S. HRG. 108–892

EXAMINATION OF THE GRAMM-LEACH-BLILEY ACT FIVE YEARS AFTER ITS PASSAGE

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

THE GRAMM-LEACH-BLILEY ACT (P.L. 106–102), TO ENHANCE COMPETITION IN THE FINANCIAL SERVICES INDUSTRY BY PROVIDING A PRUDENTIAL FRAMEWORK FOR THE AFFILIATION OF BANKS, SECURITIES FIRMS, AND OTHER FINANCIAL SERVICE PROVIDERS

JULY 13, 2004

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C O N T E N T S

TUESDAY, JULY 13, 2004

WITNESSES

Additional Material Supplied for the Record

EXAMINATION OF THE GRAMM-LEACH-BLILEY ACT FIVE YEARS AFTER ITS PASSAGE

TUESDAY, JULY 13, 2004

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order. I would like to thank our witnesses for appearing today. This morning, the Committee will engage in what is sometimes an overlooked but nevertheless an extremely important activity: Legislative oversight. I think we have a considerable responsibility to monitor the laws we pass and to periodically track developments in the markets governed by such laws and ultimately ask some basic questions, such as has the law been implemented as Congress intended? Has it achieved the ends we sought? Does it still work in the marketplace as it exists presently compared to when it was enacted?

Today, we will be considering the Gramm-Leach-Bliley Act, one of the most significant laws to come out of this Committee in many years. The Act made profound changes to the laws governing the affiliation of banking, securities, and insurance firms in an attempt to promote the modernization of the financial services sector.

Almost 5 years after passage, I think GLB merits this Committee's time and attention. We will begin our overview with witnesses who represent consumer groups and the industry sectors covered under the law. Hopefully, they will provide us with a real-world perspective about its operation and its effects.

Later this year, we are planning to bring the regulators before the Banking Committee to complete our discussion about the law. We also plan to hold further hearings concerning the state of the insurance industry in the post-Gramm-Leach-Bliley environment.

Again, I want to thank all the witnesses for appearing today, and I look forward to hearing their testimony.

And we have with us a distinguished group: Harry Doherty, Vice Chairman of the Board, Independence Community Bank Corporation, Brooklyn, New York. He will be testifying on behalf of America's Community Bankers; Terry Jorde, President and CEO, CountryBank USA, Cando, North Dakota, testifying on behalf of the Independent Community Bankers of America; Travis B. Plunkett, Legislative Director, Consumer Federation of America;

Ronnie Tubertini, President and CEO of SouthGroup Insurance and Financial Services, Jackson, Mississippi, testifying on behalf of the Independent Insurance Agents and Brokers of America; Steve Bartlett, a former Congressman, colleague of mine at one time, President and Chief Executive Officer, Financial Services Roundtable; James McLaughlin, Director, Regulatory and Trust Affairs, American Bankers Association; John Taylor, President and Chief Executive Officer, National Community Reinvestment Coalition; and Steve Judge, Senior Vice President, Government Affairs, Securities Industry Association.

This is a full panel. We will start with you, Mr. Doherty, and all of your written testimony will be made part of the hearing record in its entirety. If you could, briefly sum up your toughest remarks.

**STATEMENT OF HARRY P. DOHERTY
FIRST VICE CHAIRMAN, BOARD OF DIRECTORS
AMERICA'S COMMUNITY BANKERS AND
VICE CHAIRMAN OF THE BOARD, INDEPENDENCE
COMMUNITY BANK CORPORATION, BROOKLYN, NEW YORK
ON BEHALF OF AMERICA'S COMMUNITY BANKERS**

Mr. DOHERTY. Thank you very much, Chairman Shelby and Members of the Committee.

I am Harry P. Doherty, Vice Chairman of Independence Community Bank Corporation of Brooklyn, New York. Independence Community Bank is a New York State-chartered savings bank, operating within an OTS-regulated holding company. Our bank has more than $17 billion in assets, 121 branches, and 2,500 employees. I am here this morning representing America's Community Bankers. I am First Vice Chair of ACB, and we are pleased to have this opportunity to participate in the Committee's review of the Gramm-Leach-Bliley Act.

In 1999, as they do today, ACB's diverse members wanted financial organizations to have choices in their charters and business models. At the time, decades-old legislation stood as a barrier to the full integration of the banking, securities, and insurance industry, even though securities, insurance, and nonfinancial holding companies had been permitted to hold thrifts.

ACB supported passage of the Gramm-Leach-Bliley Act. We did so because it created new options for financial companies that wanted to offer diversified financial services through a bank charter. One of the innovations of the Act was the creation of a notice and comment process for identifying new permissible financial activities for national banks and new financial holding companies.

The process relies on the expertise of Treasury and the Federal Reserve. Congress wanted the primary consideration in that process to be the safety and soundness of the banking system. But then came the real estate brokerage rule. This was the first real test of the new system. Because of considerations other than safety and soundness, the nonpolitical process established by the Act has not been allowed to run its course.

Despite the restrictions on new commercial affiliations imposed by the Act, the unitary savings and loan holding company remained an important choice for financial firms. The expertise of the OTS in regulating diverse holding companies is one of the reasons financial companies frequently choose the unitary savings and loan holding company structure.

The Act made positive changes in the membership requirements, capital structure, and regulation of the Federal Home Loan Bank System. For example, Federal savings banks and savings associations became voluntary members instead of mandatory members. Voluntary membership enhances the cooperative nature of the system, and it provides incentives to the Federal Home Loan Banks to work for the benefit of their member-borrowers.

The Act added stability to the system's capital base. It established a leverage and risk-based capital requirement for the Bank System. It created a stable base of new capital for the system. Nine of the twelve Federal Home Loan Banks have implemented a new capital plan as required by the Act. The remaining three are on track to implement their plans, but proposals to require the Federal Home Loan Banks to register stock with the Securities and Exchange Commission without first establishing exemptions consistent with the cooperative structure of the system could delay implementation of the remaining capital plans.

The Act gave the Securities and Exchange Commission the opportunity to ensure that savings associations are regulated the same way as banks, when engaged in the same activities. Unfortunately, the most recent version of the SEC's proposed Push-Out rule does not treat savings associations the same as banks when they are engaged in the same broker activities. ACB believes that a legislative change is needed to ensure parity for savings associations under the Securities Exchange Act.

The Act created important new privacy rights for consumers. However, some of these provisions created a significant regulatory burden for all deposit institutions. Not all of the new requirements provided a benefit to consumers, and they did not increase safety and soundness. Although compliance with these provisions can be costly for all depository institutions, compliance costs fall more heavily on community banks.

Congress should act to reduce the unnecessary regulatory burden that results from these provisions. For example, Congress should eliminate the required annual privacy notices for banks that do not share information with nonaffiliated third parties.

Finally, the Act eliminated the Savings Association Insurance Fund Special Reserve. This gave the FDIC more flexibility. ACB urges the Committee to act soon on the pending deposit insurance reform legislation that will give FDIC additional flexibility to manage FDIC's insurance funds.

Thank you very much for the opportunity to testify, and I will be happy to answer questions later.

Chairman SHELBY. Ms. Jorde.

STATEMENT OF TERRY JORDE, VICE CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA AND PRESIDENT AND CEO COUNTRYBANK USA, CANDO, NORTH DAKOTA

Ms. JORDE. Thank you, Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, my name is Terry Jorde. I am Vice Chairman of the Independent Community Bankers of

America and President and CEO of CountryBank USA, a community bank with $37 million in assets located in Cando, North Dakota. Cando is a small town of only 1,300 people, but we have three banks and a motto that you can do better in Cando.

[Laughter.]

Our bank is full service and progressive, offering our customers a full range of insurance and investment services, residential mortgages, check imaging, and fully transactional Internet banking.

ICBA appreciates this opportunity to testify on the effect of the Gramm-Leach-Bliley Act and what it has had on the financial industry, the Nation, and, most importantly, our communities. The Act has had both positive and negative effects. The Federal Home Loan Bank reforms made it possible for community banks of all charter types to greatly increase their involvement in the system. Since the passage of GLB, the number of ICBA banks belonging to a Federal Home Loan Bank has increased from 17 to 76 percent.

For community banks, the Federal Home Loan Bank System is more important than ever. My bank is taking advances for the first time in years because our deposits are down and loan demand has increased. I am fortunate in that my Federal Home Loan Bank of Des Moines has been a champion in accepting small business and agricultural assets as collateral for advances, which was permitted by GLB. However, some other Federal Home Loan Banks have been slow to use the authority, either by limiting the types of loans or severely haircutting values.

ICBA is pleased that this Committee addressed this by adopting Senator Enzi's amendment to the GSE reform bill. It clarifies that the mission of the Federal Home Loan Banks includes providing liquidity and funds for these purposes. We hope this will stimulate increased use of this authority.

GLB reaffirmed the Nation's longstanding policy maintaining the separation between banking and commerce by closing the unitary thrift loophole. This helps avoid the conflicts of interest and threats to safety and soundness that will arise if commercial firms, such as retailers and manufacturers, are permitted to own their own banks. Policymakers now must face the same issue with industrial loan companies that may be owned by commercial firms.

The House's regulatory relief bill took steps to address the ILC loophole by adopting the Gilmore-Frank Amendment. However, ICBA strongly urges Congress to take the next step and bring ILC's under the Bank Holding Company Act, closing the ILC loophole completely.

ICBA repeatedly warned that GLB would likely lead to increased financial concentration. GLB and the Riegle-Neal Act have together led to the creation of truly huge financial conglomerates. We now have three $1 trillion banks in the United States. This is certain to decrease competition and increase systemic risk.

As financial conglomerates are allowed to grow exponentially, the corresponding regulatory burden falls disproportionately on the community bank. ICBA strongly urges you to reduce the burden on noncomplex community banks so that economic development and small businesses will not suffer, and competition will be maintained.

We also urge you to complete action on deposit insurance reform legislation. Since community banks are not too big to fail, our depositors look to deposit insurance to protect their funds.

ICBA is troubled by another aspect of increased concentration: The largest institutions appear to be too big to regulate and too big to punish. In case after case, regulators and courts impose only nominal fines for megabanks' misdeeds, while regulators go on to approve their massive mergers. Community banks undergo much harsher treatment for regulatory violations. State and Federal regulators properly hold management strictly accountable for everything that happens in the bank.

Congress should direct the agencies to review their policies, comparing the fines and other punishments that they apply to the largest institutions they regulate with those they mete out to the rank and file. This is certainly not the time for Congress to take new steps, such as lifting the deposit caps in the Riegle-Neal Act that would further increase concentration, and ICBA will vigorously oppose any such proposals.

GLB did not provide community banks with substantial new opportunities. Preexisting laws already allowed my own bank and many other community banks to offer insurance and investment brokerage. However, real estate brokerage is a retail service community banks believed they would have the opportunity to offer to their customers. We were disappointed that Congress has blocked the proposed real estate brokerage regulation. This new power would allow community banks to better serve customers by increasing choice, decreasing costs, and diversifying revenue sources.

GLB also required burdensome and oftentimes irrelevant retail insurance disclosures. I have seen the dumbfounded look on my customers' faces when they have been told that their auto policy or their crop insurance is not a deposit and may go down in value, followed by their look of concern when we inform them that their insurance is not guaranteed. This waste and confusion puts us at a competitive disadvantage to other insurance agencies in my community that are not housed within a bank office. ICBA urges Congress to streamline these disclosures.

The annual GLB privacy notice is another example of the disclosure blizzard that does little more than confuse and burden consumers with pages of incomprehensible legalese. Most community banks do not share their customers' financial information with outside marketers and the like. Congress should amend GLB to allow them to provide a short statement to that effect printed on the customer's bank statement. In addition, community banks and many other financial institutions maintain consistent privacy policies. They should be required to deliver the annual notice only if they change their policy. Customers would be more likely to pay attention to those notices.

I would again like to compliment the Committee on holding this hearing on the Gramm-Leach-Bliley Act. Again, we urge Congress to complete action on the Enzi Federal Home Loan Bank Amendment, close the ILC loophole, address concerns raised by increase concentration, and streamline insurance and privacy disclosures.

Thank you again for this opportunity to testify.

Chairman SHELBY. Mr. Plunkett.

STATEMENT OF TRAVIS PLUNKETT
LEGISLATIVE DIRECTOR
CONSUMER FEDERATION OF AMERICA
ON BEHALF OF THE CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, AND U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. PLUNKETT. Good morning, Mr. Chairman, Senator Sarbanes and Members of the Committee, my name is Travis Plunkett. I am the Legislative Director of the Consumer Federation of America. We appreciate the opportunity to offer our comments and those of Consumers Union and the U.S. Public Interest Research Group on the effect of the Gramm-Leach-Bliley Act on consumers.

In the decade-long debate that led to enactment of the GLBA in 1999, Congress heard many extravagant promises from financial services industry representatives about how tearing down the barriers between banking, securities, and insurance sectors would be a boon to consumers. Banks, securities firms, and insurance companies would merge into financial services supermarkets, we were told, that would then offer increased consumer access to new, innovative products at lower costs, with improved privacy protections.

Five years later, this rhetoric has proven to be mostly hype. Mergers have occurred but mostly within the banking industry, not across sectors. While some, primarily affluent consumers may benefit from larger, multistate ATM networks, from discounts offered for multiple account relationships, et cetera, we have seen no evidence that the mass of banking consumers have benefitted from the Gramm-Leach-Bliley Act.

I would like to talk specifically about some of the key issues that arose during the debate and how we think consumers are faring on those issues 5 years later, and please note that my lengthy testimony includes a number of specific solutions on some of the concerns I am going to raise.

Regarding financial privacy, the privacy requirements, as we have said many times, in the Gramm-Leach-Bliley Act are narrow and weak. Consumers have no control over the sharing of their confidential experience and transaction information if two separate parties enter joint marketing agreements to sell financial products, nor do consumers have any right to stop the sharing of any information among affiliates of financial institutions. Some financial institutions have hundreds of affiliates; others have thousands.

Consumers can opt out of the sharing of information with third parties selling nonfinancial products, but because the burden is on the consumer to take this step, and because the privacy notices that many financial institutions have used to inform consumers of their limited rights are virtually incomprehensible, very few consumers have actually opted out.

Let me turn now to safety and soundness issues. The corporate scandals of the last few years have exposed potentially significant safety and soundness risks in allowing banks to sell both credit and investment banking services. As you all are well aware, among the restrictions in the Glass-Steagall Act that the Gramm-Leach-Bliley Act eliminated were those that prohibited commercial banks from combining with investment banks to sell both credit and investment banking services.

At the time, consumer groups expressed many concerns that the banking/securities combination in particular could allow financial investors access to insured deposits for high-risk lending schemes. In my written testimony, I provide, at length, a case study that shows that just such a scandal has since occured. This is the Citigroup-WorldCom situation. It is a cautionary case study of the kinds of problems that can result when banks inappropriately link decisions about lending and investment banking.

Initially, Salomon Smith Barney had a strong incentive to promote WorldCom stock and to continue to do so after WorldCom's prospects had begun to deteriorate in order to keep WorldCom as an investment banking client. After Travelers, Citi and Salomon combined, the conflicts got bigger and more complex. In one case, the bank apparently came up with a plan to let WorldCom's CEO Bernie Ebbers turn his WorldCom stock into cash without the scrutiny that would accompany such a sale normally. In another case, Citi agreed to a very risky loan to Ebbers, in this case, $43 million to buy a ranch, with the loan banked by 2.3 million shares of WorldCom stock.

There are a number of significant lessons that we have learned from this debacle. We explore them at length in the testimony. A major lesson is that abuses are inevitable if businesses are allowed to create structures that are so big and complex that they require a major investment in regulatory oversight to prevent these abuses. However, once Congress allows these structures to be created, it had better be willing to provide the resources for regulatory oversight and to push regulatory agencies to be aggressive in enforcing the law.

Let me turn now to some consumer services issues. Gramm-Leach-Bliley has not slowed the continuing trend of rising bank fees, nor has it helped decrease the numbers of unbanked consumers. Indeed, rather than offering innovative, moderately priced products to middle-income consumers or to unbanked consumers to bring them into the financial mainstream, some banks have developed policies and services that deliver second class or downright predatory products at an extremely high cost.

Let me point, for example, to KeyBank's checkless checking system: 1.9 percent charge per deposit for a paycheck deposited into an account accessed by ATM cards. Let me point your attention to stored value cards, payroll cards, and others, where charges are extremely high. Let me also point your attention to predatory products like bounce loans that are targeted at moderate income consumers with checking accounts. This is a new form of overdraft protection at some big banks, and there are a number of big banks, using it primarily to boost their fee revenue. We are talking here about interest rates starting at a low of 240 percent and ranging as high as 540 percent.

We urge the Committee to look into steps to better regulate all of these products, and in closing, let me also say on the safety and soundness front we completely agree that the industrial loan corporation loophole in the Bank Holding Company Act needs to be shut tight.

Thank you.

Chairman SHELBY. Mr. Tubertini.

STATEMENT OF RONNIE TUBERTINI CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA, INC.

Mr. TUBERTINI. Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee.

My name is Ronnie Tubertini, and I am pleased to have the opportunity to give you the views of the Independent Insurance Agents and Brokers of America on the Gramm-Leach-Bliley Act and its effects on the insurance marketplace. I am President and CEO of SouthGroup Insurance and Financial Services, which is Mississippi's largest privately owned insurance agency, and I am also currently Chairman of the IIABA Government Affairs Committee.

I would like to discuss three points and what lessons might be learned for possible next steps for Congress. First, the expected megamergers of various financial services providers into financial supermarkets, which has not taken place; second, the success of the GLBA NARAB provisions in promoting agents' licensing reform in the States; and third, the continued importance of functional regulation and the State insurance regulatory structure.

One stop shopping for financial services has not come to pass. Some mergers certainly have occurred, but most have not been among the leading players in different fields. The convergence of products and services that began in the 1980's continues to occur but through smaller and more targeted merger activity.

Instead of purchasing insurance companies, as was predicted, banks have bought individual securities firms and insurance agencies, although this trend has not been overwhelming. Announced bank-agency deals involve a relatively small number of independent agents, and the independent agency system continues to be a principal form of property and casualty insurance distribution, as well as life and health distribution.

One of the most significant accomplishments of GLBA was the NARAB subtitle, known as the National Association of Registered Agents and Brokers, which launched agents' licensing reform that continues today. Prior to GLBA, there was no consistency or reciprocity among the States, but licensing has improved significantly over the last 5 years as a direct result of Congress' decision to address those issues in GLBA.

The GLBA put the ball in the States' court by threatening the creation of a new national NASD-style licensing entity. The creation of NARAB was only averted when a majority of the States achieved a level of reciprocity within the 3-year period. Since GLBA, over 40 jurisdictions have been certified by the NAIC as meeting the NARAB mandate.

The success of NARAB is a perfect example of what the Federal Government and States can accomplish in partnership and how Congress can assist the States to achieve the needed reforms. The NAIC and States made little progress toward reciprocal and uniform licensing until Congress set a deadline with specific goals. In fact, Congress set the bar at only a majority of the States. All but a handful of the States have met the NARAB reciprocity standard.

While there is still more to do to get to full reciprocity and ultimately to uniformity, this success would not have occurred without what are now being called Federal tools.

Perhaps GLBA's most important accomplishment in protecting insurance consumers was its focus on functional regulation. GLBA specifically reaffirmed the traditional authority of the States to regulate the business of insurance. Most observers agree that State regulation has worked effectively to protect consumers, because State officials are positioned to be responsive to the needs in the local marketplace for consumers.

Insurance is a product about which consumers have many questions, and if a problem arises, they want to be able to resolve it with a local phone call. During 2001, for example, State regulators handled over 3.5 million consumer inquiries and complaints, and today, State insurance departments employ approximately 13,000 individuals who draw on over a century and a half of regulatory experience to protect consumers.

The diversity of underlying State insurance laws and varying consumer needs from one region to another require local officials on the beat. Despite its merits, State insurance regulation is not without its share of problems. It takes too long to get new insurance products to market, and there is unnecessary duplicative regulatory oversight in licensing. The speed to market issue is the most pressing from both a consumer and an agent and broker perspective, because we all want new and innovative products.

Banks and securities firms are able to develop new products, while insurers are hampered by lengthy and complicated filing and approval products in 50 States. As a result, insurance companies and agents selling their products are at a disadvantage.

IIABA supports State regulation of insurance from all participants and for all activities in the marketplace, and we are opposed to any form of Federal regulation, optional or otherwise. But there are some problems in the State system which the States will not be able to resolve on their own. Therefore, IIABA believes that there is a vital role for Congress but that it need not replace or duplicate what is successful at the State level.

IIABA believes that the best alternative is a pragmatic, middle ground approach that utilizes Federal legislative tools to improve the State-based system. Targeted Federal legislation is not a radical concept. There is the successful NARAB precedent. The Senate Banking Committee and the House Financial Services Committee have proven that that approach can work, and IIABA believes that the NARAB model can serve as a template for further reform of State insurance regulation.

We understand the Senate Banking Committee still has much to consider on this subject and look forward to working with you in any review of State insurance regulation and potential reforms the Committee may conduct.

Chairman SHELBY. Thank you.

Mr. Bartlett.

STATEMENT OF STEVE BARTLETT
PRESIDENT AND CHIEF EXECUTIVE OFFICER
THE FINANCIAL SERVICES ROUNDTABLE

Mr. BARTLETT. Thank you, Mr. Chairman and Members of the Committee, my name is Steve Bartlett. I represent the Financial Services Roundtable, which consists of 100 of the largest financial services companies in the United States. One of the key goals of Gramm-Leach-Bliley was to achieve a competitive marketplace; that is, a financial regulation that should be for the safety and soundness and for consumer protection, not for product allocation.

More can be done to achieve this goal. I have prepared six recommendations on behalf of my members to further achieve competitiveness in the financial marketplace. Specifically, those are to establish uniform national privacy standards; to provide for optional Federal insurance chartering; to establish a national antipredatory lending law; to remove the sunset on nonfinancial activities; to remove the activity limitations on national and State banks; and to allow the Treasury and Federal Reserve to independently determine what activities are financial in nature.

First, amend Gramm-Leach-Bliley to achieve uniform national privacy statements. Title V, Mr. Chairman, of GLB imposed a number of privacy requirements on financial institutions, including the distribution of an annual privacy notice to consumers. It also expressly acknowledged the right of States to adopt their own individual separate privacy laws. Those provisions have created, I believe, some unintended confusion and conflict.

The annual privacy notice, as you have already heard, required by GLB is astoundingly complex. Federal regulators have requested to comment on alternative notices, but they lack the authority to make the notice truly consumer-friendly. A Federal court recently cited Title V of Gramm-Leach-Bliley in upholding California's privacy law, which, if that is allowed to stand, could end up repealing Gramm-Leach-Bliley with 50 different State laws.

Congress should eliminate this confusion and conflict by repealing the State law provisions and establishing national, uniform privacy standards for financial firms. Congress should also, Mr. Chairman, direct the Federal regulators to issue a simplified national privacy notice with a safe harbor.

Number two, amend Gramm-Leach-Bliley to provide for optional Federal insurance charters. Title III of Gramm-Leach-Bliley, I believe, mistakenly reaffirmed that the business of insurance is regulated primarily by the States. During the past 5 years, all parties to insurance regulation, including State insurance commissioners, have concluded that the current system of insurance regulation is fundamentally flawed.

The Roundtable believes that the best way to reform the regulation of insurance is to create a parallel system of chartering and supervision for insurance companies at the Federal level with a Federal option.

Number three, amend Gramm-Leach-Bliley to establish a national antipredatory lending law. In the 5 years since the enactment of Gramm-Leach-Bliley, the regulation of mortgage lending has become a hot topic. A variety of State and local governments have enacted laws designed to stop predatory lending practices.

The Roundtable urges this Committee to use this review of GLB as an opportunity to enact a national antipredatory lending law that establishes basic protections for mortgage borrowers. This Federal law should apply uniformly to all lenders regardless of charter and supersede State antipredatory lending laws.

Number four, amend Gramm-Leach-Bliley to remove the sunset on nonfinancial activities. In a marketplace that is subject to rapid changes in technology and even more rapid changes in consumer demand, some companies need the flexibility to provide products and services outside the statutory list of activities that are financial in nature.

Title I of Gramm-Leach-Bliley grandfathered the nonfinancial activities of companies that were not bank holding companies prior to GLB. This grandfather provision, unfortunately, is scheduled to sunset in 5 years, and thus, it is a limitation built into the law. We recommend that Congress make the grandfather permanent and remove the sunset.

Number five, amend Gramm-Leach-Bliley to remove the activity limitation of national and State banks. Section 121 authorized national banks to own financial subsidiaries and empowered those subsidiaries to engage in a range of financial activities. At the same time, GLB proposed a number of activities and other operating constraints of the financial subsidiaries of national banks and State banks that do not apply to financial holding companies.

The Roundtable recommends that the activities and operating limitations imposed on national banks and State banks be removed.

Number six, amend Gramm-Leach-Bliley to allow Treasury and the Federal Reserve to independently determine what activities are financial in nature. GLB established an overly complex notice and disapproval procedure for the authorization of new financial activities. The Roundtable recommends that the Treasury and the Federal Reserve should have independent authority to determine what is a permissible activity. The OCC and Federal Reserve would still have the authority to regulate for safety and soundness of financial affiliates.

Thank you, Mr. Chairman.

STATEMENT OF JAMES D. MCLAUGHLIN
DIRECTOR, REGULATORY AND TRUST AFFAIRS
AMERICAN BANKERS ASSOCIATION

Mr. McLaughlin. Mr. Chairman and Members of the Committee, I am Jim McLaughlin, speaking on behalf of the American Bankers Association.

Congress took a forward-thinking approach to financial services regulation by enacting the GLB Act. Dynamic market forces were already dramatically changing the financial services market. By responding to this new reality and after many years of debate, Congress modernized our financial system, making it more sensible and straightforward, removing inefficiencies in structure and regulation.

The Act lets market forces dictate what combinations of financial services would be appropriate. The Act has worked well. It has benefitted customers, diversified incomes of financial firms, and at the same time posed no new risks to the deposit insurance funds. While not all financial firms have rushed to become a financial holding company, they could if they so choose in the future.

This is a critical point: The success of the Act should not be judged by the number of financial holding companies or whether the combination of activities they now offer were a direct result of the Act. Rather it is the very option to undertake combinations of activities to meet the needs of the customers that is the measure of success. But more can be done, however, to fully realize the benefits of the GLB Act. Let me touch on a few.

First, Congress designed a flexible regulatory process to allow financial institutions to enter new lines of business. It appropriately delegated responsibilities to the two agencies most familiar with the financial services industry: The Treasury and Federal Reserve. Unfortunately, this important provision has been derailed, at least for now, in one of first proposed rulings under this Act having to do with real estate brokerage services.

As a result, Congress is once again refereeing another competitive issue, the very thing it sought to avoid. We urge Congress to let the Treasury and the Federal Reserve undertake their legal responsibilities to assure that the financial services market remains fair and competitive.

Second, the banking industry has serious concerns over the new SEC proposal known as the Broker Push-Out rule. We appreciate the SEC's responsiveness to many of our concerns. We hope that the remaining issues can be addressed during the current rulemaking process so our banks can continue to offer longstanding bank products and services such as IRA accounts and retirement plan services. During this process, we hope that the Congress will continue to exercise its oversight responsibilities.

Third, a sensible crossmarketing approach for merchant banking is needed to provide equal footing for all financial companies. Many ABA members regard the merchant banking authority as the single most important new power granted by the GLB Act. As a result, the ability to crossmarket through Internet websites and statement stuffers is very important to let our customers know about new products that can meet their needs.

And last, the most significant work left undone by the GLB Act is to modernize the State system of insurance regulation. The GLB Act did strongly encourage States to adopt licensing standards to which all insurance agents must adhere. Unfortunately, as we have already heard, uniformity across States is far from a reality, and duplicative and inefficient State insurance regulation reduces product availability and raises costs.

One solution that ABA endorses is to create an optional Federal charter for insurance companies and agencies. Like the dual banking system, this would provide an alternative to State-by-State regulation and create uniformity and efficiency.

In conclusion, the GLB Act went a long way toward removing obstacles to efficient provision of financial services. It responded to the needs of consumers and increased the competition among financial service providers. While we do not know what innovations will take place in the years ahead, we do know that free and fair competition creates an atmosphere that encourages innovation. The

GLB Act was an essential ingredient in bringing about such competition.

We congratulate you on holding this hearing, and we ask your continued oversight to assure the goals of the GLB Act are achieved.

Thank you.

Chairman SHELBY. Mr. Taylor.

STATEMENT OF JOHN TAYLOR
PRESIDENT AND CEO
NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Good morning, Chairman Shelby, Ranking Minority Member Sarbanes, and other distinguished Members of the Committee on Banking, Housing, and Urban Affairs.

Thank you for the opportunity to testify today. I think it is pretty fitting that NCRC, which is the trade association for some 600 community organizations across the country whose main focus is the increased access to credit and capital for all Americans, it is particularly fitting that we get an opportunity to testify today about the Gramm-Leach-Bliley Act or GLBA, because we believe that it has weakened the Community Reinvestment Act and thus reduced Americans' access to credit and capital.

We do believe that the United States banking system is the envy of the world. In great part, we believe this is attributable to our extensive regulatory oversight, which, among other things, ensures adequate capital reserves, safety and soundness, and fair and equal access to credit. GLBA has failed to ensure that the laws and regulations relating to fair access to credit have kept pace with safety and soundness regulation.

Mr. Chairman, I am not used to actually testifying in favor of paperwork reduction for my friends in the banking world, but I find myself in the position to make that recommendation today. One area where I believe there is strong consensus among community groups and the lending industry is the so-called CRA sunshine requirements under GLBA. We believe these need to be repealed.

The CRA sunshine provisions sought to quantify the amount of bank dollars granted to community groups. It was believed that such grants were used for operating support rather than for direct provision of financial services and products. Five years later, we now know the facts do not support this theory.

In a report issued in 2002 by the National Community Reinvestment Coalition, NCRC found that of the $3.6 billion in the 707 CRA agreements during the period of 1999 to 2002, only $11.8 million, less than three-tenths of 1 percent, actually went to grants for operating support for community groups.

CRA sunshine increases the paperwork burden on banks and community groups with no tangible benefit to the public. The repeal of this ill-advised section of GLBA must occur immediately.

Mr. Chairman, another harm, from our perspective, of GLBA is the reduction of the frequency of small bank exams. Under GLBA, small banks with assets of $250 million are examined only once every 4 or 5 years. Our 600 community members have reported that less frequent exams have reduced the amount of lending by small banks to low- and moderate-income borrowers. We call upon

Congress to commission a comprehensive study assessing the impacts of this, what we call "stretch-out of CRA exams" on working-class Americans, low- and moderate-income borrowers, as well as minorities.

Mr. Chairman, in anticipation of this testimony, I unfortunately had short notice on this testimony, but I took the opportunity just to look at the State of Alabama and to see how those lenders, who are covered under the small bank exam, and see how they were impacted with these less-frequent exams.

Chairman SHELBY. Take your time now.

[Laughter.]

Mr. TAYLOR. Okay; thank you very much.

Senator SARBANES. You just picked Alabama out of the hat.

Mr. TAYLOR. Maryland was next, Senator.

[Laughter.]

Chairman SHELBY. Absolutely, then Connecticut and then Utah.

Mr. TAYLOR. Absolutely. I would be glad to do this for anybody, but again, it would be great if Congress might want to take a look at this itself.

But in any event, what jumped out at us as the CRA exams became less frequent in Alabama, looking at the period of, say, 2000 through 2002, small banks in Alabama, in terms of all of their single-family lending as a percentage of their loans to low- and moderate-income borrowers in 2000 was about 37 percent of all of the loans to small banks went to low-income borrowers. That steadily declined until 2002 by 30 percent. Today, it is down to 27 percent by those banks.

If you just look at home purchase lending, Mr. Chairman, in Alabama, 33 percent of all the lending from banks who are covered under $250 million in assets, 33 percent of all the loans they made were made for home purchase lending. That dropped. That figure dropped to 27 percent, a 20 percent drop. So there has been this steady decline since the less frequent exams occurred, whereas for the small banks, when the examiners showed up every couple of years, there was this preparation, there was this thoughtfulness to make sure that they were making loans to low-income borrowers, and the impact has been, at least in the one State we had the opportunity to look at, has been negative.

Mr. Chairman, I appreciate your giving me some time to talk about your home State, but I will finish my remarks if I could. Gramm-Leach-Bliley added a requirement that bank holding companies must ensure that all of their affiliates passed CRA exams in order to be allowed to take advantage of the new powers under GLBA. While well-intentioned, this requirement has not been applied in a single case, to our knowledge. A major reason for this is less than 2 percent of the banks and thrifts fail their CRA exams. Since failed ratings are so rare, the have and maintain requirement must be strengthened to ensure that merging institutions will continue to serve minority and lower-income communities.

NCRC urges you to consider requiring merging institutions to submit a CRA plan with their application. In the past year, the merging activities has reached a frenzied pace and has included some of the largest mergers in our history: The Bank of America-

Fleet merger, the J.P. Morgan Chase with BankOne, which create institutions with more than $1 trillion in assets.

Despite the incredible magnitude of these mergers, the Federal Reserve Board does not require any meaningful CRA plan from the merging institutions. The CRA discussions and the merger applications usually consist of a one- or two-page boast about the bank's CRA performance. A meaningful CRA plan would require merging institutions to provide the number of loans, investments, and services they made by State, metropolitan area, and rural portions of the State in the past few years.

Recognizing that my time has expired, I will try to conclude, Mr. Chairman. While GLBA created more powerful financial institutions, it has not been updated to keep pace with the dramatic changes in the financial services industry. GLBA did not apply the CRA to mortgage companies, insurance companies, or securities firms that are part of holding companies. As a result, a very real possibility exists that CRA will apply to fewer and fewer assets of holding companies.

At the same time, CRA was not applied to credit unions. Again, we find ourselves in agreement with many of our colleagues in the banking industry that CRA needs to be expanded to credit unions, mortgage companies and other competitors of bank holding companies. The uneven application of CRA reduces the amount of community reinvestment and wealth building in these communities. The uneven application of CRA also undermines President Bush's call for more minority homeownership and subverts the dreams of millions of Americans seeking to build a future for their families. If Congress wishes to ensure that GLBA benefits all Americans, it must update CRA.

Since I have hit all of my main points, Mr. Chairman, and my time has expired, and you have noted that my written testimony is in the record, I will end. Thank you very much, sir.

Chairman SHELBY. Thank you.

Mr. Judge.

STATEMENT OF J. STEVEN JUDGE SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS SECURITIES INDUSTRY ASSOCIATION

Mr. JUDGE. Chairman Shelby, Senator Sarbanes, and Members of the Committee, I am Steve Judge, Senior Vice President for Government Affairs at the Securities Industry Association. I appreciate the opportunity to testify on our views on the Gramm-Leach-Bliley Act as we approach the 5-year anniversary of the enactment of that landmark legislation.

SIA commends this Committee for its efforts in enacting GLB and for holding these hearings to examine the effects of the Act. We hope that these hearings will initiate an important dialogue about identifying and eliminating obstacles that impede the ability of our financial service firms to develop and offer consumers a full range of financial services, structure themselves optimally, mitigate risk, and maintain global competitiveness. SIA looks forward to participating in this dialogue.

In considering the effects of GLB, it is important to recall how constrained the financial services industry was before Congress acted. Financial service firms were operating under a hodgepodge of confusing rules and regulations. The regulatory environment failed to provide the full range of relief the industry sought and the consumers demanded and tilted the playing field in favor of one segment over another.

The enactment of the Gramm-Leach-Bliley Act has, in many respects, rationalized and modernized the financial services regulatory environment. Banks, securities firms, and insurance companies can choose to affiliate under whatever structure best fits their business plan. Subsidiaries of financial service holding companies can engage in a wide variety of financial activities beyond banking, securities, and insurance. All financial service firms are subject to comprehensive privacy requirements far beyond those that exist for any other industry in the United States.

Since enactment of the Gramm-Leach-Bliley Act, there have been a number of significant combinations of financial service firms. Some firms have chosen to combine with commercial banks. Other firms have chosen to remain independent, and that is how it should be. One of the overarching goals of the Gramm-Leach-Bliley Act was to allow financial service firms to choose the optimal structure to best serve their customers' needs.

Among SIA's membership, bank or financial services holding company ownership of broker-dealers has increased from 13.4 percent in 1999 to 21 percent today. Moreover, banks affiliated with securities firms have significantly increased their presence in capital market activities. For example, banks affiliated with securities firms now lead/manage 58.2 percent of equity underwriting today versus only 36.8 percent in 1999.

As a further example of Gramm-Leach-Bliley's effectiveness, newly affiliated firms have not had to shed significant lines of business or to artificially limit their revenues from securities underwriting and certain other activities. These combinations also have not required Federal regulators to provide the type of significant regulatory relief that was often necessary prior to the passage of GLB.

When assessing the overall impact of the Gramm-Leach-Bliley Act, it is important to note various economic factors and significant changes in the capital markets over the last 5 years have made it tenuous at best to determine the cause and effect relationships to specific provisions of the Act. What we do know is that the Act is a comprehensive statute regulating a diverse, dynamic, and constantly evolving financial services industry, and as a result, there have been and likely will continue to be issues concerning the implementation of the legislation.

There are some weaknesses that exist with the Gramm-Leach-Bliley Act. Among those, securities firms in a financial services holding company should be able to engage in a full range of commercial activities to the same extent as securities firms that are unaffiliated with a bank.

There should be a national standard governing consumer privacy requirements. Requiring financial institutions to comply with Federal requirements and then the additional requirements potentially imposed by each State in which that firm operates is confusing to customers and unnecessarily burdensome on the industry.

And similarly, there should be a uniform national standard for the regulatory of securities activities. To this end, SIA is working with the State securities commissioners to secure adoption of the Model Uniform Securities Act in each of the State legislatures.

The U.S. capital markets and the financial service industry are stronger, healthier, and more dynamic since Congress enacted Gramm-Leach-Bliley. In spite of the tremendous challenges and changes over the last several years, consumers and financial service firms alike are better off as a result of increased opportunities and choices made possible by the Act.

SIA commends this Committee for holding these hearings, and we look forward to working with you to ensure that our Nation's capital markets remain the most efficient, liquid, deepest, and dynamic in the world.

Thank you.

Chairman SHELBY. I thank all of you.

During the debate that led to the passage of Gramm-Leach-Bliley, there were many predictions with respect to how the new law would radically change the appearance of the financial service industry. Mr. Doherty, you indicate in your written testimony where you quote statistics provided by the Federal Reserve Vice Chairman Roger Ferguson that significant structural change within the financial service industry has not occurred.

Mr. DOHERTY. That is true.

Chairman SHELBY. Is that correct?

Mr. DOHERTY. That is correct. I see no evidence to that effect that there have been significant changes.

Chairman SHELBY. Mr. Bartlett, are the great changes just around the next corner? Are they more likely to occur in fits and starts or what?

Mr. BARTLETT. Mr. Chairman, I think we have seen a series of changes.

Chairman SHELBY. Because there are changes.

Mr. BARTLETT. There are changes.

Chairman SHELBY. Evolution.

Mr. BARTLETT. And it is a continuum of changes. Gramm-Leach-Bliley still has some challenges that have prevented additional changes. I cited one, the sunset provision, which is, in my opinion, the largest barrier that stops companies that are not bank holding companies from applying for a financial holding company charter.

In my opinion, Mr. Chairman, what has happened is, as some of the other witnesses have said, is that there is a continuum of products and services. And 5 years post-Gramm-Leach-Bliley, companies are offering a much broader range of that continuum, both large and small companies, and that is as it should be. So the marketplace is much more driven now by the customer than by product regulation, but we still have a lot of vestiges of product regulation.

Chairman SHELBY. Has it helped the consumer that much?

Mr. BARTLETT. It has helped the consumer tremendously.

Chairman SHELBY. Brought more competition?

Mr. BARTLETT. Yes, more competition. Consumers now have additional choices of where to acquire an auto insurance loan, a home loan, an auto insurance product, auto insurance, or a mortgage; the choices are, if not infinite, at least close enough to infinite.

Chairman SHELBY. Have the changes, brought about by the law, better prepared U.S. firms for international competition, Mr. Bartlett, Mr. McLaughlin.

Mr. MCLAUGHLIN. Definitely better prepared for international competition. We have seen foreign firms take a greater presence in the United States, and some of them have had powers that U.S. banks have not been able to compete with. So it has better prepared banks in the United States.

Chairman SHELBY. Mr. Tubertini, Gramm-Leach-Bliley took a targeted approach with respect to enhancing the insurance agent and broker licensing that worked within the State-based regulatory structure. Do you believe that this was the appropriate approach, and if not, why not?

Mr. TUBERTINI. I do believe that it was the appropriate approach, Senator.

Chairman SHELBY. Do you think it is working?

Mr. TUBERTINI. It has worked in that we now have over 40 States that have been certified NARAB compliant. There are obviously still States that have not, but it was a giant step toward full reciprocity or uniformity.

Chairman SHELBY. In the State of Mississippi, do you operate all over Mississippi? Your firm is a large insurance firm.

Mr. TUBERTINI. We do, Mr. Shelby. We are in 17 locations across the State. But we also provide insurance to our customers in over 20 States.

Chairman SHELBY. Other financial products including insurance?

Mr. TUBERTINI. Not other than insurance products but across-the-board insurance products.

Chairman SHELBY. Mr. McLaughlin, in your testimony, you cite two research papers that essentially conclude, one, that most banks engage in permissible relationship banking privileges and two, that tying is not a rational strategy for banks. You recall that.

Mr. MCLAUGHLIN. That is right.

Chairman SHELBY. How would you respond to the following statements, including, in the executive summary of the Association for Financial Professionals 2004 credit access survey, and I am quoting from them, “a significant number of survey respondents note that their company has been subject to activities that the Federal Reserve indicates would violate Section 106 of the Bank Holding Company Act; further, many companies continue to report that the pressure to award business has increased over the past year.” How do you respond to that?

Mr. MCLAUGHLIN. First, Mr. Chairman, that is an attitudinal survey. The bank regulators and the GAO have consistently looked at banking practices in this area. And we have to recognize that Section 106 of the Bank Holding Company Act provides a higher standard for banks and banking organizations than the rest of the world that they are competing with have to comply with.

There is a very strict standard that applies to banks. What I think we are hearing from some of the financial treasurers and the like from that group is that they are saying they feel the fact that there is this one-stop-shopping, and that the marketing is intense. At the same time, we are hearing from our member banks that the corporate treasurers are putting greater pressure on the banks to provide better deals and packages of services. So the marketplace is working.

Chairman SHELBY. Good.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Mr. Chairman, let me just first follow up on your question. *The Wall Street Journal*, when it reported on this survey of the Association for Financial Professionals, said just this past June in an article headlined "Executives See Rise in Tying Loans to Other Fees," began its story as follows: "Corporate finance officers say banks are increasingly squeezing lucrative fees out of them by conditioning loans on the purchase of other services."

Now, tying is not permitted; is that correct?

Mr. MCLAUGHLIN. Well, you have to look at the law. It is a very complex section of the law, Section 106, Senator, and tying is permitted to traditional banking services. There is some tying that is permitted.

Chairman SHELBY. And how is traditional banking services defined?

Mr. MCLAUGHLIN. Traditional banking services are loan, deposits, trust services, cash management services, and the like.

Senator SARBANES. Now, do you agree that the Federal Reserve, in its interpretation of the antitying restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970, states that a bank would violate Section 106 if the bank informs a customer seeking only a loan from the bank that the bank will make the loan only if the customer commits to hire the bank's securities affiliate to underwrite an upcoming bond offering for the customer?

One out of seven large companies report that in the past 5 years, they have been explicitly required by a commercial bank to obtain corporate debt and/or equity underwriting services from an affiliate of the bank in order to obtain a loan from the bank. What is your view on this?

Mr. MCLAUGHLIN. I am sorry. I do not follow where that one out of seven comes from, who is saying that.

Senator SARBANES. This is the credit access survey that I made reference to.

Mr. MCLAUGHLIN. Oh, the credit access survey? Because the Fed's statement of the law is accurate, that you cannot tie underwriting of securities and condition that service for a loan.

Senator SARBANES. Right.

Mr. MCLAUGHLIN. That is clear.

Senator SARBANES. Yes, do you think that is taking place?

Mr. MCLAUGHLIN. I cannot say, but I can tell you that the GAO has examined it twice. The bank regulators have been in and examined it. The Federal Reserve on the request of this Committee has gone in and looked again at the banks, and they cannot find more than one or two isolated cases, and there have been, I think, one or two cases enforcement cases.

Senator SARBANES. To the extent it happens, as I have read it here, it is contrary to the law; is that correct?

Mr. MCLAUGHLIN. To tie underwriting services to the granting of a loan?

Senator SARBANES. Right.

Mr. MCLAUGHLIN. That is correct.

Mr. PLUNKETT. Senator, to that point——

Senator SARBANES. Yes?

Mr. PLUNKETT. I have looked at the GAO study as well, and they do point to a lack of documentation regarding the tying of availability or the price of credit to the purchase of debt underwriting services. But they also say that there may be good reasons for the lack of documentation, that the Federal regulators need to look at. For example, a lot of those deals are conducted orally. Second reason, borrowers may be reluctant to file formal complaints. And then, they point out that the Federal banking regulators need to look for indirect evidence of tying and do more to investigate these problems.

Senator SARBANES. Mr. Chairman, I want to diverge for just a moment, because I want to make sure I understand the constituencies of some of the groups at the table.

Mr. McLaughlin, the American Bankers Association encompasses all banks as potential members; is that correct?

Mr. MCLAUGHLIN. That is correct. Large banks, small banks, savings associations, commercial banks, trust companies, all banks.

Senator SARBANES. Yes; now, what about the Community Bankers? What is the definition or the parameters for your membership?

Mr. DOHERTY. We also service savings banks, savings and loans, Federal savings, commercial banks. We run the gamut.

Senator SARBANES. Regardless of size?

Mr. DOHERTY. Regardless of size, regardless of charter.

Senator SARBANES. So you, in effect, duplicate the membership of the ABA? Would that be correct? I mean, potentially.

Mr. DOHERTY. The potential; that is correct.

Senator SARBANES. Okay; and some banks would be members of both groups presumably?

Mr. DOHERTY. There are dual memberships; that is correct.

Senator SARBANES. Okay; now, what about the Independent Community Bankers of America?

Ms. JORDE. The ICBA does not have a size limitation. However, members of the ICBA generally subscribe to the philosophy that there is a symbiotic relationship between the bank and the community that it serves. The bank is dependent on its community. It is generally locally owned, or the board of directors is normally from that local area. We have nearly 5,000 member banks throughout the country, primarily independent banks and thrifts as well.

Senator SARBANES. And I take it your institutions would be, by and large, smaller in their asset size; would that be correct?

Ms. JORDE. We have banks as small as $10 million in size, and we have banks that are well into the billions of dollars in size, too. Again, it goes back to the philosophy of the bank. Many of those multibillion dollar banks started as community banks, remain as community banks and share that philosophy.

Senator SARBANES. Right.

And the Financial Services Roundtable, what are the parameters for your membership?

Mr. BARTLETT. Our membership is 100 of the largest financial services companies. We believe that size matters; that when you get to a certain size, you are able to offer a variety of products to your customers. We believe our companies share the philosophy of a competitive marketplace; that is, the marketplace or our customers should determine what products they wish to buy and not laws or regulations.

Senator SARBANES. What size does a financial institution have to be in order to qualify for membership in the Roundtable?

Mr. BARTLETT. We measure our size by market cap or by worth of the enterprise, and I think our smallest is around $2 billion, $2.5 billion of market cap.

Senator SARBANES. $2.5 billion?

Mr. BARTLETT. Yes, sir.

Senator SARBANES. And when you say you have 100, presumably, that does not encompass all institutions above that size; is that correct?

Mr. BARTLETT. That is correct.

Senator SARBANES. What percentage of the institutions above that size would be members of the Roundtable, if you know?

Mr. BARTLETT. I do not know exactly, but I would guess two-thirds.

Senator SARBANES. Two-thirds?

Mr. BARTLETT. Yes, sir.

Senator SARBANES. And are all of the largest institutions members of the Roundtable?

Mr. BARTLETT. Not all, no, sir; most but not all.

Senator SARBANES. But as you say, two-thirds above $2.5 billion. But presumably, at the higher sizes, you have a larger percentage, is that correct, of the banks?

Mr. BARTLETT. Yes, sir, yes, sir; it is a voluntary association, so people choose to join.

Senator SARBANES. Let me put it this way: The 10 largest institutions, are they all members of the Roundtable?

Mr. BARTLETT. I think, as I recall, 7 or 8 are. I think a couple of them are not.

Senator SARBANES. Mr. Chairman, could I ask just one more question?

Chairman SHELBY. Go ahead.

Senator SARBANES. I wanted to ask about this insurance to get some sense of it. On this optional Federal charter would regulate the insurance companies that chose an optional Federal charter?

Mr. BARTLETT. The Congress would choose a regulator. There are various varieties. We prefer what is known as the OCC model or an independent regulatory agency like the OCC.

Senator SARBANES. A Federal regulator.

Mr. BARTLETT. A Federal regulator.

Senator SARBANES. And how would that regulator get its budget?

Mr. BARTLETT. From the industry, I presume, similar to the OCC. We think that there is a good model of the dual banking system that should be replicated in the insurance system.

Senator SARBANES. And if you chose an optional Federal charter, by making that choice, you could remove yourself from State insurance regulation, would that be correct? And then be subject only to whatever Federal insurance regulations?

Mr. BARTLETT. That is correct, yes, sir.

Senator SARBANES. And the institution would have the choice to pick that; is that correct?

Mr. BARTLETT. Comparable to the dual banking system.

Senator SARBANES. Mr. Tubertini and Mr. Plunkett, what is your view of that proposed arrangement?

Mr. TUBERTINI. Mr. Sarbanes, we are opposed to any type of Federal regulation of insurance. Regulation of insurance, by its nature, protects the consumer. And consumer protection becomes much more difficult at a Federal level than it does at a local level, a State level. The State regulation of insurance has worked for 150 years.

There are certainly needs for reforms. GLBA provided a number of those reforms. We believe that instead of a Federal regulator of insurance that the Congress can take additional action, following in the footsteps of the NARAB provisions of GLBA, to further reform State insurance regulation, provide for the consumers in a way that no Federal regulation can do.

Senator SARBANES. Mr. Plunkett.

Mr. PLUNKETT. Senator, we are strongly opposed to the optional Federal charter proposal for one significant reason: If you give the regulated a choice of regulator, you are going to end up with State and Federal officials competing to lower standards, and that will absolutely harm consumers.

We look at the dual banking system, and we see a cautionary tale on this point. To some extent, we have seen competition between State and Federal regulators to lower standards to govern more of the regulated, and that dynamic in insurance could be a disaster.

Senator SARBANES. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Crapo.

STATEMENT OF SENATOR MICHAEL CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman.

I want to use the time that I have for questions to address the issue of the different treatment of thrifts and banks under the Investment Advisors Act and the Securities and Exchange Act, and I suppose that my questions would be most directed to those that Senator Sarbanes just discussed about your membership, the banking groups here, but I would be glad to hear from any members of the panel.

As you know, the Investment Advisors Act and the Securities and Exchange Act of 1934 together created different treatment for thrifts as opposed to banks with regard to the statutory investment advisor and broker-dealer registration requirements. And there is a proposal to legislatively eliminate that difference.

In response to that proposal, the SEC has now put out a proposed rule that is under discussion and which supposedly would eliminate the need for legislative action. And I would just like to know, frankly, what the opinion of those here on the panel is with regard to whether we need to move legislatively or whether the SEC proposal is adequate.

Mr. McLaughlin.

Mr. MCLAUGHLIN. Senator, I would be glad to respond. In fact, we have, if we have not filed it yet, we are filing today a letter addressing that very SEC proposal. We think it does not go nearly far enough. We think that there should be full competitive equity and parity between savings associations and commercial banks with respect to both the broker-dealer rules and the investment advisor rules. We have testified to that effect on the House side in the reg burden release bill, there are provisions there, and we understand that they are over here in the Senate now.

Senator CRAPO. And the SEC proposal does not——

Mr. MCLAUGHLIN. The SEC proposal provides some relief, but it goes probably halfway if that.

Senator CRAPO. All right; thank you.

Mr. Doherty or Ms. Jorde.

Mr. DOHERTY. I would agree with the analogy that it goes less than halfway. My comment would be it is half a loaf. It has to go further.

Senator CRAPO. All right.

Ms. JORDE. And I think the ICBA also agrees that there should be competitive equity between the banks and thrifts and that the SEC proposal that came out also needs to be looked at in terms of making it less complex, if possible.

Senator CRAPO. Thank you.

Mr. Bartlett, did you want to comment on this?

Mr. BARTLETT. I think that the SEC proposal is a good start, but it does not go far enough, and it is similar to the other comments.

Senator CRAPO. Thank you.

Any other members of the panel want to weigh in on this issue?

Let me just ask if there is any disagreement on the panel with the apparently unanimous position of those who have spoken up about the fact that this issue needs to be addressed legislatively.

All right; thank you.

I would like to also go to the question that Senator Sarbanes also just talked about with regard to whether the Gramm-Leach-Bliley provisions for the insurance marketplace under the NARAB subtitle were adequate. Mr. Tubertini, you indicated that you felt significant progress has been made. We still have not got all the States into a uniform system, but could you elaborate a little bit about your position that we do not need to go further with a uniform national standard at this point?

Mr. TUBERTINI. Senator, we believe that only Congress has the ability to set standards that the States will then follow. We have to admit, certainly, that the National Association of Insurance Commissioners has been trying to create for many years a set of standards for total reciprocity or uniformity in licensing and have not been able to do it. And when you are dealing with 50 different legislatures, I do not know if you would ever be able to do it.

However, if the next step is taken in creating a set of standards that then every State would adopt, continue to be regulated by the commissioners in each local jurisdiction, then, we would be able to achieve the objectives that we are trying to achieve and, frankly, be able to achieve most of the objectives that are outlined in some of the optional Federal chartering proposals.

Senator CRAPO. You are not opposed to a national standard as much as the optional Federal charter.

Mr. TUBERTINI. That is correct. We believe that creating a new Federal regulatory system would be the equivalent of throwing the baby out with the bath water. We just need to make the necessary changes to reach the objectives that we all desire.

Senator CRAPO. And Mr. Bartlett, you have a different position on that.

Mr. BARTLETT. Mr. Chairman, I have to tell you that among my 100 companies, of those that are involved in the insurance marketplace, which is most, they believe that the current system is an absolutely chaotic disaster that is a disaster for their customers, and they see the higher costs, the higher confusion, and the inability of their customers to buy products as they will in a number of areas.

First, insurance is a financial product. It is a financial product that is similar to other kinds of financial products. Sometimes, the difference between an insurance and something that is not an insurance product is almost identical: Annuities and mutual funds, for example. And yet, an annuity product has to be rolled out and approved in 50 different States with 50 different commissioners, 50 different sets of rules, sometimes as long as 2, 3, or 4 years to get approval, whereas a mutual fund is essentially at the national level.

Second, many of the companies offer the products on an interstate basis. They can better serve their customers interstate, as many do now, but they have to do it one State at a time. And many of the customers are buying insurance products on an interstate basis, both commercial and consumers, and are denied the right to do so.

And then last is on a global competitive basis, Mr. Chairman. We hear from our Europeans colleagues particularly that this is the number one trade barrier that the United States puts up that denies their entry into the marketplace. So we think it is a disaster, and it can be solved by a similar system to the dual banking system that would be an optional Federal charter or a dual insurance charter system.

Senator CRAPO. Mr. Chairman, I see that I have stirred a little thing up here. There are several more who want to respond. May I have time to let them do so?

Chairman SHELBY. Okay; yes, sir.

Senator CRAPO. Mr. McLaughlin.

Mr. MCLAUGHLIN. Senator, I will be brief. I just want to point out that there is a huge market. The State of California is not a part of the NARAB process, and that is a market that just is not available; NARAB is not working. That is one example, because that consists of a huge potential market for the companies that want to market insurance products interstate.

Senator CRAPO. Mr. Plunkett.

Mr. PLUNKETT. Senator, you have already heard our opinion on the national charter approach. Let me turn your attention to something else regarding national uniformity: consumer groups are not opposed to uniform standards at the State level, with Congress pushing the States to try to come up with more uniformity. If inefficiencies exist, consumers pay for that.

What we are concerned about and oppose are weak uniform standards, and let me just flag something for the entire Committee. Over on the House side, we have seen a proposal circulating for so-called "Federal tools," that takes the "pragmatic middle ground approach" of actually preempting all States, and there are a number of them, that regulate insurance rates.

Now, that is not an appropriate role for the Federal Government to be playing. Some of you would oppose rate regulation; some of you would support it. Let us put that aside and say that after over 100 years of State insurance regulation, Congress should not be preempting, blocking individual States from the approach they have chosen on regulating insurance rates.

Senator CRAPO. Mr. Taylor.

Mr. TAYLOR. Senator Crapo, thank you.

A related issue but something that was very much discussed in the original passage of GLBA was trying to get a handle on the picture of where exactly these insurance companies are making their policies and products available. You have heard the assertion from Mr. Bartlett and others that it is very fluid; that it happens across State lines and so on. And we have always had the concern through our experience that these policies, whether it is various forms of insurance; whether it is for commercial or personal that it disproportionately is not offered in the same fair and equitable manner to working class Americans as well as people of color.

And so, we asked that GLBA include a provision that at least allows us to get a handle on the picture, what is happening out there, because it does affect the ability of people to own homes, people to start or expand businesses. Unfortunately, we were unsuccessful on that. Perhaps you would reconsider it this time. There are some States, the Great State of Massachusetts; I have a bias, obviously, if you cannot tell from my accent, that they have this coverage. The insurance companies have to report; they have learned to live with it, and it has been very helpful. They also, by the way, have CRA coverage for credit unions, another good thing happening in that State.

And it would be great if this Committee would really consider, even if it was only temporarily, trying to get a handle on what is the impact and the application of these policies and whether or not it is occurring cross the board in a fair and equitable marketing manner.

Senator CRAPO. Thank you, and I thank the Chairman for indulging me on that.

Chairman SHELBY. Thank you, Senator Crapo.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman.

Following a little Senator Crapo's methodology, trying to determine where there is some degree of unanimity here, I have heard two things asked for, and I did not hear any objections, and so, now, we will give people some of the opportunity to object if, in fact, they do.

First, there should be a national standard on privacy. Several said that there should be. I did not hear anybody say that there should not be. Could we get a response to that? Does everybody agree that there should be a national standard on privacy?

Mr. JUDGE. Absolutely.

Mr. DOHERTY. Absolutely.

Mr. PLUNKETT. Senator, we have a different take.

Senator BENNETT. Somehow, I expected you might.

[Laughter.]

Mr. PLUNKETT. It is similar to our rather pragmatic approach on insurance. I mean, there are advantages and disadvantages to national regulation versus State regulation of insurance. Same on privacy. What we are concerned about is a weak national privacy standard, and that is what we have now. And the fact is that Section 507 of the Gramm-Leach-Bliley Act permits the States to fill in the gaps in the national privacy standard.

In response, what we are seeing are some proposals to eliminate that; let us eliminate the ability of the States to fill in the gaps, to improve what is a very weak national standard and then let the existing standard or something similar that is fairly weak stand. And that is the approach that we would oppose.

Senator BENNETT. Thank you.

Next, I heard several people say the sunset should disappear. Some are nodding yes. Now, once again, is there anybody who thinks that that is not good policy?

If we were to eliminate the sunset, that would be relatively noncontroversial, and if I listen to you, a beneficial thing that would happen.

Mr. JUDGE. We would support that, yes.

Senator BENNETT. Okay; we are getting some degree of unanimity here.

Mr. Plunkett, you talked about the few consumers who have opted out, and you blamed the complexity of opting out for that fact and said if it were much easier to opt out, a whole lot more would. Do you have any evidence or empirical studies that indicate that the reason people are not opting out is because the Government created barriers? Or maybe the reason that they are not opting out is that they do not want out?

Mr. PLUNKETT. We have a readability study done by the Privacy Rights Clearing Center that determined that the reading level in the privacy notices was close to graduate level as opposed to what is normally determined to be the appropriate reading level for these kinds of things which is at about age 12.

Senator BENNETT. You are singing Ms. Jorde's song a little bit, in that she is complaining that the reading level for some of the things that she has to tell her customers is absolutely impenetrable. And of course, that goes with Federal service. I think that kind of is part of the entrance exam when you become a bureaucrat is that you have to be able to speak unintelligibly.

I get in trouble with that, but I made the point in here that one of the best ways to hide something is to completely surround it with impenetrable verbiage, and then, no one understands what you are talking about. So, I will grant you that, but that is not my question. Do you have any studies or empirical evidence that would suggest that if the ability to go through the process were much clearer that a much higher percentage of consumers would, in fact, opt out?

Mr. PLUNKETT. We do not have a study, Senator. What we do have is a great deal of anecdotal evidence from talking to consumers, from talking to bankers, frankly, many of whom are quite critical of the privacy notices, from talking to others who all are consistent in saying two things: First, if you go the opt out approach versus the opt in approach, by definition, you will have fewer people choosing to protect their privacy, including some, we can agree on some, who would like to. Maybe it is not at the top of their priority list, but they would like to.

You compound that problem with very difficult to read privacy notices, and you have even fewer. The estimates I have heard overall of people opting out are 5 to 10 percent. That is extremely low, and we know from surveys of the American public on privacy issues that it is a popular issue. We would assume that many more people would opt out or choose privacy if there were an opt in approach, if the notices were easier to read, and if they had the opt in approach available to them.

Senator BENNETT. We have had the opt out/opt in debate in this Committee for a number of years, and I imagine we will have for a number more.

Ms. Jorde, you want to comment.

Ms. JORDE. I was just going to mention, though, that I think it would be interesting to look at the evidence as to how many banks or financial institutions are actually sharing any financial information. I think if we were able to eliminate the disclosure requirements for banks that are not sharing, those that are would be read, and now, we all know that we are getting privacy notices annually from our banks or insurance companies or insurance agencies, and it is just a statement stuffer, and it gets thrown out. It is very long, and the customer does not read it.

If the financial institution is not sharing information, then, we do not believe that they should need to send that privacy notice. If the customer knows that if they get a notice, that there is something to look at, we think it would be far more effective and efficient.

Senator BENNETT. Well, it is said, the old adage is that the best place to hide a leaf is on the floor of the forest in plain sight, surrounded by all the other leaves. And that is the phenomenon that you are seeing here.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. What was that? The best place to hide a leaf? On the floor of the forest?

Senator BENNETT. The best place to hide a leaf is on the floor of the forest, surrounded by all the other leaves.

Senator CARPER. That is great. I pick up some new material here. I always like to say if a tree falls in the forest, and there is no one there to hear it, is there really——

Senator BENNETT. I am not going there.

[Laughter.]

Senator CARPER. Now, I can switch off. I can use yours, and I will use mine some of the time.

Some familiar faces out here, Mr. Chairman. In fact, I think one fellow maybe you and I once served with on the House Banking Committee a fellow from down around Texas. It is nice to see Steve Bartlett, who had the best staff, I think, of any Committee in that House, and one of the great staff people there was Steve Judge. Steve, it is nice of you to be here today.

I want to go back and just pick up on a point that—is it Jorde? Ms. Jorde?

Ms. JORDE. Jorde.

Senator CARPER. Jorde? Ms. Jorde was making and try to tie it in with what Mr. Plunkett was saying. Go back and make your point for us again about who should be required to send out the notices. Just go back and make that. I think that is a point worth revisiting. I do not want this to be a leaf in the forest that nobody notices.

Ms. JORDE. We believe that financial institutions that are not sharing financial information on their customers, have never and do not intend to, should not have to send a notice to their customer that they do not share their financial information. I have been a banker for 25 years; we have never shared financial information. Suddenly my customers are getting notices annually that we do not share customer information. And they are confused by it, because suddenly, they think we are sharing information, or maybe we did.

So if you take some of those leaves out of the forest, the ones that are left are really going to be focused upon by those customers. They may be able to make better-informed decisions because of something that they have not just been getting a blizzard full of paperwork throughout the year.

Mr. PLUNKETT. Senator, could I offer some thoughts on that?

Senator CARPER. Well, I was going to ask you to, if you would, so go right ahead, please.

Mr. PLUNKETT. I have no doubt that the vast majority of Ms. Jorde's members are honest, and if they say they are not sharing information, they are not sharing information. Let me point out the obvious, though, that of course, the consumer groups are most concerned about people who are sharing information and that their consumers know about that and have an opportunity to prohibit that, stop it.

But, of course, the obvious issue is enforcement. And it strikes me as an enforcement nightmare. The FTC and State enforcement authorities have dealt with a number of cases where companies have said that they are not sharing information, and then, they do. So it strikes me as a very difficult thing to assure, given that we have some track record of some companies promising no sharing and then doing it.

Senator CARPER. Let me just ask the panel: Would there be some way of, if a company was asserting that they are not sharing information, a financial services company, and then, they turned around and did that, would there be some way to pick that up in a regulatory check?

Mr. MCLAUGHLIN. Obviously, nobody on this panel has—with the exception of the two bankers down at the end—have ever under-gone a bank regulatory agency compliance exam, where they check for everything and anything. I think the bankers on our panel would attest to that. The examiners would pick it up, believe me, and they would then take enforcement action. Bank compliance exams are incredibly thorough, and incredibly detailed.

Ms. JORDE. My bank is scheduled for an FDIC compliance exam at the end of August, and just the preexamination process—and again, I am a $37 million bank in North Dakota—the preexamination process consists of 17 typewritten pages of information that is requested that we send to the examiners in advance of them coming in to do the bank examination. So it is a highly regulated process, and the disclosure requirements that we have continued to have burdened upon us in the last few years are just overwhelming, and I believe it is truly driving consolidation of the community banking industry.

Senator CARPER. How many pages?

Ms. JORDE. Seventeen.

Senator CARPER. Typed?

Ms. JORDE. Yes, typed.

Senator CARPER. Small type?

[Laughter.]

Senator CARPER. Ten point?

Ms. JORDE. About six point.

[Laughter.]

Senator CARPER. That is pretty small. Pretty small.

Go ahead.

Mr. DOHERTY. I would agree with those comments. I think that with what has been happening in this area with the compliance, I think that the regulators would find, if someone made the statement that they were not sharing, that they would find it if you were sharing.

And I agree with my colleague down there about the examinations. They are very thorough. I have gone through them for 38 years, so I know what they are like. They were not all compliance all the time, but they are getting more and more difficult as each day goes by.

Senator CARPER. Okay; anybody else here who has not had a chance to say anything?

Mr. Bartlett.

Mr. BARTLETT. Senator, I would just suggest that Ms. Jorde's solution is a good step, but a better step is to solve the underlying problem, and that would be to require that the institution tell their customers what their policies are in this information sharing when a new account is opened; to provide it in a short form that is authorized by the regulators and to give a safe harbor so that companies can depend upon that form as being reliable.

That solves the problem across the board as opposed to trying to pick and choose as to who provides notices and who does not.

Senator CARPER. I think Mr. Taylor had his hand up and then Mr. McLaughlin.

Mr. TAYLOR. Senator Carper——

Senator CARPER. Mr. Taylor, where are you from?

Mr. TAYLOR. Boston, Massachusetts.

Senator CARPER. Would you say my name one more time?

Mr. TAYLOR. Carper.

Senator CARPER. Thank you.

[Laughter.]

It rhymes with pucker. I have been called a lot worse.

[Laughter.]

Mr. TAYLOR. I think I did sit with a panel of lenders very recently on the House side, and they talked a lot about the regulatory burden, and one after one mentioned the increased burden associated with the USA PATRIOT Act and the Bank Secrecy Act, and I have also made a recommendation to Mr. Bennett as well as the rest of the panel which I also heard unanimity of support that the sunshine regulation, not the sunset but the sunshine regulation that requires these banks to issue all these reports—and I am sure Ms. Jorde has relationships with community groups in her community that she works with, small, but maybe there are not a lot of community organizations.

But for most banks and lenders, they have to issue these reports that end up in some vault somewhere gathering dust and piling up and are of no apparent benefit to anybody. And so, I have made a recommendation to you to help my brothers and sisters in the banking industry reduce their regulatory burden. One is to eliminate this sunshine reporting requirement but also look at just how effective and how useful the Bank Secrecy and the Bank Privacy Acts have been.

Senator CARPER. All right; thank you.

Mr. MCLAUGHLIN. I just wanted to add to Mr. Bartlett's comment. It seems to me that it would be sensible and also environmentally sensitive to not require continued mailings, especially the privacy notices, especially when there has been no change in policy from year to year or the bank does not share information. That is just plain overkill.

Senator CARPER. All right.

Mr. Judge, last word.

Mr. JUDGE. We think it would make a lot of sense to make those privacy notices understandable, readable; it would save money, reduce confusion, and it is something that should be done.

Senator CARPER. It is a good benediction. Thank you.

Chairman SHELBY. Senator Sununu.

STATEMENT OF SENATOR JOHN E. SUNUNU

Senator SUNUNU. Thank you, Mr. Chairman.

I would like to go back to some of the questions and responses that were offered by Senator Crapo, and if I transcribed your responses correctly, Mr. Tubertini, you said that your association was against any Federal regulation of insurance but for enacting national standards.

Mr. Plunkett, you said you are not against tough standards, but you are against an optional charter that would establish a Federal regulator to establish national standards.

And Mr. Bartlett, you said that you are for a Federal charter that would address a lot of the inefficiencies in the insurance system that you talked about in your testimony and your responses.

My question for the panel is: Do any of you believe that these problems or concerns with the current affairs of insurance regulation could be dealt with without some Federal action or legislation? Who would like to begin?

Mr. BARTLETT. Absolutely not.

Senator SUNUNU. No?

Mr. BARTLETT. Could not be done.

Mr. MCLAUGHLIN. If any of us can picture the day when 50 different State regulators will be able to persuade 50 different State legislatures to grant the authority and then reach an agreement as to what that authority is, maybe. I do not believe that that is going to happen in my lifetime.

Mr. PLUNKETT. I will just add that if you define the problem as merely a lack of uniformity, then, the answer would probably be no. You could not do that without the Federal Government pushing the States a little.

We define the problem differently. We see a number of States that have gotten very weak in providing consumer protections to insurance consumers. So we feel like part of the discussion here has to be the quality of protection that is offered, not just the uniformity.

Senator SUNUNU. And to that point, I think there was some discussion of international competition and other issues that I think moved beyond the issue of just uniformity, but your point about quality is very well-taken.

Anyone else? Mr. Doherty.

Mr. DOHERTY. In one of my other lives, in one of the other hats that I wear, I am a board member of an insurance company, and we are a New York State-chartered insurance company, and we want to go nationwide. And we have gone through the process for the last 3 years of getting the approvals from all 48—the lower States, 48 States, and it took us 4 years to get 40 States, and we are still working on the other 8.

So it does take a very long time to get it done. And then, when you add a language component into it to have a Spanish component, that makes it even more difficult.

Mr. TUBERTINI. Senator, to put a positive spin on it, I think that the enactment of Federal regulation that sets a set of standards, Federal tools, if you will, will accomplish the objectives that we talked about here today.

Senator SUNUNU. With regard to that proposal that you and the independent agents have advocated, when you talk about national standards, you are suggesting standards that would preempt States in those areas, correct?

Mr. BARTLETT. That is correct.

Senator SUNUNU. Now, it would seem to me that an argument could be made that an optional charter system is more in keeping with the idea of choice and not completely preempting States, because it would leave a State regulatory system intact. Why do you see that as an inferior alternative to completely preempting States in a number of areas?

Mr. TUBERTINI. Because, Senator, I would have to disagree that it would not leave the State regulatory system intact. You would have a confusing set of standards for most consumers, and in different areas of the insurance industry, what is called, what has been referred to as an optional Federal charter is not optional.

From my position, for example, as an independent agent, the optional Federal charter proposals are not optional at all for me.

I would have to be licensed to do business on a Federal level with those who choose to be federally licensed, I would have to be licensed on a State level with those who choose to be State-regulated and add an entire level of bureaucracy and licensing problems to my part of the industry.

Senator SUNUNU. Well, let us talk more about that. One area where there was an attempt to establish uniform standards is in the area of licensing with the NARAB provisions of Gramm-Leach-Bliley. Have they been successful? Has that approach been successful? And I would certainly like to hear from Mr. McLaughlin on this as well.

Mr. TUBERTINI. Are you asking me next?

Senator SUNUNU. Yes.

Mr. TUBERTINI. Yes, it has been successful in that a limit was set in the number of States, the majority of States, which I believe was interpreted at 29.

Senator SUNUNU. How many States are yet to adopt the licensing provisions of Gramm-Leach-Bliley?

Mr. TUBERTINI. The last I was told, Senator, that there were, I think, 47 States that had adopted regulatory reform, and 40 of those States have been certified by the NAIC as compliant with the NARAB provisions.

Senator SUNUNU. Mr. McLaughlin.

Mr. MCLAUGHLIN. I think that number is closer to 40, and obviously, that is after 5 years, not the 3-year goal set in Gramm-Leach-Bliley. And there is a huge State, California, which is not part of it. And if you are an insurance company that wants to market a product, that is a big market to be out of.

Senator SUNUNU. Mr. Bartlett, we have not seen a great number of financial service holding companies form since Gramm-Leach-Bliley was enacted. What are the key reasons for the slow pace of creating a truly integrated marketplace?

Mr. BARTLETT. The key reason in my opinion, the principal reason, has been the financial activities that were sunsetted, so that a company that is not a bank holding company has a set of activities that they can participate in, but if they become a financial holding company, then, those activities are sunsetted, and they cannot continue them after 5 years.

So they give up a whole set of activities, and it is just a glaring reason why a company would not choose to do that. I think that has been the principal reason. There have been others, mostly marketplace-driven; just companies make their choices as to what kind of charter that they want, but I think that is the principal reason.

Senator SUNUNU. Yes, Ms. Jorde.

Ms. JORDE. I would just say that from the standpoint of the community banks, they were really able to do a lot of the activities that were authorized under Gramm-Leach-Bliley. We have been selling insurance in our bank since 1974. We have been selling investments through a third-party brokerage since 1987. So we were already able to do that.

What we got out of Gramm-Leach-Bliley, though, was tremendous disclosure regulations that had not been there in the past.

And so now, as I alluded in my testimony, for example, with insurance, if a customer calls us on the phone, and they have a question about auto insurance, the first thing we have to do is say, well, I am obligated to inform you that this is not a deposit product. It is not insured by the FDIC. It may go down in value.

And then, we have to mail the disclosure to them, ask them to sign it and send it back to us so we hold it in their file, and they may not even buy the insurance from us. So the protections that were put in place to, you know, prevent some self-dealing and cross-dealing really have just resulted in an exorbitant amount of disclosure requirements from banks that have very successfully and safely been providing these products all along.

Mr. PLUNKETT. Senator, I understand that this is a burden, but the question is whether it is a necessary burden, this kind of disclosure. If you recall, leading up to Gramm-Leach-Bliley, we had a situation, for example, with NationsBank and NationsSecurities. And NationsSecurities was peddling a very, very risky derivative product to NationsBank customers. And the majority of them had bought very, as you know, conservative certificates of deposit.

So these were not at all the kind of consumers that should have been approached on a derivative product. Some of them bought them; some of them lost portions of their life savings. Those were the kinds of problems that led to these types of disclosures, and the question is whether they are necessary, and we think telling somebody that it is not a depository product is a necessary disclosure.

Senator SUNUNU. Ms. Jorde, do you want to respond to that specific example?

Ms. JORDE. I think we have to give our customers more credit. They understand that car insurance is not a deposit. I mean, they are smarter than that, you know. And so, when we tell them that it may go down in value, they do not understand that, and we have to say, well, you know, they messed up a little bit in the legislation, and they did not really define what insurance is.

True, if it was an annuity product, that might be an adequate disclosure. Our insurance agency does not even sell annuities. We only sell property and casualty and life insurance and that thing. And we have 1,500 insurance customers. So we just have created this blizzard of paperwork and killed a lot of trees in the process.

Senator SUNUNU. And a lot of leaves.

Ms. JORDE. In the forest.

Senator SUNUNU. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. I am tempted to ask the panel the question whether you believe in the Federal system of Government.

[Laughter.]

I mean, is there indeed a role for the States? And I have to be very candid with you: My perception is that those who are pushing for the States not to have a role are assuming that the Federal substantive standard will be weak and therefore accommodate their interests.

And of course, that may or may not be the case at a particular time, but I dare say I have the suspicion that if it were perceived that here in the Congress, if we went to a uniform Federal standard, it would be a very high and rigorous standard, that some at the table who now seem to favor that would say "now, wait a second: We have a Federal system of Government in this country, and there is a role for the States to play." And I just throw that out.

And I want to follow up on Senator Bennett's question: When you all accede to removing the sunset, what was it you understood you were acceding to? Or let me put the question this way: How many at the table do not believe there should be a separation between banking and commerce and that financial institutions should be free, in effect, to engage in commerce and commercial institutions to engage in banking?

And we have had a line, generally speaking. We have tried to hold that line. I am sure the Federal Reserve would disagree with this, because they have been quite strong on this point, that we should maintain the separation between banking and commerce. And we have this small exception, this grandfathering, which there is an constantly effort to erode it.

But how many at the table think we ought discard the old separation between banking and commerce? Mr. Bartlett.

Mr. BARTLETT. Senator, I believe that the marketplace should be regulated for safety and soundness and for consumer protection, but product allocation should be set by the marketplace, not by either State or Federal Governments.

Senator SARBANES. So you have no problem if a major commercial outfit, Wal-Mart, to take an example, establishes a Wal-Mart Bank; is that right?

Mr. BARTLETT. Mr. Chairman, virtually every supermarket in America has a bank within the supermarket.

Senator SARBANES. Yes, but it is not their bank.

What about you, Mr. Doherty? What do you think about that?

Mr. DOHERTY. I think that the savings and loan and the savings bank industry has had a long history with commercial owners. It has worked. The OTS has been working with us over a long period of time, and we have not had any safety and soundness issues on this issue.

Back in the 1980's and 1990's, when the industry needed equity, they needed funding, the commercial firms came in and helped. So, I think it is a positive.

Senator SARBANES. Ms. Jorde.

Ms. JORDE. I guess I do not agree at all. I think that there was a reason that the unitary thrift loophole was closed in Gramm-Leach-Bliley. There was a reason that the nonbank bank loophole was closed back in 1987. And I think that it makes a lot of sense to close the loophole right now on ILC's. And the world has changed.

Senator SARBANES. The ILC's? I understand that Merrill Lynch has an ILC with $60 billion in assets in it, right?

Ms. JORDE. Yes, that is pretty big.

Senator SARBANES. And they sweep it in, and they get Federal deposit insurance coverage, if I am not mistaken; is that correct?

Ms. JORDE. That is correct.

Senator SARBANES. I also understand that since the insurance fund does not need to be replenished, since it was built up by previous premium payments by other financial institutions that they do not pay anything into the deposit insurance fund, even though they are sweeping in tens and tens of billions of dollars; is that correct?

Ms. JORDE. That is exactly correct.

Senator SARBANES. That does not sound very fair to me to the other financial institutions. It seems to me something of a free rider situation.

Ms. JORDE. That is a very good term.

Senator SARBANES. All right.

Mr. PLUNKETT. Senator, on your commerce and——

Senator SARBANES. I will come across. I am coming across, yes.

[Laughter.]

No problem. Just bide your time.

[Laughter.]

Mr. Plunkett.

Ms. JORDE. Can I just follow up just to——

Senator SARBANES. I am sorry.

Ms. JORDE. —just to finish?

You know, Wal-Mart, and I hate to pick on poor Wal-Mart, but, you know——

[Laughter.]

Ms. JORDE. —they are kind of infamous for controlling the supplier. And when Wal-Mart has a bank, or if they had a bank, I think that it would be pretty reasonable to assume that they would control the bank. And when you have a commercial firm like Wal-Mart, the largest retailer company in the world, controlling a financial institution, you deal with a lot of issues regarding impartial allocation of credit. If the local hardware store wants to go to the Wal-Mart bank to borrow money, why would Wal-Mart lend them a loan to expand their business when they would just as soon that their customers went into the department 27 to purchase hardware?

So the world has changed, and I think now, more than ever, it makes sense to look at ILC's and how they have evolved and how they have grown to the $60 billion institutions and how they have exploited the deposit insurance fund. And again, I really urge you to look at passing deposit insurance reform which will begin to address the free rider issues.

Senator SARBANES. Mr. Plunkett.

Mr. PLUNKETT. Senator, we strongly support maintaining policies separating commerce and banking. Let me just give you five names to help you figure out why: Sunbeam, Enron, WorldCom, Tyco, and Adelphia.

Chairman SHELBY. Say it slowly. We know who they are, but I want people to hear this.

Mr. PLUNKETT. Sunbeam, Enron, WorldCom, Tyco, and Adelphia. If those companies had owned banks, not only would employees, investors, and the economy have suffered but taxpayers as well. On the ILC situation, not only have we had an exponential growth of ILC's, and we are starting to see them become a shadow banking system; but we also have the handful of States that are chartering these ILC's going out and saying hey, we do not regulate you all in the way that the Federal Reserve does under the Federal Bank Holding Company Act. We do not do it as well, essentially. Come to us.

That is a very tricky situation, and I think it is incumbent on Congress to shut that loophole tight just as they did on the unitary thrift loophole.

Senator SARBANES. Mr. Tubertini.

Mr. TUBERTINI. Well, Senator, since I am here representing the independent agents and brokers——

Senator SARBANES. You are going to take a pass, right?

Mr. TUBERTINI. Well, as they would say in my area of the country and Senator Shelby's, we do not have a dog in that hunt, so we will pass.

Chairman SHELBY. Not today.

Mr. TUBERTINI. Not today.

Senator SARBANES. Mr. Bartlett.

Mr. BARTLETT. We have a bunch of dogs in that hunt. It is a free-fire zone, so I am not sure where to start.

First of all, we believe that the customers should make the decisions, and that is whether it is Wal-Mart or Merrill Lynch or others, the customers are the ones that ask for the products and the services. The hardware store has a gazillion outlets for their commercial loans of all kinds of financial institutions, and that hardware store should make the decision on where they want to get their loans.

As far as Merrill Lynch, Merrill Lynch is regulated for safety and soundness. Their Merrill Lynch ILC is regulated for safety and soundness by the FDIC, as it should be, and Merrill Lynch would pay whatever deposit insurance premiums were required of them by the FDIC. And as far as safety and soundness, safety and soundness has been long-proven.

Senator SARBANES. The FDIC does not exercise holding company supervision the way the Federal Reserve does, and that is quite a difference. So, I do not think we should just gloss over that.

Mr. PLUNKETT. Or look at capital standards for holding companies.

Senator SARBANES. Yes.

Mr. McLaughlin.

Mr. MCLAUGHLIN. Senator, the American Bankers Association continues to support the separation of commerce and banking, but what we are seeing is that the line between banking and finance is becoming blurred, witness the Gramm-Leach-Bliley Act itself. And as that happens, it becomes a little bit more difficult to figure out exactly where that line should be, but there are some obvious commerce activities that we believe should be kept separate from banking.

Senator SARBANES. Mr. Taylor.

Mr. TAYLOR. NCRC continues to support a strong firewall between commerce and banking.

Senator SARBANES. Mr. Judge.

Mr. JUDGE. We would support removal of the cap, and we do support the notion of increased synergy between banking and commerce. We think that the ILC's have proven to be a valuable tool for consumers as well as for companies. They have regulation from the FDIC, the States, and the State banking commissioner, and we think that they provide an important opportunity for investors and for companies.

Senator SARBANES. So when you say you want to remove the sunset, it would not be just to permit the continuation of the 15 percent commercial basket; it would be to eliminate that limitation altogether; is that correct?

Mr. JUDGE. We would first support removal of the sunset, but we would like to see removal of the entire—make it open for all and remove the 15 percent as well.

Senator SARBANES. Yes, but when you say remove the sunset, you encompass within it the removal of the 15 percent limitation?

Mr. JUDGE. That is the second step, yes.

Senator SARBANES. Okay; thank you, Mr. Chairman.

Chairman SHELBY. Mr. Bartlett, would you tell us what companies would have to do in order to comply with the divestiture requirements in practical terms?

Mr. BARTLETT. The divestiture requirement, as a practical matter, means that a company would have to stop providing products or services to their customers the customers are trying to buy once the sunset comes into place. So if a company, for example, owns a financial adviser and also a travel agency, they would have to divest of one or the other.

And yet, their customers may well want to engage in both. There are all kinds of other examples, but they would have to stop selling products to their customers that their customers want to buy.

Senator SARBANES. Do you encompass, as Mr. Judge does, in the elimination of the sunset the elimination of the 15 percent limitation?

Mr. BARTLETT. It is a two-step process. The elimination of the sunset is what is urgent to make the system work. On a theoretical basis, a long-term basis, I think eliminating the 15 percent is also called for. They are two different decisions.

Chairman SHELBY. Mr. Bartlett, you represent mostly the 100 largest financial institutions. And what you are saying is that you are for the blending of commerce and banking? In other words, if Wal-Mart wanted to start them a bank, and you can imagine how large they would be in just a little while or Target or any of these companies, Sears Roebuck, that is okay?

Mr. BARTLETT. We think that the ownership, the ownership of a financial services company is not the financial services company. The regulation for safety and soundness should be at the level of financial services, not with the ownership. And so, if a company, a Wal-Mart or a supermarket, owns another company that is financial services, the financial services should be regulated.

Chairman SHELBY. So if Wal-Mart was in the business, Kroger would be in the banking business, all of them would be in the banking business.

Mr. BARTLETT. Yes, sir, and those products are being offered today in Krogers and supermarkets all over the country because the customers want them, and they can be regulated for safety and soundness.

Chairman SHELBY. Well, that would change banking as we know it big time in this country, though, would it not, Ms. Jorde?

Ms. JORDE. It certainly would. I mean, we have an ATM in the local convenience store in Cando, North Dakota also, but the convenience store does not own the bank. And there is a difference between providing financial products in a commercial entity and actually owning it. And I think if you look to the experience of Japan, where there has been cross-ownership of banking companies and commercial firms, the experience has not been good.

Chairman SHELBY. Right.

Mr. PLUNKETT. Senator, could I point out that——

Chairman SHELBY. Go ahead, Mr. Plunkett.

Mr. PLUNKETT. Thank you.

I would like to point out here that the concern is not just commerce and banking but the ILC loophole being used by financial companies like those that own ILC's now, Merrill Lynch, for example, American Express, for example, as a way around the bank holding company regulatory structure, because they do not face the kind of bank holding company regulation through ownership of an ILC that they would if they exercised their right under Gramm-Leach-Bliley to buy a bank. That is the issue as well.

And then, you get deposits drawn to this new system because they do not have to go through the regulatory structure under the Bank Holding Company Act, and then, it becomes a very large shadow system.

Mr. JUDGE. Mr. Chairman, if I could: We cannot leave the impression that this is an unregulated financial institution. The ILC's existed prior to Gramm-Leach-Bliley. Gramm-Leach-Bliley allowed them to continue. They are regulated by the State banking commissioner. They are looked at in terms of the relationship with the other company by the FDIC. And they are subject to, if they are part of a thrift charter, or if they are part of a securities firm, they are subject to either OTS or CSE regulation.

It is not an unregulated entity. They pay deposit insurance at the same rate that everybody else does for the marginal increase in the deposits.

Chairman SHELBY. That is why we hold these hearings. We are dealing with very complex issues with great ramifications to our economy, to everybody in America. That is why we intend to continue to hold these oversight hearings and probably learn more about it.

Senator Sarbanes, did you have any other questions?

Senator SARBANES. I cannot let Mr. Judge's final comment go—just to stand. Under the Bank Holding Company Act, from which the ILC's are exempt, if they were under the Act, the Federal Reserve would conduct examinations of the safety and soundness, not just of banks but of the parent or holding company of these banks. And the Bank Holding Company Act grants the Federal Reserve the power to place capital requirements and impose sanctions on the holding companies.

The FDIC does not have those powers. So this is a very marked difference between the nature of the regulatory regime which I think has important implications for safety and soundness of the banking system.

Mr. JUDGE. The regulatory system is different. I mean, the bank holding company——

Senator SARBANES. No doubt about it.

Mr. JUDGE. —regulatory model is different than the FDIC.

That does not mean that it is not as effective or does not protect the safety and soundness of the financial system as well in the FDIC——

Senator SARBANES. I mean, we can argue that. I feel very strongly that the authorities under the Bank Holding Company Act exercised by the Federal Reserve do provide greater protection for safety and soundness than what exists with respect to these institutions that are not subjected to those Bank Holding Company authorities.

Mr. PLUNKETT. To protect taxpayers and deposits, you have to look at the holding company. You cannot just look at the institution itself. That is the only sure way to protect the depository system and taxpayers.

Senator SARBANES. In fact, even Chairman Powell, in testimony before this Committee—I said: Do you have regular annual examinations of the holding companies?

He said: No, sir.

I said: The process you follow does not begin to be the equivalent in terms of reviewing banking practices to the one that is followed by the Federal Reserve; is that correct?

Mr. POWELL. That is correct.

Thank you, Mr. Chairman.

Chairman SHELBY. I thank all of you. This has been an interesting panel, and as I said, these are very complex issues.

Senator SARBANES. Could I just say to Ms. Jorde, you really gave meaning, I thought, today, in your testimony to Cando in North Dakota. Thank you very much, all of you for coming.

Chairman SHELBY. Thank you. The hearing is adjourned.

[Whereupon, at 12:01 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF HARRY P. DOHERTY

VICE CHAIRMAN OF THE BOARD
INDEPENDENCE COMMUNITY BANK CORP.
FIRST VICE CHAIRMAN, BOARD OF DIRECTORS
AMERICA'S COMMUNITY BANKERS

JULY 12, 2004

Introduction

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I am Harry P. Doherty, Vice Chairman of the Board of Directors of Independence Community Bank Corp of Brooklyn, New York. Independence Community Bank is a New York State-chartered savings bank, operating within an OTS-regulated holding company. Independence Community Bank has more than $17 billion in assets, 121 branches and 2,500 employees.

I am here this morning representing America's Community Bankers. I am the First Vice Chairman of ACB's Board of Directors and will become Chairman in October. ACB is pleased to have this opportunity to participate in the Committee's review of the Gramm-Leach-Bliley Act.

America's Community Bankers supported the passage of the Gramm-Leach-Bliley Act in 1999 because, overall, it created new options for financial companies that wanted to offer diversified financial services. It also made positive changes in the capital structure and regulation of the Federal Home Loan Bank System and the law governing the FDIC's Savings Association Insurance Fund. However, the GLBA was in some ways a step backwards for an evolving financial services industry. After a lengthy and trying debate, it was decided in GLBA to undo provisions that had successfully permitted the creation of diversified financial services holding companies and to prohibit commercial firms from making any new acquisitions of savings associations. That change limited choices and holding company options for existing savings associations and deprived the financial services industry of an important source of capital, without any positive effect on the safety and soundness of the banking system.

GLBA has not always been implemented in a way to maximize its potential for bringing financial services to consumers efficiently. For example, savings associations have yet to achieve regulatory parity with banks under the securities laws. Savings associations should be given the same regulatory treatment as banks when they engage in the same securities activities as banks. The lack of parity requires savings association customers to pay more for services only because of their financial institution's charter. While ACB continues to work through the SEC's regulatory process to achieve parity, ACB believes that only a statutory change can ensure parity for savings associations under the securities laws.

Furthermore, the regulatory process established by GLBA to authorize new financial activities for banking organizations has not been allowed to work as intended, that is, through a notice and comment regulatory process that is based on safety and soundness considerations and administered by expert banking and financial regulators. As a result of a highly politicized campaign by the realtor community, the Treasury and Federal Reserve have been unable to finalize a rulemaking allowing national banks and financial holding companies to offer real estate services.

GLBA created important new privacy rights for consumers and made other changes to consumer laws, such as the Community Reinvestment Act. However, some of these provisions created significant regulatory burden for all insured depository institutions without any benefit to consumers or safety and soundness. Congress and Federal regulators should act to reduce the unnecessary regulatory burdens that result from these provisions.

I am pleased today to provide a more detailed discussion of ACB's views on these and other provisions in the GLBA.

Why Financial Modernization Was Important

In 1999, as they do today, ACB's members supported providing financial organizations choices in charters and business models that reflected the reality of integration of the financial services industry. Provisions of the Glass-Steagall Act, enacted during the Depression, and the Bank Holding Company Act of 1956 stood as barriers to the full integration of the banking, securities, and insurance industry for those organizations that wanted to provide bank services through a bank charter, rather than a savings association charter. For years prior to 1999, securities, insurance, and nonfinancial holding companies had owned savings associations. These institutions had given their holding companies the ability to offer an important array of financial services to their customers.

However, the Glass-Steagall Act hampered affiliations between commercial banks and bank holding companies, on one hand, and securities businesses, on the other. Although the Federal Reserve had loosened this restriction considerably, Glass-Stegall remained an anticompetitive anachronism. Bank holding companies could only acquire securities firms that fit within arbitrary size limits, while major securities firms were unable to acquire banks.

In a similar vein, the Bank Holding Company Act did not permit banks to associate with insurance underwriters. Beyond that, the Bank Holding Company Act limited banks to affiliations with firms "closely related" to banking. Banks that wished to sell insurance products faced a patchwork of State and Federal statutes, as well as court and agency interpretations that sometimes permitted and sometimes prohibited insurance activities. Because ACB members firmly believed that each financial institution should have a full range of choices to meet the needs of their customers and communities, ACB urged Congress to expand choices for financial institutions by repealing these decades-old restrictions on affiliations.

The Pace of Financial Integration Has Been Slow

GLBA repealed the restrictions on the integration of banking, insurance, and securities, and established a framework of functional regulation to supervise banking, insurance and securities activities of financial conglomerates. However, passage of the Act has had only a modest impact on the pace of integration of these activities.

Federal Reserve Vice Chairman Ferguson reported in a speech last November that while there were about 600 financial holding companies at the end of 2002, less than one-third reported actually engaging in any new activities authorized by the GLBA. Eighty percent of those activities were insurance agency activities, probably the "least new" and least risky of the activities authorized by the new law. Only 40 institutions reported broker-dealer assets, around 30 reported insurance underwriting assets, and less than 20 held significant merchant banking assets using GLBA authority. Ferguson concluded that even accounting for the size of some these financial holding companies, and the activities conducted in previously authorized section 20 affiliates, no evidence exists that the overall market structure of the financial services industry has changed since the passage of the GLBA.

One of the promises of the GLBA was the relatively easy authorization of new financial activities for banking organizations. GLBA established a joint Federal Reserve and Treasury regulatory process for the authorization of permissible new financial activities for banking organizations. The hope was that under this process, safety and soundness would be the dominant factor in the decisionmaking process. However, in the first real test of this authority, the two agencies have not been able to complete their work on a regulation that would authorize for national banks and financial holding companies an activity, which is already authorized for Federal savings associations and roughly half the State-chartered banks.

In January 2001, the Treasury and the Federal Reserve issued a proposed regulation to permit national bank financial subsidiaries and financial holding companies to provide real estate brokerage and real estate management services to their customers. However, due to a highly politicized campaign by the realtor community, Treasury and the Federal Reserve have not been allowed to complete their work on the regulation. In this particular instance, considerations other than safety and soundness have held sway.

GLBA Restricted an Important Holding Company Option

In 1999, we also urged Congress not to reduce choice by restricting the unitary savings and loan holding company. However, policymakers, ignoring the past success of the unitary savings and loan holding company, chose to reduce the benefits of the charter by prohibiting commercial (nonfinancial) firms from acquiring savings associations and grandfathered unitary savings and loan holding companies. Critics justified this limit by citing their concerns about mixing banking and commerce. However, unitary thrift holding companies did not then, and do not now, mix banking and commerce in any meaningful way. Savings associations are not permitted to lend to commercial affiliates under any circumstances. Savings associations' permissible commercial lending is strictly limited to 20 percent of assets, half of which must be small business loans. As a result of GLBA's restrictions on unitary savings and loan holding companies, the banking industry and its customers lost a potentially important source of capital.

Nevertheless, the unitary savings and loan holding company structure remains an important choice for financial firms. The expertise of the OTS in regulating diversified holding companies is one reason that firms continue to consider this holding company option to be an efficient choice.

SEC "Push-Out" Rule and Parity for Savings Associations

Before GLBA, banks—but not savings associations—enjoyed a blanket exemption from broker-dealer registration requirements for certain activities under the Securities Exchange Act of 1934 (Securities Exchange Act). The GLBA removed the blanket exemption and permitted banks to engage only in specified activities without having to register as a broker-dealer. All other broker-dealer activities must be "pushed out" to a registered broker-dealer affiliate. The SEC issued interim broker-dealer rules on May 11, 2001, to implement the new "push-out" requirements. As part of the broker-dealer "push out" rules, the SEC exercised its authority to include savings associations within the bank exemption. This interim rule treated savings associations the same as banks for the first time for purposes of broker-dealer registration. In the interim rule, the SEC recognized it would be wrong to continue disparate, anomalous treatment between savings associations and banks.

The SEC postponed the effective date of the interim rule several times. It published proposed amendments to the interim dealer rule on October 20, 2002 and the final dealer rule on February 24, 2003. The proposed rules gave savings associations the same exemptions as banks. On June 2, 2004, the SEC approved a new proposed rule governing when a bank or thrift must register as a broker.

Unlike the SEC's interim broker rule, the new proposal would no longer treat savings associations the same as banks in all respects. Although savings associations would be treated the same as banks for purposes of the 11 statutory activities they may engage in without registering as a broker with the SEC, as provided by the GLBA, three nonstatutory exemptions provided banks would not be extended to savings associations. The SEC describes the three nonstatutory exemptions as targeted exemptions that recognize the existing business practices of some banks. We understand that the SEC staff does not believe savings associations are engaged in the exempted securities activities and will only extend relief for savings associations to the securities activities they are currently performing. OTS General Counsel John Bowman recently testified that it appears that savings associations currently engage in some, if not all, of the securities activities covered by the three additional exemptions. The SEC's discriminatory approach makes no sense because the bank exemption applies to all banks—whether or not they are currently engaged in one of the exempted activities.

ACB vigorously supports providing parity for savings associations with banks under the Securities Exchange Act. As more savings associations engage in trust activities, there is no substantive reason to subject them to different requirements. They should be subject to the same regulatory conditions as banks engaged in the same services. ACB intends to file comments with the SEC opposing the discriminatory treatment of savings associations. However, the latest proposal from the SEC demonstrates that a legislative change is needed in order to ensure parity for savings associations under the Securities Exchange Act.

FHLBank Modernization

Title VI of GLBA made important and welcome changes to the laws governing the regulation, membership, and capital structure of the Federal Home Loan Bank System. One of the important changes involved the membership status of Federal savings banks and savings associations. Prior to the 1999 law, the institutions were required to be members of the Federal Home Loan Bank System, while other financial institutions' membership was voluntary. GLBA put Federal savings associations on the same footing as others by making their membership voluntary. Voluntary membership enhances the cooperative nature of the System and provides incentives to Federal Home Loan Banks to work for the benefit of their member-borrowers. After eliminating mandatory membership, GLBA added stability to the System's capital base by establishing a leverage and risk-based capital requirement for the FHLBanks and by creating "permanent capital" through a second class of stock with a 5-year "put" period.

The conversion of the FHLBanks to this new capital system has been a complex process. Nevertheless, 9 of the 12 Banks have already implemented their capital plans, and the other 3 are in the process of implementation. However, regulatory proposals to require the Banks to register certain equity securities with the SEC could significantly complicate the implementation of the remaining capital plans.

The GLBA also shifted much authority over the day-to-day operation of the FHLBanks from the Federal Housing Finance Board to the Banks themselves. The role of the Finance Board became more that of safety and soundness regulator rather than a co-equal or superior in the management of the system. For example, the GLBA gave the Finance Board new regulatory powers, such as the authority to issue cease-and-desist orders and to impose civil money penalties.

Title VI of GLBA made an important change to the formula for the FHLBanks' contribution to the debt service of the REFCorp bonds, issued in 1989 to fund the resolution activities of the Resolution Trust Corporation. The GLBA formula requires the Banks to pay 20 percent of net income to REFCorp. The old formula, eliminated by GLBA, had the potential to create disincentives for FHLBanks to provide advances for SAIF-insured financial institutions.

Financial Privacy

In Title V of GLBA, Congress passed the most sweeping law in American history to protect the privacy of consumers' financial information. Among other things, Title V requires each financial institution to disclose its privacy policy to the consumers and customers it serves and to restrict the sharing of nonpublic personal information sharing with most nonaffiliated third parties without first providing individuals the ability to prevent the exchange of their information (opt out). In addition to an initial disclosure of an institution's privacy policy and an initial opt out notice, GLBA requires a financial institution to provide annual disclosures and notices to its customers. GLBA required compliance with these provisions by July 1, 2001.

At the end of 2001, ACB conducted a survey to measure the costs incurred to comply with GLBA's privacy policy and opt out disclosure requirements. The survey concluded that community banks spent a disproportionately higher amount than larger banks in providing customers copies of their privacy policies and opt-out disclosures. The survey also found that customers rarely exercised the option of prohibiting their bank from sharing customer financial information with nonaffiliated third parties, and that a majority of customers did not find the disclosures useful.

The average compliance cost was $1.37 per customer, with total estimated compliance costs per bank ranging widely from as little as $1,000 to more than $2 million. The survey found the cost per customer averaged 27 cents at banks with assets of $10 billion or more, compared with per customer costs of $2.37 at banks with assets of less than $50 million—almost nine times as much. As a percentage of noninterest expenses (salaries, employee benefits, occupancy costs, etc.), banks with less than $50 million in assets paid almost four times as much as the group of banks with assets of $10 billion or more. The survey interpreted these results to mean that larger banks with in-house legal and consulting staff were able to do most of the compliance work themselves, while smaller banks sought outside legal help and consultants.

A 2002 survey found that while compliance costs were reduced significantly,—as initial policies and procedures developed in 2001 have become institutionalized—they remained high. In 2002, ACB found that the estimated average compliance per customer was about $0.65 per customer. These costs are likely to increase.

I will tell you, community banks guard their depositors' information like Fort Knox and have built their reputations on the trust of their customers that their bank will actually do so. Most community banks do not share information in any way whatsoever. Others share information only under very controlled circumstances when certain operational functions are outsourced to a vendor. We suggest that Congress eliminate annual privacy notices for banks that do not share information with nonaffiliated third parties. Banks with limited information sharing practices should be allowed to provide customers with an initial notice, and provide subsequent notices only when terms are modified.

I am sure that you are all inundated by privacy statements each fall. I am equally confident that most or all of them remain unread. The complexity of the statements—which is dictated by GLBA and the implementing privacy regulations—certainly contributes to customers' disregard of the notices. ACB suggests that the regulators improve the quality and utility of GLBA privacy notices by developing an easy-to-understand, short-form notice, and that Congress provide statutory relief as necessary to accommodate these changes.

Information Security Program

GLBA established new standards for ensuring the security and confidentiality of customer records and information. While the confidentiality and security of customer information has always been a cornerstone of community banking, the new GLBA information security standards brought increased focus to this issue.

The GLBA information security standards require every bank to conduct a risk assessment to identify and assess risks that may threaten the security, confidentiality, or integrity of customer information. Each bank is then expected to implement a comprehensive written information security program appropriate to the size and complexity of the institution. Review of the information security program is a part of the regular safety and soundness examination of every depository institution.

In response to recent high profile cases of compromised personal information such as credit and debit card numbers, Congress and the banking regulators have considered what additional measures may be necessary to protect consumer financial information. Community banks were not involved in any of the recent high profile cases of compromised consumer financial information. The development and maintenance of a formal information security program is a significant responsibility for all banks, but the burden is especially hard felt by small community banks. Congress and the regulators should carefully study the causes of these recent security breaches and avoid new information security requirements that unnecessarily increase the regulatory burden of the banking industry.

CRA Sunshine Law

Section 711 of the GLBA enacted the so-called "CRA Sunshine Law." Under the CRA Sunshine Law, parties to certain CRA-related agreements must make the agreements available to the public and the appropriate Federal banking agency. Section 711 applies to written contracts, arrangements, and understandings that are entered into by an insured depository institution or an affiliate and a nongovernmental entity or person; and which are entered into pursuant to or in connection with the fulfillment of CRA; and which call for an insured depository institution or affiliate to provide cash payments or other consideration with an aggregate value of more than $10,000 in any year, or loans with an aggregate value of more than $50,000 in any year. The law requires both depository institutions and nongovernmental groups (consumer groups) to make a report of all such agreements annually to the appropriate Federal banking agency.

The regulations implementing the CRA Sunshine Law are overly broad and impose significant paperwork, regulatory and cost burdens on banks that far outweigh possible benefits. Community banks, especially small- and mid-sized banks, are forced to spend considerable resources complying with the disclosure, reporting and recordkeeping requirements associated with CRA-related agreements rather than doing what really matters—serving their communities with affordable credit and financial services. As a result of the CRA Sunshine Law and these regulations, fewer creative and innovative partnerships are formed because of competitive and privacy concerns. According to FDIC Vice Chairman Reich, both banks and consumer groups share these views. ACB believes that the CRA Sunshine Law should be repealed in order to reduce regulatory burden on depository institutions, consumer groups and Federal banking agencies.

Deposit Insurance Reform

Finally, another important provision of GLBA eliminated the Savings Association Insurance Fund Special Reserve. The Deposit Insurance Funds Act of 1996 created a special reserve, effective as of January 1, 1999, of amounts in excess of the statutory designated reserve ratio of 1.25 percent. As a result, nearly $1 billion was removed from the SAIF on January 1, 1999. On the effective date of GLBA, November 12, 1999, those funds were restored to the SAIF, which resulted in an increase in the SAIF reserve ratio from 1.29 to 1.43 percent. The elimination of the reserve reduced the risk that the SAIF reserve ratio would fall below 1.25 percent, which triggers an FDIC insurance assessment on SAIF-insured deposits. ACB strongly supported the elimination of this costly, unnecessary reserve.

This change also established greater flexibility for the FDIC that improved the ability of the FDIC to manage the SAIF. ACB notes that many of the provisions currently being considered by the Committee to reform the Federal deposit insurance system similarly increase the FDIC's operating flexibility, and would contribute to the security of the Federal deposit insurance system. ACB urges the Committee to act on pending legislation as soon as possible.

Conclusion

I wish to again express ACB's appreciation for this opportunity to present its perspectives in connection with the Committee's review of the impact of the GLBA.

PREPARED STATEMENT OF TERRY JORDE

PRESIDENT AND CEO, COUNTRYBANK, USA, CANDO, NORTH DAKOTA
VICE CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA

JULY 13, 2004

Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, my name is Terry Jorde. I am Vice Chairman of the Independent Community Bankers of America (ICBA)[1] and President and CEO of CountryBank USA, a community bank with $37 million-in-assets located in Cando, North Dakota. Cando is a small town of only 1,300 people, but we have three banks and a motto that "You Can Do Better in Cando." Our bank is full service and progressive, offering our customers a full range of insurance and investment services, residential mortgages, check imaging, and fully transactional Internet banking.

I would like to compliment this Committee on exercising its oversight role by calling this hearing on the effect the Gramm-Leach-Bliley Act has had on the financial industry, the Nation, and—most importantly—on our communities. We conclude that the Act has had a number of effects, many positive, and some negative:

- The Federal Home Loan Bank reform provisions have been very helpful to community banks and could be further improved by the passage of Senator Enzi's amendment to this Committee's GSE reform legislation. It clarified the FHLBank's mission to provide community financial institutions with funding for agricultural and small business loans.
- GLB closed the unitary thrift loophole—which allowed any commercial firm to purchase a thrift institution—but Congress now needs to close the industrial loan company loophole to maintain the separation of banking and commerce;
- GLB contributed to increased financial concentration;
- Community banks have made limited use of the Act's new financial holding company structure, most likely to engage in insurance agency activities;
- The notice requirements under the privacy provisions should be streamlined, especially for the majority of community banks that do not share information with outside parties.

FHLBank System

The Federal Home Loan Bank reforms provided the Act's most significant benefits to community banks. Frankly, during the time the bill was being considered, ICBA concluded that these provisions and the closing of the unitary thrift loophole offset the bill's problematic aspects.

From our perspective, the FHLBank reforms included these significant benefits:

- Permitted any "community financial institution" (now—with indexing—any FDIC-insured institution with less than $550 million in total assets) to become a member. Previously, an institution had to have at least 10 percent of total assets in "residential mortgage assets" to qualify. Changing this was particularly important to many agricultural banks that found the 10 percent test difficult to meet in their markets.
- Allowed community financial institutions to use small business, small farm, and small agri-business loans as collateral for advances.
- Equalized membership requirements for commercial banks and thrifts. This was a win-win for community banks of all charter types, since it made membership for Federal thrifts voluntary and eliminated second-class membership status for commercial banks.
- Eliminated an emerging problem by repealing the 30 percent ceiling on FHLBank System advances to institutions that did not meet the qualified thrift lender test.

As a result of these reforms, community banks of all charter types have greatly increased their involvement in the System. Approximately 76 percent of ICBA members are now also members of the System, compared to 17 percent immediately after passage of GLB.

ICBA members are increasing their use of the FHLBanks' advances to fund local loans. I am sure my experience is typical of many new members. My bank was a member before GLB, but not an active advance user. For the first time in years, we are borrowing from our FHLBank because our deposits are down and loan demand has increased. Because of these liquidity pressures, the FHLBank System is more important than ever for our members.

While FHLBank access has provided community financial institutions like CountryBank needed liquidity, it has also helped us better serve our customers. FHLBanks provide many different types of advances that help bankers better meet the needs of our customers who are seeking longer-term, fixed-rate loans for resi-

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the Nation, and is dedicated exclusively to protecting the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at *www.icba.org.*

dential mortgages, commercial and agricultural real estate mortgages, and other types of loans that our deposit base does not permit without unduly exposing the bank to interest rate risk.

My bank belongs to the Federal Home Loan Bank of Des Moines that has been a champion in accepting small business and agricultural assets as collateral for advances. Some FHLBanks have been slow to accept the new collateral types permitted by the Act and have place severe constraints on pledging small business, small agri-business and small farm loans, such as limiting the types of loans or severely haircutting values. Thus, some community financial institutions have not been able to use this collateral to obtain advances as Congress envisioned. While any institution needs to be cautious about moving into a new type of business, the FHLBanks have had sufficient time since the Act's passage to develop the expertise and the policies and procedures to more readily accept these new collateral types. As the economy strengthens and loan demand increases, many community financial institutions will need the ability to pledge this collateral.

ICBA is pleased that this Committee addressed this issue by adopting an amendment by Senator Enzi to the GSE reform bill, S. 1508. That amendment clarified that the mission of the FHLBanks includes providing liquidity and funds to community financial institutions for agriculture and small business lending. We are hopeful that your endorsement of this will stimulate the FHLBanks to use the authority provided in GLB. ICBA will continue to support Senator Enzi's effort as this legislation moves through the process.

Maintaining the Separation of Banking and Commerce

GLB reaffirmed the Nation's long-standing policy maintaining the separation between banking and commerce by closing the unitary thrift loophole that permitted any commercial firm to acquire a single thrift institution. By maintaining the separation of banking and commerce, Congress helped ensure that our financial system would avoid the conflicts of interest and threats to safety and soundness that would arise if commercial firms—such as retailers and manufacturers—were permitted to own their own banks.

While GLB grandfathered the few existing commercial/unitary thrift combinations, it effectively cut off Wal-Mart's application to acquire an Oklahoma thrift. This prevented Wal-Mart from engaging in dangerous self-dealing between its huge retail operation and a federally insured thrift institution. And, since many banks already have branches in thousands of Wal-Mart stores, customers will continue to have convenient access to banking services. However, the banks will maintain their legal independence from Wal-Mart and will be able to lend on an arm's length basis to all businesses in their communities.

Congress also successfully addressed the banking and commerce issue before GLB. In 1987, the Competitive Equality Banking Act closed the nonbank bank loophole that permitted commercial firms to establish banks. In 1972, Congress closed a loophole that would have permitted any commercial firm to own a single bank.

All of these loopholes existed for many years before they were closed. However, Congress acted as soon as it became clear that they could be exploited in a major way. Policymakers now must face the same issue with industrial loan companies. Several years ago, Wal-Mart attempted to buy a California ILC. Fortunately, the California legislature quickly acted to block that attempt by closing the ILC banking and commerce loophole in its State. Unfortunately, the loophole remains in place in several other States and has been exploited most enthusiastically in Utah. ICBA joins with the Federal Reserve in urging Congress to reassert its authority and close the ILC loophole for the entire Nation by bringing the ILC's under the Bank Holding Company Act. This would prevent additional commercial/ILC affiliations and extend effective holding company regulation to the parents of ILC's.

In its regulatory relief bill, H.R. 1375, the House took steps to address the ILC loophole by adopting the Gillmor-Frank Amendment that would prevent newly formed ILC's with commercial affiliations from using the bill's new *de novo* interstate branching authority or the interstate banking and branching powers provided by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.[2] Unfortunately, the House did not include similar restrictions in the business checking provisions of H.R. 1375. As a result, ILC's—including those owned by commercial firms—would be granted completely new authority to offer business checking accounts, plus be permitted to pay interest on those accounts. This would make ILC's

[2] Without the Gillmor-Frank Amendment, Wal-Mart could buy or charter an ILC and establish a nationwide network by setting up branches of the ILC in each one of its stores.

the functional equivalent of full service banks and negate the original rationale—a limited charter—for excluding them from the BHCA.

While the Gillmor-Frank language was a positive first step, ICBA strongly urges Congress to take the next step and close the ILC loophole completely.

Increased Concentration

As Congress considered the financial modernization legislation that ultimately became GLB, ICBA repeatedly warned that it would likely lead to increased financial concentration. That has certainly proven to be the case. GLB and the Riegle-Neal Act have together led to the creation of truly huge financial conglomerates. We now have *three* $1 trillion banks in the United States. This is certain to decrease competition and increase systemic risk.

While it is too late to turn back the clock on these developments, ICBA recommends that Congress take steps to improve the competitive landscape so that consumers and businesses continue to have robust financial services choices. In this regard, ICBA has particular concern about the competitive position of community banks in this environment. Just last month, ICBA submitted testimony that highlighted the detrimental effects than increasing regulatory burden is having on community banks' ability to compete. We again strongly urge you to reduce this burden to improve our ability to serve our customers and communities. This burden falls disproportionately on community banks that cannot spread their costs across a large asset and personnel base. Unless Congress and the regulators can lift it soon in material ways, economic development and small businesses will suffer. Therefore, we urge you to follow up on our recommendations and those the financial regulatory agencies develop under the EGRPRA regulatory review.[3]

In addition, we hope that Congress will complete action on deposit insurance reform legislation this year. Deposit insurance provides the bedrock for community bank competitiveness. Since community banks are not too-big-to-fail, our depositors look to deposit insurance to protect their transaction and savings accounts. While we continue to favor immediate increases in coverage—especially for retirement funds—ICBA hopes that at least Congress can pass legislation that will provide a robust indexing system, along with other key reforms such as eliminating the 23-basis-point premium cliff and ending the free ride for rapidly growing institutions.

I would also like to draw your attention to another aspect of increased concentration, the fact that the largest institutions appear to be too big to regulate and too big to punish for their transgressions. Community bankers from around the country are increasingly concerned about what they perceive as a regulatory double standard. In case after case, they note that regulators and courts impose only nominal fines for megabanks' misdeeds and regulators go on to approve their mergers. For example, Citigroup agreed to pay investors $2.7 billion for its part in WorldCom's bankruptcy. J.P. Morgan paid $135 million for its part in the Enron scandal. This proved to be less than a speed bump for its acquisition of Bank One; the case was barely alluded to in the 63-page approval decision. UBS was fined $100 million for providing U.S. currency to Cuba, Libya, Iran, and Yugoslavia. While it was also ordered out of this line of business, it had not been particularly profitable or significant to the institution.

While some of the fines and settlements may seem large to the average person, they are tiny when applied to these companies. Commenting on Citi's WorldCom settlement, an analyst wrote that, "Citi's earning power and existing capital levels allow it to take such a charge without any material adverse impact to capital levels and [with] no impact on dividend policy."[4]

A relatively large community bank like Riggs ($6 billion) in Washington, DC, suffered more serious consequences when it failed to file Suspicious Activity Reports on certain embassy transactions. Regulators forced significant management changes and the bank is exiting its signature line of business, handling the banking needs of the diplomatic community. The $25 million fine assessed against Riggs was more than its annual earnings for each of the last 4 years. Analysts believe Riggs may even lose its independence.

The vast majority of community banks undergo even harsher treatment. State and Federal regulators (properly) hold management strictly accountable for everything that happens in the bank—from its culture to the actions and deeds (and mis-

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[3] The agencies are in the midst of reviewing 129 banking regulations to identify provisions that are outdated, unnecessary, or unduly burdensome, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

[4] (Susan Roth, Credit Suisse First Boston, quoted in "For Citi, $5B Is Price of 'Moving On' "; *American Banker,* 5/11/04)

deeds) of its staff and alliance partners. If they cross the line, both the bank and management are punished. There are no exceptions.

ICBA urges Congress to direct the agencies to review their policies, comparing the fines and other punishments that they apply to the largest institutions they regulate with those they mete out to the rank and file. It is important to eliminate the perception that large institutions are above the law and can commit serious offenses without facing serious consequences.

In the face of these concerns, this is certainly not the time for Congress to take further steps, such as lifting the deposit caps in the Riegle-Neal legislation, that would further increase concentration. ICBA will vigorously oppose any such proposals.

Additional Financial Services

GLB did not provide community banks with substantial new opportunities to provide financial services to their customers. In the years prior to enactment, State action, plus court and regulatory interpretations allowed virtually all banks to offer retail financial services—primarily insurance and securities—as agents. One exception to this general rule are the provisions of GLB that permit financial holding companies and financial subsidiaries of national banks to sell insurance even if they are not headquartered in towns of less than 5,000 in population or in States that granted insurance agency powers to State-chartered banks. A number of community banks have formed FHC's or financial subsidiaries, apparently for the purpose of engaging in insurance sales. However, only the largest financial institutions were interested in affiliating with underwriting companies. Indeed, it was the apparently illegal merger between Citibank and Travelers' Insurance that provided the final impetus to the legislation.

While community banks did not seek the new financial affiliation authority under GLB, a significant number of ICBA member community banks offer retail insurance and securities services. Just under half of the banks under $1 billion in assets earned fee income from insurance activities in 2003. That same year, nearly 23 percent of those banks earned income from mutual fund and annuity activity.[5]

My own bank is active in insurance sales and investment brokerage, though we did not need GLB to enter these fields. Insurance sales are particularly important for our bank and we are having good success. We have just purchased our third agency. In fact, 30 percent of our bank's employees are dedicated to insurance sales.

Real estate brokerage is another retail service community banks would like the opportunity to offer to our customers. Therefore, ICBA is disappointed that Congress has repeatedly used the appropriations process to block the Treasury from finalizing the proposed regulation to allow financial holding companies and financial subsidiaries of national banks to engage in real estate brokerage and management. We believe that GLB provides the Treasury and the Federal Reserve full authority to permit these activities. More importantly, these new powers will allow FHC's and financial subsidiaries to better serve customers by increasing choice and decreasing costs. And, it will allow community banks to diversify their sources of income by engaging in a low-risk agency activity analogous to securities and insurance brokerage.

The financial market is rapidly changing and evolving, and it is important for community banks to have the means and opportunity to serve all of their customers' financial needs. Many other entities already offer one-stop-shopping for real estate brokerage, mortgage lending, and real estate settlement services. It flies in the face of the GLB Act's fundamental purpose to continue blocking the proposed Treasury/Federal Reserve regulation.

While GLB did not greatly increase retail sales opportunities for community banks, it did make substantial changes in how these sales are conducted today.

Prior to GLB, banks were specifically excluded from the definition of "broker" contained in the Securities Exchange Act of 1934. As a result, banks could engage in securities sales activities and did not have to be concerned about registering as a broker with the SEC. With the enactment of GLB, banks are excluded from the definition of 'broker" only to the extent that their securities sales activities fall into one or more of the eleven statutory functional exceptions. Each of these exceptions permits a bank to act as an agent with respect to specified securities products or in transactions that meet specific statutory conditions. In particular, Section 3(a)(4) of the Exchange Act provides conditional exceptions from the definition of broker for banks that engage in third party brokerage arrangements; trust and fiduciary activities; permissible securities transactions; certain stock purchase plans; sweep ac-

[5] Michael White's Bank Insurance & Investment Fee Income Report, 2003 Year-end Edition, pp. 13 & 109.

counts; affiliate transactions; private securities offerings; safekeeping and custody activities; municipal securities; and *de minimis* transactions.

In 2001, the Commission adopted interim final rules designed to provide banks with guidance regarding the GLB by defining certain key terms used in the new statutory exceptions. These interim final rules were suspended after the trade associations and members of the banking industry expressed serious concerns about the complexity and regulatory burden of the new rules and the negative impact they would have on banks' ability to engage in traditional banking activities such as trust, fiduciary, and custody activities.

On June 17, 2004, after discussions with representatives of the industry, the SEC published new proposed rules (with comments due in August). These new rules, which are 228 pages long, are designed to define and clarify a number of the statutory exceptions from the definition of "broker" in GLB.

Although ICBA is pleased that the SEC has modified its original proposal made in 2001—particularly with respect to the definition of what is considered a "nominal" fee under the network exemption and raising the small bank threshold to $500 million under the custody exception—ICBA still is concerned about the overall complexity of the proposed rules. The regulatory burden on community banks is already significant and these rules will just add to that burden by requiring community banks to adopt compliance programs to ensure that they comply with one of the complex exceptions under the regulations. The SEC should make an effort to simplify the proposed rules, particularly with regard to the trust and fiduciary activity exemption.

The banking agencies have long since finalized the consumer protection regulations regarding the retail sale of insurance required under GLB. Like so many consumer disclosures, these regulations—which closely follow the legislative language—require far more information than consumers are prepared to absorb as they complete a financial transaction. Even more troubling, the disclosures are often irrelevant. For example, we must give all new insurance customers a disclosure that informs them that the insurance product they are inquiring about is not a deposit, not guaranteed by the bank, not insured by the FDIC, and may go down in value. This disclosure must be given even if the insurance product has no investment risk. In fact, none of the products that my agency sells have investment risk. I have seen the dumbfound look on my customers' faces when they have been told that their auto policy or their crop insurance is not a deposit and may go down in value, followed by their look of concern when we inform them that their insurance is not guaranteed. If the customer inquires about insurance over the telephone, we must make these disclosures orally and then follow up with written disclosures. And we need for them to sign the disclosure document and retain it in our file. The end result is a waste of time, paper, and postage and puts us at a competitive disadvantage to other insurance agencies in my community that are not housed within a bank office. ICBA urges Congress to ask the agencies to recommend specific changes in GLB to streamline and simplify these disclosures, while maintaining adequate consumer protection.

Increased financial conglomeration of the kind permitted under GLB has had a mixed competitive effect on community banks. Some report that insurance companies like State Farm (which bought a thrift while GLB was moving through Congress) present stiff competition by offering extremely attractive rates on deposits. Others report an opposite effect; some new financial conglomerates turn their attention away from traditional banking, opening up competitive opportunities for community banks. Still others report little direct effect at this time.

Privacy

GLB requires financial institutions to provide annual notices regarding their privacy policies to each of their customers. Many community bankers view the annual privacy notice as ineffective and unnecessary. They have become another example of the disclosure blizzard that has done little more than confuse and burden consumers with pages of incomprehensible legalese.

Most community banks do not share their customers' financial information with outside marketing companies and the like. They share information with vendors like check printers and data processors that use it strictly to help the bank provide essential services. Therefore, ICBA recommends that Congress amend GLB to allow these institutions to provide a short statement to that effect printed on the customer's bank statement.

In addition, community banks—and doubtless many other financial institutions—maintain consistent privacy policies from year to year. These institutions should have the option not to deliver the annual notice unless they have changed their privacy policy. Not only would this relieve them of a costly paperwork burden, it would make it more likely consumers would pay attention to the notices. The current requirement that banks furnish all customers with an annual privacy notice actually has a very serious unintended consequence: It encourages customers to disregard the information that is provided, making them increasingly less likely to pay heed to notices.

These notices are particularly pointless for my bank and our customers, since North Dakota has such restrictive privacy laws that the Federal requirements are a moot point. Yet we are required to mail thousands of privacy notices to our customers every year just to tell them that we will not break the law. It is this type of unnecessary burden that is driving community banks to sell out, often times leaving the very consumer that these laws are meant to protect with fewer choices for financial services.

Conclusion

I would again like to compliment the Committee on holding this oversight hearing on the Gramm-Leach-Bliley Act. Most of the benefits we anticipated have been borne out, especially with regard to the FHLBank System (although more must be done to implement the community financial institution provisions regarding use of advances for agriculture and small business lending). The Act successfully closed the unitary thrift loophole, but a new one—the ILC loophole—is emerging as an important threat. The Act has led to increased concentration, though has provided some limited new opportunities for community banks to offer insurance products. The impact of the securities push-out provisions on community banks will depend on the final rule expected to be issued by the SEC later this year. Finally, Congress should streamline the privacy notice provisions and will need to continue its oversight efforts if states seek to impose their own privacy restrictions.

Thank you again for this opportunity to testify.

PREPARED STATEMENT OF TRAVIS PLUNKETT

LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA
ON BEHALF OF THE CONSUMER FEDERATION OF AMERICA,
CONSUMERS UNION, AND THE U.S. PUBLIC INTEREST RESEARCH GROUP

JULY 13, 2004

Mr. Chairman, Senator Sarbanes, and Members of the Committee, my name is Travis Plunkett and I am the Legislative Director of the Consumer Federation of America.[1] We appreciate the opportunity to offer our comments on the effect of the Gramm-Leach-Bliley Act on consumers. This testimony is also being delivered on behalf of two other national consumer organizations, Consumers Union,[2] and the U.S. Public Interest Research Group.[3]

In the decade-long debate that led to enactment of the Gramm-Leach-Bliley Act (GLBA) in 1999, Congress heard many promises from financial services industry representatives about how tearing down the barriers between banking, securities, and insurance sectors would be a boon to consumers. Banks, securities firms and insurance companies would merge into financial services "supermarkets" that offer increased consumer access to new, innovative products at lower costs with improved privacy protections.

Five years later, this rhetoric has proven to be mostly hype. Mergers have occurred, but mostly within the banking industry, not across sectors. While some, primarily affluent consumers may benefit from larger multistate ATM networks, from discounts offered for multiple account relationships or from sophisticated financial products offered by boutique units to high-balance customers, we have seen no evi-

[1] The Consumer Federation of America is a nonprofit association of over 280 proconsumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

[2] Consumers Union is the nonprofit publisher of Consumer Reports magazine. Consumers Union was created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants, and fees. Consumers Union's publications carry no advertising and receive no commercial support.

[3] The U.S. Public Interest Research Group is the national lobbying office for State PIRG's, which are nonprofit, nonpartisan consumer advocacy groups with half a million citizen members around the country.

dence that GLBA has positively affected the mass of banking consumers. It has not slowed the continuing trend of rising bank fees, nor has it helped decrease the numbers of unbanked consumers. Indeed, rather than offering innovative, moderately priced products to middle-income consumers, or to unbanked consumers to bring them into the financial mainstream, some banks are developing policies and services that deliver second class or downright predatory products at an extremely high cost.

The corporate scandals of the last few years have also exposed potentially significant safety and soundness risks in allowing banks to sell both credit and investment banking services with inadequate regulatory oversight. The exponential growth of Industrial Loan Companies, which were allowed to continue to exist under GLBA without facing the rigorous regulatory scrutiny required of bank holding companies, has also started to create concerns that this shadow banking system could put taxpayer-backed deposits at risk.

Finally, the privacy requirements Congress ended up enacting as part of GLBA are narrow and weak. They do not provide consumers with a meaningful right to stop the sharing of much financial information with third parties or *any* financial information with corporate affiliates. Congress also missed an opportunity to modernize the Community Reinvestment Act by placing reinvestment requirements on nonbank firms that are performing bank-like functions. Instead, under the "CRA sunshine" provision, it placed burdensome and poorly crafted reporting requirements on both banks and community organizations.

Financial Privacy

During the decade-long debate that led to enactment of GLBA, our organizations repeatedly raised concerns about an almost total lack of Federal financial privacy protections for consumers. Unfortunately, this situation has not changed demonstrably since the enactment of GLBA. The financial privacy requirements that Congress imposed on financial institutions in exchange for eliminating the barriers between banks, insurers, and securities firms are narrow and weak. These requirements put the burden on consumers to stop the sharing of only some of the information shared by financial institutions with third parties. Even worse, these requirements offer consumers no ability at all to stop the sharing of sensitive financial data among financial affiliates. Moreover, the privacy notices that financial institutions are required to use to inform consumers of these limited rights are virtually incomprehensible. As a result, they are widely ignored by consumers.

Under Title V of GLBA, financial institutions only have to give consumers the opportunity to say no to ("opt out" of) the sharing of their financial information with certain nonaffiliated third parties selling nonfinancial products. However, sharing is allowed with other third parties that have joint marketing agreements with financial institutions to sell financial products. In other words, consumers have no control over the sharing of their confidential "experience and transaction" information if two separate parties enter joint marketing agreements, nor do consumers have any right to stop the sharing of information among affiliates of a financial institution. Some financial institutions have hundreds of affiliates. A few have thousands of affiliates.[4]

The implications on consumer privacy of GLBA's establishment of one-stop-shopping financial supermarkets are very serious, as decisions about the type of and prices for services and products offered to a consumer from one financial entity might be determined by information provided in the past to an affiliate. The type of information that is collected and shared often includes: Account balance, payment history, parties paid by financial transactions, all credit card usage, employment, and demographic information.

By combining all of these data about a particular consumer, financial institutions are able to create customer profiles. Profiles may then be used to determine how much a consumer will pay for a product or service or whether or not the consumer will be offered the product in the first place. Because this information sharing occurs among affiliates of a financial institution, these profiles are created and used without subjecting the firm to the requirements of or allowing consumers the protections of the Federal Fair Credit Reporting Act (15 U.S.C. 1681 et seq).

The widespread sharing and selling of personal financial information is also one of the reasons why consumers have become more vulnerable to identity theft in recent years. Many financial institutions have hundreds of affiliates that they share their customers' financial information with, and sell that same information to other

[4] See testimony before this committee of Vermont Assistant Attorney General Julie Brill for a detailed list of some institutions' affiliates. Senate Banking Committee, Hearing On Affiliate Sharing Practices and Their Relationship to the Fair Credit Reporting Act, 26 June 2003 available at *http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=46.*

third parties like telemarketers and direct mail firms. The more this information is disbursed, the greater the likelihood it will fall into the wrong hands and be used for illicit purposes. In Fall 2003, a Bank of America employee in Santa Ana, California was sentenced to State prison for stealing identity and account information for over 740 Bank of America customers. Obviously, financial institutions cannot ensure that information is perfectly secure at all times. Therefore, it is imperative to at least give consumers the ability to do everything they can to protect themselves against this crime.

Perhaps even more importantly, these business practices represent a fundamental invasion of consumers' privacy. Most of us are very selective when it comes to disclosing private financial information to others. When banks and other financial institutions share or sell information about our account balances or spending habits without first getting our permission, they are violating our desire to keep this information private.

To make matters worse, the privacy notices required under GLBA are at best extremely confusing, if not altogether deceptive. These were intended to serve two purposes. First, they were supposed to provide consumers directions on how to exercise their limited rights. Second, they were intended to inform consumers of the financial institution's privacy policies. Unfortunately, because they are so confusing and hard to understand they fail on both counts.

A July 2001 readability analysis of 60 financial privacy notices by the Privacy Rights Clearinghouse found that they are written at a 3rd-4th year college reading level. This is significantly higher than the junior high school level that is recommended for materials written for the general public. While we have heard anecdotal evidence that some privacy notices are getting clearer, they are still a far cry from sufficient.

If consumers are unable to read and comprehend their notices, they will simply throw them away and not exercise their limited rights. *The Wall Street Journal* summed up this situation accurately:

> (I)n crafting the new law, known as the Gramm-Leach-Bliley Act, the Government failed to ensure a vital detail: The mailers have to be readable to do any good. Indeed, many recipients, unwilling or unable to plough through the jargon and marketing talk, have simply tossed them in the trash. This only plays into the hands of the companies: A nonresponse to the mailer gives them a green light to sell that person's data.[5]

Our organizations argued in 1999 that financial institutions should get the affirmative consent of consumers before sharing information with any outside party whether an affiliate or a third party. Our position has not changed, and if Congress chooses to address this issue again, the standard should be opt in for information sharing among both affiliates and 3rd parties.

A number of financial institutions have been very active in recent rulemaking proceedings to improve the privacy notices. While consumer groups are generally supportive of these efforts to make the notices clearer,[6] the exercise is, to some extent, like rearranging deck chairs on the Titanic. Better notices will only help consumers more clearly understand that their underlying right to protect their financial information is very limited. Privacy notices are not privacy rights.

Safety and Soundness Issues

THE INDUSTRIAL LOAN COMPANY LOOPHOLE IS DANGEROUS TO THE BANKING SYSTEM AND TAXPAYERS AND SHOULD BE ELIMINATED

As part of GLBA, Congress eliminated the unitary thrift loophole. This sent a clear message that it was the intent of Congress to slam the door on the mixing of banking and commerce. Consumer groups applauded this measure as an important step in better protecting taxpayers and the safety and soundness of the Nation's banking system. At the same time, the GLBA made it possible for the first time for securities and insurance firms to own banks, but only if they were subject to the rigorous safety and soundness oversight required in the Bank Holding Company Act (BHCA).

[5] "Privacy Notice Offers Little Help," By Russell Gold, *Wall Street Journal*, May 31, 2002.

[6] For example, one widely-supported proposal would be to require that the highlights of the privacy notice be summarized in a statutory box with express terms, similar to the widely-used nutrition labels required by the Food and Drug Administration. However, consumer groups would oppose efforts to have that be the only information consumers receive—it would not be acceptable, for example, to have privacy rights details exclusively available in a second "layer" that only appears on the Internet.

Unfortunately, Congress left a little-noticed exception to the BHCA for Industrial Loan Companies (ILC's) in place when it put GLBA on the books. Commercial firms, such as General Motors, own ILC's, as do huge financial firms like Merrill Lynch, American Express, and Morgan Stanley. Moreover, ILC's are subject to much less rigorous oversight than that received by bank holding companies from the Federal Reserve Board. Not surprisingly, ILC's have grown exponentially in recent years and are now threatening to become a parallel banking system that will siphon commercial deposits from properly regulated bank holding companies. Even worse, these commercial and financial firms are now urging Congress to expand ILC powers, allowing them to offer business checking and to branch to all 50 States.

This trend has enormous negative implications for the safety and soundness of ILC's and thus for taxpayers, who, of course, support the deposit insurance system. Our organizations strongly urge the Committee to consider legislation that would plug the ILC loophole before it is too late, and to reject legislation that would broaden ILC powers, for the following reasons:

1. The ILC loophole to the Bank Holding Company Act is being abused and should be closed, not expanded. ILC's were never intended to be large, Nationwide banks that offered services indistinguishable from commercial banks. In 1987, Congress granted an exception to the BHCA for ILC's because there were few of them, they were only sporadically chartered in a small number of States, they held very few assets and were limited in the lending and services they offered. In fact, this exception specifically applied only to ILC's chartered in five States (Utah, California, Colorado, Nevada, and Minnesota) that have either assets of $100 million or do not offer checking services. Since that time, however, everything about ILC's has grown: The number that exist, the amount of assets, and federally insured deposits in them and the services and lending products that they can offer.

According to the Federal Reserve, the majority of ILC's had less than $50 million in assets in 1987, with assets at the largest ILC at less than $400 million. As of 2003, one ILC owned by Merrill Lynch had more than $60 billion in assets (and more than $50 billion in federally insured deposits) while eight other large ILC's had at least $1 billion in assets and a collective total of more than $13 billion in insured deposits. Moreover, the five States cited in the law are aggressively chartering new ILC's, allowing them to call themselves "banks" and giving them almost all of the powers of their State-chartered commercial banks. These States, especially Utah, are also promoting their oversight as a less rigorous alternative to those pesky regulators at the Federal Reserve. For example, the website of the Utah Department of Financial Institutions trumpets its "positive regulatory environment" and states that "ILC's offer a versatile depository charter for companies that are not permitted to, or that choose not to, become subject to the limitations of the Bank Holding Company Act . . . "

2. Large financial firms should not be permitted to skirt the GLBA by establishing a parallel banking system that is not subject to the rigorous oversight required for real banks. This represents an enormous and unacceptable risk to taxpayers. If large financial firms were to place their commercial banks under ILC oversight rather than Federal Reserve oversight, this could rapidly increase the number of ILC's and dilute the number of large financial systems that are subject to the important safety and soundness rules that the current system requires. Securities firms that own ILC's have taken the lead in promoting the expansion of ILC powers. They have not been shy about stating that they want to expand ILC powers because they do not want to deal with the regulatory oversight they would face from the Federal Reserve if they purchased a bank, as allowed under the Gramm-Leach-Bliley Act. Instead, they prefer to set up a "shadow" banking system through ILC's. They want to be able to offer the same services and loans as commercial banks without the same regulatory oversight.

According to the Federal Reserve, however, the deposits in ILC accounts are not as secure as those in real banks. As mentioned above, ILC's are exempt from BHCA, which allows the Federal Reserve to conduct examinations of the safety and soundness not just of banks, but of the parent or holding company of these banks. The BHCA also grants the Federal Reserve the power to place capital requirements and impose sanctions on these holding companies. The Federal Deposit Insurance Corporation (FDIC), which regulates ILC's, does not have these powers.

Oversight of the holding company is the key to protecting the safety and soundness of the banking system. It is immaterial whether the owner of the bank is a financial or a commercial entity. Holding company regulation is essential to ensuring that financial weaknesses, conflicts of interest, malfeasance, or incompetent leadership at the parent company will not endanger the taxpayer-insured deposits at the bank. Years of experience and bank failures have shown this to be true.

Moreover, the involvement of investment banking firms in recent corporate scandals has provided plenty of evidence of the need for rigorous scrutiny of these companies as they get more involved in the banking industry. In particular, the participation of some securities firms in the Enron and Wall Street analyst scandals has shown that these firms were rife with conflicts-of-interest that caused them to take actions that ultimately harmed their investors. Given this track record, it would be a serious dereliction of duty on the part of Congress to tie the hands of regulators in looking at bank holding companies.

3. The ILC loophole violates long-standing principles of banking law that commerce and banking should not mix. Recent corporate scandals show the serious risks involved in allowing any commercial entity to own a bank without significant regulatory scrutiny at the holding company level. Accounting scandals at Sunbeam, Enron, Worldcom, Tyco, Adelphia, and many others involved deliberate deception about the financial health of the companies involved. If these companies had owned banks, not only would employees, investors, and the economy have suffered, but also taxpayers.

As ILC's grow larger, so does commercial involvement in banking. Under current law, without any expansion of ILC powers, commercial firms can charter ILC's in several States. Under the Riegle-Neal Act's "opt in" provision for reciprocal State agreements (that allows banks chartered in each state to compete in all of them), 17 States already allow ILC's to branch into their territories. As stated above, firms such as General Motors, Pitney Bowes, BMW, Volkswagen, and Volvo already own ILC's. States that have not restricted commercial ownership of ILC's, like Utah, are aggressively encouraging other commercial firms to purchase ILC's.

Instead of moving to close the ILC loophole, legislators in both the Senate and the House are actually seeking to expand ILC powers. H.R. 1375 would allow many existing and new ILC's to branch into all 50 States, whether these States approve or not, and to offer business checking services. (Business checking can only be provided by very small ILC's with less than $100 million in deposits.)

A Senate bill, S. 1967, would also allow industrial loan companies to offer interest bearing checking accounts to businesses after 2 years. Although there is a requirement that the Secretary of the Treasury and the Federal banking agencies issue joint regulations within 2 years after the date of enactment, the authority goes into effect after this period whether the joint regulations are issued or not. As it is highly unlikely that the FDIC and the Federal Reserve Board in particular would agree on joint regulations, our organizations view this bill as a straightforward expansion of the authorities of industrial loans companies.

We strongly urge the Committee to stop both of these dangerous proposals in their tracks.

BANKING/SECURITIES CONFLICTS OF INTEREST

Among the restrictions in the Glass-Steagall Act that GLBA eliminated were those that prohibited commercial banks from combining with investment banks to sell both credit and investment banking services. Consumer groups expressed many concerns through the 1990's that the banking/securities combination in particular could allow financial investors access to insured deposits for high-risk lending schemes. This could, our groups predicted, subject consumers and shareholders to an increased potential for deception, leading to higher costs for consumers and taxpayers. Our organizations also expressed concern that complete elimination of the Glass-Steagall barriers also meant increased concentration, creating institutions of a size, and complexity that would be impossible to regulate effectively.

Unfortunately, the corporate scandals of the last few years have provided widespread evidence of the kind of deception we were concerned about, as well as proof that financial regulators were not equipped to prevent these kinds of problems before they occurred, harming millions of small investors and—in some cases—putting deposits insured by taxpayers at risk. The involvement of investment banking firms like Citigroup in these scandals have provided a cautionary "case study" of the kinds of problems that can result when banks inappropriately "tie" decisions about lending and investment banking.

WorldCom and Citigroup

For example, let's examine Citigroup's involvement in the WorldCom scandal, as documented in great depth in an Emmy award-winning segment for the Public Broadcasting series *Frontline.* [7] Before Citibank merged with Solomon Smith Barney and Travelers Insurance to become CitiGroup, WorldCom had already become a very important investment banking client of Solomon Smith Barney. As a telecommuni-

[7] The Wall Street Fix, *Frontline,* May 8, 2003.

cations firm whose business plan was to grow through mergers and acquisitions, WorldCom produced lucrative fees for the investment bankers chosen to handle these transactions. Solomon wanted that investment banking business, and Solomon's star technology analyst Jack Grubman was apparently willing to be a cheerleader for WorldCom's stock to keep this business. (As evidence that investment banking considerations influenced the research, Grubman justified his bonuses based on the investment banking business he was bringing into the firm.)

So, the first conflict that existed was that Grubman had a strong incentive to promote WorldCom's stock, and to continue to do so after its prospects had begun to deteriorate, in order to keep WorldCom as an investment banking client for Solomon. When Citibank CEO Sanford Weill consolidated Solomon, Travelers, and Citibank into a single entity, the conflicts just got bigger and more complex, with conflicts related to commercial loans added to the mix.

With WorldCom's stock having risen considerably, thanks in no small part to Grubman's cheerleading, Ebbers had a huge portion of his personal wealth in the form of WorldCom stock. He wanted cash, but he did not want to sell the stock to get it, as cashing out his stock would have been looked on as a bad sign on Wall Street. In one case, the bank apparently came up with a plan to let Ebbers turn his stock into cash without the scrutiny that would accompany a sale. To accomplish that, the bank agreed to lend Ebbers the money, in the form of a $1 billion mortgage to a company he controlled. Once the property was purchased, Ebbers was able to turn around and sell a portion of the property for cash.

In another case, Citibank agreed to lend Ebbers money—in this case $43 million to buy a ranch—with the loan backed by 2.3 million shares of WorldCom stock. This transaction was questionable for a variety of reasons. First, stock is very risky collateral for a loan because of its inherent volatility. Telecom stock is especially risky because, as events later showed, telecom is a volatile business. It is, in our view, highly unlikely that Citibank would have entered into such a risky transaction had it not been seeking to curry favor with Ebbers and WorldCom. That also added a second dimension to the conflicts of interest—Citibank needed WorldCom's stock price to stay high in order to maintain adequate backing for its loans.

We know now that WorldCom's strategy of constant mergers served in part to hide its deteriorating financial condition. When the Sprint merger fell apart, however, WorldCom could no longer keep up the façade. There was a telecommunications capacity glut. Long distance prices were plummeting. Other Wall Street analysts were turning more negative on the company's prospects. WordCom's stock price began to drop precipitously.

The company desperately needed cash, and Citibank came through again. This time, it led a bank syndicate that sold investors $17 billion of WorldCom bonds. WorldCom turned around and used some of that money to pay off its debts, and Citibank used that payment to reduce its exposure to loans backed by WorldCom stock. This brings us to a third major conflict of interest. Citibank's need to reduce its exposure to WorldCom loans appears to have been a factor in its investment bankers' willingness to approve a bond underwriting deal without appropriate due diligence on WorldCom's ability to repay the loans that those bonds represent and without adequate disclosure to investors of WorldCom's deteriorating financial condition.

Meanwhile, analyst Grubman was still doing his part, touting WorldCom's stock and calling it "an incredible bargain" at its newly reduced price. Given his access to top officers at WorldCom—he attended more than one board meeting and was listed as an adviser on the failed Sprint merger deal—it is hard to believe that Grubman could have been so oblivious to its deteriorating financial condition. At best, it seems logical to conclude that he ignored red flags because he had a strong incentive to ignore them.

There are three major lessons from this debacle for our discussion on GLBA today that are relevant. First, when major conflicts of interest exist and huge sums of money are at stake, abuses will occur. When Federal law has eliminated barriers to many of these potential conflicts, allowing them to flourish, it is naive to think that regulators can stop potential conflicts from becoming real conflicts through the erection of a few prohibitions.

Second, abuses are inevitable if businesses are allowed to create structures that are so big and complex that they require a major investment in regulatory oversight to prevent these abuses. However, once Congress allows these structures to be created, it had better be willing to provide the resources for regulatory oversight and to push regulatory agencies to be aggressive in enforcing the law. Third, investors will always be the ones left holding the bag when abuses occur. The system is not very good at restoring those losses once the damage is done.

Congress has in recent years given the Securities and Exchange Commission a much needed infusion of funding, though it is still not clear whether its funding matches its workload. Embarrassed by the New York Attorney General's Office, which has shown itself more than ready to step in and take action when it perceives there is an abuse that is not being addressed, the Commission appears to have made a new commitment to maintaining an aggressive enforcement program. Only time will tell whether the agency is up to the task. However, the SEC is not alone in bearing responsibility, and a "solution" that focuses entirely on the SEC and ignores Federal banking regulators will not solve the whole problem.

In the Citigroup/WorldCom affair, the balance of power in the relationship seems to have tipped toward WorldCom. The picture that comes through is this: Because Citigroup was desperate for WorldCom's investment banking business, it was willing not only to abandon all objectivity in its research, but also to overlook sound lending practices by offering loans to WorldCom and Ebbers that were not justified by WorldCom's underlying financial condition.

The conflicts that created this scandal are really the inverse of traditional "tying," when banks condition the availability or terms of loans or other credit products on the purchase of other products and services. In that situation, the balance of power tips toward the lender. There is some evidence that traditional tying may also be alive and well under GLBA.

A survey of corporate financial officers issued last year by the Association for Financial Professionals found that commercial banks frequently make access to credit contingent upon the purchase of other financial services.[8] Survey respondents indicated that they were concerned that if they did not award other business to their creditors, they would not receive credit in the future, would receive less credit, or pay a higher price.

While tying of this type is only a threat to the safety and soundness of the banking system if the bank offers loans at less than the market rate, or at otherwise more favorable terms to an unqualified borrower, it does represent a potential threat to shareholders, albeit one that is hard to quantify. For example, when a company is forced to pay more than it should for credit, that can affect the share price. Similarly, when a company selects investment bankers based not on which are the best qualified to do the deal or which are offering the most favorable terms to do the deal, but because of who is providing the company with credit services, this could drive up the cost of investment banking services. Those costs would also be absorbed by shareholders. We urge the Committee to investigate this problem further to examine what might be the ultimate costs and risks to shareholders.

Late last year, the GAO found a lack of documentation regarding tying the availability or price of credit to the purchase of debt underwriting services.[9] However, the GAO also stated that "the lack of documentary evidence might be due to the fact that negotiations over credit terms and conditions (during which a tying arrangement could be imposed) were generally conducted orally" and that "borrowers were reluctant to file formal complaints with banking regulators." GAO recommended that the Federal Reserve and the OCC take additional steps to enforce the antitying requirements in GLBA (in Sections 106 and 23B) and look for indirect evidence to assess whether banks unlawfully tie products and services. We strongly agree with this recommendation.

Consumer Services Issues

BANK FEES STILL A PROBLEM

In the debates leading up to the enactment of GLBA, consumer advocates focused attention on bank services and fees and bank policies for retail bank products and services. While big banks are more likely to advertise "free checking" these days, a close examination of the Federal Reserve's annual report to Congress on bank fees will show that the cost of having and using a bank account has simply been shifted around.

Checking accounts are now viewed by banks with expanding branch locations as the entry point for new customers for cross-selling of other products and services. Banks are more likely now to offer accounts without monthly maintenance fees or a minimum balance to avoid fees (required to advertise as "free" checking by TISA), but make up the revenue on penalty fees. As a result, bank noninterest income and service fee income overall continues to rise. As noted by the Federal Reserve reports

[8] *Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services;* Association for Financial Professionals, March 2003.

[9] "Bank Tying: Additional Steps Needed to Ensure Effective Enforcement of Tying Prohibitions," General Accounting Office, October 2003.

and U.S. PIRG bank fee reports [10] over the years, banks continue to charge more fees, higher fees, and make it harder to avoid paying fees. In addition, both the Federal Reserve and the PIRG studies document that larger, multistate institutions impose higher fees than local banks or credit unions.

Our groups are most concerned about growing fees that penalize consumers who have trouble making ends meet, including the insufficient funds fee, deposit item return fees, and overdraft fees. According to the Federal Reserve, NSF fees averaged $21.73 in 2002, an increase over the prior year. Bank fee surveys find that NSF fees range up to $35 per item at some banks. Seventy-five percent of banks now charge when items are deposited and returned for insufficient funds, averaging $6.88 in 2002. On average, banks charged $21.83 in 2002 for overdraft transactions, up over 1 percent from the prior year.

A CONTINUING PROBLEM: THE UNBANKED

Millions of American consumers continue to conduct their routine financial transactions outside mainstream banking, a situation that has not significantly improved since GLBA was enacted. Despite high level regulatory attention to the problem of "banking the unbanked," including the FDIC's Symposium held last November, modest First Accounts grants from Treasury over the last 2 years, and roll out of the Electronic Transaction Account program of Treasury to implement EFT'99 goals of enabling direct deposit of Federal benefits, conservative estimates find that 10 percent of American families still do not have a transaction account at a bank or credit union.

Consumers without bank accounts are more likely to be young, lower income, minorities, renters, and have less formal education, according to the Federal Reserve Survey of Consumer Finances and academic and regulatory agency studies. One in three low- to moderate-income consumers in New York City and Los Angeles does not have a bank account. Twenty-two percent of low-income households (8.4 million families making less than $25,000 a year) do not have a bank account.

The high cost of being unbanked includes paying fees to cash checks, buying money orders to pay bills, paying to wire funds to distant locations, and lacking a safe place to save money. The unbanked live paycheck to paycheck, without savings to meet emergencies, making them susceptible to high cost forms of credit, including rent to own, car title pawn, and secured credit cards. While retailers such as Wal-Mart have entered the check cashing business, charging a flat rate $3 to cash a payroll or government check, banks increasingly charge noncustomers fees to cash checks drawn on the bank.

Second Class Financial Products for the Unbanked

Instead of bringing unbanked consumers into the mainstream by designing fairly priced products and services that meet the needs of consumers, banks and others are developing policies and services that deliver subprime protections. For example, KeyBank is now offering a "checkless" checking service, Key Checkless Access, for a fee of 1.9 percent per deposit to have paychecks direct deposited into a KeyBank account accessed by an ATM card. (The account is being marketed to consumers blacklisted on ChexSystems for nonfraudulent account mismanagement in the past.) Instead of providing account management training through such programs as Get Checking (developed by the University of Wisconsin Extension Service) and a free or low-cost direct deposit account that cannot be overdrawn, KeyBank is charging check cashing fees for a limited use bank account.

Payroll cards and other stored value cards are growing in use as a way to deliver money without providing real bank accounts to unbanked consumers. Instead of opening bank accounts in the employees' names, some employers and their banks provide ATM cards that permit employees to withdraw their pay electronically from a pooled account. As the OCC noted in an Advisory Letter issued in May, unsettled regulatory issues include whether FDIC deposit insurance is available to cardholders, whether Regulation E applies to payroll card systems, whether Section 326 of the USA PATRIOT Act (verification of new customers) applies, and whether Regulation CC (Availability of Funds) applies. Non-bank involvement in payroll card programs raises the risk for both consumers and banks if the nonbank becomes insolvent.

Financial services are being increasingly delivered via stored value cards rather than through accounts open in the consumer's name. The explosive growth of stored value gift cards and delivery of tax refunds and refund anticipation loans through stored value cards is taking place without adequate Federal consumer protections.

[10] For example, *Big Banks, Bigger Fees 2001,* U.S. Public Interest Research Group, November 2001.

While consumers have Federal protections when they use credit cards and debit cards, there is no Federal stored value card law and it is unclear what Federal protections apply to stored value cards. Convergence of plastic is not being supported by upgrading of consumer protections.

Stored value cards do not provide a means of asset development or a way to build credit worthiness. It is regrettable that mainstream banks are choosing to serve the financial needs of low- to moderate-income, unbanked consumers through second-class financial products and services.

NOT WHAT CONGRESS HAD IN MIND: MAINSTREAM BANKS OFFER HIGH-COST CREDIT

GLBA was intended to modernize banking law and to permit banks to affiliate with other financial entities to offer a wide variety of mainstream products and services to benefit American consumers. As stated above, we see no evidence that the "synergies" that the proponents of the law promised have led to substantial benefits for consumers. While some, primarily affluent consumers may benefit from larger multistate ATM networks, from discounts offered for multiple account relationships or from sophisticated financial products offered by boutique units to high-balance customers, we have seen no evidence that GLBA has slowed the continuing trend of rising bank fee income (that is from service fees on deposit accounts, from penalty fees on credit cards and from ATM surcharges) nor has it helped decrease the numbers of the unbanked.

Indeed, some banks have chosen to go beyond the scope of mainstream financial services contemplated in GLBA and now participate in the triple-digit-interest rate "fringe lending" market, or offer predatory products like "bounce protection" that are all-but-indistinguishable from many fringe lending products. Given the number of banks now offering these high-cost products, or—in some cases—affiliating with lenders who do, it is legitimate to ask whether Congress was fooled by the promise of innovative, affordable financial services products, only to find that the new products that are really being promoted have an outrageously high price tag.

Payday Lending and GLBA

For example, a handful of banks have chosen to "rent" their bank powers to pawn shops and small loan companies to assist those nonbank companies to make small loans at costs that would violate State laws. Payday loans are small loans made to cash-strapped consumers, secured by a post-dated check or access to the borrower's bank account. Loans for up to $500 plus a finance charge of $15 to $30 per $100 borrowed are due in full on the borrower's next payday. Payday loans are made without regard for the borrower's ability to repay. The cost of payday loans averages 470 percent APR, far in excess of some State usury or small loan laws.

Under a "rent-a-charter" arrangement, the payday lender markets the loans, solicits borrowers, accepts applications, disburses loan proceeds, services and collects the loans. The bank generally takes only a small percentage of the loan revenues—often as little as 5 percent—while it is so-called "agent" takes the vast majority of the revenues generated by the loan.

While GLBA provided for bank affiliation with other mainstream financial entities, we are certain that Congress never intended to empower banks to rent their interest rate exportation powers to third party entities to make predatory loans or to undercut State authority to enforce usury laws, small loan regulations, and, even State payday loan laws. That is not what the payday lending industry thinks though. The industry filed an amicus brief in the U.S. Court of Appeals for the Eleventh Circuit, claiming that Georgia's law violated Section 104 of GLBA, despite the fact that Section 104 is clearly intended to govern the relationship between State laws and the sale of *insurance* by financial institutions. The Court rejected the brief on grounds that it made arguments not included in the District Court case.

Ten State-chartered FDIC-supervised banks partner with pawn chains, check cashers, and payday lenders,[11] according to CFA's latest report, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury.* No federally chartered financial institutions or state member banks partner with payday lenders, following regulatory action by the Comptroller of the Currency, Office of Thrift Supervision, and Federal Reserve. These regulators found that payday lending exposes federally insured banks to unacceptable safety and soundness risks, undermines consumer protections, and carries serious reputational risk.

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[11] State-chartered, nonmember banks currently partnering with payday lenders are County Bank of Rehoboth Beach, DE; First Bank of Delaware; BankWest, Inc., SD; First Fidelity Bank, SD: Community State Bank, SD; American Bank & Trust, SD: Bryant State Bank, SD: Reliabank Dakota, SD: Republic Bank & Trust, KY; and Venture Bank, WA.

Eleven of the thirteen largest payday loan chains use bank partners in States with consumer protection laws that do not permit unregulated payday lending, such as Pennsylvania, Arkansas, New York, North Carolina, Michigan, and Texas. Georgia recently enacted a law strengthening enforcement tools to prevent usury and to prohibit rent-a-bank payday lending where the local storefront gets the majority of the money.

State banking officials and Attorneys General in several States have challenged the claims of payday lenders that banks' exportation powers extended to them and alleged that rent-a-bank arrangements are fraudulent tactics to cloak illegal loan terms. States from California to Maryland have enacted antibroker clauses in an attempt to prevent local lenders from partnering with banks to evade State consumer protections. In court litigation to date, none of these state antibroker laws have been overturned. Federal courts in New York, Florida, Maryland, Colorado, North Carolina, and Georgia have denied bank/payday lender claims to total preemption of State law and have remanded payday loan cases to State court. Yet the FDIC continues to permit the banks it supervises to aid storefront lenders in evading State consumer protections.

As the Committee reviews the Gramm-Leach-Bliley Act, we urge you to clarify that bank charters are not for rent and halt the misuse of bank charters by third party lenders to make loans under terms prohibited by States.

Bounce Loans

Bounce loans [12] are a high-cost new form of overdraft protection that some banks are using primarily to boost their fee revenue, not to assist consumers.[13] Bounce loans represent a systematic attempt to induce consumers into using overdrafts as a form of high-cost credit. These plans offer short-term credit at triple-digit rates. For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243 percent. If the consumer pays the overdraft bank in 14 days, which is probably more typical for a wage earner, the APR is 541 percent.

Bounce loans also permit consumers to overdraw their accounts at the ATM, at Point of Sale terminals, and through preauthorized electronic payments. For many banks, the available balance displayed on the ATM screen includes the overdraft amount, misleading consumers about the true balance in accounts. Bounce loan plans turn debit cards into credit cards without consumer consent or disclosure of the cost of borrowing the bank's money.

Over 1,000 banks have implemented bounce protection plans. Although many of these banks are small community banks, several very large national banks and thrifts offer this product as well, including Washington Mutual Bank, Charter One, TCF of Minneapolis, and Fifth Third of Cincinnati.

This arrangement is much more expensive than alternatives that most banks offer, such as overdraft lines of credit, linking the account to a credit card, and transfers from savings. When a consumer uses bounce credit, the bank deducts the amount covered by the plan plus the fee by setting off the consumer's next deposit, even where that deposit is protected income, such as a welfare or Social Security check. Consumers who do not want such an expensive "courtesy" must explicitly opt out by contacting the bank. The fee is often the same amount charged for an NSF fee on a returned check, and in some cases the bank also charges an additional, per-day fee. The Office of Comptroller of Currency has recognized that bounce loans are credit as defined by TILA.[14] Some State regulators have reached the same conclusion.[15]

There is considerable confusion and misunderstanding among consumers about the rules and obligations of bounce loans. Consumers often do not understand the full cost of these loans, and they do not understand the recurring nature and exorbitant cost of the ongoing use of bounce loans. In most cases, consumers do not affirmatively agree to this coverage. Instead, the bank imposes coverage to a subset of accountholders as a "courtesy" or additional service feature of their account. Con-

[12] Bounce "protection" is a euphemism used by banks to describe this high-cost credit product.

[13] For more information on bounce credit, see Consumer Federation of America & National Consumer Law Center, *Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks* (2003), available at *www.consumerlaw.org/initiatives/test—and—comm/appendix.shtml.*

[14] Daniel P. Stipano, Deputy Chief Counsel, Office of Comptroller of Currency, Interpretive Letter #914, September 2001.

[15] Indiana Department of Financial Institutions, Newsletter—Winter 2002 Edition (Nov. 2002), at 2, Clearinghouse No. (D/E: Fill in number); Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law, Consumer Credit Unit, Mar. 21, 2001 (in response to referral from the Administrator for the Colorado Uniform Consumer Credit Code).

sumers would benefit enormously from application of TILA's open-end credit disclosure rules to these expensive and deceptive products.

The Federal Reserve Board recently announced new, proposed rules to govern bounce loans, but chose to cover them under the Truth in Savings Act, Reg DD. That is a completely inadequate response to the real need consumers have for information about the exorbitant costs of these loan products. Congress should step in and require—at the least—that bounce loans be treated just as all other extensions of credit are treated under the Federal Truth in Lending Act. This equivalent treatment would simply—and most importantly—require that creditors of bounce loans *inform* consumers about the true costs of this credit and give consumers the right to affirmatively choose this product.

Ultimately, the irresponsible actions of banks in offering bounce loans will lead to more unbanked consumers. Instead of discouraging overdrafts and encouraging sound financial management, these banks are now *encouraging* consumers to overdraw their accounts and use high-cost credit. By permitting overdrafts, not just through checks but ATM's and debit cards (where it was impossible or much harder to overdraft before), these banks are creating more ways to impose exorbitant fees and create financial hardship. These banks may ultimately drive consumers away from bank accounts, either through consumer disgust at high fees or involuntarily through the Chexsystem blacklist. Consumers who are reported in the Chexsystems database for alleged bounced check activity find it nearly impossible to open a new account.

GLBA and the Community Reinvestment Act

The Community Reinvestment Act (CRA) for over 25 years has been a major tool in bringing capital and better banking services to the Nation's underserved urban and rural communities. Yet given the changes well underway in banking and mortgage lending CRA is in need of some updating.

Two trends pose perhaps the greatest challenge to CRA. First, the increasing consolidation among banks, increased competition in the financial services industry, and the advent of new technologies have combined to shift financial assets out of traditional banks covered by CRA and into nonbank financial services providers, such as insurance, consumer finance companies, and mutual funds. Moreover, the rise of nonbank mortgage lending companies and the secondary mortgage market have reduced the importance of depository institutions as a source of mortgage funding. Consequently, CRA-covered institutions today make less than 30 percent of home purchase loans, compared with more than 80 percent they made when the law was first enacted, which has limited CRA's effectiveness.

The second important trend is the emergence of alternative delivery systems for promoting banking products, such as the Internet and telephone banking, instead of traditional brick-and-mortar branching networks. The changing way in which banks offer products to consumers poses a challenge to CRA, which traditionally relied upon a place-based definition to determine a bank's compliance responsibilities.

Two key changes to CRA would help to modernize the law and keep pace with these trends. First, CRA should be broadened to encompass a larger share of nonbank financial service providers. This can be done by extending CRA-like requirements to nonbank firms that are performing bank-like functions. The second key adjustment to CRA would be to broaden the definition of community beyond those areas where banks have physical branches. The expanding use of new technologies means that a bank's community for CRA purposes can no longer serve as a reasonable proxy for the location of a bank's customer base anymore. The banking regulators have discussed making such adjustments via regulations but have yet to act on these proposals.

GLBA provided an important opportunity to "modernize" CRA by applying these types of requirements to nonbank mortgage companies, insurance firms, and other financial institutions that affiliate with CRA covered banking institutions. Unfortunately, this did not happen. We encourage the Committee to update CRA along the lines we discuss as part of future legislation.

While failing to update CRA, GLBA includes a CRA-related provision that is not particularly constructive. I am referring to the so-called "CRA Sunshine Requirements," as contained in Section 711 of the Act. The provision requires banks and community groups to report to Federal regulators about certain "CRA agreements" made pursuant to or "in fulfillment of" CRA.

Over the years, CRA agreements between banks and local community groups have been frequently used to resolve disputes about lending practices and to target special efforts and facilitate local community reinvestment partnerships. Often these "CRA agreements" are reached while bank expansion requests are pending before regulators, although in recent years more and more institutions have elected to use pending mergers to announce unilateral CRA pledges.

Whatever the merits of requiring the reporting and disclosure of such agreements this statutory provision has not proven terribly useful to anyone concerned with these issues.

For one thing, the CRA sunshine provision is not particularly well-crafted, requiring some CRA agreements to be reported and but not others. For example, it does not require banks to report unilateral CRA pledges, which now have become the predominate form that these commitments take. At the same time, CRA sunshine continues to impose reporting burdens on those banks and their community group entering into the more traditional types of two-party agreements. This is an inequity that neither the statute nor its regulations address.

Further, the CRA sunshine requirements were premised on what appears to be a faulty assumption—that community groups are somehow using the CRA process to extort money from banks for themselves. In fact, a study by the National Community Reinvestment Coalition that reviewed CRA agreements filed with Federal regulators found that only .3 percent of the total funding contained in these agreement to be devoted toward general operating support for the nonbank parties. The disclosures confirm that the vast majority of these funds are directed to legitimate lending activities. *(CRA Sunshine Reveals Benefits of Bank-Community Group Partnerships, National Community Reinvestment Coalition, 2002, at 3).*

We believe that the CRA sunshine provision has outlasted its usefulness, if indeed it truly ever had one. We favor, therefore, repeal. Should the requirement be maintained, however, we believe that it should be overhauled to reduce its inequities and to minimize the reporting burdens and inconvenience this reporting provision imposes on the affected parties.

PREPARED STATEMENT OF RONNIE TUBERTINI

CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE

THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

JULY 13, 2004

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. My name is Ronnie Tubertini, and I am pleased to have the opportunity to give you the views of the Independent Insurance Agents & Brokers of America (IIABA) on the Gramm-Leach-Bliley Act (GLBA)[1] and its effects on the insurance marketplace. I am President and CEO of SouthGroup Insurance and Financial Services, Mississippi's largest privately owned insurance agency. SouthGroup is a Jackson-based insurance agency employing 120 people in 17 locations across the State. Although based in Mississippi, SouthGroup writes business in over 20 States and provides foreign coverage for clients operating outside of the United States. My agency represents over 50 insurance companies. I am also the current Chairman of IIABA's Government Affairs Committee.

IIABA is the Nation's oldest and largest national trade association of independent insurance agents and brokers. We represent more than 300,000 agents, brokers and agency employees nationwide. IIABA members are small, medium, and large businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents and brokers offer all lines of insurance—property, casualty, life, health, employee benefit plans, and retirement products.

Overview

The Gramm-Leach-Bliley Act,[2] signed on November 12, 1999, was the culmination of nearly two decades of effort by Congress and the financial services industry to eliminate the Depression-era laws and regulations which prevented depository institutions from affiliating with both insurance companies/producers and with securities firms. The GLBA also clarified the respective regulatory duties and powers of Federal and State regulators as these industries began to engage in each other's businesses.

We would like to focus on three parts of GLBA that directly affect insurance: (1) Title I, which facilitates affiliation between banks and securities firms and insur-

[1] Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106–102, 113 Stat. 1338 (1999).

[2] Previously known as the "Financial Services Modernization Act of 1999."

ance companies by repealing major portions of the Glass-Steagall Act,[3] the Bank Holding Company Act of 1956[4] and other Federal banking laws; (2) Title III, Subtitle C, "National Association of Registered Agents & Brokers," which was designed to encourage the States to establish a reciprocal or uniform agent licensing system; and (3) Title III, Subtitle A, "State Regulation of Insurance," which reaffirms the traditional and primary authority of the States to functionally regulate the business of insurance in the United States and clarifies the extent to which banks, or their direct subsidiaries, may engage in insurance.[5] Below we will describe these three aspects[6] and the effect each has had so far on the insurance marketplace in general and the independent agency system in particular. We will also discuss what lessons may be learned from them when considering potential reforms to the insurance regulatory structure.

The Experience under Gramm-Leach-Bliley

Affiliation Among Banks, Securities Firms, and Insurance Companies

Title I of the GLBA (Facilitating Affiliation Among Banks, Securities Firms, and Insurance Companies) allows depository institutions, securities firms, insurance companies, and other firms engaged in financial services to affiliate under a new financial holding company (FHC) structure. Title I also provides for the supervision of these new FHC's, streamlines somewhat the preexisting bank holding company (BHC) supervision and specifies what financial activities could be conducted directly in a bank or its subsidiary and which were required to be conducted through other nonbank affiliates within the FHC.

With the authorization of these new FHC systems, many industry experts predicted that mega-mergers among the largest players in the banking, securities, and insurance industries would transform the financial services landscape. The expectation was that convergence would lead to only a few, large diversified companies left standing to offer consumers "one-stop-shopping"—a smorgasborg of financial services products.

However, this has not come to pass. So far there has not been a massive move toward consolidation of the country's major financial services companies. Some mergers have occurred, but most have not been among the leading players—two exceptions to that general rule being the Citicorp-Travelers Group deal, which was on the table when GLBA was enacted;[7] and more recently the Bank One purchase of key components of Zurich Life from Zurich Financial Services Group in 2003. The convergence of products and services that began in the 1980's continues to occur but through smaller and more targeted merger activity. Banks have bought individual securities firms and insurance agencies instead of insurance companies as had been predicted, and insurance companies and agencies have also begun to offer a wider variety of products.

Banks have been reluctant to get into the insurance business, the underwriting side if not sales, for a couple of reasons. First, the insurance industry typically has a lower return on equity than the rest of the financial services industry. Over the last decade, diversified financial firms have earned nearly a 20 percent rate of return, banks around 15 percent, and insurance companies generally between 5–10 percent. Put simply, acquiring insurers oftentimes does not make economic sense for banks.

Second, there is philosophical conflict between the two industries and, it seems, limited opportunity for synergies. Banks are by nature risk averse and the insurance industry is inherently volatile and risky. After all, insurance at its core is the aggregation of risk. The insurance marketplace differs from most other financial services in that insurers must price and sell their policies *before* the full cost of coverage is known. This is especially true in the property/casualty marketplace where insurers must try to anticipate losses such as catastrophic exposures like earthquakes, hurricanes, and now terrorism. Insurer results are also whipsawed by unex-

[3] The Banking Act of 1933, Pub. L. No. 73–66, 48 Stat. 162 (1933).

[4] The Bank Holding Company Act of 1956, Pub. L. No. 84–511, 70 Stat. 133 (1956).

[5] GLBA Tit. I, Subtit. B, § 112 (Authority of State Insurance Regulators) also confirms the responsibility of States for the functional regulation of insurance; Tit. I, Subtit. C, § 121 (Subsidiaries of National Banks) similarly restricts banks' ability to engage in insurance activities through operating subsidiaries.

[6] GLBA Tit. III, Subtit. B, (Redomestication of Mutual Insurers) and Subtit. D (Rental Car Agency Insurance Activities) also relate to specialized insurance issues. In addition, Title V (Privacy) affects insurance entities as well as other financial services, but that Title makes clear—consistent with Tit. III Subtit. A's reaffirmation of the State role—that State insurance regulators are responsible for privacy supervision of the insurance sector.

[7] It should be noted, however, that in 2002 Citigroup spun off Travelers Property Casualty Group while retaining Travelers Life and Annuity Company.

pected changes in the legal system, such as Superfund or asbestos-related expenses, which can have a negative effect on company surplus. Property/casualty insurers typically break even or lose money on their underlying business, the underwriting of risk—that is before investment income is taken into account. The first half of this year was only the second time the U.S. property/casualty industry has posted a collective underwriting profit since 1986. It appears that banks are not willing to use available capital to get into underwriting insurance as it is a very complicated and difficult business.

Banks have been more inclined to get into the sale of insurance through the acquisition of insurance agencies; however, this trend has not been overwhelming. According to the *Financial Services Fact Book 2004,*[8] banks acquired 60 securities firms and 74 insurance agencies in 2002[9] (latest data available). While the number of bank purchases of insurance agencies increased in 2002 by 17 percent from 2001, the value of those deals decreased in that same year by 68 percent.[10] In fact, the number of bank/agency deals in the period from 1999–2002 has remained relatively constant with 66 in 1999, 77 in 2000, 63 in 2001, and 74 in 2002.[11]

On the flip side, more insurance trade associations and a few individual carriers have now entered the banking market. This has come more in the form of applications for thrift charters to open new OTS-supervised banks instead of buying existing banks. Examples of insurers—or their trade associations—wading into the banking market are the National Association of Mutual Insurance Companies, State Farm, and Metlife. The IIABA has done the same with InsurBanc, the Federal savings bank developed jointly by the IIABA and the W.R. Berkley Corporation to serve independent agents and brokers as well as their clients. InsurBanc opened on April 30, 2001. Three years later, InsurBanc has more than $32 million in deposits and $60 million in assets, including the investment of nearly $30 million in agency-related loans.[12] Along with agency financing products and services, InsurBanc offers working capital lines of credit, commercial term loans, and commercial real estate loans. InsurBanc also provides an array of consumer banking products that agents and brokers can offer to their clients, including consumer loans, credit cards, home equity loans, mortgages, certificates of deposit, and money market accounts.

While the mega-mergers that some envisioned have not occurred, consolidations within most financial services sectors have boosted the market share of the largest players in those sectors. This trend, which began in the mid-1990's, has continued in this decade for the insurance industry. From 1996 to 2002 the market share of the top 10 companies grew from 38 to 51 percent in the life/health insurance market and from 35 to 55 percent in the property/casualty marketplace.[13]

As life insurers, who are perhaps the most challenged by product convergence from noninsurance players, attempt to diversify their revenue streams and gain economies of scale, further consolidation among the remaining 1,462 U.S. life/health insurers is expected.[14] One commentator predicts that the market share of the top 10 life insurers will approach 75 percent by the end of the decade.[15] Continued consolidation is also anticipated in the property/casualty industry. Some expect the number of U.S. property/casualty insurers, now numbering approximately 3,300, to fall by 30 percent over the next decade.[16] With the fractured capital that this current large number of players in both the life/health and property/casualty industries represents and the inherent volatility of the business, it is perhaps not surprising that return on equity has been lower for insurance underwriters than the rest of the financial services industry.

Industry experts are currently divided on whether the industry consolidation will occur through large companies merging with or making wholesale acquisitions of others (that is the St. Paul Cos.-Travelers Property Casualty deal of 2003) or insurers taking only selected bits and pieces of other companies in the form of purchases of specific lines or blocks of business. Regardless, the result is largely expected to be the same: Increased consolidation in the insurance marketplace.

The independent agency system has followed the overall insurance industry trend toward consolidation. In 2002 (latest data available), there were 192 announced mergers and acquisitions in the agent/broker community. The number of deals has

[8] Insurance Information Institute and the Financial Services Roundtable, *The Financial Services Fact Book 2004* (Dec. 15, 2003), available at *www.financialservicesfacts.org.* (*FS Fact Book*)
[9] *Id.* at V.
[10] *Id.* at 76.
[11] *Id.*
[12] For more information on InsurBanc's products and services, go to *www.insurbanc.com.*
[13] *FS Fact Book* at V.
[14] Meg Green, *Bulking Up,* BEST'S REVIEW, JULY 2004, July 2004, at 22–23
[15] *Id.*
[16] *FS Fact Book at 1.*

remained relatively constant over the 5-year period from 1998 to 2002 with 184 deals in 1998, 235 deals in 1999, 188 deals in 2000, and 179 deals in 2001.[17] This however involves a relatively small number of all independent agencies, which continues to be a principal form of p/c insurance product distribution.

National Association of Registered Agents and Brokers (NARAB)

One of the most significant accomplishments of GLBA for the insurance marketplace was the NARAB Subtitle, which launched a producer licensing reform effort that continues today. Prior to the enactment of GLBA, each State managed its agent/broker licensing process in a distinct and independent manner, and there was virtually no consistency or reciprocity among the States. For agents and brokers, who increasingly operate in multiple jurisdictions, the financial and paperwork burdens associated with multi-State licensing compliance became overwhelming; and consumers suffered as duplicative and redundant regulatory requirements made it difficult for producers to be responsive to their needs. However, insurance producer licensing has improved dramatically over the last 5 years, and these changes are a direct result of Congress' decision to address these issues in Subtitle C.

The Subtitle put the ball in the States' court by threatening the creation of a new national, NASD-style licensing entity—known as the National Association of Registered Agents and Brokers—if the States did not satisfy the licensing reform objectives articulated by Congress. The creation of NARAB was only averted when a majority of the States and territories (interpreted to be 29 jurisdictions) achieved a specified level of licensing reciprocity within a 3-year period.

To their credit, the National Association of Insurance Commissioners (NAIC) and most States took swift and unprecedented action in response to "act-or-else" licensing provision. Nearly every State enacted new legislation that established licensing reciprocity among the States and instituted interstate uniformity in certain critical areas. According to the NAIC, at least 48 States have passed licensing reform legislation since the enactment of GLBA, and over 40 jurisdictions have been formally certified as meeting the NARAB mandates. There is no dispute that the NARAB provisions had their intended effect and initiated the move toward licensing modernization at the State level. Although more improvement is undoubtedly needed, the States have made significant progress in the 5 years since the passage of GLBA.

The success of the NARAB licensing provisions is a perfect example of what the Federal Government and the States can accomplish in partnership and how Congress can assist the States to achieve much needed marketplace reforms. The NAIC and State policymakers had been trying to move toward reciprocal and uniform licensing for over a century, but little progress was made until Congress set a specific deadline and attached specific goals and repercussions. In fact, Congress set the bar at only a majority of the States and now all but a handful of States have met the NARAB reciprocity standard. This success would not have occurred without targeted Federal legislation, or what some are now calling "Federal tools."

Some may argue that the bar was not set high enough—because uniformity was not required and several States have not adopted the reciprocity standards—but there is no arguing with the provision's effectiveness so far. There is certainly much more to do to get to full agent licensing reciprocity and the ultimate goal of licensing uniformity, but NARAB has set State insurance regulators on the right path, and Congress can now easily move the bar higher in follow-up legislation.

Functional Regulation—State Insurance Regulation

Perhaps the most important accomplishment of GLBA in protecting insurance consumers was its focus on functional regulation. The concept of functional regulation provides that insurance regulators oversee the business of insurance, banking regulators oversee banking activity, and securities regulators likewise are responsible for securities activity. GLBA specifically reaffirmed the traditional authority of the States to regulate the business of insurance in the United States.

GLBA expressly states that the McCarran-Ferguson Act[18] remains the law of the United States and further states that no person shall engage in the business of insurance in a State as principal or agent unless such person is licensed as required by the appropriate insurance regulator of such State. Title III also unequivocally provides that "[t]he insurance activities of any person (including a national bank exercising its powers to act as agent . . .) shall be functionally regulated by the States," subject only to certain exceptions which are intended to prevent a State from thereby frustrating the new affiliation policy adopted in Title I of GLBA. These

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[17] *FS Fact Book at 3.*

[18] McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011–1015 (1994)).

provisions collectively ensured that State insurance regulators retained regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. Title III also provided for expedited judicial review of disputes between State officials and Federal financial regulators, with the courts being directed to give equalized deference to the rulings or actions of both the States and the Federal regulator. These mandates were intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Since GLBA codified this important principle, the focus has largely shifted to the success of functional regulation in the insurance marketplace and the effectiveness and efficiency of State insurance regulation. The discussion has taken on more urgency as the perceived need for regulatory reform has increased due to the emergence of a more global financial services industry.

From the beginning of the insurance business in this country, it is the States that have carried out the essential task of regulating the insurance marketplace to protect consumers. The current State insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851, and insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved. When a Supreme Court decision raised questions about the role of the authority of the States, Congress quickly adopted the McCarran-Ferguson Act in 1945. That Act, which was reaffirmed by Congress 5 years ago, declared that States should regulate the business of insurance and that the continued regulation of the insurance industry by the States was in the public's best interest.

Most observers agree that State regulation has worked effectively to protect consumers, largely because State officials are positioned to be responsive to the needs of the local marketplace and local consumers. Unlike most other financial products, the purchaser of an insurance policy will not be able to fully determine the value of the product purchased until after a claim is presented—when it is too late to decide that a different insurer or a different product might make a better choice. As a result, insurance is a product with which consumers have many issues and questions and if a problem arises they want to resolve it with a local call. During 2001, State insurance regulators handled approximately 3.6 million consumer inquiries and complaints. Today, State insurance departments employ approximately 13,000 individuals who draw on over a century-and-a-half of regulatory experience to protect insurance consumers.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each State, and the policies themselves are contracts written and interpreted under the laws of each State. When property, casualty, and life claims arise, their legitimacy and amounts must be determined according to individual State legal codes. Consequently, the constitutions and statue books of every State are thick with language laying out the rights and responsibilities of insurers, agents, policyholders, and claimants. State courts have more than 100 years of experience interpreting and applying these State laws and judgments. The diversity of underlying State reparations laws, varying consumer needs from one region to another, and differing public expectations about the proper role of insurance regulation require local officials "on the beat."

Protecting policyholders against excessive insurer insolvency risk is one of the primary goals of insurance regulation. If insurers do not remain solvent, they cannot meet their obligations to pay claims. State insurance regulation gets high marks for the financial regulation of insurance underwriters. State regulators protect policyholders' interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs. The States, through the NAIC, have developed an effective accreditation system for financial regulation that is built on the concept of domiciliary deference (the State where the insurer is domiciled takes the lead role). When insolvencies do occur, a State safety net is employed: The State guaranty fund system. The system has paid out over $11 billion to cover claims asserted against insolvent insurers since they were first created in the mid-1970's. States also supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase products and file claims.

Despite its many benefits, State insurance regulation it not without its share of problems. The shortcomings of State regulation of insurance fall into two primary categories—it simply takes too long to get a new insurance product to market, and there is unnecessary duplicative regulatory oversight in the licensing and post-licensure auditing process.

In many ways, the "speed-to-market" issue is the most pressing and the most vexing from both a consumer and an agent/broker perspective because we all want access to new and innovative products that respond to identified needs. The reality of today's marketplace is that banking institutions and securities firms are able to develop and market new and more innovative products and services quickly, while insurance companies are hampered by lengthy and complicated filing and approval requirements in 50 States. As a result, insurance companies—and, derivatively, agents and brokers selling their products and services—are at a competitive disadvantage compared to their counterparts in other financial services sectors.

Today, insurance rates and policy forms are subject to some form of regulatory review in nearly every State, and the manner in which rates and forms are approved and otherwise regulated can differ dramatically from State-to-State and from one insurance line to the next. Such requirements are significant because they not only affect the products and prices that can be implemented, but also the timing of product and rate changes in today's competitive and dynamic marketplace. The current system, which may involve seeking approval for a new product or service in up to 55 different jurisdictions, is too often inefficient, paper intensive, time-consuming, and inconsistent with the advance of technology and regulatory reforms made in other industries. Cumbersome inefficiencies create opportunity costs, and the regulatory regime in many States is likely responsible for driving many consumers into alternative market mechanisms. In order to keep insurers competitive with other financial services entities and maximize consumer choice in terms of the range of products available to them, changes and improvements are needed.

Similarly, insurers are required to be licensed in every State in which they offer insurance products, and the regulators in those States have an independent right to determine whether an insurer should be licensed, to audit its market-conduct practices, to review mergers and acquisitions, and to dictate how the insurer should be governed. It is difficult to discern how the great cost of this duplicative regulatory oversight is justified.

IIABA's Support for the NARAB Approach of Targeted Reforms

As we have for over 100 years, IIABA supports State regulation of insurance—for all participants and for all activities in the marketplace—and we are opposed to any form of Federal regulation, optional or otherwise. Yet despite this historic and longstanding support for State insurance regulation, we are not confident that the State system will be able to resolve its problems on its own. For the most part, reforms must be made by statute, and State lawmakers inevitably face practical and political hurdles and collective action challenges in their pursuit of improvements on a national basis.

Therefore, IIABA believes that there is a vital role for Congress to play in helping to reform the State regulatory system, but that such an effort need not replace or duplicate at the Federal level what is already in place and successful at the State level. We propose that two overarching principles should guide any such efforts in this regard. First, Congress should attempt to fix only those components of the State system that are broken. Second, no actions should be taken that in any way jeopardize the protection of the insurance consumer, which is the fundamental objective of insurance regulation and of paramount importance to the IIABA as our members represent consumers in the insurance marketplace.

IIABA believes the best alternative for addressing the current deficiencies in the State-based regulatory system is a pragmatic, middle ground approach that utilizes Federal legislative tools to foster a more uniform system and to streamline the regulatory oversight process at the State level. By using targeted and limited Federal legislation to overcome the structural impediments to reform at the State level, we can improve rather than replace the current State-based system and in the process promote a more efficient and effective regulatory framework. Rather than employ a one-size-fits-all regulatory approach, a variety of legislative tools could be employed on an issue-by-issue basis to take into account the realities of today's increasingly global marketplace. There are only a handful of regulatory areas where uniformity and consistency are imperative, and Congress has the ability to address each of these core issues on a national basis in a single legislative act.

Congress's work in this area need not jeopardize or undermine the knowledge, skills, and experience that State regulators have developed over decades. While IIABA believes such a proposal must modernize those areas where existing requirements or procedures are outdated, it is important to ensure that this is done without displacing the components of the current system that work well. In this way, we can assure that insurance regulation will continue to be grounded on the proven expertise of State regulators at the local level.

The enactment of targeted Federal legislation to address certain, clearly identified problems with State regulation is not a radical concept. The Senate Banking Committee and the House Financial Services Committee have already proven that this approach can work with the NARAB provisions of GLBA that we have already discussed. The IIABA believes the NARAB model can serve as a template for further reform of State insurance regulation. The leadership of the House Financial Services Committee has recently decided to take the NARAB approach of "targeted reform" after conducting a 3-year, in-depth review of insurance regulation. We understand the Senate Banking Committee still has much to consider on this subject and the IIABA looks forward to working with you in any review of State insurance regulation and potential reforms that the Committee may conduct.

Conclusion

In conclusion, we can say that the GLBA has not fundamentally altered the insurance landscape for consumers. While the consolidation within the insurance marketplace that began in the 1990's has continued and perhaps increased, the mega-mergers of financial services providers that were expected have generally not occurred. GLBA reaffirmed the authority of the States to functionally regulate insurance, and led to substantial reform in the multi-State licensing of agents and brokers through the NARAB Subtitle. This was an important precedent in insurance regulation that Congress can look to in the future.

PREPARED STATEMENT OF STEVE BARTLETT

PRESIDENT AND CHIEF EXECUTIVE OFFICER
THE FINANCIAL SERVICES ROUNDTABLE

JULY 13, 2004

Mr. Chairman and Members of the Committee, I am Steve Bartlett, and I am President and Chief Executive Office of The Financial Services Roundtable.

I particularly appreciate the opportunity to testify on the impact of the Gramm-Leach-Bliley Act (GLBA). The Roundtable's membership reflects the spirit of that landmark law. The Roundtable members are 100 of the Nation's largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer.

With the enactment of GLBA, Congress acknowledged the contribution of the financial services industry to our economy. Not only are financial services firms directly responsible for almost 10 percent of our Nation's total gross domestic product (GDP), but they also contribute to the Nation's GDP by financing the activities of individual consumers and businesses. It is, therefore, appropriate for the Committee to review the impact of GLBA on the financial services industry and the economy as a whole.

One of the principal goals of GLBA was to maintain the competitiveness of the financial services industry so that all Americans could have access to financial services. Indeed, in writing GLBA, lawmakers set out to create an environment whereby the marketplace would determine through what channels consumers are able to purchase financial services. The environment is governed by regulations that ensure safety and soundness and consumer protection, but not what products can be offered, or by whom. By this standards GLBA has, in large measure, been a success. The U.S. financial services industry is the envy of the world. U.S. financial services firms are among the world's largest and best capitalized firms. The Roundtable members offer American consumers and businesses an ever-increasing array of financial products and services designed to address needs ranging from home loans, life insurance, securities brokerage, and retirement services.

However, in the past 5 years it has become apparent that some modifications to GLBA are necessary. In the remainder of my statement,I will outline some of the changes to GLBA that The Roundtable recommends.

Amend GLBA to Establish Uniform, National Privacy, Insurance, and Mortgage Lending Standards

In the past 5 years, it has become increasingly apparent that a number of financial services firms operate on a nationwide basis. They offer financial products and services to consumers and businesses not only through physical offices, but also over the Internet and telephone. Therefore, The Roundtable recommends that GLBA be amended to subject national financial services firms to uniform, national regulation.

This is not a call for the elimination of regulation. It is a recommendation that financial firms that operate on a national basis be subject to a single set of national standards rather than a multiplicity of State and local regulatory requirements.

More importantly, this is a recommendation that is intended to benefit the consumers of financial products and services. Overlapping and conflicting State and local regulatory requirements increase the operating costs of national firms, and these costs, inevitably, are passed along to consumers. Overlapping and conflicting State and local regulatory requirements also impair the ability of national firms to offer uniform products and services, This complicates life for the homeowner that moves from one State to another and seeks to receive the same financial products and services in his or her new home State. It also prevents a company that operates in multiple States from purchasing the same financial product or service for all of the company's facilities.

This Committee recently recognized the importance of uniform, national laws in the reauthorization of the Fair Credit Reporting Act. The principle of uniform, national financial regulation also is embedded in the National Bank Act, which applies to national banks, and the Home Owners' Loan Act, which applies to Federal savings associations.

The need for national standards is most evident in three areas: Privacy, insurance, and mortgage lending.

Privacy

Title V of GLBA imposed a number of privacy requirements upon financial institutions. These requirements include the distribution of an annual privacy notice to consumers, and they permit consumers to prevent the sharing of personal financial information with unaffiliated third parties. Title V of GLBA also expressly authorizes the States to adopt privacy notice and disclosure laws that afford consumers greater protection. The Roundtable urges the Committee to modify this provision of GLBA and establish uniform, national privacy standards for financial institutions.

Two examples illustrate the confusion and conflict created by current law. First, like many consumers, The Roundtable member companies have found that the annual privacy notice required by GLBA is overly confusing, and largely ignored by many consumers. Extensive research indicates that consumers have difficulty processing notices that contain more than seven elements, and that require a reader to translate vocabulary used in the notice into concepts they understand. Consumer surveys also indicate that over 60 percent of consumers would prefer a shorter notice than the lengthy privacy policy mandated by GLBA.

The Federal banking agencies, in conjunction with the Federal Trade Commission, the National Credit Union Administration, the Commodities Futures Trading Commission, and the Securities and Exchange Commission, recently requested comment on alternative notices that would be more readable and useful to consumers. Yet, even if these agencies develop a simplified notice, they lack the authority to make the notice truly consumer-friendly because GLBA leaves the States free to adopt their own, additional, notice requirements.

An illustration of the conflict created by GLBA's deference to State privacy laws arose just 2 weeks ago, when a Federal court affirmed the application of a California privacy law to financial institutions operating in that State. The California law, SB 1, permits consumers to prevent the sharing of information with affiliates (for example opt out) and requires that consumers affirmatively authorize the sharing of information with nonaffiliated third parties (for example, opt in). In ruling that the FCRA does not preempt the application of this law to financial institutions operating in California, the court based its opinion in part on the provisions of GLBA that allow States to adopt more stringent privacy laws, and that the Federal preemption applicable to affiliate sharing in the Fair Credit Reporting Act is limited strictly to credit reports. As the court stated: ". . . Title V of the Gramm-Leach-Bliley Act of 1999, which sets forth basic privacy protections that must be provided to consumers by financial institutions, demonstrates that it, and not the FCRA, encompasses the kind of information sharing at issue in this case." [1] This decision, if not reversed, amounts to an invitation to other States to pass their own privacy laws, thereby subjecting financial institutions, and their customers, to a variety of different and conflicting privacy regulations contrary to the clear intent of Congress to establish national uniform standards for affiliate sharing.

To avoid this consumer confusion and reaulatory conflict, the privacy standards in GLBA should be national, uniform standards. Also, the Federal regulators should be directed to promulgate a simplified, national privacy notice with a safeharbor.

Insurance

Title III of GLBA reaffirmed that the business of insurance is regulated primarily by the States. During the past 5 years, however, all parties to insurance regulation, including the State insurance commissioners, have concluded that the current system of insurance regulation is flawed. Indeed, the regulatory regime should be

[1] *American Bankers Assoc. et. al.* v. *Lockyer,* at page, 10.

updated to reflect the needs of our mobile, transient population. As the former President of the National Association of Insurance Commissioners, Mike Pickens, told the House Financial Services Committee last year: "We agree with critics that there is a need to make the [insurance regulatory] system more uniform, reciprocal, and efficient." [2]

The Roundtable has concluded that the best way to reform the regulation of insurance is to create a parallel system of chartering and supervision for insurance companies at the Federal level. This so-called "optional Federal chartering" system would not replace State insurance regulation. Instead, it would give insurance companies a supervisory alternative, similar to that available to banks and thrifts.

A soon-to-be published study that was partially funded by The Roundtable has found that the competition between the States and the Federal Government inherent in the dual banking system has generated significant benefits for banks, their regulators and their customers. Those benefits include enhanced product and regulatory innovation, expanded consumer choices, and expanded efficiencies in bank activities and regulations.[3] These same benefits would flow to the insurance industry, its regulators and its customers through the introduction of optional Federal regulation of insurance.

Mortgage Lending

GLBA addressed mortgage lending through provisions in Title I, which authorized financial holding companies to engage in mortgage lending, and Title VI, which made various reforms to the Federal Home Loan Bank System. In the 5 years since the enactment of GLBA, however, the regulation of mortgage lending has become a "hot" topic, as a variety of State and local governments have enacted laws designed to stop predatory lending practices, and as this Committee has debated the supervision of not only the Federal Home Loan Banks, but also Fannie Mae and Freddie Mac.

Accordingly, The Roundtable urges the Committee to amend GLBA and enact a national mortgage lending law that establishes basic antipredatory lending protections for mortgage borrowers. This Federal law should apply uniformly to all lenders, regardless of charter, and should supersede State antipredatory lending laws.

The rationale for a uniform, national mortgage lending law is the same as the rationale for a uniform, national privacy law: A single, Federal standard avoids consumer confusion and the potential for conflict between competing State and local laws.

Amend GLBA to Remove Sunset on Non-Financial Activities

One of the central features of GLBA was the creation of financial holding companies. It is now apparent that this feature of the bill has been only marginally successful. While most of the Nation's largest banking firms have become financial holding companies, only a handful of securities firms and insurance firms have chosen to do so. The financial holding company structure significantly expanded the scope of activities permissible for banking firms; it did not offer insurance firms and securities firms a similar benefit. Outside of the financial holding company structure, securities and insurance firms are subject to few limitations on affiliations. Thus, it is not surprising that only a handful of securities and insurance firms have become financial holding companies.

In a marketplace that is subject to rapid changes in technology and even more rapid changes in consumer demands, some companies need the flexibility to provide products and services outside the statutory list of activities that are financial in nature. Title I of GLBA took a step in this direction when it grandfathered the nonfinancial activities of companies that were not bank holding companies prior to GLBA, but became financial holding companies after the enactment of GLBA. This grandfather, however, only protects nonfinancial activities that constitute less than 15 percent of the financial holding company's gross revenues, and is scheduled to sunset in 5 years. We recommend that the Committee remove this sunset.

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[2] Hearing on "Reforming Insurance Regulation" before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the House Financial Services Committee, November 5, 2003.

[3] "The Benefits of Competition in Financial Regulation: Innovation, Choice and Efficiency," a paper by James A. Wilcox, Kruttschnitt Family Professor of Financial Institutions, Haas School of Business, University of California, Berkeley. We will provide the Committee a copy of this study upon publication.

Amend GLBA to Remove Activity Limitations Applicable to Financial Subsidiaries of National Banks and State Banks

Section 121 of GLBA authorized national banks to own financial subsidiaries, and empowered these subsidiaries to engage in a range of financial activities. At the same time, however, GLBA imposed a number of activity and other operating constraints on the financial subsidiaries of national banks and State banks that do not apply to financial holding companies. These constraints should be removed.[4]

The activity and operational limitations applicable to the financial subsidiaries of national and banks were imposed to eliminate a presumed subsidy enjoyed by banks as a result of the Federal safety net, but not available to uninsured bank holding companies. Thus, the activity and operational limitations were intended to ensure regulatory parity between banks and bank holding companies.

The problem with these limitations is that the case for the presumed subsidy was rather weak. Studies done by both the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) have found little, if any, evidence that banks, on net balance, receive a subsidy because of the Federal safety net. Therefore, instead of establishing regulatory parity between bank holding companies and banks, the limitations have had the effect of making the financial holding company structure, which is not subject to similar limitations, the more viable corporate vehicle for banking institutions seeking to engage in expanded financial activities.

Removing the activity and operational limitations on national and State banks would allow banking organizations to select between alternative corporate vehicles through which they could offer financial products and services.

State-chartered banks are subject to another activity limitation, which predates GLBA, and which also should be removed. In 1991, Congress barred State banks from engaging in any activity, as a principal, that is not permissible for a national bank. While the FDIC can overcome this prohibition by determining that a particular activity poses no significant risk to the deposit insurance fund, the prohibition is fundamentally at odds with the philosophy behind our dual banking system. The dual banking system is premised upon the operation of two, independent regulatory systems. Therefore, linking the powers of state banks to those permissible for national banks diminishes the independence of the State banking system. Moreover, this limitation cannot be justified on safety and soundness grounds. Both Federal regulators of State banks, the Federal Reserve Board and the Federal Deposit Insurance Corporation, have the authority to take actions against State banks if the activities of subsidiaries jeopardize the financial condition of the parent bank.[5]

Amend GLBA to Allow Treasury and the Federal Reserve Board to Independently Determine What Activities are Financial in Nature

When it comes to determining whether or not a new activity should be permissible for a financial subsidiary of a national or State bank or a subsidiary of a financial holding company, GLBA establishes a complex notice and disapproval procedure involving the Secretary of the Treasury and the Federal Reserve Board. This procedure gives each agency a veto over new activities. It also ensures that the activities permissible for financial subsidiaries of national and State banks will be the same as the activities permissible for subsidiaries of financial holding companies.

In the 5 years since GLBA was enacted, the Treasury and Federal Reserve Board have authorized few new activities. This suggests that the current procedure is overly cumbersome. Therefore The Roundtable recommends that the Treasury Department and the Federal Reserve Board should have independent authority to determine what a permissible financial activity is. 6 This would stimulate a positive competition between regulators that will benefit the customers of financial services firms and the financial services industry. This proposed change should not jeopardize the safety and soundness of affiliated depository institutions since the OCC and Federal Reserve have separate authority to ensure that the operations of financial affiliates do not harm depository institutions.

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[4] For example, financial subsidiaries of national banks may not underwrite insurance, may not engage in merchant banking activities, and may not engage in real estate development or investment. Moreover, the total assets of all financial subsidiaries of national banks cannot exceed a certain limit.

[5] For example, the prompt corrective action provisions in the Federal Deposit Insurance Act permit Federal regulators to restrictthe activities of subsidiaries or even require the divestiture of subsidiaries. Also, Section 114 of GLBA authorized the Federal banking regulators to impose restrictions or requirements on relationships and transactions between depository institutions and affiliated companies to ensure the safety and soundness ofthe depository institutions.

The Importance of National Laws, Federal Preemption, and Regulatory Competition

Three regulatory principles run throughout our testimony. The first is the need for uniform, national laws for the financial services sector of our economy. Today's financial services markets are characterized by a handful of large, national financial services firms, and thousands of smaller, local firms. The top 10 property and casualty insurers, for example, control roughly 55 percent of that industry's assets. Similarly, the top 10 banks account for 45 percent of all assets in the banking industry. Uniform, national regulation is in the best interest of these national firms, and more importantly, their customers. Uniform national regulation promotes efficiencies that can be passed along to consumers. It also permits the development of standard products and services that can be offered to consumers, regardless of their location. Therefore, we urge the Committee to incorporate the principle of uniform, national laws into GLBA in key areas such as privacy, insurance, and mortgage lending.

The regulatory companion to uniform, national laws is Federal preemption. Without Federal preemption, the goal of uniformity cannot be realized. Congress has recognized the Treasury also should have the ability to determine that certain activities are "complimentary" to financial activities; a power that Congress extended to the Federal Reserve Board when GLBA was enacted, but not to Treasury. Importance of preemption in other key sectors of our economy, such as drugs, airline safety, and communications. This principle needs to be applied more broadly to financial services.

Finally, the benefits of competition in financial regulation stand behind several of our recommended modifications to GLBA. As James Wilcox explains in his forthcoming paper, the competition between State and Federal banking regulations that is inherent in the dual banking system has produced numerous benefits to consumers, the industry and regulators. Therefore, we urge the Committee to modify GLBA in these concrete ways:

- Create national uniform privacy standards;
- Create national uniform protections against predatory lending;
- Create and optional Federal charter for life and property & casualty insurance companies;
- Remove the sunset on nonfinancial activities;
- Remove activity limitations on both national and State banks; and
- Allow Treasury and the Fed to determine independently what activities are financial in nature

Thank you for the opportunity to testify on this most important topic.

PREPARED STATEMENT OF JAMES D. McLAUGHLIN

DIRECTOR, REGULATORY AND TRUST AFFAIRS

AMERICAN BANKERS ASSOCIATION

JULY 13, 2004

Mr. Chairman and Members of the Committee, my name is James D. McLaughlin, Director, Regulatory and Trust Affairs of the American Bankers Association (ABA). The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

I am glad to be here today to present the views of the ABA on the impact of the Gramm-Leach-Bliley Act (GLB Act) on our businesses and customers. Consumers of financial services are a diverse group, ranging from individuals, small businesses, churches, and schools to large corporations and governments. The specific needs of each customer group differ, but they all expect—and deserve—efficient and convenient provision of financial services.

In 1999, Congress addressed the inefficiencies in the then-current structure and regulation of financial services by taking a forward-thinking approach to financial services regulation. By enacting the GLB Act, Congress streamlined the regulatory approval process and let market forces dictate what combinations of financial services would be most appropriate. Thus, by any measure, the GLB Act was one of the most significant laws affecting the financial services industry, providing the framework for the next century. It was not, however, a sea change. Dynamic market forces, aided by changing technologies and demographics, were already changing the market. While we do not know what future innovations will take place, we do know that free and fair competition creates an atmosphere that encourages innovation. The GLB act was an essential ingredient in bringing about such competition.

In my statement today, I would like to emphasize three points:

- The GLB Act was critical to modernizing our financial system, making it more sensible and straightforward, removing inefficiencies in structure and regulation, and letting market forces dictate what combinations of financial services would be appropriate;
- The GLB Act has worked well, benefiting customers, diversifying incomes of financial firms, and posing no new risks to the financial system or the deposit insurance funds; and
- More can be done to fully realize the benefits of the GLB Act, including preserving the regulatory flexibility given to the Federal Reserve and Treasury to adjust to a dynamic financial services market; assuring that regulatory proposals on broker "push out" address key industry concerns; providing a sensible cross marketing approach for merchant banking activities; encouraging the Federal Home Loan Banks to fully embrace the expanded collateral provisions in the Act; and creating uniformity of insurance regulation and supervision.

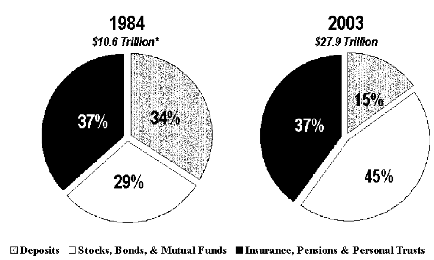
I will touch on each of these points in the remainder of my statement.

The GLB Act was Critical to Modernizing our Financial System

Economics, demographics, and technology created a whole new genre of financial consumers. Over the last 20 years, customers put a premium on efficiency and convenience; they are not intimidated by automated delivery systems; they are willing to use a wide variety of service providers—not just banks—to meet their financial needs; and they are much more active managers of their savings and investment dollars than previous generations. As a result, the mix of assets held by households changed significantly (see Chart 1).

Chart 1

Household Financial Assets

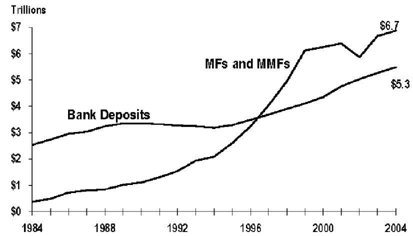


Data from the Federal Reserve *Flow of Funds* * In 2003 dollars

Financial firms began to adapt to these changes. Securities firms offered a full array of loan and loan-substitute products and mutual funds (that compete directly with deposits). Today, mutual and money market funds exceed bank deposits by $1.4 trillion (see Chart 2). Large corporate borrowers increasingly went directly to the financial markets for funding (See Chart 3). Diversified firms, like General Electric, offered a wide array of financial services—earning a substantial portion of their income from them. While the competing products were similar, the regulation was not.

Chart 2

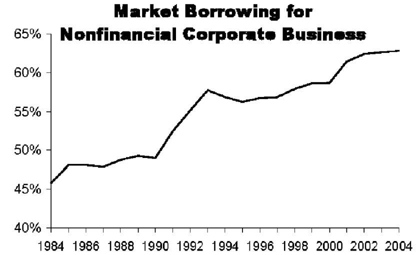
Mutual Funds *vs.* Bank Deposits



Data from the Federal Reserve *Flow of Funds*

Chart 3

Debt Instruments to Total Credit Market Borrowing for Nonfinancial Corporate Business



Data from the Federal Reserve *Flow of Funds*

Internationally, U.S. financial firms were in danger of falling behind foreign competitors, which typically were able to provide securities, insurance, and real estate services within "universal" banks. This gave foreign financial firms a competitive edge over the United States in attracting global financial business.

Banks were forced to be creative in finding ways to combine services, often in convoluted and expensive ways. Regulatory decisions helped—such as those permitting the establishment of so-called "Section 20 Subsidiaries" to allow bank holding companies to engage to a limited extent in securities underwriting and the approval for national banks to engage in the sale of insurance from towns of 5,000—but were not enough. Regulatory decisions were often challenged in court, slowing the evolution of the market. And the strict limits placed on the activities in which they could engage prevented U.S. banks—and their customers—from reaching all customers demanding these services. Thus, customers of banks were unable to take advantage of a full menu of financial services.

Responding to the need to modernize the financial system and after many years of deliberation, Congress enacted the Gramm-Leach-Bliley Act. It broke down decades-old barriers, allowed bank-affiliated firms to recognize the synergies associated with full affiliation of banking with underwriting and agency activities in securities and insurance. It also broadened the definition of financial services to enhance competition among all providers and it streamlined the approval process for acquisitions.

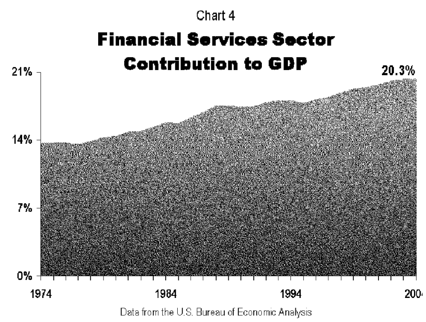
To avoid the need for Congress to continually referee disputes among financial service providers, the GLB Act gave to the Federal Reserve and the Treasury authority to define new activities that are financial in nature, or incidental to financial activities. This was designed to assure that regulation remains responsive to the evolving marketplace in financial services and to assure there was a level competitive playing field. As will be discussed briefly below, the real estate lobby has worked to derail this essential process in order to protect its own business interests rather than those of consumers of real estate services.

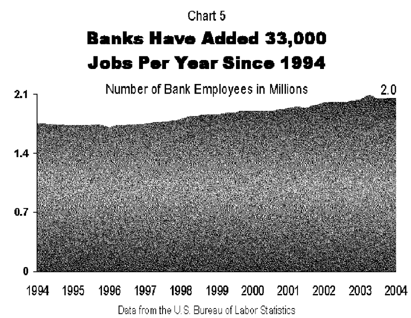
Importantly, while more efficient combinations can occur as a result of the GLB Act, they can do so without excessive risk taking or additional exposure to the FDIC fund. Several provisions help to ensure any risk is controlled and poses no threat to the deposit insurance fund. First, new products and services can now be provided to customers, thus helping to diversify income and improve the overall health of the financial institution. Second, the newly permissible activities, for the most part, are placed in financial subsidiaries or affiliates of the holding company, which are legally separate entities from the bank and thus pose no risk to insured deposits. Third, to utilize any of the new powers authorized in the GLB Act, all of the banks of the banking organization must be well-capitalized and well-managed and continue to be so. Failure to maintain these standards means that they would have to divest themselves of the new activity. And fourth, the Act also requires the large insured financial institutions have at least one issue of outstanding subordinated debt that is rated within the three highest investment grades. This provision was adopted "in order to bring market force and discipline to bear on their operation and the assessment of their viability" and applies, by regulation, to the largest 50 institutions.

The GLB Act also kept banking and commerce separate, giving the Federal Reserve the authority to determine when some nonfinancial activities are complementary to financial services.

The GLB Act Has Worked Well, Benefiting Customers and Posing No New Risks

By ratifying and rationalizing the regulatory structure of what was already occurring in the marketplace, the GLB Act has already been successful. The diversification of income sources most certainly helped many banks through the periods of slow economic growth while at the same time posing no new risks to the financial system or the deposit insurance funds. In fact, the banking industry has posted strong earnings since the enactment of the GLB Act, and now has capital and reserves exceeding $900 billion. The financial services industry continues to be a major driver in our economy, now accounting for over 20 percent of GDP (see Chart 4). Jobs within banking, and financial services generally, have continued to be created even during the recent slow economic times (see Chart 5).





As of July 2004, 647 financial holding companies—a new financial structure established in the GLB Act—had been formed (about 12 percent of banking organizations, holding 80 percent of the domestic banking-industry assets). There are many reasons for establishing a financial holding company (FHC). Some banks just wanted the streamlined approval process for acquisitions. Others wanted the market to know that their bank was well-capitalized and well-managed—a requirement to forming an FHC. Others were interested in merchant banking. About 25 percent are engaged in insurance agency activities and 5 percent in insurance underwriting (unrelated to the extension of credit).[1] Generally, all the BHC's with Section 20 subsidiaries have converted to FHC's. The reason for this is simple: These firms would no longer have to calculate the 75-to-25 ratio of permissible to impermissible income for a bank holding company—a burdensome and wasteful exercise.

While not all financial firms have rushed to become a financial holding company, they could if they so choose in the future. This is a critical point: The success of the GLB Act should not be judged by the number of financial holding companies or whether the combination of activities that firms now offer were a direct result of the GLB Act. Rather it is the very *option* to undertake combinations of activities to meet the needs of customers that is the measure of success. Importantly, the streamlined approval process for nondepository acquisitions has made a tremendous difference. FHC's now notify the Federal Reserve *after* the acquisition. Banking firms are now more competitive because they are able to make quick business decisions and implement programs to meet the changing market needs. No longer do they have to wait many months for regulatory approval of an acquisition, thereby losing business to firms that did not have such impediments. This is the way a dynamic, competitive market is supposed to work.

It should also be remembered that banks and other financial firms had already established relationships with securities and insurance firms prior to enactment of the GLB Act. The removal of the arbitrary restrictions, such as the eligibility revenue limits, has helped expand existing businesses that banks had underway. Smaller banks have used the GLB authorities to expand insurance brokerage activities without the artificial constraint of locating in a town of 5,000 residents.

There have been other benefits as well. About two dozen FHC's have used the GLB Act authorities to establish merchant banking operations. As the economy gains momentum, merchant banking activity is expected to increase. Many members of the ABA and the ABA Securities Association regard the authority to engage in

[1] As of June 2003, 52 percent of banks below $1 billion in assets were selling insurance with 33 percent selling general insurance (products other than credit related insurance and annuities).

expanded merchant banking activities as the single most important new power granted by the GLB Act. As a result, our members have a strong interest in ensuring that they can engage in merchant banking activities to the full extent allowed under the law. A particular concern, explained in more detail in Section III of this testimony, relates to provisions that restrict cross-marketing with respect to merchant banking for some firms (affiliated with securities companies) but not for others (affiliated with insurance companies). A sensible approach by Congress to cross marketing that is not based on ownership of one financial firm or another is needed.

The GLB Act established a two-way street allowing banking companies to efficiently enter securities, insurance, and other financial businesses as well as allowing these financial firms to enter the banking business. This enhances competition within the financial services market as all firms have the opportunity to provide a full range of financial services. It should be noted in this context, that the BHC Act continues to impose a more stringent antitying standard on bank and financial holding companies than on other firms competing in the financial services market.

In spite of the fact that nonbank financial firms offer bundled products, that they can form a FHC just like banking firms, and that banking firms are subject to more stringent antitying standards, some observers have claimed that banking organizations' ability to providing bundled services is somehow unfair, or even in violation of antitying statutes. These claims are serious and unfortunately are too often accepted without legal understanding or economic analysis. Two recent papers help to fill this analytical void. The first, "Legality of Relationship Banking Under Bank Antitying Restrictions" by Covington & Burling concludes that there are many permissible approaches for banks to expand customer relationships, including cross-selling and cross-marketing, engaging in certain forms of discount pricing based on the volume of services purchased, and legal tying involving traditional bank products under statutory and regulatory exceptions. This broad range of permissible relationship banking practices is consistent with the limited scope of Section 106, the antitying restrictions of the antitrust laws, and benefits of bundled products and services.[2]

The second paper, "Tying and Subsidized Loans: A Doubtful Problem" by Donald J. Mullineaux, DuPont Chair in Banking and Financial Services at the University of Kentucky, analyzes whether tying makes any sense from an economic perspective and evaluates the so-called "evidence of tying" that is based on comparisons of relative interest rates on syndicated loans and other types of financial contracts. This paper concludes that tying is not a rational strategy in today's financial environment and that no valid inferences about tying can be drawn from simple comparisons of rates on loans with those on bonds or credit default swaps.[3]

To summarize, the law no longer constrains the natural evolution of the financial services market—that will be the legacy of the GLB Act. The market will continue to evolve slowly as firms experiment and innovate, trying to find the best combination of services to meet the needs of their customers. Importantly, new combinations of services have been provided without excessive risk taking or additional exposure to the FDIC fund.

More Needs to be Done to Fully Realize the Benefits of the GLB Act

There are several issues of concern that limit or threaten the benefits of fair and open competition envisioned in the GLB Act:

- The flexible regulatory process designed to allow financial institutions to enter new lines of business must be allowed to work as envisioned in the Act;
- The banking industry has serious concerns over a new proposal by the Securities and Exchange Commission (SEC) regarding Regulation B (a.k.a., broker "push-out" rules) that should be addressed;
- A sensible cross-marketing approach for merchant banking activities is needed;
- More rapid adoption of expanded collateral provisions for Federal Home Loan Bank advances provided for in the GLB Act is needed to facilitate small business and small agri-business lending, and;
- Insurance regulatory reform is the next natural legislative step following the GLB Act to modernize the financial services industry.

[2] "Memorandum: Legality Of Relationship Banking Under Bank Antitying Restrictions," Covington and Burling, Washington, DC, May 28, 2003. This paper and the one by Dr. Mullineaux were supported by the American Bankers Association and the ABA Securities Association. The views expressed herein are strictly my own and do not necessarily represent the views of the American Bankers Association, ABASA or its members.

[3] "Tying and Subsidized Loans: A Doubtful Problem" by Dr. Donald J. Mullineaux, Director, School of Management DuPont Chair in Banking and Financial Services, Gatton College of Business and Economics, University of Kentucky, May 2003.

Regulatory Flexibility to Adjust to the Marketplace Should Be Preserved

In the more than 15 years of debate prior to enactment of the GLB Act, Congress often found itself in the middle of arguments between financial services industries about who should do what. The result was gridlock and an out-of-date financial system that did not reflect changes in consumer needs or in the use of technology. Congress also recognized that the statutory standard for regulatory approval of new activities for bank holding companies—the "closely related to banking" standard—was woefully inadequate in an economy transformed by technological progress.

To be sure that the procompetitive goals of the GLB Act continued to be met in a dynamic marketplace, Congress: (1) established a flexible regulatory process that would permit the financial industry to "compete effectively with any company seeking to provide financial services in the Unitied States" without the need for further legislation; and (2) set forth a new, considerably broader, standard to enable banks and bank holding companies to remain competitive no matter in what direction financial services evolved. That new standard—activities that are financial in nature or incidental to a financial activity—was intended to provide the flexibility Congress knew would be necessary. In an abundance of caution, those activities, even very low-risk agency activities, can only be conducted in FHC's or financial subsidiaries.

Unfortunately, this important provision has been derailed, at least for now, in one of first proposed rulings under this Act, having to do with real estate brokerage and management services. The merits of this proposal are not the subject of this hearing, and I will not belabor this matter beyond pointing out that real estate brokerage firms are competing directly with banks in providing financial services. They have even admitted so in testimony before this Committee and yet are working to frustrate the procompetitive process that Congress put into place in the GLB Act. What is central to this hearing is that an extremely important provision of the GLB Act—one that appropriately delegates responsibilities to the two agencies most familiar with the financial services industry—is not working. As a result, Congress has once again become embroiled in another competitive issue—the very thing it sought to avoid. We urge Congress to let the Treasury and the Federal Reserve undertake their responsibilities to assure that the financial services market remains fair and competitive.

Concerns Remain over Regulation B (Broker "Push-Out" Rules) Proposed by SEC

As part of its financial modernization scheme, the GLB Act removed the blanket exemption from SEC registration for banks that engage in securities activities. The blanket exemption was replaced with a set of narrow exceptions for bank "broker" and "dealer" activities. Under the GLB Act, any securities activities that fall outside of the exceptions may no longer be handled directly in the bank and, for practical reasons, must be "pushed out" into an SEC-supervised securities affiliate of the bank. The SEC delayed implementation of its rules several times, eventually putting in place a temporary exemption that effectively preserved the blanket exemption until the new rules could be rewritten. This action was very appropriate as the banking industry made clear that the rules suggested at that time, in a variety of respects, were burdensome, disruptive, costly, and unworkable.

In late 2002, the Commission took a dual track approach and issued final rules implementing the "dealer" part of the exceptions only. The "dealer" exception rules, including an exemption for securities lending activities, were issued in February 2003, and compliance became mandatory on September 30, 2003. On June 17, 2004, the SEC made public the proposed "Regulation B" rules to implement the bank exceptions from the definition of "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934, as amended by Title II of the GLB Act. In crafting proposed Regulation B, the SEC sought input from the ABA, the ABA Securities Association, and others. Bank trust officers, employee benefit professionals, custody managers, securities professionals, and private bankers all share a keen interest in the practical application of these rules.

While the proposal, in most respects, is a significant improvement over the earlier proposal, much work remains to be done. The regulation defines and clarifies a number of the statutory exceptions from the definition of "broker" and grants several new exemptions from the "broker" definition to banks and certain other financial institutions (which would supplement the statutory exceptions). Among the key issues that still need to be addressed are the following:

- The complexity of the "chiefly compensated" test under the trust and fiduciary exception;
- The inability of banks to offer order-taking to many new custodial clients after July 30, 2004, including, most importantly, IRA custodial accounts;
- The incompatibility of the employee benefit plan exception with current pension plan operations;

- The uncertainty posed by the proposal to current bank bonus and referral fee plans;
- The impact the rule will have on bank sweep programs; and,
- The proposal's refusal to treat equally thrifts and commercial banking organizations.

Over the last 3 years, the ABA has worked closely with the SEC on these issues and the proposal, in most, but not all respects, is a significant improvement over the earlier one. We appreciate the SEC's responsiveness to many of our concerns and hope that these additional problem areas can be adequately addressed in the next several months so that our member banks and savings institutions can continue to offer products and services, such as IRA accounts and pension plan services, which our customers have come to enjoy. During this process, we would hope that the Congress would continue to exercise its oversight responsibilities.

A Sensible Cross-Marketing Approach for Merchant Banking Activities Is Needed

There are two important changes in law that are needed that apply to the new merchant banking powers authorized under the GLB Act. The first change would allow *all* FHC's engaged in merchant banking activities to cross-market products and services offered by both the bank and the portfolio company in which the investment is made so long as the financial holding company has a noncontrolling investment stake in the portfolio company. The second change would permit all FHC's, whether or not their investment in the portfolio company was controlling, a limited ability to cross-market bank and portfolio company products and services. This latter change is necessary to ensure that FHC's affiliated with securities underwriting firms are not unfairly disadvantaged vis-á-vis those FHC's affiliated with insurance underwriting firms.

As background, the GLB Act generally imposes cross-marketing restrictions on FHC's engaged in merchant banking activities. The Act prohibits a depository institution controlled by an FHC from marketing any product or service of a company in which the FHC has made a merchant banking investment. The reverse is also true: The company in which the FHC has invested may not market the products and services of the FHC's affiliated depository institution to its customers.

An exception from this prohibition is provided, however, for merchant banking investments *made by insurance companies* owned by an FHC. Thus, insurance underwriting firms that affiliate with depository institutions are able to cross-market through statement stuffers, Internet websites products, or through the company in which they have made a merchant banking investment. Moreover, products and services offered by the company in which the insurance underwriting firm has invested also may be marketed via the depository institution that is affiliated with the insurance underwriting firm.

Nearly all of the members of the ABA Securities Association are FHC's that are able to make merchant banking investments because of their affiliation with *securities firms;* very few, however, own insurance companies that could engage in the type of insurance company merchant banking permitted by the GLB Act. As a result, our FHC members could not take advantage of the website/statement-stuffer exception, while other FHC's with insurance company merchant banking operations would be permitted to do so.

There is simply no rational or public policy reason for this plain competitive inequity. The ability to cross-market through Internet websites is important to banks. Current business practices often require an FHC to invest in an Internet firm in order for its banks' products to be posted on or linked to that firm's website.

Taken together, the amendments suggested above would allow banks to cross-market bank products and services to customers of a portfolio company and vice versa, so long as the FHC's investment stake was noncontrolling (which is defined as owning or controlling 25 percent or more of the total equity or any class of voting securities). In addition, we believe that even where a control situation existed, limited cross-marketing through websites and statement stuffers should be permitted for all FHC's.

Such changes will not only put our members on an equal footing with those insurance underwriting firms that engage in merchant banking, but they will also allow *all* FHC's to engage in cross-marketing so long as their merchant banking stake is noncontrolling. This latter provision is very important to level the playing field between FHC's and other non-FHC financial firms not similarly constrained by the GLB Act's bar on cross-marketing.

Federal Home Loan Banks Should Fully Embrace the Expanded Collateral Provisions of the GLB Act

Title VI of the GLB Act included a provision long advocated by the ABA that expanded categories of eligible collateral for community financial institution members of the Federal Home Loan Banks (FHLB's) to include "secured loans for small business, agriculture, or securities representing a whole interest in such secured loans."[4] Unfortunately, the acceptance of small business, small agri-business, and small farm collateral for loan advances by the Federal Home Loan Banks (FHLB's) has been spotty at best. In regions of the country where agricultural lending is a major line of business for member banks of the individual FHLB's, there has been some acceptance of the collateral. The Dallas and Topeka Federal Home Loan Banks have increased lending on this collateral the most, each accepting over $2 billion in small business, small agri-business or small farm collateral thus far this year. The Des Moines Bank has accepted $1.1 billion in this collateral thus far this year. However, even in these areas, agricultural loans (real estate secured and nonreal estate secured) continue to be heavily discounted for collateral advances. The individual FHLB's assured the public that as they gained experience with these loans that the discounting would be reduced if the loans performed as anticipated—and some have begun to do so. As an example, on July 1, 2004, the Dallas Bank increased the acceptable limit on this type of collateral from two times a member's Tier 1 capital to three times the member's Tier 1 capital. We applaud this move and encourage other FHLB's to follow suit.

In regions where agricultural lending does not dominate the business lines of the member banks, there has been little or no acceptance of these loans for collateral advances. Banks in these regions generally have required that members exhaust all other acceptable collateral before accepting the new categories.

To be fair to the FHLB's, some of the slowness is a result of the slowed down in the agricultural and rural economy due to a rapid decline in farm commodity prices and a decline in the manufacturing sector. Member banks have needed less borrowed funds to meet loan demand. Today, agricultural commodity prices have recovered, and a robust farm real estate market is occurring in all regions of the country. We are disappointed that more of the FHLB's are not positioned to meet what could potentially be a renewed need for lendable funds.

A related issue that is particularly disappointing to us is the on-going problem our members have faced when attempting to use Small Business Administration (SBA) and U.S. Department of Agriculture (USDA) guaranteed loans as collateral for FHLB advances. The Federal Housing Finance Board has made it clear that these loans, backed by the full faith and credit of the U.S. Government, are eligible collateral for purposes of borrowing from the FHLB's. However, due to technical issues related to SBA and USDA regulations on the terms and conditions of the Federal guarantees, most FHLB's place *no value* on the "full faith and credit" guaranty of the Federal Government. At best, some of the FHLB's discount the Federal guaranty and give the pledging banks no break on the collateral haircut; at other FHLB's, these loans are not acceptable collateral at all. Despite efforts of both the ABA and representatives from several FHLB's, officials that administer the loan programs at USDA and SBA have been less than willing to resolve this issue. Guaranteed loans are extended to the most economically vulnerable small farmers and small business people, and they deserve the best rates and terms possible. USDA and SBA should be encouraged to modify their regulations to solve this problem.

Insurance Regulatory Reform

The most significant work left undone by the GLB Act is modernization of the State system of insurance regulation. The American system of insurance regulation was set in place at about the same time as Allied forces were fighting the Battle of the Bulge in 1945. In March of that year, Congress delegated its authority to regulate insurance to the States with the passage of the McCarran-Ferguson Act.[5] This system is now more than half a century old and in dire need of modernization. Congress began to recognize this need in 1999 by including a provision within the GLB Act that encouraged the States to adopt either uniform or reciprocal licensing standards for insurance agents. The so-called "NARAB provision" called for the establish-

[4] 12 U.S.C. 1430(a)3E. Community financial institutions are FDIC insured institutions with less than $530 million in assets (adjusted for inflation from $500 million at the time of enactment). The FHLB's' regulator, the Federal Housing Finance Board, implemented this provision in 2000 allowing the FHLB's to accept small business, small agri-business, and small farm collateral.

[5] 15 U.S.C. Section 6701.

ment of a national licensing standard and required that standard to be adopted by a majority of the States.[6]

Accordingly, we were hopeful that a *uniform* licensing regime would be created, but that has not happened. Instead, a reciprocal licensing regime has been created, and while a majority of States have enacted this system, significant variations in licensing standards are still permitted. Unfortunately, the goal of creating just one set of licensing standards to which all insurance agents must adhere has yet to be realized. On a more positive note, NARAB's inclusion in the GLB Act began the discussion of why Congress is needed to resolve the problems inherent in the State insurance regulatory system. Although NARAB's success is limited, the States would not have achieved even such little uniformity as currently exists absent a Congressional mandate to do so. However, the narrow scope of the NARAB provision (for example, addressing only agent licensing) left unaddressed the myriad other problems of State insurance regulation that urgently need reform. The most glaring among them are:

- Non-uniform or duplicative agent and company licensing criteria;
- Inconsistent market conduct standards;
- Non-uniform privacy standards;
- Price controls; and,
- Prior approval barriers to product introduction and innovation.

All of these are fundamental problems associated with product availability and cost that duplicative and inefficient State regulation has created.

Witness the fact that most States require prior approval of insurance products and rates before the product can be sold. The same product—term life insurance, for example—must be modified to meet the different requirements imposed by every State and as a result, can take as long as 2 years to roll out a new product nationally.

Regulation of this sort impedes product innovation and introduction as the cost of complying with so many different laws restricts the ability of smaller companies to enter the marketplace. Similarly, rate regulation, or price controls as they should more appropriately be known, prevent some insurers from offering their products at prices that are profitable. Accordingly, highly regulated States, like Massachusetts and New Jersey, have a fraction of the insurance companies offering products for sale compared to States like Illinois and South Carolina where market forces set prices.

One solution to these problems endorsed by the ABA and its insurance affiliate, the American Bankers Insurance Association (ABIA), is to create an Optional Federal Charter (OFC) for insurance companies and agencies. Like the dual-banking system, an OFC would provide an alternative to the current State-by-State system of regulation and create the uniformity and efficiency that is unattainable under State regulation. Perhaps as important, an OFC would preclude or diminish the harmful effects of having State regulators create many different interpretations of a Federal standard. If uniformity is the goal, we can see no benefit to replacing the universe of differing State laws with a universe of differing State interpretations of a Federal law.

By leaving the State system intact, however, an OFC would preserve state regulation for those companies and agents preferring that system while providing choice for those that prefer the uniformity and efficiency of a single Federal regulator and the uniform regulations Federal oversight would provide. As with the dual-banking system, providing this choice for the insurance industry will create a critical dynamic that inures to the betterment of insurance regulation as a whole and insurance consumers in particular.

The problems inherent in State insurance regulation grow worse every day. We urge this Committee to examine State regulation of insurance in separate hearings and to debate solutions to these most urgent problems.

Conclusion

The GLB Act has helped to remove an obstacle to efficient provision of financial services. It responded to the needs of consumers and has increased the competition

[6] The National Association of Insurance Commissioners (NAIC) created the NARAB Working Group in December 1999 to help States implement Subtitle C requirements in Title III of the Gramm-Leach-Bliley Act. That subtitle requires State insurance regulators to meet Federal statutory requirements affecting insurance agent licensing, and provides for establishing a new organization named the National Association of Registered Agents and Brokers (NARAB) if the States fail to achieve the goals set forth in Subtitle C. The mission of the NARAB Working Group is to coordinate State regulatory actions related to NARAB, so that we can fully and promptly comply with all requirements in the GLB Act.

among financial service providers, each vying to design new and creative products by rebundling the four basic financial services—transactions services, intermediation, risk management, and advice. In this new competitive environment, customers look to suppliers who can provide combinations of services tailored to meet their needs. As Senator Phil Gramm said at the signing ceremony for this Act: "The world changes, and Congress and the laws have to change with it . . . . We have learned that we promote economic growth and we promote stability by having competition and freedom."

PREPARED STATEMENT OF JOHN TAYLOR

PRESIDENT AND CEO, NATIONAL COMMUNITY REINVESTMENT COALITION (NCRC)

JULY 13, 2004

Good morning Chairman Shelby and Ranking Minority Member Sarbanes. I am honored to be testifying this morning and representing the views of community organizations regarding a law that revolutionized the banking industry. My name is John Taylor; I am the President and CEO of the National Community Reinvestment Coalition (NCRC).

NCRC is the Nation's economic justice trade association of 600 community organizations and public agencies dedicated to increasing access to capital and credit for minority and working class communities. NCRC was founded to protect and strengthen the Community Reinvestment Act (CRA) since CRA increases access to credit by insuring that banks have an affirmative obligation to serve all communities in which they are chartered.

It is particularly fitting that NCRC is testifying today because the Gramm-Leach-Bliley Act (GLBA) has directly and indirectly weakened CRA. If the flaws of GLBA are not fixed soon, Americans' access to credit and capital will diminish dramatically. The U.S. banking system is the envy of the world. In great part, this is directly attributable to our extensive regulatory oversight, which ensures adequate capital reserves, safety and soundness, and fair and equal access to credit. GLBA has failed to ensure that regulations relating to fair and equal access to credit and capital have kept pace with safety and soundness regulation.

In order for fair lending regulation to keep pace with the changes in the financial industry unleashed by GLBA, CRA must be updated and applied to more institutions as one of GLBA's authors, Rep. James Leach, supported. In particular, community reinvestment obligations must apply to all affiliates of holding companies and to lending institutions that are not part of holding companies. Data disclosure requirements also must be enhanced. In addition, the harmful aspects of GLBA that must be repealed immediately are CRA Sunshine and the reduction in frequency of small bank CRA exams.

CRA Sunshine

The one area of strong consensus among community leaders and the lending industry is that the so-called "CRA sunshine requirements" of GLBA must be repealed. The CRA sunshine provision sought to quantify the amount of bank dollars granted to community groups. It was believed that such grants were used for operating support rather than for the direct provision of financial services and products. Five years later, we now know that the facts do not support this theory.

In fall 2002, NCRC released a report called *CRA Sunshine Reveals Benefits of Bank-Community Group Partnerships.* In this report, NCRC used the Freedom of Information Act (FOIA) to obtain 707 CRA agreements made during 1999 through 2001 subject to the CRA sunshine disclosure requirements. As defined by GLBA, a CRA agreement is a commitment in writing by a bank to a nongovernmental enterprise exceeding $10,000 in grants or $50,000 in loans. If the nongovernmental enterprise such as a community group commented to the bank or a regulatory agency about the CRA performance of the bank, the bank and community group must disclose the initial CRA agreement to Federal regulatory agencies and must disclose subsequent expenditures of funds received by the community group under the agreement.

NCRC found that of the $3.6 billion in the 707 agreements, only $11.8 million or less than three tenths of 1 percent was grants or other funding for community groups (I have submitted a copy of our report for the record).* These grants supported the vital missions of nonprofit homeless shelters, housing developers, and other neighborhoodbased groups engaged in housing and economic development. The

* Report held in Committee files.

grants also helped lenders meet community credit needs and increase their lending, investing, and services in low- and moderate-income neighborhoods, as required by CRA.

CRA sunshine frustrates the essential purpose of CRA, which is to ensure that banks affirmatively meet credit needs. Further, CRA sunshine increases paperwork burden on banks and community groups with no tangible net benefit to the public. The repeal of this ill-advised and useless section of GLBA must occur immediately.

Less Frequent Exams for Small Banks

Another direct harm of the GLBA is the reduction in frequency of small bank CRA exams. Under GLBA, small banks with assets of under $250 million are examined only once every 4 years if they have a Satisfactory CRA rating and once every 5 years if they have an Outstanding rating.

When small banks are examined that infrequently, they have little incentive to affirmatively and continually adhere to their reinvestment obligations. They will have reduced incentives to make sufficient numbers of loans to low- and moderate-income borrowers during the entire 4- or 5-year time period between exams, and may only focus their efforts during the last year or two before exams. It is commonsense that infrequent examinations lead to infrequent commitments to reinvestment, while more frequent examinations lead to more consistent commitments to reinvestment.

NCRC's 600 community organization members have reported that less frequent exams have reduced the amount of lending by small banks to low- and moderate-income borrowers. NCRC would have preferred to present quantifiable evidence to the Committee today, but we found out about testifying a mere 2 days before our testimony was due. We call upon Congress to commission a comprehensive study assessing the impacts of the CRA exam stretch-out on lending to working class Americans.

This reduction in frequency responded to industry complaints about so-called "burden of CRA exams." What continues to astonish NCRC, however, is that the Federal regulatory agencies appear to accept industry arguments about burden although the Federal regulators themselves have yet to conduct their own comprehensive cost-benefit analysis regarding CRA's application to small banks.

The lack of a thoughtful cost-benefit analysis is readily apparent in the GLBA stretch-out of the small bank CRA exam schedule. The small bank exam is a quick and straightforward exam that focuses on lending and dispenses with the investment and service test of the large bank exam. For any small bank that is true to the mission of a "community banker," the small bank CRA exam is a relatively easy exam. If Members of this Committee actually looked at small bank CRA exams, they would be astonished that all of this noise about burden can be generated by exams that rarely exceed 10 pages in length.

Despite the brevity of the exam, its importance cannot be underestimated. In too many poor rural communities, the CRA exam process is the only mechanism that holds small banks accountable for serving low- and moderate-income borrowers and communities. Smaller banks do not merge nearly as often as their larger counterparts, rendering the merger application process a seldom-used avenue for holding smaller banks accountable. Community groups are also not as prevalent in smaller rural communities as in large cities. Thus, the major mechanism for holding small banks accountable is the CRA exam.

Yet, GLBA has greatly diminished the most important means of accountability of small banks. Instead of once every 2 or 3 years, CRA exams for small banks now occur once every 4 or 5 years. In reality, the exams are probably less frequent since scheduled exams often get cancelled and rescheduled. In too many cases, the result of the stretch-out of CRA exams means that small banks may be examined only once or twice in a decade as opposed to 3 or 4 times.

In their scanty amount of analysis on small bank burdens, the Federal banking agencies have found that CRA regulations "impose a modest information collection burden on small institutions—an average of 10 burden hours per institution per year."[1] In addition, the relatively few trade articles on small bank CRA exams also reveal few complaints about burden. In fact, an *American Banker* article shortly after the CRA regulation reform in 1995 is entitled "Small Banks Give Thumbs-Up to Streamlined CRA Exams." In this article, small bankers are quoted as saying

[1] *Federal Register,* May 28, 1999 (Volume 64, Number 103), pages 29083 through 29086.

that the exams were not burdensome and that CRA examiners took less than 1 day of their time.[2]

The available evidence suggests minimal burden, but great benefits due to CRA exams. But since the 1995 regulatory changes to CRA exams, the only action by policymakers has been to reduce the rigor of CRA exams. First, GLBA reduces the frequency of small bank CRA exams. Now, the regulatory agencies wish to apply the streamlined small bank CRA exam to more than 1,000 additional institutions. Recently, the Senate Banking Committee asked NCRC to document the damage caused by this proposed change; NCRC eagerly responded, documenting in great detail the loss in community reinvestment due to this latest proposal.

Mr. Chairman, it is clear to us that CRA is not burdensome and has greatly benefited both banks and community groups by increasing the number of profitable loans, investments, and services made to low- and moderate-income communities. We urge you to halt and reverse the trend of CRA deregulation. A place to begin would be to repeal the stretchout of small bank CRA exams.

Have and Maintain Satisfactory CRA Requirement

GLBA added a requirement that bank holding companies must ensure that all of their affiliates pass CRA exams (at least Satisfactory ratings) in order to be allowed to merge with nonbank financial institutions and take advantage of the new powers under GLBA. This requirement sends a signal that banks must comply with their obligations under CRA if they wish to enjoy the privileges afforded to them by GLBA. While well-intentioned, this requirement has not been applied in one case to our knowledge. A major reason for this is less than 2 percent of banks and thrifts fail their CRA exams, and the great majority of failing banks are smaller institutions less likely to merge or engage in nonbank financial business authorized by GLBA.

In fact, the Federal Reserve Board had one opportunity in a large and controversial merger to apply this requirement, but arbitrarily and capriciously adopted a narrow reading of the GLBA requirement. During 2000, Citigroup acquired the notorious lender Associates First Capital Corporation. A subsidiary of Associates, Associates National Bank, had a Needs-to-Improve CRA rating. Once Citigroup owned Associates National Bank, it would have had an affiliate with a Needs-to-Improve CRA rating, rendering it ineligible for GLBA powers and privileges. Confronted with the first opportunity to enforce the “Have and Maintain” requirement, the Federal Reserve punted. The Federal Reserve reasoned that the GLBA requirement applied only to the holding company that is the acquirer, not to the institution being acquired. Yet, this hair-splitting distinction is not present in the GLB Act.

Strengthening the “Have and Maintain” Requirement

The intention of the “Have and Maintain” requirement was to ensure that institutions engaging in large scale mergers and embarking on broad new powers adhered to their CRA obligation to serve all communities, including low- and moderate-income ones. Unintentional loopholes have subverted Congress’ ambitious and laudatory intention. Congress must close this loophole by specifying that the “Have and Maintain” requirement must apply to the institution being acquired as well as to the acquirer.

Furthermore, since failing ratings are so rare, the “Have and Maintain” requirement must be strengthened by imposing significant affirmative obligations on institutions that wish to merge. NCRC urges you to consider requiring merging institutions to submit a CRA plan with their merger application.

In the past year, merger activity has reached a frenzied pace and has included the largest mergers in history. The Bank of America and Fleet merger and the JP Morgan Chase and Bank One merger will create institutions with more than $1 trillion in assets. Despite the incredible magnitude of these and other recent mergers, the Federal Reserve Board does not require any meaningful CRA plan from merging institutions. The CRA “convenience and needs” discussions in the merger applications usually consist of one or two page boasts about how great the banks’ CRA performance are. The presentations also usually contain predications that the banks’ CRA performance will improve once they get bigger after mergers. Yet, NCRC has too often documented with HMDA and CRA small business lending data that the amount of loans decrease dramatically after large mergers. In too many cases, banks close branches and lay-off loan offices in order to achieve merger “efficiencies.”

[2] “Small Banks Give Thumbs-Up To Steamlined CRA Exams,” Jaret Seiberg of the *American Banker,* Thursday, February 1, 1996.

A requirement for a meaningful CRA plan holds out hope for communities that mergers will not result in significant reductions in loans, investments, and services. A meaningful CRA plan would require merging institutions to provide the number of loans, investments, and services they made by State, metropolitan area, and rural portions of States in past years. The plan would then describe how the institution would increase their number of loans, investments, and services to minority and low- and moderate-income communities and borrowers. In addition, the plan would require meaningful performance measures such as comparisons between the percentages of loans a bank made to low- and moderate-income borrowers and communities, and the percentages of loans that the bank's peers made to these borrowers and communities. The plan would identify geographical areas (on a State, urban, and rural level) in which the bank lags its peers on the performance measures and would indicate how the bank will do better in these geographical areas.

Finally, and importantly, the CRA plan would include a fair lending component. Large institutions seeking expanded GLBA powers are often involved in making high-cost subprime mortgage loans or purchasing these loans. The Federal Reserve Board and the other banking agencies, however, are not requiring specific promises and reforms that would ensure that these loans are not predatory. In addition, large banks involved in the mega-mergers are financing payday lenders, car title lenders, pawnbrokers, and other fringe lenders. The Federal Reserve Board, however, is not requiring due diligence mechanisms for these financial arrangements although the Federal Reserve Board has used its supervisory powers to make sure that none of the banks it regulates engages in payday lending.

The CRA and fair lending plan would become the focus of discussion among banks, the regulators, and the general public during public comment periods and hearings. Currently, banks submit applications with no meaningful discussion of CRA and fair lending compliance; community groups comment on these glaring inadequacies; and the Federal Reserve then approves the merger applications with no conditions. In contrast, meaningful CRA plans would stimulate meaningful discussions about strengths and weaknesses in banks' CRA performance. The Federal Reserve Board would then encourage and/or require banks to specifically address weaknesses in their CRA and fair lending performance. The end result would be an increase in safe and sound lending for traditionally underserved communities.

NCRC believes that meaningful CRA and fair lending plans should be required in every merger application proceeding. At the very least, this requirement should apply to the larger mergers, involving institutions with $1 billion or more in assets. Public hearings held by the regulatory agencies in States most affected by the mergers must also be automatic for the larger mergers. In addition, the CRA plan requirement could also focus on geographical areas or parts of CRA exams in which a lender scored Low Satisfactory or below.

Updating CRA to Keep Pace with Sweeping Changes in the Financial Industry

As lawmakers debated GLBA, NCRC and our 600 member organizations continually pointed out that while GLBA would create larger and vastly more powerful financial institutions, CRA was not being updated to keep pace with the dramatic changes in the financial industry unleashed by GLBA. GLBA did not apply CRA or CRA-like requirements to mortgage company affiliates, other affiliates that made loans, insurance companies or securities firms that would become part of holding companies. As a result, a very real possibility exists that CRA will apply to fewer and fewer assets of holding companies. At the same time, CRA was not applied to credit unions, mortgage companies, and other competitors of bank holding companies. This creates an uneven playing field for bank holding companies that must comply with CRA and with institutions with no community reinvestment obligations. Of more concern to communities, the uneven application of CRA reduces the amount of community reinvestment, financial activity, and wealth building in their communities. The uneven application of CRA also undermines President Bush's call for more minority homeownership and more importantly subverts the dreams and aspirations of millions of Americans seeking to build a future for their families.

Since GLBA, NCRC worked with Congressman Gutierrez, Barrett, and 34 other Members of Congress to craft the CRA Modernization Act that would apply CRA to all parts of bank holding companies as well as to institutions outside of bank holding companies. If Congress wishes to ensure that GLBA benefits all Americans, it must take up all or at least parts of the CRA Modernization Act. A good place to begin would be to apply CRA and fair lending exams to all affiliates of holding companies that lend since the Federal Reserve still hesitates to act on the GAO's recommendation of fair lending reviews for affiliates.[3] Second, Congress can then expand CRA to all lending institutions, including credit unions and mortgage companies.

Third, Congress must increase the amount of data disclosure on lending activity. Expanding upon a provision in the CRA Modernization Act, Rep. James McGovern has sponsored H.R. 1748, the Access and Openness in Small Business Lending Act of 2003.

This bill amends the Equal Credit Opportunity Act (specifically Federal Reserve Regulation B) to permit the collection of demographic information in connection with small business loans with the applicant's consent. Currently, CRA only requires banks and thrifts to report the census tract location of small businesses receiving loans.

Unlike publicly available home loan data, the small business loan data lacks demographic characteristics of borrowers. In particular, the small business loan data does not have information on the race and gender of the small business owner. H.R. 1748 would update the CRA data to require the collection and dissemination of race and gender of the small business owner. Other data enhancements include the revenue size of the small business and data on denials as well as approvals.

The home loan data has stimulated a significant increase in lending to minorities, women, and low- and moderate-income borrowers precisely because its public availability holds lenders accountable for reaching formerly neglected borrowers. Enhancing the small business data would similarly increase lending to women- and minority-owned small businesses. We know from studies conducted by the Milken Institute and others that women-owned businesses are in the dark ages when it comes to access for credit. Improvements in small business lending data would be a great benefit to half of the American population by providing women with greater chances of securing loans for their businesses.

Research has proven that CRA works to expand access to capital and credit. Using NCRC's database of CRA agreements, Harvard University, the Department of Treasury and Federal Reserve economists have shown that banks made more loans to low- and moderate-income communities in geographical areas in which they made CRA agreements. Moreover, the research concluded that banks made more loans in geographical areas in which they had branches and underwent CRA exams than in geographical areas outside the purview of the CRA exams (often because their mortgage company affiliates were not included on their CRA exams but made considerable numbers of loans in a large number of geographical areas).[4]

Lending is good for America. Access to credit and capital is the traditional method that allows any family to build equity and create wealth. CRA brings more wealth, more stakeholders, and more parity.

Uneven Regulatory Regime Threatens Sustainability of U.S. Banking Success

Banks are highly regulated, but securities companies and insurance firms are not. By allowing banks and nonbank financial companies to merge, GLBA exposes banks to higher levels of risk from their lightly regulated affiliates. At the same time, banks themselves are taking on more risk by outsourcing their serving operations to foreign countries. This creates job loss here at home and makes it more difficult for banks to control and monitor their operations.

In addition to the safety and soundness risks, the increased financial industry consolidation and globalization creates access difficulties for low- and moderate-income borrowers. For example, consumers need insurance policies in order to secure home mortgage loans. Their bank may be covered by CRA, but the bank's insurance company affiliate is not. What happens to CRA enforcement when the bank's insurance company unfairly denies a low-income borrower for a homeowner's insurance policy? NCRC does not believe that lawmakers completely thought through the implications of industry consolidation on CRA enforcement when passing GLBA.

Clearly, the safety and soundness and fair lending oversight of nonbank financial affiliates of bank holding companies must be increased. At the same time, stronger

[3] General Accounting Office, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending,* January 2004, GAO–04–280.

[4] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System,* March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report,* produced for the U.S. Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending,* Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via *bostic@usc.edu.*

firewalls must be created between Federal regulatory agencies and financial institutions. Recently, we have all become alarmed by the case of the OCC examiner for Riggs leaving the OCC and working for Riggs while the bank was not enacting sufficient safeguards against money laundering. In the financial world shaped by GLBA, the integrity and rigor of supervisory and examiner officials assumes paramount importance. For this reason, NCRC recommends that regulatory officials be barred from working at financial institutions for a period of 5 years after they leave their agencies. With all due respect, the same requirement should be imposed upon members of Congress.

Conclusion

If research has shown beyond a reasonable doubt that CRA works, why not update CRA and apply it evenly across the financial industry? Firstly, lawmakers should do no harm to CRA and must repeal GLBA's CRA sunshine requirement and small bank exam stretch-out. Second, lawmakers must apply CRA to all parts of holding companies that lend and to lending institutions outside of holding companies. Third, lawmakers then must consider CRA-like requirements for nonbank financial institutions including insurance companies and securities firms.

Mr. Chairman, communities cannot afford another 5 years of GLBA and missed reinvestment opportunities. NCRC stands ready to support Congressional efforts to update CRA and make capitalism and the American Dream available to all Americans who work hard and play by the rules.

PREPARED STATEMENT OF J. STEVEN JUDGE

SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
SECURITIES INDUSTRY ASSOCIATION

JULY 13, 2004

Chairman Shelby, Senator Sarbanes, and Members of the Committee, I am Steve Judge, Senior Vice President of Government Affairs, Securities Industry Association (SIA).[1] I appreciate the opportunity to present our views on the Gramm-Leach-Bliley Act (GLBA) as we approach the 5-year anniversary ofthe enactment of that landmark legislation.

SIA commends this Committee for its efforts in enacting the GLBA, and for holding these hearings to examine the effects of the Act. SIA believes that these hearings will initiate an important dialogue in the financial services industry and with policymakers about identifying and eliminating unnecessary regulatory restrictions that impede the ability of our financial services firms to: Develop and offer consumers a full range of financial services and products; structure themselves optimally; mitigate risk for themselves and for the broader financial markets, and; maintain global competitiveness and preeminence. SIA looks forward to participating in that dialogue.

In considering the effects of the GLBA, it is useful to recall how constrained the financial services industry would have been without enactment of GLBA. The ability of financial services firms to affiliate was primarily governed by the Glass-Steagall Act, a Depression-era law that ceased to reflect the realities of the modern financial services industry. That law's prohibition on affiliations between banks and securities firms, for example, had long since lost any rationale it might once have had. In the 66 years since enactment of the Glass-Steagall Act, banks and securities firms had begun to offer an array of competing products and services to their retail and institutional clients, and many banks and securities firms determined that they could best serve their customers by offering "one-stop-financial-shopping."

The banking regulators, in particular, had adopted a variety of regulations that permitted banks to acquire certain securities firms, although securities firms were prohibited from affiliating with banks. The result was a "mish-mash" of confusing

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[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: *www.sia.com.*)

rules and regulations, which were never able to provide the full range of relief the industry sought and consumers needed, and which tilted the playing field in favor of the banks. For example, national banks could own subsidiaries that engaged in securities brokerage activities as long as the subsidiary did not engage in dealer or underwriting activities. Securities firms owned by bank holding companies could engage in a limited amount of dealer and underwriting activities, but those activities could not account for more than 20 percent (and eventually 25 percent) of that firm's revenues. Securities firms were prohibited from owning banks, although they were able to affiliate with thrifts and certain other types of financial institutions. State laws further complicated the regulatory picture, and banking and securities regulators occasionally wrestled in court over various jurisdictional issues.

The resulting legislative restrictions and regulatory uncertainties artificially restricted affiliations among financial services firms. Such restrictions undermined their competitive position, their ability to develop and offer new services and products, and consumers' access to a full range of financial products and services from a single financial institution.

SIA and various members of the financial services community had been working with Congress for decades to pass legislation to permit affiliations between and among securities firms, banks and insurance companies. We sought legislation that would create a "two-way street" by allowing banks, securities firms, or insurance companies to affiliate on an equal footing. Essential to that goal was the assurance that competition, not regulatory fiat, would dictate when and how financial services firms could affiliate. We sought legislation that protected consumers by ensuring that each affiliated financial services entity would be functionally regulated—that is, regulated by the regulator with the regulatory expertise and statutory mandate to regulate the activities in which that entity engaged.

The enactment of GLBA has in many respects rationalized and modernized the untenable and antiquated financial institution regulatory environment that existed prior to its passage. Under the GLBA:

- Banks, securities firms, and insurance companies can now affiliate under a financial services holding company (FSHC) structure. The FSHC is regulated by the Federal Reserve Board (FRB), and each of the subsidiary financial services firms are regulated by their respective functional regulators. A securities firm in a FSHC structure is not limited to an artificial cap on the amount of revenue it can derive from underwriting and principal transactions (such as the 20 percent, and then 25 percent, caps imposed under the Bank Holding Company Act). The ability of financial services firms to more easily affiliate under a FSHC structure should permit larger firms to become more diversified, which should in turn result in greater product and services offerings, increased domestic and international competitiveness, and greater financial stability.
- Financial services firms also have a number of other structural options available to them, further increasing their flexibility and competitiveness. For example, bank holding companies can elect to remain under the same structure as they did prior to the enactment of the GLBA. Holding companies that own securities firms, but that do not have substantial commercial banking activities, can elect to be regulated as investment bank holding companies, which are subject to the jurisdiction of the Securities and Exchange Commission (SEC). Well-capitalized and well-managed banks can own securities firms. And securities firms and certain other companies that owned thrifts and other nonbank banks prior to the enactment of the GLBA may continue to own those entities.
- Subsidiaries of FSHC's can engage in a wide variety of financial activities beyond banking, securities, and insurance activities, including merchant-banking activities. Notably, the intent of the GLBA was to permit securities firms in a FSHC structure to engage in merchant-banking activities to the same extent as securities firms that are unaffiliated with a bank. Securities firms that are subsidiaries of FSHC's also are permitted to continue to engage in certain preexisting commercial lines of business until 2009.
- Banks are permitted to engage in a variety of specified securities activities without being required to register as broker-dealers. The SEC has recently reproposed regulations (proposed Regulation B) that would implement these provisions.
- Financial services firms (regardless of whether they are affiliated with FSHC's) are subject to comprehensive privacy requirements, which among other things require disclosure of the firm's privacy policies, and impose substantive limitations on the circumstances in which a financial services firm can share confidential financial information about a customer or consumer. Financial services firms are required to implement policies and procedures to safeguard confidential customer information. To SIA's knowledge, no other industry in the United States is subject

to the comprehensive Federal privacy requirements that now apply to financial services firms.

Since the enactment of the GLBA, there have been a number of significant combinations of financial services firms. Some firms have chosen to combine with commercial banks. Other firms have chosen to remain independent. That is how it should be. One of the overarching goals of the GLBA was to allow financial services firms to choose the optimal structure to best serve their customers' needs. Among SIA's membership, bank or financial-holding company-ownership has increased from 13.4 percent in 1999 to 21 percent today. Moreover, banks have significantly increased their presence in capital markets activities. For example, banks now lead-manage 58.2 percent of equity underwriting deals versus only 36.8 percent in 1999.

As a further example of the effectiveness of the GLBA, these combinations generally have not resulted in the newly affiliated firms having to shed significant lines of business or having to artificially limit their revenues from securities underwriting and certain other activities, as was often the case prior to the GLBA. These combinations also generally have not required Federal regulators to provide the type of significant regulatory relief that was often necessary pre-GLBA.

When examining the overall effectiveness of the GLBA, it is important to note that various economic factors and significant changes in the capital markets over the last 5 years have made it tenuous, at best, to determine cause-and-effect relationships post-GLBA. We need more time and experience to get the full picture of the GLBA's effects. What we do know is that the GLBA is a comprehensive statute regulating a diverse, dynamic, and constantly evolving financial services industry. As a result, there have been, and likely will continue to be, issues concerning the implementation of the legislation. SIA and other industry participants have questioned how, for example, the FRB proposed to implement the merchant-banking provisions of the GLBA, and how the Federal Trade Commission and other regulatory agencies proposed to implement the Act's privacy provisions. Currently, the SEC has reproposed rules governing the scope of bank-securities activities; the reproposed rules are intended to respond to the significant criticism of the rules as they were initially proposed.

Neither these nor similar implementation issues, however, necessarily suggest structural problems with the GLBA. Rather, they may well be normal transition issues that are almost inevitable when first permitting combinations of companies that had largely been prohibited, or significantly restricted, from combining for over 60 years. In this regard, GLBA is notable for the fact that, despite its complexity and scope, it was so carefully drafted that not a single technical or similar amendment has been enacted to correct any of its provisions.

Moreover, there are some weaknesses that have always existed with GLBA that this Committee could address. Among the most significant of those are:

- Securities firms in a FSHC should be able to engage in a full range of commercial activities to the same extent as securities firms that are unaffiliated with a bank. Currently, the GLBA only permits securities firms in a FSHC structure to continue engaging in preexisting commercial activities until 2009.
- There should be solely national standards governing customer privacy requirements, especially given the national scope of many financial institutions, and the fact that even many smaller financial institutions now have customers from a number of States. Requiring financial institutions to comply with Federal requirements and then the additional requirements potentially imposed by each State in which that firm operates is burdensome, cumbersome, and contrary to an overarching goal of the GLBA of increasing efficiency in the regulation of financial services companies.
- There should be uniform national standards for securities. The National Conference of Commissioners on Uniform State Laws (NCCUSL) has adopted a Model Uniform Securities Act that brings uniformity to the registration process, facilitates electronic signatures, filing and records, and adopts additional investor protections. SIA is actively working with State securities commissioners for adoption of the Uniform Securities Act by their State legislatures.

The U.S. capital markets and financial services industry are stronger, healthier, and more dynamic since Congress enacted the GLBA in 1999. In spite of the tremendous challenges and changes of the last several years, consumers and financial services firms alike are better off as a result of the increased opportunities and choices that the GLBA made possible. SIA commends this Committee for holding these hearings, and looks forward to working with you, the regulators, and other industry participants to maintain our Nation's preeminent capital markets.

RESPONSE TO A WRITTEN QUESTION OF SENATOR ALLARD FROM HARRY P. DOHERTY

Q.1. In your testimony your write, “However, due to a highly politicized campaign by the Realtor community, Treasury and the Federal Reserve have not been allowed to complete their work on the regulation. In this particular instance, considerations other than safety and soundness have held sway.”

As the Senate sponsor of the Community Choice in Real Estate Act, what considerations are alleging that I am acting upon? Doesn’t this statement call into questions the integrity of the bill’s supporters?

Do you believe that the consideration of Congressional intent, which is my motivation for introducing the Community Choice in Real Estate Act, is inappropriate?

If Congress believes that a regulation is moving forward contrary to legislative intent, what should it do?

A.1. On July 13, 2004, I testified about the implementation and impact of the Gramm-Leach-Bliley Act on the financial services industry. In my written statement, I had the following to say about the joint Treasury-Federal Reserve process for determining permissible new financial activities for financial holding companies and financial subsidiaries of national banks:

> One of the promises of the GLBA was the relatively easy authorization of new financial activities for banking organizations. GLBA established a joint Federal Reserve and Treasury regulatory process for the authorization of permissible new financial activities for banking organizations. The hope was that under this process, safety-and-soundness would be the dominant factor in the decisionmaking process. However, in the first real test of this authority, the two agencies have not been able to complete their work on a regulation that would authorize for national banks and financial holding companies an activity, which is already authorized for Federal savings associations and roughly half the State-chartered banks.
>
> In January 2001, the Treasury and the Federal Reserve issued a proposed regulation to permit national bank financial subsidiaries and financial holding companies to provide real estate brokerage and real estate management services to their customers. However, due to a highly politicized campaign by the realtor community, Treasury and the Federal Reserve have not been allowed to complete their work on the regulation. In this particular instance, considerations other than safety and soundness have held sway.

It was not my intent, or the intent of America’s Community Bankers, to call into question the integrity of any Senator for his or her sponsorship of the Community Choice in Real Estate Act (S. 98) or any other legislation. It was, however, my intent to make the observation that appropriations riders have circumvented the process established by Congress in GLBA—a process that is based on safety and soundness and related statutory considerations. Moreover, because real estate activities have been authorized for years and safely conducted by Federal savings associations and State-chartered banks, we believe that safety and soundness considerations should lead the Treasury and the Federal Reserve to finalize regulations to permit financial holding companies and national bank financial subsidiaries to conduct real estate brokerage and management activities.

Congress clearly has the right to change the policy established in the GLBA and carve out, through subsequent legislation, real estate brokerage and management activities from the list of permissible activities for financial holding companies and financial subsidiaries. ACB does not support such legislation. ACB believes that permitting these banking organizations to engage in these real estate activities will bring additional, healthy competition to the real estate sector, which can only benefit consumers. Clearly, many in the real estate industry and in Congress disagree with our position. But, ours is a disagreement about policy, not about motives.

RESPONSE TO A WRITTEN QUESTIONS OF SENATOR ALLARD FROM TERRY JORDE

Q.1. Regarding real estate management and brokerage activities you testified, "We believe that GLB provides the Treasury and the Federal Reserve full authority to permit these activities." Do you at least acknowledge that a number of House and Senate Members, including a number of Members who wrote the GLB bill, would disagree with the characterization that GLB permits these activities?

Do you consider it insignificant or unimportant that more than half of the Members of Congress have indicated that they disagree with your characterization of GLB by cosponsoring bills to prohibit implementation of the regulations?

What place should the views of the Congress have in the regulatory process?

A.1. I hesitate to speculate on the motives or opinions of Members of Congress who have cosponsored legislation to block the real estate brokerage and management rule proposed by the Treasury and Federal Reserve. They may believe that the agencies lack the authority to adopt the regulation or that the agencies have the authority and they wish to take it away. Whatever the case, I do believe that it is significant when over half of the Members of Congress cosponsor any piece of legislation. And, as I indicated in my testimony, ICBA strongly encourages Congress to maintain active oversight of the legislation it enacts.

Nevertheless, in this case ICBA believes that GLB *does* provide the Treasury and the Federal Reserve the authority to adopt the real estate brokerage and management proposal and that it would provide community banks and their customers significant benefits. Therefore, we hope that Congress does not adopt permanent legislation blocking the rule or continue blocking it through the appropriations process.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ALLARD FROM JAMES D. MCLAUGHLIN

Q.1. You testified that, "What is central to this hearing is that an extremely important provision of the GLB Act—one that appropriately delegates responsibilities to the two agencies most familiar with the financial services industry—is not working." But doesn't Congress retain the authority, and in fact the duty, to oversee implementation of the laws is has passed?

A.1. Of course Congress should oversee the manner in which the laws it enacts are implemented. The July 13 hearing was such an example of the appropriate exercise of Congress's oversight duty—a review by the Committee holding substantive expertise in and jurisdiction over the law enacted.

Q.2. Once a law is enacted, does Congress become irrelevant? If not, what role should Congress play? If Congress believes that a regulation is moving forward contrary to legislative intent, what should it do?

A.2. Where the Congress sees an incorrect interpretation or an inadequate implementation of a law it can and should bring it to the attention of the agency. If further action is deemed necessary Congress has the power, through the substantive legislative process involving the Committees of jurisdiction, to change the law.

STATEMENT OF DENNIS W. ARCHER

PRESIDENT, AMERICAN BAR ASSOCIATION

JULY 13, 2004

Mr. Chairman and Members of the Committee, I am Dennis W. Archer, President of the American Bar Association. Thank you for holding this oversight hearing on the Gramm-Leach-Bliley Act 5 years after its passage. I applaud your leadership in conducting the Committee's oversight role in this important area. I respectfully submit to you this statement with the request that it be made part of the hearing record.

The American Bar Association is the world's largest voluntary professional association with more than 400,000 members. As the national umbrella organization of the legal field, our mission is to serve the public and the profession by promoting justice, professional excellence, and respect for the law.

In June 2001, attorneys nationwide awoke to find that the Federal Trade Commission had interpreted the Gramm-Leach-Bliley Act (GLBA), the most sweeping reform of the banking, securities, and insurance industries since Glass-Stegall, as amending the attorney's duty of confidentiality to clients and imposing unnecessary and counterproductive measures that confused consumers regarding the attorney-client relationship.

There was no evidence before and leading up to the passage of the GLBA to indicate that Congress intended to treat lawyers as "financial institutions" within the meaning of the Act. In fact, in the record of the 106th Congress' consideration of S. 900, the legislation that would become the GLBA, the only mention of attorneys were two references to the stringent and effective confidentiality rules with which attorneys must comply.[1] In the debate on the Conference Report of S. 900, Senator Conrad R. Burns confirmed that there was no intent that the privacy provisions of the GLBA apply to lawyers when he stated:

> Paramount to our freedom is the right to privacy; to be left alone and to be secure in the belief that our business is just that, ours and no one else's. When we do share our personal business information with others, it is with the real and reasonable expectation that it remains our property. When dealing with our doctor or lawyer we know that the communication is privileged.[2]

The ABA contributes to the high standards of conduct of the legal profession expected by the public through our development and promulgation of the Model Rules of Professional Conduct and, its predecessor, of the Model Code of Professional Responsibility. The Model Rules and its predecessor are the source of the vast majority of the professional conduct codes that are enforced in every State and every territory of the United States and with which attorneys must comply in order to retain the right to practice law in this country.

Each of the 50 States and 6 territories, including the District of Columbia, has either adopted Model Rule 1.6, Confidentiality of Information, has adopted its equivalent from the Model Code, Canon 5, or, as in the case of California, has developed a similar rule for its own jurisdiction. The text of Model Rule 1.6 is as follows:

> (a) A lawyer shall not reveal information relating to the representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).
>
> (b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:
>
> (1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or
>
> (2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or a civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.[3]

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[1] Please see 145 Cong. Rec. S13891 (daily ed. Nov. 4 1999) and 145 Cong Rec. S13908 (daily ed. Nov. 4, 1999).

[2] 145 Cong Rec. S13908 at S13908.

[3] Model Code of Professional Responsibility Rule 1.6 (1998).

The California rule states, in pertinent part: "It is the duty of an attorney to . . . maintain inviolate the confidences, and at every peril to himself or herself to preserve the secrets, of his or her client." [4]

Professional conduct rules for attorneys are enacted under the authority of the court of highest appellate authority within the State or territory, or, in some cases, the State legislature. Attorneys, as officers of the court, are answerable for their ethical conduct to the court. Violations are prosecuted through *sui generis* disciplinary proceedings that result from the inherent regulatory authority of the courts.[5]

To date, there have been no allegations of insufficient enforcement of client confidentiality rules at the state or territory level, nor has there been a call for Federal intervention. The current system for protecting clients' rights has remained in place and been effectively applied for decades. Application of the privacy provisions of the GLBA to attorneys—including requiring attorneys to mail confusing privacy notices to their clients—will not increase protection for the public above that which the State-based system currently requires.

These State and territory conduct codes, along with the attorney-client privilege and the work product doctrine found in common law, form the foundation of the attorney's duty of confidentiality. This duty exists in all matters related to the client's representation. It applies not only to communications from the client but to all information relating to the representation, whatever its source. These codes flatly prohibit disclosure of any information relating to a representation without prior discussion with, and consent by, the affected client, except in limited and legally mandated circumstances. Affiliate sharing, as envisioned by the GLBA, does not occur in the practice of law.

GLBA was enacted "to enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial service providers. . ." [6] Its broad privacy protection provisions were added to enable consumers to limit the use of their personal information by financial institutions and their affiliates. These protections were deemed necessary because of the potential for abuse that the ability to merge affiliate records. and the increased ease of dissemination through technological advances in data storage and retrieval afforded the post-GLBA financial institution.

The scope and application of the GLBA privacy provisions at issue hinge on the term "financial institution." The term was defined by Congress as "any institution the business of which is engaging in financial activities as described in Section 1843(k) of Title 12 [Section 4(k) of the Bank Holding Company Act of 1956]." [7] Regulations promulgated by the Federal Reserve Board pursuant to the Bank Holding Company Act provide that the term "financial activities" should include real estate settlement services, tax-planning and tax-preparation services, and collection of overdue accounts receivable. Based on the fact that some of the activities on this list are performed by attorneys, the Federal Trade Commission has taken the position that lawyers and law firms who engage in any of these activities in the course of practicing law are "financial institutions" within the meaning of the GLBA. This interpretation of the GLBA is overbroad and ignores both the common sense meaning of "financial institution" and the legislative history and purpose of the GLBA.

Imposing the burdens of the GLBA privacy provisions on the legal profession does not further any of the legislative objectives of the statute. Worse yet, it has been counterproductive because it has, and could continue to, create confusion among consumers regarding the scope of attorney-client confidentiality. Many attorneys have already contacted the ABA regarding the confusion and consternation that has been caused among clients as a result of the GLBA privacy notices mandated by the FTC's interpretation. They report instances in which the sending of privacy notices have revealed the fact of legal representation to adverse parties residing at the same address as the client, of anxious phone calls requesting detailed explanations of the notices' meaning in the context of a confidential relationship and of money wasted on needless mailings of confidentiality policies that already were well understood.

Clients know that their information is protected by the duty of confidentiality, by professional conduct codes and by court recognized privileges. When they receive privacy notices from their attorney listing the GLBA mandated exceptions in statutorily mandated terms, however, they question how the relationship between them and their attorney could have changed. Clients know they have the right to an opt

[4] Cal. Bus. & Prof. Code, Section 6068 (2001).

[5] See *Middlesex County Ethics Committee* v. *Garden State Bar Association,* 457 U.S. 423 (1982).

[6] H.R. Conf. Rep. No. 106–434, at 245 (1999), reprinted in 1999 U.S.C.C.A.N. 245, 245.

[7] 15 U.S.C. § 6809(3)(A).

in disclosure policy with their attorneys; that no information will be disclosed unless the client wishes to do so. The GLBA privacy provisions provide for an opt out policy, with disclosure as the default. This is contradictory and misleading to consumers. Confusion naturally results.

The ABA and several State bar associations petitioned the Federal Trade Commission for relief. When the Commission refused those requests, the New York State Bar Association and the ABA filed suit in the U.S. District Court for the District of Columbia. Twenty-five State and local bar associations [8] and the Conference of Chief Justices joined the litigation as *amici curiae.* On May 12, 2004, the District Court for the District of Columbia entered a final judgment in favor of the ABA. On July 12, 2004, the day before this hearing, the FTC filed notice of appeal, which presents the prospect of a lengthy period of litigation resulting in sustained uncertainty for more than a half-million attorneys and millions of their clients. This situation is untenable.

We urge, the Committee, as it reexamines the efficacy of GLBA, to use its authority to clarify the original intent of Congress as to the application of Title V. Attorneys are not financial institutions and should not be treated as such. Thank you for the opportunity to present the views of the American Bar Association at this time.

STATEMENT OF DAVID F. WOODS, CLU, ChFC

PRESIDENT, THE NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS

JULY 13, 2004

The National Association of Insurance and Financial Advisors (NAIFA) is delighted to have the opportunity to share with the Senate Banking Committee our views regarding the performance and impact of the Gramm-Leach-Bliley Act (GLBA) 5 years after its passage.

NAIFA is a federation of approximately 800 State and local associations representing over 225,000 life and health insurance agents and advisers and their employees. Originally founded in 1890 as the National Association of Life Underwriters, NAIFA is the Nation's oldest and largest trade association of life and health insurance agents and financial advisers. NAIFA's mission is to enhance the business and professional skills, and promote the ethical conduct, of our members, and to advocate for a positive legislative and regulatory environment.

At the outset, NAIFA commends Chairman Shelby, Senator Sarbanes, and the Committee Members for holding this hearing. Passage of the Gramm-Leach-Bliley Act was a watershed event in the financial services industry. It is critical that we understand the impact of the law since its enactment and how it will affect financial services entities, including life insurance agents and financial advisers, in the future.

NAIFA supported passage of GLBA because we believed the law would benefit agents and consumers. We believed that breaking down Federal and State law barriers among the banking, securities, and insurance industries would lead to a more vibrant financial services marketplace and help to ensure that insurance agents are on an even playing field with our colleagues and competitors in the banking and securities sectors. Since its enactment, NAIFA members have worked diligently with State and Federal regulators and lawmakers to ensure that GLBA implementation is carried out in a way that benefits consumers and benefits, or does not unduly burden, industry.

While there have been some tangible and important benefits arising from GLBA, overall the results have been mixed. On the broad scale, we have not seen the market convergence that was predicted with the repeal of the Glass-Steagall Act. The mixing of insurance and banking has taken place almost entirely at the agent level. There has been little in the way of mergers among banks, securities firms, and insurance companies. This is not necessarily a bad thing. In fact, the benefit of GLBA

[8] The State and local bar associations are: the Arizona Bar, Arkansas Bar Association, Atlanta Bar Association, Beverley Hills Bar Association, Cleveland Bar Association, Colorado Bar Association, Connecticut Bar Association, Cuyahoga County Bar Association, The Florida Bar, Illinois State Bar Association, Lawyer's Club of Los Angeles County, Maryland State Bar Association, Nashville Bar Association, New Orleans Bar Association, Ohio Bar Association, Oklahoma Bar Association, New Jersey State Bar Association, State Bar Association of North Dakota, Pennsylvania Bar Association, South Carolina Bar Association, the State Bar of Wisconsin, Tennessee Bar Association, Vermont Bar Association, Virginia State Bar, and West Virginia Bar Association.

is that it has allowed the industry, rather than regulators, to make decisions based on the workings of the marketplace. Citigroup's divestiture of its property and casualty insurance divisions is clear evidence of the marketplace at work.

GLBA has also had mixed results on the narrower insurance-specific issues. Licensing of insurance agents and brokers (also referred to herein as insurance producers), privacy, preemption, coordination and cooperation among regulators, and consumer protection are all addressed in GLBA and all significantly affect insurance agents and our clients. Although there are a number of reasons we have not realized the full benefit of these GLBA provisions, NAIFA believes one of the most critical roadblocks is the current cumbersome, duplicative insurance regulatory system. The States have made solid efforts to improve the current regulatory system, and we strongly support their work. It has become increasingly clear, however, that the State system needs help. NAIFA believes it is imperative that the problems and inefficiencies in the State regulatory system be corrected quickly, and supports the active involvement of the Congress in the reform process.

This statement addresses the performance and impact of GLBA from the perspective of a life insurance agent. Life insurance agents generally sell products including standard life insurance policies, annuities, disability income, and long-term care products. The statement focuses on two areas: (i) the impact of GLBA on the life insurance agent community and NAIFA's work with State legislators, State insurance regulators, and Federal financial services regulators in its implementation; and (ii) the need for Congressional involvement in insurance regulatory reform, which is necessary to help us realize the full potential of the Gramm-Leach-Bliley Act.

GLBA Five Years Later—Mixed Results for Insurance Agents

GLBA affects the insurance industry, including insurance producers, in numerous ways, including:

- reform of the producer licensing system and providing for creation of the National Association of Registered Agents and Brokers (NARAB);
- imposing notice and opt out obligations on financial services entities to protect consumer privacy;
- preempting State insurance laws, potentially giving Federal banking regulators significant input into insurance regulation; and
- enlarging the role of the Federal Government in insurance regulation through provisions including Federal consumer protection requirements, "functional regulation," and coordination among State and Federal regulators.

NARAB/Producer Licensing

NAIFA has worked for years to get the NAIC and State insurance regulators to fix the cumbersome, duplicative State-based system of producer licensing. GLBA's NARAB provision successfully pushed the States to enact reform. In 2000, the NAIC adopted the Producer Licensing Model Act (PLMA), which provides for a system of reciprocal licensing in the States pursuant to the NARAB requirements. The PLMA has been enacted in some form in 49 States and the District of Columbia.

NAIFA and our State affiliates have been extremely active and are, in large part, responsible for enactment of the PLMA in the States. NAIFA is also working with the NAIC in the development of specific recommendations for greater uniformity in producer licensing requirements, and we have been a board member of the National Insurance Producer Registry (NIPR), which operates the electronic database of producer information that has made licensing significantly faster and easier.

Passage of NARAB gave the States the needed incentive to streamline the insurance producer licensing system, but it did not go far enough. Today, there are approximately 40 States that the NAIC has deemed "reciprocal" for NARAB purposes. Although other States have adopted portions of the PLMA, there remain a significant number of States—including major markets such as California and Florida—that are not reciprocal and therefore not in compliance.

In addition, reciprocal States sometimes have similar legal requirements but differing standards for licensure—thus creating a patchwork of approaches across the country.

Full reciprocity, uniformity of standards and, ultimately, uniform laws in every State are needed before NARAB can be considered a complete success.

Privacy of Consumer Information

GLBA imposes obligations on financial services entities to protect the privacy of certain consumer information. The Federal banking and securities agencies promulgated regulations for banks and securities firms, and the State insurance regulators were delegated the task of promulgating regulations for the insurance industry. NAIFA worked with the NAIC Privacy Working Group to draft a model privacy regulation outlining a uniform regime for all elements of the financial services industry, and worked with the States to ensure that the model regulation was promulgated as uniformly as possible across the country. To assist NAIFA members in complying with the new privacy obligations, NAIFA produced an Insurance Producer Privacy Guide that outlines the requirements and compliance steps for producers.

The requirements of the GLBA privacy provisions have been met by regulators and industry, but they fall short of their potential. In the insurance sector, the lack of uniformity in privacy requirements makes it burdensome for insurers and producers to comply. Many States have promulgated the NAIC's privacy model regulation, but a significant number have different laws on their books, many based on an older NAIC model. In addition, the lack of preemption of State privacy laws makes it possible that the States could change their privacy requirements at any time, as demonstrated by California's privacy law, which was recently found to be not preempted by the Fair Credit Reporting Act (FCRA).

Finally, to add to the complexity of the GLBA privacy requirements, the FCRA and HIPPA also impose privacy requirements with which insurers and producers must comply. These multiple layers of protection arguably confuse, rather than help, consumers, who must work through pages of disclosure to decipher what their financial services company's policies are and to determine what their options are. It is worth noting that the State insurance regulators and the Federal agencies have deemed it necessary to review GLBA privacy notices to determine if the disclosure can be simplified to be more understandable.

Preemption of State Insurance Laws

Although GLBA prohibits the States from taking certain actions with respect to the insurance activities of banks, the parameters of these preemption provisions are not clear in the statutes and have not been firmly established by the courts. Two important preemption cases have been decided recently—one by the U.S. Court of Appeals for the First Circuit and one by the Fourth Circuit.[1] In the Fourth Circuit case, the court rejected the State of West Virginia's challenge to an OCC "preemption opinion" finding that certain West Virginia bank sales of insurance provisions were preempted because, in the court's view, the OCC has full authority to make that determination.[2] In the First Circuit case, the court took exactly the opposite view, ruling that an OCC "preemption opinion" opining that certain Massachusetts bank sales of insurance provisions were preempted by Section 104(d)(2) was entitled to no consideration whatsoever and that the Massachusetts challenge to that opinion letter was therefore moot.[3] The Massachusetts banks have begun a court challenge against those provisions but without OCC participation.

Clarification of GLBA's preemption provisions is important to all participants in the insurance marketplace, particularly producers. NAIFA supports equal treatment of all producers—whether or not they are bank-affiliated. However, we would oppose any effort to unfairly favor a particular group of producers through Federal preemption. Most important, we need to have a clear standard, so that we can make business decisions based on full knowledge of the law and marketplace.

Other Provisions

There are many other provisions of GLBA that affect insurance producers, many of them involving Federal regulators and their interaction with State insurance regulators. GLBA establishes a system of "functional regulation," in which responsibility for enforcement of laws generally is determined according to the function of the activity rather than the type of institution performing the activity. In addition, the law requires coordination and communication among State and Federal financial services regulators. This coordination was most evident in the implementation of GLBA's consumer protection provisions, a process that NAIFA was also heavily involved in. The Federal agencies and State regulators consulted each other closely in the promulgation of Federal rules and the amendment of the NAIC Unfair Claims Practices Model Act.

NAIFA supports interaction between the Federal and State regulators. As supporters of State regulation, however, we do not want the Federal banking and securities agencies to exert undue influence on the insurance regulatory process. Insur-

[1] A third case, *Association of Banks in Insurance, Inc.* v. *Duryee,* 270 F.3d 397, (6th Cir. 2001), was decided in 2001. In that case, the 6th Circuit ruled that the challenged Ohio law was preempted because it imposed a prohibition on bank insurance sales activity. Therefore, the court did not make a holding on the parameters of the "significant interference" test.

[2] *Cline* v. *Hawke,* No. 02–2100 (4th Cir. Nov. 19, 2002), *cert. denied* (U.S. October 6, 2003) (No. 02–1620).

[3] *Bowler* v. *Hawke,* 320 F.3d 59 (1st Cir. 2003).

ance is different from banking and securities, and it is important for regulation of the industry to be handled by insurance experts. Having said that, it would be extremely beneficial to have an insurance presence at the Federal level. Although the NAIC and State insurance regulators do their best to assist the Federal agencies and Congress on insurance issues, the lack of a knowledgeable insurance professional at the Federal level makes the education process much more difficult. An expert at the Federal level of Government would be able to educate policymakers so the implications of their decisions on the insurance market are well-understood. In addition, a Federal presence could serve an important role in international and trade issues, where it is important to speak with one voice. Banking and securities regulators currently serve this role with respect to the industries they regulate, and we believe it is sensible to add an insurance voice to the mix.

Full Promise of GLBA Requires Insurance Regulatory Reform

NAIFA members are long-time supporters of State regulation and remain steadfastly committed to this tradition. We believe, as others do, that fixing the problems with the insurance regulatory system will yield a strong and healthy insurance marketplace, ultimately providing better and greater choices for consumers.

Having said that, we also recognize the challenges facing State regulators in their efforts to achieve reform. In addition, the changing dynamics of the financial services industry in the 21st century compel NAIFA to be open to all promising options to improve the regulation of the industry. There is widespread agreement that the State insurance regulatory system is in need of improvement in numerous areas and that reform is critical to protect consumers and ensure a strong and healthy insurance marketplace. Insurance producers have been working with State insurance regulators for years to encourage sensible reforms to make the quilt of State insurance laws and regulations more uniform, thus enabling producers to better compete in an increasingly crowded financial services marketplace. Improvements in regulation benefit consumers, as well, who share the heavy burden of paying for the costs of complying with the current system.

Although State insurance regulators have made great efforts in the past several years to reform and modernize the system, the necessary improvements have not been made. Insurance regulation has failed to adapt to changes in the industry and the markets it serves, resulting in the significant regulatory deficiencies that exist today. Unnecessary distinctions among the States and inconsistencies within the States on issues such as licensing, product approval, and consumer protection, thwart competition, reduce predictability and add unnecessary expenses to the cost of doing business. Similarly, these outdated rules and practices do not serve the goals of regulation in today's converging financial services marketplace.

It has proved to be very difficult for State regulators and their legislatures to unilaterally correct the identified deficiencies in State insurance regulation. Both practical and political realities dictate that, if identical bills are proposed in 50 State legislatures, 50 different bills will emerge from those 50 separate legislative processes. There are numerous reasons for this lack of success—lack of will, disagreements over substantive details, structural impediments, and the fact that it is simply very difficult to get 50 different jurisdictions to act in a coordinated fashion, and act quickly in a constantly changing global marketplace.

To their credit, the State insurance regulators have recognized to some degree the need to improve and modernize the insurance regulatory system currently under their control. Ernst Csiszar, the South Carolina Insurance Director and current President of the National Association of Insurance Commissioners (NAIC), has acknowledged publicly that change is needed and that holding the regulators' "feet to the fire" could lead to improvements in the regulatory system. The Commissioners have adopted an "Action Plan for Regulatory Modernization" that outlines their plan for reform.

Despite their good intentions, however, the commissioners' action plan is limited in scope and sparse on details. It is unclear what the States will accomplish or how long it will take to achieve the reforms that are so important for the insurance marketplace. Even for those initiatives that are clearly addressed in the action plan, the commissioners' ultimate goal is less than ambitious. For example, the State regulators have drafted an interstate compact establishing a single point of filing for regulatory review and approval of certain life, annuity, disability income, and long-term care insurance products. This is extremely important to NAIFA members, and NAIFA supports the compact wholeheartedly. We are disheartened to note, however, that its implementation is not on a fast track. Very few States have adopted the compact and obtaining timely enactment of the compact in identical form in every State presents a very challenging legislative obstacle. Moreover, even if the compact is someday adopted in a substantial number of States, the compact itself permits

States to opt out of particular products, which would undermine the uniformity that is needed in the product approval process. These circumstances lead us to conclude that Congressional involvement in the reform effort could help improve the regulatory environment.

Since 2002, NAIFA policy has supported Congressional action to improve and augment the regulation of insurance, provided such action meets NAIFA's specific guidelines aimed at maintaining fairness to agents and protection for the consumers they serve. Early this year, we clarified this policy to highlight our support for the NAIC's regulatory modernization action plan and to identify certain Federal proposals that could, if properly crafted, improve the regulation of our industry. A copy of our current Insurance Regulatory Reform Policy is attached as Addendum A.

While our regulatory reform policy continues our century-long support for State regulation of insurance and confirms our commitment to improve the State-based system, we believe the status quo of insurance regulation is detrimental to consumers and NAIFA members. Thus, the recent strengthening of the policy was necessary to acknowledge that all options are on the table and that NAIFA is willing to consider a breadth of alternatives in our desire to fix the problems confronting us. As a result, we have adopted a policy that embraces Federal initiatives to improve the regulation of insurance. Simply put, NAIFA favors reform, improvement, and progress over the status quo.

Conclusion

It is still early to judge the ultimate effectiveness of the Gramm-Leach-Bliley Act because the full impact of such sweeping legislation may not be evident for years, if not decades. Nonetheless, discussion of the benefits and drawbacks of the law is worthwhile to determine if changes need to be made to realize the full potential of the law. As this statement makes clear, there are several specific areas in which changes can be made to improve GLBA's effectiveness. Most important in the view of NAIFA members is insurance regulatory reform, which is critical to enable insurance producers to enjoy streamlined, effect regulation and take full advantage of GLBA's promise for the benefit of insurance consumers.

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Addendum A

NAIFA POLICY ON INSURANCE REGULATORY REFORM

NAIFA supports the principles underlying State regulation of the business of insurance and efforts to improve the State-based system of insurance regulation, including support for the National Association of Insurance Commissioners' Action Plan for Regulatory Modernization. NAIFA also supports Congressional initiatives to improve and augment the regulation of the business of insurance, such as the creation of a Federal insurance regulator, optional Federal charters for insurance companies and agencies, a national producer's license for insurance professionals, and other Federal efforts to improve the insurance regulatory system. NAIFA supports reform of the insurance regulatory system that meets the following guidelines:

(1) With respect to producer licensing and continuing education requirements:

- All insurance producers must be licensed.
- All duplicative licensing requirements should be eliminated to ensure that each insurance producer will be required to demonstrate to only one regulator that he/she is qualified to receive a license to engage in insurance representing either a State-chartered or Federally chartered insurer.
- Uniform substantive and procedural licensing requirements should be established for each class of similarly situated producers.
- The uniform licensing requirements should include the mandated performance of a criminal background check on all applicants for licensure.
- A database to which only financial services regulators have access should be established to help ensure that individuals who have committed fraud or engaged in other behavior which should bar their participation in the business of insurance are identified and tracked.
- Each insurance producer should need to satisfy only a single set of continuing education requirements for each line of business for which he/she is licensed.
- Uniform continuing education requirements should be established for each class of similarly situated producers.

(2) With respect to other consumer protection requirements:

- The tax incentives supporting life and other insurance products must be preserved.
- Uniform trade practices and consumer protection requirements should apply to all insurance sales and service activities.
- Adequate solvency requirements for insurers must be in place such as guarantee funds or comparable fail safe mechanisms.
- Regulators' responsiveness and accessibility to consumers must be preserved.

(3) With respect to rate and form filing and approval requirements:

- Duplicative filing and approval requirements should be eliminated.
- Unifonn filing and approval requirements should be established.
- "Quality to market" concerns should not be sacrificed for "speed to market."

(4) With respect to changes in regulatory rules, structures and procedures:

- Current regulatory expertise should be preserved to the maximum extent possible as consistent with efficient regulation.
- Any "reform" should be viable for both accumulation and risk-shifting products.
- Submission to the jurisdiction of any additional newly created regulatory authority should be truly optional for all producers.
- Producers should have an institutionalized role in the development and application of all new regulatory rules, structures, and procedures.

Approved by the NAIFA Board of Trustees 1/16/04