208; E.O. 12674, 54 FR 15159, 3 CFR, 1989 Comp., p. 215, as modified by E.O. 12731, 55 FR 42547, 3 CFR, 1990 Comp., p. 306; 5 CFR part 2634, part 2635.

3. Part 0 is amended by removing subparts A, B, D, and E, by removing § 0.735–13, and by redesignating subpart F as subpart B and removing its authority citation.

4. Part 0 is further amended by redesignating subpart C as subpart A and by revising its heading to read ''Subpart A—Standards of Conduct for Current Department of Labor Employees.''

5. Part 0 is further amended by redesignating § 0.735–12 as § 0.735–2 and adding § 0.735–1 to read as follows:

§ 0.735–1 Cross-references to employee ethical conduct standards and financial disclosure regulations.

Employees of the Department of Labor (Department) are subject to the executive branch-wide standards of ethical conduct at 5 CFR part 2635, the Department's regulations at 5 CFR part 5201 which supplement the executive branch-wide standards, and the executive branch financial disclosure regulations at 5 CFR part 2634.

[FR Doc. 96–28666 Filed 11–5–96; 8:45 am]

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FEDERAL RESERVE SYSTEM

12 CFR Parts 218 and 250

[Regulation R; Docket No. R–0931]

Relations With Dealers in Securities Under Section 32, Banking Act of 1933; Miscellaneous Interpretations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is rescinding Regulation R, which the Board believes is no longer necessary. The Board also is amending its regulations to remove an interpretation of section 32 of the Glass-Steagall Act, which the Board believes is no longer necessary. This interpretation explains the position of the Board regarding the application of the prohibitions of section 32 to bank holding companies.

EFFECTIVE DATE: December 6, 1996.

FOR FURTHER INFORMATION CONTACT: Richard M. Ashton, Associate General Counsel (202/452–3750), Thomas M. Corsi, Senior Attorney (202/452–3275), or Tina Woo, Attorney (202/452–3890), Legal Division. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION:

Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act)

Section 303(a) of the CDRI Act (12 U.S.C. 4803(a)) requires the Board, as well as the other federal banking agencies, to review its regulations and written policies in order to streamline and modify these regulations and policies to improve efficiency, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability. The Board has reviewed its interpretations of section 32 of the Glass-Steagall Act (12 U.S.C. 78) with this purpose in mind, and, as is explained in greater detail in the text that follows, is amending these interpretations in a way designed to meet the goals of section 303(a).

Substantive Provisions of Regulation R

Regulation R implements section 32 of the Glass-Steagall Act,[1] which prohibits officer, director and employee interlocks between member banks and firms ''primarily engaged'' in underwriting and dealing in securities. Section 32 authorizes the Board to exempt from this prohibition, under limited circumstances, certain interlocks by regulation. Currently, Regulation R merely restates the statutory language of section 32, and sets forth the only exemption adopted by the Board since passage of the Glass-Steagall Act. The Board also has codified in the CFR a series of 14 interpretations of the substantive provisions of section 32 and the regulation.[2] In July, the Board sought public comment on removing Regulation R from the CFR and removing from the CFR an interpretation that applies the restrictions of section 32 to bank holding companies.[3]

The exemption in Regulation R, adopted by the Board in 1969, permits interlocks between member banks and securities firms whose securities underwriting and dealing activities are limited to those permissible for national banks. The adoption of the express exemption was apparently based on the assumption that the literal language of the section 32 prohibition could at least arguably cover bank-eligible securities activities.

Subsequently, in approving other applications under the Bank Holding Company Act, the Board interpreted the prohibitions of section 20 of the Glass-Steagall Act as not applying on their face to securities underwriting and dealing activities authorized for member banks.[4] At that time, the Board also expressed the view that section 32 did not cover an interlock between a member bank and a firm that was not engaged in securities activities covered by section 20.[5] Accordingly, in light of the Board's more recent view of the scope of section 32, the express exemption from the provisions of section 32 for bank-eligible securities activities is no longer necessary.[6] The Board has never adopted any other exemption to the interlocks provision and historically, requests that the Board create new exemptions have been infrequent and have been uniformly denied.[7] In seeking public comment on removing Regulation R, the Board noted that the exemption in the regulation is no longer necessary, and it is not necessary to have a substantive regulation solely to restate a statutory provision.

Extension of Section 32 Prohibitions to Bank Holding Companies

The Board also sought public comment on removing a 1969 interpretation that extended the prohibitions of section 32 to a bank holding company where the principal activity of the bank holding company is the ownership and control of member banks.[8] The Board based its 1969 interpretation not so much on the literal language of section 32, but on its belief that where the ownership and control of member banks is the principal activity

[1] 12 U.S.C. 78.

[2] 12 CFR 218.101–218.114. The Board and staff have issued other interpretations of section 32 that are contained in the FRRS.

[3] *See* 61 FR 34749, July 3, 1996.

[4] Section 20 of the Glass-Steagall Act (12 U.S.C. 377) prohibits a member bank from being affiliated with a firm engaged principally in underwriting and dealing in securities.

[5] This interpretation has been upheld by the courts. *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, 839 F.2d 47, 62 (2d Cir. 1988), *cert. denied*, 486 U.S. 1059 (1988).

[6] To avoid any confusion on this matter, the Board is inserting an additional interpretation into the CFR to clarify that the prohibitions of section 32 do not apply to bank-eligible securities activities. This interpretation will be set out at 12 CFR 250.413.

[7] A footnote to Regulation R that dates to 1936 makes clear the Board's interpretation that a broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32. The Board has since authorized bank holding companies to engage in this activity directly, reiterating that securities brokerage is not a proscribed activity under either sections 32 or 20 of the Glass-Steagall Act. *BankAmerica Corporation*, 69 Federal Reserve Bulletin 105 (1983). The courts upheld the Board's interpretation. *Securities Industry Assn.* v. *Board of Governors*, 468 U.S. 207 (1984). The removal of Regulation R does not affect this interpretation.

[8] 12 CFR 218.114.

of a bank holding company, the same possibilities of abuse that section 32 was designed to prevent would be present in the case of a director of the holding company as in the case of the member bank.[9]

The Board now believes that it could rescind this interpretation and give some measure of regulatory burden relief to bank holding companies in a manner consistent with section 32, and without frustrating the Congressional purpose underlying the section. As noted above, section 32 specifically restricts only those interlocks involving member banks. It could be argued that the bank holding company structure was not in widespread use when section 32 was adopted, and that Congress did not contemplate issues that could arise from interlocks involving bank holding companies. Congress has amended section 32 since the section was adopted and since bank holding companies have become commonplace, but never has extended the prohibitions in the section to bank holding companies. Notably, in 1987, Congress extended the prohibitions of section 32 to cover interlocks involving nonmember banks and thrift institutions but not interlocks involving bank holding companies.[10]

The potential that removal of the interpretation could frustrate Congressional purpose in enacting section 32 is mitigated by the fact that the prohibitions of section 32 would continue to apply to member banks. In a specific case where an interlock between a bank holding company and a securities firm were to result in unsafe or unsound practices, the Board could impose corrective measures by use of its formal enforcement authority. Accordingly, the directors, officers and employees of these banks, none of whom would be interlocked with a securities firm, could serve as a check against the possibilities of abuse that section 32 is intended to prohibit. Finally, by rescinding this interpretation, the Board would be granting regulatory relief to bank holding companies by giving them access to a larger pool of persons from which to choose their officers, directors, and employees.[11]

Summary of Public Comments

The Board received a total of 17 public comments in response to its proposed amendments.[12] In general, the commenters stated their support for the reduction in regulatory burden that would result from the removal of the regulation and holding company interpretation. Some of the commenters offered additional suggestions as to how the Board could reduce the regulatory burden associated with the Glass-Steagall Act.

The public commenters overwhelmingly supported the Board's proposal to remove Regulation R, and agreed with the Board that it was unnecessary to reiterate the statutory language of section 32 in a regulation. One commenter opposed the removal of Regulation R and the renumbering of the retained interpretations contending that this would cause confusion and would remove the Board's flexibility in creating exemptions to section 32 in the future.[13] All commenters generally agreed that in light of the Board's precedent and the proposed addition of section 250.413, it is unnecessary to have the exemption permitting interlocks between member banks and securities firms whose securities underwriting and dealing activities are limited to those permissible for a national bank.

All public commenters supported the proposal to remove the interpretation regarding the application of the prohibitions of section 32 to bank holding companies. These commenters believed that removal of the interpretation would benefit bank holding companies by increasing the pool from which to recruit qualified directors, officers, and employees. Many commenters recommended that the Board determine that the removal of this interpretation would allow bank holding companies and their nonbank subsidiaries to have interlocks with registered open-end investment companies (mutual funds) that receive investment advice and/or administrative services from the bank holding company's subsidiaries.

Three commenters suggested that the Board permit interlocks between member banks and mutual funds. One of these commenters recommended that the Board use its general rulemaking authority to create such an exemption. Two of these commenters stated that such interlocks should be allowed because the Investment Company Act and other federal banking laws already exist to protect banks, mutual funds, and their customers.

Two commenters suggested that the Board modify its interpretation that mutual funds are primarily engaged in the issuance, underwriting, or distribution of securities. One of these commenters argued that mutual funds are engaged in an investment business and that the offering of shares is an incidental activity. One commenter argued that a mutual fund holds a portfolio of securities and issues pro-rata interests in the pool of underlying securities, but does not engage in underwriting because it does not purchase securities from issuers and resell them to the public.

One commenter also requested that the Board exempt from the prohibitions of section 32 all but directors, policymaking officers, and officers or employees who make investment recommendations or decisions for the accounts of customers.[14]

In response to the Board's request for comment on whether other interpretations of section 32 should be amended, one commenter recommended that the Board rescind 12 CFR 218.107, which extends the prohibitions of section 32 to interlocks between a member bank and an investment adviser of a mutual fund if the adviser was created for the sole purpose of advising a particular fund. This commenter argued that this interpretation may not be consistent with current judicial and administrative positions, since the Board has permitted bank holding companies to act as investment advisers to mutual funds, pursuant to Regulation Y, without prohibiting officer, director, or employee interlocks between the investment adviser and any member bank.

Discussion

After review of the public comments, which raise no substantive issues as to adoption of the proposal, the Board is

[9] As noted in the Board's interpretation, section 32 is directed to the probability or likelihood that a bank director interested in the underwriting business may use his or her influence in the bank to involve it or its customers in securities sold by his or her underwriting house.

[10] The provisions extending the prohibitions of section 32 to nonmember banks and thrifts expired in 1988.

[11] The remaining interpretations of section 32 will be retained in the CFR and transferred to Part 250, which contains miscellaneous Board interpretations.

[12] Comments were received from eight banks and bank holding companies, five trade associations, two individuals, one investment adviser, and one law firm.

[13] This commenter believed that moving and renumbering the interpretations would make finding the interpretations more difficult, particularly where citations are found in past Board orders or other published materials. The Board believes that publication of this final action in the Federal Register and changes to the cross-citations in the interpretations that will remain in the CFR will be sufficient to inform the public of this action.

[14] This commenter also suggested that the Board should delay final action on this proposal until comments relating to Board proposals regarding limitations on so-called section 20 subsidiaries are received so that the Board could act on the portions of both proposals relating to interlocks at the same time.

adopting the changes to Regulation R as they were proposed.[15]

The Board does not believe it is within the scope of the present rulemaking or appropriate without further analysis and rulemaking to permit interlocks between a member bank and a mutual fund, or grant other exemptions from the prohibitions of section 32.

In view of the Board determination to rescind its current interpretation applying the prohibitions of section 32 to bank holding companies, section 32 would no longer bar director, officer, or employee interlocks between a bank holding company and a mutual fund.[16] The Board has been concerned that under certain circumstances interlocks between a bank holding company and a mutual fund could raise issues as to whether the holding company controls the fund in a manner that creates an affiliation with the subsidiary bank in violation of section 20 of the Glass-Steagall Act.[17] The Board is not modifying any of its prior interpretations at this time.[18] To the extent that the Board's prior interpretations do not restrict interlocks between a bank holding company and a mutual fund, bank holding companies should ensure that they do not take any action that would cause them to control a mutual fund under the Board's existing rulings concerning what constitutes control.

Other

It does not appear that it would be appropriate for the Board to follow the suggestion to rescind 12 CFR 218.107. In this interpretation, the Board opined that section 32 prevented interlocks between a member bank and a mutual fund manager that advised, managed and distributed two mutual funds. In addition, two senior officers of the mutual fund manager served as trustees of the funds. These facts, viewed in light of recent Board precedent, would continue to raise an issue as to whether the mutual fund manager noted in 12 CFR 218.107 controlled two mutual funds. Under such circumstances, interlocks between the mutual fund manager and a member bank could be prohibited. Accordingly, the Board will not rescind 12 CFR 218.107 at this time.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 95–354, 5 U.S.C. 601 *et seq.*), the Board of Governors of the Federal Reserve System certifies that adoption of this rule will not have a significant economic impact on a substantial number of small entities that would be subject to the regulation.

This amendment will remove a regulation and an interpretation that the Board believes are no longer necessary. The amendment does not impose more burdensome requirements on bank holding companies than are currently applicable.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the final rule.

List of Subjects

12 CFR Part 218

Antitrust, Federal Reserve System, Securities.

12 CFR Part 250

Federal Reserve System.

For the reasons set forth in the preamble, the Board is amending Chapter II of title 12 of the Code of Federal Regulation under the authority of 12 U.S.C. 248 as set forth below:

PART 218—[AMENDED]

§§ 218.101 through 218.113 [Redesignated as §§ 250.400 through 250.412]

1. Sections 218.101 through 218.113 are redesignated as set forth in the following table:

Old section	New section
218.101	250.400
218.102	250.401
218.103	250.402
218.104	250.403
218.105	250.404
218.106	250.405
218.107	250.406
218.108	250.407
218.109	250.408
218.110	250.409
218.111	250.410
218.112	250.411
218.113	250.412

§ 218.114 [Removed]

2. Section 218.114 is removed.

PART 218—[REMOVED]

3. Part 218 is removed.

PART 250—MISCELLANEOUS INTERPRETATIONS

1. The authority citation for part 250 is revised to read as follows:

Authority: 12 U.S.C. 78, 248(i) and 371c(e).

2. A new center heading is added immediately preceding the newly designated § 250.400 to read as follows:

Interpretations of Section 32 of the Glass-Steagall Act

3. Section 250.413 is added to read as follows:

§ 250.413 ''Bank-eligible'' securities activities.

Section 32 of the Glass-Steagall Act (12 U.S.C. 78) prohibits any officer, director, or employee of any corporation or unincorporated association, any partner or employee of any partnership, and any individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, from serving at the same time as an officer, director, or employee of any member bank of the Federal Reserve System. The Board is of the opinion that to the extent that a company, other entity or person is engaged in securities activities that are expressly authorized for a state member bank under section 16 of the Glass-Steagall Act (12 U.S.C. 24(7), 335), the company, other entity or individual is not engaged in the types of activities described in section 32. In addition, a securities broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32.

By order of the Board of Governors of the Federal Reserve System, October 30, 1996.

William W. Wiles,

Secretary of the Board.

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[15] The Board will reserve Part 218 in the CFR in the event that the Board determines in the future to adopt an exemption to section 32.

[16] The Board has not interpreted the prohibitions of section 32 as applying to a nonbanking subsidiary of a bank holding company if the nonbanking subsidiary does not directly or indirectly own shares of a member bank.

[17] The Board has found that the Glass-Steagall Act prohibits affiliates of banks from sponsoring, organizing, or controlling mutual funds or distributing their shares. 12 CFR 225.125. *See, e.g., The Governor and Company of the Bank of Ireland*, 82 Federal Reserve Bulletin __ (Order dated October 21, 1996); *Mellon Bank Corporation*, 79 Federal Reserve Bulletin 626, 630 (1993).

[18] In soliciting public comment on the instant proposal, the Board stated that its action would not affect any of its precedent regarding whether a bank holding company is deemed to control a mutual fund for purposes of section 20 of the Glass-Steagall Act.