such bank, insured institution, or subsidiary as, the terms on which and the circumstances (including credit and similar standards) under which such products and services are provided to customers of such bank, insured institution, or subsidiary who are not customers of the securities subsidiary.

"(B) If such bank, insured institution, or subsidiary does not provide such products or services to any person other than customers of the securities subsidiary, the products or services are provided on terms and under circumstances (including credit and similar standards) that in good faith would be offered to, or would apply to transactions with, persons who are not customers of the securities subsidiary.

"(2) CUSTOMER.—Any person who obtains any product or service from any company shall be treated as a customer of such company, for purposes of paragraph (1), during any 12-month period beginning on any date such person pays or becomes obligated to pay compensation to such company for such product or service.

"(d) DISCLOSURES OF CONFIDENTIAL CUSTOMER INFORMATION BY BANKS, ETC., TO SECURITIES AFFILIATES PROHIBITED.—

"(1) IN GENERAL.—No bank or insured institution subsidiary of any bank holding company which controls a securities subsidiary, and no subsidiary of any such bank or insured institution, may disclose, directly or indirectly, any confidential customer information to any securities subsidiary of such holding

company without the express written consent of that customer to the disclosure of the specific information concerned for a particular purpose.

"(2) CONFIDENTIAL CUSTOMER INFORMATION DEFINED.—For purposes of paragraph (1) of this subsection, the term 'confidential customer information' means information, including any evaluation of creditworthiness—

"(A) concerning or acquired from a customer of a bank or insured institution, or any subsidiary of the bank or insured institution, by reason of a business relationship with the customer of a type which would not, in the ordinary course of business, be divulged to a company engaged in securities and securities-related activities of which such bank, insured institution, or subsidiary is not an affiliate without the consent of the customer; or

"(B) obtained through access to the payment system.

"(e) PROHIBITION ON SHARED NAME, PREMISES, AND ADVERTISING.—

"(1) NAMES.—The corporate name and logo of any bank or insured institution subsidiary of a bank holding company which controls a securities subsidiary, or any subsidiary of any such bank or insured institution, may not contain any word or design which—

"(A) is the same as or similar to a word in, or a design connected with, the name or logo of such securities subsidiary; and

"(B) would cause a reasonable person to believe that such bank or insured institution, or any subsidiary of such bank or insured institution, is an affiliate of such securities subsidiary.

"(2) PREMISES.—No bank or insured institution subsidiary which is an affiliate of a securities subsidiary, and no subsidiary of any such bank or insured institution, may permit any use by such securities subsidiary of—

"(A) any part of any office of such bank or insured institution, or such subsidiary of such bank or insured institution, which is commonly accessible to the general public for the purpose of conducting any depository, lending, or securities business with such bank, insured institution, or subsidiary; or

"(B) any part of any office of such bank, insured institution, or subsidiary which is not described in subparagraph (A) except to the extent permitted under regulations prescribed by the Board.

"(3) JOINT ADVERTISING.—No bank or insured institution which is an affiliate of a securities subsidiary, and no subsidiary of any such bank or insured institution, may post, publish, or broadcast any advertisement relating to the bank or insured institution, or any subsidiary of such bank or insured institution, which contains, appears with, or is prepared for broadcast in conjunction with, any advertisement relating to such securities subsidiary.

"(4) REGULATIONS.—The Board, with the approval of the Securities and Exchange Commission, shall prescribe such regu-

lations as may be necessary to enforce the requirements of this subsection.

"(f) PROHIBITION ON RECIPROCAL ARRANGEMENTS.—

"(1) IN GENERAL.—No bank holding company and no subsidiary of a bank holding company may, directly or indirectly, enter into any reciprocal arrangement.

"(2) RECIPROCAL ARRANGEMENT DEFINED.—For purposes of this subsection, the term 'reciprocal arrangement' means any agreement, understanding, or other arrangement under which—

"(A) one bank holding company (or subsidiary of such bank holding company) agrees to engage in a transaction with, or on behalf of, another bank holding company (or subsidiary of such holding company), in exchange for

"(B) the agreement of the second bank holding company referred to in subparagraph (A) of this paragraph, or any subsidiary of such company, to engage in a transaction with, or on behalf of, the first bank holding company referred to in such subparagraph, or any subsidiary of such company,

for the purpose of evading any requirement or prohibition on transactions between, or for the benefit of, affiliates of bank holding companies established under or pursuant to any Federal banking law or regulation.

"(3) REGULATIONS.—The Board, with the approval of the Securities and Exchange Commission, shall prescribe such regulations as may be necessary to enforce the requirements of this subsection.

"(g) PROTECTION OF BANK, ETC. SUBSIDIARY THROUGH PROHIBITION ON INTERLOCKING DIRECTORS, OFFICERS, OR EMPLOYEES.—

"(1) IN GENERAL.—No bank holding company may allow any director, officer, or employee of any securities subsidiary of such bank holding company to serve at the same time as a director, officer, or employee of any bank or insured institution subsidiary of such bank holding company or any subsidiary of any such bank or insured institution.

"(2) BOARD AUTHORITY TO PREEMPT PARAGRAPH (1).—

"(A) IN GENERAL.—The Board may, by order or regulation with the approval of the Securities and Exchange Commission, grant exemptions from paragraph (1) of this subsection.

"(B) FACTORS TO BE CONSIDERED.—In determining whether to grant an exemption under subparagraph (A), the Board shall consider—

"(i) the size of the bank holding companies involved and the size of the bank subsidiaries and securities subsidiaries involved;

"(ii) any burdens imposed by the application of paragraph (1);

"(iii) the safety and soundness of the bank subsidiaries and the securities subsidiaries of such bank holding companies; and

"(iv) other appropriate factors, including unfair competition in securities activities and the improper exchange of confidential customer information.

"(3) EXCEPTION FOR CERTAIN BACK OFFICE OPERATIONS.—Paragraph (1) shall not apply to any employee, other than an officer or director, employed by the bank holding company or any subsidiary of such company to perform clerical, accounting, bookkeeping, statistical, or similar functions, including the receipt or transmittal of electronic transfers, if such functions are performed—

"(A) in an office or other facility which is separate from any part of any office of any bank or insured institution subsidiary and any qualified securities subsidiary of such bank holding company; and

"(B) in a manner which is consistent with the requirements of this section as determined by the Board with the approval of the Securities and Exchange Commission.

"(h) ASSET SALES TO SECURITIES SUBSIDIARY.—

"(1) IN GENERAL.—A bank or insured institution subsidiary of a bank holding company, and any subsidiary of such bank or insured institution, may, notwithstanding subsection (a)(8) of this section but subject to section 23B of the Federal Reserve Act, sell any asset of such bank, insured institution, or subsidiary to any securities subsidiary of such holding company for the purpose of including such asset in a pool of assets which is held by the securities subsidiary in connection with the issuance of asset-backed securities if—

"(A) the sale of such asset to the securities subsidiary is without recourse;

"(B) the asset-backed securities which represent interests in, or obligations backed by, the pool of assets of which such asset is a part—

"(i) are rated as investment grade by at least one independent and nationally recognized statistical rating organization; or

"(ii) are issued or guaranteed by, or represent an interest in securities issued or guaranteed by—

"(I) the Federal Home Loan Mortgage Corporation;

"(II) the Federal National Mortgage Association; or

"(III) the Government National Mortgage Association; and

"(C) the price at which an equity security or the yield at which a debt security is to be distributed to the public is established at a price no higher, or yield no lower, than that recommended by a qualified independent underwriter which has also participated in the preparation of the registration statement and the prospectus, offering circular, or similar document.

"(2) REGULATIONS.—The Board, with the approval of the Securities and Exchange Commission, shall prescribe such regulations as may be necessary to ensure that transactions de-

scribed in paragraph (1) comply with the requirements of this subsection and section 23B(a)(1) of the Federal Reserve Act.

"(3) ASSET DEFINED.—For purposes of this subsection, the term 'asset' means any note, draft, acceptance, loan, lease, receivable, other obligation, or pools of any such obligations.

"(4) QUALIFIED INDEPENDENT UNDERWRITER.—For purposes of this subsection, the term 'qualified independent underwriter' shall be defined by rule or regulation prescribed by the Securities and Exchange Commission.

"(i) SHAREHOLDERS IN BANKERS' BANK HOLDING COMPANY, ETC., TREATED AS AFFILIATES OF SECURITIES SUBSIDIARY.—

"(1) IN GENERAL.—In the case of any bank holding company which controls a depository institution described in section 19(b)(1)(A)(vii) of the Federal Reserve Act and a qualified securities subsidiary, any company which owns any interest in or participates in the activities of such bank holding company or depository institution, and any subsidiary of any such company, shall be treated as a bank or insured institution subsidiary of such bank holding company for purposes of this section (and any provision of section 14, 15, or 16 which is applicable to any proceeding relating to the enforcement of this section).

"(2) EXCEPTION.—Paragraph (1) shall not apply with respect to any bank, and any affiliate of such bank, if the aggregate amount of the interests held by such bank and all affiliates of such bank in a bank holding company or depository institution described in such paragraph do not exceed 5 percent of all interests in such bank holding company or depository institution.

"(j) EXCEPTION FOR INTRA-DAY EXTENSIONS OF CREDIT IN CONNECTION WITH CLEARING GOVERNMENT SECURITIES.—Subsection (a)(1) of this section shall not apply with respect to any extension of credit by any bank or insured institution subsidiary of a bank holding company, or any subsidiary of any such bank or insured institution, made for the purchase or sale of any securities of the United States or any agency of the United States or any securities on which the principal and interest are fully guaranteed by the United States or such agencies if—

"(1) the extension of credit is to be repaid on the same calendar day;

"(2) the extension of credit is incidental to the clearing of transactions in those securities through such bank, insured institution, or subsidiary; and

"(3) both the principal of and the interest on the extension of credit are fully secured by securities of the United States or any agency of the United States or securities on which the principal and interest are fully guaranteed by the United States or any such agency.

"(k) DISCRIMINATORY TREATMENT OF SECURITIES FIRMS THAT ARE NOT AFFILIATED WITH BANKING ORGANIZATIONS PROHIBITED.—No bank or insured institution shall, directly or indirectly, acting alone or with others—

"(1) extend or deny credit or services (including clearing services) or vary the terms or conditions thereof, if the effect of such action would be to treat securities firms not affiliated with a bank or an insured institution less favorably than any

securities subsidiary of a bank holding company, unless the bank or insured institution demonstrates that the extension or denial is based on objective criteria and is consistent with sound business practices; or

"(2) extend or deny credit or services or vary the terms or conditions thereof with the intent of creating a competitive advantage for a securities subsidiary of a bank holding company.

"(l) INDEPENDENT ANNUAL AUDITS OF BANK HOLDING COMPANIES AND THEIR BANK OR OTHER INSURED INSTITUTION AND SECURITIES SUBSIDIARIES.—

"(1) ANNUAL INDEPENDENT AUDITS OF FINANCIAL STATEMENTS.—Each bank holding company which controls a securities subsidiary, and each bank or other insured institution subsidiary of such bank holding company, shall have an annual audit made of its consolidated financial statements by an independent public accountant in accordance with generally accepted auditing standards. The Board may, by order or regulation, grant exemptions from the requirements of this subsection to any bank holding company with respect to any bank or other insured institution subsidiary in accordance with criteria in paragraph (2) of this subsection.

"(2) FACTORS TO BE CONSIDERED BY BOARD IN EXERCISE OF EXEMPTION AUTHORITY.—In making a determination to grant an exemption with respect to a bank or other insured institution subsidiary pursuant to paragraph (1) of this subsection, the Board shall consider—

"(A) the size of the securities subsidiary and bank or other insured institution subsidiary involved;

"(B) the cost of complying with the audit and reporting requirements of this section;

"(C) the safety and soundness of the bank or insured institution subsidiary; and

"(D) other appropriate factors, including the number of securities transactions, the dollar volumes of such transactions, and the extent to which a bank or other insured institution subsidiary's financial results are evaluated as part of an audit of a bank holding company under this section.

"(3) FILING OF AUDIT REPORT.—Each bank holding company, bank, or other insured institution which is subject to the audit requirements of this subsection shall file with the appropriate Federal depository institutions regulatory agency an annual report containing the financial statements audited in accordance with paragraph (1) of this subsection.

"(4) MANAGEMENT STATEMENT REQUIRED.—Such annual report shall also include a statement, in such form as the Board shall prescribe by rule or regulation, concerning—

"(A) management's responsibilities for the preparation of the financial statements of the bank holding company, bank, or insured institution; and

"(B) management's responsibilities for establishing and maintaining an adequate system of internal controls relating to the financial statements and to controls directly related to, and designed to provide reasonable assurance as

to compliance with, the preceding subsections of this section.".

SEC. 202. CONSUMER DISCLOSURE REQUIREMENTS.

The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by inserting after section 9 (as added by section 201 of this title) the following new section:

"SEC. 10. CONSUMER DISCLOSURE REQUIREMENTS.

"(a) IN GENERAL.—No bank or insured institution subsidiary of a bank holding company, and no subsidiary of such bank or insured institution, shall provide an opinion to any customer on the value of, or the advisability of purchasing or selling, securities of which a securities subsidiary or other nonbank affiliate of such bank holding company is an underwriter or which such securities subsidiary or affiliate sells, or offers for sale, to the customer unless such bank, insured institution, or subsidiary discloses to the customer that—

"(1) the securities subsidiary or affiliate is an affiliate of such bank, insured institution, or subsidiary;

"(2) the securities subsidiary or affiliate—

"(A) is not a bank or insured institution; and

"(B) is a separate corporate entity with respect to any bank or insured institution (or any subsidiary of such bank or insured institution) which is an affiliate of such securities subsidiary or affiliate; and

"(3) the securities underwritten, sold, offered, or recommended by the securities subsidiary or affiliate—

"(A) are not deposit instruments which are federally insured;

"(B) are not instruments which are guaranteed either as to principal or interest by a bank or insured institution affiliate of such subsidiary or affiliate; and

"(C) are not otherwise obligations of any bank or insured institution.

"(b) LIMITATION.—Nothing in this section shall be construed to permit a bank or insured institution to engage in securities activities prohibited by section 5 of this Act.".

SEC. 203. ADMINISTRATIVE ENFORCEMENT AND PENALTIES FOR VIOLATIONS.

(a) IN GENERAL.—Section 14 of the Bank Holding Company Act of 1956 (12 U.S.C. 1847) (as redesignated by section 2(b) of this Act) is amended by adding at the end thereof the following new subsections:

"(c) CRIMINAL PENALTIES FOR VIOLATION OF SAFEGUARD PROVISIONS.—

"(1) IN GENERAL.—Whoever knowingly violates any provision of section 9, or any regulation prescribed or order issued pursuant to any such provision, shall be fined under title 18, United States Code, or imprisoned for not more than 5 years, or both.

"(2) ALTERNATIVE TERM OF IMPRISONMENT FOR INTENTIONAL VIOLATIONS.—If the defendant intentionally committed the offense under paragraph (1), a term of imprisonment shall be imposed for such offense and such term shall be not less than 2 years nor more than 20 years.

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"(3) ALTERNATIVE FINE.—In lieu of the amount determined under title 18, United States Code, for an offense under paragraph (1)—

"(A) an individual may be fined an amount not to exceed 2 times the annual compensation of such individual at the time of the offense; and

"(B) a person other than an individual may be fined an amount not to exceed .01 percent of the minimum required capital of such person.

"(d) CIVIL MONEY PENALTIES FOR VIOLATION OF SAFEGUARD PROVISIONS.—

"(1) PENALTY ESTABLISHED FOR VIOLATIONS BY INSTITUTIONS.—Any bank holding company or any subsidiary of a bank holding company which violates any provision of section 9, or any regulation prescribed or order issued pursuant to any such provision, shall forfeit and pay a civil penalty of not more than—

"(A) $100,000 for each such violation; and

"(B) an additional $10,000 for each day the violation continues,

except that in no case shall any such amount for any violation or related series of violations exceed 1 percent of the minimum required capital of the bank holding company or subsidiary involved.

"(2) PENALTY ESTABLISHED FOR VIOLATIONS BY INDIVIDUAL.—Any officer, director, employee, or other person participating in the conduct of the affairs of any bank holding company or any subsidiary of a bank holding company who violates any provision of section 9, or any regulation prescribed or order issued pursuant to any such provision, shall forfeit and pay a civil penalty of not more than $10,000 for each day such violation continues.

"(3) PROCEDURE.—Any penalty imposed under paragraph (1) or (2) shall be assessed by the appropriate Federal depository institutions regulatory agency in the same manner as provided in subsection (b) for civil penalties imposed under such subsection and shall be determined, reviewed, and collected in the manner provided in such subsection.

"(e) APPROPRIATE FEDERAL DEPOSITORY INSTITUTIONS REGULATORY AGENCY DEFINED.—For purposes of this section and sections 9, 10, and 15 of this Act, the term 'appropriate Federal depository institutions regulatory agency' means—

"(1) the Comptroller of the Currency, in the case of any national bank, any District bank, or any Federal branch or agency of a foreign bank (as such terms are defined in section 1(b) of the International Banking Act of 1978);

"(2) the Board, in the case of—

"(A) any bank holding company;

"(B) any branch or agency of a foreign bank, other than a Federal branch or agency (as such terms are defined in section 1(b) of the International Banking Act of 1978);

"(C) any State member bank (as defined in section 3(b) of the Federal Deposit Insurance Act); and

"(D) any other subsidiary of a bank holding company;

"(3) the Board of Directors of the Federal Deposit Insurance Corporation, in the case of insured banks that are not members of the Federal Reserve System (except a District bank);

"(4) the Federal Home Loan Bank Board, in the case of any association (as defined in section 2(d) of the Home Owners' Loan Act of 1933); and

"(5) the Federal Savings and Loan Insurance Corporation, in the case of any insured institution (other than a Federal association).".

(b) DIVESTITURE UNDER CERTAIN CIRCUMSTANCES.—Section 12 of the Bank Holding Company Act of 1956 (as redesignated by section 2(b) of this Act) is amended by inserting after subsection (g) (as added by section 107 of this Act) the following new subsection:

"(h) SPECIAL RULE FOR DIVESTITURE OF BANK SUBSIDIARIES FOR CONTINUING COURSE OF MISCONDUCT WITH SECURITIES SUBSIDIARY.—

"(1) NOTICE OF PRELIMINARY DETERMINATION.—

"(A) PRELIMINARY FINDING.—In addition to any other regulatory and supervisory authority of the Board, if the Board has reason to believe that a bank holding company which controls a qualified securities subsidiary, or any subsidiary of such bank holding company, has engaged in a continuing course of conduct involving a violation of section 5 or 9, or regulations prescribed by the Board pursuant to any such section, the Board may make an initial determination that the bank holding company shall be required to terminate such company's control of any bank or insured institution or any subsidiary of such bank or insured institution.

"(B) NOTICE.—The Board shall notify any bank holding company with respect to which a preliminary determination is made under subparagraph (A) of such determination before the end of the 3-day period beginning on the date on which the determination is made.

"(C) CONTENTS OF NOTICE.—Any notice under subparagraph (B) shall contain a statement of the basis for the Board's determination.

"(2) HEARING AND FINAL ORDER.—

"(A) REQUEST FOR HEARING.—Any bank holding company which receives a notice under paragraph (1)(B) of this subsection may request, at any time before the end of the 30-day period beginning on the date of the receipt of such notice, a hearing before the Board.

"(B) ADJUDICATORY PROCEDURE AND FINAL ORDERS.—Any proceeding under this paragraph shall be conducted in accordance with section 554 of title 5, United States Code, and all other provisions of subchapter II of chapter 5 of such title which are applicable with respect to any adjudication required to be determined on a record after opportunity for agency hearing.

"(3) FAILURE TO REQUEST REVIEW.—If any bank holding company which receives a notice under paragraph (1)(B) of this subsection fails to request an agency hearing under paragraph (2)(A) of this subsection, such bank holding company shall be

deemed to have consented to the issuance of a final order affirming the initial finding without the necessity of the hearing provided for in this subsection.

"(4) DIVESTMENT WITHIN TIME SPECIFIED IN ORDER.—If any order issued by the Board under this subsection becomes final and the order affirms the initial finding, the bank holding company shall terminate such company's control of the bank or insured institution, or the subsidiary of such bank or insured institution, specified in such order by the end of the period specified in the order.".

(c) TECHNICAL AND CONFORMING AMENDMENTS.—Section 15 of the Bank Holding Company Act of 1956 (12 U.S.C. 1848) (as redesignated by section 3(b) of this Act) is amended—

(1) in the first sentence—

(A) by inserting "or any appropriate Federal depository institutions regulatory agency under section 9, 10, or 14 of this Act" after "Board under this Act";

(B) by striking out "Board's" and inserting in lieu thereof "Board or such agency's"; and

(C) by striking out "Board be set aside" and inserting in lieu thereof "Board or such agency be set aside"; and

(2) by inserting "or any other appropriate Federal depository institutions regulatory agency" after "Board" each place such term appears (other than in the first sentence).

SEC. 204. REGULATIONS.

(a) IMPLEMENTATION REPORT TO CONGRESS.—The Board of Governors of the Federal Reserve System shall submit a report to Congress containing proposed regulations required to implement the amendments made by this part to the Bank Holding Company Act of 1956 before the end of the 90-day period beginning on the date of the enactment of this title.

(b) FINAL REGULATIONS.—The final regulations required to implement the amendments made by this part shall be prescribed and published before the end of the 150-day period beginning on the date of the enactment of this Act.

## PART B—SAFEGUARD PROVISIONS ENFORCED BY THE SECURITIES AND EXCHANGE COMMISSION

SEC. 211. PROVISIONS RELATING TO CERTAIN BROKER-DEALERS AFFILIATED WITH BANK HOLDING COMPANIES.

The Securities Exchange Act of 1934 is amended by inserting after section 15C (15 U.S.C. 78o–5) the following new section:

"PROVISIONS RELATING TO CERTAIN BROKER-DEALERS AFFILIATED WITH BANK HOLDING COMPANIES

"SEC. 15D. (a) DEFINITIONS.—As used in this section—

"(1) the terms 'bank holding company', 'bank', 'insured institution', 'Board', 'control', 'subsidiary', 'securities subsidiary', 'qualified securities subsidiary', and 'commercial paper' have the meanings provided by section 2 of the Bank Holding Company Act of 1956; and

"(2) the term 'affiliated bank, insured institution, or subsidiary thereof' means, with respect to any securities subsidiary

that is controlled by a bank holding company, a bank or insured institution that is controlled by such bank holding company, or a subsidiary of such bank or insured institution.

"(b) CERTAIN FINANCIAL TRANSACTIONS BETWEEN BROKER-DEALER AND AFFILIATED BANKS, ETC., PROHIBITED.—It shall be unlawful for a securities subsidiary to engage, directly or indirectly, in any of the following transactions involving an affiliated bank, insured institution, or subsidiary thereof:

"(1) Except as provided in subsection (i) of this section, knowingly obtain, receive, or enjoy the beneficial use of, any extension of credit in any manner from an affiliated bank, insured institution, or subsidiary thereof.

"(2) Knowingly receive, obtain, or enjoy the beneficial use of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, from an affiliated bank, insured institution, or subsidiary thereof.

"(3) Knowingly sell to an affiliated bank, insured institution, or subsidiary thereof, for its own account, any asset of the securities subsidiary.

"(4) Knowingly sell to an affiliated bank, insured institution, or subsidiary thereof, for its own account, any security or commercial paper of which the securities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period.

"(5) Knowingly sell to an affiliated bank, insured institution, or subsidiary thereof, in the bank, insured institution, or subsidiary's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates with respect to the account of a customer, any security or commercial paper of which the securities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period, except at the express request of the customer.

"(6) Knowingly sell to an affiliated bank, insured institution, or subsidiary thereof, in the bank, insured institution, or subsidiary's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates with respect to the account of a customer, any security—

"(A) which is issued by an investment company for which such bank, insured institution, or subsidiary acts as investment adviser, or

"(B) which is distributed by such bank, insured institution, or affiliate,

except that the Securities and Exchange Commission may, by rule or order, grant such exemptions from this paragraph as it considers necessary or appropriate in the public interest or for the protection of investors.

"(7) Arrange for the extension of credit from an affiliated bank, insured institution, or subsidiary thereof in any manner to any investment company—

"(A) for which the securities subsidiary, bank, insured institution, or subsidiary of the bank or insured institution acts as investment adviser; or

"(B) whose securities are distributed by the securities subsidiary, bank, insured institution, or subsidiary of the bank or insured institution;

except as permitted pursuant to section 18(f)(3) of the Investment Company Act of 1940.

"(8) Except as provided in subsection (h), purchase any asset of an affiliated bank, insured institution, or subsidiary thereof, either for its own account or for the account of any investment company for which it acts as investment adviser.

"(9) Arrange for the extension of credit from an affiliated bank, insured institution, or subsidiary to an issuer of securities or commercial paper of which the securities subsidiary is an underwriter—

"(A) for the purpose of paying, in whole or in part, the principal of, or any interest or dividends on, those securities or commercial paper; or

"(B) providing terms, conditions, or maturities that are substantially similar to those of the underwritten securities or commercial paper.

"(10) Arrange for the extension of credit from, or arrange for the issuance or entry into of, a standby letter of credit, asset purchase agreement, indemnity, guarantee, insurance, or other instrument or facility by, an affiliated bank, insured institution, or subsidiary thereof for the purpose of enhancing the marketability of, or in connection with, the issuance of any security or commercial paper of which the securities subsidiary is an underwriter or member of a selling group.

"(11) Arrange for the extension of credit from an affiliated bank, insured institution or affiliate thereof on the collateral of securities or commercial paper issued by the securities subsidiary or by an investment company for which the securities subsidiary acts as investment adviser.

"(c) DISCLOSURES OF CONFIDENTIAL CUSTOMER INFORMATION BY SECURITIES SUBSIDIARIES PROHIBITED.—

"(1) IN GENERAL.—It shall be unlawful for a securities subsidiary to disclose, directly or indirectly, any confidential customer information to an affiliated bank, insured institution, or subsidiary thereof without the express written consent of that customer to the disclosure of the specific information concerned for a particular purpose.

"(2) CONFIDENTIAL CUSTOMER INFORMATION DEFINED.—For purposes of paragraph (1) of this subsection, the term 'confidential customer information' means information, including any evaluation of creditworthiness concerning or acquired from a customer of a securities subsidiary, by reason of a business relationship with the customer, of a type which would not, in the ordinary course of business, be divulged to a bank or insured institution without the consent of the customer.

"(d) PROHIBITION ON SHARED NAME, PREMISES, AND ADVERTISING.—

"(1) NAMES.—It shall be unlawful for the corporate name and logo of any securities subsidiary to contain any word or design which—

"(A) is the same as or similar to a word in, or a design connected with, the name or logo of an affiliated bank, insured institution, or subsidiary thereof; and

"(B) would cause a reasonable person to believe that such securities subsidiary is an affiliate of such affiliated bank, insured institution, or subsidiary thereof.

"(2) PREMISES.—It shall be unlawful for a securities subsidiary to use—

"(A) any part of any office of an affiliated bank, insured institution, or subsidiary thereof which is commonly accessible to the general public for the purpose of conducting any depository, lending, or securities business with such bank, insured institution, or subsidiary; or

"(B) any part of any office of such an affiliated bank, insured institution, or subsidiary thereof which is not described in subparagraph (A) except to the extent permitted under regulations prescribed by the Board with the approval of the Commission.

"(3) JOINT ADVERTISING.—It shall be unlawful for any securities subsidiary to post, publish, or broadcast any advertisement relating to such securities subsidiary which contains, appears with, or is prepared for broadcast in conjunction with, any advertisement relating to such an affiliated bank, insured institution, or subsidiary thereof.

"(4) REGULATIONS.—The Board, with the approval of the Securities and Exchange Commission, shall prescribe such regulations as may be necessary to enforce the requirements of this subsection.

"(e) DISCLOSURES OF AFFILIATION REQUIRED.—Each securities subsidiary shall, in accordance with such regulations as the Commission prescribes in the public interest and for the protection of investors, prominently disclose in writing to each of such subsidiary's customers that—

"(1) the securities subsidiary—

"(A) is not a federally insured bank or insured institution; and

"(B) is a separate corporate entity from any bank or insured institution affiliate of such subsidiary; and

"(2) commercial paper and securities underwritten, sold, offered, or recommended by the securities subsidiary—

"(A) are not deposit instruments which are federally insured;

"(B) are not instruments which are guaranteed either as to principal or interest by a bank or insured institution affiliate of such subsidiary; and

"(C) are not otherwise obligations of any bank or insured institution.

"(f) PROHIBITION ON RECIPROCAL ARRANGEMENTS.—It shall be unlawful for any securities subsidiary to enter into or participate in any reciprocal arrangement prohibited by section 9(f) of the Bank Holding Company Act of 1956.

"(g) PROHIBITION ON INTERLOCKING DIRECTORS, OFFICERS, OR EMPLOYEES.—

"(1) IN GENERAL.—It shall be unlawful for any director, officer, or employee of any securities subsidiary of such bank holding company to serve at the same time as a director, officer, or employee of an affiliated bank, insured institution, or subsidiary thereof.

"(2) BOARD AUTHORITY TO PREEMPT PARAGRAPH (1).—

"(A) IN GENERAL.—The Board may, by order or regulation with the approval of the Commission, grant exemptions from paragraph (1) of this subsection.

"(B) FACTORS TO BE CONSIDERED.—In determining whether to grant an exemption under subparagraph (A), the Board shall consider—

"(i) the size of the bank holding companies involved and the size of the bank subsidiaries and securities subsidiaries involved;

"(ii) any burdens imposed by the application of paragraph (1);

"(iii) the safety and soundness of the bank subsidiaries of such bank holding companies; and

"(iv) other appropriate factors, including unfair competition in securities activities and the improper exchange of confidential customer information.

"(3) EXCEPTION FOR CERTAIN BACK OFFICE OPERATIONS.—Paragraph (1) shall not apply to any employee, other than an officer or director, employed by the bank holding company or any subsidiary of such company to perform clerical, accounting, bookkeeping, statistical, or similar functions, including the receipt or transmittal of electronic transfers, if such functions are performed—

"(A) in an office or other facility which is separate from any part of any office of any bank or insured institution subsidiary and any qualified securities subsidiary of such bank holding company; and

"(B) in a manner which is consistent with the requirements of this section as determined by the Board with the approval of the Commission.

"(h) ASSET PURCHASES FROM AFFILIATED BANK, INSURED INSTITUTION, OR SUBSIDIARY THEREOF.—

"(1) IN GENERAL.—A securities subsidiary of a bank holding company may, notwithstanding subsection (a)(7) of this section but subject to section 23B of the Federal Reserve Act, purchase any asset of an affiliated bank, insured institution, or subsidiary thereof for the purpose of including such asset in a pool of assets which is held by the securities subsidiary in connection with the issuance of asset-backed securities if—

"(A) the sale of such asset to the securities subsidiary is without recourse;

"(B) the asset-backed securities which represent interests in, or obligations backed by, the pool of assets of which such asset is a part—

"(i) are rated as investment grade by at least one independent and nationally recognized statistical rating organization; or

"(ii) are issued or guaranteed by, or represent an interest in securities issued or guaranteed by—

"(I) the Federal Home Loan Mortgage Corporation;

"(II) the Federal National Mortgage Association; or

"(III) the Government National Mortgage Association; and

"(C) the price at which an equity security or the yield at which a debt security to be distributed to the public is established at a price no higher, or yield no lower, than that recommended by a qualified independent underwriter which has also participated in the preparation of the registration statement and the prospectus, offering circular, or similar document.

"(2) REGULATIONS.—The Board, with the approval of the Securities and Exchange Commission, shall prescribe such regulations as may be necessary to ensure that transactions described in paragraph (1) comply with the requirements of this subsection and section 23B(a)(1) of the Federal Reserve Act.

"(3) ASSET DEFINED.—For purposes of this subsection, the term 'asset' means any note, draft, acceptance, loan, lease, receivable, other obligation, or pools of any such obligations.

"(4) QUALIFIED INDEPENDENT UNDERWRITER.—For purposes of this subsection, the term 'qualified independent underwriter' shall be defined by regulation prescribed by the Securities and Exchange Commission.

"(i) EXCEPTION FOR INTRA-DAY EXTENSIONS OF CREDIT IN CONNECTION WITH CLEARING GOVERNMENT SECURITIES.—Subsection (b)(1) of this section shall not apply with respect to any extension of credit obtained, received, or used by a securities subsidiary for the purchase or sale of any securities of the United States or any agency of the United States or any securities on which the principal and interest are fully guaranteed by the United States or such agencies if—

"(1) the extension of credit is to be repaid on the same calendar day;

"(2) the extension of credit is incidental to the clearing of transactions in those securities through such bank, insured institution, or subsidiary; and

"(3) both the principal of and the interest on the extension of credit are fully secured by securities of the United States or any agency of the United States or securities on which the principal and interest are fully guaranteed by the United States or any such agency.

"(j) SPECIAL AUDIT REQUIREMENTS.—The annual audit report required under section 17(e) of this title with respect to each securities subsidiary shall include a statement, in such form as the Commission shall prescribe by rule or regulation, concerning—

"(1) management's responsibilities for the preparation of the financial statements of the securities subsidiary;

"(2) management's responsibilities for establishing and maintaining an adequate system of internal controls relating to the financial statements and to controls directly related to, and de-

signed to provide reasonable assurance as to compliance with, the preceding subsections of this section.

"(k) AUTHORITY OF COMMISSION TO PRESCRIBE RULES.—In addition to the regulations prescribed under this section by the Board (with the approval of the Commission), the Commission—

"(1) may adopt such regulations as may be necessary or appropriate in the public interest or for the protection of investors—

"(A) to implement the provisions of this section;

"(B) to define any term used in this section; and

"(C) to prescribe means reasonably designed to prevent any person from evading or circumventing the provisions of this section; and

"(2) may adopt such regulations or orders as may be necessary or appropriate in the public interest or for the protection of investors to exempt any person or transaction or class of persons or transactions as not comprehended within the purposes of this section, in whole or in part, either unconditionally or upon specific terms and conditions.".

SEC. 212. DISCLOSURES IN CONNECTION WITH MUTUAL FUNDS.

Section 17 of the Investment Company Act of 1940 (15 U.S.C. 80a-17) is amended by adding at the end thereof the following new subsection:

"(k) BANK DISCLOSURES IN CONNECTION WITH MUTUAL FUND DISTRIBUTIONS.—Any bank or affiliated person which distributes securities issued by an investment company shall, in accordance with such regulations as the Commission prescribes in the public interest and for the protection of investors, prominently disclose in writing to each of such bank or affiliated person's customers that—

"(1) the investment company—

"(A) is not a federally insured bank; and

"(B) is a separate corporate entity from any bank; and

"(2) the securities of such investment company—

"(A) are not deposit instruments which are federally insured;

"(B) are not instruments which are guaranteed either as to principal or interest by any bank; and

"(C) are not otherwise obligations of any bank.".

SEC. 213. REGISTRATION EXEMPTION FOR SECURITIES COVERED BY CERTAIN GUARANTEES.

(a) AMENDMENT TO THE SECURITIES ACT OF 1933.—Section 3(a) of the Securities Act of 1933 (15 U.S.C. 77c(a)) is amended—

(1) in paragraph (2), by striking out "issued or guaranteed by any bank" and inserting in lieu thereof "issued by any bank";

(2) by striking the period at the end of paragraph (11) and inserting in lieu thereof a semicolon; and

(3) by adding after paragraph (11) the following:

"(12) Any security on which the payment of interest, principal, and any other amounts when due is guaranteed—

"(A) by an insurance contract described in paragraph (8) of this subsection, issued by a corporation which (i) has filed with the Commission such information as would be required to register a class of such corporation's securities

under section 12 of the Securities Exchange Act of 1934, and (ii) after the filing of such information, files with the Commission such information as would be required pursuant to section 13 of that Act with respect to a class of securities registered pursuant to section 12 of that Act; or

"(B) by a guarantee issued by a bank which (i) has filed with the appropriate regulatory agency (as that term is defined in section 3(a)(34) of that Act) such information as would be required to register a class of such bank's securities under section 12 of the Securities Exchange Act of 1934, and (ii) after the filing of such information, files with the Commission such information as would be required pursuant to section 13 of that Act with respect to a class of securities registered pursuant to section 12 of that Act;

subject to such rules and regulations as the Commission may prescribe in the public interest or for the protection of investors.".

(b) AMENDMENT TO THE TRUST INDENTURE ACT OF 1939.—Section 304(a)(4)(A) of the Trust Indenture Act of 1939 (15 U.S.C. 77ddd(a)(4)(A)) is amended by striking "or (11)" and inserting in lieu thereof "(11), or (12)".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect one year after the date of enactment of this Act, except that the authority of the Commission to prescribe rules or regulations pursuant to section 3(a)(12) of the Securities Exchange Act of 1934 (as added by subsection (a) of this section) shall take effect on such date of enactment.

## PART C—ADDITIONAL INVESTOR PROTECTIONS

### Subpart 1—Broker-Dealer Provisions

**SEC. 221. DEFINITION OF BROKER.**

Section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)) is amended to read as follows:

"(4)(A) The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others.

"(B) A bank shall not be deemed to be a 'broker' because it engages in one or more of the following activities:

"(i) engages in trust activities (including effecting transactions in the course of such trust activities) permissible for national banks under the first section of the Act of September 28, 1962 (12 U.S.C. 92a) or for State banks under relevant State trust statutes of law unless the bank—

"(I) publicly solicits brokerage business other than by advertising, in conjunction with advertising its other trust activities, that it effects transactions in securities, or

"(II) is compensated for such business by the payment of commissions or similar remuneration based on effecting transactions in securities (excluding fees calculated as percentage of assets under management)

in excess of the bank's incremental costs directly attributable to effecting such transactions;

except that this clause does not apply to securities safekeeping, self-directed individual retirement accounts, or managed agency or other functionally equivalent accounts of a bank;

"(ii) effects transactions in exempted securities, other than municipal securities, or in commercial paper, bankers' acceptances, or commercial bills; and

"(iii) effects transactions in municipal securities and is not an affiliate of a qualified securities subsidiary as defined in section 2(n)(1) of the Bank Holding Company Act of 1956.".

SEC. 222. DEFINITION OF DEALER.

Section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(5)) is amended to read as follows:

"(5)(A) The term 'dealer' means any person engaged in the business of buying and selling securities for his own account through a broker or otherwise.

"(B) Such term does not include—

"(i) any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business; or

"(ii) any bank insofar as the bank (I) buys and sells commercial paper, bankers' acceptances, or commercial bills, or exempted securities other than municipal securities; (II) buys and sells municipal securities and is not an affiliate of a qualified securities subsidiary as defined in section 2(n)(1) of the Bank Holding Company Act of 1956; or (III) buys and sells securities for investment purposes in the course of trust activities.".

SEC. 223. POWER TO EXEMPT FROM THE DEFINITIONS OF BROKER AND DEALER.

Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c) is amended by adding at the end the following:

"(e) The Commission, by rule, regulation, or order, upon its own motion or upon application, may conditionally or unconditionally exempt any person or class of persons from the definitions of 'broker' or 'dealer,' if the Commission finds that such exemption is consistent with the public interest, the protection of investors, or the purposes of this title.".

SEC. 224. REQUIREMENT THAT BANKS FALLING WITHIN THE DEFINITIONS OF BROKER OR DEALER PLACE THEIR SECURITIES ACTIVITIES IN A SEPARATE CORPORATE ENTITY.

Section 15(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(a)) is amended to read as follows:

"SEC. 15. (a)(1) It shall be unlawful for any broker or dealer that is either a person other than a natural person or a natural person not associated with a broker or dealer that is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any

transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this section.

"(2) It shall be unlawful for any bank to act as a broker or dealer, except in the course of an exclusively intrastate business. This section shall not preclude a subsidiary of a bank or an affiliate of a bank holding company other than a bank, as those terms are defined in the Bank Holding Company Act of 1956, that is registered in accordance with subsection (b) of this section from acting as a broker or dealer to any extent otherwise permissible by law.

"(3) The Commission, by rule or order, as it deems consistent with the public interest and the protection of investors, may conditionally or unconditionally exempt from paragraphs (1) and (2) of this subsection any broker or dealer or class of brokers or dealers specified in such rule or order.".

### Subpart 2—Bank-Investment Company Activities

## SEC. 241. CUSTODY OF INVESTMENT COMPANY ASSETS BY AFFILIATED BANKS.

Section 17(f) of the Investment Company Act of 1940 (15 U.S.C. 80a-17(f)) is amended—

(1) by redesignating clauses (1), (2), and (3) of the first sentence as clauses (A), (B), and (C), respectively;

(2) by designating the five sentences of such section as paragraphs (1) through (5), respectively;

(3) by adding at the end thereof the following new paragraph:

"(6) Notwithstanding paragraph (1)(A) of this subsection, if a bank or banks described in such paragraph, or affiliated person thereof, is an affiliated person of the registered management company, such bank may not serve as custodian under this subsection except in accordance with such rules, regulations, and orders as the Commission prescribes consistent with the protection of investors.".

SEC. 242. AFFILIATED PERSONS AND TRANSACTIONS.

(a) AFFILIATED PERSONS.—Section 2(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3)) is amended by—

(1) striking "thereof; and" and inserting in lieu thereof "thereof;"; and

(2) by inserting before the period at the end of clause (F) the following: "; and (G) if such other person is an investment company, any person or class of persons which the Commission by order or rule or regulation shall have determined to be affiliated persons by reason of having had, at any time since the beginning of the last two completed fiscal years of such company, a material business or professional relationship with such company or with any person that is a principal underwriter for, or promoter or sponsor of, such company or any affiliated person (as described in clauses (A) through (F) of this paragraph) of such company".

(b) PURCHASES OR ACQUISITIONS DURING UNDERWRITING.—Section 10(f) of the Investment Company Act of 1940 (15 U.S.C. 80a-10(f)) is amended by—

(1) inserting "(1)" immediately before "a principal underwriter" the first place it appears; and

(2) inserting after "for the issuer" the following: "; or (2) the proceeds of which will be used to retire any part of an indebtedness owed to a bank where the bank or an affiliated person thereof is an affiliated person of such registered company".

SEC. 243. BORROWING FROM AN AFFILIATED BANK.

Section 18(f) of the Investment Company Act of 1940 (15 U.S.C. 80a-18(f)) is amended by adding a new paragraph (3) at the end thereof to read as follows:

"(3) Notwithstanding the provisions of paragraph (1) of this subsection, it shall be unlawful for any registered open-end company to borrow from any bank if such bank or any affiliated person thereof is an affiliated person of such company, except that the Commission may, by rule, regulation, or order, permit such borrowing which the Commission finds to be in the public interest and consistent with the protection of investors.".

SEC. 244. INDEPENDENT DIRECTORS.

(a) DEFINITION OF INTERESTED PERSON.—Section 2(a)(19)(A)(v) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)(A)(v)) is amended by striking out "1934 or any affiliated person of such a broker or dealer, and" and inserting in lieu thereof: "1934 or any person that, at any time during the last 6 months, has executed any portfolio transactions for, engaged in any principal transactions with, or loaned money to, the investment company or any other investment company having the same investment adviser, principal underwriter, sponsor, or promoter, or any affiliated person of such a broker, dealer, or person, and".

(b) BANK HOLDING COMPANIES.—Section 10(c) of the Investment Company Act of 1940 (15 U.S.C.80a-10(c)) is amended by striking "bank, except" and inserting in lieu thereof: "bank and its subsidiaries or any bank holding company and its affiliates and subsidiaries, as those terms are defined in the Bank Holding Company Act of 1956, except".

(c) EFFECTIVE DATE.—The provisions of subsection (a) of this section shall become effective after one year following enactment.

SEC. 245. PROHIBITION AGAINST USE OF A BANK'S NAME BY AN AFFILIATED MUTUAL FUND.

Section 35(d) of the Investment Company Act of 1940 (15 U.S.C. 80a-35(d)) is amended by inserting after the first sentence thereof the following: "It shall be deceptive and misleading for any registered investment company which has as an investment adviser or distributor a bank or affiliated person thereof, to adopt, as part of the name, title, or logo of such company, or of any security of which it is the issuer, any word or design which is the same as or similar to, or a variation of, the name, title, or logo of such bank.".

SEC. 246. DEFINITION OF BROKER.

Section 2(a)(6) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(6)) is amended to read as follows:

"(6) 'Broker' has the same meaning as in the Securities Exchange Act of 1934, but does not include any person solely by reason of the fact that such person is an underwriter for one or more investment companies.".

SEC. 247. DEFINITION OF DEALER.

Section 2(a)(11) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(11)) is amended to read as follows:

"(11) 'Dealer' has the same meaning as in the Securities Exchange Act of 1934, but does not include an insurance company or investment company.".

SEC. 248. TREATMENT OF PUBLICLY ADVERTISED COMMON TRUST FUNDS.

(a) SECURITIES ACT OF 1933.—Section 3(a)(2) of the Securities Act of 1933 (15 U.S.C. 77c(a)(2)) is amended—

(1) by inserting "that is" after "common trust fund or similar fund"; and

(2) by inserting after "administrator, or guardian" the following: ", and that is not offered to the general public".

(b) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a)(12)(A)(iii) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)(A)(iii)) is amended—

(1) by inserting "that is" after "common trust fund or similar fund"; and

(2) by inserting after "administrator, or guardian" the following: ", and that is not offered to the general public".

(c) INVESTMENT COMPANY ACT OF 1940.—Section 3(c)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(3)) is amended—

(1) by inserting "that is" after "common trust fund or similar fund"; and

(2) by inserting after "administrator, or guardian" the following: ", and that is not offered to the general public".

SEC. 249. REMOVAL OF THE EXCLUSION FROM THE DEFINITION OF INVESTMENT ADVISER FOR BANKS THAT ADVISE INVESTMENT COMPANIES.

Section 202(a)(11)(A) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)(A)) is amended by striking out "investment company" and inserting in lieu thereof "investment company, except that the term 'investment adviser' includes any bank or bank holding company to the extent that such bank or bank holding company acts as an investment adviser to a registered investment company".

SEC. 250. DEFINITION OF BROKER.

Section 202(a)(3) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(3)) is amended to read as follows:

"(3) 'Broker' has the same meaning as in the Securities Exchange Act of 1934.".

SEC. 251. DEFINITION OF DEALER.

Section 202(a)(7) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(7)) is amended to read as follows:

"(7) 'Dealer' has the same meaning as in the Securities Exchange Act of 1934, but does not include an insurance company or investment company.".

## PART D—ADDITIONAL REQUIREMENTS

### SEC. 261. ESTABLISHMENT OF COMPLIANCE PROGRAMS BY REGULATORY AGENCIES.

(a) REQUIREMENT FOR COMPLIANCE PROGRAMS.—

(1) ESTABLISHMENT.—Each agency shall establish a program for monitoring and enforcing compliance with the amendments made by title I and this title by bank holding companies, banks, insured institutions, qualified securities subsidiaries, and other nonbank subsidiaries of bank holding companies under the supervision of such agency.

(2) REPORT.—Each agency shall, within 120 days from enactment of this Act, submit to the Committee on Banking, Finance and Urban Affairs, the Committee on Energy and Commerce, and the Committee on Appropriations of the House of Representatives and the Committee on Banking, Housing and Urban Affairs and the Committee on Appropriations of the Senate a plan describing the techniques and methods such agency will use in monitoring and enforcing compliance with the provisions of the amendments made by title I and this title.

(b) DEVELOPMENT OF COMPLIANCE PLANS.—In preparing the plan required to be developed under subsection (a), each agency shall describe how the plan, and the techniques and methods to monitor compliance contained in the plan, assures the supervision of compliance with all applicable provisions of the amendments made by title I and this title, and shall specify—

(1) any increases in personnel necessary to—

(A) supervise any new activities which the amendments made by title I and this title permit for bank holding companies, banks, or qualified securities subsidiaries; and

(B) enforce compliance with the safeguard provisions and other requirements contained in section 9 of the Bank Holding Company Act of 1956 (as added by section 201 of this title) or section 15D of the Securities Exchange Act of 1934 (as added by section 211 of this Act);

(2) the length of time the agency will need to increase such agency's oversight capability under such amendments; and

(3) the cost of the agency's expanded oversight capability.

(c) CONSULTATION.—In developing the plan required under subsection (a), each agency shall consult with each other agency.

(d) DEFINITIONS.—For purposes of this section—

(1) AGENCY.—The term "agency" means the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation, and the Securities and Exchange Commission.

(2) OTHER DEFINITIONS.—The terms "bank holding company", "bank", "insured institution", "qualified securities subsidiary", and "subsidiary" have the meanings given to such terms in

section 2 of the Bank Holding Company Act of 1956, except that the term "bank" includes any national bank and any other insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act).

SEC. 262. FEDERAL RESERVE BOARD AND SECURITIES AND EXCHANGE COMMISSION STUDY.

(a) REQUIREMENTS FOR STUDY.—The Board of Governors of the Federal Reserve Board and the Securities and Exchange Commission shall study and evaluate the impact on the securities markets and the banking system of the amendments made by this Act and the effectiveness of the amendments made by this Act in protecting investors and minimizing risks to the safety and soundness of the banking system and the Federal deposit insurance system. The study shall include—

(1) the effectiveness of the safeguard provisions established by the amendments made by this title in insulating the bank, its depositors, and the Federal deposit insurance system from the risks associated with the conduct of securities activities;

(2) the adequacy of the safeguard and investor protection provisions in the context of the combination of the extension of credit and the provision of securities products and services (A) within banks, (B) within bank subsidiaries, and (C) within bank holding company systems;

(3) the impact that the participation of qualified securities subsidiaries in securities activities has on competition in the securities markets and on the pricing of securities products and services;

(4) the impact that foreign securities and foreign exchange activities of banks have on the Federal deposit insurance system and on the safety and soundness of the banking system;

(5) the adequacy of existing laws and regulations in allowing the Board and the Commission to monitor and assess capital adequacy and the financial and operational condition of broker-dealers and bank holding company systems;

(6) the advisability of establishing a permanent international framework for developing and implementing global policies to better harmonize financial market regulation, including capital adequacy standards, and dealing with international market emergencies; and

(7) the impact of financial services competition from insurance companies and other firms that are neither banks nor securities firms.

(b) CONSULTATION.—In conducting the study required by subsection (a), the Board and the Commission shall consult with and solicit comment from the Secretary of the Treasury and appropriate Federal bank regulatory agencies.

(c) REPORT.—The Board and the Commission shall, on or before 18 months after the date of enactment of the Act, submit a report to the Congress containing—

(1) the results of the study under this section;

(2) the actions they propose to take on the basis of this study;

(3) recommendations, if any, for legislation; and

(4) the views of the Board and the Commission with respect to any of the matters described in paragraphs (1), (2), and (3) on which the Board and the Commission do not agree.

Page 82, strike out line 6 and all that follows through the end of title III and insert the following:

# TITLE III—INSURANCE ACTIVITIES

SEC. 301. SHORT TITLE.

This title may be cited as the "Bank Holding Company and National Bank Improvements Act of 1988".

SEC. 302. AMENDMENTS TO THE BANK HOLDING COMPANY ACT OF 1956 RELATING TO INSURANCE ACTIVITIES.

(a) DEFINITION.—Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended by inserting after subsection (p) (as added by section 102(d) of this Act) the following new subsection:

"(q) DEFINITIONS RELATING TO INSURANCE ACTIVITIES.—For the purposes of this Act—

"(1) INSURANCE ACTIVITIES.—The term 'insurance activities' means providing insurance as principal, agent, or broker.

"(2) FINANCIAL GUARANTY INSURANCE SUBSIDIARY.—The term 'financial guaranty insurance subsidiary' means any company—

"(A) which—

"(i) is a subsidiary of a bank holding company;

"(ii) is not a bank or insured institution or a subsidiary of a bank or insured institution;

"(iii) provides, in the United States, financial guaranty insurance in accordance with section 6(c) of this Act; and

"(iv) is licensed to provide financial guaranty insurance under State law; and

"(B) the establishment of which by the bank holding company has been approved by the Board under section 6(c)(2).".

(b) INSURANCE ACTIVITIES.—The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by inserting after section 5 (as added by section 102(c) of this Act) the following new section:

"SEC. 6. INSURANCE ACTIVITIES.

"(a) IN GENERAL.—Except as otherwise provided in this section and notwithstanding any provision of section 3 or 4 of this Act, no bank holding company and no subsidiary of a bank holding company, including any bank or insured institution subsidiary, may engage in insurance activities in the United States.

"(b) EXCEPTIONS.—Subsection (a) shall not apply with respect to insurance provided—

"(1) pursuant to section 3(f), the first proviso of section 4(a)(2), or section 4(c)(8) of this Act or section 5136(g) of the Revised Statutes;

"(2) through a State bank, or any subsidiary of a State bank, to the extent permissible under subparagraph (A), (B), (C), (E), or (F) of section 4(c)(8) and any applicable State law;

"(3) as agent or broker by a State bank subsidiary of a bank holding company, or by a subsidiary of such State bank, if—

"(A) such State bank or subsidiary is located in the 1 State in which the operations of such bank holding company's banking subsidiaries are principally conducted (as determined under section 3(d) of this Act);

"(B) the insurance activities engaged in by the bank or subsidiary are authorized by State law; and

"(C) such State bank or subsidiary acts as agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—

"(i) any individual who—

"(I) is a resident of the State in which such State bank is chartered; or

"(II) is employed in such State;

"(ii) any person, including an individual—

"(I) who is engaged in business in such State and has a permanent business office located in such State; or

"(II) whose principal headquarters is located in such State,

except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and

"(iii) any other person if the insurance policy is issued with respect to—

"(I) real property located in such State; or

"(II) personal property which is principally used in such State;

"(4) by a State bank subsidiary of a bank holding company (without regard to the date on which such bank became a subsidiary of such company), or by a subsidiary of such State bank, if—

"(A) such State bank or subsidiary is located in the State of Indiana;

"(B) the insurance activities engaged in by the bank or subsidiary—

"(i) are authorized by State law (as in effect at the time such activities are engaged in by such bank or subsidiary); and

"(ii) were authorized by State law in effect on September 22, 1988, for State banks located in the State of Indiana; and

"(C) the insurance activities of such State bank or subsidiary meet the requirements of paragraph (3)(C) of this subsection;

"(5) through a State bank, or any subsidiary of a State bank, if—

"(A) permitted pursuant to a State ballot initiative allowing a State bank, or any subsidiary of a State bank, insurance underwriting authority;

"(B) such State bank is located in such State;

"(C) the operations of the banking subsidiaries of the bank holding company which controls such State bank are principally conducted in such State (as determined under section 3(d) of this Act);

"(D) such ballot initiative was certified for a vote on November 8, 1988, by the Secretary of State of such State; and

"(E) the insurance underwriting activities of such State bank or subsidiary do not involve any insurance other than insurance provided to—

"(i) any individual who—

"(I) is a resident of the State in which such State bank is chartered; or

"(II) is employed in such State;

"(ii) any person, including an individual—

"(I) who is engaged in business in such State and has a permanent business office located in such State; or

"(II) whose principal headquarters is located in such State,

except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and

"(iii) any other person if the insurance is provided with respect to—

"(I) real property located in such State; or

"(II) personal property which is principally used in such State; or

"(6) as agent or broker by a national bank subsidiary of a bank holding company, or by a subsidiary of such national bank, if—

"(A) such bank or subsidiary is located in the State of Oklahoma;

"(B) the State in which the operations of such bank holding company's banking subsidiaries are principally conducted (as determined under section 3(d) of this Act) is the State of Oklahoma;

"(C) the insurance activities engaged in by the bank or subsidiary are authorized by the law of the State of Oklahoma for State banks, and subsidiaries of State banks, which are chartered in such State; and

"(D) such national bank or subsidiary acts as agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—

"(i) any individual who—

"(I) is a resident of the State in which such State bank is chartered; or

"(II) is employed in such State;

"(ii) any person, including an individual—

"(I) who is engaged in business in such State and has a permanent business office located in such State; or

"(II) whose principal headquarters is located in such State,

except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and

"(iii) any other person if the insurance policy is issued with respect to—

"(I) real property located in such State; or

"(II) personal property which is principally used in such State.

"(c) EXCEPTION FOR FINANCIAL GUARANTY INSURANCE PROVIDED BY A NONBANK SUBSIDIARY WHICH IS NOT A SUBSIDIARY OF ANY BANK SUBSIDIARY.—

"(1) IN GENERAL.—Subsection (a) shall not apply with respect to financial guaranty insurance provided by any financial guaranty insurance subsidiary to the extent permissible under State law.

"(2) BOARD APPROVAL REQUIRED.—No bank holding company may, directly or indirectly, form a company, or acquire or retain shares of any existing company, for the purpose of establishing a financial guaranty insurance subsidiary, or otherwise commence, directly or indirectly, to engage in providing financial guaranty insurance, unless the Board approves a written application (containing such information with respect to such formation, acquisition, or activity as the Board may prescribe by regulations) by the bank holding company.

"(3) PROHIBITION ON APPROVAL UNDER CERTAIN CIRCUMSTANCES.—The Board shall not approve any application under paragraph (2) with respect to the proposed financial guaranty insurance activity by a bank holding company if the Board determines that any of the following conditions exist or would likely result from the approval of the application:

"(A) ADVERSE AFFECT ON HOLDING COMPANY RESOURCES TO THE DETRIMENT OF DEPOSITORY INSTITUTION SUBSIDIARIES.—The establishment of a financial guaranty insurance subsidiary would affect the managerial or financial resources of the bank holding company to such an extent that the establishment would likely—

"(i) have an adverse impact on the safety and soundness of any bank or insured institution subsidiary of the bank holding company; or

"(ii) impair or diminish the bank holding company's ability to act as a source of strength for any bank or

insured institution subsidiary of the bank holding company.

"(B) INCOMPLETE APPLICATION.—The applicant bank holding company has failed to provide information required by regulations prescribed pursuant to paragraph (2) or such additional information as the Board may require the bank holding company to submit in connection with the application.

"(C) PUBLIC BENEFIT.—The Board determines that the establishment and operation of a financial guaranty insurance subsidiary cannot reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

"(D) INADEQUATE STATE REGULATION.—The Board determines that the regulation provided by the State in which the financial guaranty insurance subsidiary is licensed as an insurance company is inadequate to assure the financial soundness of such subsidiary.

"(E) MINIMUM RISK-BASED CAPITAL REQUIREMENT.—The Board determines that any bank subsidiary of such bank holding company fails, at the time of such application, to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.

"(4) LIMITATION ON INTERLOCKING DIRECTORS AND OFFICERS.—

"(A) DIRECTORS.—A majority of the directors of the financial guaranty insurance subsidiary shall be individuals who are not directors or officers of any bank or insured institution which is an affiliate of the financial guaranty insurance subsidiary.

"(B) OFFICERS.—No officer of the financial guaranty insurance subsidiary may serve at the same time as an officer or director of any bank or insured institution which is an affiliate of the financial guaranty insurance subsidiary.

"(5) APPLICATION OF SAFEGUARD PROVISIONS.—No bank or insured institution subsidiary of a bank holding company may engage, directly or indirectly, in any transaction involving any financial guaranty insurance subsidiary of such bank holding company if such bank or insured institution would be prohibited from engaging in such transaction under section 9(a) if the transaction involved a securities subsidiary of such holding company.

"(6) EXCEPTIONS TO PARAGRAPHS (2) AND (3).—If, as of the date of the enactment of the Depository Institutions Act of 1988, a subsidiary of a national bank subsidiary of a bank holding company is engaged in municipal bond guarantee insurance activities pursuant to authorization issued by the Comptroller of the Currency on or before May 2, 1985, such bank holding company may continue to engage in such municipal bond guarantee insurance activities after the date of the enact-

ment of such Act without the approval of the Board under paragraph (3) of an application submitted to the Board pursuant to paragraph (2) (to establish a financial guarantee insurance subsidiary) if—

"(A) such activities are transferred to a subsidiary which would be a financial guaranty insurance subsidiary (within the meaning of section 2(q)(2)(A)) of such company but for this subparagraph; and

"(B) such subsidiary does not engage in any financial guaranty insurance activity other than municipal bond guarantee insurance activities.

"(d) PROTECTION OF CONSUMERS AND COMPETITION.—

"(1) CONFIDENTIAL CUSTOMER INFORMATION.—

"(A) IN GENERAL.—No bank holding company and no subsidiary of a bank holding company, including any bank or insured institution, which engages in any insurance activity in accordance with this Act may, directly or indirectly, use any confidential customer information for the purpose of furthering any insurance activity without the express written consent of that customer.

"(B) CONFIDENTIAL CUSTOMER INFORMATION DEFINED.—For purposes of subparagraph (A), the term 'confidential customer information' has the meaning given to such term in section 9(d)(2) of this Act.

"(2) FAVORING CAPTIVE AGENTS PROHIBITED.—No bank holding company or subsidiary of a bank holding company, including any bank or insured institution subsidiary, may—

"(A) require, as a condition for the provision of any product or service to any customer, or any renewal of any contract for the provision of such product or service, that the customer acquire, finance, or negotiate any policy or contract of insurance through a particular insurer, agent, or broker or group of insurers, agents, or brokers;

"(B) permit any subsidiary, or any department or agent of such company or subsidiary, which engages in any insurance activity to solicit, directly or indirectly, any customer of such company or subsidiary to provide any insurance required under the terms of any loan or extension of credit (to such customer by such company or subsidiary) before such customer has received a written commitment from such company or subsidiary with respect to such loan or other extension of credit;

"(C) unreasonably reject any contract of insurance obtained by the customer from any insurer, agent, or broker which is not an affiliate of such company for failing to meet the insurance requirements of any loan or other extension of credit (to such customer by any such company or subsidiary) the terms of which require the customer to obtain insurance in connection with such loan or other extension of credit; or

"(D) require any procedures, conditions, or other actions of duly licensed agents which are not affiliated with, or in any other way connected to, such bank holding company if such procedures, conditions, or other actions are not cus-

tomarily required by such company or subsidiary of agents, brokers, or insurers which are affiliated with the bank holding company.

"(3) EXCEPTION.—No provision of this subsection shall be construed as prohibiting a bank holding company or any subsidiary of any bank holding company from placing insurance on real or personal property in the event a debtor has failed to provide reasonable evidence of required insurance in accordance with the terms of any loan or credit document.

"(e) AUTHORITY TO CONTINUE CERTAIN ACTIVITIES.—Notwithstanding any other provision of this section, any bank holding company may continue to—

"(1) engage in any insurance activity through a State bank, or any subsidiary of a State bank, if—

"(A) the bank was acquired after December 31, 1984, and before March 2, 1988, pursuant to Board approval of an application to which section 3(d) of this Act applies;

"(B) the bank provides insurance only to—

"(i) residents of such State;

"(ii) individuals employed in such State; or

"(iii) individuals otherwise present in such State; and

"(C) such insurance insures against—

"(i) the same types of risks as insurance provided by such bank or subsidiary as of—

"(I) the day before the date of the acquisition of such Bank or subsidiary by the out-of-State bank holding company; or

"(II) March 2, 1988; or

"(ii) functionally equivalent risks;

"(2) provide title insurance coverage through any State bank which is a subsidiary of such bank holding company, and any subsidiary of such State bank, if the initial charter issued to such bank under State law required that such bank be authorized to provide title insurance;

"(3) engage in any insurance activity lawfully engaged in before the date of the enactment of this subsection in the State of Indiana and in any State contiguous to the State of Indiana if the bank holding company or subsidiary—

"(A) is located in the State of Indiana; and

"(B) was acquired on June 30, 1986, pursuant to Board approval on May 28, 1986, of an application to which section 3(d) of this Act applies;

"(4) engage in any insurance activity through a State bank, or any subsidiary of a State bank, if—

"(A) such bank is described in subparagraphs (A) and (B) of paragraph (1); and

"(B) the insurance activity of such State bank or subsidiary is limited to—

"(i) life, accident, and health insurance activities for which such bank or subsidiary was licensed before March 2, 1988, pursuant to a State law which was enacted after July 20, 1987, and was in effect before September 28, 1987; and

"(ii) the State in which such State bank or subsidiary has been licensed;

"(5) provide financial guaranty insurance through a State bank, or any subsidiary of such bank, pursuant to an authorization by the appropriate State banking regulator which was issued before March 2, 1988;

"(6) retain ownership interests, including the right to convert nonvoting interests to voting interests, in a company engaged in providing financial guaranty insurance if the Board determined by letter dated October 31, 1986, that the initial investment in such company by such bank holding company, or any predecessor of such bank holding company, was consistent with this Act at the time any such investment was made;

"(7) engage in underwriting insurance, including reinsurance, through a State bank subsidiary of such bank holding company, or by a subsidiary of such State bank, if—

"(A) such bank or subsidiary was engaged in underwriting insurance on or before July 27, 1988;

"(B) such insurance insures against the same types of risks as insurance underwritten by such bank or subsidiary as of July 27, 1988, or functionally equivalent risks;

"(C) the insurance underwriting activities engaged in by the bank or subsidiary are authorized by State law;

"(D) the insurance underwriting activities are engaged in by the bank or subsidiary only in States in which such bank or subsidiary was engaged in underwriting insurance on or before July 27, 1988; and

"(E) control of such bank or subsidiary is not acquired by any other bank holding company after July 27, 1988; or

"(8) engage in any insurance activity through a State bank, or a subsidiary of a State bank, in any State in which the insurance activities were lawfully conducted by such bank or subsidiary, or in which such bank or subsidiary was licensed to conduct such activity, prior to the date of enactment of this subsection if the bank holding company which controls such State bank is located in Virginia (as determined under section 3(d)) and the insurance activities are conducted from the State of Tennessee.

"(f) LIMITATIONS RELATING TO SECTION 4(c)(8)(D).—

"(1) GRANDFATHER PROVISION CEASES IF CONTROL OF CERTAIN COMPANIES CHANGE.—The authority for any company to provide insurance pursuant to section 4(c)(8)(D) of this Act shall terminate if control of the company providing the insurance is acquired by a bank holding company—

"(A) on or after October 15, 1982, in a transaction requiring Board approval of an application to which section 3(d) of this Act applied if the bank holding company did not obtain Board approval to engage in such insurance activities under section 4 before March 2, 1988; or

"(B) on or after March 2, 1988,

unless the acquiring company is a successor or is, and continues to be, a bank holding company with total assets of $50,000,000 or less.

"(2) CERTAIN BANK HOLDING COMPANIES ALLOWED TO CONTINUE TO ENGAGE IN INSURANCE ACTIVITIES.—If—

"(A) control of any company providing insurance pursuant to section 4(c)(8)(D) of this Act was acquired by a bank holding company on or after October 15, 1982; and

"(B) the bank holding company obtained Board approval pursuant to section 4(c)(8)(D) of this Act before March 2, 1988, to acquire and retain the shares of the company which engages in such insurance activities,

such bank holding company may retain the shares of such company and such company may continue to engage in such insurance activities.

"(3) INDEPENDENT QUALIFICATION OF AFFILIATES.—No company that is an affiliate of a company providing insurance pursuant to section 4(c)(8)(D) of this Act shall provide insurance pursuant to such section after March 1, 1988, unless such affiliated company also meets the requirements of such section.

"(g) LIMITATIONS ON SECTION 4(c)(8)(C)(i) PROVISION.—The authorization for any company to provide insurance pursuant to section 4(c)(8)(C)(i) of this Act shall apply only if—

"(1) the insurance activities of such company are authorized by the appropriate authorities of the State in which the place described in section 4(c)(8)(C)(i) is located;

"(2) the insurance company for which such company acts as agent or broker is authorized to do business in such State by the appropriate authorities of the State; and

"(3) such company acts as an agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—

"(A) individuals who are residents of or employed in the place described in section 4(c)(8)(C)(i);

"(B) persons, including individuals—

"(i) who are engaged in business in the place described in section 4(c)(8)(C)(i) and have a permanent business office located in such place; or

"(ii) whose principal headquarters is located in such place,

except that insurance policies may be issued under this subparagraph only with respect to employees (including such individuals) who reside in or who are principally employed in such place, real property located in such place, personal property which is principally used in such place, or services provided by persons located in such place; and

"(C) any other person if the insurance policy is issued with respect to—

"(i) real property located in the place described in section 4(c)(8)(C)(i); or

"(ii) personal property which is principally used in such place.

"(h) NOTICE AND COMMENT.—

"(1) IN GENERAL.—Except as provided in subsection (c)(2) with respect to financial guaranty insurance and notwithstanding any other provision of this Act, no bank holding company may commence to engage, directly or indirectly, in any insur-

ance activity or acquire the shares of any company (including any State bank) engaged in insurance activity, unless such bank holding company provides notice to the Board in the manner provided in section 4(i) of this Act.

"(2) APPLICABILITY OF NOTICE AND DISAPPROVAL PROCEDURES.—Section 4(i) shall apply with respect to any notice under paragraph (1) without regard to the fact that the insurance activity is authorized under a provision of this Act other than any paragraph of section 4(c).

"(3) PUBLICATION OF NOTICE.—Any notice received by the Board pursuant to this subsection shall be published in the Federal Register.

"(i) DATA COLLECTION.—

"(1) REPORTS REQUIRED.—The Board shall require each bank holding company which engages, directly or indirectly, in insurance activities in accordance with this Act to submit, on an annual basis, the following information with respect to such activity:

"(A) Of the total number of customers of all bank subsidiaries of such company, the percentage of such number of customers who purchased, directly or indirectly, insurance products or services from such company.

"(B) Any other information the Board determines to be appropriate for enforcing the provisions of section 106(b) of the Bank Holding Company Act Amendments of 1970.

"(2) PUBLIC INSPECTION.—The Board shall evaluate the information submitted pursuant to paragraph (1) and shall make available for public inspection such information and such evaluations.

"(j) DEFINITIONS.—

"(1) RESIDENTS.—For purposes of this section, the term 'residents', when used in connection with a reference to a State, includes—

"(A) individuals who are residents of the State; and

"(B) companies which—

"(i) are incorporated in or organized under the laws of the State;

"(ii) are licensed to do business in the State; or

"(iii) have an office in the State.

"(2) FINANCIAL GUARANTY INSURANCE.—For purposes of this section—

"(A) IN GENERAL.—The term 'financial guaranty insurance' means a contract issued by an insurer under which loss is payable upon proof of the occurrence of financial loss to an insured claimant, obligee, or idemnitee as a result of any of the following:

"(i) The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted.

"(ii) Changes in the levels of interest rates or the differential in interest rates between various markets or products.

"(iii) Changes in the rate of exchange of currency.

"(iv) Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general.

"(B) EXCEPTIONS.—Such term does not include any of the following:

"(i) Insurance of a loss resulting from an event described in subparagraph (A), if the loss is payable only upon the occurrence of any of the following:

"(I) A fortuitous physical event.

"(II) A failure of or deficiency in the operation of equipment.

"(III) An inability to extract or recover a natural resource.

"(ii) A contract bond, including a bid, payment, or maintenance bond, or a performance bond, which guarantees the execution of a contract other than a contract of indebtedness or other monetary obligation.

"(iii) An indemnity bond for the benefit of a public body, railroad, or charitable organization or a lost security or utility payment bond.

"(iv) Becoming surety on, or guaranteeing the performance of, any lawful contract where the bond is guaranteeing the execution of a contract other than a contract of indebtedness or other monetary obligation.

"(v) Becoming surety on, or guaranteeing the performance of, bonds and undertakings required or permitted in a judicial proceeding or otherwise allowed by law, including surety bonds accepted by States and municipal authorities in lieu of deposits as security for the performance of insurance contracts.

"(vi) An individual or schedule public official bond.

"(vii) A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond.

"(viii) A bond running to a Federal, State, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege.

"(ix) A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization.

"(x) A lease, purchase and sale, or concessionaire surety bond.

"(xi) Residual value insurance.

"(xii) Insurance guaranteeing the fidelity of persons holding positions of public or private trust, or indemnifying businesses, banks, thrifts, brokers, or other financial institutions against loss of money, securities,

negotiable instruments, other specified valuable papers, or tangible items of personal property caused by larceny, misplacement, destruction, or other State perils including loss while being transported in an armored motor vehicle or by messenger and including insurance for loss caused by the forgery of signatures on, or alteration of, specified documents, and valuable papers.

"(xiii) Insurance against losses that businesses or financial institutions become legally obligated to pay by reason of loss.

"(xiv) Credit unemployment insurance on a debtor in connection with a specific loan or other credit transaction, to provide payments to a creditor in the event of unemployment of the debtor for the installments or other periodic payments becoming due while a debtor is unemployed.

"(xv) Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed to him for goods or services provided in the normal course of his business.

"(xvi) Guaranteed investment contracts that are issued by life insurance companies and that provide that the life insurer will make specified payments in exchange for specific premiums or contributions.

"(xvii) Mortgage guaranty insurance.

"(3) AUTHORIZED BY STATE LAW.—In the case of any insurance activity in which a State bank may not engage as of the date of the enactment of this paragraph under any State law or rule of law, the term 'authorized by State law', in connection with any subsequent authorization for such bank to engage in such activity, means express authorization under the statute laws of a State, including referenda and ballot initiatives, by language to that effect and not by implication.".

(c) ADDITIONAL LIMITATION ON BHC SMALL TOWN EXCEPTION.—

(1) IN GENERAL.—Section 4(c)(8)(C)(i) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)(C)(i)) is amended by inserting "and is the location of such bank holding company's principal place of banking business (which shall be the place where the total bank deposits of the entire bank holding company system is the greatest)" after "decennial census)".

(2) EFFECTIVE DATE.—Section 6(g)(3) of the Bank Holding Company Act of 1956 (as added by subsection (b) of this section) and the amendment made by paragraph (1) shall not apply before the end of the 1-year period beginning on the date of the enactment of this Act.

(d) ADDITIONAL PROVISION.—For purposes of section 6 of the Bank Holding Company Act of 1956 (as added by subsection (b) of this section), the State in which the operations of the bank subsidiaries of any bank holding company described in section 6(e)(6) of such Act are principally conducted shall be deemed to be the State in which the total deposits of all such bank subsidiaries were the largest on March 2, 1988.

(e) REGULATIONS.—

(1) IN GENERAL.—Before the end of the 9-month period beginning on the date of the enactment of this section, the Board of Governors of the Federal Reserve System shall prescribe regulations which describe the standards for determining that a place has inadequate insurance facilities for purposes of section 4(c)(8)(C)(ii) of the Bank Holding Company Act of 1956 and section 5136(g)(7) of the Revised Statutes.

(2) FACTORS TO BE TAKEN INTO ACCOUNT.—The standards established pursuant to paragraph (1) shall take into account—

(A) the total population of the area;

(B) the geographic extent of the area;

(C) the density of population within the geographic area; and

(D) the proximity of the area to a metropolitan area or other urban area.

(3) DEMONSTRATION REQUIREMENT SATISFIED IF STANDARDS ARE MET.—The requirements contained in section 4(c)(8)(C)(ii) of the Bank Holding Company Act and section 5136(g)(7) that a bank or bank holding company demonstrate that a place has inadequate insurance facilities shall be deemed to have been met with respect to any place which meets the standards prescribed under paragraph (1).

(f) ADDITIONAL EXCEPTION.—Section 408(p)(2) of the National Housing Act (12 U.S.C. 1730a(p)(2)) is amended by adding at the end thereof the following new subparagraph:

"(C) EXCEPTION.—This paragraph shall not apply so as to prohibit the insured institution subsidiary of a diversified savings and loan holding company from offering or marketing insurance products or services on behalf of an affiliate if such insured institution has its corporate headquarters in the State of New Jersey and such diversified savings and loan holding company was formed pursuant to an acquisition agreement which was publicly announced on August 4, 1987.".

(g) TECHNICAL AND CONFORMING AMENDMENT.—Subsections (c)(1), (d)(1), and (d)(2) of section 14 of the Bank Holding Company Act of 1956 (12 U.S.C. 1847) (as added by section 203 of this Act) are each amended by striking out "section 9," and inserting in lieu thereof "section 6(c)(5) or 9,".

SEC. 303. AMENDMENT TO SECTION 5136 OF THE REVISED STATUTES RELATING TO INSURANCE ACTIVITIES.

Section 5136 of the Revised Statutes (12 U.S.C. 24) is amended by inserting after subsection (f) (as added by section 103(b)(5) of this Act) the following new subsection:

"(g) INSURANCE ACTIVITIES.—

"(1) IN GENERAL.—Except to the extent provided in any other paragraph of this subsection, no national bank and no subsidiary of a national bank may engage in insurance activities in the United States.

"(2) EXCEPTION FOR CREDIT LIFE INSURANCE, ETC.—Paragraph (1) shall not apply with respect to insurance issued or otherwise provided by a national bank, or any subsidiary of a na-

tional bank, to any individual which is limited to assuring the repayment of the outstanding balance of any specific extension of credit to such individual by such national bank, or any subsidiary of such national bank, in the event of the death, disability, or involuntary unemployment of such individual.

"(3) EXCEPTION FOR CERTAIN TITLE INSURANCE ACTIVITIES.—Paragraph (1) shall not prohibit any company lawfully engaged in title insurance activities as of March 2, 1988, from continuing to engage in such activities, to the extent that—

"(A) such activities are limited to the State in which the bank is located; and

"(B) such bank is not acquired after March 2, 1988, by a bank holding company the principal banking operations of which are conducted in another State (as determined under section 3(d) of the Bank Holding Company Act of 1956).

"(4) EXCEPTION FOR NATIONAL BANKS LOCATED IN SMALL TOWNS.—Notwithstanding paragraph (1), if the principal place of banking business of any national bank is located in any place which has a population not exceeding 5,000 (as shown by the most recent decennial census) and such place is within the State in which such bank is chartered, such national bank, and any subsidiary of such national bank, may act as agent or broker for an insurance company if—

"(A) the insurance activities of such bank or subsidiary are authorized by the appropriate authorities of such State;

"(B) the insurance company for which such bank or subsidiary acts as agent or broker is authorized to do business in such State by the appropriate authorities of the State; and

"(C) such bank or subsidiary acts as an agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—

"(i) any individual who is a resident of or is employed in any place in such State which has a population not exceeding 5,000 (as determined by the most recent decennial census);

"(ii) any person, including an individual—

"(I) who is engaged in business in any place described in clause (i) of this subparagraph and has a permanent business office located in any such place; or

"(II) whose principal headquarters is located in any such place,

except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such place, real property located in such place, personal property which is principally used in such place, or services provided by persons located in such place; and

"(iii) any other person if the insurance policy is issued with respect to—

"(I) real property located in any place described in clause (i) of this subparagraph; or

"(II) personal property which is principally used in any such place.

"(5) CERTAIN ACTIVITIES PROHIBITED IN CONNECTION WITH INSURANCE ACTIVITIES.—No national bank, or subsidiary of a national bank, which sells insurance pursuant to paragraph (4) may—

"(A) assume or guarantee the payment of any premium on insurance policies issued through the agency of such bank or subsidiary by the insurance company for which such bank or subsidiary is acting as agent pursuant to paragraph (4); or

"(B) guarantee the truth of any statement made by an insurance customer in filing such customer's application for insurance.

"(6) EXCEPTION FOR CERTAIN ACTIVITIES.—Notwithstanding paragraphs (1) and (4)—

"(A) a national bank, or a subsidiary thereof, located in the State of Oregon or Washington, may continue to engage in insurance activities in which such bank or subsidiary was lawfully engaged as of March 2, 1988, within the State in which the main office of such national bank is located; and

"(B) a national bank chartered in 1882 (or any subsidiary of such bank) may continue to engage in insurance activities in which such bank or subsidiary was lawfully engaged as of March 2, 1988, within 30 miles of such bank's main office if such main office is not within 30 miles of any city that had a population exceeding 150,000 under the 1980 census.

"(7) EXCEPTION FOR UNDERSERVED AREAS.—Notwithstanding paragraph (1) and subject to regulations prescribed by the Board of Governors of the Federal Reserve System pursuant to section 302(e) of the Depository Institutions Act of 1988, any national bank, and any subsidiary of such national bank, may act as agent or broker for an insurance company in any place which—

"(A) is within the State in which such bank is chartered; and

"(B) has inadequate insurance agency facilities, as demonstrated by the bank to the Board, after notice and opportunity for a hearing.

"(8) ACTIVITIES AUTHORIZED FOR STATE BANKS.—Notwithstanding paragraph (1) and subject to paragraph (5), a national bank and any subsidiary of such national bank may act as agent or broker for an insurance company if—

"(A) such bank or subsidiary is located in the State of Oklahoma;

"(B) the insurance activities engaged in by the bank or subsidiary are authorized by the law of the State of Oklahoma for State banks, and subsidiaries of State banks, which are chartered in such State; and

"(C) such national bank or subsidiary acts as agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—

"(i) any individual who—

"(I) is a resident of the State in which such State bank is chartered; or

"(II) is employed in such State;

"(ii) any person, including an individual—

"(I) who is engaged in business in such State and has a permanent business office located in such State; or

"(II) whose principal headquarters is located in such State,

except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and

"(iii) any other person if the insurance policy is issued with respect to—

"(I) real property located in such State; or

"(II) personal property which is principally used in such State.

"(9) DEFINITIONS.—For purposes of this subsection—

"(A) INSURANCE ACTIVITIES.—The term 'insurance activities' has the meaning given to such term in section 2(q)(1) of the Bank Holding Company Act of 1956.

"(B) RESIDENTS.—The term 'residents', when used in connection with a reference to a State, includes—

"(i) individuals who are residents of the State; and

"(ii) companies which—

"(I) are incorporated in or organized under the laws of the State;

"(II) are licensed to do business in the State; or

"(III) have an office in the State.

"(C) SUBSIDIARY.—The term 'subsidiary' has the meaning given to such term in section 2(d) of the Bank Holding Company Act of 1956.".

SEC. 304. EFFECTIVE DATE.

Except as otherwise provided in this title, the provisions of this title shall apply on and after March 5, 1987.

## PURPOSE AND SUMMARY

It has been 55 years since Congress passed the Banking Act of 1933. Four sections of that Act, sections 16, 20, 21 and 32, are collectively known as the Glass-Steagall Act. These provisions were designed to separate commercial from investment banking by prohibiting commercial banks and affiliates of Federal Reserve member banks from underwriting, distributing, or dealing in a broad range of securities within the United States.

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In recent years, this wall between investment and commercial banking experienced a considerable degree of erosion. Banking regulators again and again found ways to circumvent the clear intent of Glass-Steagall. As a result of a series of regulatory and judicial decisions, commercial banks have been able to make significant incursions into investment banking activities. At the same time, asset-securitization and other innovations in investment banking have cut into traditional bank lending activities.

As a result of the blurring of the line between investment and commercial banking, and the apparent degree of confusion that exists among regulators, courts, and market participants with regard to a banking organization's legal right to undertake particular activities, the Committee determined that it was appropriate to provide legislative clarity.

Accordingly, the Committee's amendment to Title I clearly defines the activities in which a banking organization may engage and also sets forth those activities that are prohibited to banking organizations. The amendment expressly prohibits banking organizations from underwriting corporate debt and equity, and from underwriting or sponsoring mutual funds. Certain of the authorized powers may be exercised within the bank itself, while others must be exercised in a broker-dealer subsidiary or in a qualified securities subsidiary (QSS). The Committee's amendment also sets limits on the size of the combinations that can be formed by the merger of banking and securities firms.

In order to accommodate these expanded powers for banking organizations, to protect depositors' funds, to safeguard as well as protect the investing public from confusing product marketing and conflicts of interest, and to ensure competitive equity as between the banking and securities industries, the Committee's amendment to Title II establishes a series of firewalls and other safeguards. These provisions prohibit certain types of transactions between the bank and its securities affiliate or third parties and govern the cross-marketing of bank and securities products. Included are prohibitions against banks and their securities affiliates sharing, subject to limited exceptions, the same name, logo, premises, officers, directors or employees. The amendment requires disclosure of the relationship between the bank and the securities affiliate in certain circumstances and prescribes annual audits of the firewalls and related provisions. In order to ensure investor protection, this Title also amends the definitions of "broker" and "dealer" to include banks, with certain specified exceptions, and provides the Securities and Exchange Commission (SEC) with rulemaking authority over certain situations involving banks affiliated with management investment companies (i.e., mutual funds and closed-end investment companies) and unit investment trusts.

Title III of the Committee amendment contains provisions designed to ensure the competitiveness of the U.S. insurance industry and to protect the interests of insurance consumers. Under these provisions, national banks, bank holding companies and their subsidiaries are generally prohibited from engaging in insurance activities as a principal, agent or broker, except under certain exemptions intended to accommodate insurance activities that certain bank and their subsidiaries may already be engaged in. In addition,

Title III gives bank holding companies and their subsidiaries new authority to sell insurance in the state in which they are principally located. It also gives bank holding companies and their nonbank subsidiaries the authority to engage in financial guaranty insurance activity under certain circumstances.

## Background and Need for the Legislation

### Title I and Title II—Securities Activities

#### *Why Glass-Steagall Limited Commercial Banks' Securities Activities*

The separation of commercial from investment banking was the product of neither legislative whim nor idle experimentation. It occurred during and as a result of the events of the Great Depression, events which remain among the most catastrophic in the history of capitalism. There is substantial evidence that unsound banking and securites practices were a major contributing factor to both the tide of speculation which preceded economic collapse and the depth and intractability of the depression.

Commercial banking as practiced before the turn of the century in the United States was separate from investment banking. When the National Bank Act of 1864 was passed, the extent of any intertwining of the two forms of banking was insignificant. The Act made no reference to any power of a national bank to engage in securities activities, and early court decisions interpreted the Act to prohibit such activities.[1] State-chartered institutions, on the other hand, had significantly greater freedom to participate in investment banking activities.

Following the Civil War there developed an economic need to issue securities to finance Reconstruction and the construction of railroads throughout the West. National banks did not underwrite these securities. Rather, investment banking houses were established in order to perform these tasks. As late as 1902, the Comptroller of the Currency formally ruled that national banks had no legal authority to underwrite such corporate securities.[2] Around the turn of the century, judicial interpretation of the National Bank Act became less restrictive and the Comptroller of the Currency began to permit banks to underwrite and trade in municipal and corporate debt. Equity underwriting, however, remained off-limits.

While national banks had long been at a disadvantage with respect to state chartered banks, the progressively increasing extent to which the latter were engaging in a full set of securities activities began to magnify the differences between the two. The practice developed for national banks to create or purchase state chartered affiliates in order to conduct a much broader spectrum of securities activities than was permissible under federal law.

These new relationships, including others with investment banks and insurance companies to form underwriting syndicates, led a specially-appointed Congressional committee, the Pujo Committee, to recommend in 1913 that national banks be barred from securi-

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[1] See, Pitt, Miles and Ain, "The Law of Financial Services" 94 (1988).
[2] Id., at 96.

ties underwriting. The expression of Congressional concern embodied in the Pujo Report notwithstanding, commercial banks continued to extend their penetration into the investment banking field both through their affiliates and, because of the growing reluctance of the Comptroller to enforce his own regulations, within the banks themselves.

By 1927, banks had devised so many ways around the restrictions on securities underwriting that Congress, as part of the McFadden Act of 1927, allowed national banks to underwrite those securities approved by the Comptroller of the Currency. The McFadden Act accelerated the trend toward bank participation in securities underwriting, particularly of bonds. By 1930, banks and their affiliates originated 45 percent of all bond issues, although only 566 of the nation's 25,000 banks were engaging in securities activities.

The stock market crash of 1929 and the onset of the Depression resulted in a new Congressional inquiry into the wisdom of commingling investment and commercial banking enterprises.

The Senate Banking and Currency Committee's 1932-1934 hearings on the securities practices of banks (the so-called Pecora hearings)[3] disclosed that bank affiliates had underwritten and sold unsound and speculative securities, published deliberately misleading prospectuses, manipulated the price of particular securities, misappropriated corporate opportunities for the benefit of bank officers, and engaged in insider lending practices and unsound transactions with affiliates. Evidence also pointed to cases where banks had made unsound loans to assist their affiliates and to protect the securities underwritten by the affiliates.

Banks also were found to have made loans to their customers to purchase securities underwritten by their securities affiliates. Bank officers had received compensation from affiliates which far exceeded their salaries from the bank. Confusion by the public as to whether they were dealing with a bank or its securities affiliate and loss of confidence in the banking system were also revealed to be adverse consequences of the securities affiliate system.

The House Report on the Glass-Steagall Act in May, 1933, states clearly that the purpose of the Act was to restrict banks from making loans and "investing bank funds" for speculative securities purposes. The Report went on to conclude that—

> * * * there seems to be no doubt anywhere that a large factor in the over-development of security loans and in the dangerous use of the resources of bank depositors for the purpose of making speculative profits and incurring the danger of hazardous losses, has been furnished by perversions of the national banking and State banking laws, and that, as a result machinery has been created which tends toward danger in several directions * * * the greatest of such dangers is seen in the growth of "bank affiliates" which devote themselves in many cases to perilous underwriting operations, stock speculation and market making activities, often with the resources of the parent bank.

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[3] "Stock Exchange Practices," Hearings before the Senate Banking Committee, 72nd and 73rd Congs. (1932-1934), commonly called the Pecora hearings in recognition of the decisive role of the Committee's counsel, Ferdinand Pecora.

The Pecora hearings uncovered additional abuses by all segments of the financial community, but none was so spectacular as that committed by the nation's two largest banks and their securities affiliates: National City Bank and Chase National Bank.

Among the abuses and excesses were a Brazilian state's bond underwriting, one-half the proceeds of which went to the underwriter, National City Co., which had made previous loans to Brazil. These and other low quality securities were pushed upon the American public, which had no way of learning their true value. As Ferdinand Pecora stated, people purchased these securities largely because of their "faith in the integrity and presumed conservatism of the National City Bank."

National City Bank, through its affiliate, speculated on the stock exchange and participated in pool operations. National City Co., for its part, traded heavily in the stock of its subsidiary bank, and drove up the price to what Pecora called "dizzy heights". In general, Pecora found that—

> While the affiliate engaged in these questionable activities, the bank assisted it by providing clients. Bank officials advised depositors seeking investment counsel to call on the affiliate's security salesmen, all of whom were exhorted to push sales contests. The bank assisted and cooperated with the affiliate in numerous other ways as well.
>
> Such close ties as existed among their institutions, especially those between the bank and its investment affiliate, disguised bad banking practices and kept mistakes and losses from reaching the attention of the stockholders. V. Carosso, "Investment Banking in America," at p. 333.

The extensive speculation and undisclosed interrelationships between Chase National Bank and its affiliate Chase Securities Corporation also resulted in substantial harm to the public. Ironically, the president of both Chase Bank and Chase Securities Corporation, Albert H. Wiggin, had been dubbed "the most popular banker on Wall Street."

To his credit, Wiggin's successor at the Chase was horrified by the revelations. Winthrop W. Aldrich succeeded Wiggin as chief executive of the Chase in January 1931. His condemnation of his predecessor's actions was vigorous; he spoke openly of his opposition to affiliates of banks originating, underwriting, and distributing securities and warmly endorsed the recommendations of Pecora. Even before he learned of Wiggin's conduct, Aldrich issued a public statement urging reforms that might prevent further abuses such as those uncovered by the subcommittee. In a March 8, 1933 speech, he argued that "the spirit of speculation should be eradicated from the management of commercial banks" and that commercial and investment banking should be walled off entirely from one another.

While it is important to note that the roughly contemporaneous advent of the Securities Act of 1933, the Securities Exchange Act of 1934, and the introduction of federal deposit insurance, served the role of protecting investors on the one hand and depositors on the other, these lessons from the Great Depression and the banking crisis continue to have great import. Though the existence of depos-

it insurance minimizes the likelihood of serious runs on banks, it also represents a commitment of taxpayers' money that must not be made vulnerable to exploitation and the kinds of conflicts of interest that the events of the 1920s and 30s so amply demonstrate. In addition, the disclosure provisions of the securities laws lessen the likelihood of investors buying securities without any basis for evaluating them. Nonetheless, these laws do not address the inherent conflicts and opportunities for abuse that combining investment and commercial banking may present.

Fifty-five years have passed since the Pecora hearings and the enactment of the Glass-Steagall Act. There is little doubt that the financial services industry has changed significantly since that time as a result of the development of new technologies, products, methods of providing services, and an unprecedented degree of global interdependency and interaction. As a result of these and other forces, including a willingness on the part of the Nation's banking regulators to interpret broadly gaps that exist in the Glass-Steagall wall, banks have over time—and especially over the last decade—accreted significant securities powers.

*Regulatory and Judicial Interpretations of the Glass-Steagall Act*

In recent years, regulatory agencies with jurisdiction over federal depository institutions have permitted banking organizations to enter upon a wide variety of securities activities that for decades had been denied such organizations under prevailing interpretations of the Glass-Steagall Act. Banks and their regulators have read expansive exceptions into the law in order to facilitate changes they thought desirable, even through Congress had not expressed any change in policy. In fact, Congress has proved unwilling until now to make major changes in a system that has worked well to protect the banking system from risks associated with new securities activities. The deregulatory approach of the banking regulators and the increasing trend of courts to give deference to this approach have been major motivating forces behind the scrutiny Congress has given these issues this session. As the following summary of this trend suggests, the federal banking regulators have moved generally in the same permissive and expansive direction, though not necessarily in tandem.

*i. Bank Private Placements of Securities.*—During the late 1970s, the federal bank regulators determined that banks could act as agents in connection with the private placement of securities without violating the Glass-Steagall Act.[4] By 1985, the Board of Governors of the Federal Reserve System (the "Board") concluded that the placement of third-party commercial paper, although not necessarily a private placement of within the meaning of the federal securities laws, did not violate the Glass-Steagall Act.[5] Since that

[4] Federal Reserve Board Staff Study. *Bank Private Placement Activities* at 81 (June 27, 1977); Propriety of National Bank Private Placement Activity in Light of Glass-Steagall Act (Comptroller of the Currency) (Letter No. 32, December 9, 1977). The Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, *Commercial Paper Private Placement Activities* (June 1, 1978).

[5] Statement Concerning Applicability of the Glass-Steagall Act to the Commercial Paper Placement Activities of Bankers Trust Company (June 4, 1985) (concluding that the prohibitions of Section 21 on "underwriting" and "distributing" apply only to "public offerings" and that the

Continued

time, banking organizations have become heavily involved in the placement of commercial paper.

In its statement regarding private placement activities, the Board imposed limitations on the credit support which could be provided to an issuer whose commercial paper was being placed. In contrast, the Comptroller of the Currency (the "Comptroller") permitted national banks to extend credit to an issuer of securities privately placed by the bank.[6]

*ii. Bank Sales of Mutal Funds.*—Prior to 1985, the sale of mutual fund shares by banks generally was limited to purchasing as agent for a bank customer shares of mutual funds for which neither the bank nor any affiliate of the bank acted as investment adviser. In addition, banks acting for their customers generally would not retain any portion of the purchase price (a "sales load") or other payment from a mutual fund or its distributor in connection with purchases of mutual fund shares for bank customers.[7]

Since 1985, the Comptroller has issued a series of letters, which, together, permit a national bank or its broker-dealer subsidiary to: (i) act as adviser to an open-end mutual fund, (ii) advise bank customers to purchase shares of the mutual fund, and (iii) retain a distribution payment or sales load paid by the mutual fund in connection with the customer's purchase of the mutual fund's shares.[8]

*iii. Bank Provision of Discount Brokerage and Investment Advisory Services.*—When the Glass-Steagall Act was enacted in 1933, it expressly barred banks from most securities activities. A small exception was allowed, however, that permitted banks, as an accommodation for their customers, to execute brokerage transactions. This exception allowed banks, upon request, to execute transactions for trust and other customers.

After almost 50 years of allowing that which was clearly intended and no more, bank regulatory agencies and the courts held that both national banks and the nonbanking subsidiaries of bank holding companies could provide discount securities brokerage services, so long as they did not involve investment advisory or research services.[9] In 1987, the United States Court of Appeals for the District of Columbia Circuit upheld an order by the Board apprving an application by National Westminister PLC to operate a "full-service" securities brokerage subsidiary that, subject to specified condi-

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nature of the commercial paper market is such that a bank's selling activities do not amount to a public offering).

In 1986, the United States Court of Appeals for the District of Columbia Circuit, reversing a lower court, upheld the Board's position that the commercial paper placement activities conducted by Bankers Trust were permissible under the Glass-Steagall Act. *Securities Industry Ass'n.* v. *Board of Governors*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 107 S.Ct. 3228 (1987).

[6] Comptroller Staff Interpretive Letter No. 212 [1981–1982 Transfer Binder] Fed. Banking L. Rep. (CCH) paragraph 85,293 (July 2, 1981); Comptroller Staff Interpretive Letter No. 329 [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) paragraph 85,499 (March 4, 1985).

[7] *See e.g.*, 12 C.F.R. '225,125 (1987).

[8] Compultroller Staff Interpretive Letter No. 332 [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) paragraph 85,502 (March 8, 1875). Comptroller Staff Interpretive Letter No. 363 [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) paragraph 85,533 (May 23, 1986). Comptroller Staff Interpretive Letter No. 403 [Current] Fed. Banking L. Rep. paragraph 85,627 (December 9, 1987).

[9] Securities Industry Ass'n. v. Board of Governors, 716 F.2d 92 (2d Cir. 1983), *aff'd*, 468 U.S. 207 (1984) (upholding a Board regulation currently at 12 C.F.R. '225.25(b)(15)(1987); *Securities Industry Ass'n.* v. *Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C.) (1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985), *reh'g. den.*, 765 F.2d 1196 (D.C. Cir. 1985), *cert. denied* (on permissibility of brokerage issue), 474 U.S. 1054 (1986) (approving ruling by the Comptroller).

tions, offered both brokerage and investment advisory services solely to institutional customers.[10]

Subsequent applications approved by the Board have relaxed these conditions by, among other things, (i) lowering the threshold for determining the net worth of individuals and other entities that may qualify as "institutional" customers, (ii) permitting the subsidiary to provide discount brokerage, without investment advice, to non-institutional customers and to underwrite and deal in securities permissible for banks under the Glass-Steagall Act, (iii) authorizing the subsidiary to exercise limited investment discretion, and (iv) permitting the subsidiary to share customer lists with its affiliates.[11] The Comptroller also has authorized national banks and their operating subsidiaries to provide to both institutional and retail customers a combination of brokerage and investment advisory services through a single entity under certain circumstances.[12]

*iv. Bank Distribution of Asset-Backed Securities.*—In recent years, the securitization of bank assets has expanded from securities representing interests in pools of federally guaranteed mortgage loans to securities backed by automobile loans, credit card receivables, student loans and various other business and consumer receivables. The Board has not formally considered whether (i) interests in these asset pools are "securities" for Glass-Steagall Act purposes, or if (ii) banks may underwrite and distrubute their own securitized assets. The Comptroller, on the other hand, issued a letter expressing the opinion that national banks may securitize their assets and participate in the public distribution of certain of these securities without violating the Glass-Steagall Act.

*v. Activities of Bank Affiliates Not "Engaged Principally" in Distributing Securities.*—Section 20 of the Glass-Steagall Act prohibits member banks from being affiliated with any company "engaged principally" in the issue, flotation, underwriting, public sale or distribution" of securities. On December 24, 1986, the Board approved an application by Bankers Trust New York Corporation to engage in the placement of commercial paper through a commercial lending affiliate.[13] The Board concluded that such placement of commercial paper did not constitute underwriting, distributing, or the public sale of securities within the meaning of Section 20.

As an alternative basis for its decision, the Board concluded that, even if the proposed placement activities constituted underwriting under Section 20, the commercial lending affiliate would not be "engaged principally" in underwriting activities if the affiliate's

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[10] *Securities Industry Ass'n.* v. *Board of Governors*, 821 F.2d 810 (D.C. Cir. 1987).

[11] J.P. Morgan & Co. Incorporated, 73 Fed. Res. Bull. 810 (1987); Manufacturers Hanover Corporation, 73 Fed. Res. Bull. 930 (1987); The Royal Bank of Canada, 74 Fed. Res. Bull.—(March 28, 1988). Pending applications would further relax the structures imposed on NatWest. Chase Manhattan Corp., 53 Fed. Reg. 5833 (Feb. 26, 1988); Sovran Financial Corp., 52 Fed. Reg. 42,040 (Nov. 2, 1987).

[12] *See, e.g.*, Comptroller Staff Interpretive Letter No. 370 [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) paragraph 85,540 (Apr. 16, 1986); Comptroller Staff Interpretive Letter No. 360 [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) paragraph 85,530 (Apr. 16, 1986); Comptroller Staff Interpretive Letter No. 386 [Current] Fed. Banking L. Rep. (CCH) paragraph 85,610 (June 19, 1987).

[13] 73 Fed. Res. Bull. 138 (1987). On February 8, 1988, the United States Court of Appeals for the Second Circuit upheld the Board's interpretation of the term "engaged principally". *Securities Industry Ass'n* v. *Federal Reserve Board*, No. 87-4041 (2d Cir. Feb. 8, 1988).

annual gross revenues from its commercial paper placement activities would not exceed five percent of its total gross revenues and the volume of commercial paper placed by it outstanding at any one time would be less than five percent of the average outstanding volume for all dealer-placed commercial paper during the preceding four calendar quarters.[14] Subsequently, subject to essentially the foregoing limitations, the Board approved the use by several bank holding companies of wholly-owned subsidiaries engaged in underwriting and dealing in United States government securities to underwrite and deal in commercial paper, municipal revenue bonds (including industrial development bonds), consumer receivable related securities and certain types of mortgage-backed securities. This decision has been upheld by the United States Court of Appeals for the Second Circuit.[15]

Coincident with these actions, the banking regulators urged Congress to make changes in the law. Congress responded in 1987 by adopting the moratorium contained in the Competitive Equality Banking Act, which provision halted the expansion-by-regulator of bank powers in the areas of securities, insurance, and real estate.

The moratorium has expired and there is a need for the Congress to reassert its public policy-making role and to rationalize banking regulation. As a result, four committees of Congress have spent a considerable amount of time in the 100th Congress in seeking to develop a new structure for common ownership of banking and nonbanking entities by banking organizations. Because the same concerns exist today about conflicts of interest, investor and taxpayer protection, and unfair bank competition in nonbanking areas, Congress has had to forge a complex new structure to replace the simple rules of Glass-Steagall. As part of the process of creating the new structure, every effort is being made to prevent future destabilization of statutory policy by federal and state bank regulators and state legislatures. The need for a uniform policy for protection of the federal taxpayer from the nonbanking activities of federally-insured banks and their affiliates remains paramount. The need to proceed cautiously in testing the new structure is imperative.

*Congressional Response*

*a. General.*—In 1933, Congress undoubtedly concluded that the controls required to isolate federally-insured deposits from risk-filled securities activities would be too complex to permit the continuation of securities activities by banks. Prohibition of common owership was deemed simple, effective, and not unduly onerous. It is still the simplest remedy. However, today there exists greater confidence that regulators can enforce the complex rules that are

[14] On January 29, 1987, the Comptroller released an interpretation stating that securities activities prohibited for affiliates of banks under Section 20 of the Glass-Steagall Act do not include securities activities that the bank itself may engage in under Section 16 of the Glass-Steagall Act. The interpretation provided also that the measure of "engaged principally" under Section 20 of the Glass-Steagall Act may be conservatively set at 25 percent of the firm's business as an initial step and that the statute may permit a percentage of business as high as 50 percent. Comptroller Interpretive Letter No. 383 [Current] Fed. Banking L. Rep. (CCH) paragraph 85,607 (January 29, 1987).

[15] *Securities Industries Ass'n.* v. *Board of Governors*, No 87-4041 (2d Cir. 1988) (and consolidated cases).

required as a substitute for the simple prohibition of common ownership on banking and nonbanking functions. Banks are only too aware that if they engage in abusive banking and securities practices, their critics will point to their lapses. But problems remain in some depository institutions such as the savings and loan and certain sectors of the banking industries, which have raised questions about the adequacy of regulatory oversight of traditional banking functions. These concerns are magnified by reports by the banking regulators themselves acknowledging that the majority of failures in economically-depressed areas are due not to the economic downturn but rather to mismanagement and fraud.

It is the intention of this Committee to erect a new structure, with appropriate firewalls, in which banking organizations can conduct their activities with vigor and safety. A report to Congress on how well this structure stands up to the stresses of the marketplace is an important part of this bill. Undoubtedly, changes and fine-tuning will be needed as experience is gained.

While an absolute prohibition on all forms of investment banking activities by banking organizations is unnecessary at this time, there remain certain securities underwriting powers, in particular corporate securities powers, that the Committee feels remain sufficiently risky and fraught with irreparable conflicts of interest when engaged in by bank affiliates. This Committee believes, therefore, that a continued prohibition on these activities is in order at this time. Even those securities powers that are expressly permitted by this legislation are themselves not without associated hazards. For this reason, the Committee has constructed a set of bank and investor safeguard provisions that are critical to the approval of new powers.

It is the intent of the Committee that banking organizations not be able to expose their federally-insured banks to the risks of the securities business. Therefore, there is concern that the ability to use credit facilities to support securities activities will undermine the objective credit judgment of banks to the detriment of federally-insured deposits. Dealing in foreign exchange raises the same concerns. Therefore, whether or not securities activities and foreign exchange activities are carried on in a bank or in a securities affiliate or in a nonsecurities affiliate of such a bank in a bank holding company, there should be no combining of credit facilities with securities or foreign exchange activities.

Another concern this Committee has sought to address in this bill is the potential for anti-competitive behavior by securities firms affiliated with banks. At the same time, the Committee recognizes that parallel equity as between investment banks that have bank affiliates and those that do not is very important to maintain. It is not the intent of this Committee to subject securities firms within banking organizations to restrictions not imposed upon securities firms unaffiliated with banks unless those restrictions are related to dangers or advantages peculiar to the circumstances of such an affiliation. Principles of competitive equity underlie, at least in part, the need for the functional regulation by the SEC of securities activities, whether conducted by an independent securities firm or by an entity within a banking organization.

It is the further objective of this Committee to modernize the legal framework governing the banking industry, consistent with the mandate to ensure a safe and sound banking system. The international competitiveness of this nation's financial institutions is an important component of this modernization. Yet it is not the intend of the Members of this Committee to allow risky liasions between commercial and investment banks simply because other Nations do so. In this era of global interdependence, we cannot afford to join an international race to the bottom. Given the fundamental regulatory and structural issues raised in the wake of the October 1987 stock market crash, it is especially important that the lessons of the 1920s and 30s be borne in mind.

*b. Bank and Affiliate Mutual Fund Powers.*—The Committee has considered proposals to enlarge the power of banks and their affiliates to engage in mutual fund activities. Based upon its careful evaluation of these proposals and the arguments concerning them, the Committee has determined that the most prudent course of action is flatly to prohibit banks and QSSs from sponsoring and underwriting mutual funds, to prohibit banks and affiliated organizations from distributing the shares of investment companies that are advised by the bank or any of its affiliates, but to permit banks to distribute shares of an investment company that is not advised by the bank or any affiliated entity.

During the 1920s, banks and bank affiliates were heavily involved in sponsoring and underwriting mutual funds, then called "investment trusts." Abundant evidence documents that such involvement resulted in widespread abuses by both banks and their affiliates. Congress extensively considered these and other abuses in extensive hearings following the collapses of the stock market and the banking system. Based upon the substantial conflicts of interest and other hazards that may arise when banks and their affiliates sponsor and underwrite mutual funds, Congress rejected a regulatory approach as inadequate. Instead, it flatly prohibited the sponsorship and underwriting or mutual funds by banks and bank affiliates. The Committee firmly believes that the conclusions that were reached by Congress when it considered and passed the Glass-Steagall Act remain equally valid at the present time.

The Supreme Court, in 1971, had the opportunity to consider the Glass-Steagall Act's prohibitions when it struck down a decision of the Comptroller of the Currency that permitted Citibank to sponsor and underwrite a mutual fund. *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971). In its landmark opinion, the Court noted that "the potential hazards and abuses that flow from a bank's entry into the mutual investment business are the same basic hazards and abuses that Congress intended to eliminate" when it enacted the Glass-Steagall Act. In its opinion, the Court identified no less than eleven potential hazards:

1. "the bank and the [sceurities] affiliates are closely associated in the public mind, and should the affiliate fare badly, public confidence in the bank might be impaired";

2. "since public confidence is essential to the solvency of a bank, there might exist a natural temptation to shore up the affiliate through unsound loans or other aid";

3. "the bank would make its credit facilities more freely available to those companies in whose stock or securities the affiliate has invested";

4. "banks might even go so far as to make unsound loans to such companies";

5. "bank depositors might suffer losses on investments that they purchased in reliance on the relationship between the bank and its [securities] affiliate. This loss of customer goodwill might 'become an important handicap to a bank during a major period of security market deflation' ";

6. "banks * * * might be tempted to make loans to customers with the expectation that the loan would facilitate the purchase of stocks and securities";

7. "security affiliates might be driven to unload excessive holdings through the trust department of the sponsor bank";

8. "the bank would have a salesman's stake in the performance of the fund, for if the fund were less successful than the competition the bank would lose business and the resulting fees";

9. "the bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund";

10. "the bank might undertake, directly or indirectly, to make its credit facilities available to the fund or to render other aid to the fund inconsistent with the best interests of the bank's depositors"; and

11. "the bank might divert talent and resources from its commercial banking operation to the promotion of the fund."

Because there is a substantial possibility that these dangers could occur if banks or bank affiliates were permitted to sponsor and underwrite mutual funds, the Committee strongly believes that it would be contrary to the public interest to authorize banks or their affiliates to engage in such activities. Rather, the Committee intends that the bill preserve the prohibition on bank and bank affiliate sponsorship and underwriting of mutual funds.

Although the Committee has considered numerous arguments that adequate firewalls could prevent the hazards that Congress in 1933 and the Supreme Court in 1971 found to be pervasive, the Committee has determined, in light of substantial evidence, that firewalls do not always work and can be circumvented. Consequently, their utility must be viewed in the context of the inherent risk of particular securities activities and the potential for serious losses by the institution as a whole. For example, firewalls have been bypassed on numerous occasions in the past. In the 1970s, the Federal Reserve Board permitted banks to operate Real Estate Investment Trusts (REITs), invetment vehicles similar to mutual funds. When these affiliated trusts began to fail, the banks often ignored existing firewalls and pumped millions of dollars into their affiliated REITs in attempts to save them from bankruptcy.

Firewalls are particularly vulnerable to breeches in times of stress, when they are most critical. For example, firewalls collapsed following the stock market crash of October 1987. Continental Illinois, in direct violation of a firewall, pumped more than

ninety million dollars into its options subsidiary to prevent it from failing.

The Committee also found that there would be little if any benefit to consumers from authorizing baks or their affiliates to sponsor and underwrite mutual funds. The mutual fund business is currently highly diversified, with over twenty-seven hundred funds in existence that offer investors countless investment alternatives and cost structures. There is no evidence to indicate that permitting banks or their affiliates to enter this market would increase the investment options or returns available to customers.

Because of these same potential hazards, the Committee bill also prohibits a bank or lists affiliates from distributing the shares of an investment company that is advised by the bank or an affiliate. Substantial conflicts of interest could occur as a result of the bank's "salesman's stake" in the fund's success, especially when the receipt of investment advisory fees is dependent upon the size of the fund advised. Thus, a bank's advisory fees would increase to the extent that it distributed shares of the advised fund to the bank's customers, regardless of whether such fund ownership was in the customer's best interest. Other hazards, such as banks dumping fund shares into trust accounts that they manage, would be detrimental to banks and their customers. Similarly, allowing banks and affiliates to engage in advising and selling simultaneously could result in banks threatening their safety and soundness by making imprudent loans to their affiliated funds or to companies in whose securities the funds are invested.

While the Committee bill prohibits banks and their affiliates from distributing securities of affiliated investment companies, the Committee determined that it is in the public interest to permit QSSs and small banks with less than 500 million dollars in assets to distribute shares of unaffiliated invesment companies. This authority is granted only where the fund is registered under the Investment Company Act of 1940 and the fund is not advised by the bank or one of its affiliates. The Committee determined that this authority creates benefits for consumers by permitting customers to purchase investment company shares from their local depository institutions.

The Committee has imposed strong firewalls upon entities that exercise the limited mutual fund powers granted by the bill. The Committee decided that the benefits to consumers outweigh the risks in these very limited circumstances.

*c. Corporate Debt Powers.*—The Members of this Committee determined that it is inappropriate to grant banking institutions the authority to underwrite corporate debt. The risks that accompany this activity are considerable, especially in the secondary market. Because of innovations in corporate debt underwriting, there is currently robust competition among existing underwriters of corporate debt. Therefore, there is little likelihood that entry by banking institutions into this field would benefit corporate consumers in a sufficiently measurable way to justify the accompanying systemic risks.

While corporate debt or corporate bonds bear some superficial resemblance to commercial loans, the differences are critical. Commercial loans are either fully collateralized by assets that can be

revalued over the life of the loan, or have seniority over other debt. Corporate debentures, however, are neither secured nor backed by isolable revenue streams. Corporate debt is also distinguishable from commercial paper, which, though unsecured like other forms of corporate debt, is ordinarily backed by a secure line or letter of credit from a highly rated bank. Corporate debt is a long-term credit, subject to the vicissitudes of a corporation's life over several years or decades. Commercial paper, on the other hand, remains outstanding for at most nine months.

Morever, concern has been expressed that there is a potential for conflict of interest when a banking institution underwrites or deals in securities issued by a corporation with which it has creditor relationship. The option to underwrite debt securities for a corporate loan customer would enable a banking institution to shift credit risk to public investors whenever the risk level of its outstanding loans to that customer began to rise.

Although corproate debt is held by the underwriter for a short period of time during a typical underwriting, the underwriter must ordinarily make substantial commitments in the secondary market in order to compete successfully as an underwriter. The underwriter typically will trade in the secondary market in order to maintain liquidity for the issue. The underwriter thus serves as a dealer, a function that carries with it the most significant degree of risk in the securities business. Underwriters, who often sell corporate bonds instantly with the assistance of a shelf registration, are frequently expected by the issuer to ensure that the secondary or trading market remains liquid and retains depth. Dealers can suffer substantial losses quickly as a result of this kind of dealing commitment.

To the extent, therefore, that the underwriter deals in the secondary market in furtherance of its service as an underwriter, as well as to the extent that it retains any inventory of the bonds underwritten (which such underwriters typically do), the underwriter remains vulnerable to a volatile and unpredictable marketplace.

On December 18, 1987, the Subcommittee on Telecommunications and Finance requested the General Accounting Office to undertake an analysis of how the overseas securities affiliates of U.S. commercial banks fared during the past two years. Representatives of the banking industry had often argued that they should not be prohibited from underwriting activities in the U.S. because banking organizations perform these activities successfully abroad. The Subcommittee believed that Congress needed to obtain an independent determination of the accuracy of these representatives before it based a change in national policy on them.

The General Accounting Office (GAO) issued its report in September 1988. It found that London securities subsidiaries of U.S. banks were only marginally profitable or suffered losses during 1986 and 1987. In some cases, these securities losses were so large as to require infusions of capital from the parent U.S. banking institution.

Of particular relevance to the question of corporate debt is the GAO's finding that the subsidiaries of U.S. commercial banks suffered significant losses in the Eurodebt market because they

proved unable to distribute debt issues in a safe and efficient manner in the secondary market. The report states:

> To be able to underwrite large issues and to sell the bonds they purchase in the underwriting process, banks need to have in place a strong network of customers, such as central banks, corporation and investment managers, insurance companies, and pension and public funds. Without a strong London customer base to purchase portions of debt issues, U.S. banks were limited in the number and size of debt underwritings they could prudently manage. Because banks retained ownership of underwriting issues longer than they had planned, the risk of loss was increased in those cases where banks engaged in debt underwriting without a sufficient customer base. Some banks were left holding portions of their debt underwriting issues and absorbed losses when their holdings decreased in value.

*d. Corporate Equity Powers.*—The Committee was strongly of the view that banks should continue to be prohibited from underwriting and dealing in equities and convertible debt. The risk of loss that exists with regard to both of these instruments is considerable and it is the judgment of the Committee that banking organizations must not participate in that risk.

An underwriter of equity essentially guarantees that it will distribute the entire stock offering to qualified investors, or subscribe for its own account those shares that remain unsold. In addition, firms that underwrite equity must undertake to make a deep and liquid secondary market in those shares.

The movements of today's financial and securities markets are often precipitous. The securities market especially, as fueled by program trading and index arbitrage strategies, can fluctuate greatly in a matter of hours. On the afternoon of October 19, 1987, the stock market dropped approximately one point every 30 seconds. In that time frame, several issues that were under distribution and the entire portfolio of experienced firms trading in the secondary market were devastated. It is the judgment of the Committee that the banking institutions, as the guardians of our nation's insured deposits, must be protected from such market dislocations. The risk to our nation's financial system is too great to rely on even the strongest of firewalls.

In the judgment of the Committee, the underwriting of convertible securities is sometimes tantamount to a back-door way of underwriting equities. Both the Senate and the Banking Committee agreed that bank-affiliated securities firms should not underwrite equity at this time. The House Banking Committee, however, authorized securities affiliates to underwrite convertible debt. Such debt can be exchanged for securities for 115% above the market price of the stock on the date the debt was issued. Our nation has just experienced a bull market where such 15 percent increases in the price of stock were commonplace and occurred in short time periods. In such a market, there is every likelihood that such debt will be converted into equity, perhaps quite soon after issuance.

Moreover, the Securities Exchange Act treats convertible debt as equity, as to securities firms generally. Preferred stock and convertible debt are treated similarly; they both bear a close market relationship with the stock market. There is no similar correspondence with the movement of the debt market. Also similar is the pricing approach for new issues of preferred stock and convertible debt.

Finally, selling convertible debt is not like selling a convertible car; the seller cannot just walk away from the purchaser after the deal is closed. Purchasers expect that the seller will be available to make a deep and liquid secondary trading market in convertibles. Purchasers will select the underwriter based on its ability to "stand by the issue" and make a secondary trading market. But banks, for the most part, do not have the distribution network that is necessary to create this secondary market. Indeed, this was one of the problems cited by the GAO in its recent report on bank trading losses in London. The GAO discovered that the bank examiners themselves had concluded that banks lacked a sufficient Eurodebt distribution network or customer base to place securities successfully.

## TITLE III—INSURANCE ACTIVITIES

The only federal laws which currently limit who may engage in insurance activities are the Bank Holding Company Act of 1956 (BHCA) and the National Banking Act, as well as other statutes regulating federally insured depository institutions. Section 4 of the BHCA generally prohibits bank holding companies from acquiring or retaining the shares of any company other than a bank or bank holding company. The major exception to this rule is found in subsection 4(c)(8), which permits a bank holding company to acquire shares of a company engaging in activities that are "so closely related to banking or managing or controlling banks as to be a proper incident thereto."

This exception was amended in 1982 to specifically provide that it is not closely related to banking or managing or controlling a bank for a bank holding company to provide insurance as a principal, agent, or broker, unless the insurance is provided under one or more of seven listed exceptions. However, there has been a debate about whether this prohibition on engaging in insurance activities applies to both bank and nonbank subsidiaries of a bank holding company, or to the nonbank subsidiaries alone.

### *House Banking Committee Bill*

Title III of the Banking Committee's bill resolves this dispute by adding a new section to the BHCA which clearly controls the permissible insurance activities of bank holding companies and their bank and nonbank subsidiaries, including nonbank subsidiaries of the bank.

Under Title III of the Banking Committee's bill, a bank holding company, or a bank or nonbank subsidiary of a bank or nonbank that is itself a subsidiary of a bank holding company, could engage in insurance agency and brokerage activities to the extent permitted by State law, as long as the operations of the holding compa-

nies' banking subsidiaries are principally conducted in that State and the insurance activities are conducted within that State. Nothing in Title III of the Banking Committee's bill would affect the right of free-standing state-chartered banks to engage in insurance activities, if permitted by state law. And finally, the Banking Committee bill permits bank holding companies and their subsidiaries to provide financial guaranty insurance if permitted by State law.

*Energy and Commerce Committee Amendment*

The Energy and Commerce Committee amendment in the nature of a substitute would make a number of changes in Title III of the Banking Committee's bill. These changes are designed to ensure the competitiveness of the U.S. insurance industry and to protect the interests of insurance consumers.

Given the current state of regulatory affairs and solvency problems that face certain segments of both the banking and insurance industries, the Committee wants to ensure that bank entry into the insurance market promotes the overall well-being of the insurance industry, as well as the banking industry. The Committee does not wish to see banks enter the insurance industry in a manner that destabilizes the insurance industry or places the financial services industry at risk.

As a rule the Committee believes the insurance activities of a bank holding company should not be intermingled with the banking activities of a bank holding company. The Committee amendment, therefore, would require that financial guaranty insurance activities be conducted only in a separately capitalized nonbank subsidiary of a bank holding company. Under the Committee amendment the Federal Reserve Board must approve the application of a bank holding company before such holding company could engage in financial guaranty insurance activity, and the amendment would prohibit the Federal Reserve Board's granting of such approval if the Board determines that:

the financial guaranty activity would adversely affect the holding company's financial and managerial resources to the detriment of depository institution subsidiaries;

the applicant failed to provide the Board with information it requests;

there is no public benefit to the establishment and operation of a financial guaranty subsidiary;

the regulation provided by the state in which the financial guaranty insurance subsidiary is licensed as an insurance company is inadequate to assure the financial soundness of such subsidiary; or

the Board determines that any bank subsidiary of such bank holding company fails, at the time of application, to meet the risk-based capital requirements established by the Bank for International Settlements.

In addition, the Committee amendment would require that the officers and a majority of the directors of the financial guaranty insurance subsidiary be individuals who are not directors or officers of any bank or insured institution which is an affiliate of the financial guaranty subsidiary. It would also make the same restrictions that apply to transactions between an insured depository subsidi-

ary of the bank holding company and a securities subsidiary of the holding company under Title II of the Committee amendment applicable to transactions between the insured depository subsidiary and the financial guaranty subsidiary of the holding company.

The Committee amendment contains a definition of financial guaranty insurance which does not encompass all forms of financial guaranty insurance being offered. Instead, the Committee's definition is limited to those forms of financial guaranty that are based on assessments of creditworthiness, not actuarial experience.

The Committee also believes that in order to protect the interests of insurance consumers, there is a need for some separation between the banking operations of a bank holding company and any general insurance sales activities engaged in by the holding company.

Just as the Committee amendment prohibits the use of confidential customer information for the purpose of furthering securities activities, it also prohibits the use of such information for the purpose of furthering any insurance activity without the express written consent of the customer. The Committee amendment also safeguards against coercive activities and guarantees that bank holding companies and their subsidiaries cannot engage in activities that favor captive insurance agents over insurance agents that are not affiliated with the holding company.

The Committee amendment specifically prohibits a bank holding company or any subsidiary of a holding company from requiring a bank credit customer to purchase insurance through a particular insurer, agent or broker. And, a bank's insurance sales operation would be prohibited from soliciting a bank credit customer to provide any insurance required under the terms of a loan or extension of credit until the customer has first received a written commitment with respect to such loan or extension of credit.

To help the Board evaluate how bank holding companies are complying with these consumer protection provisions, the Committee amendment requires holding companies that engage in insurance activities to submit information annually to the Board identifying the number of bank customers who purchased insurance from the insurance subsidiary of the holding company. In this way the Board can monitor whether banks may be improperly influencing their customers to buy insurance from the bank insurance subsidiary. In addition, the amendment gives the Board the authority to require bank holding companies to provide any other information that the Board determines to be appropriate for enforcing the consumer provisions of the amendment.

The Committee amendment contains a number of technical changes so that the insurance powers granted under the amendment would be used in the manner intended. For example, the Committee amendment would clarify to whom banks could sell insurance under the new authority to sell insurance in the same state where the holding company has its principal place of business.

Under the amendment, insurance can be sold only (1) to individuals who reside in the state or are employed there; (2) to any person engaged in business in the state, as long as the insurance covers only employees who reside in or are principally employed in

the state, real property located in the state, personal property principally used in the state, or services provided by persons located in the state; or (3) to any other person as long as the insurance covers only real property located in the state or personal property principally used in the state.

The Committee amendment also would clarify the "small town" exemption which allows banks to sell insurance in small towns. The Committee is concerned that the small town exemption not be used as a basis for banks to sell insurance in suburban or urban areas. Under the amendment insurance could be sold only to individuals who reside or are employed in the small town or to businesses for their operations in the small town. However, the amendment would require the Federal Reserve Board to promulgate a rule setting standards to ensure that persons in rural areas have adequate access to insurance services.

The amendment would require that, after the date of enactment, any new state authorization to state banks to sell insurance be by express legislation and not by inference or administrative interpretation if the authorization is to form the basis for a bank holding company or its subsidiaries to engage in insurance activities under the BHCA.

The amendment makes several other changes which would apply to specific situations.

It would permit Indiana State banks, and their subsidiaries, to engage in insurance activities in that State, regardless of a subsequent change of ownership, if they were authorized to engage in those activities under State law as of the date of enactment. This exemption applies as long as such activities continue to be lawful under State law.

It would permit a Tennessee state bank subsidiary of a specific Virginia bank holding company to engage in the insurance activities in Tennessee, Virginia, Maryland and the District of Columbia in which it was lawfully engaged, or in which it was licensed to engage, as of the date of enactment.

It would permit the insurance underwriting activities in which bank holding company subsidiaries can engage in the State of California to be determined by the referendum on the California ballot in the November 1988 election.

It would permit national banks in the State of Oklahoma to act as an agent or broker for an insurance company in the event that Oklahoma State banks are authorized to do so and such insurance activities are limited to the State of Oklahoma.

It would clarify that, notwithstanding the limitations in the small town exemption, national banks, or their subsidiaries, located in Oregon or Washington State may continue to engage in the insurance activities in which they were lawfully engaged as of March 2, 1988, within the State in which the main office of the national bank is located.

It would permit a specific insurance company in New York to market its insurance products through a specific savings and loan institution in New Jersey which it acquired under an agreement announced August 6, 1987.

It would clarify that individuals may own both a bank holding company and an insurance company as long as there is no corporate ownership relationship between them.

## HEARINGS

On August 5, October 5, and October 14, 1987, as well as on February 10, April 13, and August 3, 1988, the Subcommittee on Telecommunications and Finance held oversight hearings which in part concerned the separation of commercial and investment banking, the role of financial institutions in our economy and the possibilities of Glass-Steagall reform. Witnesses included then-Acting Chairman Charles C. Cox and Chairman David S. Ruder of the Securities and Exchange Commission; Chairman Alan Greenspan, Board of Governors, Federal Resreve System; Comptroller General Charles A. Bowsher, U.S. General Accounting Office; Chairman L. William Seidman, Federal Deposit Insurance Corporation; Comptroller of the Currency, Robert L. Clark; and Assistant Secretary Michael R. Darby, Department of the Treasury.

Testimony was also received from Ulice Payne, Chairman, North American Securities Administrators Association; Bevis Longstreth, Partner, Debevoise & Plimpton; John Quinton, Chairman, Barclays Bank, PLC; Jiro Yamana, Vice President, Daiwa Securities Co., Ltd.; Hans Angermueller, Vice Chairman, Citicorp/CitiBank; Matthew Fink, Senior Vice President & General Counsel, Investment Company Institute; Robert A. Gerard, Managing Director, Morgan Stanley & Co., Inc.; John R. Petty, Chairman, Association of Bank Holding Companies and Chairman, Marine Midland Bank; Jonathan Brown, Director, Bankwatch; Bert Ely, President, Ely & Company, Inc.; Catherine England, Director of Regulatory Studies, Cato Institute; Ralph Nader, Center for Study of Responsive Law; W. James Lopp, Chairman and President, Financial Security Assurance Inc.; Robert Dugger, Chief Economist, American Bankers Association; and Gregory P. Plunkett, President, First New England Securities.

On February 3, 1988, the Committee's Subcommittee on Oversight and Investigations held a hearing on actions by Continental Illinois Corp. and its bank affiliate, Continental Illinois National Bank & Trust Co. of Chicago, to make cash advances exceeding investment and loan limits to its First Options of Chicago unit, the nation's largest options-clearing firm, to cover losses sustained by First Options during last year's stock market plunge. Witnesses included Emory W. Rushton, Deputy Comptroller for Multinational Banking, OCC; Mary Bender, Vice President, Chicago Board Options Exchange; Thomas C. Theobald, Chairman, Continental Illinois Corporation; William Gunlicks, Executive Vice President, Continental Illinois Bank; Jim R. Porter, Chairman, First Options of Chicago, Inc.; Barry L. Seidman, President, First Options; and David L. Browning, Vice President, First Options.

The Oversight and Investigations Subcommittee held a hearing on the regulatory requirements for the proposed merging of investment and commercial banking activities on September 13, 1988. Testimony was received from Richard L. Fogel, Assistant Comptroller General, General Accounting Office.

On September 14 and 15, 1988, the Subcommittee on Oversight and Investigations held a hearing on the failures of the Mission Insurance Company and the Integrity Insurance Company and regulatory and business practices similar to practices that led to the savings and loan industry crisis. Witnesses included Karl L. Rubenstein, Special Deputy Insurance Commissioner, Mission Insurance Company; William S. Price, Special Deputy Insurance Commissioner, Mission Insurance Company; Michael Merin, Deputy Liquidator, Integrity Insurance Company in Liquidation; Paul Davies, Reinsurance Agency, Inc.; Ivor Kiverstein, Chairman, Chitlington (North America) Ltd.; Ronald Bengston; Robert Marsh; Richard De Rosa; Louis J. Marioni, Superior National Insurance Company; and Michael Mulholland, Superior National Insurance Company.

The Committee's Subcommittee on Commerce, Consumer Protection, and Competitiveness held a hearing on H.R. 5094 on September 9, 1988. Testimony was received from the Honorable H. Robert heller, Board of Governors of the Federal Reserve System; the Honorable Robert L. Clarke, Comptroller of the Currency; the Honorable L. William Seidman, Chairman, Federal Deposit Insurance Corporation; Edward Yingling, Executive Director of Government Relations, American Bankers Association; Raymond Van Houtte, President and Chief Executive Office, Tompkins County Trust Company (on behalf of the New York State Bankers Association); Warren R. Wise, Senior Vice President and General Counsel, Massachusetts Mutual Life Insurance Company (on behalf of the American Council of Life Insurance and the American Insurance Association); Sophie M. Korczyk, President, Analytical Services; James M. Stevenson, Hilb, Rogal & Hamilton Co.; and Jonathan Sallet, Esq., Miller, Cassidy, Larroca and Lewin (on behalf of the Alliance for the Separation of Banking and Insurance); the Honorable Claire Traylor, Chairman, Colorado Senate Business Affairs Committee (on behalf of the National Conference of State Legislatures); David H. Elliott, President, Municipal Bond Investors Assurance Corporation; and Gerald L. Friedman, President and Chief Executive Officer, Financial Guaranty Insurance Corporation (on behalf of the Association of Financial Guaranty Insurors).

### Committee Consideration

On September 22, 1988, the Committee met in open session and ordered reported the bill H.R. 5094 with amendment, a quorum being present. The Committee adopted an amendment in the nature of a substitute for Titles I, II, and III offered by Mr. Dingell and agreed to by voice vote. The amendment will be described in greater detail in the Section-by-Section Analysis.

### Committee Oversight Findings

Pursuant to clause 2(l)(3)(A) of rule XI of the Rules of the House of Representatives, the Committee's Subcommittees held oversight hearings and made findings and recommendations that are reflected in the legislative report.

COMMITTEE ON GOVERNMENT OPERATIONS

Pursuant to clause 2(l)(3)(D) of rule XI of the Rules of the House of Representatives, no oversight findings have been submitted to the Committee by the Committee on Government Operations.

COMMITTEE COST ESTIMATE

In compliance with clause 7(a) of rule XIII of the Rules of the House of Representatives, the Committee believes that the bill as reported by the Committee is not expected to incur any significant costs or savings.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
*Washington, DC, September 26, 1988.*

Hon. JOHN D. DINGELL,
*Chairman, Committee on Energy and Commerce,*
*House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 5094, the Depository Institutions Act of 1988, as reported by the House Committee on Energy and Commerce, September 22, 1988. We expect that enactment of this bill would result in net costs to the federal government of $6 million to $8 million in 1989, and between $9 million and $17 million in each of the fiscal years 1990 and beyond. About $3 million per year of these amounts represent costs of the Federal Reserve Board, which would be reflected in the budget as a decrease in revenues; the remaining costs would appear as increases in outlays, which would not require appropriation action, except in the case of the Securities and Exchange Commission.

In addition, the proposal to abolish the Federal Asset Disposition Association (FADA) may create temporary delays in receipts to receiverships. These receiverships, which are established by the Federal Savings and Loan Insurance Corporation (FSLIC) to manage assets of failed thrifts, make periodic payments to the FSLIC. Given the uncertainty over the timing and amount of funds that FADA would generate for the FSLIC, as well as the effect that abolishing FADS would have on income to the FSLIC, it is not possible to estimate the budget impact, if any, of this proposal at this time.

This bill amends H.R. 5094, as ordered reported by the House Committee on Banking, Housing, and Urban Affairs. The estimated budget impact of both versions of H.R. 5094 is identical.

H.R. 5094 would make changes in the authority of banks to invest in securities, real estate, and insurance activities. It would require that each federal regulator of financial institutions—the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Federal Home Loan Bank Board (FHLBB)—establish a separate division to conduct examinations of institutions to determine the level of compliance with the laws and regulations relating to consumer protection, including community

reinvestment laws. Based on information from the agencies, we expect that they would hire and train new staff to carry out this function. Assuming that beginning in 1991 the agencies would conduct a consumer audit once every two years for each of approximately 17,000 institutions, the additional expenses incurred for this purpose would range from zero to $4 million in 1989, from $5 million to $9 million in 1990, from $11 million to $19 million in 1991, and from $19 million to $31 million in each year thereafter. The costs to the OCC and the FHLBB would be largely offset by fees, resulting in a net budget impact of half that amount or less in each year.

This bill would amend provisions of the Glass-Steagtall Act that affect affiliations between banks and securities firms. Based on information from the Securities and Exchange Commission, we expect that costs to regulate and monitor market securities activities, as well as to conduct studies and prepare reports, would be approximately $3 million in 1989, increasing to $4.5 million by 1993, assuming the necessary appropriations.

H.R. 5094 would give the FSLC three months to abolish FADA, which currently provides a number of services to the FSLIC, including appraising, maintaining and selling assets from failed savings and loans. FADA currently handles about $4 billion in assets, and has over 300 employees. The bill establishes a ceiling of 200 additional staff that the FSLIC could hire to replace FADA, but also allows the FSLIC to hire private management firms. It is not clear at this time how FSLIC would replace FADA staff, and what the cost of the alternatives to FADA would be. As a result, we cannot estimate the total long-term cost or savings from abolishing FADA.

We expect that the initial administrative costs of disbanding FADA could range from $5 million to $12 million in 1989, depending upon the amount of severance pay required for current FADA employees, the additional management and legal fees incurred while assets are being transferred, and the other costs associated with moving equipment and personnel. These costs are not included in our outlay estimate, because in view of the FSLIC's limited resources, they would probably displace other spending. In addition, if sales of assets managed by FADA are delayed until new staff is available to assume this function, it is possible that FSLIC could experience a temporary drop in collections from liquidations, although we have no way of knowing at this time if this would happen. Furthermore, assuming enactment of the legislation early in fiscal year 1989, cumulative collections during the year would probably not change significantly.

The bill assigns several responsibilities to the Federal Reserve Board in its role of regulating and supervising the commerical banking structure. The Federal Resrve would be required to examine the relationship between the securities affiliate, the bank holding company, and the bank and nonbank affiliates to ensure that the required degree of separability is maintained and that the safety of the holding company and bank affiliates is not jeopardized. The Federal Reserve also would have to prepare several reports and would have certain regulatory duties for the consumer provisions of the bill (Title IV), including the Truth in Savings Act,

the Home Equity Loan Consumer Protection Act of 1988, and the Community Benefits Amendments of 1988.

Based on information from the Federal Reserve, we estimate that additional costs for examination, supervision, training and other administrative requirements would be approximately $3 million annually through 1993. Because the Federal Reserve remits its surplus each year to the Treasury as a revenue, any additional operating costs would reduce federal revenues and would not require appropriation action.

In addition, the bill requires numerous studies and reports, and makes a number of other changes, which we do not expect to have a significant budget impact beyond the costs already specified.

No costs would be incurred by state or local governments as a result of enactment of this bill.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Mary Maginniss, who can be reached at 226-2860, and Mark Booth, who can be reached at 226-2680.

Sincerely,

JAMES L. BLUM,
*Acting Director.*

## INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee makes the following statement with regard to the inflationary impact of the reported bill:

The Committee is unaware that an inflationary impact on the economy will result from the passage of H.R. 5094.

## SECTION-BY-SECTION ANALYSIS

### TITLE I—SECURITIES ACTIVITIES OF NATIONAL BANKS AND BANK HOLDING COMPANY SUBSIDIARIES

*Section 101. Amendments to the Banking Act of 1933*

Sections 16, 20, 21, and 32 of the Banking Act of 1933 are commonly known as the Glass-Steagall Act.

Section 101 modifies section 20 of the Glass-Steagall Act. Section 20 of that Act prohibits member banks from affiliating with businesses "engaged principally" in investment banking activities. The Board of Governors of the Federal Reserve System ("Board") has interpreted this prohibition to allow a member bank that is a subsidiary of a bank holding company to affiliate with an investment bank engaged in certain impermissible activities so long as the latter is not deemed to be engaged principally in those activities.

This Committee believes that Congress, rather than the Board, should determine the securities powers available to a banking organization. Section 101 thus modifies section 20 of the Glass-Steagall Act by amending the prohibition on bank affiliations with companies "engaged principally" in securities underwriting, distributing, and dealing to prohibit all such affiliations. At the same time, this section creates an exception to this general prohibition by permitting a member bank to affiliate with a qualified securities subsidiary ("QSS").

*Section 102. Authorization for Bank Holding Companies To Establish Securities Subsidiaries*

Section 4 of the Bank Holding Company Act of 1956 (BHCA) establishes a general prohibition against a bank holding company acquiring an ownership interest in companies other than banks or, if previously acquired, against a holding company retaining an ownership interest in companies other than banks. It also prohibits bank holding companies from engaging directly in activities related to nonbanking activities. Subsection (c) of section 4 grants numerous exemptions from those general prohibitions.

Section 102(a) of this Act adds new paragraph 15 to section 4(c) of the BHCA. This paragraph effectuates the purposes of the amendment made to section 20 of the Glass-Steagall Act in section 101 of this Act. Paragraph 15 thus contains an exemption permitting a bank holding company to own shares of a QSS.

Section 102(b) of this Act amends section 2 of the BHCA by adding subsection (n), which defines "qualified securities subsidiary" and "securities subsidiary."

Subsection (n)(1) defines a "qualified securities subsidiary" to mean any company:

(A) which—

(i) is a subsidiary of a bank holding company;

(ii) is not a bank or insured institution or a subsidiary of a bank or insured institition;

(iii) engages, in the U.S., in securities activities; and

(iv) is registered as a broker or dealer, government securities broker or government securities dealer, or municipal securities dealer as required by the Securities Exchange Act of 1934 or as an investment adviser as required by the Investment Advisers Act of 1940; and

(B) the formation or acquisition of which has been approved by the Board under section 5(b).

The QSS is thus to be a separately capitalized subsidiary of the bank holding company, and must register as required by either the Securities Exchange Act of 1934 or the Investment Advisers Act of 1940. Because the Committee feels it important that risky securities activities be isolated structurally from the federally insured depository institution, the bank holding company structure is most appropriate. This structure is best equipped to accommodate the application and enforcement of protective firewalls and investor safeguards and to ensure the corporate separateness of the bank. It also facilitates the functional regulation of securities activities on the one hand and banking activities on the other.

Subsection (n)(2) defines a "securities subsidiary" to mean—

(A) any QSS; and

(B) any subsidiary of any QSS.

Section 102(c) of this Act adds a new section 5 to the BHCA.—Securities Activities.

Section 5(a)(1) authorizes a QSS to engage in a series of activities. This list is permissive rather than mandatory, and a QSS may engage in any of the enumerated activities. In addition, while this paragraph includes securities activities that may only be engaged in by a QSS, such as the underwriting, distributing, or dealing in

qualified municipal securities when engaged in within a bank holding company, it also includes activities that may continue to be conducted by other nonbank subsidiaries of the holding company or by the bank itself, such as the buying and selling of foreign currency. A QSS may—

(A) engage in underwriting, distributing, or dealing in any obligation which is—

(i) described in section 5136(b)(6) of the Revised Statutes ("bank eligible securities");

(ii) a qualified municipal security;

(iii) commercial paper; or

(iv) an asset-backed security;

(B) engage in securities brokerage, investment advisory services, financial advisory services, and such additional securities activities that are not prohibited by paragraph (2)(A) and that are permitted for brokers or dealers registered under the Securities Exchange Act of 1934 or for invesment advisers registered under the Investment Advisers Act of 1940;

(C) engage in buying and selling foreign currency, coin, and bullion and engage in interest rate and currency swaps;

(D) engage in, or acquire the shares of a company engaged in, any activity that is not described in clause (A), (B), or (C) of this section, if a provision of section 4 of the BHCA permits a bank holding company or subsidiary thereof to engage in that activity or acquire those shares, and—

(i) the Board permits the bank holding company to engage in that activity or acquire those shares; or

(ii) that provision permits the bank holding company or a subsidiary thereof to engage in that activity or acquire those shares without the Board's approval.

(E) engage in distributing securities issued by an investment company—

(i) that is registered pursuant to section 8 of the Investment Company Act of 1940;

(ii) that is not promoted, sponsored, or controlled by an affiliate of the QSS; and

(iii) for which neither the QSS nor any affiliate of the QSS acts as investment adviser.

A QSS may therefore conduct any of the securities activities presently permissible for a national bank. It may also underwrite, distribute, or deal in certain obligations (commercial paper, qualified municipal securities, and asset-backed securities) in which bank holding companies have not been allowed to underwrite, distribute, or deal under current law except to a limited degree, as permitted by the Board's interpretation of section 20 of the Glass-Steagall Act.

Brokerage and investment advisory services are also permitted, as is the distribution of mutual fund shares. In contrast to current authority granted by the banking regulators, a QSS may engage in the full retail sale of mutual fund shares. Such sales may not, however, occur if the fund is promoted, sponsored or controlled by an affiliate of the QSS or advised by the QSS or any affiliate. The intent of this provision is to minimize conflicts of interest and promote investor protection.

The QSS may, in addition, engage directly, or may own the shares of a company that engages in activities permissible under section 4 of the BHCA. This provision is intended to allow bank holding companies to consolidate any activities authorized under section 4 within the QSS if it is convenient to do so.

Section 5(a)(2) explicitly defines those activities in which a QSS may not engage. This paragraph (2) has been added in order to avoid the lack of clarity that has subjected current law to regulatory interpretation at odds with its original intent. It states that a QSS may not:

(i) underwrite (except as agent), distribute, or deal in any corporate debt security not specifically described in paragraph (1)(A) of this subsection (bank-eligible securities and commercial paper):

(ii) underwrite, distribute, place, or deal in any equity security (as defined in section 3(a)(11) of the Securities Exchange Act of 1934), other than an asset-backed security;

(iii) underwrite, distribute, place, or deal in any derivatives or variants of such debt or equity security; or

(iv) act as promoter or sponsor of any open-end investment company, or as underwriter to any investment company, registered or required to register under the Investment Company Act of 1940.

It would impermissible, for example, for the QSS to underwrite, distribute, or deal in convertible debt or options and futures on options on corporate debt and equity. On the other hand, the prohibition on equity underwriting does not extend to asset-backed securities or traditional loans or loan participations, and other activities in which banks and bank affiliates can currently engage. It should be noted, however, that the reference to "asset-backed security" in section 5(a)(2)(A)(II) does not imply that asset-backed securities can have equity features such as conversion rights, warrants or other rights relating to equity.

Section 5(b) prescribes the criteria for the establishment of a QSS.

Paragraph (1) requires the Board to approve a written application before a QSS may be established.

Subparagraphs (A) through (F) of paragraph (2) provide that the Board shall not approve a written application to establish a QSS if any of the following conditions exist or would likely result from the approval of the application:

(A) The Board may disapprove an application if establishing a QSS would affect the managerial or financial resources of the bank holding company to such an extent that the establishment would likely—

(i) have an adverse impact on the safety and soundness of any depository institution subsidiary of a bank holding company; or

(ii) impair or diminish the bank holding company's ability to act as a source of strength to its depository institution subsidiaries.

(B) The Board determines that disapproval is required under subsection (e) of this section.

(C) An application can be denied if it is incomplete.

(D) The Board may disapprove an application for failure to comply with the community benefit requirements set out in section 11 of the BHCA.

(E) The Board determines that any bank subsidiary of such BHCA fails, at the time of application, to meet the new risk-based capital guidelines with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.

(F) The Board determines that the establishment and operation of a QSS cannot reasonably be expected to produce public benefits such as greater convenience, increased competition, or gains in efficiency that outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

Paragraph (3) requires the Board to provide for public notice and opportunity for comment before making any determination with respect to any application to establish a QSS.

Section 5(c) lists the rules applicable to the transfer of securities activities from a depository institution subsidiary of a bank holding company.

Paragraph (1) of subsection (c) requires any bank holding company that establishes a QSS to transfer out of its depository institution subsidiary any securities activities as of the date such QSS commences operations.

This subsection establishes the principle that if a QSS is established, most securities activities housed within the bank should, for ease of regulation and to promote parallel equity as between the securities and banking industries, be transferred to the newly formed QSS. This transfer requirement applies only if a QSS is formed. This requirement does not affect the overseas securities activities of the bank holding company or any of its subsidiaries. Thus, for example, the transfer requirements in no way affect the securities activities conducted overseas by Edge Act or Agreement corporations.

Certain categories of securities activities need not be transferred and, as a result, may be conducted whether in the bank, insured institution, or subsidiary thereof even after a QSS has been established. To effectuate this, paragraph (2), provides an exception to the above transfer rule by permitting a depository institution subsidiary of a bank holding company to continue to:

(A) underwrite and deal in U.S. Treasury securities;

(B) buy and sell, without recourse, investment securities for the bank's own account and engage in certain information processing activities;

(C) buy and sell, without recourse, any securities in the bank's capacity as trustee, executor, administrator, custodian, or guardian of estates with respect to the account of a customer;

(D) conduct investment and financial advisory activities; and

(E) conduct activities:

(i) that are necessary and incidental to the international or foreign business of the bank or its subsidiaries; or

(ii) through small business investment companies.

The intent of subparagraph (E)(i) of this paragraph is to permit banks to perform activities of a technical "Securities" nature that

are both necessary and incidental to the international or foreign business of the bank or its subsidiaries. This is intended to be a narrow window through which a bank may, for example, provide information to its overseas branch or subsidiary that the letter may need in the course of its securities operations. It is not intended to allow, for example, a U.S. bank or nonbank affiliate to underwrite or distribute in the U.S. a Eurobond issue that is underwritten or managed by its London branch, subsidiary, or affiliate, such as an Edge Act corporation.

Sections 25 and 25(a) of the Federal Reserve Act (FRA), which govern the establishment of foreign subsidiaries of U.S. banks, state that such subsidiaries shall not conduct any business in the U.S. except such business that in the judgment of the Board is incidental to the international or foreign business of such foreign subsidiary. The Board has strictly applied this provision. It is intended that section 5(c)(2)(E)(i) be interpreted consistent with such application.

Section 5(c)(3) provides a transition period of up to one year for the transfer of the above securities activities if the Board determines that the transfer would cause:

(A) undue hardship to the depository institution; or

(B) excessive disruption to the operations of the bank holding company.

Section 5(c)(4) limits regulatory agency authority by prohibiting agencies from issuing any regulation or order authorizing or permitting any bank or insured institution affiliate of a QSS or any non-securities subsidiary affiliate of such bank or insured institution from engaging in the U.S. in securities activities other than those activities specifically described in subparagraph (A), (B), (C), (D), or (E) of paragraph (2). This paragraph (4) seeks further assurance that regulatory authority not be employed to expand the securities powers of banks and any affiliate of a bank other than a securities subsidiary beyond those that are explicitly granted by this legislation.

Section 5(d) phases out the securities activities of most nonbanking subsidiaries of a bank holding company whether or not it establishes a QSS. In order to facilitate efficient and effective regulation and to extend the firewall and other safeguard provisions of this Act to as much of the securities business of the bank holding company as possible, these securities activities are consolidated within the QSS, even to the extent that extant securities affiliates must phase out their own securities activities. Paragraph (1) of subsection (d) therefore prohibits the nonbank subsidiaries (except the QSS) from engaging in the U.S. in securities activities after the earlier of—

(A) the date a QSS commences operations; or

(B) the end of a two year period beginning on the date of the enactment of this Act.

Section 5(d)(2) contains two general exceptions to this prohibition. It permits a nonbank subsidiary of a bank holding company to engage in either (but not both) of the following:

(A) investment advisory or financial activities; or

(B) buying and selling securities—

(i) for the account of a customer

(ii) upon the order of the customer; and
(iii) without recourse.

Thus, for example, a discount brokerage subsidiary of a bank holding company could continue in existence even after the establishment of a QSS so long as it does not also provide investment advisory services.

Section 5(d)(4) creates an exception for primary dealers such that a nonbank subsidiary of a bank holding company that is a government securities broker or government securities dealer registered under section 15C of the Securities Exchange Act of 1934 may engage in securities activities as a primary dealer recognized by the Federal Reserve Bank of New York.

Section 5(e) prohibits affiliations that would result in undue concentration of economic resources. This section expresses the intent of this Committee that expanded securities powers for banking organizations be used to enhance competition within the financial services industry rather than to promote a concentration of resources that might have the opposite effect.

Paragraph (1) states that no bank holding company may establish a QSS through the acquisition of an existing securities firm if—

(A) the establishment of a QSS would result in the affiliation of a bank or a bank holding company that is among the 15 largest in the United States in terms of total consolidated assets with a securities firm and is among the 15 largest securities firms in the United States in terms of total consolidated assets;

(B) the establishment of a QSS would result in the affiliation of a bank or bank holding company with total worldwide consolidated assets of more than $30 billion with a securities firm that was among the 15 largest in the United States in terms of total consolidated assets; or

(C) the establishment of a QSS would result in the affiliation of a securities firm with total worldwide assets of more than $15 billion and a bank holding company which was among the 15 largest banking organizations in the United States.

Paragraph (2) contains an inflation adjustment factor for the dollar amounts appearing in the above concentration provision.

Section 5(f) grants the Board the authority to require a bank holding company to cease conducting securities activities other than activities in which a national bank is permitted to engage under section 5136(b) of the Revised Statutes if any one of its bank affiliates fails to meet the new risk-based capital guidelines with respect to tier 1 and tier 2 capital as such guidelines apply after 1992.

Section 5(g) provides a rule of construction that—

(1) states that no provision of the amendments to the Federal banking laws contained in this Act shall be construed as superseding or limiting any provision of Federal securities law or regulation or limiting the authority of the Securities and Exchange Commission (SEC); and

(2) states that the Board may issue orders and regulations to carry out the purpose of the Act. Furthermore, the Board is empowered to require reports of the QSS, and is in no way lim-

ited from regulating the bank holding company or its nonbank subsidiaries and transactions between or among a bank holding company and its affiliates. Section 102(d) of this Act adds subsections (o) and (p) to section 2 of the BHCA.

Section 2(o) defines asset-backed security, commercial paper, security, corporate debt security, securities activities, and qualified municipal securities.

The definition of asset-backed security is intended to denote a security that is secured by or represents interests in the obligations of multiple unrelated obligors (e.g., pools of many residential mortgage or consumer loans). A transaction which in substance represents the fractionalization of the obligation of a single obligor or the obligations of a group of related obligors through the use of a trust or other conduit structure or otherwise will not qualify as a permissible transaction in asset-backed securities for a QSS and is not authorized by this Act. In no event can the revenue stream of the asset-backed securities exceed the aggregate revenues derived from the underlying obligations.

Section 2(p) states that notwithstanding section 8(d) of the International Banking Act of 1978, subsection (r) requires any branch or agency of a foreign bank to be treated as a bank for purposes of this Act.

*Section 103. Bank Securities and Investment Activities*

Section 103(a) is a restatement and reorganization of section 5136 of the Revised Statutes.

Section 103(b) of paragraph (1) contains various amendments to add new law to the reorganized and restated section 5136 of the Revised Statutes is divided into three seaprate subsections (a), (b), and (c). The intent of the restatement and reorganization is simply to make the statute easier to read than it is in its present form and to permit easier reference to the various functions it authorizes. No court should conclude based on the restatement and reorganization that there is an intent to alter section 5136 of the Revised Statutes substantively. Specifically, there is no intent through this restatement and reorganization of section 5136 either to affirm or take exception to existing regulatory and judicial interpretation of section 5136.

Section 5136(a) is a restatement and reorganization of the general powers of a national bank as reflected in current law.

Section 5136(b) is a restatement and reorganization of the powers relating to national bank securities activities and commercial paper activities.

Paragraph (1) of subsection (b) prohibits a national bank from being an underwriter of securities except as otherwise provided in this section.

Paragraph (2) of subsection (b) prohibits a national bank from buying or selling any security unless the purchases or sale is made—

(A) for the account of a customer;

(B) by the bank—

(i) upon the order of a customer;

(ii) in the bank's capacity as trustee, executor, administrator, custodian, or guardian of estates with respect to the account of customers;

(C) without recourse.

Paragraph (3) of subsection (b) authorizes a national bank to issue and sell securities which are guaranteed by the Government National Mortgage Association under section 306(g) of the National Housing Act.

Paragraph (4) of subsection (b) authorizes a national bank to buy and sell, and underwrite "bank-eligible securities." Bank-eligible securities are defined in paragraph (6).

Paragraph (5) of subsection (b) permits a national bank to purchase or sell:

(A) any security of which the national bank is the issuer; or

(B) any security which the national bank is purchasing or has purchased for the bank's own account for investment in accordance with subsection (c) of this section.

Paragraph (6) of subsection (b) defines "bank-eligible security" and lists those securities. The list includes obligations of the U.S., general obligations of any State or political subdivision of any State, and other securities.

Section 5136(c) of the Revised Statutes defines those investment securities that a bank may purchase for the bank's own account, as well as any limits on such purchases.

Section 103(a)(2) of this Act contains a rule of construction pertinent to the restatement and reorganization which provides that the amendment made by section 103(a)(1) to section 5136 of the Revised Statutes—

(A) may not be construed as making any substantive change in the meaning of any provision of such section; and

(B) shall not modify, affirm, or otherwise affect any regulation prescribed, any order issued, or any action taken before the effective date of such amendment under or pursuant to such section.

Section 103(b) of this Act contains additional amendments to subsections (b) and (c) of section 5136 of the Revised Statutes and adds new subsections (d), (e), and (f) to section 5136.

Section 103(b)(2) adds new paragraphs (7), (8), and (9) to section 5136(b).

New paragraph (7) clarifies that a national bank may buy and sell commercial paper, as such term is defined in section 2(o)(2) of the BHCA.

New paragraph (8) provides that no provision of this section is to be construed as prohibiting a national bank from performing certain information processing and clearing functions as described in paragraph (22)(A) or paragraph (23)(B)(iii) of section 3(a) of the Securities Exchange Act of 1934.

New paragraph (9) grants the Board the authority to prohibit any activity of a national bank which would be a securities activity if engaged in by any person other than a bank. This authority is deemed necessary in order to guard against evasions of sections 5136(b), section 21 of the Glass-Steagall Act, or the 20th paragraph of section 9 of the Federal Reserve Act. The Board has authority to prohibit securities activities undertaken by national banks in con-

travention of the expense provisions of this Title and deemed inconsistent with its purposes. The Board's authority does not, however, extend to prohibiting activities expressly authorized by other sections of this Act, such as brokerage services and the distribution of mutual funds.

Section 103(b)(3) of this Act adds new subparagraphs (R) and (S) to the list of bank-eligible securities contained in paragraph (6) of section 5136(b). The additional bank-eligible securities are as follows:

(R) Shares issued and securities guaranteed by the Federal Agricultural Mortgage Corporations;

(S) Obligations of the Financing Corporation.

Section 103(b)(4) of this Act amends paragraph (c)(2) of section 5136 of the Revised Statutes. This amendment provides that a national bank may own the stock of a bankers' bank or bankers' bank holding company that owns a bankers' bank, provided that the bankers' bank or bankers' bank holding company is owned exclusively either by banks or bank holding companies. This section further provides that a bankers' bank may be organized within a holding company and that the bankers' banks and bankers' bank holding companies can provide services to bank holding companies.

Section 103(b)(5) of this Act adds new subsections (d) and (e) to section 5136 of the Revised Statutes.

New subsection (d) authorizes small and medium-sized banks to conduct certain securities activities in the bank itself. Paragraph (1) provides municipal securities powers for independent national banks with assets of not more than $500 million. A freestanding national bank with banking assets of not more than $500 million may buy and sell, as principal or agent, and be an underwriter of qualified municipal securities.

Paragraph (2) provides mutual fund distribution powers for national banks with assets of not more than $500 million. A national bank with banking assets of not more than $500 million may distribute securities of a registered investment company so long as it is not organized, sponsored, managed, or controlled by the bank or any affiliate of the bank and so long as neither the bank nor any affiliate of the bank acts as investment adviser to the mutual fund whose shares it distributes.

New subsection (e) states that no national bank may engage in any activity after the date of the enactment of the Depository Institutions Act of 1988 in which such bank could engage before such date if such bank fails to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.

New subsection (f) states that no national bank may act as promoter or sponsor of, or underwriter to, any open-end investment company registered or required to register under the Investment Company Act of 1940 as a common trust fund or common investment fund which—

(1) is registered under the Investment Company Act of 1940

(2) is used solely for the investment of individual retirement account assets; and

(3) is maintained in accordance with the requirements of section 408 of the Internal Revenue Code of 1986.

Section 103(c)(1) of this Act amends section 18(j)(3)(A) of the Federal Deposit Insurance Act by providing that no insured bank may be an affiliate of any company which engages in any securities other than activities in which a national bank may engage under subsection (b) or (d) of section 5136 of the Revised Statutes. This paragraph seeks to impose restrictions on the securities affiliations of insured banks similar to those included within the BHCA and in section 20 of the Glass-Steagall Act, as amended by this Act. It is the intent of this Act to provide uniform rules for bank affiliations with securities firms, to the extent possible. At the same time, this paragraph seeks to apply uniform rules to banks and to operating subsidiaries of banks so that securities powers authorized for banks—those contained in sections 5136(b) and (d)—may also be conducted in bank subsidiaries without the need for establishment of a bank holding company and a QSS.

Section 103(c)(2) of this Act provides a new subparagraph (B) that would clarify that the preceding amendment to subparagraph (A) of section 18(j)(3) does not prohibit any company engaged directly or indirectly in any securities activities on March 1, 1988, and that was affiliated with an insured bank on such date, from continuing to be affiliated with such insured bank, and, in the case of any such company which is also a company described in section 4(f)(1) of the BHCA, shall not prohibit such company from directly or indirectly establishing, organizing, sponsoring, acquiring, managing, or controlling additional affiliates engaged directly or indirectly in any securities activities. These grandfather provisions are applicable only to those insured banks that are neither national banks nor members of the Federal Reserve System.

This clarification ensures that securities firms, insurance companies, or other companies already affiliated with banks (affiliations with which were grandfathered in the Competitive Equality Banking Act) not be prohibited from establishing, organizing, underwriting, sponsoring, acquiring, managing, or controlling additional affiliates in furtherance of their core securities or securities-related business.

Section 103(c)(3) of this Act provides for a transition rule that states that an insured bank has two years from the date of enactment to discontinue securities activities not permitted by this subsection. For purposes of this section, the term affiliate has the same meaning given to such term in section 2(k) of the BHCA.

Section 103(d) of this Act contains technical and conforming amendments.

*Section 104. Effect on Certain State Laws*

Newly designated section 13 of the BHCA generally preserves a State's authority over companies, banks, bank holding companies, and subsidiaries of those entities.

Section 104 amends section 7 of the BHCA to add a limited exception to the above rule by providing that a State may not prohibit a bank or bank holding company from being affiliated with a QSS and vice versa, solely because the QSS is engaged in securities activities that are described in section 5(a) of the BHCA.

*Section 105. Bank Holding Company Formation Through Reorganizations*

Under section 3 of the BHCA, it is generally unlawful to form a bank holding company without prior approval of the Board. Section 105 provides for expedited procedures when forming a bank holding company under certain circumstances.

Subsection (a) provides an exception to the Board's prior approval requirement if certain requirements contained in subsection (h) are satisfied.

Subsection (b) adds a new subsection (h) to section 3 which describes a reorganization which qualifies for expedited approval.

Paragraph (1) of new subsection (h) describes a reorganization qualifying for expedited procedures as one in which:

(A) any person or group of persons exchange the shares of a bank for shares of a newly formed bank holding company;

(B) each such person holds substantially the same proportional interest in the bank holding company as such person held in the bank; and

(C) immediately following the reorganization, the resulting bank holding company meets the capital and other financial standards for bank holding companies as prescribed by the Board.

Paragraph (2) of new subsection (h) provides that the exception to the approval requirements contained in subparagraph (C) shall apply with respect to a reorganization described in paragraph (1) above if—

(A) the bank referred to in paragraph (1)(A) provides notice to the Board at least 30 days before the date on which such reorganization is scheduled to begin;

(B) the board has not—

(i) issued an order before such date disapproving such reorganization; or

(ii) issued a notice before such date that the provisions of the subsection are not applicable to such reorganization by reason of paragraph (3).

Paragraph (3) of new subsection (h) provides that the expedited procedures contained in this section shall not apply to a reorganization that would result in a bank holding company that would be engaged in any activity other than banking or managing or controlling banks.

Paragraph (4) of new subsection (h) requires the Board not to require more capital of a subsidiary bank resulting from a reorganization described in paragraph (1) of this subsection immediately following such reorganization than is required for a similarly sized bank that is not a subsidiary of a bank holding company.

*Section 106. Expedited Procedures for Bank Holding Companies to Seek Approval to Engage in Certain Nonbanking Activities*

This section amends section 4 of the BHCA by adding a new subsection (i) which provides expedited procedures for approval to engage in certain nonbanking activities.

Paragraph (1) of new subsection (i) provides that no bank holding company shall engage in any activity or acquire the shares of any nonbanking company, either *de novo* or by acquisition unless—

(A) the Board has given 60 days prior written notice; and

(B) within the 60-day period the Board has not issued an order—

(i) disapproving the proposal; or

(ii) extending the period within which the Board may disapprove the proposal.

Paragraph (2) provides for exceptions to the above rule.

Subparagraph (A) of paragraph (2) states that an acquisition may be made prior to the expiration of the period described in paragraph (1)(A) if the Board issues a written statement that it does not intend to disapprove such application.

Subparagraph (B) of paragraph (2) allows the Board to provide for no notice under this subsection or notice of a shorter period of time with respect to—

(i) a notice involving a thrift institution if the Board determines an emergency exists and the primary regulator of the thrift concurs with the Board's determination; or

(ii) an extraordinary acquisition involving nonbanking activities pursuant to section 13(f) of the Federal Deposit Insurance Act.

Subparagraph (C) provides that no notice is required for a bank holding company to establish de novo an office to engage in a previously authorized activity or to change the location of an office engaged in that activity.

Paragraph (3) and (4) provide that the notice submittted to the Board shall contain such information as the Board prescribes and that the Board may require additional information in connection with such notice.

Paragraph (5) provides that the Board may have an additional 60 days within which to disapprove the proposed activity or acquisition.

Paragraph (6) provides criteria for disapproval of a notice under this section.

Paragraph (7) provides that the Board may differentiate between activities commenced de novo and activities commenced by the acquisition of a going concern in issuing orders and prescribing regulations under subsection (c) with respect to activities or acquisitions referred to in paragraph (1) of this subsection.

Subsection (b) of section 106 requires the Board to take into account technological and other innovations in the provisions of banking products or services in determining whether to disapprove a notice under this subsection.

*Section 107. Monitoring of Foreign Exchange Operations of Bank Holding Companies*

This section adds subsection (g) to new section 12 of the BHCA. It reresents a recognition on the part of the Members of this Committee that too little information is available and supervision dedicated to the foreign exchange operations of banking organizations and, indeed, of corporations generally. Most critically, the Members of the Committee share a concern that neither the level of risk

these activities may pose to the safety and soundness of these organizations as well as, potentially, to the federal deposit insurance fund, nor the appropriate measures to take against undue risk, are well understood. This section seeks to ensure that these activities will be monitored adequately and that, if the safety and soundness of the bank is threatened, the Board, after consultation with the SEC, may establish limits to the extent to which bank holding companies may engage in foreign exchange operations.

Paragraph (1) of new subsection (g) requries the Board to establish procedures appropriate to supervise the foreign exchange operations of any nonbank or despository institution subsidiary of bank holding companies, and grants the Board authority to conduct examinations of the foreign exchange operations as deeded appropriate.

Paragraph (1) also enumerates factors to be considered in establishing procedures to supervise the foreign exchange operations. The Board shall consider the extent of the exposure to risks associated with foreign currency operations, managerial expertise, and other factors related to foreign exchange activities in the bank holding company, its depository institution and nonbank subsidiaries.

Paragraph (2) authorizes the Board, after consultation with the SEC, to establish limits on the extent to which bank holding companies may engage in foreign exchange operations to protect the safety and soundness of any depository institution subsidiary of a bank holding company.

Paragraph (3) authorizes the Board, in consultation with the Office of the Comptroller of the Currency (OCC) and the SEC to require changes in the manner in which foreign exchange operations are conducted by an bank holding company, its depository institution and nonbank subsidiaries.

*Section 108. Regulations; Effective Date*

Subsection (a) of section 108 pertains to regulations to be promulgated by the Board and the Comptroller of the Currency.

Paragraph (1) of subsection (a) requires the Board and the OCC to each submit a report to Congress containing proposed regulations required to implement the amendments made by this Act to the BHCA and section 5136 of the Revised Statutes before the end of a 90-day period beginning on the date of the enactment of this Act.

Paragraph (2) of subsection (a) states that the final regulations required to implement the amendment made to the BHCA and section 5136 of the Revised Statutes shall be prescribed and published before the end of the 150-day period beginning on the date of the enactment of this Act.

Subsection (b) section 108 states that the amendments made by this title shall take effect at the end of the 180-day period beginning on the date of enactment of this Act.

## TITLE II—SAFEGUARD PROVISIONS FOR BANK SAFETY, INVESTOR AND CONSUMER PROTECTION, AND FAIR COMPETITION

### Part A—Safeguard Provisions Enforced by Federal Depository Institutions Regulatory Agencies

*Section 201. Bank Safety and Soundness*

This section amends the BHCA to add a new section 9 to place necessary and appropriate restrictions on transactions between affiliates within a bank holding company where the holding company controls a QSS. These prohibitions become applicable at the time that a QSS commences operations pursuant to new section 5 of the BHCA.

These prohibitions (so-called "firewalls") are necessary (1) to preclude the added risk associated with securities powers from jeopardizing the safety and soundness of the affiliated bank or insured institution, and (2) to prevent consumers from being subject to misrepresentations and potentially harmful conflicts of interests. Finally, the various firewall provisions under the bill attempt to minimize the competitive advantage garnered by securities companies which become affiliated with federally-insured banks and insured institutions. Due to their federally-insured status and access to the Federal Reserve's discount window, banks and insured institutions are able to obtain capital at reduced costs, such benefit subsequently being transferred into a competitive advantage to affiliates of such entries vis-a-vis nonaffiliated companies. As a result, this section includes various restrictions on affiliate transactions and cross-marketing activities which represent a careful balance between minimizing this competitive advantage while preserving many of the consumer benefits garnered by such affiliations.

*Section 9(a)—Certain financial transactions involving banks, insured institutions and their subsidiaries and qualified securities subsidiaries to be prohibited.*—Section 9(a) prohibits bank and insured institutions subsidiaries of bank holding companies which control a QSS, and any subsidiary of such bank or insured institution (hereafter all such entities to be referred to collectively as "bank") from, directly or indirectly, engaging in the following transactions:

(1) extend credit in any manner to the QSS or any subsidiary of that securities subsidiary, with an exception provided in subsection (j) for extensions of credit made in the course of clearing U.S. Government or agency securities where such extensions of credit are repaid on the same calendar day, are incidental to the clearing of transactions in those securities, and are fully secured by such securities;

(2) issue a guarantee, acceptance, or letter of credit (including an endorsement or a standby letter of credit) for the benefit of the QSS or its subsidiaries;

(3) purchase for the bank's own account, any asset of the QSS or its subsidiaries;

(4) purchase for the bank's own account, any security underwritten or distributed by the QSS (or it subsidiary) during the underwriting period and 30 days thereafter;

(5) purchase in the bank's or securities subsidiary's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates with respect to the account of a customer, any security of which the securities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period, except at the express request of the customer;

(6) purchase in the bank's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates, any security (A) which is issued by an investment company for which such bank acts as investment adviser, or (B) which is issued by an investment company and which is distributed, as defined in section 2(o) of the BHCA, by such bank or securities subsidiary, except that the Securities and Exchange Commission (SEC) may, by rule or order, grant exemptions from this paragraph;

(7) extend credit in any manner to any investment company (A) for which the bank acts as investment adviser; or (B) whose securities are distributed, as defined in section 2(o) of the BHCA, by the bank, except as permitted pursuant to section 18(f)(3) of the Investment Company Act of 1940;

(8) sell any asset of the bank to the securities subsidiary or to any investment company (A) for which the securities subsidiary or bank acts as investment adviser; or (B) the securities of which are distributed, as defined in section 2(o) of the BHCA, by the securities subsidiary or bank, except as provided in subsection (h) providing for the sale of asset-backed securities by the securities subsidiary;

(9) extent credit to an issuer of securities of which the securities subsidiary is an underwriter (A) for the purpose of paying, in whole or in part, the principal of, or any interest or dividends on, those securities; or (B) providing terms, conditions, or maturities that are substantially similar to those of the underwritten securities;

(10) extend credit, arrange for the extension of credit, or issue or enter into a standby letter of credit, asset purchase agreement, indemnity, guarantee, insurance, or other instrument or facility, for the purpose of enhancing the marketability of, or in connection with, the issuance of any security of which the securities subsidiary is an underwriter or member of a selling group;

(11) accept, as collateral for any extension of credit to any person, securities issued by the securities subsidiary or by an investment company for which the securities subsidiary acts as investment adviser.

The "directly or indirectly" language included in this section, as well as elsewhere in the bill, makes clear that a bank may not do indirectly what it is prohibited from doing directly. Thus, for example, a bank may not loan money to a 4(c)(8) subidiary of its parent holding company with the understanding that the money will be transferred to the qualified securities affiliate. Further, a bank cannot do through one of its own subsidiaries what it is prohibited from doing directly. Circuitous transfers of funds in contravention of the firewall prohibitions included in this bill are prohibited in

this manner and are subject to civil and criminal penalties, as provided in Section 203 of this Act. Continuing violations of the provisions of this title may subject the parent holding company to an order by the Federal Reserve Board requiring divestiture of its bank or insured institution subsidiary, pursuant to new section 12(h) of the BHCA (as set forth in section 203(b) of this Act.)

*Section 9(b)—Certain financial transactions during distribution period for certain new issues prohibited.*—Section 9(b) prohibits any bank holding company or its subsidiaries, other than a QSS, from, directly or indirectly, knowingly extending credit or arranging for the extension of credit to any person that is secured by or is extended for the purpose of purchasing any security (1) while that security is the subject of a distribution in which a QSS of the bank holding company participates as an underwriter or as a member of a selling group, and (2) for 30 days after that security ceases to be the subject of such a distribution. The prohibition applies by its terms to any subsidiary of a QSS, as well as any other subsidiary of a bank holding company subsidiary.

*Section 9(c)—Arms-length transactions required.*—Section 9(c) provides that a bank may provide products or services to a customer of an affiliated QSS only if such products or services are provided on terms and under circumstances (including credit and similar standards) which are substantially the same, or at least as favorable to the bank, as such products and services are provided to customers of the bank who are not customers of the affiliated QSS. If such products or services are not provided to anyone other than customers of the QSS, such products and services shall be provided on terms and circumstances that in good faith would be offered to persons who are not customers of the securities subsidiary. This section defines "customer" to mean any person who obtains any product or service from such company, and shall be treated as such for a 12-month period beginning on the date such person pays or becomes obligated to pay compensation to such company.

*Section 9(d)—Disclosures of confidential customer information prohibited.*—Section 9(d)(1) prohibits a bank from disclosing, directly or indirectly, any confidential customer information to any QSS (or its subsidiaries) without the express written consent of that customer to the disclosure of the specific information concerned for a particular purpose. Section 9(d)(2) proceeds to define the term "confidential customer information" to include any evaluation of the creditworthiness of any customer of such bank (a) which is acquired from a customer by reason of a business relationship with the bank which would not, in the ordinary course of business, be divulged by such entity to nonaffiliated securities companies without the consent of the customer, or (b) is obtained through access to the payment system.

This section does not affect other laws governing the use of material nonpublic information, such as the prohibitions against insider trading. Thus, for example, although this section allows disclosure of nonpublic information with the customer's express written consent, it in no way legitimizes an otherwise impermissible use of that information to purchase or sell a security.

*Section 9(e)—Prohibition on shared name, premises and advertising.*—Section 9(e) prohibits a bank from sharing the same name or

logo with its affiliated QSS. Further, this section would prohibit an affiliated bank from sharing with its QSS any part of any office which is commonly accessible to the public for the purpose of conducting any depository, lending or securities business. Additionally, it would prohibit the sharing of any other office not commonly accessible to the public (i.e. backroom operations), except to the extent that such sharing is permissible under Federal Reserve Board regulations with the approval of the SEC. Any permissible shared operations would, however, be subject to the prohibitions on disclosure of confidential customer information contained in section 9(d). Further, this section would prohibit the bank from posting, publishing or broadcasting any advertisement in conjuction with or relating to the QSS.

*Section 9(f)—Prohibition on reciprocal arrangements.*—Section 9(f) addresses the problem of reciprocal arrangements between bank holding companies. Reciprocal arrangements, whereby a holding company or its subsidiaries would engage in transactions with another bank holding company or its subsidiaries for the purpose of evading the provisions of any Federal banking law, are prohibited.

The Federal Reserve Board, with the approval of the SEC, shall prescribe such regulations as may be necessary to enforce these requirements.

*Section 9(g)—Prohibition on interlocking directors, officers, or employees.*—Section 9(g) prohibits a bank holding company from allowing any director, officer, or employee of its QSS from serving at the same time as a director, officer, or employee of its subsidiary bank. The Federal Reserve Board is given the authority to grant exemptions, with the approval of the SEC, from these interlocking restrictions. In making such determinations, the Board shall consider the size of the bank holding company, bank and securities company involved; the burdens such restrictions impose; the safety and soundness of the bank and securities company; and other appropriate factors, including unfair competition in securities activities or the improper exchange of nonpublic customer information.

Section 9(g)(3) contains an exception for certain back office operations. The prohibitions under paragraph (1) do not apply to any employee, other than an officer or director, employed by the bank holding company or any subsidiary of such company to perform clerical, accounting, bookkeeping, statistical, or similar functions if such functions are performed in a separate office or facility and in a manner consistent with requirements determined by the Board with the approval of the SEC.

*Section 9(h)—Asset sales to the qualified securities subsidiary.*—Section 9(h) permits a bank, notwithstanding subsection (a)(7) of this section but subject to section 23B of the Federal Reserve Act, to sell to its affiliated QSS assets which will be used by that subsidiary as security for, or which represent an interest in, securities it underwrites or distributes if:

(1) the assets are sold for the purpose of including such assets in a pool in connection with the issuance of asset-backed securities;

(2) the sale of such assets is without recourse;

(3) the securities underwritten or distributed by the QSS (and backed by these assets) are either (i) rated investment

grade by at least one independent nationally recognized securities rating company, or (ii) guaranteed by, or represent an interest in securities issued or guaranteed by, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Government National Mortgage Association; and

(4) the price at which an equity security or the yield at which a debt security is to be distributed to the public is established at a price no higher, or yield no lower, than that recommended by a qualified independent underwriter which has also participated in the preparation of the registration statement and the prospectus, offering circular, or similar document.

The board, with the approval of the SEC, shall prescribe such regulations as may be necessary to ensure compliance with these provisions and with the "arm's length" requirements set out in Section 23B(a)(1) of the Federal Reserve Act.

For purposes of this subsection, "asset" is defined as any note, draft, acceptance, loan, lease, receivable or other obligation.

The provisions included in the bill are meant to allow a QSS to "securitize" assets obtained from its affiliated bank or insured institution, but only if the securities backed by those assets meet the quality control requirements set out herein. This section intended to protect against the dumping by banks of low-quality assets into the asset-backed securities markets through affiliated underwriters.

*Section 9(i)—Shareholders in bankers' banks treated as affiliates of securities subsidiary.*—Section 9(i) provides that any bank which owns any interest in a "bankers' bank" affiliated with a QSS, or any interest in a holding company which controls such bankers' bank, shall be treated as a bank affiliated with the QSS for purposes of the firewall provisions. An exception is provided for banks and their affiliates who, in the aggregate, hold a 5 percent or less interest in such bankers' bank or bankers' bank holding company.

*Section 9(j)—Exception for intra-day extensions of credit in connection with clearing government securities.*—Section 9(j) provides an exception from the prohibition on extensions of credit included in section 9(a)(1) for extensions of credit made in the course of clearing U.S. Government or agency securities where such extensions of credit are repaid on the same calendar day, are incidental to the clearing of transactions in those securities, and are fully secured by such securities.

*Section 9(k)—Discriminatory treatment of securities firms that are not affiliated with banking organizations prohibited.*—Section 9(k) prohibits any bank or insured institution from, directly or indirectly, acting alone or in concert with others, extending or denying credit or services (including clearing services) or varying the terms or conditions thereof, if the effect would be to treat securities firms not affiliated with a bank less favorably than a securities affiliate of a bank (unless the bank or insured institution demonstrates that the extension or denial is based on objective criteria and is consistent with sound business practices) or if such action is intended to crate a competitive advantage for a securities affiliate.

*Section 9(l)—Independent annual audits of bank holding companies and their bank or other insured institution and securities sub-*

*sidiaries.*—In order to ensure compliance with the firewall provisions and safeguards to ensure the safety and soundness of the banking sytem under expanded bank powers, section 9(l) requires annual independent audits of the consolidated financial statements of each bank holding company which controls a securities subsidiary, and each bank or other insured institutions subsidiary of such bank holding company. These entities shall prepare and submit to the appropriate Federal depository institutions regulatory agency, an annual report which, shall include a management report, in such form as the Board may prescribe by rule or regulation, on internal controls relating to financial statements and to compliance with the safeguard provisions of Section 9.

The Board may, by order or regulation, grant exemptions from the annual audit requirements of section 9(l)(1) to any bank holding company with respect to any bank or other insured institution subsidiary in accordance with certain criteria:

(A) the size of the securities subsidiary and bank or other insured institution subsidiary involved;

(B) the cost of complying with the audit and reporting requirements of this section;

(C) the safety and soundness of the bank or insured institution subsidiary; and

(D) other appropriate factors, including the number of securities transactions, the dollar volumes of such transactions, and the extent to which a bank or other insured institution subsidiary's financial results are evaluated as part of an audit of a bank holding company under this section.

*Section 202. Consumer Disclosure Requirements*

This section amends the BHCA to add a new section 10 to provide consumers with information as to potential conflict-of-interest problems which may arise as a result of the bank's, insured institution's, or securities affiliate's involvement in securities activities.

Section 10 provides that no bank or insured institution subsidiary of a bank holding company, and no subsidiary of such bank or insured institution, shall provide an opinion to any customer on the value of, or the advisability of purchasing or selling, securities of which a securities subsidiary of such bank holding company is an underwriter or which such securities subsidiary sells, or offers for sale, unless such bank, insured institution, or subsidiary disclosure to the customer that—

(1) the securities subsidiary is an affiliate of such bank, insured institution, or subsidiary;

(2) the subsidiary is not a federally insured bank or insured institution, and that it is a separate corporate entity from its affiliated bank or insured institution; and

(3) that the securities underwritten, sold, offered, or recommended by the securities subsidiary are not federally insured, guaranteed or otherwise an obligation of the affiliated bank or insured institution.

*Section 203. Administrative Enforcement and Penalties for Violations*

*a. Criminal penalties.*—This section amends section 14 of the BHCA to authorize the imposition of criminal penalties against individuals and organizations who knowingly violate the firewall provision of new section 9 of the BHCA. Fines shall be assessed pursuant to the provisions of title 18 of the U.S. Code. Individuals who violate these provisions are subject to a maximm fine of $250,000 or not more than 5 years' imprisonment, or both. Organizations who violate these provisions are subject to a maximum fine of $500,000 per offense.

This section further provides an alternative term of imprisonment for intentional violations of the firewall provisions. A defendant who intentionally violates any firewall provision, or any regulation or order issued pursuant thereto, shall be subject to imprisonment for a term of not less than 2 years and not more than 20 years.

Finally, this section provides that, in lieu of the amount determined under title 18, a court may fine an individual in violation of these provisions an amount not to exceed two times the annual compensation of that individual at the time of the offense; organizations may be fined an amount not to exceed .01 percent of the minimum required capital of that organization.

*b. Civil penalties.*—This section further authorizes the imposition of civil monetary penalties against bank holding companies, banks, insured institutions, their subsidiaries and persons that violate the provisions of new section 9 of the BHCA. The penalty imposed upon institutions shall not exceed an initial fine of $100,000, with an additional fine not to exceed $10,000 per day for each day a violation continues, up to 1 percent of the bank holding company's or institution's minimum required capital. Officers, directors, employees and agents that violate the provisions of new section 9 shall be fined not more than $10,000 per day for each day a violation continues. Such penalties shall be imposed in accordance with the procedures set out under section 14(b) of the BHCA.

*c. Appropriate Federal depository institutions regulatory agency.*—This section also provides that for purposes of sections 9, 10, 14, and 15 of the BHCA, the appropriate federal regulatory agency shall be: the Comptroller of the Currency in the case of national banks, district banks, or any Federal branch or agency of a foreign branch; the Federal Reserve Board in the case of bank holding companies, branches or agencies of a foreign bank (other than Federal branches or agencies), member banks (other than national banks), and any other subsidiary of a bank holding company; the Federal Deposit Insurance Corporation (FDIC) in the case of covered insured non-member banks; and the Federal Home Loan Bank Board in the case of covered insured institutions.

*d. Divestiture provisions.*—This section provides the Federal Reserve Board with the authority to require a bank holding company to divest its bank or insured institution subsidiary, or any subsidiary of such bank or insured institution, where the holding company or its subsdiaries has engaged in a continuing course of conduct involving violations of the securities activities and firewall provi-

sions contained in new sections 5 and 9, respectively, of the BHCA. This section also provides notice, administrative hearing and adjudicatory procedures for requiring such divestiture.

*Section 204. Regulations*

This section requires the Federal Board to submit a report to Congress containing proposed regulations required to implement this title within 90 days of enactment of this title. It goes on to require that final regulations be prescribed and published before the end of 150 days after enactment.

Part B—Safeguard Provisions Enforced by the Securities and Exchange Commission

*Section 211. Provisions Relating to Certain Broker-Dealer Affiliated with Bank Holding Companies*

This section amends the Securities Exchange Act of 1934 to add a new section 15D to mirror the restrictions in new section 9 of the BHCA to place necessary and appropriate restrictions on transactions between affiliates within a bank holding company where the holding company controls a QSS. These prohibitions are neccessary to enhance compliance with the safeguard provisions of Part A by providing for surveillance and enforcement of both sides of the firewalls.

*Section 15D(a)—Definitions.*—Section 15D(a) defines certain terms for purposes of this section.

*Section 15D(b)—Certain transactions between broker-dealer and affiliated banks, etc., prohibited.*—Section 15D(b) provides that it shall be unlawful for a securities subsidiary to engage, directly or indiectly or indirectly, in any of the following transactions involving an affiliated bank, insured institution, or subsidiary thereof (hereafter all such entities to be referred to collectively as "bank"):

(1) knowingly obtain, receive, or enjoy the beneficial use of, any extension of credit in any manner from an affiliated bank, insured institution, or subsidiary thereof with an exception provided in subsection (i) for extensions of credit made in the course of clearing U.S. Government or agency securities where such extensions of credit are repaid on the same calendar day, are incidental to the clearing of transactions in those securities, and are fully secured by such securities;

(2) knowingly receive, obtain, or enjoy the beneficial use of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, from an affiliated bank;

(3) knowingly sell to an affiliated bank for its own account, any asset of the securities subsidiary;

(4) knowingly sell to an affiliated bank for its own account, any security or commercial paper of which the securities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period;

(5) knowingly sell to an affiliated bank in the bank's capacity as trustees, executor, administrator, custodian, managing agent, or guardian of estates with respect to the account of a customer, any security or commercial paper of which the secu-

rities subsidiary is an underwriter or a member of the selling group during the underwriting period and for 30 days after the end of such period, except at the express request of the customer;

(6) knowingly sell to a securities subsidiary or an affiliated bank in the securities or bank's capacity as trustee, executor, administrator, custodian, managing agent, or guardian of estates with respect to the account of a customer, any security (A) which is issued by an investment company for which such securities subsidiary or bank acts as investment adviser, or (B) which is distributed by such securities subsidiary or bank except that the SEC may, by rule or order, grant such exemptions from this paragraph as it considers necessary or appropriate in the public interest or for the protection of investors;

(7) arrange for the extension of credit from an affiliated bank in any manner to any investment company (A) for which the securities subsidiary or bank acts as investment adviser; or (B) whose securities are distributed by the securities subsidiary or bank, except as permitted pursuant to section 18(f)(3) of the Investment Company Act of 1940;

(8) purchase any asset of an affiliated bank either for its own account or for the account of any investment company (A) for which the securities subsidiary or bank acts as investment adviser; or (B) the securities of which are distributed, as defined in section 2(o) of the BHCA, by the securities subsidiary or bank, except as provided in subsection (h);

(9) arrange for the extension of credit from an affiliated bank to an issuer of securities or commercial paper of which the securities subsidiary is an underwriter (A) for the purpose of paying, in whole or in part, the principal of, or any interest or dividends on, those securities or commercial paper; or (B) providing terms, conditions, or maturities that are substantially similar to those of the underwritten securities or commercial paper;

(10) arrange for the extension of credit from, or arrange for the issuance of or entry into, a standby letter of credit, asset purchase agreement, indemnity, guarantee, insurance, or other instrument or facility by, an affiliated bank for the purpose of enhancing the marketability of, or in connection with, the issuance of any security or commercial paper of which the securities subsidiary is an underwriter or member of a selling group;

(11) arrange for the extension of credit from an affiliated bank on the collateral of securities or commercial paper issued by the securities subsidiary or by an investment company for which the securities subsidiary or bank acts as investment adviser.

*Section 15D(c)—Disclosures of confidential customer information prohibited.*—Section 15D(c) makes it unlawful for a securities subsidiary to disclose, directly or indirectly, any confidential customer information to any affiliated bank (or its subsidiaries) without the express written consent of that customer to the disclosure of the specific information concerned for a particular purpose. Section 15D(c)(2) defines the term "confidential customer information" to include any evaluation of the creditworthiness of any customer of

such securities subsidiary which is acquired from a customer by reason of a business relationship and which would not, in the ordinary course of business, be divulged by such entity to a bank without the consent of the customer.

This section does not affect other laws governing the use of material nonpublic information, such as the prohibitions against insider trading. Thus, for example, although this section allows disclosure of nonpublic information with the customer's express written consent, it in no way legitimizes an otherwise impermissible use of that information to purchase or sell a security.

*Section 15D(d)—Prohibition on shared neme, premises and advertising.*—Section 15D(d) makes it unlawful for the corporate name or logo of any securities subsidiary to contain any word or design which is the same as or similar to that of an affiliated bank. Further, this section would prohibit a securities subsidiary from sharing with an affiliated bank any part of any office which is commonly accessible to the public for the purpose of conducting any depository, lending or securities business. Additionally, it would prohibit the sharing of any other office not commonly accessible to the public (i.e. backroom operations), except to the extent that such sharing is permissible under Federal Reserve Board regulations with the approval of the SEC. Any permissible shared operations would, however, be subject to the prohibitions on disclosure of confidential customer information contained in section 15D(c). Further, this section would prohibit the securities subsidiary from posting, publishing or broadcasting any advertisement in conjunction with or relating to an affiliated bank.

*Section 15D(e)—Disclosures of affiliation required.*—Section 15D(e) requires each securities subsidiary, in accordance with regulations prescribed by the SEC, prominently to disclose in writing to each of its customers that:

(1) the securities subsidiary is not a federally insured bank or insured institution, and that it is a separate corporate entity from its affiliated bank or insured insitution; and

(2) that the commercial paper and securities underwritten, sold, offered, or recommended by the securities subsidiary are not federally insured, guaranteed or otherwise an obligation of the affiliated bank or insured institution.

*Section 15D(f)—Prohibition on reciprocal arrangements.*—Section 15D(f) addresses the problem of reciprocal arrangements between bank holding companies. It makes it unlawful for any securities subsidiary to engage in any reciprocal arrangement prohibited by section 9(f) of the BHCA.

*Section 15D(g)—Prohibition on interlocking directors, officers, or employees.*—Section 15D(g) makes it unlawful for a securities subsidiary to allow any director, officer, or employee of the securities subsidiary to serve at the time as a director, officer, or employee of an affiliated bank. The Federal Reserve Board is given the authority to grant exemptions, with the approval of the SEC, from these interlocking restrictions. In making such determinations, the Board shall consider the size of the bank holding company, bank and securities company involved; the burdens such restrictions impose; the safety and soundness of the bank and securities company; and other appropriate factors, including unfair competition in securities

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activities or the improper exchange of nonpublic customer information.

Section 15D(g)(3) contains an exception for certain back office operations. The prohibitions under paragraph (1) do not apply to any employee, other than an officer or director, employed by the bank holding company or any subsidiary of such company to perform clerical, accounting, bookkeeping, sttistical, or similar functions if such functions are performed in a separate office or facility and in a manner consistent with requirements determined by the Board with the approval of the SEC.

*Section 15D(h)—Asset purchases from affiliated bank.*—Section 15D(h) permits a securities subsidiary, notwithstanding subsection (a)(7) of this section buy subject to section 23B of the Federal Reserve Act, to purchase any asset of an affiliated bank which will be used by that subsidiary as security for, or which represent an inerest in, securities it underwrites or distributes if:

(1) the assets are purchased for the purpose of including such assets in a pool in connection with the issuance of asset-backed securities;

(2) the sale of such assets is without recourse;

(3) the securities underwritten or distributed by the QSS (and backed by these assets) must be either (i) rated investment grade by at least one independent nationally recognized securities rating company, or (ii) guaranteed by, or represent an interest in securities issued or guaranteed by, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Government National Mortgage Association; and

(4) the price at which an equity security or the yield at which a debt security is to be distributed to the public is established at a price no higher, or yield no lower, than that recommended by a qualified independent underwriter which has also participated in the preparation of the registration statement and the prospectus, offering circular, or similar document.

The Board, with the approval of the SEC, shall prescribe such regulations as may be necessary to ensure compliance with these provisions and with the "arm's length" requirements set out in Section 23B(a)(1) of the Federal Reserve Act.

For purposes of this subsection, "asset" is defined as any note, draft, acceptance, loan, lease, receivable or other obligation.

The provisions included in the bill are meant to allow a QSS to "securitize" assets obtained from its affiliated bank or insured institution, but only if the securities backed by those assets meet the quality control requirements set out herein. This section is intended to protect against the dumping by banks of low-quality assets into the asset-backed securities markets through affiliated underwriters.

*Section 15D(i)—Exception for intra-day extensions of credit in connection with clearing government securities.*—Section 15D(i) provides an exception from the prohibition on extensions of credit included in section 15D(b)(i) for extensions of credit made in the course of clearing U.S. Government or agency securities where such extensions of credit are repaid on the same calendar day, are

incidental to the clearing of transactions in those securities, and are fully secured by such securities.

*Section 15D(j)—Special audit requirements.*—In order to ensure compliance with the firewall provisions and safeguards to ensure the safety and soundness of the banking system under expanded bank powers, section 15D(j) provides that the annual audit report required under section 17(e) of the Exchange Act with respect to each securities subsidiary shall include a management report, in such form as the SEC shall prescribe by rule or regulation, on internal controls relating to financial statemetns and to compliance with the safeguard provisions in the preceding subsections of this section.

*Section 15D(k)—Authority of Commission to prescribe rules.*—Section 15D(k) grants the SEC specific rulemaking authority to implement the provisions of this section, define any term used in this section, prescribe means reasonably designed to prevent any person from evading or circumventing the provisions of this section, and exempt any person or transaction or class of persons or transactions as not comprehended within the purposes of this section, in whole or in part, unconditionally or upon specific terms and conditions.

*Section 212. Disclosures in Connection with Mutual Funds*

This section amends section 17 of the Investment Company Act of 1940 by adding a new subsection (k) with respect to bank disclosures in connection with mutual fund distributions. Any bank or affiliated person which distributes securities issued by an investment company must, in accordance with such regulations as the SEC shall prescribe, prominently disclose in writing to each of such bank or affiliated person's customers that:

(1) the investment company is not a federally insured bank and that it is a separate corporate entity from its affiliated bank or insured institution; and

(2) that the securities of such investment company are not deposit instruments which are federally insured, guaranteed or otherwise an obligation of the affiliated bank or insured institution.

*Section 213. Registration Exemption for Securities Covered by Certain Guarantees*

In section 105 of the Government Securities Act of 1986, Pub. L. No. 99-571, Congress directed the SEC to perform "a study of the use of the exemption contained in [S]ection 3(a)(2) of the Securities Act of 1933 (15 U.S.C. 77c(a)(2)) for securities guaranteed by banks, and the use of insurance policies to guarantee securities." More specifically, Congress directed that the Commission analyze:

(1) the impact of the guarantee provision of section 3(a)(2) on investor protection and the public interest;

(2) the impact of the guarantee provision of section 3(a)(2) on competition between banks and insurance companies and between domestic and foreign guarantors;

(3) whether and under what circumstances debt securities guaranteed by insurance policies should be exempt from registration under the Securities Act of 1933;

(4) the impact of such an exemption on investor protection and the public interest; and

(5) such other issues as the Commission deemed relevant.

In conducting this study, the SEC issued a release seeking public comment on the issues to be addressed in the study (Release 33-6688); held a public hearing to explore further the views of interested parties; consulted with the Department of the Treasury, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the FDIC; and issued a report dated August 28, 1987, as Congress directed in section 105, containing the analysis and recommendations of the Commission.

In response thereto, section 213 amends section 3(a)(2) of the Securities Act of 1933 by striking "issued or guaranteed by any bank" in paragraph (2) and inserting in lieu thereof "issued by a bank" and adding a new paragraph (12) to exempt any security guaranteed by an insurance contract or by a guarantee issued by a bank under certain circumstances and subject to such rules and regulations as the SEC may prescribe in the public interest and for the protection of investors. The section makes a conforming amendment to the Trust Indenture Act of 1939 and provides that the amendments shall take effect one year after date of enactment but the SEC's rulemaking authority shall take effect on date of enactment.

## Part C—Additional Investor Protections

The policy objectives underlying the federal securities laws differ from those underlying banking regulation. While banking regulation seeks to ensure the safety and soundness of the banking system and thereby to protect depositors, securities regulation seeks to protect investors and maintain fair and orderly markets. These polices are accomplished by a regulatory scheme that include, among other things:

(1) full and fair disclosure in the purchase and sale of securities;

(2) registration of brokers, dealers, and investment advisers and regulation of their activity; and

(3) protection against conflicts of interest and dishonest practices in the sale and management of professionally managed pools of capital (investment companies).

Under Title I of the bill, a bank holding company's QSS is subject to "functional regulation" by the SEC as a registered broker-dealer under the Securities Exchange Act of 1934. Part C extends the functional regulation concept to certain securities activities engaged in by banks outside the contest of the new QSS so that investors will be protected regardless of where the activities are conducted.

The Exchange Act currently excludes banks from its definitions of "broker" and "dealer". As a result, today banks engage directly in a variety of securities activities such as brokerage, private placements, and underwriting of certain asset-backed securities, subject to potential regulation by the appropriate bank regulator, but not subject to SEC registration, capital, recordkeeping, reporting and other requirements applicable to other brokers and dealers. This

bank exclusion from SEC regulation (subject to certain exceptions, such as the requirement for banks dealing in municipal bonds to register either directly or through a separately identifiable department or division under section 15B of the Exchange Act and comply with rules promulgated by the SEC and the Municipal Securities Rulemaking Board) reflects the fact that banks historically have executed occasional trades for customers on an accommodation basis, often in conjunction with traditional bank functions, such as trust and fiduciary activities.

As banking organizations expand the scope of their broker-dealer activities, and in order to ensure investor protection, it is appropriate that SEC regulation apply as a general matter to bank securities activities, while minimizing regulatory overlap and complexity. Part C accomplishes this by adopting the principle of functional regulation: A bank is required to engage in securities activities, through a subsidiary or affiliate, subject to SEC regulation but a bank may continue to engage directly in certain securities activities connected to traditional banking activities subject to primary superivision by its appropriate bank regulator.

The SEC, the Federal Reserve Board, the Comptroller of the Currency, and the FDIC have all endorsed this concept.

Subpart 1—Broker-Dealer Provisions

*Section 221. Definition of Broker*

This section amends the definition of "broker" in the Exchange Act to include banks within the general definition of a broker, with certain specified exceptions. A bank that fails within the definition of "broker" would have to conduct its brokerage activities in a nonbank subsidiary or affiliate registered with the SEC and subject to SEC regulation.

There are two important exceptions for bank activities included in the definition of brokers. Activities falling within the exceptions could still be conducted in the bank subject to regulation by the appropriate bank regulator. These exceptions permit:

most trust account securities activities, if the bank does not solicit brokerage business or receive incentive compensation (transactions in accounts, such as custody or managing agency accounts are not included in this exception); and

transactions in exempt securities, commercial paper, bankers acceptances, and (if the bank is not an affiliate of a QSS) municipal securities.

The SEC may grant additional exemptions pursuant to section 223 of this Act to any person or class of persons for "networking arrangements," where a bank contracts with a registered broker-dealer (whether or not affiliated with the bank) to provide brokerage services on bank premises on a full disclosed basis, or for banks conducting a certain de minimus number of securities transactions, such as less than 500 transactions a year.

*Section 222. Definition of Dealer*

This section amends the definition of "dealer" to include banks within the scope of the definition. A bank's dealing functions will be included in this definition unless they fall within one of two ex-

ceptions: purchases and sales by banks of (1) commercial paper, bankers' acceptances, commercial bills, exempted securities, and (if the bank is not an affiliate of a QSS) municipal securities, or (2) securities for investment purposes in the course of trust activities.

*Section 223. Power to Exempt from the Definitions of Broker and Dealer*

This section adds a new paragraph (e) to section 3 of the Exchange Act to authorize the SEC, by rule, regulation, or order, to conditionally or unconditionally exempt any person or class of persons from the definitions of "broker" or "dealer" consistent with the public interest, the protection of investors, and the purposes of this title. This section authorizes the SEC to provide exemptions for banks in addition to those expressly set forth in the amendments to sections 3(a)(4) and 3(a)(5) where consistent with the standards of this section.

*Section 224. Requirement that Banks Falling Within the Definitions of Broker or Dealer Place Their Securities Activities in a Separate Corporate Entity.*

This section amends the general registration requirement for brokers and dealers under the Exchange Act to prohibit a bank from becoming a broker or dealer, except on an exclusively intrastate basis. This change is intended to require banks that come under the revised definitions of "broker" and "dealer" in the Exchange Act to create a separate affiliate or subsidiary to perform these securities. Consistent with the general purposes of this legislation, this section would not restrict the substantive authority of any bank or bank holding company, under the national banking laws or any State banking law provision, to offer through an affiliate or subsidiary any permitted securities brokerage and dealing services.

Under this section, either an affiliate or a subsidiary of a bank could engage in activities as a "broker" or "dealer" subject to the Exchange Act's registration provisions. For those activities not required to be conducted in a securities affiliate pursuant to section 4(c)(15) of the BHCA, banking organizations will—insofar as this section is concerned—be allowed the organizational flexibility to select the corporate form through which they would offer brokerage and dealing services.

Subpart 2—Bank-Investment Company Activities

*Section 241. Custody of Investment Company Assets by Affiliated Banks*

This section amends the Investment Company Act of 1940 to provide the SEC with rulemaking authority over certain situations involving banks affiliated with management investment companies (i.e., mutual funds and closed-end investment companies) and unit investment trusts.

This section amends section 17(f) of the Investment Company Act to clarify and strengthen the SEC's authority to adopt regulations governing the conditions under which banks may serve as custodians of affiliated management investment companies. Specifically,

a registered investment company is permitted to place its assets with a bank that is an affiliated person, for such a company only in accordance with rules that the SEC may adopt consistent with the protection of investors. Without this provision, a bank may cause its affiliated mutual fund to select the bank as the fund's custodian, thereby depriving the fund of an independent custodian and creating the potential for abuse and self-dealing.

Regulation of custodianship of securities owned by an investment company has historically been one of the fundamental investor protection mechanisms of the Investment Company Act of 1940. Modification of Glass-Steagall Act prohibitions on commercial banks engaging in certain investment banking activities creates new dangers and threatens to erode the consumer protection safeguards afforded by independent bank custodianship of assets owned by investment companies. In the absence of full hearings on the subject, the Committee is unwilling at this time to recommend a complete ban on affiliated bank custodianship. Yet the Committee is concerned about the greater potential for abuse where an affiliated bank, rather than an independent bank, serves as custodian. Accordingly, while authorizing the SEC to permit affiliated bank custodianship, the Committee anticipates that the SEC will authorize affiliated bank custodianship only where the conditions and limitations imposed by the Commission assure that investors enjoy the same degree of protection as exists under independent bank custodianship today.

The Committee's concern that affiliated bank custodianship presents opportunities for abuse not present in truly independent bank custodianship is not solely with outright theft, which is exceedingly rare, but with unconventional practices which injure investors. A particularly offensive abuse associated with affiliated custodianship is the typing of underwriting services by an investment company's underwriter to the appointment of an affiliated bank as custodian for the investment company's assets. Without regard to whether such tying arrangements are unlawful under the antitrust laws, the Committee anticipates that any regulations or orders of the Commission authorizing affiliate bank custodianship will also expressly prohibit such anticompetitive arrangements.

*Section 242. Affiliated Persons and Transactions*

This section amends section 2(a)(3) of the Investment Company Act to add to the definition of "affiliated person" a new clause (G) which provides: if such other person is an investment company, any person or class of persons which the Commission by order or rule or regulation shall have determined to be affiliated persons by reason of having had, at any time since the beginning of the last two completed fiscal years of such company, a material business or professional relationship with such company or with any person that is a principal underwriter for, or promoter or sponsor of, such company or any affiliated person.

This section also prohibits an investment company from knowingly acquiring securities during an underwriting where the proceeds will be used to retire indebtedness to an affiliated bank. Specifically, section 10(f) of the Investment Company Act is amended to prohibit a registered investment company from knowingly pur-

chasing or acquiring, during the existence of an underwriting or selling syndicate, any security (except a security of which it is the issuer) the proceeds of which will be used to retire indebtedness owed to a bank where the bank or an affiliated person thereof is an affiliated pserson of such registered company.

*Section 243. Borrowing from an Affiliated Bank*

This section prohibits a mutual fund from borrowing from an affiliated bank except as permitted by the SEC. Specifically, section 18(f) of the Investment Company Act is amended to prohibit any registered open-end company from borrowing from any bank if such bank or any affiliated person of such company, except that the Commission may, by rule, regulation, or order, permit such borrowing which the Commission finds to be in the public interest and consistent with the protection of investors.

*Section 244. Independent Directors*

This section amends two provisions of the Investment Company Act to strengthen its requirements for independent directors serving on the boards of investment companies.

Subsection (a) amends the definition of "interested person" in section 2(a)(19)(A) of the Investment Company Act to include any person that, at any time during the last 6 months, has executed any portfolio transactions for, engaged in any principal transactions with, or loaned money to, the investment company or any other investment company having the same investment adviser, principal underwriter, sponsor, or promoter, or any affiliated person of such a broker, dealer, or person. Such persons would not be prevented from serving as directors of that investment company; rather, they merely would be considered "interested persons" for purposes of the required percentage of disinterested or independent directors of that investment company. The amendment is effective one year after the date of enactment of the Act.

Subsection (b) amends section 10(c) of the Investment Company Act, which currently provides that no registered investment company may have a majority of its board of directors consisting of persons who are officers, directors, or employees of any one bank. The amendment extends the prohibition to the officers, directors, or employees of any one bank and its subsidiaries, or any one bank holding company and its affiliates and subsidiaries. This eliminates the potential to circumvent the legislative intent of section 10(c) by a bank operating under a multiple bank holding structure.

*Section 245. Prohibition Against Use of a Bank's Name by an Affiliated Mutual Fund*

This section amends section 35(d) of the Investment Company Act to prohibit the use by a mutual fund of a name, title, or logo that is the same as or similar to the name, title, or logo of any affiliated bank or bank affiliate. If a bank affiliate advises or distributes a mutual fund with a name or logo similar to that of the affiliated bank, or if a bank or bank affiliate acts as investment adviser to a mutual fund which has a name or logo which is similar to that of the affiliated bank, investors may be misled into believing that the mutual fund shares are insured deposits or backed by the

bank's resources. Moreover, the resulting link in the public mind between a bank and its mutual fund may damage the bank's reputation and public confidence in the bank if the bank's mutual fund encounters financial difficulty. For the same reasons, this section also prohibits advertisements that are designed to create the same impression.

*Section 246. Definition of Broker*

This section amends the definition of "dealer" in section 2(a)(6) of the Investment Company Act to reflect the bill's amended definition of that term in the Exchange Act. The new definition would, however, continue to exclude any person (including a bank) solely by reason of the fact that such person is an underwriter for one or more investment companies.

*Section 247. Definition of Dealer*

Similarly, this section amends the definition of "dealer" in section 2(a)(11) of the Investment Company Act to reflect the bill's amended definition of that term in the Exchange Act. The new definition would continue to exclude insurance companies and investment companies.

*Section 248. Treatment of Publicly Advertised Common Trust Funds as Investment Companies*

This section amends sections 3(a)(2) of the Securities Act, 3(a)(12)(A)(iii) of the Securities Exchange Act, and 3(c)(3) of the Investment Company Act to clarify that a bank common trust fund is not entitled to the exemptions from the registration and reporting provisions of these Acts if the common trust fund is offered to the public. These provisions would codify in the Acts the original legislative intent of the exemptions, that any publicly-offered common trust fund for IRA assets is the functional equivalent of an investment company and must be regulated as such. *See* S. Rep. No. 184, 91st Cong., 1st Sess. 27 (1969). This section, together with new section 5136(f) of the Revised Statutes, prohibits banks from sponsoring and operating all other publicly offered common trust funds.

*Section 249. Removal of the Exclusion from the Definition of Investment Adviser for Banks that Advise Investment Companies*

This section amends section 202(a)(11) of the Investment Advisers Act of 1940 (Adviser Act) to remove the current exclusion from the definition of "investment adviser" for a bank or bank holding company that serves as an investment adviser to a registered investment company.

This removal of the bank exclusion is intended to strengthen the SEC's ability to oversee the activities of registered investment companies. It is also intended to subject banks and bank holding companies that advise investment companies to the Advisers Act restrictions on performance fees, as well as agency cross and principal transactions.

*Section 250. Definition of Broker*

This section amends the definition of "broker" in section 202(a)(3) of the Advisers Act to make it identical to the definition of "broker" in the Exchange Act, as amended by this legislation.

*Section 251. Definition of Dealer*

This section amends the definitions of "dealer" in section 202(a)(7) of the Advisers Act to make it identical to the definition of "dealer" in the Securities Exchange Act, as amended by this legislation, except that it does not include an insurance company or an investment company.

## Part D—Additional Requirements

*Section 261. Establishment of Compliance Programs by Regulatory Agencies*

This section requires each agency (as defined in such section) to establish a program for monitoring and enforcing compliance with the amendments made by title I and this title by bank holding companies, banks, insured institutions, QSSs, and other nonbank subsidiaries of bank holding companies under the supervision of such agency. The agencies are required to consult with one another and, within 120 days from the date of enactment, to submit a compliance plan to the Congress.

*Section 262. Federal Reserve Board and Securities and Exchange Commission Study*

This section requires the Federal Reserve Board and the SEC to study and evaluate the impact on the securities markets and the banking system of the amendments made by this Act and the effectiveness of the amendments made by this Act in protecting investors and minimizing risks to the safety and soundness of the banking system and the Federal deposit insurance system.

A report, based on such study, shall be submitted to Congress on or before 18 months after the date of enactment.

As part of its study the Board and the SEC shall examine foreign exchange transactions carried out on behalf of pension, trust and other accounts as to which bank holding companies and their subsidiaries and banks serve as fiduciaries. They should ascertain the extent to which such institutions or their affiliates execute foreign exchange transactions on behalf of accounts as to which they are fiduciaries; the pricing conditions; their performance relative to the market; the extent to which independent foreign exchange dealers are solicited for their services. They should examine whether bank holding companies and their subsidiaries and banks enjoy unfair competitive advantages over foreign exchange dealers not affiliated with banks or banking organizations (1) in access to such fiduciary accounts and (2) is not being prohibited from using the credit support of such banking organizations and banks in carrying out foreign exchange transactions.

In making this recommendation, however, the Committee does not intend that either the Board or the SEC refrain, until the completion of the study, from using existing supervisory and enforce-

ment authorities to remedy extant abuses, in the interest of the safety and soundness of bank holding companies and their subsidiaries and of investor protection.

TITLE III—INSURANCE ACTIVITIES

*Section 301. Short Title*

Section 301 contains the short title, the "Bank Holding Company and National Bank Improvements Act of 1988".

*Section 302. Insurance Activities by Bank Holding Companies*

*Section 302(a)—Definitions.*—Section 302(a) adds two new definitions to the BHCA. "Insurance activities" is defined to mean providing insurance as principal, agent, or broker. "Financial guaranty insurance subsidiary" is defined to mean an independent nonbank subsidiary of a bank holding company, licensed under state law and approved by the Federal Reserve Board.

*Section 302(b)—Amendment to Bank Holding Company Act.*—Section 302(b) creates a new section 6 of the BHCA relating to insurance activities by bank holding companies.

*Section 6(a)—Prohibition on Insurance Activities.*—This section generally prohibits bank holding companies and their subsidiaries from engaging in insurance in the United States. The Committee deleted the reference to affiliates of a bank holding company to clarify that individuals may own both a bank holding company and an insurance company as long as there is no corporate ownership relationship between them.

*Section 6(b)—Exemptions.*—This section creates several exemptions from the prohibition.

*1. Activities permissible under federal law*

Section 6(b)(1) exempts insurance activities engaged in pursuant to section 3(f), the first proviso of section 4(a)(2), or section 4(c)(8) of the BHCA, or pursuant to section 5136(g) of the Revised Statutes (the National Banking Act).

—Qualified savings banks which are subsidiaries of a bank holding company and are engaging in insurance activities under section 3(f) may continue to do so. A savings bank will lose this exemption if it is acquired by a company that is not a savings bank or savings bank holding company.

—Bank holding companies engaging in insurance activities pursuant to the grandfather provision in the first proviso of section 4(a)(2) may continue to do so as long as they comply with that proviso.

—Bank holding companies may engage in insurance activities pursuant to section 4(c)(8), including the grandfather rights conferred by section 4(c)(8) (D) or (G), as long as they comply with the applicable requirements and limitations of that section, including the requirement that such activities be permitted under State law.

—Bank holding companies may engage in insurance activities through a national bank subsidiary (or subsidiary of such bank) to the same extent that a freestanding national bank may do so. These activities include credit-related life, health, and unemployment insurance, insurance sold in locations with a population of 5,000 or less, and certain other activities limited to particular institutions or States. As explained below, there are various limitations to these rights.

*2. State bank activities described in section 4(c)(8)*

Section 6(b)(2) clarifies that through their State banks and subsidiaries of such State banks, bank holding companies may engage in insurance activities permitted under subparagraphs (A), (B), (C), (E), or (F) of section 4(c)(8) of the BHCA as long as the activities are also authorized under State law.

—Section 4(c)(8)(A) permits bank holding companies to engage in credit-related life, disability, and unemployment insurance activities. This exemption clarifies that a State bank or subsidiary authorized under State law to provide such insurance may continue to do so.

—Section 4(c)(8)(B) permits bank holding companies which are subsidiaries of a bank holding company to engage in certain credit-related insurance activities. This exemption clarifies that a State bank or subsidiary authorized by the Federal Reserve Board to have a finance company that engages in such credit-related insurance may continue to engage in such activities.

—Section 4(c)(8)(C) permits bank holding companies to provide insurance in a place with population not exceeding 5,000 or in a place that the holding company can demonstrate has inadequate insurance. This exemption clarifies that a bank holding company may also provide insurance in these locations through a State bank subsidiary if permitted under State law.

—Section 4(c)(8)(E) permits bank holding companies to supervise on behalf of insurance underwriters the activities of retail insurance agents selling certain types of coverage. This exemption clarifies that bank holding companies may engage in this activity through State bank subsidiary if permitted under State law.

—Section 4(c)(8)(F) permits bank holding companies with total assets of $50 million or less to engage in certain insurance agency activities. This exemption clarifies that a bank holding companies meeting this asset test may engage in this activity through a State bank subsidiary if such activities are authorized under State law.

*3. Intrastate insurance sales*

Section 6(b)(3) permit bank holding companies to engage in insurance agency or brokerage activities through a State bank (or subsidiary thereof) if the State bank or sub-

sidiary is located in the holding company's "home State" and the bank or subsidiary is authorized by State law to engage in the activities.

Section 6(b)(3)(C) states that the insurance may be provided only to individuals who reside or are employed in the State; to any person engaged in business in the State and has a permanent business office there, for employees who reside in or are principally employees in the State or services provided by person located in the State; or to any person, for real property located in the State or personal property principally used in the State. This limitation assures that this exemption will actually be confined to the state and will not permit, for example, selling a company in the state in which it is headquartered a group health policy which covers its employees nationwide.

A bank holding company's "home State" is determined under section 3(d) of the BHCA, as the State in which the total amount of deposits held by all bank subsidiaries of the holding company was greatest on May 9, 1956 or on the date the company became a bank holding company, whichever is later.

*4. Indiana State banks*

Section 6(b)(4) permits bank holding companies to engage in insurance activities in the State of Indiana through Indiana State bank subsidiaries and subsidiaries of such banks. The insurance activities must have been authorized by State law in effect on September 22, 1988 for State banks located in Indiana. This exemption applies even if the State bank has been acquired or is acquired in the future by a bank holding company, as long as the activities continue to be authorized by State law. The same geographical limitations apply as to whom such insurance may be provided as apply intrastate activities under section 6(b)(3)(C) of the BHCA, as amended.

*5. California initiative*

Section 6(b)(5) permits bank holding companies to engage in insurance underwriting through a California State bank or its subsidiary, if California voters approved a scheduled November 8, 1988 State ballot initiative permitting such underwriting, and if California is the bank holding company's "home State." The same geographical limitations apply as to whom such insurance may be provided as apply for intrastate activities under section 6(b)(3)(C) of the BHCA, as amended.

*6. Oklahoma national banks*

Section 6(b)(6) permits Oklahoma national bank subsidiaries of a bank holding company whose "home state" is Oklahoma, and Oklahoma subsidiaries of such banks, to provide insurance as agent or broker in Oklahoma to the extent Oklahoma State law may authorize Oklahoma State banks to engage in such insurance activities. The

same geographic limitations apply as to who may purchase such insurance as apply to the section 6(b)(3) exemption for intrastate activities.

*Section 6(c) Financial Guaranty Insurance—*

*1. Separately capitalized nonbank subsidiary required*

Section 6(c)(1) permits a bank holding company to provide financial guaranty insurance through a separately capitalized nonbank subsidiary. As explained below, the definition of financial guaranty insurance is clarified in section 6(j)(2).

*2. Federal Reserve Board approval required*

Section 6(c)(2) requires Federal Reserve Board approval before a bank holding company may establish a financial guaranty insurance subsidiary.

*3. Grounds for Federal Reserve Board disapproval*

Section 6(c)(3) requires that the Board disapprove the application if it determines: that the financial guaranty insurance subsidiary will not be adequately regulated; that the establishment will adversely affect the financial soundness of the holding company or any bank subsidiary; that the public cannot reasonably be expected to benefit; or that a bank subsidiary of the holding company fails to meet the risk-based capital guidelines established by the Bank for International Settlements as such guidelines apply after 1992.

*4. Financial safeguards*

Section 6(c) (4) and (5) establish safeguards to assure that the financial guaranty insurance subsidiary is kept financially separate from the bank subsidiaries of the bank holding company, including a requirement that all the officers of the financial guaranty insurance subsidiary, and a majority of its directors, be independent of any affiliated bank.

*5. Grandfather provision*

Section 6(c)(6) permits a bank holding company currently engaged in municipal bond guaranty insurance activities pursuant to authorization issued by the Comptroller of the Currency on or before May 2, 1985 to transfer such activities to a separately capitalized financial guaranty insurance subsidiary without seeking Federal Reserve Board approval. If the bank holding company seeks to engage in any financial guaranty insurance activity other than municipal bond guaranty insurance activities, it must seek the Board's approval and meet the new requirements. The Committee intends that the financial guarantee activities of other bank holding companies and their subsidiaries grandfathered under this bill be transferred to a separately capitalized nonbank subsidiary of the bank holding com-

pany and that Federal Reserve Board approval be obtained before such activities are expanded.

*Section 6(d)—Protection of Consumers and Competition.*—This section protects consumers and competition by prohibiting bank holding companies and their subsidiaries from using confidential customer information to further their insurance activity without express written consent of the customer, and from engaging in activity designed to use their banking leverage to favor an affiliated insurer or agent. An exception is created to allow a bank holding company subsidiary to place insurance on real or personal property if a debtor has failed to provide reasonable evidence of required coverage in accordance with the terms of a loan or credit document.

*Section 6(e)—Grandfather Provisions.*—This section provides grandfather rights to several specifically described institutions of specific States.

*1. Current interstate activities*

A State bank which was acquired after December 31, 1984, and before March 2, 1988, by a bank holding company whose "home State" is outside the State in which the State bank is located (hereinafter, "acquired interstate") may continue to provide insurance against the same kinds of risks as insured against by the bank or subsidiary as of the day before its acquisition or as of March 2, 1988, or against functionally equivalent risks. The same geographic limitations apply as to who may purchase such insurance as apply to the section 6(b)(3) exemption for intrastate activities.

*2. Title insurance*

A bank holding company may provide title insurance through a State bank (or subsidiary thereof) if the bank was required to be empowered to provide title insurance as a condition of its initial State charter. This exemption is not affected by a change in State law altering this requirement after the bank was chartered.

*3. Other grandfather provisions*

—A bank holding company or subsidiary located in Indiana and acquired interstate on June 30, 1986 pursuant to Board approval on May 28, 1986 may continue to engage in any insurance activity lawfully engaged in before the date of enactment of this bill in Indiana or in any State continguous to Indiana.

—A State bank which was acquired interstate after December 31, 1984 and before March 2, 1988 may continue to engage within that State in life, accident, and health insurance activities for which the State bank or subsidiary was licensed before March 2, 1988, pursuant to a State law enacted after July 20, 1987 and in effect before September 28, 1987.

—A bank holding company, which was issued authorization by the appropriate State banking regulator before March 2, 1988, to provide financial guaranty insurance through a State bank or subidiary of such bank, may continue to provide such insurance through such bank or subsidiary.

—Another bank holding company, which acquired nonvoting interests in a company engaged in financial guaranty insurance in an investment which the Federal Reserve Board determined by letter dated October 31, 1986, was consistent with the BHCA, may convert those nonvoting interests into voting interests.

—A State bank subsidiary of a bank holding company (or a subsidiary of such bank) that was engaged in insurance underwriting activities, including reinsurance, may continue to engage in such activities to the extent such activities are authorized by State law, were commenced on or before July 27, 1988, are confined to the States in which the bank or subsidiary was engaging in such activities as of July 27, 1988, and involve underwriting the same type of risk as that being underwritten on or before such date. This grandfather provision terminates for the bank or subsidiary if it is acquired by any other bank holding company after July 27, 1988.

—A Virginia bank holding company currently engaging in insurance activities through a Tennessee State bank may continue to do so through that bank (or a subsidiary thereof) in Tennessee, Maryland, Virginia and the District of Columbia. The bank or subsidiary must have been lawfully conducting such insurance activities, or must have been licensed to conduct such activities, in the State prior to the date of enactment of this bill.

*Section 6(f) Limitations to Section 4(C)(8)(D).—*

*1. Transferability of existing 4(c)(8)(D) grandfather provision*

Section 4(c)(8)(D) of the BHCA permits bank holding companies to engage in certain insurance activities that were engaged in by the bank holding company or any of its subsidiaries on May 1, 1982. Recent Federal Reserve Board decisions permitting transfer of this grandfather are currently under challenge in federal court.

Section 6(f)(1) resolves this dispute by terminating the section 4(c)(8)(D) grandfather rights in the event the grandfathered company is acquired by another bank holding company, or the insurance activities are transferred to any other subsidiary of the bank holding company, on or after March 2, 1988. This provision does not apply if the new bank holding company is merely a corporate successor, as defined in section 2(e) of the BHCA, or if the total assets of the new holding company and its subsidiaries are, and remain, $50 million or less.

Section 6(f)(1) retains 4(c)(8)(D) grandfather rights, however, for companies acquired interstate on or after October 15, 1982 and before March 2, 1988 if the bank holding company which acquired the company obtained approval of the Federal Reserve Board before March 2, 1988 to engage in such insurance activities.

*2. Continued authorization to engage in insurance activities under section 4(c)(8)(D)*

Section 6(f)(2) permits certain bank holding companies that acquired a company engaging in insurance activities pursuant to section 4(c)(8)(D) of the BHCA on or after October 12, 1982, and that obtained approval under section 4(c)(8)(D) from the Federal Reserve Board to acquire and retain the shares of such company before March 2, 1988, to continue to hold shares in such company.

*3. Independent qualification required of affiliates*

Section 6(f)(3) clarifies that an affiliate of a company providing insurance pursuant to section 4(c)(8)(D) of the BHCA may not provide insurance pursuant to that section unless the affiliate also meets the section 4(c)(8)(D) requirements.

*Section 6(g)—Limitations on Small Town Exemption.*—Section 4(c)(8)(C) of the BHCA permits a bank holding company to engage in insurance activities as agent or broker in a place with a population not exceeding 5,000.

Section 6(g) clarifies that it must be lawful under State law for the bank holding company to do so and that the insurance company for which the bank holding company is acting as agent or broker must be licensed by the appropriate State authorities. Section 6(g) applies the same geographic limitations as to who may purchase such insurance as apply to the section 6(b)(3) exemption for intrastate activities. Section 302(c)(2) of the bill delays application of these new limitations and requirements for one year after the date of enactment of the bill. Subsections (c) and (e) of section 302 of the bill, which further limit the small town exemption, are discussed in more detail below.

*Section 6(h)—Notice and Comment.*—This section codifies the current requirement that bank holding companies seeking to engage directly or indirectly in insurance activities must first follow a public notice and comment process. Under this process, notice of the proposed insurance activity is published in the *Federal Register,* soliciting public comments. The Federal Reserve Board must review those comments before determining whether to grant the application.

*Section 6(i)—Data Collection.*—This section furthers the consumer and competition protections of section 6(d) by requiring each bank holding company that engages in insurance activities to report to the Federal Reserve Board the percentage of its banking customers who purchased insurance from the bank holding company or from any of its

subsidiaries. The Board has discretion to ask for additional information to enforce these protections. The information, and the Board's evaluations, shall be available to the public.

*Section 6(j)—Definitions.*—This section defines "residents," "financial guaranty insurance," and "authorized under State law."

"Residents" is defined to include individuals who reside in the State and companies which are incorporated in the state or organized under its laws, are licensed to do business there, or have an office there.

"Financial guaranty insurance" is defined to include only insurance for losses resulting from financial default or insolvency. Seventeen specific exceptions are enumerated to limit this broad general definition. This definition is based on a model definition on which several States have based their definitions.

"Authorized by State law" is defined to clarify that new insurance powers granted to State banks by States after the date of enactment of this bill must be by express authorization, either by statute or by initiative or referendum, and may not be by implication or construction of existing or of new legislation.

*Section 302(c)—Additional Limitation on Small Town Exemption.*—Section 302(c) further limits the section 4(c)(8)(C) small town exemption under by requiring that, beginning one year after the date of enactment of the bill, the principal place of banking business of the bank holding company must be in the small town in which it is engaging in insurance activities under the exemption.

*Section 302(d)—Home State.*—Section 302(d) shifts the "home state" of one of the bank holding companies grandfathered in section 6(e) of the BHCA, by establishing a new date on which to determine the State in which the total deposits of all bank subsidiaries were largest.

*Section 302(e)—Inadequately Served Rural Areas.*—Section 302(e) assures that rural areas in the vicinity of small towns have adequate access to insurance products. It requires the Federal Reserve Board to promulgate a rule within nine months of the date of enactment, to establish standards for determining when a place has inadequate insurance facilities for purposes of section 4(c)(8)(C)(ii) of the Act BHCA. These standards will determine when a bank holding company that otherwise qualifies to provide insurance in a small town may also provide insurance in the rural areas in the vicinity of the small town.

A number of geographical factors for the Board to consider in establishing its standards are specified, to prevent the small town exemption from being misused to reach beyond the small town and its environs into metropolitan areas. Meeting these standards will be deemed to satisfy the requirement in section 4(c)(8)(C)(ii) of the BHCA, and in section 5136(f)(7) of the Revised Statutes, that a bank holding company demonstrate that a place has inadequate insurance facilities.

*Section 302(f)—National Housing Act Grandfather Provision.*—Section 302(f) creates an exception to section 408(p)(2) of the National Housing Act, to permit a New York insurance company which acquired a savings and loan institution pursuant to an acquisition agreement which was publicly announced on August 4, 1987 to offer or market its insurance products through the savings and loan insitution.

*Section 303. Amendment to National Banking Act*

Under the National Banking Act, a national bank is permitted to engage in insurance activities that are incidential to its business as a national bank. Section 303 creates a new subsection (f) to section 5136 of the Revised Statutes, relating to insurance activities by national banks.

*Subsection (f)(1)—Prohibition on Insurance Activities.*—Subsection (f)(1) generally prohibits national banks and their subsidiaries from engaging in insurance activities in the United States. Subsections (f)(2) through (f)(8) create several exceptions to this prohibition. In addition, a national bank subsidiary of a bank holding company (or a subsidiary of such bank) may engage in insurance activities if permitted to do so under section 302 of this bill.

*Subsection (f)(2)—Exception for Credit Life Insurance.*—Subsection (f)(2) permits national banks and their subsidiaries to provide insurance limited to assuring the repayment of the outstanding balance of any specific extension of credit by the bank to the individual in the event of the individual's death, disability, or involuntary unemployment.

*Subsection (f)(3)—Exception for Title Insurance.*—Subsection (f)(3) permits national banks and their subsidiaries lawfully engaged in title insurance activities as of March 2, 1988 to continue to do so, as long as such activities are limited to the State in which the bank is located. A bank loses the benefit of this exception if it is acquired after March 2, 1988 by a bank holding company whose "home State" is in a State other than the State in which the bank is located.

*Subsection (f)(4)—Small Town Exemption.*—Subsection (f)(4) permits national banks and their subsidiaries to sell insurance in places with a population of 5000 or less. Subsection (f)(4) applies the same conditions and geographical limitations to national banks and their subsidiaries as apply to bank holding companies under section 4(c)(8)(C) and section 6(g) of the BHCA, as amended by this bill.

*Subsection (f)(5)—Additional Limitations on Small Town Activities.*—Subsection (f)(5) restates the additional limitations contained in an earlier 1916 authorization for national banks to sell insurance in small towns. These limitations prohibit the bank from making a guarantee to the insurance company on behalf of the customer.

*Subsection (f)(6)—Grandfather Provision.*—Subsection (f)(6) permits national banks and their subsidiaries in

Oregon and Washington, and a national bank chartered in 1882 whose main office is not within 30 miles of any city that had a population exceeding 150,000 under the 1980 census, to continue to engage in insurance activities lawfully engaged in as of March 2, 1988. The Oregon and Washington banks may continue to engage in such insurance activities within the State in which the main office of the national bank is located. The bank chartered in 1882 may continue to engage in such insurance activities within 30 miles of the bank's main office.

*Subsection (f)(7)—Inadequately Served Rural Areas.*—Subsection (f)(7) extends the application of section 302(e) to national banks applying to provide insurance as agent or broker to inadequately served rural areas in the vicinity of small towns in which the national bank is already providing insurance as agent or broker.

*Subsection (f)(8)—Oklahoma National Banks.*—Subsection (f)(8) permits, subject to subsection (f)(5), national banks located in Oklahoma (and their subsidiaries in Oklahoma) to provide insurance as agent or broker to the extent Oklahoma State law may authorize such insurance activity for Oklahoma State banks. The same geographical limitations apply as to whom such insurance may be provided as apply for intrastate activities under section 6(b)(3)(C) of the BHCA, as amended.

*Subsection (f)(9)—Definitions.*—Subsection (f)(9) defines "insurance activities" and "residents" consistent with the definitions of those terms in section 2(q) and section 6(j) of the BHCA.

*Section 304. Effective Date*

Section 304 provides that, except as otherwise provided in Title III, the provisions of Title III apply as of March 5, 1987. This is the date on which the Competitive Equality Banking Act moratorium on additional insurance activities by bank holding companies went into effect.

## AGENCY VIEWS

SECURITIES AND EXCHANGE COMMISSION,
*Washington, DC, September 27, 1988.*

Re: Section 213 of H.R. 5094.

Hon. JOHN D. DINGELL,
*Chairman, Committee on Energy and Commerce,*
*Rayburn House Office Building, Washington, DC.*

DEAR CHAIRMAN DINGELL: The purpose of this letter is to express opposition to an exemption from the registration requirements of the Securities Act of 1933 contained in H.R. 5094. Section 213 of that bill would add a new Section 3(a)(12) to the Securities Act. The new Section would exempt any security guaranteed by an insurance contract and continue the similar exemption for any security guaranteed by a bank, subject to such rules and regulation as the

Commission may prescribe. There is no comparable provision in the Senate version of this legislation.

For the reasons discussed below, Section 213 would not serve the public interest or the protection of investors. In its attempt to address a possible competitive disparity by allowing insurance companies to compete more effectively with banks for financial guarantee business, the section ignores investor protection problems created by repealing the registration requirements and associated liabilities for insurance backed securities.

As the draft Section-by-Section Analysis of H.R. 5094 points out, in 1986, Congress directed the Commission to study "the use of the exemption contained in [S]ection 3(a)(2) of the Securities Act of 1933 (15 U.S.C. 77c(a)(2)) for securities guaranteed by banks, and the use of insurance policies to guarantee securities." In response, on August 28, 1987, the Commission issued the "Report by the United States Securities and Exchange Commission on the Financal Guarantee Market: The Use of the Exemption in Section 3(a)(2) of the Securities Act of 1933 for Securities Guaranteed by Banks and the Use of Insurance Policies to Guarantee Debt Securities." In that Report, the Commission recognized an apparent advantage for banks competing with insurance companies for financial guarantee business, but it rejected the idea of creating a new statutory exemption for securities guaranteed by insurance contracts. The Commission instead recommended two other approaches to deal with this possible competitive disparity.

The first was to amend Section 3(a)(2) of the Securities Act to remove the exemption from registration for securities issued or guaranteed by banks. The second was to authorize the Commission to grant exemption relief from the registration requirements of the Securities Act on a case-by-case basis in those situations that are consistent with investor protection, the pubic interest, and the purposes of the Securities Act.

The statutory provision included in Section 213 differs as to certain details from the one discussed in the Report. Its objective, however, is the same—to provide an exemption from the registration requirements of the Securities Act for securities guaranteed by insurance policies where the insurer provides the Commission with information about itself similar to that required under the Securities Exchange Act of 1934. The reasons why the Commission opposed the proposed exemption to the statute remain as valid today as they were a year ago when the Report was issued.

Most fundamentally, obtaining a guarantee does not reduce the need for the disclosures required by the registration process. The basis for the exemption for securities issued or guaranteed by a bank contained in Section 3(a)(2) of the Securities Act was not the lack of a need for disclosure, but an apparent perception by Congress in 1933 that bank regulatory authorities exercise adequate supervision over the issuance of bank securities.[1] Guarantees are deemed to be separate securities under the Securities Act. As a result, registration statements relating to guaranteed securities must include information as to the guarantor as well as the issuer

[1] The Commission has recommended repeal of the bank guarantee exemption in part because of its view that this theory of equivalent regulation should be replaced by functional regulation.

of the underlying security. In addition, where the guarantee runs to the holder of the security, the guarantee must be separately registered unless it is exempt under Section 3(a)(2) or is an insurance policy excluded from registration pursuant to Section 3(a)(8) of the Securities Act. Even where the insurance policy providing the guarantee is not required to be registered because of the exclusion provided by Section 3(a)(8), the insurer is required to provide information on its financial resources and full disclosure concerning the provisions of the insurance policy providing the guarantee.

Accordingly, while the presence of a guarantor is an important factor in making an investment decision, it does not replace the need for material information regarding the financial resources of both the issuer and the guarantor or insurer, the terms of the underlying security and of the insurance policy providing the guarantee, and the material terms of the proposed transaction.

Insurance currently is used as a credit enhancement for many novel and complex financial instruments and transactions. Disclosure of the terms of these instruments is a vital focus of the Securities Act registration requirements and the review process conducted by the Commission's staff. Under the proposed statutory amendment, investors could lose the benefits provided by mandatory disclosure concerning the terms of such instruments and by staff review undertaken to secure compliance with those requirements.

One key aspect of the disclosure presently required is the description of the terms of the guarantee, including its possible limits. Supporters of the exemption have stressed the absolute nature of the insurance guarantees, informing the Commission that the defense of fraudulent inducement of the policy of insurance is not available to a financial guarantee insurer because payments under such policies are unconditional. Reliance on the relatively low risk of an investment has not been, and should not be, the basis for an exemption from registration. Disclosure, not merit regulation, is the philosophy underlying the Securities Act. In any event, reliance on the absolute nature of a financial guarantee may well be misplaced. In a recent case involving financial guarantees issued by a mortgage insurance company, in re: *Epic Mortgage Insurance Litigation,* M.D.L. No. 680 (E.D. Va., July 28, 1988), the insurance company successfully raised the defense of fraudulent inducement against claims brought by investors. In that case, the payment on the policy was not unconditional. Significantly, Section 213 would not require that the insurance contract be unconditional.

A guarantee also would not justify altering the civil liabilities associated with offering securities. Under the proposed amendment, Section 11 of the Securities Act, which sets forth a comprehensive liability scheme for registered offerings (including strict liability for the issuer), would not apply to insurance-backed securities.

While the proposed Section-by-Section Analysis does not reveal the basis for the exemption, earlier proposals relied, in part, on regulation of the insurance industry.[2] Even if reliance on another

[2] The specific legislative proposal addressed in the Report also was conditioned on the securities receiving a triple A rating from at least one nationally recognized rating agency. While Sec-

Continued

regulatory scheme could support a registration exemption, financial guarantee insurance, as the Report discussed in detail, is an essentially unregulated business. Because of the rapid growth of financial guarantee insurance, the apparent risk of the industry, and the inadequacy of current regulation, the National Association of Insurance Commissioners has developed a model act to deal with these insurers. To date, however, only one state, Florida, has adopted comparable legislation. Even if the model act were adopted by all 50 states, however, it would not be a substitute for full and fair disclosure under the Securities Act. The objective of such regulation would be to provide for safe and sound operation of the insurer, but it would not replace the need for full disclosure about the issuer of the securities, the insurer, the terms of proposed distribution of the securities, and the guarantee.

One further problem with the proposed legislative approach is the continuing lack of empirical evidence with respect to results of such insurance guarantees. While insurance contracts are becoming more prevalent in corporate defaults and payments under the insurance contracts is limited. For that reason, the result in the *Epic* matter referred to earlier is particularly disquieting.

To further the protection of investors and the public investors, the insurance guarantee exemption should be removed from the legislation before final Congressional action. I ask that you include this letter in the report on H.R. 5094 to be filed by the House Committee on Energy and Commerce.

Sincerely,

DAVID S. RUDER,
*Chairman.*

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as H.R. 5094 SAC (E&C) reported, are shown as follows (exising law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing, law in which no change is proposed is shown in roman):

## BANK HOLDING COMPANY ACT OF 1956

AN ACT To define bank holding companies, control their future expansion, and require divestment of their nonbanking interest

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.* [That this Act may be cited as the "Bank Holding Company Act of 1956".]

*SECTION 1. SHORT TITLE; TABLE OF CONTENTS.*

*(a) SHORT TITLE.—This Act may be cited as the "Bank Holding Company Act of 1956".*

*(b) TABLE OF CONTENTS.—*

*Sec. 1. Short title; table of contents.*
*Sec. 2. Definitions.*

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tion 213 does not include a similar condition, as the Commission stated in its Report, ratings are not adequate substitutes for Securities Act registration requirements and rating agencies' procedures are not adequate to replace the registration requirements.

*Sec. 3. Acquisition of bank shares or assets.*
*Sec. 4. Interests in nonbanking organizations.*
*Sec. 5. Securities activities.*
*Sec. 6. Insurance activities.*
*Sec. 7. Real estate activities.*
*Sec. 9. Safeguard provisions and other requirements applicable in the case of bank holding companies with securities subsidiaries.*
*Sec. 10. Consumer disclousre requirements.*
*Sec. 11. Community benefits requirements.*
*Sec. 12. Administration.*
*Sec. 13. Reservation of rights to States.*
*Sec. 14. Penalties.*
*Sec. 15. Judicial review.*
*Sec. 16. Saving provision.*
*Sec. 17. Separability of provisions.*

DEFINITIONS

SEC. 2. (a) * * *

* * * * * * *

*(n) SECURITIES SUBSIDIARIES DEFINED.—For purposes of this Act—*

*(1) QUALIFIED SECURITIES SUBSIDIARY.—The term "qualified securities subsidiary" means any company—*

*(A) which—*

*(i) is a subsidiary of a bank holding company;*

*(ii) is not a bank or insured institution or a subsidiary of a bank or insured institution;*

*(iii) engages, in the United States, in securities activities; and*

*(iv) is registered as a broker or dealer government securities broker or government securities dealer, or municipal securities dealer as required by the Securities Exchange Act of 1934 or as an investment adviser as required by the Investment Advisers Act of 1940; and*

*(B) the formation or acquisition of which by the bank holding company has been approved by the Board under section 5(b).*

*(2) SECURITIES SUBSIDIARY.—The term "securities subsidiary" means—*

*(A) any qualified securities subsidiary; and*

*(B) any subsidiary of any qualified securities subsidiary.*

*(o) ADDITIONAL DEFINITION RELATING TO SECURITIES ACTIVITIES.—*

*(1) ASSET-BACKED SECURITY.—The term "asset-backed securities" means securities which represent interests in, or are secured by, notes, drafts, acceptances, loans, leases, receivables, other obligations, or pools of any such obligations, if the securities provide for payment obligations in the aggregate no greater than the underlying payment obligations, but does not include a security issued by an investment company registered or required to register under section 8 of the Investment Company Act of 1940.*

*(2) COMMERCIAL PAPER.—The term "commercial paper" means a security which is exempted from registration under section 3(a)(3) of the Securities Act of 1933 or such other similar*

*instrument as the Securities and Exchange Commission determines, by rule or order, to be commercial paper.*

*(3) SECURITY.—The term "security" means a security within the meaning of section 3(a)(10) of the Securities Exchange Act of 1934 or commercial paper.*

*(4) CORPORATE DEBT SECURITY.—The term "corporate debt security" means any security that is not an equity security (as defined in section 3(a)(11) of the Securities Exchange Act of 1934).*

*(5) SECURITIES ACTIVITIES.—The term "securities activities" means—*

*(A) the underwriting, distribution, dealing or making markets in, private placement, or purchase or sale for the account of others of any security;*

*(B) investment advisory services with respect to securities, or financial advisory services relating to mergers, acquisitions, restructurings, or reorganizations; and*

*(C) any other activities determined by the Securities and Exchange Commission, after consultation with the Board, to be securities activities.*

*(6) QUALIFIED MUNICIPAL SECURITIES.—*

*(A) IN GENERAL.—Except as provided in subparagraph (B), the term "qualified municipal securities" means obligations issued by, or on behalf of, or guaranteed as to principal and interest by any State, any political subdivision of any State, or any agency or instrumentality of any State or political subdivision.*

*(B) EXCEPTION.—The term "qualified municipal securities" does not include any private activity bond (as defined in section 141 of the Internal Revenue Code of 1986) unless—*

*(i) the interest on such bond is excludable from gross income under section 103 of the Internal Revenue Code of 1986 and all the property to be financed by the net proceeds of such bond is owned, for Federal income tax purposes, by a governmental unit; or*

*(ii) any State or any political subdivision of any State has pledged such State or political subdivision's full faith and credit for the payment of all principal and interest on such bond.*

*(C) STATE.—For purposes of this paragraph, the term "State" includes the District of Columbia and any possession of the United States.*

*(p) BRANCHES AND AGENCIES OF FOREIGN BANKS TREATED AS BANKS FOR CERTAIN PURPOSES.—Notwithstanding section 8(d) of the International Banking Act of 1978, any branch or agency of a foreign bank (as such terms are defined in section 1(b) of such Act) shall be considered to be a bank for purposes of sections 5 and 9 of this Act.*

*(q) DEFINITIONS RELATING TO INSURANCE ACTIVITIES.—For the purposes of this Act—*

*(1) INSURANCE ACTIVITIES.—The term "insurance activities" means providing insurance as principal, agent, or broker.*

*(2) FINANCIAL GUARANTY INSURANCE SUBSIDIARY.—The term "financial guaranty insurance subsidiary" means any company—*

*(A) which—*

*(i) is a subsidiary of a bank holding company;*

*(ii) is not a bank or insured institution or a subsidiary of a bank or insured institution;*

*(iii) provides, in the United States, financial guaranty insurance in accordance with section 6(c) of this Act; and*

*(iv) is licensed to provide financial guaranty insurance under State law; and*

*(B) the establishment of which by the bank holding company has been approved by the Board under section 6(c)(2).*

ACQUISITION OF BANK SHARES OF ASSETS

SEC. 3. (a) It shall be unlawful, except with the prior approval of the Board, (1) for any action to be taken that causes any company to become a bank holding company; (2) for any action to be taken that causes a bank to become a subsidiary of a bank holding company; (3) for any bank holding company to acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 per centum of the voting shares of such bank; (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; or (5) for any bank holding company to merge to consolidate with any other bank holding company. Notwithstanding the foregoing this prohibition shall not apply to (A) shares acquired by a bank, (i) in good faith in a fiduciary capacity, except where such shares are held under a trust that constitutes a company as defined in section 2(b) and except as provided in paragraphs (2) and (3) of section 2(g), or (ii) in the regular course of securing or collecting a debt previously contracted in good faith, but any shares acquired after the date of enactment of this Act in securing or collecting any such previously contracted debt shall be disposed of within a period of two years from the date on which they were acquired [or (B)] *(B)* additional shares acquired by a bank holding company in a bank in which such bank holding company owned or controlled a majority of the voting shares prior to such acquisition*; or (C) the acquisition by a company of control of a bank in connection with a reorganization described in paragraph (1) of subsection (h) if the requirements of such subsection are met.* The Board is authorized upon application by a bank to extend, from time to time for not more than one year at a time, the two-year period referred to above for disposing of any shares acquired by a bank in the regular course of securing or collecting a debt previously contracted in good faith, if, in the Board's judgment, such an extension would not be detrimental to the public interest, but no such extension shall in the aggregate exceed three years. For the purpose of the preceding sentence, bank shares acquired after the date of enactment of the Bank Holding Company Act Amendments of 1970 shall not be deemed to have been acquired in good faith in a fiduciary capacity if the ac-

quiring bank or company has sole discretionary authority to exercise voting with respect thereto, but in such instances acquisitions may be made without prior approval of the Board if the Board, upon application filed within ninety days after the shares are acquired, approves retention or, if retention is disapproved, the acquiring bank dispose of the shares or its sole discretionary voting rights within two years after issuance of the order of disapproval.

* * * * * * *

(c) Every bank that is a holding company and every bank that is a subsidiary of such a company shall become and remain an insured bank as such term is defined in section 3(h) of the Federal Deposit Insurance Act. This subsection does not apply to a [bank described in the last sentence of section 2(c)] *depository institution described in section 19(b)(1)(A)(vii) of the Federal Reserve Act.*

* * * * * * *

(f) SAVINGS BANK SUBSIDIARIES OF BANK HOLDING COMPANIES.—

(1) IN GENERAL.—Notwithstanding any other provision of this Act (other than paragraphs (2) and (3)), any qualified savings bank which is a subsidiary of a bank holding company may engage, directly or through a subsidiary, in any activity in which such savings bank may engage (as a State chartered saving bank) pursuant to express, incidental, or implied powers under any statute or regulation, or under any judicial interpretation of any law, of the State in which such savings bank is located.

(2) INSURANCE ACTIVITIES.—Except as provided in paragraph (3), any insurance activities of any qualified savings bank which is a subsidiary of a bank holding company shall be limited to insurance activities allowed under section 4(c)(8) *or 6.*

* * * * * * *

*(h) EXPEDITED PROCEDURES FOR CERTAIN REORGANIZATIONS OF BANKS INTO HOLDING COMPANIES.—*

*(1) REORGANIZATION DESCRIBED.—For purposes of subparagraph (C) of the second sentence of subsection (a), a reorganization is described in this paragraph if—*

*(A) any person or any group of persons exchange the shares of a bank which are held by any such person for shares of a newly formed bank holding company;*

*(B) each such person holds, after such exchange, substantially the same proportionate interest in the bank holding company as each such person held in the bank before such exchange other than any change in the shareholders' proportionate interest in such holding company which resulted from the exercise of dissenting shareholders' rights under State or Federal law; and*

*(C) immediately following the reorganization, the resulting bank holding company meets the capital and other financial standards prescribed by the Board by regulation for a bank holding company.*

*(2) EXPEDITED PROCEDURE.—The exception provided by subparagarph (C) of the second sentence of subsection (a) to the approval requirement of such subsection shall apply with respect*

*to a reorganization described in paragraph (1) of this subsection, if—*

*(A) the bank referred to in paragarph (1)(A) provides notice to the Board of such reorganization at least 30 days before the date on which such reorganization is scheduled to begin; and*

*(B) the Board has not—*

*(i) isued an order before such date disapproving such reorganization; or*

*(ii) issued a notice before such date that the provisions of this subsection are not applicable to such reorganization by reason of paragraph (3).*

*(3) EXCEPTION IN CASE OF CERTAIN NONBANKING ACTIVITIES.—This subsection shall not apply to any reorganization described in paragraph (1) if, as a result of such reorganization, the bank holding company would be engaging in any activity other than banking or managing and controlling banks.*

*(4) CAPITAL REQUIREMENT.—In promulgating regulations pursuant to this subsection, the Board shall not require more capital for the subsidiary bank resulting from a reorganization described in paragraph (1) of this subsection immediately following such reorganization than is required for a similary sized bank that is not a subsidiary of a bank holding company.*

INTERESTS IN NONBANKING ORGANIZATIONS

SEC. 4. (a) * * *

* * * * * * *

(c) The prohibitions in this section shall not apply to any bank holding company which is (i) a labor, agricultural, or horticultural organization and which is exempt from taxation under section 501 of the Internal Revenue Code of 1954, or (ii) a company covered in 1970 more than 85 per centum of the voting stock of which was collectively owned on June 30, 1968, and continuously thereafter, directly or indirectly, by or for members of the same family, or their spouses, who are lineal descendants of common ancestors; and such prohibitions shall not, with respect to any other bank holding company, [apply to—] *apply with respect to the following shares:*

(1) *The* shares of any company engaged or to be engaged solely in one or more of the following activities: (A) holding or operating properties used wholly or substantially by any banking subsidiary of such bank holding company in the operations of such banking subsidiary or acquired for such future use; or (B) conducting a safe deposit business; or (C) furnishing services to or performing services for such bank holding company or its banking subsidiaries; or (D) liquidating assets acquired from such bank holding company or its banking subsidiaries or acquired from any other source prior to May 9, 1956, or the date on which such company became a bank holding company, whichever in later[;].

(2) *The* shares acquired by a bank holding company or any of its subsidiaries in satisfaction of a debt previously contracted in good faith, but each shares shall be disposed of within a period of two years from the date on which they were acquired,

except that the Board is authorized upon application by such bank holding company to extend such period of two years from time to time as to such holding company for not more than one year at a time if, in its judgment, such an extension would not be detrimental to the public interest, but no such extensions shall extend beyond a date five years after the date on which such shares were acquired[;].

(3) *The* shares acquired by such bank holding company from any of its subsidiaries which subsidiary has been requested to dispose of such shares by any Federal or State authority having statutory power to examine such subsidiary, but such bank holding company shall dipose of such shares within a period of two years from the date on which they were acquired[;].

(4) *The* shares held or acquired by a bank in good faith in a fiduciary capacity, except where such shares are held under a trust that constitutes a company as defined in section 2(b) and except as provided in paragraphs (2) and (3) of section 3(g)[;].

(5) *The* shares which are of the kinds and amounts eligible for investment by national banking associations under the provisions of section 5136 of the Revised Statutes[;].

(6) *The* shares of any company which do not include more than 5 per centum of the outstanding voting shares of such company[;].

(7) *The* shares of an investment company which is not a bank holding company and which is not engaged in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting shares of any company[;].

(8) *The* shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks, *after taking into account technological and other innovations in the provision of banking products or services* as to be a proper incident thereto, but for purposes of this subsection it is not closely related to banking or managing or controlling banks for a bank holding company to provide insurance as a principal agent or broker except (A) where the insurance is limited to assuring repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death, disability, or involuntary unemployment of the debtor; (B) in the case of a finance company which is a subsidiary of a bank holding company, where the insurance is limited to assuring repayment of the outstanding balance on an extension of credit in the event of loss or damage to any property used as collateral on such extension of credit and, during the period beginning on the date of the enactment of this subparagraph and ending on December 31, 1982, such extension of credit is not more than $10,000 ($25,000 in the case of an extension of credit which is made to finance the purchase of a residential manufactured home and which is secured by such residential manufactured home) and for any given year after 1982, such extension of credit is not more than an amount equal to

$10,000 ($25,000 in the case of an extension of credit which is made to finance the purchase of a residential manufactured home and which is secured by such residential manufactured home) increased by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics, for the period beginning on January 1, 1982, and ending on December 31 of the year preceding the year in which such extension of credit is made; (C) any insurance agency activity in a place that (i) has a population not exceeding five thousand (as shown by the last preceding decennial census) *and is the location of such bank holding company's principal place of banking business (which shall be the place where the total bank deposits of the entire bank holding company system is the greatest,* or (ii) the bank holding company, after notice and opportunity for a hearing, demonstrates has inadequate insurance agency facilities; (D) any insurance agency activity which was engaged in by the bank holding company or any of its subsidiaries on May 1, 1982, or which the Board approved for such company or any of its subsidiaries on or before May 1, 1982, including (i) sales of insurance at new locations of the same bank holding company or the same subsidiary or subsidiaries with respect to which insurance was sold on May 1, 1982, or approved to be sold on or before May 1, 1982, if such new locations are confined to the State in which the principal place of business of the bank holding company is located, any State or States immediately adjacent to such State, and any State or States in which insurance activities were conducted by the bank holding company or any of its subsidiaries on May 1, 1982, or were approved to be conducted by the bank holding company or any of its subsidiaries on or before May 1, 1982, and (ii) sales of insurance coverages which may become available after May 1, 1982, so long as those coverages insure against the same types of risks as, or are otherwise functionally equivalent to, coverages sold on May 1, 1982, or approved to be sold on or before May 1, 1982 (for purposes of this subparagraph, activities engaged in or approved by the Board on May 1, 1982, shall include activities carried on subsequent to that date as the result of an application to engage in such activities pending on May 1, 1982, and approved subsequent to that date or of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition; (E) any insurance activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell (i) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or any of its subsidiaries, and (ii) group insurance that protects the employees of the bank holding company or any of its subsidiaries; (F) any insurance agency activity engaged in by a bank holding company, or any of its subsidiaries, which bank holding company has total assets of $50,000,000 or less: *Provided, however,* That such a bank holding company and its subsidiaries may not engage

in the sale of life insurance or annuities except as provided in subparagraph (A), (B), or (C); or (G) where the activity is performed, or shares of the company involved are owned, directly or indirectly, by a bank holding company which is registered with the Board of Governors of the Federal Reserve System and which, prior to January 1, 1971, was engaged, directly or indirectly, in insurance agency activities as a consequence of approval by the Board prior to January 1, 1971. [In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulation under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern. Notwithstanding any other provision of this Act, if the Board finds that an emergency exists which requires the Board to act immediately on any application under this subsection involving a thrift institution, and the primary Federal regulator of such institution concurs in such finding, the Board may dispense with the notice and hearing requirement of this subsection and the Board may approve or deny any such application without notice or hearing. If an application is filed under this paragraph in connection with an application to make an acquisition pursuant to section 13(f) of the Federal Deposit Insurance Act, the Board may dispense with the notice and hearing requirement of this paragraph and the Board may approve or deny the application under this paragraph without notice or hearing. If an application described in the preceding sentence is approved, the Board shall publish in the Federal Register, not later than 7 days after such approval is granted, the order approving the application and a description of the nonbanking activities involved in the acquisition;]

(9) *The* shares held or activities conducted by any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of this Act and would be in the public interest[;].

(10) *The* shares lawfully acquired and owned prior to May 9, 1956, by a bank which is a bank holding company, or by any of its wholly owned subsidiaries[;].

(11) *The* shares owned directly or indirectly by a company covered in 1970 in a company which does not engage in any activities other than those in which the bank holding company, or its subsidiaries, may engage by virtue of this section, but nothing in this paragraph authorizes any bank holding company, or subsidiary thereof, to acquire any interest in or the

assets of any going concern (except pursuant to a binding written contract entered into before June 30, 1968, or pursuant to another provision of this Act) other than one which was a subsidiary on June 30, 1968[;].

(12) *The* shares retained or acquired, or activities engaged in, by any company which becomes, as a result of the enactment of the Bank Holding Company Act Amendments of 1970, a bank holding company on the date of such enactment, or by any subsidiary thereof, if such company—

(A) within the applicable time limits prescribed in subsection (a)(2) of this section (i) ceases to be a bank holding company, or (ii) ceases to retain direct or indirect ownership or control of those shares and to engage in those activities not authorized under this section; and

(B) complies with such other conditions as the Board may be regulation or order prescribe[;].

(13) *The* shares of, or activities conducted by any company which does no business in the United States except as an incident to its international or foreign business, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of this Act and would be in the public interest[;].

(14) *The* shares of any company which is an export trading company whose acquisition (including each acquisition of shares) or formation by a bank holding company has not been disapproved by the Board pursuant to this paragraph, except that such investments, whether direct or indirect, in such shares shall not exceed 5 per centum of the bank holding company's consolidated capital and surplus.

(A)(i) No bank holding company shall invest in an export trading company under this paragraph unless the Board has been given sixty days' prior written notice of such proposed investment and within such period has not issued a notice disapproving the proposed investment or extending for up to another thirty days the period during which such disapproval may be issued.

(ii) The period for disapproval may be extended for such additional thirty-day period only if the Board determines that a bank holding company proposing to invest in an export trading company has not furnished all the information required to be submitted or that in the Board's judgment any material information submitted is substantially inaccurate.

(iii) The notice required to be filed by a bank holding company shall contain such relevant information as the Board shall require by regulation or by specific request in connection with any particular notice.

* * * * * * *

*(15) The shares of any qualified securities subsidiary.*

[In the event of the failure of the board to act on any application for an order under paragraph (8) of this subsection within the

ninety-one-day period which begins on the date of submission to the Board of the complete record on that application, the application shall be deemed to have been granted. The Board shall include in its annual report to the Congress a description and a statement of the reasons for approval of each activity approved by it by order or regulation under such paragraph during the period covered by the report.]

* * * * * * *

(f) CERTAIN COMPANIES NOT TREATED AS BANK HOLDING COMPANIES.—

(1) * * *

* * * * * * *

(3) LIMITATION ON BANKS CONTROLLED BY PARAGRAPH (1) COMPANIES.—

(A) * * *

(B) LIMITATIONS.—Until such time as the Congress has taken action pursuant to subparagraph (A), a bank controlled by a company described in paragraph (1) shall not—

(i) engage in any activity in which such bank was not lawfully engaged as of March 5, 1987;

(ii) offer or market products or services of an affiliate that are not permissible for bank holding companies to provide under subsection (c)(8) *or section 6* or permit its products or services to be offered or marketed by or through an affiliate (other than an affiliate that engages only in activities permissible for bank holding companies under subsection (c)(8) *or section 6),* unless such products or services were being so offered or marketed as of March 5, 1987, and then only in the same manner in which they were being offered or marketed as of that date;

(iii) after the date of enactment of the Competitive Equality Amendments of 1987, permit any overdraft (including an intraday overdraft), or incur any such overdraft in such bank's account at a Federal Reserve bank, on behalf of an affiliate, other than an overdraft described in subparagraph (C); or

(iv) increase its assets at an annual rate of more than 7 percent during any 12-month period beginning after the end of the [1-year] *3-year* period beginning on the date of the enactment of the Competitive Equality Amendments of 1987.

* * * * * * *

(g) LIMITATIONS ON CERTAIN BANKS.—

(1) IN GENERAL.—Notwithstanding any other provision of this section (other than the last sentence of subsection (a)(2)), a bank holding company which controls an institution that became a bank as a result of the enactment of the Competitive Equality Amendments of 1987 may retain control of such institution if such institution does not—

(A) engage in any activity after the date of the enactment of such Amendments which would have caused such institution to be a bank (as defined in section 2(c), as in effect before such date) if such activities had been engaged in before such date; [or]

(B) increase the number of locations from which such institution conducts business after March 5, 1987[.]; *or*

*(C) accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others, or make commercial loans, unless—*

*(i) such institution was authorized in writing to do so (other than as an incidental activity) by the Board as of August 10, 1987 (and then only to the extent authorized by the Board as of such date); or*

*(ii) such institution—*

*(I) was informed in writing by the General Counsel of the Board as of December 31, 1987, that an application is not required to be filed by such bank holding company for Board approval under this Act to retain ownership of such institution or to expand such institution's activities in a manner which is consistent with the requirements of subparagraph (A) of this paragraph;*

*(II) does not increase the number of locations of such institution in excess of the number of locations in existence on July 7, 1988; and*

*(III) does not move any location to any place other than a place within any of the counties in which such institution maintained locations on July 7, 1988.*

* * * * * * *

*(i) EXPEDITED APPROVAL FOR NONBANKING ACTIVITIES.—*

*(1) NOTICE REQUIREMENT.—Except as provided in paragraph (2), no bank holding company shall engage, directly or indirectly, in any activity or acquire the shares of any company pursuant to any paragraph of subsection (c) which requires an application or notice to the Board, other than paragraph (15), either de novo or by an acquisition, in whole or in part, of a going concern, unless—*

*(A) the Board has been given 60 days prior written notice of such company's intention to engage in such activity or acquire such shares; and*

*(B) within the 60-day period described in subparagraph (A), the Board has not issued an order—*

*(i) disapproving the proposal; or*

*(ii) extending the period within which the Board may disapprove the proposal in accordance with paragraph (5).*

*(2) EXCEPTIONS.—*

*(A) BOARD NOTICE OF INTENT BEFORE END OF DISAPPROVAL PERIOD.—An acquisition may be made prior to the expiration of the period described in paragraph (1)(A) (or extended in accordance with paragraph (5)) for disapproving*

*such acquisition if the Board issues a written statement that the Board does not intend to disapprove the proposal.*

*(B) BOARD EXCEPTION FOR EMERGENCY ACQUISITIONS.—The Board may provide, by regulation or order, for no notice under this subsection, or notice for a shorter period of time, with respect to—*

*(i) a notice under paragraph (1) involving a thrift institution if—*

*(I) the Board determines an emergency exists; and*

*(II) the primary Federal regulator of such thrift institution concurs in the Board's determination; or*

*(ii) nonbanking activities involved in an acquisition pursuant to section 13(f) of the Federal Deposit Insurance Act.*

*(c) CHANGE IN METHOD OF ENGAGING IN PREVIOUSLY AUTHORIZED ACTIVITIES.—No notice under this paragraph is required for a bank holding company to establish de novo an office to engage in any activity previously authorized for that bank holding company under this paragraph or to change the location of an office engaged in that activity.*

*(3) CONTENTS OF NOTICE.—The notice submitted to the Board shall contain such information as the Board shall prescribe by regulation.*

*(4) ADDITIONAL INFORMATION.—The Board may, by specific request in connection with a particular notice, require additional information with respect to such notice, except that the Board may require only such information as may be relevant to—*

*(A) the nature and scope of the proposed activity or acquisition; and*

*(B) the Board's evaluation of the notice under the criteria specified in paragraph (6).*

*(5) EXTENSION OF DISAPPROVAL PERIOD.—If, in connection with a particular notice, the Board requests additional relevant information pursuant to paragraph (4), the Board may by order provide that the Board shall have an additional period (not to exceed 60 days beginning on the date the Board receives such information) within which to disapprove the proposed activity or acquisition.*

*(6) CRITERIA FOR DISAPPROVAL.—In considering a notice under this subsection, the Board shall consider (in addition to the requirements contained in the applicable paragraph of subsection (c) or any applicable provision of section 6 or 7) whether the performance of the activity or the acquisition described in the notice by a bank holding company, or a subsidiary of such holding company, can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.*

*(7) DIFFERENTIATION BETWEEN ESTABLISHMENT DE NOVO AND ACQUISITION OF ONGOING CONCERN.—In issuing orders and prescribing regulations under subsection (c) with respect to activities or acquisitions referred to in paragraph (1) of this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern.*

*SEC. 5. SECURITIES ACTIVITIES.*

*(a) AUTHORIZED ACTIVITIES FOR QUALIFIED SECURITIES SUBSIDIARY.—*

*(1) ACTIVITIES AUTHORIZED FOR QUALIFIED SECURITIES SUBSIDIARY.—A qualified securities subsidiary may—*

*(A) engage in underwriting, distributing, or dealing in any obligation which is—*

*(i) described in section 5136(b)(6) of the Revised Statutes;*

*(ii) a qualified municipal security;*

*(iii) commercial paper; or*

*(iv) an asset-backed security;*

*(B) engage in securities brokerage, investment advisory services, financial advisory services, and such additional securities activities that are not prohibited by paragraph (2)(A) and that are permitted for brokers or dealers registered under the Securities Exchange Act of 1934 or for investment advisors registered under the Investment Advisers Act of 1940;*

*(C) engage in buying and selling foreign currency, coin, and bullion and engage in interest rate and currency swaps;*

*(D) engage in, or acquire the shares of any company engaged in, any activity which is not described in subparagraph (A), (B), or (C) of this paragraph if—*

*(i) a provision of section 4 of this Act allows a bank holding company or any subsidiary of a bank holding company to engage in, or acquire the shares of any company engaged in, such activity; and*

*(ii) either—*

*(I) the Board permits the bank holding company to engage in, or acquire the shares of a company engaged in, such activity; or*

*(II) such provision of section 4 allows the bank holding company or any subsidiary of a bank holding company to engage in, or acquire the shares of a company engaged in, such activity without the Board's approval; and*

*(E) engage in distributing securities issued by an investment company—*

*(i) that is registered pursuant to section 8 of the Investment Company Act of 1940;*

*(ii) that is not promoted, sponsored, or controlled by any affiliate of the qualified securities subsidiary; and*

*(iii) for which neither the qualified securities subsidiary nor any affiliate of the qualified securities subsidiary acts as investment adviser.*

*(2) LIMITATIONS ON SECURITIES SUBSIDIARY ACTIVITIES.—*

*(A) IN GENERAL.—Notwithstanding paragraph (1) of this subsection, no securities subsidiary may—*

*(i) underwrite (except as agent), distribute, or deal in any corporate debt security not specifically described in paragraph (1)(A) of this subsection;*

*(ii) underwrite, distribute, place, or deal in any equity security (as defined in section 3(a)(11) of the Securities Exchange Act of 1934), other than an asset-backed security;*

*(iii) underwrite, distribute, place, or deal in any derivatives or variants of such debt or equity security; or*

*(iv) act as promoter or sponsor of any opened investment company, or as underwriter to any investment company, registered or required to register under the Investment Company Act of 1940.*

*(B) LIMITATION ON BOARD AUTHORITY.—The Board may not issue any regulation, order, or interpretation authorizing or permitting a securities subsidiary to engage in the United States in any securities activities other than—*

*(i) activities specifically described in subparagraph (A), (B), or (C) of paragraph (1) of this subsection that are not prohibited by subparagraph (A) of this paragraph; or*

*(ii) securities activities in a capacity as a trustee, executor, administrator, custodian, or guardian of estates.*

*(b) FORMATION OF QUALIFIED SECURITIES SUBSIDIARY.—*

*(1) BOARD APPROVAL REQUIRED.—No bank holding company may form a company, or acquire any shares of any existing company, for the purpose of establishing a qualified securities subsidiary unless the Board approves a written application (containing such information with respect to such formation or acquisition as the Board may prescribe by regulations) by the bank holding company.*

*(2) PROHIBITION ON APPROVAL UNDER CERTAIN CIRCUMSTANCES.—The Board shall not approve any application under paragraph (1) with respect to the proposed establishment of a qualified securities subsidiary by a bank holding company if the Board determines that any of the following conditions exist or would likely result from the approval of the application:*

*(A) ADVERSE EFFECT ON HOLDING COMPANY RESOURCES TO THE DETRIMENT OF DEPOSITORY INSTITUTION SUBSIDIARIES.—The establishment of a qualified securities subsidiary would affect the managerial or financial resources of the bank holding company to such an extent that the establishment would likely—*

*(i) have an adverse impact on the safety and soundness of any depository institution subsidiary of the bank holding company; or*

*(ii) impair or diminish the bank holding company's ability to act as a source of strength for any depository institution subsidiary of the bank holding company.*

*(B) UNDUE CONCENTRATION OF RESOURCES.—The Board determines that disapproval of the application is required under subsection (e) of this section.*

*(C) INCOMPLETE APPLICATION.—The applicant bank holding company has failed to provide information required by regulations prescribed pursuant to paragraph (1) or such additional information as the Board may require the bank holding company to submit in connection with the application.*

*(D) COMMUNITY BENEFITS.—The Board determines that disapproval of the application is required under section 11.*

*(E) MINIMUM RISK-BASED CAPITAL REQUIREMENT.—The Board determines that any bank subsidiary of such bank holding company fails, at the time of such application, to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.*

*(F) PUBLIC BENEFIT.—The Board determines that the establishment and operation of a qualified securities subsidiary cannot reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.*

*(3) OPPORTUNITY FOR COMMENT.—The Board shall provide for public notice and opportunity for comment before making any determination with respect to any application under paragraph (1).*

*(c) TRANSFER OF SECURITIES ACTIVITIES FROM DEPOSITORY INSTITUTION SUBSIDIARIES.—*

*(1) IN GENERAL.—If any bank holding company establishes a qualified securities subsidiary, no bank or insured institution subsidiary of the bank holding company, and no subsidiary of any such bank or insured institution, may engage in the United States in any securities activities as of the date such qualified securities subsidiary commences operations.*

*(2) CERTAIN ACTIVITIES NOT INCLUDED.—Paragraph (1) of this subsection shall not apply so as to prohibit any bank or insured institution subsidiary of a bank holding company, or any subsidiary of any such bank or insured institution, from—*

*(A) buying or selling, as principal or agent, or underwriting any security issued by the Secretary of the Treasury under chapter 31 of title 31, United States Code;*

*(B) engaging in any activity or transaction described in paragraph (5) or (8) of section 5136(b) of the Revised Statutes;*

*(C) buying or selling, without recourse, any security in such subsidiary's capacity as trustee, executor, administrator, custodian, or guardian of estates with respect to the account of a customer;*

*(D) securities activities described in section 2(o)(5)(B) of this Act; or*

*(E) engaging in activities—*

*(i) that are necessary and incidental to the international or foreign business of the subsidiary; or*

*(ii) through a subsidiary established or acquired pursuant to section 302(b) of the Small Business Investment Act of 1958.*

*(3) LIMITED EXTENSION IN CASE OF HARDSHIP.—If the Board determines that the requirement that any subsidiary referred to in paragraph (1) of this subsection shall cease any activity described in such paragraph as of the date the qualified securities subsidiary commences operation would cause—*

*(A) undue hardship to the subsidiary; or*

*(B) excessive disruption in the operations of the bank holding company while such activities are being transferred from such subsidiary,*

*the Board may authorize such subsidiary to continue to engage in an activity described in such paragraph after such date for a period not to exceed 1 year.*

*(4) LIMITATION ON REGULATORY AGENCY AUTHORITY.—No appropriate Federal depository institutions regulatory agency may issue any regulation or order authorizing or permitting any bank or insured institution affiliate of a qualified securities subsidiary or any affiliate of such bank or insured institution (other than a securities subsidiary) to engage in the United States in securities activities other than activities specifically described in subparagraph (A), (B), (C), (D), or (E) paragraph (2) of this subsection.*

*(d) SECURITIES ACTIVITIES OF OTHER BHC NONBANK SUBSIDIARIES.—*

*(1) CERTAIN SECURITIES ACTIVITIES PROHIBITED AFTER TRANSITION.—Notwithstanding any other provision of this section or section 4, no bank holding company and no nonbank subsidiary of a bank holding company (other than a qualified securities subsidiary) may engage in the United States in securities activities after the earlier of—*

*(A) the date of qualified securities subsidiary of such bank holding company commences operations; or*

*(B) the end of the 2-year period beginning on the date of the enactment of the Depository Institutions Act of 1988.*

*(2) EXCEPTION FOR ADVISORY SERVICES OF DISCOUNT BROKERAGE.—Notwithstanding paragraph (1), a nonbank subisidiary of a bank holding company may engage in either (but not both) of the following:*

*(A) securities activities described in section 2(o)(5)(B) of this Act; or*

*(B) buying and selling securities—*

*(i) for the account of a customer;*

*(ii) upon the order of the customer; and*

*(iii) without recourse.*

*(3) EXCEPTION WITH RESPECT TO INTERNATIONAL OR FOREIGN BUSINESS.—Paragraph (1) shall not prohibit any bank holding company or any nonbank subsidiary of a bank holding company*

*from engaging in activities that are necessary and incidental to the international or foreign business of such company or subsidiary.*

*(4) EXCEPTION FOR PRIMARY DEALERS.—Notwithstanding paragraph (1), a nonbank subsidiary of a bank holding company that is a government securities broker or government securities dealer registered under section 15C of the Securities Exchange Act of 1934 may engage in securities activities as a primary dealer recognized by the Federal Reserve Bank of New York.*

*(e) AFFILIATIONS WHICH WOULD RESULT IN UNDUE CONCENTRATION OF RESOURCES PROHIBITED.—*

*(1) IN GENERAL.—No bank holding company may establish a qualified securities subsidiary through the acquisition of an existing securities firm if—*

*(A) the establishment of the qualified securities subsidiary would result in the affiliation of—*

*(i) a bank holding company or bank which—*

*(I) is, as of the latest report of financial condition date (before such affiliation); or*

*(II) was, as of the end of any of the 8 calendar quarters preceding such report of financial condition date,*

*among the 15 largest banking organizations in the United States in terms of total consolidated assets; with*

*(ii) a securities firm which—*

*(I) is, as of the latest quarterly report of financial condition (before such affiliation); or*

*(II) was, as of the end of any of the 8 calendar quarters preceding such date of report of financial condition, among the 15 largest securities firms in the United States in terms of total consolidated assets;*

*(B) the establishment of the qualified securities subsidiary would result in the affiliation of—*

*(i) a bank holding company or bank which has, or had on average during any of the 8 calendar quarters preceding the date of application to establish such securities subsidiary, total worldwide consolidated assets or more than $30,000,000,000; with*

*(ii) a securities firm described in subparagraph (A)(ii); or*

*(C) the establishment of the qualified securities subsidiary would result in the affiliation of—*

*(i) a securities firm which has, or had on average during any of the 8 calendar quarters preceding the date of application to establish such securities subsidiary, total worldwide consolidated assets of more than $15,000,000,000; with*

*(ii) a bank holding company or bank described in subparagraph (A)(i).*

*(2) ANNUAL ADJUSTMENT FOR INFLATION.—The dollar amounts of assets referred to in clause (i) of paragraph (1)(B) and clause (i) of paragraph (1) shall be increased by the Board*

*at the end of each calendar year beginning after December 31, 1988, by the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics.*

*(f) DIVESTMENT REQUIRED IF RISK-BASED CAPITAL REQUIREMENTS ARE NOT MET.—In the case of any bank holding company which controls a qualified securities subsidiary, the Board may order such bank holding company to cease conducting any securities activities other than activities in which a national bank may engage under section 5136(b) of the Revised Statutes if any bank subsidiary of such bank holding company fails to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.*

*(g) RULE OF CONSTRUCTION.—No provision of this section or section 9 shall be construed as—*

*(1) superseding or limiting any provision of any Federal securities law or regulation or limiting the authority of the Securities and Exchange Commission; or*

*(2) limiting the authority of the Board—*

*(A) under section 12, to—*

*(i) prescribe regulations and issue orders to carry out the purposes of this Act and to prevent evasions of the requirements of this Act or any such regulation or order; and*

*(ii) require reports and make examinations for the purposes referred to in clause (i), with respect to any qualified securities subsidiary of a bank holding company; or*

*(B) under any other provision of this Act, the Federal Reserve Act, the Federal Deposit Insurance Act, or any other provision of law, to regulate bank holding companies and bank holding company subsidiaries, including nonbank subsidiaries, and the transactions between or among bank holding companies and bank and nonbank subsidiaries of such companies.*

*SEC. 6. INSURANCE ACTIVITIES.*

*(a) IN GENERAL.—Except as otherwise provided in this section and notwithstanding any provision of section 3 or 4 of this Act, no bank holding company and no subsidiary of a bank holding company, including any bank or insured institution subsidiary, may engage in insurance activities in the United States.*

*(b) EXCEPTIONS.—Subsection (a) shall not apply with respect to insurance provided—*

*(1) pursuant to section 3(f), the first proviso of section 4(a)(2), or section 4(c)(8) of this Act or section 5136(g) of the Revised Statutes;*

*(2) through a State bank, or any subsidiary of a State bank, to the extent permissible under subparagraph (A), (B), (C), (E), or (F) of section 4(c)(8) and any applicable State law;*

*(3) as agent or broker by a State bank subsidiary of a bank holding company, or by a subsidiary of such State bank, if—*

*(A) such State bank or subsidiary is located in the 1 State in which the operations of such bank holding company's banking subsidiaries are principally conducted (as determined under section 3(d) of this Act);*

*(B) the insurance activities engaged in by the bank or subsidiary are authorized by State law; and*

*(C) such State bank or subsidiary acts as agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—*

*(i) any individual who—*

*(I) is a resident of the State in which such State bank is chartered; or*

*(II) is employed in such State;*

*(ii) any person, including an individual—*

*(I) who is engaged in business in such State and has a permanent business office located in such State; or*

*(II) whose principal headquarters is located in such State,*

*except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and*

*(iii) any other person if the insurance policy is issued with respect to—*

*(I) real property located in such State; or*

*(II) personal property which is principally used in such State;*

*(4) by a State bank subsidiary of a bank holding company (without regard to the date on which such bank became a subsidiary of such company), or by a subsidiary of such State bank, if—*

*(A) such State bank or subsidiary is located in the State of Indiana;*

*(B) the insurance activities engaged in by the bank or subsidiary—*

*(i) are authorized by State law (as in effect at the time such activities are engaged in by such bank or subsidiary); and*

*(ii) were authorized by State law in effect on September 22, 1988, for State banks located in the State of Indiana; and*

*(C) the insurance activities of such State bank or subsidiary meet the requirements of paragraph (3)(C) of this subsection;*

*(5) through a State bank, or any subsidiary of a State bank, if—*

*(A) permitted pursuant to a State ballot initiative allowing a State bank, or any subsidiary of a State bank, insurance underwriting authority;*

*(B) such State bank is located in such State;*

*(C) the operations of the banking subsidiaries of the bank holding company which controls such State bank are principally conducted in such State (as determined under section 3(d) of this Act);*

*(D) such ballot initiative was certified for a vote on November 8, 1988, by the Secretary of State of such State; and*

*(E) the insurance underwriting activities of such State bank or subsidiary do not involve any insurance other than provided to—*

*(i) any individual who—*

*(I) is a resident of the State in which such State bank is chartered; or*

*(II) is employed in such State;*

*(ii) any person, including an individual—*

*(I) who is engaged in business in such State and has a permanent business office located in such State; or*

*(II) whose principal headquarters is located in such State,*

*except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and*

*(iii) any other person if the insurance is provided with respect to—*

*(I) real property located in such State; or*

*(II) personal property which is principally used in such State; or*

*(6) as agent or broker by a national bank subsidiary of a bank holding company, or by a subsidiary of such national bank, if—*

*(A) such bank or subsidiary is located in the State of Oklahoma;*

*(B) the State in which the operations of such bank holding company's banking subsidiaries are principally conducted (as determined under section 3(d) of this Act) is the State of Oklahoma;*

*(C) the insurance activities engaged in by the bank or subsidiary are authorized by the law of the State of Oklahoma for State banks, and subsidiaries of State banks, which are chartered in such State; and*

*(D) such national bank or subsidiary acts as agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—*

*(i) any individual who—*

*(I) is a resident of the State in which such State bank is chartered; or*

*(II) is employed in such State;*

*(ii) any person, including an individual—*

*(I) who is engaged in business in such State and has a permanent business office located in such State; or*

*(II) whose principal headequarters is located in such State,*

*except that insurance may be provided pursuant to this clause only with respect to employees (including such individual) who reside in or who are principally employed in such State, real property located in such State, personal property which is principally used in such State, or services provided by persons located in such State; and*

*(iii) any other person if the insurance policy is issued with respect to—*

*(I) real property located in such State; or*

*(II) personal property which is principally used in such State.*

*(c) EXCEPTION FOR FINANCIAL GUARANTY INSURANCE PROVIDED BY A NONBANK SUBSIDIARY WHICH IS NOT A SUBSIDIARY OF ANY BANK SUBSIDIARY.—*

*(1) IN GENERAL.—Subsection (a) shall not apply with respect to financial guaranty insurance provided by any financial guaranty insurance subsidiary to the extent permissible under State law.*

*(2) BOARD APPROVAL REQUIRED.—No bank holding company may, directly or indirectly, form a company, or acquire or retain shares of any existing company, for the purpose of establishing a financial guaranty insurance subsidiary, or otherwise commence, directly or indirectly, to engage in providing financial guaranty insurance, unless the Board approves a written application (containing such information with respect to such formation, acquisition, or activity as the Board may prescribe by regulations) by the bank holding company.*

*(3) PROHIBITION ON APPROVAL UNDER CERTAIN CIRCUMSTANCES.—The Board shall not approve any application under paragraph (2) with respect to the proposed financial guaranty insurance activity by a bank holding company if the Board determines that any of the following conditions exist or would likely result from the approval of the application:*

*(A) ADVERSE EFFECT ON HOLDING COMPANY RESOURCES TO THE DETRIMENT OF DEPOSITORY INSTITUTION SUBSIDIARIES.—The establishment of a financial guaranty insurance subsidiary would affect the managerial or financial resources of the bank holding company to such an extent that the establishment would likely—*

*(i) have an adverse impact on the safety and soundness of any bank or insured institution subsidiary of the bank holding company; or*

*(ii) impair or diminish the bank holding company's ability to act as a source of strength for any bank or insured institution subsidiary of the bank holding company.*

*(B) INCOMPLETE APPLICATION.—The applicant bank holding company has failed to provide information required by regulations prescribed pursuant to paragraph (2) or such additional information as the Board may require the bank*

*holding company to submit in connectin with the application.*

*(C) PUBLIC BENEFIT.—The Board determines that the establishment and operation of a financial guaranty insurance subsidiary cannot reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.*

*(D) INADEQUATE STATE REGULATION.—The Board determines that the regulation provided by the State in which the financial guaranty insurance subsidiary is licensed as an insurance company is inadequate to assure the financial soundness of such subsidiary.*

*(E) MINIMUM RISK-BASED CAPITAL REQUIREMENT.—The Board determines that any bank subsidiary of such bank holding company fails, at the time of such applications, to meet the risk-based capital guidelines established by the Bank for International Settlements with respect to both tier 1 and tier 2 capital as such guidelines apply after 1992.*

*(4) LIMITATION ON INTERLOCKING DIRECTORS AND OFFICERS.—*

*(A) DIRECTORS.—A majority of the directors of the financial guaranty insurance subsidiary shall be individuals who are not directors or officers of any bank or insured institution which is an affiliate of the financial guaranty insurance subsidiary.*

*(B) OFFICERS.—No officer of the financial guaranty insurance subsidiary may serve at the same time as an officer or director of any bank or insured institution which is an affiliate of the financial guaranty insurance subsidiary.*

*(5) APPLICATION OF SAFEGUARD PROVISIONS.—No bank or insured institution subsidiary of a bank holding company may engage, directly or indirectly, in any transaction involving any financial guaranty insurance subsidiary of such bank holding company if such bank or insured institution would be prohibited from engaging in such transaction under section 9(a) if the transaction involved a securities subsidiary of such holding company.*

*(6) EXCEPTIONS TO PARAGRAPHS (2) AND (3).—If, as of the date of the enactment of the Depository Institutions Act of 1988, a subsidiary of a national bank subsidiary of a bank holding company is engaged in municipal bond guarantee insurance activities pursuant to authorization issued by the Comptroller of the Currency on or before May 2, 1985, such bank holding company may continue to engage in such municipal bond guarantee insurance activities after the date of the enactment of such Act without the approval of the Board under paragraph (3) of an application submitted to the Board pursuant to paragraph (2) (to establish a financial guarantee insurance subsidiary) if—*

*(A) such activities are transferred to a subsidiary which would be a financial guaranty insurance subsidiary (within the meaning of section 2(q)(2)(A)) of such company but for this subparagraph; and*

*(B) such subsidiary does not engage in any financial guaranty insurance activity other than municipal bond guarantee insurance activities.*

*(d) PROTECTION OF CONSUMERS AND COMPETITION.—*

*(1) CONFIDENTIAL CUSTOMER INFORMATION.—*

*(A) IN GENERAL.—No bank holding company and no subsidiary of a bank holding company, including any bank or insured institution, which engages in any insurance activity in accordance with this Act may, directly or indirectly, use any confidential customer information for the purpose of furthering any insurance activity without the express written consent of that customer.*

*(B) CONFIDENTIAL CUSTOMER INFORMATION DEFINED.—For purposes of subparagraph (A), the term "confidential customer information" has the meaning given to such term in section 9(d)(2) of this Act.*

*(2) FAVORING CAPTIVE AGENTS PROHIBITED.—No bank holding company or subsidiary of a bank holding company, including any bank or insured institution subsidiary, may—*

*(A) require, as a condition for the provision of any product or service to any customer, or any renewal of any contract for the provision of such product or service, that the customer acquire, finance, or negotiate any policy or contract of insurance through a particular insurer, agent, or broker or group of insurers, agents, or brokers;*

*(B) permit any subsidiary, or any department or agent of such company or subsidiary, which engages in any insurance activity to solicit, directly or indirectly, any customer of such company or subsidiary to provide any insurance required under the terms of any loan or extension of credit (to such customer by such company or subsidiary) before such customer has received a written commitment from such company or subsidiary with respect to such loan or other extension of credit;*

*(C) unreasonably reject any contract of insurance obtained by the customer from any insurer, agent, or broker which is not an affiliate of such company for failing to meet the insurance requirements of any loan or other extension of credit (to such customer by any such company or subsidiary) the terms of which require the customer to obtain insurance in connection with such loan or other extension of credit; or*

*(D) require any procedures, conditions, or other actions of duly licensed agents which are not affiliated with, or in any other way connected to, such bank holding company if such procedures, conditions, or other actions are not customarily required by such company or subsidiary of agents, brokers, or insurers which are affiliated with the bank holding company.*

*(3) EXCEPTION.—No provision of this subsection shall be construed as prohibiting a bank holding company or any subsidiary of any bank holding company from placing insurance on real or personal property in the event a debtor has failed to pro-*

*vide reasonable evidence of required insurance in accordance with the terms of any loan or credit document.*

*(e) AUTHORITY TO CONTINUE CERTAIN ACTIVITIES.—Notwithstanding any other provision of this section, any bank holding company may continue to—*

*(1) engage in any insurance activity through a State bank, or any subsidiary of a State bank, if—*

*(A) the bank was acquired after December 31, 1984, and before, and before March 2, 1988, pursuant to Board approval of an application to which section 3(d) of this Act applies;*

*(B) the bank provides insurance only to—*

*(i) residents of such State;*

*(ii) individuals employed in such State; or*

*(iii) individuals otherwise present in such State; and*

*(C) such insurance insures against—*

*(i) the same types of risks as insurance provided by such bank or subsidiary as of—*

*(I) the day before the date of the acquisition of such Bank or subsidiary by the out-of-State bank holding company; or*

*(II) March 2, 1998; or*

*(ii) functionally equivalent risks;*

*(2) provide title insurance coverage through any State bank which is a subsidiary of such bank holding company, and any subsidiary of such State bank, if the initial charter issued to such bank under State law required that such bank be authorized to provide title insurance;*

*(3) engage in any insurance activity lawfully engaged in before the date of the enactment of this subsection in the State of Indiana and in any State contiguous to the State of Indiana if the bank holding company or subsidiary—*

*(A) is located in the State of Indiana; and*

*(B) was acquired on June 30, 1986, pursuant to Board approval on May 28, 1986, of an application to which section 3(d) of this Act applies;*

*(4) engage in any insurance activity through a State bank, or any subsidiary of a State bank, if—*

*(A) such bank is described in subparagraphs (A) and (B) of paragraph (1); and*

*(B) the insurance activity of such State bank or subsidiary is limited to—*

*(i) life, accident, and health insurance activities for which such bank or subsidiary was licensed before March 2, 1988, pursuant to a State law which was enacted after July 20, 1987, and was in effect before September 28, 1987; and*

*(ii) the State in which such State bank or subsidiary has been licensed;*

*(5) provide financial guaranty insurance through a State bank, or any subsidiary of such bank, pursuant to an authorization by the appropriate State banking regulator which was issued before March 2, 1988;*

*(6) retain ownership interests, including the right to convert nonvoting interests to voting interests, in a company engaged in providing financial guaranty insurance if the Board determined by letter dated October 31, 1986, that the initial investment in such company by such bank holding company, or any predecessor of such bank holding company, was consistent with this Act at the time any such investment was made;*

*(7) engage in underwriting insurance, including reinsurance, through a State bank subsidiary of such bank holding company, or by a subsidiary of such State bank, if—*

*(A) such bank or subsidiary was engaged in underwriting insurance on or before July 27, 1988;*

*(B) such insurance insures against the same types of risks as insurance underwritten by such bank or subsidiary as of July 27, 1988, or functionally equivalent risks;*

*(C) the insurance underwriting activities engaged in by the bank or subsidiary are authorized by State law;*

*(D) the insurance underwriting activities are engaged in by the bank or subsidiary only in States in which such bank or subsidiary was engaged in underwriting insurance on or before July 27, 1988; and*

*(E) control of such bank or subsidiary is not acquired by any other bank holding company after July 27, 1988; or*

*(8) engage in any insurance activity through a State bank, or a subsidiary of a State bank, in any State in which the insurance activities were lawfully conducted by such bank or subsidiary, or in which such bank or subsidiary was licensed to conduct such activity, prior to the date of enactment of this subsection if the bank holding company which controls such State bank is located in Virginia (as determined under section 3(d)) and the insurance activities are conducted from the State of Tennessee.*

*(f) LIMITATIONS RELATING TO SECTION 4(f)(8)(D).—*

*(1) GRANDFATHER PROVISION CEASES IF CONTROL OF CERTAIN COMPANIES CHANGE.—The authority for any company to provide insurance pursuant to section 4(c)(8)(D) of this Act shall terminate if control of the company providing the insurance is acquired by a bank holding company—*

*(A) on or after October 15, 1982, in a transaction requiring Board approval of an application to which section 3(d) of this Act applied if the bank holding company did not obtain Board approval to engage in such insurance activities under section 4 before March 2, 1988; or*

*(B) on or after March 2, 1988;*

*unless the acquiring company is a successor or is, and continues to be, a bank holding company with total assets of $50,000,000 or less.*

*(2) CERTAIN BANK HOLDING COMPANIES ALLOWED TO CONTINUE TO ENGAGE IN INSURANCE ACTIVITIES.—If—*

*(A) control of any company providing insurance pursuant to section 4(c)(8)(D) of this Act was acquired by a bank holding company on or after October 15, 1982; and*

*(B) the bank holding company obtained Board approval pursuant to section 4(c)(8)(D) of this Act before March 2,*

*1988, to acquire and retain the shares of the company which engages in such insurance activities,*

*such bank holding company may retain the shares of such company and such company may continue to engage in such insurance activities.*

*(3) INDEPENDENT QUALIFICATION OF AFFILIATES.—No company that is an affiliate of a company providing insurance pursuant to section 4(c)(8)(D) of this Act shall provide insurance pursuant to such section after March 1, 1988, unless such affiliated company also meets the requirements of such section.*

*(g) LIMITATIONS ON SECTION 4(c)(8)(C)(i) PROVISION.—The authorization for any company to provide insurance pursuant to section 4(c)(8)(C)(i) of this Act shall apply only if—*

*(1) the insurance activities of such company are authorized by the appropriate authorities of the State in which the place described in section 4(c)(8)(C)(i) is located;*

*(2) the insurance company for which such company acts as agent or broker is authorized to do business in such State by the appropriate authorities of the State; and*

*(3) such company acts as an agent or broker for an insurance company only with respect to insurance policies issued by such insurance company to—*

*(A) individuals who are residents of or employed in the place described in section 4(c)(8)(C)(i);*

*(B) persons, including individuals—*

*(i) who are engaged in business in the place described in section 4(c)(8)(C)(i) and have a permanent business office located in such place; or*

*(ii) whose principal headquarters is located in such place,*

*except that insurance policies may be issued under this subparagraph only with respect to employees (including such individuals) who reside in or who are principally employed in such place, real property located in such place, personal property which is principally used in such place, or services provided by persons located in such place; and*

*(C) any other person if the insurance policy is issued with respect to—*

*(i) real property located in the place described in section 4(c)(8)(C)(i); or*

*(ii) personal property which is principally used in such place.*

*(h) NOTICE AND COMMENT.—*

*(1) IN GENERAL.—Except as provided in subsection (c)(2) with respect to financial guaranty insurance and notwithstanding any other provision of this Act, no bank holding company may commence to engage, directly or indirectly, in any insurance activity or acquire the shares of any company (including any State bank) engaged in insurance activity, unless such bank holding company provides notice to the Board in the manner provided in section 4(i) of this Act.*

*(2) APPLICABILITY OF NOTICE AND DISAPPROVAL PROCEDURES.—Section 4(i) shall apply with respect to any notice under paragraph (1) without regard to the fact that the insur-*

*ance activity is authorized under a provision of this Act other than any paragraph of section 4(c).*

*(3) PUBLICATION OF NOTICE.—Any notice received by the Board pursuant to this subsection shall be published in the Federal Register.*

*(i) DATA COLLECTION.—*

*(1) REPORTS REQUIRED.—The Board shall require each bank holding company which engages, directly or indirectly, in insurance activities in accordance with this Act to submit, on an annual basis, the following information with respect to such activity:*

*(A) Of the total number of customers of all bank subsidiaries of such company, the percentage of such number of customers who purchased, directly or indirectly, insurance products or services from such company.*

*(B) Any other information the Board determines to be appropriate for enforcing the provisions of section 106(b) of the Bank Holding Company Act Amendments of 1970.*

*(2) PUBLIC INSPECTION.—The Board shall evaluate the information submitted pursuant to paragraph (1) and shall make available for public inspection such information and such evaluations.*

*(j) DEFINITIONS.—*

*(1) RESIDENTS.—For purposes of this section, the term "residents", when used in connection with a reference to a State, includes—*

*(A) individuals who are residents of the State; and*

*(B) companies which—*

*(i) are incorporated in or organized under the laws of the State;*

*(ii) are licensed to do business in the State; or*

*(iii) have an office in the State.*

*(2) FINANCIAL GUARANTY INSURANCE.—For purposes of this section—*

*(A) IN GENERAL.—The term "financial guaranty insurance" means a contract issued by an insurer under which loss is payable upon proof of the occurrence of financial loss to an insured claimant, obligee, or idemnitee as a result of any of the following:*

*(i) The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obigor who also defaulted.*

*(ii) Changes in the levels of interest rates or the differential in interest rates between various markets or products.*

*(iii) Changes in the rate of exchange of currency.*

*(iv) Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general.*

*(B) EXCEPTIONS.—Such term does not include any of the following:*

*(i) Insurance of a loss resulting from an event described in subparagraph (A), if the loss is payable only upon the occurrence of any of the following:*

*(I) A fortuitous physical event.*

*(II) A failure of or deficiency in the operation of equipment.*

*(III) An inability to extract or recover a natural resource.*

*(ii) A contract bond, including a bid, payment, or maintenance bond, or a performance bond, which guarantees the execution of a contract other than a contract of indebtedness or other monetary obligation.*

*(iii) An indemnity bond for the benefit of a public body, railroad, or charitable organization or a lost security or utility payment bond.*

*(iv) Becoming surety on, or guaranteeing the performance of, any lawful contract where the bond is guaranteeing the execution of a contract other than a contract of indebtedness or other monetary obligation.*

*(v) Becoming surety on, or guaranteeing the performance of, bonds and undertakings required or permitted in a judicial proceeding or otherwise allowed by law, including surety bonds accepted by States and municipal authorities in lieu of deposits as security for the performance of insurance contracts.*

*(vi) An individual or schedule public official bond.*

*(vii) A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond.*

*(viii) A bond running to a Federal, State, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege.*

*(ix) A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization.*

*(x) A lease, purchase and sale, or concessionaire surety bond.*

*(xi) Residual value insurance.*

*(xii) Insurance guaranteeing the fidelity of persons holding positions of public or private trust, or indemnifying businesses, banks, thrifts, brokers, or other financial institutions against loss of money, securities, negotiable instruments, other specified valuable papers, or tangible items of personal property caused by larceny, misplacement, destruction, or other State perils including loss while being transported in an armored motor vehicle or by messenger and including insurance for loss caused by the forgery of signatures on, or alteration of, specified documents, and valuable papers.*

*(xiii) Insurance against losses that businesses or financial institutions become legally obligated to pay by reason of loss.*

*(xiv) Credit unemployment insurance on a debtor in connection with a specific loan or other credit transaction, to provide payments to a creditor in the event of unemployment of the debtor for the installments or other periodic payments becoming due while a debtor is unemployed.*

*(xv) Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed to him for goods or services provided in the normal course of his business.*

*(xvi) Guaranteed investment contracts that are issued by life insurance companies and that provide that the life insurer will make specified payments in exchange for specified premiums or contributions.*

*(xvii) Mortgage guaranty insurance.*

*(3) AUTHORIZED BY STATE LAW.—In the case of any insurance activity in which a State bank may not engage as of the date of the enactment of this paragraph under any State law or rule of law, the term "authorized by State law", in connection with any subsequent authorization for such bank to engage in such activity, means express authorization under the statute laws of a State, including referenda and ballot initiatives, by language to that effect and not be implication.*

*SEC. 7. REAL ESTATE ACTIVITIES.*

*(a) IN GENERAL.—Except as provided in subsection (b) of this section and section 3(f)(1) of this Act, no bank or nonbank subsidiary of a bank holding company (including any subsidiary of a foreign bank or other company which is subject to this Act under section 8(a) of the International Banking Act of 1978) and no bank holding company may engage in any real estate activity in the United States during the 2-year period beginning on the date of the enactment of the Depository Institutions Act of 1988.*

*(b) EXCEPTIONS.—Subsection (a) shall not apply with respect to—*

*(1) any real estate activity of a bank holding company or a bank or nonbank subsidiary of such bank holding company in which such bank holding company or bank or nonbank subsidiary was engaged on or before July 27, 1988;*

*(2) any insured institution subsidiary of a bank holding company;*

*(3) real estate activities engaged in by any State bank pursuant to an application approved by the banking commissioner of such State which was approved on or before, or was pending on, July 27, 1988, to the extent such activities are specifically authorized in the approved application; and*

*(4) any real estate activity engaged in by a State bank subsidiary of a bank holding company under a State law which expired on June 30, 1988, to the extent authorized under the law of such State.*

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