

Gramm-Leach-Bliley Five Years On

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The Gramm-Leach-Bliley Financial Modernization Act

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The Financial Modernization Act Gramm-Leach-Bliley (GLBA)

- ✓ Repealed the Glass-Steagall Act and restrictions in Bank Holding Company Act
 - Banks may affiliate with securities firms and vice versa
 - Banks may affiliate with insurance companies and vice versa
- ✓ Made possible “one-stop financial shopping”

Affiliation through Financial Services Holding Company (FSHC)

- ✓ FSHC may have bank and nonbank subsidiaries
- ✓ Oversight by the Fed, but subject to lighter regulation than Bank Holding Companies (“Fed Lite”)
 - Subsidiaries subject to regulation by existing functional regulators
 - No federal regulation of insurance
- ✓ OCC may continue to authorize direct subs to conduct securities business
 - In 5 years, perhaps merchant banking activities as well

Retained Separation of Banking & Commerce

- ✓ Restricted ownership of banks by commercial companies
- ✓ Forbids additional chartering of unitary thrifts to nonfinancial firms
 - Sets May 4, 1999 as deadline for applications to create new unitary thrifts
 - Bars sale of existing unitary thrifts to commercial companies
- ✓ Grandfathered firms not previously BHCs: may earn 15% of gross revenue from nonfinancial activities until 2009 sunset

FSHCs Include Only 2 Nonbanks

✓ Why?

1. Economies of scope less powerful than believed?
2. Firms learned how to negotiate loopholes to diversify as much as they wished without FSHC?
3. Although FSHC broadened powers for BHCs, it reduced them for nonbanks and so not attractive?
4. Concerns that Fed Lite cannot possibly be light enough?

Fed Lite

- ✓ Deference to functional regulators, but responsibility for safety and soundness of group
 - What does it mean?
 - What will it mean?
 - Regulatory responsibility implies pressure to act
- ✓ How can it be done?
 - A central challenge for the FSA model as well

Differences in Objectives and Scope of Regulation

- ✓ All emphasize consumer/investor protection
- ✓ Differ re: systemic risk
 - Traditional preoccupation of bank regulators
 - Emphasis on consolidated prudential supervision
 - Not a traditional concern of insurance regulators
 - Focus on solvency of individual legal entities, not group
 - Not a principal concern of the SEC
 - Focus on broker/dealer, not holding company
 - EU: same rules to banks and securities firms

Pervasive Differences in Accounting & Regulatory Concepts of Capital

- ✓ Net Worth: similarities more apparent than real
 - Mark to market accounting in securities firm
 - Mix of mark to market & book value in banks
 - Statutory accounting in insurance companies
- ✓ Differences in what counts as regulatory capital
 - Subordinated debt
 - Reserves

Financial Conglomerates Directive ...

- ✓ EU extends scope of consolidated supervision
 - If consolidated supervision not deemed “equivalent”
 - May impose substantial costs on US securities firms, insurance companies and diversified financial firms in Europe
 - Higher capital & risk control requirements or
 - Form a sub-holding company in Europe or
 - Submit entire US holding company to European consolidated supervision

The SEC Alternative to FSHC

- ✓ Introduction of Supervised Investment Bank Holding Company (SIBHC)
 - An option for investment banks not affiliated with bank or thrift, in GLBA amendment to SEC Act of 1934
 - Group-wide supervision by SEC
 - Prevent regulatory gaps in oversight
 - Donaldson: “SIBHC [may] satisfy some EU regulatory requirements and thereby avoid inconsistent or redundant obligations”
- ✓ Other nonbanks – e.g. GE Capital, AIG – may have found other means to comply with EU

Continuing GLBA Issues

- ✓ National Rules for the Provision of Financial Services
 - Privacy
 - Predatory Lending
 - A national insurance charter
- ✓ Activity restrictions on FSHCs
 - Lifting of sunset provision
 - Requirement that Fed and Treasury agree on “activities that are financial in nature”