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**TESTIMONY OF JOHN D. HAWKE, JR.**  
**COMPTROLLER OF THE CURRENCY**  
**Before the**  
**COMMITTEE ON BANKING AND FINANCIAL SERVICES**  
**of the**  
**U.S. HOUSE OF REPRESENTATIVES**  
**February 12, 1999**

Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## **Introduction**

Mr. Chairman, thank you for the opportunity to appear before you today to discuss H.R. 10, the “Financial Services Act of 1999.” Virtually everyone agrees that the laws that currently prohibit affiliations among banks and other financial services providers and limit the ability of banking organizations to diversify their financial activities are archaic. Changing these laws in ways that promote increased competition, greater efficiency, and more effective delivery of financial products to consumers will strengthen U.S. financial services firms and benefit their customers.

Financial modernization is both a political process and the process of innovation in a competitive marketplace. Every day, financial services firms evolve and adapt to serve the changing needs of their customers. Technological advances and the development of new financial products and services have increasingly blurred the old lines that once separated the offerings of banks, securities firms, and insurance companies. As a result, consumers of financial services now have a greater choice of financial services and products, at more competitive prices.

An important goal of financial modernization legislation should be to ensure that the government does not impede or frustrate the process taking place in the marketplace. Of course, some constraints are necessary to ensure that the interests of consumers are properly protected, and that important governmental interests are safeguarded. But legislation that is crafted to preserve competitive advantages for particular interests, to discriminate against any segment of the industry, or to limit the choices financial firms have for organizing their businesses for no compelling or clearly demonstrable public policy purpose, retards the real and dynamic financial modernization already occurring in the marketplace. Even more significantly, legislation that will diminish the safety and soundness of our insured financial institutions should not be enacted under the guise of “financial modernization.” I am greatly concerned that some aspects of H.R. 10 may have this effect.

In my testimony today, I will discuss why I believe that financial modernization legislation should be pursued in a form that will not interfere with the free operation of financial markets, except to the degree necessary to protect fundamental and clearly demonstrable government interests such as promoting the safety and soundness of our financial system and safeguarding the interests of consumers. I will then broadly address the provisions of H.R. 10 that relate to bank organizational structure, insurance activities, and consumer protection issues. I am attaching to my testimony a more detailed analysis of the bill’s provisions and the Office of the Comptroller of the Currency’s (OCC) views on the major issues it presents. My testimony will highlight some areas we support and those that concern us.

## **Modernization Has Been Occurring in Financial Markets**

Federal laws restricting bank geographic and product diversification date back nearly 70 years. Although many restrictions have been removed, allowing banks to become more efficient and competitive, significant constraints still exist. Geographic restrictions on bank

location were dramatically reduced when the Riegle-Neal Interstate Banking and Branching Efficiency Act was passed in 1994. However, other laws restricting the activities of banking organizations remain, most notably, the Glass-Steagall Act of 1933, which was intended to separate commercial banking from investment banking, and provisions of the Bank Holding Company Act that confine the ability of corporations owning banks to diversify into other financial activities.

It has become clear in recent years that these constraints segregating various sectors of the financial marketplace have outlived their usefulness. The financial services marketplace has undergone enormous changes. Banks, securities firms, and insurance companies increasingly offer a similar array of products and services. Regulatory and judicial rulings continue to erode many of the barriers separating the different segments of the financial services industry. In short, technological and financial innovation, together with market pressures to offer consumers a wider array of services, are breaking down the traditional segmentation of the financial services marketplace.

While many financial service providers have been able to respond to these competitive forces without legislation, there is a strong case that the time has come for Congress to unambiguously undo antiquated constraints that exist in current law and bring the statutory framework into line with the realities and needs of the marketplace. I respectfully regret to say, however, that many of the provisions in the current version of H.R. 10 impose new and needless constraints on banks, particularly our nation's community banks, and will not permit them to innovate and compete in the most efficient manner. Those provisions will have significant adverse effects on the long-term safety and soundness of our banking system.

### **Ability to Diversify Products and Services is Essential to Banks' Safety and Soundness**

Preservation of the safety and soundness of the banking system is a fundamental government interest and a pivotal consideration in any financial modernization legislation. For this reason, we have supported the inclusion of strong safety and soundness provisions, such as the requirement that all of the banks in a holding company be well capitalized and well managed, as a precondition for engaging in expanded activities. But protecting the safety and soundness of banking institutions involves more than simply writing safeguards against loss into the law. Providing banks the opportunity to maintain strong and diversified earnings through a range of prudently conducted financial activities is an equally critical component of safety and soundness.

Historically, banks have been heavily dependent on net interest margins -- traditional lending -- as a source of earnings. This makes banks particularly vulnerable to changes in economic conditions. During the 1990s, the net interest income of commercial banks has declined, both as a percentage of assets and as a percentage of net operating revenue, and the growth in the volume of lending activity due to the strong economy has been offset by significant compression in bank net interest margins. At the same time, however, banks have been able to preserve or enhance their profitability through growth in noninterest income. In the last 10 years alone, noninterest income has increased from approximately 30 percent of net operating revenue to 39 percent. Noninterest income consists primarily of fees, service

charges, commissions, and the performance of data processing services for others, and is equally critical to large and small institutions trying to enhance and vary their income streams. Thus, banks' long-term stability and viability will be affected by whether they are allowed to continue to pursue financial activities that produce noninterest income to counterbalance the likely continued reduction in earnings from interest-bearing assets.

Banks can seek additional earnings sources by providing new products and services or moving into new geographic markets; or they can improve earnings by reducing their operating costs or increasing their risk profile in their lines of business. The OCC and other financial institution regulators have increasingly expressed concern about banks taking on additional credit risks to achieve high earnings targets, particularly given the slowdown in global economic activity and the likelihood of stresses in regional economies. Evidence over the past year showing deterioration in the quality of loan underwriting standards for commercial and industrial loans has been a particular source of worry.

Product, geographic, and income diversification all contribute importantly to bank safety and soundness. Many different factors have been responsible for the waves of bank failures that have characterized various periods of our financial history. However, one consistent factor has been excessive *concentrations* -- geographic concentrations or concentrations in one or another type of *lending*. The high rate of bank failures in the 1920s was largely confined to small agricultural banks that lacked diversification with respect to either geography or lines of business. In the early 1980s, banks that had excessive concentrations of loans in the oil business and/or in the southwestern region of the United States failed in large numbers. Many of the banks that failed in the years 1984-1986, when agricultural land prices fell more than 40 percent from their 1981 peak, also appear to have suffered from an inability to diversify. And, finally, in the late 1980s and early 1990s, bank failures throughout the world were associated with excessive real estate lending.

Ideally, of course, bank regulators could anticipate what geographic areas and product lines would be associated with future loan losses and would use their powers of persuasion to prevent banks from developing heavy exposures in lending to those areas. Given the impossibility of perfectly foreseeing the future regarding the nature and location of lending problems, however, the prudential strategy of diversification reduces the vulnerability of banks to unexpected losses from lending, wherever they may occur.

A wealth of empirical research demonstrates that diversification is critically important to maintaining a strong banking system. Firms with diversified assets and revenue streams can better withstand economic shocks during the business cycle, whereas firms limited by geographic or product restrictions can be impacted more seriously by downturns. Diversification can enable banks to increase their average rate of return for any given volatility of return, or to reduce the volatility of earnings for any average level of return, in either case reducing their probability of failure.<sup>1</sup>

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<sup>1</sup> For a review of the literature, see Mote, Larry, R., "The Separation of Banking and Commerce," *Emerging Challenges for the International Services Industry*, JAI Press, 1992, pp. 211-17, and Whalen, Gary, *Bank Organizational Form and the Risks of Expanded Activities*, Economics Working Paper 97-1, January 1997, pp.5-12.

The business of banking revolves around risk management, and banks have demonstrated they can effectively manage a variety of risks. Banks already manage complex risks, such as those associated with derivatives and other off-balance sheet activities -- risks that are similar to those presented by new financial activities, such as insurance. The effect of H.R. 10, which forces banks to remain primarily intermediaries of credit risk, is to make them inherently more exposed to risk than institutions with diversified sources of income. When bank activities are restricted, risk exposures are correspondingly concentrated, and the banking system as a whole is more vulnerable to economic shocks.

### **Operating Subsidiaries Will Strengthen Banks and Enhance Safety and Soundness**

Financial modernization legislation should not artificially restrict the ability of financial services providers to choose, consistent with safety and soundness, the most efficient way to conduct their business. There is no a priori governmental interest in restricting organizational choice, and with appropriate safeguards, expanded activities may be conducted safely and soundly in either a bank subsidiary or a bank affiliate.

The current version of H.R. 10 mandates that banking organizations wishing to diversify into new activities as principal do so only through bank holding company affiliates -- a "one-size-fits-all" approach that needlessly denies firms the choice of expanding through a bank subsidiary structure. This restrictive approach undermines, rather than enhances, safety and soundness. It will inevitably force resources out of banks and diminish the protections for the federal deposit insurance fund.

Consider the business decision facing a banking organization that may want to take advantage of a newly legislated opportunity to expand into insurance or securities activities. If the only organizational choice available is the holding company affiliate, it is highly likely that resources of the bank will be drawn down to capitalize and fund the new activity. The bank will upstream dividends to its parent either to inject capital into the new affiliate, or to support new holding company debt or equity issued for that purpose. The bank itself will reap no financial benefit from the new activity. In fact, since many of the business opportunities of the new affiliate may be generated by the day-to-day business of the bank, the bank will be deprived of profit opportunities that would rightfully belong to and be captured by it if the operating subsidiary format had been permitted.

By contrast, if the new activity could be positioned in a subsidiary of the bank, any capital or funding provided by the bank would remain as part of the bank's consolidated resources. In addition, banks would be able to capture directly the benefits of new business opportunities that may be closely related to, or generated by, their normal day-to-day banking activities. Income flows resulting from such new activities would flow directly to the bank, would not be diverted to the holding company, and would provide the bank with a diversified source of earnings. And, as the Federal Deposit Insurance Corporation (FDIC) has repeatedly testified, in the event that a bank should itself suffer financial difficulties, earnings from bank subsidiaries can compensate for a downturn in bank profits, and, in the event of bank failure,

the existence of such subsidiaries can significantly reduce the losses of the federal deposit insurance fund.

There is also clear evidence that banking organizations can benefit from engaging in expanded financial activities through bank subsidiaries without creating undue safety and soundness concerns. For example, the Federal Reserve Board has long permitted U.S. banking organizations to engage in securities activities overseas through foreign subsidiaries. At year-end 1997, U.S. banking organizations operated 100 direct and indirect bank securities subsidiaries, a high proportion of which (88 percent) were profitable, with aggregate net income of \$732.3 million.<sup>2</sup>

This comparison also highlights the discriminatory nature of the structural restraints H.R. 10 imposes on U.S. banks as compared to foreign banks. Under H.R. 10, U.S. banks could have subsidiaries -- operating abroad -- that conduct an expanded range of financial activities. But a U.S. bank's domestic subsidiary cannot engage in the activities that are permissible for that bank's foreign subsidiary. Also, a *foreign* bank may engage in nonbanking activities in the U.S., including securities underwriting, through a direct subsidiary of the bank. But a U.S. bank could not have a U.S. subsidiary that engages in the same range of activities permitted for a *foreign* bank's U.S. subsidiary. Thus, U.S. law would allow a foreign bank to use the structure it determines most efficient for the delivery of products and services in the United States, while U.S. banks would be restricted to a single format. This result cannot be rationalized.

In addition, H.R. 10 uniquely discriminates against national banks relative to *state* banks by retaining or imposing burdensome statutory requirements that are not imposed on state banks. For example, national bank subsidiaries are flatly barred from engaging as principal in expanded financial activities; state banks are subject to no such comprehensive bar. Further, although the bill requires that all of a national bank's depository institution affiliates be well capitalized and well managed in order for the national bank's subsidiary to conduct new *agency* activities, no similar requirements are imposed on either state banks or thrifts engaged in the same activities through subsidiaries. And national bank subsidiaries, in addition to being limited to expanded financial activities conducted on an *agency* basis, are further limited to conducting those new *agency* activities *only* through a *wholly-owned* subsidiary. Thus, national banks, but not state banks, are deprived of the ability to use joint ventures or consortiums of banks to engage in new *agency* activities. This type of outright discrimination in the treatment of national banks embedded in H.R. 10 is simply impossible to justify on any principled basis.

Moreover, the approach embodied in H.R. 10, which would force resources out of banks, is contrary to the interests of the federal deposit insurance fund. FDIC Chairman Donna

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<sup>2</sup> At year-end 1997, these 100 direct and indirect bank securities subsidiaries had aggregate total assets of \$249.5 billion. They represented 90.9 percent of the total number of overseas securities subsidiaries and accounted for more than 98 percent of the total assets in all foreign securities subsidiaries. The average aggregate rate of return on assets for bank securities subsidiaries over the 1987-1997 period was around 60 basis points, roughly three times higher than the comparable figure for holding company securities subsidiaries. See Whalen, Gary, *The Securities Activities of the Foreign Subsidiaries of U.S. Banks: Evidence on Risks and Returns*, Economics Working Paper 98-2, February 1998.

Tanoue and former FDIC chairs have consistently pointed out that the subsidiary format provides better protection for the deposit insurance fund. Last September, in a joint article in the *American Banker*, former Chairmen Helfer, Isaac, and Seidman stated their position clearly: “Requiring that bank-related activities be conducted in holding company affiliates will place insured banks in the worst possible position. They will be exposed to the risk of the affiliates’ failure without reaping the benefits of the affiliates’ successes.”<sup>3</sup> In her testimony before the Senate Banking Committee last June, Chairman Tanoue stated that “the subsidiary structure can provide superior safety and soundness protection.”<sup>4</sup> In 1997, former Chairman Helfer noted in her testimony that “[w]ith appropriate safeguards, having earnings from new activities in bank subsidiaries lowers the probability of failure and thus provides greater protection for the insurance fund than having the earnings from new activities in bank holding company affiliates. The reason for this is that diversification often leads to less volatile earnings. ... Thus, on average, allowing a bank to put new activities in a bank subsidiary lowers the probability of failure and provides greater protection to the insurance funds.”<sup>5</sup>

One could argue, then, that from the perspective of prudent bank supervision and the interests of the deposit insurance fund, the *only* format that should be used for expanded activities is the operating subsidiary. But individual banking organizations may have particular reasons, based on their business, why the use of a holding company affiliate is more effective for them, and a prescriptive approach would be inconsistent with the basic principle I discussed earlier -- that restrictions on organizational format should not be imposed except where unavoidably needed to protect clearly defined governmental interests. To forbid the operating subsidiary format, however, is not only flatly inconsistent with that principle, but positively inimical to well defined governmental interests. The responsible approach is to allow institutions the freedom to choose the organizational structure that best suits their needs, subject -- in either case -- to the imposition of solid financial protections for insured banks.

### **Promoting Full and Fair Competition in Insurance Markets Benefits Consumers**

Financial modernization legislation should nurture innovation in the marketplace so that consumers have better access to a greater variety of financial products and services at more competitive prices. To that end, any new law should maximize business opportunities for all market participants by eliminating archaic or protectionist restraints on the delivery of products and services. In the insurance area, H.R. 10 does not achieve that result. Instead, it hobbles banks that want to sell insurance by undercutting the Supreme Court’s decision in the *Barnett* case and sanctioning discriminatory state insurance sales laws.

The *Barnett* case applied well recognized judicial standards of preemption to states’ efforts to curtail the “broad permission” that national banks have to sell insurance under the

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<sup>3</sup> “Ex-FDIC Chiefs Unanimously Favor the Op-Sub Structure,” *American Banker*, September 2, 1998.

<sup>4</sup> See testimony of Donna Tanoue, Chairman, FDIC, on financial modernization before the Committee on Banking, Housing, and Urban Affairs, United States Senate, June 25, 1998.

<sup>5</sup> See testimony of Ricki Helfer, Chairman, FDIC, on financial modernization before the Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises, Committee on Banking and Financial Services, U.S. House of Representatives, March 5, 1997.

federal statute that authorizes national bank insurance sales. H.R. 10 would replace the law and precedents as they stand today with a virtually indecipherable combination of:

1) not one, but several new preemption standards to apply to different types of insurance activities; 2) “safe harbors” of unclear scope that allow the states to impose discriminatory restrictions on bank insurance activities free from *any* preemption by federal law; 3) new definitions and redefinitions of insurance products that will tell if a bank can even provide an insurance product *at all*; 4) a new standard for judicial review of issues that arise under these new standards; 5) *differences* in preemption standards applicable depending upon *when* a particular state’s provision was adopted; and 6) the astonishing prospect that in each state, banks selling insurance could be subject to a different combination of some or all of the insurance sales customer protection regulations required to be promulgated by the federal banking agencies and state provisions that, in a given state would sometimes co-exist with, sometimes supercede, and sometimes would be superceded by, particular provisions of those federal rules.

For example, the bill lists 13 “safe harbor” areas in which the states may legislate or impose regulations or restrictions on banking organizations selling insurance that would not apply to nonbank competitors, and to do so free from any federal constraints. In these 13 areas -- which include important aspects of insurance sales such as licensing requirements, disclosures, and advertising -- *any* state may write rules for banks and companies affiliated with banks that are more onerous than those for any other insurance provider. Those state rules may be written (as some state rules have been) in ways that unreasonably disadvantage banks and bank affiliates relative to other insurance providers. Indeed, even if the purpose of such rules were to provide a competitive advantage to nonbank competitors -- which would almost certainly be their effect -- they would still be protected. Any state provision that fits within one of these “safe harbors” would be immune from challenge despite such discrimination, and even if, contrary to the *Barnett* standard, it prevented or significantly interfered with the authority of national banks to sell insurance.

The OCC does not seek to be an insurance regulator and supports the role of state insurance regulators in the supervision of insurance activities conducted by banks, their subsidiaries, and their affiliates. Since the *Barnett* decision was handed down, the OCC has tried to work constructively with state insurance regulators to resolve issues where state provisions impacted national banks in a manner contrary to the principles of the *Barnett* decision. In those very few cases where differences of opinion were litigated, the courts had clear and time-tested standards of preemption that they used to resolve the questions presented.

The tangle of insurance provisions in H.R. 10 is most likely to produce new rounds of litigation in several areas, under untested new standards. These provisions are not necessary to ensure that adequate customer protections exist for bank insurance sales and actually retard the development of new products and delivery channels that could benefit customers.

Moreover, it is clear that H.R. 10 does not modernize the ability of national banks in particular to participate in the insurance sales market, nor does it promote parity with their state-chartered competitors. The federal statute that the Supreme Court reviewed in *Barnett* authorizes national bank insurance sales only in places with 5,000 or fewer inhabitants. H.R.

10 leaves this restriction in place even though it is just as outdated as the Glass-Steagall provisions that the bill would repeal. Moreover, at least 17 states permit bank-direct insurance sales in state-chartered banks free from any similar geographic limitation.<sup>6</sup> After enactment of H.R. 10, then, national banks will continue to be subject to an outdated constraint on their ability to compete in insurance markets.

The insurance provisions in H.R. 10 perpetuate an approach to financial services legislation that attempts to segment markets and retain competitive advantages for favored groups. They retard, rather than encourage, competitive and marketplace developments and thus they fail the key test for financial modernization legislation.

### **Ensuring Adequate Consumer Protection is an Essential Component of Financial Modernization**

Financial modernization legislation also must ensure that the interests of consumers are appropriately protected through adequate disclosure mechanisms and the deterrence of deceptive sales practices. The federal banking agencies have worked together to advise depository institutions to conduct retail sales in a safe and sound manner that protects the interests of consumers. It is not only appropriate but essential for the government to foster an environment in which consumers can evaluate the relative riskiness of their financial choices based on a fair understanding of the products and services available to them.<sup>7</sup> But to do this, the standards expected of banks need to be clear and workable. The scheme of insurance customer regulations that would be applied under H.R. 10 is neither.

Finally, it is important to note that technological advances and the emergence of diversified financial services companies have also raised significant issues regarding the proper handling and safeguarding of customer financial information and the protection of consumer privacy. The financial services industry has many years of experience in handling that information and protecting their privacy. As banks affiliate with other financial services providers, and share an increasing amount of confidential customer information, it is imperative that regulators have the ability to ensure compliance with existing privacy laws that govern the handling of customer information. It is for this reason that we urge that the bank regulators' examination authority under the Fair Credit Reporting Act be restored.

### **Conclusion**

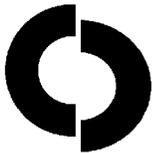
In conclusion, let me again emphasize the importance of limiting intervention in financial markets to that which is necessary to protect clearly defined, demonstrable

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<sup>6</sup> See Conference of State Bank Supervisors, *A Profile of State Chartered Banking*, (16<sup>th</sup> edition, 1996).

<sup>7</sup> The OCC's "Guidance to National Banks on Insurance and Annuity Sales Activities," issued on October 8, 1996 ("Advisory") instructs banks to follow proper procedures to ensure customers are able to distinguish between insurance and deposit products. These procedures include making adequate disclosures that an insurance product is not FDIC insured, is not a deposit or an obligation of the bank, and is not guaranteed by the bank. Moreover, the OCC's Advisory emphasizes that banks need to ensure that only qualified people are selling insurance, and that insurance is sold in areas that are separate from traditional banking functions, *e.g.*, deposit taking, to the extent practicable.

governmental interests, such as maintaining the safety and soundness of the banking system and ensuring that consumers are adequately protected. Our concerns over the current version of H.R. 10 arise from the inclusion of provisions that diminish safety and soundness and fail to remove existing barriers to product diversification and competition, and thus do not meet the essential requirements of true financial modernization.



# THE OCC'S PRIMARY CONCERNS ABOUT H.R. 10

"The Financial Services Act of 1999"  
Introduced January 6, 1999

February 12, 1999

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## 1. DISPARAGEMENT OF THE NATIONAL BANK CHARTER

As discussed in greater detail below, provisions throughout H.R. 10 uniquely disadvantage national banks. The cumulative effect of these provisions is to undermine significantly the national bank charter, which is held by the preponderance of the nation's large and internationally active banks, hundreds of regional banks, and by more than 2,500 community banks. A basic principle of financial modernization legislation should be to ensure that new laws do not interfere with the free operation of financial markets, except to the extent necessary to protect fundamental and clearly defined governmental interests, such as safety and soundness and safeguarding the interests of consumers. Contrary to this basic principle, including safety and soundness, under H.R. 10, national banks would be subject to artificial, unnecessary, and costly restrictions that deprive them of the benefits of increased earnings and product diversification that the bill is intended to promote.

### **Specific Concerns:**

- *National banks are deprived of flexibility in structuring their business operations:* Under Section 121, national banks are generally not permitted to use subsidiaries to offer expanded products as principal. Yet, foreign banks are permitted to have direct subsidiaries in the United States that engage in a full range of new financial activities, including underwriting securities. Nearly 40% of the so-called "Section 20 affiliates" permitted to underwrite and deal in bank impermissible securities in the United States today are, in fact, subsidiaries of foreign banks.
- *National bank subsidiaries offering products as an agent are subject to burdensome statutory requirements that are not imposed on state banks:* Section 121 applies restrictions to national banks conducting new agency activities through subsidiaries that are not applied to other depository institutions engaged in the same activities through subsidiaries.
- *The Barnett case is undercut:* The Supreme Court's decision in Barnett Bank v. Nelson is overturned and replaced with the new preemption standards in Section 104. That decision relied on preemption principles well-recognized by the courts and found that certain state insurance sales restrictions were preempted for national banks. The new preemption standards in H.R. 10 will permit states to discriminate against banks and their subsidiaries and affiliates in the sales of insurance. The new, complex, confusing and untested preemption standards will generate needless litigation and represent a step back from current law.

- *National banks continue to be subject to the “place of 5,000” rule in selling insurance:* No such restriction is applied to state banks. In fact, many states permit their banks to sell insurance anywhere.
- *OCC deference is eliminated for insurance:* The Supreme Court has consistently held that Federal agencies should be given deference for reasonable interpretations of the laws they administer. This long-standing and well established principle is eliminated under Section 306(e) for OCC determinations relating to national bank insurance activities. As a result, national banks will not be able to rely on OCC decisions and will be faced with increased business uncertainty and litigation risks.
- *National banks lose the authority to conduct safe and sound activities that are permissible today:* Banks and their subsidiaries cannot offer new insurance products as principal after January 1, 1997. Offering annuities as principal is flatly prohibited. National banks’ title insurance underwriting is severely restricted. Many currently permissible securities activities, such as certain asset-backed securities transactions, are pushed out of the bank and into an affiliate.
- *National banks are subject to increased regulatory burdens:* The bill gives the Federal Reserve Board (rather than the OCC in the case of national banks) the authority to determine whether a bank is well capitalized if the bank is part of a bank holding company engaging in the new financial activities. The Board also has the authority under certain conditions to impose other restrictions on national banks, e.g., restrictions on transactions with nonbank affiliates (except subsidiaries of the bank). This subjects national banks to two different Federal regulators implementing Federal capital and operational standards.

## 2. SUBSIDIARIES OF BANKS

Section 103 permits bank holding company affiliates to engage in a broad range of financial activities, including securities and insurance underwriting. However, under Section 121, national bank operating subsidiaries may engage “solely as agent” in new financial activities that are impermissible for the parent bank to conduct directly, and even then, may do so only through wholly owned subsidiaries. Subsidiaries of national and state banks, as well as subsidiaries of thrifts, are expressly prohibited from engaging in new securities underwriting activities after September 15, 1997. Moreover, Section 304 prohibits national (and state) banks and their subsidiaries from producing any new insurance products after January 1, 1997. Foreign banks are NOT subject to these prohibitions and, under the bill, may have direct subsidiaries in the United States that engage in securities and insurance underwriting activities, as well as all other financial activities.

In addition, Section 121 subjects transactions between a national bank and its subsidiary engaging in the new agency activities--but not transactions between state banks or thrifts and their subsidiaries engaged in the same activities--to the operational requirements in section 23B of the Federal Reserve Act. Further, the new agency activities may be conducted in a subsidiary of a national bank only if all of its depository institution affiliates are well capitalized and well managed and satisfy other requirements. None of these requirements or restrictions are imposed on state banks or thrifts engaged in the same agency activities through subsidiaries.

### Specific Concerns:

To compete effectively with other financial services providers, banks cannot be hobbled by provisions that unnecessarily restrict their options, flexibility, and efficiency. In some cases, it may be preferable for a bank to conduct activities through a subsidiary and, in other instances, through a holding company affiliate structure. Banks should be free to make these business decisions for themselves without government mandates. Without appropriate organizational flexibility, banks will be less safe and less sound, offer fewer choices to customers, and be less able to serve the financial needs of their communities and customers.

- Safety and Soundness Benefits: With appropriate safeguards in place, the operating subsidiary structure is more safe and more sound than the affiliate structure.
  - First, income from an operating subsidiary flows to the bank, not the holding company, and, thus, provides a source of earnings that can serve as

an important counter-cyclical, diversified source of funds for the bank. If banks cannot diversify their operations through a subsidiary, assets and activities will be siphoned from the bank to the affiliate, leaving the bank with a narrow base of activities and depleted assets. A “narrow bank” will be significantly less stable and more vulnerable to economic shocks than a fully diversified financial institution.

- Second, if a bank needs to raise capital, it can sell the subsidiary. If the activities are in an affiliate, the funds from the sale of the affiliate will not flow to the bank.
- Third, in the event of a bank failure, the FDIC would be able to sell the subsidiary. The proceeds from the sale would be available to the FDIC to reduce the costs of the bank failure that are borne by the taxpayer-backed deposit insurance fund. If the company were a bank holding company affiliate and not a subsidiary, the proceeds from the sale would not be available to protect the deposit insurance fund.
- Fourth, subsidiaries of U.S. banks have for decades engaged overseas in activities, e.g., securities underwriting and merchant banking that are impermissible for the parent bank. U.S. banks’ foreign subsidiaries represent our longest experience with securities underwriting and other expanded activities by companies under common ownership with banks. Thus, banks have experience in conducting these activities in a safe and sound manner.
- For these reasons, current FDIC Chairman Tanoue and recent past Chairmen Helfer, Seidman, and Isaac have unanimously taken the position that these safety and soundness benefits make the subsidiary structure the preferable option.
- Corporate Separateness: Subsidiaries are (1) separately organized, (2) functionally regulated, (3) discrete corporate entities, and (4) distinct from the insured bank entity. These factors are common to both bank subsidiaries and holding company subsidiaries. Yet these factors are frequently cited as support for *mandating* the holding company subsidiary structure and *prohibiting* the equivalent use of bank subsidiaries for U.S. financial organizations. This argument fails to consider that a bank subsidiary is an insulated, separate, corporate entity just like a holding company affiliate.
- No Greater Risk to the Bank: The risks to the bank from activities conducted in a

subsidiary with appropriate safeguards are no greater than if the activities are conducted in an affiliate with the equivalent safeguards. Various legislative proposals considered last year applied appropriate safeguards to bank subsidiaries.

- Under the previous legislative proposals, a bank engaging in new financial activities through an operating subsidiary is required to deduct its investment in the subsidiary from capital and is not permitted to consolidate its assets with those of the subsidiary. Further, the bank must be well capitalized before and after taking the capital deduction. As a result, the bank can lose its entire investment in the subsidiary and remain well capitalized. If the subsidiary loses money, the liability of the bank is limited to its equity investment in the subsidiary and its well capitalized status is not affected.
  - As a further safeguard, transactions between the parent bank and a financial subsidiary are treated the same as transactions between a bank and a bank holding company affiliate for purposes of sections 23A and 23B of the Federal Reserve Act. These provisions require that loans and other covered transactions between the bank and its financial subsidiary are subject to collateral requirements and quantitative limits, and must be made on an arm's length basis. The parent bank's equity investments in the subsidiary would require regulatory approval if the amount that was being invested in the financial subsidiary exceeded the amount that could have been paid in a dividend to a bank holding company, without the approval of the regulator. Moreover, the requirement that the bank remain well capitalized after deducting its equity contribution to the subsidiary provides a significant constraint on downstream flows.
  - The holding company structure does not better insulate the bank from the risks of nonbanking activities as some claim. To the contrary, statistics demonstrate that, where corporate veil piercing occurs, it has more frequently occurred between companies that are affiliated by common control (i.e., the bank and a holding company nonbank affiliate) than between a parent and its subsidiary.<sup>1</sup> Veil piercing depends on how the entities conduct their operations and not on how the operations are structured within an organizational chart.
- No Greater Subsidy Transfer: It has been suggested that only the affiliate

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<sup>1</sup> Thompson, Robert, "Piercing the Corporate Veil: An Empirical Study," *Cornell Law Review* 76 (July 1991), 1036-74.

structure effectively maintains competitive equity and prevents banks from transferring to nonbank affiliates any funding advantages that the banks may receive from deposit insurance, the availability of the discount window, and access to the payments system. But, there is no demonstrable evidence to support this claim.

-- After factoring in the costs of regulation and what banks pay for the services contained in the Federal safety net, it is difficult to argue that any net subsidy actually exists. Banks bear significant regulatory costs in return for access to the safety net. Among other things, banks are subject to laws and regulations that require regular examinations, and control exit and entry to the banking system, geographic and product expansion, fiduciary activities, the quality of internal and external information systems, and equal access to credit and other financial services. National banks also are subject to assessments, based on their assets. Taken together, these costs eliminate any net subsidy.

-- The way banks behave is further evidence that a net subsidy does not exist. If it existed, one would expect banks to behave in a manner to take advantage of the subsidy. This is not the case. For example, if banks realized a subsidy that lowered the cost of funds, banking organizations would be expected to issue debt exclusively at the bank level. Instead, we see debt issuances by all components of the organization -- banks, bank holding companies, and nonbank affiliates.

-- Moreover, if banks had a competitive advantage, they would dominate the nonbank financial services markets. However, in many fields, nonbank providers have a bigger market share than banks. As of June 1997, two

of the top five largest servicers of residential mortgages were nonbanks, and two of the top five originators of mortgages were nonbanks.<sup>2</sup>

-- For the sake of argument (and despite the evidence to the contrary), even assuming that a net subsidy exists, there is no evidence that a bank holding company affiliate structure would be any more effective in containing the subsidy than the operating subsidiary structure, under equivalent safeguards. It bears repeating that these safeguards include (1) restricting

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<sup>2</sup> "Ranking the Banks, Statistical Review 1997," American Banker.

the bank's equity investment in the subsidiary to the amount a bank could dividend to its parent bank holding company (unless the regulator permits a greater investment), (2) further limiting the size of the subsidiary by deducting the bank's investment in the subsidiary from the bank's capital and requiring the bank to remain "well capitalized" after the deduction, and (3) imposing the same limitations on transactions between the parent bank and the subsidiary that apply to transactions between the bank and its holding company affiliates.

- Similar safeguards and restrictions were used by the Federal Reserve Board to justify its decision to allow foreign banks to have U.S. subsidiaries that engage in all aspects of securities underwriting in this country. In fact, the Board has approved some 18 foreign bank subsidiaries to engage in a full line of securities underwriting and dealing activities in the U.S., despite the fact that the parent bank has, according to the Board, the benefits of the bank's home country's safety net and a subsidized cost of funds. These decisions have allowed foreign banks to compete in the U.S. through the structure those banks find most effective, while denying similar opportunities to U.S. institutions. If the regulatory constraints are sufficient to wall off the flow of subsidized funds to foreign bank subsidiaries, why are they not sufficient to perform the same function for U.S. institutions?
- CRA Benefits: Foreclosing the subsidiary option diminishes the benefits of the Community Reinvestment Act (CRA).
  - The operating subsidiary structure enhances the bank's capacity to perform CRA activities. OCC examiners look at the assets and profitability of operating subsidiaries, among other performance context considerations, to ascertain a bank's capacity for performance.
- Consumer and Community Bank Benefits: Forcing most new financial activities to be conducted in holding company affiliates, limits the competitiveness of community banks, and deprives consumers of the benefits of competition in financial services and access to a full range of financial products.
  - Denying banks the opportunity to organize their operations in the manner that is the most effective and efficient particularly impacts community banks. The subsidiary option may be the best option for community banks to offer their customers a full range of financial products in the most cost efficient manner.

- Allowing banks of all sizes to offer financial services using the most effective and efficient structure for that organization ensures that consumers will be able to have the benefits of competitively priced financial products and services, as well as access to the full range of these products and services.

### 3. **BANK INSURANCE ACTIVITIES**

H.R. 10 contains provisions that (1) permit states to impose discriminatory requirements on banks that limit their ability to compete in the sales of insurance products, (2) permanently freeze the ability of banks to produce new products if the product, or even a component of the product, is labeled “insurance,” and (3) limit the traditional deference that the OCC would receive in conflicts with a state insurance regulator over interpretations of national banking law. As a result, banks cannot realize the safety and soundness benefits from true financial modernization by diversifying into new lines of business, and consumers will not realize the benefits of increased competitive pricing of insurance products and product innovation.

#### ***A. Insurance Sales Activities/Preemption***

Under Section 121, well capitalized national banks may have a wholly-owned insurance agency subsidiary that may operate from any location in a state. But H.R. 10 does not repeal the “place of 5,000” restriction that limits banks’ direct insurance sales under current law.

Section 104 establishes a complex scheme for determining the scope of permissible state regulation of insurance sales activities by banks and their subsidiaries and affiliates. The provision overturns the U.S. Supreme Court’s decision in *Barnett Bank v. Nelson*<sup>3</sup> and permits state regulators to impose rules that discriminate against banks and impose significant, anticompetitive, and in many cases virtually incomprehensible sets of restrictions on banks’ ability to sell insurance. Under these new preemption standards, banks will have less protection from state discriminatory insurance sales restrictions than they do today.

Section 104 creates 13 safe harbors under which states may freely regulate bank sales of insurance without any limitations. The current version of H.R. 10 expands the

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<sup>3</sup> *Barnett Bank v. Nelson*, 116 S. Ct. 1103 (1996).

safe harbors and the potential for increased litigation for banks.<sup>4</sup> It also includes any state law that is substantially the same as, but no more burdensome or restrictive than any of the 13 safe harbors that are expressly listed within the safe harbor protections.

Section 104 sets out a general rule that no state may -- “in accordance with” the preemption standards set forth in *Barnett* -- “prevent or significantly interfere” with the ability of a bank to engage in insurance sales or cross-marketing activities. In addition, for state laws that do not fall within the safe harbors, Section 104 differentiates between state laws enacted before or after September 3, 1998. For state laws enacted prior to September 3, 1998, the prohibition on a court giving traditional deference to the OCC’s interpretation (described below) will not apply and the so-called nondiscrimination standards will not apply.

### **Specific Concerns:**

- *Barnett is Overturned:* While H.R. 10 says that it codifies *Barnett*, its operative terms do not. The *Barnett* Court uses the words “prevent or significantly interfere” and cites with approval various cases holding that state law is preempted if, for example, it encumbers, impairs the efficiency of, or hampers national bank functions. Thus, H.R. 10 would narrow the judicially developed, well-recognized and time-tested standards, making it easier for states to pass laws that impinge on national bank insurance sales authority.
- *“Safe Harbors” Allow States to Discriminate Against Banks:* The “safe harbors” give states the right to impose 13 types of restrictions on bank insurance sales, all of which permit discriminatory treatment of insured depository institutions. States also may add other restrictions that are substantially the same as the safe harbors.

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<sup>4</sup> Two other provisions included in this version of H.R. 10 in Section 104 add to the issues that may prove troublesome to national banks. First, state antitrust laws and corporate laws of “general applicability” are exempt from the general rule that states cannot “prevent or restrict” a bank or its subsidiaries or affiliates from affiliating with any person as authorized by H.R. 10. The state laws that are protected from preemption under this provision may, however, have a disparate impact on banks and interfere with their ability to exercise Federally authorized powers. National banks have previously experienced problems with these types of laws. Second, an exception is made to another general rule that state laws cannot “prevent or restrict” the activities (other than insurance sales and cross-marketing activities which are subject to a different preemption standard) authorized by H.R. 10. This broad exception covers “state regulation of financial activities other than insurance.” This provision is confusing and we cannot determine how it will work, why it is necessary, or what state laws will be covered.

## ***B. Insurance Underwriting***

Section 304 prohibits banks and their subsidiaries from underwriting new “insurance” products, unless the OCC had approved the product (except for annuities which are prohibited and title insurance which is restricted) as of January 1, 1997, or a national bank was actually offering the product as of that date. Insurance is broadly defined as (1) any product regulated as insurance as of January 1, 1997, (2) any product first offered after January 1, 1997, which a state insurance regulator determines shall be regulated as insurance and is not on a list in the bill of banking products, or (3) an annuity. Section 305 contains restrictions on title insurance underwriting by banks and their subsidiaries.

### **Specific Concerns:**

- *Anticompetitive Requirements:* Section 304 may prohibit banks from offering new banking products that are authorized by the national bank charter. Any new banking product will be called into question if the regulator in the state where the product is provided labels it “insurance.” Product innovation will be stifled. It is important to note that the consequence of a product being labeled “insurance” under this scheme is not that the product will be regulated as insurance, but that banks will be barred from providing it.
- *Undermines the National Bank Charter:* National banks will be exposed to the determinations of 50 different state insurance regulators. This means that a national bank may not be able to offer a product in one state that it is free to offer in another.

## ***C. Deference***

In a conflict with a state regulator over whether a product is insurance or banking (the answer to which determines whether a bank may produce a product after January 1, 1997 and not merely whether the product will be regulated as “insurance”) or whether a state statute is properly treated as preempted, Section 306(e) provides that the OCC will not receive the traditional deference accorded to Federal agencies when interpreting the statutes they administer.

### **Specific Concerns:**

- *Traditional Judicial Doctrine Overturned:* All Federal government agencies--including some of the more obscure agencies--are accorded deference on

interpreting statutes they are charged with administering.<sup>5</sup> Although the 1984 U.S. Supreme Court decision in the *Chevron* case<sup>6</sup> represents the newest restatement of judicial deference doctrine, the Supreme Court has been giving weight to the construction of Federal statutes by executive branch officials since as early as 1809.<sup>7</sup> However, in an unprecedented step, Section 306(e) prohibits a court from giving the OCC deference even when the OCC is interpreting the National Bank Act, or even when the OCC is opining on whether a state law or rule interferes with the ability of a national bank to sell insurance. This result singles out national bank insurance activities and uniquely excludes OCC decisions in these areas from the long-standing doctrine of judicial deference.

- *Anticompetitive Consequences:* The result of this provision is to limit competition in insurance markets. This provision will have a chilling effect on bank business decisions to offer new products. The bank will no longer be able to rely on the OCC's decisions that have not been tested in the courts if a product may be deemed "insurance" by a state regulator.

#### ***D. Other Issues***

Section 301 restates that the McCarran-Ferguson Act is the law of the land. Sections 301 and 302 require all persons providing insurance in a state to be licensed in accordance with state law and all insurance sales activities to be functionally regulated by the state subject to the preemption standards in Section 104 (discussed above).

#### **Specific Concerns:**

- *Confusing and Conflicting Standards.* It is not clear what these provisions mean, why they are necessary, or how they will be interpreted and applied by a court. Retaining these ambiguous provisions in the legislation will only serve to expose banks to additional litigation risk.

#### **4. BANK SECURITIES ACTIVITIES**

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<sup>5</sup> We have found Federal cases, for example, that accorded deference to the Korean War Veterans Memorial Advisory Board, the Legal Services Corporation (which is a Federally-chartered corporation not subject to the full measure of the Administrative Procedures Act), the Pacific Northwest Electric Power & Conservation Planning Council, the Railroad Retirement Board, and the American Battle Monuments Commission.

<sup>6</sup> *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

<sup>7</sup> See *United States v. Vowell*, 9 U.S. (5 Cranch) 368, 371-72 (1809).

Section 181 authorizes well-capitalized national banks and their subsidiaries to underwrite and deal in municipal revenue bonds. In other respects, H.R. 10 limits the ability of banks to engage in many currently permissible activities. Sections 201 and 202 repeal the broker-dealer exemptions for banks under Federal securities law, replacing them with a list of certain activities (interpreted and administered by the Securities and Exchange Commission (SEC)) in which a bank may engage without being required to register as a broker-dealer. These provisions have a “push-out” effect forcing banks to use separate legal entities to engage in many securities activities that banks provide today in a safe and sound manner. Under Section 206, the SEC has the authority to impose registration requirements on banks that effect transactions in or buy and sell new banking products that are determined by the SEC to be “securities” after consultation with the Federal Reserve Board--but with no other banking agencies. In addition, Section 121 contains amendments to current law to prevent subsidiaries of banks and thrifts from engaging in new securities underwriting activities after September 15, 1997.

### **Specific Concerns:**

- *Current Safe and Sound Activities Will Be Forced Out of the Bank:* The various financial modernization legislation proposals under consideration contain provisions that will force banks to use separate legal entities in order to engage in many securities activities that banks currently provide. This is true because, as a practical matter, banks cannot register as broker-dealers due to the SEC net capital rules designed for securities firms rather than banks.

The proposals require banks to “push out” securities activities into separate securities companies, unless the bank only engages in currently permissible brokerage through a qualified networking arrangement with an SEC registered broker or dealer under conditions enforced by the SEC. Banks that sell, as agent, mutual funds or other securities (other than U.S. and municipal securities) must move the activity to separate SEC-regulated legal entities, either bank subsidiaries or holding company affiliates. In addition, Section 201 inserts back into the bill similar provisions that were struck by the Senate Banking Committee preventing a bank from engaging in private placements of securities if it is affiliated with a securities firm. Other current activities will be subject to limitations. The activities affected include: loan sales or participations if the loans were not “made by a bank,” variable annuity sales, securitization of assets if “predominantly originated by the bank or its affiliate,” and 401(k) and other securities purchase plans if the bank is not the transfer agent for the securities offered by the plan.

- *Community Banks Will Be Particularly Disadvantaged.* The expanded securities

powers under H.R. 10 (except underwriting municipal revenue bonds) are available only to holding company affiliates. Requiring this structure will impose operating burdens and relatively larger costs on smaller banks that do not have a holding company structure in place. Effectively, many community banks will not be able to take advantage of the new authority or will be uncompetitive due to the relatively higher cost of the holding company affiliate structure.

## **5. BANK SUPERVISION**

H.R. 10 contains several provisions that give the Federal Reserve Board confusing, overlapping authority over depository institutions that are regulated by other Federal banking agencies. For example, as a requirement to engage in the new financial activities, Section 103 requires all subsidiary depository institutions of a financial holding company to be well capitalized. If the Federal Reserve Board determines that a financial holding company has a subsidiary depository institution that is not well capitalized, or well managed, the company must execute an agreement with the Board to correct the deficiency. Until the conditions are corrected, the Board may impose limitations on the activities of the company or any affiliate, including a depository institution. Section 114 gives the Board additional authority to impose restrictions and requirements on relationships or transactions between a depository institution subsidiary of a bank holding company and any affiliate of the depository institution (other than a subsidiary of the institution). The Board may impose these restrictions if it determines, among other things, that the restrictions are necessary to avoid significant safety and soundness risk to the depository institution or the Federal deposit insurance fund.

**Specific Concerns:** These provisions will subject depository institution subsidiaries of bank holding companies to unprecedented, new regulatory burdens and overlapping, potentially conflicting, regulatory requirements.

## **6. CONSUMER PROTECTIONS**

Section 307 requires the Federal banking agencies to prescribe joint consumer protection regulations that would apply to retail sales and advertising of any insurance product by an insured depository institution, wholesale financial institution (WFI), subsidiaries thereof (as deemed necessary), and employees/agents thereof.

The regulations must include, for example, (I) a prohibition on misrepresentation (*e.g.*, “any practice” that “could mislead any person or otherwise cause a reasonable person” to conclude erroneously that the product is insured); (ii) a prohibition on coercion (*e.g.*, “any practice that would lead a consumer to believe” that credit is conditional upon the purchase of a particular insurance product); (iii) disclosure

requirements to inform the consumer that the product is not insured and is subject to anti-coercion rules; (iv) requirements that insurance transaction activities be physically separated (“to the extent practicable”) from areas where retail deposits are routinely accepted; (v) restrictions on referral compensation; (vi) requirements that insurance sales agents/employees be appropriately qualified and licensed; (vii) procedures to receive complaints by consumers alleging violations of these provisions; and (viii) a prohibition on discrimination (except as expressly permitted under state law) against victims of domestic violence. We generally support these types of consumer protection requirements, many of which are substantially similar to protections found in the OCC’s October 8, 1996 Guidance.

**Specific Concerns:** This section also establishes a new preemption scheme prohibiting an “inconsistent” or “contrary” state provision from being preempted by the Federal regulations unless the Federal banking agencies jointly make certain determinations. This provision is extraordinarily convoluted and presents the astonishing prospect that in each state, banks selling insurance would be subject to a different combination of provisions of the Federal rules, state provisions that co-exist with the Federal rules, state provisions that supersede the Federal rules and state provisions that are superseded by the Federal rules. The mix of these provisions could be different in each state in which a bank sells insurance.

## **7. COMMUNITY REINVESTMENT ACT**

Under this version of H.R. 10, for a bank holding company to engage in new financial activities, all of its subsidiary depository institutions must have a satisfactory CRA rating at the time the holding company applies to become a “financial holding company.” A similar requirement is made applicable to national banks seeking to engage in financial activities through a subsidiary. Section 136 of the bill applies CRA to national and state bank WFIs.

### **Specific Concerns:**

CRA has achieved positive results, and has led to significant financing for affordable housing, economic revitalization for communities, and increased profitable lending opportunities for banks. As a result, the OCC supports the approach taken in the House-passed version of H.R. 10, which would apply a satisfactory CRA requirement on an on going basis.

## **8. PRIVACY OF BANK CUSTOMERS**

The consumer financial privacy provisions in H.R. 10 include: (1) Section 114

permits the Board to impose restrictions or requirements on relationships or transactions between a depository institution and any affiliate (except a subsidiary of the depository institution) if it enhances the privacy of customers of depository institutions, is found to be in the public interest, and is consistent with various Federal laws; (2) Section 104 (addressing Federal preemption standards) permits states to adopt laws to prohibit the release of certain customer insurance information for the purpose of soliciting or selling insurance (or health information for any purpose) without the customer's express consent; and (3) Section 109 provides that the ongoing, multi-stage Federal Trade Commission study on consumer privacy issues will be submitted to Congress at the conclusion of each stage, together with recommendations for legislative action.

**Specific Concerns:** Technological advances and the emergence of diversified financial services companies--which would intensify upon the enactment of H.R. 10--creates a parallel responsibility for policymakers to ensure that customers' private financial information is properly handled and appropriately safeguarded.

- *FCRA Should Be Amended to Restore the Federal Bank Regulators' Examination Authority:* Recent amendments to the Fair Credit Reporting Act (FCRA) allow persons related by "common ownership or affiliated by corporate control" to share and use any customer information they possess (in addition to experience information, which can be freely shared) subject to certain requirements. This information may be shared within the corporate family only if clear and conspicuous disclosures are made to consumers that the information may be shared under FCRA and consumers are given the opportunity to "opt-out" of any information sharing.

The same recent amendments to FCRA also restrict the Federal banking agencies' authority to examine for compliance with FCRA, including the information sharing and opt-out provisions. A Federal banking agency may only examine an institution for FCRA compliance if the agency has information--following an investigation of a complaint or otherwise--that an institution has violated FCRA. Absent these circumstances, a banking agency cannot examine for compliance with the FCRA information sharing requirements. It is recommended that full examination authority for the Federal banking agencies be restored.

## **9. NATIONAL WHOLESALE FINANCIAL INSTITUTIONS**

Section 136 creates both national and state bank WFIs. These uninsured institutions can be affiliated with insured depository institutions. The bill prohibits WFIs from accepting initial deposits of \$100,000 or less (except for a 5% *de minimis* amount). While the OCC is given chartering authority over national WFIs, national WFIs in all

other respects are supervised and regulated by the Federal Reserve Board.

**Specific Concerns:** National WFIs will be subject to duplicative, confusing regulation-- chartered by the OCC but, for all other purposes, including prompt corrective action, supervised by the Federal Reserve Board and subject to the Board's enforcement authority. This is tremendously inefficient and confusing.