

Six steps to modernisation

The US Congress has made a quick start this year in yet another attempt to modernise the structure of the US financial services industry. But, reports Bert Ely, serious hurdles remain.

After coming so close last year to enacting legislation to modernise the structure of the US financial services industry, this year the US Congress is off to a fast start, for Congress, in yet another attempt to pass comprehensive financial services legislation. However the very comprehensiveness of this legislation may again impede its passage during the two-year congressional session which started in January, for this legislation has two quite different objectives.

First, it seeks to knock down statutory barriers to the full integration of banking, insurance, and securities activities which electronic technology increasingly facilitates. Second, much like shifting deck chairs on the proverbial Titanic, it attempts, in the guise of functional regulation, to reallocate regulatory turf within the context of America's increasingly obsolete regulatory structure. There is broad, but not universal, agreement on the first objective and much dispute over the second. Rapid progress so far this year masks the numerous unsettled disputes which could sink this legislation before Congress adjourns in October 2000.

By mid-May, the Senate, on a narrow and largely party-line vote (54-44), had passed its version of the modernisation legislation (S. 900) while the House of Representative's Banking Committee, by a large bipartisan majority (51-8) reported its version, H.R. 10. Broadly, each bill would repeal most of the infamous Glass-Steagall act and authorise financial holding companies to engage in banking, securities,

and insurance activities through holding company subsidiaries or in some cases, in subsidiaries of a bank owned by a holding company. However, crucial differences exist between the two bills. Even more differences will develop before Congress enacts a bill which President Bill Clinton will sign into law. However inefficient it may look to outsiders, this messy, convoluted legislative process reflects the intent of the authors of the US constitution.

Six legislative hurdles

Six important steps remain before financial services modernisation can become law during this Congress:

- Because of its legislative jurisdiction over the securities and insurance industries, the House's Commerce Committee must act on H.R. 10 as the next step in the legislative process. It most likely will report its version of the bill by mid-June. However, that version will differ in significant regards from the Banking Committee's version. Those differences, discussed below, will spark new battles over the legislation.
- The Rules Committee of the House, which acts as the gatekeeper for all legislation moving to the House floor, must then develop the rule or procedures under which H.R. 10 will be debated on the House floor. This committee is chaired by Rep. David Drier, a former member of the Banking Committee with ideas of his own on financial services modernisation. Most likely, the rule will permit key differences

between the two versions of H.R. 10 to be debated on the House floor through amendments to the bill. Many Republicans in the House do not relish a debate over such arcane issues that will force them to choose between friends, such as bankers and insurance agents.

- The House must then pass H.R. 10 in some form in order to advance the process. While passage is likely, H.R. 10's content, as passed by the House, is quite uncertain, in part because the Commerce Committee's version of the bill is not yet known. Although some would like the House to take up H.R. 10 in June, floor action most likely will not occur until July, at the earliest. If the House does not pass H.R. 10, then financial services modernisation is dead for this Congress unless, and this is unlikely, the House simply passes the Senate's version (S.900).
- Assuming the House passes H.R. 10, a House-Senate conference would then attempt to resolve the differences between H.R. 10 and S. 900. The conference promises to be quite contentious because of the substantial differences that will exist between the two houses' bills. The conference most likely will not start until Autumn and could easily last for several months, or longer.
- The House and Senate separately must then adopt the conference committee report. Adoption is far from certain since the compromises reached by the conferees may not be acceptable to a majority in each House.
- President Clinton almost certainly will veto the financial services modernisation bill if it contains objectionable provisions such as significant restrictions on the operating subsidiaries of national banks, any rollback of the Community Reinvestment Act, or serious invasions of consumer privacy. Treasury Secretary Robert Rubin's departure should not materially weaken the President's resolve on these issues, in part because Stuart Eizenstat, the new Deputy Secretary of the Treasury, is savvy politically and knowledgeable about banking issues.

The key debates

Enactment of financial services modernisation will not clear these hurdles unless there is a satisfactory resolution of numerous contentious issues. The principal issues are as follows:

Operating subsidiaries of national banks

The battle over "op-subs" has become one of the most highly charged issues in this legislation, in part because of a personal and public battle between Rubin and Fed chairman, Alan Greenspan. In reality, this is nothing more than a regulatory turf fight – the Treasury regulates national banks and their operating subsidiaries while the Fed regulates holding companies and their non-bank subsidiaries. The House Banking Committee's version of H.R. 10 leans towards the Treasury in this turf war, by not limiting the power of op-subs too much, while S. 900 tilts towards the Fed by sharply limiting the powers of op-subs owned by banks with more than \$1 billion of assets. The Commerce Committee's version of H.R. 10 also will limit the power of op-subs. Although the Fed is winning important battles in this turf war, it will lose in the end because Mr. Clinton will veto any bill which significantly limits the activities of op-subs.

Community Reinvestment Act

The Community Reinvestment Act (CRA), which mandates that banks and thrift institutions serve low and moderate income communities, has become a highly charged and partisan battleground. S. 900 would exempt rural banks with less than \$100 million of assets from the CRA and shield banks with three years of "satisfactory" or better ratings from community group merger protests based on CRA grounds. On the other hand, H.R. 10, as reported by the House Banking Committee, would extend the reach of the CRA by requiring a holding company's banks to have and maintain a 'satisfactory' or better rating if the holding company is to engage in new financial activities in either non-bank subsidiaries or

op-subs. The Clinton Administration vigorously opposes any weakening of CRA, but has been ambivalent on broadening its reach.

Consumer privacy

Consumer privacy, specifically limitations on cross-marketing by affiliates of banks, has emerged as a contentious issue in the modernisation debate. The House Banking Committee's version of H.R. 10 contains some privacy limits on bank-affiliated insurance companies; the Commerce Committee probably will broaden and toughen those limits, possibly to the point of generating strong banker opposition to H.R. 10. H.R. 10 now also contains provisions prohibiting acquisition of confidential bank customer information by deceptive or fraudulent means. S. 900 has no such provisions.

Bank insurance activities

Although an agreement negotiated last year between the banks and insurance agents over state regulation of bank insurance sales activities is holding up so far this year, the Commerce Committee may attach provisions to H.R. 10 that give the insurance agents more of what they want. The banks will vigorously fight this effort.

Securities "push out"

The Securities and Exchange Commission has made headway in both bills in its long-sought objective of trimming the broad exemption banks have from the SEC's broker-dealer regulations. It stands to achieve this objective, in the guise of functional regulation, through provisions that will "push out", from banks into SEC-regulated affiliates or subsidiaries, those products deemed by the SEC to be securities products, unless Congress specifically exempts those products from SEC regulation. The House Commerce

Committee, which has legislative oversight over the SEC, almost certainly will broaden the range of activities which must be pushed out of banks, possibly to the point that securities push-out will generate substantial bank opposition. Such a battle will draw attention to the legislation's fundamental weakness: its attempted to shore up, rather than discard, the obsolete notion of functional regulation.

Banking and commerce/unitary thrifts

This Congress, as did the last, continues to oppose any meaningful mixing of banking and commerce. The financial holding company concept, which will permit the affiliation of a bank with entities engaged in a broad range of financial activities, bars non-financial activities, except with regard to grandfathered activities which must be divested over a 10 to 15 year period. However, unitary thrift holding companies, which permit a thrift institution to be owned by any corporate entity, represent a major exception to a ban on mixing banking and commerce. Financial services modernisation legislation therefore may, at a minimum, bar the formation of new unitary thrift holding companies, although the exact scope of the limitations on unitaries is not clear at this time.

As can be seen from this long list of obstacles, there are plenty of reasons to suppose that even the year and one-half remaining in this Congress will not suffice. But the US legislative process is always full of surprising twists and turns, so almost anything can happen, from rapid enactment to a collapse of the entire effort this summer. Stay tuned.

Bert Ely, principal of Ely & Company, Alexandria, Virginia, is a financial institutions and monetary policy consultant. His website address is <http://www.ely-co.com>