Testimony of
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on
H.R. 10, Financial Services Act of 1999
before the
Committee on Banking and Financial Services
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Mr. Chairman, Mr. LaFalce, and members of the Committee, I appreciate this opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on H.R.10, the Financial Services Act of 1999, and related issues. I commend you, Mr. Chairman, for acting quickly in the 106th Congress and beginning formal deliberations on how best to strengthen and improve the financial services industry. H.R. 10 represents a positive legislative initiative with which to proceed in this important endeavor.

The FDIC has been and remains supportive of efforts to modernize the nation's banking and financial systems. Since its creation under the Banking Act of 1933, the FDIC has worked to ensure the safety and soundness of the banking system and to assure depositors that their insured deposits are safe. Consistent with its broad perspective on public-policy issues, this concern for the safety and soundness of insured depository institutions underscores the FDIC's approach to financial modernization.

The financial markets have changed dramatically since the 1930s when many of our nation's laws governing the financial system were written. Improvements in information technology and innovations in financial markets have rendered the current system increasingly obsolete and unable to provide the full range of financial services required by businesses and individual consumers in today's global economy. Modernization of the financial system is not only desirable, but necessary, to enable the financial services industry to meet the challenges that lie ahead.

The FDIC has long held the view that the maintenance of healthy and viable depository institutions requires that these institutions generate sufficient returns to attract new capital in support of normal growth and expansion into new areas. To achieve these goals, insured depository institutions must have the ability to compete on an equitable basis with other business enterprises, and their products and services must be permitted to evolve with the marketplace in a manner consistent with safety and soundness. Equally important, the legitimate needs of consumers must be addressed. As part of any effort to modernize the financial system, the potential effect on small communities, isolated markets, and customers of insured depository institutions must be considered.

H.R. 10 repeals key Glass-Steagall restrictions and authorizes holding companies and other affiliates of banks to engage in a wider range of securities and insurance activities. These represent important steps toward achieving the goals of financial modernization. In addition, I commend you, Mr. Chairman and the co-sponsors of H.R. 10, for including a repeal of the Savings Association Insurance Fund (SAIF) Special Reserve.

Although H.R. 10 is a significant start toward financial modernization, the FDIC believes it can be improved. First, although H.R. 10 would eliminate the SAIF Special Reserve, it does not mandate a merger of the SAIF and the Bank Insurance Fund (BIF). Second, the proposed legislation unnecessarily favors the holding company affiliate structure over the bank operating subsidiary structure as the means by which banking organizations could expand into new financial products and services. Third, the banking and commerce provisions in the bill do not recognize adequately either the track record of unitary savings-and-loan holding companies in this area or foreign and domestic developments in the financial marketplace. Finally, in implementing a greater degree of functional regulation, the bill reduces the authority of the federal banking regulators to determine the appropriate products and services of banks.

THE DEPOSIT INSURANCE FUNDS

H.R. 10 would eliminate the SAIF Special Reserve, and the FDIC applauds this provision. The Special Reserve was created by the Deposit Insurance Funds Act of 1996 (the Funds Act). Under the Funds Act, on January 1, 1999, the FDIC was required to establish a Special Reserve comprised of SAIF funds above the dollar amount required to meet the 1.25 percent Designated Reserve Ratio (DRR) at year-end 1998. The Special Reserve can only be drawn upon if the reserve ratio of the SAIF is less than 50 percent of the DRR and is expected to remain so for four consecutive quarters.

As required by law, the Special Reserve was established on January 1, 1999. On the basis of September 30, 1998 data, approximately $1 billion was segregated into the Special Reserve, thus lowering the SAIF reserve ratio from 1.39 percent to 1.25 percent. The amount of the SAIF Special Reserve will be adjusted to reflect year-end figures when those figures become available in March 1999.

Ironically, if the SAIF Special Reserve is not eliminated, the Special Reserve could lead to an assessment rate disparity between the BIF and the SAIF, thus recreating the very same circumstances the Funds Act - which levied a $4.5 billion special assessment on SAIF-assessable deposits - was intended to eliminate. As a result of the Special Reserve, unanticipated failures of banks and savings associations, or faster-than-expected growth in insured deposits, could cause the reserve ratio of the SAIF to drop below the DRR. Any drop in the SAIF reserve ratio below the DRR likely would precede the reserve ratio of the BIF falling below 1.25 percent, because the SAIF would be starting at a lower reserve ratio. When a fund's reserve ratio drops below the DRR, the FDIC is required to increase deposit insurance assessments to restore the fund's

reserve ratio to the DRR. Thus, the FDIC most likely would be required to raise SAIF assessments before instituting a comparable increase in BIF rates, recreating a rate disparity between the two funds. This disparity in assessment rates could arise even though the actual amount of funds available to support the SAIF, which would include the Special Reserve, might exceed the amount of funds necessary to meet the DRR.

Differences in deposit insurance assessment rates among institutions should reflect differences in risk posed to the insurance funds, not artificial distinctions, such as those that existed before the passage of the Funds Act. Higher assessment rates for SAIF-insured deposits resulted in the shifting of deposits from the SAIF to the BIF and other inefficiencies that were detrimental to virtually all parties. Such market distortions have an economic cost as institutions devote resources to countering artificial statutory distinctions. Thus, the FDIC strongly endorses the elimination of the Special Reserve as outlined in H.R. 10.

Although the Special Reserve is a recent creation, much of H.R. 10 deals with modernizing laws that have become outdated with the passage of time. However, there is one relic of the statutory framework established after the Great Depression that the bill does not address - two separate deposit insurance funds. The arguments for a merger of the BIF and the SAIF are persuasive, the timing is optimal, and the administrative and logical steps required to bring it about are not complicated or difficult.

The FDIC was established in 1933 and the Federal Savings and Loan Insurance Corporation (FSLIC) was established in 1934. Throughout its history, the FDIC always has insured some savings institutions, notably state-chartered savings banks, but for the most part it has insured commercial banks. The FSLIC insured savings-and-loan associations (S&Ls). The SAIF was established in 1989, in the aftermath of the savings-and-loan crisis of the 1980s and the insolvency of the FSLIC, to succeed the FSLIC fund and the FDIC fund was renamed the BIF. Both funds were put under the management of the FDIC.

In the 1930s, there were substantial differences between commercial banks and S&Ls. In general, S&Ls were mutual institutions that primarily offered savings accounts and home mortgages for consumers. Because their charters permitted limited activities, they were not allowed to offer checking accounts, consumer loans, or commercial loans. Indeed, their loans were virtually all long-term fixed-rate residential mortgages. Commercial banks, on the other hand, served mostly commercial customers. More than two-thirds of bank deposits were demand deposits and banks made very few residential mortgages. Thus, there were significant differences in the institutions insured by the FDIC and the FSLIC when the agencies were created.

Over time, the distinctions between banks and thrifts have become blurred. Each has entered what was once the other's domain. On the asset side, the portfolios of all but the largest banks often look very similar to the portfolios of thrift institutions. Both offer essentially an identical array of deposit accounts. From the point of view of the insured depositor, there is virtually no difference between banks and thrifts.

Not only have the banking and thrift industries become more similar over time, but the composition of who holds SAIF-insured deposits has changed as well. The name Savings Association Insurance Fund connotes a fund that insures savings associations. When it was established, this was indeed the case. Virtually all SAIF-insured deposits were held by SAIF-member thrifts. However, over the last decade, this has changed dramatically. As of September 30, 1998, commercial banks (35.1 percent) and BIF-member savings banks (8.1 percent) held over 40 percent of all deposits insured by the SAIF. Indeed, two of the five largest holders of SAIF-insured deposits are First Union National Bank and NationsBank N.A. The name Savings Association Insurance Fund has become a misnomer. The SAIF has become a true hybrid fund.

If the only problem with having two insurance funds is that one is misnamed, there would be little reason to merge the funds. However, there are substantive reasons why the two funds should be merged. First, as I have previously stated, the BIF and the SAIF provide an identical product - deposit insurance. Yet, as long as there are two deposit insurance funds, whose assessment rates are determined independently, the prospect of a premium differential exists. When an identical product is offered at two different prices, consumers - in this case, banks and thrifts that pay deposit insurance assessments - naturally gravitate to the lower price. This phenomenon was observed before the passage of the Funds Act when some SAIF-insured institutions successfully shifted deposits to BIF insurance. Despite moratoriums, entrance and exit fees, and bans on deposit shifting, market forces ultimately prevailed. Inefficiency and waste were introduced as institutions expended time and money trying to circumvent restrictions that prohibited them from purchasing deposit insurance at the lowest price. Although the Funds Act led to the elimination of the premium disparity that then existed between the BIF and the SAIF, a merged fund would guarantee that such a disparity would not recur in the future. It would have a single assessment rate schedule whose rates would be set solely on the basis of the risks that institutions pose to the single fund. The prospect of different prices for identical deposit insurance coverage would be eliminated.

Second, a merger of the funds would help mitigate the increased concentrations of risk facing both the SAIF and the BIF. Since its inception, the SAIF has insured far fewer, and more geographically concentrated institutions than the BIF has insured. Consequently, the SAIF has faced greater long-term structural risks and has been subject to proportionately greater losses from the failure of a single member. Although interstate merger activity may have reduced the geographic concentration of SAIF deposits somewhat, recent merger activity has increased the relative size of the largest members of either fund. As of midyear 1990, the three largest holders of SAIF-insured deposits held 8.7 percent of these deposits, and the three largest holders of BIF-insured deposits held 5 percent of these deposits. As of September 30, 1998, that figure was 13.3 percent for the SAIF and 10.1 percent for the BIF. In a combined insurance fund, the three largest institutions would hold 9.3 percent of insured deposits.

Finally, a merger of the funds also would result in lower administrative costs to the FDIC and to approximately 900 institutions that hold both BIF- and SAIF-insured deposits

(Oakar deposits) that must be tracked and assessed separately. Although these costs may not be large in absolute dollars, they represent wasted funds.

Instead of providing for a merger of the funds, H.R. 10 would require the FDIC to undertake a study of, and report to the Congress on, the adequacy of the deposit insurance funds in light of ongoing consolidation in the industry and the possible merger of the funds. The study must include the FDIC's plans for merging the BIF and the SAIF, as well as an estimate of the costs of a funds merger and how those costs may be passed on to the industry, particularly SAIF-members. The report to the Congress would be due within nine months of enactment.

FDIC staff has examined whether there are significant obstacles confronting the FDIC in effecting a merger of the BIF and the SAIF. The primary goal was to identify any initiatives that should be undertaken by the FDIC to ensure that a merger could be implemented in a timely manner. After considering the broad range of possible legal, accounting, logistical and technical issues that may arise in implementing a merger of the funds, the staff concluded that there were no major obstacles to a timely merger of the insurance funds. Moreover, as noted above, a merger of the funds would reduce the regulatory burden on institutions that hold both BIF- and SAIF-insured deposits and lower administrative costs to the FDIC.

In addition, the FDIC has begun a study of the effects of industry consolidation and megamergers on the risks to the BIF. The study analyzes the probability of the BIF becoming insolvent under various assumptions about the concentration of the banking industry. It includes an analysis of historical trends in consolidation and a review of the differences (in terms of BIF losses) between large and small banks. The main part of the analysis is a projection of the BIF under various consolidation scenarios, including a future with megabanks. We expect to complete this study by June. However, regardless of its outcome, it is difficult to see how this study could lead one to conclude that the funds should not be merged. Even if the study concludes that megabanks will not appreciably increase the risk to the funds, eliminating the possibility of future premium disparities and eliminating wasteful administrative costs for the FDIC and depository institutions are themselves sufficient reasons to merge the funds. If the study concludes that megabanks have increased risks, that is merely one more reason to merge the funds.

In summary, the BIF and the SAIF both are capitalized fully, with identical assessment rate schedules, and the members of both funds are healthy and profitable. Upon elimination of the SAIF Special Reserve, the reserve ratio of the SAIF would be restored to reflect its true level, and the BIF and the SAIF would have comparable reserve ratios. A merger of the two funds under these circumstances would not result in a material dilution of either fund, and would strengthen the deposit insurance system. This is an excellent time to merge the funds and eliminate a weakness in the federal deposit insurance system. It would be unfortunate if the Congress, while modernizing the rest of our statutes governing the financial services industry, left the anachronism of two deposit insurance funds in place.

PERMISSIBLE ACTIVITIES AND CORPORATE STRUCTURE

H.R. 10 would repeal key Glass-Steagall restrictions that inhibit member-bank affiliations with securities underwriters and would authorize the creation of financial holding companies (FHCs). These holding companies and their nonbank subsidiaries could conduct a wide range of financial activities, including the full range of insurance and securities activities. These expanded activities could not be conducted by the direct subsidiaries of banks. The new test for permissible activities for an FHC would be "financial in nature or incidental to such financial activities." H.R. 10 would modify the Bank Holding Company Act to include a list of activities that would be so classified.

The bill permits FHCs, but not national banks through their direct operating subsidiaries, to offer, on a limited basis, additional services and products that have not yet been found to be financial in nature. However, the FHC must reasonably believe that such activities are financial in nature. Referred to as a "developing basket," these activities may not exceed 5 percent of any of the following: the holding company's gross revenues; the holding company's total assets; and the holding company's total capital.

The bill would expressly authorize a subsidiary of a national bank to engage in any activity classified as financial in nature, in an agency capacity, but not as principal, with the approval of the Comptroller of the Currency, if the bank and any depository institution affiliates are well-capitalized and well-managed. Additionally, at the time the bank first acquires control or an interest in a subsidiary, in order to conduct the new financial agency activity, the bank and any affiliated depository institutions must have a satisfactory Community Reinvestment Act (CRA) rating. The bill also would authorize a well-capitalized national bank to underwrite within the bank or in a direct subsidiary of the bank certain limited obligation or revenue bonds on behalf of states or their political subdivisions, including public agencies or authorities.

The FDIC has gone on record as supporting the repeal of the Glass-Steagall restrictions and the expansion of permissible financial activities, subject to proper safeguards to protect the safety and soundness of insured depository institutions and the federal deposit insurance funds. The FDIC also endorses the developing basket provision of H.R. 10 that would allow FHCs to offer products and services that are financial in nature in the estimation of the holding companies. These provisions advance the goals of financial modernization, consistent with safety and soundness. However, there is no reason to withhold from banks the option of conducting the full range of expanded financial activities, including activities conducted as principal, through bank subsidiaries. H.R. 10 should be revised to permit the greatest flexibility and freedom to financial firms in deciding how best to organize themselves.

The question as to whether new activities for financial institutions should be authorized for direct subsidiaries of banks or be conducted only in nonbank subsidiaries of bank holding companies has emerged as one of the more critical issues to be decided in the

current debate over financial modernization. Aside from its competitive implications, the resolution of this issue is particularly important because, to a large extent, it will determine the future legal and operational structure of diversified financial service providers in the United States.

The FDIC has studied this issue closely for a long time and it is our judgment that both national and state-chartered banks should have the freedom to choose the corporate structure that best suits their business needs for conducting activities not directly permissible to the bank itself, provided certain safeguards are in place to protect the bank, the safety and soundness of the banking system, consumers, and the taxpayer. The necessary safeguards include: (1) applying principles such as those contained in Sections 23A and 23B of the Federal Reserve Act to transactions between a bank and its operating subsidiary, with the appropriate principles to be determined by the federal banking agencies; (2) requiring that the bank's investment in the operating subsidiary be deducted from regulatory capital; (3) requiring that after this deduction, the bank be well-capitalized; and (4) requiring that the corporate separateness of the bank be protected. In addition, the adoption of real-time reporting requirements should be considered for intracompany transactions under certain conditions, analogous to SEC requirements. With these safeguards in place, we see no compelling public-policy reason to mandate a particular organizational form.

From a safety-and-soundness perspective, both the bank operating subsidiary and the holding company affiliate structures can provide adequate protection to the insured depository institution from the direct and indirect effects of losses in nonbank subsidiaries or affiliates. Some have argued otherwise - that the bank holding company structure provides greater safety-and-soundness protection than does the operating subsidiary structure. As the deposit insurer, we have examined this issue closely and we disagree. Indeed, from the standpoint of benefits that accrue to the insured depository institution, or to the deposit insurer in the case of a bank failure, there are advantages to a direct subsidiary relationship with the bank. The properly insulated operating subsidiary structure and the holding company structure can provide similar safety-and-soundness protection when the bank is sound and the affiliate/subsidiary is financially troubled. However, when it is the bank that is financially troubled and the affiliate/subsidiary is sound, the value of the subsidiary serves to directly reduce the exposure of the FDIC. If the firm is a nonbank subsidiary of the parent holding company, none of these values is available to insured bank subsidiaries, or to the FDIC if the bank should fail. Thus, the subsidiary structure can provide superior safety-and-soundness protection. Appendix A to this testimony contains an in-depth analysis of this issue.

The FDIC certainly has had experience where the placement of an activity in a holding company affiliate has raised the cost of a resolution. For example, in many instances in the 1980s and early 1990s, data processing activities were conducted in a holding company affiliate. This gave the holding company bankruptcy trustee considerable leverage to extract fees from the bank receivership that the holding company would not have received had the data processing activities been conducted in the bank.

From a public-policy perspective, however, not all decisions should be dictated by savings to the deposit insurance fund at the time of bank failure. For example, there may be legitimate business reasons to place a data processing unit that is serving a number of different sister companies in a separate holding company affiliate. Similarly, it may be cheaper for a holding company to raise capital - thus benefiting insured banks - if nonbank activities are placed in holding company affiliates, rather than in bank subsidiaries where the entire net worth of the subsidiaries would be subordinated to depositors and the insurance fund. Thus, despite the fact that the bank subsidiary mode of organization provides certain advantages at the time of bank failure, we believe it is important that banks have a choice of organizational structure.

In addition to safety-and-soundness issues, some have argued that banks have a lower net marginal cost of funds than nonbanks because of a perceived federal subsidy from deposit insurance and access to the payments system and the Federal Reserve discount window. Further, it is argued that the ability of institutions to pass a net subsidy from the federal safety net is easier under a bank subsidiary structure than under the holding company structure. Thus, the argument continues, activities conducted in bank subsidiaries are subsidized, resulting in an expansion of the federal safety net. For well-capitalized banks, the evidence shows that if a net marginal funding advantage exists at all, it is very small.

Setting aside the issue of whether a marginal safety-net subsidy exists and its magnitude, it is useful to consider the channels through which banks may have an opportunity to transfer a subsidy beyond the parent bank. First, banks could transfer the subsidy through capital infusions to their direct subsidiary, or by routing dividends through their holding company to an affiliate. Second, banks could extend loans or engage in the purchase or sale of assets at terms that favor their subsidiary units. Yet, in practice, regulatory safeguards for operating subsidiaries, such as those discussed above, and existing safeguards for affiliates, such as Sections 23A and 23B of the Federal Reserve Act, would inhibit a bank from passing any net marginal subsidy either to a direct subsidiary or to an affiliate of the holding company.

We also would note that forcing banks to conduct insurance and securities activities through holding company affiliates might be particularly burdensome to small banks that may not have holding companies. These banks would be required to set up a holding company structure in order to conduct new activities, or in some cases to continue to conduct existing activities. With increased competition in the banking industry, we need to be especially cautious about putting unnecessary regulatory burdens and costs on community banks.

BANKING AND COMMERCE

The financial modernization debate also encompasses the issue of whether banking organizations should be allowed to affiliate with commercial enterprises. Both the benefits and risks of mixing banking and commerce have been debated for many years.

While there is no hard evidence that combinations of banking and commerce are harmful, there is no hard evidence that they are beneficial, either. Nevertheless, foreign and domestic marketplace developments suggest that combinations involving banking and commerce are becoming more numerous. Appendix B to this testimony discusses the mixing of banking and commerce in the United States in more detail.

H.R. 10 allows insurance companies, securities firms, and other firms that currently are not a bank holding company or a foreign bank that owned or controlled entities engaged in nonfinancial activities as of September 30, 1997, and became FHCs after enactment, to retain such ownership or control, subject to a "grandfather" provision that is limited in duration and volume of activities. An FHC could derive up to 15 percent of its annual gross revenues from nonfinancial activities of its own, or of its subsidiaries other than depository institutions, and could not increase such activities through merger or consolidation. The grandfather provision would have a duration of ten years, with possible individual extensions of up to five years.

H.R. 10 grandfathers for perpetuity existing unitary savings-and-loan (S&L) holding companies and those companies that had filed an application to become a unitary S&L holding company as of October 7, 1998. A unitary S&L holding company controls only one savings association subsidiary, which must meet the Qualified Thrift Lender (QTL) test. Unitary S&L holding companies may engage, directly or through their non-thrift subsidiaries, in any activities that do not threaten the safety and soundness of their subsidiary savings association or do not have the effect of enabling a savings association to evade applicable laws or regulations. Beyond these general provisions, there are no limitations on the scope of permissible activities of unitary S&L holding companies. Thus, unitary S&L holding companies generally are permitted to engage in activities closely related to banking, general securities underwriting and dealing, other financial services, real-estate investment and development, and commercial and industrial enterprises.

Under H.R. 10, new unitary S&L holding companies, whose applications were filed after October 7, 1998, could engage in all activities classified as financial in nature, but not in nonfinancial activities. This provision of the bill would place limits on a vehicle that has enhanced financial modernization without causing significant safety-and-soundness problems. Commercial companies historically have not been a source of risk to the thrift industry. For example, in 1995, the Office of Thrift Supervision reported to the Congress that unitary S&L holding companies, rather than causing harm to their subsidiaries, had in fact provided a source of strength to them in times of need. Moreover, the difference in the grandfather provision would create another class of institution that has no basis other than historical accident. Creating differences between otherwise identical institutions on the basis of arbitrary dates does not make economic sense.

Placing activity restrictions on unitary S&L holding companies would ignore recent developments concerning banking and commerce in the global financial marketplace. One such development is the 1998 merger of Daimler-Benz, Germany's biggest industrial group, with Chrysler Corporation to form DaimlerChrysler. Germany's

Deutsche Bank owns slightly more than one-fifth of the stock of the former Daimler-Benz and was active in the merger discussions. Soon after the merger was consummated, DaimlerChrysler announced it would combine its global services operations, such as automobile leasing and finance, information technology, real estate, and telecommunications, into one financial services provider called DaimlerChrysler Services AG. According to news reports, this entity, which will be headquartered in Berlin, will be the fourth-largest provider of financial services in the world outside the banking and insurance sectors.

The emergence of domestic and foreign financial powerhouses, such as General Electric's GE Capital Services (see Appendix B) and DaimlerChrysler Services AG, underscores the need for policymakers to fashion and adopt a more realistic approach to the mixing of banking and commerce in the United States. The mixing of banking and commerce under H.R. 10 would be confined to grandfathered entities, as discussed earlier. In practice, this restriction would preclude commercial banks and thrifts from affiliating with commercial enterprises and, in effect, would place a moratorium on the further mixing of banking and commerce in the United States at the federal level. This moratorium would not apply to domestic entities such as captive finance companies or industrial loan companies.

The FDIC supports a cautious easing of the restrictions on the mixing of banking and commerce, consistent with safety-and-soundness considerations. There have been no significant safety-and-soundness problems that have come to light in recent years regarding the mixing of banking and commerce. The provisions of the bill would place U.S. financial organizations at a competitive disadvantage in the global marketplace. Nevertheless, we recognize that U.S. banking organizations have had limited experience in affiliating with commercial enterprises. We believe that commercial activities should be permitted, provided that adequate safeguards exist to ensure safety and soundness. Moreover, we believe that we should proceed cautiously in order to allow banks time to adjust to a new competitive environment and to allow regulators and others to assess the actual benefits and risks of permitting banking and commerce to mix.

REGULATORY AUTHORITY

Under Section 10(b)(4) of the Federal Deposit Insurance Act, the FDIC has the authority to examine any affiliate of any depository institution as may be necessary to disclose fully: (1) the relationship between such depository institution and any such affiliate; and (2) the effect of any such relationship on the depository institution. The FDIC has used this authority sparingly and only after careful analysis. The very fact the authority exists, however, gives the FDIC the leverage to obtain necessary information that might not otherwise be available or forthcoming. The experiences of the 1980s underscore the importance of the insurer's ability to monitor in a timely and effective manner the relationships a depository institution has with its affiliates, especially during a period of major changes in the marketplace and the law. The current version of H.R. 10

preserves the FDIC's authority to examine any registered investment company for insurance purposes to determine the condition of an affiliated insured depository institution. Preservation of this authority is vitally important to allow the FDIC to discharge its insurance responsibilities and we commend you for including it in this bill.

The FDIC has a concern about the provisions in H.R. 10 that involve possible impediments to the evolution of products and services in the banking industry. H.R. 10 would narrow exemptions that banks have from registering as brokers or dealers under the securities laws. If doubt existed about whether an activity fell within an exemption, the Securities and Exchange Commission (SEC) would make the final regulatory determination and could use its enforcement authority to require registration. Thus, the SEC would have discretion to determine whether a bank needed to register as a broker or dealer and be subject to the regulatory requirements resulting from that status. Moreover, although one of the categories for exemption is effecting transactions in traditional banking products, the bill would authorize the SEC, after consultation with the Federal Reserve Board, to determine whether "new products" were securities, and thus subject to SEC regulation. Consequently, a nonbanking regulator would be given considerable authority over the activities of banks, a situation that could inhibit the evolution of banking products and services.

The last item regarding regulatory authority that concerns the FDIC involves certain potential disputes between federal banking regulators and state insurance regulators. For these disputes, H.R. 10 would eliminate the deference usually accorded federal agencies' interpretations of their statutes. We question whether this curtailment of the ability of federal banking regulators to determine the scope of the permissible products and services of banks is necessary or desirable. The concept of judicial deference recognizes an agency's expertise in interpreting any vagueness in federal legislation for which the agency has overall responsibility. We do not believe it is wise to begin a process that could erode the sound public-policy reasons for providing deference. Concerning the particular focus of these provisions of the bill, the elimination of the deference usually accorded the decisions of the federal banking regulators could, over time, produce a number of state-by-state differences in the treatment of the insurance-related activities of banks. Maintaining a degree of national uniformity in the area of the financial arena where insurance and banking meet would appear to be the preferable course.

CONCLUDING REMARKS

We have a unique opportunity to achieve financial modernization against the backdrop of a prosperous economy. This favorable environment will better enable institutions to accommodate the necessary changes. Rather than miss this opportunity, we should use it to its best advantage. Mr. Chairman and members of the Committee, the FDIC stands ready to work with you in this important endeavor.

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