Statement of the

Shadow Financial Regulatory Committee

on

Current Bank Holding Company Applications
for Increased Securities Activities

November 17, 1986

The Federal Reserve Board presently has before it applications by four bank holding companies -- Chase, Chemical, Citicorp, and Morgan Guaranty -- which, if approved, would expand the securities activities which are permissible for bank holding companies. If approved, bank holding companies would, for the first time, be permitted through a wholly-owned subsidiary to engage domestically in underwriting and dealing in municipal revenue bonds, mortgage-related securities, and consumer receivable-related securities, as well as commercial paper.

The Committee believes that these applications should be approved. The proposed activities are closely related to banking and a proper incident of banking, do not pose an unacceptable risk to the soundness of bank holding companies, do not compromise the interest of either the company's subsidiary bank customers or its affiliates' customers, and would promote competition in the relevant securities markets.

More broadly, the pending applications are part of a general trend towards expanding the securities activities which are permissible for bank holding companies under both the Glass-Steagall Act and the Bank Holding Company Act. The Committee believes that this trend is a constructive development that promises to improve the quality of financial services and to provide greater economic stability for financial institutions and markets.

With respect to the specific applications, the Committee would go further than the Federal Reserve Board would if it were to approve the applications as submitted. Section 20 of the Glass-Steagall Act requires that the proposed securities affiliates not to "engaged principally" (emphasis added) in the underwriting and/or dealing in the new securities activities that are proposed in the application. To adhere to this standard, the applicants have agreed to restrict their new activities in two ways. First, they would impose on their new activities an internal limit of 10% of the gross sales of both their presently permissible activities and their newly proposed activities. In addition, the applicants have agreed to limit their proposed activities to specified percentages of the total market value of all underwriting...
and/or dealing in the market for the securities activities in question.

The Committee believes that, although there is no authoritative judicial interpretation of the Section 20 "engage principally" test, the Federal Reserve Board should give maximum reasonable latitude to this limitation. In addition, the Committee sees no constructive purpose in the specified limits on total market value. These limits are not necessary to meet the "engaged principally" test, and would needlessly restrict competition. The Committee believes that no such restriction should be imposed on the applicants.

Finally, the Committee recognizes that the legislative barrier between banking and securities activities erected by the Glass-Steagall Act is being eroded in a piecemeal and haphazard fashion and that the applications at issue are part of this larger drama that is being played out. The Committee, therefore, strongly believes that new legislation be enacted that is more consistent both with current market forces and present economic theory and fact. Until that is done, however, the Federal Reserve Board, by approving the proposed applications, has the opportunity to move us forward toward the desired goal.

It is the Committee's policy that members abstain from voting on policy statements in instances in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Messrs. Aspinwall, Kaufman and Scott abstained from voting on this statement.