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Statement by

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before the

Committee on Banking, Finance and Urban Affairs

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I appreciate the opportunity to review with you proposals to restructure the laws governing bank and thrift holding company activities. I am hopeful that these hearings will represent the conclusion of an extensive review by the Congress of legislative proposals affecting the competitive environment in the markets for banking and other financial services, so that much needed legislation can be enacted this year.

I have on several occasions expressed my conviction, before Congressional Committees and elsewhere, that we must move with a sense of urgency to reform the existing legislative framework governing "banking" organizations. The time remaining for Congressional action in this session has grown shorter, but the pressures of events remain. The banking and financial system will evolve in new directions. The only question is whether that evolution will proceed within a framework established by the Congress, with full consideration and a balancing of the public interests involved, or whether it will proceed entirely under the impetus of market forces pushing around, and over, a legislative structure set in quite different circumstances years ago.

The latter possibility cannot be satisfactory, opening the clear danger that the overriding public interest in a strong, stable and competitive financial system will be lost. New technologies, intense market pressures, the growing

aggressiveness of states in competing with each other for jobs in banking, and potentially conflicting decisions of regulators and courts attempting to apply old laws to today's circumstances, all demand a considered and adequate response. Your Committee has the opportunity to take a leading role in that effort.

The basic framework within which we at the Federal Reserve approach these questions can be simply summarized:

- We want to encourage fair competition in the provision of banking and financial services;
- We want to promote efficiency and minimal cost to benefit consumers;
- We want to protect against concentration of economic resources, discrimination, conflicts of interest, and other potential abuses; and
- We want a strong and stable banking system, implying continuing attention to safety and soundness of banks and other depository institutions.

These goals in some circumstances will, to be sure, be in conflict or point to different approaches. Consequently, they must be appropriately balanced. In approaching that balance, the normal perception for most industries -- that we can simply look to the marketplace to promote competition and efficiency -- must be considered in the light of the crucial

importance of maintaining confidence in banking institutions, continuity in the provisions of money and payments systems, and, the ability of the central bank to conduct effective monetary policy.

Public policy has long recognized the importance of protecting the safety and soundness of banks and depository institutions generally: they perform a unique and critical role in the financial system as operators of the payments system, as custodians of the bulk of liquid savings, as unbiased suppliers of short-term credit, and as the critical link between monetary policy and the economy. In our judgment, those concerns remain central today in any consideration of banking legislation. Recent developments only emphasize the point.

One aspect of those concerns is reflected in the federal "safety net" long provided by the discount window and deposit insurance, and that "safety net" also implies an effective supervisory and regulatory framework for depository institutions to contain excessive risk. Moreover, that framework must, to a degree, extend to holding companies of which the depository institutions are a part because banking institutions cannot be wholly separated from the fortunes of their affiliates and from the success or failure of their business objectives.

At the same time, banking and thrift organizations must be able to compete, and compete effectively and profitably in the marketplace, if they are to be strong and stable institutions, capable of serving the public and public policy effectively. That need itself requires adaptation of the legislative framework. It is establishing that balance among the needs for soundness, continuity, and competitive strength that represent the legislative challenge before you.

The Current Situation

The accelerated pace of change in the structure of our financial system grows out of several developments that are by now well known. New communications and data processing technology has led to computerization of many financial services and a blurring in the capacities of banks, thrifts, and other potential suppliers of financial services. There are greater opportunities for providing efficient services and more services by banks and nonbanks alike. At the same time, business and consumer experience with inflation and related higher interest rates of the late 1970's and 1980's has increased sensitivity to yield differentials and has put a premium on the ability to move money quickly both nationally and internationally.

Removal of interest rate ceilings on depository institutions liabilities, and aggressive competition with new forms of liquid deposits and deposit substitutes, have spurred

efforts to attain new sources of income through fees, through expanded asset powers, and by operating interstate. At the same time, nonbanks, offering broadly similar types of financial instruments, have sought ways to enter the banking business in order to gain access to federal deposit insurance and to the payments mechanism without having all the burdens carried by the regulated banking sector.

There have been numerous reactions to the forces driving change. We see new combinations of financial firms and new services. Increasingly, it seems, those services are similar to those offered by banks -- money market funds, cash management accounts and more recently brokerage of insured deposits. The phenomenon known as "nonbank banks," growing out of loopholes in current law, provide a vehicle by which financial and nonfinancial firms can enter the banking business outside the framework of law and regulation surrounding bank holding companies, actually or potentially violating the policy proscriptions against the combining of banking and commerce, and in the case of banks themselves, the established policies limiting interstate banking. Among depository institutions the distinctions are also blurring, with many thrifts increasingly assuming the characteristics of banks. Moreover, "bank-like" thrifts are also able, particularly under much more liberal laws in some states, to undertake activities prohibited for banks.

Now, we can also see a strong movement among states to enact banking laws more permissive than federal law -- in an effort to attract institutions, to enhance state revenues, and to create new state employment opportunities -- with the obvious potential for undermining federal law and policy. And, as those efforts become generalized, they will be self-defeating even in their immediate purpose. Meanwhile, the decisions of federal regulators in the framework of existing law may be, or appear to be, inconsistent, whether they are meant to facilitate change or to maintain Congressional intent. Such decisions are increasingly subject to court challenges to stop or speed the process, as they impact on particular private interest concerns, and the courts themselves are hard pressed to apply old laws to new circumstances.

As regulators and legislators concerned with the public interest, we must be sensitive to abiding and valid concerns of the public interest without blocking responses to real needs in the marketplace. As things now stand, there is no assurance that the process of change will adequately address public policy concerns. Quite the opposite -- it is clear that some of the time-tested tenets of banking law and policy are being undermined as market pressures and competitive instincts play against an outmoded legal and regulatory framework. The longer difficult decisions about the direction in which change should be encouraged or discouraged by public policy are

postponed, the more difficult these decisions will ultimately become. And, more importantly in my view, delay only increases the risks that policy concerns -- including the safety and soundness of the banking system -- will be undermined.

A Balanced Approach to Banking Legislation

In previous testimony on these issues before the Senate Banking Committee, I have suggested that new legislation, should now address several areas affecting banking institutions. Those are:

- (a) a strengthened definition of a bank;
- (b) a definition of a "qualified" thrift;
- (c) statutory guidelines to govern the division of state and federal authority in the area of banking organization powers;
- (d) new procedures to streamline application of the Bank Holding Company Act; and
- (e) expanded powers of depository institutions holding companies.

That testimony described in considerable detail our position on each of these areas and, rather than reviewing those positions again, I have attached my Senate testimony to this statement for the use of the Committee.

The legislation introduced by Chairman St Germain and Mr. Wylie -- The Financial Institutions Equity Act of 1984 -- deals in a broadly appropriate way with the first three areas I

have mentioned. So far as they go, the provisions closely parallel the views of the Federal Reserve Board. Specifically, they would more adequately define what a bank is, define the essential nature of a thrift eligible for the privilege of "unitary" savings and loan holding company treatment, and limit the ability of states to regulate banking in ways inconsistent with federal policy. Provisions along these lines are important in any legislation. What is necessary, however, is redefinitions of the powers of bank holding companies in a manner more in line with present needs, while consistent with safety and soundness as a whole. Therefore, I urge the Committee, in its consideration of the legislation, to add the two vital elements now omitted: namely the streamlining of provisions under the Bank Holding Company Act and expanded powers of depository institutions holding companies.

In reviewing H.R. 5734, my comments will be fairly general. Therefore, I have appended specific legislative language encompassing suggested changes that the Committee may wish to consider.

Definition of a Bank

The definition of a bank proposed in H.R. 5734 -- (1) an FDIC insured bank, (2) a bank eligible for FDIC insurance, or (3) a depository institution that accepts transaction accounts and makes commercial loans -- is the one originally recommended by the Federal Reserve. The new

definition would close the nonbank bank loophole in current law, and would not allow so-called "consumer banks" to be exempt from the Bank Holding Company Act. We believe it to be basically sound.

We have suggested a few limited changes to the basic definition in the bill in Senate testimony attached. Those changes are designed to avoid impacting unnecessarily a limited number of state-chartered nonbank institutions should the Committee wish to do so, although we fully agree that nonbank depository institutions such as industrial banks and privately insured thrifts should be covered by the basic policies of the bank and S&L holding company acts.

An important provision of the bill would provide for divestiture of institutions that are defined as banks if the parent owner is engaged in businesses that are inconsistent with the restrictions and limitations of the Bank Holding Company Act, without providing any grandfathering. While we have been willing to support provisions which would permit a limited amount of grandfathering for institutions proceeding in good faith before legislative proposals were introduced, we agree that such exceptions should be made with great caution.

I would like to remind the Committee of a related point concerning equity among financial institutions: we regulate banks to preserve the integrity of the nation's payments mechanism and to meet the needs of monetary policy.

It has been the longstanding Board view that authority should be provided to it to define transaction accounts and to apply reserve requirements to institutions that are not formally depository institutions (and thus are not covered by the prudential rules applicable to these institutions and their holding companies) but that do offer transaction accounts similar to those offered by banks and thrifts. As long as these close substitutes for bank deposits are free from reserve requirements, potential competitive advantages relative to bank deposits exist, particularly when no interest is paid on required reserves. At some time, the result of the competitive disparity could be to complicate the task of conducting monetary policy.

Thus, the Board believes it would be prudent to incorporate into the bill a provision whereby it would have authority to determine if instruments issued by nonbank institutions allowing third-party payment have, in fact, the essential characteristic of transaction accounts and should thus be subject to reserve requirements. The Board would not expect to use this authority unless conditions arose to demonstrate its necessity. Also, we believe that institutions with such powers should be subject to requirements pertaining to reporting of deposits.

Definition of Qualified Thrift

As in the case of nonbank banks, there has been increasingly clear recognition of the need to adopt rules to assure equality of treatment of various types of depository institutions exercising similar or overlapping powers. Thrift institutions have become more like banks with respect to the powers they are allowed to exercise, and that has become increasingly true with respect to the powers they do exercise. Moreover, the powers available to thrift institutions in other respects extend well beyond those available to banks and even over time will call into question the basic separation of banking and commerce now incorporated in public policy. Considerations of competitive equity alone dictate that the privileges and restrictions of banks and thrifts be brought into a more coherent relationship. But it is not just a matter of competitive equity. Restrictions on powers of bank holding companies and on "nonbank banks" will inevitably be undercut, and rapidly, to the extent thrift institutions with banking powers can simply substitute as a vehicle for combining various activities. The need for action is reflected in the interest of a variety of nonfinancial and financial businesses in the acquisition of thrifts in order to benefit from their bank-like powers, to have expanded opportunity for branching, to gain access to federal deposit insurance, and to be direct participants in the payments mechanism while retaining their range of nonbanking, and even nonfinancial, business.

I recognize that there are difficult questions posed by firms that already have operations on both sides of the line between commerce and "thrift banking." In the past, some industrial or commercial firms have owned thrifts operating as separate and distinct entities without significant problems arising. But in the environment we now face, these questions need to be approached anew, and a firm policy established with respect to which combinations are acceptable and which are not.

H.R. 5734 approaches this issue by defining a "qualified" thrift institution to be a thrift which has at least 65 percent of its assets in residential mortgages or related investments. This test must be met within two years, except for mutual and stock savings banks which are given a 10 year period to comply. Further, "nonqualified" thrifts would be precluded from engaging in commercial lending activities whether or not they are part of a holding company. Similarly, commercial lending activities would not be permitted by those "qualified" thrifts that are owned by a unitary S&L holding company that engages in activities not permitted for a multiple S&L holding company.

We believe that this qualified thrift test is appropriate for a savings and loan holding company to be eligible for treatment as a unitary thrift holding company, with the special benefits that status carries. Further, we believe the basket of assets to be included under H.R. 5734 in

the 65 percent ratio, which would include residential mortgages or mortgaged backed securities, mobile home loans, loans for home improvement, or participation in any of these instruments is appropriate and consistent with the historic purposes and the special benefits Congress has given to thrifts as housing lenders. Based on this definition, according to our calculations, almost three-quarters of FSLIC institutions would currently meet this test.

We believe that the transition periods provided in H.R. 5734 -- two years for S&L's and 10 years for mutual or stock savings banks, with interim targets as set in the bill, represent reasonable timeframes for thrift institutions to decide whether they wish to be excluded from holding company act policies and continue to be treated as thrifts or conform to those policies as do banks. If necessary, a longer transition period than two years could be considered for S&L's, provided they meet interim targets. Further we agree that ownership of a thrift by an industrial or commercial firm could be continued during the transition period and thereafter, provided that "tandem" operations between the holding company and its depository subsidiary or vice versa are not permitted.

Some clarification of the proposed treatment of banks and thrifts with regard to tandem operations would be desirable. The Board's position has been that tandem operations between a thrift institution and an affiliated

nonbanking subsidiaries of the parent holding company -- in either direction -- should not be permitted. That is, the thrift could not jointly market or offer its services and the products or service of the nonbanking affiliates, and the nonbanking affiliates could not market or offer the products or services of the thrift. We believe the legislation should clearly indicate that the prohibition would work in both directions. In the Appendix, we have suggested legislative language to accomplish this result and to make a number of other technical changes.

The bill also applies the tandem operations limitations to relationships between banks and nonbanking affiliates of bank holding companies. Bank holding companies are already subject to strict anti-tying prohibitions in the Bank Holding Company Act and in the Board's regulations. Considering these provisions and the activities limitations of the Bank Holding Company Act, I would not see any need for the provisions of Section 2(b) of H.R. 5734 related to tandem operations between banks and bank holding companies.

Finally, the bill prohibits the affiliation of thrifts and securities firms applying the Glass-Steagall Act to insured and uninsured savings and loan associations. Such a provision is necessary to assure safety and soundness and competitive equity, has been recommended by the Federal Home Loan Bank Board, and is strongly supported by the Federal Reserve Board.

Activities of State-Chartered Depository Institutions

There has been concern expressed about authorizations by states permitting banks or thrifts (and their subsidiaries) to conduct nonbanking businesses that would not otherwise be permitted to bank holding companies under present or new federal laws. The question must certainly be asked whether it makes sense for Congress to work out carefully balanced arrangements for depository holding companies in the conduct of nonbanking activities, taking full account of what is necessary to assure a safe and sound banking system, only to see subsequently far different and inconsistent arrangements established for state-chartered institutions under state law for reasons that are often more concerned with shifting revenues and jobs than with the overriding need to provide a secure and stable banking system.

H.R. 5734 deals with this problem by permitting states to authorize activities beyond the scope of Section 4(c)(8) of the Bank Holding Company Act or Section 408 of the National Housing Act, but requiring that such activities be conducted only within the authorizing state and provided only to residents of the state.

These provisions directly address the problems created by certain state actions, such as in South Dakota, where nonbanking activities, such as insurance underwriting and brokerage, by state-chartered banks are encouraged so long as

these activities are directed largely out of state. Moreover, the proposal would allow an area of state initiative and experimentation consistent with the traditions of the dual banking system.

At the same time, the Board believes one additional step should be taken to enforce basic national policy when questions of safety and soundness are fundamentally at stake. That step would involve a Congressional decision to rule out specific activities for banks or their affiliates that the Congress specifically decides to prohibit or limit on grounds that the safety or stability of the banking system might be impaired -- areas in which the federal government, through the provision of a national "safety net," has a unique and overriding interest. For example, if Congress reaffirms its decision to exclude banking organizations from participating in underwriting corporate debt and equity, or limits the participation of these organizations in real estate development on grounds of risk, as we believe appropriate, the states should not be able to overrule that judgment and expose the insured depository system to those risks. A similar point might be made with respect to insurance underwriting and the general prohibitions on links between commerce and banking. However, in areas where safety and soundness are not so heavily involved, such as in a decision to authorize real estate or insurance brokerage powers or travel services for banking institutions, but rather involve questions of consumer

protection and competitive equity, an overriding federal interest does not appear to be present. Consequently, state legislatures might authorize banking organizations to participate in these activities within the confines of their own state, as H.R. 5734 provides. Here each state may be in at least as good a position as the federal government to make the judgment as to what is desirable to protect local customers and local interests, while encouraging a competitive environment and efficiency.

In sum, we would suggest that the balance between federal and state interest be struck as follows: states may not authorize activities that Congress has ruled out of bounds for safety and soundness reasons; states may optionally authorize other activities but only if they are conducted within separate affiliates within their borders and provided to their own residents. We have attached to this testimony a draft of these provisions which the Committee may find useful.

Other Provisions of H.R. 5734

The legislation contains several other provisions all having to do with securities activities of depository institutions and their holding companies. It would appropriately extend Glass-Steagall prohibitions on the intermingling of banking and security dealings to cover affiliations with securities firms by all banks and thrifts. Currently the Glass-Steagall prohibitions arguably cover only

member banks. The statutory omission of explicit coverage of nonmember banks is an anomaly that appears to have developed as an oversight rather than by Congressional intent. Explicit coverage of thrifts is overdue, both to assure safety and soundness and as a matter of competitive equity. The legislation would also close another potential loophole by making it clear that the Glass-Steagall limitations on the affiliation of securities firms and depository institutions apply when securities activities are conducted in affiliates of depository institutions. We support these provisions.

The bill would also prohibit all retail brokerage activities for all types of depository institutions or their holding companies. This would include so-called "discount brokerage" -- shorthand for a passive brokerage function separated from research and active management or advice with respect to specific accounts or stocks. Discount brokerage, involving the purchase and sale of securities at the request and initiative of a customer, has been approved for bank holding companies by the Federal Reserve Board. In the Board's view, that activity does not raise questions of safety and soundness or of conflict of interest, and is an appropriate and natural extension of services that banks and other depositories have historically offered to their customers. Particularly when conducted in a separate subsidiary of a depository institution holding company, we see no public policy reason why

these institutions should not be able to offer discount brokerage service. In fact, considerations of competitive equality and potential benefits to consumers would suggest that such activities would have positive public benefits. We believe that discount brokerage should be permitted for depository institution holding companies. A more substantive question would arise with respect to general stock brokerage activities. If the Congress feels it important to provide limitations in this area, we would confine such limitations only to a combination of brokerage with the dissemination of advice and research, and active solicitation of transactions in particular securities.

Bank Holding Company Procedures

As I noted above, the Federal Reserve has recommended that banking legislation should include amendments to the Bank Holding Company Act to permit new procedures for streamlining the processing of applications under the Act. These provisions do not appear in H.R. 5734. The Board believes the new procedures that are contained in legislation being considered in the Senate would minimize the cost and burdens of regulation of holding companies, would provide the Board with adequate supervisory authority over the activities of holding companies and their nonbanking subsidiaries, and are fully consistent with the public interest. These provisions are desirable not only to avoid unnecessary procedural delays for bank holding

companies but also are necessary to place bank holding companies on more equal footing with their competitors by eliminating the need for a positive finding of public benefits and for formal hearings. As things now stand, those requirements, which other businesses do not face in undertaking new activities, can become a tool for competitors to limit bank entry into lines of activity now dominated by others.

In the proposed approach, new activities could go forward, after notice to the Federal Reserve Board, unless the Board found grounds for disapproval under statutory criteria, relevant to broad public policy considerations. Specifically, new initiatives could be disapproved if inadequacy of financial and managerial resources would be demonstrated, if resources would be widely concentrated, or if there were adverse affects on bank safety and soundness. As further protection, the Board would also have general authority to set out regulations on nonbanking activities to assure "safe and sound financial practices," including appropriate capital standards.

The purpose of those provisions, and the provision reducing the scope for judicial review by competitors, is to reduce unnecessary regulatory burdens while maintaining a necessary level of supervision to protect public policy interests. While potentially dilatory formal hearings on applications would be limited, formal rulemaking procedures would, of course, remain in place with respect to decisions to

add new activities to permissible bank holding company powers. The Board would continue to request public comments on notices and hold informal hearings, when necessary, to obtain information necessary to make decisions.

Our conclusion is that those provisions adequately balance the need for reducing the regulatory burdens with the requirement for adequate supervision to enforce fully the provisions of the Bank Holding Company Act. I strongly recommend that these provisions be included in legislation now before the Committee.

New Activities for Bank Holding Company

H.R. 5734 provides for no new expanded powers for bank holding companies. In our view, considerations of competitive equality as among types of financial institutions (including thrifts), potential benefits to consumers of a broader range of suppliers of financial services, and the need for banks to broaden their earning capacity strongly point to an increase in the range of banking related activities permitted bank holding companies. The point is reinforced by the need to assure that these companies are in a position to take advantage of the burgeoning technological developments that are enhancing the delivery of financial services.

As I have stressed, those considerations must be -- and they can be -- balanced against other public policy concerns: assurance of fair and open competition in the

provision of credit and other services, maintenance of impartiality of banks and credit judgments, and avoidance of practices that can undermine the strength of the bank itself, and the banking system more generally. My earlier testimony before the Senate deals with these questions at length, considering each of the most significant powers in turn. Rather than burden you by reiterating that analysis here, I would only point out that in approaching these questions, we firmly believe the issues of safety and soundness of concern to members of the Committee can be appropriately addressed in the legislative process consistent with a broadening of bank holding company powers.

Interstate Banking

We surely need a fresh Congressional review of our entire policy toward interstate banking. While I understand the difficulties involved in this issue, we also must recognize that the proliferation of nonbank affiliates of bank holding companies operating across state lines, integrated loan production and "Edge Act" offices, national and regional marketing of credit card and related services, the current action of some states themselves to permit entry of out-of-state banking organizations, and the broader powers of thrift institutions able to operate interstate, have by now led to interstate banking de facto for many banking services. But this de facto system has inherent inefficiencies and gaps, and

in some instances may be more difficult to operate, from the standpoint of the bank, or to supervise from the standpoint of the regulator.

While most of the issues in this controversial area will need to be held over to a later Congress, the present movement towards regional interstate banking arrangements does raise major constitutional and public policy issues that need to be dealt with now. Recently, in three bank holding company merger applications under New England reciprocal statutes, the Board had to address Constitutional issues inherent in these discriminatory arrangements. As anticipated, the basic issues in these cases are now before the federal courts.

We cannot anticipate the outcome of those actions, but we do believe the matter should be decided as a matter of Congressional policy, not by regulators or courts attempting to read the legislature's intent into old laws originally intended to deal with different problems. If Congress wishes to support regional arrangements, legislation explicitly authorizing that approach should be enacted. We believe, as a matter of public policy, such authorization should be for a strictly limited period, and viewed as a transition toward interstate banking arrangements that avoid "Balkanization" of banking into regions.

Brokered Deposits

An important issue that has received considerable attention is the proliferation of insured brokered deposits.

Developments in this area are an example of how the marketplace can respond to one element of governmental intervention -- in this case federal deposit insurance -- in a manner that can have unintended and undesirable effects. The deposit insurance agencies are rightly concerned about the proliferation of brokered deposits. Indeed, brokered deposits have in a number of instances facilitated extremely rapid, unsustainable growth and excessive risk-taking by some institutions that subsequently failed or are now in serious financial condition. If permitted to expand without appropriate constraints, such activities could have serious and unintended effects on the insurance funds and the structure of depository institutions.

The Board has taken the position that legislation to permit regulatory agencies to set a cap on insured brokered deposits -- at a low level, such as five percent of deposits or tied to capital -- would be appropriate. I have attached legislative language that would accomplish this. In our view, it should be added to this legislation.

Conclusion

I cannot emphasize strongly enough the urgent need for definitive Congressional action on the legislation now before you during the current session. Decisions cannot be postponed any longer, for if they are, the financial system will be markedly restructured without guidance from the Congress. The

legislation before you -- H.R. 5734 -- is a positive step, and as indicated, we support the main thrust, so far as it goes.

What we find lacking in the bill is an appropriate response to the need for striking an appropriate balance in the powers permitted bank holding companies. Without such provision, the job of reform will be incomplete, only to be left to later Congresses, and at risk to the competitive strength of the banking organizations upon which we rely so heavily.

Members of the Committee have called attention to the degree of pressures and strains in the banking system that have called into play the federal safety net. I believe we must be extremely careful in drawing conclusions from those events. While the overall stability of the banking system should not be in question, in individual instances there may indeed be question raised, for bankers and supervisors alike, about the conduct of traditional banking business. Appropriate standards for capital, for liquidity, and for credit risk are continuing questions that deserve, and are receiving, our attention.

But those questions affecting the use of existing powers are not directly at issue in this legislation. The matters covered by H.R. 5734 do deal with some implicit threats to safety and soundness, particularly from the proliferation of competition in banking by unregulated institutions. New powers need to be assessed in the light of those concerns as well.

But simply prohibiting banking organizations from competing in areas consistent with criteria of safety and soundness -- areas that would in fact enhance their prospects and stability -- does not serve either the consumer or other public policy concerns. To that extent, H.R. 5734 strikes us as incomplete legislation, deferring issues that need to be resolved.

In sum, the basic policies of the Bank Holding Company Act against excessive risk, conflicts of interest, impartiality in the credit granting process, and concentration of resources, remain sound. Those principles are now being undermined by a haphazard pattern of interindustry acquisitions and by new combinations of banking, securities, insurance and commercial products. Decisions shaped by market forces working around present outmoded law will not produce a coherent framework and can only in the end undermine and weaken the fabric of the banking system.

This is a critical time in our financial history. You have a unique opportunity to adapt the enduring principles to present needs.

The time is already late. But the issues are clearly before you, ready for decision and action. I urge you to move ahead with a sense of urgency, to protect and strengthen the financial system.

SUGGESTED AMENDMENTS TO H.R. 5734

. Definition of Bank

Amend lines 11-13 on page 2 to read as follows:

"(i) accepts transaction accounts; and"

Amend line 4, page 3 to add a new paragraph (3) to define "transaction account":

"(3) The term 'transaction account' means a demand deposit or negotiable order of withdrawal account, savings account subject to automatic transfer, share draft account, or other deposit that the depositor may withdraw by check, payment order of withdrawal, negotiable or transferable instrument, or other means, including electronic means, for the purpose of making payments or transfers to third parties or others."

Explanation

This amendment would clarify that the "bank" definition is intended to include demand deposits that are not subject to withdrawal by check, as well as other accounts that are functionally equivalent to checking accounts. This amendment essentially applies the definition of transaction account in the Monetary Control Act of 1980.

2. Exclusion of non-federally insured savings and cooperative banks from "bank" definition

Amend line 19 on page 2 to read as follows:

"(B) an insured institution or uninsured institution as defined in section 408(a) of the National Housing Act;"

Delete subparagraph (C), lines 21 to 23, page 2.

Explanation

This amendment would exclude from the "bank" definition privately insured savings banks and cooperative banks, in addition to privately insured S&Ls. The bill currently excludes only privately insured S&Ls. This amendment would seem appropriate in view of the provision in section 6 of the bill subjecting savings banks and cooperative banks to the Savings and Loan Holding Company Act.

3. Clarification amendment

Amend lines 7, 8, and 9 on page 3 to read as follows:

"such paragraph (2)) shall not apply in the case of a company that becomes a bank holding company as a result of the enactment of the Financial Institutions Equity Act of 1984 on the date of such enactment."

Explanation

The provision in the existing bill could be interpreted to apply only with respect to companies that become bank holding companies after the date of enactment and not on the date of enactment. The amendment would clarify the intent of the provision to apply to companies that become bank holding companies on the date of enactment of the bill as a result of enactment.

4. Tandem operations

Amend line 11, page 9 by inserting after the words "tandem operations" the words "with such holding company or any subsidiary or affiliate thereof."

Amend subparagraph (B) on line 17, page 9 and subparagraph (B) on line 1, page 10 to read as follows:

"(B) An insured or uninsured institution that is a subsidiary of a savings and loan holding company may engage in tandem operations with such holding company or with a subsidiary or affiliate thereof only if such holding company or such subsidiary or affiliate thereof, as the case may be, is engaged solely in an activity or activities permissible for a multiple savings and loan holding company under subsection (c) of this section.

"(C) For purposes of this subsection, the term 'tandem operations' means the offering or marketing of the products or services of an insured or uninsured institution by or to an affiliate or the offering or marketing by an insured or uninsured institution of the products or services of an affiliate."

Explanation

This amendment would clarify that the tandem operation restriction applies to the provision of services by a

subsidiary thrift to an affiliate. This amendment also would clarify that the tandem operation restriction runs to affiliates as well as to the thrift itself. Finally, the amendment would clarify the intent of the bill to permit a subsidiary of a unitary savings and loan holding company to engage in tandem operations with an affiliate, provided the affiliate is engaged in an activity permissible for a multiple savings and loan holding company under the National Housing Act.

5. Securities activities of depository institutions

Amend Section 4 of the bill (line 8, page 5) to read as follows:

"(a) For purposes of section 21(a)(1) of the Banking Act of 1933, a person or entity shall be deemed to be engaged in the business of receiving deposits if it is controlled in any manner by another person or entity that engages at the same time, to any extent whatsoever, in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor."

Amend line 14, page 5 by changing the numeral "2" to the letter "b" and deleting lines 17 to 19, page 5.

Explanation

This amendment would clarify the intent of this provision to apply the section 21 prohibitions to any company that is controlled by an institution that accepts deposits.

6. Unitary S&L holding company exemption

Delete subsection (o)(1)(A) on lines 6-13 of page 8.

Redesignate paragraphs (6)(B) and (C) on page 10 as paragraphs (C) and (D) and move paragraph (B) beginning at line 14 on page 8 to line 20 on page 10.

Redesignate paragraphs (2), (3), (4), (5), and (6) on pages 9 and 10 as paragraphs, (3), (4), (5), (6), and (7), respectively, and substitute "subparagraph (B) of this subsection" for "subsection (o)" in line 13 on page 7.

Explanation

The first amendment would delete proposed subsection (o)(1)(A), which would apply the activity restrictions of the Savings and Loan Holding Company Act to savings and loan holding companies whose subsidiary insured or uninsured institutions become nonqualified institutions. This section appears to be redundant since the activity restrictions in proposed subsection (n)(1) on page 7 of the bill would apply to such companies.

The second amendment is a technical amendment to transfer the phase-in provision to the definition of "qualified institution" since the provision is written in such a way as to effectively amend that definition.

The third amendment is a technical amendment to reflect the above changes.

7. Prohibitions on commercial lending

The bill prohibits nonqualifying thrifts and a thrift owned by a unitary savings and loan holding company from engaging in any commercial lending activity. The bill, however, does not define the term or specify whether the term includes only secured or unsecured loans for commercial, corporate, business or agricultural purposes (as authorized under 12 U.S.C. 1464(c)(1)(R) up to 10 percent of a thrift's assets) or loans on non-residential property (authorized up to 40 percent of a thrift's assets under 12 U.S.C. 1464(c)(1)(B)) and other types of commercial loans that are not encompassed under 12 U.S.C. 1464(c)(1)(R).

The Committee may wish to clarify the scope of the commercial lending covered by these sections of the bill.

8. Activities of state chartered depository institutions

Amend section 7 of the bill to read as follows:

NONBANKING ACTIVITIES PROHIBITED FOR STATE DEPOSITORY INSTITUTIONS

Sec. 7 (a) Section 7 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1846), is hereby amended by inserting at the beginning thereof "(a)" and adding the following new subsections.

"(b) Nothing in this Act shall prohibit a bank from engaging directly in an activity authorized by the state in which such bank is chartered, except that:

"(1) if such activity is not permissible for a bank holding company under section 4 of this Act, a bank may conduct such activity directly or indirectly only in the state authorizing the activity and only for the bank's customers located in that state; and

"(2) a bank shall not engage directly or indirectly in any activity prohibited for a member bank or affiliate thereof under the Banking Act of 1933 or in any real estate investment or development or insurance underwriting activity except to the extent permissible for a bank holding company under this Act.

"(c) Notwithstanding subsection (b) of this section, a bank that, on or before July 1, 1983, commenced any activity that would have been prohibited by this section if commenced after enactment of this section may continue to engage in such activity. A bank that, after July 1, 1983, commenced any activity that would have been prohibited by this section if commenced after enactment of this section shall terminate such activity within six months of enactment of this section."

(b) Section 408 of the National Housing Act (12 U.S.C. 1730a) is hereby amended by adding the following new subsection (o):

"(o)(1) Nothing in this section shall prohibit an insured or uninsured institution from engaging directly or indirectly in an activity authorized by the state in which such insured or uninsured institution is chartered, except that:

"(A) if such activity is not permissible for a multiple savings and loan holding company under section 408 of the National Housing Act (12 U.S.C. 1730a), an insured or uninsured institution may conduct such activity, directly or indirectly, only in the state authorizing the activity and only for the institution's customers located in that state; and

"(B) an insured or uninsured institution may not engage directly or indirectly in any activity prohibited for a member bank or affiliate thereof under the Banking Act of 1933 or in any real estate investment or development or insurance underwriting activity prohibited for a multiple savings and loan holding company under subsection (c) of this section. Nothing in this subsection shall prohibit a state-chartered savings and loan association or savings bank from engaging in any activity expressly permitted by statute for a Federal savings and loan association or Federal savings bank.

"(2) Notwithstanding paragraph (1) of this subsection, an insured or uninsured institution that, on or before July 1, 1983, commenced, directly or indirectly, any activity that would have been prohibited by this subsection if commenced after enactment of this subsection may continue to engage in such activity. An insured or uninsured institution that, after July 1, 1983, commenced any activity, directly or indirectly, that would have been prohibited by this subsection if commenced after enactment of this subsection shall terminate such activity within six months of enactment of this subsection."

Explanation

This amendment prohibits banks and thrifts from engaging, directly or through a subsidiary, in any activity authorized by state law that is prohibited under the Bank Holding Company Act, in the case of banks, or the Savings and Loan Holding Company Act, in the case of thrifts.

This amendment also provides that this section does not authorize any state chartered depository institution to engage in any real estate investment or development or insurance underwriting activity except to the extent permissible for a bank holding company under the Bank Holding Company Act, or for a multiple savings and loan holding company under the National Housing Act. In addition, authority could be included which would allow the Board and the FSLIC to designate other activities as raising safety and soundness issues and thus not eligible for authorization by the states for state chartered institutions. The amendment provides that an institution that commenced an activity before July 1, 1983, that would be prohibited by this bill, may continue to engage in the activity. An institution that commenced such a prohibited activity after July 1, 1983, must terminate the activity within six months.

9. Technical and simplifying amendments

Redesignate subsection (b) at line 18 on page 14 as subsection (c) since there is a preceding subsection (b).

Clarify to which section subsection (c) beginning at line 1 on page 15 applies.

Amend section 8 beginning at line 5 on page 15 to read as follows:

"SEC. 8. A depository institution that commences between May 24, 1984, and the date of the enactment of this Act, any activity that becomes prohibited by this Act shall cease such prohibited activity on such date of enactment."

10. Reserve Requirements on other transaction accounts

Add a new section 9 to the bill to read as follows:

SEC. 9 (a) Section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)) is amended by adding at the end thereof the following:

"(12)(A) The Board may, if it deems it appropriate to implement monetary policy, require by regulation any person, company, or other entity not otherwise subject to reserve requirements under paragraphs (2) or (5) of this subsection to maintain reserves against its transaction accounts, including transaction accounts held in the form of shares.

"(B) The Board may vary the reserve requirements imposed under this paragraph from those established for depository institutions, but the ratios specified for such reserve requirements shall not be more than the ratios specified for depository institutions under this subsection.

"(C) Reserves held under this paragraph shall be maintained in the same form and subject to the same conditions as are applicable to reserves maintained by depository institutions but subject to such transitional adjustments as the Board may prescribe.

"(D) The exemption from reserve requirements provided in paragraph (11) of this subsection shall also apply to transaction accounts subject to reserve requirements under this paragraph.

"(E)(i) The Board may require any person, company, or other entity required to maintain reserves under this paragraph to make, at such intervals as the Board may prescribe, such reports of its assets, liabilities and capital as the Board may determine to be necessary or desirable to enable the Board to discharge its responsibilities to monitor and control monetary and credit aggregates.

"(ii) The Board shall have the authority to make inspections, using such examiners as the Board selects or approves, of the books and records of each person, company, or other entity required to maintain reserves under this paragraph for the purpose of verifying the accuracy and completeness of reports submitted to the Board by such persons, companies or entities.

"(F) A person, company, or other entity required to maintain reserves under this paragraph shall not be eligible for extensions of credit from the Federal Reserve Banks, except

under paragraphs 3 and 13 of section 13 of this Act, and except to the extent the Board determines is necessary for the maintenance of reserve balances, shall not be entitled to receive Federal Reserve Bank services, except such services as are necessary to maintain a required reserve balance with a Federal Reserve Bank, as determined by the Board.

"(13) Any depository institution, person, company or other entity that is required to maintain reserves pursuant to this section and that violates any provision of this section or any regulation issued thereunder shall be subject to a civil money penalty of \$1,000 per day for each day such violation shall continue, which shall be assessed and collected in accordance with the provisions of section 505 of this Title as if the person, company, or entity were a member bank."

(b) Section 19(1)(1) of the Federal Reserve Act (12 U.S.C. 505(1)) is amended by striking out "\$100" and inserting in lieu thereof "\$1,000".

Explanation

This section would authorize the Board to impose reserve requirements on nondepository institutions that maintain transaction accounts, on a standby basis and only to the extent such action is appropriate for the implementation of monetary policy.

11. Effective date

At the end of the bill, add a new section 10 to read as follows:

"SEC. 10. This Act shall be effective immediately upon enactment."

Explanation

Since many of the bill's provisions are structured so that they must apply on the date of enactment in order to serve the purpose for which they have been included, the bill should include a provision specifically providing for an immediate effective date.

PROPOSED LEGISLATIVE LANGUAGE FOR
BROKERED DEPOSITS

SHORT TITLE

SEC. 1. This Act shall be referred to as the "Financial Institutions Supervisory Improvements Act of 1984".

LIMIT ON INSURED BROKERED DEPOSITS

SEC. 2. No insured depository institution shall accept an insured deposit placed by or through a deposit broker if accepting such a deposit would cause the outstanding amount of the institution's insured deposits placed by or through deposit brokers to be in excess of five per centum of its daily average total deposits for the three month period ending on the day before the deposit is placed.

TRANSITIONAL ADJUSTMENT PERIOD

SEC. 3. (a) An insured depository institution with outstanding insured deposits placed by or through deposit brokers in excess of five percent of total deposits on the date of enactment of the Financial Institutions Supervisory Improvements Act of 1984 shall have a transitional period of six months from the effective date of this Act to first comply with the limit established by section 2.

(b) During the transitional period, the limitation applicable to such an insured depository institution shall not exceed the amount of its insured deposits outstanding placed by or through deposit brokers on [date bill is introduced]. The appropriate Federal supervisory agencies shall, at their discretion, issue joint rules and regulations under Section 5 of this Act establishing such additional limitations during the

transitional adjustment period as may be required to assure compliance with section 2 of this Act at the end of the transitional adjustment period.

DEFINITIONS

SEC. 4. As used in this Act--

(a) (1) The term "deposit broker" shall mean--

(A) any person engaged in the business of (i) placing funds, or facilitating the placement of funds, of third parties with insured depository institutions, or (ii) placing funds with insured depository institutions for the purpose of selling interests in those deposits to third parties;

(B) an agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan; and

(C) a trustee or plan administrator, including an investment advisor acting in connection therewith, of a Keogh Plan or Individual Retirement Account established pursuant to 26 U.S.C. §§ 401, 408.

(2) Notwithstanding paragraph 1, the term "deposit broker" shall not include such persons or entities as determined by joint rules and regulations issued under Section 5 of this Act.

(b) The term "insured depository institution" shall mean an insured bank, as defined in section 3(i) of the Federal Deposit Insurance Act, an insured Federal savings bank, defined in section 3(t) of the Federal Deposit Insurance Act, or an insured institution, as defined in section 401(a) of the National Housing Act.

(c) The term "deposit" shall have the same meaning as in section 3(l) of the Federal Deposit Insurance Act, and shall include deposits, accounts, or shares authorized for associations under section 5(b)(1) of the Home Owners' Loan Act of 1933.

(d) The term "insured deposit" shall mean (1) an insured deposit as defined in section 3(m) of the Federal Deposit Insurance Act; or (2) an insured account, as defined in section 401(c) of the National Housing Act.

(e) The term "appropriate Federal supervisory agency" shall mean (1) the appropriate Federal banking agency, as defined in section 3(g) of the Federal Deposit Insurance Act, with respect to an insured bank, as defined in section 3(i) of such Act, or a deposit broker that conducts business with an insured bank; and (2) the Federal Home Loan Bank Board with respect to an insured institution, as defined in section 401(a) of the National Housing Act, or a deposit broker that conducts business with an insured institution.

REGULATIONS

SEC. 5. The Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board shall adopt jointly such rules and regulations as necessary to effectuate the purposes of this Act and to prevent evasions thereof.

PENALTIES

SEC. 6. (a) Any insured depository institution, any officer, director, employee, agent, or other person participating in the conduct of the affairs of such an insured depository institution violating any provision of this Act, or any regulation or order issued under the authority of this Act, shall forfeit and pay a civil money penalty of not more than \$10,000 per day for each day during which such violation continues: Provided, That the appropriate Federal supervisory agency may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under authority of this section. The penalty may be assessed and collected by the appropriate Federal supervisory agency by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

(b) Any action to impose a civil money penalty shall otherwise follow the procedures set forth in section 8(i)(2)(ii) through (vii) of the Federal Deposit Insurance Act for the appropriate Federal banking agency, as defined in section 3(g) of the Federal Deposit Insurance Act, or section 407(k)(3)(B) through (G) of the National Housing Act for the Federal Home Loan Bank Board.

EFFECTIVE DATE

SEC. 7. This Act shall become effective ninety days after enactment.

SECTION BY SECTION ANALYSIS

SEC. 1. This Act may be cited as the Financial Institutions Supervisory Improvements Act of 1984.

SEC. 2. This section prohibits an insured depository institution from accepting an insured brokered deposit if such a deposit would cause the insured depository institution to have outstanding insured brokered deposits on the day the deposit is accepted of more than five percent of its daily average total deposits over the previous three months. A violation would not occur if an insured depository institution held insured brokered deposits in excess of the five percent limit by virtue of a runoff of other deposits. However, no additional insured brokered deposits could be accepted until such time that accepting an insured deposit placed by or through a broker would not result in the institution exceeding the limitation on insured brokered deposits.

SEC. 3. A transitional period of six months from the effective date of the Act is provided for insured depository institutions to meet the limit established by the Act. During this period, an institution would have a dollar "cap" on insured brokered deposits equal to the amount of insured brokered deposits outstanding on the date that the legislation is introduced. The supervisory

agencies are given the discretion to issue joint regulations requiring a phase-down of or other limitation on insured brokered deposits during the transition period to assure compliance with the 5 percent "cap" at the end of the transition period.

SEC. 4. This section defines key terms, including "deposit broker." A "deposit broker" means any person engaged in the business of placing funds, or facilitating the placement of funds, of third parties with insured depository institutions, or for the purpose of selling participations in shares of deposits to third parties, or one who establishes a deposit account under an arrangement such that the funds would be used to make a prearranged loan. It also includes a trustee or plan administrator, including an investment adviser acting in connection therewith, of a Keogh Plan or Individual Retirement Account. Other terms are defined by reference to existing provisions in the Federal Deposit Insurance Act, the Home Owners' Loan Act, and the National Housing Act.

SEC. 5. The three banking agencies and the Federal Home Loan Bank Board are given joint rulemaking powers to carry out the purposes of this Act.

SEC. 6. Civil money penalties may be imposed by the appropriate federal supervisory agency for violations of this Act. Such penalties may be up to \$10,000 for each

day that a violation continues. Civil money penalties could be imposed for example, if a depository institution exceeds its limit on brokered deposits.

SEC. 7. The effective date of this title is deferred 90 days from date of enactment.