Remarks by
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Since the early 1960s, this conference has provided a forum for regulators, academics and industry to debate current issues facing the financial services industry. Many of the issues debated here ... and the solutions that followed ... modernized and radically transformed the industry.

Interest-rate deregulation was the hot topic for conferences held in the 1970s and geographic and product deregulation during the 1980s and 90s. And this year's conference again highlights a cutting-edge issue: banking and commerce.

Mixing banking and commerce is often talked about when policymakers consider permissible activities for a bank, its parent and affiliates. Today the debate is focused on commercial ownership of industrial loan companies or industrial banks, commonly known as ILCs. Yet, it has much broader implications for how affiliations between banking, financial and commercial firms will be regulated and supervised.

Three waves of change: Is this a fourth?

So how did we get here? Three waves of regulatory reform brought on by market pressures and changes in customer needs have changed the face of the industry. Each wave required legislative action. And each wave resulted in new regulations that modernized and changed the way the financial services industry did business.

In the first wave, federal restrictions on the interest rates that banks could pay on deposits were phased out. These limits had been on the books since the 1930s. In the second wave, banks were allowed to cross state lines. By the early 1990s, many states were already allowing interstate banking, which replaced an inefficient, piecemeal approach to banking.

The third wave of regulatory reform lifted restrictions on affiliations among banking, investment and insurance providers. Pressure for change began to build in the 1980s and continued into the 1990s. A mix of market demand, rapid advancements in technology, evolving capital markets and globalization had combined to alter the financial landscape.

Lawmakers responded prudently to each of these waves after intensive debate with a careful eye on protecting the safety and soundness of our financial system. If these waves of regulatory change have a message for us, it is that we can expect market-driven innovation to continue.

Are we on the crest of a fourth wave? Possibly.

There are powerful market forces at work: the unbundling of banking services, the democratization of credit, and the information revolution. We see bank-like services provided by nonfinancial firms. And we see the recent trends in the ILC industry. And so, back to ILCs.

ILCs are a small part of our banking system ... less than two percent of industry assets and just 60 institutions. ILC assets have grown from about $4 billion at the end of 1987 to $212 billion at the end of last year. Much of this growth comes from ILCs owned by financial firms. Several are subject to consolidated supervision by the Federal Reserve or the Office of Thrift Supervision. Others --15 in fact --are owned by retailers, manufacturers and other commercial firms. And they account for just over 14 percent of ILC assets. Today, several companies -- including some that are commercial in nature -- are seeking to charter or acquire ILCs. These trends have caused us to reconsider how the ILC industry is regulated. And they are reopening the debate about commercial affiliations with banks.

But, does that mean that Congress should reopen the current regulatory structure to consider the mixing of banking and commerce? Does the popularity of the ILC charter or the failure of many financial firms to use the financial holding company structure signal the need for significant regulatory change?

After all, in crafting the Gramm-Leach–Bliley Act (GLB) in 1999, Congress created a framework that could adapt to change and future market developments. It benefited the banking industry through expanded powers and the ability to affiliate with financial firms. It also gave financial firms an ability to acquire a commercial bank. And the framework kept in place the ILC exemption from the Bank Holding Company Act.

The FDIC in late January determined that the issue was not about ILCs ... but rather about whether such banks may be owned by commercial companies. To that end, we extended the moratorium on industrial bank insurance applications and change in bank control notices filed by commercial companies. At the same time, the FDIC determined that it would act on filings by businesses subject to consolidated bank regulation as a matter of course. And subject to conditions as appropriate, the FDIC decided to consider filings by financial firms not subject to such supervision, on a case-by-case basis.

The moratorium ends next January. However, the longer we wait, the more we risk stifling innovation, and prolong uncertainty in the marketplace.

The question of whether banking and commerce should be mixed and ...if at all ... to what degree, needs answering. This is a fundamental policy decision that should be made by elected officials. And it's now up to Congress to decide where do we go from here.

So, what are the options?

I suggest the following for lawmakers to consider.

Above all else, I hope that resolving the ILC debate will be based on sound policy and keeping in mind what's in the long-term public interest. ILCs have proven to be useful business models, even though concerns about the mixing of banking and commerce remain.

Yet, today, the ILC charter remains under a cloud because of the commercial ownership question. It is my hope that by resolving the controversy over commercial ownership -- by banning it ... or by allowing it ... or by finding a middle ground -- that Congress can remove the uncertainty that hangs over the industry.

Is maintaining the status quo an option? Of course!

Congress could choose to do that. But the concerns expressed by many about ILC ownership by large commercial firms would remain. In particular, concerns about mixing banking and commerce and the need for the parent company to be a source of strength for the insured depository.

And despite our current moratorium on ILC applications and notices to change control by commercial firms, the FDIC is responsible for considering these under existing rules. We cannot defer those decisions indefinitely. On the other hand, commercial affiliations could be prohibited.

The question then is whether a ban would hold up in the face of market forces. It certainly didn't hold up for the restrictions on interest rates, interstate banking and the bundling of financial services.

Finding the middle ground

Or Congress could seek a middle ground. Lawmakers might decide to allow some form of limited commercial ownership of ILCs.

For example, the House bill would limit commercial ownership to no more than 15 percent of the organization's consolidated gross revenues. Such limited experimentation was used in the past to test the effects of allowing banks to affiliate with securities firms.

Or Congress might choose to limit commercial ownership to special-purpose ILCs with restrictions on activities or branching. Recently, there's been discussion of allowing some commercial firms to own a limited form of self-financing ILC.

However, without sufficient conditions or restraints on ownership or on the charter, many might remain fearful that major retailers will try getting in the back door with an ILC charter. That could weaken the wall between banking and commerce that Congress recently reconfirmed in the GLB law.

But if Congress decides -- to whatever degree -- to allow commercial affiliation, then Congress also must consider how best to regulate it.

Different regulatory approaches have been advocated. One is the bank-centric approach that focuses regulatory oversight first on the insured entity, and secondarily on the parent and nonbank affiliates. This is, in essence, the FDIC's current supervisory model.

An alternative is consolidated supervision of the parent, the insured entity and the affiliates. This approach was endorsed by Congress in GLB.

Twenty years ago, then-FDIC chairman Bill Seidman argued that to meet the public interest ... policymakers should craft a financial services industry where customers benefit from enhanced competition within a banking system that is viable and competitive; operates in a safe and sound manner; and is flexible enough to respond to market and technological change.

Mr. Seidman argued that the best way to achieve these objectives was to take the bank-centric approach ... and to use the simplest, and least-costly regulatory and supervisory structure. After seeing the difficulties experienced in Japan and Korea -- with conflicts of interest and concentrations of economic and financial power -- he recognized the value of overseeing the parent company. His advice was to ensure that regulators be given sufficient powers to regulate the relationship between banking and commerce rather than not allow it.

If Congress decides that federal consolidated oversight is appropriate, then lawmakers must determine how to achieve this.

As I have testified, if Congress wants to make the FDIC a holding company regulator, then we believe that our powers should be comparable to those of the Federal Reserve.

Closing

Each time the market demanded change over the past 40 years, Congress responded prudently and rationally. I think we can expect that Congress will again be equally cautious and careful as it considers what to do about this age-old question of combining banking and commerce.

Let me end by saying that as a regulator, I see myself as a Swiss diplomat. I'm neutral on what lawmakers ought to do. But I stand ready to help in any way I can.

The FDIC was founded 75 years ago with two mandates: to protect depositors and to ensure the safety and soundness of the banking system. We stand ready to put our experience to work as this debate unfolds. Thank you very much.

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