

# Looking To The Future of the National Bank Charter In A Rapidly Modernizing Financial Services Industry

Remarks by Bert Ely for the program, "The Future of National Banking: Facing New Threats and Seizing New Opportunities," sponsored by the Support Group for Modern National Banking and The Bankers Roundtable

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The national bank charter does not need any congressional help at this time because it is evolving just fine through judicial actions and the regulatory initiatives of the Comptroller of the Currency. In fact, any attempt by Congress to "help" the national bank charter almost certainly will seriously hurt it through restrictions on the activities of national banks and their operating subsidiaries.

Before discussing how financial services modernization should play out in the political arena, I will first explain why Congress should not involve itself in this process at this time. Instead, Congress should wait until the Comptroller and the courts, in response to marketplace dynamics, have recast the national bank charter into a charter for the universal financial services firm. Such a firm should be able to engage in all financial services activities without restriction and therefore without the need for holding company ownership.

The reason why Congress should stand aside at this time is as follows. The U.S. Constitution was carefully designed, through its system of checks-and-balances, to prevent radical shifts in political sentiment. While this institutional resistance to change has the implicit effect of protecting the political status quo, in this age of extremely rapid technological change, the commercial status quo should not be protected because doing so creates inefficient and potentially dangerous distortions in the financial system. This is not an argument for regulatory indifference or negligence, such as we saw in the years leading up to the S&L crisis. Rather, it is the rationale for Congress to simply let the less politicized branches of government -- the regulators and the courts -- adapt regulatory mechanisms to the changing marketplace in a manner which promotes sound banking.

There is a more specific reason why Congress should not attempt to frustrate technology's gravitational pull -- technology is rapidly destroying longstanding lines of regulatory demarcation. Specifically, it is becoming increasingly difficult to cleanly classify many financial products as either a banking, securities, or insurance product. Money market mutual funds, variable annuities, and credit derivatives are just a few examples of product melding that technology has made feasible. In effect, technology has destroyed the concept of functional regulation, a foundation of H.R. 10, which currently lies in a no-man's land between the House Banking and Commerce Committees.

Product blending leads to organizational blending. That is, a financial services firm which produces and sells blended financial products cannot itself be neatly categorized as a bank, insurance company, or securities firm. Therefore, to avoid even more regulatory arbitrage than now exists, financial services firms, and specifically the national bank and its subsidiaries, must be permitted to engage in the full range of financial services activities without regard to how those services might be defined in a traditional regulatory sense. In effect, why should anyone care any more what a financial product is called? The existing statutory framework for the national bank charter provides the corporate framework for whatever product and organizational blending the commercial marketplace demands.

Efficiency and political realities dictate that non-bank financial firms also should be able to evolve into universal financial services firms. However, the necessary legislative authorization to permit them to conduct banking activities does not warrant any legislative restrictions on the powers of national banks and their subsidiaries. Because today's financial services firms have varied origins, there must be several paths towards the universal financial services firm; one of those paths must be the national bank charter, without the impediment of a bank holding company. Within five or ten years, there should be sufficient convergence of the three basic types of financial services charters -- depository institution, insurer, and broker/dealer -- that quite frankly it will not make any practical difference as to what type of charter a financial firm has and what the firm's origins are.

But, and this is a big but, there are other constituencies who oppose charter melding and the natural evolution of the national bank charter. These constituencies include much of the regulatory establishment -- state as well as federal -- and some members of the House Banking and Commerce committees. In effect, the toughest challenge today to financial services modernization is not within the private sector, but in the public sector, and for this very simple reason: technology is not just destroying regulatory distinctions, it also is shifting power over financial services from the political marketplace to the commercial marketplace. That is not a happy prospect for those who presently prosper in the political marketplace, but it is an inevitable impact of electronic technology. Worse, while the commercial marketplace can restructure itself, when permitted to do so, the political marketplace can restructure itself only through explicit congressional action.

I will devote my remaining remarks to this much needed political restructuring, addressing first regulatory restructuring and then, saving the toughest for last, realigning the jurisdiction of several House committees.

Historically, federal and state regulation of financial services has divided along industry lines and therefore product lines. But, as I mentioned previously, technology is rapidly destroying those distinctions. Accordingly, it is not practical for several old-style regulators to simultaneously regulate the activities of a diversified financial services firm offering blended financial products within one corporate entity or in a parent company-subsidary structure managed in a highly integrated manner. While employment

opportunities for regulatory lawyers would blossom, the regulatory turf wars would be very debilitating to the regulatees. Ultimately, it will be intolerable for multiple regulators to constantly fight over turf in a universal financial services firm operating under a national bank charter or some other type of broadly empowering financial services charter. Instead, a regulator's reach must be as broad as the permissible business reach of the universal financial services firm.

While there may exist competing regulators during a transition period, each offering a broad financial services charter in a manner comparable to the dual banking system, eventually the United States should follow the lead of the United Kingdom and more so Australia in shifting towards an entirely different regulatory structure, what I call a horizontal regulatory structure in contrast to today's vertical or industry regulatory structure. I will summarize below my perspective on regulatory restructuring which I presented in a February 24, 1998, [American Banker](#) article.

Briefly, all financial services regulatory concerns fall into two categories. One is the prudential operation of financial institutions to protect certain classes of creditors, specifically depositors, insureds, and customers of broker-dealers, against insolvency losses. The prudential operation of financial institutions in turn greatly reduces the potential for systemic financial instability, a growing concern of elected officials. The second regulatory concern is consumer protection, broadly defined. Specific concerns include fair dealing; marketplace transparency so that market insiders are not taking advantage of their customers; and anti-trust laws designed to bar collusive behavior among buyers and sellers.

Prudential regulation differs sufficiently from consumer protection that these two regulatory responsibilities should be placed in different regulatory agencies, which is the approach that Australia is taking. The UK is transferring all aspects of financial services regulation into one new agency, the Financial Services Authority, so that regulators can view the entire financial services landscape. In my opinion, the United States should follow Australia's lead; that is, it should establish two federal regulatory agencies -- one that deals exclusively with all prudential regulation issues within the financial services sector of the economy while the other deals only with consumer protection issues.

This proposed regulatory restructuring raises an important issue -- federal regulation of insurance. Although the states have traditionally regulated insurance, there needs to be a federal insurance regulatory option so that a federally chartered financial services firm can seamlessly integrate its insurance activities with its banking and securities activities. Regulatorily expanding the authority of national bank operating subsidiaries to include insurance underwriting represents an important first step towards facilitating that integration. Perhaps the OCC is the ideal agency for chartering and regulating national insurance companies. The idea of federal insurance chartering and regulation may seem radical to some, but true financial services modernization simply cannot otherwise be achieved. Gene Ludwig's comments this morning regarding John Hancock's desire for a federal insurance charter reinforce this point.

Providing a federal chartering option for insurance companies will, though, significantly expand the federal safety net because the insureds of federally chartered insurers will expect the same degree of insolvency protection that the insureds of state-chartered insurance companies now receive through state guarantee funds. This reality brings us to the mother of all financial services issues, deposit insurance reform, or more broadly, reform of the federal financial safety net. Shifting all financial services prudential regulation into one organization should make it easier to reform the federal safety net, a task that otherwise will grow much more complex as financial services product melding increasingly fuzzes the edges of the safety net. Time does not permit me to discuss how the federal safety net, or more specifically deposit insurance, should be reformed, but many in the audience know where I think all roads lead to.

I will close by discussing another modernization issue -- the legislative jurisdiction of the House Banking and Commerce committees. As an aside, legislative jurisdiction is not a significant issue in the Senate. In the House, the Banking Committee has jurisdiction over banks, thrifts, and credit unions while the Commerce Committee has jurisdiction over the securities and insurance industries. This jurisdictional split in a legislative body where committee jurisdiction is all-important raises havoc with the concept of the universal financial services firm for the law which authorizes such a firm must, as a practical matter, lie primarily within the jurisdiction of just one committee. Therefore, at some point in time, the House committee jurisdictions must be realigned so that all financial services activities lie within one committee's jurisdiction.

Various options exist for structuring this realignment -- each has merits and demerits. What is important, as has become quite evident with the failure of H.R. 10 to move beyond the committee stage, is to acknowledge the technological obsolescence of the existing jurisdictional boundaries. Oftentimes such realignments have to be forced by external events -- a steady but logical and thoughtful regulatory expansion of national bank powers is one way, and perhaps the fastest way, to force that realignment.

In closing, I lay the blame for this modernization challenge on the computer microchip and fiber optic cable. But these innovations are a reality for which most of us are quite thankful. Our challenge is modernizing financial services regulation so that the financial services industry can modernize itself to take full advantage of present and future technological innovations. Given the constitutionally permissible legislative paralysis we now face, we must, as we have in the past, rely upon the states, the courts, and the regulators to permit financial services modernization to progress until sufficient marketplace consensus has been reached as to what Congress should enact. Preserving the existing powers of the Comptroller and continuing to encourage the Comptroller to modernize the national bank charter represent a key element of this modernizing process.