The New Policy Agenda for Financial Services

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PROFESSOR CARNELL: The topic for this panel is “The New Policy Agenda for Financial Services.” There are a lot of different ways to view the new policy agenda. Let me illustrate one of them.

I think back to when I was leaving Washington after serving as the Assistant Secretary of the Treasury.1 A venerable lobbyist from the securities industry, one of the “bicycle chain” guys who helped head off the repeal of the Glass-Steagall Act (“Glass-Steagall”)2 for many years, told me in all candor that he and his
colleagues were surprised that they were able to delay the repeal of Glass-Steagall for five to ten years. That was the most for which they had hoped. He also hoped, as a professional lobbyist, that it would have been enough work to help him put his kids through college. In fact, the battle stretched out for over two decades. He later said, with a smile, that it actually helped put his grandchildren through college.

I use that background to underscore the point that, for the past two decades, the Congressional financial services agenda has been dominated to a large extent by the unfinished business of dealing with restrictive financial services legislation. The agenda has been


4. Mike Doming and Frank James, Deal Done to Overhaul Banking Law; Depression-Era Leash Nears Its End, CHICAGO TRIBUNE, Oct. 23, 1999 ("Although Congress repeatedly has considered legislation to repeal the Depression-Era laws since 1979, this was the first year [1999] a deregulatory measure was passed by both the House and Senate.").
dominated by proposals to repeal the Glass-Steagall Act, reform the Bank Holding Company Act, and relax geographic restrictions on banks. During these past two decades, a lot of other issues affected the Congressional financial services agenda. We had the thrift debacle, for example. The chronic, and among the larger,
agenda items, however, concerned loosening old, outmoded, and restrictive legislation.\(^9\)

Now that the agenda—you could say the 1980s–1990s agenda, or the 1980s agenda that went into the 1990s—has to a large degree been achieved, what is next on the financial services policy agenda? Going back to the kids-in-school example, you could, as a figure of speech, say that one's own kids have grown up and gone off to college. Is there going to be an eerie silence in the house? What are people going to do next in the financial services policy debates?

Here, to help respond to those questions and to commence a larger debate, are Laurie Schaffer of the House Committee on Banking and Financial Services, William Rutledge of the Federal Reserve Bank of New York, Michael Smith of the New York Bankers Association, and Beth Climo of the American Bankers Association Securities Association and American Bankers Association Insurance Association.

The first person to whom I want to give an opportunity to speak is Laurie Schaffer. Ms. Schaffer is Deputy Staff Director of the House Committee on Banking and Financial Services. She is an alumna of the Fordham University School of Law. Ms. Shaffer has worked, over the years, at the Securities and Exchange Commission, the American Bankers Association, the Treasury Department, and the Federal Reserve Board. In fact, she has worked on financial services issues since the 1980s. I met Ms. Shaffer in 1998, when she was dealing with devising the predecessor to what became Title II of the Gramm-Leach-Bliley

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9. See Statement of Michael Patterson, supra note 5 (stating that restrictive financial legislation was "designed in response to a marketplace that no longer exists"). This old, outmoded legislation included the Glass-Steagall Act, §§ 16, 20, 21, and 32 of the Banking Act of 1933, 48 Stat. 162, (separating banking from securities industry). It also included the Bank Holding Company Act of 1956, 70 Stat. 133 (preventing bank holding companies from engaging in activities in which banks could not engage).
Financial Services Modernization Act of 1999 ("Gramm-Leach-Bliley").

Ms. Schaffer, if you would, give us your initial thoughts.

MS. SCHAFFER: Thank you, Professor Carnell. Before I begin, I provide this disclaimer: These are my own views and not the views of the House of Representatives Banking and Financial Services Committee or its Chairman, Congressman Jim Leach.

First, I feel duty-bound to defend the recent legislation. I want to quickly touch on what the people working on Gramm-Leach-Bliley thought they were trying to achieve. For Congress, the hallmark of the Gramm-Leach-Bliley Financial Modernization Act is flexibility. The Act broadened permissible activities from those closely relating to banking to those generally financial in nature, directing the Board of Governors of the Federal Reserve System and the Department of Treasury to take into account such factors as technological changes and the various other businesses that compete with traditional financial companies.

Second, the legislation provided flexibility in structure—it provided the choice between operating as a holding company and operating as a financial subsidiary of a national bank. Regardless


13. Id.

14. See id. § 729(a) (requiring the federal banking agencies to conduct a study of banking regulations concerning the delivery of financial services, including "regulations that may assume that there will be person-to-person contact during the course of a financial services transaction," and requiring such agencies to "report their recommendations on adapting those existing requirements to online banking and lending"); § 729(b) (requiring that the federal banking agencies submit a report to Congress on the findings, conclusions, and recommendations resulting from the study required under § 729(a), "before the end of the 2-year period beginning on the date of the enactment of this Act").

15. Id. § 103 (allowing financial holding companies to engage in and acquire interest in any company to be financial in nature); § 121 (authorizing national
of what your views were on the debate between the Office of the Comptroller of the Currency ("OCC")\(^6\) and the Federal Reserve,\(^7\) Gramm-Leach-Bliley\(^8\) put into law, for the first time, a clearly authorized and operating subsidiary system.\(^9\) For instance, there were significant questions raised, and a lively debate ensued, as to the legality of some of what the OCC had previously done.\(^10\) Gramm-Leach-Bliley clearly takes away any of that potential litigation risk. It clearly set up the operating subsidiary as a structure that can be used if banks feel that is the best manner to

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16. The OCC is an independent bureau of the Department of the Treasury. It charters, regulates, and supervises all national banks. The OCC also supervises the federal branches and agencies of foreign banks and serves as a director of the Federal Deposit Insurance Corporation (FDIC). \textit{See} http://www.occ.treas.gov/AboutOCC.htm (last visited Oct. 20, 2000).

17. The OCC–Federal Reserve debate is rooted in the broad powers provided in the Twentieth Century to banks by the OCC, which allowed banks to sell various financial products, such as insurance. Before the passage of Gramm-Leach-Bliley, banks were generally restricted from engaging in such activities. \textit{See} sources cited \textit{supra} notes 2 and 3 (providing the historical statutory limitations). The OCC, however, loosely interpreted provisions of the financial regulatory laws and garnered significant victories in the courts, resulting in the engagement of banks in the sale of certain financial products, especially certain types of insurance, if such sales were deemed incidental to the business of banking. Leigh Rademacher, \textit{Banking Law Symposium: Powers of National Banks to Sell Insurance, Annuities and Securities from Bank Premises}, 30 CREIGHTON L. R. 753, 754-55 (1997) [hereinafter Rademacher]. The OCC–Federal Reserve conflict flowed into the debates about the organizational structure that Gramm-Leach-Bliley proposed. \textit{See} Clyde Mitchell, \textit{Operating Subsidiaries–The Current Debate}, 221 N.Y. L.J. 3 (1999) (discussing, in part, the debate concerning the extent to which banks should be able to conduct activities in operating subsidiaries owned by them, as opposed to through affiliates that are subsidiaries of their holding companies); \textit{see also} Jaret Seiberg, \textit{Changes in Regs Hang Fire as Congress Debates Reform}, AM. BANKER, Mar. 5, 1999, \textit{available at} 1999 WL 6033164 (discussing the compromises made by banking agencies, including the Federal Reserve Board, during the financial services reform debate by Congress).


19. \textit{Id.} § 121(a) (allowing national banks to, generally, control a financial subsidiary or hold an interest in a financial subsidiary).

offer services.\textsuperscript{21}

Third, the legislation attempted—and this probably will have to be worked on further in the future—to adopt a principle of functional regulation. It tries to streamline holding company supervision to make the presence of the government less burdensome. We heard talk today about all the regulators that various holding companies could potentially have.\textsuperscript{22} There is truth to that, I believe, and I am not going to say otherwise. The regulators could be the insurance regulators, the state securities regulators, the Federal Reserve regulators, et cetera. With Gramm-Leach-Bliley,\textsuperscript{23} however, there is an attempt to have one functional regulator of the financial entity.\textsuperscript{24} There is an attempt to have the Federal Reserve operate as the umbrella regulator, but to rely on the functional regulators of the subsidiaries to do the examinations of the subsidiaries themselves.\textsuperscript{25} Therefore, this recent legislation was really a first step towards trying to make this

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24. Id. § 111 (amending §5(c) of the Bank Holding Company Act of 1956, 70 Stat. 133) (stating that the Board of Governors may make examinations of a functionally regulated subsidiary of a bank holding company only if the Board of Governors has (1) reasonable cause to believe that such subsidiary is engaged in activities that pose a material risk to an affiliated depository institution; (2) the Board reasonably determines from reports that examination of the subsidiary is necessary to adequately inform the Board of the systems for monitoring and controlling financial and operational risks within the holding company that may pose a threat to the safety and soundness of any depository institution subsidiary of the holding company; or, (3) based on reports and other available information, the Board has reasonable cause to believe that a subsidiary is not in compliance with Gramm-Leach-Bliley or any other federal law that the Board of Governors has specific jurisdiction to enforce against such subsidiary, including provisions relating to transactions with an affiliated depository institution, and the Board cannot make such determination through examination of the affiliated depository institution or the bank holding company).

25. See id. § 115(a) ("[A] federal bank agency may not inspect or examine any registered investment company that is not a bank holding company or a savings and loan company.")
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concept work. Further work may be needed, but this was certainly the first step in what was intended.

I want to touch briefly on privacy, too, before I turn to what I see as emerging legislatively in the future. The privacy provisions in Gramm-Leach-Bliley were a very, very significant and important part of the bill.26 I agree with what Oliver Ireland said about the free market working. This legislation was an attempt to give people the information that they needed to make choices about sharing their private information. A lot of what was heard during the debates on the legislation, for example, about what was going on to some extent with the US West,27 was that people just did not know that their personal information would be shared. If people want to make the choice of using an institution that shares information, then that is fine. I think, however, what people were most surprised about is that they just did not know, or they did not realize, that their personal information would be shared. Maybe they should have been aware and they just did not think about it. Gramm-Leach-Bliley28 was, in fact, really an attempt to provide people with such information. Privacy issues are very, very complicated issues. If extreme measures are taken, for example, people end up with unintended consequences. There was a lot of effort in Gramm-Leach-Bliley29 to try to ensure that the legislation did not affect the free flow of credit.30 These are just not easy issues with which to deal.

I find it sort of humorous that people talk about what has

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26. Id. §§ 501-510 (regulating disclosure of nonpublic personal information) and §§ 521-527 (regulating fraudulent access to financial information).
27. U.S. West, Inc. v. Federal Communications Comm’n, 182 F.3d 1224 (10th Cir. 1999) (holding, inter alia, that the FCC failed to show that its regulations, which generally required telecommunications companies to obtain customers’ approval before company could use customers’ propriety information for marketing purposes, directly and materially furthered FCC’s interests in privacy and increased competition).
29. Id.
30. Gramm-Leach-Bliley, Pub. L. No. 106-102, § 502, 113 Stat. 1338 (providing financial institutions several options with respect to sharing the nonpublic personal information of their customers).
From my standpoint, the United States has done a very good job of protecting people's personal information, with respect to the government having access—for example, the Right to Financial Privacy Act and other provisions—whereas, in Europe they are protecting citizens' privacy against businesses, but not against the government having access to its citizens' personal information. From my personal standpoint, I prefer to limit the availability of personal information to the government than to limit it to businesses. Maybe that is an American standpoint. In short, I think the European example works, but only to a certain extent.

Having said that, let me touch briefly on some of the things, in terms of an agenda for financial services, that people on Capital Hill are contemplating and discussing. One of the first issues is deposit insurance. The Federal Depositary Insurance Corporation (the "FDIC") is going to hold some seminars across the country, in order to look at deposit insurance issues and how the deposit insurance system works. When people refer to the Gramm-Leach-Bliley bill as being a "bank-centric" bill, in that there is some truth. It is bank-centric, in part, because the U.S. Government stands behind banks, since they have the full faith and

31. See Joel R. Reidenberg, Resolving Conflicting International Data Privacy Rules in Cyberspace, 52 Stan. L. Rev. 1315, 1318 (2000) [hereinafter Reidenberg] (stating that while the U.S. has a market-dominated approach to the protection of personal information and only provides limited legal rights to information privacy, Europe reflects a rights-dominated approach and it now requires each of its Member States to have thorough statutory protections for citizens.).

32. See 12 U.S.C. § 3412, § 3412(a) (2000) (stating that financial records shall not be transferred by a government agency to another government agency unless the transferring agency or department certifies in writing that there is reason to believe the records are relevant to a legitimate law enforcement inquiry within the receiving agency's or department's jurisdiction).

33. See generally Reidenberg, supra note 31 (discussing the legal protections in the U.S. against government access to personal information and those afforded in various European contexts).


credit of the U.S. Government. The insurance companies and securities firms do not have that feature. Securities firms have the Securities Investment Protection Corporation Fund ("SIPC"), which is a different type of provision than the FDIC. That is, to a large extent, why the Bank Holding Company Act of 1956 exists, as well as other provisions related to financial institutions, because of the function of deposit insurance.

There are proposals to both decrease deposit insurance and to increase deposit insurance. The small banks have proposed increasing deposit insurance to $200,000. There are also proposals to give full insurance coverage to municipal deposits, so that if, for example, New York City had all of its deposits in one institution, those deposits, regardless of their size, would be completely covered, which essentially means the United States is backing all those municipal deposits.

Thus, a lot of debate exists concerning the amount of potentially allowable deposit insurance. You may have seen that Merrill Lynch is offering to its customers to sweep their money into insured accounts, as opposed to into money market funds. Merrill is saying that they are going to offer $200,000 in coverage. Now,


39. C.f., Rob Blackwell, Crisis Haunts Deposit Insurance Reform, AM. BANKER, Sept. 11, 2000, at 6 (discussing the reasoning behind opposition to an increase in deposit insurance coverage).

they are doing that by sweeping the money into an insured industrial loan company in Utah. When a customer reaches the $100,000 limit there, then they are going to sweep it into a bank they have in New Jersey. Therefore, there are a lot of issues that cause the FDIC some concern, because these issues involve a substantial sum of money that would flow into the Bank Insurance Fund (BIF), which would reduce its current capitalization. Thus, there are a lot of issues concerning deposit insurance. I do not think you will see any legislation this year—perhaps sometime in 2001—but it is something that is on the radar screen and it is something about which people are beginning to talk.

Another issue concerns, and Ernie Patrikis touched on this in an earlier panel, federal regulation of insurance. People again are beginning to talk about a federal insurance charter. Where that will go, I do not know. I know Ms. Climo is going to discuss this, so I will not delve into this subject, but it is certainly an issue that is relevant. Further, another issue that the Staff of the House Banking Committee is beginning to look at and consider is reviewing the interstate banking bill that was put into law in 1994.

It has been six years since that law was enacted. Nationwide banking is a reality, and now we have Internet banks that are operating across the country without any geographic restrictions.

As many of you who are familiar with interstate banking know, states still can impose restrictions on de novo bank branching (opening a new branch in a state) and there is

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43. Cf. 12 U.S.C. § 36(g)(1) (allowing the Comptroller of the Currency to approve an application by a national bank to establish and operate a de novo
consideration of whether it is time to really take another serious
look at interstate banking, in general, and at what changes need to
be made. The regulators have told us that there are some glitches
in the interstate banking bill that need to be addressed, at a
minimum. But the real question is: given what has happened with
the Internet and nationwide banking, do we need to do sort of a
top-to-bottom review of how that statute works? This is more of
a long-term project, but it is being considered.

Finally, something that is actually a near-term project and that
is in conference now between the House and the Senate is the e-
signature/e-records bill. This is a bill that would essentially say
that electronic signatures and electronic records agreed to by both
parties can be used and will have the same legal effect as written
records of written documents. It is a very broad provision that
basically overrides all federal laws concerning the use of written
documents or written signatures. This bill, however, does not
override the content or timing of disclosures. Specifically, it deals
with how written signatures are delivered and used.

This is a bill in which the high-tech industry is very, very
interested. For instance, you may have seen that Microsoft is
creating software dealing with home mortgages. They are going to
be entering into partnerships with various financial institutions. In

branch in a State, other than the bank's home state, in which the bank does not
maintain a branch if there exists in the host State a law that (1) applies equally to
all banks; and, (2) such law expressly permits all out-of-State banks to establish
de novo branches in such State; and (3) certain other conditions of 12 U.S.C. § 36
are met.

44. Riegle-Neil Interstate Banking and Branching Efficiency Act of 1994,
sections of 7, 12, and 31 U.S.C.).

45. Id.

46. The Electronic Signatures in Global and National Commerce Act, Pub.
provisions set out as a note under Section 231 of Title 47) (providing legal effect
to a signature, contract, or other record that is in electronic form and is in or
affects interstate or foreign commerce); see also Danielle Fugazy, Legislation:
Acceptance of E-Signatures Moves Ahead, WEB FIN., June 5, 2000, available at
2000 WL 4044381 (providing background on the Congressional debate
concerning e-signatures and passage of bill).

47. Id.
addition, a lot of banks are becoming more active in activities such as on-line banking, wanting to offer mortgages and other services on the Internet. That is something for which I think you will actually see legislation enacted and signed by the President this year. The House and the Senate are in conference on it now. There are some issues concerning financial institution liability, because the way the e-signature/e-records bill is drafted, it is essentially a freestanding federal law with no federal agency having any regulatory interpretation. That means that, unlike the Truth in Lending Act, there are no safe harbor provisions. The Federal Reserve, now, can adopt a rule saying “this is how you do it, and you are safe if you do it within these confines.” That is something on which I know the conferees are going to be working. With that, I will turn it back to Professor Carnell.

PROFESSOR CARNELL: Thank you, Ms. Schaffer.

Our next speaker is William Rutledge. He is Executive Vice President for Bank Supervision at the Federal Reserve Bank of New York. He is responsible for supervising all bank holding companies, state member banks, and foreign banks in the New York District. He is an economist by background. Mr. Rutledge has a wealth of experience in bank supervision dating back to the 1970s, and we look forward to hearing his views.

MR. RUTLEDGE: Thank you, Professor Carnell.

As Professor Carnell mentioned, I am an economist by training. I think I am one of the few non-lawyers on your program today. As such, the focus of my comments will probably differ from those of some of my confreres. I will approach issues as a bank supervisor, not as a lawyer. I will focus on provisions in Gramm-Leach-Bliley that have a much stronger supervisory overtone than the more regulation-oriented ones upon which many of my colleagues have commented. I will also attempt to reach

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48. 15 U.S.C. § 1638, et seq. (2000). Section 1638(a) requires disclosures by creditors to borrowers before credit is extended. Id. at § 1638(a).

49. A safe harbor provision in a statute, rule or regulation generally renders protection to a person as long as efforts were made by such person to comply with the law, even if such efforts to comply ultimately fail. See BLACK’S LAW DICTIONARY (6th ed. 1991).

beyond the statute and talk about a few changes that have occurred in the financial services industry, changes that will portend some further developments that are quite distinct from the old regime, which was comprised of a heavy focus on deposit taking and lending.

Presently, we see much more reaching out, particularly by the major banking organizations, into derivatives activities, including credit derivatives, securities underwriting, corporate advisory activities, and asset securitization. Many banking organizations have also decided that they even want to get away from this core set of activities that are credit-related and move much more into the processing businesses and be involved in custody or asset management in the pursuit of fee income. Further, numerous banking organizations have started to explore the potential of banking on the Internet ("e-banking"). These various developments have led to some fundamental changes in the way in which we supervise banking organizations. They also have led to some prospective changes in the overall capital adequacy approach to banking organizations, much of that work being done by the Basel Supervisors Committee (the "Basel Committee").

Touching briefly on the immediate impact of Gramm-Leach-Bliley on our bank supervisory process here, I think the conventional wisdom was that the new statute, in terms of the powers side, was largely directed to the biggest banking organizations. What developed, however, is that numerous smaller organizations see some opportunities here as well. If you look at the first set of filers to become financial holding companies, more than two-thirds of those filers were banking organizations under $1 billion in total assets. Much of their interest relates to getting


53. See Dean Anason, Fed to Approve 100 'Holding Company' Applications, AM. BANKER, March 10, 2000, at 1 (indicating that Federal Reserve Chairman
involved in insurance agency activities more readily, perhaps getting more involved into merchant banking. I think the statute is likely to result in relatively few of the Citigroup-type combinations of major commercial banking, insurance underwriting, and securities underwriting activities. There may be a few, but not terribly many. I say this for a couple of reasons.

On the commercial banking securities side, as many of you may know, the Federal Reserve Bank has liberalized what the rules were under the previous statute, in terms of Section 20 activities, and upgraded the percentage limit of ineligible revenue, if you will, which in effect allowed for the acquisition by commercial bank holding companies of numerous securities firms. Therefore, some of the prime targets for a prospective merger or acquisition by banking organizations have already been taken over by commercial bank holding companies, even prior to this statute.

On the insurance side, I believe, there too, we may not see a tremendous number of affiliations between banks and insurance companies, at least immediately. It is not clear to me how strong the synergies may be between commercial banking and insurance underwriting. I also wonder whether most commercial bank holding companies will be satisfied with the rate of return that insurance companies have traditionally been able to generate. Further, difficulties will occur structurally in that many insurance companies are still in mutual form so, prior to acquisition, they will have to go through the process of de-mutualization.

Alan Greenspan stated that, "Two-thirds of the requests for financial holding companies were filed by companies with less than $1 billion of assets..."); see also Eric Winig, Financial Holding Company Structure Not for Giants Only, AM. BANKER, March 31, 2000, at 7 ("Of the 144 financial holding companies approved by the Federal Reserve Board, more than two-thirds are banking companies with less than $1 billion of assets.").

Glass-Steagall Act, Section 20 of the Banking Act 1933, Act of June 16, 1933, ch. 89, 48 Stat. 162 (codified in 12 U.S.C.) (repealed 1999). Section 20 of the Glass-Steagall Act provided, "[N]o member bank shall be affiliated ... with any corporation ... [or] association ... engaged principally in the issue ... of stocks, bonds, debentures, notes, or other securities ..." Id.

De-mutualization is a process where a mutual insurance company converts into a stock insurance company. Generally, the mutual policyholders' ownership interest in the old company is converted into ownership interest in the form of stock in the new company. The process is usually the result of a need to
I think, over time, in any event, we will see a growth in affiliations between financial institutions and we will certainly see an opening up of the range of opportunities for financial services organizations. Whether those financial services organizations want to try to be all things to all people and be very diversified, or whether they want to be very focused and specialized, the Gramm-Leach-Bliley Act will open an increased range of opportunities in either of those dimensions.

In terms of the new legislation's direct effect on the supervisory process, let me make a couple of comments. It was alluded to earlier that the statute does introduce the concept of umbrella supervision, with the Federal Reserve Bank being the umbrella supervisor for the overall financial holding company, and with a second tier of supervisors, the functional regulators of the individual non-bank firms. The Act requires the Federal Reserve Bank, as umbrella supervisor, to rely very heavily on the functional regulators. For example, it relies to the fullest extent possible on publicly available information, externally audited financial statements, and information submitted to the functional regulators, rather than seeking information directly from the firm.

As umbrella supervisor, the Federal Reserve Bank is expected to be principally concerned with understanding group-wide risk management and internal controls and consolidated capital adequacy. That is a tricky process. The Federal Reserve is in the process of defining the appropriate rules of approach. We are also

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57. Id. § 111 (amending the Bank Holding Company Act of 1956, 12 U.S.C. 1844(5)(c)).
58. Id.
59. Id.
60. Id. ("In the event that the Board requires a report under this subsection from a functionally regulated subsidiary of a bank holding company of a kind that is not required by another Federal or State regulatory authority or an appropriate self-regulatory organization, the Board shall first request that the appropriate regulatory authority or self-regulatory organization obtain such report."). Id.
expected to be looking into intra-group transactions, particularly ones that could have deleterious effects on the depository institution. We are also expected to be looking into payment system risk issues.

The focus of umbrella supervision, as the statute directs, is actually quite consistent with the approach we have taken as a supervisor of bank holding companies in recent years. We have become, within the Federal Reserve, much more focused on a top-down approach, focusing on how processes are managed within the banking organization, in order to be more risk-focused and process-oriented in our overall approach to supervision. By process-oriented, I mean that our examiners have been looking at the risk management processes and internal controls at an organization, rather than looking to do point-in-time assessments of financial conditions and performance. Those can change quickly in today’s environment. We expect our examiners to conduct reviews that cut across corporate entities, to focus on business lines or risk areas in banking as well as various non-banking areas.

Another focus of our approach as bank holding company supervisor, that I think will carry over very well as financial holding company supervisor, is that we are looking to do all we can to encourage banking organizations, now financial services firms, to upgrade the quality of their own risk management systems. We are trying to encourage organizations to improve their own managerial systems, rather than trying to “hard-wire” a lot of regulatory processes and expectations on banking organizations. We are trying to do that with the various supervisory steps that we are taking through the examinations process. We are also trying to do that working through the Basel Committee in overall approaches to capital adequacy. The Basel Committee, of which I just became a member, has focused in recent years, for example, in its market risk amendment, on trying to build upon the models that banking

61. See Basel Committee, supra note 51.
62. Amendment to the Capital Accord to Incorporate Market Risks (January 1996), at http://www.bis.org/publ/bcbs24a.htm (last visited Apr. 5, 2001) (providing a detailed account of the methodology put forth by the Basle Committee to set capital requirements for market risks and describing two alternative approaches to the measurement of market risk: a standardized method and an internal models approach); see also Modifications to the
organizations have used to manage their own market risk exposure and on managing how they allocate capital in support of that market risk.\(^\text{63}\)

In a recent consultative paper\(^\text{64}\) the Basel Committee advanced the notion a step further and said, “Let’s look at the way banking organizations look at credit risk issues. How do they allocate capital internally? How do they rate credits risks internally? Can we use this internal ratings approach much more as a basis for a capital adequacy regime that stretches out to include gradations of credit risk as well?”\(^\text{65}\) Thus, Gramm-Leach-Bliley,\(^\text{66}\) as I mentioned, creates some challenges for banking organizations and for supervisors, but is, simultaneously, quite consistent with a lot of recent trends within the banking industry and trends in our approach to supervision, in any event.

PROFESSOR CARNELL: Thank you, Mr. Rutledge.

Our next speaker is Michael Smith. He is President of the New York Bankers Association (the “NYBA”).\(^\text{67}\) Mr. Smith played a crucial role in the development of the Gramm-Leach-Bliley Act.\(^\text{68}\) In 1998, he led a task force that negotiated compromise on issues involving bank insurance activities. These

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MARKET RISK AMENDMENT. TEXTUAL CHANGES TO THE AMENDMENT TO THE 
BASLE CAPITAL ACCORD OF JANUARY 1996 (September 1997), at
http://www.bis.org/publ/bcbs24a.pdf (last visited Apr. 5, 2001). See generally
http://www.bis.org (last visited Apr. 5, 2001) (detailing the proposal of a new
Basel Capital Accord).

\(^{63}\) Id.

\(^{64}\) A NEW CAPITAL ADEQUACY FRAMEWORK (June 1999), at
http://www.bis.org/publ/bcbs50.pdf (last visited Apr. 5, 2001) (consisting of three
“pillars”: minimum capital requirements, a supervisory review process, and the
effective use of market discipline, and introduced to replace the 1988 Basel
Capital Accord).

\(^{65}\) See id.

\(^{66}\) Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No.

\(^{67}\) See New York Bankers Association (NYBA) web page, at
http://www.nyba.com/pages_about/about.html (last visited Apr. 5, 2001) (stating
that the NYBA is New York State’s primary trade organization for the banking
industry and that it promotes sound but progressive fiscal policies that advance
commercial and community interests as well as individual initiative).

\(^{68}\) Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No.
were issues that had destroyed prior versions of the legislation in 1998, 1995, and 1991—and this is probably not an exhaustive list of the years in which fatal terminations occurred—and divisiveness on these issues had also come close to bringing down Gramm-Leach-Bliley in the House in 1998. So this task force achieved what many believed was impossible, that is, a negotiated agreement that had substantial support in both the banking and insurance industries.

MR. SMITH: Thank you, Professor Carnell.

I want to comment on Mr. Rutledge's and Ms. Schaffer's remarks and then give you just a brief overview of where we, the NYBA, view the situation.

My first reaction is to the earlier commentary about where the industry stands today. The NYBA represents about 140 banks in New York State, from the smallest to the largest. I say, as we talk about this law and we look at it in the broad sense—legal, economic, and from the other perspectives that were discussed today the industry is just starting to cope with Gramm-Leach-Bliley. It is an extensive law, it is a comprehensive law, and we forget sometimes that its effects are not going to surface immediately.

In addition, the industry is in a state of consolidation. I agree with Mr. Rutledge, that what we are seeing now is that, while many people talked—to some extent ad nauseam—about how this was a "big bank bill" and was a financial center or money center bill, what we have seen so far is a lot of activity by our smaller institutions, especially in the insurance agency area, where there have been acquisitions of insurance agencies across the United States.

69. Id.
70. Id.
And also, another area that we had identified early is title
insurance, which is another example of a micro issue that was not
discussed much during the legislative debate but has taken on
relevancy after the law has been signed. Further, Ms. Schaffer
mentioned in her prognosis a couple of "hot buttons" in the history
of banking over the last twenty years, one being branching and the
other is deposit insurance, along with the so-called issue of "too big
to fail." All of this is so broad and so controversial that we could
have a four- or five-day session on each one of those issues. In any
event, I will try to look at things in the macroeconomic sense as a
representative for the banking industry in New York, and I am an
advocate for that industry, as is Ms. Climo.

One thing that I have not heard so far is that this bill is a great
law.\textsuperscript{72} It is a great law for New York, and it is certainly an
economic development bill and a jobs bill, because before you can
be a consumer, before you can do anything else, you have to have a
job. A half-million people directly owe their employment to the
financial services industry in New York today and, by our
estimates, another half-million jobs are directly related through the
legal profession, the advertising profession, or the communications
industry. That is a significant segment of the economy of this
state.\textsuperscript{73}

What this law did was validate what had occurred before,
made sense out of it, and gave the institutions in the United States
and in the State of New York the ability to compete. At the same
time, which I think is very unfortunate, is the sense that the

\textsuperscript{72} See William W. Streeter, \textit{Keeping One Eye on the Horizon}, ABA
ABA President Don Mengedothen's endorsement of the Gramm-Leach-Bliley
Act); \textit{see also} Debt and Government Sponsored Enterprises: Hearing Before the
Task Force on Hous. and Infra-structure of the House Budget Comm., 105th
Cong. (2000), \textit{available at} 2000 WL 23832018 (statement of William C. Apgar,
HUD Designee to the Fed. Hous. Fin. Bd.) (articulating Apgar's endorsement of
the Gramm-Leach-Bliley Act because it enhanced the Federal Home Loan
Bank's capacities).

\textsuperscript{73} See Wall Street, Consumer Services Fuel Job Gains in New York; Standard
& Poor's DRI Forecasts Continued Employment Growth In Empire State, \textit{Bus.
Wire}, July 19, 1999 (stating that business and financial services industries alone
account for 15% of New York State's total employment).
consumer somehow loses due to this kind of legislation. In fact, this legislation is pro-consumer. The privacy stipulations\textsuperscript{74} in Gramm-Leach-Bliley\textsuperscript{75} were the broadest that had ever been applied to an industry in the United States. And, as one who has appeared before the New York Legislature on this issue, I can tell you that this industry is taking that issue very seriously, as was noted in the earlier panel.

What Professor Carnell said at the outset is very true. As someone who has seen his entire career evolve over this twenty-five-year span, this is a generation of work by thousands and thousands of people, culminating in diligence and the perseverance of Chairman Jim Leach,\textsuperscript{76} and his colleagues. They held it together.

In the past, with regard to financial services, this country had a checkerboard square of laws and regulations. It failed federal efforts, and individual state action. If you practice or study the banking law or have an interest in financial services in general, you understand that the tension and the dynamics of the state and federal system is absolutely unique in the United States through its so-called dual banking system,\textsuperscript{77} which has been preserved. The dual banking system was very important in this effort, as was a very active legal and regulatory system.

When one looks back over the last twenty-five years, one sees that there existed individual actions on interstate banking, fee deregulation and interest rate deregulation. One often forgets about these actions. For example, in New York, there was the DeWind Commission on Insurance and Banking\textsuperscript{78} and so-called


\textsuperscript{75} Id.

\textsuperscript{76} See source cited supra note 11.

\textsuperscript{77} See generally Timothy J. King, Insurers Should Get Dual Charter System Like Banks', AM. BANKER, Apr. 28, 2000 [hereinafter King] (defining the dual banking system as the competing state and national regulatory systems).

\textsuperscript{78} See William G. Blair, Cuomo Names 17 To Insurance Investment Panel, N.Y. TIMES, Sept. 18, 1983, at 48 (discussing how the DeWind Commission planned to examine a New York law which allowed insurance companies to make riskier investments than in the past).
Section 20, with which some of you are familiar. Further, we had the thrift crisis, as Professor Carnell indicated, which was significant because it delayed comprehensive reform for probably four or five years. Finally, there was state intervention.

As to the future, my professional opinion is that the biggest issue confronting the industry, besides getting up to speed and dealing with all the regulations resulting from the new legislation and the marketplace itself, is re-regulation. While a vibrant economy currently exists, a lot of what we are seeing is happening in one of the most robust markets in the history of the United States. The United States and New York are in a very good position right now. Obviously, we hope that this prosperity continues. But, at the same time, you are seeing consumer interest in a myriad of issues that are all related to the financial services market, whether it is privacy, ATM fees, rate or fee deregulation, or deregulation in general. These are all aspects of the financial services market. As we go forward, I think we are going to see escalating interest in greater regulation, and that will be a large part of the NYBA agenda.

I refer briefly to the fact that we have in New York the "wild card" statute that allows the state regulatory system to react immediately to federal action. It is a watershed law that was passed three or four years ago in New York. What that meant for New York is very simple: nine out of the top ten banks in the State of New York are state-chartered.

Privacy has been discussed at length. Nevertheless, I

79. N.Y. CLS Bank § 20 (2001) ("In case of the insolvency or voluntary or involuntary liquidation of any banking organization... all unpaid charges lawfully assessed against it by the superintendent and all unpaid penalties and forfeitures incurred by it under any section of this chapter shall be entitled to priority of payment from its assets on an equality with any other priority given by this chapter.").

80. See Starbuck and Pant, Swire, and Providenti, supra note 8.

81. See N.Y. CLS Bank § 14-g (1999) ("It is the intention of the legislature... to ensure that banks and trust companies may exercise the same rights and powers and engage in the same activities as national banks... "); see also 2000 N.Y. ALS 418 (amending, in part, N.Y. CLS Bank § 14-g in regards to insurance activities of banking organizations).

82. Id.
completely agree with Ms. Schaffer's comments that the European model is one that we should look at very seriously. Yet, at the same time, we should recognize that the American system provides the greatest democratic credit system in the world. By our estimation, a domestic mortgage is 200 basis points lower on average mortgages in Europe, due to the credit system that exists in the United States. Other topics that we may discuss in the panel include deposit insurance, issues concerning regulating ATMs, e-banking, and the Community Reinvestment Act. Finally, and I think most importantly for those who study the system, there is this very elaborate regulatory system that still exists in the United States. People can say we should have a consolidated regulatory system, but, so far, the complex regulatory scheme has worked well for the United States. With the Federal Reserve Bank as an umbrella organization, I think we can look forward to a good system.

PROFESSOR CARNELL: Thank you, Mr. Smith.

Our next panelist is Beth Climo. Ms. Climo is Managing Director of the American Bankers Association Securities Association and the American Bankers Association Insurance Association ("ABAIA"). These are separate affiliates of the American Bankers Association, whose members are right at the intersection between banking on the one hand and the securities and insurance businesses on the other. Ms. Climo has had a distinguished career working at Bingham Dana & Gould, and as Senior Counsel for the Senate Banking Committee, as Director of Legislative Affairs for the FDIC at a critical time during the thrift debacle, at a time, I would note, when the FDIC gained new substantial powers and responsibilities. Most recently, she worked for the Federal Housing Finance Board.

MS. CLIMO: I will be brief. With financial modernization, at least as a legislative matter, behind us, some of the things on which

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83. Community Reinvestment Act of 1977, 12 U.S.C. § 2901, § 2901(b) (2000) (“It is the purpose of this chapter to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.”).

84. See Starbuck and Pant, Swire, and Providenti, supra note 8.
Congress will refocus, as Ms. Schaffer mentioned, are regulatory and supervisory structural issues.

Now, one area quite ripe for that, as you heard from Ms. Schaffer and from Ernie Patrikis before her, is the regulation of insurance, which for more than fifty years has been reserved to the states. Under the McCarran-Ferguson Act, the regulation and supervision of the insurance industry is done under a state-by-state structure rather than through any federal entity.

The ABAIA represents the insurance operations of some of the largest banks in the United States. More than a year ago, this organization identified the state-by-state system of regulation as a problem that should be addressed, and it developed a fairly comprehensive proposal for an optional federal charterer and regulator for the insurance industry. Even though that proposal was developed, the ABAIA decided to back-burner it because it seemed to put the cart before the horse by addressing the regulatory structure before the banking industry was fully permitted to get into the insurance business. Therefore, the federal charter proposal was back-burned. But, once Financial Modernization via Gramm-Leach-Bliley was enacted, the organization returned the proposal to the front burner and decided to make it its top priority. Hence, one of the reasons I am here before you today is to talk about that proposal. We think, at the ABAIA, that federal chartering is the next logical step for the insurance industry after financial modernization. It is a necessary development in view of the nationalization, and even globalization.

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86. 15 U.S.C. § 1012, § 1012(b) (2000) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . ").
89. See Brostoff, supra note 87 and accompanying text.
of the insurance business, and many other industries.

We do have a very detailed proposal. It is currently being put into legislative form. Although we by no means think we have the ultimate wisdom on exactly how this should happen, we do think that the process is encouraging dialogue among other large insurance organizations that are looking at similar proposals. Our plan certainly has caught the attention of the National Association of Insurance Commissioners (the "NAIC") and other insurance commissioners. If nothing else, I think either the state insurance regulation or the ABAIA will benefit at the state level from the kind of pressures that these kinds of proposals impose.

I will make just two key points about the proposal, at least as we have structured it. One is the focus on the word "optional." This proposal does not supplant the state system but supplements it. The proposed regulation plan is designed to work in tandem with the state system. In other words, what it does is it gives insurance companies, insurance agents, and brokers a choice of regulator and supervisory system. The second important point, at least, again, as our proposal is structured, is that the legislative plan is closely patterned after the dual banking system, both in the form of the proposal and in the contemplated benefits. For example, three such features are:

(1) It would make the option of a federal charter available. Under our proposal, there would actually be two options: a full insurance option and one just for agents and brokers, consisting of a complete charter which includes insurance underwriting.

90. See Two Banking and Insurance Groups Joining to Form New Association, BESTWIRE, Feb. 20, 2001 ("ABAIA has drafted a legislative proposal to establish a structure similar to the federal system for regulating banks. More than two years in the making, the draft would give insurance companies the option of being chartered and regulated by the federal government or by an individual state.").

91. See generally, Gramm-Leach-Bliley Issues Top NAIC Agenda, INS. ACCOUNT., Mar. 13, 2000, at 1 [hereinafter NAIC Agenda] (discussing how the NAIC, along with the insurance industry in general, is responding to financial modernization); see also Miles Maguire, Schact Urges NAIC to Fix 'Identity Crisis, PRIVATE PLACEMENT REP., May 22, 1995, at 8 (discussing whether the NAIC is a private trade group or a public governmental entity).

92. See King, supra note 77 and accompanying text.
The regulatory structure would include a federal commissioner. Ours is patterned after the OCC\textsuperscript{93} and the Office of Thrifts Supervision (the "OTS"),\textsuperscript{94} which is a separate department under the Treasury Department. Now, by no means was that the only avenue. The other option was setting up an independent agency, like the Securities and Exchange Commission, the Federal Reserve Bank, or something similar, but we opted to go the route of the OCC and the OTS. This proposed entity will be the charterer, the regulator and the supervisor, again as the OTS and the OCC are today.

The third leg of the proposal is the guarantee system. Again, the federal guarantee system that we would put into place would mirror the FDIC in a number of ways. For one, it would be independent of the commissioner. In other words, it would be a separate board that is not beholden to the administration. Further, a majority of its members would be independent. Professor Carnell remembers, as I do, how important we thought the independence of the FDIC was in helping to work through the thrift debacle in the late 1980s.\textsuperscript{95}

As we have structured it, the proposal would guarantee all insurance activities. We would keep the same types and levels of coverage that exist under the state systems today, and would additionally cover all insured activities, irrespective of whether they are under a state charter, state regulatory system, or federal system. Again, that mirrors the FDIC system today under the dual banking system, where the FDIC is the insurer of both the state banks and the federal banks.

A difference between our proposal and the current state system is that the state system would no longer be "post-funded." Now, if there is a failure and there is an insolvency, then the funds are collected at that point from those that are part of that fund.

\textsuperscript{93} See source cited supra note 16.

\textsuperscript{94} The OTS is the primary regulator of all federal and many state-chartered thrift institutions, including savings banks and savings and loan associations. It was established in 1989 and replaced the Federal Home Loan Bank Board, which had overseen the banking industry during the Thrift Debacle. See generally the OTS web site at http://www.ots.treas.gov/default.cfm (last visited Oct. 19, 2000).

\textsuperscript{95} See Starbuck and Pant, Swire, and Providenti, supra note 8 and accompanying text.
Our concept, however, would pre-fund it—again, much like the FDIC—and the risk would be spread much more broadly because essentially all the insurance entities would be feeding into that guarantee fund.

There are many benefits of the proposal. One is the virtue of modeling the dual banking system. The dual banking system, we believe, has served the banking industry well for more than 140 years. It is very strong. Even though there has been the federal charter option for 140 years, two-thirds of the institutions—although I think only about half of the assets—continue to be under a state charter, as opposed to a federal charter. I would like to say that Mr. Smith, in fact, made my case very well when he said that nine of the ten top banks in New York continue to be state-chartered banks. The benefits of the proposal are self-evident. The proposal is beholden to the banking industry for bringing this forward because the banking industry has experienced this, where independent insurance companies have not operated under a similar system. But, in fact, all those benefits can be brought to bear on the insurance business over the long run if this sort of proposal is enacted.

PROFESSOR CARNELL: Thank you, Ms. Climo.

I will put a series of questions to the panelists, some of them designed to be provocative, but most of them designed to be susceptible to short answers, not that short answers would do entire justice to the subject matter, but when does one do entire justice anyway?

What potential policy issue or proposal should financial services firms fear the most over the next five years? MS. CLIMO: To use one term—we had a big panel on it before—I will say privacy regulation. Is that short enough?

PROFESSOR CARNELL: Absolutely.

MS. CLIMO: And I do not mean the regulations coming out of the fairly extensive privacy rules that are in Gramm-Leach-Bliley, but additional layers of privacy regulation. Probably, the

96. See King, supra note 77 (arguing that the dual banking system has been a success for 140 years and a similar system should be applied to the insurance industry).

new policy rules would create among states a patchwork of protections and disclosures that would be impossible for a consumer to navigate through, which I think is a real threat not only to institutions, but also to consumers.

MS. SCHAFFER: I agree with Ms. Climo. I think, Joel Reidenberg's prior presentation, demonstrated some of the issues and the debate that occurs in this area. Privacy becomes a very emotional issue. It becomes an issue that is difficult to keep "contained," although I doubt "contained" is the right word, because I think everybody supports privacy. The question is, what is all the controversy about? When you look at polls and you look at different types of information on the issue, you get various responses. Everybody is in favor of privacy, but, as I think Carl Felsenfeld pointed out, privacy regulation is sensitive. If people are going to get certain benefits, maybe they are willing to have certain information shared.

In some of the debates in Congress, people were talking about getting catalogs from Victoria's Secret—I mean, this is what the debate concerned in a Congressional committee—and who was sharing their mail order information and how embarrassed they were. It is a debate that takes a life of its own. In fact, pending bipartisan legislation seeks to establish a commission to study the issues and address privacy questions— not just financial industry ones, dealing with information on one's side, but issues that involve driver's licenses, social security numbers and all sorts of privacy issues. The pending legislation's goal is to try to come up with only one recommendation. I think that makes a lot of sense.

MR. SMITH: Certainly privacy protection presents a problem, from the NYBA's point of view. For one, Congress specifically


98. See Symposium, Panel II: The Policy Aspect, Consumer Data Privacy, 6 FORDHAM J. CORP. & FIN. L. 69, 96-105 (2001) (laying out the issues of banks sharing account balances with third parties and banks notifying that they will be disclosing private information to its affiliates).

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reserved certain powers to the states.103 Moreover, there certainly is an interest by the public on this topic, as witnessed by the article on the front page of the New York Times today.101 Every week for the last three or four months, there has been some story dealing with privacy, whether it is about DoubleClick102 or someone else. Privacy is a fundamental issue in the industry, in the near and distant future.

In addition, as one who talks to the media and consumer groups frequently, I say that another vital issue for the industry is pricing regulation with the one exception dealing with mortgages, passed by the Congress in 1980.103 In that piece of legislation, Congress overrode state usury statutes on mortgages.104 But this issue may also be in the State purview, as mortgage laws are still regulated by the States to a great extent. And, irrespective of the court cases and the OCC's authority as to ATM fees, for example, the States still have the right to action, and we spend a great deal of our time talking about that. Now fee regulation does not just affect banking, it affects the securities and insurance industries, as well as

100. Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, § 507(a), 113 Stat. 1338 (1999) (stating that Gramm-Leach-Bliley does not supersede State statute, regulation, order or interpretation, unless such is inconsistent with Gramm-Leach-Bliley, and only to the extent of the inconsistency); see also id. § 507(b) (allowing the States to provide greater protection than that in Gramm-Leach-Bliley).


104. Id. § 105 (overriding provisions in constitutions or laws of any State expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved which applied to any loan, mortgage, or advance which was "(A) secured by a first lien on residential real property or by a first lien on stock in a residential cooperative housing corporation where the loan, mortgage, or advance [was] used to finance the acquisition [sic] of such stock; (B) made after the date of enactment of this Act; and (C) described in section 527(b) of the National Housing Act").
other financially related industries. Thus, fee regulation and privacy are the two most troublesome issues, in my opinion.

MR. RUTLEDGE: Just to add more of a concept, rather than a specific prospective piece of legislation, I think an area about which bankers and financial services people should be particularly concerned is the possibility of overreaction on the part of Congress or State legislators to a particular adverse development within the banking industry.

I believe we have a system right now in which there is enough complexity and enough new areas to cause organizations that get involved to experience some hiccups. When those hiccups occur, will there be a visceral reaction to try to cure that through the legislative process, or will there be a recognition that a lot of those issues can be dealt with on a case-by-case basis, as long as the relevant supervisors have enough authority and discretion to deal with them?

PROFESSOR CARNELL: Ms. Climo outlined a proposal for an optional federal insurance charter. I want to ask the panelists about the legislative prospects for such a proposal.

Let me provide background. The American Council of Life Insurance ("ACLI") about two years ago started talking about how they might be exploring this issue. In fact, another way to look at part of what impelled the Gramm-Leach-Bliley Act is as a response to a fear in the insurance industry that if there was not legislation, the national bank charter might become the de facto optional federal insurance charter, which the insurance industry did not see as producing the kind of playing field they had in mind. Given the culture and history exemplified in the McCarran-Ferguson Act, which says there will be no federal regulation of

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105. See Brostoff, supra at 87 and accompanying text (explaining and outlining the proposed insurance charter).
106. See Federal Charter Amongst Life Insurers' Options, INS. ACCOUNT., Apr. 10, 2000, at 1 [hereinafter Federal Charter] (explaining that the ACLI had been working on a study for two years, concluding that there was a need for improvements in the state-based regulatory system).
insurance as such,¹⁰⁹ for the ACLI to broach the idea of an optional federal charter is sort of like the Dalai Lama broaching the idea of becoming a Southern Baptist. Against the background of the changes that have occurred so far, but still keeping in mind the large changes that would be required for this to happen, what are the legislative prospects for an optional federal insurance charter?

MR. SMITH: As I often sit at tables with agents and companies from around the country. I would say insurance is still very much a state-regulated business. There is very strong presence in the construction of the insurance provisions of the federal law to preserve the state regulatory system. I think you are right, Professor Carnell, in the comments preceding your question. I think that if there were federal regulation of insurance at the front end, not unlike deposit insurance in interstate banking, it would be controversial.

MS. SCHAEFFER: I agree. I think it is a debate that will happen, and it will occur eventually, but it is a long-term issue. I do not think it is something you will see in the near term.

PROFESSOR CARNELL: Is this still too hot to touch right now?

MS. SCHAEFFER: Yes.

PROFESSOR CARNELL: Not just too hot to pass, but too hot to touch?

MS. SCHAEFFER: Yes. The industry is beginning to come out and say, “We have these ideas, we’d like to sit down and talk to people,” but it is at its very initial stages of floating the ideas.

MR. RUTLEDGE: I do think that Ms. Climo raised a very good point in her remarks, that just the discussion of the possibility of a federal charter has some implications for the way in which the states perform their activities. In the course of the last couple of years, in some ways, I have been extremely impressed by the work of the NAIC.¹¹⁰ They have quarterly meetings where they bring together supervisors from across the country into very heavily structured, very rigorous sessions to discuss how to develop

¹⁰⁹.  Id. § 1012(b) (“No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance. . . .”)

¹¹⁰.  See NAIC Agenda, supra note 91 and accompanying text.
approaches to insurance supervision that can be adopted across the Fifty States. The fact that they are doing this in such a way shows what a challenge it is to get fifty parties together to work out issues.

I think, with the debate going on about the possibility of federal chartering, it puts even more pressure on the organizations to try to work together and hammer out differences so that there still can be some measure of creativity exercised by individual state supervisors, but with enough consistency of approach that maybe the issue gets somewhat downplayed.

PROFESSOR CARNELL: It is worth noting that the legislation incorporates an exercise like that in a somewhat more limited area. There is the National Association of Registered Agents and Brokers (the "NARAB"),¹¹¹ and Gramm-Leach-Bliley¹¹² also sets up a system under which federal regulation will occur unless certain criteria are met.¹¹³ Therefore, the legislation is sort of setting a deadline and a process that will then presumably galvanize the insurance people for a solution of their own.

MR. SMITH: Also too, Professor Carnell, I do not think it was emphasized in the earlier panel, but on privacy issues, the insurance regulators are mandated by the Statute to put together regulations.¹¹⁴ They will be promulgating those in short order. That can be significant. Even though it applies just to insurance companies under the financial services holding company, there are profound implications for banks and for securities firms. Further, in the New York State statute in the safe harbors, there is the ability to deal with opt-in on medical information and such things, which we are very much familiar with here in New York. So the insurance regulators still have a tremendous amount of authority

¹¹¹. regulatory system).
¹¹³. See id. § 114 (providing that the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation may impose restrictions or requirements by regulation or order on certain entities if such agencies make certain findings).
¹¹⁴. Id. § 505 (a)-(b).
even as it relates to the privacy regulations.

MS. CLIMO: I think how the insurance industry implements that will have a lot to say with respect to whether they really are going to be able to go towards nationalization and uniformity, which is what this NARAB provision in the Gramm-Leach-Bliley Act\textsuperscript{115} tries to encourage, because if they do not follow what the federal agencies have done and essentially implement the previously instituted rules and they go in a patchwork, I think that is when you will start seeing the ACLI\textsuperscript{116} and American Insurance Association (the "AIA") react.\textsuperscript{117} Even though they are talking in the back room about it, I think that will be a very telling sign, if they cannot get it done even at that level.

PROFESSOR CARNELL: A question? Mr. Larry Uhlick.

MR. UHLICK: Could Ms. Climo just elaborate more on the mandatory insurance provisions? It is one thing to have an option for a federal insurance charter. It is another thing, if I understood you correctly, to have mandatory coverage of insurance liabilities by a federal agency. Is that what we are talking about here?

MS. CLIMO: You mean the National Association of Registered Agents and Brokers?

PROFESSOR CARNELL: No, the insurance guarantee fund.

QUESTIONER: Are we talking about an FDIC kind of model for the insurance industry?

MS. CLIMO: Yes.

QUESTIONER: Would that be pre-funded coverage of all liabilities?

MS. CLIMO: You have a state guarantee fund in each state for the insurance business today. The new model would essentially be the substitute for that, but it would exist at the federal level. It

\textsuperscript{115}Id. § 322 (establishing the National Association of Registered Agents and Brokers).

\textsuperscript{116}See generally Federal Charter, supra note 106 and accompanying text (discussing the ACLI's recent efforts in improving the state-based regulatory system).

\textsuperscript{117}See Steven Brostoff, Financial Services Groups Unite For Functional Regulation, NAT. UNDERWRITER, Feb. 10, 1997, at 3 (stating that major insurance, securities and banking associations, including the ACLI, announced strong collective support for broad financial services legislation based on functional regulation).
would cover the entire industry, as opposed to current state-by-state coverage. Again, I do not know how well those funds work, but an analogy exists to when there were state insurance funds for the banking industry. We saw a couple of those—Maryland and Ohio—I believe they were, “belly-up” is not quite the right word, but they went by the wayside, as did some S&L insurance funds. The concept is to have a federal insurer go with the federal charter. We have opted to mirror the dual banking system and have the insurance cover all entities irrespective of whether they are state or federally chartered. Again, these are all what I consider to be details. As other groups start working on similar proposals, they may have different ways of addressing those details, and we are very open to all suggestions, of course.

PROFESSOR CARNELL: Within computer science, people speak of something called Moore’s Law. Moore’s Law is a name for the phenomenon under which the price of computing power falls by half every eighteen months. This has held true for decades. When you think about compounding a fall like that again and again, the results are extraordinary. That is why any personal computer produced in the last few years has more computing power than the NASA computers that sent people around the moon years ago, far more.

So if you carry this phenomenon to its logical conclusion, it suggests that the cost of transmitting and processing data will approach zero. Now, financial services to a significant degree involve processing data. Does this phenomenon suggest pressure for a dramatic end to intermediation in financial services, that is, for those who have capital to provide and those who want to borrow or otherwise receive financial services to connect up with each other through markets at the expense of the diminution in the role of more traditional financial institutions? This connects to the question of whether the Internet will commoditize financial

118. See Art Wittman, Feeding Moore’s Law, NETWORK COMPUTING, Dec. 27, 1999 (discussing how Gordon Moore in 1965, one of the founders of Intel, charted the increasing density of transistors housed on a single microchip and noted that the number doubled every 18 months, leading to the coining of “Moore’s Law”).

119. Id.
services, although it is putting the question in even more radical form.

MS. SCHAFFER: Actually, I read an article from CBS MarketWatch. It concerns connecting with B2B software stocks. Specifically, it discusses an interview of an analyst from CS First Boston who talked about these marketplaces bringing sellers and buyers together. The interesting thing is that he asked, who was in a position to give these companies a run for their money? The analyst said the other alternative would be for banks to get into this business. He talked about the need of getting credit to small businesses and providing a marketplace to do it.

It struck me that this is something about which, while not exactly approved under Gramm-Leach-Bliley, the OCC has opinions. The OCC says a national bank can act as a finder putting together a buyer and a seller. One could argue that these marketplaces are very similar in concept and why shouldn't they be approved for a financial subsidiary or for a holding company. I do not know if that is exactly what Professor Carnell is talking about, but it is fascinating.

PROFESSOR CARNELL: I invite views on the likelihood of this.

MR. RUTLEDGE: I think it is without question that advances in technology will allow various current barriers to seemingly break down. Geographic barriers will unequivocally break down; they already have, to a very significant extent. The barriers between what constitutes financial services and what is the provision of other kinds of services, as was just discussed, could well also break down.

I think the question for banking organizations is, how can they harness the technology to aid their delivery of products, their reaching out, and provision of services to their customers? We have seen a number of banking organizations that have made the big investment in technology and have made it in a somewhat...

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121. 12 C.F.R. § 7.1002 (2001); see id. § 7.1002(b) (excluding activities that would characterize the bank as a broker under applicable federal law).
122. See supra note 7 and accompanying text.
specialized dimension. They have made a choice. They made a choice to be the big processing firm. They made a choice to become, in effect, an investment banking firm. They have targeted a particular set of customers, tried to understand what array of services those customers want, and make sure that they deliver the platforms so they can more effectively serve those customers. They have certain built-in advantages. Maybe some of these advantages are eroding. But if they build upon the various technologies that may be available and have an appropriate strategy, I think it can be a positive for banking organizations, rather than necessarily leading to their erosion of market share and customer base.

Mr. SMITH: Commenting on the pricing, I would not go so far as to try to predict how institutions are going to price down the road. When people talk about the Internet, it is a little bit like, if you remember twenty-five years ago, when people talked about home banking. Chemical Bank had to drop home banking because they could not get anyone to sign up. Currently, Internet banking is at the front end.

I think there are two critical elements to the implementation of technology. One, there needs to be consumer and business acceptance. Actually, there needs to be customer acceptance of the technology. Obviously, there is a lot going into the branding of that technology. Second, there needs to be clarity about the topics raised today. What are the legal and regulatory compliance issues? What will they be? If you go the route that some advocates would take on the privacy provisions, obviously that might have profound impacts on the Internet system. I think it is probably too early to tell whether Moore’s Law is going to remain in the economics books or wherever it exists.

PROFESSOR CARNELL: You are suggesting a sunset on Moore’s Law. During the 1980s, bank regulators developed a practice of treating large banks as “too big to fail,” in the sense that the FDIC would provide 100 percent protection to all depositors, even those over the $100,000 limit.¹²³ We saw that in 1984, when Continental Illinois, the largest bank in the country at the time, was

in effect rescued, together with its holding company. By the end of the decade, the FDIC was protecting uninsured depositors at banks with less than $1 billion in assets. In 1991, in the Federal Deposit Insurance Corporation Improvement Act (the "FDICIA"), Congress sought to curtail that practice, and so, for example, it required the FDIC to follow the least-cost effective approach to resolving a failing institution and it did establish a narrow systemic risk exception, which has not in fact been used. But since then there has been a lot of consolidation within the banking industry, and the Gramm-Leach-Bliley Act should facilitate additional consolidation between banks and other financial services firms. So what is the outlook for the government extending formal or informal support for financial institutions that get into trouble, whether they be depository institutions or affiliated financial firms?

MR. RUTLEDGE: I think it is a bit of a misnomer to refer to the doctrine of "too big to fail." I have long thought of it as much more "too big to fail in a disruptive manner," that even in the largest situations, the typical situation has been that equity holders have been wiped out and that a number of debt holders in many instances have also suffered losses.

I think the challenge for us as supervisors, and particularly the Federal Reserve, which functions as an umbrella supervisor, is to be mindful of the systematic implications arising from the implementation of activities by various organizations. When problems arise, however, knowledge of inter-organizational relationships, specifically large organizations and other key players in financial markets, are crucial. This will facilitate a more effective understanding and management of the knock off effects of participants in other organizations. I do think that part of our

126. Id. § 141 (requiring the least-cost resolution).
127. Id.
role is to make sure that tremendous systemic disruptions do not occur. At the same time, we have to continue to press for the right kind of market incentives so that organizations do recognize that there is a downside to taking overly risky strategies.

MS. SCHAFFER: The people on the first panel talked about the requirements of Gramm-Leach-Bliley\textsuperscript{129} for a bank to be well-capitalized and well-managed, and I think to some extent that was Congress's response to part of this question. The thought was that if you write legislation that encourages affiliations and you are not going to extend the safety net, you need to make the institutions that are under the safety net stronger. I am sure that they are stronger. I think that, while there was a lot of criticism of some of those requirements and the cure proceedings, there was a desire on the part of Congress, first, to not extend the safety net, and, second, to make the institutions stronger under the net.

MR. SMITH: I argue that, rather than FDICIA\textsuperscript{130} being tested, maybe it is working, and maybe because there have not been any failures, God forbid, that the trip wires that were put in FDICIA actually have acted as a safeguard.

Also, it is my understanding, at least from the FDIC, that if there were a failure, that the largest institutions would have to share in paying for the replenishment of the insurance fund, so there is a self-policing mechanism. So I think that the feeling is, while there is a concern about, and there is always mention of, "too big to fail," enough safeguards have been put into place, enough safeguards that, hopefully, will never have to be used.

PROFESSOR CARNELL: We will have a better sense when we have gone through a full economic cycle with the safeguards in place. Let me ask the impossible question. Well, I will tell you the question I was going to ask and then I will ask a watered-down version of it. The question I was going to ask is, what do you predict the biggest policy issues in financial services will be ten years from now? Now, nobody knows that, or at least I think that would be very difficult to know, so I am just going to ask you what

\textsuperscript{129} Id.

you think the biggest policy issues in financial services will be five years from now.

MR. SMITH: Eighteen months?

MS. CLIMO: If Ms. Schaffer’s boss has his way, they will still be talking about the fact that we should not be mixing banking and commerce. That is probably an issue for the next three to five years.

MS. SCHAFFER: Depending where the economy is, and if there is a downturn, depending what its impact will be, I think eventually—I do not know if it is going to be five years from now—we will get to the issue of regulatory consolidation and how to address the fact that at the federal level we have four bank regulators, a securities regulator, possibly an insurance regulator, the Commodity Futures Trading Commission\(^{131}\)—I mean, we have a lot of financial regulators. One debate is whether this represents a strength or a weakness. Is there a way of addressing it? I do not know if it is going to be five years or ten years, but I think eventually that issue will be addressed.

MR. RUTLEDGE: I do think, and I am not sure whether it is five years or some different time period, that the issue that was alluded to a moment ago of what exactly financial activities are and what constitutes commercial activities unequivocally has to be addressed. That line is going to be blurred by behavior within the industry. Congress has typically reacted to changing market behavior by seeking to rationalize what has evolved through creative lawyering and creative business decisions. So I anticipate that there will be a policy issue refocused on what constitutes that dividing line.

MR. SMITH: We get taught to think in two-year cycles, but if history is the judge, it will not be as galactic as we may think. We will probably still be living with the implementation of this law. Concerning Mr. Rutledge’s point, the big debate now occurring is the regulations on merchant banking. Quite frankly, merchant banking can be a mix of banking, commerce, and the investing in

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firms. Therefore, in the next couple of years, I say that we will probably still be talking about many of the things that we are talking about today.

PROFESSOR CARNELL: Ms. Climo, any comments?

MS. CLIMO: I put my money on banking and commerce, that with the Internet and such, just as now we cannot tell the difference between a banking, insurance and a securities product, probably five years from now we will not know if it is a commercial product or service, or a financial product or service. So we will have the same debate, but at a different level.

PROFESSOR CARNELL: I will contribute one subversive thought. My panelists assume a system in which the largest issues are going to involve conventional privately owned firms that borrow money on the strength of their own capital and financial strength. I note that we have a number of large financial institutions in the United States—Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System, in particular—that raise capital based on the market perception that they are the U.S. Government in disguise. They have a cost of funds that is close to that of the U.S. Treasury, which enables them to borrow money even at a cheaper cost than the triple-A-rated fully private firms. These healthy, growing gorillas are, as one person has pointed out, growing a good deal faster than the cage that contains them. In a market environment that puts a huge emphasis on earnings momentum, they are going to have to look for a lot more room to grow, or else they will face the market consequences with their stocks. Further, a candidate for a future policy issue is the extent to which these so-called government-sponsored enterprises will dominate the financial services sector.


133. An “AAA” rating by Standard & Poor’s indicates that an obligor has an “extremely strong” capacity to meet its financial commitments. See http://www.standardandpoors.com/ResourceCenter/IssCreLT.html (last visited Apr. 4, 2001) (listing S&P long-term issuer credit ratings).