

MEMO# 10734

February 18, 1999

INSTITUTE TESTIFIES BEFORE HOUSE BANKING COMMITTEE IN SUPPORT OF H.R. 10,

1 See Memorandum to Board of Governors No. 5-99, Federal Legislation Members No. 3-99, Primary Contacts – Member Complex No. 7-99, and Public Information Committee No. 2-99, dated February 2, 1999. 1 [10734] February 18, 1999 TO: BOARD OF GOVERNORS No. 8-99 FEDERAL LEGISLATION MEMBERS No. 5-99 PRIMARY CONTACTS - MEMBER COMPLEX No. 16-99 PUBLIC INFORMATION COMMITTEE No. 4-99 RE: INSTITUTE TESTIFIES BEFORE HOUSE BANKING COMMITTEE IN SUPPORT OF H.R. 10,

On February 10, the Institute testified before the House Banking and Financial Services Committee regarding H.R. 10, the “Financial Services Act of 1999.”¹ The hearing was the first of three held by Committee Chairman James Leach (R-IA) to review the bill. In an unexpected development shortly before the hearing, SEC Chairman Arthur Levitt informed Chairman Leach that the SEC cannot support H.R. 10 as currently drafted. A summary of his objectives for financial modernization is provided below. Institute Testimony In its testimony (which is attached), the Institute expressed support for H.R. 10 and noted that H.R. 10 represents a sound framework for financial services reform. In particular, it would: ! permit affiliations among all types of financial services companies; ! grant banks full mutual fund powers; ! modernize the federal securities laws to address bank mutual fund activities; and ! implement an oversight system based on the principle of functional regulation. In expressing its support, the Institute suggested that the committee also review several other issues. The most important of these is the need to ensure that the principle of functional regulation applies to all of the bank regulatory agencies. Clearly defined functional regulation is important because it reduces overlap between regulators and, more importantly, because it avoids regulatory concepts designed for one type of financial institution from being applied to different types of institutions for which they are inappropriate. To ensure that the bill’s goal of functional regulation is met, the Institute recommended that the standards for functional regulation laid out in the bill for the Federal Reserve Board and the FDIC should also apply to the Comptroller of the Currency and the Office of Thrift Supervision. 2The Institute also suggested two other changes. First, H.R. 10 should be amended to allow a limited degree of commercial activities for diversified financial services organizations. Second, the “grandfather date” for unitary thrift status should change from October 7, 1998, as proposed in the bill, to the effective date of H.R. 10. “Financial Services Modernization Act” (H.R. 665) On the same day as the hearing, Representative John LaFalce (D-NY), the Ranking Democrat of the House Banking Committee, introduced H.R. 665, the “Financial Services Modernization Act of 1999.” While there are several differences between this bill and H.R. 10, one important similarity is that

in all key aspects the functional regulation provisions are the same. The most significant difference between the two bills for the investment company industry is the creation of a commercial basket. H.R. 665 would allow the creation of a 15 percent commercial basket. Specifically, this would allow qualified bank holding companies to own an interest in a commercial, nonfinancial firm, so long as that firm generates less than 15 percent of the holding company's gross domestic revenues. A cutoff level would prohibit a qualified bank holding company from acquiring any commercial firm with consolidated assets exceeding \$750 million, effectively precluding acquisition of the top 1,000 commercial firms. Significantly, the Administration generally supports the LaFalce approach; the only exception is the Administration's continued opposition to the commercial basket. In particular, the Treasury supports the bill's compromise on the activities of national bank operating subsidiaries that will include all new financial activities except insurance underwriting and real estate development. Inability to resolve this issue was the source of the Treasury Department's veto recommendation last Congress. SEC Opposes Current H.R. 10 In a departure from last year's support, SEC Chairman Arthur Levitt, in a February 4 letter to Banking Committee Chairman Leach, said that the Commission cannot support H.R. 10 as currently drafted. These concerns were reflected in the SEC's testimony before the House Banking Committee on February 12. Chairman Levitt provided an outline of the SEC's objectives for financial modernization, which include: ! maintaining aggressive SEC policing and oversight of all securities activities; ! protecting mutual fund investors with uniform adviser regulations and conflict-of-interest rules; ! safeguarding customers by enabling the SEC to set net capital rules for all securities businesses; ! protecting investors by applying the SEC sales practice rules to all securities activities; and ! enhancing global competitiveness through voluntary broker-dealer holding companies. Chairman Leach has announced that the House Banking Committee markup on H.R. 10 will take place on March 4. Meanwhile, Senate Banking Committee Chairman Phil Gramm (R-TX) has scheduled hearings for February 23, 24, and 25, with Federal Reserve Board Chairman Alan Greenspan testifying on February 23. Chairman Gramm has rescheduled markup on the legislation for March 3. We will keep you informed of further developments. Matthew P. Fink
3President Attachments