Testimony Of Texas Banking Commissioner Catherine A. Ghiglieri On Behalf Of The Conference Of State Bank Supervisors Before The Finance And Hazardous Materials Subcommittee Of The House Commerce Committee United States House Of Representatives

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SUMMARY OF COMMISSIONER GHIGLIERI'S TESTIMONY:

DUAL BANKING SYSTEM

CSBS is the professional association of state officials who charter, regulate and supervise the 6,802 state-chartered banks and more than 400 state-licensed foreign banking offices nationwide.

State-chartered institutions have driven most of the financial product and services innovation, and have served as the laboratory for financial modernization.

Currently 43 states authorize discount or full securities brokerage; 17 allow banks to underwrite securities; 47 allow bank insurance sales, 29 of which do not limit sales to towns of less than 5,000; and 17 allow their state-chartered banks to sell real estate.

EXPANDED POWERS THROUGH BANK SUBSIDIARIES

Within the bounds of safety and soundness, CSBS believes that a bank should be able to choose between an affiliate and an operating subsidiary, deciding which is best suited to its business strategy.

INSURANCE ACTIVITIES

H.R. 10 inappropriately rolls back the authority of national banks to sell title insurance.
CSBS opposes the definition of insurance in H.R. 10 which limits the ability of banks to offer innovative new financial products.

NATIONAL COUNCIL ON FINANCIAL SERVICES

CSBS believes that the creation of the National Council on Financial Services is unnecessary, would diminish the authority and role of the primary supervisor, and stifle innovation of financial products.

SUPERVISION OF NONBANKING ACTIVITIES

With safety and soundness of the banking system as our primary objective, CSBS supports provisions in H.R. 10 which provide for comprehensive supervision and establish the Federal Reserve as umbrella regulator of new, qualified bank holding companies.

CONCLUSION

While H.R. 10 advances the goal of financial modernization by breaking down outdated barriers between financial services providers and establishing appropriate regulatory oversight, we believe more must be achieved. In particular, we are concerned about insurance roll-backs and restrictions contained in the bill and the creation of a new federal regulatory body.

Good morning, Chairman Oxley, and members of the Commerce Finance Subcommittee. I am Catherine A. Ghiglieri, Banking Commissioner for the State of Texas, and Chair of the Legislative Committee of the Conference of State Bank Supervisors (CSBS). I am pleased to be here today to share the views of CSBS on financial modernization.

CSBS is the professional association of state officials who charter, regulate and supervise the 6,802 state-chartered banks and more than 400 state-licensed foreign

banking offices nationwide. We appreciate your invitation to appear before this committee to discuss financial modernization and its impact on the dual banking system.

CSBS has a long-standing policy in support of expanded bank activities that provide a broader range of choices to the consumer, enhance competition, and do not jeopardize safety and soundness. CSBS believes that any changes to our current system must preserve safety, soundness and public confidence. The keys to accomplishing this are:

- enhancing competition in the financial marketplace;
- offering opportunities for innovation in products and delivery systems;
- providing flexibility to regulators and bank management; and
- allowing the market to promote efficiency by preserving investor choice.

H.R. 10 advances these goals by breaking down outdated barriers between financial services providers. This is a good start, but more must be achieved. Most important, we must not forget that mandatory changes in regulatory and business structures can pose very costly burdens on the institutions that must adapt to these legal changes. Congress should carefully contemplate any changes to the regulatory structure that has protected the safety and soundness of the United States' financial system so successfully.

State Authorization of Expanded Bank Activities

Under our dual banking system, states and the federal government independently charter and regulate financial institutions. The vast majority of banks -- 71.4% of the industry -- are state-chartered. These banks hold approximately 45% of all assets and deposits in the U. S. banking system.

A key benefit of our dual banking system is that it provides for initiatives at the state level and at the federal level. In fact, state initiatives have spurred most advances in U. S. bank products and services. Everything from checking accounts to adjustable-rate mortgages, from electronic funds transfers to interstate branching, originated at the state level. A state bank was the first to offer a NOW account, and state banks developed the automatic teller machine. Furthermore, most consumer protections have originated at the state level. Because states can act individually to authorize new products and services, banks in other states and the federal banking agencies can

learn from these state-chartered banks' experience. When new activities emerge one state at a time, systemic risk is minimized. If an activity proves too risky, unprofitable, or harmful to consumers, it is much easier for a single state to change its law than for the federal government to reverse itself.

State-chartered banks have conducted many non-banking activities, as authorized by their state legislatures. They have done so within the bounds of safety and soundness, as determined by their state supervisors. These activities have primarily been in the fields of agency and brokerage: insurance sales, real estate agencies, sales of uninsured investment products, and travel agencies. Forty-three states currently authorize discount or full securities brokerage for their state-chartered banks. Seventeen states allow banks to underwrite securities; forty-seven allow bank insurance sales, and twenty-seven of these place no geographic restrictions on these sales. Seventeen states allow their state-chartered banks to sell real estate.

Until 1991 states were also able to authorize their banks to engage as principal in a wide range of expanded activities. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) restricted state bank activities to those permitted to national banks, unless the FDIC determines on a case-by-case basis that the activity poses no significant risk to the deposit insurance fund.

When changing federal law, we must preserve the states' ability to experiment independently with new products and services, new structures and new delivery methods. State-authorized powers are the bridge that brought us to this point. Now that we are here, we must not burn that bridge. If federal law becomes the only avenue for innovation in the banking system, we will close the book on the dual banking system that has served our country, and our economy, so well for so long.

Expanded Powers Through Bank Subsidiaries

H.R. 10 appropriately allows banks to choose the best structure to meet their organization's needs within the bounds of safety and soundness. With this principle in mind, we believe a bank should be able to choose between an affiliate and an operating subsidiary structure, deciding which is best suited to its business strategy. We are pleased that H.R. 10 incorporates the operating subsidiary approach currently used by state-chartered banks. In our view, successful financial modernization requires that we allow institutions to make a business choice, rather than dictate these choices by regulatory requirements.

State-chartered banks that are not currently members of the Federal Reserve System generally have the option of conducting their state-authorized expanded activities within the bank or through operating subsidiaries. In fact, many states that allow their banks to engage in expanded activities require that they do so through subsidiaries. This subsidiary structure provides for consolidated supervision of a bank's entire business by the state bank supervisor. States may also require that subsidiaries such as insurance agencies receive separate licenses from the appropriate state regulator. This combination of functional regulation with consolidated oversight has worked well at the state level.

H.R. 10 specifically authorizes national banks to engage in expanded activities through operating subsidiaries, and applies sections 23A and 23B to transactions between the bank and the subsidiary in these new areas.

Requiring an additional structure, such as a holding company, unnecessarily centralizes power within the federal government, moving regulatory authority away from the states that developed these innovative activities. It would be a monumental loss if, in modernizing our banking system, we limited the organizational structures available to bank management or the traditional authority of the states over the delivery of financial services to their citizens. We support the flexibility provided in H.R. 10 for bank management to choose the appropriate structure for their institution, and this should be retained.

Permissible Activities of State-Chartered Banks

Almost every state allows insurance sales for banks in towns of fewer than 5,000, and twenty-seven states allow insurance sales with no geographical restrictions. Some states have allowed their banks to sell insurance since the turn of the century with no significant safety and soundness or consumer protection problems. While H.R. 10 does not generally address bank sales of insurance, it does specifically roll back the authority for national banks to sell title insurance. Insurance is a natural extension of the business of banking. When properly implemented, it poses no safety and soundness concerns. All banks should be allowed to sell insurance, and title insurance should not be singled out.

H.R. 10 also freezes the definition of an insurance product that banks would be permitted to offer as principal. This is unfortunate. It eliminates the possibility of the marketplace's developing new products. New hybrid instruments could have elements of both insurance and banking. Under H.R. 10, such a hybrid could be deemed an insurance product and impermissible for banks, forcing an insurance affiliate structure for a product that is actually banking in nature. This aspect of H.R. 10 could force a costly and inappropriate structure for a banking institution while allowing an insurer to operate within its traditional structure.

This legislation preserves the authority of banks to continue to engage in a limited number of securities activities. The activities that continue to be exempt from securities law regulations have not caused safety and soundness or consumer protection concerns. We recommend that a financial modernization bill should not roll back the current authority granted to our nation's financial institutions if they have not proven to be a problem for safety and soundness or consumer protection.

National Council on Financial Services

The dual banking system recognizes that, although the market for financial services is now nationwide, individual market characteristics may vary widely from region to region, state to state, or even from community to community. State banking laws provide an opportunity for local policy makers to determine how best to meet their citizens' needs and protect their citizens' well-being.

Regulation should not drive new products and services or new delivery systems; rather, the market should drive changes in the industry. As regulators, we must supervise these changes to

safeguard consumers, depositors and taxpayers. Regulation in a market-driven environment can promote safe and sound behavior by supplying incentives for well-managed institutions and by limiting the activities of unhealthy banks.

We are therefore concerned that this legislation creates a new super-regulator at the federal level. The National Council on Financial Services would ultimately determine what products and services are available for financial institutions, and will have rulemaking authority over how those activities can be conducted. This new federal regulator would diminish the authority and role of the primary supervisor. While the proposed Council would include state supervisory authorities, the Council could very well stifle innovations among the regulated industries that fall under its domain.

CSBS opposes the creation of this Council. However, if Congress chooses to create this new super-regulator, a current state bank supervisor must have a seat on the Council rather than someone with state bank experience. The decisions on future activities permitted for banks, and the rules that will apply to these activities, are critical to the future of the financial services industry. The expertise of a current state bank supervisor, who has daily hands-on experience within the state banking system, would benefit the Council's decisions, and ultimately the fate of the financial services industry. We recommend that the provision creating the National Council on Financial Services be dropped, or alternatively, that a current state bank supervisor be added to the panel.

Supervision of Nonbanking Activities

As we learned all too well during the savings and loan crisis of the 1980's, the key to expanding powers is effective supervision. Therefore, state and federal banking agencies must supervise any banking organization that engages in additional activities from the top down and from the bottom up.

We are not comfortable with a "functional regulation" model that disregards the banking regulators' responsibility for the overall safety and soundness of the entire organization. As we have seen throughout this debate, interested parties do not agree on exactly what "functional regulation" is or on how it would work in practice.

Comprehensive supervision can be equally effective in a subsidiary structure, as the parent bank's primary regulators can examine the subsidiaries as part of a comprehensive examination of the bank. H.R. 10's structure is appropriate because it does provide for comprehensive supervision at the top. We reiterate our conviction that comprehensive supervision at the top of an organization, whether it is a bank or a holding company, is absolutely necessary to protect insured deposits, consumer interests, and -- for very large organizations -- the stability of our financial system as a whole. CSBS believes that the Federal Reserve, with its joint responsibilities of protecting the safety and soundness of the banking system and promoting stability and growth for the economy, is perfectly suited to serve in this umbrella regulatory role for the new, qualified bank holding companies. Virtually all of the large holding companies now operate and are managed as integrated units, especially in their management of risk. As it is managed on a comprehensive basis, this global holding company risk must be supervised on a comprehensive basis as well.

This comprehensive supervision will require coordination and cooperation among all regulators involved with an institution. To advance this necessary cooperation and coordination, CSBS has formed a joint task force with the National Association of Insurance Commissioners, and is in the process of forming a similar task force with the North American Association of Securities Administrators. The purpose of these task forces is to share information and coordinate our supervision of financial institutions toward our mutual goal: a wide range of safe, responsible, accessible financial services for our states' citizens. A system of functional regulation could address consumer protection issues since it will tend to be specific to individual products and services.

States have worked very well with both the FDIC and the Federal Reserve in supervising a wide range of financial institutions engaged in many types of activities. We believe comprehensive supervision is necessary and that the Federal Reserve is well qualified to serve in this function for qualifying bank holding companies.

Activities of Foreign Banking Offices

Foreign banks hold a significant portion of the assets that state bank supervisors oversee. These international banks operating in the United States have different structures; the majority are wholesale, uninsured operations that are prohibited from taking insured deposits.

We believe that "national treatment" means parity of treatment, not identical treatment. H.R. 10 attempts to provide national treatment to foreign banking organizations operating in the United States. This is the right thing to do. While foreign banking organizations operate under different structures, equivalent treatment is important. These international banks in the United States add important sources of liquidity to our markets and provide many opportunities for U. S. companies to export their products to overseas markets.

Merger of the Bank and Thrift Charters

CSBS very much appreciates H.R. 10's recognition of the dual banking system by allowing the continuation of the state thrift charter. The choice of charter is fundamental to the dual banking system, and states are continuing to innovate by developing new charters. Maine recently created a merchant bank charter and a "universal" bank charter to promote economic development and increase the credit and capital available to new business. Connecticut is considering a new community bank charter, and several states have acted to create new savings bank charters for institutions that want to continue to focus on housing finance.

One concern CSBS does have about the merger of the bank and thrift charters is the question of branching laws that currently apply to savings and loan associations, which differ considerably from the branching laws that apply to commercial banks. As you know, savings and loans are not subject to Riegle-Neal's structure for interstate branching or the McFadden Act's structure for intrastate branching. When merging the federal bank and thrift charters, Congress needs to make sure that the result is not two different classes of financial institution branches. The rules that apply to banks must also apply to newly-converted thrift institutions. Otherwise, Congress will have enacted into law a significant competitive disadvantage for existing commercial banks. CSBS believes that converted thrift charters should be subject to Riegle-Neal and the McFadden Act's structure for intrastate branching.

Conclusion

State bank supervisors are an integral part of this nation's bank regulation system. State regulation and supervision is professional, cost-effective and efficient. State banks are well-capitalized, profitable, and are serving their customers well. Restricting state powers, state-bank structures, and state regulation weakens the system as a whole. Preserving the authority of each state to decide the bank structure, products and services that best suit its citizens' needs, strengthens the system.

H.R. 10 is a good beginning to modernizing our federal banking system, but more must be done. It recognizes that the lines between traditional banking and other financial services are disappearing. It provides for a system of comprehensive oversight. We look forward to working with you, Mr. Chairman, and with the other members of the Committee, in adapting our dual banking system for the 21st century.

I would be happy to answer any questions the Committee may have.