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FEDERAL DEPOSIT INSURANCE CORPORATION

STATEMENT ON

SECURITIES ACTIVITIES
OF
FDIC-SUPERVISED BANKS

PRESENTED TO

SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION, AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
U.S. HOUSE OF REPRESENTATIVES

BY

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FEDERAL DEPOSIT INSURANCE CORPORATION

9:30 a.m.
Tuesday, June 28, 1983
Rayburn House Office Building

Mr. Chairman:

I am pleased to have this opportunity to discuss with your Subcommittee the FDIC's proposed rule to govern indirect securities activities of FDIC-supervised banks. Three years ago when the regulators proposed legislative authority to permit interstate acquisitions of large failing banks, there were vociferous protests that we were out to destroy the McFadden Act constraints. I believe time and subsequent events have demonstrated that interstate bidding has had the desired results and that we have utilized the authority responsibly. The current proposal has generated a more vocal chorus of protest, and we welcome this opportunity to set the record straight.

First, I would like to discuss the circumstances which led to this proposal and then say a few words about the proposal itself. Finally, I would like to respond to some of the charges levied against this action.

The issue of a bank's indirect involvement in securities activities is not of recent origin. In 1969 the FDIC granted deposit insurance to Investors Bank and Trust Co., Boston, Massachusetts, which was affiliated with Eaton and Howard, Inc., a securities firm. It was the FDIC's opinion then, as it is today, that the Glass-Steagall Act does not prohibit a state nonmember bank from being affiliated with a company engaged in securities activities. That opinion has never been successfully challenged in court.

Competition in financial markets was not nearly as intense in 1969 as it is today and our action was given little attention. During the intervening years we approved five additional applications by securities firms to acquire or charter state nonmember banks. Although these involved some very visible securities firms -- Shearson-Loeb, Dreyfus, Marsh & McLennan, and FMR Corporation (two applications) -- for the most part they also attracted little attention. Because so few cases had been before the FDIC, safety and soundness issues were dealt with on a case-by-case basis.

Last year the Boston Five Cent Savings Bank, Boston, Massachusetts, registered a mutual fund with the SEC which was to be advised and distributed by two wholly-owned bank subsidiaries. Pressed by the SEC for an opinion on the pending registration, although we had no regulatory responsibility for the application, the FDIC issued a policy statement consistent with our previous rulings. It reiterated our belief that Glass-Steagall does not prohibit an affiliation between a state nonmember bank and a securities firm.

We believed that if Boston Five's application proceeded there would likely be applications from others. In anticipation of this, we decided it would be appropriate to address the possible problems of safety and soundness, conflicts of interest and tie-ins in a more formal way than we had previously done. Thus, we issued a notice of proposed rule making and, subsequently, the proposed rules which have prompted this hearing.

Let me point out, so long as Glass-Steagall does not apply to subsidiaries of state nonmember banks, those subsidiaries are free to engage in any activity authorized by their state laws. The FDIC has no authority to prohibit those activities except where it is determined that a particular activity is unsafe or unsound. What the FDIC can do is to say that if a bank is going to avail itself of such authorities and have its deposits insured, it must adhere to certain operating standards. Our proposed rule is intended to spell out these standards. It should, therefore, be viewed as a regulation of activities, not an authorization of them.

Let me now turn to the proposal itself. It is an effort to establish a regulation appropriate to the problem being addressed. We are, therefore, genuinely interested in receiving constructive criticism.

At the public hearing held on June 17th only two witnesses appeared, one of whom gave testimony on behalf of two organizations.

The two speakers were Matthew P. Fink, Senior Vice President and General Counsel of the Investment Company Institute (ICI) and Lawrence Connell, President, Washington Mutual Savings Bank, who spoke on behalf of the bank and the National Association of Mutual Savings Banks (NAMSB). The ICI's comments focused on five major points: (1) the FDIC's interpretation of the Glass-Steagall Act is incorrect,

(2) even if the FDIC is correct about the law as it stands, any action to address the state of the law should come from Congress, (3) the FDIC lacks the expertise to develop an adequate regulatory structure to deal with bank involvement in securities activities, (4) the FDIC's actions could lead to an unprecedented exodus from the Federal Reserve System, and (5) bank involvement in the securities area is inherently unsafe or unsound even if conducted by a separate subsidiary.

We welcome the ICI's comments, especially those we feel are in the nature of constructive criticism. We will carefully weigh its prepared remarks as well as the more detailed written comments we are told will be submitted prior to the close of the comment period.

The testimony on behalf of NAMSB and Washington Mutual Savings Bank, Seattle, Washington, posed an interesting contrast to that of the ICI. NAMSB testified that the existing federal and state statutory and regulatory structure governing the securities industry coupled with state and federal regulation of nonmember banks is sufficient to address possible safety and soundness problems and conflicts of interest. NAMSB acknowledged that the FDIC's proposed regulation addresses valid safety and soundness concerns and suggested that guidelines such as those set out in subsection (e) of the FDIC's proposal were appropriate, although the proposed regulation's emphasis on the nature of the underwriting commitment and the type of security being underwritten

were inappropriate. Lastly, the FDIC was cautioned not to inhibit the development and delivery of new products and services by establishing rigid restrictions.

Written comments may be received until July 18, but to date we have received only 11. As the deadline approaches we may receive more.

Three of the comments, two of which were from banks, objected to the FDIC "encouraging" bank entry into the securities area. One banker applauded a recent enactment in North Carolina permitting bank subsidiaries to underwrite securities and urged the FDIC to leave the matter to the state legislatures. One banker saw no need for a regulation, while another indicated the safeguards in the proposal are reasonable. The remainder of the comments generally supported the proposal and suggested certain changes such as entirely prohibiting bank trust departments from dealing with the bank's securities subsidiary or affiliate; establishing education and experience requirements for the subsidiary's staff; and permitting normal lending from the bank to its securities subsidiary and/or companies whose securities are underwritten or distributed by the subsidiary.

Now I would like to respond to a few of the comments made about the proposed rule.

First is the allegation that the FDIC's policy statement and/or the proposed rule permit state nonmember banks to engage in activities which are contrary to the spirit,

if not the letter, of the Glass-Steagall Act. Neither document authorizes anything. Suggestions that the FDIC act to stop interindustry activities would have us exercise a power Congress has not given us.

We at the FDIC are not in the business of making law, although we have not been shy about making recommendations. One legislative recommendation we have made -- because we really believe it was something of an oversight when Congress framed the Glass-Steagall Act some 50 years ago -- is that banks be authorized to underwrite municipal revenue bonds. We believe this is desirable, but we have never presumed to take any administrative or regulatory action to circumvent the law on this or any other subject.

We are mystified by statements which suggest the FDIC's policy statement and our proposed rule ignore the fact that there may be safety and soundness or other problems associated with banks engaging in securities activities. The entire rule making procedure is designed to address these questions.

Mr. Chairman, although I believe the FDIC's proposed rule is a reasonable response to an existing situation, I agree with some critics of the current situation. It makes no sense at all to say that eight or nine thousand state nonmember banks may indirectly engage in securities activities while no member bank can do so. We have no problem with banks engaging in a variety of brokerage activities. To us, these

are financial services with very limited risk to the banks. When it comes to underwriting corporate securities, the potential risks increase. Our proposed rule is designed to put some limits on those risks.

However, this proposal should not be viewed in a vacuum. We have submitted extensive proposals to the Banking Committees for changes in the deposit insurance programs and are working with Vice President Bush's Study Group on regulatory reform. In those studies we have addressed a number of the issues raised by critics of our proposed rule. For example, we have endorsed uniform supervision of securities activities by the SEC.

The entry of banks into the securities business and securities firms into the banking business raises a number of questions and concerns relating to safety and soundness, competitive equity, concentration of financial resources and potential conflicts of interest. We believe Congress should promptly address these and other issues.

Unfortunately, to date the public debate on these questions has involved far too much empty rhetoric and hypocrisy. Why, for example, did the securities industry wait to voice its concerns about mixing banking and securities activities until 1982, when Boston Five decided to organize a securities affiliate, rather than during the preceding 13 years when securities firms were acquiring banks? A few weeks ago, representatives of the insurance

industry testified before the Senate Banking Committee in strong opposition to mixing banking and insurance. At that very moment, the FDIC was processing an application by Prudential-Bache to acquire a bank in Georgia.

The FDIC is not opposed to at least some mixing of such financial services as banking, insurance and securities activities provided certain safeguards, including a strengthened antitrust law, are put in place. If proper safeguards are established, we believe the American public will be the principal beneficiary of a more competitive and responsive financial services industry.

We recognize there are other legitimate points of view on the subject and that Congress may ultimately decide the barriers separating these industries should be strengthened rather than dismantled. If so, we will accept that judgment and will continue to enforce the law as written. But competitors -- be they banks, securities firms, insurance companies or others -- cannot have it both ways. They should not be permitted to enter another line of business and, at the same time, argue that their own business is entitled to special protection against entry.

Thank you once again Mr. Chairman for this opportunity to clarify our position on these important issues. I will be pleased to respond to any questions you or other members of the Subcommittee may have.