restriction. As noted above, the Board believes that the disclosure requirements contained in the section 20 Orders and the Interagency Statement on Retail Sales of Nondeposit Investment Products may be a more narrowly tailored and less burdensome method of protecting against customer confusion as to whether the customer is dealing with a section 20 subsidiary or an affiliated bank or thrift.

The Board notes that the Glass-Steagall reform legislation passed at various times by the Senate and reported by the House Banking Committee has not prohibited cross-marketing and agency activities. That legislation would have relied instead on disclosures regarding the uninsured status of securities affiliates to prevent customer confusion.

Purchase of Financial Assets

The Board is also seeking comment on amending the financial assets restriction, which generally prohibits a bank or thrift from purchasing financial assets from, or selling such assets to, an affiliated section 20 subsidiary. An existing exception to this restriction allows the purchase or sale of U.S. Treasury securities or direct obligations of the Canadian federal government at market terms, provided that they are not subject to repurchase or reverse repurchase agreements between the underwriting subsidiary and its bank or thrift affiliates. See, *e.g.*, 1989 Order at 216; Canadian Imperial Bank of Commerce, The Royal Bank of Canada, Barclays PLC and Barclays Bank PLC, 76 Federal Reserve Bulletin 158, 172 (1990).

In establishing the exception for U.S. Treasury securities, the Board cited the breadth and liquidity of the market for such instruments, which make evident the ''market terms'' on which the sale must be transacted and ensure that the bank will be able to resell any asset it purchases. In its 1990 Notice, the Board sought comment on extending this exception to include those U.S. Government agency securities and U.S. Government-sponsored agency securities for which there is a market with a breadth and liquidity comparable to that for U.S. Treasury securities.

The Board now seeks comment on whether it should expand this exception to include the purchase or sale of any assets with a sufficiently broad and liquid market to ensure that the transaction is on market terms and that the bank is not incurring credit or liquidity risk through the purchase of assets. The Board notes that the 1987 Order did not contain a financial assets firewall. In the Board's experience, banks and thrifts whose holding companies operate free of the financial assets restriction have not experienced adverse effects from purchasing assets from, or selling assets to, their affiliated section 20 subsidiaries.

The Board does intend to retain for now the financial assets restriction to the extent that it prohibits a purchase or sale of illiquid assets and any purchase or sale of assets subject to a repurchase or reverse repurchase agreement. The Board believes that any further changes to the financial assets restriction should be considered in conjunction with other funding firewalls, as part of a more comprehensive review of all the remaining firewalls between a section 20 subsidiary and its affiliated banks and thrifts.

By order of the Board of Governors of the Federal Reserve System, July 31, 1996.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96–19867; Filed 8–2–96; 8:45 am]

BILLING CODE: 6210–01–P

[Docket No. R–0932]

Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice; Request for comments.

SUMMARY: The Board is proposing for comment a change in the manner in which interest earned on securities authorized for investment by a member bank of the Federal Reserve System is treated in determining whether a company is engaged principally in underwriting and dealing in securities for purposes of section 20 of the Glass-Steagall Act. In order to ensure compliance with section 20, the Board required that the amount of revenue a company derived from underwriting and dealing in securities that a member bank may not underwrite or deal in (ineligible securities) not exceed 10 percent of the total revenue of the company. The Board is proposing to clarify that interest earned on the types of debt securities that a member bank may hold for its own account is not treated as revenue from underwriting or dealing for purposes of section 20.

DATES: Comments must be received by September 3, 1996.

ADDRESSES: Comments, which should refer to Docket No. R–0932, may be mailed to the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, D.C. 20551, to the attention of Mr. William Wiles, Secretary. Comments may also be delivered to Room B–2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP–500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in section 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Richard M. Ashton, Associate General Counsel (202/452–3750), Thomas M. Corsi, Senior Attorney (202/452–3275), Legal Division; Michael J. Schoenfeld, Senior Securities Regulation Analyst (202/452–2781), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452–3544), Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, D.C.

SUPPLEMENTARY INFORMATION:

Background

Beginning with orders issued in 1987, the Board has authorized nonbank subsidiaries of bank holding companies, so-called section 20 subsidiaries, to underwrite and deal in ineligible securities.[1] In order to assure compliance with section 20 of the Glass-Steagall Act,[2] the Board provided as a condition of its orders that the gross revenue derived by the subsidiary from ineligible securities underwriting and dealing activities not exceed 10 percent of the total gross revenue of the subsidiary, when revenue is averaged over a rolling 8-quarter period.

For purposes of computing the 10 percent revenue limit section 20 subsidiaries currently report all interest earned on third-party ineligible debt securities held by the subsidiaries in an underwriting or dealing capacity as revenue derived from underwriting and dealing in securities.[3] Questions have

[1] *E.g.*, Citicorp, 73 Federal Reserve Bulletin 473 (1987), *aff'd, Securities Industry Ass'n* v. *Board of Governors*, 839 F.2d 47 (2d Cir.), *cert. denied*, 486 U.S. 1059 (1988).

[2] Section 20 provides that a member bank may not be affiliated with a company that is ''engaged principally'' in underwriting and dealing in securities. 12 U.S.C. 377. Section 20 does not prohibit a bank affiliate from underwriting and dealing in securities that banks may underwrite and deal in directly (eligible securities).

[3] Instructions for Preparation of the Financial Statements for a Bank Holding Company Subsidiary

been raised as to whether this treatment is appropriate for interest earned on debt securities that a member bank is authorized to hold. Under the Glass-Steagall Act, a member bank is expressly authorized to purchase and sell for its own account ''investment securities,'' which generally include investment grade corporate debt and certain municipal revenue securities.[4] The Board is aware that pursuant to this authority many banks hold for their own account a significant amount of investment grade debt securities. In addition, many banks buy and sell these securities on a relatively frequent basis as part of managing their investment portfolio. In recognition of this activity, changes to accounting rules were made at the end of 1993 to establish separate accounting treatment for bank portfolio securities that are ''available for sale'' and not intended to be held to maturity.[5]

In view of the above, the Board is proposing to clarify that interest earned on the types of debt securities that a member bank may hold for its own account is not treated as revenue from underwriting or dealing in ineligible securities for purposes of section 20. The Board believes a distinction can be made between the interest earned by a section 20 subsidiary from holding these kinds of securities and the profit made from underwriting or reselling them. The profit or loss a section 20 subsidiary earns on the resale of investment grade ineligible debt securities the subsidiary holds in inventory more closely approximates the revenue that should be attributed to performing the functions of dealing in or underwriting securities, the critical element of which is the actual offering and sale of the instruments involved.[6]

On the other hand, the interest the subsidiary earns on investment grade ineligible debt securities while it holds them in inventory more closely represents the revenue that can be attributed to holding the securities as a member bank may do.[7] Thus, the Board believes that it is reasonable to conclude that interest revenue derived from holding the kinds of debt securities a member bank may hold should not be treated as revenue from underwriting or dealing in securities. The proposed clarification would apply only to interest derived from those types of debt securities that a member bank may hold for its own account, but not underwrite or deal in.

By order of the Board of Governors of the Federal Reserve System, July 31, 1996.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96–19865 Filed 8–2–96; 8:45am]

BILLING CODE 6210–01–P

Engaged in Bank-Ineligible Securities Underwriting and Dealing, Form FR Y–20. Schedule SUD–I, Line Item 5 (December 1994) (FR Y–20 Instructions). See also ''Structuring Bank-Eligible and Bank-Ineligible Transactions'' in FR Y–20 Instructions.

[4] 12 U.S.C. 24 Seventh, 335; 12 CFR 1.3. Member banks may not purchase any non-investment grade debt securities or equity securities for their own account.

[5] Statement of Financial Accounting Standards No. 115.

[6] For purposes of the section 20 revenue limitation, the Board has viewed ''public sale'' to include the activity of dealing in securities—the process of buying and reselling to the public specific securities as part of an ongoing, regular business. *E.g., Citicorp, supra,* 73 Federal Reserve Bulletin at 506–08. The term ''underwriting'' generally refers to the process by which new issues of securities are offered and sold to the public. *E.g., Securities Industry Ass'n* v. *Board of Governors,* 807 F.2d 1052, 1062–66 (D.C. Cir. 1986), *cert. denied,* 483 U.S. 1005 (1987).

[7] This distinction is further reflected in the current reporting requirements for section 20 subsidiaries and in Generally Accepted Accounting Principles for bank holding companies, which prescribe that interest revenue be reported separately from gains or losses on securities owned. FR Y–20 Instructions, Statement of Income, Schedule SUD–I, Line Items 2, 5); Securities and Exchange Commission FOCUS Report (Form X–17A–5 Part II) and instructions thereto. Generally Accepted Accounting Principles incorporate the format of the FOCUS Report.

[Docket No. R–0841]

Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice; request for comments.

SUMMARY: The Board is proposing to increase from 10 percent to 25 percent the amount of total revenue that a nonbank subsidiary of a bank holding company (a so-called section 20 subsidiary) may derive from underwriting and dealing in securities that a member bank may not underwrite or deal in. The revenue limit is designed to ensure that section 20 subsidiaries will not be engaged principally in underwriting and dealing in such securities in violation of section 20 of the Glass-Steagall Act. Based on its experience supervising these subsidiaries and developments in the securities markets since a revenue limitation was adopted in 1987, the Board believes that a company earning 25 percent or less of its revenue from underwriting and dealing would not be engaged principally in that activity for purposes of section 20.

DATES: Comments must be received by September 30, 1996.

ADDRESSES: Comments, which should refer to Docket No. R–0841, may be mailed to the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551, to the attention of Mr. William Wiles, Secretary. Comments addressed to the attention of Mr. Wiles may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mail room and security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in room MP–500 between 9 a.m. and 5 p.m. weekdays, except as provided in section 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Gregory A. Baer, Managing Senior Counsel (202/452–3236), Thomas M. Corsi, Senior Attorney (202/452–3275), Legal Division; Michael J. Schoenfeld, Senior Securities Regulation Analyst (202/452–2781), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452–3544), Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC.

SUPPLEMENTARY INFORMATION:

Background

Section 20 of the Glass-Steagall Act provides that a member bank may not be affiliated with a company that is ''engaged principally'' in underwriting and dealing in securities.[1] In 1987, the Board first allowed bank affiliates to engage in underwriting and dealing in bank-ineligible securities—that is, those securities that a member bank would not be permitted to underwrite or deal in—when the Board approved an application by three bank holding companies to underwrite and deal in commercial paper, municipal revenue bonds, mortgage-backed securities, and consumer-receivable-related securities.[2] In 1989, the Board allowed five section 20 subsidiaries to underwrite and deal in all debt and equity securities, subject to more rigorous firewalls.[3]

[1] 12 U.S.C. 377.

[2] *Citicorp, J.P. Morgan & Co., and Bankers Trust New York Corp.,* 73 Federal Reserve Bulletin 473 (1987), *aff'd, Securities Industry Ass'n* v. *Board of Governors,* 839 F.2d 47 (2d Cir.), *cert. denied,* 486 U.S. 1059 (1988) (hereafter ''*1987 Order*'').

[3] *J.P. Morgan & Co., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp,* and

Continued