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FEDERAL RESERVE press release

For immediate release November 22, 1989

The Federal Reserve Board today announced its approval of the application of J.P. Morgan & Company Incorporated, New York, New York, to engage through its subsidiary, J.P. Morgan Securities, Inc., New York, New York, as agent in the private placement of all types of securities, including providing related advisory services, and to buy and sell all types of securities on the order of investors as a "riskless principal".

Attached is the Board's Order relating to this action.

Attachment

FEDERAL RESERVE SYSTEM

J.P. Morgan & Company Incorporated
New York, New York

Order Approving Application to Act as Agent in the Private Placement of All Types of Securities and Act as Riskless Principal in Buying and Selling Securities

J.P. Morgan & Company Incorporated, New York, New York ("Morgan"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has applied for the Board's approval under section 4(c)(8) of the BHC Act (12 U.S.C. § 1843(c)(8)) and section 225.23 of the Board's Regulation Y (12 C.F.R. 225.23), for its subsidiary, J.P. Morgan Securities Inc., New York, New York ("Company"), to act as agent in the private placement of all types of securities, including providing related advisory services, and to buy and sell all types of securities on the order of investors as a "riskless principal". Some of the proposed services are currently being offered by Morgan's lead subsidiary bank.

Morgan, with consolidated assets of $99.9 billion, is the third largest banking organization in the United States.[1] It operates two subsidiary banks and engages directly and through subsidiaries in a broad range of nonbanking activities, including engaging through Company in underwriting and dealing in, to a limited extent, certain securities.[2] Company is and will continue

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[1] Data are as of June 30, 1989.

[2] See J.P. Morgan & Co. Incorporated, The Chase Manhattan Corporation, Bankers Trust New York Corporation, Citicorp and Security Pacific Corporation, 75 Federal Reserve Bulletin 192 (1989) ("J.P. Morgan et al."); Citicorp, J.P. Morgan & Co. Incorporated and Bankers Trust New York Corporation, 73 Federal Reserve Bulletin 473 (1987), aff'd sub nom., Securities Industry

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to be a broker-dealer registered with the Securities and Exchange Commission and subject to the record-keeping, reporting, fiduciary standards, and other requirements of the Securities Exchange Act of 1934, the New York Stock Exchange and the National Association of Securities Dealers.

Notice of the application, affording interested persons an opportunity to submit comments on the proposal, has been published (53 Federal Register 16,406 (1989)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the public interest factors set forth in section 4(c)(8) of the BHC Act. The Board received written comments opposing the application from the Securities Industry Association ("SIA"), a trade association of the investment banking industry, and the Investment Company Institute ("ICI"), a trade association of the mutual fund industry.[3]

Because Company would be affiliated through common ownership with a member bank, Company may not be "engaged principally" in underwriting or dealing in securities within the meaning of section

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Association v. Board of Governors of the Federal Reserve System, 839 F.2d 47 (2d Cir. 1988), cert. denied, 108 S.Ct. 2830 (1988); and J.P. Morgan & Co. Incorporated, 73 Federal Reserve Bulletin 875 (1987); as modified by Order Approving Modifications to Section 20 Orders, 75 Federal Reserve Bulletin 751 (1989).

[3] The comments of the ICI were received substantially after the close of the comment period prescribed in the notice of this application and therefore are not required to be considered by the Board. In any event, the ICI has objected to Morgan's proposal to the extent that it could be construed to seek approval for Company to privately place securities of investment companies that are sponsored or advised by Company or Morgan. Morgan has not requested approval to place such securities.

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20 of the Banking Act of 1933 (the "Glass-Steagall Act").[4] In earlier decisions, the Board has determined that Company is not "engaged principally" in section 20 activities if revenues from underwriting and dealing in securities that banks are not authorized to underwrite and deal in directly ("ineligible securities") do not exceed 10 percent of Company's gross revenues.

In its recent Bankers Trust decision, the Board determined that acting as agent in the private placement of securities and purchasing and selling securities on the order of investors as a "riskless principal" do not constitute underwriting and dealing in securities for purposes of section 20 of the Glass-Steagall Act, and therefore revenue derived from these activities is not subject to the 10 percent revenue limitation on ineligible securities underwriting and dealing.[5] Except as described below, the methods and procedures Company will use in conducting its private placement and riskless principal activities will be consistent with those approved in the Bankers Trust decision.

Additionally, in that decision the Board found that, subject to a number of prudential limitations that address the potential for conflicts of interests, unsound banking practices or other

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[4] Section 20 of the Glass-Steagall Act (12 U.S.C. § 377) provides that ". . . no member bank shall be affiliated . . . with any . . . organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. . . ."

[5] Bankers Trust New York Corporation, 75 Federal Reserve Bulletin ___ (Order dated October 30, 1989) ("Bankers Trust").

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adverse effects, private placement and riskless principal activities were so closely related to banking as to be a proper incident thereto within the meaning of section 4(c)(8) of the BHC Act. Morgan has committed that Company will conduct its private placement and riskless principal activities subject to all of the prudential limitations agreed to by Bankers Trust with the following exceptions.[6]

Specifically, Morgan has not agreed to conditions in the prior decision that restrict 1) extensions of credit by the bank holding company or any of its affiliates to pay the principal amount of, or interest on, securities placed by the section 20 subsidiary; and 2) purchases for their own account by the parent holding company and other nonbank affiliates of section 20 subsidiaries of

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[6] The SIA argues that the fact that Morgan is proposing that Company privately place all types of securities, as opposed to only high grade commercial paper notes as had been previously approved by the Board, is significant in assessing the applicability of the Glass-Steagall Act prohibitions in this case. See Statement Concerning Applicability of the Glass-Steagall Act to the Commercial Paper Placement Activities of Bankers Trust Company (June 4, 1985); and Securities Industry Association v. Board of Governors, 807 F.2d 1052 (D.C. Cir. 1986), cert. denied, 483 U.S. 1005 (1987) ("Bankers Trust II"). The Board considered this argument in Bankers Trust and noted that because the Board and the Bankers Trust II court clearly recognized that commercial paper is a security for purposes of the Glass-Steagall Act, the fact that Bankers Trust (or in this case, Morgan) wishes to privately place all types of securities in a manner similar to that used in the commercial paper case, would not, by itself, change the activity into underwriting and dealing.

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securities being placed by the section 20 subsidiary.[7] These conditions were established by the Board to ensure that the objectivity and sound judgment of banks and other affiliates of section 20 subsidiaries would not be impaired by the placement or underwriting profit that the section 20 subsidiary would receive for marketing the securities.

Morgan has proposed to have its affiliated banks extend credit to an issuer whose debt securities have been placed by the section 20 subsidiary where the proceeds would be used to pay the principal amount of the securities at maturity. Morgan has stated that such transactions may be appropriate if at the time the securities mature it were more advantageous to the issuer to obtain financing from the bank rather than to reissue the securities.

In situations where the decision to extend credit to an issuer of securities placed by the section 20 subsidiary to repay the principal amount of the securities at maturity is made at a different time than when the securities are actually being placed, the likelihood that the decision to extend credit would be influenced by any promotional incentive associated with the placement activity would be minimized, especially in the case of longer term securities. Since the decision whether to extend credit in this situation would not be made while the securities

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[7] Morgan has agreed to consult with Federal Reserve staff before transferring its private placement and riskless principal activities from Company to any other nonbank subsidiary of Morgan to assure that none of the firewall provisions committed to is evaded by the transfer.

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are being marketed, the likelihood that the bank would not exercise independent judgment in assessing the creditworthiness of the issuer in light of all relevant circumstances at the time would be lessened. The bank's credit decisions, moreover, can be closely scrutinized through the examination process. In addition, many of these credit transactions could be subject to the requirements of section 23B of the Federal Reserve Act, which provides that certain types of transactions between a bank and a nonbank affiliate must be on an arms' length basis.[8] While it is not entirely clear that section 23B will apply to all of these credit transactions, the Board expects that the standards set out in that section will nevertheless be complied with.

Accordingly, the Board believes that it is appropriate to allow banks affiliated with section 20 subsidiaries or other nonbank affiliates to extend credit to an issuer to repay the principal amount of the securities, provided there is some reasonable time difference between the placement of the securities and the decision to extend credit,[9] and provided the extensions of credit meet prudent and objective standards. The Board conditions its decision with regard to these extensions of credit on the requirement that Morgan's subsidiary banks or other affiliates maintain detailed and clearly identified credit and collateral

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[8] 12 U.S.C. § 371c-1.

[9] In the Board's view, this requirement will be satisfied if at the time the extension of credit is made, a period of at least three years has elapsed from the time of the placement of the securities.

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documentation so that examiners may determine that a thorough, objective and independent analysis of the credit has been undertaken. In addition, documentation must be maintained to show that the participation by a bank or thrift affiliate in the transaction has been undertaken under circumstances and on terms and conditions (including pricing, minimum borrower cash flow-to-debt service or collateral requirements, or repayment terms) that are not preferential and that fully reflect the risks associated with the loan, as required under section 23B of the Federal Reserve Act. The Federal Reserve Bank of New York will closely review loan documentation of bank affiliates to ensure that an independent and thorough credit evaluation has been undertaken with respect to the participation of the bank in these credit extensions to issuers of securities privately placed by an agent affiliated with the bank.

With respect to the affiliate purchase restriction, Morgan has also proposed to have Company place securities with its parent holding company or with a nonbank subsidiary of the parent company.[10] In this regard, the Board notes that banks that currently place securities do place them with the parent company or other nonbank affiliates. No particular supervisory problem has to date arisen from such investments. In addition, since purchases of securities will not be made by the affiliated bank, the

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[10] Under current legal restrictions, member banks cannot generally purchase securities privately placed by an affiliate. This is because member banks are prohibited from acquiring any equity securities or unmarketable debt securities, i.e., those that cannot be resold because of SEC private placement restrictions. See 12 U.S.C. §§ 24(Seventh) and 335.

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possibility that losses as a result of these investments will adversely affect the federal safety net protecting the bank is minimized.

Accordingly, the Board believes that it is appropriate to allow Company to place securities with its parent holding company or a nonbank affiliate. The Board recognizes that the potential for certain conflicts of interest may be increased if affiliates were to purchase the entire issue of securities placed by the section 20 subsidiary or a substantial portion of such an issue. The Board therefore believes that it is appropriate to require that affiliates of the section 20 subsidiary limit their investment, both individually and in the aggregate, in any particular issue of securities that are placed by the section 20 subsidiary. The Board expects that Morgan will establish appropriate internal policies, procedures, and limitations regarding the amount of securities of any particular issue placed by Company that may be purchased by Morgan and each of its nonbanking subsidiaries, individually and in the aggregate.[11] These policies and procedures, as well as the purchases themselves, will be reviewed by the Federal Reserve Bank of New York.

In sum, the record shows that under the framework established

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[11] This limit should be less than 50 percent of the issue being placed. Additionally, in the development of these policies and procedures, Morgan should incorporate, with respect to placements of securities, the limitations established by the Board in condition 12 of its J.P. Morgan et al. Order regarding aggregate exposure of the holding company on a consolidated basis to any single customer whose securities are underwritten or dealt in by Company.

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in this and prior decisions, consummation of this proposal is not likely to result in any significant undue concentration of resources, decreased or unfair competition, conflicts of interest, unsound banking practices, or other adverse effects.

Consummation of this proposal would provide greater efficiencies and added convenience to Morgan's customers by allowing consolidation of a wider range of services in a single entity. Accordingly, the Board has determined that the performance of the proposed activities by Morgan can reasonably be expected to produce public benefits which would outweigh adverse effects under the proper incident to banking standard of section 4(c)(8) of the BHC Act.

Based on the above, the Board has determined to approve Morgan's application subject to all of the terms and conditions set forth above. The Board's determination is subject to all of the conditions set forth in the Board's Regulation Y, including those in sections 225.4(d) and 225.23(b), and to the Board's authority to require modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to assure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and Orders issued thereunder.

This transaction shall not be consummated later than three months after the effective date of this Order, unless such period is extended for good cause by the Board, or by the Federal Reserve Bank of New York, pursuant to delegated authority.

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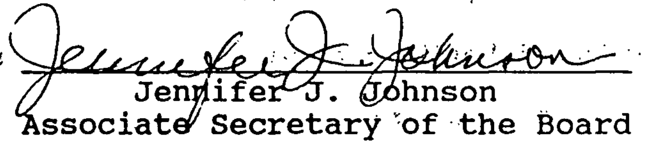
By order of the Board of Governors,[12] effective November 22, 1989.



Jennifer J. Johnson
Associate Secretary of the Board

[12] Voting for this action: Chairman Greenspan and Governors Johnson, Seger, Angell and LaWare. Absent and not voting: Governor Kelley.

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