

# Memorandum

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## Federal Reserve Recommends Legislative Repeal of Merchant Banking Authority and Exemptions for ILCs and Grandfathered Thrifts

September 9, 2016

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The Federal Reserve has issued a set of sweeping and surprising recommendations to Congress that, if enacted, would dramatically limit the authority of banking institutions subject to the Bank Holding Company Act of 1956 (the “BHC Act”) to engage in certain non-banking activities and investments. The Federal Reserve also proposed eliminating the current exemptions for owners of industrial loan companies and “grandfathered” thrifts. The recommendations were contained in a report issued yesterday by the Federal Reserve, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency to Congress and the Financial Stability Oversight Council.

Although the prospects for legislative passage are low, at least in the near term, the recommendations (and related commentary) constitute a significant public statement of the Federal Reserve’s views on longstanding statutory authorities that it has administered.

### **Federal Reserve Recommends Full-Scale Repeal of Four Key Exemptions**

The Federal Reserve recommended that Congress:

- repeal the “merchant banking” authority under Section 4(k)(4)(H) of the BHC Act, which financial holding companies have relied upon since 1999 to acquire shares of companies engaged in all sorts of non-financial activities (subject to restrictions on “routine management” and holding period limitations) and which would complete the process begun by the Volcker Rule of barring banking organizations from the private equity business;
- repeal the “grandfather” authority under Section 4(o) of the BHC Act, which has permitted Goldman Sachs and Morgan Stanley to engage in a broad range of physical commodities activities, including the storage, transportation and extraction of commodities;

- repeal the exemption that permits corporate owners of industrial loan companies (“ILCs” or “industrial banks”) to operate outside the regulatory and supervisory framework applicable to other corporate owners of insured depository institutions (because an ILC is not technically a “bank” for purposes of the BHC Act, a company that controls an industrial bank is not currently regulated as a bank holding company and is not subject to consolidated capital requirements or activities restrictions); and
- repeal the exemption for grandfathered unitary savings and loan holding companies from the BHC Act’s activities restrictions that apply to all other savings and loan holding companies.

The report did not recommend any proposed effective date or transition period, nor did it offer any grandfathering exceptions for current activities or investments.

If adopted, the recommendations would have far-reaching legal and economic implications for many banking organizations and certain of their shareholders, and effectively require the sale, spin-out or restructuring of affected business units and operations.

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For more information regarding the report, which is available [here](#), please contact any member of the Firm’s Financial Institutions Group, including those listed below.

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