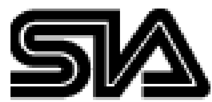

Securities Industry Association

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September 30, 1996

William W. Wiles
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Comments on the Releases Entitled: "Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities" (Docket No. R-0841)

Dear Mr. Wiles:

I. INTRODUCTION AND PURPOSE

The Securities Industry Association ("SIA")[1] appreciates this opportunity to comment on the recent proposal contained in the release by the Board of Governors of the Federal Reserve System (the "Board") entitled: "Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities" (the "Release"). In the Release, the Board proposes to increase from 10 percent to 25 percent the revenue limit applicable to bank-ineligible activities of subsidiaries of bank holding companies engaged in underwriting and dealing in securities.

SIA opposes the proposal to increase the revenue limit by 150 percent (i.e., 2 1/2 times). SIA respectfully submits that the Board should consider this proposal -- along with recent related proposals [2]-- in the context of achieving a comprehensive restructuring and modernization of the United States financial services industry. It is important to all constituents of the financial services industry -- and not just affiliates of bank holding companies -- that comprehensive reform of the financial services marketplace be accomplished. Such comprehensive reform can be accomplished only through legislative reform and not through regulatory reform. Congress is the only forum in which such legislative reform can be undertaken, and the only forum in which all types of financial services competitors can participate in the reform process on an equal footing.

SIA strongly supports comprehensive financial services modernization legislation. Such legislation is the only way that all providers of financial services -- and their customers -- will benefit. SIA members include, among others, securities firms affiliated with banks (including securities firms engaged in securities underwriting and dealing activities), investment banks, broker-dealers, specialists, market makers and diversified financial

services firms. SIA believes all of its member firms should be afforded the same competitive opportunities, and should be subject to the same rules and regulations. This result can be accomplished only through legislation.

As the Board is aware, and as discussed in greater detail below, SIA -- and many other members of the financial services industry -- actively worked with Congress, the Board and others this legislative term, in a serious effort to achieve comprehensive reform. While these efforts did not result in legislation this term, these efforts were distinguished from prior attempts to comprehensively modernize the financial services industry by the wide-spread industry participation and support in the legislative process. For example, in a precedent-setting effort, a number of financial trade groups that historically have been Glass-Steagall adversaries successfully worked as a group -- called the Alliance for Financial Services Modernization -- to develop comprehensive financial services modernization legislation.

As the Board also is aware, the potential advantages of comprehensive financial services modernization legislation include greater diversification for and financial strength of financial institutions, greater opportunities for product development, greater competition in the United States financial services market, and increased international competitiveness for United States financial services firms. The ultimate beneficiary of these advantages would be the financial services consumer, who would have available more and better products and services at a lower cost. These benefits cannot be achieved by the Board unilaterally acting to expand the securities powers of banks and bank holding companies. Rather, such an action by the Board would only reallocate the current competitive balance within the financial services community, to the advantage of banks and bank holding companies and to the disadvantage of securities firms and other financial services companies. While this might produce short-term competitive benefits for banks and bank holding companies, it would do so only at the significant long-term cost of jeopardizing the chances for comprehensive financial services modernization legislation, and thus jeopardizing the chances for the significantly greater increased competition and other significant benefits that such legislation could bring.

The legislative efforts this term of various Congressional leaders, as well as industry members and groups such as SIA and the Alliance, demonstrate that comprehensive financial services modernization finally is a realistic legislative goal, if all members of the financial services community have the economic and other incentives to reach a meaningful compromise. SIA, however, is greatly concerned that piecemeal increases in the securities powers of banks and bank holding companies -- such as the current proposal by the Board to raise the revenue limit to 25 percent -- could have the unintended consequence of significantly reducing the chances for comprehensive financial services modernization. Any part of the financial services industry that achieves major regulatory advantages over other industry participants also will correspondingly be disinclined to support comprehensive legislative reform. While regulatory advantages may serve short-term competitive interests, they will have a deleterious impact on the long-term competitiveness of the United States financial services industry as a whole, including on banks and bank holding companies. Such regulatory advantages could, in turn, significantly disadvantage the U.S. consumer, who will not receive the benefits that

comprehensive financial services modernization would bring.

During the present session of Congress, much progress was made toward building a broad consensus within the industry in support of comprehensive reform. However, as discussed below, SIA believes that adoption of the proposed increase in the revenue limit to 25 percent significantly would decrease the likelihood that Congress could continue to develop the broad-based consensus necessary to enact comprehensive financial services modernization legislation. Specifically, SIA believes that, if the Board adopts the proposal to increase the revenue limit to 25 percent, banks and bank affiliates will have little or no incentive to support a financial services modernization bill, because they would have received by rule much of the relief they would have sought in legislation. At the same time, consumers would be unfairly disadvantaged, because they would lose the significant benefits that financial services modernization could bring, and securities, insurance and other financial services firms would be placed at a competitive disadvantage with respect to banks, because many of these firms still would be unable to affiliate with a bank, or accept deposits.

SIA also believes that the Board lacks the authority to increase the revenue limit to 25 percent. As discussed below, judicial decisions, prior Board interpretations, and the legislative history to the Glass-Steagall Act firmly demonstrate that a securities affiliate of a bank holding company cannot engage in bank-ineligible securities underwriting and dealing activities to a substantial extent. These same sources, and others -- as well as common sense and common usage -- require the conclusion that 25 percent of a company's revenues is a substantial amount of the company's revenues. The Board's proposal could have the consequence of permitting banks to affiliate with some of the largest and most prominent securities firms in the United States and throughout the world, because it is likely that many of these firms -- particularly in light of their broad and diversified activities -- do not derive more than 25 percent of their revenues from bank-ineligible securities underwriting and dealing activities. Such affiliations would fly in the face of the purpose and intent of the Glass-Steagall Act, which was enacted precisely to prohibit such affiliations, and, to the extent possible, divorce investment from commercial banking. The Board and individual members of Congress may disagree with the lines drawn by the Glass-Steagall Act, and may believe that perhaps no such lines should have been drawn at all. Regardless of the merits of these positions, the Glass-Steagall Act lines have been drawn, and the Board cannot redraw those lines on its own authority. Only Congress has that power.

The courts have, of course, agreed with the Board that a bank affiliate may engage in bank-ineligible securities underwriting and dealing activity to an insubstantial extent. SIA believes that the Board's prior decisions have identified the maximum amount of such permissible activities at 10 percent of revenues, and the courts have confirmed this interpretation. Even if the permissible level were higher than 10 percent -- and we think it is not -- the Board should increase the level only in a measured and incremental fashion, and only on a case by case basis and in compelling circumstances, at least until the Board gains sufficient experience with any such incremental increases. In this regard, we note that the Board's experience to date under the 10 percent revenue limit does not provide the Board with any meaningful method of evaluating the consequences of

increasing the revenue limit by 150 percent in one concerted action. The Board cannot know what affiliations could occur under a 25 percent revenue limit, or what additional prudential or other limitations might be appropriate if, as is possible, the 25 percent revenue limit permitted significant banks to affiliate with significant securities firms.

Nonetheless, SIA understands that, in certain cases, the 10 percent revenue limit may impose significant hardships on certain bank securities affiliates. Without conceding that the Board has the authority to permit those securities affiliates to engage in additional bank-ineligible securities underwriting and dealing activities, SIA believes that there may be some circumstances under which it would not be objectionable if the Board permitted a modest amount of such additional activities -- although only on a case by case basis. We will discuss some of these circumstances below.

II. CONTEXT: THE NEED FOR COMPREHENSIVE FINANCIAL SERVICES MODERNIZATION LEGISLATION OR RULEMAKING

As discussed in our September 3, 1996 Comment Letter on the Firewalls Release and the Revenue Calculation Release, SIA believes that comprehensive reform and modernization of the financial services industry by Congress is the only means by which banks and securities firms (as well as insurance companies and other financial services providers) will be able to compete and affiliate on a fair and rational basis. As the Board is aware, the potential advantages of permitting such competition and affiliations, with appropriate firewalls and other safeguards, include greater diversification for and financial strength of financial institutions, greater opportunities for product development, greater competition in the United States financial services market, and increased international competitiveness for United States financial services firms. The ultimate beneficiary of these advantages would be the financial services consumer, who would have available more and better products and services at a lower cost.

As the Board also is aware, several financial services modernization legislative proposals recently have been advanced. During this term, House Banking and Financial Services Chairman James Leach (R-IA) proposed such legislation, which advanced quite far in the legislative process. Many members of the financial services community supported that legislation in varying degrees. SIA supported many aspects of the legislation, and actively worked with Representative Leach and others to address SIA's remaining concerns with the legislation by proposing modifications intended to assure functional regulation and a full "two-way" street, and to prevent the direct and indirect use of deposit insurance to finance securities and insurance activities. In addition, Senator Alfonse D'Amato (R-NY) and Representative Richard Baker (R-LA) previously developed and introduced an alternative legislative approach to financial services modernization, which was re-introduced this term in both the Senate and the House. In addition, on September 25, 1996, Representative Marge Roukema (R-NJ), together with co-sponsors Representatives William McCollum (R-FL), Bruce Vento (D-MN), David Dreier (R-CA), Elizabeth Furse (D-OR), Floyd Flake (D-NY), Peter King (R-NY), Sonny Bono (R-CA) and Cynthia McKinney (D-GA), introduced The Depository Institution Affiliation and Thrift Charter Conversion Act, H.R. 4182. This financial services modernization legislation is intended to provide a framework for debate of this topic in the 105th Congress.

This term's legislative efforts were distinguished from prior attempts to comprehensively modernize the financial services industry by the wide-spread industry participation and support in the legislative process. For example, in a precedent-setting effort, a number of financial trade groups that historically have been Glass-Steagall adversaries successfully worked as a group to develop comprehensive financial services modernization legislation. Specifically, the Alliance for Financial Services Modernization -- an industry group consisting of the American Bankers Association (the "ABA"), ABA Securities Association, American Financial Services Association, America's Community Bankers, Bankers Roundtable, Consumer Bankers Association, Financial Services Council, Investment Company Institute and SIA -- developed a proposal for comprehensive financial services modernization legislation, the broad terms of which generally were supported by the Alliance members. The Alliance proposal formed the framework for H.R. 4182.

In contrast to comprehensive financial services modernization, piecemeal increases by bank regulators in the securities powers of banks and bank holding companies -- such as increasing the revenue limit to 25 percent -- are not long-term solutions to the complicated competitive issues caused by the now-antiquated statutes regulating the financial services industry. Rather, as the recent efforts to craft broadly acceptable financial services modernization legislation demonstrates, such modernization involves weighing legitimate and competing interests of many members of the financial services community, not just the interests of banks and bank holding companies. Permitting securities subsidiaries of bank holding companies to increase dramatically their corporate equity, debt and other bank-ineligible securities underwriting and dealing activities would provide those holding companies with a competitive advantage over other financial services holding companies. Most notably, many securities, insurance and diversified financial services firms still would be unable to affiliate with banks, while bank affiliates dramatically could expand their securities activities. No corresponding benefit would be provided to competing securities firms that are not affiliated with banks.

SIA is greatly concerned that piecemeal increases in the securities powers of banks and bank holding companies, whether by the Board or other Federal banking regulators, could have the unintended consequence of significantly reducing the chances for comprehensive financial services modernization. As the Board is aware, to date the difficulty Congress has faced in enacting such legislation has been that certain institutions prefer the competitive advantages under existing rules while keeping other institutions constrained. Any part of the financial services industry that achieves major regulatory advantages over other industry participants also will correspondingly be disinclined to support comprehensive legislative reform. While regulatory advantages may serve short-term competitive interests, they will have a deleterious impact on the long-term competitiveness of the United States financial services industry as a whole, including on banks and bank holding companies. Such regulatory advantages could, in turn, significantly disadvantage the U.S. consumer, who will not receive the benefits that comprehensive financial services modernization would bring.

SIA also believes that the Board should not view its mandate, as do some Federal regulators, as advancing the interests of one narrow set of members of the financial

services community. Rather, because of its unique regulatory roles, the Board should view the impact of its actions in light of the effects those actions would have on the financial services industry, and on the American economy, as a whole. As a matter of policy and fairness, the Board should not view its mandate to regulate bank holding companies as a mandate to put their specific (even if legitimate) interests ahead of the (equally legitimate) interests of the rest of the financial services community.

Further, there is no compelling need for the Board at this time to take piecemeal actions (such as increasing the revenue limit) that could jeopardize comprehensive financial services modernization, or provide a competitive advantage to only one segment of the financial services community. As the Board is aware, banks and bank holding companies already have a significant ability to engage in securities and insurance activities -- even though securities firms and insurance companies cannot engage in commercial banking activities. As a result, banks and bank holding companies already can and do obtain significant revenues from these securities and insurance activities (as well as from their bank-eligible securities underwriting and dealing activities, and their offshore underwriting and dealing activities). Thus, the historic argument that banks and bank holding companies should be permitted to engage in greater securities activities to provide greater financial diversification simply is not compelling.

SIA is aware that some securities affiliates of banks argue that they are constrained in the revenues they may receive from underwriting and dealing in bank-ineligible securities, and that this too presents competitive issues. However, the appropriate method for addressing this and other competitive disparities is not for the Board to unilaterally increase the amount of revenue securities affiliates of bank may derive from ineligible activities -- particularly when the proposed increase may well violate the Glass-Steagall Act. Rather, the Board's efforts should focus on assuring functional regulation and a full "two-way" street for all members of the financial services community, and on preventing the direct and indirect use of deposit insurance to finance securities and insurance activities. If all banks can affiliate with securities firms, all securities firms should be able to affiliate with banks. And, a securities firm that chooses to affiliate with a bank should not become subject to the full panoply of regulation as a bank holding company, when that firm's principal activities already are subject to comprehensive regulation by its principal regulators (such as the Securities and Exchange Commission and the Commodity Futures Trading Commission).

As recent legislative activities demonstrate, comprehensive financial services modernization can be achieved only if a broad segment of the financial services industry, and a broad segment of the relevant Federal and State regulators, work together to reach reasonable compromises on many difficult issues. The Board's efforts in achieving financial services modernization therefore should be focused (to the extent permissible under federal law) on attempting to assemble and work with such a broad-based coalition, rather than seeking to expand unilaterally the powers of bank holding companies.

Finally, SIA notes that the Board is proposing changes to prudential limitations established in its Section 20 Orders, which were issued pursuant to Section 4 of the Bank Holding Company Act and the Board's Regulation Y. SIA therefore submits that the

Board, in its consideration of the proposed changes, should consider the factors contained in the Board's Regulation Y that must be applied by the Board to proposals to engage in nonbanking activities[3] -- i.e., whether the proposed changes can reasonably be expected to produce benefits to the public (such as greater convenience, increased competition, and gains in efficiency) that outweigh possible adverse effects (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices). In view of the limited record currently before the Board, SIA believes that the Board has no basis upon which to make these determinations. For example, the Board does not appear to have evaluated which securities and diversified financial services firms would be eligible to affiliate with banks under the proposal. Further, it appears that the Board's Release does not request comment on this and similar issues, and it therefore is unlikely that the Board will have a sufficient record on which to make such determinations following its review of those comments.

III. THE BOARD MAY LACK THE AUTHORITY TO INCREASE THE 10 PERCENT REVENUE LIMIT

As discussed in our September 23, 1994 letter to the Board (see pages 6-8 and 22-23), SIA believes that, under the "engaged principally" requirement in Section 20 of the Glass-Steagall Act, the Board may lack the authority to increase (directly or indirectly) the 10 percent revenue limit. For example, at the time the Board adopted the 10 percent revenue limit in its 1987 Citicorp decision, the Board also stated that a test which permitted 10 to 15 percent of a Section 20 Subsidiary's activities to consist of ineligible-securities activities would "exceed the levels which the Board believes represent an appropriate interpretation of the provisions of section 20 that is consistent with both its language and the intention of Congress.[4] The Board went on to state that, at the levels permitted under such a 10 to 15 percent revenue test, the Section 20 Subsidiaries "would be clearly engaged principally in underwriting and dealing in securities." [5]

The Court of Appeals for the Second Circuit expressly upheld the Board's interpretation in Citicorp, stating that "[t]his range [i.e., the 5-10 percent range] is both reasonable and consistent with the statute." [6] In so doing, the court expressly upheld the Board's decision rejecting the request of one bank holding company to permit its Section 20 Subsidiary to engage in ineligible-securities activities constituting up to 15 percent of its gross revenues. [7] We note that, in a separate case, the Second Circuit held that once the Board has made a reasonable interpretation of a statute, and that interpretation was affirmed by a court, the Board may not thereafter adopt a position inconsistent with that interpretation. [8]

Moreover, even if the Board does have some authority to increase the 10 percent revenue limit -- and we believe it does not -- SIA believes that the Board does not have the authority to increase that level to twenty-five percent.[9] Both the Board and the courts have interpreted the "engaged principally" limitation as prohibiting "substantial" bank-ineligible securities underwriting and dealing activities.[10] Even in the absence of the prior interpretations (discussed above) by the courts and the Board, activities generating one-quarter of a Section 20 Subsidiary's revenues should be deemed to be "substantial."

Such activities would constitute no less than the third largest source of revenue to such a Section 20 Subsidiary. [11] And, for a reasonably well-diversified Section 20 Subsidiary, it is likely that any activity constituting 25 percent of its revenues would be the first or second largest source of revenues. It therefore would be inconsistent with the ordinary meaning of the term "substantial" to take the position that a 25 percent revenue limit would permit only insubstantial bank-ineligible securities underwriting and dealing activities.

The view that 25 percent is "substantial" also is consistent with other provisions of the Bank Holding Company Act, and other financial laws. For example, the Bank Holding Company Act presumes that a person that owns 25 percent of a company has a sufficiently substantial stake in the company to be deemed to "control" that company. [12] Further, both the Bank Holding Company Act and the Board's Regulation Y recognizes that ownership of as little as 5 percent of a company is sufficiently substantial to permit a finding of control.[13] Similarly, under the regulations of both the Office of the Comptroller of the Currency and the Office of Thrift Supervision, a person may be determined to have a sufficiently substantial stake in a national bank or a savings association to have acquired control of such institution if the person acquires as little as 10 percent of the stock of the institution. [14]

In addition, raising the revenue limit to 25 percent may well render Section 20 of the Glass-Steagall Act virtually meaningless. As the Supreme Court and the Board have noted, investment banking firms typically engage in numerous other activities in addition to securities underwriting and dealing.[15] It is quite possible that many major investment banking firms derive less than 25 percent of their revenue from underwriting and dealing in ineligible securities.[16] If so, raising the revenue limit to 25 percent would permit "affiliations between large member banks and the largest investment banks in the country, the precise situation at which the Glass-Steagall Act was directed." [17]

Finally, raising the revenue limit to 25 percent would be plainly contrary to the intent of Congress when it enacted Section 20, as evidenced by the legislative history of the Glass-Steagall Act. That legislative history repeatedly emphasizes that the goal of Congress in enacting the Glass-Steagall Act was to effect as complete a divorcement as possible between commercial banking and investment banking. For example, the Senate Report accompanying S. 1631, the Senate bill that contained what became Section 20 of the Glass-Steagall Act, stated:

There seems to be no doubt anywhere that a large factor in the overdevelopment of security loans, and in the dangerous use of the resources of bank depositors for the purpose of making speculative profits and incurring the dangers 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 maintaining a market forthe banks' own stock often largely with the resources of the parent bank. . . . The committee has, therefore, determined to present proposed legislation aimed at the following objects: (1) To separate as far as possible national and member banks from affiliates of all kinds. . . .[18]

This view was echoed by then Board Governor Eugene Mayer, who in 1932 hearings before the Senate Banking and Currency Committee on the legislation that eventually became the Glass-Steagall Act, stated "I am in hearty sympathy personally, I may say, Senator, with your desire to separate commercial banking from investment banking. That is what you really have in mind." [19]

And, in a 1987 letter regarding applications by Citicorp and others to underwrite certain securities pursuant to section 4(c)(8) of the Bank Holding Company Act, then-Senator William Proxmire (D-Wis) stated the common understanding of the Congressional intent behind the Glass-Steagall Act:

The clear and overriding intent of the Congress in enacting the Glass-Steagall Act was to prohibit banks from underwriting ineligible securities, whether directly or through affiliates. That intent was well understood in 1933, and no one doubted that the Act carried it into effect. Banks promptly divested or dissolved their securities affiliates; no bank attempted to continue underwriting securities through an affiliate on the theory that the affiliate was not principally engaged in underwriting.[20]

While prior decisions of the courts and the Board have interpreted Section 20 as permitting some level of affiliation between commercial and investment banking firms, no legislative or judicial developments have occurred that override the intent of Congress in enacting the Glass-Steagall Act -- to divorce, as completely as possible, investment banking from commercial banking. Taken in this context, it seems self-evident that the 1933 Congress never intended that, under the Glass-Steagall Act, a bank could affiliate with a securities firm that derived up to 25 percent of its revenues from bank-ineligible securities underwriting and dealing activities. Again, if changes in the financial services industry since 1933 have made the continuing validity of Congress' judgment suspect, the appropriate -- and only -- course available is for Congress to amend the Glass-Steagall Act. The Board cannot authorize the remarriage of investment and commercial banking.

IV. PROPOSALS TO INCREASE OR MODIFY THE 10 PERCENT REVENUE LIMIT IN A MEASURED AND INCREMENTAL FASHION

Notwithstanding our objections to the Board's proposal to implement in one broad sweep such a substantial increase in the gross revenue limit, an increase to 25 percent or some 2 1/2 times the present limit, if the Board decides that it nonetheless is appropriate to consider proposing some increase of the present 10 percent limit, the Board should consider only measured and incremental increases and only to the extent necessary to permit individual securities firms presently affiliated with banks ("Section 20 Subsidiaries") to continue to compete effectively, as determined on a case-by-case basis. We suggest the following measured and incremental approaches for consideration by the Board. However, we emphasize that, despite our suggestions, SIA firmly opposes any increase in the 10 percent revenue limit.

In addition, SIA respectfully urges the Board to continue to pursue comprehensive financial services modernization legislation, and to consider the effect of any increase in the 10 percent revenue limit only if that increase or modification would not interfere with the likelihood of enacting such legislation.

A. Compelling Circumstances Approach

The Board could consider permitting, by order, Section 20 Subsidiaries to exceed the 10 percent revenue limit on a case-by-case basis, and only in compelling circumstances, such as when the bank holding company underwrites securities of one or more issuers whose underwriting needs cannot adequately be served by other underwriters. In determining whether a particular circumstance is "compelling," the focus should be on whether the ultimate consumers would be significantly and directly advantaged (as opposed to theoretically advantaged, such as by the general potential for increased competition).

Such an increase or modification should be permitted only if, among other things:

- The Section 20 Subsidiary, the bank holding company, and all of the bank holding company's subsidiary banks are well capitalized;
- The Section 20 Subsidiary's securities underwriting and dealing activities have been at or near the 10 percent revenue limit for at least two years, and those securities activities have not had an adverse financial impact on, or substantially increased the risk of an adverse financial impact to, the bank holding company or its subsidiary banks;
- Following the increase or modification, the bank holding company would be engaged principally in one or more other permissible activities, as measured by its profits and revenues from, and its assets devoted to, those activities; and
- Any direct or indirect increase in the 10 percent revenue limit would be made only in small increments, and only in light of the particular Section 20 Subsidiary's legitimate and prudential growth requirements.

B. Temporary Non-Compliance Approach

The Board could consider permitting Section 20 Subsidiaries to exceed the 10 percent revenue limit by a small amount for up to two years, prior to requiring divestiture of the Section 20 Subsidiary, or compliance by the Section 20 Subsidiary with the 10 percent revenue limit. This approach would be consistent with the Board's practice of permitting a bank holding company to retain ownership of an impermissible subsidiary for up to two years (such as following an acquisition) prior to requiring divestiture of the subsidiary. This approach also could provide a strong incentive for Section 20 Subsidiaries to actively support comprehensive financial services modernization legislation during the two-year period they were out of compliance with the 10 percent revenue limit.

C. Limited Growth Approach

The Board could consider permitting particular Section 20 Subsidiaries, by order, to increase their bank-ineligible securities activities by a small amount each year, for up to, say, five years, as long as revenues from those activities do not exceed an absolute maximum percentage of total revenues, which the Board would not re-evaluate in the absence of comprehensive financial services modernization legislation. SIA might consider not objecting to such an approach if the yearly increases in bank-ineligible securities activities, and the absolute maximum percentage of total revenues derived from

such activities, were appropriately modest. As with the "temporary non-compliance" approach, this approach also could provide a strong incentive for Section 20 Subsidiaries to actively support comprehensive financial services modernization legislation.

CONCLUSION

For the reasons discussed above, SIA respectfully submits that the Board should not increase the 10 percent revenue limit -- either to 25 percent or to any other level. Such an increase should occur only in the context of the enactment of comprehensive financial services legislation, rather than on a piecemeal basis that would benefit banks over securities and other financial services firms. Indeed, absent such legislation, SIA believes that the Board lacks the authority to increase the revenue limit. Nonetheless, notwithstanding the policy and legal arguments in support of SIA's position, if the Board decides that it would be appropriate in certain specific cases to consider raising the 10 percent revenue limit, it should do so only in a measured and incremental fashion, and only on a case-by-case basis.

Respectfully Submitted,

Marc E. Lackritz
President

Footnotes:

[1] The Securities Industry Association brings together the shared interests of more than 730 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the U.S., SIA members collectively account for approximately 90 percent, or $100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans.

[2] See, e.g., Review of Restrictions on Director and Employee Interlocks, Cross-Marketing Activities and the Purchase and Sale of Financial Assets, Docket No. R-0701(the "Firewalls Release"); and Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, Docket No. R-0932 (the "Revenue Calculation Release"). SIA previously submitted to the Board a comment letter, dated September 3, 1996, on the proposals in the Firewalls Release and the Revenue Calculation Release.

[3] See 12 C.F.R.225.24.

[4] See Citicorp, 73 Fed. Res. Bull. 473, 485 (1987), aff'd Securities Industry Association v. Board of Governors of the Federal Reserve System, 839 F.2d 47 (2d Cir.), cert. denied, 486 U.S. 1059 (1988) ("Citicorp").

[5] Id.

[6] See Citicorp, 839 F.2d at 67. In that case, the court upheld the Board's quantitative test (i.e., the 5 to 10 percent of revenues test) as reasonable, expressly noting that the legislative history of the Glass-Steagall Act "supports the conclusion that the Board's stringent quantitative interpretation of 20 is reasonable." Id. at 67. Importantly, the Court found the 5 to 10 percent limitation reasonable in the context of the Board's rejection of several applicants' requests that they be allowed to derive up to 15 percent of gross revenues from ineligible-securities activities. Id. at 62-63. See also id. at 68 (In rejecting a bank holding company's argument that the Board should adopt a case by case approach to determining appropriate levels of Section 20 activity, the court stated that "Section 20 must be read to set down at some point a hard and fast limit on the amount of bank-ineligible securities activities, and we have determined that the Board's limit of five to ten percent of the gross revenue is reasonable. Beyond this limit, there is no room for adjustment in order to ameliorate competitive inequality.").

[7] See Citicorp, 839 F.2d at 68-9.

[8] See Citicorp v. Board of Governors, 936 F.2d 66 (2d Cir. 1991), cert. denied sub nom Independent Insurance Agents of America v. Citicorp, 502 U.S. 1031 (1992) (Refusing to permit the Board to regulate under the Bank Holding Company Act the activities of subsidiaries of banks that are in turn subsidiaries of bank holding companies, following a prior decision of the court affirming the Board's decision that it had no authority under the Bank Holding Company Act to regulate banks that are subsidiaries of bank holding companies).

[9] See, e.g., Board of Governors v. Agnew, 329 U.S. 441, 446 (1947) (Holding that an investment banking firm was "primarily engaged" in underwriting or distributing securities, within the meaning of Section 32 of the Glass-Steagall Act, when 26% to 39% of the firm's gross income derived from underwriting, and 40% to 47% of its gross income derived from brokerage activities).

[10] See Bankers Trust New York Corp. , 73 Fed. Res. Bull. 138, 142 (1987) (The term "engaged principally" in Section 20 of the Glass-Steagall Act denotes an activity that is "substantial") (" Bankers Trust "). The United States Court of Appeals for the District of Columbia Circuit affirmed the Board's reasoning in Bankers Trust in Securities Industry Association v. Board of Governors of the Federal Reserve System, 847 F.2d 890 (D.C. Cir. 1988). See also Board of Governors v. Agnew, 329 U.S. 441, 446 (1947) (The term "primarily engaged," as used in Section 32 of the Glass-Steagall Act, denotes an activity or a function that is "substantial").

[11] Alternatively, three other activities could produce exactly the same amount of revenue (i.e., 25% each) as would be produced by the ineligible-securities activities, and these four activities, taken together, would produce 100% of the Section 20 Subsidiary's activities. In such a scenario (which is quite unlikely), the ineligible-securities activities would be tied with three other activities as the most significant revenue-producing activity of the Section 20 Subsidiary.

[12] See Section 2(a)(2) of the Bank Holding Company Act, 12 U.S.C. 1841(a)(2); 12 C.F.R. 225.11(c).

[13] See Section 2(a)(2) of the Bank Holding Company Act, 12 U.S.C. 1841(a)(2); 12 C.F.R. 225.11(c).

[14] 12 C.F.R. 5.50(d); 12 C.F.R. 574.4(b).

[15] Board of Governors of the Federal Reserve System v. Agnew, 329 U.S. 441, 446 (1947); Citicorp, 73 Fed. Res. Bull. at 483; Bankers Trust, 73 Fed Res. Bull. at 143. See also Citicorp, 839 F.2d at 58 (Quoting Senator Bulkley, who in connection with proposing an amendment to the bill that became the Glass-Steagall Act, stated "[i]t has become apparent that at least some of the great investment houses are engaged in so many forms of business that there is some doubt as to whether the investment business is the principal one." (internal quotation marks omitted)); id. at 64-5 (Observing that a commentator had pointed out that reading "principally" as "chief" would allow a bank to be affiliated with Merrill Lynch & Co.).

[16] Cf. Citicorp. 73 Fed. Res. Bull. at 505 (dissenting statement of Chairman Volcker and Governor Angell) (The interpretation adopted by the majority, which defined the term "securities" as used in Section 20 to mean only ineligible securities, appeared to make feasible "the affiliations of banks with some of the principal underwriting firms or investment houses of the country.").

[17] Bankers Trust, 73 Fed Res. Bull. at 142 (footnote omitted). Accord Agnew, 329U.S. at 447; Citicorp, 73 Fed. Res. Bull. at 483.

[18] S. Rep. No. 77, S. 1631, 72nd Congress, 1st Sess. at 9-10 (1933).

[19] Hearings on the Operation of the National and Federal Reserve Banking Systems, Senate Banking and Currency Committee, S. 4115, 72nd Congress, 1st sess. (1932), Part I, at 393.

[20] Letter from William Proxmire, Chairman, Senate Committee on Banking, Housing and Urban Affairs, to The Honorable Paul A. Volker, Chairman, Board of Governors of the Federal Reserve System, dated January 30, 1987.

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