

Statement of
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before the

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Mr. Chairman and members of the Committee, thank you for inviting me to testify on H.R. 10, the Financial Services Act of 1998. I commend you for holding these hearings and for recognizing the importance of financial modernization to our nation's economy, as well as to its consumers and communities. While H.R. 10 takes some important and promising steps toward modernizing our financial system, it also contains major flaws that, on balance, make it more damaging than progressive for the financial services industry. I'd like to briefly highlight several issues in this regard.

First, there has been much discussion about the impact of various provisions of H.R. 10 on the agencies that supervise financial institutions -- turf. Some have suggested that allowing a choice between conducting additional financial activities either in bank holding company affiliates or through subsidiaries of the bank itself, would upset the delicate balance of roles between the various federal financial institution regulators.

In fact it is necessary to allow this choice in order to maintain the current -- and successful -- balance we now have. Today, the range of activities that may be conducted in bank subsidiaries -- state and national -- is substantially equivalent to the range of activities that a holding company affiliate may conduct. H.R. 10 significantly alters this balance by requiring banks to conduct virtually all newly authorized types of activities in holding company affiliates.

In other words, what is at issue here is whether you preserve the balanced perspective that has made our banking system innovative, strong and successful.

The second issue of whether allowing banks to choose between the subsidiary or the holding company affiliate structure would be consistent with safety and soundness. Experience here shows that the activities in question are not inherently any riskier than other activities that banks have conducted for decades. Many of the proposed new financial activities in fact have been conducted for years -- safely and profitably -- by subsidiaries of state-chartered banks and by other U.S. bank subsidiaries that operate overseas.

Moreover, we support imposing additional supervisory

safeguards where bank subsidiaries conduct new types of financial activities to ensure that they enhance the safety and soundness of their parent bank, and protect the bank from downside risk. For example:

The amount the bank could loan to the subsidiary would be capped.

The amount the bank could invest in the subsidiary would be capped.

The bank's loans to the subsidiary would have to be fully collateralized by high quality collateral.

The amount of the bank's investment in the subsidiary would have to be deducted from the bank's capital in determining the bank's regulatory capital adequacy and the bank would have to be well-capitalized even after deducting that investment. This last safeguard prevents losses in the subsidiary from ever depleting the bank's capital for regulatory capital adequacy purposes.

In short, there is no compelling safety and soundness basis for depriving banks of the ability to decide how best to structure their own businesses -- quite the contrary. As the FDIC has said, allowing a prudent diversification of activities in bank subsidiaries, subject to safeguards such as those I have mentioned, enhances safety and soundness and reduces the risk to the deposit insurance funds.

Third, some supporters of H.R. 10 contend that banks enjoy a subsidy not available to other financial institutions and that banks are able to gather funds at lower cost and pass those savings on to their subsidiaries, resulting in an unfair advantage over competing firms. Many researchers -- and certainly many bankers -- will argue, however, that the costs of regulation imposed on banks outweigh the value of any lower cost funds banks are able to gather.

But let's assume for the moment that some net subsidy actually exists. There is a simple answer to prevent its transmission from the bank to a subsidiary. You need only apply to funding transactions between banks and their new subsidiaries the same limitations provided for funding transactions between banks and their affiliates. This way, if there were a net subsidy, its transfer to the subsidiary would be prevented to the same extent it is prevented for affiliates.

Fourth, H.R. 10 would effectively roll back the role of CRA by diverting resources and income from new growth lines of business away from banks and thus away from supporting CRA.

And finally, I'd like to note an issue that is both a philosophical and a practical one. America's financial system and the opportunities it makes available to our people are the envy of the world. A big part of our success has been the result of letting free markets work and letting businesses

decide how to compete most effectively and efficiently -- unless there is a compelling public policy need to intervene.

As we undertake financial modernization, we should try to build upon -- and expand upon -- the best elements of our current system. Unfortunately, in major respects, H.R. 10 does not do this.

The treatment of bank insurance activities is a glaring case in point. H.R. 10 would protect some insurance product providers and, in some cases, exclude others, including banks. In general, H.R. 10's standard of permissibility for banks to conduct insurance activities is so complex and so unclear that many banks will be unwilling or unable to figure out just what they are allowed to do, and consumers will be deprived of the potential cost and convenience benefits that can come from increased competition. I know that you have heard a lot about this issue. But it's difficult to fully appreciate the complexity and lack of clarity in this standard without mapping out the steps a banker would have to take to figure out what insurance activity was permissible under H.R. 10. Such a map is not only hard to follow -- it's full of road blocks and dead ends.

Mr. Chairman, H.R. 10 requires a major reconfiguration before it can serve as the framework for our nation's financial system in the next century. I urge you and your colleagues to take the necessary time, and let's fix it so we have it right.