

# FEDERAL RESERVE press release



For immediate release

July 21, 1997

The Federal Reserve Board today announced its approval of the notice filed by Bankers Trust New York Corporation, New York, New York, to acquire 100 percent of the voting shares of Alex. Brown Incorporated, Baltimore, Maryland, and thereby engage in a variety of nonbanking activities, including underwriting and dealing in all types of debt and equity securities on a limited basis.

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

Attachment

FEDERAL RESERVE SYSTEM

Bankers Trust New York Corporation  
New York, New York

Order Approving Notice to Engage in Nonbanking Activities

Bankers Trust New York Corporation, New York, New York ("BTNY"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 4(c)(8) of the BHC Act (12 U.S.C. § 1843(c)(8)) and section 225.24 of the Board's Regulation Y (12 C.F.R. 225.24) to acquire all the voting securities of Alex. Brown Incorporated, Baltimore, Maryland ("Alex. Brown"), and thereby engage in the following nonbanking activities:<sup>1/</sup>

- (1) providing various types of investment and financial advice, pursuant to section 225.28(b)(6) of Regulation Y (12 C.F.R. 225.28 (b)(6));
- (2) providing securities brokerage, private placement, and riskless principal services pursuant to section 225.28(b)(7)(i), (ii), and (iii) of Regulation Y (12 C.F.R. 225.28 (b)(7)(i), (ii), and (iii));
- (3) underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. §§ 24 and 335, pursuant to section 225.28(b)(8) of Regulation Y (12 C.F.R. 225.28 (b)(8));

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<sup>1/</sup> The acquisition will be structured as a merger of Alex. Brown into a newly created, wholly owned subsidiary of BTNY, Voyager Merger Corporation, New York, New York ("BT Sub").

(4) underwriting and dealing in, to a limited extent, all types of debt and equity securities other than interests in open end investment companies ("mutual funds");

(5) providing administrative and other services to investment companies, including mutual funds;

(6) making, acquiring, brokering and servicing loans or other extensions of credit for its own account and the account of others, pursuant to section 225.28(b)(1) of Regulation Y

(12 C.F.R. 225.28(b)(1)); and

(7) performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency or custodial nature), pursuant to section 225.28(b)(5) of Regulation Y (12 C.F.R. 225.28 (b)(5)).

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (62 Federal Register 33,411 (1997)). The time for filing comments has expired, and the Board has considered the notice and all comments received in light of the factors set forth in section 4(c)(8) of the BHC Act.

BTNY, with total consolidated assets of \$120.2 billion, is the seventh largest commercial banking organization in the United States.<sup>2/</sup> BTNY controls two subsidiary banks and engages, directly and through its subsidiaries, in a broad range of permissible nonbanking activities in the United States and throughout the world. Alex. Brown, with consolidated assets of \$2.5 billion, engages worldwide in a broad range of investment advisory, securities brokerage, securities underwriting, lending,

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<sup>2/</sup> Asset and ranking data are as of December 31, 1996.

custodial, and other activities.<sup>3/</sup> BTNY proposes to merge the principal subsidiary of Alex. Brown, Alex. Brown & Sons Incorporated, Baltimore, Maryland ("ABSI"), with and into BT Securities Corporation, New York, New York ("Company"), a subsidiary of BTNY that engages in a wide range of securities- and derivatives-related activities, including underwriting and dealing in all types of debt and equity securities (other than securities issued by open-end investment companies) on a limited basis.<sup>4/</sup> Company is, and will continue to be, a broker-dealer registered with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*) and a member of the National Association of Securities Dealers ("NASD"). Accordingly, Company would be subject to the recordkeeping and reporting obligations, fiduciary standards, and other requirements of the Securities Exchange Act of 1934, the SEC, and the NASD.

#### Activities Previously Approved by the Board

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<sup>3/</sup> Alex. Brown also currently engages in certain insurance activities and controls several limited partnerships that invest in debt and equity securities beyond the levels permissible for bank holding companies. BTNY has committed to conform, within two years of acquiring Alex. Brown, all activities and investments of Alex. Brown and its subsidiaries to those permissible for bank holding companies under section 4 of the BHC Act and Regulation Y. BTNY also has committed to cease, within six months of consummation of the proposal, the sale of new impermissible insurance policies and annuities.

<sup>4/</sup> See Bankers Trust New York Corporation, 75 Federal Reserve Bulletin 829 (1989) ("Bankers Trust"). Prior to the merger of ABSI with and into Company, BTNY would contribute the stock of Company to BT Sub, which would thus become the intermediate holding company of Company. Under this proposal, BTNY also would retain Alex. Brown Capital Advisory and Trust Company, a nonbanking subsidiary of Alex. Brown that engages in trust company and asset management activities, as a stand alone nonbanking subsidiary of BTNY.

Except as discussed below, the Board previously has determined by regulation or order that all the activities proposed to be conducted by BTNY after its acquisition of Alex. Brown are closely related to banking within the meaning of section 4(c)(8) of the BHC Act.<sup>5/</sup> BTNY proposes to conduct these activities in accordance with Regulation Y and relevant Board interpretations and orders.

Bank-Ineligible Securities Underwriting and Dealing Activities

Company currently is engaged in limited underwriting and dealing activities that the Board previously has determined are permissible under section 20 of the Glass-Steagall Act (12 U.S.C. § 377).<sup>6/</sup> Alex. Brown's principal subsidiary, ABSI, also is engaged in underwriting and dealing in securities. The Board has determined that the conduct of these securities underwriting and dealing activities is consistent with section 20,<sup>7/</sup> provided that the company engaged in the underwriting

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<sup>5/</sup> See 12 C.F.R. 225.25(b)(1), (5), (6), (7), and (8).

<sup>6/</sup> See Bankers Trust.

<sup>7/</sup> See J.P. Morgan & Co. Incorporated, et al., 75 Federal Reserve Bulletin 192 (1989), aff'd sub nom. Securities Industry Ass'n v. Board of Governors of the Federal Reserve System, 900 F.2d 360 (D.C. Cir. 1990); Citicorp, et al., 73 Federal Reserve Bulletin 473 (1987), aff'd sub nom. Securities Industry Ass'n v. Board of Governors of the Federal Reserve System, 839 F.2d 47 (2d Cir. 1988), cert. denied, 486 U.S. 1059 (1988); as modified by Review of Restrictions on Director, Officer and Employee Interlocks, Cross-Marketing Activities, and the Purchase and Sale of Financial Assets Between a Section 20 Subsidiary and an Affiliated Bank or Thrift, 61 Federal Register 57,679 (1996) (collectively, "Section 20 Orders"). See also Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities, 61 Federal Register 68,750 (1996). Compliance with the 25-percent revenue limitation shall be calculated in accordance with the method stated in the Section 20 Orders, as modified by the Order Approving Modifications to the Section 20 Orders, 75 Federal Reserve Bulletin 751 (1989); and 10 Percent Revenue Limit on Bank-Ineligible Activities of Subsidiaries of

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and dealing activities derives no more than 25 percent of its total gross revenue over any two-year period from underwriting and dealing in securities that a state member bank may not underwrite or deal in directly ("bank-ineligible securities").<sup>8/</sup> BTNY has committed to conduct the underwriting and dealing activities of the entity resulting from the merger of ABSI with and into Company in compliance with the 25-percent revenue limit and other prudential limitations previously established by the Board.<sup>9/</sup>

#### Mutual Fund Activities

Under the Glass-Steagall Act, a company that owns a member bank may not control "through stock ownership or in any other manner" a company that engages principally in distributing, underwriting or issuing securities.<sup>10/</sup> The Board has found that this provision prohibits affiliates of banks from sponsoring,

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Bank Holding Companies Engaged in Underwriting and Dealing Securities, 61 Federal Register 57,679 (1996) (collectively, "Modification Orders").

<sup>8/</sup> The Board also notes that Company may engage in activities that are necessary incidents to the proposed underwriting and dealing activities, provided that they are treated as part of the bank-ineligible securities activities, unless Company has received specific approval under section 4(c)(8) of the BHC Act to conduct the activities independently. Until such approval is obtained, any revenues from the incidental activities must be counted as ineligible revenues subject to the 25-percent revenue limitation.

<sup>9/</sup> BTNY proposes that the chairman of an overseas subsidiary of BTNY's lead bank, Bankers Trust Company, New York, New York ("Bankers Trust Company"), serve as co-chief executive officer of Company. This person would not be a director, officer, or employee of Bankers Trust Company, and thus his service would not be prohibited by the interlocks limitation applicable to section 20 subsidiaries.

<sup>10/</sup> 12 U.S.C. §§ 221a and 377.

organizing, or controlling a mutual fund. The Board previously has determined, however, that the Glass-Steagall Act does not prohibit a bank holding company from providing advisory and administrative services to a mutual fund.<sup>11/</sup>

Alex. Brown currently provides administrative, advisory, promotional, and other services to mutual funds. Through its lead bank, Bankers Trust Company, New York, New York, and other nonbanking subsidiaries, BTNY plans to continue providing these services, including promotional, marketing, and advertising services, to mutual funds.<sup>12/</sup> The promotional activities that BTNY plans to continue involve contact only with financial intermediaries and are similar to activities previously approved by the Board.<sup>13/</sup>

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<sup>11/</sup> See 12 C.F.R. 225.28(b)(6); 12 C.F.R. 225.125; and Mellon Bank Corporation, 79 Federal Reserve Bulletin 626 (1993) ("Mellon").

<sup>12/</sup> See Commerzbank AG, 83 Federal Reserve Bulletin \_\_ (1997) (Order dated June 16, 1997) ("Commerzbank"). Company also plans to provide transfer agency services and act as agent, upon the order and for the account of customers, to purchase or sell shares of mutual funds that it provides administrative and/or advisory services (the "Funds").

<sup>13/</sup> An independent distributor would enter into an agreement with the Funds under which the distributor would serve as "principal underwriter" of the Funds. 15 U.S.C. § 80a-2(a)(29). The distributor or intermediaries other than Company would enter into the sales agreements with financial intermediaries to sell shares of the Funds on behalf of the Funds. Personnel of Company may review the agreements and be involved in discussions with financial intermediaries regarding provisions that relate to Company's advisory or administrative role. BTNY would have primary responsibility for preparing the advertising and marketing materials. The independent distributor would be responsible for placing all advertisements, and would have legal responsibility under the rules of the NASD for the form and use of all advertising and sales literature prepared by Company, and also would be responsible for filing these materials with the NASD or the SEC. Neither the Company nor any employee of Company would receive transaction-based income or commissions from the Funds

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BTNY also proposes to have officers of BTNY or its nonbank affiliates serve as up to two of the nine or ten directors of the Funds, one of whom would serve as chairman of the board of directors of the Funds. BTNY also plans to have a limited number of its employees serve as junior-level officers of the Funds.<sup>14/</sup> The Board previously has authorized a bank holding company to have director and officer interlocks with mutual funds that the bank holding company advises and administers.<sup>15/</sup> The Board does not believe that the proposed interlocks between Company and the Funds in this case would compromise the independence of the boards of directors of the Funds, or the independent distribution of the Funds, or result in control of the Funds by BTNY.<sup>16/</sup>

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<sup>13/</sup>(...continued)

in connection with Company's promotional or marketing activities. See Commerzbank.

<sup>14/</sup> These employees would serve as secretary, treasurer, assistant secretary, or assistant treasurer of the Funds, and would be supervised by the board of directors or senior-level officers, including the president, executive vice president, and vice president of the Funds. The employees would have no policy-making authority at the Funds and would not be responsible for, or involved in, making recommendations regarding policy decisions. No employee or officer of Company would serve as a senior-level officer of any BTNY advised funds.

BTNY also may acquire up to 5 percent of the shares of mutual funds for which it provides administrative or advisory services, but any such ownership may not be used in any way in marketing or selling the shares of the investment company. See Mellon at n. 21.

<sup>15/</sup> See Commerzbank.

<sup>16/</sup> Any director of the Funds who also serves as an officer or employee of Company would be an "interested person" under the Investment Company Act of 1940 and, therefore, would be required to abstain from voting on the Funds' investment advisory and other major contracts. In addition, BTNY has committed that its representatives would not vote on any advisor's agreement, administrative

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Based on the foregoing, the Board concludes that control of the Funds would rest with the independent members of the boards of directors of the Funds, and that the proposed interlocks between Company and the Funds would not compromise the independence of the boards of the Funds or permit BTNY to control the Funds. Thus, the Board concludes that this proposal is consistent with the Glass-Steagall Act.

#### Other Considerations

In order to approve this notice, the Board must determine that the proposed activities are a proper incident to banking, that is, that the performance of the activities "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."<sup>17/</sup>

As part of its review of these factors, the Board considered the financial and managerial resources of BTNY and its subsidiaries and the effect the transaction would have on such resources.<sup>18/</sup> The Board also has reviewed the capitalization of BTNY and Company in accordance with the standards set forth in the Section 20 Orders and finds the capitalization of each to be consistent with approval.<sup>19/</sup> The determination about the capitalization of Company is based on all

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<sup>16/</sup>(...continued)  
services agreement, sub-administration agreement, or any amendment thereto.

<sup>17/</sup> 12 U.S.C. § 1843(c)(8).

<sup>18/</sup> See 12 C.F.R. 225.26.

<sup>19/</sup> The Board notes that, as a registered broker-dealer, Company must comply with the SEC's net capital rule. See 15 C.F.R. 240.15c3-1.

the facts of record, including BTNY's projections of the volume of Company's underwriting and dealing activities in bank-ineligible securities.

On the basis of its supervisory experience with BTNY and Company, the commitments provided in this case, and the proposed management of Company, the Board also has determined that BTNY and Company have established policies and procedures to ensure compliance with this order and the Section 20 Orders, including computer, audit, and accounting systems, internal risk management controls, and the necessary operational and managerial infrastructure. The Board also has reviewed other aspects of the managerial resources of the entities involved in this proposal, including the expected effect of this proposal on such resources.

On the basis of the foregoing and all the facts of record, the Board has concluded that financial and managerial considerations are consistent with approval of this proposal.

The Board expects that the proposed acquisition would provide added convenience to customers of BTNY and Alex. Brown, including Alex. Brown's current mutual fund clients. The Board previously has determined that the provision of advisory and administrative services to mutual funds within certain parameters is not likely to result in the types of subtle hazards at which the Glass-Steagall Act is aimed or in any other adverse effects. As required by the Board's regulations, for example, Company would provide disclosures to its customers designed to alert them to the relationships between Company and the Funds. These disclosures include those required by the Board's interpretive rule on investment advisory activities to address conflicts of interests that may be raised by the relationship between Company and the Funds.<sup>20/</sup> BTNY also has indicated that the proposed

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<sup>20/</sup> See 12 C.F.R. 225.125. The interpretive rule requires a bank holding

transaction would result in operational efficiencies that would allow it to become a more effective competitor and thereby provide improved services at a lower cost to its customers.

The Board also has carefully considered the competitive effects of this proposal. BTNY operates nonbanking subsidiaries that compete with certain nonbanking subsidiaries of Alex. Brown. In each case, the markets for the nonbanking services are unconcentrated, and there are numerous providers of the services. As a result, consummation of this proposal would have a de minimis effect on competition for the services, and the Board has concluded that the proposal would not result in a significantly adverse effect on competition in any relevant market.

Under the framework established in this and prior decisions, including the prudential limitations established by the Board in the Section 20 Orders, the Board has determined that consummation of the proposal is not likely to result in any significantly adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices that would outweigh the public benefits of the proposal.

Accordingly, based on all the facts of record, the Board has determined that the balance of public benefits that it must consider under the proper incident to

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<sup>20/</sup>(...continued)

company that recommends to customers shares of a mutual fund that the bank holding company advises to caution customers to read the fund prospectus before investing and to advise customers in writing that the fund's shares are not insured by the Federal Deposit Insurance Corporation, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any bank, unless that happens to be the case. The holding company also must disclose in writing to the customer the role of the company or its affiliate as investment advisor to the fund.

banking standard of section 4(c)(8) of the BHC Act is favorable and consistent with approval of the proposal.

### Conclusion

On the basis of all the facts of record, including all the commitments and representations made by BTNY, the Board has determined to, and hereby does, approve this notice subject to all the terms and conditions discussed in this order and in the Section 20 Orders, as modified by the Modification Orders. The Board's approval of this proposal extends only to activities conducted within the limitations of those orders and this order, including the Board's reservation of authority to establish additional limitations to ensure that Company's activities are consistent with safety and soundness, avoiding conflicts of interests, and other relevant considerations under the BHC Act. Underwriting and dealing in any manner other than as approved in this order and the Section 20 Orders, as modified by the Modification Orders, is not authorized for Company.

The Board's determination also is subject to all the terms and conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c) (12 C.F.R. 225.7 and 225.25(c)), 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. The Board's decision is specifically conditioned on BTNY's compliance with all the commitments made in connection with this notice, including the commitments discussed in this order and the conditions set forth in the Board regulations and orders noted above. The commitments and conditions shall be deemed to be conditions imposed in writing by the Board in connection with its findings and decisions, and may be enforced in proceedings under applicable law.

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 the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors,<sup>21/</sup> effective July 21, 1997.

(signed)

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Jennifer J. Johnson  
Deputy Secretary of the Board

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<sup>21/</sup> This action was taken pursuant to the Board's Rules Regarding Delegation of Authority (12 C.F.R. 265.4(b)(1)) by a committee of Board members. Voting for this action: Chairman Greenspan, Vice Chair Rivlin, and Governor Meyer.

## APPENDIX

### List of Administrative Services

1. Maintaining and preserving the records of the Funds, including financial and corporate records.
2. Computing net asset value, dividends, performance data and financial information regarding the Funds.
3. Furnishing statistical and research data.
4. Preparing and filing with the SEC and state securities regulators registration statements, notices, reports, and other materials required to be filed under applicable laws.
5. Preparing reports and other informational materials regarding the Funds, including proxies and other shareholder communications.
6. Providing legal and other regulatory advice to the Funds in connection with their other administrative functions.
7. Providing office facilities and clerical support for the Funds.
8. Developing and implementing procedures for monitoring compliance with regulatory requirements and compliance with the Funds' investment objectives, policies and restrictions as established by the board of directors/trustees of the Funds.
9. Providing routine fund accounting services and liaison with outside auditors.
10. Preparing and filing tax returns, and monitoring tax compliance.
11. Reviewing and arranging for payment of expenses of the Funds.
12. Providing communication and coordination services with regard to the Funds' investment advisor, transfer agent, custodian, distributor and other service organizations that render recordkeeping or shareholder communication services.

13. Reviewing and providing advice to the distributor, the fund and the investment advisor regarding sales literature and marketing plans for the Funds.
14. Providing information to the distributor's personnel concerning performance and administration of the Funds.
15. Providing marketing support with respect to sales of the Funds through financial intermediaries, including participating in seminars, meetings and conferences designed to present information concerning the operations of the Funds.
16. Providing reports to the directors of the Funds with regard to the activities of the Funds.
17. Providing telephone shareholder services through a toll-free 800 number.