

U.S. DEPARTMENT OF THE TREASURY

UNDER SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE GARY GENSLE REMARKS TO THE BOND MARKET ASSOCIATION 1999 ANNUAL LEGAL AND COMPLIANCE CONFERENCE NEW YORK, NY

October 28, 1999

(Archived Content)

FROM THE OFFICE OF PUBLIC AFFAIRS

LS-184

I am very pleased to be here today. This is a historic moment for the U.S. financial system. Legislation that will repeal the arcane Depression era Glass-Steagall Act is likely to be voted on by both Houses of Congress in the coming week. For decades, prior Congresses and Administrations have worked to repeal the laws that have separated the banking, securities, and insurance industries. Finally, we are on the brink of success with the newly renamed Gramm-Leach-Bliley Act. Beyond the efforts of these three Chairmen of the Conference Committee, I'd like to recognize the significant leadership and accomplishments of Senator Sarbanes and Representatives LaFalce and Dingell.

As a result of these efforts, we believe that the agreements that have been reached on a bipartisan basis will result in a final bill that is good for the economy and the financial system and good for consumers and communities. While repealing Glass-Steagall is important, the Administration insisted that the bill benefit consumers and communities as well as the financial industry. That's why we were willing to walk away from the bill, even at the eleventh hour, if it did not meet that standard. We believe the final bill will meet that standard. If the language of the bill and the report remain consistent with the agreements that have been reached, the Administration will support enactment of this legislation.

When the Glass-Steagall Act was passed, the financial and economic landscape of our country differed greatly from today. In 1933, banks dominated the financial industry and the economy to an extent that we find difficult to imagine today. Banks had no choice but to hold the mortgages and loans they originated and consumers had little choice as to where to place their savings. In addition, banks served only their local markets.

Today, there is broad consumer choice. Banks compete for deposits with money market funds and savings products offered by securities firms, asset managers, and insurers. Securitization has changed the way banks manage their assets -- mortgages and other loans are readily put in tradeable form and sold. An \$80 trillion dollar derivatives market has revolutionized the way financial firms manage their risks and the products they offer. And today, the markets for financial products are not just national, but truly global in reach. Spurred by competition, innovation, and technology, our financial industry and our economy have been reshaped over the decades since 1933.

To a significant extent, our financial services industry has already modernized itself, even without the final repeal of the Glass-Steagall Act. The industry is preeminent globally. This has been facilitated, in part, by the erosion through judicial and regulatory actions of the walls erected in 1933. Subject to certain limits, banking institutions have been able to offer brokerage services and to engage in securities underwriting through so-called ASection 20 firms.

Benefits of the Bill

The greatest benefit of the bill will be to permit financial services firms to offer banking, securities, and insurance products all within one organization. At its core, the bill pulls down barriers to competition. Allowing financial services firms to offer this wider array of products will give these firms the flexibility to respond to their customers needs. Financial institutions will be able to expand the banking, securities, and insurance products they offer without artificial structural limitations.

Common ownership of diverse financial services firms will enable these firms to compete using the best that each discipline has to offer. Asset and risk management techniques, funding techniques, technological innovation, product development, and approaches to serving customers and communities are just some of the areas in which significant gains can be made through new business combinations. Particularly in an era of rapidly changing technology, firms will be able to take advantage of greater operating efficiencies.

I believe that this legislation will result in a diversity of approaches to financial services. Just as with any other industry, some companies will be successful at serving their customers by remaining specialized and focusing on particular markets or areas. Others will be successful by offering a broad range of products or by serving many markets. There will not be just one single approach that will be successful. This legislation will ensure that the choices firms make are dictated by the markets and by customers -- not by artificial barriers erected by the government decades ago.

Consumers and Communities

As important as these benefits of financial modernization are, the President insisted that a financial modernization bill must include adequate protections for consumers and must preserve the relevance of the Community Reinvestment Act. As a result of the provisions included on CRA, investor protection, and privacy, we believe the final bill achieves these objectives.

Over the many years of major financial modernization proposals, no major bill ever addressed the issue of consumer privacy. The President took an important step when on May 4 he laid out his principles on protection of individual privacy. The Senate bill, which had already passed, included no privacy provisions. The House then acted by a vote of 427-1 to add privacy to their bill. The final bill goes further, providing significant privacy protections.

For the first time, financial institutions will be required to adopt privacy policies and to disclose these policies to their customers. Financial Institutions will be required to give their customers notice annually on how their personal information is being shared, even amongst affiliates. Consumers will have the right to prevent personal financial information from being shared with third parties, subject to limited exceptions that will permit institutions to continue to operate efficiently. The financial regulatory agencies will have the authority to write and enforce rules to implement these privacy protections. Importantly, this bill will preserve the rights of States to provide even stronger privacy protections. While we believe more can and should be done to give consumers choice before their information is shared with affiliates, the final bill takes an important first step.

We believe that communities also will benefit from the bill. For the first time, a bank's performance under the Community Reinvestment Act will be considered when it expands outside of traditional banking activities. A banking organization will not be able to commence a new activity, directly or indirectly, or to merge with or acquire a company engaged in such

activities, unless every insured bank within the organization is serving its communities, as measured by a satisfactory CRA rating.

Under the bill, CRA will continue to apply to all banks without exception, and existing procedures for public comment are preserved. Small banks will have an incentive to achieve better CRA ratings to reduce the frequency of examinations. The final bill includes disclosure provisions related to certain agreements entered into by banks related to CRA. These provisions were improved substantially from the Senate bill and from the initial proposals of the Chairmen of the Conference Committee. It is important that these requirements be implemented in a reasonable manner to ensure that they do not chill the work of those who do so much in our underserved communities. We will work hard in the regulatory process to ensure this result. Community-based organizations are essential to effective implementation of CRA, and to combined growth and opportunity in our communities.

I believe that, taken together, these provisions will ensure that CRA continues to work for all communities.

Organizational Structure

The bill contains important limitations on the financial services firms of the future. We believe that a modern financial system should retain some separation between banking and other financial activities. The alternative, universal banking, is popular around the world, but we believe is the wrong choice for this country at this time. Thus, although the bill allows common ownership of banking, securities, and insurance firms, it still requires those activities to be conducted separately within an organization, subject to functional regulation and funding limits.

At the same time, the bill allows for organizational choice, enabling a financial institution to structure itself and its activities in a manner that best suits its needs, as well as promoting safety and soundness. The provisions of the final bill will preserve an important role for the executive branch with regard to banking policy and the evolution of the financial system of the future.

We believe that when it comes to non-financial firms, even greater separation is appropriate, and that common ownership should be prohibited. One of the lessons of the Asian experience of the past few years is that financial institutions tend to make bad decisions when it comes to lending to corporate owners or siblings. The synergy gains of combining financial and non-financial firms are not great and the potential downside is considerable. Thus, I believe that the

United States economy has been well served by preserving a clear separation between those who allocate capital and the majority of those competing for it.

Importantly, the bill would prohibit the transfer of unitary thrifts to non-financial firms. In addition, it sets some important limitations on merchant banking activities in banking institutions. Surely, this is an area where we need to move cautiously, at least until we gain experience with the effects of broader financial firms.

Commodity Exchange Act

As Congress passes this historic legislation this week, we are also embarking on another effort to revise a significant piece of legislation that is in need of updating -- the Commodity Exchange Act.

The Presidents Working Group on Financial Markets will shortly be reporting on our joint views on over-the-counter derivatives. We will also report on proposed revisions to the Commodity Exchange Act in connection with the upcoming reauthorization of the Commodity Futures Trading Commission. The process represents a unique opportunity to move forward to modernize the legal and regulatory framework for the derivatives markets. There are a number of important principles I would like to mention in that regard.

First, it is critical that we provide legal certainty for OTC derivatives. Legitimate transactions have come under a legal cloud as a result of expansive interpretations of the CEA over the years. Such uncertainty can create systemic risk and must be resolved. Second, we must consider the potential for properly designed, centralized clearing of OTC contracts. This could significantly reduce systemic risk in these markets and contribute to the stability of our financial markets. Third, we must allow for innovation and the emergence of more efficient trading mechanisms in order to ensure that the U.S. remains preeminent in these markets. Fourth, the Working Group also must address other extremely important areas, particularly concerning the Treasury Amendment, which excludes from the CEA transactions in government securities or foreign currency. Lastly, we need to ensure that loopholes do not exist that allow bucket shops and other fraudulent operators to prey on retail customers.

The members of the Working Group are working diligently to achieve a consensus on recommendations that can be sent forward to the Congress. The Working Group has focused on finding resolutions that will ensure the integrity of markets while fostering innovation and competition. These two goals, ensuring market integrity and fostering innovation, need not be

competing or incompatible objectives. Innovation and competition are critical to ensuring the integrity of our markets over the long term.

Let me conclude by saying that we have a historic opportunity to prepare for the 21st Century by updating archaic laws from the early 20th Century. It will strengthen our financial sector and promote our economy.

Thank you.
