

MEMO# 3005

August 13, 1991

STATUS OF GLASS-STEAGALL LEGISLATION

August 13, 1991 TO: BOARD OF GOVERNORS NO. 59-91 RE: STATUS OF GLASS-STEAGALL LEGISLATION _____ The purpose of this memorandum is to advise you as to the current status of financial services restructuring legislation. Congress has adjourned until after Labor Day, but is expected to move quickly on this legislation upon its return. House Banking Committee. The House Banking Committee reported the Administration's bill on financial services legislation on June 28. (See Memorandum to Board of Governors No. 50-91, dated July 3, 1991.) The bill contains a number of provisions endorsed by the Institute: a full "two-way street", under which all banks could affiliate with securities firms and all securities firms, including those with insurance or commercial affiliates, could affiliate with banks; interstate banking; and a requirement that most new bank securities activities, including mutual fund sponsorship, be conducted in separate affiliates, subject to full SEC regulation. As we informed you earlier, the House Banking Committee voted to strike all provisions in the Administration's bill that would amend the federal securities laws, including mutual fund firewalls and other provisions endorsed by the Institute. The Committee Report confirms that this action was a procedural move made for jurisdictional reasons. The report states: "The Committee wants to make it clear that the adoption of the amendment should not be interpreted as a vote by the Committee against the firewalls contained within the subtitle. The Committee is on the record in strong support of such consumer and safety and soundness protections." Senate Banking Committee. On August 2, the Senate Banking Committee reported S.543, the "Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991." S.543, as expected, would repeal Section 20 of the Glass-Steagall Act and thereby permit bank affiliates to engage in all securities activities, including the sponsorship and underwriting of mutual funds. In addition, as also expected, S.543 does not provide for a full competitive "two-way street"; as a result, most securities firms affiliated with insurance companies or commercial corporations could not affiliate with banks. (There is a narrow exception that would allow some firms with limited insurance activities to own small banks.) Indeed, there was never any consideration of the "banking and commerce" issue by the Senate Banking Committee; the debate focused on "firewalls." S. 543 is in many respects similar to S.1886, which passed the Senate in 1988. However, S.543 contains several additional mutual fund firewall provisions, which have been endorsed by the Institute. These include a prohibition on a fund having a similar name as an affiliated bank (with SEC exemptive authority), additional disclosure obligations in the case of banks that invest fiduciary accounts in affiliated mutual funds, a narrowing of the common trust fund exemption, and the authorization of an SEC study of the regulation of collective investment funds for retirement plans. Despite the efforts of banking representatives to strike or weaken these provisions, the Institute was successful in preserving them. Attached is a memorandum that describes

certain provisions of S.543 in greater detail. House Energy and Commerce Committee. The legislation reported by the House Banking Committee has been referred to the House Energy and Commerce Committee, and to three other House Committees. Each of these Committees must act by September 27. Contrary to widespread reports, we do not expect that the Energy and Commerce Committee will seek to remove provisions granting securities powers to banks from the legislation. Instead, we expect that the Committee's actions will be generally focused on firewalls and increased authority to the SEC and that the Committee will oppose efforts to permit affiliations between banking and commercial firms. In this regard, Chairman Dingell and other members of the Committee have introduced a bill, H.R. 797, which contains many firewall provisions endorsed by the Institute and which is expected to be the basis of the firewall provisions reported by the Energy and Commerce Committee. Outlook. A convergence of views both within the Congress and the Executive branch makes the repeal of Glass-Steagall more likely than ever: in 1988, the Senate passed a bill nearly identical to the Senate Banking Committee's current bill by a vote of 94-2. Similarly, in 1988, a Glass-Steagall repeal bill was reported by the House Banking Committee; the current crisis in the federal deposit insurance system makes some banking legislation necessary; the Bush Administration strongly supports financial services reform and will accept as "comprehensive" the repeal of the Glass-Steagall Act without attendant changes to traditional bars on banking and commerce affiliations. Thus, there is a very good chance that legislation that grants bank affiliates broad securities powers, including mutual fund powers, will be passed this year by Congress. The most likely scenario precluding such action would involve a Congressional decision that the federal deposit insurance fund must be recapitalized quickly by the passage of noncontroversial legislation. The Institute, in accordance with the resolution adopted by the Board in January 1990, will continue its efforts to ensure that any such legislation includes strong mutual fund firewalls and, to the extent possible, a two-way competitive street. However, with respect to the latter, the insurance industry is expected to undertake a massive effort on the House floor to remove the provisions in the House Banking Committee bill that would permit affiliations between banks and insurance companies, including those affiliated with mutual fund organizations, and thus preclude the possibility for a two-way street. Other major issues to be decided involve brokered deposits (on which major brokerage houses have devoted most of their resources) and Congressman Schumer's proposed "core bank". It is not yet clear how the resolution of these issues will affect other provisions in the legislation or the bill as a whole. We will keep you informed of developments. Matthew P. Fink Senior Vice President & General Counsel Attachment