Remarks by

Julie L. Williams
Acting Comptroller of the Currency

before the

Tennessee Bankers Association
Nashville, Tennessee

June 8, 1998

Thank you and good morning. I was delighted when the Vice President's office called to ask if I would be available to join you today, because it gives me the opportunity to resume some of the acquaintances that I made during the recent visit of the Tennessee bankers to our offices in Washington and to make new acquaintances of those of you who were not then able to join us. It also permits me to share my thoughts with you on some key legislative issues in greater detail than was possible given your busy schedules while you were in the capital.

I have a confession to make: I have spent nearly my entire adult life in Washington, and most of my childhood, too, since my father was an attorney with the Department of Justice. Over that span, I have witnessed many public policy controversies. And, in recent years, I have been a frequent participant in the debate surrounding our policies toward financial institutions. But I frankly do not recall a legislative season -- and I've seen my share -- so full of significance for bankers as the one we are in the midst of today. Right now, we have pending before one or both houses of Congress legislation dealing with credit unions, IMF refunding, regulatory relief, bankruptcy reform, Year 2000 readiness, privacy in electronic commerce, and more. But the legislation I am most concerned with now -- as I believe you should be -- is more comprehensive in scope and far-reaching in effect. I'm referring to H.R. 10 -- the Financial Services Act of 1998. That is what I'd like to talk to you about today.

Just weeks ago, the House of Representatives leadership finally brought H.R 10 to the floor. It was the culmination of months of hearings, negotiations, procedural wrangling, backroom bargaining, and political arm-twisting. It involved dozens of lobbyists representing the insurance, securities and banking industries, as well as consumer and other affected groups. When the votes were counted, H.R. 10 had passed by a margin of one.

Although most analysts now question whether the Senate will invest much of its remaining time this session in a bill that has barely survived its first real test, its supporters have hardly abandoned the fight. They point out -- rightly -- that H.R. 10 has several times returned to life after others had written it off. The way the bill's backers see it, they have won a historic victory -- the narrowest of victories, to be sure, but a highly

significant one nonetheless.
Just as those who have supported H.R. 10 are looking ahead, those who oppose the bill in its current form must not view its passage as either a foregone conclusion or a lost cause. Regardless of what becomes of it during the current session, H.R. 10 is still very much in play -- and thus, so is your future. The worst thing that could happen now -- for people on all sides of the debate -- would be to call a halt to our discussion of the issues and what H.R. 10 would actually mean for financial institutions and the American people. Indeed, precisely what is crucial is that all involved parties truly understand what the bill does and its implications for the future. My remarks here today are designed to aid in that understanding.

Certainly a number of misunderstandings have arisen in the course of the debate over H.R. 10. Take the operating subsidiary issue, for example. The basic question is this: who shall decide the manner in which banking organizations conduct the new types of financial activities -- for example, securities activities and providing insurance and annuities -- that may be authorized under the legislation? Shall those new activities be conducted only in a holding company affiliate? Or -- the alternative supported by the OCC, the Treasury Department, and our colleagues at the FDIC -- shall bankers like yourselves have the choice of conducting those activities either in a holding company affiliate or in a subsidiary of the bank? Although both forms have their advantages and drawbacks, for many banks the subsidiary will be the simpler and less costly organizational alternative. Some bankers have told me that, for them, it is the only feasible option.

Recent comments by the Federal Reserve have suggested that allowing bank subsidiaries to conduct the same range of financial and financially-related activities as would be permitted for bank holding companies would present risks to the federal deposit insurance funds. I respectfully disagree -- and so does the FDIC, which has the primary responsibility for the safety of those funds. Indeed, FDIC Chairman Ricki Helfer testified that allowing banks to generate earnings from activities in bank subsidiaries actually lowers the probability of bank failures.

Until it started raising these safety and soundness concerns, the Fed's case against the operating subsidiary was largely based on the argument that a so-called "public subsidy" provided to banks could be passed along to a bank's subsidiaries, giving them a potential unfair advantage in competition with providers not owned by banks. The subsidy, as the Fed defines it, consists of access to the Federal Reserve discount window, final settlement of payments transferred on Fedwire, and federal deposit insurance -- benefits that supposedly exceed the costs of the federal regulation to which bankers are subject.

I must tell you that we have searched high and low for evidence of a net public subsidy to banks, and have come up with little analytical support for the Fed's proposition. In fact, the best estimates -- not only the OCC's, but also those of leading independent scholars -- show that the costs of regulation -- in

the form of assessments for examinations, forgone interest on sterile reserves, interest on FICO bonds, deposit insurance premiums, the cost of compliance activities, and so forth -- exceed the cost of any so-called safety net subsidy.

The real test, however, takes place in the real world, and there too we see no sign of bankers behaving as though a net subsidy existed. Do you feel like you have a government subsidy compared to your competitors?

The OCC's position on operating subsidiaries has been consistent throughout the H.R. 10 debate. We believe that banks of all sizes should be permitted to engage in an expanded range of financial activities and should have the freedom to choose the corporate structure that is best for their business, consistent with safety and soundness.

Why is this issue so important? It is crucial because if you hope to be able to compete against the giant financial conglomerates that H.R. 10 would permit --not to mention other competitors, such as credit unions, that you already face -- you should at least be allowed to choose the corporate structure that allows you to compete and to compete most effectively and efficiently.

This is, quite simply, a matter of your future. While you may not be contemplating new financial activities today or tomorrow, it is essential that your options for the future not be cut off. Or think of it this way. Even though you may not want to go down the road to conduct certain new financial activities today, you don't want your business to be turned into a dead end street. The banking industry is the only industry that is targeted this way in H.R. 10.

Let's take another example -- the impact of H.R. 10 on bank insurance powers. Yet again we find needless regulatory burden and punitive provisions that would limit banks' ability to underwrite and to sell insurance products and annuities. H.R. 10 would permanently restrict banks' ability to offer "insurance" in a principal capacity to those products already approved by the OCC as of January 1, 1997. That means no bank could ever become an innovator in insurance products; indeed, under this provision, banks could not even emulate innovations introduced by others. This provision was plainly intended to ensure that banks could never compete on an equal footing in the insurance business.

Then there is the provision of H.R. 10 that would require banks wishing to sell insurance in a particular state for the first time after the enactment of the legislation to buy an existing insurance agency -- a provision some have dubbed the "Independent Insurance Agents Retirement Income Security Act."

Backers of H.R. 10 are quick to point to the liberalization of the "place of 5,000" restriction as a symbol of the bill's evenhandedness toward banks. This refers to the provision of the National Bank Act that allows banks located in a place with less than 5,000 inhabitants to sell insurance. H.R. 10 would

eliminate the "place of 5,000" requirement for insurance agency activities conducted in a bank subsidiary. But this liberalization comes with strings attached. When a bank subsidiary's insurance agency is located in a place with a population over 5,000, H.R. 10 would treat the subsidiary as an "affiliate" under the law and subject it to affiliate transaction restrictions. The paperwork and reporting requirements to document compliance with that standard would prove particularly burdensome for community banks, which might otherwise be the biggest beneficiary of the change. The bank subsidiary's insurance agency could avoid this new regulatory burden as long as the local population held below 5,000; but if, at the next census, the population passed that threshold, any new bank entrant would be effectively barred by competitive disadvantage from the local market. That result -- bad for competition, bad for communities, bad for consumers -- is unfortunately closer to the genuine spirit of H.R. 10.

There are other insurance-related provisions of H.R. 10 that are discriminatory and anti-competitive. But I would like to close this part of my discussion by mentioning just one. That is the provision that would eliminate the deference that the OCC receives from the courts in connection with our interpretations of permissible bank insurance activities under the National Bank Act. Naturally I am distressed at the prospect that the OCC might be stripped of its historic responsibility for interpreting the national banking laws in the interests of a safe, sound, and competitive national banking system -- a mandate, dating back to the days of Lincoln, that has been endorsed in recent years by repeated unanimous decisions of the United States Supreme Court. What I find even more objectionable is H.R. 10's provision to do away with the deference principle -- a principle carefully grounded not only in constitutional law but in the common sense proposition that, unless shown to be unreasonable, regulators' expert judgment deserves respect from the courts. H.R. 10 would attack this precedent and, in an important area for the banking industry, distort the careful balance, established over decades, between the judicial, legislative, and executive branches of our government.

From a practical perspective, why should you care about this issue? Because it means you will have less certainty -- and more litigation -- about whether activities are permissible for banks. Because you will have less protection against discriminatory state regulation that targets banks' insurance activities. Because, down the road, there will be safe and sound new activities -- new products and services -- that you would like to provide to your customers -- that you won't be able to provide, even though, today, under current law, the OCC might find them to be permissible.

Now, some have contended that despite all these faults, H.R. 10's redeeming feature is that it will prevent the mixture of commerce and banking. Whether these two lines of business should be kept apart is a separate and complex question. But if you believe in separation, be aware of the fact that, despite what its proponents say, H.R. 10 actually provides many new opportunities

for firms to commingle banking and commerce. Financial holding companies with extended grandfathering of their commercial activities, wholesale financial institution holding companies (called "woofies"), unitary thrift holding companies, nonbank banks, merchant banking, insurance companies' permissible commercial investments, and investment bank holding companies -- each of these entities could mix banking and commerce to at least some degree under H.R. 10, and in some cases to a greater extent than is permissible today. Some of these financial entities would have their commercial activities grandfathered for a 10 to 15 year period; for woofies, the grandfather would be permanent.

In the case of unitary thrift holding companies, grandfathered powers would be transferable. In other words, a commercial company could buy a unitary thrift holding company, and the acquiring commercial company could continue and expand its commercial activities because it succeeds to the unitary thrift holding company's powers, regardless of what the thrift holding company was actually doing.

For so-called "nonbank banks," H.R. 10 would eliminate the asset and activity restrictions that now prevent them from engaging simultaneously in banking and commerce. The list goes on and on, but the point should be clear: under H.R. 10, the mixture of banking and commerce would not only continue, but could expand.

I am heartened by the way the banking industry has been pulling together of late in expressing its concerns about H.R. 10 and trying to focus on the type of legislation the industry as a whole needs for the future. If you have not done so already, thinking perhaps that the complex legal gobbledygook of H.R. 10 cannot be of much relevance to you in terms of your ability to do your job, day in and day out, please think again. If you have not done so already, you owe it to yourself to understand the provisions of the bill and reflect upon how it would affect your business and the people you serve.

I do think that America needs financial modernization soon. We need legislation that recognizes the changes that have occurred in the marketplace. But we must have legislation that truly advances the needs of consumers and communities and that gives banks of all sizes an even chance to compete and succeed in the challenging financial world of the 21st century. In my judgment, H.R. 10 is not that legislation.

It's imperative that we take the time to fully understand the implications of financial modernization and get it right. You as bankers, your customers, and your communities deserve no less. Whatever we do will be yours to live with well into the next century.