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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Ellen S. Seidman to Phillip Caplan at 20:00:18.00. Subject: Financial services modernization memo. (partial) (1 page)	05/15/1997	P6/b(6)
002a. email	Ellen Seidman to Daniel Tarullo et al re: Financial services modernization (2 pages)	05/06/1997	P5
002b. memo	Gene Sperling and Ellen Seidman to NEC Principals re: Financial Services Modernization - Part III (11 pages)	ca. 05/1997	P5
002c. memo	Gene Sperling to The President re: Treasury's Proposed Financial Servivces Modernization Legislation (14 pages)	ca. 03/1997	P5
002d. summary	Summary of Treasury Proposal (2 pages)	ca. 03/1997	P5

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
WHO ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 500000

FOLDER TITLE:

[05/01/1997 - 01/30/1998]

2010-0384-F
ab951

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
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Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

March __, 1997

MEMORANDUM FOR: *THE PRESIDENT*

FROM: *GENE SPERLING*

SUBJECT: *TREASURY'S PROPOSED FINANCIAL SERVICES MODERNIZATION LEGISLATION*

ACTION-FORCING EVENT: The Treasury seeks to propose legislation that would increase competition among providers of financial services by repealing the Depression-era Glass-Steagall Act, allowing a broader range of affiliations between banks and other companies (including both other financial companies and commercial and industrial companies), and merging the regulation of banks and savings institutions. This proposal would satisfy a statutory requirement that the Secretary of the Treasury report to Congress by March 31, 1997 (which will probably be delayed until April 7 when Congress returns from recess), on how to harmonize and integrate the regulation of banks and thrifts. The proposal would also respond to Congressional requests for the Administration to set forth a plan for modernizing financial services regulation, including requests for Secretary Rubin to testify before the House Banking Committee in April.

On March 18 and 20, the NEC principals and relevant White House offices met to discuss the Treasury proposal. Although the group concluded that the Administration should go forward with the Treasury proposal with limited modifications, we also concluded that prior to authorizing the Treasury to proceed, you should be aware of signficant substantive and political concerns raised by the principals. This memorandum outlines the case for financial services modernization, the essential parameters of the Treasury proposal, and the issues that raise the most questions and concerns.

BACKGROUND: Current law restricts affiliations between banks and other companies (i.e., it prevents them from owning one another or being under common ownership). The Glass-Steagall Act generally prohibits affiliations between banks and securities firms. The Bank Holding Company Act of 1956 generally restricts companies that control banks (bank holding companies) to activities closely related to banking, and specifically prohibits such companies from underwriting or selling insurance. These laws essentially sought to limit competition by segmenting different types of financial and other services from one another, and thus reinforce the traditional distinctions among banks, securities firms, insurance companies, and other financial institutions.

But technological and financial innovation, together with market pressures to offer consumers a wider array of services, have rendered this segmentation untenable. Different types of financial products have converged with one another. No longer is there a sharp practical distinction between a syndicated loan and privately placed commercial paper, between a security and a financial future, between a checking account and a money-market mutual fund, or between a mutual fund and a variable-annuity insurance policy. Derivative financial instruments even challenge such fundamental distinctions as those between debt and equity or between dollars and drachmas.

In the face of these developments -- this proliferation of new types of financial products -- the old distinctions among financial institutions are eroding. Banks and thrifts are now practically indistinguishable (although thrifts -- but not banks -- can form affiliations with any company, financial or nonfinancial). Banks offer insurance, mutual fund shares, and brokerage services, and underwrite a wide range of securities, directly or through affiliates. Securities firms make or syndicate commercial loans, and offer money-market accounts with check-writing privileges. Securities markets constitute the largest source of home-mortgage financing. A wide range of nonfinancial companies own banks that offer credit cards.

Yet the old statutory restrictions remain on the books -- imposing needless regulatory and management costs, and impeding competition, innovation and consumer choice. Allowing financial firms of all types to affiliates holds promise that consumers will benefit as fair competition -- less hindered by regulatory restrictions -- will drive firms to achieve and pass savings on to consumers. For example, for many years a very limited group of savings banks, mainly in the northeast, has be allowed to offer savings bank life insurance, an extremely reasonably-priced product attractive to people (such as young married couples with children) whose income and capacity to purchase insurance make them inefficient prospects for the higher-cost insurance agent distribution channel. Expanding the ability of banks to offer insurance products should, on the basis of this experience, make insurance more widely available, at reduced prices. Similarly, securities firms have clearly proven their ability to offer highly attractive savings vehicles at greater yields than available from banks -- witness the fact that last year for the first time more money was in mutual funds than in bank deposits. Providing securities firms the opportunity to more directly offer their efficiencies to bank depositors may well enhance yields available to small savers on insured deposits.

In addition to providing benefits to consumers, greater affiliation among financial institutions should reduce the operating costs of the institutions, which, whether passed on to consumers, employees or shareholders, will almost certainly will increase the institutions' productivity and should have similar benefits economy-wide. Increased affiliation will increase intra-firm diversification, which will almost certainly reduce the risk of institutional failure. And finally, by aligning what our financial firms can do in the United States with what they can do abroad and with what foreign financial firms can do in the United States, allowing increased affiliations should increase the international competitiveness of US firms.

For these reasons, there has been a growing agreement that the restrictions against affiliations among financial institutions have become outdated. Over the years, both Congressional Banking Committees have approved legislation to repeal the Glass-Steagall Act, and the Senate passed such a bill in 1988 by a vote of 94-2. Yet such legislation has repeatedly foundered on inter-industry conflicts (e.g., between banks and securities firms, insurance companies, and insurance agents), most recently during the last Congress.

During the past year, however, trade associations representing a wide range of market participants have made significant progress toward bridging the gaps that have traditionally divided them. The Alliance for Financial Modernization -- a coalition of 10 bank, thrift, securities, insurance, and diversified-company trade associations -- has agreed on legislation (the Alliance, or Roukema/Vento, bill) that would permit any company to affiliate with a bank if it has at least 75 percent of its business in financial institutions or financial activities.[1] Thus the Alliance bill would remove existing constraints on

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[1] This provision encouraged the securities and insurance industries -- which have always been allowed to affiliate with non-financial companies and did not wish to divest such companies as the price for access to banking -- to join together with banks to support modernization legislation. The bill has been introduced in the House, and there have been initial hearings. While it has attracted some support, there has also been much skepticism, mainly on the banking and commerce issue, to a lesser extent on consumer and community concerns. In addition, at least one Alliance member -- America's Community Bankers (the thrift trade group) -- has said it can't support the bill it its present form, because it would *reduce* the scope of thrift activities. The bill is very vague on how to measure the 25 limit, and different measurements generate very different results. An asset-based measurement is least restrictive and a gross revenue-based measurement most restrictive of financial/non-financial combinations.

affiliations among different types of firms that concentrate in financial services, and give these financial firms latitude to conduct nonfinancial activities of significant, but not overwhelming, scale.

Other major proposals currently pending in Congress include the D'Amato/Baker and Leach bills. The D'Amato/Baker bill is the most sweeping of these proposals. It would permit banks to affiliate with any company, financial or nonfinancial. By contrast, the Leach bill -- the most restrictive of the Congressional proposals -- would permit affiliations among banks, securities firms, and insurance companies (but not nonfinancial firms), retain much bank-type regulation of companies affiliated with banks, and vest broad regulatory authority in the Federal Reserve Board.

One other concern motivates this legislation. Last year Congress passed legislation that rehabilitated the two FDIC insurance funds -- one that insures thrifts, and the other that insures banks. All your financial advisors, as well as the FDIC, strongly believe these two funds should be merged in order to maximize their ability to withstand any future shocks to the financial system. However, Congress has conditioned merging of the funds on the elimination of the thrift charter. The proposed legislation would satisfy this precondition and thus permit a fund merger.

We see the Treasury proposal as raising four key issues. First, whether (and to what extent) to permit affiliations between banks and nonfinancial companies. Second, to what extent and how to regulate companies affiliated with banks, and what the role the Federal Reserve would have in such regulation. Third, how do deal with issues raised by the Community Reinvestment Act, which only applies to banks and their subsidiaries. And finally, whether the Administration should go forward with the proposal.

1. Affiliations Between Financial and Nonfinancial Companies

Issue: To what extent (if at all) to permit affiliations between banks and nonfinancial companies -- the so-called "banking and commerce" issue.

Treasury Approach: Would permit financial services companies that are predominantly financial -- i.e., if 75 percent of their business consists of financial institutions or financial activities -- to have a 25 percent "basket" of nonfinancial activities[2]. Any bank holding

[2] Treasury draft legislation at OMB for clearance does not define "business." See footnote 1. If the most restrictive definition is chosen -- measurement according to gross revenue, Chase (the second

company, whether operating or non-operating, finanical or non-financial, would be required to guarantee the well-capitalized status of the bank.

largest bank) could affiliate with the 191st largest nonfinancial company (Merisel, Inc) or anything smaller, but the combination of Chase and Salomon could affiliate with the 97th largest nonfinancial company (CSX). Conversely, under such a definition, Microsoft could acquire any of the three largest banks (Citicorp, Chase, or Bank of America), although it is fair to ask whether such a purchase would make any finanical sense to Microsoft. Treasury is working with the CEA and OMB to refine the definition to prevent these kinds of "giant to giant" combinations. The Treasury draft, like both the Roukema and Leach bills, would authorize any firm to own a "Wholesale Financial Institution" (or WOOFIE) -- a new kind of entity that would be a bank with full access to the payment system and strong capital standards, but could not accept insured deposits.

Discussion: The decision whether to allow any affiliation of finanical and nonfinancial firms (the "banking and commerce" issue) is one of the two most contentious issues arising from the legislation. In general, the substantive arguments for permitting affiliation to the extent allowed in the Treasury draft are (i) to get the benefits of financial firm synergies, it is important to allow securities and insurance companies -- which contain signficant non-financial elements -- to have access to retail banking customers; (ii) there are synergies between financial and non-financial firms -- seen most clearly in GE, but also present at various times in firms such as Sears (Allstate) and GM (GMAC) -- that should be allowed to provide consumers with the maximum benefit from modernization; (iii) allowing firms such as Microsoft into banking would increase competition, which -- together with the natural synergies from such a combination -- would benefit consumers; and (iv) such combinations are already permitted in the thrift industry, where they have not caused any problems.[3]

In addition to these substantive arguments, there are two political arguments for permitting the combination Treasury proposes: (i) the securities and insurance companies,[4] and Senators Dodd and D'Amato, will not support modernization without the 25 basket, and without their support, the legislation is dead; and (ii) because of likely opposition to any significant banking and commerce combination from the Fed and others, the basket is likely to get smaller as the legislation progresses, making it important to start from a position with some "give."

The substantive reasons for opposition to the combination are: (i) unlike other finanical services, banking comes with government backing, which generates capital subsidies and moral hazard; it is inappropriate to extend this safety net to commerce without far greater evidence of positive synergies; (ii) most of the cited synergies between commercial and finanical firms involve using the financial firm as a marketing tool for the commercial firm (indeed, GE may be sui generis in having a consistently profitable finance subsidiary), which is an inappropriate use of the government safety net; (iii) this country, unlike Japan and Germany, has a long legal and cultural tradition against combinations of banking and

[3] Under current law, any type of company -- including an industrial company -- can own a thrift, as long as it owns only one such institution (it becomes a "diversified unitary thrift holding company"). There are currently only 14 such institutions, the largest one being a paper company that owns a $9 billion thrift. However, in the past Ford Motor Company owned a thrift based in California. Ford poured alot of money into the institution before it finally sold it for far less than it had contributed in capital.

[4] And the thrifts, see footnote 1.

commerce; (iv) the combination will exacerbate the already strong trend toward moving control of credit and financial services out of the local communities where these services are needed; and (v) it is difficult to believe that financial regulators can or should effectively regulate even the capital of non-financial companies -- which is what would be required to ensure the value of any capital guarantee of the bank by a non-financial parent or a holding company with significant commercial activities. As far as concerns synergies between financial firms and companies doing a business that truly would provide some positive synergies for the finanical firm, such a software or telecommunications firm, it may well be possible to add these gradually to the mix by establishing in the legislation a system by which regulators could expand the definition of "financial" over time, without having to move all the way to allowing combinations of financial and industrial firms.

In addition to these substantive arguments, there are two political arguments against permitting the combination: (i) Senator Sarbanes and such traditional Democratic constituencies as community and consumer groups have stated they will unalterably oppose any legislation that permits any banking/commerce combination; and (ii) House Banking Committee Chairman Leach and the Fed (and former Fed Chairman Paul Volcker) have come out firmly in opposition to any significant banking and commerce combination.

Positions of Other Relevant Parties: Persons who support an even broader approach, as in the D'Amato/Baker bill, include: the Securities Industry Association, the Investment Company Institute, the Financial Services Council, the American Council of Life Insurance, America's Community Bankers, the American Financial Services Association, and Bankers Roundtable.

Persons opposing full removal of restrictions on affiliations between banks and nonfinancial companies including: Senators Conrad, Daschle, Dorgan, Feingold, Harkin, Johnson, Kerrey, Kohl, and Sarbanes; Representatives Leach, and Gonzalez; the Independent Bankers Association of America; the AFL-CIO, ACORN, National People's Action, the Consumer Federation of America, Consumers Union, and the Greenlining Coalition.

Persons who support the 75 percent test in the Alliance bill and the Treasury approach include: the American Bankers Association and the other members of the Alliance for Financial Modernization, including the trade associations listed above as supporting the D'Amato/Baker bill.

2. Holding Company Regulation, and the Role of the Fed

Issue: To what extent should the government regulate nonbank companies that own banks, and what role should the Federal Reserve play in that regulation?

Treasury Approach: The Federal Reserve Board would continue to regulate bank holding companies, and could conduct examinations and overall risk-management, require reports, and take enforcement action. But it would no longer prescribe bank-type capital standards for nonbank affiliates of banks. Instead, subsidiary banks would have to remain well capitalized (i.e., keep the capital above the normal required level) after subtracting dollar-for-dollar any investment in a non-bank firm, transactions between banks and related firms would be limited, and the holding company could be asked to guarantee its subsidiary banks' capital.

Discussion: This issue raises most clearly a central question about this legislation: the extent to which affiliations that provide synergies and thus benefits to consumers can be regulated in a manner that does not stifle those synergies yet at the same time protects taxpayers, primarily by restricting the reach of the deposit insurance. [5]

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[5] While it is a subject of substantial debate in Congress, the Administration has strongly and consistently supported the proposition that the choice whether to conduct financial activities as a subsidiary of a bank or as a subsidiary of a holding company (and thus as an affiliate of a bank) should be a matter of corporate choice, i.e., that no particular form should either be mandated or encouraged by law. This position is based on the following: (i) legal and economic analysis that suggests strongly that the downside risk to the bank -- that it will harm itself through its dealing with related financial entities to the point of creating a risk to the deposit insurance funds -- is the same whether the party is a subsidiary or an affiliate, as long as rules are in place requiring the bank to be well capitalized at all times without taking investment in the subsidiary into account and there are limits on the amount of bank funds that can be invested in a subsidiary; (ii) there is no evidence that any "subsidy" from deposit insurance -- which is small or non-existent on a net basis anyway -- "leaks" more to the benefit of a subsidiary than an affiliate; (iii) profits from a subsidiary are more likely to flow to the bank as a parent than as an affiliate, creating upside benefit; (iv) under CRA, all the assets and income of the bank and its subsidiaries are taken into account in determining the "context" of the bank's performance; affiliates are only taken into account at the bank's option; and (v) the holding company structure is cumbersome and costly (which is why a non-operating holding company is rare outside of banking), and firms should not be forced into it. There is also the fact that the OCC regulates banks and their subsidiaries, whereas the Fed regulates bank holding companies, and thus forcing activities into affiliates reduces the Administration's reach with respect to financial services policy. There is significant disagreement (mainly from the Fed) about the first and second points, although the FDIC, which is responsible for the deposit insurance funds, backs the Administration's position. We have therefore not raised this as a discussion issue in this memo. Chairman Yellen is,

however, concerned the the subsidiary structure (even for financial activities such as insurance and seucrities underwriting) does not sufficiently protect the deposit insurance system.

The Treasury approach rests on the proposition that the deposit insurance system can be protected by requiring very high capital standards of any bank that wishes to -- through a subsidiary or affiliate -- engage in non-bank finanical activities (including insurance and securities underwriting) or -- through an affiliate -- engage in nonfinanical activities, and by protecting those high capital standards through limitations on dealings within the corporate family ("corporate separateness") and by a guarantee of the high capital levels by a bank holding company where one exists. The holding company would be monitored by the Fed to ensure its continued ability to make good on the guarantee, and to provide early warning of any risk issues arising out of the consolidated entity's activities that might harm the bank.[6] By isolating the bank, the Treasury's approach would limit intrusion by bank regulators into activities of non-bank parts of a corporate family while simultaneously protecting the deposit system. The Treasury approach also is based on traditional bank statuory construction, under which broad principles (such as the need for corporate "separateness") are stated, but their definition is left to the regulator, making them somewhat easier to change over time as cirucmstances evolve.

Politically, the Treasury's approach responds the the Fed's strong desire to ensure its continued role as a supervisor of bank holding companies while still not imposing the entire panoply of holding company regulation on diversified financial companies (including those with non-financial businesses). The Treasury and the Fed are continuing discussions about the extent to which full holding company regulation (including capital requirements) would apply to a holding company whose bank was extremely large, even if the entity had other large non-bank subsidiaries.

Questions have been raised in the course of our discussions over the last week about both (i) the effectiveness of the Treasury's proposal in protecting the deposit insurance system -- from both a risk and a subsidy perspective -- from access by non-bank firms and (ii) the extent to which the Treasury proposal's attempt to isolate the bank will prevent the synergies that the entire modernization effort is about from actually being realized. These are obviously logically inconsistent concerns, but they highlight the degree to which the efficacy of the Treasury's proposal depends on effective, but not overbearing, regulation by the Fed.

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[6] For example, if a single corporate family included both a property and casualty insurance company and a mortgage lender, it would be important to take into account the extent to which the risk of mortgage default arising from an earthquake was *not* in fact mitigated by insurance written (and risk retained) by the related insurance company.

Politically, the Treasury's proposal provides the Fed with more authority over diversified holding companies than do either the Roukema or D'Amato bills, but it is unlikely that the Fed will ever be satisfied with a level of regulatory authority that Treasury believes is limited enough to keep securities and insurance firms supportive of the legislation. It is clear that this part of the Treasury's proposal will be finetuned in the course of the legislative process.

Positions of Other Relevant Parties: Persons opposing any significant Federal Reserve role in holding company regulation include: the Securities Industry Association, the Investment Company Institute, the American Council of Life Insurance, and diversified financial services firms (e.g., American Express).

Persons supporting a significant Fed role in holding company regulation include: the Fed, Chairman Leach, Paul Volcker, and the Independent Bankers Association of America.

3. COMMUNITY REINVESTMENT ACT

Issue: How should any proposal deal with the Community Reinvestment Act (CRA)?

Treasury Approach: Apply the CRA to Wholesale Financial Institutions -- banks that do not accept accounts uner $100,000 and thus do not have insured desposits, but avoid putting CRA "in play" by proposing an expansion of CRA coverage to nonbanking firms. In addition, the Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- should state explicitly that we will tolerate no weakening of CRA.

Discussion: One of the hallmarks of your Administration has been its recognition that access to credit and other finanical services is essential to the vitality and growth of communities. From the start of the Administration, you have pressed bank regulators to make the Community Reinvestment Act work to generate "performance, not paperwork." The regulators -- working through an unprecedented series of hearings and other outreach efforts -- responded effectively: new CRA regulations, which are just coming into effect, have been praised as effective without being burdensome. As a result of this Administration's efforts in this area (including not only CRA, but also effective enforcement of non-discrmination laws, and the National Homeownership Strategy), over

$90 billion in CRA commitments have been made and the number of mortgages made in low- and moderate-income communities is up 22% and to minorities 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). In the 104th Congress, the Administration stood strong against any cutback in CRA in the context of banking regulatory relief regulation -- and succeeded in fending off all challenges.

It is quite clear that, notwithstanding continued strong bank profitability, assets and lending are flowing out of the banking system. Through 1980, the bank share of assets held by financial institutions was about 40 . Today it is barely 22 . And the share of non-farm, non-financial debt supplied by US banks to the corporate sector declined from 20 in 1979 to 15 in 1994; banks now write barely half of the short- and medium-term business loans in the United States, down from three quarters 30 years ago. The question is the pace at which the outflow will continue, and in particular whether finanical services modernization will significantly accelerate the pace.

The power of CRA and related statutes and the regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system.

Whatever support CRA has among community groups and some Congressmen (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potential [important] exception of Senator D'Amato, almost no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion. Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial services debate would become a fight about CRA, and it is very likely the Adminstration would be called upon to veto the resulting bill.

It should be noted that the Treasury bill would make CRA applicable to the new Wholesale Financial Institutions. They believe this change will not generate the kind of CRA firefight other expansions might because (i) WFI's are banks who take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs. Treasury admits, however, that it is not clear this distinction will satisfy CRA opponents.

4. *WHETHER TO GO FORWARD*

Issue: Should the Treasury go forward with its legislative proposal?

Treasury Approach: Go forward with the proposal outlined in the appendix (as a Treasury proposal rather than a White House initiative).
Discussion:

The decision whether to proceed with this legislation is essentially one of weighing the very real -- although hard to quantify -- benefits to the economy and consumers from rationalizing a finanical services regulatory system that was established 60 years ago, under totally different economic conditions against the concerns that traditional Democratic allies are likely to express -- strongly -- that the legislation will lead to increased economic concentration and less credit, capital and financial access to underserved consumers and communities.

Without the Administration's active participation, legislation is unlikely to move forward. With the Administration's support, it is possible that -- even in a heavily partisan climate -- financial services modernization legislation could pass.[7] However, it is quite clear from discussions with senior Senators, that only an Administration bill that (i) allows at least a 25 "basket" of nonfinancial assets and (ii) does not expand CRA will be regarded as credible enough to move the discussions forward and keep the Administration as part of the debate.

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[7] As noted above, passage of modernization legislation that merges the thrift into the bank charter is also a precondition for merger of the thrift and bank insurance funds -- a result that is universally regarded as desirable. Such a merger would also allow the consolidation of the Office of Thrift Supervision in the the Comptroller of the Currency, reducing the number of independent bank regulators.

Positions of Other Relevant Parties: Persons who have urged the Treasury to propose financial modernization legislation include: Senators Dodd, Bryan, and D'Amato; Representatives Gonzalez, LaFalce, Vento, Frank, Flake, Leach, McCollum, Roukema, Baker; the American Bankers Association, the Bankers Roundtable, America's Community Bankers, the Consumer Bankers Association, the Securities Industry Association, the American Council of Life Insurance, the American Insurance Association, and the Financial Services Council.

Senator Sarbanes, community groups and the Independent Bankers Association of America have urged the Treasury not to propose such legislation.

RECOMMENDATION: Your economic and political advisors have concluded that Treasury should go forward with its proposal, subject to (i) better clarification of the limitation on the extent to which nonfinancial activities can be included in a financial firm that includes a bank and (ii) a firm statement by the Admininstration that any attempt to weaken CRA will be grounds for vetoing any finanical services modernization legislation, no matter how otherwise beneficial.

DECISION:

_____ Treasury should proceed with legislation as proposed, subject to conditions noted

_____ I support legislation, but have concerns about the Treasury proposal. See me.

_____ I do not believe we should go forward with legislation at this time. See me.

SUMMARY OF TREASURY PROPOSAL

I. CONVERSION OF THRIFT INSTITUTIONS TO BANK CHARTERS

Thrifts could become national banks under streamlined conversion rules. After two years, any federal thrift remaining would automatically be converted to a national bank charter. Any remaining state-chartered thrifts would be treated as state-chartered banks for all federal banking regulatory purposes. Thrifts becoming national banks could generally continue the activities they conducted and retain the assets they held as thrifts, and keep all branches and agencies they operated as of the date of enactment. Subsequent branching would be subject to laws for national banks. Thrifts could continue to specialize as mortgage lenders. A former thrift holding company could conduct any activity that it was authorized to conduct before becoming a bank holding company if it meets certain grandfather conditions.

II. ACTIVITIES OF BANKS AND THEIR SUBSIDIARIES

Two years after enactment, national banks would have powers previously permissible for any national bank or federally chartered thrift. Banks could not engage directly in most insurance underwriting, but would be permitted to act as general agents for the sale of insurance.

Subsidiaries of well-capitalized and well-managed national banks may engage in any financial activity not permissible for national banks. (Similar rules would apply to state banks, to the extent permitted by state law.) Safeguards would include regulatory capital deductions, Federal Reserve Act affiliate restrictions, and corporate separateness requirements.

III. AFFILIATIONS BETWEEN BANKS AND OTHER COMPANIES

Bank holding companies could engage in nonbank activities if their subsidiary banks are well-capitalized and well-managed. No less than 75 percent of the business of the consolidated holding company must be in financial institutions and financial activities. The holding company would have to execute a capped capital guarantee if any insured bank subsidiary loses its well-capitalized status. Holding company affiliates must abide by corporate separateness requirements.

A National Council on Financial Services would be established to (among other things) determine if activities are financial and if additional safeguards need to be imposed between banks and affiliates. The Federal Reserve would continue to regulate bank holding companies, but would not set holding company capital requirements.

Uninsured "wholesale financial institutions" would be authorized, operating under either a national or state bank charter. They could be owned by, or affiliated with, any company.

Functional regulation would generally apply for most new activities of banks and their insurance and securities subsidiaries and affiliates.

IV. FUND MERGER

The Bank Insurance Fund and the Savings Association Insurance Fund would be merged.

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Kara Morrow to Maureen T. Shea at 09:37:38.00. Subject: RE: Community Reinvestment Act. (partial) (1 page)	04/21/1999	P6/b(6)
002a. email	Peter Rundlet to Maria Echaveste re: Revised CRA Decision memo (2 pages)	04/11/1999	P5
002b. memo	Robert Rubin, larry Stein, Chuck Ruff, Gene Sperling, Bruce Reed to The President and the Vice President re: Community Reinvestment Act (CRA) Strategy Memo (4 pages)	04/07/1999	P5

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
WHO ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 500000

FOLDER TITLE:

[03/03/1999 - 10/19/1999]

2010-0384-F
ab953

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Freedom of Information Act - [5 U.S.C. 552(b)]

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April 7, 1999

MEMORANDUM FOR THE PRESIDENT & THE VICE PRESIDENT

FROM: ROBERT RUBIN, LARRY STEIN, CHUCK RUFF, GENE SPERLING, BRUCE REED

SUBJECT: Community Reinvestment Act (CRA) Strategy Memo

ACTION-FORCING EVENT

The House and Senate Banking Committees have approved major financial services legislation. On March 12, the House Banking Committee approved its bill -- developed by Chairman Leach and Ranking Democrat LaFalce -- on a broad, bipartisan vote (51-8). The bill includes a provision we strongly support requiring banks to have and maintain an adequate CRA record in order to engage in newly authorized financial activities. But the Senate bill, developed by Chairman Gramm, and reported out on strict party lines (11-9) on March 4, would: significantly weaken CRA; erode the national bank charter and the Administration's role in financial services policy making; provide inadequate consumer protections; and provide increased leeway for affiliations between banks and nonfinancial firms. You issued a veto threat on the Gramm bill on March 2, citing these concerns.

In addition to the context of financial modernization legislation, CRA will be the focus of hearings likely to be held this spring by Chairman Gramm and House Financial Institutions Subcommittee Chair Roukema. Senator Gramm and other Republicans may also introduce CRA proposals as stand-alone bills or in "regulatory burden relief" legislation. <u>The purpose of this memorandum is to present you with a strategy to prevent any rollback of CRA and preserve CRA's relevance in the financial services industry of the 21st century.</u>

BACKGROUND

Current law. CRA requires a bank to serve the convenience and needs of all communities in which it operates. Although banks are examined periodically (every 24-36 months) for CRA compliance, and these CRA ratings and evaluations are made public, enforcement comes only when a bank files an application to merge with another bank or opens a new branch. The regulator must then consider the bank's CRA record in evaluating the bank's application. The public has an opportunity to comment on the application. A bank's CRA record is not *currently* scrutinized in connection with applications to affiliate with non-banking companies. In 1993, at your request, the banking regulators revised the CRA regulations to focus on performance, not paperwork. They now base CRA ratings on a three-pronged test: lending, services, and investments. In addition, regulators revised and streamlined the examination process, particularly for smaller institutions.

Effectiveness of CRA. Evidence suggests that public disclosure of CRA ratings, together with the changes made by the regulators under your leadership, have significantly contributed to improved performance by financial institutions in meeting the needs of low and moderate income communities and minorities. Since 1993, the number of home mortgage loans to African Americans increased by 58 percent, to Hispanics by 62 percent, and to low and moderate income borrowers by 38 percent, well above the overall market increase. Since 1992, nonprofit community organizations estimate that the private sector has pledged over $1 trillion in loans and investment under CRA. In 1997, banks and thrifts subject to CRA's reporting requirement made 2.6 million small business loans for a total of $159 billion, two-thirds of all small business loans made that year. More than one-fifth of those loans were made to small businesses in low and moderate income communities.

Changing Nature of the Financial Services Industry. Commercial banks have seen their share of assets decline from about 60 percent at the end of World War II, to roughly 25 percent. As the lines between banking and non-banking products become increasingly blurred and as financial firms become larger and financial power in the industry more concentrated, some have become concerned that financial modernization -- both as it is already occurring in the marketplace, and in the form of new legislation -- will reduce the assets subject to CRA. Communities groups are likely to oppose any financial modernization legislation unless CRA were extended to securities and insurance providers which stands no chance of success in the current or foreseeable political environment and which presents practical and theoretical difficulties.

Status of Legislation

House. The Leach-LaFalce bill contains no weakening of CRA, and requires that banks must "have and maintain" a satisfactory CRA rating in order to undertake newly authorized non-banking activities. Secretary Rubin sent a letter to Leach and LaFalce on March 3 indicating our strong support for their legislation.

Democratic amendments to expand CRA to securities and insurance firms, in various ways, were defeated by significant margins, as was a Waters amendment, which we supported, to require the provision of low-cost "life-line" banking accounts as a precondition for expanded nonbanking activity (31-27).

Senate. Chairman Gramm's financial modernization bill would seriously weaken CRA, and you have issued a statement that you would veto the bill in its current form. The bill has three main problems with respect to CRA: (1) it does not require banks to have and maintain an adequate CRA record as a condition for engaging in newly authorized financial activities; (2) it gives banks with satisfactory CRA records a safe harbor from CRA reviews during applications; and **(3) it exempts small banks outside metropolitan areas from CRA. In addition, Gramm may yet offer an "anti-extortion" amendment that would chill legitimate relationships between financial institutions and communities.**

Senator Sarbanes, the Ranking Democrat, worked with the Treasury to unite Banking Committee Democrats behind an alternative bill that had much in common with the Leach-LaFalce bill. The Democratic alternative lost on an 11 - 9 party line vote.

Failure to condition authority to conduct new non-banking activities on banks having a satisfactory CRA record. The Leach-LaFalce bill allows a financial services company to engage in new non-banking activities only if the company's subsidiary banks have and maintain a satisfactory CRA record. Although such a requirement was not contained in the Administration's 1997 bill, Treasury and Rep. LaFalce successfully argued that such an argument had to be included this time. The Leach-LaFalce bill has now been referred to the House Commerce Committee, and we understand that Commerce will leave this provision intact.

Basically, the "have and maintain" requirement, while not expanding the scope of CRA beyond insured depository institutions, broadens the enforcement mechanism for CRA to include the potential for denial of applications for non-banking activities as well as banking activities, and for further consequences if the bank's CRA record becomes unsatisfactory *after* the application is approved. **(Under the Leach-LaFalce, this later action explicitly includes a requirement that a compliance plan be submitted and the possibility of forced divestitures of the newly approved activities. It could be read to include civil money penalties -- a sanction that the Justice Department found in 1994 does not apply under CRA as it is currently written.) In arguing for this provision in the Senate and the House testimony, Secretary Rubin noted that the financial services system of the future may include fewer bank merger applications and more non-banking activities. Thus, absent this additional enforcement mechanism, there could be fewer opportunities to take action against a bank with an unsatisfactory CRA record. A bill that is silent on CRA (and thus supposedly neutral) would, in our view, tend to weaken the effect of CRA, and we would oppose such a bill.**

RECOMMENDATION

Our near-term goal is to continue to assist Leach and LaFalce in moving their bill forward, while doing everything possible to block the Gramm bill. By taking a strong stand on CRA, we should be able to help unite Democrats against the Gramm bill and for the Leach-LaFalce bill. We also need to find opportunities for you, Secretary Rubin, and others to highlight the vital importance of CRA for building homes, creating jobs, and restoring hope in economically distressed communities throughout the United States.

The Administration's long-term strategy should be to 1) continue to strongly oppose legislation that would weaken CRA, and insist on provisions that would, for the first time, require banks to have and maintain an adequate record on CRA to engage in newly authorized non-banking activities. <u>All of your advisers support this position at a minimum.</u> **2) In addition, the DPC and (?) believe we should actively encourage amendments that would enhance enforcement of CRA, such as the LaFalce amendment requiring financial institutions to report on their progress in meeting publicly announced "commitments" under CRA -- an amendment LaFalce has not offered this year in recognition of Republican restraint in not offering amendments to weaken CRA. DPC believes supporting something along these lines could strengthen our hand in negotiations later on; moreover, as we provide the industry with new opportunities, they argue, we should insist on some new responsibilities. However, a majority of your other advisers, including Treasury and the NEC, believe these amendments would present an uncomfortable vote for moderate Democrats, have slim prospects for passage, and could possibly jeopardize the CRA provisions already in the House bill.**

_____Agree on Long-Term Strategy (1)
_____Agree on Modified Long-Term Strategy (2)
_____Discuss Further

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001a. memo	To Ronald Jones from Ellen Seidman. Subject: Treasury report on HR 10 Financial Services Competition Act (Annotations) (1 page)	07/14/1997	P5
001b. draft	re: Administration's principal concerns about H.R. 10 (Annotations) (13 pages)	07/14/1997	P5
002. memo	To Ronald Jones from Ellen Seidman. Subject: Treasury report on HR 10 Financial Services Competition Act (Annotations) (1 page)	07/14/1997	P5
003a. memo	To President Clinton from Todd Stern. Subject: Financial Services Modernization (Notations) (1 page)	05/18/1997	P5 4101
003b. memo	To President Clinton from Robert Rubin. Subject: Treasury's Financial Modernization proposal (1 page)	05/16/1997	P5 4102
003c. memo	To President Clinton from Gene Sperling. Subject: Attached memorandum on Treasury's Financial Modernization proposal (1 page)	05/16/1997	P5 1641
003d. memo	To President Clinton from Gene Sperling. Subject: Request for decision concerning Treasury's Financial Services Modernization proposal (14 pages)	05/16/1997	P5 1642

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National Economic Council
Ellen Seidman
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FOLDER TITLE:
Financial Services Reform - 1997 [1]

Jamie Metrailer
2010-0384-F
jm656

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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THE PRESIDENT HAS SEEN
5-19-97

THE WHITE HOUSE

WASHINGTON

May 16, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Request for Decision Concerning Treasury's Financial Services Modernization Proposal

I. ACTION FORCING EVENT: Treasury was required by statute to report to Congress by March 31 on the potential merger of the bank and thrift charters and of the bank and thrift insurance funds. The specific items in the report are inextricably bound up with the broader issue of financial services modernization, namely the extent to which all types of financial entities -- including banks, thrifts, securities firms and insurance companies -- can affiliate with each other, and the extent to which firms affiliated with banks can affiliate with non-financial commercial firms.

All your economic advisors believe financial modernization reform is long overdue, that it is good government, good for the American economy and good for American consumers. Consolidation in the banking industry will probably continue, with some loss of jobs, with or without modernization. But modernization should make all financial services companies more competitive at home and abroad and should enable the sector to continue its recent job growth.

Although Treasury has not yet submitted its report, Congress -- especially the House -- is already considering financial services modernization, including the repeal of the Glass-Steagall Act[1]. After declining several previous invitations to testify, Secretary Rubin has agreed to testify before the House Banking Committee the first week in June. He would like to be able to announce Treasury's proposals in a speech on May 21, so that the announcement would be in a forum he, rather than the Congress, controls. Any financial services modernization effort would be a Treasury, rather than a Presidential, initiative.

II. DECISION REQUIRED: WHETHER TO AUTHORIZE THE TREASURY TO PROCEED WITH PRESENTATION OF ALTERNATIVE FINANCIAL SERVICES MODERNIZATION PROPOSALS.

Over the past several months, the NEC has run an interagency process to consider Treasury's proposals. Treasury, Commerce, Justice, SBA, OMB, CEA, DPC and White House Legislative Affairs have been participants. We have been able to develop a consensus on all issues. On several issues, however, we wish to inform you of important countervailing considerations. This memo provides you with a quick overview of the major issues, with a substantial amount of background following.

[1] The 1933 Glass-Steagall Act prohibits the combination of commercial and investment banking.

Issue 1. How should banking and commerce combinations be dealt with? Treasury proposes to provide two alternatives. The **first** would allow banks to affiliate freely with all types of financial service companies and allow the combinations to include up to an unspecified percentage of commercial business (measured by gross revenues), but exclude any combination of the 1000 largest non-financial firms with any bank. The **second** would allow banks to affiliate freely with all types of financial service companies but not allow such affiliations to do any non-financial business. In the second alternative, the thrift charter, which allows any type of business to affiliate with a thrift, would be retained. Your advisors agree with Treasury's proposal. While the Administration will surely be criticized for not being decisive, this appears to be a reasonable way of moving the process forward while accommodating the strong feelings against any combination of banking and commerce held by several senior Democratic Senators (including Senators Sarbanes and Daschle).

Issue 2. How should diversified holding companies be regulated and what should be the role of the Fed? Treasury proposes to allow the Fed to impose capital requirements only on a limited group of diversified bank holding companies, those: (i) with total assets over $75 billion which include bank assets totaling over $5 billion; (ii) in which the aggregate bank assets constitute at least 75% of total holding company assets; or (iii) where a subsidiary bank's capital level falls below the "well-capitalized" level (the highest statutory capital level) and remains there for 90 days. The diversified holding company would guarantee to the Fed that each of its depository institution subsidiaries would be continuously well-capitalized or the depository institution will be divested with a requirement that it be well-capitalized after divestiture. Some diversified financial companies interested in affiliating with banks may complain that this is too much regulation, and the Fed may assert it is too little. However, we believe it is a responsible starting point for the legislative process.

Issue 3. Should the Community Reinvestment Act (CRA) be extended beyond banks and thrifts as part of financial services modernization? Treasury proposes to extend CRA only to a new class of banks -- Wholesale Financial Institutions, which could not take insured deposits but would be banks in most other respects. Treasury does not propose any further extension because, not only is there no support in Congress for extension, but Republicans have given clear warning that an attempt to extend will lead to new efforts to repeal or gut CRA. Your advisors agree with Treasury's assessment of the political situation and with Treasury's position. However, you should be aware that community groups will regard proposing modernization without extending CRA to non-bank entities that are part of a bank holding company to be backtracking on your Administration's most successful economic development initiative.

Issue 4. Should strong consumer protections be hardwired into the statue, particularly to prevent consumer confusion about federal insurance on non-deposit products and excessive pressure to purchase insurance as part of a loan transaction? Treasury proposes to require bank regulators to adopt regulations on these issues (currently there are only "guidelines"), including a very simple disclosure about insurance status. Your advisors agree with this proposal, believing that there are one-stop shopping synergies in financial services modernization that really will benefit consumers. However, consumer groups are likely to regard the proposal as insufficient, in part because of lack of trust of the bank regulators, and in part because banking law would not be amended to establish a private right of action for violation of the regulations.

Issue 5. Should Treasury submit legislative language with its report? Treasury proposes to provide Congress with legislative language from which Congress can proceed to consider financial services modernization. Your advisors agree with Treasury's position, but Legislative Affairs raises the caution that once we have sent up legislative language, the process may well begin to move and we may have difficulty controlling it, particularly with respect to issues such as CRA and the ability of banks to do non-bank activities in a bank, rather than a holding company, subsidiary (see footnote 8). It is generally agreed that without an Administration submission, the legislative process will stall.

III. BACKGROUND: Current law restricts affiliations between banks and other companies (i.e., it prevents them from owning one another or being under common ownership). The Glass-Steagall Act generally prohibits affiliations between banks and securities firms. The Bank Holding Company Act of 1956 generally restricts bank holding companies to activities closely related to banking, and specifically prohibits such companies from underwriting or selling insurance[2].

Technological and financial innovation, together with market pressures to offer consumers a wider array of services, have rendered this segmentation of the financial market untenable. Different types of financial products have converged with one another. No longer is there a sharp practical distinction between a syndicated loan and privately placed commercial paper, between a security and a financial future, between a checking account and a money-market mutual fund, or between a mutual fund and a variable-annuity insurance policy. Derivative financial instruments even challenge such fundamental distinctions as those between debt and equity or between dollars and drachmas.

In the face of these developments -- this proliferation of new types of financial products -- the old distinctions among financial institutions are eroding. Banks and thrifts are now practically indistinguishable. Many banks offer insurance, mutual fund shares, and brokerage services, and underwrite a wide range of securities, directly or through affiliates. Securities firms make or syndicate commercial loans, and offer money-market accounts with check-writing privileges. Securities markets constitute the largest source of home-mortgage financing. A wide range of nonfinancial companies own specialized banks that offer credit cards.

Yet the old statutory restrictions remain, imposing needless regulatory and management costs, and impeding competition, innovation and consumer choice. Allowing financial firms of all types to affiliate holds promise that consumers will benefit as fair competition -- less hindered by regulatory restrictions -- will drive firms to achieve savings and pass them on to consumers[3].

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[2] The Comptroller of the Currency has permitted national banks, under specific provisions of the National Bank Act, to sell insurance, and has been upheld by the Supreme Court. Insurance agents, in particular, are very much opposed to this "extension" of bank powers, and the issue has been both a catalyst for and a political barrier to, financial services modernization.

[3] For example, for many years a very limited group of savings banks, mainly in the Northeast, has been allowed to offer savings bank life insurance, an extremely reasonably-priced product attractive to people (such as young married couples with children) whose income and capacity to purchase insurance make them inefficient prospects for the higher-cost insurance agent distribution channel. Expanding the ability of banks to offer insurance products should, on the basis of this experience, make insurance more widely available, at

In addition to providing benefits to consumers, affiliations among financial institutions should reduce the operating costs of the institutions, which, whether passed on to consumers, employees or shareholders, will almost certainly increase the institutions' productivity and should provide economy-wide benefits. Increased affiliation will increase intra-firm diversification, which should help reduce the risk of institutional failure. And finally, by aligning what our financial firms can do in the United States with what they can do abroad and with what foreign financial firms can do in the United States, allowing increased affiliations should increase the international competitiveness of US firms.

For these reasons, there has been a growing agreement that the restrictions against affiliations among financial institutions have become outdated. Over the years, both Congressional Banking Committees have approved legislation to repeal the Glass-Steagall Act, and the Senate passed such a bill in 1988 by a vote of 94-2. Yet such legislation has repeatedly foundered on inter-industry conflicts (e.g., between banks and securities firms, insurance companies, and insurance agents), most recently during the last Congress.

During the past year, trade associations representing a wide range of market participants have made significant progress toward bridging the gaps that have traditionally divided them. The Alliance for Financial Modernization -- a coalition of 10 bank, thrift, securities, insurance, and diversified-company trade associations -- has agreed on legislation (the Alliance, or Roukema/Vento, bill) that would permit any company to affiliate with a bank if the resulting company has at least 75 percent of its business in financial institutions or financial activities. Thus the Alliance bill would remove existing constraints on affiliations among different types of firms that concentrate in financial services, and give these financial firms latitude to conduct nonfinancial activities of significant, but not overwhelming, scale.

Other major proposals currently pending in Congress include the D'Amato/Baker and Leach bills. The D'Amato/Baker bill is the most sweeping, permitting banks to affiliate with any company, financial or nonfinancial. By contrast, the Leach bill -- the most restrictive proposal -- would permit affiliations among banks, securities firms, and insurance companies (but not nonfinancial firms), retain much bank-type regulation of companies affiliated with banks, and vest broad regulatory authority in the Federal Reserve Board. Chairman Leach has scheduled hearings on his bill for the first two weeks of June.

One other concern motivates this legislation. Last year Congress passed legislation that rehabilitated the FDIC insurance fund that insures thrifts (SAIF). All your financial advisors, as well as the FDIC, strongly believe SAIF should be merged with the Bank Insurance Fund (BIF) to maximize their ability to withstand any future shocks to the financial system. However, the "Frist Amendment" conditioned merging of the funds on the elimination of the thrift charter. Both banks and thrifts have taken the position that this means creation of a unified charter that provides both types of institutions with virtually all the benefits each now has, including banks' broad commercial lending powers and at least some of the thrifts' right to affiliate with any type of entity.

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reduced prices. Similarly, security firms have clearly proven their ability to offer highly attractive savings vehicles at higher yields than those available from banks -- witness the fact that last year for the first time more money was in mutual funds than in bank deposits. Providing securities firms the opportunity to offer their efficiencies more directly to bank depositors may well enhance yields available to small savers on insured deposits.

ISSUE 1. HOW SHOULD BANKING AND COMMERCE COMBINATIONS BE DEALT WITH?

Treasury Alternative A (consolidation of the bank and thrift charters, permitting affiliations among all financial firms, with a "basket" of non-financial activities allowed): Alternative A is similar to the Roukema bill. The thrift charter would be abolished and all thrifts would become banks[4]. A "basket" of non-financial[5] activities would be permitted within a holding company structure that includes a bank, but the Treasury report would not provide a specific size for the basket. Banking/non-financial affiliations would be further limited in that none of the largest 1000 non-financial firms (by asset size) would be allowed to affiliate with a bank[6].

The capital of any bank within a diversified holding company (i.e., one that engages in activities, including securities and insurance underwriting, that could not have been done in the bank) would have to be maintained at the "well-capitalized"[7] level, and the holding company would have to provide a guarantee to that effect. While banks could engage in non-bank financial activities in subsidiaries of the bank[8], all non-financial activities would have to be done in holding company subsidiaries and there would be a total ban on any extension of credit by a bank to or for the benefit of a non-financial affiliate.

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[4] The Office of Thrift Supervision (OTS) would be merged with the Office of the Comptroller of the Currency (OCC). Both are bureaus of the Treasury.

[5] "Financial" would generally be defined in the statute to include banking and any activity currently authorized for a bank, the activities of bank operating subsidiaries, and all activities that can be performed by securities, commodities and insurance companies. The National Council on Financial Services could add other financial or financially-related activities to the definition. All other activities would be deemed non-financial.

[6] Any company, financial or non-financial, could affiliate with a "Wholesale Financial Institution" (WFI, pronounced "WOOFIE"), which could not take insured deposits and would not be subject to the Bank Holding Company Act.

[7] Bank (and thrift) capital categories are set by statute at "well-capitalized," "adequately capitalized," "undercapitalized" (which subjects the bank to regulatory sanctions), "significantly undercapitalized" (regulatory sanctions required), and "critically undercapitalized" (bank subject to being placed in receivership). Current law in effect requires a holding company to either maintain the bank or thrift at the adequately capitalized level or divest itself of the institution.

[8] The Administration has supported the proposition that the choice whether to conduct financial activities as a subsidiary of a bank or as a subsidiary of a holding company (and thus as an affiliate of a bank) should be a matter of corporate choice, i.e., that no particular form should either be mandated or encouraged by law. The Fed (and a number of its supporters) has taken the position that all non-bank activity should be done in a holding company subsidiary only. While there are substantive issues involved in this debate, much of the dispute in fact revolves around the fact that OCC regulates banks and their subsidiaries, whereas the Fed regulates bank holding companies, and thus forcing activities into holding company subsidiaries reduces the Administration's reach with respect to financial services policy. The FDIC, which is responsible for the deposit insurance funds, backs the Administration's position.

Alternative A's abolition of the federal thrift charter (and the treatment of any remaining state thrifts as state banks) substantively satisfies the Frist Amendment. A major complication with this change, however, is how to handle differences in the affiliation powers of bank holding companies and unitary thrift holding companies (companies that own one and only one thrift). Currently, unitary thrift holding companies can engage in nonfinancial activities with virtually no limits.[9] Fewer than 30[10] thrifts are part of holding companies that engage in non-financial businesses. (Approximately 45 others are engaged in real estate development, investment and management, which is regarded as "financial" by OTS but not "closely related to banking" by the Fed.) Treasury proposes to grandfather the right of all 515 existing unitary thrift holding companies to engage in nonfinancial activities without regard to the basket. The grandfather rights would not survive a change in control of the holding company (i.e., the expanded franchise could not be sold), but would otherwise be unlimited in duration.

Treasury Alternative B (retain separate bank and thrift charters, allow affiliations among banks and all financial firms, but with no basket of non-financial activities): Alternative B would approach the banking and commerce issue by leaving the existing thrift charter, holding company structure and regulatory system intact. As noted above, unitary thrift holding companies can currently affiliate with any type of institution. Furthermore, the federal thrift charter has recently been altered to permit (i) unlimited consumer lending and (ii) up to 10% of assets to be commercial loans and an additional 10% to be small business loans -- thus making the charter very similar to the actual asset mix of approximately 60% of the commercial banks.[11]

Alternative B in essence preserves the current right of a diversified financial holding company that includes non-financial activities to get into retail "banking" by buying a single thrift. Alternatively, such an institution could get into wholesale banking by affiliating with a WFI (see note 6). The Bank Holding Company Act would be amended to allow any **financial** firm to affiliate with a bank and to allow any bank to buy, establish or otherwise affiliate with, any other type of financial firm including, in particular, an insurance or securities underwriter. Under Alternative B, the Frist Amendment would

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[9] Under current law, the initial purchase must be approved by OTS (which must approve holding company management) and OTS can impose limitations on safety and soundness grounds. Informally, OTS has indicated that they would look skeptically on, e.g., purchase of a thrift by a company a significant portion of whose business was gambling. Multiple thrift holding companies (companies that own more than one thrift, but no banks) are basically limited to activities permitted to bank holding companies, although they may engage in real estate development, investment and management. Under alternative A, all thrift holding companies would be turned into bank holding companies (albeit with special powers in some cases), and would be regulated by the Fed.

[10] Numbers relating to thrift holding companies are as of 12/31/96.

[11] While it is difficult to tell precisely from publicly available data, it appears unlikely that many of the largest banks could qualify as thrifts, mainly because of their commercial lending and investments in non-mortgage securities. However, it is possible that one or more of the large banks with a heavily consumer orientation (e.g., NationsBank) might so qualify, and could, therefore, make a choice to become a thrift to take advantage of the commerce "opportunity." In the past, banks such as Wells Fargo that have considered moving to a thrift charter have ultimately rejected the idea.

simply be statutorily deemed to be satisfied, on the theory that its real purpose was to ensure the opportunity of banks to expand into insurance and securities and this has been accomplished.

Discussion:

Substantive issues: The decision whether to allow any affiliation of financial and nonfinancial firms is one of the most contentious issues arising from the legislation. In general, the substantive arguments for permitting affiliation are:

- to get the benefits of financial firm synergies, it is important to allow securities and insurance companies -- which contain significant non-financial elements -- to have access to retail banking customers;
- there may be synergies between financial and non-financial firms that would provide consumers with additional benefits from modernization;
- allowing firms with non-financial elements into banking would increase competition, which would benefit consumers; and
- such combinations are already permitted in the thrift industry, where they have not caused any problems.

The substantive arguments for opposition to any combination of banking and commerce are:

- unlike other financial services, banking comes with government backing, which generates subsidies and moral hazard; it is inappropriate to extend this safety net or subsidy to commerce;
- most of the synergies between commercial and financial firms involve using the financial firm as a marketing or financing tool for the commercial firm, which is an inappropriate use of the government safety net;
- this country, unlike Japan and Germany, has a long cultural tradition against combinations of banking and commerce, and has had legal prohibitions during the period in which modern financial institutions have developed;
- the combination may exacerbate the already strong trend toward moving control of credit and financial services out of the local communities where these services are needed;
- allowing combinations of banking and commerce will lead to over-concentration of economic power; and
- it is difficult to believe that financial regulators could effectively regulate non-financial companies.

Affiliations between bank-affiliated firms and companies doing a business that truly would provide some positive synergies for the finanical firm, such as a software or telecommunications firm, may well be possible to achieve gradually by establishing in the legislation a system by which regulators could expand the definition of "related to a financial activity" over time, without having to move all the way to allowing combinations of banking and industrial firms.

Political Issues: The political argument favoring a significant degree of banking and commerce affiliation is that the securities and insurance companies and the thrift industry, and Senators Dodd and D'Amato, will not support modernization without a substantial opportunity for entities affiliated with depository institutions to do non-financial activities. Without their support, the legislation cannot proceed[12]. There are two political arguments against permitting any banking and commerce combination: (i) Senator Sarbanes and such traditional Democratic constituencies as community and consumer groups have stated they will unalterably oppose any legislation that permits any banking/commerce combination; and (ii) House Banking Committee Chairman Leach and former Fed Chairman Paul Volcker have come out firmly in opposition to any significant banking and commerce combination, while Fed Chairman Greenspan has indicated willingness to consider only very limited combinations as the start of a go-slow approach.

Alternative A has generated some interest from Chairman Leach, as closer to his minimalist approach to banking and commerce than the Roukema bill, and commands support from those, such as Rep. Roukema, who support the basket approach. However, Senator Sarbanes remains opposed. Proponents of full banking and commerce, particularly Mr. Baker, have voiced their displeasure with this more limited approach.

Within the Administration, Chairman Yellen and Director Raines believe that grandfathering all the unitary thrift holding companies is far too broad, and that grandfather rights should be limited to those unitaries that are actually using their authority to engage in non-financial activities to an extent in excess of whatever basket is established. Treasury responds that not cutting back on thrift powers is critical to maintaining thrift support for legislation, which in turn is critical for legislation to move forward. Treasury has agreed that the Administration would be willing to cut back substantially on the scope of grandfathering as a bill moved through the legislative process.

Treasury has been able to keep Alternative B from leaking, so it is unclear how it will be received. The issues that will potentially arise are:

- banks might assert that the Frist amendment has not been satisfied and therefore the conditions for merging the funds have not been met[13];
- diversified financial holding companies that have non-financial affiliates might not view the thrift option as sufficient;
- banking/commerce opponents may view the proposal as unsatisfying since it preserves, and publicizes, an existing banking/commerce "loophole"; and
- there may be serious concern about the ability of OTS to regulate effectively a large number of powerful new unitary thrift holding companies.

On this last point, Director Raines believes that if Alternative B prevails as the basis of financial services modernization legislation, thrift holding companies that engage, through holding company subsidiaries, in financial or non-financial activities that could not be carried out in the thrift itself, should be regulated by the Fed, not by OTS.

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[12] The extent to which this concern can be met by allowing affiliations of non-financial institutions with thrifts (as in Alternative B) rather than banks (as in Alternative A) is unclear, as Alternative B has not yet been discussed publicly as a possible response to the companies' or Senators' concerns.

[13] In general, banks don't much care about merging the funds; that is a good government and a thrift issue. But, understanding the interest of others in merging the funds, banks view the BIF/SAIF merger as a quid pro quo for agreeing to take on part of the FICO obligation as part of the SAIF recapitalization last year.

Conclusion: Your advisors recommend proceeding with two alternatives, as Treasury has proposed, taking into consideration, as the legislative process proceeds, the concerns raised by Chairman Yellen and Director Raines.

ISSUE 2. HOW SHOULD DIVERSIFIED HOLDING COMPANIES BE REGULATED AND WHAT SHOULD BE THE ROLE OF THE FED?

Treasury proposal: Treasury proposes that the Fed would regulate all bank holding companies (under Alternative B thrift holding companies would continue to be regulated by OTS). Holding companies engaging in activities that cannot be done directly in the bank (including, for example, securities or insurance underwriting) would be required to provide the Fed an undertaking to maintain the capital of the subsidiary banks at the "well-capitalized" level[14], which exceeds the level at which a bank is considered to be in good standing under regular capital standards.

If the bank's capital fell below the "well-capitalized" level, the holding company would be required to bring the capital level back up to well-capitalized and maintain it at that level. If, within 180 days, the holding company were unable to bring bank capital back up to the well-capitalized level, the holding company would be required to either (i) divest the bank in a manner that results in the bank being well-capitalized upon divestiture (e.g., by shrinking the balance sheet or by getting the buyer to add capital as part of the transaction); or (ii) cease engaging within the holding company in any activity the bank could not engage in directly. If the bank got seriously in trouble so quickly that the FDIC were forced to put it into receivership or conservatorship, the holding company's guarantee of the bank's well-capitalized status would be enforceable by the FDIC. The Fed would be responsible, as part of its normal supervisory process, for continuously evaluating the holding company's ability to support the bank's capital at the well-capitalized level, and would be authorized to examine bank holding companies and their nonbank subsidiaries.

The Fed would have general regulatory authority to establish holding company capital requirements in the following situations:

- A subsidiary bank's capital has remained below the well-capitalized level for more than 90 days and the holding company engages in activities not permitted in a bank;
- Consolidated banking assets constitute more than 75% of the assets of the holding company; or
- The holding company has assets in excess $75 billion and owns one or more banks with consolidated assets in excess of $5 billion[15].

In addition, the Fed could impose holding company capital requirements either on a case-by-case or class basis upon a determination that such a requirement "is or may be necessary to avert a material risk to the safety and soundness of a subsidiary insured depository institution."

The Treasury's proposal would not impose similar requirements on thrift holding companies (under Alternative B), nor does current law.

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[14] See note 7.

[15] As of 12/31/96, 134 commercial banks had assets in excess of $5 billion, as did 35 thrifts.

Treasury has discussed the proposal with the Fed, and has received indications from a key staff contact that the proposal is generally "in the ballpark." However, there has been no official agreement.

Discussion: The proposal to allow all types of financial services companies to affiliate (and perhaps to allow some non-financial affiliations in addition) has raised concerns that the consolidated activities of these diversified holding companies could generate risks to the subsidiary banks or even to the financial system that cannot be detected through individual regulation of the bank, securities and insurance affiliates. Just as the firms continue to consolidate their risk analysis and management at the holding company level, there is a need for some holding company level oversight by the federal government.

On the other hand, proposals for consolidation of all financial services regulators, even at the federal level, have been notoriously unsuccessful, in part because of turf jealousies, but also in part because of a real recognition of substantive differences in the statutory schemes under which the firms operate -- differences that, for the most part, would not be changed by either Treasury's proposal, or any other proposal currently being considered in Congress. This leaves aside the even greater objections to bringing insurance regulation under the federal umbrella. Moreover, neither federal regulators nor potential diversified firms that would like to affiliate with banks have any interest in bank-like regulation being imposed on, e.g., American Express.

In recognition of both the substantive and political implications of the Fed's current role as regulator of bank holding companies, all parties to the debate have concluded that some level of Fed oversight and supervision of diversified bank holding companies is appropriate. Proposals have ranged from permitting such regulation only upon a demonstration of imminent danger to the banking or financial system to imposing full bank holding company regulation on all diversified firms.

Conclusion: The nature and extent of diversified holding company supervision and regulation by the Fed has thus been one of the most difficult we have faced. Over the course of the last several months, the principals have discussed numerous variations among themselves, and Treasury has discussed many of these variations with the Fed. In the opinion of the principals, Treasury's current proposal represents a responsible balance. It provides the Fed with sufficient general authority to regulate large diversified holding companies and those overwhelmingly engaged in banking -- about which legitimate concern of banking or financial systemic risk could arise -- while neither requiring the Fed to exercise that authority where it is not needed nor involving them in regulating the capital of smaller diversified holding companies.

Treasury also notes that Congressional dynamics make it highly likely that the Fed's authority will be strengthened during the legislative process, and it is therefore important to start at a point that provides bargaining room.

Your advisors therefore recommend that Treasury's proposal be adopted, but that we remain flexible on the precise boundaries set out.

ISSUE 3. SHOULD THE COMMUNITY REINVESTMENT ACT BE EXTENDED BEYOND BANKS AND THRIFTS AS PART OF FINANCIAL SERVICES MODERNIZATION?

Treasury proposes to extend CRA to Wholesale Financial Institutions but not to nondepository financial institutions (e.g., mutual funds or insurance companies), even if they were affiliated with a depository institutuion. The Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- would state explicitly that we will tolerate no weakening of CRA.

Discussion: One of the hallmarks of your Administration has been its recognition that access to credit and other financial services is essential to the vitality and growth of communities. Bank regulators have been directed to make the Community Reinvestment Act work to generate "performance, not paperwork." The regulators -- working through an unprecedented series of hearings and other outreach efforts -- responded effectively: new CRA regulations, which are just coming into effect, have been praised as effective without being burdensome. As a result of this Administration's efforts in this area (including not only CRA, but also effective enforcement of non-discrimination laws, and the National Homeownership Strategy), over $90 billion in CRA commitments have been made and the number of mortgages made in low- and moderate-income communities rose 22% and the number to minorities rose 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). In the 104th Congress, the Administration stood strong against any cutback in CRA in the context of banking regulatory relief regulation -- and succeeded in fending off all challenges.

The power of CRA and related statutes and of the bank regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. They believe financial services modernization will encourage assets to flow out of banks, and thus reduce the impact of CRA. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system. They have strongly urged the Administration, as a condition of financial services modernization, to expand CRA coverage to all financial institutions affiliated with a bank or at least to all bank-eligible products (such as mortgage loans) no matter where in the holding company they are offered.

Conclusion: Your advisors unanimously recommend that, notwithstanding the concerns of the community groups, CRA expansion beyond WFIs[16] should not be included in the proposal. There are two basic reasons: practical and political. On the practical side, Treasury notes that mutual funds and securities broker-dealers operate in nationwide financial markets largely without respect to geographic boundaries. CRA, by contrast, has always had an intensely geographic focus, aimed at getting banks and thrift to lend and invest in the communities they are chartered to serve. Moreover, insurance companies, commercial financial companies and consumer finance companies -- unlike depository

[16] Treasury would expand CRA to WFIs because: (i) WFIs are banks that take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs. With one exception, all the non-bank companies likely to create WFIs have said they would not oppose application of CRA to WFIs.

institutions -- are not subject to comprehensive federal regulation in the sense that banks and thrifts are. Thus it is not clear how CRA, which is keyed to the federal bank regulatory-application process, would be applied to them.

In addition, while there may be some increased flow of assets out of banking as part of the synergies created by modernization, it is also likely that assets will flow in. For example, if an insurance company has a bank affiliate, it may be inclined to encourage recipients of insurance proceeds who wish to invest them with limited risk to invest in a bank CD, rather than in some non-bank vehicle. Similarly, securities firms may put uninvested customer cash into bank products, rather than money funds. And, if banks can provide one-stop shopping for business borrowers, they may be able to boost the bank share of large syndicated credits.

As a political matter, whatever support CRA has among community groups and some Members of Congress (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potentially important exceptions of Senator D'Amato and some senior House Banking Committee Democrats (such as Representatives LaFalce and Vento), no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion.

Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial services debate would become a fight about CRA, and it is very likely the Administration would be called upon to veto any resulting bill. Senator D'Amato has indicated that he will protect CRA from depredation if the Administration does not push to expand its reach. The Senator did help us accomplish this result in 1996, when he was under significantly less electoral pressure to do so, and we believe he can and will hold the line again.

ISSUE 4. SHOULD STRONG CONSUMER PROTECTIONS BE HARDWIRED INTO THE STATUTE, PARTICULARLY TO PREVENT CONSUMER CONFUSION ABOUT INSURANCE ON NON-DEPOSIT PRODUCTS AND EXCESSIVE PRESSURE TO PURCHASE INSURANCE AS PART OF A LOAN TRANSACTION?

Treasury would establish that federal bank and securities regulators have an obligation, with respect to retail sales of non-deposit investment products by depository institutions, to avoid customer confusion about the applicability and scope of FDIC and SIPC insurance; to prevent improper disclosure of confidential customer information; and to avoid conflicts of interest and other abuses.

The regulations adopted by the banking regulators and the SEC would be required to "encourage the use of disclosure that is simple, direct, and readily understandable," and to encourage oral as well as written disclosure. (Studies have shown that oral disclosure is more effective, but it is, of course, more difficult to monitor, particularly in face-to-face, rather than telephone, conversations.) The National Council on Financial Services, on which both the federal banking regulators and the SEC would sit, could establish more stringent regulations than those adopted by the individual regulators.

The Treasury's proposal would prohibit non-depository institution affiliates within a bank holding company from sharing with any depository institution in the holding company non-public customer information, including in particular evaluations of creditworthiness, unless the customer received "clear and conspicuous disclosure" that such information might be shared and had an opportunity to direct that it not be shared. As a practical matter, customers would probably be given an opportunity to make this choice for all classes of information upon the opening of an account, rather than on an event-by-event basis.

Treasury would require the National Council on Financial Services to biennially review, starting on June 30, 2001, the regulations adopted pursuant to these requirements to determine whether they achieve the statute's purposes.

Finally, Treasury's proposal would, by adopting a greater degree of functional regulation of securities activities than is currently the case, impose more consumer-protective requirements on bank activities relating to securities sales and work for investment companies than is currently the case.

Discussion: Treasury's proposal is designed to be at least as protective of consumer concerns as proposals currently being considered in the House, but to do so in a manner that hardwires fewer requirements into statute and requires more of the regulators. However, the requirement for simple disclosure goes further than other proposals. In contrast to current law, bank regulators would have to adopt **regulations**, not guidelines, regarding the sale of non-deposit investment products.

The consumer groups are not likely to be fully satisfied with this approach for three reasons:
- they are skeptical of the bank regulators' ability and willingness to adopt strong and effective regulations in this area and they would therefore prefer to hardwire more into the statute;
- the proposal would not provide consumers with a private cause of action against a depository institution that caused harm by violating the regulations;
- the proposal would not explicitly deal with "implicit" tying, under which a consumer gets the impression, by the mere fact that credit insurance is offered before a loan is approved, that approval of the loan is contingent on purchase of insurance from the bank.

Conversely, financial institutions will be concerned that this proposal -- particularly the information disclosure portion -- may severely limit their ability to cross-sell securities and investment products, which they regard as one of the benefits to both consumers and institutions of allowing greater affiliations among financial institutions.

The history of hardwiring consumer protections into financial statutes has been very spotty, in large part because the industry and technology are changing so quickly that what appears effective in protecting consumers when a statute is enacted quickly becomes marginally useful and very burdensome. Truth in Savings, Truth in Lending and the Real Estate Settlement Protection Act all needed statutory modification for years before Congress got around do doing the job last session. By using instead a regulatory process with full notice and comment (unlike the development of guidelines, which is in general done without public notice), and by requiring periodic review and updating, rules that make more sense for both businesses and consumers are likely to be established and kept current.

Conclusion: Your advisors unanimously recommend that Treasury go ahead with its proposed consumer protection provisions. The bill as a whole should generate significant consumer benefits through opportunities for one-stop shopping and cross-marketing. While implicit tying probably does occur in the minds of some consumers[17], more opportunities for competition within the financial services sector should reduce, rather than increase it.

ISSUE 5. SHOULD TREASURY SUBMIT LEGISLATIVE LANGUAGE WITH ITS REPORT?

In 1995, as Congress started its most recent financial services modernization debate, Treasury chose to participate through testimony and a statement of principles. There is a general feeling that the result was that the Administration was marginalized and not really a player once Members of Congress, such as Chairman Leach, submitted bills. Treasury's opinion is that it is even more important for the Administration to come to the table with legislative language this time, since several bills have already been introduced, serious hearings have started, and -- while it looks less likely than it did several months ago -- the stars may be aligned to actually produce legislation this Congress. People on the Hill are clearly waiting for statuory language.

At the same time, however, taking a firm position on banking and commerce would, as discussed above, be counterproductive. Treasury therefore intends to submit a single draft, with alternative language as necessary to conform to Alternatives A and B on banking and commerce. Treasury and White House Legislative Affairs are discussing alternative formats that are simultaneously technically feasible and politically optimal; no package will be transmitted without their joint agreement.

Conclusion: Your advisors agree with the Treasury proposal to submit legislative language as a Treasury initiative. Your advisors also believe it is critical that Treasury do a careful and complete rollout of the proposal, particularly with Democrats, both to avoid confusion and to position the proposal as a thoughtful and sensible way to move the debate forward, rather than a fainthearted response to a difficult substantive and political problem.

IV. DECISIONS

_____ Treasury should proceed as it has proposed.

_____ We need further discussion before deciding whether and how to proceed. Please arrange for a meeting of relevant principals with me. I am particularly concerned about:

_____ I do not believe we should proceed with any legislative proposal at this time. Treasury should simply fulfil its statutory mandate to send Congress a report.

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[17] Under current law, explicit tying is prohibited to banks, without the showing of market power required under traditional antitrust law.

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	re: Draft of NEC Principals status memo (9 pages)	03/20/1997	P5
002. memo	To President Clinton from Gene Sperling. Subject: Treasury's proposed Financial Services Modernization legislation (12 pages)	03/1997	P5 1643

COLLECTION:

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FOLDER TITLE:

Financial Services Reform - 1997 [2]

Jamie Metrailer
2010-0384-F
jm657

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

1. AFFILIATIONS BETWEEN FINANCIAL AND NONFINANCIAL FIRMS

Treasury Alternative A: Alternative A is in essence the previous Treasury proposal of allowing a "basket" of non-financial[1] activities within a holding company structure that includes a bank. Treasury's proposal as of March 20 was 25% of the combined entity's business. The current proposal varies in several critical respects from the March 20 proposal:

- The measure for calculating the basket would be specified as gross revenues.
- The legislative language would be submitted **without** a percentage specified.
- Banking/non-financial affiliations would be further limited in that none of the largest 1000 non-financial firms (by asset size) would be allowed to affiliate with a bank.

Treasury has also clarified that: (i) while banks could engage in non-bank financial activities in subsidiaries of the bank, all non-financial activities would have to be done in holding company subsidiaries and (ii) as is currently the case with thrift holding companies, there would be a total ban on any extension of credit by a bank to or for the benefit of a non-financial affiliate.

Although not fully discussed in the earlier memos, a critical element of Treasury's initial proposal, now Alternative A, is the abolition of the thrift charter and the conversion of all thrifts to banks (together with the merger of the Office of Thrift Supervision with the Office of the Comptroller of the Currency). Abolition of the thrift charter meets the explicit requirements of the "Frist Amendment," which prohibits merger of the BIF (bank) and SAIF (thrift) insurance funds until the charters are merged.

A major complication with the thrift charter conversion, however, is how to handle differences in the affiliation powers of bank holding companies and unitary thrift holding companies (companies that own one and only one thrift). Currently, unitary thrift holding companies can engage in nonfinancial activities with virtually no limits.[2] As far as we can tell (and the data are far from perfect), only 29[3] thrifts are part of holding companies that engage in non-financial businesses. (Approximately 45 others are engaged in real estate development, investment and

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[1] "Financial" would be defined in the statute to include banking and any activity currently authorized for a bank, the activities of bank operating subsidiaries, and all activities that can be performed by securities, commodities and insurance companies. The National Council on Financial Services could add to the definition. All other activities would be deemed non-financial.

[2] The initial purchase must be approved by OTS (which must approve holding company management) and OTS can impose limitations on safety and soundness grounds. Informally, OTS has indicated that they would look skeptically on, e.g., purchase of a thrift by a company a significant portion of whose business was gambling. Multiple thrift holding companies (companies that own more than one thrift, but no banks) are basically limited to activities permitted to bank holding companies, although they may engage in real estate development, investment and management.

[3] Numbers relating to thrift holding companies are as of 12/31/96.

management, which is regarded as "financial" by OTS but not "related to banking" by the Fed.) Treasury proposes to grandfather the right of all 515 existing unitary thrift holding companies to engage in nonfinancial activities without regard to the basket. The grandfather rights would not survive a change in control of the holding company (i.e., the expanded franchise could not be sold), but would not otherwise be limited in duration.

Treasury Alternative B: Alternative B would approach the banking and commerce issue by leaving the existing thrift charter, holding company structure and regulatory system intact. As noted above, unitary thrift holding companies can currently affiliate with any type of institution. Furthermore, the thrift charter has recently been altered to permit (i) unlimited consumer lending and (ii) up to 10% of assets to be commercial loans and an additional 10% to be small business loans -- thus making the charter very similar to the actual asset mix of approximately 60% of the commercial banks.[4]

Alternative B in essence offers any diversified financial holding company that includes non-financial activities the opportunity to get into retail "banking" by buying a single thrift. Alternatively, such an institution could get into wholesale banking (only non-insured deposits over $100,000) by establishing a "Wholesale Financial Institution" (WFI, pronounced "WOOFIE"), which would not be subject to the Bank Holding Company Act. The Bank Holding Company Act would be amended to allow any **financial** firm to affiliate with a **bank** and to allow any bank to buy, establish or otherwise affiliate with, any other type of financial firm including, in particular, an insurance or securities underwriter. Under Alternative B, the Frist Amendment would simply be statutorily deemed to be satisfied, on the theory that its real purpose was to ensure the opportunity of banks to expand into insurance and securities and that this has been accomplished.

Discussion: As revised, Alternative A has generated some interest from Chairman Leach, as moving closer to his minimalist approach to banking and commerce, and still commands support from those, such as Rep. Roukema, who supported the basket approach in the first place. However, Senator Sarbanes is still not convinced. Proponents of full banking and commerce, particularly Mr. Baker, have voiced their displeasure. Within the Administration, Chairman Yellen has expressed her concern that the extent of the grandfathering of unitary thrift holding companies is far too broad, and should be limited to those unitaries that are actually using their authority to engage in non-financial activities to an extent in excess of whatever basket is established. Treasury responds that not cutting back on thrift powers is critical to maintaining

[4] While it is difficult to tell precisely from publicly available data, it appears unlikely that many of the largest banks could qualify as thrifts, mainly because of their commercial lending and investments in non-mortgage securities. However, it is possible that one or more of the large banks with a heavily consumer orientation (e.g., NationsBank) might so qualify, and could, therefore, make a choice to become a thrift to take advantage of the commerce "opportunity." In the past, banks such as Wells Fargo that have considered moving to a thrift charter have ultimately rejected the idea.

thrift support for legislation, which in turn is critical for legislation to move forward. For a discussion of other issues related to this approach see pages 4-6 of Tab A.

Treasury has been able to keep Alternative B from leaking, so it is unclear how it will be received. The issues that will potentially arise are: (i) banks might assert that the Frist amendment has **not** been satisfied and therefore the conditions for merging the funds have not been met[5]; (ii) diversified financial holding companies that have non-financial affiliates might not view the thrift option as sufficient; (iii) banking/commerce opponents may view the proposal as unsatisfying since it preserves, and publicizes, an existing banking/commerce "loophole"; and (iv) there may be serious concern about the ability of OTS to effectively regulate a large number of powerful new unitary thrift holding companies.

2. Holding Company Regulation and the Role of the Fed

Treasury proposal: Treasury's latest proposal, which has not been vetted with the Fed, would apply to either Alternative A or Alternative B. Under this scheme, the Fed would regulate all bank holding companies (but under Alternative B not thrift holding companies, which would be regulated by OTS). Holding companies engaging in activities that cannot be done directly in the bank (including, for example, securities or insurance underwriting) would be required to provide the Fed an undertaking to maintain the capital of the subsidiary banks at the "well-capitalized" level[6]. If the bank's capital falls below that level the holding company would be required to bring the capital level back up to well-capitalized and maintain it at that level. If, within 180 days, the holding company were unable to bring bank capital back up to the well-capitalized level, the holding company would be required to **either** (i) divest the bank in a manner that results in the bank being well-capitalized upon divestiture (e.g., by shrinking the balance sheet or by getting the buyer to add capital as part of the transaction); or (ii) cease engaging within the holding company in any activity the bank could not engage in directly (including, for example, most insurance and securities underwriting). If the bank got seriously in trouble so quickly that the FDIC were forced to put it into receivership or conservatorship, the holding company's guarantee of the bank's well-capitalized status would be enforceable by the FDIC.

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[5] In general, banks don't much care about merging the funds; that is a good government and a thrift issue. But, understanding the interest of others in merging the funds, banks view the BIF/SAIF merger as leverage to enable them to get "paid" for agreeing to take on part of the FICO obligation as part of the SAIF recapitalization last year.

[6] Bank (and thrift) capital levels are set by statute at "well-capitalized," "adequately capitalized," "undercapitalized" (which subjects the bank to regulatory sanctions), "significantly undercapitalized" (regulatory sanctions required), and "critically undercapitalized" (bank subject to being placed in receivership). Current law in effect requires a holding company to guarantee to maintain the bank or thrift at the adequately capitalized level.

The Fed would be responsible, as part of its normal supervisory process, for continuously evaluating the holding company's ability to support the bank's capital at the well-capitalized level, and would be able to examine bank holding companies and their nonbank subsidiaries if there were reason to suspect those entities were engaged in activities that could pose a significant threat to a subsidiary bank.

Although bank holding companies would be subject to Fed regulation under the Bank Holding Company Act, the Fed's authority to establish holding company capital requirements[7] would be limited to the following situations:

- A subsidiary bank's capital has remained below the well-capitalized level for more than 180 days;
- Banking assets constitute more than 90% of the assets of the holding company **and imposition of holding company capital requirements is or may be necessary to avoid a threat to the safety and soundness of the bank**; or
- On a case-by-case basis if the holding company has assets in excess $100 billion and owns a bank with assets in excess of about $5 billion[8] **and imposition of holding company capital requirements is or may be needed to avert systemic risk to the economy or a threat to bank safety and soundness.**

The Treasury's proposal would not impose similar requirements on thrift holding companies (under Alternative B), nor does current law.

Discussion: With respect to the holding company guarantee, the issues likely to be raised are (i) the ability of the Fed adequately to monitor the effective strength of the guarantee when it is neither authorized or set up to regularly and fully examine the holding company or its non-bank subsidiaries (a concern Director Raines has raised) and (ii) the extent to which the difference between "well-capitalized" and "adequately capitalized" provides a sufficient cushion in capital and time so that a bank that falls below the well-capitalized level can be recapitalized or sold before it is truly in trouble (a concern Chairman Yellen and Director Raines have both raised).

On the issue of Fed capital standards, the major substantive question, raised by Chairman Yellen, is whether these standards amount to attempting to close the barn door after the horse is out. In particular, if the Fed can impose holding company capital standards during the first 180 days when a bank falls below the well-capitalized level only **after** finding a threat or likelihood of threat to the bank or of systemic risk, will the capital standards be effective in preventing the risk from materializing? Chairman Yellen also believes that defining a holding company that is

[7] The Fed asserts it has such authority under current law. However, it is unclear whether the assertion would survive legal challenge.

[8] As of 12/31/96, 134 commercial banks had assets in excess of $5 billion. As of 9/30/96, 31 thrifts had assets in excess of $5 billion..

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primarily bank-related as one in which the bank accounts for 90% of the assets is too lax: moving sufficient assets out of the bank to fall below the 90% level would be fairly painless. She would support a lower threshold. Director Raines has also expressed concern in the past that capital requirements that are discretionary with regulators may pose "forebearance risk": the risk that capital standards will not be imposed when needed because regulators and the regulated can convince each other that the situation will be resolved without the imposition of standards.

Treasury responds that: (i) holding company capital regulation is in fact an extremely minor part of the entire bank regulatory structure that, with the post-1990 rules concerning prompt corrective action, would ensure the security of the deposit insurance funds; (ii) providing the Fed with **any** degree of explicit holding company capital authority is more than the Fed has now; and (iii) since the goal of holding company capital regulation in the case of a holding company that is predominantly a bank is to prevent "double-leveraging"[9] in order to protect the deposit insurance fund, it does not matter that a holding company could avoid the capital requirements by moving assets out of the bank. An additional substantive question is whether, whatever system is proposed to allow the Fed to set holding company capital standards, a similar system should be proposed with respect to OTS' regulation of thrift holding companies under Alternative B.

Treasury's current proposal is an attempt to provide for holding company capital requirements where the strength of the holding company really would be needed to protect the safety and soundness of the banking system, while keeping the Fed out of this business -- particularly with respect to diversified financial holding companies -- under normal circumstances. Whether this will prove (i) too little to satisfy the Fed and its supporters or (ii) too much to satisfy the diversified holding companies is unclear.

3. Consumer Protection

Treasury proposal: Treasury would establish that federal bank and securities regulators have an obligation, with respect to retail sales of non-deposit investment products by depository institutions, to avoid customer confusion about the applicability and scope of FDIC and SIPC insurance; to prevent improper disclosure of confidential customer information; and to avoid conflicts of interest and other abuses.

Treasury's proposal would direct the bank regulators, in consultation with the SEC, to adopt regulations for sales of non-deposit investment products by insured depository institutions that are not registered securities brokers. Such regulations would be required to cover the following

[9] Double leveraging occurs when a holding company issues debt that is then used to capitalize the bank. The result is that the bank nominally has equity, but it is under pressure to dividend profits to the holding company to pay the debt service. This can result in the bank holding less capital (e.g., little in excess of the minimum amount required -- in the case of a bank in a diversified holding company, the well-capitalized level) than would otherwise be the case. In contrast, if the bank itself has raised the equity, there is no debt service, and so less pressure to pay holding company dividends.

areas: advertising, disclosure, sales practices, qualifications and training of sales personnel, compensation of sales personnel, and the circumstances under which transactions and referrals occur. With respect to non-deposit investment products that are securities (including mutual funds) or annuities, the bank regulators would be required to adopt regulations comparable to those adopted by the SEC. The SEC would be required (to the extent such rules are not already in place) to adopt similar rules concerning sales of non-deposit investment products by brokers or dealers who are depository institutions (in the case of brokers) or are affiliated with a depository institution. The SEC would have to consider one major new item, namely the disclosure by depository institution subsidiaries and affiliates of the financial interest of the depository institution or securities subsidiary or affiliate with respect to referrals or transactions.

The regulations adopted by the banking regulators and the SEC would be required to "encourage the use of disclosure that is simple, direct, and readily understandable" (model language would be included), and to encourage oral as well as written disclosure. (Studies have shown that oral disclosure is more effective, but it is, of course, more difficult to monitor, particularly in face-to-face, rather than telephone, conversations.) The National Council on Financial Services, on which both the federal banking regulators and the SEC would sit, could establish more stringent regulations than those adopted by the individual regulators.

The Treasury's proposal would prohibit non-depository institution affiliates within a bank holding company from sharing **with any depository institution** in the holding company non-public customer information, including in particular evaluations of creditworthiness, unless the customer received "clear and conspicuous disclosure" that such information might be shared and had an opportunity to direct that it not be shared. As a practical matter, customers would probably be given an opportunity to make this choice for all classes of information upon the opening of an account, rather than on an event-by-event basis.

Treasury would require the National Council on Financial Services to biennially review, starting on June 30, 2001, the regulations adopted pursuant to these requirements to determine whether they carry out the purposes.

Finally, Treasury's bill would, by adopting a greater degree of functional regulation of securities activities than is currently the case, impose more consumer-protective requirements on bank activities relating to securities sales and work for investment companies than is currently the case.

Discussion: Treasury's proposal is designed to be at least as protective of consumer concerns as proposals currently being considered in the House, but to do so in a manner that hardwires fewer requirements into statute and requires more of the regulators. However, the requirement for simple disclosure and model language goes further than other proposals. In contrast to current law, bank regulators would have to adopt **regulations**, not guidelines, regarding the sale of non-deposit investment products.

The consumer groups are not likely to be fully satisfied with this approach for three reasons: (i) they are skeptical of the bank regulators' ability and willingness to adopt strong and effective regulations in this area and they would therefore prefer to hardwire more into the statute; (ii) the proposal would not provide consumers with a private cause of action against a depository institution that caused harm by violating the regulations; and (iii) the proposal would not explicitly deal with "implicit" tying, under which a consumer gets the impression, by the mere fact that insurance is offered before a loan is approved, that approval of the loan is contingent on purchase of insurance from the bank. Conversely, financial institutions will be concerned that this proposal -- particularly the information disclosure portion -- may severely limit their ability to cross-sell securities and investment products, which they regard as one of the benefits to both consumers and institutions of allowing greater affiliations among financial institutions.

4. COMMUNITY REVINESTMENT ACT

Treasury's proposal with respect to CRA has not changed since March 20. The only external developments since March 20 are that (i) Senator D'Amato has suggested that expanding CRA even to WFIs will put CRA "in play" and (ii) the companies that are likely to create WFIs have -- with one exception -- said they will have no objection to expansion of CRA to such institutions. We may also want to consider whether the fact that Treasury proposes sending up a report with legislative language rather than a bill, changes the dynamic of what can and should be included.

Treasury Proposal: Apply CRA to Wholesale Financial Institutions -- banks that do not accept accounts under $100,000 and thus do not have insured deposits, but avoid putting CRA "in play" by proposing an expansion of CRA coverage to nonbanking firms. The Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- would state explicitly that we will tolerate no weakening of CRA.

Discussion: One of the hallmarks of this Administration has been its recognition that access to credit and other financial services is essential to the vitality and growth of communities. Bank regulators have been directed to make the Community Reinvestment Act work to generate "performance, not paperwork." The regulators -- working through an unprecedented series of hearings and other outreach efforts -- responded effectively: new CRA regulations, which are just coming into effect, have been praised as effective without being burdensome. As a result of this Administration's efforts in this area (including not only CRA, but also effective enforcement of non-discrimination laws, and the National Homeownership Strategy), over $90 billion in CRA commitments have been made and the number of mortgages made in low- and moderate-income communities rose 22% and the number to minorities rose 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). In the 104th Congress, the Administration stood strong against any cutback in CRA in the context of banking regulatory relief regulation -- and succeeded in fending off all challenges.

It is quite clear that, notwithstanding continued strong bank profitability, assets and lending are flowing out of the banking system. While much of the asset loss in the last few years is attributable to large businesses (who are unlikely to rely on CRA for access to capital) directly accessing the capital markets, the movement of deposits from banks to mutual funds has put a strain on both the theory and practice of CRA.

The power of CRA and related statutes and the regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system. They have strongly urged the Administration, as a condition of financial services modernization, to expand CRA coverage to all financial institutions affiliated with a bank or at least to all bank-eligible products (such as mortgage loans) no matter where in the holding company they are offered.

Treasury believes that, notwithstanding the concerns of the community groups, CRA expansion beyond WFIs[10] should not be included in the proposal. There are two basic reasons: practical and political. On the practical side, Treasury notes the difficulty of defining the geographic service area -- a critical CRA concept -- for securities firms and mutual funds, and the difficulty of imposing federal CRA regulation on state-regulated insurance companies and unregulated finance companies. They note that, while the OCC currently takes the activities of non-bank subsidiaries into account in evaluating the CRA performance of a national bank, in general the subsidiaries are small in relation to the bank. If, in an attempt to avoid imposing CRA directly on securities firms, insurance companies and finance companies affiliated with banks, one were to impose on a relatively small bank the community obligations of all affiliated companies, the most likely result would be a sharp decrease in the interest of anyone in affiliating with a bank.

As a political matter, whatever support CRA has among community groups and some Congressmen (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potential [important] exception of Senator D'Amato, almost no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion. Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial

[10] Treasury would expand CRA to WFIs because: (i) WFIs are banks that take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs.

services debate would become a fight about CRA, and it is very likely the Administration would be called upon to veto the resulting bill.

4. WHETHER TO GO FORWARD, AND IN WHAT FORM

Treasury proposal: Treasury proposes to release, on or about May 21, a brief statement by Secretary Rubin, covering draft legislative language containing the two alternatives discussed above.

Discussion: After a lengthy series of discussions with both members of Congress and interested parties, Treasury came to the conclusion that the best way to both (i) respond to the statutory directive that it report on the merger of the bank and thrift charters by March 31 and (ii) move the financial services debate forward is to send forth a legislative proposal that is complete and defensible, but that provides alternative ways to deal with the most contentious issue.

Sending alternatives rather than a legislative proposal may lead some to question both the Administration's purposes and its strength of commitment to financial services modernization. And the result may be that the debate does not proceed or the Administration is marginalized. On the other hand, it is quite clear that taking the position on banking and commerce that is most likely to move the debate quickly -- the basket approach with a fairly large basket -- will seriously offend critically important Democratic Senators such as Senator Sarbanes. One lesson of last Congress' unsuccessful discussion of this issue is that even if there is no legislation, the ball moves: there no longer is a serious debate about whether to repeal Glass-Steagall or whether to allow banks to affiliate with insurance companies, rather the debate is how. For the Administration to be a serious player in this session's discussions, and to protect our interests (particularly with respect to CRA and the role of the OCC[11]), almost certainly requires that Treasury fulfill its report obligation reasonably quickly and do so in a manner that indicates we have been considering the issues seriously and have cogent proposals to put on the table, even if we have two of them.

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[11] As described in footnote 5 of the memo at Tab A, an important aspect of Treasury's proposal is that banks would be allowed to do non-bank financial activities in **either** a subsidiary or an affiliate of the bank. In contrast, the Fed is insisting that such activities be done only in a bank affiliate (a subsidiary of a bank holding company rather than of a bank). As footnote 5 points out, whatever the substantive issues involved, there are clear jurisdictional implications: national banks and their subsidiaries are regulated by the OCC, a bureau of the Treasury, whereas bank holding companies (including holding companies of national banks) are regulated by the Fed.

March __, 1997

MEMORANDUM FOR: THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: TREASURY'S PROPOSED FINANCIAL SERVICES MODERNIZATION LEGISLATION

ACTION-FORCING EVENT: The Treasury seeks to propose legislation that would increase competition among providers of financial services by repealing the Depression-era Glass-Steagall Act, allowing a broader range of affiliations between banks and other companies (including both other financial companies and commercial and industrial companies), and merging the regulation of banks and savings institutions. This proposal would satisfy a statutory requirement that the Secretary of the Treasury report to Congress by March 31, 1997 (which will probably be delayed until April 7 when Congress returns from recess), on how to harmonize and integrate the regulation of banks and thrifts. The proposal would also respond to Congressional requests for the Administration to set forth a plan for modernizing financial services regulation, including requests for Secretary Rubin to testify before the House Banking Committee in April.

On March 18 and 20, the NEC principals and relevant White House offices met to discuss the Treasury proposal. Although the group concluded that the Administration should go forward with the Treasury proposal with limited modifications, we also concluded that prior to authorizing the Treasury to proceed, you should be aware of signficant substantive and political concerns raised by the principals. This memorandum outlines the case for financial services modernization, the essential parameters of the Treasury proposal, and the issues that raise the most questions and concerns.

BACKGROUND: Current law restricts affiliations between banks and other companies (i.e., it prevents them from owning one another or being under common ownership). The Glass-Steagall Act generally prohibits affiliations between banks and securities firms. The Bank Holding Company Act of 1956 generally restricts companies that control banks (bank holding companies) to activities closely related to banking, and specifically prohibits such companies from underwriting or selling insurance. These laws essentially sought to limit competition by segmenting different types of financial and other services from one another, and thus reinforce the traditional distinctions among banks, securities firms, insurance companies, and other financial institutions.

But technological and financial innovation, together with market pressures to offer consumers a wider array of services, have rendered this segmentation untenable. Different types of financial products have converged with one another. No longer is there a sharp practical distinction between a syndicated loan and privately placed commercial paper, between a security and a financial future, between a checking account and a money-market mutual fund, or between a mutual fund and a variable-annuity insurance policy. Derivative financial instruments even challenge such fundamental distinctions as those between debt and equity or between dollars and drachmas.

In the face of these developments -- this proliferation of new types of financial products -- the old distinctions among financial institutions are eroding. Banks and thrifts are now practically indistinguishable (although thrifts -- but not banks -- can form affiliations with any company, financial or nonfinancial). Banks offer insurance, mutual fund shares, and brokerage services, and underwrite a wide range of securities, directly or through affiliates. Securities firms make or syndicate commercial loans, and offer money-market accounts with check-writing privileges. Securities markets constitute the largest source of home-mortgage financing. A wide range of nonfinancial companies own banks that offer credit cards.

Yet the old statutory restrictions remain on the books -- imposing needless regulatory and management costs, and impeding competition, innovation and consumer choice. Allowing financial firms of all types to affiliates holds promise that consumers will benefit as fair competition -- less hindered by regulatory restrictions -- will drive firms to achieve and pass savings on to consumers. For example, for many years a very limited group of savings banks, mainly in the northeast, has be allowed to offer savings bank life insurance, an extremely reasonably-priced product attractive to people (such as young married couples with children) whose income and capacity to purchase insurance make them inefficient prospects for the higher-cost insurance agent distribution channel. Expanding the ability of banks to offer insurance products should, on the basis of this experience, make insurance more widely available, at reduced prices. Similarly, securities firms have clearly proven their ability to offer highly attractive savings vehicles at greater yields than available from banks -- witness the fact that last year for the first time more money was in mutual funds than in bank deposits. Providing securities firms the opportunity to more directly offer their efficiencies to bank depositors may well enhance yields available to small savers on insured deposits.

In addition to providing benefits to consumers, greater affiliation among financial institutions should reduce the operating costs of the institutions, which, whether passed on to consumers, employees or shareholders, will almost certainly will increase the institutions' productivity and should have similar benefits economy-wide. Increased affiliation will increase intra-firm diversification, which will almost certainly reduce the risk of institutional failure. And finally, by aligning what our financial firms can do in the United States with what they can do abroad and with what foreign financial firms can do in the United States, allowing increased affiliations should increase the international competitiveness of US firms.

For these reasons, there has been a growing agreement that the restrictions against affiliations among financial institutions have become outdated. Over the years, both Congressional Banking Committees have approved legislation to repeal the Glass-Steagall Act, and the Senate passed such a bill in 1988 by a vote of 94-2. Yet such legislation has repeatedly foundered on inter-industry conflicts (e.g., between banks and securities firms, insurance companies, and insurance agents), most recently during the last Congress.

During the past year, however, trade associations representing a wide range of market participants have made significant progress toward bridging the gaps that have traditionally divided them. The Alliance for Financial Modernization -- a coalition of 10 bank, thrift, securities, insurance, and diversified-company trade associations -- has agreed on legislation (the Alliance, or Roukema/Vento, bill) that would permit any company to affiliate with a bank if it has at least 75 percent of its business in financial institutions or financial activities.[1] Thus the Alliance bill would remove existing constraints on affiliations among different types of firms that concentrate in financial services, and give these financial firms latitude to conduct nonfinancial activities of significant, but not overwhelming, scale.

Other major proposals currently pending in Congress include the D'Amato/Baker and Leach bills. The D'Amato/Baker bill is the most sweeping of these proposals. It would permit banks to affiliate with any company, financial or nonfinancial. By contrast, the Leach bill -- the most restrictive of the Congressional proposals -- would permit affiliations among banks, securities firms, and insurance companies (but not nonfinancial

[1] This provision encouraged the securities and insurance industries -- which have always been allowed to affiliate with non-financial companies and did not wish to divest such companies as the price for access to banking -- to join together with banks to support modernization legislation. The bill has been introduced in the House, and there have been initial hearings. While it has attracted some support, there has also been much skepticism, mainly on the banking and commerce issue, to a lesser extent on consumer and community concerns. In addition, at least one Alliance member -- America's Community Bankers (the thrift trade group) -- has said it can't support the bill it its present form, because it would reduce the scope of thrift activities. The bill is very vague on how to measure the 25% limit, and different measurements generate very different results. An asset-based measurement is least restrictive and a gross revenue-based measurement most restrictive of financial/non-financial combinations.

firms), retain much bank-type regulation of companies affiliated with banks, and vest broad regulatory authority in the Federal Reserve Board.

One other concern motivates this legislation. Last year Congress passed legislation that rehabilitated the two FDIC insurance funds -- one that insures thrifts, and the other that insures banks. All your financial advisors, as well as the FDIC, strongly believe these two funds should be merged in order to maximize their ability to withstand any future shocks to the financial system. However, Congress has conditioned merging of the funds on the elimination of the thrift charter. The proposed legislation would satisfy this precondition and thus permit a fund merger.

We see the Treasury proposal as raising four key issues. First, whether (and to what extent) to permit affiliations between banks and nonfinancial companies. Second, to what extent and how to regulate companies affiliated with banks, and what the role the Federal Reserve would have in such regulation. Third, how do deal with issues raised by the Community Reinvestment Act, which only applies to banks and their subsidiaries. And finally, whether the Administration should go forward with the proposal.

1. AFFILIATIONS BETWEEN FINANCIAL AND NONFINANCIAL COMPANIES

Issue: To what extent (if at all) to permit affiliations between banks and nonfinancial companies -- the so-called "banking and commerce" issue.

Treasury Approach: Would permit financial services companies that are predominantly financial -- i.e., if 75 percent of their business consists of financial institutions or financial activities -- to have a 25 percent "basket" of nonfinancial activities[2]. Any bank holding company, whether operating or non-operating, finanical or non-financial, would be required to guarantee the well-capitalized status of the bank.

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[2] Treasury draft legislation at OMB for clearance does not define "business." See footnote 1. If the most restrictive definition is chosen -- measurement according to gross revenue, Chase (the second largest bank) could affiliate with the 191st largest nonfinancial company (Merisel, Inc) or anything smaller, but the combination of Chase and Salomon could affiliate with the 97th largest nonfinancial company (CSX). Conversely, under such a definition, Microsoft could acquire any of the three largest banks (Citicorp, Chase, or Bank of America), although it is fair to ask whether such a purchase would make any finanical sense to Microsoft. Treasury is working with the CEA and OMB to refine the definition to prevent these kinds of "giant to giant" combinations. The Treasury draft, like both the Roukema and Leach bills, would authorize any firm to own a "Wholesale Financial Institution" (or WOOFIE) -- a new kind of entity that would be a bank with full access to the payment system and strong capital standards, but could not accept insured deposits.

Discussion: The decision whether to allow any affiliation of finanical and nonfinancial firms (the "banking and commerce" issue) is one of the two most contentious issues arising from the legislation. In general, the substantive arguments for permitting affiliation to the extent allowed in the Treasury draft are (i) to get the benefits of financial firm synergies, it is important to allow securities and insurance companies -- which contain signficant non-financial elements -- to have access to retail banking customers; (ii) there are synergies between financial and non-financial firms -- seen most clearly in GE, but also present at various times in firms such as Sears (Allstate) and GM (GMAC) -- that should be allowed to provide consumers with the maximum benefit from modernization; (iii) allowing firms such as Microsoft into banking would increase competition, which -- together with the natural synergies from such a combination -- would benefit consumers; and (iv) such combinations are already permitted in the thrift industry, where they have not caused any problems.[3]

In addition to these substantive arguments, there are two political arguments for permitting the combination Treasury proposes: (i) the securities and insurance companies,[4] and Senators Dodd and D'Amato, will not support modernization without the 25% basket, and without their support, the legislation is dead; and (ii) because of likely opposition to any significant banking and commerce combination from the Fed and others, the basket is likely to get smaller as the legislation progresses, making it important to start from a position with some "give."

The substantive reasons for opposition to the combination are: (i) unlike other finanical services, banking comes with government backing, which generates capital subsidies and moral hazard; it is inappropriate to extend this safety net to commerce without far greater evidence of positive synergies; (ii) most of the cited synergies between commercial and finanical firms involve using the financial firm as a marketing tool for the commercial firm (indeed, GE may be sui generis in having a consistently profitable finance subsidiary), which is an inappropriate use of the government safety net; (iii) this country, unlike Japan and Germany, has a long legal and cultural tradition against combinations of banking and commerce; (iv) the combination will exacerbate the already strong trend toward moving control of credit and financial services out of the local communities where these services are needed; and (v) it is difficult to believe that financial regulators can or

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[3] Under current law, any type of company -- including an industrial company -- can own a thrift, as long as it owns only one such institution (it becomes a "diversified unitary thrift holding company"). There are currently only 14 such institutions, the largest one being a paper company that owns a $9 billion thrift. However, in the past Ford Motor Company owned a thrift based in California. Ford poured alot of money into the institution before it finally sold it for far less than it had contributed in capital.

[4] And the thrifts, see footnote 1.

should effectively regulate even the capital of non-financial companies -- which is what would be required to ensure the value of any capital guarantee of the bank by a non-financial parent or a holding company with significant commercial activities. As far as concerns synergies between financial firms and companies doing a business that truly would provide some positive synergies for the finanical firm, such a software or telecommunications firm, it may well be possible to add these gradually to the mix by establishing in the legislation a system by which regulators could expand the definition of "financial" over time, without having to move all the way to allowing combinations of financial and industrial firms.

In addition to these substantive arguments, there are two political arguments against permitting the combination: (i) Senator Sarbanes and such traditional Democratic constituencies as community and consumer groups have stated they will unalterably oppose any legislation that permits any banking/commerce combination; and (ii) House Banking Committee Chairman Leach and the Fed (and former Fed Chairman Paul Volcker) have come out firmly in opposition to any significant banking and commerce combination.

Positions of Other Relevant Parties: Persons who support an even broader approach, as in the D'Amato/Baker bill, include: the Securities Industry Association, the Investment Company Institute, the Financial Services Council, the American Council of Life Insurance, America's Community Bankers, the American Financial Services Association, and Bankers Roundtable.

Persons opposing full removal of restrictions on affiliations between banks and nonfinancial companies including: Senators Conrad, Daschle, Dorgan, Feingold, Harkin, Johnson, Kerrey, Kohl, and Sarbanes; Representatives Leach, and Gonzalez; the Independent Bankers Association of America; the AFL-CIO, ACORN, National People's Action, the Consumer Federation of America, Consumers Union, and the Greenlining Coalition.

Persons who support the 75 percent test in the Alliance bill and the Treasury approach include: the American Bankers Association and the other members of the Alliance for Financial Modernization, including the trade associations listed above as supporting the D'Amato/Baker bill.

2. Holding Company Regulation, and the Role of the Fed

Issue: To what extent should the government regulate nonbank companies that own banks, and what role should the Federal Reserve play in that regulation?

Treasury Approach: The Federal Reserve Board would continue to regulate bank holding companies, and could conduct examinations and overall risk-management, require reports, and take enforcement action. But it would no longer prescribe bank-type capital standards for nonbank affiliates of banks. Instead, subsidiary banks would have to remain well capitalized (i.e., keep the capital above the normal required level) after subtracting dollar-for-dollar any investment in a non-bank firm, transactions between banks and related firms would be limited, and the holding company could be asked to guarantee its subsidiary banks' capital.

Discussion: This issue raises most clearly a central question about this legislation: the extent to which affiliations that provide synergies and thus benefits to consumers can be regulated in a manner that does not stifle those synergies yet at the same time protects taxpayers, primarily by restricting the reach of the deposit insurance. [5]

The Treasury approach rests on the proposition that the deposit insurance system can be protected by requiring very high capital standards of any bank that wishes to -- through a subsidiary or affiliate -- engage in non-bank finanical activities (including insurance and securities underwriting) or -- through an affiliate -- engage in nonfinanical activities, and by protecting those high capital standards through limitations on dealings within the

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[5] While it is a subject of substantial debate in Congress, the Administration has strongly and consistently supported the proposition that the choice whether to conduct financial activities as a subsidiary of a bank or as a subsidiary of a holding company (and thus as an affiliate of a bank) should be a matter of corporate choice, i.e., that no particular form should either be mandated or encouraged by law. This position is based on the following: (i) legal and economic analysis that suggests strongly that the downside risk to the bank -- that it will harm itself through its dealing with related financial entities to the point of creating a risk to the deposit insurance funds -- is the same whether the party is a subsidiary or an affiliate, as long as rules are in place requiring the bank to be well capitalized at all times without taking investment in the subsidiary into account and there are limits on the amount of bank funds that can be invested in a subsidiary; (ii) there is no evidence that any "subsidy" from deposit insurance -- which is small or non-existent on a net basis anyway -- "leaks" more to the benefit of a subsidiary than an affiliate; (iii) profits from a subsidiary are more likely to flow to the bank as a parent than as an affiliate, creating upside benefit; (iv) under CRA, all the assets and income of the bank and its subsidiaries are taken into account in determining the "context" of the bank's performance; affiliates are only taken into account at the bank's option; and (v) the holding company structure is cumbersome and costly (which is why a non-operating holding company is rare outside of banking), and firms should not be forced into it. There is also the fact that the OCC regulates banks and their subsidiaries, whereas the Fed regulates bank holding companies, and thus forcing activities into affiliates reduces the Administration's reach with respect to financial services policy. There is significant disagreement (mainly from the Fed) about the first and second points, although the FDIC, which is responsible for the deposit insurance funds, backs the Administration's position. We have therefore not raised this as a discussion issue in this memo. Chairman Yellen is, however, concerned the the subsidiary structure (even for financial activities such as insurance and seucrities underwriting) does not sufficiently protect the deposit insurance system.

corporate family ("corporate separateness") and by a guarantee of the high capital levels by a bank holding company where one exists. The holding company would be monitored by the Fed to ensure its continued ability to make good on the guarantee, and to provide early warning of any risk issues arising out of the consolidated entity's activities that might harm the bank.[6] By isolating the bank, the Treasury's approach would limit intrusion by bank regulators into activities of non-bank parts of a corporate family while simultaneously protecting the deposit system. The Treasury approach also is based on traditional bank statuory construction, under which broad principles (such as the need for corporate "separateness") are stated, but their definition is left to the regulator, making them somewhat easier to change over time as cirucmstances evolve.

Politically, the Treasury's approach responds the the Fed's strong desire to ensure its continued role as a supervisor of bank holding companies while still not imposing the entire panoply of holding company regulation on diversified financial companies (including those with non-financial businesses). The Treasury and the Fed are continuing discussions about the extent to which full holding company regulation (including capital requirements) would apply to a holding company whose bank was extremely large, even if the entity had other large non-bank subsidiaries.

Questions have been raised in the course of our discussions over the last week about both (i) the effectiveness of the Treasury's proposal in protecting the deposit insurance system -- from both a risk and a subsidy perspective -- from access by non-bank firms and (ii) the extent to which the Treasury proposal's attempt to isolate the bank will prevent the synergies that the entire modernization effort is about from actually being realized. These are obviously logically inconsistent concerns, but they highlight the degree to which the efficacy of the Treasury's proposal depends on effective, but not overbearing, regulation by the Fed.

Politically, the Treasury's proposal provides the Fed with more authority over diversified holding companies than do either the Roukema or D'Amato bills, but it is unlikely that the Fed will ever be satisfied with a level of regulatory authority that Treasury believes is limited enough to keep securities and insurance firms supportive of the legislation. It is clear that this part of the Treasury's proposal will be finetuned in the course of the legislative process.

[6] For example, if a single corporate family included both a property and casualty insurance company and a mortgage lender, it would be important to take into account the extent to which the risk of mortgage default arising from an earthquake was not in fact mitigated by insurance written (and risk retained) by the related insurance company.

Positions of Other Relevant Parties: Persons opposing any significant Federal Reserve role in holding company regulation include: the Securities Industry Association, the Investment Company Institute, the American Council of Life Insurance, and diversified financial services firms (e.g., American Express).

Persons supporting a significant Fed role in holding company regulation include: the Fed, Chairman Leach, Paul Volcker, and the Independent Bankers Association of America.

3. COMMUNITY REINVESTMENT ACT

Issue: How should any proposal deal with the Community Reinvestment Act (CRA)?

Treasury Approach: Apply the CRA to Wholesale Financial Institutions -- banks that do not accept accounts uner $100,000 and thus do not have insured desposits, but avoid putting CRA "in play" by proposing an expansion of CRA coverage to nonbanking firms. In addition, the Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- should state explicitly that we will tolerate no weakening of CRA.

Discussion: One of the hallmarks of your Administration has been its recognition that access to credit and other finanical services is essential to the vitality and growth of communities. From the start of the Administration, you have pressed bank regulators to make the Community Reinvestment Act work to generate "performance, not paperwork." The regulators -- working through an unprecedented series of hearings and other outreach efforts -- responded effectively: new CRA regulations, which are just coming into effect, have been praised as effective without being burdensome. As a result of this Administration's efforts in this area (including not only CRA, but also effective enforcement of non-discrmination laws, and the National Homeownership Strategy), over $90 billion in CRA commitments have been made and the number of mortgages made in low- and moderate-income communities is up 22% and to minorities 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). In the 104th Congress, the Administration stood strong against any cutback in CRA in the context of banking regulatory relief regulation -- and succeeded in fending off all challenges.

It is quite clear that, notwithstanding continued strong bank profitability, assets and lending are flowing out of the banking system. Through 1980, the bank share of assets held by financial institutions was about 40%. Today it is barely 22%. And the share of non-farm, non-financial debt supplied by US banks to the corporate sector declined from

20% in 1979 to 15% in 1994; banks now write barely half of the short- and medium-term business loans in the United States, down from three quarters 30 years ago. The question is the pace at which the outflow will continue, and in particular whether finanical services modernization will significantly accelerate the pace.

The power of CRA and related statutes and the regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system.

Whatever support CRA has among community groups and some Congressmen (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potential [important] exception of Senator D'Amato, almost no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion. Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial services debate would become a fight about CRA, and it is very likely the Adminstration would be called upon to veto the resulting bill.

It should be noted that the Treasury bill would make CRA applicable to the new Wholesale Financial Institutions. They believe this change will not generate the kind of CRA firefight other expansions might because (i) WFI's are banks who take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs. Treasury admits, however, that it is not clear this distinction will satisfy CRA opponents.

4. WHETHER TO GO FORWARD

Issue: Should the Treasury go forward with its legislative proposal?

Treasury Approach: Go forward with the proposal outlined in the appendix (as a Treasury proposal rather than a White House initiative).

Discussion:

The decision whether to proceed with this legislation is essentially one of weighing the very real -- although hard to quantify -- benefits to the economy and consumers from rationalizing a finanical services regulatory system that was established 60 years ago, under totally different economic conditions against the concerns that traditional Democratic allies are likely to express -- strongly -- that the legislation will lead to increased economic concentration and less credit, capital and financial access to underserved consumers and communities.

Without the Administration's active participation, legislation is unlikely to move forward. With the Administration's support, it is possible that -- even in a heavily partisan climate -- financial services modernization legislation could pass.[7] However, it is quite clear from discussions with senior Senators, that only an Administration bill that (i) allows at least a 25% "basket" of nonfinancial assets and (ii) does not expand CRA will be regarded as credible enough to move the discussions forward and keep the Administration as part of the debate.

Positions of Other Relevant Parties: Persons who have urged the Treasury to propose financial modernization legislation include: Senators Dodd, Bryan, and D'Amato; Representatives Gonzalez, LaFalce, Vento, Frank, Flake, Leach, McCollum, Roukema, Baker; the American Bankers Association, the Bankers Roundtable, America's Community Bankers, the Consumer Bankers Association, the Securities Industry Association, the American Council of Life Insurance, the American Insurance Association, and the Financial Services Council.

Senator Sarbanes, community groups and the Independent Bankers Association of America have urged the Treasury not to propose such legislation.

RECOMMENDATION: Your economic and political advisors have concluded that Treasury should go forward with its proposal, subject to (i) better clarification of the limitation on the extent to which nonfinancial activities can be included in a financial firm that includes a bank and (ii) a firm statement by the Admininstration that any attempt to weaken CRA will be grounds for vetoing any finanical services modernization legislation, no matter how otherwise beneficial.

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[7] As noted above, passage of modernization legislation that merges the thrift into the bank charter is also a precondition for merger of the thrift and bank insurance funds -- a result that is universally regarded as desirable. Such a merger would also allow the consolidation of the Office of Thrift Supervision in the the Comptroller of the Currency, reducing the number of independent bank regulators.

DECISION:

______ Treasury should proceed with legislation as proposed, subject to conditions noted

______ I support legislation, but have concerns about the Treasury proposal. See me.

______ I do not believe we should go forward with legislation at this time. See me.

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	To NEC Principals from Gene Sperling. Subject: Treasury's Proposed Financial Services Modernization legislation (11 pages)	03/17/1997	P5 1645

COLLECTION:
Clinton Presidential Records
National Economic Council
Kathy Wallman
OA/Box Number: 10588

FOLDER TITLE:
Financial Services Modernization [1]

Jamie Metrailer
2010-0384-F
jm662

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
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b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

THE WHITE HOUSE

WASHINGTON

March 17, 1997

MEMORANDUM FOR: NEC PRINCIPALS

FROM: GENE SPERLING GBS

SUBJECT: TREASURY'S PROPOSED FINANCIAL SERVICES MODERNIZATION LEGISLATION

ACTION-FORCING EVENT: The Treasury seeks to propose legislation that would increase competition among providers of financial services by repealing the Depression-era Glass-Steagall Act, allowing a broader range of affiliations between banks and other companies (including both other financial companies and commercial and industrial companies), and merging the regulation of banks and savings institutions. This proposal would satisfy a statutory requirement that the Secretary of the Treasury report to Congress by March 31, 1997 (which will probably be delayed until April 7 when Congress returns from recess), on how to harmonize and integrate the regulation of banks and thrifts. The proposal would also respond to Congressional requests for the Administration to set forth a plan for modernizing financial services regulation, including requests for Secretary Rubin to testify before the House Banking Committee in April.

This memo reflects both the critical features of Treasury's proposal and concerns that have been raised in the course of staff-level discussions about the proposal over the last several months. It is meant to serve as background for our discussion on Tuesday, March 18. That, in turn, will shape any informational or decision memo to the President, including recommendations.

BACKGROUND: Current law restricts affiliations between banks and other companies (i.e., it prevents them from owning one another or being under common ownership). The Glass-Steagall Act generally prohibits affiliations between banks and securities firms. The Bank Holding Company Act of 1956 generally restricts companies that control banks (bank holding companies) to activities closely related to banking, and specifically prohibits such companies from underwriting or selling insurance. These laws essentially sought to limit competition by segmenting different types of financial and other services from one another, and thus reinforce the traditional distinctions among banks, securities firms, insurance companies, and other financial institutions.

But technological and financial innovation, together with market pressures to offer consumers a wider array of services, have rendered this segmentation untenable. Different types of financial products have converged with one another. No longer is there a sharp practical distinction between a syndicated loan and privately placed commercial paper, between a security and a financial future, between a checking account and a money-market mutual fund, or between a mutual fund and a variable-annuity insurance policy. Derivative financial instruments even challenge such fundamental distinctions as those between debt and equity or between dollars and drachmas.

In the face of these developments -- this proliferation of new types of financial products -- the old distinctions among financial institutions are eroding. Banks and thrifts are now practically indistinguishable (although thrifts -- but not banks -- can form affiliations with any company, financial or nonfinancial). Banks offer insurance, mutual fund shares, and brokerage services, and underwrite a wide range of securities, directly or through affiliates. Securities firms make or syndicate commercial loans, and offer money-market accounts with check-writing privileges. Securities markets constitute the largest source of home-mortgage financing. A wide range of nonfinancial companies own banks that offer credit cards.

Yet the old statutory restrictions remain on the books -- imposing needless regulatory and management costs, and impeding competition, innovation and consumer choice.

There is increasing agreement that these restrictions have become outdated. Over the years, both Congressional Banking Committees have approved legislation to repeal the Glass-Steagall Act, and the Senate passed such a bill in 1988 by a vote of 94-2. Yet such legislation has repeatedly foundered on inter-industry conflicts (e.g., between banks and securities firms, insurance companies, and insurance agents), most recently during the last Congress.

During the past year, however, trade associations representing a wide range of market participants have made significant progress toward bridging the gaps that have traditionally divided them. The Alliance for Financial Modernization -- a coalition of 10 bank, thrift, securities, insurance, and diversified-company trade associations -- has agreed on legislation (the Alliance, or Roukema, bill) that would permit any company to affiliate with a bank if it has at least 75 percent of its business in financial institutions or financial activities. Thus the Alliance bill would remove existing constraints on affiliations among different types of firms that concentrate in financial services, and give these financial firms some latitude to conduct nonfinancial activities.[1]

Other major proposals currently pending in Congress include the D'Amato/Baker and Leach bills. The D'Amato/Baker bill is the most sweeping of these proposals. It would permit banks to affiliate with any company, financial or nonfinancial. By contrast, the Leach bill -- the most restrictive of the Congressional proposals -- would permit affiliations among banks, securities firms, and insurance companies (but not nonfinancial firms), retain much bank-type regulation of companies affiliated with banks, and vest broad regulatory authority in the Federal Reserve Board.

One other concern motivates this legislation. Last year Congress passed legislation that rehabilitated the two FDIC insurance funds -- one that insures thrifts, and the other that insures banks. The Treasury and FDIC strongly believe these two funds should be merged in order to maximize their ability to withstand any future shocks to the financial system. However, Congress has conditioned merging of the funds on the elimination of the thrift charter. The proposed legislation would satisfy this precondition and thus permit a fund merger.

We see the Treasury proposal as raising four key issues. First, whether the Administration should go forward with the proposal. Second, whether (and to what extent) to permit affiliations between banks and nonfinancial companies. Third, to what extent and how to regulate companies affiliated with banks, and what the role the Federal Reserve would have in such regulation. And fourth, the Community Reinvestment Act.

1. Whether to Go Forward

Issue: Should the Treasury go forward with its legislative proposal?

Treasury Approach: Go forward with the proposal outlined in the appendix (as a Treasury proposal rather than a White House initiative).

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[1] The Alliance bill has been introduced in the House by Representatives Roukema and Vento, and there have been initial hearings. While the bill has attracted some support, there has also been much skepticism, mainly on the banking and commerce issue, to a lesser extent on consumer and community concerns. In addition, at least one Alliance member -- America's Community Bankers (the thrift trade group) -- has said it can't support the bill it its present form, because it would reduce the scope of thrift activities. The bill is very vague on how to measure the 25% limit, and different measurements generate very different results. An asset-based measurement is least restrictive and a gross revenue-based measurement most restrictive of financial/non-financial combinations.

Pros and Cons of Treasury Approach:

Pros

- Would enable the Administration to exert positive leadership -- helping to guide legislation in a direction that promotes competition, innovation, and consumer choice, keeps the financial system safe and sound, and maintains the Administration's role in financial services policymaking.

- Would also -- by showing how to reconcile competing policy interests in a manner consistent with the Administration's objectives -- help reduce the chances that Congress would produce legislation unacceptable to the Administration.

- Would satisfy the statutory requirement that the Secretary of the Treasury report to Congress on how to harmonize the regulation of banks and thrifts.

- Would satisfy the statutory condition for a merger of the bank and thrift deposit insurance funds.

Cons

- The forces at work -- competing industry groups, competing regulators, community groups, consumers -- are extremely complex and have very different agendas. In particular, it is unclear there would be much overt support for Treasury's proposed position that banks should be able to carry on almost all financial activities in a bank subsidiary (rather than in an affiliate through a holding company)[2]. Moreover, among those likely to

[2] In general, the Administration has supported the proposition that the choice whether to conduct financial activities as a subsidiary of a bank or as a subsidiary of a holding company (and thus as an affiliate of a bank) should be a matter of corporate choice, i.e., that no particular form should either be mandated or encouraged by law. This position is based on the following: (i) legal and economic analysis that suggests strongly that the downside risk to the bank -- that it will harm itself through its dealing with related financial entities to the point of creating a risk to the deposit insurance funds -- is the same whether the party is a subsidiary or an affiliate, as long as rules are in place requiring the bank to be well capitalized at all times without taking investment in the subsidiary into account and there are limits on the amount of bank funds that can be invested in a subsidiary; (ii) there is no evidence that any "subsidy" from deposit insurance -- which is small or non-existent on a net basis anyway -- "leaks" more to the benefit of a subsidiary than an affiliate; (iii) profits from a subsidiary are more likely to flow to the bank as a parent than as an affiliate, creating upside benefit; (iv) under CRA, all the assets and income of the bank and its subsidiaries are taken into account in determining the "context" of the bank's performance; affiliates are only taken into account at the

support going forward with legislation, few support extension (or even effective maintenance) of the Community Reinvestment Act. Some traditional Administration allies -- primarily community groups, but also including labor and consumer groups and senior Senate Democrats -- would prefer no legislation at all. It is questionable whether legislation will move without Administration support. Putting forth an Administration bill may therefore put in play forces we cannot control.

- Would benefit ordinary Americans only indirectly or incrementally -- principally by stimulating greater competition among providers of financial services -- and thus may tend to lack grassroots appeal.

- May not be a White House priority.

Positions of Other Relevant Parties: Persons who have urged the Treasury to propose financial modernization legislation include: Senators Dodd, Bryan, and D'Amato; Representatives Gonzalez, LaFalce, Vento, Frank, Flake, Leach, McCollum, Roukema, Baker; the American Bankers Association, the Bankers Roundtable, America's Community Bankers, the Consumer Bankers Association, the Securities Industry Association, the American Council of Life Insurance, the American Insurance Association, and the Financial Services Council.

Senator Sarbanes, community groups and the Independent Bankers Association of America have urged the Treasury not to propose such legislation.

2. AFFILIATIONS BETWEEN BANKS AND NONFINANCIAL COMPANIES

Issue: To what extent (if at all) to permit affiliations between banks and nonfinancial companies -- the so-called "banking and commerce" issue.

Treasury Approach: Would permit financial services companies that are predominantly financial -- i.e., if 75 percent of their business consists of financial institutions or

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bank's option; and (v) the holding-company structure is cumbersome and costly (which is why a non-operating holding company is rare outside of banking), and firms should not be forced into it. There is also the fact that the OCC regulates banks and their subsidiaries, whereas the Fed regulates bank holding companies, and thus forcing activities into subsidiaries reduces the Administration's reach with respect to financial services policy. There is significant disagreement (mainly from the Fed) about the first and second points, although the FDIC, which is responsible for the deposit insurance funds, backs the Administration's position.

financial activities -- to have a 25 percent "basket" of nonfinancial activities.[3] Would not permit nonfinancial firms generally to acquire banks.

Pros and Cons of Treasury Approach:

Pros

- Would recognize that it is neither realistic nor appropriate to attempt to enforce an outmoded segmentation between different types of financial services or to draw a rigid line between financial and nonfinancial activities.

- Would provide a two-way street by which securities firms and insurance companies can affiliate with banks that take retail deposits. (These companies have developed without bank holding company restrictions, and often have some nonfinancial affiliations.)

- Would (by requiring that a company's financial operations be at least three times the size of its nonfinancial operations) have the effect of precluding affiliations between the largest banks and the largest commercial firms, and would thus to a significant degree mitigate populist concerns about banking-commerce affiliations.

- Is consistent with current status of diversified unitary thrift holding companies.[4]

Cons

- There is no reason to believe there is any synergy between financial and industrial firms, and reason to believe such combinations are usually

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[3] Treasury draft legislation at OMB for clearance does not define "business." See footnote 1. The Treasury draft, like both the Roukema and Leach bills, would authorize any firm to own a "Wholesale Financial Institution" (or WOOFIE) -- a new kind of entity that would be a bank with full access to the payment system and strong capital standards, but could not accept insured deposits.

[4] Under current law, any type of company -- including an industrial company -- can own a thrift, as long as it owns only one such institution (it becomes a "diversified unitary thrift holding company"). There are currently only 14 such institutions, the largest one being a paper comapny that owns a $9 billion thrift. However, in the past Ford Motor Company owned a thrift based in California. Ford poured alot of money into the institution before it finally sold it for far less than it had contributed in capital.

unsuccessful (consider, for example, the problems of Westinghouse Credit and the auto credit companies -- which frequently get used to support faltering auto sales, the failures of conglomerization in the 1970s and 1980s, and the sui generis status of GE). While this is of little concern if the federal government is not backing a player, there is reason to question whether we should allow such combinations where deposit insurance may implicate the federal government -- not just shareholders -- in failure. Although a 25% basket, particularly if calculated on a gross revenue basis, would prevent some of the largest pure bank/industrial combinations (e.g., GM and Citicorp), large financial conglomerates would be able to buy very large industrial firms (e.g., the combination of Chase and Salomon could buy CSX).

- There are other, more targeted, ways of dealing with issues raised by, the desire of firms owning the means of transacting financial business (e.g., software and telecom firms) to become affiliated with banks (and vice versa). For example, expanding the definition of "related to financial business" to include software companies is less of a stretch than extending it to armored car companies or travel agencies, both of which have happened. To the extent diversified securities and insurance firms that have non-financial affiliates (and purely non-financial companies) want to affiliate with banks to gain access to the payment system rather than to retail customers, allowing them to own Wholesale Financial Institutions (see footnote 3) should be sufficient.

- Would not fully respond to strongly-held concerns about concentration of economic power, conflicts of interest, unsound banking practices, and partiality in granting credit.

Positions of Other Relevant Parties: Persons who support an even broader approach, as in the D'Amato/Baker bill, include: the Securities Industry Association, the Investment Company Institute, the Financial Services Council, the American Council of Life Insurance, America's Community Bankers, the American Financial Services Association, and Bankers Roundtable.

Persons opposing full removal of restrictions on affiliations between banks and nonfinancial companies including: Senators Conrad, Daschle, Dorgan, Feingold, Harkin, Johnson, Kerrey, Kohl, and Sarbanes; Representatives Leach, and Gonzalez; the Independent Bankers Association of America; the AFL-CIO, ACORN, National People's Action, the Consumer Federation of America, Consumers Union, and the Greenlining Coalition.

Persons who support the 75 percent test in the Alliance bill and the Treasury approach include: the American Bankers Association and the other members of the Alliance for Financial Modernization, including the trade associations listed above as supporting the D'Amato/Baker bill.

3. HOLDING COMPANY REGULATION, AND THE ROLE OF THE FED

Issue: To what extent should the government regulate nonbank companies that own banks, and what role should the Federal Reserve play in that regulation?

Treasury Approach: The Federal Reserve Board would continue to regulate bank holding companies, and could conduct examinations and overall risk-management, require reports, and take enforcement action. But it would no longer prescribe bank-type capital standards for nonbank affiliates of banks. Instead, subsidiary banks would have to remain well capitalized (i.e., keep the capital above the normal required level), and the holding company could be asked to guarantee its subsidiary banks' capital.

Pros and Cons of Treasury Approach:

Pros

- Would go a considerable way towards meeting the Federal Reserve's goal of retaining a significant role in the overall supervision of companies that own banks. (Treasury and the Fed are currently discussing the extent to which the Fed will want full holding company regulatory authority over entities that contain a very large bank, even if the bank is owned by a non-bank institution.)

- Increasingly, firms are recognizing that risk is a corporate-family-wide concept[5], and at least in sophisticated financial and industrial companies, particularly those with global operations, they are measuring risk this way. It is appropriate that regulators have the same view, as risk to the bank may arise not from the bank's (or even its subsidiaries') activities, but from the activities or exposure of related parties.

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[5] For example, if a single corporate family included both a property and casualty insurance company and a mortgage lender, it would be important to take into account the extent to which the risk of mortgage default arising from an earthquake was not in fact mitigated by insurance written (and risk retained) by the related insurance company.

Cons

- A holding company guarantee is worth little if not coupled with some system for ensuring that the holding company has sufficient (and sufficiently liquid) capital to make good on it. This may suggest more regulation is needed -- particularly of holding company capital -- than Treasury has proposed.

- Would, in the view of many securities, insurance, and diversified financial companies, leave too big a role for what they perceive as heavy-handed Federal Reserve regulation.

- Insurance companies (and their regulators) may balk at any requirement that they guarantee an affiliated bank's capital.

- May still not satisfy the Federal Reserve's desire to retain its current power over bank holding companies.

- Particularly if wide-ranging financial/non-financial combinations are allowed, it is unclear whether the Fed (or any regulator) can effectively regulate consolidated risk, and attempting to do so may provide a false sense of security.

Positions of Other Relevant Parties: Persons opposing any significant Federal Reserve role in holding company regulation include: the Securities Industry Association, the Investment Company Institute, the American Council of Life Insurance, and diversified financial services firms (e.g., American Express).

Persons supporting a significant Fed role in holding company regulation include: the Fed, Chairman Leach, Paul Volcker, and the Independent Bankers Association of America.

4. COMMUNITY REINVESTMENT ACT

Issue: How should any proposal deal with the Community Reinvestment Act (CRA)?

Treasury Approach: Apply the CRA to Wholesale Financial Institutions -- banks that do not accept accounts uner $100,000 and thus do not have insured desposits, but avoid putting CRA "in play" by proposing an expansion of CRA coverage to nonbanking firms. In addition, the Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- should state explicitly that we will tolerate no weakening of CRA.

Pros and Cons of Treasury Approach:

Pros

- May be sufficiently limited and discrete that it would minimize the risk of opening the CRA to major amendments (e.g., safe harbor against CRA protests) by a hostile Republican Congress.

- Would keep any migration of deposits to wholesale depository institutions from weakening the CRA.

- Might, for the first time, extend the CRA to Wall Street firms if such firms became Wholesale Financial Iinstitutions.

Cons

- Might nonetheless inadvertently open the CRA to hostile amendments. Since the start of the Administration, we have resisited proposals by friends of CRA in Congress to broaden the statute, out of concern that any such action would "put CRA in play" and unleash forces that want to narrow or repeal it. The issue presented here is whether -- in the context of financial services modernization -- we should and could successfully make such an extension a condition for our support of modernization.

- Would pass up an occasion to try to extend CRA to nondepository financial institutions, including institutions, such as mortgage lenders, who sell products and services that could have been housed in the bank. By not reaching out for these products and services, will continue the migration of assets and activities out of banks, and thus out of CRA.

- Would put President on the defensive on the major CRA issue, which relates to retail products and services, rather than taking the offensive, which has been Administration policy in the regulatory context.

Positions of Other Relevant Parties: Senator Sarbanes' staff opposes including any CRA provision, lest it inadvertently open the door to hostile Republican amendments. Many community groups share that concern. Based on the Administration's behavior in the 104th Congress, they believe they can stop -- or the Administration will successfully threaten to veto -- any stand-alone attempt to weaken CRA, even if included in a "regulatory relief" package that contains items we might otherwise support. However, they are not convinced they can similarly stop an otherwise acceptable financial modernization bill, or that the President could or would veto such a bill. They are especially concerned about this result if the weakening is implicit, rather than explicit, i.e., through facilitation of doing bank activities and products outside of a bank or its subsidiaries, rather than through a statutory limitation or repeal of CRA.

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	John Podesta, Todd Stern to the President; Re: Glass-Steagall Reform (2 pages)	02/24/1995	P5 4084
002. memo	From Bo Cutter for the President; Re: Need for Decision Concerning Treasury's Proposed Approach to Financial Services Modernization and Repeal of the Glass-Steagall Act (5 pages)	2/21/1995	P5 Dup 4086
003. memo	John Podesta and Todd Stern to the President; Re: Glass-Steagall Reform (2 pages)	2/24/1995	P5 4085
004. memo	From Bo Cutter for the President; Re: Need for Decision Concerning Treasury's Proposed Approach to Financial Services Modernization and Repeal of the Glass-Steagall Act (5 pages)	2/21/1995	P5 Dup 4086
005. memo	John Podesta and Todd Stern to the President; Re: Glass-Steagall Reform (2 pages)	2/24/1995	P5 Dup 001
006. note	Re: Phone numbers [partial] (1 page)	2/25-26	P6/b(6)
007. memo	From Bo Cutter for the President; Re: Need for Decision Concerning Treasury's Proposed Approach to Financial Services Modernization and Repeal of the Glass-Steagall Act (5 pages)	2/21/1995	P5 4086
008. memo	From Bo Cutter for the President; Re: Need for Decision Concerning Treasury's Proposed Approach to Financial Services Modernization and Repeal of the Glass-Steagall Act (5 pages)	2/21/1995	P5 Dup 007

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Presidential Records Act - [44 U.S.C. 2204(a)]

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b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

THE PRESIDENT HAS SEEN
2-27-95

THE WHITE HOUSE

WASHINGTON

95 FEB 24 A 9:32

February 24, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: JOHN PODESTA
TODD STERN

SUBJECT: Glass-Steagall Reform

The attached is a decision memo from Bo Cutter laying out Treasury's approach to reforming Glass-Steagall. **Bob Rubin wants to announce our position in a February 27 speech, ahead of testimony the next day by Chairman Greenspan and other regulators. Consequently, Bo is seeking your approval as soon as possible.**

The argument for reform is that the separation between banking and other financial services mandated by Glass-Steagall is out of date in a world where banks, securities firms and insurance companies offer similar products and where firms outside the U.S. do not face such restrictions. The chief concern about reform is that allowing banks to engage in riskier activities like securities or insurance could subject the deposit insurance fund to added risk.

The Hill. There are two key bills. The **D'Amato bill** would basically let any company -- banks, commercial businesses, securities firms or insurance companies -- own any other. The bill would set up firewalls, particularly between banking and securities activities. Financial services within the corporate family would be "functionally regulated", with no consolidated regulation of the corporate family. The **Leach bill**, more protective of the deposit insurance fund, would allow only banks and securities firms to affiliate. It too uses firewalls and would have the Fed regulate the consolidated entity.

Treasury approach. Treasury adopts elements of both bills, allowing banks to affiliate with securities or insurance firms, but not commercial businesses. A National Financial Services Commission, chaired by the Secretary of the Treasury, would make important policy decisions, such as what activities are deemed "financial" and the standards for firewalls. Other members would be the heads of the Fed, FDIC, CFTC, SEC, OCC and OTS. The Fed would regulate bank holding companies, while affiliates would be regulated functionally.

Bo notes that, while there is increasing consensus for reform, there are real obstacles ranging from differing views among the players and interests involved; to likely opposition from small banks and small insurance companies; regulatory jurisdiction as between the Fed and Treasury; and the possibility that poison amendments, like repeal of the CRA, might be attached. In light of these realities, Bo recommends walking a fine line, with Treasury in the lead -- articulating our position (but not introducing a bill), working to fashion good legislation but not becoming too invested in passage too early. **All NEC principals endorse the Treasury approach Bo has outlined. Leon and George concur.**

Concur √ Disagree____ Discuss____

THE WHITE HOUSE

WASHINGTON

95 FEB 24 A 9 : 32

February 24, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: JOHN PODESTA
TODD STERN TDS

SUBJECT: Glass-Steagall Reform

The attached is a decision memo from Bo Cutter laying out Treasury's approach to reforming Glass-Steagall. **Bob Rubin wants to announce our position in a February 27 speech, ahead of testimony the next day by Chairman Greenspan and other regulators. Consequently, Bo is seeking your approval as soon as possible.**

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Concur____ Disagree____ Discuss____

THE WHITE HOUSE

WASHINGTON

February 21, 1995

MEMORANDUM FOR PRESIDENT CLINTON

FROM: Bo Cutter BC
Deputy Assistant to the President for Economic Policy

SUBJECT: Need for Decision Concerning Treasury's Proposed Approach to Financial Services Modernization and Repeal of the Glass-Steagall Act

ACTION FORCING EVENT

On March 1, Secretary Rubin will testify before the House Banking Committee on the Administration's position on pending legislation to modernize the United States' financial services system by repealing or modifying Depression Era laws, such as the Glass-Steagall Act. House Banking Committee Chairman Leach and Senate Banking Committee Chairman D'Amato have introduced substantially different modernization legislation. Richard Baker, an influential senior Republican member of the House Banking Committee, has introduced the D'Amato bill in the House.

Secretary Rubin's testimony will follow testimony, on February 28, by Alan Greenspan, Gene Ludwig, Ricki Tigert Helfer, and Jonathan Fiechter (Acting Director of the Office of Thrift Supervision). In order to position Secretary Rubin -- rather than any of the regulators -- as the Administration's chief spokesman on this issue, the Secretary intends to discuss the Administration's position at a speech which will be covered by the press in New York on February 27.

It is therefore necessary to have an agreed-upon Administration position by the end of the day on Friday, February 24. The NEC principals recommend that you approve the Treasury's proposal -- outlined below -- as the Administration position.

BACKGROUND

Historic: The Glass-Steagall Act was passed in 1933, and essentially separates commercial banking from investment banking and from commerce. The Act's supporters argued it was necessary to protect banks from failure, prevent abuses, and generally safeguard the financial system and the national economy.

The segmentation of financial markets and institutions envisioned by Glass-Steagall does not correspond to the realities of today's financial services system. In part as a result of changed technology, it has become increasingly difficult to distinguish between the products and services of commercial banks, investment banks and insurance companies. This renders their legal separation increasingly awkward and artificial and may reduce consumers' choices and convenience. In addition, international financial services firms, particularly in Europe, have long engaged in full service commercial and investment banking, and the separation of these functions in the United States has arguably placed our firms at a competitive disadvantage.

Economists differ about the extent of evidence that significant economies of scope are available as a result of financial services consolidation. However, even those who think there are few direct economic benefits tend to support substantial changes in current law because the existing system is replete with loopholes and circumventions, and new legislation will reduce transactions costs and improve safeguards.

Nevertheless, repealing Glass-Steagall raises the concern that, if companies engaging in activities not directly related to banking (such as securities dealing and insurance underwriting) are owned by or affiliated with a depository institution, the deposit insurance "safety net" will implicitly extend to those activities. The argument is that this will generate more risk for the system and that such risk either could not or would not be supported by sufficiently increased insurance premiums.

Current Proposals: Chairman D'Amato (and Mr. Baker) have introduced a bill that would permit any type of company (including commercial entities, securities firms and insurance companies) to become affiliated -- through a holding company -- with a well-capitalized commercial bank. The D'Amato bill would establish rules ("firewalls") to prevent the bank from being used to support, in particular, the securities activities of a related company. Under the D'Amato bill, financial services would be "functionally regulated," and there would be no consolidated regulation of the corporate family. If the lead bank in a consolidated entity were a national bank, it would continue to be regulated by the Comptroller of the Currency, not the Fed. A coordinating regulatory Commission -- chaired by the Secretary of the Treasury, and including the heads of the federal bank regulatory agencies, the Secretary of Commerce, the Attorney General and the Chairs of the SEC and CFTC -- would be created, but would have no authority to develop policy or regulations.

Chairman Leach has introduced a more narrow bill, which would allow affiliation of banks with securities firms only. The affiliation could (with limited exceptions) be accomplished only through a bank holding company structure, with the Federal Reserve Board regulating the consolidated entity. The Leach bill also contains numerous "firewalls." (A chart outlining the major provisions of the D'Amato and Leach bills, as well as of the Treasury proposal discussed below, is at Attachment A.)

TREASURY'S PROPOSAL

Treasury proposes that the Administration adopt a position that incorporates elements of both the D'Amato and Leach approaches, includes additional items that would both reduce any new risk generated by affiliation, and enhances the authority of a Treasury-chaired regulatory coordinating commission to enable it to adopt policies and procedures to reduce potential systemic risk in the enhanced financial services system.

Under Treasury's approach, well-capitalized and well-managed FDIC-insured depository institutions could affiliate with other firms engaged in financial activities, such as investment banks, and insurance companies. The choice of organizational structure would be left to the management of the organization, although insurance, securities and other financial activities could (with limited exceptions) be conducted only in a separately incorporated subsidiary or affiliate of a depository institution, not in the bank or thrift itself. A series of "firewalls" would restrict certain transactions between the depository institution and other members of the corporate family. An affiliate of an insured depository could have investments in nonfinancial firms, subject to limits, but commercial firms would not be allowed to own banks.

A newly established seven-member National Financial Services Commission, chaired by the Secretary of the Treasury, would be authorized to make decisions that include: determining what activities are financial; setting minimum standards for firewall restrictions and coordinated examinations; facilitating coordinated supervision; and determining whether to impose consolidated capital requirements on bank holding companies whose subsidiary insured depository institutions account for less than half the consolidated entity's total assets. The other members of the commission would be the heads of the Federal Reserve Board (who would serve as Vice Chairman), FDIC, CFTC, SEC, OCC, and OTS.

Under the Treasury proposal, the Federal Reserve would maintain its authority over bank holding companies, and would be authorized to impose consolidated capital regulations over holding companies (no matter what the nature of the parent company) in which insured depositories account for at least half of the holding company's total assets. Affiliates would be regulated functionally. The primary federal regulator of a bank or thrift (which could be any of the four federal regulators) would have the authority to ensure compliance with restrictions on transactions with affiliates, and ensure affiliates do not otherwise endanger the institution.

MAJOR ISSUES

The movement of Glass-Steagall reform on the Hill, and the development and unveiling of an Administration position forces consideration of two major issues, which have been briefly touched upon above. In addition, one smaller issue -- the manner in which insurance regulation is dealt with -- potentially raises difficult federal/state issues. These issues are:

- o To what extent can limiting the extent of permissible affiliation, establishment of firewalls, and regulation of both individual members of a corporate family and the total corporate entity moderate any risk to the deposit insurance system and the broader financial system that affiliation would entail while simultaneously retaining the attractiveness of affiliation for companies that can operate more efficiently and competitively in such a structure?

  The NEC principals believe Treasury's proposal strikes an effective balance in this respect, although not without some concern that the details of both legislation and regulation will tilt the balance toward greater risk. The Administration will need to emphasize its intention to hold tight to strict capital standards for both affiliating depository institutions and other affiliated financial institutions in order to place the least possible reliance on "firewalls," whose effectiveness in a crisis is not at all certain.

- o How can the Administration ensure that financial services restructuring does not also lead to an effective neutering of the Administration's policy influence on the financial services system through the regulatory system?

  The NEC principals support Treasury's proposed combination of primacy of the traditional lead federal financial regulator for affiliated depository institutions, Fed jurisdiction over the most bank-intensive holding companies, and creation of a coordinating commission -- chaired by Treasury -- with some real policy responsibilities. The fact that the coordinating regulator would not have supervisory responsibilities concerning individual institutions should make this structure more palatable to Republicans and Democrats alike. However, this issue of Administration influence will be an extremely difficult one throughout the debate.

- o How can insurance companies be safely integrated into the consolidated system when they are regulated entirely at the state level, and the states differ widely in the manner and effectiveness of their regulation?

  The assumption in the Treasury proposal (as in the D'Amato bill) is that state insurance regulation, plus the regulatory requirements on the depository institutions and the firewalls would prevent an insurance firm failure from harming the depository institution. The NEC principals would, in theory, prefer to limit insurance company affiliates to those with **federal** charters, but such a charter does not now exist and the political difficulty of creating one would be great. The principals recommend you approve the Treasury's handling of this issue.

POLITICAL ISSUES

Notwithstanding the increasing consensus that the time is right for some form of Glass-Steagall repeal, accomplishing the task -- particularly in a manner the Administration believes is sound -- will not be easy. Given the proposals on the Hill, the Administration must have a position, and the Treasury position is substantively sound and politically careful. However, the personalities involved, multiple agendas, suspicion of the Administration's motives concerning bank regulation, likely opposition to any proposal in this area from small banks and small insurance companies, and honest disagreement about what should be done could result in this issue eventually being positioned in a bill that your advisors would recommend your vetoing (such as a bill containing a repeal of the Community Reinvestment Act).

It is therefore critical that the Administration not get too invested in passage of Glass-Steagall reform too early, while simultaneously using our support of reform to strengthen our position with those who would attempt to extract unacceptable terms. (This is one reason we recommend that Treasury's proposal be put forth in detailed testimony, not in proposed legislation.) With Treasury leading, the Administration walked this fine line last year in getting both community development financial institutions and interstate banking legislation passed. Even with the changes on the Hill, we believe we can do it again.

RECOMMENDATION

That you approve the Treasury's proposal as the Administration's approach to financial services modernization.

____________Agree ______________Disagree ________________Let's discuss

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Paul R. Dimond to Gene Sperling et al re: Community Investment and Housing (2 pages)	12/08/1994	P5

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
OPD ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 250000

FOLDER TITLE:

[11/02/1993 - 04/04/1995]

2010-0384-F
ds388

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
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b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	re: Draft of NEC Principals status memo (9 pages)	03/20/1997	P5
002. memo	To President Clinton from Gene Sperling. Subject: Treasury's proposed Financial Services Modernization legislation (12 pages)	03/1997	P5 Dup 1643

COLLECTION:

Clinton Presidential Records
National Economic Council
Mark Silverman
OA/Box Number: 11816

FOLDER TITLE:

Financial Services Modernization [binder]

Jamie Metrailer
2010-0384-F
jm659

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
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1. Affiliations Between Financial and Nonfinancial Firms

Treasury Alternative A: Alternative A is in essence the previous Treasury proposal of allowing a "basket" of non-financial[1] activities within a holding company structure that includes a bank. Treasury's proposal as of March 20 was 25% of the combined entity's business. The current proposal varies in several critical respects from the March 20 proposal:

- The measure for calculating the basket would be specified as gross revenues.
- The legislative language would be submitted **without** a percentage specified.
- Banking/non-financial affiliations would be further limited in that none of the largest 1000 non-financial firms (by asset size) would be allowed to affiliate with a bank.

Treasury has also clarified that: (i) while banks could engage in non-bank financial activities in subsidiaries of the bank, all non-financial activities would have to be done in holding company subsidiaries and (ii) as is currently the case with thrift holding companies, there would be a total ban on any extension of credit by a bank to or for the benefit of a non-financial affiliate.

Although not fully discussed in the earlier memos, a critical element of Treasury's initial proposal, now Alternative A, is the abolition of the thrift charter and the conversion of all thrifts to banks (together with the merger of the Office of Thrift Supervision with the Office of the Comptroller of the Currency). Abolition of the thrift charter meets the explicit requirements of the "Frist Amendment," which prohibits merger of the BIF (bank) and SAIF (thrift) insurance funds until the charters are merged.

A major complication with the thrift charter conversion, however, is how to handle differences in the affiliation powers of bank holding companies and unitary thrift holding companies (companies that own one and only one thrift). Currently, unitary thrift holding companies can engage in nonfinancial activities with virtually no limits.[2] As far as we can tell (and the data are far from perfect), only 29[3] thrifts are part of holding companies that engage in non-financial businesses. (Approximately 45 others are engaged in real estate development, investment and

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[1] "Financial" would be defined in the statute to include banking and any activity currently authorized for a bank, the activities of bank operating subsidiaries, and all activities that can be performed by securities, commodities and insurance companies. The National Council on Financial Services could add to the definition. All other activities would be deemed non-financial.

[2] The initial purchase must be approved by OTS (which must approve holding company management) and OTS can impose limitations on safety and soundness grounds. Informally, OTS has indicated that they would look skeptically on, e.g., purchase of a thrift by a company a significant portion of whose business was gambling. Multiple thrift holding companies (companies that own more than one thrift, but no banks) are basically limited to activities permitted to bank holding companies, although they may engage in real estate development, investment and management.

[3] Numbers relating to thrift holding companies are as of 12/31/96.

management, which is regarded as "financial" by OTS but not "related to banking" by the Fed.) Treasury proposes to grandfather the right of all 515 existing unitary thrift holding companies to engage in nonfinancial activities without regard to the basket. The grandfather rights would not survive a change in control of the holding company (i.e., the expanded franchise could not be sold), but would not otherwise be limited in duration.

Treasury Alternative B: Alternative B would approach the banking and commerce issue by leaving the existing thrift charter, holding company structure and regulatory system intact . . As noted above, unitary thrift holding companies can currently affiliate with any type of institution. Furthermore, the thrift charter has recently been altered to permit (i) unlimited consumer lending and (ii) up to 10% of assets to be commercial loans and an additional 10% to be small business loans -- thus making the charter very similar to the actual asset mix of approximately 60% of the commercial banks.[4]

Alternative B in essence offers any diversified financial holding company that includes non-financial activities the opportunity to get into retail "banking" by buying a single thrift. Alternatively, such an institution could get into wholesale banking (only non-insured deposits over $100,000) by establishing a "Wholesale Financial Institution" (WFI, pronounced "WOOFIE"), which would not be subject to the Bank Holding Company Act. The Bank Holding Company Act would be amended to allow any **financial** firm to affiliate with a **bank** and to allow any bank to buy, establish or otherwise affiliate with, any other type of financial firm, including, in particular, an insurance or securities underwriter. Under Alternative B, the Frist Amendment would simply be statutorily deemed to be satisfied, on the theory that its real purpose was to ensure the opportunity of banks to expand into insurance and securities and that this has been accomplished.

Discussion: As revised, Alternative A has generated some interest from Chairman Leach, as moving closer to his minimalist approach to banking and commerce, and still commands support from those, such as Rep. Roukema, who supported the basket approach in the first place. However, Senator Sarbanes is still not convinced. Proponents of full banking and commerce, particularly Mr. Baker, have voiced their displeasure. Within the Administration, Chairman Yellen has expressed her concern that the extent of the grandfathering of unitary thrift holding companies is far too broad, and should be limited to those unitaries that are actually using their authority to engage in non-financial activities to an extent in excess of whatever basket is established. Treasury responds that not cutting back on thrift powers is critical to maintaining

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[4] While it is difficult to tell precisely from publicly available data, it appears unlikely that many of the largest banks could qualify as thrifts, mainly because of their commercial lending and investments in non-mortgage securities. However, it is possible that one or more of the large banks with a heavily consumer orientation (e.g., NationsBank) might so qualify, and could, therefore, make a choice to become a thrift to take advantage of the commerce "opportunity." In the past, banks such as Wells Fargo that have considered moving to a thrift charter have ultimately rejected the idea.

thrift support for legislation, which in turn is critical for legislation to move forward. For a discussion of other issues related to this approach see pages 4-6 of Tab A.

Treasury has been able to keep Alternative B from leaking, so it is unclear how it will be received. The issues that will potentially arise are: (i) banks might assert that the Frist amendment has **not** been satisfied and therefore the conditions for merging the funds have not been met[5]; (ii) diversified financial holding companies that have non-financial affiliates might not view the thrift option as sufficient; (iii) banking/commerce opponents may view the proposal as unsatisfying since it preserves, and publicizes, an existing banking/commerce "loophole"; and (iv) there may be serious concern about the ability of OTS to effectively regulate a large number of powerful new unitary thrift holding companies.

2. Holding Company Regulation and the Role of the Fed

Treasury proposal: Treasury's latest proposal, which has not been vetted with the Fed, would apply to either Alternative A or Alternative B. Under this scheme, the Fed would regulate all bank holding companies (but under Alternative B not thrift holding companies, which would be regulated by OTS). Holding companies engaging in activities that cannot be done directly in the bank (including, for example, securities or insurance underwriting) would be required to provide the Fed an undertaking to maintain the capital of the subsidiary banks at the "well-capitalized" level[6]. If the bank's capital falls below that level the holding company would be required to bring the capital level back up to well-capitalized and maintain it at that level. If, within 180 days, the holding company were unable to bring bank capital back up to the well-capitalized level, the holding company would be required to **either** (i) divest the bank in a manner that results in the bank being well-capitalized upon divestiture (e.g., by shrinking the balance sheet or by getting the buyer to add capital as part of the transaction); or (ii) cease engaging within the holding company in any activity the bank could not engage in directly (including, for example, most insurance and securities underwriting). If the bank got seriously in trouble so quickly that the FDIC were forced to put it into receivership or conservatorship, the holding company's guarantee of the bank's well-capitalized status would be enforceable by the FDIC.

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[5] In general, banks don't much care about merging the funds; that is a good government and a thrift issue. But, understanding the interest of others in merging the funds, banks view the BIF/SAIF merger as leverage to enable them to get "paid" for agreeing to take on part of the FICO obligation as part of the SAIF recapitalization last year.

[6] Bank (and thrift) capital levels are set by statute at "well-capitalized," "adequately capitalized," "undercapitalized" (which subjects the bank to regulatory sanctions), "significantly undercapitalized" (regulatory sanctions required), and "critically undercapitalized" (bank subject to being placed in receivership). Current law in effect requires a holding company to guarantee to maintain the bank or thrift at the adequately capitalized level.

The Fed would be responsible, as part of its normal supervisory process, for continuously evaluating the holding company's ability to support the bank's capital at the well-capitalized level, and would be able to examine bank holding companies and their nonbank subsidiaries if there were reason to suspect those entities were engaged in activities that could pose a significant threat to a subsidiary bank.

Although bank holding companies would be subject to Fed regulation under the Bank Holding Company Act, the Fed's authority to establish holding company capital requirements[7] would be limited to the following situations:

- A subsidiary bank's capital has remained below the well-capitalized level for more than 180 days;
- Banking assets constitute more than 90% of the assets of the holding company **and imposition of holding company capital requirements is or may be necessary to avoid a threat to the safety and soundness of the bank**; or
- On a case-by-case basis if the holding company has assets in excess $100 billion and owns a bank with assets in excess of about $5 billion[8] **and imposition of holding company capital requirements is or may be needed to avert systemic risk to the economy or a threat to bank safety and soundness.**

The Treasury's proposal would not impose similar requirements on thrift holding companies (under Alternative B), nor does current law.

Discussion: With respect to the holding company guarantee, the issues likely to be raised are (i) the ability of the Fed adequately to monitor the effective strength of the guarantee when it is neither authorized or set up to regularly and fully examine the holding company or its non-bank subsidiaries (a concern Director Raines has raised) and (ii) the extent to which the difference between "well-capitalized" and "adequately capitalized" provides a sufficient cushion in capital and time so that a bank that falls below the well-capitalized level can be recapitalized or sold before it is truly in trouble (a concern Chairman Yellen and Director Raines have both raised).

On the issue of Fed capital standards, the major substantive question, raised by Chairman Yellen, is whether these standards amount to attempting to close the barn door after the horse is out. In particular, if the Fed can impose holding company capital standards during the first 180 days when a bank falls below the well-capitalized level only **after** finding a threat or likelihood of threat to the bank or of systemic risk, will the capital standards be effective in preventing the risk from materializing? Chairman Yellen also believes that defining a holding company that is

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[7] The Fed asserts it has such authority under current law. However, it is unclear whether the assertion would survive legal challenge.

[8] As of 12/31/96, 134 commercial banks had assets in excess of $5 billion. As of 9/30/96, 31 thrifts had assets in excess of $5 billion..

primarily bank-related as one in which the bank accounts for 90% of the assets is too lax: moving sufficient assets out of the bank to fall below the 90% level would be fairly painless. She would support a lower threshold. Director Raines has also expressed concern in the past that capital requirements that are discretionary with regulators may pose "forebearance risk": the risk that capital standards will not be imposed when needed because regulators and the regulated can convince each other that the situation will be resolved without the imposition of standards.

Treasury responds that: (i) holding company capital regulation is in fact an extremely minor part of the entire bank regulatory structure that, with the post-1990 rules concerning prompt corrective action, would ensure the security of the deposit insurance funds; (ii) providing the Fed with **any** degree of explicit holding company capital authority is more than the Fed has now; and (iii) since the goal of holding company capital regulation in the case of a holding company that is predominantly a bank is to prevent "double-leveraging"[9] in order to protect the deposit insurance fund, it does not matter that a holding company could avoid the capital requirements by moving assets out of the bank. An additional substantive question is whether, whatever system is proposed to allow the Fed to set holding company capital standards, a similar system should be proposed with respect to OTS' regulation of thrift holding companies under Alternative B.

Treasury's current proposal is an attempt to provide for holding company capital requirements where the strength of the holding company really would be needed to protect the safety and soundness of the banking system, while keeping the Fed out of this business -- particularly with respect to diversified financial holding companies -- under normal circumstances. Whether this will prove (i) too little to satisfy the Fed and its supporters or (ii) too much to satisfy the diversified holding companies is unclear.

3. CONSUMER PROTECTION

Treasury proposal: Treasury would establish that federal bank and securities regulators have an obligation, with respect to retail sales of non-deposit investment products by depository institutions, to avoid customer confusion about the applicability and scope of FDIC and SIPC insurance; to prevent improper disclosure of confidential customer information; and to avoid conflicts of interest and other abuses.

Treasury's proposal would direct the bank regulators, in consultation with the SEC, to adopt regulations for sales of non-deposit investment products by insured depository institutions that are not registered securities brokers. Such regulations would be required to cover the following

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[9] Double leveraging occurs when a holding company issues debt that is then used to capitalize the bank. The result is that the bank nominally has equity, but it is under pressure to dividend profits to the holding company to pay the debt service. This can result in the bank holding less capital (e.g., little in excess of the minimum amount required -- in the case of a bank in a diversified holding company, the well-capitalized level) than would otherwise be the case. In contrast, if the bank itself has raised the equity, there is no debt service, and so less pressure to pay holding company dividends.

areas: advertising, disclosure, sales practices, qualifications and training of sales personnel, compensation of sales personnel, and the circumstances under which transactions and referrals occur. With respect to non-deposit investment products that are securities (including mutual funds) or annuities, the bank regulators would be required to adopt regulations comparable to those adopted by the SEC. The SEC would be required (to the extent such rules are not already in place) to adopt similar rules concerning sales of non-deposit investment products by brokers or dealers who are depository institutions (in the case of brokers) or are affiliated with a depository institution. The SEC would have to consider one major new item, namely the disclosure by depository institution subsidiaries and affiliates of the financial interest of the depository institution or securities subsidiary or affiliate with respect to referrals or transactions.

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The consumer groups are not likely to be fully satisfied with this approach for three reasons: (i) they are skeptical of the bank regulators' ability and willingness to adopt strong and effective regulations in this area and they would therefore prefer to hardwire more into the statute; (ii) the proposal would not provide consumers with a private cause of action against a depository institution that caused harm by violating the regulations; and (iii) the proposal would not explicitly deal with "implicit" tying, under which a consumer gets the impression, by the mere fact that insurance is offered before a loan is approved, that approval of the loan is contingent on purchase of insurance from the bank. Conversely, financial institutions will be concerned that this proposal -- particularly the information disclosure portion -- may severely limit their ability to cross-sell securities and investment products, which they regard as one of the benefits to both consumers and institutions of allowing greater affiliations among financial institutions.

4. COMMUNITY REVINESTMENT ACT

Treasury's proposal with respect to CRA has not changed since March 20. The only external developments since March 20 are that (i) Senator D'Amato has suggested that expanding CRA even to WFIs will put CRA "in play" and (ii) the companies that are likely to create WFIs have -- with one exception -- said they will have no objection to expansion of CRA to such institutions. We may also want to consider whether the fact that Treasury proposes sending up a report with legislative language rather than a bill, changes the dynamic of what can and should be included.

Treasury Proposal: Apply CRA to Wholesale Financial Institutions -- banks that do not accept accounts under $100,000 and thus do not have insured deposits, but avoid putting CRA "in play" by proposing an expansion of CRA coverage to nonbanking firms. The Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- would state explicitly that we will tolerate no weakening of CRA.

Discussion: One of the hallmarks of this Administration has been its recognition that access to credit and other financial services is essential to the vitality and growth of communities. Bank regulators have been directed to make the Community Reinvestment Act work to generate "performance, not paperwork." The regulators -- working through an unprecedented series of hearings and other outreach efforts -- responded effectively: new CRA regulations, which are just coming into effect, have been praised as effective without being burdensome. As a result of this Administration's efforts in this area (including not only CRA, but also effective enforcement of non-discrimination laws, and the National Homeownership Strategy), over $90 billion in CRA commitments have been made and the number of mortgages made in low- and moderate-income communities rose 22% and the number to minorities rose 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). In the 104th Congress, the Administration stood strong against any cutback in CRA in the context of banking regulatory relief regulation -- and succeeded in fending off all challenges.

It is quite clear that, notwithstanding continued strong bank profitability, assets and lending are flowing out of the banking system. While much of the asset loss in the last few years is attributable to large businesses (who are unlikely to rely on CRA for access to capital) directly accessing the capital markets, the movement of deposits from banks to mutual funds has put a strain on both the theory and practice of CRA.

The power of CRA and related statutes and the regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system. They have strongly urged the Administration, as a condition of financial services modernization, to expand CRA coverage to all financial institutions affiliated with a bank or at least to all bank-eligible products (such as mortgage loans) no matter where in the holding company they are offered.

Treasury believes that, notwithstanding the concerns of the community groups, CRA expansion beyond WFIs[10] should not be included in the proposal. There are two basic reasons: practical and political. On the practical side, Treasury notes the difficulty of defining the geographic service area -- a critical CRA concept -- for securities firms and mutual funds, and the difficulty of imposing federal CRA regulation on state-regulated insurance companies and unregulated finance companies. They note that, while the OCC currently takes the activities of non-bank subsidiaries into account in evaluating the CRA performance of a national bank, in general the subsidiaries are small in relation to the bank. If, in an attempt to avoid imposing CRA directly on securities firms, insurance companies and finance companies affiliated with banks, one were to impose on a relatively small bank the community obligations of all affiliated companies, the most likely result would be a sharp decrease in the interest of anyone in affiliating with a bank.

As a political matter, whatever support CRA has among community groups and some Congressmen (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potential [important] exception of Senator D'Amato, almost no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion. Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial

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[10] Treasury would expand CRA to WFIs because: (i) WFIs are banks that take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs.

services debate would become a fight about CRA, and it is very likely the Administration would be called upon to veto the resulting bill.

4. Whether to Go Forward, and in What Form

Treasury proposal: Treasury proposes to release, on or about May 21, a brief statement by Secretary Rubin, covering draft legislative language containing the two alternatives discussed above.

Discussion: After a lengthy series of discussions with both members of Congress and interested parties, Treasury came to the conclusion that the best way to both (i) respond to the statutory directive that it report on the merger of the bank and thrift charters by March 31 and (ii) move the financial services debate forward is to send forth a legislative proposal that is complete and defensible, but that provides alternative ways to deal with the most contentious issue.

Sending alternatives rather than a legislative proposal may lead some to question both the Administration's purposes and its strength of commitment to financial services modernization. And the result may be that the debate does not proceed or the Administration is marginalized. On the other hand, it is quite clear that taking the position on banking and commerce that is most likely to move the debate quickly -- the basket approach with a fairly large basket -- will seriously offend critically important Democratic Senators such as Senator Sarbanes. One lesson of last Congress' unsuccessful discussion of this issue is that even if there is no legislation, the ball moves: there no longer is a serious debate about whether to repeal Glass-Steagall or whether to allow banks to affiliate with insurance companies, rather the debate is how. For the Administration to be a serious player in this session's discussions, and to protect our interests (particularly with respect to CRA and the role of the OCC[11]), almost certainly requires that Treasury fulfill its report obligation reasonably quickly and do so in a manner that indicates we have been considering the issues seriously and have cogent proposals to put on the table, even if we have two of them.

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[11] As described in footnote 5 of the memo at Tab A, an important aspect of Treasury's proposal is that banks would be allowed to do non-bank financial activities in **either** a subsidiary or an affiliate of the bank. In contrast, the Fed is insisting that such activities be done only in a bank affiliate (a subsidiary of a bank holding company rather than of a bank). As footnote 5 points out, whatever the substantive issues involved, there are clear jurisdictional implications: national banks and their subsidiaries are regulated by the OCC, a bureau of the Treasury, whereas bank holding companies (including holding companies of national banks) are regulated by the Fed.

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001a. memo	re: Draft of NEC Principals status memo (9 pages)	03/20/1997	P5
001b. memo	To President Clinton from Gene Sperling. Subject: Treasury's proposed Financial Services Modernization legislation (12 pages)	03/1997	P5 Dup 1643

COLLECTION:
Clinton Presidential Records
National Economic Council
Kathy Wallman
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FOLDER TITLE:
Financial Services Modernization [Loose]

Jamie Metrailer
2010-0384-F
jm661

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

1. Affiliations Between Financial and Nonfinancial Firms

Treasury Alternative A: Alternative A is in essence the previous Treasury proposal of allowing a "basket" of non-financial[1] activities within a holding company structure that includes a bank. Treasury's proposal as of March 20 was 25% of the combined entity's business. The current proposal varies in several critical respects from the March 20 proposal:

- The measure for calculating the basket would be specified as gross revenues.
- The legislative language would be submitted **without** a percentage specified.
- Banking/non-financial affiliations would be further limited in that none of the largest 1000 non-financial firms (by asset size) would be allowed to affiliate with a bank.

Treasury has also clarified that: (i) while banks could engage in non-bank financial activities in subsidiaries of the bank, all non-financial activities would have to be done in holding company subsidiaries and (ii) as is currently the case with thrift holding companies, there would be a total ban on any extension of credit by a bank to or for the benefit of a non-financial affiliate.

Although not fully discussed in the earlier memos, a critical element of Treasury's initial proposal, now Alternative A, is the abolition of the thrift charter and the conversion of all thrifts to banks (together with the merger of the Office of Thrift Supervision with the Office of the Comptroller of the Currency). Abolition of the thrift charter meets the explicit requirements of the "Frist Amendment," which prohibits merger of the BIF (bank) and SAIF (thrift) insurance funds until the charters are merged.

A major complication with the thrift charter conversion, however, is how to handle differences in the affiliation powers of bank holding companies and unitary thrift holding companies (companies that own one and only one thrift). Currently, unitary thrift holding companies can engage in nonfinancial activities with virtually no limits.[2] As far as we can tell (and the data are far from perfect), only 29[3] thrifts are part of holding companies that engage in non-financial businesses. (Approximately 45 others are engaged in real estate development, investment and management,

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[1] "Financial" would be defined in the statute to include banking and any activity currently authorized for a bank, the activities of bank operating subsidiaries, and all activities that can be performed by securities, commodities and insurance companies. The National Council on Financial Services could add to the definition. All other activities would be deemed non-financial.

[2] The initial purchase must be approved by OTS (which must approve holding company management) and OTS can impose limitations on safety and soundness grounds. Informally, OTS has indicated that they would look skeptically on, e.g., purchase of a thrift by a company a significant portion of whose business was gambling. Multiple thrift holding companies (companies that own more than one thrift, but no banks) are basically limited to activities permitted to bank holding companies, although they may engage in real estate development, investment and management.

[3] Numbers relating to thrift holding companies are as of 12/31/96.

which is regarded as "financial" by OTS but not "related to banking" by the Fed.) Treasury proposes to grandfather the right of all 515 existing unitary thrift holding companies to engage in nonfinancial activities without regard to the basket. The grandfather rights would not survive a change in control of the holding company (i.e., the expanded franchise could not be sold), but would not otherwise be limited in duration.

Treasury Alternative B: Alternative B would approach the banking and commerce issue by leaving the existing thrift charter, holding company structure and regulatory system intact . As noted above, unitary thrift holding companies can currently affiliate with any type of institution. Furthermore, the thrift charter has recently been altered to permit (i) unlimited consumer lending and (ii) up to 10% of assets to be commercial loans and an additional 10% to be small business loans -- thus making the charter very similar to the actual asset mix of approximately 60% of the commercial banks.[4]

Alternative B in essence offers any diversified financial holding company that includes non-financial activities the opportunity to get into retail "banking" by buying a single thrift. Alternatively, such an institution could get into wholesale banking (only non-insured deposits over $100,000) by establishing a "Wholesale Financial Institution" (WFI, pronounced "WOOFIE"), which would not be subject to the Bank Holding Company Act. The Bank Holding Company Act would be amended to allow any **financial** firm to affiliate with a **bank** and to allow any bank to buy, establish or otherwise affiliate with, any other type of financial firm including, in particular, an insurance or securities underwriter. Under Alternative B, the Frist Amendment would simply be statutorily deemed to be satisfied, on the theory that its real purpose was to ensure the opportunity of banks to expand into insurance and securities and that this has been accomplished.

Discussion: As revised, Alternative A has generated some interest from Chairman Leach, as moving closer to his minimalist approach to banking and commerce, and still commands support from those, such as Rep. Roukema, who supported the basket approach in the first place. However, Senator Sarbanes is still not convinced. Proponents of full banking and commerce, particularly Mr. Baker, have voiced their displeasure. Within the Administration, Chairman Yellen has expressed her concern that the extent of the grandfathering of unitary thrift holding companies is far too broad, and should be limited to those unitaries that are actually using their authority to engage in non-financial activities to an extent in excess of whatever basket is established. Treasury responds that not cutting back on thrift powers is critical to maintaining

[4] While it is difficult to tell precisely from publicly available data, it appears unlikely that many of the largest banks could qualify as thrifts, mainly because of their commercial lending and investments in non-mortgage securities. However, it is possible that one or more of the large banks with a heavily consumer orientation (e.g., NationsBank) might so qualify, and could, therefore, make a choice to become a thrift to take advantage of the commerce "opportunity." In the past, banks such as Wells Fargo that have considered moving to a thrift charter have ultimately rejected the idea.

thrift support for legislation, which in turn is critical for legislation to move forward. For a discussion of other issues related to this approach see pages 4-6 of Tab A.

Treasury has been able to keep Alternative B from leaking, so it is unclear how it will be received. The issues that will potentially arise are: (i) banks might assert that the Frist amendment has not been satisfied and therefore the conditions for merging the funds have not been met[5]; (ii) diversified financial holding companies that have non-financial affiliates might not view the thrift option as sufficient; (iii) banking/commerce opponents may view the proposal as unsatisfying since it preserves, and publicizes, an existing banking/commerce "loophole"; and (iv) there may be serious concern about the ability of OTS to effectively regulate a large number of powerful new unitary thrift holding companies.

2. Holding Company Regulation and the Role of the Fed

Treasury proposal: Treasury's latest proposal, which has not been vetted with the Fed, would apply to either Alternative A or Alternative B. Under this scheme, the Fed would regulate all bank holding companies (but under Alternative B not thrift holding companies, which would be regulated by OTS). Holding companies engaging in activities that cannot be done directly in the bank (including, for example, securities or insurance underwriting) would be required to provide the Fed an undertaking to maintain the capital of the subsidiary banks at the "well-capitalized" level[6]. If the bank's capital falls below that level the holding company would be required to bring the capital level back up to well-capitalized and maintain it at that level. If, within 180 days, the holding company were unable to bring bank capital back up to the well-capitalized level, the holding company would be required to **either** (i) divest the bank in a manner that results in the bank being well-capitalized upon divestiture (e.g., by shrinking the balance sheet or by getting the buyer to add capital as part of the transaction); or (ii) cease engaging within the holding company in any activity the bank could not engage in directly (including, for example, most insurance and securities underwriting). If the bank got seriously in trouble so quickly that the FDIC were forced to put it into receivership or conservatorship, the holding company's guarantee of the bank's well-capitalized status would be enforceable by the FDIC.

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[5] In general, banks don't much care about merging the funds; that is a good government and a thrift issue. But, understanding the interest of others in merging the funds, banks view the BIF/SAIF merger as leverage to enable them to get "paid" for agreeing to take on part of the FICO obligation as part of the SAIF recapitalization last year.

[6] Bank (and thrift) capital levels are set by statute at "well-capitalized," "adequately capitalized," "undercapitalized" (which subjects the bank to regulatory sanctions), "significantly undercapitalized" (regulatory sanctions required), and "critically undercapitalized" (bank subject to being placed in receivership). Current law in effect requires a holding company to guarantee to maintain the bank or thrift at the adequately capitalized level.

The Fed would be responsible, as part of its normal supervisory process, for continuously evaluating the holding company's ability to support the bank's capital at the well-capitalized level, and would be able to examine bank holding companies and their nonbank subsidiaries if there were reason to suspect those entities were engaged in activities that could pose a significant threat to a subsidiary bank.

Although bank holding companies would be subject to Fed regulation under the Bank Holding Company Act, the Fed's authority to establish holding company capital requirements[7] would be limited to the following situations:

- A subsidiary bank's capital has remained below the well-capitalized level for more than 180 days;
- Banking assets constitute more than 90% of the assets of the holding company **and imposition of holding company capital requirements is or may be necessary to avoid a threat to the safety and soundness of the bank**; or
- On a case-by-case basis if the holding company has assets in excess $100 billion and owns a bank with assets in excess of about $5 billion[8] **and imposition of holding company capital requirements is or may be needed to avert systemic risk to the economy or a threat to bank safety and soundness.**

The Treasury's proposal would not impose similar requirements on thrift holding companies (under Alternative B), nor does current law.

Discussion: With respect to the holding company guarantee, the issues likely to be raised are (i) the ability of the Fed adequately to monitor the effective strength of the guarantee when it is neither authorized or set up to regularly and fully examine the holding company or its non-bank subsidiaries (a concern Director Raines has raised) and (ii) the extent to which the difference between "well-capitalized" and "adequately capitalized" provides a sufficient cushion in capital and time so that a bank that falls below the well-capitalized level can be recapitalized or sold before it is truly in trouble (a concern Chairman Yellen and Director Raines have both raised).

On the issue of Fed capital standards, the major substantive question, raised by Chairman Yellen, is whether these standards amount to attempting to close the barn door after the horse is out. In particular, if the Fed can impose holding company capital standards during the first 180 days when a bank falls below the well-capitalized level only after finding a threat or likelihood of threat to the bank or of systemic risk, will the capital standards be effective in preventing the risk from materializing? Chairman Yellen also believes that defining a holding company that is primarily

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[7] The Fed asserts it has such authority under current law. However, it is unclear whether the assertion would survive legal challenge.

[8] As of 12/31/96, 134 commercial banks had assets in excess of $5 billion. As of 9/30/96, 31 thrifts had assets in excess of $5 billion..

bank-related as one in which the bank accounts for 90% of the assets is too lax: moving sufficient assets out of the bank to fall below the 90% level would be fairly painless. She would support a lower threshold. Director Raines has also expressed concern in the past that capital requirements that are discretionary with regulators may pose "forebearance risk": the risk that capital standards will not be imposed when needed because regulators and the regulated can convince each other that the situation will be resolved without the imposition of standards.

Treasury responds that: (i) holding company capital regulation is in fact an extremely minor part of the entire bank regulatory structure that, with the post-1990 rules concerning prompt corrective action, would ensure the security of the deposit insurance funds; (ii) providing the Fed with **any** degree of explicit holding company capital authority is more than the Fed has now; and (iii) since the goal of holding company capital regulation in the case of a holding company that is predominantly a bank is to prevent "double-leveraging"[9] in order to protect the deposit insurance fund, it does not matter that a holding company could avoid the capital requirements by moving assets out of the bank. An additional substantive question is whether, whatever system is proposed to allow the Fed to set holding company capital standards, a similar system should be proposed with respect to OTS' regulation of thrift holding companies under Alternative B.

Treasury's current proposal is an attempt to provide for holding company capital requirements where the strength of the holding company really would be needed to protect the safety and soundness of the banking system, while keeping the Fed out of this business -- particularly with respect to diversified financial holding companies -- under normal circumstances. Whether this will prove (i) too little to satisfy the Fed and its supporters or (ii) too much to satisfy the diversified holding companies is unclear.

3. CONSUMER PROTECTION

Treasury proposal: Treasury would establish that federal bank and securities regulators have an obligation, with respect to retail sales of non-deposit investment products by depository institutions, to avoid customer confusion about the applicability and scope of FDIC and SIPC insurance; to prevent improper disclosure of confidential customer information; and to avoid conflicts of interest and other abuses.

Treasury's proposal would direct the bank regulators, in consultation with the SEC, to adopt regulations for sales of non-deposit investment products by insured depository institutions that are

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[9] Double leveraging occurs when a holding company issues debt that is then used to capitalize the bank. The result is that the bank nominally has equity, but it is under pressure to dividend profits to the holding company to pay the debt service. This can result in the bank holding less capital (e.g., little in excess of the minimum amount required -- in the case of a bank in a diversified holding company, the well-capitalized level) than would otherwise be the case. In contrast, if the bank itself has raised the equity, there is no debt service, and so less pressure to pay holding company dividends.

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It is quite clear that, notwithstanding continued strong bank profitability, assets and lending are flowing out of the banking system. While much of the asset loss in the last few years is attributable to large businesses (who are unlikely to rely on CRA for access to capital) directly accessing the capital markets, the movement of deposits from banks to mutual funds has put a strain on both the theory and practice of CRA.

The power of CRA and related statutes and the regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system. They have strongly urged the Administration, as a condition of financial services modernization, to expand CRA coverage to all financial institutions affiliated with a bank or at least to all bank-eligible products (such as mortgage loans) no matter where in the holding company they are offered.

Treasury believes that, notwithstanding the concerns of the community groups, CRA expansion beyond WFIs[10] should not be included in the proposal. There are two basic reasons: practical and political. On the practical side, Treasury notes the difficulty of defining the geographic service area -- a critical CRA concept -- for securities firms and mutual funds, and the difficulty of imposing federal CRA regulation on state-regulated insurance companies and unregulated finance companies. They note that, while the OCC currently takes the activities of non-bank subsidiaries into account in evaluating the CRA performance of a national bank, in general the subsidiaries are small in relation to the bank. If, in an attempt to avoid imposing CRA directly on securities firms, insurance companies and finance companies affiliated with banks, one were to impose on a relatively small bank the community obligations of all affiliated companies, the most likely result would be a sharp decrease in the interest of anyone in affiliating with a bank.

As a political matter, whatever support CRA has among community groups and some Congressmen (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potential [important] exception of Senator D'Amato, almost no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion. Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a

[10] Treasury would expand CRA to WFIs because: (i) WFI's are banks that take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs.

result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial services debate would become a fight about CRA, and it is very likely the Administration would be called upon to veto the resulting bill.

4. WHETHER TO GO FORWARD, AND IN WHAT FORM

Treasury proposal: Treasury proposes to release, on or about May 21, a brief statement by Secretary Rubin, covering draft legislative language containing the two alternatives discussed above.

Discussion: After a lengthy series of discussions with both members of Congress and interested parties, Treasury came to the conclusion that the best way to both (i) respond to the statutory directive that it report on the merger of the bank and thrift charters by March 31 and (ii) move the financial services debate forward is to send forth a legislative proposal that is complete and defensible, but that provides alternative ways to deal with the most contentious issue.

Sending alternatives rather than a legislative proposal may lead some to question both the Administration's purposes and its strength of commitment to financial services modernization. And the result may be that the debate does not proceed or the Administration is marginalized. On the other hand, it is quite clear that taking the position on banking and commerce that is most likely to move the debate quickly -- the basket approach with a fairly large basket -- will seriously offend critically important Democratic Senators such as Senator Sarbanes. One lesson of last Congress' unsuccessful discussion of this issue is that even if there is no legislation, the ball moves: there no longer is a serious debate about whether to repeal Glass-Steagall or whether to allow banks to affiliate with insurance companies, rather the debate is how. For the Administration to be a serious player in this session's discussions, and to protect our interests (particularly with respect to CRA and the role of the OCC[11]), almost certainly requires that Treasury fulfill its report obligation reasonably quickly and do so in a manner that indicates we have been considering the issues seriously and have cogent proposals to put on the table, even if we have two of them.

---

[11] As described in footnote 5 of the memo at Tab A, an important aspect of Treasury's proposal is that banks would be allowed to do non-bank financial activities in either a subsidiary or an affiliate of the bank. In contrast, the Fed is insisting that such activities be done only in a bank affiliate (a subsidiary of a bank holding company rather than of a bank). As footnote 5 points out, whatever the substantive issues involved, there are clear jurisdictional implications: national banks and their subsidiaries are regulated by the OCC, a bureau of the Treasury, whereas bank holding companies (including holding companies of national banks) are regulated by the Fed.

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	To Anne Gomez and Kathleen Wallman from Ellen Seidman. Subject: Financial services - status note for Gene (1 page)	03/18/1997	P5
002. memo	To NEC Principals from Gene Sperling. Subject: Treasury's proposed Financial Services Modernization legislation (11 pages)	03/17/1997	P5 Dup164S

COLLECTION:

Clinton Presidential Records
National Economic Council
Kathy Wallman
OA/Box Number: 10588

FOLDER TITLE:

Financial Services Modernization - National Economic Council Principals

Jamie Metrailer
2010-0384-F
jm663

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
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b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Ellen S. Seidman 03/18/97 07:31:05 PM

Record Type: Record

To: Anna M. Gomez/OPD/EOP

cc: Kathleen M. Wallman/WHO/EOP

Subject: Financial servcies - status note for Gene

I must admit today's meeting was not neat and clean, but it finally got on the table some critical issues that it has been impossible to get the Treasury to face squarely. Much to my surprise I got a call from Jerry Hawke thanking us.

Working with Deich and Bill English, we have put together a set of diagrams of what we think are the Raines, Yellin and official Treasury (as opposed to unofficial Bob Rubin) positions, which we will use to try to smoke out what really concerns Frank and Janet about Treasury's proposal at a meeting of Raines, Yellin, Hawke, Seidman, Deich, English and Wallman tomorrow at noon. The goal will be at the very least to make certain we all know what the positions are in a manner that can, if need be, taken to the President. Hopefully, we'll do much better than that, and get to some sort of solution.

Anna is working on scheduling another principals meeting for Thursday. It's beginning to converge on 6:00 PM if we're to get Rubin -- which I believe is ABSOLUTELY essential.

Notwithstanding the pounding Treasury took today, there's still much to their position on the regulatory structure (which really depends on the proposition that we're NOT that good at regulating complex financial (let alone non-financial) companies, but we're pretty good at walling off the bank to protect the taxpayers), and there will be synergies anyway. The banking/commerce issue -- unless we do something chicken like support a grandfathering of all non-financial activities in financial companies as of the day of enactment if they ever decide to affiliate with a bank -- is, I suspect, going to go to the Presdient as a purely political choice.

Frankly, when we start to add CRA into this mix, I believe we're going to get very close to a "no go" decision, or, alternatively, a deicison to go with a proposal that Treasury -- likely not contradicted by John Hilley -- will assert will blow us out of the water, make us essentially irrelevant in the debate, and lead to no legislation. But strange things happen in this business, and moreover, no legislation might not be the worst result.

ellen

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Paul R. Dimond to Gene Sperling et al re: Community Investment and Housing (2 pages)	12/08/1994	P5 1631

COLLECTION:
Clinton Presidential Records
Automated Records Management System [Email]
OPD ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 250000

FOLDER TITLE:
[11/02/1993 - 04/04/1995]

2010-0384-F
ds388

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
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RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

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RECORD TYPE: FEDERAL (ALL-IN-1 MAIL)

CREATOR: Paul R. Dimond (DIMOND_P) (OPD)

CREATION DATE/TIME: 8-DEC-1994 16:07:56.83

SUBJECT: Community Investment and Housing

TO: Gene B. Sperling (SPERLING_G) Autoforward to: Paul A. Deeg
READ: 8-DEC-1994 16:20:43.11

TO: Bruce N. Reed (REED_B) (OPD)
READ: 9-DEC-1994 10:23:05.13

TO: Sheryll D. Cashin (CASHIN_S) (OPD)
READ: 8-DEC-1994 17:06:12.92

TO: Paul J. Weinstein, Jr (WEINSTEIN_P) (OPD)
READ: 8-DEC-1994 17:41:37.41

TO: Peter M. Yu (YU_P) (OPD)
READ: 8-DEC-1994 16:19:36.96

TO: Ellen S. Seidman (SEIDMAN_E) (OPD)
READ: 8-DEC-1994 17:57:20.20

TO: Michael D. Deich (DEICH_M) (OPD)
READ: 8-DEC-1994 16:22:13.48

CC: Paul A. Deegan (DEEGAN_P) (OPD)
READ: 8-DEC-1994 16:20:43.11

CC: Theo Lubke (LUBKE_T) (OPD)
READ: 8-DEC-1994 16:41:11.70

TEXT:
Gene, Bill and Friends
Concerning HUD's reinvention -- Community Investment and Housing -- three ideas that I have discussed with Chris Edley (and, to a lesser extent, Bruce Katz and Andrew Cuoimo):
1. As much as as possible, put direct housing subsidies in the hands of individuals as part of overall consistent strategy for perosn-family based economic self-suffiency. You know, this is another aspect of my continuing plea that WE have an individual/family empowerment message rather than just consolidating and devolivng to another layer of government/bureaucracy.
2. Put any remaining construction, rehab, modernization other dollars into the Economic Development Incentive Grant to the Mayors. This forms a pool of funds to redevelop distressed/poverty places so that they can become economically self-sustaining, integral components (whether through business development, more income-mixed market housing and neighborhood retail and other services)of city/regional economy. The 10% performance bonus on these funds will depend on evaluation and performance relating to criterai such as extent of co-investment from private sector and region, extent of private development in place. Politically, the idea of running this through the mayors is essential; and the requirement of a strategic vision and co-investment in redevelopment provides some assurance that this new grant will be something more than a block grant (ie., real pork) for another layer of government. This can be a major part of a commuity empowerment strategy for investment that has broader appeal than just with the mayors.
3. Don't put all of economic development eggs into one basket --

a. Substantial additional investment in CD Banks (where, with private 1-1 match, we get 15-20 to 1 AND intermediary to partner with major egulated and unregualted fiancial insitutions in private sector investment). I believe that most of the Mayors will support such inrtermediary institutions, we will gain support from rural folks as well. The BEA becomes a BIG potential asset (both politically and as a way to assure that networks with mainstream financial institutions grow. I propose $500 million per year. With a credible CRA regulation (and any possible voluntary extension to unregulated financial insitution), this could be a very powerful agent for rebuilding poor communities on a safe and sound basis so that they reconnect to the mainstreams of economic growth and opportunity in local regions throughout the country. AS a political statement of a New Democrat way to proceed, this would be hard to beat -- whatever the reception in Congress. It may well be, however, that we could finance the CD Bank Fund by an appropriate entry investment in the CDFI Fund for Banks that want to get around Glass-Steagall.....In any event, why should we not put our money where our mouth is on a major Presidential initiative that relies on the private sector for community empwoerement? [PAUL W and ELLEN., is there anything that we can make of the secondary market pparts of the CDFI bill put in by D'Amato, to coopt him, consistent with the private sector investment, community reinvestment theme? Will your review and get back to me?]

b. If the decision is made to have an infrastructure bank, make sure its window is open to high poverty urban and rural areas for economic development and Brownfields clean-up. But don't create or support a separate economic development bank -- too much clutter, and doesn't have nearly the leverage or private sector orientation of the CDFI Fund.

4. Finally, I think that we should consider how we can push the Home Ownership Strategy -- with all three of the GSEs, and a reformulated FHA, and the Cisneros campaign-- as a part of the community-building message and real guts of the program. I think increasing home ownership is more important to the Mayors than place-based, low-income housinging project subsidies (and surely is a possible tool important to rebuilding many distressed places), as well as a key part of self-sufficiency and upward mobility for persons and families. [The details of what the business of FHA as a corporation should be remain for debate, of course.]

Thoughts?

Dimond aka Paul

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Jonathan A. Kaplan to Sarah Rosen at 19:08:09.00. Subject: Re: Community Reinvestment Act. (1 page)	04/20/1999	P6/b(6)
002. email	Sarah Gegenheimer to Paul Weinstein Jr. (5 pages)	04/07/1999	P5 1632
003. email	Sarah Rosen Wartell to Richard Siewert re: Congress Daily story on banking/privacy (3 pages)	05/01/1999	P5 1633

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
OPD ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 250000

FOLDER TITLE:

[03/04/1999 - 08/16/1999]

2010-0384-F
ab949

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
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b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sarah E. Gegenheimer (CN=Sarah E. Gegenheimer/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME: 7-APR-1999 15:19:57.00

SUBJECT: Re:

TO: Paul J. Weinstein Jr. (CN=Paul J. Weinstein Jr./OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:
Thank you!

Paul J. Weinstein Jr.
04/07/99 03:20:00 PM

Record Type: Record

To: Sarah E. Gegenheimer/WHO/EOP
cc:
Subject:

March __, 1999

MEMORANDUM FOR THE PRESIDENT

CC: THE VICE PRESIDENT

FROM: ROBERT RUBIN GENE SPERLING
LARRY STEIN BRUCE REED

SUBJECT: Community Reinvestment Act: Update on Legislation

ACTION-FORCING EVENT: The House and Senate Banking Committees have approved major financial services legislation. On March 12, the House Banking Committee approved its bill, developed by Chairman Leach and Ranking Democrat LaFalce, on a broad, bipartisan vote (51-8). The bill includes a provision we strongly support requiring banks to have and maintain an adequate CRA record in order to engage in newly authorized financial activities. But the Senate bill, developed by Chairman Gramm, and reported out on strict party lines (11-9) on March 4, would: significantly weaken CRA; erode the national bank charter and the Administration□,s role in financial services policymaking; provide inadequate consumer protections; and provide increased leeway for affiliations between banks and nonfinancial firms. You issued a veto threat on the Gramm bill on March 2, citing these concerns.

In addition to the context of financial modernization legislation, CRA will be the focus of hearings likely to be held this spring by Chairman Gramm and House Financial Institutions Subcommittee Chair Roukema. Senator Gramm and other Republicans may also introduce CRA proposals as stand-alone bills or in □®ulatory burden relief□8legislation. We need to decide how to prevent any rollback of CRA and preserve CRA□,s relevance in the financial services industry of the 21st century.

RECOMMENDED ACTION: Continue to strongly oppose legislation that would weaken CRA, and insist on provisions that would, for the first time, require banks to have and maintain an adequate record on CRA to engage in newly authorized non-banking activities.

Agree ____ Disagree _____ Discuss ____

BACKGROUND:

Current law. CRA requires a bank to serve the convenience and needs of all communities in which it operates. Although banks are examined periodically (every 24-36 months) for CRA compliance, and these CRA ratings and evaluations are made public, enforcement comes only when a bank files an application to merge with another bank or open a new branch. The regulator must then consider the bank□,s CRA record in evaluating the bank□,s application. The public has an opportunity to comment on the application. A bank's CRA record is not currently scrutinized in connection with applications to affiliate with non-banking companies.

Early in your Administration, at your request, the banking regulators revised the CRA regulations to focus on performance, not paperwork. They now base CRA ratings on a three-pronged test: lending, services, and investments. Regulators revised and streamlined the examination process, particularly for smaller institutions.

Effectiveness of CRA. Evidence suggests that public disclosure of CRA ratings, together with the changes made by the regulators under your leadership, have significantly contributed to improved performance by financial institutions in meeting the convenience and needs of low and moderate income communities, as well as minority borrowers. Home Mortgage Disclosure Act data from 1997, show that lending to minority and low income borrowers is on the rise. Since 1993, the number of home mortgage loans to African Americans increased by 58 percent, to Hispanics by 62 percent, and to low and moderate income borrowers by 38 percent, well above the overall market increase. In 1997, large commercial banks made $18.6 billion in community development investments. Since 1992, nonprofit community organizations estimate that the private sector has pledged over $1 trillion in loans and investment under CRA. In 1997, banks and thrifts subject to CRA□,s reporting requirement made 2.6 million small business loans for a total of $159 billion, two-thirds of all small business loans made that year. More than one-fifth of those loans were made to small businesses in low and moderate income communities.

Changing Nature of the Financial Services Industry. Commercial banks have seen their share of total financial intermediary assets decline from about 60 percent at the end of World War II, to roughly 25 percent today. As the financial services industry becomes increasingly less focused on banks and thrifts, as the lines between banking and non-banking products become increasingly blurred, and as financial firms become larger and financial power in the industry more concentrated, community groups have become concerned that financial modernization -- both as it is already occurring in the marketplace, and in the form of new legislation -- will reduce the assets subject to CRA, reduce financial institution□,s connection to local communities, and thus harm low and moderate income communities. Communities groups are likely to oppose any financial modernization legislation unless CRA were extended to securities and insurance providers, an outcome with practical and theoretical difficulties that we have not supported, and which stands no chance of success in the current or foreseeable political environment.

Status of Legislation

House. The Leach-LaFalce bill contains no weakening of CRA, and requires that banks must □&have and maintain□8 a satisfactory CRA rating in order to undertake newly authorized non-banking activities. Secretary Rubin sent a letter to Leach and LaFalce on March 3 indicating our strong support for their legislation.

[During mark-up, Leach and LaFalce worked together to avoid any amendments that would weaken CRA. Filed amendments by Rep. McCollum to provide small bank exemptions, and to weaken the Department of Justice□,s role in enforcing the Fair Housing Act and Equal Credit Opportunity Act, were not offered. Chairman Leach also chose not to offer -- despite earlier indications to the contrary -- an amendment weakening enforcement of the □&have and maintain□8 requirement.]

[Democrats succeeded in passing (28-27) an amendment by Rep Lee, which we supported, requiring insurance companies to be in compliance with the Fair Housing Act prior to affiliating with insured depository institutions. An amendment by Rep. Watt requiring a study of the effect of financial modernization legislation on CRA also passed.]

Democratic amendments to expand CRA to securities and insurance firms, in various ways, were defeated by significant margins, as was a Waters amendment, which we supported, to require the provision of low-cost □&life-line□8 banking accounts as a precondition for expanded nonbanking activity (31-27). [An amendment offered by Rep. Schakowsky to require reporting of race and income data on small business borrowers was withdrawn in the face of strong Republican opposition. (We have been working to get the Federal Reserve Board to change its rules, to permit (but not require) financial institutions to collect and report such data to expand access to minority small business borrowers.)]

[Last year, Representative LaFalce had introduced an amendment requiring financial institutions to report on their progress in meeting publicly announced □&commitments□8 under CRA, but in recognition of Republican restraint in not offering amendments to weaken CRA, LaFalce did not offer his provision this year.]

Senate. Chairman Gramm□,s financial modernization bill would seriously weaken CRA, and you have issued a statement that you would veto the bill in its current form. The bill has three main problems with respect to CRA: (1) it does not require banks to have and maintain an adequate CRA record as a condition for engaging in newly authorized financial activities; (2) it gives banks with satisfactory CRA records a safe harbor from CRA reviews during applications; and (3) it exempts small banks outside metropolitan areas from CRA. In addition, Gramm may yet offer an □&anti-extortion□8 amendment that would chill legitimate relationships between financial institutions and communities. These are discussed more fully below.

Senator Sarbanes, the Ranking Democrat, worked with the Treasury to unite Banking Committee Democrats behind an alternative bill that had much in common with the Leach-LaFalce bill. The Democratic alternative lost on an 11 - 9 party line vote.

Failure to condition authority to conduct new non-banking activities on banks having a satisfactory CRA record. The Leach-LaFalce bill allows a financial services company to engage in new non-banking activities only if the company□,s subsidiary banks have and maintain a satisfactory CRA record. Although such a requirement was not contained in the Administration□,s 1997 bill, Treasury and Rep. LaFalce successfully argued that such an argument had to be included this time. The Leach-LaFalce bill has now been referred to the House Commerce Committee, and we understand that Commerce will leave this provision intact.

Basically, the □&have and maintain□8 requirement, while not expanding the scope of CRA beyond insured depository institutions, broadens the enforcement mechanism for CRA to include the potential for denial of applications for non-banking activities as well as banking activities, and for further consequences if the bank□,s CRA record becomes unsatisfactory after the application is approved. (Under the Leach-LaFalce, this later action explicitly includes a requirement that a compliance plan be submitted and the possibility of forced divestitures of the newly approved activities. It could be read to include civil money penalties -- a sanction that the Justice Department found in 1994 does not apply under CRA as it is currently written.) In arguing for this provision in the Senate and the House testimony, Secretary Rubin noted that the financial services system of the future may include fewer bank merger applications and more non-banking activities. Thus, absent this additional enforcement mechanism, there could be fewer opportunities to take action against a bank with an unsatisfactory CRA record. A bill that is silent on CRA (and thus supposedly neutral) would, in our view, tend to weaken the effect of CRA, and we would oppose such a bill.

Gramm□,s safe harbor amendment. Gramm has proposed a safe harbor for applications now subject to CRA. A satisfactory CRA rating at a bank□,s most recent examination would conclusively establish the bank□,s CRA performance, unless public comment provides substantial verifiable informat ion to the contrary. Thus, a regulatory agency could not review the bank□,s CRA record unless there were an adverse public comment meeting the test□*even if the previous examination were old or otherwise stale. And, even if there were an adverse comment, Gramm would create a rebuttable presumption favoring approval of the application. In so doing, he would place a significant burden of proof on consumer and community organizations that generally have less access than the bank to relevant information. He would also, in effect, force community groups to stretch their limited resources to comment on many examinations, instead of focusing those resources on major applications (e.g., for mergers or acquisitions). Secretary Rubin has testified that such a safe harbor would tend to eviscerate the effectiveness of CRA, and the Administration has repeatedly threatened vetoes of bills containing safe harbors provisions.

Small bank exemption. The Committee passed an amendment (supported by all but one Republican (Sen. Santorum, PA) and opposed by all but one Democrat (Sen. Johnson, SD)) that exempts from CRA banks with less than $100 million in assets located outside metropolitan areas. These banks constitute 38 percent of FDIC-insured institutions, with 3% of assets. We have repeatedly stated that you would veto legislation containing a small bank exemption. CRA is important for small banks. Banks with less than $100 million in assets received 70% of the □&needs to improve□8 and □&substantial noncompliance□8 ratings under CRA. The new CRA rules lifted the regulatory burden on small banks, with a streamlined examination and no additional reporting requirements. The major small bank trade association recently praised the small bank exemption, although at the time of the release of the new CRA rules, it had praised the streamlined small bank exam □&as a big step in regulatory burden reduction for community banks.□8

Gramm□,s anti-extortion amendment. Gramm also considered proposing a so-called "anti-extortion" provision. As Secretary Rubin has testified, we strongly oppose extortion. Yet laws punishing extortion, bribery, and false statements already apply to the CRA process. In our view, and that of the Department of Justice, Gramm□,s broad and vague proposal would criminalize normal, legitimate arms-length transactions and cooperation between banks and community groups (e.g., bank grants to support community groups□, home ownership counseling programs if the community group later comments favorably on the bank□,s CRA record)□*the very sort of activity CRA seeks to foster. Gramm may well pursue this proposal in CRA hearings, or in financial modernization, or in □®ulatory burden relief□8 legisla tion.

Near-Term Strategy

Our near-term goal is to continue to assist Leach and LaFalce in moving their bill forward, while doing everything possible to block the Gramm bill. By taking a strong stand on CRA, we should be able to help unite Democrats against the Gramm bill and for the Leach-LaFalce bill. We also need to find opportunities for you, Secretary Rubin, and others to highlight the vital importance of CRA for building homes, creating jobs, and restoring hope in economically distressed communities throughout the United States. We will propose several potential events for you to highlight CRA□,s success in the coming months.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Sarah Rosen Wartell (CN=Sarah Rosen Wartell/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME: 1-MAY-1999 13:43:04.00

SUBJECT: Congress Daily story on banking/privacy

TO: Richard L. Siewert (CN=Richard L. Siewert/OU=WHO/O=EOP@EOP [WHO])
READ:UNKNOWN

CC: marne.levine@do.treas.gov (marne.levine@do.treas.gov [UNKNOWN])
READ:UNKNOWN

CC: Peter P. Swire (CN=Peter P. Swire/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

CC: Roger S. Ballentine (CN=Roger S. Ballentine/OU=WHO/O=EOP@EOP [WHO])
READ:UNKNOWN

CC: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

CC: gregory.baer@do.treas.gov (gregory.baer@do.treas.gov [UNKNOWN])
READ:UNKNOWN

CC: Broderick Johnson (CN=Broderick Johnson/OU=WHO/O=EOP@EOP [WHO])
READ:UNKNOWN

CC: Gene B. Sperling (CN=Gene B. Sperling/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

TEXT:
Jake --

This spin will get worse next week when we unveil the consumer financial package (with privacy) on Tuesday while Fin Mod is on the Senate floor. People will assume we are trying to kill Fin Mod. What would you recommend as an affirmative way for us to rebuff this story. Could we plant a remark in one of the daily press briefings? Should we have someone say something about this on the Senate floor during debate? We have a good Q&A, and we'll probably be asked, but we could just be the subject of endless speculation about this. Please advise.

thanks.
---------------------- Forwarded by Sarah Rosen Wartell/OPD/EOP on 05/01/99 01:40 PM ---------------------------

James J. Jukes@EOP
04/30/99 04:35:00 PM
Record Type: Record

To: Sarah Rosen@eop
cc:
Subject: Congress Daily story on banking/privacy

Message Creation Date was at 30-APR-1999 16:35:00

Privacy Issue Could Further Complicate Banking Reform
A new wild card has emerged in the legislative deck on financial services reform, and
it is one that some fear the White House could play to its advantage as the
Senate
prepares to take up the financial services bill next week. That card is fi
nancial privacy:
One insurance source called financial privacy a "make or break" issue that
the White
House "potentially could use to stall or kill" the modernization effort. Just
weeks ago,
lobbyists working the halls outside the House Banking panel modernization
markup
whispered that a surprise amendment offered by Rep. Jay Inslee, D-Wash., to
restrict
the sharing of customer information among affiliates of a financial holding
company was a
bill killer. The Inslee amendment was at odds with what is at the heart of
the industry's
desire to modernize: To cross into new markets and share customer information
among its
new affiliates.
Ultimately approved was a measure offered by Banking Chairman Leach and
Rep.
Bruce Vento, D-Minn., chiefly requiring insurance companies that affiliate
with a bank to
keep confidential customer health and medical information. Although diluted,
the provision
represents a placeholder that ensures the matter will be revisited. The looming fear among
reform proponents is that the White House, which is ambivalent about modernization, may
use the privacy issue to leverage other aims, or as justification for a veto.
Or the White
House effectively could tank the bill simply by forcing a vote on the privacy
matter. Such a
vote would be awkward at best for modernization supporters from both parties
□!* but
especially for Republicans such as Senate Banking Chairman Gramm, who were
especially vociferous in their recent attacks on Know Your Customer, a proposed federal
regulation that would have required banks to monitor and profile customer
transactions.

The White House has been threatening for weeks to unveil a package on consumer
protections, including proposals to protect financial privacy. Senate Banking
ranking
member Paul Sarbanes, D-Md., and House Commerce member Edward Markey,
D-Mass., reportedly have privacy amendments in the works.

At least one part of the fight with respect to modernization will center on whether
customers should be empowered to "opt in" to a policy that would permit their
financial
institutions to share information, or whether the industry preferred "opt
out" would prevail.

A Markey spokesman noted that if information sharing "is such a great idea,
then
[industry] should be able to get customer permission. If they can't, then it
suggests to me
that perhaps your customer is not interested in all of the wonderful opportunities you have
for them." Speaking recently to a group of financial services providers, House
Commerce Finance and Hazardous Materials Subcommittee Chairman Michael
Oxley, R-Ohio, acknowledged the privacy question was a potential problem. In
that vein,
Oxley urged the crowd to "come up with a strategy where members can feel comfortable
with a vote on privacy and not screw it up with your ability to
cross-market."

Meanwhile, Senate Minority Leader Daschle today said he and Senate Majority
Leader Lott are working to establish a procedure for considering the Senate
financial
services modernization bill next week. Daschle expressed his hope that Democrats would
be allowed to offer a substitute amendment and get a vote on the Community
Reinvestment Act. □!* by Pamela Barnett

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	David Dreyer to Dee Dee Myers et al re: Racism in Home Lending (1 page)	06/09/1993	P5

1634

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
WHO ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 500000

FOLDER TITLE:

[04/20/1993 - 03/23/1995]

2010-0384-F
ds389

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (RECONSTRUCTED EMAIL)

CREATOR: David Dreyer (DREYER_D) (WHO)

CREATION DATE/TIME:09-JUN-1993 09:53:00.00

SUBJECT: Racism in home lending

TO: Dee Dee Myers (MYERS_D) (WHO)
READ: UNKNOWN

TO: Heather Beckel (BECKEL_H) (WHO)
READ: UNKNOWN

TO: George Stephanopoulos (STEPHANOPO_G) (WHO)
READ: UNKNOWN

TO: Mark D. Gearan (GEARAN_M) (WHO)
READ: UNKNOWN

TO: Gene Sperling (SPERLING_G) (OPD)
READ: UNKNOWN

TO: Michael Waldman (WALDMAN_M) (WHO)
READ: UNKNOWN

TEXT:
Memorandum from David Dreyer
Here is an idea....based on the following premises:
1. We need to do some recovery work with the CBC following the Guanier episode.
2. The Washington Post has been running a series on racism by banks in the home mortgage loan process.
3. We have a friendly comptroller of the current, Gene Ludwig, who is committed to fighting for enforcement of laws like the Community Reinvestment Act and Fair Lending.
4. We have a meeting coming up with the CBC.
5. The Chairman of the CBC is Kweisi Mfume, a Member of the House Banking Committee.
6. Could someone responsibly talk with Gene about the possibility of announcing some kind of investigation or inquiry into the banking practices discussed by the Washington Post in advance of President's meeting with the Black Caucus, with the hope we could announce something at the meeting?
That's my idea. Please respond.
D2

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he CB t
□
he CNJ

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Ellen S. Seidman to Phillip Caplan at 20:00:18.00. Subject: Financial services modernization memo. (partial) (1 page)	05/15/1997	P6/b(6)
002a. email	Ellen Seidman to Daniel Tarullo et al re: Financial services modernization (2 pages)	05/06/1997	P5 1635
002b. memo	Gene Sperling and Ellen Seidman to NEC Principals re: Financial Services Modernization - Part III (11 pages)	ca. 05/1997	P5 1636
002c. memo	Gene Sperling to The President re: Treasury's Proposed Financial Servivces Modernization Legislation (14 pages)	ca. 03/1997	P5 1637
002d. summary	Summary of Treasury Proposal (2 pages)	ca. 03/1997	P5

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
WHO ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 500000

FOLDER TITLE:

[05/01/1997 - 01/30/1998]

2010-0384-F
ab951

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
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b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ellen S. Seidman (CN=Ellen S. Seidman/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME: 6-MAY-1997 17:44:30.00

SUBJECT: Financial services modernization - memo to principals for Thursday meeting

TO: YELLEN_J (YELLEN_J @ A1 @ CD @ LNGTWY [EOP]) (CEA)
READ:UNKNOWN

TO: Daniel K. Tarullo (CN=Daniel K. Tarullo/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Bruce N. Reed (CN=Bruce N. Reed/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Alan B. Rhinesmith (CN=Alan B. Rhinesmith/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Rebecca R. Culberson (CN=Rebecca R. Culberson/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Ron Klain (CN=Ron Klain/O=OVP @ OVP [UNKNOWN])
READ:UNKNOWN

TO: Daniel C. Tate (CN=Daniel C. Tate/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: John Podesta (CN=John Podesta/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Kathleen M. Wallman (CN=Kathleen M. Wallman/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: ENGLISH_W (ENGLISH_W @ A1 @ CD @ LNGTWY [EOP]) (CEA)
READ:UNKNOWN

TO: Kristen E. Panerali (CN=Kristen E. Panerali/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: WEINSTEIN_P (WEINSTEIN_P @ A1 @ CD @ LNGTWY [EOP]) (OPD)
READ:UNKNOWN

TO: Alice Veenstra (CN=Alice Veenstra/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Michael Deich (CN=Michael Deich/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Franklin D. Raines (CN=Franklin D. Raines/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Paul R. Carey (CN=Paul R. Carey/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: John L. Hilley (CN=John L. Hilley/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TO: Jason S. Goldberg (CN=Jason S. Goldberg/OU=WHO/O=EOP @ EOP [WHO])

READ:UNKNOWN

TO: Gene B. Sperling (CN=Gene B. Sperling/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Jonathan A. Kaplan (CN=Jonathan A. Kaplan/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Russell W. Horwitz (CN=Russell W. Horwitz/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Wendy J. Einhellig (CN=Wendy J. Einhellig/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Melissa Green (CN=Melissa Green/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

CC: Anna M. Gomez (CN=Anna M. Gomez/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:
The document named "finsern3.wpd" is the memo to the principals for Thursday's meeting. The document named "finserpo.wpd" is Tab A to the memo to the principals. Tab B, which are Treasury documents, will be sent by hard copy (together with a set of these two documents) tomorrow.

If you have any questions, please call me, on 65359.

Ellen=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D27]MAIL44605752N.116 to ASCII,
The following is a HEX DUMP:

FF575043BF210000010A0201000000000205000000309C000000020000DEF21805FC7A04B49429BB
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January 19, 2012

MEMORANDUM FOR NEC PRINCIPALS

FROM: GENE SPERLING
ELLEN SEIDMAN

SUBJECT: **Financial Services Modernization - Part III**

On Thursday, May 8, we will have a principals meeting to develop a recommendation to the President concerning Treasury's financial services modernization proposal. Attached to this memorandum at Tab A is a draft memo to the President (that was never sent) that reflects the state of play as of the end of our last meeting on March 20. It is quite similar to the memo we sent you on March 17 in preparation for the March 18 and 20 meetings, and is a good refresher for the upcoming meeting. At Tab B are (i) a Treasury outline of its current proposal and (ii) a chart showing critical elements of the banking/commerce alternatives.

EVENTS SINCE MARCH 20: Following our March 20 meeting, Treasury decided to have a further series of discussions with both Members of Congress and other interested parties concerning their positions on various aspects of the proposal, particularly the most contentious: the degree to which commercial (i.e., non-financial) firms could affiliate with banks. (See issue 1 of Tab A, pages 4-6.) This issue, in turn, implicates the question of the nature and extent of holding company regulation and the role of the Fed. (See issue 2 of Tab A, pages 6-9.)

Based on those discussions -- which delayed transmission of Treasury's report to Congress beyond the March 31 statutory deadline -- Treasury is now recommending that it submit to Congress not legislation for introduction, but rather a report with legislative language including two distinct alternative ways of dealing with banking and commerce and related issues. Treasury has also done further work on the nature and extent of holding company regulation, and has finished drafting the consumer protection provisions of the bill. Treasury's position with respect to the Community Reinvestment Act (see issue 3 of Tab A, pages 9-10) has not changed: the proposal would extend CRA to Wholesale Financial Institutions, but no further.

Treasury would like to have Administration clearance of its proposal in time to submit and/or testify on it on May 21.

1. Affiliations Between Financial and Nonfinancial Firms

Treasury Alternative A: Alternative A is in essence the previous Treasury proposal of allowing a "basket" of non-financial[1] activities within a holding company structure that includes a bank. Treasury's proposal as of March 20 was 25% of the combined entity's business. The current proposal varies in several critical respects from the March 20 proposal:

- The measure for calculating the basket would be specified as gross revenues.
- The legislative language would be submitted **without** a percentage specified.
- Banking/non-financial affiliations would be further limited in that none of the largest 1000 non-financial firms (by asset size) would be allowed to affiliate with a bank.

Treasury has also clarified that: (i) while banks could engage in non-bank financial activities in subsidiaries of the bank, all non-financial activities would have to be done in holding company subsidiaries and (ii) as is currently the case with thrift holding companies, there would be a total ban on any extension of credit by a bank to or for the benefit of a non-financial affiliate.

Although not fully discussed in the earlier memos, a critical element of Treasury's initial proposal, now Alternative A, is the abolition of the thrift charter and the conversion of all thrifts to banks (together with the merger of the Office of Thrift Supervision with the Office of the Comptroller of the Currency). Abolition of the thrift charter meets the explicit requirements of the "Frist Amendment," which prohibits merger of the BIF (bank) and SAIF (thrift) insurance funds until the charters are merged.

[1] "Financial" would be defined in the statute to include banking and any activity currently authorized for a bank, the activities of bank operating subsidiaries, and all activities that can be performed by securities, commodities and insurance companies. The National Council on Financial Services could add to the definition. All other activities would be deemed non-financial.

A major complication with the thrift charter conversion, however, is how to handle differences in the affiliation powers of bank holding companies and unitary thrift holding companies (companies that own one and only one thrift). Currently, unitary thrift holding companies can engage in nonfinancial activities with virtually no limits.[2] As far as we can tell (and the data are far from perfect), only 29[3] thrifts are part of holding companies that engage in non-financial businesses. (Approximately 45 others are engaged in real estate development, investment and management, which is regarded as "financial" by OTS but not "related to banking" by the Fed.) Treasury proposes to grandfather the right of all 515 existing unitary thrift holding companies to engage in nonfinancial activities without regard to the basket. The grandfather rights would not survive a change in control of the holding company (i.e., the expanded franchise could not be sold), but would not otherwise be limited in duration.

Treasury Alternative B: Alternative B would approach the banking and commerce issue by leaving the existing thrift charter, holding company structure and regulatory system intact. As noted above, unitary thrift holding companies can currently affiliate with any type of institution. Furthermore, the thrift charter has recently been altered to permit (i) unlimited consumer lending and (ii) up to 10% of assets to be commercial loans and an additional 10% to be small business loans -- thus making the charter very similar to the actual asset mix of approximately 60% of the commercial banks.[4]

Alternative B in essence offers any diversified financial holding company that includes non-financial activities the opportunity to get into retail "banking" by buying a single thrift. Alternatively, such an institution could get into wholesale banking (only non-insured deposits over $100,000) by establishing a "Wholesale Financial Institution" (WFI, pronounced "WOOFIE"), which would not be subject to the Bank Holding Company Act. The Bank Holding Company Act would be amended to allow any **financial** firm to affiliate with a **bank** and to allow any bank to buy, establish or otherwise affiliate with, any other type of financial firm including, in particular, an insurance or securities underwriter. Under Alternative B, the

---

[2] The initial purchase must be approved by OTS (which must approve holding company management) and OTS can impose limitations on safety and soundness grounds. Informally, OTS has indicated that they would look skeptically on, e.g., purchase of a thrift by a company a significant portion of whose business was gambling. Multiple thrift holding companies (companies that own more than one thrift, but no banks) are basically limited to activities permitted to bank holding companies, although they may engage in real estate development, investment and management.

[3] Numbers relating to thrift holding companies are as of 12/31/96.

[4] While it is difficult to tell precisely from publicly available data, it appears unlikely that many of the largest banks could qualify as thrifts, mainly because of their commercial lending and investments in non-mortgage securities. However, it is possible that one or more of the large banks with a heavily consumer orientation (e.g., NationsBank) might so qualify, and could, therefore, make a choice to become a thrift to take advantage of the commerce "opportunity." In the past, banks such as Wells Fargo that have considered moving to a thrift charter have ultimately rejected the idea.

Frist Amendment would simply be statutorily deemed to be satisfied, on the theory that its real purpose was to ensure the opportunity of banks to expand into insurance and securities and that this has been accomplished.

Discussion: As revised, Alternative A has generated some interest from Chairman Leach, as moving closer to his minimalist approach to banking and commerce, and still commands support from those, such as Rep. Roukema, who supported the basket approach in the first place. However, Senator Sarbanes is still not convinced. Proponents of full banking and commerce, particularly Mr. Baker, have voiced their displeasure. Within the Administration, Chairman Yellen has expressed her concern that the extent of the grandfathering of unitary thrift holding companies is far too broad, and should be limited to those unitaries that are actually using their authority to engage in non-financial activities to an extent in excess of whatever basket is established. Treasury responds that not cutting back on thrift powers is critical to maintaining thrift support for legislation, which in turn is critical for legislation to move forward. For a discussion of other issues related to this approach see pages 4-6 of Tab A.

Treasury has been able to keep Alternative B from leaking, so it is unclear how it will be received. The issues that will potentially arise are: (i) banks might assert that the Frist amendment has **not** been satisfied and therefore the conditions for merging the funds have not been met[5]; (ii) diversified financial holding companies that have non-financial affiliates might not view the thrift option as sufficient; (iii) banking/commerce opponents may view the proposal as unsatisfying since it preserves, and publicizes, an existing banking/commerce "loophole"; and (iv) there may be serious concern about the ability of OTS to effectively regulate a large number of powerful new unitary thrift holding companies.

2. HOLDING COMPANY REGULATION AND THE ROLE OF THE FED

Treasury proposal: Treasury's latest proposal, which has not been vetted with the Fed, would apply to either Alternative A or Alternative B. Under this scheme, the Fed would regulate all bank holding companies (but under Alternative B not thrift holding companies, which would be regulated by OTS). Holding companies engaging in activities that cannot be done directly in the bank (including, for example, securities or insurance underwriting) would be required to provide the Fed an undertaking to maintain the capital of the subsidiary banks at the "well-capitalized" level[6]. If the bank's capital falls below that level the holding company would be required to

[5] In general, banks don't much care about merging the funds; that is a good government and a thrift issue. But, understanding the interest of others in merging the funds, banks view the BIF/SAIF merger as leverage to enable them to get "paid" for agreeing to take on part of the FICO obligation as part of the SAIF recapitalization last year.

[6] Bank (and thrift) capital levels are set by statute at "well-capitalized," "adequately capitalized," "under capitalized" (which subjects the bank to regulatory sanctions), "significantly undercapitalized" (regulatory sanctions required), and "critically undercapitalized" (bank subject to being placed in receivership). Current law in effect requires a holding company to guarantee to maintain the bank or thrift

bring the capital level back up to well-capitalized and maintain it at that level. If, within 180 days, the holding company were unable to bring bank capital back up to the well-capitalized level, the holding company would be required to **either** (i) divest the bank in a manner that results in the bank being well-capitalized upon divestiture (e.g., by shrinking the balance sheet or by getting the buyer to add capital as part of the transaction); or (ii) cease engaging within the holding company in any activity the bank could not engage in directly (including, for example, most insurance and securities underwriting). If the bank got seriously in trouble so quickly that the FDIC were forced to put it into receivership or conservatorship, the holding company's guarantee of the bank's well-capitalized status would be enforceable by the FDIC.

The Fed would be responsible, as part of its normal supervisory process, for continuously evaluating the holding company's ability to support the bank's capital at the well-capitalized level, and would be able to examine bank holding companies and their nonbank subsidiaries if there were reason to suspect those entities were engaged in activities that could pose a significant threat to a subsidiary bank.

at the adequately capitalized level.

Although bank holding companies would be subject to Fed regulation under the Bank Holding Company Act, the Fed's authority to establish holding company capital requirements[7] would be limited to the following situations:

- A subsidiary bank's capital has remained below the well-capitalized level for more than 180 days;
- Banking assets constitute more than 90% of the assets of the holding company **and imposition of holding company capital requirements is or may be necessary to avoid a threat to the safety and soundness of the bank**; or
- On a case-by-case basis if the holding company has assets in excess $100 billion and owns a bank with assets in excess of about $5 billion[8] **and imposition of holding company capital requirements is or may be needed to avert systemic risk to the economy or a threat to bank safety and soundness.**

The Treasury's proposal would not impose similar requirements on thrift holding companies (under Alternative B), nor does current law.

Discussion: With respect to the holding company guarantee, the issues likely to be raised are (i) the ability of the Fed adequately to monitor the effective strength of the guarantee when it is neither authorized or set up to regularly and fully examine the holding company or its non-bank subsidiaries (a concern Director Raines has raised) and (ii) the extent to which the difference between "well-capitalized" and "adequately capitalized" provides a sufficient cushion in capital and time so that a bank that falls below the well-capitalized level can be recapitalized or sold before it is truly in trouble (a concern Chairman Yellen and Director Raines have both raised).

On the issue of Fed capital standards, the major substantive question, raised by Chairman Yellen, is whether these standards amount to attempting to close the barn door after the horse is out. In particular, if the Fed can impose holding company capital standards during the first 180 days when a bank falls below the well-capitalized level only **after** finding a threat or likelihood of threat to the bank or of systemic risk, will the capital standards be effective in preventing the risk from materializing? Chairman Yellen also believes that defining a holding company that is primarily bank-related as one in which the bank accounts for 90% of the assets is too lax: moving sufficient assets out of the bank to fall below the 90% level would be fairly painless. She would support a lower threshold. Director Raines has also expressed concern in the past that capital requirements that are discretionary with regulators may pose "forebearance risk": the risk that capital standards will not be imposed when needed because regulators and the regulated can convince each other that the situation will be resolved without the imposition of standards.

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[7] The Fed asserts it has such authority under current law. However, it is unclear whether the assertion would survive legal challenge.

[8] As of 12/31/96, 134 commercial banks had assets in excess of $5 billion. As of 9/30/96, 31 thrifts had assets in excess of $5 billion..

Treasury responds that: (i) holding company capital regulation is in fact an extremely minor part of the entire bank regulatory structure that, with the post-1990 rules concerning prompt corrective action, would ensure the security of the deposit insurance funds; (ii) providing the Fed with **any** degree of explicit holding company capital authority is more than the Fed has now; and (iii) since the goal of holding company capital regulation in the case of a holding company that is predominantly a bank is to prevent "double-leveraging"[9] in order to protect the deposit insurance fund, it does not matter that a holding company could avoid the capital requirements by moving assets out of the bank. An additional substantive question is whether, whatever system is proposed to allow the Fed to set holding company capital standards, a similar system should be proposed with respect to OTS' regulation of thrift holding companies under Alternative B.

Treasury's current proposal is an attempt to provide for holding company capital requirements where the strength of the holding company really would be needed to protect the safety and soundness of the banking system, while keeping the Fed out of this business -- particularly with respect to diversified financial holding companies -- under normal circumstances. Whether this will prove (i) too little to satisfy the Fed and its supporters or (ii) too much to satisfy the diversified holding companies is unclear.

3. Consumer Protection

Treasury proposal: Treasury would establish that federal bank and securities regulators have an obligation, with respect to retail sales of non-deposit investment products by depository institutions, to avoid customer confusion about the applicability and scope of FDIC and SIPC insurance; to prevent improper disclosure of confidential customer information; and to avoid conflicts of interest and other abuses.

Treasury's proposal would direct the bank regulators, in consultation with the SEC, to adopt regulations for sales of non-deposit investment products by insured depository institutions that are not registered securities brokers. Such regulations would be required to cover the following areas: advertising, disclosure, sales practices, qualifications and training of sales personnel, compensation of sales personnel, and the circumstances under which transactions and referrals occur. With respect to non-deposit investment products that are securities (including mutual funds) or annuities, the bank regulators would be required to adopt regulations comparable to those adopted by the SEC. The SEC would be required (to the extent such rules are not already in place) to adopt similar rules concerning sales of non-deposit investment products by brokers or dealers who are depository institutions (in the case of brokers) or are affiliated with a depository

[9] Double leveraging occurs when a holding company issues debt that is then used to capitalize the bank. The result is that the bank nominally has equity, but it is under pressure to dividend profits to the holding company to pay the debt service. This can result in the bank holding less capital (e.g., little in excess of the minimum amount required -- in the case of a bank in a diversified holding company, the well-capitalized level) than would otherwise be the case. In contrast, if the bank itself has raised the equity, there is no debt service, and so less pressure to pay holding company dividends.

institution. The SEC would have to consider one major new item, namely the disclosure by depository institution subsidiaries and affiliates of the financial interest of the depository institution or securities subsidiary or affiliate with respect to referrals or transactions.

The regulations adopted by the banking regulators and the SEC would be required to "encourage the use of disclosure that is simple, direct, and readily understandable" (model language would be included), and to encourage oral as well as written disclosure. (Studies have shown that oral disclosure is more effective, but it is, of course, more difficult to monitor, particularly in face-to-face, rather than telephone, conversations.) The National Council on Financial Services, on which both the federal banking regulators and the SEC would sit, could establish more stringent regulations than those adopted by the individual regulators.

The Treasury's proposal would prohibit non-depository institution affiliates within a bank holding company from sharing **with any depository institution** in the holding company non-public customer information, including in particular evaluations of creditworthiness, unless the customer received "clear and conspicuous disclosure" that such information might be shared and had an opportunity to direct that it not be shared. As a practical matter, customers would probably be given an opportunity to make this choice for all classes of information upon the opening of an account, rather than on an event-by-event basis.

Treasury would require the National Council on Financial Services to biennially review, starting on June 30, 2001, the regulations adopted pursuant to these requirements to determine whether they carry out the purposes.

Finally, Treasury's bill would, by adopting a greater degree of functional regulation of securities activities than is currently the case, impose more consumer-protective requirements on bank activities relating to securities sales and work for investment companies than is currently the case.

Discussion: Treasury's proposal is designed to be at least as protective of consumer concerns as proposals currently being considered in the House, but to do so in a manner that hardwires fewer requirements into statute and requires more of the regulators. However, the requirement for simple disclosure and model language goes further than other proposals. In contrast to current law, bank regulators would have to adopt **regulations**, not guidelines, regarding the sale of non-deposit investment products.

The consumer groups are not likely to be fully satisfied with this approach for three reasons: (i) they are skeptical of the bank regulators' ability and willingness to adopt strong and effective regulations in this area and they would therefore prefer to hardwire more into the statute; (ii) the proposal would not provide consumers with a private cause of action against a depository institution that caused harm by violating the regulations; and (iii) the proposal would not explicitly deal with "implicit" tying, under which a consumer gets the impression, by the mere fact that insurance is offered before a loan is approved, that approval of the loan is contingent on purchase of insurance from the bank. Conversely, financial institutions will be concerned that this proposal -- particularly the information disclosure portion -- may severely limit their ability to cross-sell securities and investment products, which they regard as one of the benefits to both consumers and institutions of allowing greater affiliations among financial institutions.

4. COMMUNITY REVINESTMENT ACT

Treasury's proposal with respect to CRA has not changed since March 20. The only external developments since March 20 are that (i) Senator D'Amato has suggested that expanding CRA even to WFIs will put CRA "in play" and (ii) the companies that are likely to create WFIs have -- with one exception -- said they will have no objection to expansion of CRA to such institutions. We may also want to consider whether the fact that Treasury proposes sending up a report with legislative language rather than a bill, changes the dynamic of what can and should be included.

Treasury Proposal: Apply CRA to Wholesale Financial Institutions -- banks that do not accept accounts under $100,000 and thus do not have insured deposits, but avoid putting CRA "in play" by proposing an expansion of CRA coverage to nonbanking firms. The Secretary's speech announcing any proposal -- and all subsequent statements from the Administration -- would state explicitly that we will tolerate no weakening of CRA.

Discussion: One of the hallmarks of this Administration has been its recognition that access to credit and other financial services is essential to the vitality and growth of communities. Bank regulators have been directed to make the Community Reinvestment Act work to generate "performance, not paperwork." The regulators -- working through an unprecedented series of hearings and other outreach efforts -- responded effectively: new CRA regulations, which are just coming into effect, have been praised as effective without being burdensome. As a result of this Administration's efforts in this area (including not only CRA, but also effective enforcement of non-discrimination laws, and the National Homeownership Strategy), over $90 billion in CRA commitments have been made and the number of mortgages made in low- and moderate-income communities rose 22% and the number to minorities rose 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). In the 104th Congress, the Administration stood strong against any cutback in CRA in the context of banking regulatory relief regulation -- and succeeded in fending off all challenges.

It is quite clear that, notwithstanding continued strong bank profitability, assets and lending are flowing out of the banking system. While much of the asset loss in the last few years is attributable to large businesses (who are unlikely to rely on CRA for access to capital) directly accessing the capital markets, the movement of deposits from banks to mutual funds has put a strain on both the theory and practice of CRA.

The power of CRA and related statutes and the regulators to get results is beyond anything community groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups. Their concern is exacerbated by what they see as the lack of benefit to consumers -- particularly poor consumers -- from changes, such as interstate banking, that have already occurred in the system. They have strongly urged the Administration, as a condition of financial services modernization, to expand CRA coverage to all financial institutions affiliated with a bank or at least to all bank-eligible products (such as mortgage loans) no matter where in the holding company they are offered.

Treasury believes that, notwithstanding the concerns of the community groups, CRA expansion beyond WFIs[10] should not be included in the proposal. There are two basic reasons: practical and political. On the practical side, Treasury notes the difficulty of defining the geographic service area -- a critical CRA concept -- for securities firms and mutual funds, and the difficulty of imposing federal CRA regulation on state-regulated insurance companies and unregulated finance companies. They note that, while the OCC currently takes the activities of non-bank subsidiaries into account in evaluating the CRA performance of a national bank, in general the subsidiaries are small in relation to the bank. If, in an attempt to avoid imposing CRA directly on securities firms, insurance companies and finance companies affiliated with banks, one were to impose on a relatively small bank the community obligations of all affiliated companies, the most likely result would be a sharp decrease in the interest of anyone in affiliating with a bank.

As a political matter, whatever support CRA has among community groups and some Congressmen (including in particular Senator Sarbanes), it is strongly disliked by many banks, most Republican members of Congress and many pro-business Democrats. In fact, it is probably fair to say that, with the potential [important] exception of Senator D'Amato, almost no one strongly in favor of financial services legislation is strongly in favor of CRA. And the securities and insurance industries (backed by, e.g., Senator Dodd) are unalterably opposed to any expansion. Moreover, even many CRA proponents (such as Senator Sarbanes) believe that any attempt to expand CRA as a price for modernization legislation will lead either to no legislation (a result to which they would not object) or a frontal assault on CRA by opponents such as Senators Shelby and Mack, with the result that -- if it went anywhere at all -- the entire financial services debate would become a fight about CRA, and it is very likely the Administration would be called upon to veto the resulting bill.

4. WHETHER TO GO FORWARD, AND IN WHAT FORM

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[10] Treasury would expand CRA to WFIs because: (i) WFIs are banks that take deposits; (ii) they have access to the payment system; and (iii) to create WFIs without CRA would open the way for an immediate contraction of CRA coverage as such wholesale banks as Bankers Trust and JP Morgan -- now subject to CRA -- became WFIs.

Treasury proposal: Treasury proposes to release, on or about May 21, a brief statement by Secretary Rubin, covering draft legislative language containing the two alternatives discussed above.

Discussion: After a lengthy series of discussions with both members of Congress and interested parties, Treasury came to the conclusion that the best way to both (i) respond to the statutory directive that it report on the merger of the bank and thrift charters by March 31 and (ii) move the financial services debate forward is to send forth a legislative proposal that is complete and defensible, but that provides alternative ways to deal with the most contentious issue.

Sending alternatives rather than a legislative proposal may lead some to question both the Administration's purposes and its strength of commitment to financial services modernization. And the result may be that the debate does not proceed or the Administration is marginalized. On the other hand, it is quite clear that taking the position on banking and commerce that is most likely to move the debate quickly -- the basket approach with a fairly large basket -- will seriously offend critically important Democratic Senators such as Senator Sarbanes. One lesson of last Congress' unsuccessful discussion of this issue is that even if there is no legislation, the ball moves: there no longer is a serious debate about whether to repeal Glass-Steagall or whether to allow banks to affiliate with insurance companies, rather the debate is how. For the Administration to be a serious player in this session's discussions, and to protect our interests (particularly with respect to CRA and the role of the OCC[11]), almost certainly requires that Treasury fulfill its report obligation reasonably quickly and do so in a manner that indicates we have been considering the issues seriously and have cogent proposals to put on the table, even if we have two of them.

[11] As described in footnote 5 of the memo at Tab A, an important aspect of Treasury's proposal is that banks would be allowed to do non-bank financial activities in **either** a subsidiary or an affiliate of the bank. In contrast, the Fed is insisting that such activities be done only in a bank affiliate (a subsidiary of a bank holding company rather than of a bank). As footnote 5 points out, whatever the substantive issues involved, there are clear jurisdictional implications: national banks and their subsidiaries are regulated by the OCC, a bureau of the Treasury, whereas bank holding companies (including holding companies of national banks) are regulated by the Fed.

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. letter	To Gene Sperling from consumer and community advocates. Subject: Previous meeting with NEC concerning bank deregulation legislation (3 pages)	04/07/1997	P5 1644
002. email	Secret Service (Partial); DOB's (Partial); SSN's (Partial) (1 page)	03/31/1997	P6/b(6), b(7)(C)
003. memo	To John Hawke from Bill English. Subject: Financial market reform proposals (1 page)	04/30/1997	P5

COLLECTION:

Clinton Presidential Records
National Economic Council
Ellen Seidman
OA/Box Number: 13058

FOLDER TITLE:

Financial Services Reform - 1997 [3]

Jamie Metrailer
2010-0384-F
jm658

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Ellen -
FYI.
Jen

April 7, 1997

Gene Sperling
Assistant to the President
The White House
Washington, D.C. 20500

Sent via mail and facsimile

Dear Gene:

We appreciated the opportunity to meet with you, Ellen Seidman, and Kathy Wallman, on March 19 to discuss our views on pending bank deregulation legislation. As we indicated to you, we are deeply concerned that the Treasury Department is promoting major changes in the banking system, in particular mixing banking and commerce, without adequate consideration of its effects on under served populations. We urge President Clinton not to lend his support to proposals labeled as "financial modernization," but which in reality are little more than financial services industry groups "wish lists."

During our meeting, we emphasized two aspects of bank deregulation legislation that concern us: 1) the mixing of banking and commerce; 2) permitting banks and other financial services firms to own one another. Here is a summary of our views on both of these issues:

1. Mixing Banking and Commerce.

Rather than increasing competition, removing the current restrictions against banks owning and being owned by commercial firms would concentrate financial power in the hands of a few all-purpose corporate giants. Mixing banking and commerce opens the door for a vast restructuring of our nation's businesses and undermines the traditional role of banks as independent and impartial arbiters of credit. We especially fear that such changes would result in distortions in the flow of credit to under served communities, to low and moderate income families, and to small businesses. Any such plan deserves, at the very least, long and serious discussion with all segments of our population that will be affected. Such discussions have not occurred.

2. Cross affiliations between financial services firms.

Consumers and communities already are beginning to feel the effects of the changes that are occurring in banking and the financial services industry. Unfortunately, most of the focus in Congress thus far has been on reviewing the bank deregulation proposals favored by the various financial industry interest groups. On the other hand, we find that scant attention has been given to upgrading existing safeguards, such as the Community Reinvestment Act, to reflect new market conditions. Yet, unless consumer and community protections keep pace with the bank restructuring that has occurred, much of the progress that the Administration and others can point to as improving credit availability opportunities for minorities and other under served population groups is in danger of being reversed.

Accordingly, we believe the President has an important and historic opportunity to spur a much broader policy discussion about the type of financial system that most American families want and need.

In our meeting, we discussed three important ways in which Presidential leadership in this area could help. First, to ensure that if banking legislation is to be enacted it in no way undermines the effectiveness of the existing CRA statute -- either directly or indirectly. For example, the White House should be prepared to oppose any legislation that would permit the establishment of "wholesale financial institutions" (i.e., uninsured banks) that would not come under CRA coverage. New CRA rules that include the disclosure of important new small business loan data are set to go into effect this summer. However, the impact of these rules as a tool for promoting increased credit opportunities for job generating small businesses will be curtailed, should banks now covered by CRA be permitted to escape from future coverage.

Second, the President should propose a series of steps for strengthening community reinvestment and consumer safeguards to reflect the new and emerging new banking environment. For example, CRA must be adapted to track the way large bank holding companies now operate. We are finding that the nation's largest banking companies cross market products, such as mortgages, consumer loans, and small business loans between their bank and non-bank affiliates. While the bank affiliates of these parent companies are evaluated by federal regulators to ensure that their activities meet certain community reinvestment requirements, their non-bank affiliates are not. In today's marketplace, this is a distinction without a purpose. In fact, these practices appear to be used by these companies to circumvent what would otherwise be the community reinvestment obligations of their bank affiliates.

New policies must be instituted to provide for either CRA reviews for non-bank affiliates of parent companies of banks, or extending CRA coverage along product lines. Banks offering mortgages and are covered by CRA; so should the lending activities of mortgage banking affiliates of the same parent companies of these two entities.

Additionally, community reinvestment responsibilities should be expanded to cover non-bank financial services institutions. CRA was enacted to cover banking institutions based upon the premise that although they are privately capitalized, these institutions are subject to underlying obligations that form the *quid pro quo* for the extensive public backing they receive (i.e., taxpayer guarantees for deposit insurance, access to the Federal Reserve System's lender of last resort facility, etc.).

We believe a case can be made for extending similar, although not necessarily identical, requirements to other nonbank financial institutions as well. Nonbank financial institutions have gained access to many of the same federal protections as banks but operate with no comparable reinvestment responsibility. We would hope to see the President raising questions about what the appropriate public responsibilities should be for non-bank financial institutions, such as mortgage banking companies, mutual funds, insurance firms, etc.

Further, we discussed the unprecedented opportunities that the President has to make appointments that would for the first time make the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation consumer and community "friendly" agencies. The President can do this by filling the two vacancies on the Federal Reserve Board and by appointing to the FDIC Chairman slot, individuals who have evidenced a strong background in support of the effective enforcement of CRA, consumer protections, and the nation's fair lending laws. There is a wealth of talent across the nation which the President could draw upon in selecting nominees for the current vacancies. We urge the President to reach out beyond the usual financial interests in filling these critical positions.

Finally, we wanted to let you know that we very much appreciated Ellen's extra efforts to arrange a last minute meeting with Secretary Rubin. Although we found the results of our meeting with the Secretary and his staff less than encouraging, it provided us with an opportunity to raise issues that need to be more thoroughly discussed within his agency.

Again, thank you for your time. We hope that our message will be heard by the President.

Sincerely,

Bernard Fulton, ACORN
Allen Fishbein, Center for Community Change
Gale Cincotta, National People's Action
Bud Kanitz, National Neighborhood Coalition
Donet Graves, Organization for a New Equality

Others attending the meeting: Lindsay Durr (NTIC), Debby Goldberg (CCC)

cc: Ellen Seidman, Special Assistant to the President
Kathy Wallman, Chief of Staff, National Economic Council

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

April 30, 1997

MEMORANDUM FOR JOHN D. HAWKE, JR., UNDER SECRETARY
DEPARTMENT OF THE TREASURY

FROM: BILL ENGLISH

SUBJECT: Financial Market Reform Proposals

I was able to speak briefly to Janet about the proposals that you outlined at today's meeting. She had comments in four areas.

1. **Two track approach.** Janet had no objections to sending two bills to the hill. She also thought it was reasonable to leave the percentage of nonfinancial activity allowed (the basket limit) unspecified in the proposal.

2. **Grandfathering.** Janet feels very strongly that we should not grandfather unitary thrift holding companies that are not currently in violation of the basket limit. Basically, she believes institutions that are over the limit should be allowed a basket limit equal to their current nonfinancial share (with perhaps some modest increase allowed in the future so they are not constantly on the verge of exceeding their limit), but they should not be allowed to expand nonfinancial activities without limit. Those currently under the basket limit should be required to remain there.

3. **Holding company guarantee.** Janet thought that the new approach was reasonable. However, it is important that the language be written so that the FDIC can force the holding company to provide resources following a bank failure. The concern is that a bank could fall below the well-capitalized threshold, and then quickly deteriorate further. The holding company should not be off the hook if the FDIC has to step in as conservator before the 180 days allowed for recapitalization have elapsed. Also, what happens in the event that the holding company cannot recapitalize the bank?

4. **Holding company capital regulation.** Janet thought the new approach for large holding companies was unworkable since the capital requirement would not be in place when it was needed, but only after an unexpected event had already threatened either the institution or financial stability. She also thought that defining "predominantly banking" as 90 percent of holding company assets accounted for by banks was potentially too lax. She is afraid that many banks would find it relatively easy to spin off 10 percent of their assets into an affiliate, and so could avoid holding company capital requirements. She would also like more information about the proposal to calculate holding company capital ratios excluding the assets and capital of some subsidiaries.

Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	To Gene Sperling from Ellen Seidman and Paul Dimond. Subject: Financial Services Modernization and community concerns (6 pages)	02/24/1997	P5 1646

COLLECTION:

Clinton Presidential Records
National Economic Council
Kathy Wallman
OA/Box Number: 10588

FOLDER TITLE:

Financial Services Modernization - Community Reinvestment Act

Jamie Metrailer
2010-0384-F
jm660

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
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THE WHITE HOUSE

WASHINGTON

February 24, 1997

MEMORANDUM FOR GENE SPERLING

FROM: Ellen Seidman
Paul Dimond

SUBJECT: Financial Services Modernization and Community Concerns

Background

In 1977, Congress passed the Community Reinvestment Act (CRA), to respond to concerns that bank deposits were not being reinvested in the community in which the bank was located. Subsequently, Congress enacted the Home Mortgage Disclosure Act (HMDA), which required banks (mortgage banks were added later) to disclose to bank regulators the number of mortgage loans they made, by gender and income category. Bank regulators were to make the information available to the public, but were extremely slow, and provided the information in an essentially useless format.

Because (i) CRA had few teeth (its only official role is that community investment is to be taken into account as bank regulators consider applications for mergers and acquisitions); (ii) the regulators of that era cared little for the role of banks in communities; and (iii) the HMDA data was virtually inaccessible, both acts remained essentially dormant throughout the 1980s. In 1989, however, as part of the S&L bailout, Congress amended HMDA to require that banks report the number of applications as well as the number of loans and the reasons applications were rejected and that the regulators make the information available far more quickly and in a much more useful manner. Although the Atlanta Constitution had been able to write a very provocative series (called "The Color of Money") about lending discrimination based on the old HMDA data, and various community groups (including the Center for Community Change) had been able to do some HMDA-based CRA complaints, the new data resulted in much greater attention to the issue. The Wall Street Journal wrote a major series of articles and regional papers covered low-income and minority lending in their regions.

As a result, Congress and community groups stepped up pressure on both banks and their regulators. Democrats on both sides of the aisle started badgering bank regulators. Based on Fannie Mae's and Freddie Mac's fairly poor showing in the HMDA data, the new legislation regulating the companies (passed in 1992) set significantly higher numerical standards for buying loans made to low-income households and in "underserved areas." And at the same time, the big wave of bank mergers and acquisitions started. Community groups learned how to use the HMDA data to target merging firms with less-than-stellar records and to get the banks to agree to greater community investment (in more than just housing) as a condition of regulatory approval for the merger.

In July 1993, the President challenged the bank regulators to improve CRA by basing its enforcement on "performance, not paperwork." The underlying thought was that without credit and access to mainstream financial services, communities cannot prosper and grow by attracting businesses and people who want to live there. Although the process took well into 1995 to complete, it was a huge success. The regulators went around the country taking testimony on what was wrong with the existing system and how to create a new system that met the President's goal. The new CRA regulations (together with improvements in regulations concerning small business loan disclosure), the activities of the regulators (particularly OCC) and the publicity given CRA ratings, provide all banks -- even those not planning to be part of a merger or acquisition -- with real incentives to serve their community.

Action in the 104th Congress

Early in the 104th Congress, the new Republican majority, led by Senators Shelby and Mack and Mr. Bereuter on the House side, started pushing a major "regulatory relief" package. There was much in these bills that was good and overdue, and much that the Administration supported. However, the bills also included major attacks on CRA and HMDA. On CRA, the favored technique was either to exempt small banks altogether, or to give "safe harbors" from consideration of community protests in the context of a merger or acquisition application for banks with ratings of "satisfactory" or higher. (As of the first quarter of 1994, over 95% of the banks and thrifts had ratings of "satisfactory" or "outstanding.") There were also a number of activities that were being treated as mergers or acquisitions that the bills proposed to exempt from the process. On HMDA, the proposal was to exempt more small entities from reporting.

The Administration made clear early in the process that any weakening of CRA would be ground for a Presidential veto of the entire regulatory relief package, no matter how many other things we supported was in it. As a result, most of the worst provisions were deleted from the Senate bill as it sailed through the Banking Committee early in the Congress. Things went a little more slowly on the House side, and while the Democrats showed remarkable cohesion and some tactical brilliance, we were never able to clean up the House bill as well as we did the Senate.

Both bills sat until the very end of the session. Then, with the Clinton Administration holding very tight on CRA and only a little less so on HMDA (we allowed the level below which reporting was not required to go up some), the regulatory relief package was passed as part of the omnibus appropriations bill. The bill that was passed was significantly better on community issues than even the Senate bill, and a vast improvement over anything we had seen in the House. We had substantial political muscle because everyone wanted the savings from BIF/SAIF. The community groups understand that we used that muscle on behalf of CRA and HMDA.

Activities since the close of the 104th Congress

After the 104th Congress ended, the Fed published a proposed revision to its Reg Y (which just went final), and the OCC went final with its new Part 5. Both these regulations deal with applications by banks to engage in new financial services activities. The Fed's regulation (i) vastly streamlines the process and (ii) allows more activities in subsidiaries of bank holding companies, i.e., affiliates, but not subsidiaries, of banks. The OCC streamlined the process but, particularly in its examiner guidance, tried hard to protect and even enhance the relevance of CRA to determinations. It also proposes to allow more activities in bank subsidiaries, not affiliates. The critical thing from a community perspective about this arcane legal distinction is that if the activity is carried out in a subsidiary of a bank (i) the profits of the activity go to the bank, which then has more money for community activities and (ii) the assets of the subsidiary are taken into account by the OCC in determining the bank's capacity to serve its community. More assets mean more capacity. Neither condition applies if the activity is in an affiliate.

Community groups protested both regulations, but definitely are more displeased with the Fed. The OCC has largely been able to satisfy the community groups with the examiner guidance and by persuading them that CRA actually will apply more fully to all of the assets and subsidiaries of the bank. In sum, the OCC regulation implements the President's policy to use CRA to expand credit and the reach of financial services to all communities, which the Fed's regulation does not.

Current state of play

Community groups have come to recognize how terribly powerful CRA has been as a tool for making credit and financial services available in previously underserved communities. By some counts, $90 billion of CRA-based commitments have been made since this administration took office. HMDA data suggests that the number of mortgages made in low- and moderate-income communities is up 22% and to minorities 33% between 1993 and 1995 (compared with an overall increase in number of mortgages of 10%). The power of the disclosure, the ratings, the regulations and the regulators to get results is beyond anything these groups have been able to accomplish in the remainder of the financial services industry, where the best they get is philanthropy, some social investing, and purchases of municipal bonds. So anything that diminishes the reach of the banking regulators, and of CRA, is troublesome to these groups.

Financial services modernization is attractive to policy experts and some members of the financial services community because the roles of various types of financial institutions are changing rapidly. Mutual funds now hold more money than banks hold in deposits. Finance companies, such as General Motors Credit Corporation and GE Capital, are major consumer and, increasingly, business lenders. Banks are in the securities brokerage and, increasingly, underwriting, business, and are rapidly expanding their reach into insurance. Merrill Lynch owns a thrift. The system seems to call out for legal rationalization to increase efficiency and competitiveness. On the other hand, as with all regulatory systems, many of the players are interested only in getting into others' turf, and will oppose legislation that allows others into theirs; regulators want to retain control of institutions and assets; and clever businessmen and lawyers have found their way around many of the legal barriers and don't want to risk the legislative process. Community groups, in this mix, are concerned that modernization will increase the flow of funds out of banks and into entities not subject to CRA -- including, in the Fed model, bank affiliates.

Financial services modernization bills have been introduced in both the House (3 bills) and Senate (1 bill), and hearings have started in the House. The Treasury Department is statutorily required to submit a report to Congress on the subject by March 31, and they very much want to include legislation as part of that report. The critical issues with respect to the legislation are turning out to be:

- Will there be any legislation at all? (The expansion of at least the financial companies into each others' business is well underway under existing law, and one option is to do what the country did on interstate banking: allow the process to get 80% of the way home, and then ratify and simplify it.)

- If there is legislation, to what extent will it allow commercial -- rather than just financial -- firms to own banks, i.e., could General Motors own Citicorp? (Leach would prohibit any overlap; Roukema would allow 25% of the assets of a combined company to be non-financial; D'Amato and Baker would allow full integration; Treasury seriously considered allowing full integration but is getting much negative heat from folks who really would prefer not to have any legislation at all.)

- Will either or both of non-traditional banking activities (e.g., insurance and securities brokering) or commercial activities be able to be carried on in a subsidiary of a bank, rather than an affiliate? (Leach and Roukema say subs are acceptable, although Leach has since changed his position; D'Amato and Baker say affiliates only for most things; the Treasury position will very definitely be to allow subsidiaries.)

Community groups, together with their consumer brethren, have stated they are concerned about concentrations of financial power, distortions of the credit and equity markets, and unfair (even if not technically illegal) tying of services if banking and commerce are combined. They strongly feel (although the data, such as it is, seems to contradict this) that the bank mergers of the last several years have hurt communities, particularly small communities, by removing the local banker and substituting a megabank -- larger, more impersonal, and less caring of the community. They assert this will be even worse if commercial firms can own banks.

As we move into the next phase of financial services modernization, therefore, the community groups are (i) strongly resisting any legislation at all -- for fear CRA will get caught up in the mix and that the Administration (and, indeed, many Democrats) will not hold tight when presented with a decent modernization bill; (ii) are resisting a combination of banking and commerce ~~if there~~ must be legislation; and (iii) prefer the subsidiary to holding company model, but think this is not nearly as important as the other two issues -- i.e., if we win this one and lose the others, the community groups will regard the whole exercise as a loss, and will probably feel we betrayed them -- and the President -- in the bargain.

Concluding thoughts

The strategy of this issue is going to be very tricky. It is extremely complex, and except for the Administration, a few Democrats, perhaps Senator D'Amato for the next several months and the community groups, no one cares about the impact of the legislation on CRA or, indeed, communities. To make people care, we're going to have to be specific and tough and to ask for more than we'll get but understand where our ultimate line in the sand is. Full integration of banking and commerce is good policy, but perhaps more importantly, a position we're going to have to start with to get people who want to tank us on the other issues -- CRA and affiliate/subsidiaries -- to the table.

Addendum from Paul

(Ellen couldn't do this justice in a rewrite. She agrees with its essential points, although thinks political reality checking is in order on the potential backlash damage to CRA the position stated in the first paragraph might do.)

On CRA, in particular, Paul believes that the President should make clear his firm and unalterable position: The President will sign no financial modernization bill -- regardless of the form in which banking activity is authorized -- unless CRA applies to all financial activities that could have been done in the bank or a bank subsidiary: (i) of the bank; (ii) of the bank's subsidiaries; and (iii) of the bank's holding company and its non-bank subsidiaries. Paul further believes that the President should announce this position at an event on the South Lawn of the White House (or other appropriate Presidential venue) to celebrate the tremendous results of the reform he directed of the CRA regulations (as well as consistent pressure on HMDA and the Fannie/Freddie goals). The President should be joined by community groups, mayors, and major financial leaders (including major banks and thrifts, Fannie and Freddie, home mortgage lenders) and any other major financial institutions we can get to stand up, and Chairman Greenspan, the rest of the Fed, Comptroller Ludwig, FDIC, OTS, Secretaries Rubin, Cuomo, and Daley, and OMB Director Raines. [We could even invite members of Congress as we did four years ago!]

At this event and announcement, the President should further request the bank regulators, Secretaries Rubin, Cuomo, Daley and Director Raines to conduct a series of meetings in communities throughout the country to get advice from banks, thrifts, other financial institutions, CBOs and CDFIs, mayors and other community and business leaders as to how best to assure that we build on what the past four years have proven to work: extend the wellspring of private capital and financial services on a safe and sound basis to credit-worthy home-buyers, businesses, entrepreneurs, and CBOs in all communities in America. This process is precisely what happened after the President's direction to reform CRA in 1993, and it brought the regulators, the banks and the CRA community together on CRA reforms; it also created a new appreciation with all stakeholders of the opportunities and responsibilities for implementing CRA. The President should tout this success and direct the participants to go forth again -- on both CRA and a challenge to non-bank financial institutions on what they can do voluntarily -- and report back, to the President and to the American people.

This event, announcement, and direction will -- once again -- enable the President to dominate the playing field in a way that will show his leadership and will command respect from all -- including particularly Congress and the regulators. Whatever financial modernization bill may (or may not) emerge, the President will be the one with the power to shape the outcome and to continue to expand the spirit -- if not the letter of CRA and HMDA -- across a financial services landscape that is rapidly changing in a direction that will make traditional banks and banking activity a smaller and smaller portion of financial services in the future. This new landscape presents the real risk of having the major gains of CRA in the past four years erode over time. Only such a firm Presidential announcement, direction and open process with the regulators and Administration principals out in the country will enable the President to achieve what no one ever thought possible four years ago in this rapidly changing environment for financial services: to expand access to capital and financial services in low- and moderate-income communities. Once again the President can demonstrate that when he acts firmly, prudently, creatively, and publicly, more good things can happen than anyone except you [Gene] and the President ever dreamed possible.

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Kara Morrow to Maureen T. Shea at 09:37:38.00. Subject: RE: Community Reinvestment Act. (partial) (1 page)	04/21/1999	P6/b(6)
002a. email	Peter Rundlet to Maria Echaveste re: Revised CRA Decision memo (2 pages)	04/11/1999	P5 1639
002b. memo	Robert Rubin, larry Stein, Chuck Ruff, Gene Sperling, Bruce Reed to The President and the Vice President re: Community Reinvestment Act (CRA) Strategy Memo (4 pages)	04/07/1999	P5 1640

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
WHO ([Financial Services Modernization, Community Reinvestment])
OA/Box Number: 500000

FOLDER TITLE:

[03/03/1999 - 10/19/1999]

2010-0384-F
ab953

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

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b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Peter Rundlet (CN=Peter Rundlet/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME:11-APR-1999 20:27:34.00

SUBJECT: Revised CRA decision memo.

TO: Maria Echaveste (CN=Maria Echaveste/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

CC: Clara J. Shin (CN=Clara J. Shin/OU=WHO/O=EOP @ EOP [WHO])
READ:UNKNOWN

TEXT:
Attached below is a draft memo to the President about the status and substance of the House and Senate bills on financial services modernization and, in particular, their impact on the Community Reinvestment Act. It is not clear to me that there is agreement to send this up yet, but I thought you might want to see it. If you have any comments, please let me know.

---------------------- Forwarded by Peter Rundlet/WHO/EOP on 04/11/99 08:24 PM ---------------------------

Paul J. Weinstein Jr.
04/09/99 10:27:56 AM

Record Type: Record

To: Michael.Barr @ do.treas.gov @ inet, Marne.Levine @ do.treas.gov @ inet, Sarah Rosen/OPD/EOP @ EOP, Peter Rundlet/WHO/EOP @ EOP
cc:
Subject: Revised CRA decision memo.

---------------------- Forwarded by Paul J. Weinstein Jr./OPD/EOP on 04/09/99 10:26 AM ---------------------------

Paul J. Weinstein Jr.
04/08/99 06:51:57 PM

Record Type: Record

To: "LEVINEM%DOM3.DOPO5" <MARNE.LEVINE @ MS01.DO.treas.sprint.com, "BARRM%DOM3.DOPO6" <Michael.Barr @ MS01.DO.treas.sprint.com>, Sarah Rosen/OPD/EOP, Peter Rundlet/WHO/EOP,
cc: Bruce N. Reed/OPD/EOP
Subject: Revised CRA decision memo.

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D13]MAIL46774641Z.136 to ASCII,
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001a. memo	To Ronald Jones from Ellen Seidman. Subject: Treasury report on HR 10 Financial Services Competition Act (Annotations) (1 page)	07/14/1997	P5
001b. draft	re: Administration's principal concerns about H.R. 10 (Annotations) (13 pages)	07/14/1997	P5
002. memo	To Ronald Jones from Ellen Seidman. Subject: Treasury report on HR 10 Financial Services Competition Act (Annotations) (1 page)	07/14/1997	P5
003a. memo	To President Clinton from Todd Stern. Subject: Financial Services Modernization (Notations) (1 page)	05/18/1997	P5 4101
003b. memo	To President Clinton from Robert Rubin. Subject: Treasury's Financial Modernization proposal (1 page)	05/16/1997	P5 4102
003c. memo	To President Clinton from Gene Sperling. Subject: Attached memorandum on Treasury's Financial Modernization proposal (1 page)	05/16/1997	P5 1641
003d. memo	To President Clinton from Gene Sperling. Subject: Request for decision concerning Treasury's Financial Services Modernization proposal (14 pages)	05/16/1997	P5 1642

COLLECTION:
Clinton Presidential Records
National Economic Council
Ellen Seidman
OA/Box Number: 13058

FOLDER TITLE:
Financial Services Reform - 1997 [1]

Jamie Metrailer
2010-0384-F
jm656

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
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P3 Release would violate a Federal statute [(a)(3) of the PRA]
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b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Michael Barr — 622-5672

LRM ID: REJ172 **SUBJECT:** TREASURY Report on HR10 Financial Services Competition Act

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RESPONSE TO
LEGISLATIVE REFERRAL
MEMORANDUM

If your response to this request for views is short (e.g., concur/no comment), we prefer that you respond by e-mail or by faxing us this response sheet. If the response is short and you prefer to call, please call the branch-wide line shown below (NOT the analyst's line) to leave a message with a legislative assistant.

You may also respond by:

(1) calling the analyst/attorney's direct line (you will be connected to voice mail if the analyst does not answer); or

(2) sending us a memo or letter

Please include the LRM number shown above, and the subject shown below.

TO: Ronald E. Jones Phone: 395-3386 Fax: 395-3109
Office of Management and Budget
Branch-Wide Line (to reach legislative assistant): 395-3454

FROM: 7/14/97 (Date)
Ellen Seidman (Name)
NEC (Agency)
65359 (Telephone)

The following is the reponse of our agency to your request for views on the above-captioned subject:

_____ Concur

_____ No Objection

_____ No Comment

X See proposed edits on pages 1-8, 10-13

_____ Other: ____________

_____ FAX RETURN of ____ pages, attached to this reponse sheet

this will be read as a strident "NO!!!" response which it's not — we will take Treasury/Admin out of the ballpark. ~~It~~ It needs to be toned down.

OTS has provided Treasury with some serious concerns about how the grandfather provisions of Title III will work - they are currently unworkable. Some of this ~~should~~ needs to be added. Also, the WFI section needs to raise the question whether these WFIs are worthwhile. Also, consideration of how the reverse basket works. Finally, given Treasury's record on FRB

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THE ADMINISTRATION'S PRINCIPAL CONCERNS ABOUT H.R. 10

The Financial Services Competition Act of 1997 As Reported by the House Committee on Banking and Financial Services

July __, 1997

DRAFT -- July 14, 1997, 01:37 am

In approaching financial modernization legislation, the Administration has three key objectives. First, to protect the federal deposit insurance funds and the safety and soundness of our financial system. Second, to reduce costs and increase access to financial services for consumers, businesses, and communities. And third, to promote innovation and enhance the worldwide competitiveness of the U.S. financial services industry.

As the Commerce Committee considers financial modernization legislation, we would like to express our principal concerns about H.R. 10 as reported by the Committee on Banking and Financial Services (the "bill"). We look forward to working with Members to resolve these concerns.

Safety-and-Soundness Safeguards

Lack of Divestiture Requirement

Sections 103, 141, and 142 of the bill establish a framework under which an FDIC-insured depository institution can affiliate with a company engaged in nonbanking activities. Although these sections deal with different types of affiliations,[1] they each require the depository institution to be well-capitalized and well-managed. If regulators find a capital or managerial deficiency, these sections would require regulators to give

[1] Section 103 governs holding company affiliations -- i.e., between a depository institution and its parent company or any subsidiary of that company. Section 141 governs subsidiaries of national banks. Section 142 governs subsidiaries of state banks.

formal notice of the deficiency to the regulated entity (i.e., the holding company or the institution itself, depending on the type of affiliation involved), and then give that entity 45 days to execute an agreement to correct the deficiency within a reasonable time. But unlike the Treasury's proposal, those sections would *not* require the affiliation to terminate if the depository institution persistently fails to remain well-capitalized and well-managed. The bill makes divestiture merely an *option* for the depository institution's primarily federal regulator, and creates no safeguards against excessive forbearance.

We believe that termination of the affiliation should be *mandatory* if the depository institution fails to correct its capital or managerial deficiencies after being given a reasonable opportunity to do so (as set forth above). Specifically, if the deficiencies were not corrected within 180 days, we would require that the affiliation (or, at the regulated entity's election, the nonbanking activities) terminate then or within such additional time as regulators may allow.

The prospect of mandatory termination would give a depository institution's owners and managers strong incentives to keep the institution well-capitalized and well-managed -- and thus minimize the chances of it ever causing a loss to the FDIC. In our view, these rules strike a reasonable balance between mandatory safeguards and regulatory discretion.

At the very least, this legislation should include a strong *presumption* in favor of terminating the affiliation when an institution fails to execute a timely, acceptable agreement to correct a capital or managerial deficiency, or fails to correct the deficiency within the period prescribed in the agreement. Specifically, we would require that the affiliation terminate unless regulators determined in writing that its continuation would best serve the interests of the deposit insurance fund, in view of (1) how terminating the affiliation would affect the depository institution's prospects, and (2) how permitting this affiliation to continue would affect other FDIC-insured depository institutions' incentives to become and remain well-capitalized and well-managed. To help assure continued regulatory vigilance, we would also require regulators to review such determinations every six months if the capital or managerial deficiency persisted.

Holding Company Commitment to Keep Its FDIC-Insured Depository Institutions Well Capitalized

The bill should include section 121 of the Treasury proposal, which would require a bank holding company -- as a condition of qualifying for broader affiliations -- to make

COPY

I really think we need to add something on the obligation of a non shell parent under the reverse basket — that is, there should be such an obligation

an acceptable written commitment that it will either keep its FDIC-insured depository institutions well capitalized or will divest them in a manner that leaves them well capitalized. Such a commitment would strengthen the holding company's incentives to keep its insured depository institutions safe and sound, and would thus help protect the federal deposit insurance funds.

Insurance Powers of National Banks and Their Subsidiaries

We strongly oppose section 151 of the bill as discriminatory and anticompetitive.

Section 151 could have a serious adverse effect not only on future national bank insurance-related activities but also on banking activities that any single state insurance regulator may label "insurance." It would bar national banks from engaging as principal in "insurance" activities unless (1) the OCC has authorized the activity in writing before January 1, 1997, or (2) one can show that national banks have engaged in the activity before that date. By labeling a product or activity "insurance," any state insurance regulator could bar national banks from engaging in the activity unless one of those two tests were met or unless, through an elaborate process, the National Council on Financial Services found the product or activity not to be insurance. Thus a state regulator's labeling of a product or activity as "insurance" would not simply mean that it would be *regulated* as insurance; it may result in *prohibiting* all national banks from engaging in the activity at all.

Many state laws currently define "insurance" to include activities -- such as indemnities, guarantees, and acting as a surety -- that could be construed to cover many banking functions. Thus section 151 could cut off current and future banking-related functions unless one of the two documentation requirements above is satisfied or someone successfully runs the gamut of the Council process to prove that the activity is not insurance. The bill would impose no similar restrictions on state banks.

State regulation of insurance activities conducted by national or state banks is an entirely legitimate issue. But the solution is not to deprive national banks of their current powers to conduct activities that may be found to be part of or incidental to banking just because those activities may also be labeled "insurance" activities. Section 151 should be amended by modifying the provisions unduly restricting bank powers, and by changing the issue to be determined by the National Council to whether a particular product should be *regulated* as an insurance product or a banking product. This would preserve the states' role in regulating insurance activities while not undermining the national bank charter.

because . . .

Section 151's use of the term "product" (in addition to "activity") is also unduly restrictive.

The procedures prescribed by section 151 are seriously flawed. The process by which the National Council on Financial Services would review state insurance regulators' challenges to OCC rulings on permissible insurance products is unduly time-consuming and cumbersome. In an effort to mitigate some of the defects of that process, section 151 would have the Federal Reserve Board determine whether a petition presents a substantial question for review by the Council. But that use of the Federal Reserve as a gatekeeper for the Council and check on the OCC is objectionable. And section 131, by requiring the Federal Reserve to defer to state regulators in interpreting state insurance law, would defeat the ostensible purpose of such screening by virtually assuring that any state regulator's petition would present a substantial question.

The bill would also retain current law regarding the insurance agency powers that national banks can exercise directly, including the restriction on offering insurance only from towns whose population does not exceed 5,000. We strongly believe that meaningful financial services reform should remove such outdated and cumbersome barriers to competition and permit national banks to conduct full insurance agency activities from any location as long as they do so in accordance with state law generally applicable to all insurance providers in the state. (Roughly half of the states permit their state-chartered banks to sell insurance without regard to local population size and without having to set up separate subsidiaries or affiliates.)

Similarly, there is no reason to prevent financial subsidiaries of national banks from engaging as principal in the full range insurance activities. The subsidiaries would be subject to state law applicable to insurance providers in the state. The capital deduction and other safeguards applicable to such subsidiaries would protect the parent bank from any risks in the subsidiary and prevent the subsidiary from having funding or other competitive advantages over other insurance providers.

Section 151(c), which would generally prohibit national banks and their subsidiaries from underwriting or selling title insurance, is a particularly egregious example of special-interest protectionism. If its goal really were consumer protection, then it logically should apply to national and state banks alike. Yet the prohibition would single out national banks, which are strictly regulated and have long engaged in selling title insurance.

National Council on Financial Services

We support creation of a National Council on Financial Services, but we have several concerns about provisions of the bill relating to the Council. Section 121(b) would provide for the appointment of one individual with experience in state-level securities regulation, one individual with experience in state-level bank supervision, and two members with state-level insurance regulation. We believe that one insurance member would suffice.

The Banking Committee's changes in the membership of the Council, together with the creation of an Advisory Council on Community Revitalization, would significantly increase the costs charged to each member agency. The Treasury's proposal contemplated seven agency members and one appointed member, with the member agencies sharing the appointed member's expenses pro rata. Section 121 would provide for six agency members and four appointed members. Section 123 creates an Advisory Council with five additional appointed members. The bill specifies that the six member agencies would, pro rata, bear the expenses of all nine appointed members. Budget authority is needed to cover at least some of these expenses.

Finally, section 123 does not clearly specify the duration of the Advisory Council. It implies that the Advisory Council will have a limited life, since members will be appointed "for the life of the Advisory Council" and since the Advisory Council's reporting obligations terminate after five years. We recommend inclusion of a sunset provision to take effect at that time.

Bank Holding Company Capital

Section 133 of the bill would give the Federal Reserve Board excessively broad authority to impose capital requirements on bank holding companies. Despite captions that suggest significant constraints on the Board's discretion (e.g., "FOCUS ON DOUBLE LEVERAGE"), that discretion is essentially open-ended. We urge the Committee to strike this section -- and thus preserve current law -- or replace it with section 143 of the Treasury proposal.[2]

Again, this is a place to say something about the leverage basket

[2]Note that even as section 133 would authorize intrusive capital regulation of bank holding companies, section 103 would remove the last meaningful restrictions on companies controlling grandfathered nonbank banks, while preserving those companies' complete exemption from bank holding company regulation.

COPY

Don't you mean coordinated but separate authority?

Wholesale Financial Institutions

Sections 161 and 162 of the bill, dealing with wholesale financial institutions (WFIs), are seriously flawed. We urge the Committee to substitute sections 171, 172, and 173 of the Treasury proposal. [Move to here the basic "is it worth it?" argument from the bottom of the next page. 156

Discriminatory Policy-Setting

Section 161 of the bill would essentially give the Federal Reserve exclusive control of policy relating to WFIs -- including rulemaking, other standard-setting, and exemptions -- even if the WFIs have national bank charters. We strongly object to this subversion of the dual banking system. The section should be modified to give the Federal Reserve and the Comptroller of the Currency joint rulemaking authority regarding such matters as capital standards, capital categories for prompt corrective action, and exemptions from other laws. The Federal Reserve should have unilateral authority to protect the payments system (in addition to the Board's existing authority) by taking into account the financial condition of a WFI's affiliate when setting credit limits or by prescribing special clearing balance requirements for WFIs.

WFIs are better than this! (We were even close to saying no need for WFIs under our original proposal)

Inadequate Safeguards

Section 161 of the bill contains inadequate safeguards to protect consumers, the payments system, and the taxpayers. The Federal Reserve Board may exempt WFIs from most provisions of law (i.e., those other than the WFI statute) as long as the exemption is "not inconsistent" with a vague set of objectives, which include "the protection of the deposit insurance funds" and "the protection of creditors and other persons . . . engaged in transactions with" WFIs. Similar objectives govern the process of setting capital requirements for WFIs. The "minimum tier 1 capital ratio" imposes little constraint on regulatory laxity because "tier 1 capital" is a regulatory construct meaning what regulators say it means. By contrast, section 171(g) and (h)(3) of the Treasury proposal provides stronger, clearer requirements designed to protect the taxpayers and the financial system from risks associated with WFIs' access to the payments system and the discount window, and to minimize any moral hazard related to that access.

the comma is important

Section 161 would in effect permit WFIs to serve retail customers, who need deposit insurance and consumer protections. It would require only an "initial deposit" of $100,000 or more in a WFI, and would permit the WFI to derive up to 5 percent of its total deposits from accounts with initial deposits of less than $100,000. The bill should be amended to screen out retail customers. Section 171(f)(1) of the Treasury proposal

COPY

We're always open
why single this out?

would require a $100,000 minimum balance, with no 5 percent leeway. ~~We would be open to other approaches that effectively screen out retail customers.~~ We also believe that regulators should be able to exempt a WFI from the consumer protections of section 112 only if they specifically determine that the WFI does not sell investment products to customers needing the protections of that section (section 171(f)(4) of the Treasury proposal).

Section 161 purports to apply to WFIs the prompt corrective action provisions of the Federal Deposit Insurance Act. But those provisions have as their lodestar the purpose expressed in section 38(a)(1) of that Act: namely, "resolving the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund." Because WFIs are uninsured, this purpose logically does not apply; it certainly fails to provide clear guidance for dealing with WFIs. Section 171(e)(2) of the Treasury proposal would avoid this pitfall by specifying that, in the case of WFIs, the purpose of prompt corrective action shall be to protect taxpayers and the financial system from risks associated with WFIs' access to the payments system and the Federal Reserve discount window.

Insolvency

~~If~~ The Treasury proposal (sections 171(i) and 173) ~~were adopted,~~ provide that failed WFIs would be resolved under the Bankruptcy Code -- thus sending an important signal to capital markets that creditors of WFIs should not expect troubled WFIs to receive special treatment, as if they were too big to fail. ~~This should be included in the~~ The bill should be amended to include this provision.

WFI Holding Company Regulation

The bill would subject WFI holding companies (i.e., companies that own a WFI but not an FDIC-insured depository institution) to regulation under the Bank Holding Company Act. Despite the extreme complexity of the WFI holding company provisions, it is not clear whether they provide much more flexibility than other provisions of the bill, notably those that (1) define a broad range of investment activities, including merchant banking, as financial; (2) permit a qualified bank holding company to derive 15 percent of its revenues from nonfinancial activities; and (3) permit a nonfinancial company to control a full-service, FDIC-insured bank with revenues up to 15 percent as large as its own. For example, section 162 refers to ownership of nonfinancial companies that "would not otherwise be permitted under this Act," and yet requires that the nonfinancial company be "sufficiently small such that the financial nature of the bank holding company is unaffected" and suggests that the holding company should generally derive

I really think this (and having WFIs at all) should be rewritten as such + moved up.

COPY

no more than 5 percent of its revenues from such companies. It is difficult to determine how the WFI provisions relate to the rule permitting a qualified bank holding company to derive us to 15 percent of its revenues from nonfinancial activities -- and whether they are more restrictive or less restrictive. Likewise, although section 106 would permit a large nonfinancial company to control a full-service, FDIC-insured bank, section 162 would not permit such a company to control a WFI.

We see no need for the bill's restrictive complexity. Under the safeguards provided in sections 171-173 of the Treasury bill, there is no need to apply the Bank Holding Company Act to WFIs with no FDIC-insured affiliates. An acceptable alternative might be to limit ownership of WFIs to companies that derive a specified percentage of their domestic gross revenues from financial activities. Requiring, for example, that a company derive at least 50 percent of such revenues from financial activities would provide strong assurance that only companies significantly involved in providing financial services would own WFIs.

exactly why do we care?

Functional Regulation

Bank-Issued Securities

Unlike sections 205 and 206 of the Treasury proposal, the bill does not transfer oversight of bank-issued securities from the banking agencies to the SEC. We see no justification for continuing the present system of overlapping and duplicative functions by four banking regulators and the SEC. For the most part the banking regulators already administer these functions comparably to SEC regulation. Where different treatment of banks and nonbank issuers may be necessary for safety and soundness or other reasons, the SEC would make appropriate adjustments after consulting with the appropriate banking regulator. ~~Thus~~ Consolidating these functions in the SEC would promote efficiency in government and reduce regulatory costs. It would be consistent with the goals of functional regulation by ensuring uniformity of regulation and enforcement.

Authority to Define Banking Products

Section 152 of the bill authorizes the Federal Reserve Board -- rather than the National Council on Financial Services -- to decide whether a product is a "banking product" exempt from broker-dealer regulation under the Securities Exchange Act, thus potentially giving a single banking agency a decisive influence over future product innovation and financial structure. Vesting this authority solely in the Federal Reserve fails to provide the SEC with a voice on an issue that directly affects its mission, excludes the views of the other banking regulators even though the determination applies to depository institutions within their primary jurisdiction, and denies the Council dispute resolution authority for which it is well designed.

A better approach would involve a joint determination of the issue by the SEC and the bank's primary federal regulator, with the Council resolving any disputes (as under section 207 of the Treasury proposal). The procedure is designed to accommodate fully the views of both the SEC and the banking regulator and to encourage them to resolve differences without having to resort to a Council determination. If they were unable to agree, the Council would be the appropriate arbiter because its membership would consider the issue from a broad financial services perspective.

Section 152 specifies that, for purposes of the banking-product exemption from broker-dealer regulation, swap agreements are banking products unless the appropriate federal banking agencies determine that "credit swaps and equity swaps" should not be included. In our view, the status of swap agreements for purposes of broker-dealer regulation is sufficiently unclear that it should be resolved in due course by the banking regulators and the SEC jointly (as under section 207 of the Treasury proposal), with the Council as a back-up, rather than by statutorily defining swaps as a banking product.

Municipal Securities Regulation

Unlike sections 201 and 202 of the Treasury proposal, the bill does not exempt from broker-dealer regulation banks' municipal securities activities, including activities involving general obligation securities that banks have long conducted under the existing regulatory framework. We believe the existing regulatory framework should be preserved, and extended to municipal revenue securities, by including the exemptions we have proposed for municipal securities activities. The established system has worked well and does not require modification.

Requiring Deference to the SEC and State Insurance Regulators

New section 5(c)(5) of the Bank Holding Company Act, added by section 131, creates uncertainties regarding the Federal Reserve's regulation of bank securities and insurance activities. Read literally, it would require the Federal Reserve, in administering the Bank Holding Company Act, to: (1) defer to the SEC regarding "all interpretations and enforcement" of applicable Federal securities laws relating to broker-dealers, investment advisers, and investment companies; and (2) defer to the relevant state insurance authorities regarding "all interpretations and enforcement" of applicable state

COPY

insurance laws relating to insurance companies and agents. While we normally would expect the Federal Reserve, as a matter of regulatory comity, to provide some deference to the SEC and state insurance regulators, the amendment could inappropriately undermine the Fed's exercise of independent authority under the BHC Act.

This section, when taken together with the powers of national banks in section 151, would further confusion over regulatory authority. Section 151 would give the Federal Reserve the authority to determine whether disputes between the Comptroller and insurance or securities regulators should be sent to the National Council. If the Federal Reserve must always defer to the SEC and insurance regulators, it would never be able to determine that the Comptroller's positions had more merit than those of the ~~other regulators~~. regulators to whom it is statutorily bound to defer.

National Association of Registered Agents and Brokers

This seems really weak

We see logic in establishing a self-regulatory organization for insurance agents and brokers, as under title IV of the bill. But such an organization must not become a means by which one group of competitors ~~gang up on~~ can gain a legally sanctioned advantage over another -- e.g., by discriminating against agents and brokers because they are affiliated with depository institutions.

Title IV not only fails to prohibit such discrimination but would actually facilitate it. The new self-regulatory organization, to be known as the National Association of Registered Agents and Brokers (NARAB), could adopt uniform licensing standards for sellers of products that any state labels as "insurance." Because Congress would have specifically authorized this rulemaking, depository institutions could no longer use the principles articulated in the Supreme Court's *Barnett* decision to attack NARAB standards that are discriminatory in purpose or effect.

Federal Home Loan Bank System

The Federal Home Loan Bank System has structural flaws that raise serious policy and safety and soundness concerns. Changes in housing finance, technology, and the System's membership have rendered the System's 65-year-old structure obsolete, and raise questions about the allocation and effectiveness of the System's federal subsidy. For example, ~~Consider, for example, the following three points. First~~, there is no effective mechanism for assuring that borrowings by the System, as well as advances by the System to its members, directly promote the System's public purposes. ~~At the end of May, the System had \$303 billion in outstanding liabilities but only \$168 billion in advances. The remainder funded nearly \$150 billion in investment securities that are unrelated to the~~

COPY

System's mission. Moreover, a majority of the System's outstanding advances ~~have a remaining~~ maturity of one year or less, which suggests that they are ~~generally~~ not serving as a long-term funding source for home mortgage lending. ~~Thus,~~ while Congress created the System to facilitate the availability of credit ~~for~~ mortgages, insured depository institutions may join the System with limited mortgage assets and no mortgage loans. And, once a member, the institution need not maintain any mortgage assets. With several thousand commercial bank members, more diversified lending by thrifts, minimal eligibility standards based on mortgage lending, and no accountability for how advances are used, there is no public accountability for ensuring that federally subsidized funds ~~passed on to members as advances~~ promote their intended public ~~purpose~~. Second, the System's required capital is not sensitive to the risks undertaken. And, ~~Third,~~ the 12 FHLBank presidents earn considerably more than their Federal Reserve Bank counterparts yet arguably have considerably fewer responsibilities and less difficult jobs. ~~The~~ unconstrained compensation of FHLBank ~~officers siphons off~~ some of the System's subsidies and encourages the search for extraneous activities that may be used to justify even ~~higher compensation.~~

The ~~FHLBank provisions contained in the bill would likely~~ expand the size of the System without ~~increasing its focus on meeting a clearly defined~~ public purpose. The bill contains some positive provisions such as eliminating mandatory membership and fixing the REFCorp allocation formula, and adding a risk-based element to FHLBank capital requirements. However, the bill would ~~open~~ open FHLBank membership to insured depository institutions with less than $500 million in assets without *any* limit; increasing ~~significantly increase~~ the membership and advance activity of large financial institutions; placing ~~place~~ only modest limitations on investments, ~~and then only~~ at the discretion of the Finance Board; and create 12 different capital structures. ~~The net result of these amendments would likely be an unfocused increase in FHLBank advance activity (especially among large financial institutions) and only limited reform of the FHL Banks' investment activities.~~ likely expand the size of the System without responding to its underlying problems,

For the FHLBank provisions in the bill ~~to be acceptable~~, several fundamental changes ~~would be necessary. In particular,~~ the bill should strengthen the nexus between advances and mission-related activities by establishing a continuous mission-related asset test, limiting a member's access to advances to a percentage of its mission-related assets, and maintaining an overall cap on advances. by ~~We believe that this may best be~~ This could be accomplished by (1) requiring all members with more than $100 million in assets to continually maintain at least 10 percent of their assets in whole mortgage loans, (2) limiting a member's advances to no more than 25 percent of their mortgage assets, (3) removing the stock purchase ceiling for large institutions, and (4) limiting a member's

We believe

advances to 20 times its FHLBank capital stock and a FHLBank's debt to 20 times ~~its~~ capital.

pilot program

The bill should also curtail the investment arbitrage activities of the FHLBanks through more specific limitations on investment activities. ~~If Congress intends~~ to permit the Finance Board ~~to approve pilot programs, we believe~~ the parameters of ~~such a process~~ and the levels of such activity should be explicitly set in the legislation. ~~System debt~~ outstanding should not be permitted to exceed advances outstanding ~~and prepaid~~. Since pilot programs reflect a broadening of System ~~activities~~ beyond those permitted by Congress, Congress should ~~at least be~~ setting careful limitations on program expansions and define the ~~acceptable purposes of pilot programs~~.

~~In addition, the bill should lower~~ the size threshold for loosened ~~membership rules and expanded access to advances from $500 million to $100 million~~. We recognize the concerns raised by some community institutions that the 10 percent whole loan test may be difficult to meet and we recognize that some small depository institutions believe they are facing increasing difficulty obtaining funding. Thus, we support easing, to some extent, FHLBank access for small institutions. However, we believe that $100 million is a sufficient cutoff point as it would cover about 6200 banks, nearly 1000 thrifts, and over 10,000 credit unions. We urge lowering the $500 million threshold — which covers over 8700 banks and over 1500 thrifts — to $100 million.

In addition to these fundamental changes, the Treasury believes other aspects of the bill could be significantly improved. While the bill proposes numerous changes to increase the permanence of the FHLBanks capital structure, it could be improved upon by tightening the stock redemption rules. The bill should also include prompt corrective action rules parallel to those applicable to FDIC-insured depository institutions. Excessive compensation of FHLBank officers should be checked by establishing pay comparability with Federal Reserve Bank officers. Finally, since the Finance Board's revised oversight responsibilities will be less time consuming, we recommend that two of the appointed directors be made part-time (leaving the Chairman as the only full-time member of the Finance Board).

FDIC Board

In the context of abolishing the federal thrift charter, ending the separate regulation of thrift institutions, and combining the OTS with the OCC, we support restoring the FDIC's Board of Directors to the three-member configuration it had for 56 years until 1989 (when the OTS was established). This included 12 years with a three-member board fully subject to the Government in the Sunshine Act.

Section 334 of the bill would, at an additional cost of over $1 million annually, maintain a five-member Board of Directors. No showing has been made that the FDIC needs a five-member board to get its work done. Indeed, the only case that has been advanced for the five-member size has been the agency's desire to avoid the constraints of the Government in the Sunshine Act. We believe that to be an inadequate reason to justify the expenditures involved. The federal government currently includes at least ~~eight~~ three-member boards: the Farm Credit Administration, Merit Systems Protection Board, National Credit Union Administration, National Mediation Board, Occupational Safety and Health Review Commission, Pension Benefit Guaranty Corporation, Railroad Retirement Board, and Tennessee Valley Authority.

not applicable, as all the members are cabinet secretaries + designees can sit,

COPY

LRM ID: REJ171 SUBJECT: TREASURY Testimony on HR10 Financial Services Competition Act

RESPONSE TO
LEGISLATIVE REFERRAL
MEMORANDUM

If your response to this request for views is short (e.g., concur/no comment), we prefer that you respond by e-mail or by faxing us this response sheet. If the response is short and you prefer to call, please call the branch-wide line shown below (NOT the analyst's line) to leave a message with a legislative assistant,

You may also respond by:
(1) calling the analyst/attorney's direct line (you will be connected to voice mail if the analyst does not answer); or
(2) sending us a memo or letter.
Please include the LRM number shown above, and the subject shown below.

TO: Ronald E. Jones Phone: 395-3386 Fax: 395-3109
Office of Management and Budget
Branch-Wide Line (to reach legislative assistant): 395-3454

FROM: 7/14/97 (Date)
Ellen Seidman (Name)
NEC (Agency)
65359 (Telephone)

The following is the reponse of our agency to your request for views on the above-captioned subject:

_____ Concur

_____ No Objection

_____ No Comment

_____ See proposed edits on pages _____

X Other: _____

_____ FAX RETURN of / pages, attached to this reponse sheet

This is a wasted opportunity to get the Commerce Ctee to fix some of the stuff in the Banking Ctee bill - or at least to make sure they know our concerns. Talking about our bill is not only a waste - it suggests we have no respect for either the Banking or the Commerce Committee. Pages 8-20 need to be totally reworked to praise/support those parts of the BC bill that are like ours + suggest appropriate changes in the rest.

COPY

THE PRESIDENT HAS SEEN
5-19-97

THE WHITE HOUSE

WASHINGTON

May 18, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: TODD STERN

SUBJECT: Financial Services Modernization

The attached memo from Gene Sperling seeks your approval to let Treasury proceed with a proposal for financial services modernization. Sec. Rubin hopes to announce Treasury's modernization proposals in a May 21 speech, and he has agreed to testify before the House Banking Committee the first week of June. If you agree, Treasury will, tomorrow, put out some advance word on the Rubin speech.

The attached memo is long, detailed and technical, but you can get the essentials by looking at the first four pages. Those give you a summary of the five main controversial issues, plus a review of action on the Hill. (Pages 5-14 go back over the five key issues in depth.) Internally, there is consensus on Treasury's proposal among all involved agencies -- NEC, Commerce, Justice, SBA, OMB, CEA, DPC, and Leg. Affairs.

The five key issues and Treasury's answers, in a nutshell: (1) Should banks be allowed to affiliate with other financial service companies (e.g., insurance, securities) and with non-financial firms? *Treasury intends to propose two different alternatives, which would each allow banks to affiliate freely with other financial companies, but would treat affiliation with non-financial firms differently;* **(2)** should diversified holding companies be regulated, with special reference to the role of the Fed? *Treasury would allow Fed to impose capital requirements in limited circumstances -- where (I) the holding company has assets over $75 billion including bank assets over $5 billion, (ii) aggregate bank assets constitute at least 75% of total holding company assets, or (iii) bank subsidiary falls below "well-capitalized" category;* **(3)** should the CRA be extended beyond banks and thrifts? *No. Infeasible and possible damaging politically*; **(4)** should strong consumer protections be written into new legislation as distinguished from being left to regulation? *Treasury would require bank regulators to adopt regulations to protect consumers, but not write protections into the bill itself*; and **(5)** should Treasury submit legislative language with its report? *Yes.*

Rubin note. I have also included a note from Bob Rubin which emphasizes that (a) this would be a Treasury initiative, requiring little White House time; (b) although he thinks prospects for passing legislation, even next year, are uncertain, Treasury's absence from the field would appear as a lack of leadership; and (c) trying to extend the CRA to nondepository financial institutions, such as insurance companies or mutual funds, could render an overall bill dead on arrival.

Approve Treasury proceeding √ Disapprove___ Discuss___

COPY

'97 MAY 16 PM2:31

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

THE PRESIDENT HAS SEEN
5-19-97

SECRETARY OF THE TREASURY

May 16, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Robert E. Rubin R.E.R.

SUBJECT: Treasury's Financial Modernization Proposal

I would like to share with you a few observations of my own in addition to the views represented in the attached memorandum from the National Economic Council.

Over the past nine months, the Treasury has carefully reviewed the political and policy issues relating to modernization of financial services regulation. We have conferred with a range of experts on the subject and met with dozens of associations representing the views of providers and users of financial services. I believe that our proposal, although controversial in some respects, strikes a reasonable balance among the competing interests and policy considerations. It also leaves the most controversial issue -- affiliations between banks and nonfinancial companies -- for further debate.

Should you approve our recommendation to move forward, the proposal would be a Treasury initiative, and would not require a significant time commitment from the White House. I and my staff will manage the process of advancing the proposal, and with due regard for your Administration's overall priorities.

Historically, Congress has had great difficulty enacting legislation to modernize federal regulation of financial services -- which involves thorny issues and longstanding conflicts among banks, securities firms, insurance companies, and others. This Congress may be no exception: we do not expect legislation to pass this year, and the prospects next year are uncertain.

But the Treasury's absence from the field would be seen as a failure by the Administration to provide leadership where leadership is expected.

Lastly, some have suggested using financial modernization legislation as a vehicle for extending the Community Reinvestment Act to nondepository financial institutions (such as mutual funds or insurance companies). We believe that such an extension is neither practical nor politically feasible -- and could, in fact, render any financial modernization proposal dead on arrival. We will, in any event, block any Congressional efforts to weaken CRA.

I look forward to learning soon of your decision on this matter.

THE PRESIDENT HAS SEEN
5-19-97

THE WHITE HOUSE
WASHINGTON

May 16, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Attached memorandum on Treasury's Financial Services Modernization Proposal

The attached memorandum asks you to authorize Treasury to proceed to announce and submit their financial services modernization proposal. Secretary Rubin intends to introduce the proposal in a May 21 speech, and to testify before the House Banking Committee the first week of June.

The memo is arranged as follows:

- Page 1 sets the procedural context, including why the timing is important
- Page 2 and the top of page 3 summarize the five primary issues
- Page 3 through the top of page 14 contain more extensive discussion of each of the five issues, together with your advisors' recommendations
- Page 14 sets out the decision alternatives

The proposal has been under development by Treasury for about a year, and has been the subject of a several-month NEC process. During the process, your advisors were able to raise and resolve a number of important issues. Your advisors are in unanimous agreement that Treasury should proceed with its proposal as outlined in the memo.

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION	
[redacted]	To Joel Wiginton from President Clinton. Subject: Juvenile Justice / Byrd amendment (Annotations) (1 page)	n.d	P5	4100
001b. letter	To Jackson Dunn from Robert Jones. Subject: Internet wine shipping (Notations) (3 pages)	10/15/1999	P5	

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Subject Files
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FOLDER TITLE:

Financial Services Modernization [1]

Jamie Metrailer
2010-0384-F
jm655

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

THE WHITE HOUSE

Joel -

Attached please find information from Patton Boggs re. Juvenile Justice - Byrd amendment.

I don't know where we are on this - but thought you might want the attached.

Thanks Jerry Dunn

PATTON BOGGS LLP
ATTORNEYS AT LAW

2550 M Street, NW
Washington, DC 20037-1350
202-457-6000

Facsimile 202-457-6315

October 15, 1999

Robert C. Jones
(202) 457-6435
rjones@pattonboggs.com

Jackson T. Dunn
Associate Director for
Business Outreach
116 Old Executive Office Building
Washington, D.C. 20501

Dear Jay:

On behalf of my client Kendall-Jackson Vineyards and Winery, I am writing to bring your attention to the internet wine shipping provision (referred to as the "Byrd provision") which is included in the Senate passed version of the Juvenile Justice bill, H.R. 1501. This special interest provision, which we discussed when Pete Downs and I met with you on September 16, is currently pending before the conference committee. As Pete and I mentioned, this provision is not only adverse to small American wineries who legally ship their product across state lines to consumers, but also to the emerging virtual market-place occurring on the internet.

When Pete was in Washington, we also met with several Members of Congress to express our concerns with the provision and explain the efforts within the wine industry to prevent underage purchase and consumption of wine. We also called upon the lawmakers to limit the scope of the Byrd provision to focus only on state laws regarding the underage purchase of wine rather than to enact broad legislation that is, as a practical matter, intended to chill the legal shipment of wine to adult consumers.

We are pleased to be able to report to you that several Members of Congress recently took up this cause, and sent a letter to the President encouraging him to veto the conference report if it contains the harmful provision. I have included a copy of this letter.

Numerous other interest groups and corporations have expressed their similar concerns with these proposed limitations on e-commerce, including the Electronic Commerce Association, Mothers Against Drunk Driving, the Wine Institute, the American Vintners Association, the Association of Online Professionals, The Direct Marketing Association, MCI WorldCom, PSINet, America On Line, AT&T, and the Intel Corporation.

We understand that there is a strong likelihood that the President will veto whatever comes out of the Juvenile Justice bill conference on grounds unrelated to the internet wine provision. Nevertheless, we strongly hope that you will recommend that he also state his concerns for the deleterious effects of the Byrd provision in announcing his rationale for vetoing the underlying bill (assuming this scenario takes place). Please let me know is there is anything further I can do in this regard.

In addition to the congressional letter to the President mentioned above, I have also included:

- a letter Kendall-Jackson sent to Chairman Hatch in March, 1999 regarding the "Byrd Amendment's" potential effects on the winemaking industry;
- a letter from Senator Feinstein to Chairman Hatch expressing her concerns regarding the Byrd provision;
- a letter from Mothers Against Drunk Driving disassociating itself from supporters of the "Byrd Amendment" and rejecting its language;
- a letter from the Wine Institute and the American Vintners Association to Chairman Hatch expressing opposition to the "Byrd Amendment;"
- a letter from the Electronic Commerce Association to Chairman Henry Hyde regarding concerns specifically related to internet commerce;
- a letter from the Intel Corporation opposing the "Byrd Amendment" for creating a bad precedent for unfettered internet commerce;
- a letter from several technology associations and companies to Senator Hatch and Congressman Hyde expressing concerns that the internet alcohol sales provision will impede legal internet commerce;
- an outstanding two-part Wall Street Journal feature on the wine industry and the history of the nation's current alcohol distribution system;
- an editorial from the Wall Street Journal opposing the nationwide trend towards felonies for wine consumers and shippers;
- an editorial from USA Today criticizing the legislative goals and misleading tactics of the wholesalers and distributors lobby as they relate to restricting consumers' direct access to wine and beer producers.

In sum, we urge you to encourage the Administration to oppose the Byrd provision in its current form. We think that this issue merits the President's involvement, given the importance of promoting unfettered growth in e-commerce, and we are hopeful that the President will strongly enunciate his opposition to broad initiatives aimed at chilling legitimate e-commerce. Furthermore, we believe that regardless of the final outcome of the Juvenile Justice bill, it is highly likely that the proponents of restrictive wine sales legislation will continue to press this issue, most likely in the form of Congressman Scarborough's stand-alone bill, H.R. 2031. We are

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hopeful that the President will recognize the importance of this issue, and will state his opposition to any efforts to preserve the hegemony of wholesalers to the detriment of U.S. consumers and winemakers.

I hope you will not hesitate to call me if you have any questions or would like additional information.

Sincerely,

Robert C. Jones

Attachments
cc: Edgar B. "Pete" Downs, Vice President
Kendall-Jackson Vineyards and Winery

COPY

Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	To Anne Gomez and Kathleen Wallman from Ellen Seidman. Subject: Financial services - status note for Gene (1 page)	03/18/1997	P5
002. memo	To NEC Principals from Gene Sperling. Subject: Treasury's proposed Financial Services Modernization legislation (11 pages)	03/17/1997	P5 Dup1645

COLLECTION:

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National Economic Council
Kathy Wallman
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FOLDER TITLE:

Financial Services Modernization - National Economic Council Principals

Jamie Metrailer
2010-0384-F
jm663

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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Ellen S. Seidman 03/18/97 07:31:05 PM

Record Type: Record

To: Anna M. Gomez/OPD/EOP

cc: Kathleen M. Wallman/WHO/EOP
Subject: Financial servcies - status note for Gene

I must admit today's meeting was not neat and clean, but it finally got on the table some critical issues that it has been impossible to get the Treasury to face squarely. Much to my surprise I got a call from Jerry Hawke thanking us.

Working with Deich and Bill English, we have put together a set of diagrams of what we think are the Raines, Yellin and official Treasury (as opposed to unofficial Bob Rubin) positions, which we will use to try to smoke out what really concerns Frank and Janet about Treasury's proposal at a meeting of Raines, Yellin, Hawke, Seidman, Deich, English and Wallman tomorrow at noon. The goal will be at the very least to make certain we all know what the positions are in a manner that can, if need be, taken to the President. Hopefully, we'll do much better than that, and get to some sort of solution.

Anna is working on scheduling another principals meeting for Thursday. It's beginning to converge on 6:00 PM if we're to get Rubin -- which I believe is ABSOLUTELY essential.

Notwithstanding the pounding Treasury took today, there's still much to their position on the regulatory structure (which really depends on the proposition that we're NOT that good at regulating complex financial (let alone non-financial) companies, but we're pretty good at walling off the bank to protect the taxpayers), and there will be synergies anyway. The banking/commerce issue -- unless we do something chicken like support a grandfathering of all non-financial activities in financial companies as of the day of enactment if they ever decide to affiliate with a bank -- is, I suspect, going to go to the Presdient as a purely political choice.

Frankly, when we start to add CRA into this mix, I believe we're going to get very close to a "no go" decision, or, alternatively, a deicison to go with a proposal that Treasury -- likely not contradicted by John Hilley -- will assert will blow us out of the water, make us essentially irrelevant in the debate, and lead to no legislation. But strange things happen in this business, and moreover, no legislation might not be the worst result.

ellen