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Press Guidance
May 23, 1997

Banking

Greenspan yesterday weighed in on the issue of bank reform. He called for reform but cautioned against moving too quickly particularly in the area of banks merging with commercial institutions.

- The Secretary of the Treasury announced the Administration's banking reform proposal on Wednesday. The Administration has taken a measured and common sense approach to ensure the soundness and efficiency of the banking industry.

Yesterday's announcement sought to:

- Reduce costs and increase access to financial services for consumers, businesses and communities;
- Enhance competitiveness of our financial services industry worldwide;
- Protect the safety and soundness of our financial institutions

What is the Administration's view on banks merging with commercial institutions?

As Secretary Rubin said in his speech to the Exchequer Club yesterday, in contrast to repeal of Glass-Steagall and full affiliation among financial firms, this is an area in which there are still strongly held contrasting views and no consensus. By putting forward two reasonable alternatives, we hope to assist the Congress and the country in moving the debate forward toward a consensus.

Mellody per Ellen Seidman, OMB

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

KEY PROVISIONS OF THE TREASURY'S FINANCIAL MODERNIZATION PROPOSAL

May 21, 1997

1. **FINANCIAL ACTIVITIES OF COMPANIES OWNING INSURED DEPOSITORY INSTITUTIONS**

- Companies that own banks (bank holding companies) and meet certain qualifications would -- subject to certain safeguards -- be permitted to engage in any financial activity, including the full range of:
    - securities activities;
    - insurance activities;
    - investment advisory activities and mutual fund sponsorship; and
    - merchant banking.
- Likewise, financial companies could own banks.

2. **FINANCIAL ACTIVITIES OF INSURED DEPOSITORY INSTITUTIONS AND THEIR SUBSIDIARIES**

- National banks (and state banks to the extent permitted by state law) would be authorized, subject to certain safeguards, to conduct any financial activity through subsidiaries (except that national bank subsidiaries would not be authorized to engage in real estate development).
- National banks would be permitted to engage in the full scope of activities that had previously been permissible for national banks or federally chartered thrifts (except investing in real estate development).
    - National banks (and state banks to the extent permitted by state law) would be permitted to act as general agents for the sale of insurance. National banks would be prohibited from engaging directly in insurance underwriting other than what is currently permissible (e.g., credit-related insurance).

RR-1700

- National banks (and state banks to the extent permitted by state law) would be permitted to underwrite and deal in municipal revenue bonds in addition to other securities activities currently permissible in the bank.

3. **NONFINANCIAL AFFILIATIONS**
Two alternative approaches will be suggested:

- Under the **"basket"** approach (**Alternative A**), bank holding companies that derive some significant percentage (specified by Congress) of their gross revenues in the U.S. from financial activities could derive the remainder of their revenues from nonfinancial activities.

  - In addition to the "basket" limitation, we would suggest prohibiting any affiliation between a bank holding company and a nonfinancial firm having assets in excess of a specified amount (calculated to approximate the 1,000 largest nonfinancial companies).

  - The federal thrift charter would be eliminated after two years, and existing unitary thrift holding companies (which presently have no activity restrictions) would be given a grandfather exemption from the "basket" test (terminable upon a change of control).

- Under the **"financial-only"** approach (**Alternative B**), bank holding companies would not be permitted to engage in *any* nonfinancial activities.

  - The existing thrift charter would be preserved, and thrift holding companies would retain their current authority to engage in any lawful activity.

4. **CAPITAL PROTECTIONS AND OTHER SAFEGUARDS**

- The following safeguards would apply if a bank holding company or a subsidiary of a bank engaged as principal in activities not permissible for a national bank to engage in directly:

  - The bank would have to remain "well capitalized" -- that is, to be in the highest regulatory capital category, with capital exceeding normal requirements.

    - The bank would have to deduct from its regulatory capital the entire amount of its equity investment in any subsidiary engaged in such activities. Thus even if the investment were to be a total loss, the bank would still be well-capitalized.

- The bank would have to be well-managed.

- Any company controlling the bank would have to give an undertaking that if the bank's capital fell below the well capitalized level, it would be promptly restored.

- Existing limits on loans and other transactions between banks and affiliated companies (sections 23A and 23B of the Federal Reserve Act) would be extended to bank subsidiaries engaged in such activities. Thus any transactions between the bank and the subsidiary would have to be conducted at arm's length, could not exceed 10 percent of the bank's capital, and would have to be fully collateralized. (In addition, the bank's transactions with all affiliates, including the subsidiary, could not exceed 20 percent of the bank's capital.)

- Banks could not be held vicariously liable -- under the "piercing the corporate veil" theory -- for obligations of a subsidiary or other affiliate that the bank had not assumed.

  - Bank regulators would be specifically required to assure that banks observed principles of corporate separateness.

- Under **Alternative A**, banks would be prohibited from extending any credit to, or for the benefit of, any nonfinancial affiliate. (**Alternative B** would permit no nonfinancial affiliates.)

5. **Federal Reserve Regulation of Holding Companies**

- The Federal Reserve would continue to approve the formation of, and to supervise and regulate, all bank holding companies.

  - The Federal Reserve would be able to require financial reports from holding companies if they are not reasonably available from other sources. The Board would have access to information that was provided by the holding company or any of its units to other regulatory organizations.

- Federal Reserve examinations of a bank holding company would be limited, to the fullest extent possible, to holding company units that could have a materially adverse effect on the safety and soundness of a bank affiliate.

  - The Board would, to the fullest extent possible, make use of examination reports made by, or on behalf of, regulators of holding company units.

- The Federal Reserve would be permitted to set consolidated capital requirements for a bank holding company if:

- With the elimination of the OTS, the FDIC Board would be restored to its original three-member size.
- The FDIC's Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) would be merged.

- Under **Alternative B** (the "financial-only" approach to bank affiliations), the thrift system would be left as it is today.
  - OTS and OCC would be kept intact (although the prohibition against combining functions of the two agencies would be lifted).
  - No conversion of thrifts would be required, and unitary thrift holding companies would retain their diversified affiliation authority.
  - BIF and SAIF would be merged.

7. WHOLESALE FINANCIAL INSTITUTIONS

- Wholesale financial institutions (WFIs) could be chartered as either national banks or state member banks.
- WFIs would not have FDIC insurance and could not accept retail deposits.
- The OCC and Federal Reserve would supervise WFIs and set their capital requirements.
- Owners of WFIs would not be treated as bank holding companies, could therefore engage in any lawful business.
- WFIs would be subject to Community Reinvestment Act (CRA) requirements.

8. FUNCTIONAL REGULATION OF INSURANCE AND SECURITIES ACTIVITIES

- Insurance activities of banking organizations would be subject to normal state insurance regulations, if those regulations do not discriminate against financial institutions. States could not apply to national banks laws that had the purpose or effect of discriminating against, or had a disproportionately adverse effect on, financial institutions.
- Securities activities of banking organizations would be regulated as follows:
  - The Securities Exchange Act's exemption of banks from broker and dealer registration would be narrowed to permit SEC regulation of activities other than traditional banking activities.

- The SEC would be required to amend its net capital rule to avoid a *de facto* pushing out of broker-dealer activities from the bank.

- SIPC insurance would not apply to broker-dealer activities conducted in the bank.

- Products traditionally provided by banks would not subject to SEC broker-dealer regulation, and the primary banking regulator and the SEC could jointly exempt new banking activities.

- The Investment Company Act's application to banking activities would be updated and clarified. Banks' exemption from the Investment Advisers Act would be narrowed.

- The SEC, rather than the banking agencies, would handle registration of bank-issued securities and periodic reporting by banks having securities registered under the Securities Exchange Act of 1934.

9. **CONSUMER PROTECTION**

- The banking agencies, in consultation with the SEC, would be required to prescribe rules regarding banks' retail sales of nondeposit investment products, in order to avoid customer confusion about the nature and applicability of FDIC and SIPC insurance, and to protect against conflicts of interest and other abuses.

  - Such rules would address such matters as sales practices, qualifications of sales personnel, incentive compensation, and referrals.

- The rules would require simple, direct and understandable disclosures, such as the following:

  "NOT FDIC-INSURED OR SIPC-INSURED
  "NOT GUARANTEED BY THE BANK
  "MAY GO DOWN IN VALUE."

- Customers could prevent sharing of confidential customer information between banks and their nonbank affiliates.

- The National Council on Financial Services would periodically assess the effectiveness of such regulations, and could adopt regulations more stringent than those of the agencies.

10. **NATIONAL COUNCIL ON FINANCIAL SERVICES**

- A National Council on Financial Services would be created.
- Among other functions, the Council would do the following:
  - Prescribe (under **Alternative A**) the method for applying the gross revenues test for measuring the extent of a bank holding company's financial activities;
  - Consider whether additional activities are financial;
  - Impose additional firewall restrictions, if determined to be necessary, between banks and their affiliates, including subsidiaries of banks;
  - Review the adequacy of consumer protections to determine whether modifications are needed; and
  - Resolve differences among the agencies on such questions as whether an activity is "financial," or whether a particular product or activity is insurance, securities, or banking.

11. **TIME FRAME FOR MODERNIZATION**

- Under **Alternative A**, modernization of bank activities and affiliations would occur two years after enactment. The two-year period would accommodate unification of the bank and thrift charters, as well as the respective federal regulators.
- Under **Alternative B**, the thrift system would remain intact. Thus modernization of bank activities and affiliations would begin nine months after enactment.

DEPARTMENT OF THE TREASURY

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FOR RELEASE AT 1 P.M. (EDT)
May 21, 1997

Remarks by Treasury Secretary Robert E. Rubin
to the Exchequer Club

Thank you for the opportunity to speak here today.

I'd like to talk about financial modernization, and the Treasury's approach to dealing with this important issuc. Our objcctive is simple: modernizing financial services in a way that will benefit consumers, businesses, and communities, enhance competitiveness of our industry worldwide, and protect the safety and soundness of our financial institutions.

And the stakes here are enormous. The Bureau of Economic Analysis estimates that in 1995, Americans spent nearly $300 billion on brokerage, insurance, and banking services. Even if increased competition from financial modernization were to reduce costs to consumers by just 1 percent, that would be savings of $3 billion a year. And, as I'll explain a bit later, substantiality greater savings than that may be likely.

In many respects, moving forward on financial modernization is a logical next step in the financial services agenda the Administration has pursued since 1993.

We helped bring to conclusion one of the most costly chapters in the history of U.S. finance, the savings and loan debacle, by helping four years ago to pass the Resolution Trust Corporation Completion Act, and last year by helping pass legislation to increase capitalization of the Savings Association Insurance Fund, which insures deposits at thrift institutions.

We've also worked to enact landmark interstate banking legislation, which will go into effect nationwide on June 1st. And the bank and thrift regulators have been eliminating unnecessary regulatory burdens that serve no clear purpose, while protecting consumers and communities.

In 1995, at President Clinton's urging, regulators completely rewrote their Community Reinvestment Act rules, to enable banks and thrifts to focus on performance, not paperwork. Today depository institutions and communities are coming together in innovative ways to help serve creditworthy borrowers and rebuild areas long left behind. Similarly, the Treasury has established the Community Development Financial Institutions Fund, whose primary purpose is

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to help non-traditional lenders meet the financing needs of economically distressed communities.

All of these measures were good for the consumer, businesses and communities that depend every day on financial services.

Today, our nation's financial marketplace is exceptionally strong. Unprecedented numbers of Americans have access to credit. We have the most reliable, liquid markets anywhere. Our financial institutions are innovative, and function effectively in a highly competitive global economy.

The Challenge

But in the midst of all this progress, we're still operating under an outdated legal and regulatory structure. National banks can sell insurance, but only from a town of five thousand. Securities firms provide bank-like products, but can't actually own a bank. Bank holding companies can underwrite securities, but with arbitrary limitations on the revenues they can derive from that activity.

The Glass Steagall law may have been appropriate when we had a dramatically different financial system. But think of the enormous changes that we've seen since then: We have developed a very sophisticated system of bank supervision. Our securities markets are the most liquid and reliable in the world. Geographic barriers to competition have come down. Financial products are rapidly converging. Globalization has spurred greater opportunity and competition. And technological innovation is a driving force behind the development of sophisticated financial products.

As you know better than anyone, the old lines that separated the insurance, securities, and banking industries have increasingly blurred as new financial products and services have appeared. And regulatory and judicial rulings continue to erode many of the barrier that were put in place to restrain competition among financial services firms.

Our goal now is to create a regulatory and legal environment in which: 1) consumers benefit from lower costs, better services and greater convenience; 2) financial services providers operate on a level playing field; 3) financial institutions can offer products and services without maneuvering through a maze of archaic laws; and 4) we protect the deposit insurance funds and safety and soundness. However, we don't simply want regulation to reflect the market realities of 1997. We want to create a framework in which US financial markets can innovate, evolve and compete well into the 21st century.

The Approach

Let me share with you our current thinking on several legislative changes we think should be considered.

First, we would propose to break down barriers that inhibit or prevent competition among various providers of financial products and services. We would permit banks, securities firms and insurance companies to affiliate with one another, reflecting the consensus that this reform is long overdue. These affiliations would help promote a genuine two-way street, one in which all participants have the opportunity to compete and innovate.

Second, we would give firms the choice to organize their financial activities in the most efficient way they see fit -- either as a subsidiary of a bank, or as an affiliate of a bank holding company regulated by the Federal Reserve Board. Banks would, if they took the subsidiary route, have to subtract from their regulatory capital 100% of any investment in subsidiaries that undertake activities not permissible for the bank itself, and banks would have to establish firewalls restricting certain transactions between the bank and its subsidiary. Safeguards like these -- which will be the same for subsidiaries as for holding company affiliates -- will protect banks and the federal deposit insurance funds from any risks posed by subsidiaries.

In establishing subsidiaries, banks could expand the range of financial products and services they offer, and diversify the sources of their earnings. In this respect, subsidiaries can help promote safety and soundness at banking institutions.

We should not and do not favor one form of corporate structure over another. But, by developing equal and consistent safeguards for subsidiaries and affiliates, we give companies the power to choose their structure for business, not regulatory, reasons. And let me emphasize: banks and the federal deposit insurance funds will be equally well protected under either format.

Third -- and perhaps the most difficult question in this debate -- is whether to permit companies that include banks to engage in non-financial activities, the so-called "banking and commerce" issue.

As we examined this issue, we recognized that people on all sides have strongly held views about this issue. There are, for example, some who believe that permitting broader affiliations between banking and commercial firms could have not only significant economic implications but also important cultural and social effects. Therefore, because of the nature of the issues and the complete lack of consensus, we think the issue needs to be further debated by Congress before settling on a final approach.

Consequently, we believe that Treasury can be most helpful in resolving this issue by providing two possible alternative legislative models.

Under the first model, Congress could decide to permit some modest measure of non-financial activity for bank holding companies. In such a case, it would be sensible to set a high threshold -- expressed in terms of gross domestic revenues -- to qualify the organization as predominantly financial. Under this model, Congress also could prohibit any affiliation between a bank and any of the 1,000 largest non-financial companies.

This alternative, would provide a basis for Congress to unify the regulation of banks and thrifts.

Under the second model, Congress may decide not to relax limits on non-financial activities of firms affiliated with banks, while as I've already said permitting bank holding companies to engage in the broad range of financial activities.

Under this alternative, the likely outcome would be for Congress to retain the separate thrift charter and the current rules relating to unitary thrift holding companies. While this alternative would not eliminate the current disparities between banks and thrifts, it does permit bank holding companies to engage in the full range of financial activity.

Let me now turn to the fourth item in our approach -- the creation of a new wholesale financial institution (so-called "woofies"). WFIs would be banks which accept only wholesale uninsured deposits, but they would not be considered banks for the purpose of holding company regulation. As chartered financial institutions with access to the payments system, they would be subject to prompt corrective action and other safeguards to ensure they don't pose a significant risk to the financial system. We would also require these banks to comply with the Community Reinvestment Act.

Lastly, we believe that we should move closer to a system of regulation by function, whereby specific financial activities would be regulated by the appropriate federal or state agency, regardless of where these activities are conducted. In this way, consumers would receive consistent regulatory protections. In the securities area, we would maintain and strengthen the important role of the Securities and Exchange Commission, without pushing current securities activities out of banks. With respect to insurance, we'd permit states to apply state laws to bank insurance activities as long as those laws were truly non-discriminatory. Finally, we would propose to create a council of financial regulators that would help resolve questions about the regulation of specific financial products.

Safeguards

With all these changes, of course, we must ensure that any and all financial modernization proposals are safe. In the past eight years, we've made great strides in restoring safety and soundness to our financial system. We're mindful of the S&L experience and are committed to avoiding anything of this sort again.

The Treasury approach would enhance existing consumer safeguards. We would provide for important disclosures -- in plain, straightforward terms -- so buyers can understand whether or not the products they purchase from financial services providers are insured.

For financial institutions, we believe that our proposal for expanded activities, which employs a "belt and suspenders" approach, is safe and sound because it provides even greater safety and soundness protections than current law. The expanded business opportunities we described above are linked to greater protections for insured depository institutions. Banks would have to be well-capitalized -- the highest regulatory capital category -- and well-managed to qualify for broader affiliations. They would have to meet other important prudential safeguards that prevent subsidiaries or affiliates from weakening the depository institution.

And finally, this proposal comes with an absolute commitment to safeguard communities. This Administration will not tolerate any weakening of CRA in any legislation.

Benefits

In the past, when we have permitted greater competition in the financial services industry, consumers of financial products have benefited significantly. For example, after the New York Stock Exchange eliminated fixed commission rates in 1975, brokerage rates dropped by over 20 percent and an entire new industry -- discount brokers -- was created. From 1986 to 1989, as affiliates of banks began to underwrite municipal revenue bonds, issuers like local governments saved as much as $9 per $1000 of borrowed funds -- savings that could be passed on directly to taxpayers to help build roads, schools, hospitals and their communities.

Even more dramatic savings have accrued to consumers after the government has lifted barriers to competition in other industries.

As I mentioned earlier, the Bureau of Economic Analysis estimates that in 1995, American consumers spent nearly $300 billion on brokerage, insurance, and banking services. If increased competition from financial modernization were to reduce costs to consumers by 1 percent, that would be a savings of about $3 billion a year. Based on the efficiencies that could be realized from increased competition, it is plausible to expect ultimate savings to consumers of up to 5 percent from increased competition in the securities, banking and insurance industries -- as much as $15 billion per year. The bulk of these savings should come as financial services firms, driven by increased competition, adopt best-practices.

As I indicated earlier, the financial services industry is undergoing fundamental and dramatic change. The question we need to address is: what will be the rules of the road in the years to come? Will we rely on the old rules -- crafted primarily in the depth of the Depression -- or will we look forward to creating a legal and regulatory structure that will meet the needs of a dynamic and ever-changing system?

I share the views of many others who feel that the time has come to modernize the rules of our financial services system. Such a move, if done with due regard for safety and soundness, will benefit the broad range of users of financial services: consumers, small and large businesses, communities, and state and local governments. A more rational system, with a level playing field and appropriate safeguards, is in everyone's interest.

We look forward to working with the Congress on this important initiative in the time ahead.

8/1/96
Bank Reform

Press Guidance on Bank Reform
August 1, 1996

The Federal Reserve yesterday proposed to steps to modernize financial services. Congress looked at legislation to reform the Glass-Steagall Act earlier, but never passed any legislation.

Points:

- The Administration has indicated its long standing support for bank reform.
- This is a step in the right direction.
- Obviously we have look at the specific proposal, but raising the limit (the Fed proposed to raise the amount a bank can earn from securities from 10 to 25 %) is something we've indicated our support for in the past.

April Mellody per Ellen Seidman, NEC and Dan Tate, leg affairs

Banks' Access To Wall Street May Widen

Fed Proposes New Rules To Weaken 'Firewalls'

THE NEW YORK TIMES
THURSDAY, AUGUST 1, 1996

By RICHARD W. STEVENSON

WASHINGTON, July 31 — The Federal Reserve took a step today to loosen the Depression-era law that limits banks from competing in the securities business, proposing new regulations that would allow some of the largest banking companies to expand greatly the business they conduct on Wall Street.

The proposals represent a clear if limited victory for many of the nation's largest banking companies, including J. P. Morgan, Chase Manhattan, Citicorp, Bank of America and Nationsbank.

The most important change would allow the securities subsidiaries of bank holding companies to generate as much as 25 percent of their revenue from underwriting and dealing stocks and many types of bonds, up from a limit of 10 percent.

The Fed also proposed ending or scaling back some of the "firewalls" it had required banking companies to establish between banking and securities operations. Among the biggest changes would be easing the restrictions on sharing employees and directors and ending the ban on banks helping to market the activities of the securities subsidiary.

Banking industry executives said they expected the proposals to be adopted. The Fed requested comments from the affected industries on the revenue proposal by Sept. 30 and on the other proposals by Sept. 3. The Fed was expected to make final decisions within a matter of months.

Banks had been pushing for the rules to be eased as part of legislative changes to the Glass-Steagall Act of 1933, which divided up the financial industry to shield Federally insured banks from what was seen as the riskier ethos of Wall Street. But the attempt to remove the barriers in Congress broke down this spring amid feuding within the financial services industry.

Since then, banks, supported by the chairman of the House Banking Committee, Jim Leach, a Republican from Iowa, have been pressing the Fed to use its power over bank holding companies to accomplish some of the same ends.

The Fed has allowed bank holding companies to establish so-called Section 20

Continued on Page D19

Continued From First Business Page

securities subsidiaries for the last nine years, and there are currently 39 American and foreign banks that have done so. The subsidiaries are permitted to underwrite and deal in securities that banks are otherwise barred from. Banks are permitted to trade some securities, like United States Government bonds.

"We are in total sync with the Fed on where banks need flexibility in their operations, so we commend the Fed for proposing that flexibility and doing it in such timely fashion," said Larry LaRocco, the managing director of the ABA Securities Association, an affiliate of the American Bankers Association, which represents the 20 big American banks with large securities operations.

"It means that some of the banks that are bumping up against the revenue limits can move forward with their underwriting activities, and it means they will no longer be hamstrung by regulations on cross-marketing and sharing employees," Mr. LaRocco said.

Bank executives said, however, that the Fed proposals should not slow efforts to overhaul or repeal Glass-Steagall.

"While we fully support this modest step, we think the time is long overdue for the full dismantling of the artificial constraints of the Glass-Steagall Act that are relics of markets and thinking more than 60 years old," said Alan S. MacDonald, Citibank's executive vice president and global head of corporate finance.

But the Securities Industry Association, which represents Wall Street firms, said that the Fed's action could undercut efforts to forge a consensus on repeal of the Glass-Steagall Act by giving big banks much of what they want.

The association said the Fed should grant only temporary relief to Section 20 subsidiaries that are reaching the regulatory limits on the amount of business they can do as a way of spurring banking companies to negotiate a legislative solution.

"While clearly there is a need for a temporary solution for those Section 20 bank affiliates that have bumped up against the current 10 percent limit based on their revenues," said Steve Judge, the Securities Industry Association's senior vice president for government affairs, "for the Fed to propose allowing a generous and long-term solution, as they did today, just puts us one step back in our efforts to hammer out an approach to modernize existing Federal laws and regulations covering the financial services industry."

In releasing its proposals, the Fed said the securities subsidiaries of the banking companies it regulates "have operated in a safe and sound manner without adverse effects on their affiliated banks or the public, and have provided additional competition in the securities market."

The Fed said it believed "that this increase in the revenue limit would not give rise to the potential dangers to commercial banks from general underwriting activities that motivated Congress to enact the Glass-Steagall Act."